Annual

Federal Reserve Bank of Philadelphia

The Fed in the 20th Century: Adventures in Finance

White Cascade, by sculptor Alexander Calder, hangs in the Eastburn Court of the Federal Reserve Bank of Philadelphia. The 100-foot long mobile consists of 14 aluminum discs connected by stainless steel rods and rotates clockwise. The 10-ton artwork was installed in 1976, during construction of the building, which is located on Independence Mall in Center City Philadelphia.

At the Federal Reserve's founding in 1913, Congressman Carter Glass said that the Federal Reserve System would be an "adventure in finance." Definitions of adventure aside, the 20^{th} century has been eventful for the Federal Reserve Bank of Philadelphia, and as the century approaches its close, we take a look back. Quotes in this report are drawn from annual reports published by the Philadelphia Fed over the past 85 years; after each, the original publication date appears in parentheses.

Executive Letters

More than any other year in recent memory, 1999 caused us to contemplate the future and the past. Here at the Philadelphia Fed, we spent the year anticipating, and preparing for, the century date change. As we did, we reflected on our 85-year history.

The Federal Reserve System was our nation's third attempt at establishing a central bank. Ironically, one of the secrets of its success is that it is a central bank that is not too centralized. The System is composed of 12 District banks and the Board of Governors in Washington, a structure that enables the Fed to incorporate regional sensibilities into System-wide policy discussions.

Over the decades, the Fed has become an integral participant in the American economy. The Federal Reserve helped organize the payments system, regulated financial institutions, and as it matured, executed monetary policy to support our national prosperity. In the Third Federal Reserve District, the Bank strove to stay current with changing economic conditions in the region and to help meet the financial needs of those who live and work here. This remains our challenge in the new century.

The new year also brings me to a pivotal point: In May I will step down as president of the Federal Reserve Bank of Philadelphia. I want to take this opportunity to thank those who have been indispensable to the Bank's success over the last 19 years. Thanks to my colleagues here at the Philadelphia Fed, in Washington, and throughout the System. Thanks also to the financial, business, and civic communities, and to our ultimate customers, consumers throughout the Third District. Your efforts, advice, and support have made my tenure very rewarding.

Edward G. Boehne

President

I am pleased to report that midnight of December 31st passed quietly in the financial world. Computer systems performed well, records were retained and updated on schedule, cash was available, and the banking public remained confident that their funds were secure. Banks and their customers moved into the year 2000 virtually without a hitch, thanks to the excellent preparation of those at depository institutions and at the Fed.

Given the dire predictions of Y2K chaos that circulated early in the year, the banking community faced a dual challenge. First, bankers had to be certain that their institutions were ready for the rollover. Then they had to communicate to the public that the banking system would remain sound through the transition. Congratulations to all of you whose months of diligent work made the rollover uneventful. The results affirm the confidence demonstrated by the public in our nation's financial system.

William H Stone Jr.

First Vice President

President Edward G. Boehne (left)and First Vice President William H. Stone at the Second Bank of the United States, Philadelphia.

THE CREATION OF THE FEDERAL RESERVE

The Nation's Central Bank

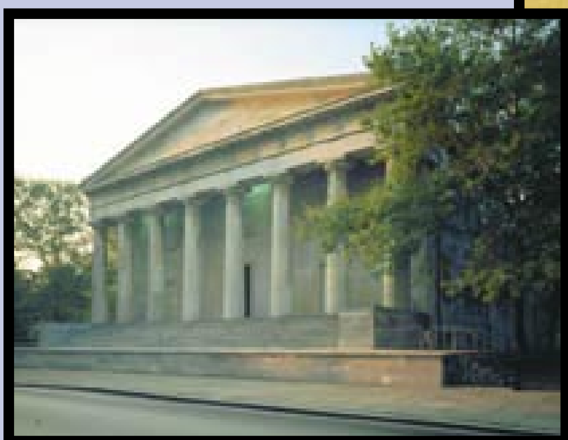
The Federal Reserve is sometimes described as the "bankers' bank," or the "federal government's bank," phrases that underscore the Fed's integral role in the U.S. economy and hint at the reasons behind its creation. As the nation's central bank, the Federal Reserve System ensures the reliable flow of payments among banks, businesses, and individuals and provides banking services for the United States government. It also helps supervise and regulate the activities of commercial banks and bank holding companies. And the Fed is best known for its execution of monetary policy, using its control of bank cash reserves to influence the supply of money and availability of credit in the economy. All of these functions are directed toward a single goal: to promote a sound currency and foster sustained economic growth.

The need for a central bank was recognized long before the Federal Reserve was established in 1913; the concept had been tried – and had failed – twice. Both the First Bank of the United States (1791-1811) and the Second Bank of the United States (1816-1836) were created to give financial credibility to the young federal government and to avoid economic panics and depressions. Both were undone by states' suspicion of ceding power to a centralized institution.

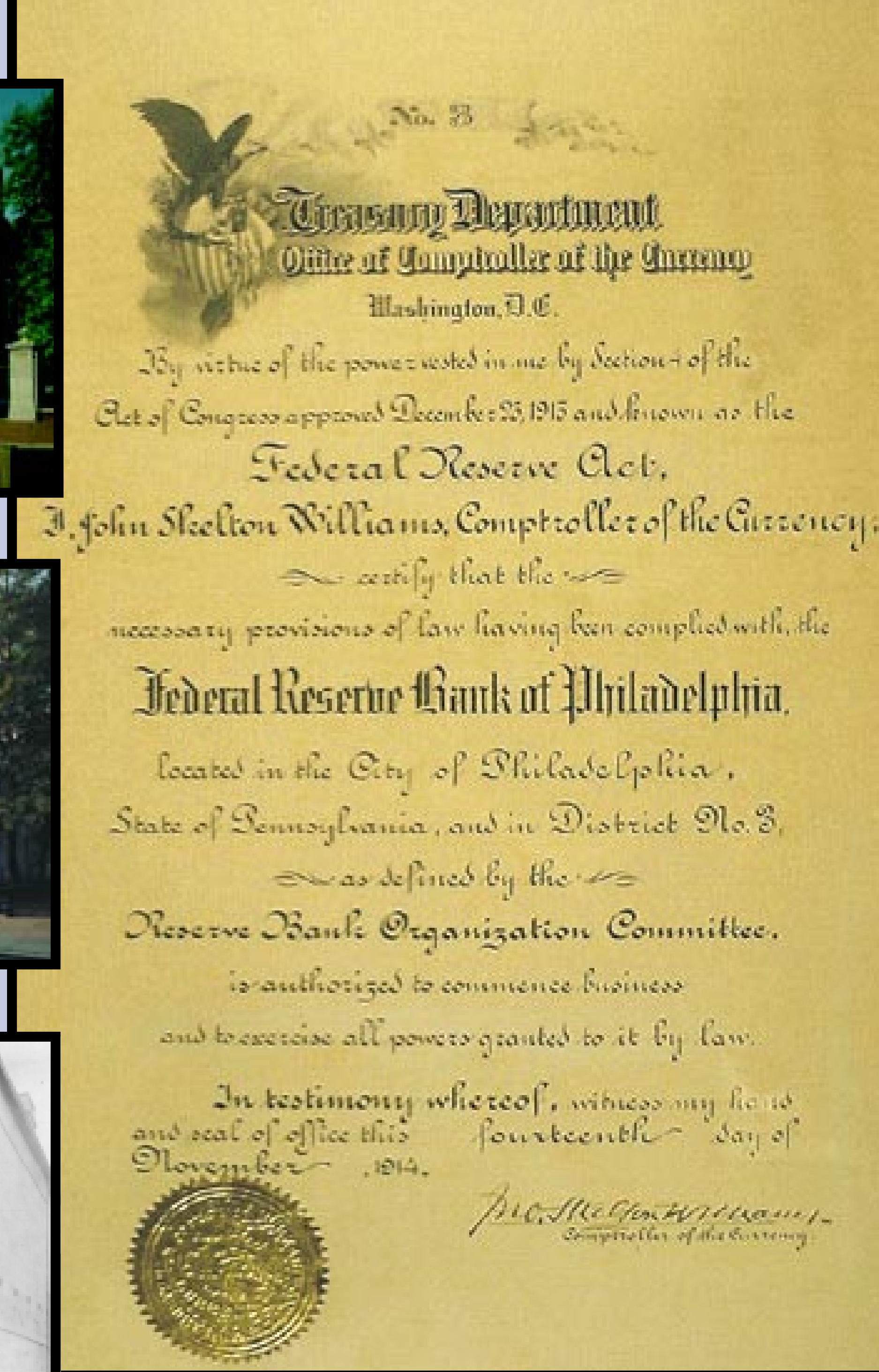
In the new central bank, this concern was resolved by balancing strong central authority with broad regional representation. Early in the 20th century, a compromise was crafted by President Woodrow Wilson, Congressman Carter Glass, and Senator Robert Owen. *"The First and Second Banks…became extinct because they had serious flaws – their powers were overly concentrated, their locations too centralized, they were dominated by special interests, and they became snared in partisan politics…In contrast, the Federal Reserve System that was born on December 23, 1913 has a regional structure, all sorts of checks and balances, and a workable blend of public and private interests. In addition, it was carefully insulated from short-run politics."* (1988)

On November 14, 1914, the Federal Reserve opened for business. In the next 30 years, it would encounter two events that dramatically affected the history of the System and the nation: The Great Depression and World War II. These events radically altered Americans' expectations of government and institutions. For the Fed, the depression and the war changed the ways in which the central bank carried out its mission, transforming it from a passive entity into one that initiated decisive action to ensure growth and stability for the economy.


The First Bank of the United States, today


The Second Bank of the United States, today


The Federal Reserve Bank of Philadelphia, in 1914


No. 3

Treasury Department
Office of Comptroller of the Currency
Washington, D.C.

By virtue of the power vested in me by Section 4 of the Act of Congress approved December 23, 1913 and known as the
Federal Reserve Act,
I, John Skelton Williams, Comptroller of the Currency,
certify that the
necessary provisions of law having been complied with, the
Federal Reserve Bank of Philadelphia,
located in the City of Philadelphia,
State of Pennsylvania, and in District No. 3,
as defined by the
Reserve Bank Organization Committee,
is authorized to commence business
and to exercise all powers granted to it by law.

In testimony whereof, witness my hand and seal of office this fourteenth day of November, 1914.

Comptroller of the Currency

The Federal Reserve Bank of Philadelphia Charter

The Federal Reserve, the nation's third central bank, began operation in 1914. It consists of 12 District banks, each serving a specific geographic area, overseen by a Board of Governors in Washington, D.C. In Philadelphia, headquarters for the Third District, the Federal Reserve Bank was originally located at 406-408 Chestnut Street (above), near its predecessors, the First Bank of the United States and the Second Bank of the United States. Though the building no longer exists, all three locations are now part of Independence National Historical Park.

SERVING IN TIMES OF NATIONAL CRISIS

Facing the Depression

The depression that began with the stock market crash of 1929 was a watershed event in banking. Many financial institutions were swept away in the ensuing financial panic, hysteria swallowing well and poorly run institutions alike. *"Excessive demands of frightened or disturbed depositors are difficult to control and may quickly result in the suspension of a bank…Under present conditions the closing of a bank by no means is proof of incompetent management."* (1931)

The Philadelphia Fed and other Federal Reserve Banks worked as regulators and consultants to help banks cope. *"Nearly 2,000 visits were received from bank officers during 1931 and members of the bank relations department made 1,800 visits to banks of the district. These visits and the activities of the*

bank examination department…reflected the bankers' desire for advice in the handling of situations which had arisen outside of their usual operation." (1931)

Economic distress quickly spread far beyond the financial system. Fortunes evaporated, businesses failed, and unemployment soared. Americans' faith in the economic system was shaken. *"The intensity and, most of all, the duration of the Great Depression were shocking, especially to people who had allowed themselves to believe that a 'new era' of permanent prosperity had arrived…"* (1949)

People looked to government for help, and after his inauguration in 1933, President Franklin D. Roosevelt acted swiftly: *"…mere relief gave way to*

Though methods have changed, most Fed functions have not. From the beginning, Federal Reserve services have included bond sales, provision of loans and currency, check clearance, funds transfer, bank examination, and economic research. From left: Bookkeeping and Currency Counting (1918); Two views of the Currency Department (1951); World War I Liberty Bond poster (1917).

positive action by Government to move the flywheel of the economic machine off dead center…It soon resorted to 'pump priming'…Most wanted security at the expense of the laissez-faire tradition." (1949)

To restore public confidence in banks, President Roosevelt declared a nationwide bank holiday – mandatory closure – in March of 1933 to give banks and their nervous customers time to catch their breath. Institutions were required to receive Fed approval to reopen. To further reassure savers, deposits were guaranteed up to $2,500 by the newly established Federal Deposit Insurance Corporation.

Reserve Banks were important sources of capital during the depression, both providing funds for banks to lend and making direct loans to commercial and industrial applicants. In 1934, the Philadelphia Fed approved $6.3 million in direct loans.

The passage of the Banking Act of 1935 also laid the groundwork for the Fed's future role in setting monetary policy. The act gave the Board of Governors the power to set reserve requirements for member banks and required that boards at Federal Reserve Banks meet every 14 days to reset the discount rate, the interest charged on loans to banks. Most important, the Banking Act established the Federal Open Market Committee. The FOMC, composed of the seven Fed Governors and five of the 12 Reserve Bank presidents, was to direct the use of the Fed's most powerful monetary tool, open market operations. Buying and selling securities in the open market would enable the Fed to manage the flow of reserves to banks, thereby influencing banks' capacity to supply money and credit to the economy.

When banks were ordered closed in March 1933, about 640 financial institutions were operating in the Third District. The Philadelphia Federal Reserve authorized the reopening of 547 by the end of the month and a total of 606 by year-end.

ECHOES FROM MID-CENTURY

The advance of technology…the proper role of government in the economy…the financial stability of the individual…and the astounding time in which they lived, these were all concerns of the people at the Federal Reserve Bank of Philadelphia in 1949. Their thoughts, recorded as the second half of the 20th century was about to start, echo ours, poised at the beginning of the 21st.

"The machine [computer] does not think; men have built into it an extremely limited degree of judgement…Its technical powers are huge, yet its capacities are completely limited by the ability of its operators…"

"While government's intervention seems to have solved some pressing problems, it has created others…As each economic group seeks security or advantage through government support, and as government strives to maintain a high level of employment by bolstering the economy wherever weakness appears, the path of least resistance is likely to be continual concession and compensation. It is easier to make competing upward adjustments than to face squarely the need for choosing among alternatives…"

"Undoubtedly more people are concerned more about finance now than was the case in 1900. It is no longer 'high finance' carried on by a select few. Today more than two-thirds of the employed people pay a federal income tax; in 1920 the proportion was only one-twelfth. Over half the population owns life insurance, as against about one-tenth at the start of the century; about one-half owns United States Savings Bonds; and one-twelfth of the spending units holds corporate securities. These facts mean a wider participation and interest in the financial problems of government, business and consumers..."

"To those of us who have lived through this half-century…and have gradually absorbed its material offerings into everyday living, the nature of the advance that has been made since 1900 is seldom noticed as the spectacular thing it really was."

Supporting the War Effort

In both World Wars, and again during hostilities in Korea, the Federal Reserve assisted with the sale of government bonds to raise funds in support of the nation's armed forces. The Fed's Fiscal Agency Department, which conducted the sale of bonds during World War II, expanded from 39 staff members to 586 within five months of the bombing of Pearl Harbor. At the time, there were more than 1,400 organizations authorized to sell bonds in the Third District, and the Fed used its role as bond liaison to broaden its relationships with banks and industries throughout the region.

During the First and Second World Wars, savings bond sales were considered the most important function of the banking system. Not only did they provide much-needed financing for defense and a way for workers to participate in the war effort, bonds also provided a place for investing rapidly rising income, income that could not be spent on scarce consumer goods.

Just as it had provided direct industrial loans in the aftermath of the depression, the Fed extended credit to firms involved in defense work. The bank also advised bankers and contractors on the allocation and funding of defense production. The Philadelphia Fed was particularly active: *"The volume of credit extended by this Bank directly or in participation with other banks…to industries primarily engaged in war work has increased over 80 percent, more than one-half of such loans now outstanding in the [Federal Reserve] System having been made by this Bank."* (1941) For governmental agencies such as the War Production Board, the Philadelphia Fed's Research and Statistics Department furnished much-needed data on employment, income, production, distribution, inventories, prices, and banking.

In 1941 Congress enacted wide-ranging legislation directed toward several wartime economic goals: transferring resources to defense industries, curbing inflation and profiteering, promoting civilian savings to finance defense spending, and limiting the debt taken on by consumers, so it would not dampen their spending when the war was over. To help enforce this legislation, the Fed issued Regulation W, which set the terms under which consumers received credit.

Throughout World War II, the Fed anticipated the return to a peacetime economy. *"As many as eight million men and women may be released from the armed forces. Unfinished contracts…will probably amount to $60 billion. Immense quantities of Government property will have to be removed before private plants can prepare for peacetime operations…The job of reconversion which industry faces consists of two essential parts. The first and less difficult is the reshaping of physical facilities and the reestablishment of assembly lines for the production of civilian goods. The second and more difficult part…is merchandising – adapting products to the market."* (1943)

In both World Wars, bond sales raised monies to support the armed forces and gave civilians a patriotic vehicle for saving and investment. Above: Soldiers transport government payroll (1951).

MEETING THE NEEDS OF A DYNAMIC ECONOMY

The combined experiences of the Great Depression and World War II shifted people's view of government and the central bank. Economists' thinking about the proper function of these institutions changed as well. Now, government was expected to actively promote and sustain economic stability. The Fed was similarly charged. It was no longer enough simply to provide credit for commerce. The central bank should use its control over the supply of money and credit to help manage overall demand for goods and services, to help the economy avoid the extremes of boom and bust, enabling it to prosper. *"At first, the principal goal of Federal Reserve policy was assuring a sufficiency of credit to meet the needs of business…Eventually attention shifted more toward regulating the quantity of credit in order to maintain stability. Along with this shift there developed a better idea of the various factors that influence reserves and how the volume of member bank reserves influences the money supply."* (1949)

Before the Fed could pursue this new activist role, one vestige of its wartime mission had to be eliminated. During the war, the Fed was responsible for maintaining a ready market for U.S. government securities at steady interest rates, a responsibility that prevented it from responding fully to inflationary threats in the postwar economy. In 1951, the U.S. Treasury agreed with the Fed to free the central bank of its obligation to stabilize the government securities market so that it could more effectively promote stability in the larger economy. This agreement made it possible for the Fed to conduct monetary policy as it is known today, a function that has become its best-known. *"When flexible rates are permissible…Federal Reserve authorities are free to follow policies of expansion, contraction, or neutrality as the situation warrants."* (1952)

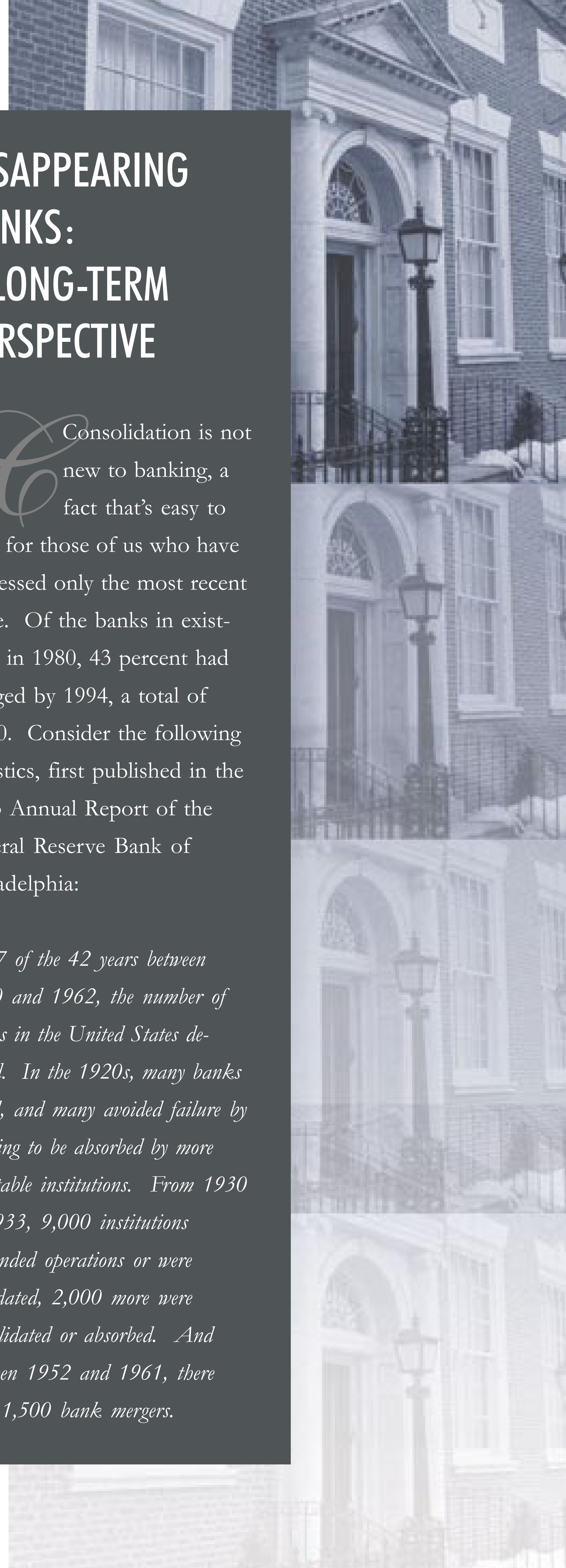
For the next decade, the Fed set its influence against prevailing economic winds, increasing supplies of money and credit when the economy slackened, trimming them when the

Record-high interest rates in 1981 created many challenges for the Federal Reserve, one of which was to keep up with savers' demand for high-yielding Treasury securities.

economy flew a little too high. *"Monetary policy is simply one way of holding demands down so that prices don't go up. It restrains demands now [through tighter credit] so that they may be better satisfied later …General monetary controls are designed…to interfere as little as possible in the detailed workings of the economy – leaving it up to the market place to distribute this overall supply."* (1960)

By the late 1960s, it was clear that simple monetary policy prescriptions were not enough. Military spending for the Vietnam War and domestic spending for the Great Society spurred demand that triggered inflation. Federal wage and price controls failed to restore order. And when the subsequent Middle East oil embargo drove worldwide oil prices skyward, the rate of inflation followed. By the late 1970s, Americans felt the economy was tearing apart as inflation spiraled upward.

The Fed took decisive action, dramatically raising interest rates and reversing the inflationary spiral. The Fed's action was necessary but painful, sending the economy into the deepest recession since World War II had ended. Meanwhile, dramatic changes in the financial sector signaled new challenges for the Federal Reserve as a bank regulator and payments provider.



DISAPPEARING BANKS: A LONG-TERM PERSPECTIVE

Consolidation is not new to banking, a fact that's easy to miss for those of us who have witnessed only the most recent wave. Of the banks in existence in 1980, 43 percent had merged by 1994, a total of 6,300. Consider the following statistics, first published in the 1963 Annual Report of the Federal Reserve Bank of Philadelphia:

In 37 of the 42 years between 1920 and 1962, the number of banks in the United States declined. In the 1920s, many banks failed, and many avoided failure by agreeing to be absorbed by more profitable institutions. From 1930 to 1933, 9,000 institutions suspended operations or were liquidated, 2,000 more were consolidated or absorbed. And between 1952 and 1961, there were 1,500 bank mergers.

REGULATING BANKS IN AN AGE OF CONSOLIDATION

Market innovation and new legislation have made the past 25 years a time of increasingly intense competition for banks. Bankers have reconfigured what they do and how they do it. They have restructured, rethought functions, staked out new territories, and offered nontraditional products. They have merged, consolidated, and expanded, completely changing the banking landscape. As a bank regulator, the Federal Reserve has had to keep pace in this rapidly evolving environment.

When mutual fund companies introduced the money market mutual fund in the late 1970s, consumers learned that banks need not be their sole provider of financial services. Profitable deposits were successfully siphoned away from traditional savings accounts and certificates of deposit. Banks responded with new products, such as interest-bearing checking accounts and money market deposit accounts, which were legalized by the Monetary Control Act of 1980.

While banks struggled to hold off nontraditional competitors, state legislation intensified competition within the banking industry by opening borders to banks from other areas. In the Third District, Delaware encouraged the establishment of banks by out-of-state holding companies, leading to the addition of 12 new banking institutions in 1982 alone. Pennsylvania passed more liberal branching laws, smoothing the way for statewide competition. Faced with stronger and more numerous competitors, many banks merged to survive. Smaller institutions were acquired by larger ones, while some survivors pursued narrower market segments.

Throughout this period, the Fed was required to verify the soundness of then-unfamiliar financial practices, such as repurchase agreements, leveraged buyouts, and off-balance-sheet commitments. *"Deregulation has had a direct impact both on the volume of our supervisory workload and its complexity. Following passage of Pennsylvania legislation that liberalized rules on holding companies and branching, the number of applications for mergers, acquisitions, and other purposes made to this Bank almost tripled."* (1984)

Increasing competition and accelerating innovation in banking boiled over into some excesses. In 1993, Congress responded with the FDIC Improvement Act, which legislated more frequent examinations for banks, deposit insurance premiums based on portfolio risk, and prompt corrective action to reduce failures. *"The competitive pressures of the 1980s had pushed too many banks into unwise excesses and, ultimately, failure. By 1990, a crisis atmosphere had developed, putting banks and their regulators on the defensive. The turmoil in banking rippled out into the economy, deepening the recession and slowing the process of recovery…With loan portfolios shrinking, revenues declining, and the regulatory burden mounting, some questioned whether the banking industry could survive. But bankers went to work, making the necessary adjustments, and their efforts paid off."* (1993)

The forces that reshaped banking in the 1980s continue to push the industry toward consolidation and product innovation. As the century came to a close, passage of the landmark Financial Modernization Act of 1999 guaranteed that more change and more challenges lay ahead for banks and for the Fed as a regulator. To accommodate the increasing geographic scope and functional complexity of financial institutions, Fed regulatory personnel continue to develop expertise in specialized content areas and share this knowledge throughout the Federal Reserve System.

Though the task of regulating banks is not as straightforward as it once was, the Federal Reserve's approach remains the same: communicate and consult. It has been this way since the Bank's early days. *"The bank examination department is not only concerned with the verification of assets and liabilities of banks, it also stands ready and is constantly being called upon to render assistance in the improvement of methods and operating policies."* (1928)

The Fed has always preferred consultation to issuing directives. In 1946, the Philadelphia Fed introduced field conferences as a way of keeping in touch with bankers throughout the Third District. Initially a forum for the discussion of postwar business, banking, and credit, the meetings proved so popular that they became an annual event and continue to be an *"off-the-record forum for frank exchange of information and views on…national business and credit trends, monetary policy, consumer credit, operating ratios, and bank personnel."* (1956) In the spring of 1999, the tradition continued with field meetings in 10 locations, from Haddonfield, NJ, to Dover, DE, to Williamsport, PA.

Once the primary source of information for Federal Reserve bank examiners, precise columns of numerals in ledgers have given way to complex calculations on computer spreadsheets. This evolution has demanded increasing technical and analytical skill on the part of Supervision and Regulation staff.

PROVIDING PAYMENTS SERVICES IN A COMPETITIVE MARKETPLACE

The Monetary Control Act of 1980, which made banks more competitive in the financial services marketplace, radically altered the position of the Fed in the marketplace as well. It transformed Reserve Banks into competitive providers of banking services. Prior to this, Reserve Banks had cleared checks and completed wire transfers free of charge and only for member institutions. When the Monetary Control Act mandated that the Fed offer services to any bank, thrift, or credit union at market prices, Reserve Banks were suddenly confronted with a host of new issues: how to keep current customers and attract new ones; how to market and price current products and develop new ones; and how to improve service and increase efficiency.

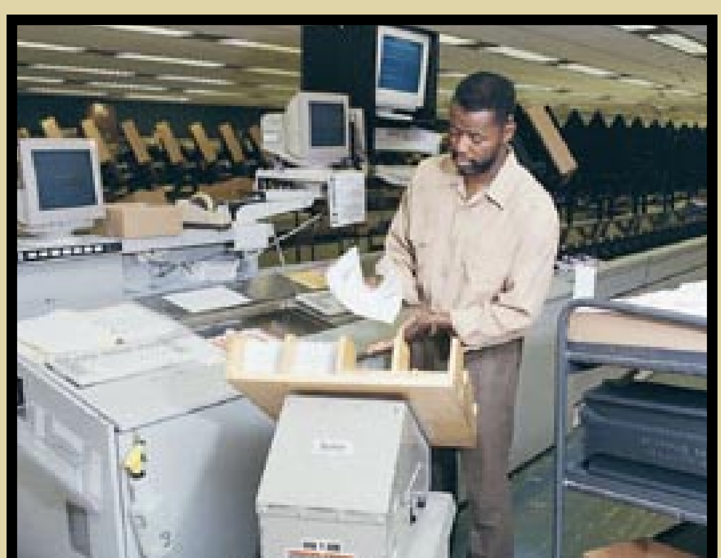
Like so many organizations, Reserve Banks met the challenge of a more competitive marketplace by drawing on its knowledge of and experience with its core businesses. The Fed had been established, fundamentally, to ensure the safe, reliable flow of funds among individuals, businesses, and banks. Since 1914, the Fed had supplied cash to banks, cleared checks, and transferred funds in ways that reflected evolving technology: by telegraph, telephone, and computer.

Early in its history, the Fed's objective was to improve the efficiency of check payments. Float – dollars added to one account but not yet deducted from another – is a measure of payment inefficiency. *"Before the establishment of the Federal Reserve System, many hundreds of millions of dollars of float were shown in the statements of the banks.*

This was recognized as an evil and the Federal Reserve System was expected to correct it. The method of collecting checks followed by the system, known as transit operation, has shortened the time in transit by sending checks to their destinations by the shortest route and has reduced the risk and float by the daily telegraphic settlement of balances. It can be reduced further by the development of county and regional clearings on a

Clearing checks has always been an important—labor-intensive—Fed function. As the volume of paper drafts increased, the Check Department relied on technology to process them more quickly and efficiently. Today, just a few people are needed to keep the 24-hour operation running smoothly.

Check clearing evolves: (top row, from left) 1918, 1940s, 1950s; (bottom row, from left) 1961 and two current views.



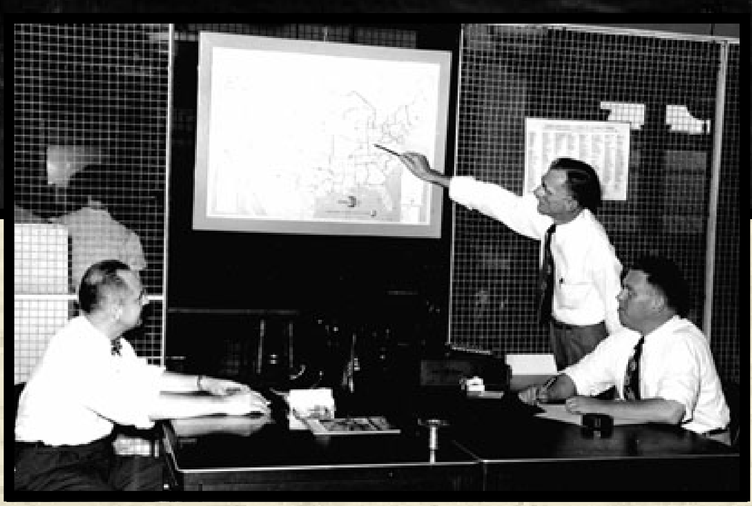
broader scale and the more widespread practice of sending checks, payable in other districts, directly to those districts." (1928)

During the 1940s, the Fed's check processing system proved valuable not only to the economy but to the war effort: *"Should this central clearing of checks slow down, the tempo of business in war plants employing millions of war workers would be retarded…The department which handles this seemingly unimportant household detail has now been assigned the function of clearing ration checks, because it is recognized as an efficient, labor-saving organization."* (1942)

The ongoing emphasis on efficiency has led payments operations to become the most technologically advanced within the Federal Reserve. Manual operations prevailed into the 1940s, but soon gave way to punchcards read by tabulating machines. This equipment made it easier to process the Fed's own payrolls and to keep a running total of securities being held for member institutions. In the 1930s, a weekend audit of securities held in the Federal Reserve vault typically kept 100 typists busy from Friday night until Sunday.

Late in the 1940s, check clearing became more streamlined with the arrival of machines to proof, endorse, sort, and list checks. Check collection and distribution, the responsibility of the Transportation Department, accelerated as horse-drawn wagons were replaced by automobiles and airplanes. The Philadelphia Fed, the first Federal Reserve Bank to set up its own transportation network, gradually expanded its coverage from Philadelphia's near suburbs to cities at the edges of the Third District, collecting, clearing, and returning checks in ever shorter periods of time.

Computers arrived at the Philadelphia Fed in 1961, and by the end of the decade, payroll, deposit ledger, group clearings, and automatic cash letter charges were all computer-based functions. Automated Clearinghouse followed in 1974, reducing to just a few seconds the time it took to transfer millions between accounts.



Though the geographic dimensions of the Third District have not changed, technology has shrunk them by reducing the time it takes a check, a service request, or a person to get from here to there. Clockwise, from top: A new bank vehicle is put into service (1949); Collections Department (1950); Check transport takes to the air (1950).

The Philadelphia Fed was instrumental in the development of two computer-based Federal Reserve services: Treasury Direct and FedLine. Treasury Direct, the Federal Reserve's computerized book-entry system for government securities, was developed by Philadelphia and the U.S. Treasury. It began operation in 1986. FedLine, the network that provides customers on-line access to all Fed services, was first tested in Philadelphia in 1987.

Fed tellers determined the fitness of currency (bottom) by sight and touch until the 1980s, when the task was taken on by sophisticated bill counting equipment. Unfit currency was burned at a local crematory until 1953, when the Fed installed an incinerator (top).

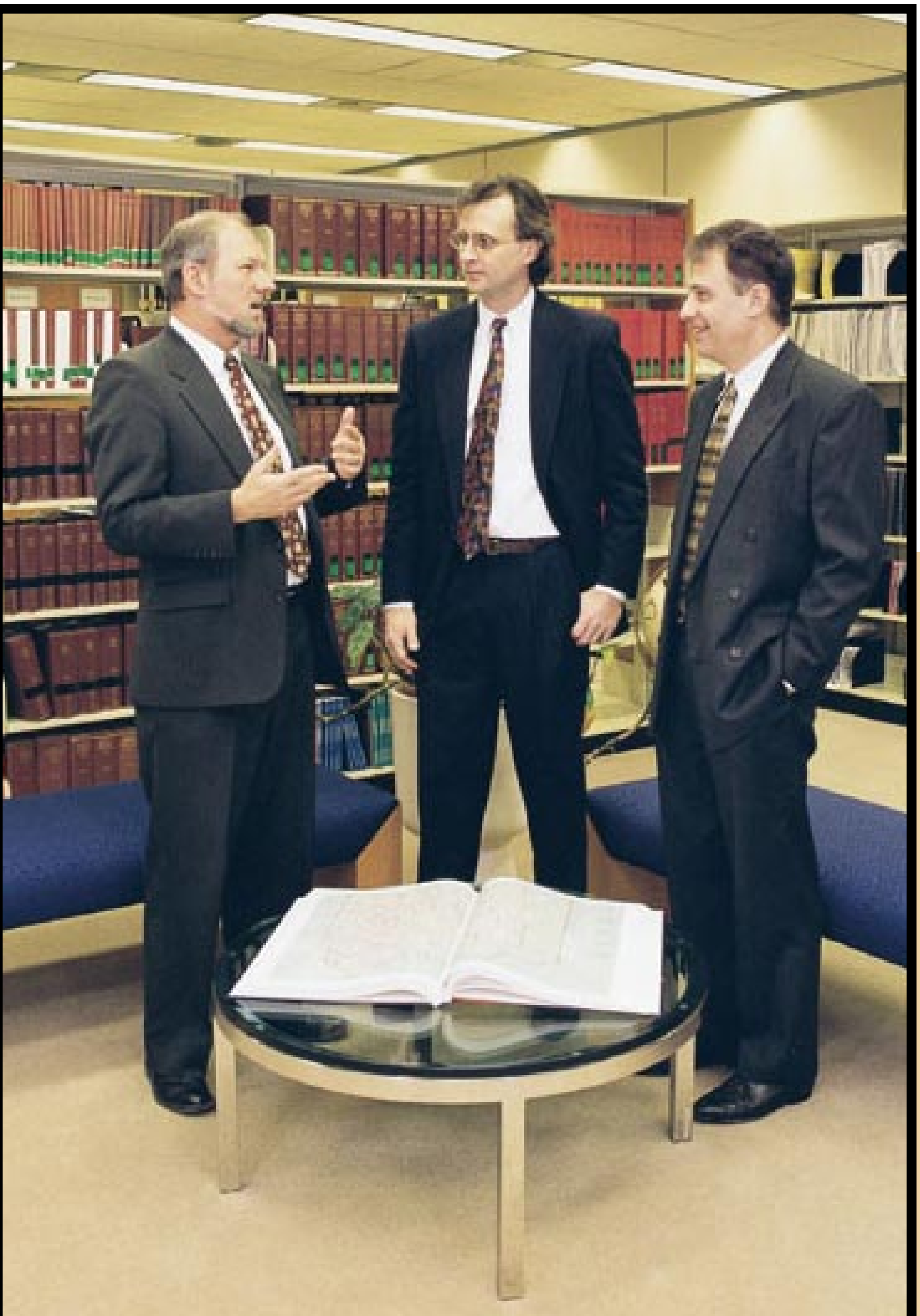
Despite the growing popularity of electronic funds, cash remains the most immediate and universal payment method, and it is cash that generates considerable conversation when its appearance changes. Witness the attention paid to the recently redesigned $100, $50, and $20 bills, and to the 1999 introduction of quarters representing each of the 50 states. This is nothing new. In 1929, the downsizing of currency was a topic of note. *"The replacement of the old series, or large size paper money, kept certain departments of the bank busily engaged over a large part of 1929."* (1929)

Conversely, the 1969 withdrawal from circulation of $1,000, $5,000, and $10,000 notes slipped by almost unnoticed – perhaps because few people ever saw them anyway. At the time, the $10 bill was the most commonly used denomination.

ENSURING GROWTH AND STABILITY

The 1990s marked the longest period of uninterrupted economic growth in American history, an achievement supported by the Federal Reserve's deft application of monetary policy. As Philadelphia Fed President Edward G. Boehne explained, *"Monetary policy played a key role in helping to stimulate a durable expansion. Although a very accommodative monetary stance was appropriate to get the economy moving, a more neutral stance is essential to sustain growth. Lightening up on the monetary accelerator in a timely fashion is better than slamming on the brakes later."* (1993)

Though recent years have brought increasing acknowledgment of the Fed's role in the expansion of the 1990s, the central bank's most important contribution to it had come almost a decade earlier. In the early 1980s, the Fed laid the foundation for sustained prosperity when it took dramatic action to end runaway inflation. Bringing inflation under control ultimately yielded low interest rates and financial market stability, which created incentives to invest in new technologies and boost productivity.



The research function was added shortly after the founding of the Federal Reserve System "...for the purpose of collecting and interpreting such regional and national data as were not obtained by other agencies and for the assembling, in usable form, of other available information." (1929)

The key to the Fed's successful monetary policy is its focus on creating a financial environment that fosters sustained growth. That is a task that requires equal measures of economic art and science.

The Bank's Research and Statistics Department brings academic discipline to Fed policy deliberations. The department conducts the monthly Business Outlook Survey, a widely recognized barometer of manufacturing in the Third District and the nation. Its bi-monthly *Business Review* and ongoing scholarly research projects apply theory to real-world situations.

The art of policymaking lies in the ability to discern the nuances of market behavior and to anticipate the impact of trends that elude statistical analysis. That art is crucial to good policymaking, and it comes to the Fed in a unique way through the boards of directors at Reserve Banks. Reserve Banks' boards of directors represent not only banking, but business, industry, agriculture, labor, and community interests. As board members bring their experiences to bear on discount rate deliberations every two weeks, they infuse Fed thinking with realistic perspectives and fresh insights.

Over the years, the Philadelphia Fed has developed close relationships with many banking, business, and community leaders across the District whose contributions add significantly to the Fed's ability to assess economic conditions and evaluate the need for policy action.

Anyone who witnessed the demise of the First Bank of the United States, and then the Second, two centuries ago would hardly have predicted the success of the Federal Reserve. The Fed has been an integral part of the 20th century and contributed to the financial stability and economic prosperity we experienced as the century drew to a close. What began as an adventure in finance has become an economic institution – a steadying influence on a system that has survived depression, exuberance, and everything in between.

Philadelphia Fed economists brief President Edward G. Boehne. In addition to advising officers and boards, Fed economists share information with member banks, businesses, and the public.

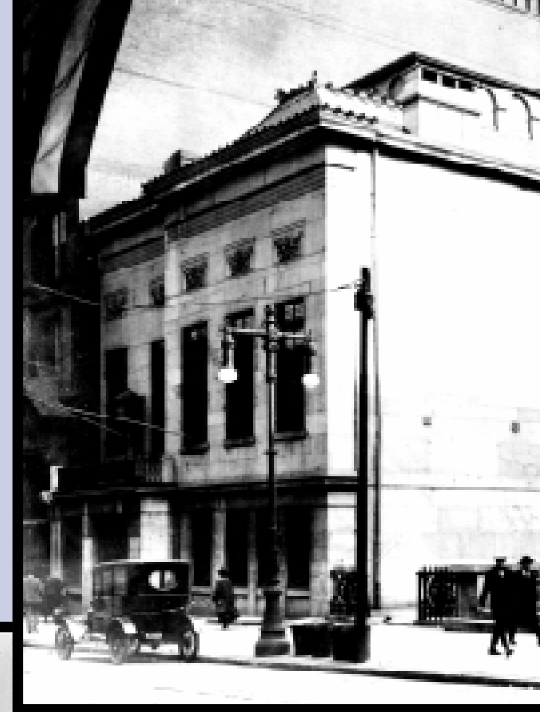
HOMES WE HAVE KNOWN

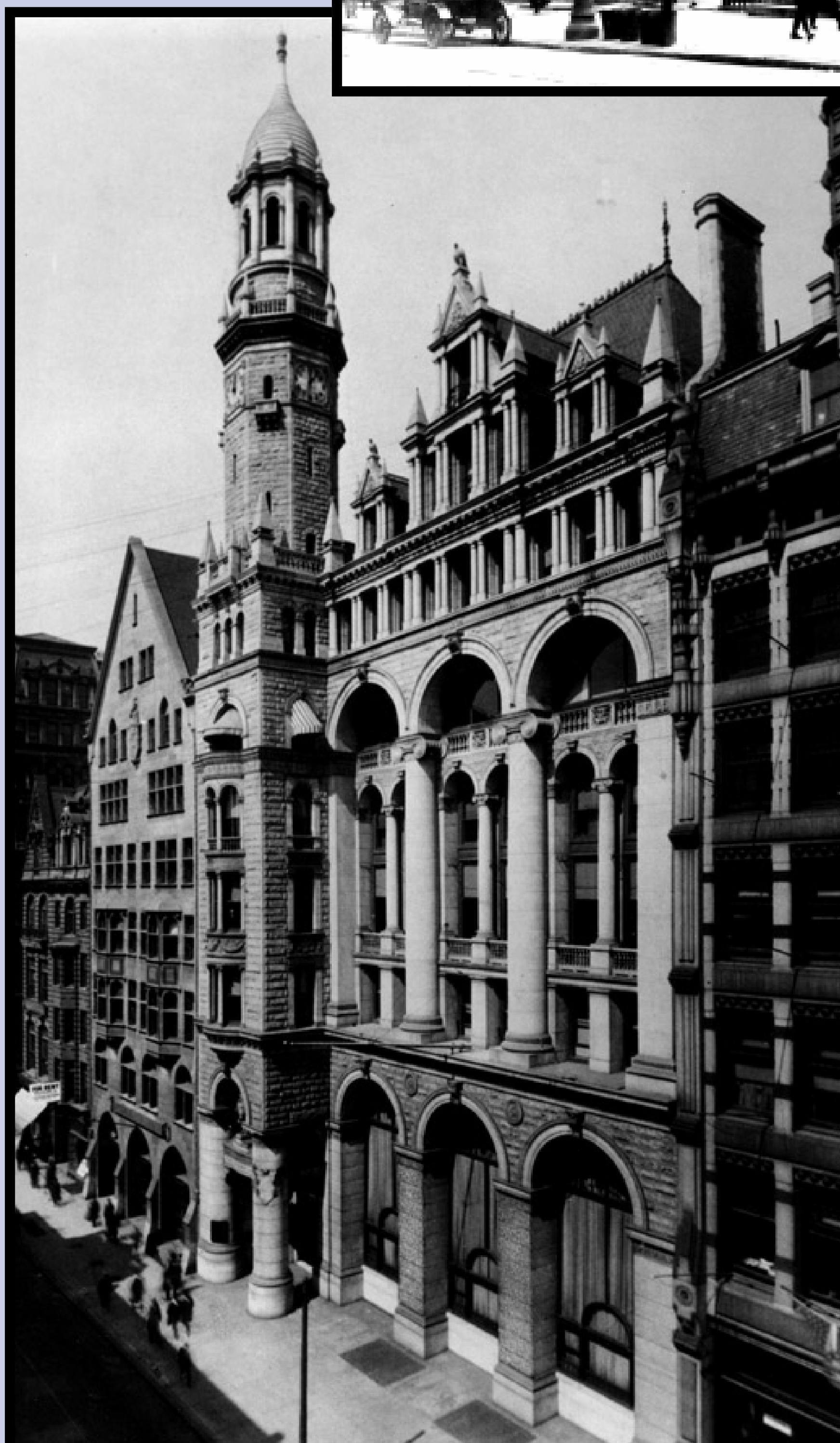
The Federal Reserve Bank of Philadelphia has had three official addresses in its 85 years, all in Center City, all within a few blocks of each other. When it opened for business in 1914, the Fed was located at 406-408 Chestnut Street in an existing building that had taken just 10 days to prepare. When more room was needed, the bank leased space in two buildings nearby.

In 1918, the Philadelphia Fed moved into 925 Chestnut Street and over time acquired most of the block, which is why the location was commonly known as "10th and Chestnut." The most notable feature of this structure, previously home to the Penn Mutual Insurance Company, was a vault suspended in thick glass, which made comings and goings completely visible from every angle, including the floor below.

Executive offices were housed in 925 Chestnut, which was the oldest building on the site and was originally known as the Horner Building. A wing was added in 1925 when a neighboring hotel was torn down. An adjacent structure, once home to the Producers and Consumers Bank, was purchased in 1925. Finally in 1932, the Fed purchased and demolished the Record Building, on the northeast corner of 10th and Chestnut. This became the

The Fed's first and second homes: 406-408 Chestnut Street (right), and 925 Chestnut Street (below)





site of a new structure designed by Paul Cret, who had already designed the Benjamin Franklin Bridge, the Rodin Museum, and the Barnes Foundation Gallery. The new building opened in 1934; an addition was constructed in 1941. The garden, visible from Chestnut Street, was added in 1942, and two more floors were added in 1953.

Despite this expansion, the Fed had outgrown 10th and Chestnut by the 1970s and had dispatched employees to several other locations, including the Keystone AAA Building at 20th and Market, the Gimbel Building at 9th and Market, and the Public Ledger Building at 6th and Chestnut. Construction on the bank's current home on Independence Mall, 6th and Arch Streets, began in 1971.

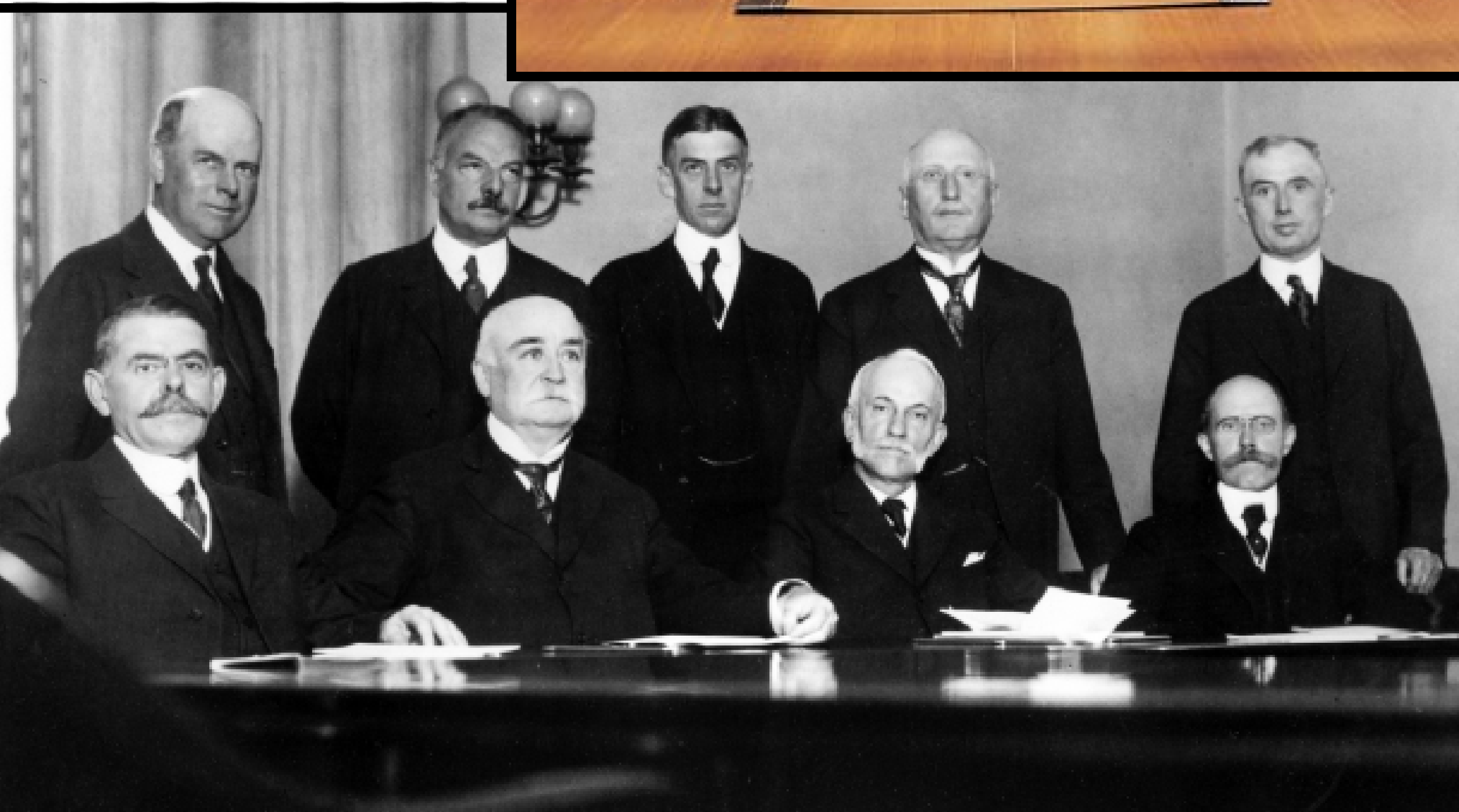
The Fed's most recent move took place on July 10, 1976. Because the relocation involved the transfer of billions of dollars, the date and time of the move was a carefully guarded secret. At midnight, a caravan of armored trucks threaded along the five-block route, accompanied by 24 cars of Secret Service agents, with weapons drawn. Philadelphia police and Federal Reserve security guards lined the streets and watched from rooftops. A helicopter hovered overhead. Five hours later, without incident, the Fed was home again.

The 1953 addition to 925 Chestnut: on paper (top left) and after completion (top center). The Fed's current home, Sixth and Arch Streets today (top right, center) and during construction in 1975 (bottom).


BANK OF PHILADELPHIA

Directors

Pictured in the Board Room 1999: Philadelphia Fed Board Chairman Joan Carter (left) and Deputy Chairman Charisse R. Lillie. Ms. Carter is President & COO, UM Holdings Ltd., Haddonfield, NJ; Ms. Lillie is a partner at Ballard Spahr Andrews & Ingersoll, Philadelphia, PA.



Pictured in the Board Room 1918: The first Philadelphia Board of Directors: (seated, from left) George W. F. Gaunt, Edwin S. Stuart, William H. Peck, George W. Norris; (standing, from left) Deputy Chairman George M. LaMonte, Chairman Richard L. Austin, Governor Charles J. Rhoads, Alba B. Johnson, and M. J. Murphy.

Pictured in the Eastburn Court from left: J. Richard Jones, President and CEO, Insignia/ESG Jackson-Cross, Philadelphia, PA; Rufus A. Fulton, Jr., Chairman, President and CEO, Fulton Financial Corporation, Lancaster, PA; and Howard E. Cosgrove, Chairman and CEO, Conectiv, Wilmington, DE.

Pictured in the vault area from left: Glenn A. Schaeffer, President, Pennsylvania Building and Construction Trades Council, Harrisburg, PA; David B. Lee, President & CEO, Omega Bank, National Association, State College, PA; Harry Elwell, III, President and CEO, First National Bank of Absecon, Absecon, NJ; and Robert D. Burris, President & CEO, Burris Foods, Inc., Milford, DE.

Officers

In 1999, there was one promotion in our official staff. Howard M. James became Assistant Vice President in the Supervision, Regulation, and Credit Department.

Edward G. Boehne
President

William H. Stone, Jr.
First Vice President

Donald F. Doros
Executive Vice President

William A. Bonifield, Jr.
Senior Vice President and Manager Cash/Fiscal Product Office

Michael E. Collins
Senior Vice President and Lending Officer

Richard W. Lang
Senior Vice President and Director of Research

Ronald B. Lankford
Senior Vice President

D. Blake Prichard
Senior Vice President

Milissa M. Tadeo
Senior Vice President

J. Warren Bowman, Jr.
Vice President

Robert J. Bucco
Vice President

Gerard A. Callanan
Vice President and Discount Officer

Theodore M. Crone
Vice President and Economist

John J. Deibel
Vice President

Patrick L. Donahue
Vice President

William Evans, Jr.
Vice President

Joanna H. Frodin
Vice President

Arun K. Jain
Vice President

Jerry Katz
Vice President

Henry T. Kern
Vice President

Edward M. Mahon
Vice President and General Counsel

Loretta J. Mester
Vice President and Economist

Stephen A. Meyer
Vice President and Associate Director of Research

Mary DeHaven Myers
Vice President and Community Affairs Officer

Louis N. Sanfelice
Vice President

John B. Shaffer
Vice President and General Auditor

Herbert E. Taylor
Vice President and Secretary

Vish P. Viswanathan
Vice President and Cash/Fiscal Product Officer

Eileen P. Adezio
Assistant Vice President

John G. Bell
Assistant Vice President

Shirley L. Coker
Assistant Vice President and Counsel

Dean Croushore
Assistant Vice President and Economist

Donna L. Franco
Budget Officer and Assistant Secretary

William L. Gaunt
Assistant Vice President

John V. Heelan
International Examinations Officer

Mary Ann Hood
Assistant Vice President

Howard M. James, Jr.
Assistant Vice President

Alan L. Kiel
Assistant Vice President

Linda K. Kirson
Treasury Services Officer

Thomas P. Lambinus
Assistant Vice President

Joseph L. McCann
Administrative Services Officer and Security Officer

Alice J. Menzano
Assistant Vice President and Cash/Fiscal Product Officer

Edward Morrison
Operations Officer

Camille M. Ochman
Assistant Vice President

A. Reed Raymond, III
Assistant Vice President and Examination Review Officer

Patrick M. Regan
Assistant Vice President and Information Security Officer

Richard A. Sheaffer
Assistant Vice President

Ronald R. Sheldon
Assistant Vice President

Stephen J. Smith
Assistant Counsel

Marie Tkaczyk
Assistant Vice President

Sharon N. Tomlinson
Assistant Vice President and Planning Officer and Assistant Secretary

Richard A. Valente
Assistant General Auditor

Elisabeth C. Videira-Dzeng
International Examinations Officer

Bernard M. Wennemer
Assistant Vice President

Anthony J. White
Financial Services Officer

Michael P. Zamulinsky
Assistant Vice President

Executive Area, Federal Reserve Bank of Philadelphia

Advisory Councils

Community Bank Council

Chairman
Jay M. Ford, *President & CEO*
Crest Savings Bank, SLA, Wildwood Crest, NJ

Deputy Chairman
Gerald A. Nau, *President & CEO*
Great Valley Savings Bank, Reading, PA

Theodore D. Bessler, *President & CEO*
Shore Community Bank, Toms River, NJ

Stephen C. Nelson, *President & CEO*
Artisans' Bank, Wilmington, DE

Daniel L. Price, Sr., *President & CEO*
Century Savings Bank, Bridgeton, NJ

Theodore H. Reich, *Chairman & President*
Jersey Shore State Bank, Williamsport, PA

Thomas F. Robinson, *President & CEO*
Malvern Federal Savings Bank, Paoli, PA

Kenneth R. Shoemaker, *President & CEO*
Orrstown Bank, Shippensburg, PA

John R. Stranford, *President & CEO*
Third Federal Savings Bank, Newtown, PA

Thomas A. Vento, *President & CEO*
Prudential Savings Bank PASA, Philadelphia, PA

W. Jack Wallie, *President & CEO*
East Stroudsburg Savings Association, Stroudsburg, PA

Robert C. Wheeler, *Chairman*
Grange National Bank, Tunkhannock, PA

Community Bank Council (from left): Thomas A. Vento, Kenneth R. Shoemaker, Jay M. Ford, Stephen C. Nelson, Theodore D. Bessler

Credit Union Council

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William J. Lavage, *President & CEO*
Service First FCU, Danville, PA

Deputy Chairman
John D. Buchinski, *President & CEO*
Wheatland FCU, Lancaster, PA

Margaret B. Coan, *Executive Vice President*
K of C FCU, Philadelphia, PA

James E. Everhart, Jr., *Manager*
Louviers FCU, Newark, DE

Virginia M. Fifer, *CEO & Manager*
Atlantic City Electric Company Employees FCU, Mays Landing, NJ

Anthony R. Hinds, *CEO*
DPL FCU, Newark, DE

John P. Kebles, *CEO*
Choice One FCU, Wilkes-Barre, PA

David G. Keffer, *CEO & Manager*
Cornerstone FCU, Carlisle, PA

Paul J. Ladd, *CEO & Manager*
Garden State FCU, Moorestown, NJ

Lee T. MacMinn, *President & CEO*
Freedom Credit Union, Philadelphia, PA

Ignacio I. Morales, *Manager*
Borinquen FCU, Philadelphia, PA

Steven D. Schlundt, *President & CEO*
Atlantic City Firemen's FCU, Northfield, NJ

Credit Union Council (from left): William J. Lavage, John D. Buchinski, Lee T. MacMinn, Anthony R. Hinds, Ignacio I. Morales, Margaret B. Coan, Paul J. Ladd, David G. Keffer

Small Business & Agriculture Council

Chairman
Joan R. Henderson, *President*
J.R. Henderson & Associates, Lancaster, PA

Small Business & Agriculture Council (from left): Dennis E. Duffy, David C. Hileman, Joan R. Henderson, Thomas K. Leidy, Daniel R. Hawbaker, Janis Herschkowitz, Peter Bylone

Deputy Chairman
Thomas K. Leidy, *President & Chairman*
Leidy's, Inc., Souderton, PA

Cary S. Borish, *Co-President*
Marathon Grill, Philadelphia, PA

Peter Bylone, *Manager*
Vineland Produce Auction, Vineland, NJ

Della L. Clark, *President*
The Enterprise Center, Philadelphia, PA

Dennis E. Duffy, *President*
Duffy, Dolcy & McManus, Absecon, NJ

Daniel R. Hawbaker, *President*
Glenn O. Hawbaker, Inc., State College, PA

Janis Herschkowitz, *President & CEO*
PRL, Inc., & Subsidiaries, Cornwall, PA

David C. Hileman, *Owner*
Hilecrest Farms, Tyrone, PA

Philip B. Mitman, *Owner*
Bixler's Jewelers, Easton, PA

Jay Windsor, *President*
Lakeside Greenhouses, Inc., Laurel, DE

Operating Statistics

The trend toward electronic payments and consolidation in the banking industry produced some dramatic shifts in our business volumes in 1999. Because of the ongoing campaign to sign up recipients of U.S. government payments for direct deposit, the volume of government ACH payments we process continued to rise, and the number of government checks we process continued to decline.

The decline in food coupons reflects state governments' shift from paper coupons to electronic debit cards as a means of distributing benefits. The sharp decline in our electronic book-entry transfers reflects a national pattern of bank mergers, consolidations, and interstate branching that is shifting volumes among Federal Reserve Districts.

Our gains in commercial checks processed and the decline in our commercial ACH payments processed are the result of bank consolidations and mergers in our District.

We began outsourcing some coin processing in 1998, and as a result, the volume of coin processed in the Bank continued to decline in 1999.

	1999 Volume	1999 Dollar Value	1998 Volume	1998 Dollar Value
SERVICES TO DEPOSITORY INSTITUTIONS				
Wire Transfer of Funds	7.7 million transfers	$22.7 trillion	7.9 million transfers	$23.2 trillion
ACH:				
Government	245.2 million	$300.4 billion	220.2 million items	$269.7 billion
Commercial	109.3 million	$268.5 billion	136.4 million items	$391.1 billion
Check processing:				
U.S. Government	32.3 million	$33.7 billion	37.3 million checks	$38.2 billion
All other	1,124.4 million	$1,723.6 billion	909.5 million checks	$1,338.4 billion
Cash operations:				
Currency processed	1,575.8 million	$30.1 billion	1,360.4 million notes	$21.4 billion
Coin processed	21.9 thousand bags	$10.3 million	55.1 thousand bags	$6.5 million
Loans to depository institutions	219	$365 million	212 loans	$314 million
SERVICES TO U.S. TREASURY				
Electronic book-entry transfers	40,500	$241 million	1.5 million transfers	$19.9 trillion
Food coupons processed	18.6 million coupons	$99.0 million	91.6 million coupons	$484.3 million

FINANCIAL REPORTS

FEDERAL RESERVE BANK OF PHILADELPHIA

January 14, 2000

To the Board of Directors of the Federal Reserve Bank of Philadelphia:

The management of the Federal Reserve Bank of Philadelphia is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 1999 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks, and as such, include amounts, some of which are based on judgments and estimates of management.

The management of the Federal Reserve Bank of Philadelphia is responsible for maintaining an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the Federal Reserve Bank of Philadelphia assessed its process of internal controls over financial reporting including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control -- Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, the management of the Federal Reserve Bank of Philadelphia believes that the Federal Reserve Bank of Philadelphia maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.

By Edward G. Boehne

Edward G. Boehne, President

By William H. Stone

William H. Stone, First Vice President

By Ronald B. Lankford

Ronald B. Lankford, Chief Financial Officer

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
2400 Eleven Penn Center
Philadelphia PA 19103-2962
Telephone (215) 963 8000
Facsimile (215) 963 8700

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of the
Federal Reserve Bank of Philadelphia

We have examined management's assertion that the Federal Reserve Bank of Philadelphia ("FRB Philadelphia") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the Financial Statements as of December 31, 1999, included in the accompanying Management's Assertion.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that the FRB Philadelphia maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the Financial Statements as of December 31, 1999, is fairly stated, in all material respects, based upon criteria described in " Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

March 3, 2000

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
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Philadelphia PA 19103-2962
Telephone (215) 963 8000
Facsimile (215) 963 8700

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Governors of The Federal Reserve System
and the Board of Directors of The Federal Reserve Bank of Philadelphia

We have audited the accompanying statements of condition of The Federal Reserve Bank of Philadelphia (the "Bank") as of December 31, 1999 and 1998, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3, the financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of The Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of The Federal Reserve System, are set forth in the "Financial Accounting Manual for Federal Reserve Banks" and constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 1999 and 1998, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 3, 2000

FEDERAL RESERVE BANK OF PHILADELPHIA
STATEMENTS OF CONDITION
(in millions)

	As of December 31, 1999	1998
ASSETS		
Gold certificates	$ 319	$ 323
Special drawing rights certificates	187	282
Coin	8	23
Items in process of collection	282	266
Loans to depository institutions	1	-
U.S. government and federal agency securities, net	14,494	13,277
Investments denominated in foreign currencies	479	1,035
Accrued interest receivable	146	125
Interdistrict settlement account	8,761	2,181
Bank premises and equipment, net	72	73
Other assets	81	112
Total assets	$ 24,830	$ 17,697
LIABILITIES AND CAPITAL		
Liabilities:		
Federal Reserve notes outstanding, net	$ 23,437	$ 16,456
Deposits:		
Depository institutions	592	433
Other deposits	1	8
Deferred credit items	326	242
Surplus transfer due U.S. Treasury	15	147
Accrued benefit cost	51	50
Other liabilities	9	8
Total liabilities	24,431	17,344
Capital:		
Capital paid-in	199	176
Surplus	200	177
Total capital	399	353
Total liabilities and capital	$ 24,830	$ 17,697

The accompanying notes are an integral part of these financial statements.

FEDERAL RESERVE BANK OF PHILADELPHIA
STATEMENTS OF INCOME
(in millions)

	For the years ended December 31, 1999	1998
Interest income:		
Interest on U.S. government and federal agency securities	$ 814	$ 804
Interest on foreign currencies	7	23
Total interest income	821	827
Other operating income:		
Income from services	41	40
Reimbursable services to government agencies	25	24
Foreign currency gains (losses), net	(15)	98
U.S. government securities gains (losses), net	(1)	1
Other income	3	4
Total other operating income	53	167
Operating expenses:		
Salaries and other benefits	71	68
Occupancy expense	8	8
Equipment expense	11	10
Cost of unreimbursed Treasury services	4	4
Assessments by Board of Governors	23	22
Other expenses	34	43
Total operating expenses	151	155
Net income prior to distribution	$ 723	$ 839
Distribution of net income:		
Dividends paid to member banks	$ 12	$ 16
Transferred to (from) surplus	23	(96)
Payments to U.S. Treasury as interest on Federal Reserve notes	688	385
Payments to U.S. Treasury as required by statute	-	534
Total distribution	$ 723	$ 839

The accompanying notes are an integral part of these financial statements.

FEDERAL RESERVE BANK OF PHILADELPHIA
STATEMENTS OF CHANGES IN CAPITAL

for the years ended December 31, 1999 and December 31, 1998
(in millions)

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 1998			
(5.7 million shares)	$ 284	$ 273	$ 557
Net income transferred (from) surplus	-	(96)	(96)
Net change in capital stock			
(redeemed) (2.2 million shares)	(108)	-	(108)
Balance at December 31, 1998			
(3.5 million shares)	$ 176	$ 177	$ 353
Net income transferred to surplus	-	23	23
Net change in capital stock issued	23	-	23
(0.5 million shares)			
Balance at December 31, 1999			
(4.0 million shares)	$ 199	$ 200	$ 399

The accompanying notes are an integral part of these financial statements.

FEDERAL RESERVE BANK OF PHILADELPHIA
NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION:

The Federal Reserve Bank of Philadelphia ("Bank") is part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act") which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. Other major elements of the System are the Federal Open Market Committee ("FOMC") and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY") and, on a rotating basis, four other Reserve Bank presidents.

Structure:

The Bank in Philadelphia serves the Third Federal Reserve District, which includes Delaware and a portion of New Jersey and Pennsylvania. In accordance with the Federal Reserve Act, supervision and control of the Bank is exercised by a board of directors. Banks that are members of the System include all national banks and any state chartered bank that applies and is approved for membership in the System.

Board of Directors:

The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

2. OPERATIONS AND SERVICES:

The System performs a variety of services and operations. Functions include: formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse operations and check processing; distribution of coin and currency; fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies, and state member banks; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

Continued

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, and the lending of U.S. government securities. Additionally, the FRBNY is authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange and securities contracts in fourteen foreign currencies, maintain reciprocal currency arrangements ("F/X swaps") with various central banks, and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks.

3. SIGNIFICANT ACCOUNTING POLICIES:

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are documented in the "Financial Accounting Manual for Federal Reserve Banks" ("Financial Accounting Manual"), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and generally accepted accounting principles in the United States ("GAAP"). The primary differences are the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowings with pledged collateral, as is required by GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows or a Statement of Comprehensive Income. The Statement of Cash Flows has not been included as the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. The Statement of Comprehensive Income, which comprises net income plus or minus certain adjustments, such as the fair value adjustment for securities, has not been included because as stated above the securities are recorded at amortized cost and there are no other adjustments in the determination of Comprehensive Income applicable to the Bank. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows or a Statement of Comprehensive Income would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Unique accounts and significant accounting policies are explained below.

a. ***Gold Certificates***

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged and the Reserve Banks' gold certificate accounts are lowered. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

b. ***Special Drawing Rights Certificates***

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. The Board of Governors allocates each SDR transaction among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

c. ***Loans to Depository Institutions***

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is recorded on the accrual basis and is charged at the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve Banks, subject to review by the Board of Governors. However, Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

The Board of Governors established a Special Liquidity Facility (SLF) to make discount window credit readily available to depository institutions in sound financial condition around the century date change (October 1, 1999, to April 7, 2000) in order to meet unusual liquidity demands and to allow institutions to confidently commit to supplying loans to other institutions and businesses during this period. Under the SLF, collateral requirements are unchanged from normal discount window activity and loans are made at a rate of 150 basis points above FOMC's target federal funds rate.

d. ***U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies***

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or other needs specified by the FOMC in carrying out the System's central bank responsibilities.

Purchases of securities under agreements to resell and matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Purchases under agreements to resell are transactions in which the FRBNY purchases a security and sells it back at the rate specified at the commencement of the transaction. Matched sale-purchase transactions are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction.

Effective April 26, 1999, FRBNY was given the sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires FRBNY to take possession of collateral in amounts in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA. Prior to April 26, 1999, all Reserve Banks were authorized to engage in such lending activity.

Foreign exchange contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with authorized foreign central banks. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed upon period of time (up to twelve months), at an agreed upon interest rate. These arrangements give the FOMC temporary access to foreign currencies that it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank, and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury and ESF for financing purchases of foreign currencies and related international operations.

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts which contain varying degrees of off-balance sheet market risk, because they represent contractual commitments involving future settlement, and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, earnings and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as "Interest on U.S. government and federal agency securities" or "Interest on foreign currencies," as appropriate. Income earned on securities lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as "U.S. government securities gains (losses), net." Foreign currency denominated assets are revalued monthly at current market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains (losses), net." Foreign currencies held through F/X swaps, when initiated by the counter party, and warehousing arrangements are revalued monthly, with the unrealized gain or loss reported by the FRBNY as a component of "Other assets" or "Other liabilities," as appropriate.

Balances of U.S. government and federal agencies securities bought outright, investments denominated in foreign currency, interest income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Effective April 26, 1999, income from securities lending transactions undertaken by FRBNY was also allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to FRBNY and not to other Reserve Banks.

e. ***Bank Premises and Equipment***

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from 2 to 50 years. New assets, major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs and minor replacements are charged to operations in the year incurred.

f. ***Interdistrict Settlement Account***

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check clearing and automated clearinghouse ("ACH") operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the "Interdistrict settlement account."

g. ***Federal Reserve Notes***

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents to the Reserve Banks upon deposit with such Agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve Agent must be equal to the sum of the notes applied for by such Reserve Bank. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and agency securities, loans, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. The Reserve Banks have entered into an agreement which provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by cash held in the vaults of the Bank of $7,493 million, and $1,978 million at December 31, 1999 and 1998, respectively.

h. ***Capital Paid-in***

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6% of the capital and surplus of the member bank. As a member bank's capital and surplus changes, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of $100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6% on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

i. *Surplus*

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66, Section 3002) codified the existing Board surplus policies as statutory surplus transfers, rather than as payments of interest on Federal Reserve notes, for federal government fiscal years 1998 and 1997 (which ended on September 30, 1998 and 1997, respectively). In addition, the legislation directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $107 million and $106 million during fiscal years 1998 and 1997, respectively. Reserve Banks were not permitted to replenish surplus for these amounts during this time. Payments to the U.S. Treasury made after September 30, 1998, represent payment of interest on Federal Reserve notes outstanding.

The Consolidated Appropriations Act of 1999 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S Treasury additional surplus funds of $3,752 million during the Federal Government's 2000 fiscal year. The Reserve Banks will make this payment prior to September 30, 2000.

In the event of losses, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury may vary significantly.

j. *Income and Cost related to Treasury Services*

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but will not be paid are reported as the "Cost of unreimbursed Treasury services."

Beginning January 1, 1998, the reimbursement process for all Reserve Banks was centralized at the Bank that included the transfer of each Reserve Bank's Treasury reimbursement receivable to the Bank. The centralized portion of the Bank's reimbursement receivable, reported in "Other assets," totaled $65 million and $96 million at December 31,1999 and

1998, respectively. The centralized portion of the Bank's Costs of unreimbursed Treasury services in both 1999 and 1998 totaled $3 million.

k. *Taxes*

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

4. U.S. Government and Federal Agency Securities:

Securities bought outright and held under agreements to resell are held in the SOMA at the FRBNY. An undivided interest in SOMA activity, with the exception of securities held under agreements to resell and the related premiums, discounts and income, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 2.995% and 2.907% at December 31, 1999 and 1998, respectively.

The Bank's allocated share of securities held in the SOMA at December 31, that were bought outright, were as follows (in millions):

	1999	1998
Par value:		
Federal agency	$ 5	$ 10
U.S. government:		
Bills	5,287	5,662
Notes	6,544	5,463
Bonds	2,485	2,020
Total par value	14,321	13,155
Unamortized premiums	273	215
Unaccreted discounts	(100)	(93)
Total allocated to Bank	$ 14,494	$ 13,277

Total SOMA securities bought outright were $483,902 million and $456,667 million at December 31, 1999 and 1998, respectively.

The maturities of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 1999, were as follows (in millions):

	Par value		
Maturities of Securities Held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 139	$ -	$ 139
16 days to 90 days	2,753	1	2,754
91 days to 1 year	4,189	1	4,190
Over 1 year to 5 years	3,719	-	3,719
Over 5 years to 10 years	1,531	3	1,534
Over 10 years	1,985	-	1,985
Total	$ 14,316	$ 5	$ 14,321

At December 31, 1999, and 1998, matched sale-purchase transactions involving U.S. government securities with par values of $39,182 million and $20,927 million, respectively, were outstanding, of which $1,174 million and $608 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES:

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 2.965% and 5.229% at December 31, 1999 and 1998, respectively.

The Bank's allocated share of investments denominated in foreign currencies, valued at current exchange rates at December 31, were as follows (in millions):

	1999	1998
German Marks:		
Foreign currency deposits	$ -	$ 547
Government debt instruments including agreements to resell	-	124
European Union Euro:		
Foreign currency deposits	129	-
Government debt instruments including agreements to resell	75	-
Japanese Yen:		
Foreign currency deposits	10	35
Government debt instruments including agreements to resell	264	324
Accrued interest	1	5
Total	$ 479	$ 1,035

Total investments denominated in foreign currencies were $16,140 million and $19,769 million at December 31, 1999 and 1998, respectively. The 1998 balance includes $15 million in unearned interest collected on certain foreign currency holdings that is allocated solely to the FRBNY.

The maturities of investments denominated in foreign currencies which were allocated to the Bank at December 31, 1999, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	$ 447
Over 1 year to 5 years	15
Over 5 years to 10 years	17
Total	$ 479

At December 31, 1999 and 1998, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 1999 and 1998, the warehousing facility was $5,000 million with nothing outstanding.

6. BANK PREMISES AND EQUIPMENT:

A summary of bank premises and equipment at December 31 is as follows (in millions):

	1999	1998
Bank premises and equipment:		
Land	$ 2	$ 2
Buildings	63	62
Building machinery and equipment	9	9
Construction in progress	-	-
Furniture and equipment	54	52
	128	125
Accumulated depreciation	(56)	(52)
Bank premises and equipment, net	$ 72	$ 73

Depreciation expense was $8 million for each of the years ended December 31, 1999 and 1998.

The Bank leases unused space to outside tenants. Those leases have terms ranging from 1 to 3 years. Rental income from such leases was $1 million and $2 million for the years ended December 31, 1999 and 1998, respectively. Future minimum lease payments under agreements in existence at December 31, 1999, were $4 million for the years 2000 through 2002.

7. COMMITMENTS AND CONTINGENCIES:

At December 31, 1999, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from 1 to approximately 4 years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $590 thousand and $576 thousand for the years ended December 31, 1999 and 1998, respectively. Certain of the Bank's leases have options to renew. The Bank has no capital leases.

Future minimum rental payments under noncancelable operating leases with terms of one year or more, at December 31, 1999, were $1 million for the years 2000 through 2003.

At December 31, 1999, the Bank has no other significant commitments or long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1% of the capital paid-in of the claiming Reserve Bank, up to 50% of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 1999 or 1998.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

8. RETIREMENT AND THRIFT PLANS:

Retirement Plans:

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 1999 and 1998, and for the years then ended, are not material.

Thrift plan:

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $2 million for each of the years ended December 31, 1999 and 1998 and are reported as a component of "Salaries and other benefits."

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS:

Postretirement benefits other than pensions:

In addition to the Bank's retirement plans, employees who have met certain age and length of service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit cost is actuarially determined using a January 1 measurement date.

Following is a reconciliation of beginning and ending balances of the benefit obligation (in millions):

	1999	1998
Accumulated postretirement benefit obligation at January 1	$ 35.3	$ 33.8
Service cost-benefits earned during the period	0.7	0.9
Interest cost of accumulated benefit obligation	2.1	2.3
Actuarial (gain)/loss	(6.7)	6.7
Contributions by plan participants	0.1	0.2
Benefits paid	(1.2)	(1.0)
Plan amendments, acquisitions, foreign currency exchange rate changes, business combinations, divestitures, curtailments, settlements, special termination benefits	-	(7.6)
Accumulated postretirement benefit obligation at December 31	$ 30.3	$ 35.3

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit cost (in millions):

	1999	1998
Fair value of plan assets at January 1	$ -	$ -
Actual return on plan assets	-	-
Contributions by the employer	1.1	0.8
Contributions by plan participants	0.1	0.2
Benefits paid	(1.2)	(1.0)
Fair value of plan assets at December 31	$ -	$ -
Unfunded postretirement benefit obligation	$ 30.3	$ 35.3
Unrecognized prior service cost	19.4	21.3
Unrecognized net actuarial (loss)	(5.6)	(12.8)
Accrued postretirement benefit cost	$ 44.1	$ 43.8

Accrued postretirement benefit cost is reported as a component of "Accrued benefit cost."

The weighted-average assumption used in developing the postretirement benefit obligation as of December 31, 1999 and 1998 was 7.5% and 6.25%, respectively.

For measurement purposes, an 8.75% annual rate of increase in the cost of covered health care benefits was assumed for 2000. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.50% by 2006, and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 1999 (in millions):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit cost	$ 0.1	$ (0.1)
Effect on accumulated postretirement benefit obligation	1.4	(1.3)

The following is a summary of the components of net periodic postretirement benefit cost for the years ended December 31 (in millions):

	1999	1998
Service cost-benefits earned during the period	$ 0.7	$ 0.9
Interest cost of accumulated benefit obligation	2.1	2.3
Amortization of prior service cost	(1.8)	(1.5)
Recognized net actuarial loss	0.4	0.3
Net periodic postretirement benefit cost	$ 1.4	$ 2.0

Net periodic postretirement benefit cost is reported as a component of "Salaries and other benefits."

Postemployment benefits:

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at both December 31, 1999 and 1998, were $6 million. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in both 1999 and 1998 operating expenses were $1 million.

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