Annual Report 1987

FEDERAL RESERVE BANK OF RICHMOND

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Entrance to the Federal Reserve Bank of Richmond with night lights on and security shutter in place.

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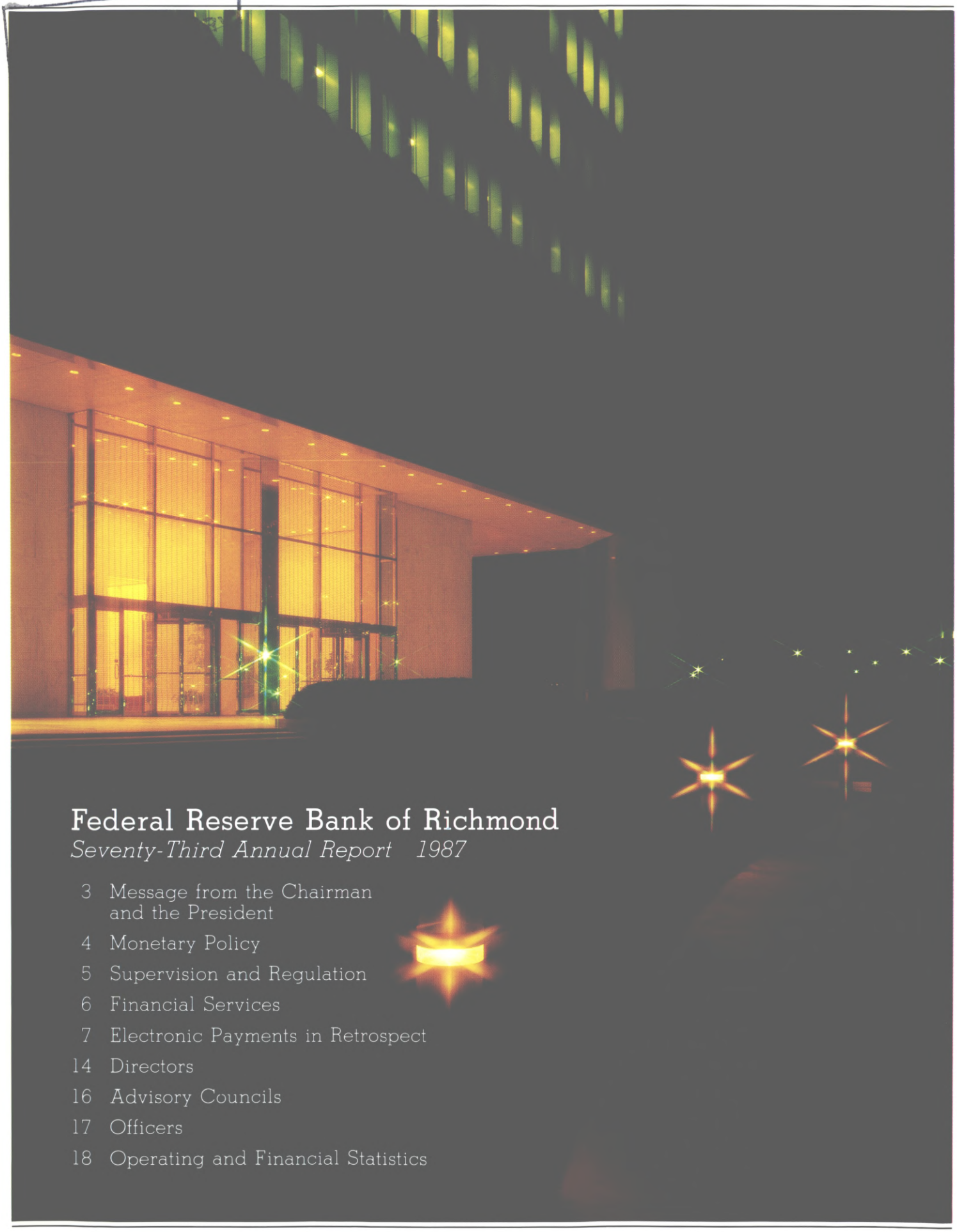

Federal Reserve Bank of Richmond

Seventy-Third Annual Report 1987

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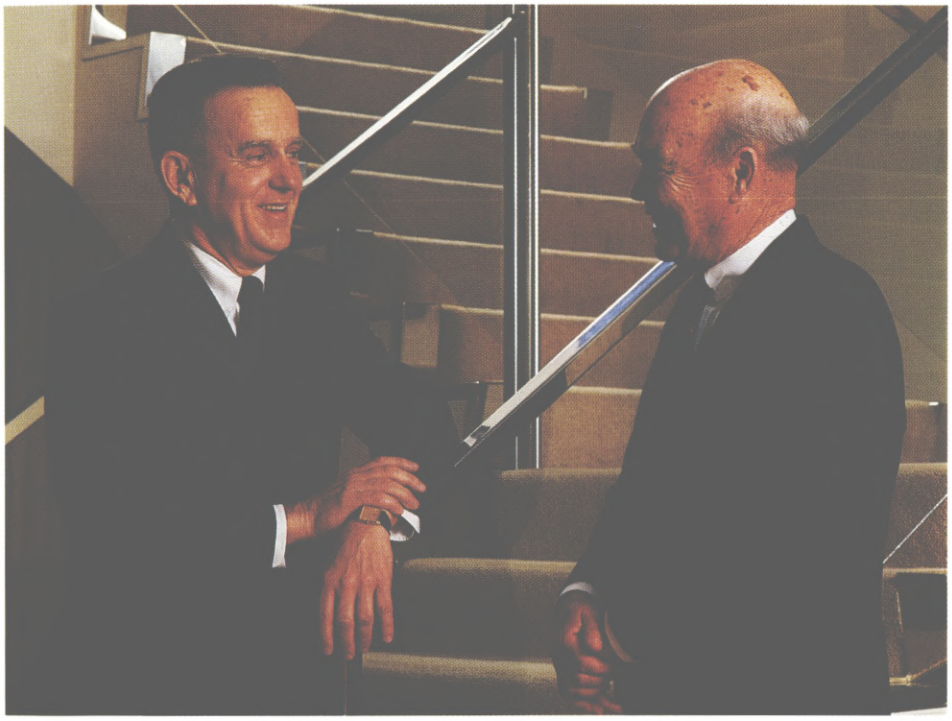
Message from the Chairman and the President



Robert P. Black
President

Leroy T. Canoles, Jr.
Chairman of the Board

We are pleased to present the 1987 Annual Report of the Federal Reserve Bank of Richmond. This year we feature an article on electronic payments. For the past five years at the Federal Reserve Bank of Richmond, a special planning and management unit headed by First Vice President Jimmie Monhollon has directed developments in electronic payments for the entire Federal Reserve System. In "Electronic Payments in Retrospect," Senior Vice President Bruce Summers examines the pattern and extent of use of electronic funds transfers and charts a course for their future.

Three shorter articles complete the textual portion of the report. Two—one on financial services and one on supervision and regulation—focus on the application of electronic technology to Bank functions. The third presents a review of monetary policy in 1987, a year that held an unusual mixture of challenges for System policymakers. We hope that you will find the articles interesting and informative.

On behalf of our directors and staff, we wish to thank you for the cooperation and support you extended to us throughout the year.

Chairman of the Board

President

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Monetary Policy

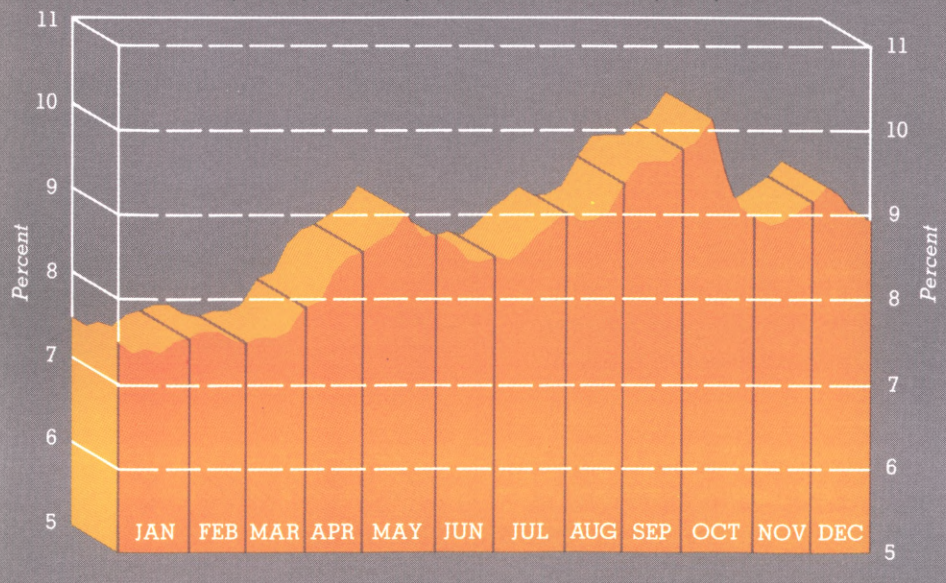
As 1987 began and as it progressed, the Federal Reserve faced the continuing challenge of providing enough liquidity to support a fifth year of economic expansion without risking an increase in inflationary pressures. As in other recent years, this task was complicated by uncertainty over how deregulation in banking markets had distorted relationships between the monetary aggregates and economic activity. Because of this uncertainty, the Federal Open Market Committee did not set an annual target range for the M1 aggregate. The Committee did set annual target ranges for the broader M2 and M3 aggregates, but in making its month-to-month policy decisions it also focused directly on a number of other indicators including inflation, economic conditions, and the exchange rate.

Through most of the year, the System sought to moderate a rise in inflation expectations that was apparently triggered by increases in commodity prices and declines in the foreign exchange value of the dollar. These expectations intensified in late summer, and on September 4 the Federal Reserve raised the discount rate from 5½ to 6 percent in order "to deal effectively and in a timely way with potential inflationary pressures." This increase was the first since March 1984.

Senior Vice President Al Broaddus reports on economic conditions in the aftermath of the stock market plunge.

The primary concern of policy shifted abruptly in October following the record plunge in the stock market. In the aftermath of the crash, the Federal Reserve affirmed "its readiness to serve as a source of liquidity to support the economic and financial system," and the financial system survived without major dislocations.

The goal of continued expansion in 1987 without a significant rise in the inflation rate proved to be an attainable one. The economy grew at a rate of about 4 percent, well above the consensus forecast. The price level rose by approximately 3½ to 4 percent. Industrial production, which had been virtually flat in 1985 and 1986, climbed by roughly 5 percent. As the year came to a close, however, there remained an unusual amount of uncertainty over the course of the economy in the months to come.



Concern over the possibility of a resurgence in inflation was especially evident in bond yields, which rose sharply in the spring and again in the late summer and early fall.

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Supervision and Regulation

It was not too many years ago that it was common for a bank's general books to be kept on a hand-posted "Boston Ledger," and for the noise of an early model proof machine to be the most tangible evidence of technological progress. Examiners could easily trace the progression of items through fairly elementary accounting systems. Today, the subdued hum of a computer's central processing unit is evidence of a drastic change that has occurred in the way banks keep up with transactions.

The scope of change has gone far beyond automation of accounts. Interest rates have been deregulated, new services have been added, banks that were once independent units have become holding company affiliates.

How do examiners keep abreast? There is no easy answer, but two key words are training and automation.

On-the-job training remains the foremost teacher, for there is no substitute for experience gained in the field. The rapidly changing banking environment of today, however, necessitates a comprehensive and formal training program for both new and experienced examiners.

Intensive, informal training sessions help novice examiners develop necessary skills.

Formal schools are sponsored by the Board of Governors and the Federal Financial Institutions Examination Council (FFIEC). Graduate schools of banking and schools sponsored by state banking associations are also used extensively. During 1987, approximately three-fourths of the field examining force attended one or more of these formal schools, and senior personnel served as instructors in several. In addition, the Examining Department conducted two bank holding company schools at state banking department offices for joint use by state examiners and department personnel.

Education is also provided on a continuous basis by informal departmental training sessions. Subjects covered are as diverse as loan documentation and parent holding company cash flow analysis, but lately no subject has been emphasized more than the use of personal computers.

Not too many years ago, examiners carried large briefcases bulging with workpapers when they entered a bank. Today, at least one examiner carries a personal computer. The computer is used to enter, analyze, review, and edit data. In many instances, the examination report is printed only when it is completed and ready for mailing.

In 1988, the FFIEC will encourage banks to submit their reports of condition electronically. It is possible that examination reports will someday be sent to banks in the same fashion.

The personal computer is a valuable adjunct to both field examinations and office analytical work.

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Financial Services

Group meetings foster the exchange of ideas and information between the users of Federal Reserve on-line services and members of the Customer Support staff.

Electronics and telecommunication continue to play increasingly large roles in the Federal Reserve's provision of safe, sound, and efficient services that are responsive to customer needs. In 1987, the thrust was on improving the technology for providing on-line services, and on developing major new service offerings.

The Federal Reserve provides on-line services by means of the **FOX** (**F**ed **O**nline **X**change) system, which transmits payments and information between the Federal Reserve and financial institutions by way of personal computers and ordinary telephone lines. Approximately 300 financial institutions were FOX users by year-end 1987. An additional 100 institutions that currently use unintelligent terminals for funds and securities transfers will have converted to personal computer technology by early 1988. Now, many smaller institutions can join the larger, high-volume banks that use direct computer-to-computer connections to obtain the convenience, timeliness, efficiency, wider range of services, and greater security offered by on-line services.

The Bank's Customer Support Department has a staff dedicated to support users of on-line services. Its members train new users, answer questions, and help solve problems. This group takes pride in being responsive to user questions and sensitive to new service needs. Customer Support holds annual user group meetings at various locations in the District to give on-line users the opportunity to exchange ideas, provide feedback concerning services, and learn about future plans.

A wide range of services is available to on-line customers, and each service was developed with the help of the financial institutions themselves. The Operations Advisory Committee, made up of representatives of financial institutions throughout the Fifth District, plays a key role in the design of services. Through their comments at meetings and their participation in market research surveys, members of this committee provide valuable aid in identifying service needs and improvements.

Whether it's a funds or securities transfer, information related to check presentment or cash deposits or orders, account balance inquiries, or report of transactions—it's all available over the Federal Reserve's on-line network.

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Electronic Payments in Retrospect

Bruce J. Summers

The "cashless and checkless" society has been a dominant theme in the thinking of bankers for twenty years. Because electronic funds transfer (EFT) represents a breakthrough in the payment process, most discussions of electronic payments have dealt only with expected future developments. In contrast, this article focuses on the lessons of the past. There is now enough experience with EFT to permit a meaningful historical examination of the uses and successes of electronic payments.

Electronic Payments Overview

Before conducting this examination, it is useful to review the types of electronic payments that are currently in use. The oldest and most mature EFT system is Fedwire, the Federal Reserve's large-dollar funds transfer service. Fedwire is used for time-critical payments, like interbank purchases and sales of overnight funds, real estate closings, and so forth. The average value of a Fedwire payment is about $2.6 million. The New York Clearing House Association also operates a large-dollar funds transfer system called Clearing House Interbank Payment System (CHIPS). CHIPS is primarily used for dollar denominated, foreign exchange, and international trade payments. The average value of a CHIPS payment is about $3.0 million.

The remaining EFT systems are principally consumer oriented. They include the automated clearing house (ACH), automated teller machine (ATM), and point-of-sale (POS) systems. The ACH is a value-dated mechanism; that is, payments settle one to two business days after they are originated. ACH payments consist primarily of social security and salary payments, and preauthorized insurance premium debits. The ACH is also used by corporations to concentrate cash balances and is beginning to be used for vendor payments. In contrast to Fedwire and CHIPS, the ACH is primarily a small-dollar mechanism. The average value of an ACH payment is about $3,300, and over 80 percent of all ACH payments have a value of $1,000 or less.

Senior Vice President Bruce J. Summers explains a proposed innovation in Federal Reserve electronic payments to First Vice President Jimmie R. Monhollon.

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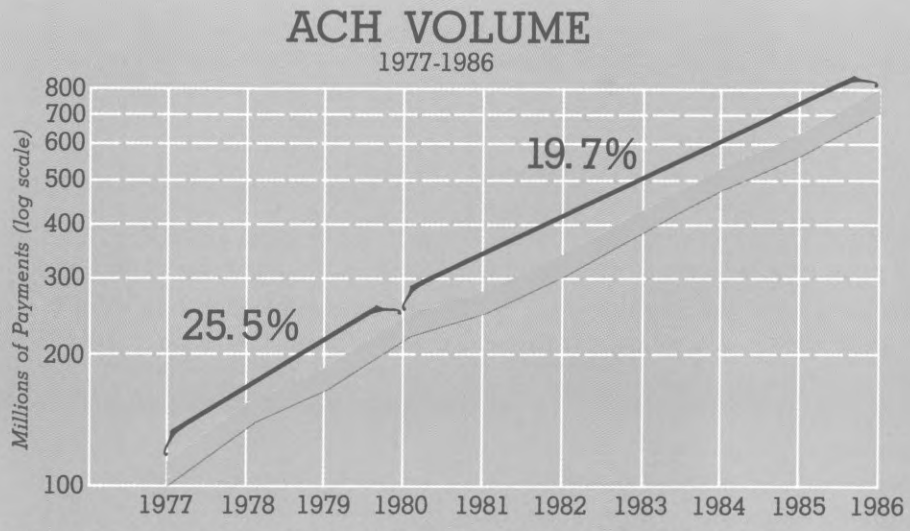
ATM networks are primarily used for cash withdrawals. The average ATM transaction is very small, about $40 per transaction. ATM networks process the highest volume of all EFT systems. POS systems permit consumers to pay for purchases through direct debits to their accounts. Like ATM transactions, POS transactions are small-dollar payments, averaging about $25 per transaction. Some POS systems are on-line, real-time systems that transfer funds to the merchant immediately. Other systems are off-line and use the ACH for clearing. Currently, POS systems are used predominantly by oil companies, grocery chains, and convenience stores. About 66 million transactions were processed in 1987.

Combined, these electronic payment mechanisms account for only 1.2 percent of the nation's total noncash payments.[1] Thus, in terms of market share, EFT has not fulfilled expectations that it would become the widely accepted substitute for paper checks. Further, EFT volume growth rates appear to be declining, with the exception of POS, which is a very young service with many applications considered pilot projects. In particular, as shown on the chart, ACH volume growth has been slowing since 1980. In traditional models of the life cycle of a service, this signals a mature stage that follows the low-growth start-up period and the "take-off" period of accelerating growth. The suggestion of maturity for the ACH comes as a surprise, because the ACH is typically viewed as an infant system on the threshold of accelerating growth and the most likely substitute for the check.



The annual rate of growth in total ACH volume processed by both the Federal Reserve and private operators averaged 25.5 percent in the late 1970s, then slowed to 19.7 percent over the next six years.

Why has the objective of significantly increasing the efficiency of the payment system by converting from checks to electronic payments not been met?

Lessons from the EFT Experience

The recent history of EFT reveals four lessons that help explain the successes and failures of electronic payments.

Lesson 1: EFT Is Not Challenging a Static Check System

It is important to understand the overall payment system and how it affects EFT usage. In particular, it must be recognized that the check system is itself changing. The costs of handling checks are probably falling, service is improving, and consequently the users of checks are probably more, not less, satisfied.

Congress has recently passed legislation that requires further improvements in the check system. The Competitive Equality Banking Act of 1987 mandates improved funds availability for depositors of checks. The process

[1] Allen N. Berger, "The Economics of Electronic Funds Transfer," Board of Governors of the Federal Reserve System, October 2, 1985.

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leading to this legislation has already resulted in major efforts on the part of the industry, including the Federal Reserve and depository institutions, to improve the check return item process.

Improvements in the check system will challenge electronic payment substitutes to provide better and more efficient service to encourage a market-based conversion from the check. Over the long run, however, improved funds availability will encourage greater use of EFT because, as described below, the writers of checks stand to lose some of the "benefits" of check float.

Lesson 2: Reduction in Check Float Is a Prerequisite to EFT Growth

The savings from using EFT in place of checks promise to be significant. For example, a recent study has shown that the cost of ACH direct deposits made by the U. S. government is significantly less than the cost of making the same payments by check. But, the loss of the float benefit to the U. S. government from using the ACH for salary and benefit payments more than offsets the real resource savings (lower cost) of using ACH.[2]

Total check collection float has declined in recent years, especially since the Monetary Control Act of 1980 required the Federal Reserve to eliminate or price all float in its payment operations. Daily average Federal Reserve check collection float has been reduced from a peak of approximately $6.0 billion in 1979 to about $700 million to $800 million today. This reduction is not sufficient in-and-of-itself to change behavioral patterns, however, because an estimated $183 billion in check processing and mail float still exists in the rest of the check system.[3]

The Federal Reserve has examined the possibility of shifting the cost of at least part of the float arising in the check collection process to the payor bank, that is, the institution (and by extension the individual check writer) benefiting from check float. According to the Uniform Commercial Code (UCC) and its interpretation by the courts, however, collecting institutions, including Federal Reserve Banks, are providing services to the collecting party and have no right to assess charges to the payor. Thus, sound economic arguments notwithstanding, the current legal framework apparently does not permit a redistribution of float cost to the party making the decision to use checks. Absent a change in the legal environment, there will continue to be a strong disincentive for converting to EFT due to the float benefit from writing checks.

Lesson 3: Consumer Habits Favor the Use of Checks

Few users are actively seeking new payment services to substitute for the check. Individuals are not; for them the paper check very tangibly represents earning power and wealth. For individuals and businesses, checks also satisfy the need to control and account for transactions in a manner that is consistent with traditional accounting and bookkeeping practices.

Some business and governmental entities, however, have actively sought out new payment methods. The great reliance now placed on funds transfer systems to support money market activity is a prominent example. Only "immediate" wire transfer systems have the speed and automation to support the increasingly active pace of trading, especially in national and international markets. In addition, EFT is being encouraged for corporate payments as an extension of efforts to automate manufacturing and inventory management. The automation of corporate bill paying is being "pulled along" as part of the much larger movement toward

[2] William C. Dudley, *A Comparison of Direct Deposit and Check Payment Costs,* Staff Studies 141, Board of Governors of the Federal Reserve System, November 1984.

[3] William C. Dudley, "The Tug-of-War Over Float," *Morgan Guaranty Survey,* December 1983, pp. 11-14.

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total automation. This external momentum appears to be great enough for companies to seek ways to negotiate the loss of float benefits that currently exist in the check system. Thus, use of new payment methods appears to depend in part on the acceptance by corporations and individuals of new technology in the overall management of their affairs.

Lesson 4: Complexity and Lack of Standards Inhibit the Use of EFT

Several specialized electronic payment networks have been developed to meet the requirements of particular market segments. A certain amount of specialization, following the natural differences in business requirements for various electronic payment applications, makes sense. For example, wire transfer systems that serve the money markets, such as Fedwire and CHIPS, meet very different needs than do ATM and POS systems that provide alternatives to using cash and checks for purchases of relatively small value. The current specialization among EFT networks based on differences in business requirements has not created undue complexity for depository institutions or end users. On the contrary, a concern with complexity has arisen as a result of the lack of specialization.

The complexity of the EFT process has become an issue in the case of the ACH, which has become a general purpose system supporting both corporate and consumer transfers. Corporations actively involved in both corporate and consumer transactions have become concerned that the ACH is overly complex as a result of its being modified to support many different types of applications. For example, a recent survey of corporate cash managers found that over two-thirds of these knowledgeable individuals find the diversity of applications for which the ACH is used to be so daunting that they can no longer readily differentiate among them.[4]

Prescriptions for the Future

These four lessons suggest the elements of a plan for managing the future of electronic payments. Four prescriptions are offered.

Prescription 1: Revise Expectations for EFT to Reflect Institutional and Market Realities

Market share should be accorded less importance as a measure of success and expectations for the conversion to EFT should be revised downward.[5] Typically, the measure of success for electronic payments is related to the one-for-one displacement of checks by electronic transfers. It is unreasonable, however, to expect a large-scale conversion from checks to electronic transfers when institutional and behavioral factors create a bias in favor of existing payment methods. Float incentives that favor checks, as well as consumer habits, should be recognized as having an important influence on the overall rate of acceptance of electronic payments.

As an alternative to market share, a more specific measure of the contribution of EFT to the payment process should be adopted. EFT applications that offer enhanced service or greater efficiency should be *individually* catalogued and assessed, taking into account any institutional disincentives that must be overcome. Viewed in this light, the cumulative evidence of experiences, such as ACH direct deposit, corporate cash concentration, and money market transactions, paints a more positive picture of EFT as a successful contributor to the payment process.

Prescription 2: Stress Institutional Change to Encourage EFT

Institutional changes that eliminate artificial barriers are a necessary prerequisite to the broad-based acceptance of EFT.

[4] Steven F. Maier and Larry A. Marks, "Applications and Models: Cash Managers' Use of ACH," *Journal of Cash Management*, September/October 1986, pp. 46-48.

[5] Jimmie R. Monhollon and Bruce J. Summers, "The Role of the Federal Reserve in the Electronic Payments Evolution," *Journal of Cash Management*, May/June 1987, pp. 23-26.

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In particular, laws and regulations should be examined to determine if changes can be made to permit charging float costs to check writers. Because check writers control how payments are initiated, charging them at least part of the cost of check float would reduce what is probably the single most significant institutional barrier to use of EFT.

Prescription 3: Simplify EFT

If marketplace complaints about complexity are a gauge, then "immediate" wire transfer systems appear to be doing their job reasonably well. Further, the original ACH structure used for retail applications also appears to meet basic user requirements. Today's concern is centered around the support provided in the ACH for new corporate trade payments.

The ACH currently supports a wide range of payment applications, including salary and preauthorized debit transactions that require little explanatory information and vendor payments that must frequently support extensive amounts of information relating to the underlying transaction. The ACH design should be fundamentally reviewed to determine if the complexity that arises by combining widely differing payments in one system can be reduced.

Efforts to simplify the ACH should take into account the possibility that the new corporate trade payment applications might best be supported in a system separate from that designed and used for simpler consumer and commercial transactions. Separation of payment systems may be a way to simplify services for different categories of users. Such separation might take the form of an entirely distinct set of formats and operating rules for highly specialized types of payments. It is also possible that sophisticated corporate trade payment applications may be handled only by a subset of depository institutions, rather than becoming a "universal service" like ACH.

Prescription 4: Stress Proven EFT Applications

If one accepts the prescriptions for promoting payment system efficiency centering around revised expectations for EFT combined with major institutional and structural changes, then clearly much work is required. The process of effecting institutional change could take years. In the meantime, how should investment in EFT be managed to maximize economic returns?

The Federal Reserve's nationwide computer and communications network uses state-of-the-art technology to process ACH and Fedwire transactions.

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A shift in emphasis away from "exotic" ACH applications to proven uses would permit a continued commitment to EFT that is consistent with sound business strategy. For example, based on Federal Reserve estimates, there is still a very large untapped market for preauthorized payments and direct deposit ACH services, which represented the original reason for developing the ACH. It is estimated that only 10 to 12 percent of all insurance premiums and 6 to 8 percent of all payrolls are made using the ACH. The objective of increasing the efficiency of the payment system by converting from checks to EFT can still best be met by focusing EFT marketing efforts on proven applications whose full potential remains untapped.

Conclusion

When measured using the traditional concept of market share, growth in electronic payments has resulted in unfulfilled expectations. Yet, the recent history of EFT shows that institutional conditions are largely responsible for preventing a broad-based conversion from the check. In addition to institutional disincentives, EFT growth has been hurt in the 1980s because of a shift in marketing focus away from traditional payment markets to exotic new markets. Further, by mixing simple ACH applications with sophisticated corporate trade applications in one system, the EFT process has become more complex.

The objective of encouraging a more efficient payment system can best be met by relying on the market process. The future of EFT depends on institutional changes to provide market-based economic incentives for using better payment techniques, especially changes in how float costs are borne. For now, investment in and promotion of EFT should be refocused on proven markets that offer the greatest potential for volume growth with the least complexity.

This approach will result in more realistic expectations for EFT growth and a more orderly evolution to electronic payments.

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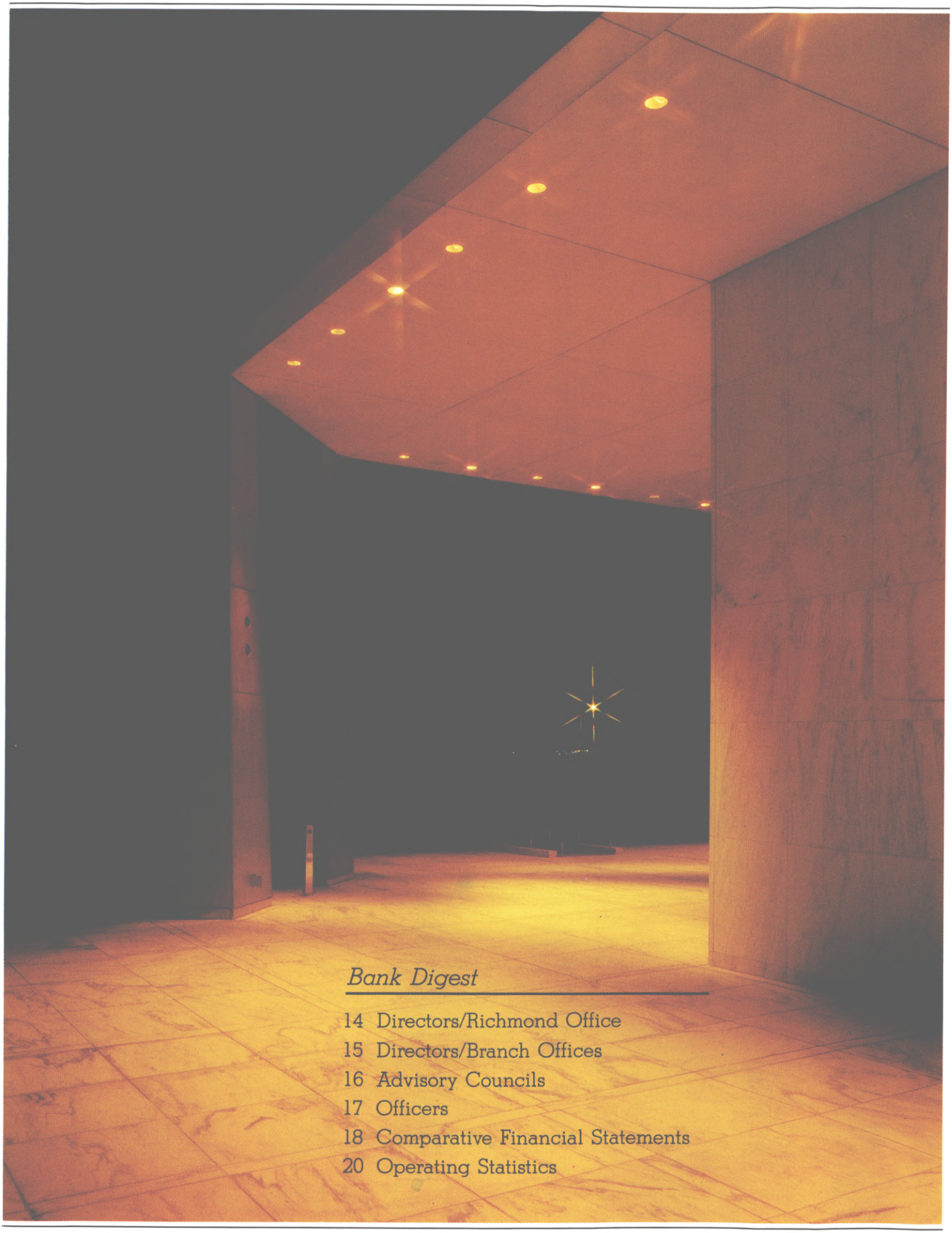

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* Resigned from the Board in September after being transferred out of the District.

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Senior Vice President
Columbia First Federal Savings & Loan Association
Washington, D.C.

F. G. Walker
President
Raleigh Federal Savings Bank
Raleigh, North Carolina

Rick A. Wieczorek
President
District of Columbia Credit Union League
Washington, D.C.

James R. Wilson
Vice President
First Carolina Corporate Credit Union
Greensboro, North Carolina

Michael T. Wilson
Chief Executive Officer and Executive Vice President
South Branch Valley National Bank
Moorefield, West Virginia

Small Business and Agriculture Advisory Council

Chairman
Leon A. Dunn, Jr.
Chairman and President
Guardian Corporation
Rocky Mount, North Carolina

Vice Chairman
Julia M. Walsh
Managing Director
Julia M. Walsh & Sons/Tucker Anthony
Washington, D.C.

Watts Auman
Manager
Auman Farm
West End, North Carolina

Dickie S. Carter
President and Chief Executive Officer
Urban Service Systems Corporation
Washington, D.C.

Michael Clark
President
Clark Insurance Services Company, Inc.
Richmond, Virginia

E. Allen Fisher
Secretary-Treasurer
West Virginia State Building and
Construction Trades Council, AFL-CIO
Charleston, West Virginia

Cecil H. Gannon
President
Cecil H. Gannon & Sons, Inc.
Easton, Maryland

Daniel P. Henson III
Senior Developer
Struever Brothers, Eccles & Rouse
Baltimore, Maryland

Charles H. James II
President
C. H. James & Co.
Charleston, West Virginia

William E. Masters
President
Perception, Inc.
Easley, South Carolina

Charles O. Strickler
President
Rocco Enterprises, Inc.
Harrisonburg, Virginia

Julian D. Wiles, Sr.
President
J. D. Wiles Farms, Inc.
Fort Motte, South Carolina

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Officers (December 31, 1987)

Richmond

Robert P. Black, *President*

Jimmie R. Monhollon, *First Vice President*

Welford S. Farmer, *Executive Vice President*

J. Alfred Broaddus, Jr., *Senior Vice President and Director of Research*
Roy L. Fauber, *Senior Vice President*
Arthur V. Myers, Jr., *Senior Vice President*
James D. Reese, *Senior Vice President*
Bruce J. Summers, *Senior Vice President*
James F. Tucker, *Senior Vice President*

J. Lander Allin, Jr., *Vice President*
Fred L. Bagwell, *Vice President*
Dan M. Bechter, *Vice President*
Lloyd W. Bostian, Jr., *Vice President*
Timothy Q. Cook, *Vice President*
William E. Cullison, *Vice President*
Donna G. Dancy, *Vice President*
Wyatt F. Davis, *Vice President*
George B. Evans, *Vice President*
William C. Fitzgerald, *Associate General Counsel*
Marvin S. Goodfriend, *Vice President*
Robert L. Hetzel, *Vice President*
David B. Humphrey, *Vice President and Payments System Adviser*
Thomas M. Humphrey, *Vice President*
William D. Martin III, *Vice President and General Counsel*
Joseph C. Ramage, *Vice President*
John W. Scott, *Vice President*
R. Wayne Stancil, *Vice President*
Andrew L. Tilton, *Vice President*
Walter A. Varvel, *Vice President*
Jack H. Wyatt, *Vice President*

Kemper W. Baker, Jr., *Assistant Vice President*
William H. Benner, *Assistant Vice President*
Jackson L. Blanton, *Assistant Vice President*
William A. Bridenstine, Jr., *Assistant General Counsel*
Bradford N. Carden, *Assistant Vice President*
Michael Dotsey, *Research Officer*
Betty M. Fahed, *Assistant Vice President*
Sharon M. Haley, *Assistant Vice President and Secretary*
Anatoli Kuprianov, *Research Officer*
Harold T. Lipscomb, *Assistant Vice President*
Yash P. Mehra, *Research Officer*
David L. Mengle, *Research Officer*
Joseph F. Morrissette, *Assistant Vice President*
Michael W. Newton, *Assistant Vice President*
Virginius H. Rosson, Jr., *Assistant Vice President*
G. Ronald Scharr, *Assistant Vice President*
Gary W. Schemmel, *Assistant Vice President*
Jesse W. Seamster, *Assistant Vice President*
James R. Slate, *Assistant General Counsel*
Roy H. Webb, *Research Officer*
Bobby D. Wynn, *Assistant Vice President*

Floyd M. Dickinson, Jr., *Examining Officer*
Eugene W. Johnson, Jr., *Examining Officer*
Thomas P. Kellam, *Accounting Officer*
Edgar A. Martindale III, *Budget and Control Officer*
Susan Q. Moore, *Personnel Officer*
Lawrence P. Nuckols, *Examining Officer*
Marsha S. Shuler, *Planning Officer*
William F. White, *Examining Officer*
Howard S. Whitehead, *Cash Operations Officer*
Arthur J. Zohab, Jr., *Examining Officer*

David B. Ayres, Jr., *General Auditor*

H. Lewis Garrett, *Assistant General Auditor*

Baltimore

Robert D. McTeer, Jr., *Senior Vice President*

Ronald B. Duncan, *Vice President*
William E. Pascoe III, *Vice President*
Gerald L. Wilson, *Vice President*

John S. Frain, *Operations Officer*
William J. Tignanelli, *Operations Officer*
John I. Turnbull II, *Financial Services Officer*

Charlotte

Albert D. Tinkelenberg, *Senior Vice President*

Samuel W. Powell, Jr., *Vice President*
Robert F. Stratton, *Vice President*
Jefferson A. Walker, *Vice President*

Woody Y. Cain, *Assistant Vice President*
Marsha H. Malarz, *Assistant Vice President*
Francis L. Richbourg, *Assistant Vice President*
Harry B. Smith, *Assistant Vice President*

Culpeper

John G. Stoides, *Senior Vice President*

James G. Dennis, *Assistant Vice President*
James J. Florin III, *Assistant Vice President*

Charleston

Richard L. Hopkins, *Vice President*

Columbia

Boyd Z. Eubanks, *Vice President*

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Comparative Financial Statements

CONDITION

Assets:	December 31, 1987	December 31, 1986
Gold certificate account	$ 933,000,000.00	$ 959,000,000.00
Special Drawing Rights certificate account	461,000,000.00	461,000,000.00
Coin	63,434,941.85	80,890,546.79
Loans to depository institutions	181,212,000.00	231,000,000.00
Federal agency obligations	638,222,016.06	672,887,594.81
U. S. government securities:		
Bills	9,099,673,161.09	8,918,900,705.44
Notes	7,011,103,775.81	5,855,031,850.66
Bonds	2,386,359,052.21	2,210,824,569.48
Total U. S. government securities	18,497,135,989.11	16,984,757,125.58
Cash items in process of collection	421,956,975.87	700,830,083.49
Bank premises	111,136,140.60	99,640,399.57
Furniture and equipment, net	19,584,111.80	22,294,284.84
Other assets	762,873,308.72	736,526,920.68
Interdistrict settlement account	(1,736,454,431.36)	(158,021,943.88)
Accrued service income	4,821,828.12	4,766,054.77
TOTAL ASSETS	$20,357,922,880.77	$20,795,571,066.65

Liabilities:		
Federal Reserve notes	$16,550,033,156.00	$17,149,730,871.00
Deposits:		
Depository institutions	2,902,100,768.55	2,644,737,594.34
Foreign	8,100,000.00	7,650,000.00
Other	60,885,688.57	44,628,035.02
Total deposits	2,971,086,457.12	2,697,015,629.36
Deferred availability cash items	382,874,070.33	564,081,639.47
Other liabilities	226,089,397.32	182,440,026.82
TOTAL LIABILITIES	20,130,083,080.77	20,593,268,166.65

Capital Accounts:		
Capital paid in	113,919,900.00	101,151,450.00
Surplus	113,919,900.00	101,151,450.00
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	$20,357,922,880.77	$20,795,571,066.65

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EARNINGS AND EXPENSES

Earnings:	1987	1986
Loans to depository institutions	$ 1,736,474.67	$ 8,683,418.54
Interest on U. S. government securities	1,374,138,058.63	1,393,795,931.93
Foreign currencies	18,592,590.56	20,081,599.46
Income from services	53,254,196.48	52,082,122.89
Other earnings	757,809.39	795,768.68
Total current earnings	$1,448,479,129.73	$1,475,438,841.50
Expenses:		
Operating expenses	85,224,519.55	82,432,182.17
Cost of earnings credits	8,253,737.39	7,809,201.41
Net expenses	93,478,256.94	90,241,383.58
CURRENT NET EARNINGS	$1,355,000,872.79	$1,385,197,457.92
Profit and Loss		
Additions to current net earnings:		
Profit on sales of U. S. government securities (net)	3,539,914.02	5,797,536.06
Profit on foreign exchange transactions	97,430,955.51	100,502,150.57
All other	55,808.80	191,382.70
Total additions	101,026,678.33	106,491,069.33
Deductions from current net earnings:		
Losses on foreign exchange transactions	0	0
All other	17,474.44	4,346,604.54
Total deductions	17,474.44	4,346,604.54
Net additions or deductions	+101,009,203.89	+102,144,464.79
Cost of unreimbursed Treasury services	3,444,185.72	0
Assessment for expenses of Board of Governors	4,405,700.00	5,019,100.00
Federal Reserve currency costs	14,984,887.04	16,595,017.76
NET EARNINGS BEFORE PAYMENTS TO U.S. TREASURY	$1,433,175,303.92	$1,465,727,804.95
Distribution of Net Earnings		
Dividends paid	$ 6,431,001.28	$ 5,798,974.83
Payments to U. S. Treasury (interest on Federal Reserve notes)	1,413,975,852.64	1,449,589,630.12
Transferred to surplus	12,768,450.00	10,339,200.00
TOTAL	$1,433,175,303.92	$1,465,727,804.95

SURPLUS ACCOUNT

Balance at close of previous year	$ 101,151,450.00	$ 90,812,250.00
Addition of profits for year	12,768,450.00	10,339,200.00
BALANCE AT CLOSE OF CURRENT YEAR	$ 113,919,900.00	$ 101,151,450.00

CAPITAL STOCK ACCOUNT (Representing amount paid in, which is 50% of amount subscribed)

Balance at close of previous year	$ 101,151,450.00	$ 90,812,250.00
Issued during the year	13,938,800.00	12,166,100.00
	115,090,250.00	102,978,350.00
Cancelled during the year	1,170,350.00	1,826,900.00
BALANCE AT CLOSE OF CURRENT YEAR	$ 113,919,900.00	$ 101,151,450.00

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Summary of Operations

Operation	Number		Amount ($ thousands)	
	1987	1986	1987	1986
Currency and coin processed:				
Currency received and verified	1,787,276,000	1,531,763,000	22,290,709	19,365,754
Currency verified and destroyed	538,463,000	598,266,000	3,705,281	4,788,919
Coin received and verified	3,254,102,000	3,383,000,000	507,294	513,816
Checks handled:				
Commercial—processed*	1,351,532,000	1,305,602,000	884,173,727	831,674,024
Commercial—packaged items	277,961,000	262,165,000	99,412,000	95,463,000
U.S. government	69,064,000	71,468,000	121,768,095	119,571,103
Collections items handled:				
U.S. government coupons paid	107,000	154,000	81,251	88,504
Noncash items	164,680	174,736	451,837	549,155
U.S. government securities issued, redeemed, and exchanged:				
Definitive	10,439,834	11,134,827	2,339,871	3,216,607
Book-Entry	398,414	358,246	2,425,570,419	2,250,040,413
Funds transfers sent and received	4,318,886	4,228,922	7,629,810,000	6,354,217,000
Food stamps redeemed	181,570,000	190,676,000	840,804	887,483
Loans advanced	1,478	2,792	6,166,700	28,594,200

*Excluding checks on this Bank.

Operating Expenses

Item	Amount (dollars)	
	1987	1986
Personnel	55,784,834	54,118,490
Materials and supplies	4,347,044	4,117,490
Equipment	13,405,628	12,797,856
Shipping	6,446,858	6,576,593
Travel	1,897,198	1,665,257
Communications	884,222	999,950
Building	9,783,867	9,349,997
Other	5,385,032	4,887,932
Recoveries	−4,655,683	−4,092,201
Contra expense	−228,842	−201,859
Shared cost distributed	−3,342,136	−2,981,749
Shared cost received	2,794,721	2,814,299
Total expenses	92,502,743	90,052,055
Reimbursements	−7,278,223	−7,619,873
Net expenses	85,224,520	82,432,182

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