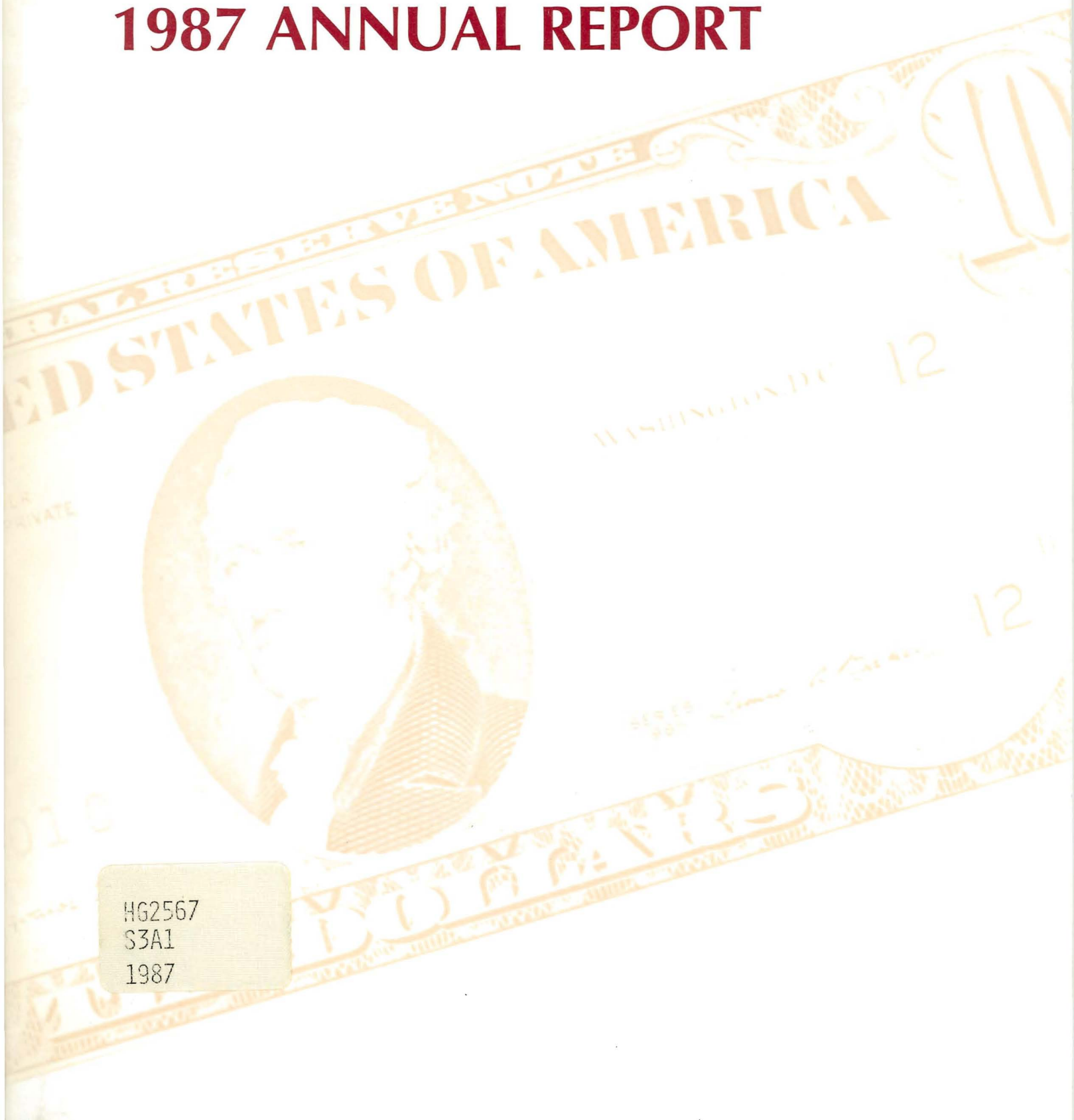


Federal Reserve Bank of San Francisco

1987 ANNUAL REPORT



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1987



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**Federal Reserve Bank
of San Francisco**

MAR 17 1988

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The Federal Reserve Bank of San Francisco is one of twelve regional Reserve Banks which, together with the Board of Governors in Washington, D.C., comprise the nation's central bank.

As the nation's central bank, the Federal Reserve is responsible for determining and carrying out our nation's monetary policy. It also is a bank regulatory agency, a provider of wholesale priced banking services, and the fiscal agent for the United States Treasury.

The Federal Reserve Bank of San Francisco serves the Twelfth Federal Reserve District, which includes Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, Washington, Guam, and American Samoa. This District is the largest within the Federal Reserve System in terms of geographic size and population, and the busiest in terms of economic activity considering employment, income, and the diversity of industries — all of which also affect the structure of banking in the West.

To serve this expansive region, the San Francisco Reserve Bank has five offices: the headquarters in San Francisco, and offices in Los Angeles, Portland, Salt Lake City, and Seattle. Each office provides financial services to the public and banking institutions in its locale. Supervisory and regulatory functions are based in San Francisco, as is economic research for formulating monetary policy.

From the Boardroom

In every part of the District served by the Federal Reserve Bank of San Francisco, we can find evidence of emerging trends in both the economy and in the banking industry. This *Report* highlights some of the major issues of 1987 and how we have responded to the challenges they present. The photographs both illustrate our responses and emphasize the geographic diversity of the Twelfth District.

The issues include the increasing prominence of Pacific Basin economies both on the world scene and in relation to our regional and national economies, community responsibility in a time of growing regional interstate banking and consolidation of financial services, electronic innovations that continue to re-shape the banking industry, and a sharp upward trend in the volume of cash distributed and recirculated by the Federal Reserve.

Our response to these challenges has been marked by attention to maintaining a high quality of service, anticipation of the needs of the largest and most populous district in the Federal Reserve System, and sensitivity to the personal details not only of service delivery but also of the impact of economic and banking developments on people and industries.

These qualities also characterize our approach to ongoing responsibilities. Our regional economic research included studies of the impact of the new immigration law on transient labor for western industries, and our bank studies focused extensively on the efficacy of capital and other regulations to manage bank risk-taking. Supervision, Regulation, and Credit completed a multi-year project strengthening and enhancing its supervision capabilities.

On March 11, we formally dedicated a new building for our Los Angeles Branch to serve the West's most populous financial market. The larger modern facility will improve financial services to depository institutions in Southern California, Arizona, and Southern Nevada.

During the year a number of improvements and new products were introduced into our line-up of financial services provided to depository institutions and individual investors. They covered electronic access methods, especially in our Automated Clearing House service, new equipment for processing dishonored checks, longer hours for our securities transfer service, and contingency arrangements.

All of these changes were undertaken with an eye to improving the effectiveness and efficiency of our operations as well — their management as well as their cost. Recognizing that the quality of services depends primarily on the people evaluating, creating, and administering them, we adopted a management development program aimed at rewarding good work, identifying management talent, and enhancing that talent. On the financial side, we were able to maintain our standards of quality while, at the same time, controlling our expenses. Actual expenses in 1987 constituted only a 1.0 percent increase over 1986.

In meeting the challenges of 1987, management was particularly helped by the strong involvement and support of the Bank's Board of Directors at our headquarters office and branches in Los Angeles, Portland, Salt Lake City, and Seattle. The directors provided guidance on major management decisions and planning goals. In addition, they supplied information and views on economic and financial conditions to support the Federal Reserve's formulation of monetary policy.

We especially appreciate the contributions of Fred W. Andrew (Partner, Andrew & Williamson Sales Co., Bakersfield, CA), who retired as Chairman of the Board of Directors of the San Francisco Headquarters Office last year following eight years of service as a director in this District. His energy and great gifts of leadership provided an invaluable source of counsel and inspiration to the Bank's management, to its five boards of directors, and to the Bank's Advisory Council on small business and agriculture, which he will continue to chair in 1988.

Our heartfelt thanks also go to several other individuals who completed terms of service: Donald J. Gehb (President and Chief Executive Officer, Alameda First National Bank) and George H. Weyerhaeuser (President and Chief Executive Officer, Weyerhaeuser Company) from our San Francisco Board; Robert R. Dockson (Chairman of the Board, CalFed, Inc.) from our Los Angeles Branch Board; John A. Elorriaga (Chairman and Chief Executive Officer, Retired, United States National Bank of Oregon) from our Portland Branch Board; Lela M. Ence (Executive Director, University of Utah Alumni Association) and Fred C. Humphreys (Director, Moore Financial Group) from our Salt Lake City Branch Board; John W. Ellis (Chairman and Chief Executive Officer, Puget Sound Power & Light Co.) who chaired our Seattle Branch Board; and John D. Mangels (Chairman and Chief Executive Officer, Rainier National Bank), our 1987 Twelfth District Member of the Federal Advisory Council.

Robert T. Parry
President

Robert Erburu
Chairman



From left, Fred W. Andrew, Chairman (1987), Robert F. Erburu, Chairman (1988) and Robert T. Parry, President.

Economic Research

The Federal Reserve System has the sole responsibility for the nation's monetary policy and shared responsibility for regulating many of the largest institutions in the financial community. Each Federal Reserve Bank contributes its own unique regional perspective to national monetary and regulatory policy by maintaining core programs of basic research and current analysis that seek to identify and explain key economic issues that policy needs to address.

Rapidly changing economic conditions created many uncertainties for monetary policy in 1987. During much of the year, monetary policy focused on containing inflationary pressures. When the stock market fell sharply in October, maintaining financial market confidence and economic growth became major concerns as well.

Judging from the robust economic growth, rebound in the price of oil, and depreciating dollar early in the year, our macroeconomic analyses concluded that inflation would rise significantly higher in 1987 and 1988 than in 1986. This concern over inflation increased at mid-year as the unemployment rate declined and the rate of utilization of the nation's factories rose. Tightness in the labor market suggested that wage increases would accelerate somewhat in 1988, while a depreciating dollar would continue to put upward pressure on prices.

The dollar's foreign exchange value has been declining since early 1985, but the trade deficit has been surprisingly slow to respond. Our analyses suggested that the trade deficit would improve in terms of real volume throughout 1987 and 1988, even though the nominal trade deficit might continue to worsen throughout 1987. The slowness was due in part to foreign producers who tended to absorb the impact of the depreciating dollar by reducing their profit margins. It also was due to more rapid economic growth in the U.S. compared to the rest of the world, which has tended to worsen our trade deficit.

Movement toward more stimulatory monetary, and to some extent, fiscal policies in Europe and Japan toward the end of the year should make those countries' economies grow more rapidly, and thus reduce the burden on the exchange rate in inducing the much-needed international adjustments. In this context, we believe it important that the U.S. budget deficit be reduced, but unfortunately, the budget compromise reached by Congress toward the end of the year was not encouraging.

The stock market crash in October quickly turned our primary attention from the threat of higher inflation to the possibility that the economy might slow significantly. The loss of wealth resulting from the stock market fall created the possibility that consumer spending might decline substantially over the following two or three quarters.

Since the economy had been growing at a healthy clip prior to the crash, and the Federal Reserve was willing to provide the liquidity needed to support the economy and financial system during this period of heightened uncertainty, we believed that the prospects for a recession were remote. Economic data at year-end seemed to confirm this belief as they gave no strong signs of significant slowdown in growth. Nevertheless, the risk of a loss of consumer and business confidence remained as we entered 1988.

M1 "Retired"

These economic developments greatly complicated the task of designing monetary policies that would promote the continuation of the economic recovery and, at the same time, keep inflation under control.

Earlier in the year, the Federal Reserve de-emphasized the use of M1 as a guide to making monetary policy. In view of the aggregate's instability in recent years, we examined alternative measures of money. None of the conventionally defined aggregates – M1A, M2, and M3 – was found to be as useful to policy as M1 once had been. However, the broader aggregates, such as M2 and M3, promised to be more reliable guides than the narrower aggregates, such as M1 and M1A, since they tended to internalize much of the portfolio shifting that has occurred since the financial deregulation of the 1980s.

Western Well-Being

Closer to home, our research showed that the service-oriented and highly diversified local economies in the West made the expansion in the District economy particularly robust. Even agriculture has fared better in the West than in other parts of the country. Moreover, manufacturing employment in the West showed signs of healthier growth than in the nation.

The West coast's trade with countries throughout the Pacific Basin proved to be an additional boon. Not only has the exchange value of the dollar declined dramatically relative to the Japanese yen, but the demand for many products – such as aircraft, automatic data processing equipment, wood products, cotton, and nuts – traded through western ports also has improved.

A new national immigration law was of particular concern to western farmers and manufacturers who historically have made heavy use of undocumented and transient labor. Our study of this situation indicated that special provisions for agricultural workers probably would buffer agriculture against the most severe effects, but that light manufacturing, service industries, and some other sectors also important to the West probably would face a tighter labor supply and higher wage costs.

Banking and Finance

In the areas of banking and finance, we explored issues with important implications for regulation and federal tax policy. Emerging trends in banking and financial markets and their implications for regulatory policies affecting deposit insurance, expanded bank powers, and payments system risk constituted one major focus that resulted in a comprehensive paper. Other studies focused on new financial instruments, off-balance sheet activities of banks, and the merging of banking, investment banking, and commercial activities.

Our theoretical research into the relationship between capital regulation and its effects on risk-taking by banks contradicted earlier academic work. We found that higher required capital ratios would reduce bank risk because banks would not tend to offset the higher capital fully with more risky assets. At year-end, we were looking at the empirical relationships between capital regulation and actual bank risk.

Ongoing banking analyses focused on acquisitions in banking, particularly interstate acquisitions in the West; the earnings of western banks; and loan quality problems of the farm credit system and lenders to lesser developed countries. While the earnings prospects for western banks as a whole appeared reasonably healthy, prospective debt restructurings within the farm credit system and foreign lending network remained worrisome consequences of the early 1980s.

Where East Meets West

One study of the growth of "junk" bond issuance showed that recent changes in government tax policy have favored debt financing by corporations, and consequently spurred the growth of debt over equity and the growth of the junk bond market in particular. These developments have increased the potential risk exposure of the corporate sector and the economy.

Public Information

The Bank's research findings were shared with the general public through the Bank publications, *Weekly Letter* and quarterly *Economic Review*. The publications form the core of an information program designed to help the public understand and evaluate the conduct of monetary policy, regulatory actions, and other Federal Reserve responsibilities.

A speaking program reinforces our overall information effort. Our president, senior officers, and other staff discussed the economic outlook and changes in the financial industry while members of our boards of directors described the functions of the Federal Reserve before community and industry groups throughout our District.

Major public information issues of 1987 included proposed and actual bank mergers and acquisitions, the opening of the new Los Angeles Branch building and economics exhibition, and a referendum in the state of Washington challenging the constitutionality of the Federal Reserve System. In addition, we expanded our outreach efforts through greater media exposure for our economic research and more speaking engagements. We continued to respond to inquiries from news media seeking economic commentary and information on our financial services.

To enhance understanding of the functions of the Federal Reserve, we continued to provide education in basic economic principles through *The World of Economics Audiovisual Series* and *Exhibition*. This effort also is a response to the demand for educational resources, which is growing as more states around the country mandate the study of economics in high school.

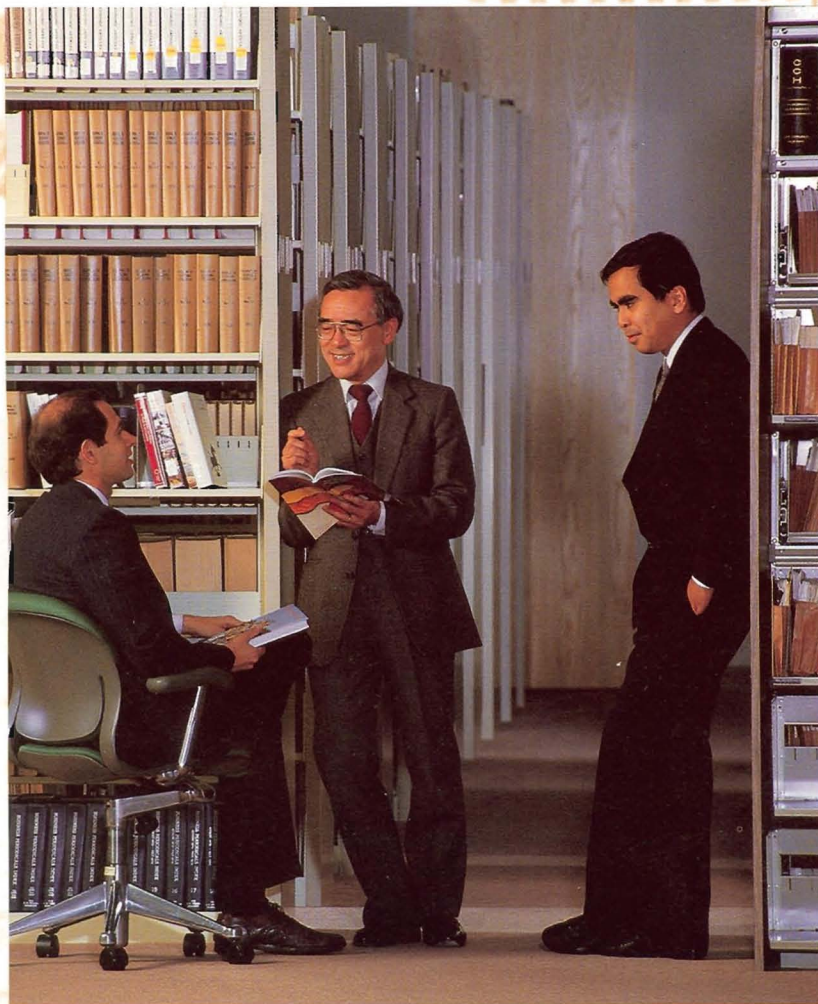
More than 500,000 students throughout the U.S. have viewed the *Series* since its inception in 1985. Students and visitors to our San Francisco and Los Angeles offices also have enjoyed *The World of Economics Exhibition*, which reviews American economic history and the progress of economic thought, and illustrates economic principles and the functions of the Federal Reserve.

Tea no longer comes to mind first when we think about trade in the Pacific Basin — where East meets West. For several years now, the total value of U.S. trade with Pacific Basin countries has exceeded that of our trade with Europe.

Because western states have particularly close economic ties to Pacific countries, we keep a special focus on issues in the Pacific Basin. Besides serving as a center of research and information on Pacific Basin economies, we aim to foster mutual understanding and cooperation among central banks of the region.

One concrete example of this special focus was the Pacific Basin Monetary Policy Conference we hosted in September 1987. The conference provided a forum for examining and comparing the region's monetary policy experiences over the last fifteen years. Among the eighty participants were six Pacific Basin central bank governors, four Federal Reserve presidents, and other senior U.S. and Pacific Basin officials as well as noted scholars. Sixteen background papers were prepared for the conference, four of them by Bank economists.

On an ongoing basis, we conduct research on economic issues in the Pacific Basin, host a program welcoming foreign visitors and resident scholars, and maintain a clearinghouse publication on the results of economic research at the region's central banks and a unique library of information on the economies of the Pacific Basin.



Planning the Pacific Basin Conference are (from left) Senior Economist Reuven Glick, Hang-Sheng Cheng, Vice President of International Studies, and Economist Ramon Moreno.

Supervision, Regulation, and Credit

By supervising and examining state member banks, bank holding companies, and international entities, the Federal Reserve promotes a safe and sound financial system. As regulator, the Federal Reserve checks for compliance with laws and regulations and implements consumer credit laws. The Fed also provides liquidity through the "discount window" to institutions subject to reserve requirements.

Most banks in the Twelfth District upgraded the quality of their assets and maintained their profit margins in 1987. However, foreign credit remained a special problem for the large banks, and their heavy second and fourth quarter provisions for possible losses on these foreign loans cut deeply into earnings.

The number of District banks closed during the year totalled 14, the same as in 1986, but their combined assets at \$962 million were more than double the amount (\$474 million) in the earlier year.

Alaska's economy, whose foundation was weakened by falling energy prices, presented a particularly difficult environment. Two of the state's banks were among those closed during the year, and another three were being merged through an FDIC-assisted acquisition to avoid failure. Altogether, some \$1.5 billion in banking assets were involved out of a state total of \$4 billion.

At year-end, 25 District state member banks were subject to special supervisory attention, compared to 31 at year-end 1986. The number of bank holding companies with supervisory actions in place remained unchanged at 9.

The overall improvements in liquidity among District banks, despite some weaknesses, were evident in decreased borrowing from the discount window. Both the number and amount of loans declined in 1987.

Enhanced Supervision

In supervising and regulating banking organizations, we have strived to maintain a spirit of cooperation while developing innovative techniques to improve the effectiveness of financial analyses and supervisory procedures.

Last year saw completion of the final phase of a major initiative begun in late 1985 to enhance bank supervision. The initiative called for increasing the frequency and scope of state member bank examinations and bank holding company inspections, and for improving the communication of findings to the institutions' boards of directors. We greatly expanded our staff of examiners and developed a new comprehensive credit evaluation program for their training.

In the areas of bank holding company and international regulation, we explicitly adopted the goal of delivering "timely, rational opinions and error-free products that meet or exceed user expectations."

In financial analysis, we adopted new procedures to speed up the review of financial data and the production of analytical reports, including an early-warning model that ranks state member banks by degree of deterioration. We also strengthened the collection and management of nonfinancial and regulatory data, such as changes in ownership and internal organization, and are preparing an automated database for such information.

Managing Payments Risk

We have been helping depository institutions carry out the Federal Reserve's "Payments System Risk" policy to reduce intra-day overdrafts on private transfer networks and to tighten controls on Fedwire. Under the policy, institutions are encouraged to limit the net amount they can owe at any one time across all networks and on any one network. We helped coordinate the necessary changes in software to carry out changes in the policy, and provided training in procedures both for meeting overdraft standards and for improving securities transfer services.

Regional Interstate Banking

Expansion plans among western banks coincided with national trends focusing on regional interstate banking compacts. The applications we received from banking organizations consisted mainly of proposals for geographic expansion as opposed to proposals for the formation of bank holding companies, which dominated in the early 1980s. In particular, eleven applications were filed for interstate acquisitions in Washington, Arizona, Utah, Idaho, California, and Texas. All states in the Twelfth District, except Hawaii, have enacted interstate banking legislation.

Community and Consumer Affairs

A flurry of protests accompanied proposals for interstate acquisitions in 1987. Community groups asserted that the banks involved were not meeting their responsibilities under the Community Reinvestment Act. We mediated these disputes in private meetings with the protest groups and banks.

We also play an ongoing role in facilitating compliance with the Community Reinvestment Act by promoting community development. During the year, we arranged informational meetings with development groups and provided meeting facilities where planning for community development could take place.

Other consumer credit-related federal laws and regulations under our purview include the Equal Credit Opportunity, Truth in Lending, and Electronic Funds Transfer Acts. During the year, we handled consumer complaints against member banks, and responded to inquiries from consumers and creditors about their rights and responsibilities under consumer credit regulations.



Tami Bell (right), District Community Investment Adviser, meets with Warren H. Widener, President of the Urban Housing Institute of Oakland, California.

Community Responsibility

Over the last few years, the growth in the number of applications for interstate banking and consolidation of financial services has been accompanied by an increasing number of public challenges. These challenges are based on the Community Reinvestment Act of 1977, which provides for consideration by the Federal Reserve of the community lending records of acquiring or target financial institutions as one of the criteria for approving an application.

When a challenge is made with regard to a state member bank or bank holding company, our Community Affairs Unit must analyze the merits of the protest and make recommendations to the Board of Governors for final decision on the application involved.

Tami Bell, District Community Investment Adviser, notes, "The bank's record of performance in meeting the credit needs of its community becomes the focal point of our review. One role we play in handling challenges is to mediate private meetings between the protestant and applicant financial institutions. In these meetings, we try to clarify and resolve the issues raised." In 1987, this procedure was used in settling challenges in Arizona, California, Utah, and Washington.

Community Affairs also takes an active role in promoting community responsibility as defined by the Community Reinvestment Act. Bell adds, "We have facilitated the formation of lender organizations to enhance the community lending record of banks, and,

through conferences and seminars involving financial institutions and community groups, we have provided information on successful community investment opportunities."

In June 1987, the San Francisco Reserve Bank conducted a successful community investment conference in southern California, co-sponsored by the Federal Home Loan Bank of San Francisco. Over 150 representatives from financial, government, and community groups from Arizona, California, and Nevada attended to exchange ideas and information about community investment opportunities.

Electronic Advantage

In terms of the value of payments made, electronic exchanges long ago replaced the passing of pieces of paper. Electronic networks have extended the geographic reach of banking activity, offering both bank customers and depository institutions greater convenience, speed, and security.

In the far-flung Twelfth Federal Reserve District, these advantages are as important for the salmon fisherman in Anchorage, Alaska, receiving payment from an out-of-state buyer, as it is for her uncle receiving social security payments in San Diego.

That is why we continually promote the use of electronic access, and seek even greater innovations.

FedLine User Groups

Almost 1,200 depository institutions in the Twelfth District use our FedLine service and participate in FedLine User Group meetings. The meetings are held twice a year in each of the areas served by our five Branch offices. The San Francisco User Group, for example, met in San Francisco, Sacramento, and Fresno, California in 1987.

Coordinated by the Financial Services staff at each Branch, the User Groups appeal to large banks and small credit unions alike, managers as well as day-to-day operators.

Dawn Allen, Assistant Vice President of Financial Services in the San Francisco Branch, describes each meeting as "a forum for showcasing new products, announcing policy changes, and sharing common concerns and ideas. "Our customers can tell us directly what they like and what could be improved, and that information is invaluable to us in maintaining high quality service."

No More Certificates

Since mid-1986, purchasers of Treasury securities have not received engraved certificates by registered mail as proof of their purchases. Instead, their transactions have been recorded in a computer system called TREASURY DIRECT.

"Once our customers hear about the conveniences TREASURY DIRECT offers, we see a lot more smiling faces," says Frank Frazzitta, Assistant Manager of the marketable Securities Division.

In TREASURY DIRECT, all payments are directly deposited in the investor's bank account, thereby eliminating the possibility of lost or stolen checks. A single master statement of all holdings, like a bank account, makes record keeping easier. And investors can get account information at any Federal Reserve Bank, regardless of where purchase was made.

Encouraging ACH Competition

"Keeping people happy is more challenging when they have a choice. When we're able to do that, it is a better measure of success.

"We are responsible for promoting efficiency in the payments mechanism. Strong competition encourages us to be more efficient, and promotes better performance all around." Steve Kaufman, Assistant Vice President of Electronic Payment Services, is listing the benefits of competition in automated clearinghouse services.

In 1987, we helped the Cal-western ACH Association transfer its processing operations from General Electric to VISA U.S.A. VISA's electronic access connection was the first to use new service features that benefit all our customers. These features include positive responses to transmissions, electronic communication of transmittal letters, and delivery of information three to four hours earlier.



FedLine User Groups – Planning a users meeting are (from left) Account Manager Archie Emerson, Secretary Janis Keiter, Service Representative Jeannette Cormier, and Account Manager Cindy Yoshifuji.



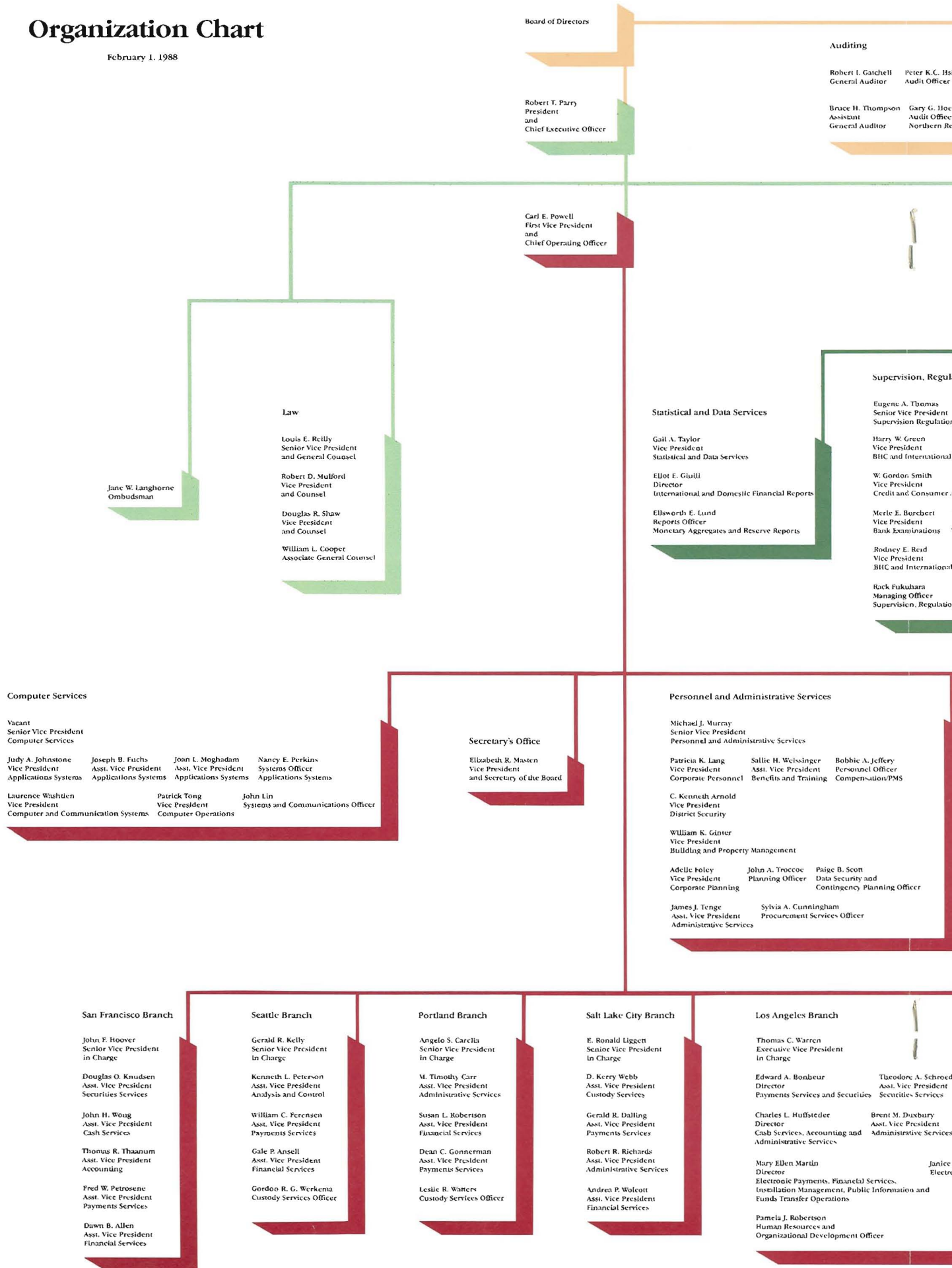
Treasury Direct – Working on the new system are (from left) Securities Services Clerks Sandra Stapleton, Rosvida Zaragoza, and Zeneida Palomares.



ACH – Discussing the VISA conversion with Stephen Kaufman, Assistant Vice President of Electronic Payment Services, is District Accounting Officer Trudy Nio.

Organization Chart

February 1, 1988



ing

L. Gatchell
Auditor

Peter K.C. Hsieh
Audit Officer

Bl. Thompson
Auditor

Gary G. Hoeth
Audit Officer
Northern Region

Charles O. Bowden
Audit Officer
Southern Region

Thomas D. Thomson
Executive Vice President
Central Bank Functions

Supervision, Regulation and Credit

Eugene A. Thomas
Senior Vice President
Supervision Regulation and Credit

Harry W. Green
Vice President
BHC and International Regulation

Robert A. Johnston
Director
Reports and Analysis

Kenneth R. Blinning
Asst. Vice President
Applications

W. Gordon Smith
Vice President
Credit and Consumer Affairs

Donald R. Lieb
Asst. Vice President
District Credit

Wayne L. Rickards
Asst. Vice President
Bank and Consumer Regulation

David M. Vandre
District Compliance Officer

Merle E. Borchert
Vice President
Bank Examinations

W. Starr Seegmiller
Examining Officer
Trust

Harold H. Blum
Asst. Vice President
Bank Examinations

Thomas P. McGrath
Asst. Vice President
Bank Examinations, S.L.C.

Robert C. Johnson
Examining Officer, L.A.

James M. Barnes
Examining Officer, S.F.

Rodney E. Reid
Vice President
BHC and International Supervision

Richard S. Campos
Examining Officer
BHC Inspections

Philip M. Ryan
Examining Officer
International Inspections

Thomas J. Backer
Examining Officer
BHC Inspections, L.A.

Reck Fukuhara
Managing Officer
Supervision, Regulation and Credit

Public Information

Robert L. Fienberg
Vice President and
Director of Public Information

Economic Research

John H. Beebe
Senior Vice President
and Director of Research

John P. Judd
Vice President and
Associate Director of Research

Adrian W. Throop
Research Officer
Macroeconomic Studies

Hang-Sheng Cheng
Vice President
International Studies

Randall J. Pozdena
Asst. Vice President
Banking and Regional Studies

Finance and Product Management

Sara K. Garrison
Senior Vice President
Finance and Product Management

Buffington Clay Miller
Vice President
Product Management

Stephen A. Kaufman
Asst. Vice President
Electronic Payments

Barbara J. Contini
Product Management Officer

John W. Gleason
Vice President
Product Management

Gregory B. Williams
Director
Financial Planning and Control

Trudy L. Nio
District Accounting Officer

Theodore A. Schroeder
Asst. Vice President
Securities Services

Thomas W. Rodewald
Checks Officer

Brent M. Draxbury
Asst. Vice President
Administrative Services

Raymond A. Stradotto
Cash Services Officer

Janice Hardina
Electronic Payments Officer

G. Bradley Snodgrass
Financial Services Officer

Financial Services

The Federal Reserve provides wholesale banking services and acts as the federal government's fiscal agent. As required by the Monetary Control Act of 1980, many of the wholesale banking services are priced to encourage competition in the market for financial services, and thereby greater efficiency in the payments system.

Cash Services

Since 1984, the volume of cash deposited with us has grown explosively. Last year alone, cash deposits increased 11 percent and challenged our capacity for processing on high-speed equipment, particularly in Los Angeles and San Francisco. In response, we set up weekend shifts and redistributed the workload among our other branches. We also purchased two more high-speed sorters and new storage equipment to make better use of vault space in Los Angeles.

In addition to distributing and re-circulating cash, we act as a liaison between carriers and depository institutions in designing and contracting for armored car routes for cash transportation. In that role, we can promote efficiency by coordinating the needs of a number of institutions in one region, and improve access by arranging transportation for smaller and remotely located institutions.

Check Services

In our check collection services for depository institutions, we strive to accommodate the needs for timely information and speedy transfer of funds. We continually seek opportunities to improve service levels and quality because we handle the largest, and one of the fastest growing, volume of checks in the Federal Reserve System.

In 1987, for example, we developed a new tracking and reporting system in our Los Angeles Branch to handle adjustments to institutions' accounts. Our Salt Lake City Branch began to give depository institutions more information about their check activity by adding processing categories (fine sort and reject items) to the Account Totals service.

In anticipation of future needs, we retired equipment used for processing dishonored checks and checks that cannot be read by our high-speed sorting equipment, and installed a new automated "low-speed and return items" system. Since the new system also will act as back-up for our high speed check system, it will allow us to reduce float during periods of heavy volume or equipment failures. Installation in all five of our branch locations will be complete in the middle of 1988 when our largest check operation, in Los Angeles, begins using the new equipment.

Automated Clearing House

In terms of total value, most payments are not made by paper but electronically through automated clearing houses (ACH) or wire transfer networks. Because electronic processing greatly improves efficiency in the payments system, we have strongly promoted its use.

ACH payments usually involve high volumes of batch payments with low dollar amounts, such as payroll deposits or Social Security payments, while wire transfers involve fewer individual payments, often of high dollar amounts.

In 1987, we greatly improved our Automated Clearing House (ACH) service, began making processed transactions available electronically to our customers at earlier times within the day, and offered a number of new products and enhancements tailored to various processing volumes. To ACH participants with the largest volumes, we began to offer access through computer-to-computer interfaces. We enhanced our FedCom ACH product, which gives medium-volume ACH participants the ability to send and receive transactions electronically. Over 400 institutions signed up to use our FedLine ACH product with its added receipt capability.

Another enhancement was made to support the U.S. Treasury's Vendor Express program. That program will allow government agencies to use the ACH service to pay vendors and other organizations.

We also worked with private sector processors to improve ACH service. In 1987, we played a major role in helping the Calwestern Automated Clearing House transfer its processing from the General Electric Information Services Company to VISA U.S.A.

Wire Transfer

The Federal Reserve offers Fedwire for the electronic transfer of payments involving large dollar amounts. This high quality service offers high-speed transfer and immediate availability of funds. Aside from the Federal Reserve Bank of New York, we handle the largest volume of wire transfers in the Federal Reserve System.

In a major project to help receiving institutions handle transfers in a more automated fashion, we put in place a structured format for recording wire transfer information.

This format will enable the institutions to post many transactions automatically to individual accounts. To facilitate its use, we provided on-line Fedwire participants with data-entry screens on their terminals, and will make this service available to our FedLine customers as well.

Contingency Arrangements

With \$1 trillion exchanged among depository institutions over wire transfer networks on an average day, the smooth, continuous, and timely flow of payments is critical. Payments risk arises from overdrafts by individual institutions and from possible operational failures in the networks themselves.

In 1987, we participated in several new initiatives to improve the Federal Reserve's disaster contingency plans. We developed a plan to minimize disruption to our funds transfer service during the period following a major computer outage, and we continued to work toward the goal of same-day recovery for all critical operations in the event of a system failure.

Electronic transfer also presents special security risks. We made large strides last year toward enhancing controls over access to and use of electronic communications. They included encryption for all electronic connections between depository institutions and the Federal Reserve, and the enforcement of new data security standards for sensitive data.

Securities and Fiscal Services

In addition to cash and payments services, we offer securities and fiscal services involving mainly the issuing, servicing, and redeeming of marketable Treasury securities and savings bonds. We also provide depository institutions with safekeeping and transfer services for book-entry (electronically recorded) securities issued by government agencies.

Last year, we expanded the operating hours for our securities transfer service in each Branch, and focused extensively on improving internal controls over the handling of valuables.

Explosive Cash Growth in Los Angeles

To improve savings bond services, we established a project to consolidate and automate processing. Under the first phase, all payroll bonds issued from magnetic tape were centralized in San Francisco. We also started a project to automate and centralize accounting for the stock of savings bonds issued by outside agents, such as banks. This effort should further reduce ongoing costs while improving the timeliness and quality of service to customers and the Treasury.

With the conversion of Treasury Bill accounts in 1987, the TREASURY DIRECT program begun in 1986 was completed. TREASURY DIRECT allows individuals to hold marketable Treasury securities in their own electronic safe-keeping accounts, and to receive principal and interest payments electronically at depository institutions.

The Twelfth District serves as the development and maintenance site for the Federal Reserve's automated book-entry securities transfer system. In this capacity, we completed two new enhancements that increased system security and supported the Federal Reserve's ability to offer a broader range of securities transfer products.

Summary of Operations

	Volume (thousands)		
	1985	1986	1987
Custody Services			
Cash Services			
Currency paid into circulation	2,438,168	2,651,545	3,044,958
Coin paid into circulation	4,773,270	4,980,392	5,443,894
Food Coupons processed	272,231	265,921	275,531
Securities Services			
Savings Bonds original issues	2,019	2,821	3,835
Savings Bonds redemptions processed	293	231	217
Other Treasury original issues	108	74**	128**
Book-Entry Securities processed	323	319	303
Payments Services			
Check Services			
Commercial checks collected	2,431,129	2,690,145	2,853,718
Government checks processed	93,451	91,458	87,945
Return items processed	28,800	31,239	32,090
Electronic Payment Services			
Wire transfers processed	11,457	12,632	13,285
Automated clearinghouse transactions processed	129,930	150,272	174,933
Discounts and Advances			
Total discounts and advances*	1,818	1,074	1,037
Number of financial institutions accommodated*	149	130	115

*Whole number (not in thousands)

**Includes volume processed in the Treasury Direct System

Over the last two years, our Los Angeles Branch in particular has experienced explosive growth in currency volumes. Volumes increased in the 10 to 15 percent annual growth range in response to the cash needs of the 1984 Summer Olympics, but have shot into the 15 to 25 percent range in the last two years. The growth in volume has multiple causes, including the mounting use of automated teller machines and the dynamics of southern California's growing economy.

According to Charles Huffstetler, Director, Los Angeles Administration, "Managing currency growth is one of our most challenging issues. For the time being, we have effectively expanded our capacity by adding more processing equipment and purchasing stackable storage modules.

"Since currency volumes are continuing to grow at unusually high rates throughout the Federal Reserve System, we are exploring some long-range strategies."

The distribution and re-circulation of cash is one of the little-known services of the Federal Reserve. Coins minted by the U.S. Mint and currency printed by the U.S. Treasury are distributed by Reserve Banks to depository institutions that then put them into public circulation. We also hold deposits of excess cash from depository institutions and sort currency to remove unfit notes.



The Bank's Management Committee discusses currency volume growth: (from left) Los Angeles Executive Vice President Thomas C. Warren, First Vice President Carl E. Powell, Senior Vice President Michael J. Murray, President Robert T. Parry, and Executive Vice President Thomas D. Thomson.





Branch Operations – (From left, back row) E. Ronald Liggett, Senior Vice President in Charge, Salt Lake City; Gerald R. Kelly, Senior Vice President in Charge, Seattle; First Vice President Carl E. Powell; (from left, front) Angelo S. Carella, Senior Vice President in Charge, Portland; Thomas C. Warren, Executive Vice President in Charge, Los Angeles; and John F. Hoover, Senior Vice President in Charge, San Francisco.

Directors

Directors of the Federal Reserve bring management expertise to the task of overseeing Reserve Bank operations. They provide information on key economic developments in various areas of the District, complementing the Bank's internal research. In addition, Board members give advice on the general direction of monetary policy, especially with regard to the Bank's discount rate.

Head Office

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Chief Executive Officer
The Times Mirror Company
Los Angeles, California

Deputy Chairman

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President and
Chief Executive Officer
Chambers Communications Corp.
Eugene, Oregon

Rayburn S. Dezember
Chairman, President and
Chief Executive Officer
Central Pacific Corporation
and Chairman
American National Bank
Bakersfield, California

Spencer F. Eccles
Chairman and
Chief Executive Officer
First Security Corporation
Salt Lake City, Utah

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Willamina Lumber Company
Portland, Oregon

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President and
Chief Executive Officer
Ireland Bank
Malad City, Idaho

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Executive Vice President
and Director
Bechtel Group, Inc.
San Francisco, California

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Nordstrom, Inc.
Seattle, Washington

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Gramercy Enterprises, Inc.
Los Angeles, California

Federal Advisory Council Member

Paul Hazen
President and Chief
Operating Officer
Wells Fargo Bank, N.A. and
Wells Fargo & Co.
San Francisco, California



Erburu



Dezember



Hull



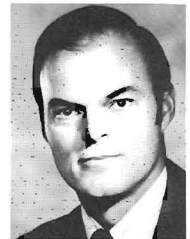
Hull



Tanaka



Chambers



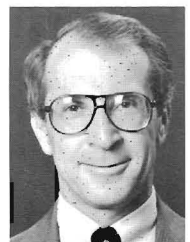
Eccles



Hawkes



Nordstrom



Hazen

Los Angeles

Chairman of the Board

Richard C. Seaver
Chairman
Hydril Company
Los Angeles, California



Seaver

Ross M. Blakely
Chairman of the Executive
Committee of the Board
Coast Savings and Loan
Los Angeles, California



Blakely

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Chairman of the Board
Burr-Brown Corporation
Tucson, Arizona



Brown

Yvonne Brathwaite Burke
Partner
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Los Angeles, California



Burke

Fred D. Jensen
Chairman of the Board,
President and Chief
Executive Officer
National Bank of Long Beach
Long Beach, California



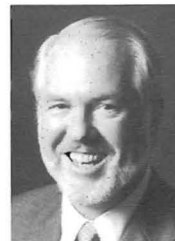
Jensen

Howard C. McCrady
Chairman of the Board and
Chief Executive Officer
Valley National Bank of Arizona
Phoenix, Arizona



McCrady

William L. Tooley
Chairman
Tooley & Company,
Investment Builders
Los Angeles, California



Tooley

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Chairman of the Board

Paul E. Bragdon
President
Reed College
Portland, Oregon



Bragdon

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Former President and
Chief Executive Officer
Tri-County Banking Company
Junction City, Oregon



Bradley

Stephen G. Kimball
President and
Chief Executive Officer
Baker Boyer Bancorp
Walla Walla, Washington



Kimball

G. Johnny Parks
Former Northwest Regional Director
International Longshoremen's &
Warehousemen's Union
Portland, Oregon



Parks

Wayne E. Phillips
Vice President
Phillips Ranch, Inc.
Baker, Oregon



Phillips

Sandra A. Suran
Partner
Peat Marwick Main & Co.
Portland, Oregon



Suran

G. Dale Weight
Chairman and
Chief Executive Officer
Benjamin Franklin Savings
and Loan Association
Portland, Oregon



Weight

Salt Lake City



Christensen



Hanson



Pratt



Wheeler



Eaton



Kelson



Rose

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Seattle, Washington



Nygren

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Chairman of the Board
InterWest Savings Bank
Oak Harbor, Washington



Beeksma

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Hospital Administrator
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Goertzen

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Larison

Byron I. Mallott
Chief Executive Officer
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Juneau, Alaska



Mallott

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President and Chief
Executive Officer
Puget Sound Bancorp
Tacoma, Washington



Philip

William S. Randall
Chairman, President and
Chief Executive Officer
First Interstate Bank
of Washington, N.A.
Seattle, Washington



Randall

Comparative Statement of Account

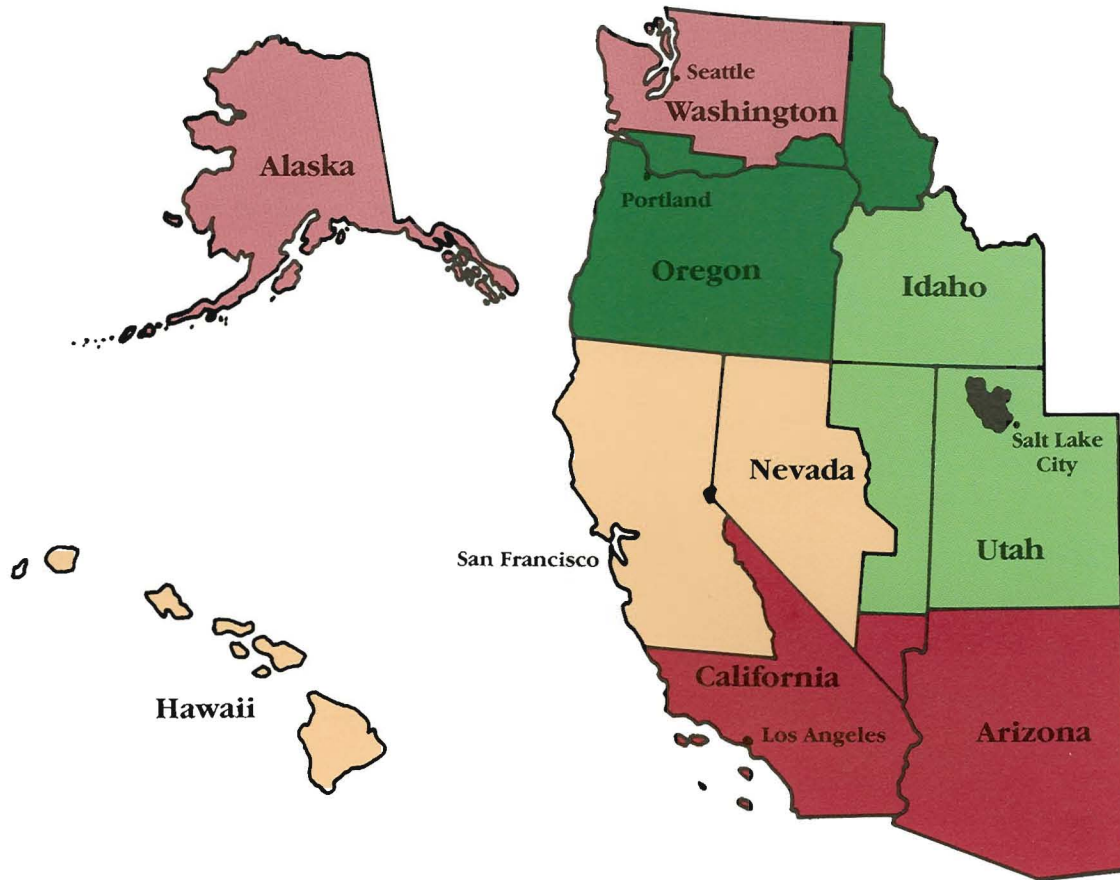
(Thousands of Dollars)

	December 31,	
	1987	1986
Assets		
Gold certificate account	\$ 1,483,000	\$ 1,470,000
Special Drawing Rights certificate account	670,000	670,000
Other Cash	81,045	106,026
Loans to depository institutions	15,930	21,050
Federal Agency obligations	1,046,315	1,091,697
United States Government securities:		
Bills	14,918,204	14,470,075
Notes	11,494,158	9,499,237
Bonds	3,912,249	3,586,854
Total United States Government Securities	30,324,611	27,556,166
Total loans and securities	31,386,856	28,668,913
Items in process of collection	1,168,430	1,544,691
Bank premises	152,764	153,781
Operating equipment	33,496	31,503
Other assets:		
Denominated in foreign currencies	1,134,712	1,496,892
All other	575,643	451,117
Interdistrict Settlement Account	- 3,099,488	154,261
Total assets	33,586,458	34,747,184
Liabilities		
Federal Reserve Notes	24,761,047	23,371,204
Deposits:		
Total depository institutions—reserve accounts	6,659,644	9,037,467
Foreign	21,900	23,700
Other deposits	103,214	81,595
Total deposits	6,784,758	9,142,762
Deferred credit items	1,080,665	1,390,792
Other liabilities	377,846	300,946
Total liabilities	33,004,316	34,205,704
Capital Accounts		
Capital paid in	291,071	270,740
Surplus	291,071	270,740
Total liabilities and capital accounts	33,586,458	34,747,184

Earnings and Expenses

(Thousands of Dollars)

	December 31,	
	1987	1986
Current Earnings		
Discounts and advances	\$ 1,845	\$ 2,447
United States Government securities	2,246,662	2,205,867
Foreign currencies	50,118	62,188
Income from services	74,576	72,767
All other	1,801	1,997
Total current earnings	2,375,002	2,345,266
Current Expenses		
Total current expenses	137,972	136,643
Less: reimbursement for certain fiscal agency and other expenses	12,348	12,314
Net expenses	125,624	124,329
Cost of earnings credit	9,192	7,853
Current net earnings	2,240,186	2,213,084
Profit and Loss		
Additions to current net earnings		
Profit on Prior Period Adjustments	54	—
Profit on sales of United State Government securities (net)	5,802	9,193
Profit on foreign exchange transactions (net)	263,424	311,360
Total additions	269,280	320,553
Deductions from current net earnings		
All other	44	5,692
Total deductions	44	5,692
Net additions (+) deductions (-)	+ 269,236	+ 314,861
Cost of Unreimbursed Treasury Services	- 6,903	—
Assessments by Board of Governors		
Board expenditures	- 11,783	- 14,937
Federal Reserve currency costs	- 20,421	- 24,121
Net earnings before payments to the United States Treasury	2,470,315	2,488,887
Dividends paid	16,763	16,343
Payments to the United States Treasury (interest on Federal Reserve Notes)	2,433,221	2,482,277
Transferred to surplus	20,331	- 9,733
Surplus, January 1	270,740	280,473
Surplus, December 31	291,071	270,740



Twelfth Federal Reserve District

San Francisco Office

P.O. Box 7702, San Francisco, California 94120

Los Angeles Branch

P.O. Box 2077, Terminal Annex, Los Angeles, California 90051

Portland Branch

P.O. Box 3436, Portland, Oregon 97208

Salt Lake City Branch

P.O. Box 30780, Salt Lake City, Utah 84125

Seattle Branch

P.O. Box 3567, Terminal Annex, Seattle, Washington 98124

This *Report* was designed and produced by Karen Rusk and written by Gregory J. Tong of the Federal Reserve Bank of San Francisco. Assistance was provided by Corporate Planning, Economic Research, Supervision, Regulation and Credit, District Operations, Finance and Product Management, and Personnel. Graphics by William Rosenthal. Photography by Paul Schulz.

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