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Monetary Policy Report to the Congress

Report submitted to the Congress on February 11, 2004, pursuant to section 2B of the Federal Reserve Act

MONETARY POLICY AND THE ECONOMIC OUTLOOK

The economic expansion in the United States gathered strength during 2003 while price inflation remained quite low. At the beginning of the year, uncertainties about the economic outlook and about the prospects of war in Iraq apparently weighed on spending decisions and extended the period of subpar economic performance that had begun more than two years earlier. However, with the support of stimulative monetary and fiscal policies, the nation's economy weathered that period of heightened uncertainty to post a marked acceleration in economic activity over the second half of 2003. Still, slack in resource utilization remained substantial, unit labor costs continued to decline as productivity surged, and core inflation moved lower. The performance of the economy last year further bolstered the case that the faster rate of increase in productivity, which began to emerge in the late 1990s, would persist. The combination of that favorable productivity trend and stimulative macroeconomic policies is likely to sustain robust economic expansion and low inflation in 2004.

At the time of our last *Monetary Policy Report to the Congress*, in July, near-term prospects for U.S. economic activity remained unclear. Although the Federal Open Market Committee (FOMC) believed that policy stimulus and rapid gains in productivity would eventually lead to a pickup in the pace of the expansion, the timing and extent of the improvement were uncertain. During the spring, the rally that occurred in equity markets when the war-related uncertainties lifted suggested that market participants viewed the economic outlook as generally positive. By then, the restraints imparted by the earlier sharp decline in equity prices, the retrenchment in capital spending, and lapses in corporate governance were receding. As the price of crude oil dropped back and consumer confidence rebounded last spring, household spending seemed to be rising once again at a moderate rate. Businesses, however, remained cautious; although the deterioration in the labor market showed signs of abating, private payroll employment was still declining, and capital spending continued to be weak. In addition, economic activity abroad gave few signs of bouncing back, even though long-term interest rates in major foreign economies had declined sharply. At its June meeting, the FOMC provided additional policy accommodation, given that, as yet, it had seen no clear evidence of an acceleration of U.S. economic activity and faced the possibility that inflation might fall further from an already low level.

During the next several months, evidence was accumulating that the economy was strengthening. The improvement was initially most apparent in financial markets, where prospects for stronger economic activity and corporate earnings gave a further lift to equity prices. Interest rates rose as well, but financial conditions appeared to remain, on net, stimulative to spending, and additional impetus from the midyear changes in federal taxes was in train. Over the remainder of the year, in the absence of new shocks to economic activity and with gathering confidence in the durability of the economic expansion, the stimulus from monetary and fiscal policies showed through more readily in an improvement in domestic demand. Consumer spending and residential construction, which had provided solid support for the expansion over the preceding two years, rose more rapidly, and business investment revived. Spurred by the global recovery in the high-tech sector and by a pickup in economic activity abroad, U.S. exports also posted solid increases in the second half of the year. Businesses began to add to their payrolls, but only at a modest pace that implied additional sizable gains in productivity.

The fundamental factors underlying the strengthening of economic activity during the second half of 2003 should continue to promote brisk expansion in 2004. Monetary policy remains accommodative. Financial conditions for businesses are quite favorable: Profits have been rising rapidly, and corporate borrowing costs are at low levels. In the household sector, last year's rise in the value of equities and real estate exceeded the further accumulation of debt by enough to raise the ratio of household net worth to disposable income after three consecutive years of decline. In addition, federal spending and tax policies are slated to remain stimulative during the current fiscal year, while the restraint from the state and local sector should diminish. Lastly, the lower foreign exchange value of the dollar and a sustained economic expansion among our trading partners are likely to boost the demand for U.S. production. Considerable uncertainty, of course, still attends the economic outlook despite these generally favorable fundamentals. In particular, questions remain as to how willing businesses will be to spend and hire and how durable will be the pickup in economic growth among our trading partners. At its meeting on January 27–28, 2004, the Committee perceived that upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal.

Prospects for sustained high rates of increase in productivity are quite favorable. Businesses are likely to retain their focus on controlling costs and boosting efficiency by making organizational improvements and exploiting investments in new equipment. With the ongoing gains in productivity, the existing margins of slack in resource utilization should recede gradually, and any upward pressure on prices should remain well contained. The FOMC indicated at its January meeting that, with inflation low and resource use still slack, it can be patient in removing its policy accommodation.

Monetary Policy, Financial Markets, and the Economy over 2003 and Early 2004

During the opening months of 2003, the softness in economic conditions was exacerbated by the substantial uncertainty surrounding the onset of war in Iraq. Private nonfarm businesses began again to cut payrolls substantially, consumer spending slowed, and business investment was muted. Although the jump in energy prices pushed up overall inflation, slack in resource utilization and the rapid rise in labor productivity pushed core inflation down. In financial markets, the heightened sense of caution among investors generated safe-haven demands for Treasury and other fixed-income securities, and equity prices declined.

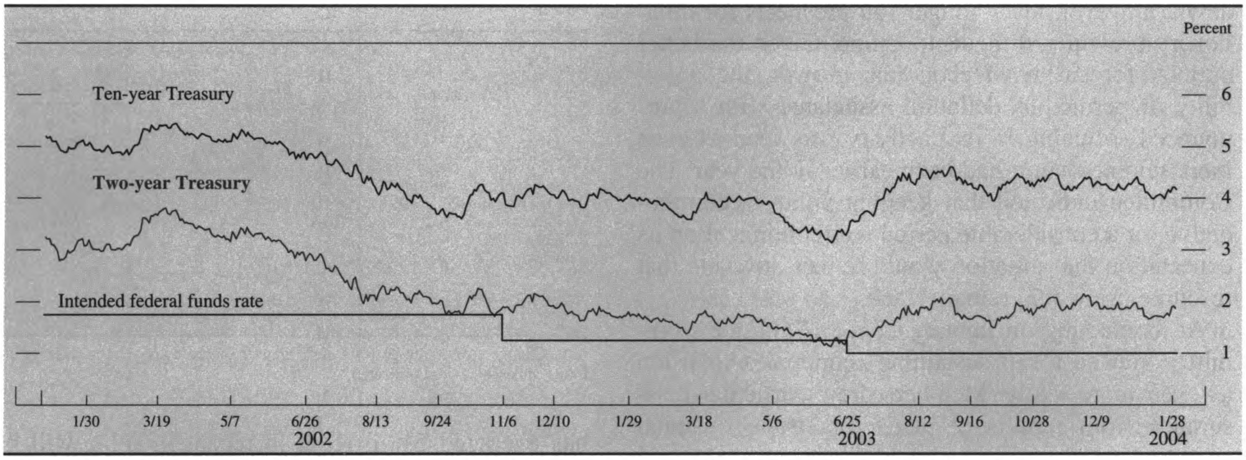
At its meeting on March 18, the FOMC maintained its 1¼ percent target for the federal funds rate to provide support for a stronger economic expansion that appeared likely to materialize. The Committee noted that the prevailing high degree of geopolitical uncertainty complicated any assessment of prospects for the economy, and members refrained from making a determination about the balance of risks with regard to its goals of maximum employment and stable prices. At the same time, the Committee agreed to step up its surveillance of the economy, which took the form of a series of conference calls in late March and early April to consult about developments. When military action in Iraq became a certainty, financial markets began to rally, with risk spreads on corporate debt securities narrowing and broad equity indexes registering notable gains. Economic news, however, remained mixed.

Indicators of the economy at the time of the May 6 FOMC meeting continued to suggest only tepid growth. Uncertainty in financial markets had declined, and rising consumer confidence and a wave of mortgage refinancing appeared to be supporting consumer spending. However, persistent excess capacity evident in labor and product markets pointed to possible further disinflation. The lifting of some of the uncertainty clouding the economic outlook allowed the Committee to make the determination that the risks to economic growth were balanced but that the probability of an unwelcome substantial fall in inflation exceeded that of a pickup in inflation. The FOMC judged that, taken together, the balance of risks was weighted toward weakness. The Committee left the federal funds rate target at 1¼ percent, but the Committee's announcement prompted a rally in the Treasury market, and coupon yields fell substantially as market participants marked down their expectations for the path of the federal funds rate.

By the time of the June 24–25 FOMC meeting, risk spreads had narrowed further and equity prices had extended their rise, but the prospects for sustained economic expansion still seemed tentative. Although Committee members referred to signs of improvement in some sectors of the economy, they saw no concrete evidence of an appreciable overall strengthening in the economic expansion and viewed the excess capacity in the economy as likely to keep inflation in check. The Committee lowered the target for the federal funds rate ¼ percentage point, to 1 percent, to add further support to the economic expansion and as a form of insurance against a further substantial drop in inflation, however unlikely. The members saw no serious obstacles to further conventional policy ease down to the zero lower bound on nominal interest rates should that prove to be necessary. The Committee also discussed alternative means of providing monetary stimulus should the target federal funds rate be reduced to a point at which they would have little or no latitude for additional easing through this traditional channel.

Longer-term interest rates backed up following the meeting, as investors had apparently placed substantial odds on a policy move larger than 25 basis points

Selected interest rates



NOTE. The data are daily and extend through February 4, 2004. The dates on the horizontal axis are those of scheduled FOMC meetings.

and may have been disappointed that the announcement failed to mention any potential "unconventional" monetary policy options. Ten-year Treasury yields rose sharply during the following weeks in reaction to interpretations of the Chairman's congressional testimony, the release of Committee members' economic projections, and positive incoming news about the economy and corporate profits. A substantial unwinding of hedging positions related to mortgage investments may well have amplified the upswing in market yields. Over the intermeeting period, labor markets continued to be soft, but industrial production, personal consumption expenditures, and business outlays all strengthened, and the housing market remained robust. By the time of the August 12 FOMC meeting, members generally perceived a firming in the economy, most encouragingly in business investment spending, and believed that, even after the rise in longer-term rates, financial conditions were still supportive of vigorous economic growth. Given the continued slack in resource use across the economy, however, members saw little risk of inducing higher inflation by leaving the federal funds rate at its accommodative level. On the basis of the economic outlook, and to reassure market participants that policy would not reverse course soon, Committee members decided to include in the announcement a reference to their judgment that under the anticipated circumstances, policy accommodation could be maintained for a "considerable period."

Through the September 16 and October 28 FOMC meetings, the brightening prospects for future growth put upward pressure on equity prices and longer-term interest rates. The Committee's retention of the phrase "considerable period" in the announcements following each of these meetings apparently provided an anchor for near-term interest rates. The Committee's discussion at these two meetings focused on the increased evidence of a broadly based acceleration in economic activity and on the continued weakness in labor markets. Rising industrial production, increased personal consumption and business investment spending, higher profits, receptive financial markets, and a lower foreign exchange value of the dollar all suggested that sustained and robust economic growth was in train. The Committee's decision to leave the stance of monetary policy unchanged over this period reflected, in part, a continuing confidence that gains in productivity would support economic growth and suppress inflationary pressures. In fact, the Committee generally viewed its goal of price stability as essentially having been achieved.

By the time of the December 9 FOMC meeting, the economic expansion appeared likely to continue at a rate sufficient to begin to reduce slack in labor and product markets. Equity markets continued to rally, and risk spreads, particularly on the debt of speculative-grade firms, narrowed further. The labor market was finally showing some signs of improvement, and spending by households remained strong even as the impetus from earlier mortgage refinancings and tax cuts began to wane. The acceleration in capital spending and evidence that some firms were beginning to accumulate inventories seemed to signal that business confidence was on the mend. However, twelve-month core consumer price inflation was noticeably lower than in the previous year. Even though the unemployment rate was expected to move down gradually, continued slack in labor and product markets over the near term was viewed as sufficient to keep any nascent inflation subdued. Uncertainty about the pace at which slack would be worked down, however, made longer-run prospects for inflationary pressures difficult to gauge. Given the better outlook for sustained economic growth, the possibility of pernicious deflation associated with a pronounced softening in real activity was seen as even more remote than it had been earlier in the year. The Committee indicated that keeping policy accommodative for a considerable period was contingent on its expectation that inflation would remain low and that resource use would remain slack.

At its meeting on January 27–28, 2004, the Committee viewed a self-sustaining economic expansion as even more likely. Members drew particular reassurance from reports of plans for stronger capital spending and the widespread distribution of increased activity across regions. Accommodative financial market conditions, including higher equity prices, narrower risk spreads on bonds, and eased standards on business loans, also seemed supportive of economic expansion. However, some risks remained in light of continued lackluster hiring evidenced by the surprisingly weak December payroll employment report. With the likelihood for rapid productivity growth seemingly more assured, Committee members generally agreed that inflation pressures showed no sign of increasing and that a bit more disinflation was possible. Under these circumstances, the Committee concluded that current conditions allowed monetary policy to remain patient. As to the degree of policy accommodation, the Committee left its target for the federal funds rate unchanged. The Committee's characterization that policy could be patient instead of its use of the phrase "considerable period" in its announcement prompted a rise in Treasury yields across the yield curve and a fall in equity prices.

Economic Projections for 2004

Federal Reserve policymakers expect that the economic expansion will continue at a brisk pace in 2004. The central tendency of the forecasts of the change in real gross domestic product made by the members of the Board of Governors and the Federal Reserve Bank presidents is 4½ percent to 5 percent, measured from the final quarter of 2003 to the final quarter of 2004. The full range of these forecasts is somewhat wider—from 4 percent to 5½ percent. The FOMC participants anticipate that the projected increase in real economic activity will be associated with a further gradual decline in the unemployment rate. They expect that the unemployment rate, which has averaged 5¾ percent in recent months, will be between 5¼ percent and 5½ percent in the fourth quarter of the year. With rapid increases in productivity likely to be sustained and inflation expectations stable, Federal Reserve policymakers anticipate that inflation will remain quite low this year. The central tendency of their forecasts for the change in the chain-type price index for personal consumption expenditures (PCE) is 1 percent to 1¼ percent; this measure of inflation was 1.4 percent over the four quarters of 2003.

Economic projections for 2004
Percent

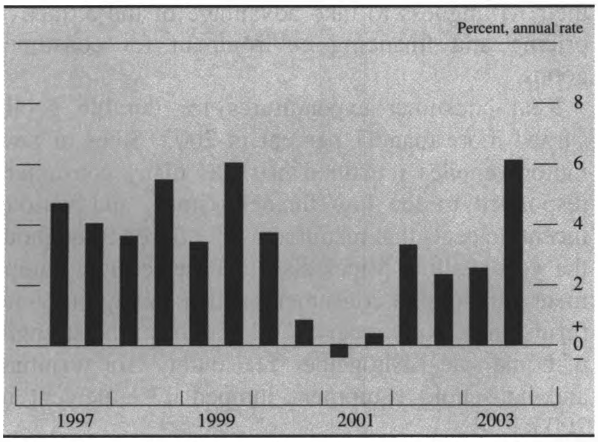
Indicator	Memo: 2003 actual	Federal Reserve Governors and Reserve Bank presidents	
		Range	Central tendency
Change, fourth quarter to fourth quarter[1]			
Nominal GDP	5.9	5½–6½	5½–6¼
Real GDP	4.3	4–5½	4½–5
PCE chain-type price index	1.4	1–1½	1–1¼
Average level, fourth quarter			
Civilian unemployment rate	5.9	5¼–5½	5¼–5½

1. Change from average for fourth quarter of previous year to average for fourth quarter of year indicated.

Economic and Financial Developments in 2003 and Early 2004

The pace of economic expansion strengthened considerably in the second half of 2003 after almost two years of uneven and, on balance, sluggish growth. In early 2003, accommodative monetary policy and stimulative fiscal policies were in place, but economic activity still seemed to be weighed down by a number of factors that had restrained the recovery earlier: Geopolitical tensions were again heightened, this time by the impending war in Iraq, businesses remained unusually cautious about the strength of the expansion, and economic activity abroad was still weak. In June the continued lackluster economic growth and a further downshift in inflation from an already low level prompted a further reduction in the federal funds rate. In addition, the tax cuts that became effective at midyear provided a significant boost to disposable income. In the succeeding months, the macroeconomic stimulus began to show through clearly in sales and production, and some of the business caution seemed to recede. Real GDP increased at an annual rate of 6 percent, on average, in the third and fourth quarters of last year. In contrast, between late 2001 and mid-2003, real GDP had risen at an annual rate of only 2½ percent.

Change in real GDP

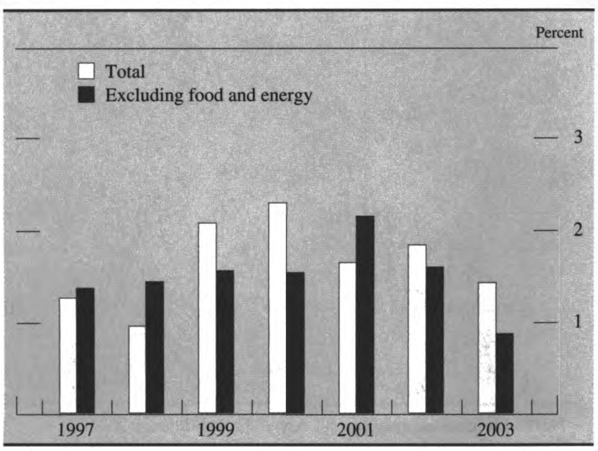


NOTE. Here and in subsequent charts, except as noted, change for a given period is measured to its final quarter from the final quarter of the preceding period.

During the period of recession and subpar economic expansion, considerable slack developed in labor and product markets. The firming of economic activity in the second half of last year produced modest increases in rates of resource utilization. Sustained efforts by businesses to control costs led to further rapid gains in productivity. As a result, unit labor costs declined, and core rates of inflation continued to slow in 2003; excluding food and energy, the PCE chain-type price index increased just 0.9 percent last year. Measures of overall inflation, which were boosted by movements in food and energy prices, were higher than those for core inflation.

Domestic financial market conditions appeared to become increasingly supportive of economic growth last year. The economic expansion lowered investors' perception of, and perhaps aversion to, risk, and continued disinflation was interpreted as a sign that monetary policy would remain on hold, even as the economy picked up steam. Although yields on Treasury coupon securities rose modestly on balance over the year, risk spreads on corporate debt narrowed to the point that yields on corporate issues declined. The low-interest-rate environment spurred considerable corporate bond issuance and generated a massive wave of mortgage refinancing activity by households. Equity markets began to rally when the uncertainty over the timing of military intervention in Iraq was resolved. The climb in stock prices continued for the rest of the year, driven by improving corporate earnings reports and growing optimism about the prospects for the economy. At the same time, with economic conditions abroad improving and with concerns about the financing burden of the U.S. current account deficit gaining increased attention in financial markets, the dollar fell appreciably on a trade-weighted basis.

Change in PCE chain-type price index



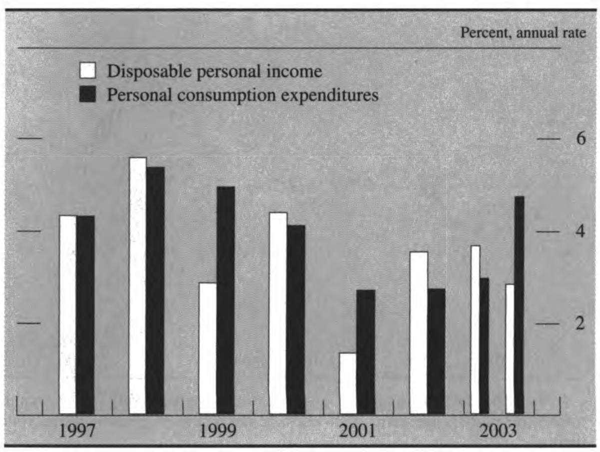
NOTE. The data are for personal consumption expenditures (PCE).

The Household Sector

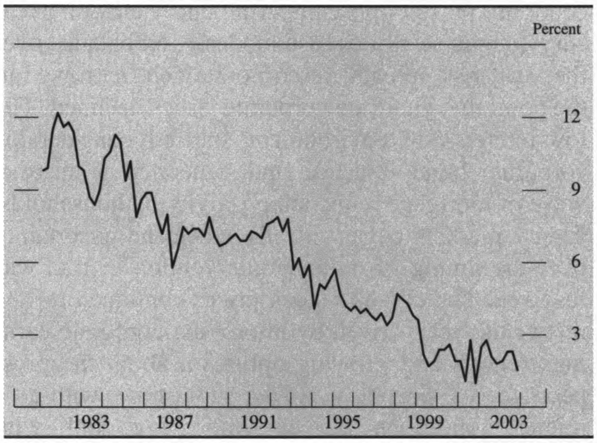
Consumer Spending

Early in 2003, consumer spending was still rising at about the same moderate pace as in 2001 and 2002. In the late spring and in the summer, however, households stepped up their spending sharply. As a result, in the second half of last year, real personal consumption expenditures rose at an annual rate of 4¾ percent after having increased at a rate of just under 3 percent in the first half. Although wage and salary earnings rose slowly during most of the year, the midyear reductions in tax rates and the advance of rebates to households eligible for child tax credits provided a substantial boost to after-tax income. In 2003, real disposable personal income increased 3¼ percent,

Change in real income and consumption



Personal saving rate



NOTE. The data are quarterly and extend through 2003:Q4.

after having risen 3½ percent in 2002. Low interest rates provided additional impetus to household spending by reducing borrowing costs for new purchases of houses and durable goods; they also indirectly stimulated spending by facilitating an enormous amount of mortgage refinancing.

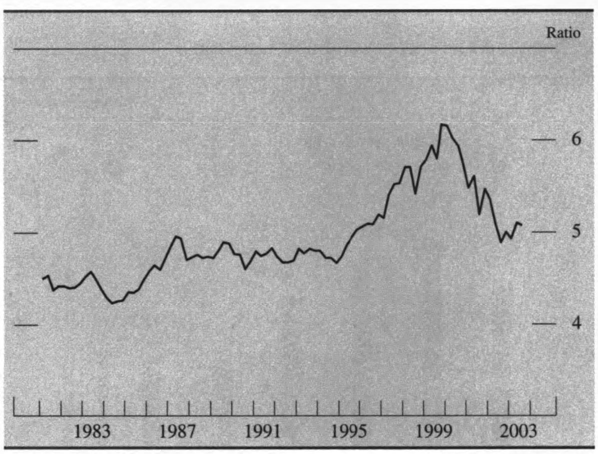
The personal saving rate has fluctuated within a fairly narrow range around 2 percent over the past three years. Although households continued to see the value of their homes appreciate over this period, they also were adjusting to the substantial drop in equity wealth that occurred after the peak in the stock market in 2000. By itself, a fall in the ratio of household wealth to income of the magnitude that households experienced between 2000 and 2002 might have triggered a noticeable increase in the personal saving rate. However, in this case, the tendency for households to save more as their wealth declines appears to have been tempered in part by their willingness to take advantage of the attractive pricing and financing environment for consumer goods.

Real consumer expenditures for durable goods surged more than 11 percent in 2003. Sales of new motor vehicles remained brisk as many consumers responded to the low financing rates and various incentive deals that manufacturers offered throughout the year. Falling prices also made electronic equipment attractive to consumers, and spending on home furnishings likely received a boost from the strength of home sales. Altogether, real outlays for furniture and household equipment jumped 13½ percent in 2003.

In contrast, real consumer expenditures on nondurable goods and on services continued to rise at a moderate pace, on balance, last year. Outlays for food and apparel increased a bit faster than in 2002, and the steady uptrend in spending for medical services was well maintained. However, consumers responded to the higher cost of energy by cutting back their real spending on gasoline, fuel oil, and natural gas and electricity services.

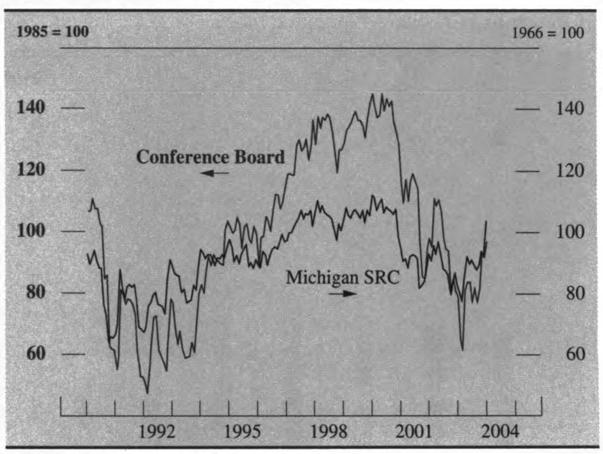
Consumer confidence was shaken temporarily early in 2003 by concerns about the consequences of a war in Iraq, but it snapped back in the spring. Toward year-end, sentiment appeared to brighten more as households saw their current financial conditions improve and gained confidence that business conditions would be better during the year ahead. Those positive views became more widely held in January, and the index of consumer sentiment prepared by the Michigan Survey Research Center (SRC) reached its highest level in three years.

Wealth-to-income ratio



NOTE. The data are quarterly and extend through 2003:Q3. The wealth-to-income ratio is the ratio of household net worth to disposable personal income.

Consumer sentiment



NOTE. The data are monthly and extend through January 2004.
SOURCE. University of Michigan Survey Research Center and The Conference Board.

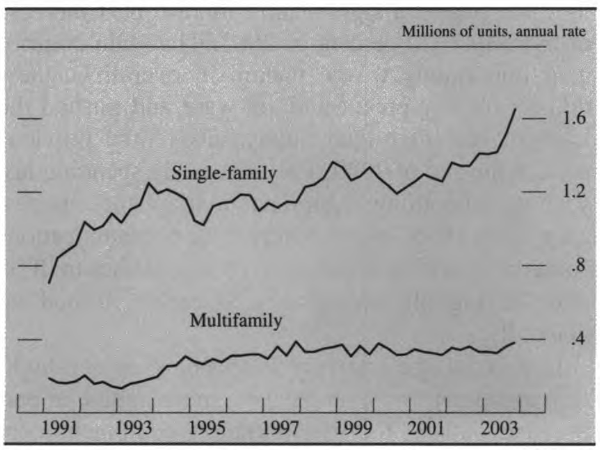
Residential Investment

Housing activity was robust for a second consecutive year in 2003. After having risen 7 percent in 2002, real expenditures on residential construction jumped more than 10 percent in 2003. These gains were fueled importantly by the lowest levels of mortgage interest rates in more than forty years, which, according to the Michigan SRC's survey of consumer sentiment, buoyed consumer attitudes toward homebuying throughout the year. The average rate on thirty-year fixed-rate mortgages dropped sharply during the first half of 2003 and reached a low of 5¼ percent in June. Although the thirty-year rate subsequently firmed somewhat, it remained below 6 percent, on average, in the second half of last year.

Construction of new single-family homes accelerated during 2003, and for the year as a whole, starts averaged 1.5 million units, an increase of 10 percent compared with the level in 2002. Sales of both new and existing single-family homes also picked up sharply further last year. The brisk demand for homes was accompanied by rapid increases in the average price paid for them. The average price paid for new homes rose 10 percent over the four quarters of 2003, and the average price of existing homes was up 7¾ percent over the same period. However, house price inflation was lower after adjusting for shifts in the composition of transactions toward more expensive homes. The constant-quality price index for new homes, which eliminates the influence of changes in their amenities and their geographic distribution, increased 4¾ percent over the four quarters of 2003—down from an increase of 6 percent during 2002. The year-over-year increase in Freddie Mac's index of the prices paid in repeat sales of existing homes stood at 5½ percent as of the third quarter of 2003, compared with a rise of 7¼ percent as of the third quarter of 2002.

Starts in the multifamily sector totaled 350,000 units in 2003, a pace little changed from that of the past several years. Vacancy rates for these units rose and rents fell during the year, but falling mortgage rates apparently helped to maintain building activity.

Private housing starts

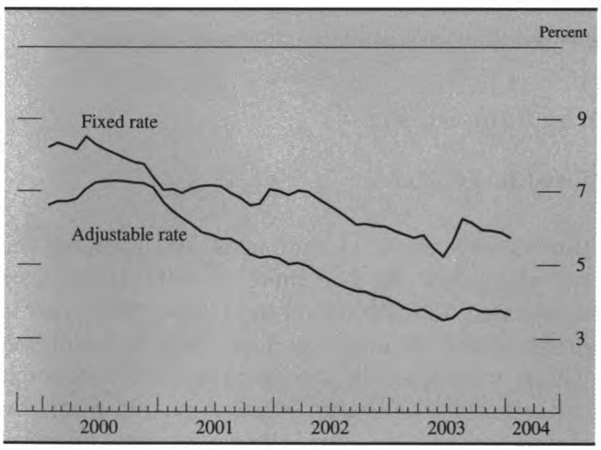


NOTE. The data are quarterly and extend through 2003:Q4.

Household Finance

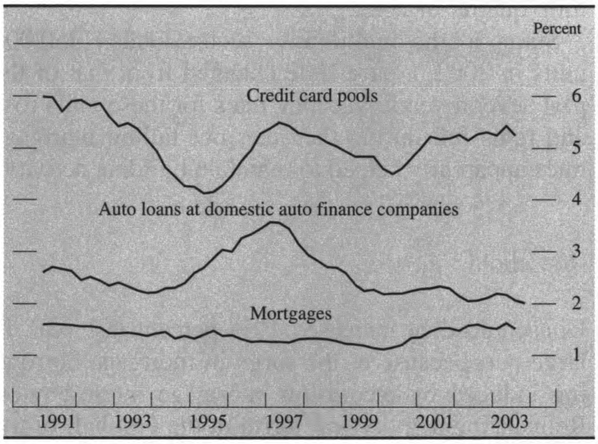
Household debt increased 10¾ percent last year, in large part because of the surge in mortgage borrowing induced by record-low mortgage interest rates. Refinancing activity was torrid in the first half of the year, as mortgage rates declined. Some of the equity that households extracted from their homes during refinancings was apparently used to fund home improvements and to pay down higher-interest consumer debt. When mortgage rates rebounded in the second half of the year, mortgage borrowing slowed from the extremely rapid clip of the first half, but it remained brisk through year-end. Consumer credit increased at a pace of 5¼ percent in 2003, a little faster than a year earlier, as revolving credit picked up somewhat from the slow rise recorded in 2002. Despite the pickup in household borrowing, low interest rates kept the household debt-service and financial-obligation ratios—which gauge precommitted expenditures relative to disposable income—at roughly the levels posted in 2002. Most measures of delinquencies on consumer loans and home mortgages changed little on net last year, and household bankruptcies held roughly steady near their elevated level in 2002.

Mortgage rates



NOTE. The data, which are monthly and extend through January 2004, are contract rates on thirty-year mortgages.
SOURCE. Federal Home Loan Mortgage Corporation.

Delinquency rates on selected types of household loans



NOTE. The data are quarterly. The rates for credit card pools and mortgages extend through 2003:Q3; the rate for auto loans extends through 2003:Q4.
SOURCE. For mortgages, the Mortgage Bankers Association; for auto loans, the Big Three automakers; for credit cards, Moody's Investors Service.

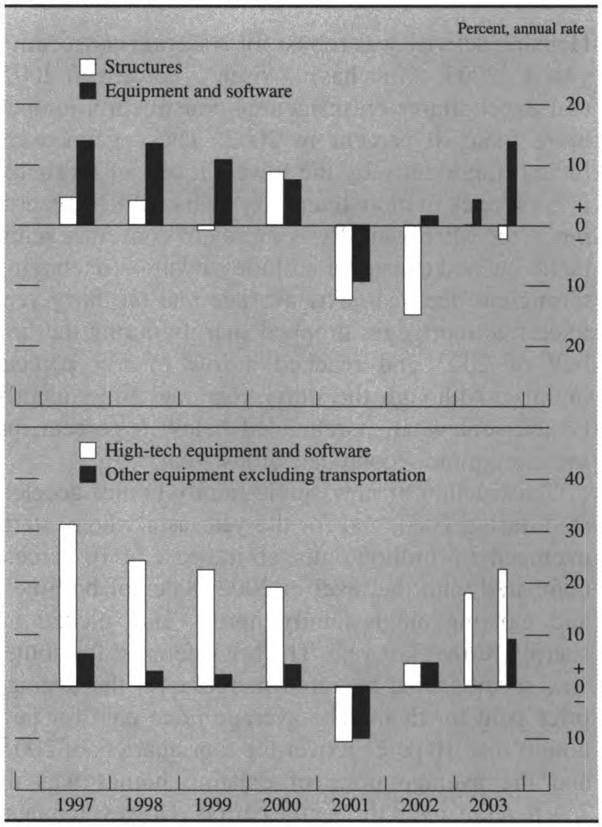
Even with the rapid expansion in debt, net worth of the household sector increased as the value of household assets rose noticeably. Stock prices were boosted by the rise in corporate earnings and the ebbing of uncertainty about future economic growth. Households directed substantial flows into stock mutual funds in the third and fourth quarters despite highly publicized scandals in the mutual fund industry. Although the companies directly implicated in wrongdoing experienced heavy outflows from their funds, most of these withdrawals apparently were transferred to other mutual funds with little effect on the industry as a whole. A considerable rise in real estate wealth further augmented household assets. Although prices of existing homes climbed more slowly than they had in the previous year, the rate of increase remained sizable. Overall, the advance in the value of household assets outstripped the accumulation of household debt by enough to boost the ratio of net worth to disposable income over the year.

The Business Sector

Fixed Investment

Business spending on equipment and software was still sluggish at the beginning of 2003. However, it accelerated noticeably over the course of the year as profits and cash flow rebounded and as businesses gained confidence in the strength of the economic expansion and in the prospective payoffs from new investment. At the same time, business financing conditions were very favorable: Interest rates remained low, equity values rallied, and the enhanced

Change in real business fixed investment



NOTE. High-tech equipment consists of computers and peripheral equipment, software, and communications equipment.

partial-expensing tax provision gave a special incentive for the purchase of new equipment and software. After having changed little in the first quarter of the year, real outlays for equipment and software increased at an annual rate of 11¾ percent over the remaining three quarters of the year.

Outlays for high-technology items—computers and peripherals, software, and communications equipment—which had risen a moderate 4½ percent in 2002, posted a significantly more robust increase of more than 20 percent in 2003. That gain contributed importantly to the pickup in overall business outlays for equipment and software and pushed the level of real high-tech outlays above the previous peak at the end of 2000. The increase in spending last year on computing equipment marked the sharpest gain since 1998, and investment in communications equipment, which had continued to contract in 2002 after having plummeted a year earlier, turned up markedly.

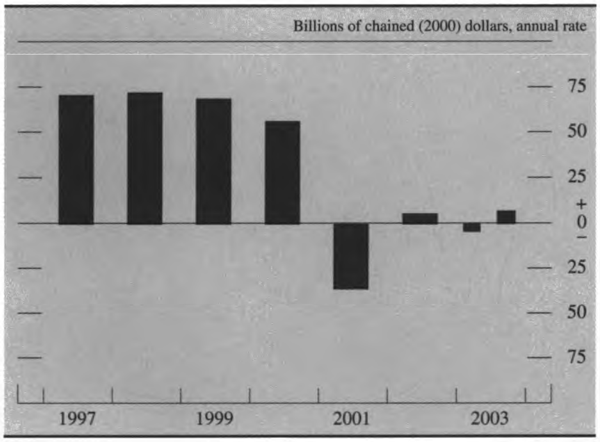
In contrast, the recovery in spending on non-high-tech equipment was, on balance, more muted, in part because outlays for transportation equipment continued to fall. The prolonged slump in business purchases of new aircraft continued in 2003 as domestic air carriers grappled with overcapacity and high fixed costs. By the fourth quarter, real outlays for aircraft had dropped to their lowest level in ten years. In the market for heavy (class 8) trucks, sales were quite slow in early 2003 when businesses were concerned about the performance of models with engines that met new emission standards. But as potential buyers overcame those concerns, sales recovered. By the fourth quarter of 2003, sales of medium and heavy trucks had moved noticeably above the slow pace of 2001 and 2002. Apart from outlays for transportation equipment, investment in other types of non-high-tech equipment was, on balance, little changed during the first half of the year. Demand was strong for medical equipment, instruments, and mining and oil-field machinery, but sales of industrial equipment and farm and construction machinery were sluggish. In the second half of the year, however, the firming in business spending for non-high-tech items became more broadly based.

The steep downturn in nonresidential construction that began in 2001 moderated noticeably in 2003, although market conditions generally remained weak. After having contracted at an average annual rate of 13½ percent during 2001 and 2002, real expenditures for nonresidential construction slipped just 1¼ percent, on balance, during 2003. Spending on office buildings and manufacturing structures, which had dropped sharply over the preceding two years, fell again in 2003. The high office vacancy rates in many areas and low rates of factory utilization implied little need for new construction in these sectors even as economic activity firmed. Investment in communications infrastructure, where a glut of long-haul fiber-optic cable had developed earlier, also continued to shrink. In contrast, outlays for retail facilities, such as department stores and shopping malls, turned up last year, and the retrenchment in construction of new hotels and motels ended. In addition, investment in drilling and mining structures, which is strongly influenced by the price levels for crude oil and natural gas, increased noticeably in 2003.

Inventory Investment

During 2002, businesses appeared to have addressed most of the inventory imbalances that had developed a year earlier. But the moderate pace of final demand during the first half of 2003 apparently restrained firms from embarking on a new round of inventory accumulation. Even though final sales picked up in the second half of the year, the restraint seemed to recede only gradually. Over the first three quarters of 2003, nonfarm businesses trimmed their inventories at an average annual rate of $2¾ billion in constant-dollar terms, and the preliminary estimate for the final quarter of the year indicated only modest restocking. As a result, most firms appear to have ended the year with their inventories quite lean relative to sales, even after taking into account the downward trend in inventory–sales ratios that has accompanied the ongoing shift to improved inventory management. Motor vehicle dealers were an exception; their days' supply of new vehicles moved higher on average for a second year in a row.

Change in real business inventories

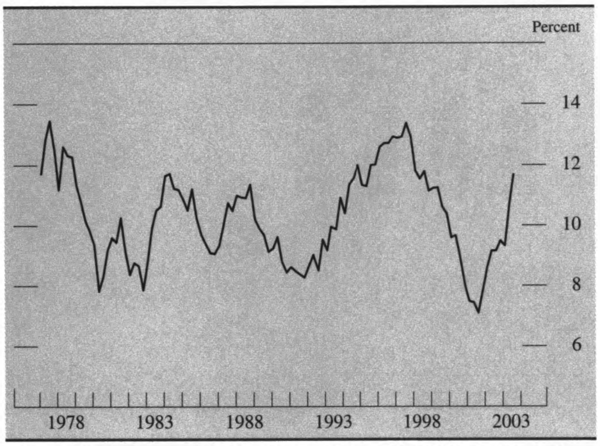


Corporate Profits and Business Finance

Higher profits allowed many firms to finance capital spending with internal funds, and business debt rose only slightly faster than the depressed rate in 2002. Moreover, a paucity of cash-financed merger and acquisition activity further limited the need to issue debt. Gross equity issuance was extremely weak in the first half of the year but perked up in the latter half in response to the rally in equity prices. Nevertheless, for the year as a whole, firms extinguished more equity than they issued.

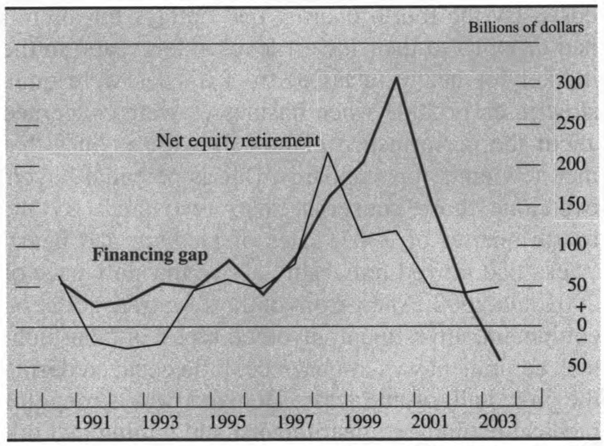
The pace of gross corporate bond issuance was moderate at the start of the year but shot up in late spring as firms took advantage of low bond yields to pay down short-term debt, to refund existing long-term debt, and to raise cash in anticipation of future spending. Bond issuance by investment-grade firms slowed after midyear as firms accumulated a substantial cushion of liquid assets and as interest rates on higher-quality debt backed up. However, issuance by speculative-grade firms continued apace, with the

Before-tax profits of nonfinancial corporations as a percent of sector GDP



NOTE. The data are quarterly and extend through 2003:Q3. Profits are from domestic operations of nonfinancial corporations, with inventory valuation and capital consumption adjustments.

Financing gap and net equity retirement at nonfinancal corporations

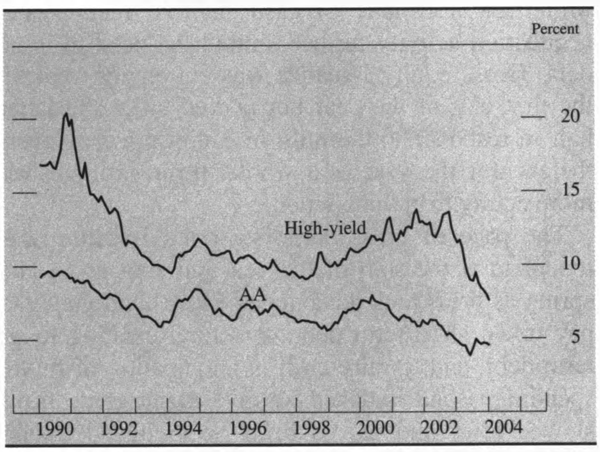


NOTE. The data are annual; 2003 is based on partially estimated data. The financing gap is the difference between capital expenditures and internally generated funds. Net equity retirement is the difference between equity retired through share repurchases, domestic cash-financed mergers, or foreign takeovers of U.S. firms and equity issued in public or private markets, including funds invested by venture capital partnerships.

yields on their debt continuing to decline dramatically presumably because of investors' increased optimism about the economic outlook and greater willingness to take on risk. The sum of bank loans and commercial paper outstanding, which represent the major components of short-term business debt, contracted throughout the year. In large part, this decline reflected ongoing substitution toward bond financing, but it also was driven by the softness of fixed investment early in the year and the liquidation of inventories over much of the year.

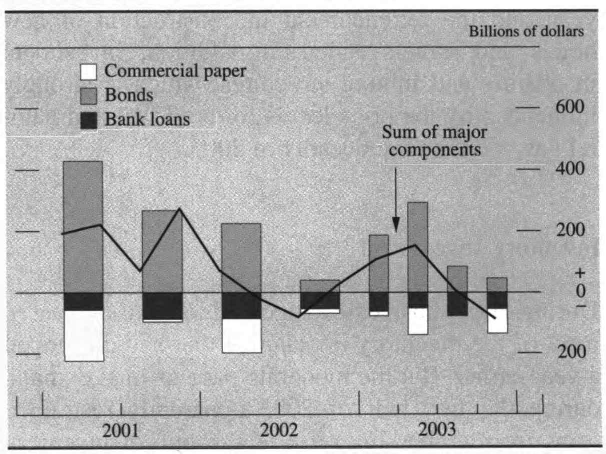
Respondents to the Senior Loan Officer Opinion Survey on Bank Lending Practices noted that terms and standards on business loans were tightened during the first half of the year but that both had been eased considerably by year-end. They also reported that demand for business loans was quite weak for much of the year. However, despite the fact that outstanding levels of business loans continued to decline, survey responses in the last quarter of the year indicated that demand for loans had begun to stabilize. Many banks cited customers' increased investment and inventory spending as factors helping to generate the increase in loan demand toward the end of the year. The apparent divergence between survey responses and data on actual loan volumes may suggest that demand for lines of credit has increased but that these lines have not yet been

Corporate bond yields



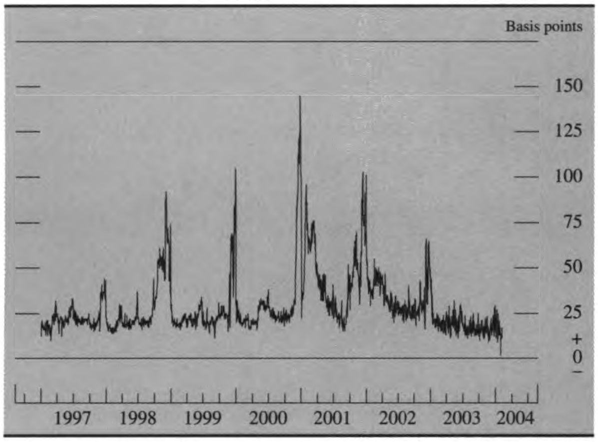
NOTE. The data are monthly averages and extend through January 2004. The AA rate is calculated from bonds in the Merrill Lynch AA index with a remaining maturity of seven to ten years. The high-yield rate is the yield on the Merrill Lynch 175 high-yield index.

Major components of net business financing



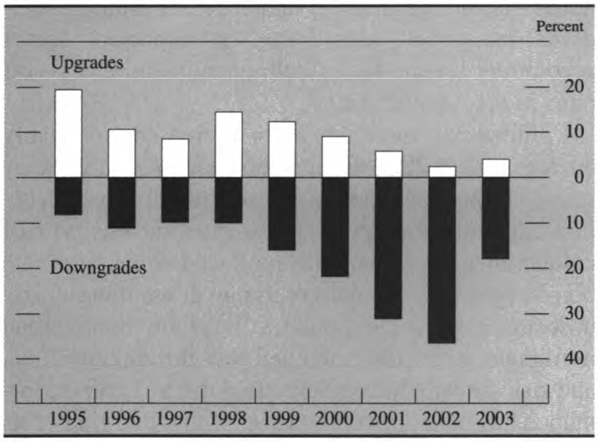
NOTE. Seasonally adjusted annual rate for nonfinancial corporate business. The data for the sum of major components are quarterly. The data for 2003:Q4 are estimated.

Spread of low-tier CP rates over high-tier CP rates



NOTE. The data are daily and extend through February 4, 2004. The series shown is the difference between the rate on A2/P2 nonfinancial commercial paper and the AA rate.

Ratings changes of nonfinancial corporate bonds



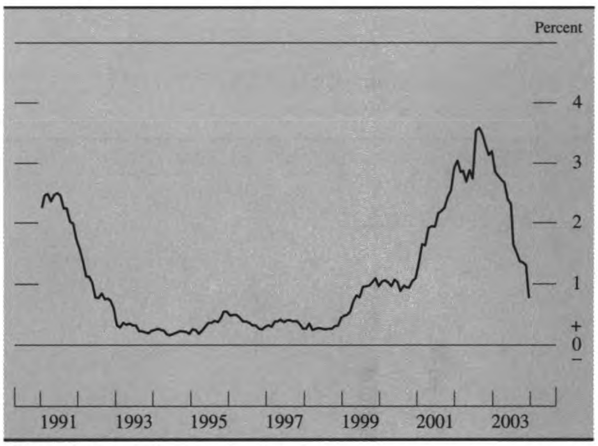
NOTE. For a given year, the percentage is calculated as the par value of bonds that were upgraded or downgraded in that year and outstanding in the fourth quarter of the previous year divided by the par value of the outstanding bonds of all nonfinancial corporations in that quarter.
SOURCE. Moody's Investors Service.

drawn. In other short-term financing developments, nonfinancial firms that issued commercial paper in 2003 found a very receptive market, in large part because of the scarcity of outstanding issues. Many of the riskiest borrowers had exited the market in 2002, and remaining issuers improved their attractiveness to investors by continuing to restructure their balance sheets.

Gross equity issuance rose over the course of 2003 as the economic outlook strengthened and stock prices moved higher. The market for initial public offerings continued to languish in the first half of the year but showed signs of life by the end of the summer. The volume of seasoned offerings also picked up in the second half of the year. On the other side of the ledger, merger and acquisition activity again extinguished shares in 2003, although only at a subdued pace. In addition, firms continued to retire a considerable volume of equity through share repurchases. For the year as a whole, net equity issuance was negative.

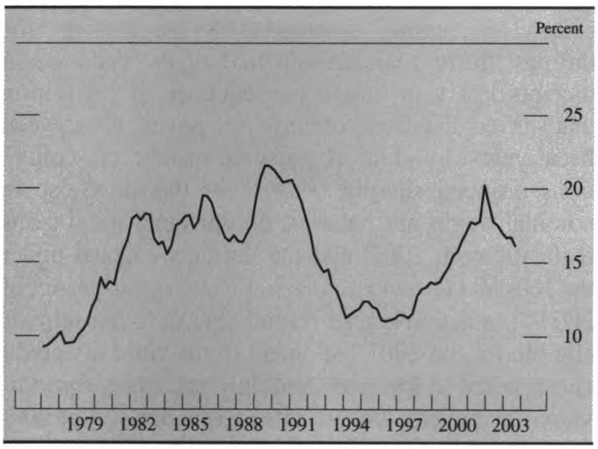
Corporate credit quality improved, on balance, over the year. Notably, the default rate on corporate bonds declined sharply, delinquency rates on commercial and industrial (C&I) loans at commercial banks turned down, and the pace of bond-rating downgrades slowed considerably. Low interest rates and the resulting restructuring of debt obligations toward longer terms also importantly contributed to

Default rate on outstanding bonds



NOTE. The default rate is monthly and extends through December 2003. The rate for a given month is the face value of bonds that defaulted in the twelve months ending in that month divided by the face value of all bonds outstanding at the end of the calendar quarter immediately preceding the twelve-month period.
SOURCE. Moody's Investors Service.

Net interest payments of nonfinancial corporations as a percent of cash flow

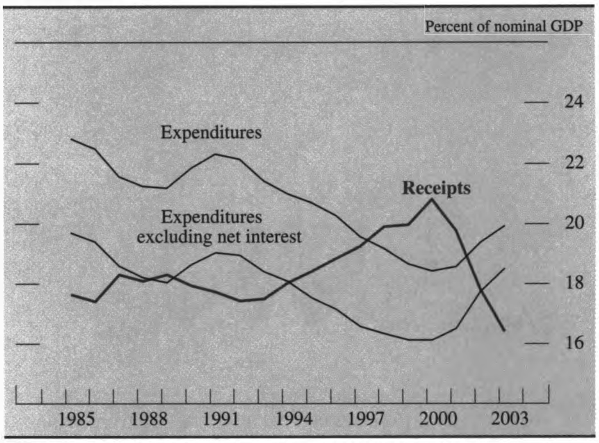


NOTE. The data are quarterly and extend through 2003:Q3.
SOURCE. Bureau of Economic Analysis.

improved business credit quality. Bank loan officers noted that the aggressive tightening of lending standards in earlier years was an important factor accounting for the lower delinquency and charge-off rates in recent quarters.

Commercial mortgage debt increased noticeably during most of 2003 despite persistently high vacancy rates, falling rents, and sluggish growth in construction expenditures. Low interest rates on this type of collateralized debt may have induced some corporate borrowers to tap the market to pay down more-costly unsecured debt. Delinquency rates on commercial mortgages generally remained low throughout 2003, and risk spreads were relatively narrow. Loan performance has held up well because of low carrying costs for property owners and because the outstanding loans generally had been structured to include a sizable equity contribution, which makes default less attractive to borrowers.

Federal receipts and expenditures



NOTE. The budget data are from the unified budget and are for fiscal years (October through September); GDP is for the year ending in Q3.

The Government Sector

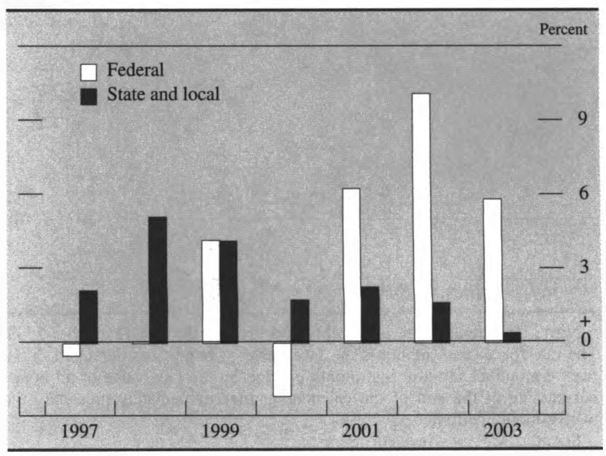
Federal Government

The federal budget deficit continued to widen in fiscal year 2003 as a result of the slow increase in nominal incomes, outlays associated with the war in Iraq, and legislative actions that reduced taxes and boosted spending. The deficit in the unified budget totaled $375 billion, up substantially from the deficit of $158 billion recorded in fiscal 2002. The Congressional Budget Office is projecting that the unified federal deficit will increase further in fiscal 2004, to more than $475 billion.

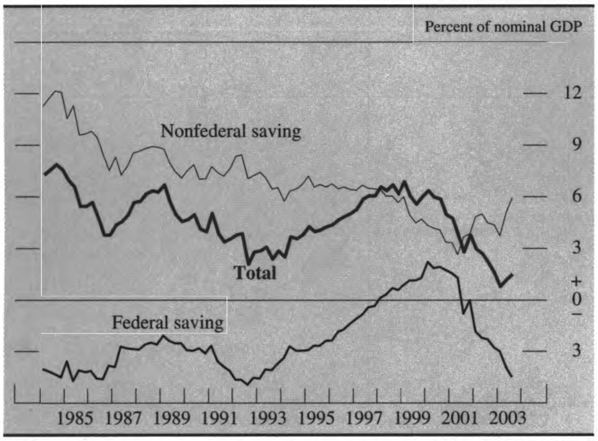
Federal receipts have fallen in each of the past three years; the drop of nearly 4 percent in fiscal 2003 brought the ratio of receipts to GDP to 16½ percent, 2 percentage points below the average for the past thirty years. About half of the decrease in receipts last year was a consequence of legislation that shifted due dates for corporate payments between fiscal years. In addition, personal income tax collections dropped sharply because of the slow rise in nominal wages and salaries, diminished capital gains realizations in 2002, and the tax cuts enacted under the Jobs and Growth Tax Relief Reconciliation Act of 2003. The act advanced refund checks to households eligible for the 2003 increment to the child tax credit and resulted in lower withholding schedules for individual taxpayers. The act also expanded the partial-expensing incentive for businesses, but because corporate profits accelerated sharply last year, corporate tax receipts rose appreciably after adjusting for the shifts in the timing of payments.

At the same time, federal outlays other than for interest expense rose rapidly for the second consecutive year in fiscal 2003; these outlays increased about 9 percent after having risen 11 percent in fiscal 2002. Spurred by operations in Iraq, defense spending soared again, and outlays for homeland security rose further. Spending for income support, such as unemployment insurance, food stamps, and child credits under the earned income tax credit program, also posted a sizable increase. The ongoing rise in the cost and utilization of medical services continued to push up spending for Medicare and Medicaid. Overall, real federal consumption and investment (the measure of federal spending that is included in real GDP) increased 6 percent over the four quarters of 2003, after having risen 10 percent a year earlier.

Change in real government expenditures on consumption and investment

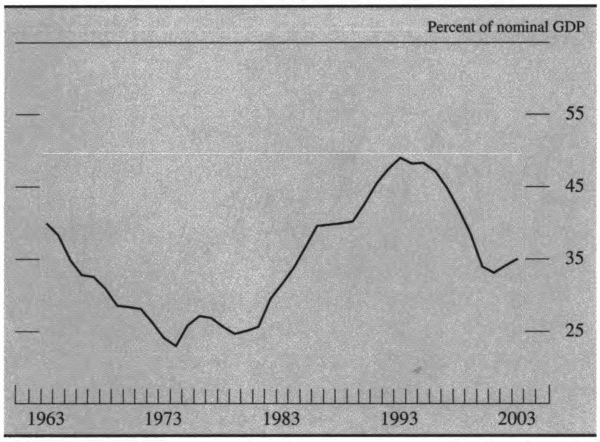


Net national saving



NOTE. The data are quarterly and extend through 2003:Q3. Nonfederal saving is the sum of personal and net business saving and the net saving of state and local governments.

Federal government debt held by the public



NOTE. Through 2002, the data for debt are year-end figures, and the corresponding value for GDP is for Q4 at an annual rate; the final observation is for 2003:Q3. Excludes securities held as investments of federal government accounts.

The federal government had contributed increasingly to national saving in the late 1990s and 2000 as budget deficits gave way to accumulating surpluses. However, with the swing back to large deficits in recent years, the federal government has again become a drain on national saving. Using the accounting practices followed in the national income and product accounts (NIPA), gross federal saving as a percent of GDP dropped sharply in late 2001 and has trended down since then; the drop contributed to a decline in overall gross national saving as a percent of GDP from 18 percent in calendar year 2000 to 13 percent, on average, in the first three quarters of 2003. Federal saving net of estimated depreciation fell from its recent peak of 2½ percent of GDP in 2000 to negative 4 percent of GDP, on average, in the first three quarters of 2003. As a result, despite a noticeable pickup in saving from domestic nonfederal sources, overall net national saving, which is an important determinant of private capital formation, fell to less than 1½ percent of GDP, on average, in the first three quarters of 2003, compared with a recent high of 6½ percent of GDP in 1998.

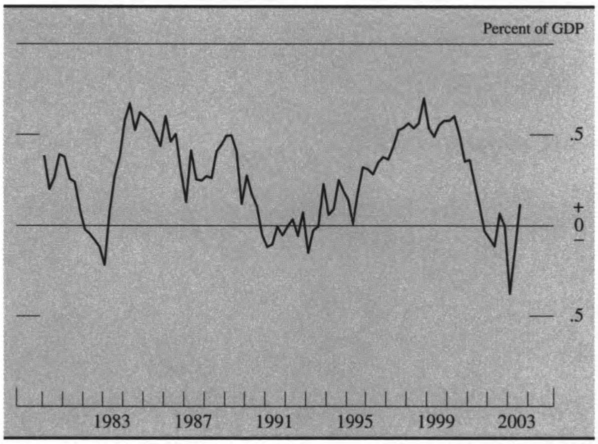
Federal Borrowing

The Treasury ramped up borrowing in 2003 in response to the sharply widening federal budget deficit, and federal debt held by the public as a percent of nominal GDP increased for a second year in a row after having trended down over the previous decade. As had been the case in 2002, the Treasury was forced to resort temporarily to accounting devices in the spring of 2003 when the statutory debt ceiling became a constraint, but debt markets were not disrupted noticeably. In May, the Congress raised the debt ceiling from $6.4 trillion to $7.4 trillion. With large deficits expected to persist, the Treasury made a number of adjustments to its regular borrowing program, including reintroducing the three-year note, increasing to monthly the frequency of five-year note auctions, reopening the ten-year note in the month following each new quarterly offering, and adding another auction of ten-year inflation-indexed debt. As a result of these changes, the average maturity of outstanding Treasury debt, which had reached its lowest level in decades, began to rise in the latter half of 2003.

State and Local Governments

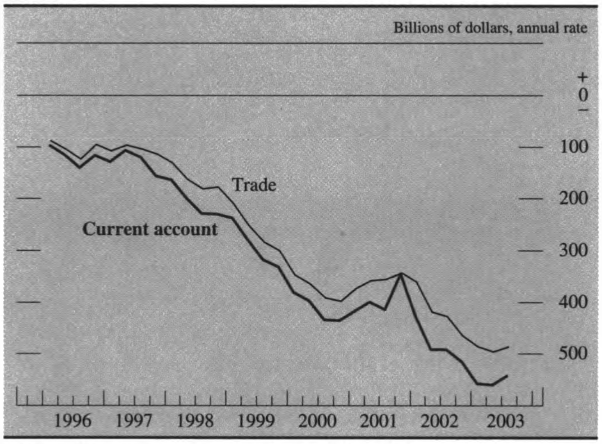
State and local governments faced another difficult year in 2003. Tax receipts on income and sales continued to be restrained by the subdued performance of the economy. Despite further efforts to rein in spending, the sector's aggregate net saving, as measured in the NIPA, reached a low of negative $40 billion (at an annual rate), or negative 0.4 percent of GDP, in the first quarter of the year. Most of these jurisdictions are subject to balanced-budget requirements and other rules that require them to respond to fiscal imbalances. Thus, in addition to reducing operating expenses, governments drew on reserves, issued bonds, sold assets, and made various one-time adjustments in the timing of payments to balance their books. In recent years, many have also increased taxes and fees, thereby reversing the trend toward lower taxes that prevailed during the late 1990s.

State and local government net saving



NOTE. The data, which are quarterly, are on a national income and product account basis and extend through 2003:Q3.

U.S. trade and current account balances



NOTE. The data are quarterly and extend through 2003:Q3.

Recent indications are that the fiscal stress in this sector is beginning to ease. The improvement reflects a noticeable upturn in tax collections in recent quarters while restraint on operating expenditures largely remains in place. On a NIPA basis, real spending on compensation and on goods and services purchased by state and local governments was little changed in the second half of 2003, as it was over the preceding year. However, investment in infrastructure, most of which is funded in the capital markets, accelerated in the second half of 2003. As of the third quarter of 2003, state and local net saving had moved back into positive territory.

State and Local Government Borrowing

Gross issuance of debt by state and local governments was quite robust last year. Weak tax receipts from a sluggish economy, significant demands for infrastructure spending, and low interest rates all contributed to the heavy pace of borrowing. Borrowing was strongest in the second quarter of the year, as governments took advantage of the extraordinarily low longer-term rates to fund capital expenditures and to advance refund existing higher-cost debt. Because of the financial stresses facing these governments, the credit ratings of several states, most notably California, were lowered last year. Although bond downgrades outnumbered upgrades for the sector as a whole, the imbalance between the two was smaller than it was in 2002.

The External Sector

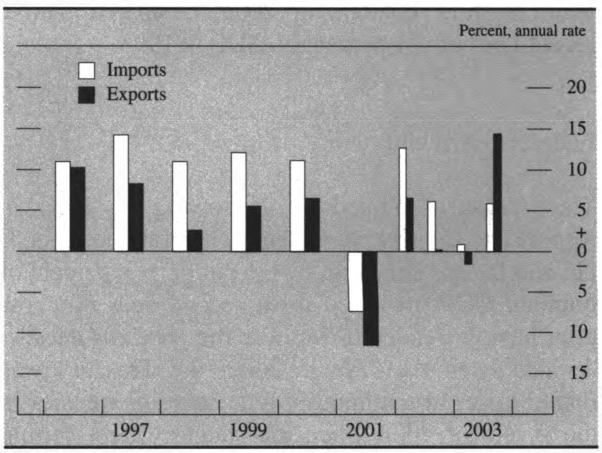
Over the first three quarters of 2003, the U.S. current account deficit widened relative to the comparable period in 2002, a move largely reflecting developments in the deficit on trade in goods and services. Net investment income rose over the same period, as receipts from abroad increased and payments to foreign investors in the United States declined.

International Trade

The trade deficit widened considerably in the first half of 2003 but narrowed slightly in the third quarter, as the value of exports rebounded in response to strengthening foreign economic activity and the depreciation of the dollar. Available trade data through November suggest that the trade deficit narrowed further in the fourth quarter, as an additional strong increase in exports outweighed an increase in imports.

Real exports of goods and services increased about 6 percent in 2003. Exports of services rose about

Change in real imports and exports of goods and services

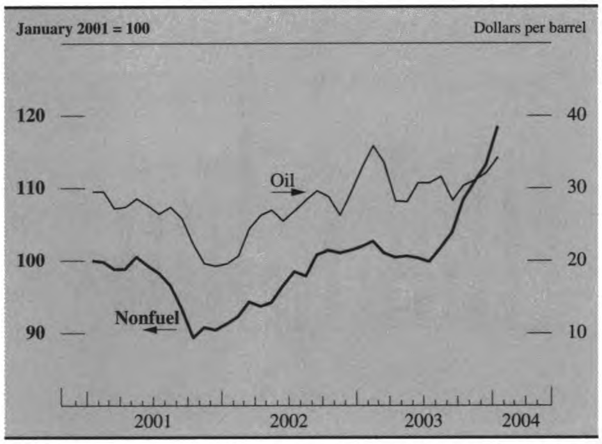


5 percent. They were held down early in the year by a drop in receipts from foreign travelers, owing to the effects of the SARS (severe acute respiratory syndrome) epidemic and the war in Iraq; services exports rebounded strongly later in the year as those concerns receded. Exports of goods rose about 6¾ percent over the course of the year—considerably faster than in 2002. Exports increased in all major end-use categories of trade, with particularly strong gains in capital goods and consumer goods. Reflecting the global recovery in the high-tech sector, exports of computers and semiconductors picked up markedly in 2003, particularly in the second half. By geographic area, exports of goods increased to Western Europe, Canada, and, particularly, to developing countries in East Asia—a region where economic activity expanded at a rapid pace last year. Prices of exported goods rose in 2003, with prices of agricultural exports recording particularly large increases. In response to poor crops and strong demand, prices for cotton and soybeans increased sharply. For beef, disruptions in supply led to notably higher prices through much of 2003. Beef prices, however, fell back in late December after a case of mad cow disease was discovered in the state of Washington and most countries imposed bans on beef imports from the United States.

Real imports of goods and services rose about 3½ percent in 2003. Imports of services fell in the first half of the year but bounced back in the second half, as concerns about the SARS epidemic and the war in Iraq came and went; for the year as a whole, real imports of services were about unchanged from the previous year. Real imports of goods expanded about 4 percent in response to the strengthening of U.S. demand, but the pattern was choppy, with large gains in the second and fourth quarters partially offset by declines in the first and third. Despite a surge in the second quarter, the volume of oil imports increased modestly, on balance, over the course of the year. Real non-oil imports were up about 4½ percent, with the largest increases in capital goods and consumer goods. Imports of computers posted solid gains, whereas imports of semiconductors were flat.

Despite a substantial decline in the value of the dollar, the prices of imported non-oil goods rose only moderately in 2003. By category, the prices of consumer goods were unchanged last year, and prices of capital goods excluding aircraft, computers, and semiconductors increased only a little more than 1 percent. Price increases were larger for industrial supplies. The price of imported natural gas spiked in March and rose again late in the year; these fluctuations were large enough to show through to the overall price index for imported goods. At year-end, prices of industrial metals rose sharply, with the spot price of copper reaching the highest level in six and one-half years. The strength in metals and other commodity prices has been attributed, at least in part, to depreciation of the dollar and strong global demand, particularly from China.

Prices of oil and of nonfuel commodities



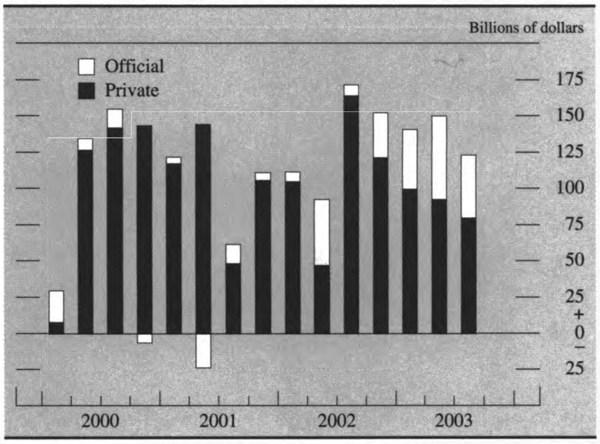
NOTE. The data are monthly and extend through January 2004. The oil price is the spot price of West Texas intermediate crude oil. The price of nonfuel commodities is a weighted average of thirty-nine primary-commodity prices from the International Monetary Fund.

In 2003, the spot price of West Texas intermediate (WTI) crude oil averaged more than $31 per barrel—the highest annual average since the early 1980s. The spot price of oil began to rise at the end of 2002 when ethnic unrest in Nigeria and a nationwide strike in Venezuela sharply limited oil supplies from those two countries. In the first quarter of 2003, geopolitical uncertainty in the period leading up to the war in Iraq also added upward pressure on oil prices. On March 12, the spot price of WTI closed at $37.83 per barrel, the highest level since the Gulf War in 1990. When the main Iraqi oil fields had been secured and it became apparent that the risks to oil supplies had subsided, the spot price of WTI fell sharply to a low of $25.23 per barrel on April 29. However, oil prices began rising again when, because of difficult security conditions, the recovery of oil exports from Iraq was slower than expected. Prices also were boosted in September by the surprise reduction in OPEC's production target. In the fourth quarter of 2003 and early 2004, strengthening economic activity, falling oil inventories, and the continued depreciation of the dollar contributed to a further run-up in oil prices.

The Financial Account

The financing counterpart to the current account deficit experienced a sizable shift in 2003, as net private

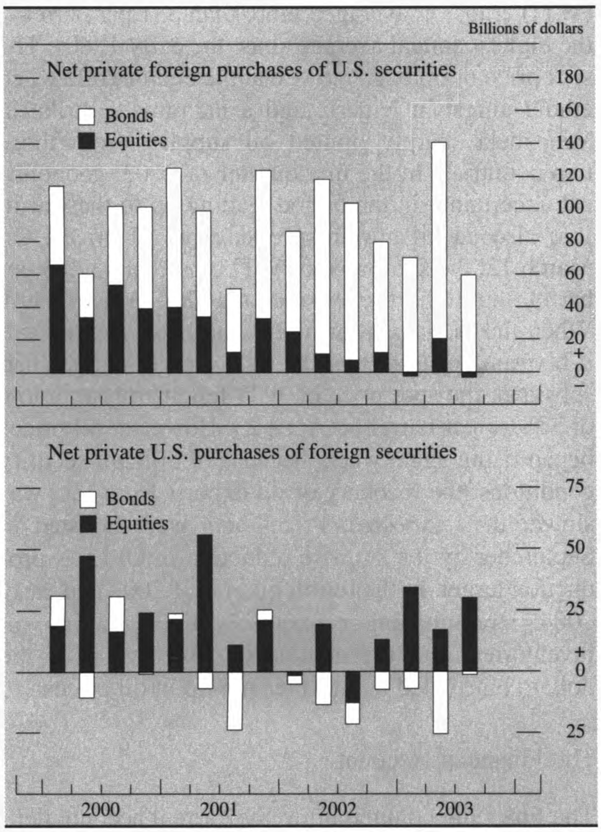
U.S. net financial inflows



SOURCE. Department of Commerce.

inflows fell while foreign official inflows increased. Private foreign purchases of U.S. securities were at an annual rate of about $350 billion through November, about $50 billion lower than in the previous year. Private foreign purchases of U.S. equities continued to recede, and, although the level of bond purchases was little changed in the aggregate, foreign purchases

U.S. net international securities transactions



SOURCE. Department of Commerce and the Federal Reserve Board.

shifted somewhat away from agency bonds and toward corporate bonds. Over the same period, purchases by private U.S. investors of foreign securities increased nearly $80 billion. Accordingly, net inflows through private securities transactions decreased markedly. In contrast, foreign official purchases of U.S. assets surged to record levels in 2003, with the accumulation of dollar reserves particularly high in China and Japan.

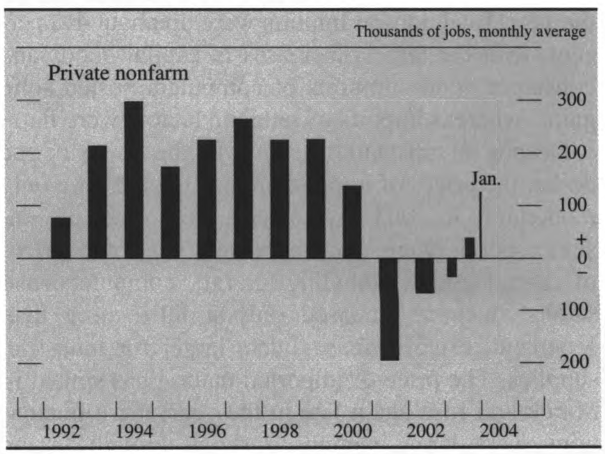
Compared with the pace in 2002, foreign direct investment in the United States increased, as merger activity picked up and corporate profits improved. U.S. direct investment abroad held relatively steady at a high level that was largely the result of continued retained earnings. On net, foreign direct investment outflows fell about $50 billion through the first three quarters of 2003.

The Labor Market

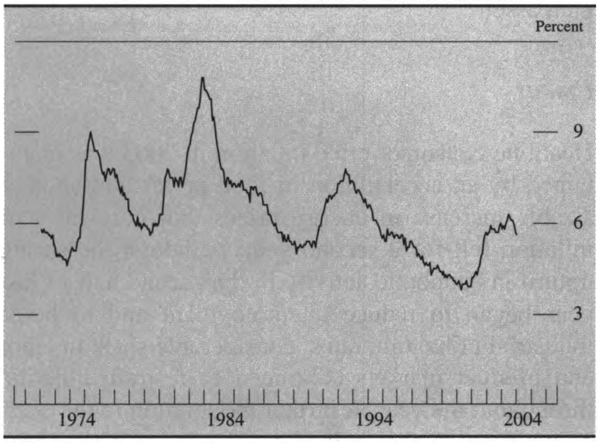
Employment and Unemployment

With economic activity still sluggish during the first half of 2003, the labor market continued to weaken. Over the first eight months of the year, private nonfarm payroll employment fell, on average, more than 35,000 per month, extending the prolonged period of cutbacks that began in early 2001. The civilian unemployment rate, which had hovered around 5¾ percent for much of 2002, moved up to 6¼ percent by June. However, by late in the summer, the labor market began to recover slowly. Declines in private payrolls gave way to moderate increases in employment; over the five months ending in January, private nonfarm establishments added, on average, about 85,000 jobs per month. By January, the unemployment rate moved back down to 5.6 percent.

Net change in payroll employment



Civilian unemployment rate



NOTE. The data are monthly and extend through January 2004.

During the late summer and early fall, prospects for business sales and production brightened, and firms began to lay off fewer workers. Initial claims for unemployment insurance dropped back, and the monthly Current Population Survey (CPS) of households reported a decline in the number of workers who had lost their last job. However, for many unemployed workers, jobs continued to be difficult to find, and the number of unemployed who had been out of work for twenty-seven weeks or more remained persistently high. The labor force participation rate, which tends to be sensitive to workers' perceptions of the strength of labor demand, drifted lower. Although the CPS indicated a somewhat greater improvement in employment than the payroll report—even after adjusting for conceptual differences between the two measures—the increase in household employment lagged the rise in the working-age population, and the ratio of employment to population fell further during 2003.

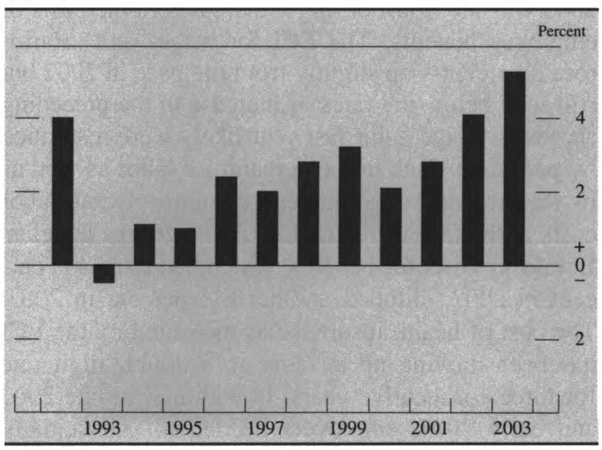
The modest upturn in private payroll employment that began in September was marked by a step-up in hiring at businesses supplying professional, business, and education services, and medical services continued to add jobs. Employment in both the construction industry and the real estate industry rose further, although the number of jobs in related financial services dropped back a bit as mortgage refinancing activity slackened. At the same time, although manufacturers were still laying off workers, the monthly declines in factory employment became smaller and less widespread than earlier. Employment stabilized in many industries that produce durable goods, such as metals, furniture, and wood products, as well as in a number of related industries that store and transport goods. In several other areas, employment remained weak. Manufacturers of nondurables, such as chemicals, paper, apparel, and textiles, continued to cut jobs. Employment in retail trade remained, on net, little changed.

Productivity and Labor Costs

Business efforts to increase efficiency and control costs led to another impressive gain in labor productivity last year. Output per hour in the nonfarm business sector surged 5¼ percent in 2003 after having risen a robust 4 percent in 2002 and 2¾ percent in 2001. What is particularly remarkable about this period is that productivity did not decelerate significantly when output declined in 2001, and it posted persistently strong gains while the recovery in aggregate demand was sluggish. Typically, the outsized increases in productivity that have occurred during cyclical recoveries have followed a period of declines or very weak increases in productivity during the recession and have been associated with rebounds in economic activity that were stronger than has been the case, until recently, in this expansion.

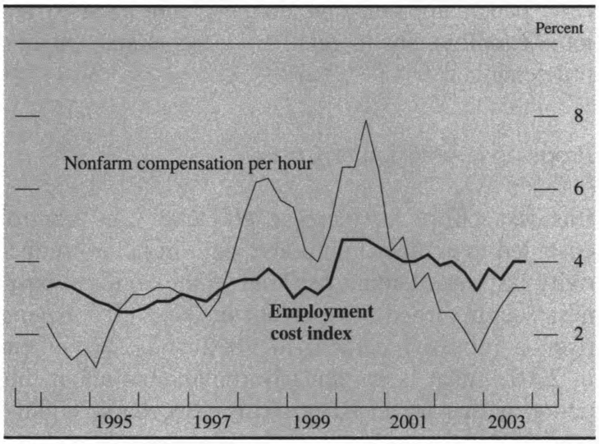
On balance, since the business cycle peak in early 2001, output per hour has risen at an average annual rate of 4 percent—noticeably above the average increase of 2½ percent that prevailed between 1996 and 2000. In the earlier period, an expansion of the capital stock was an important element in boosting the efficiency of workers and their firms; that impetus to productivity has weakened in the recent period as a result of the steep cutbacks in business investment in 2001 and 2002. Instead, the recent gains appear to be grounded in organizational changes and innovations in the use of existing resources—which are referred to as multifactor productivity. The persistence of a

Change in output per hour



NOTE. Nonfarm business sector.

Measures of change in hourly compensation



NOTE. The data are quarterly and extend through 2003:Q4. For nonfarm compensation, change is over four quarters; for the employment cost index (ECI), change is over the twelve months ending in the last month of each quarter. Nonfarm compensation is for the nonfarm business sector; the ECI is for private industry excluding farm and household workers.

rapid rise in multifactor productivity in recent years, along with signs of a pickup in capital spending, suggests that part of the step-up in the rate of increase of labor productivity may be sustained for some time.

In 2003, the employment cost index (ECI) for private nonfarm businesses, which is based on a survey conducted quarterly by the Bureau of Labor Statistics, rose 4 percent—about ¾ percentage point more than the increase in 2002. Compensation per hour in the nonfarm business sector, which is based on data constructed for the NIPA, is estimated to have increased 3¼ percent in 2003, up from 1½ percent in 2002. In recent years, the NIPA-derived series has shown much wider fluctuations in hourly compensation than the ECI, in part because it includes the value of stock option exercises, which are excluded from the ECI. The value of options exercised shot up in 2000 and then dropped over the next two years.

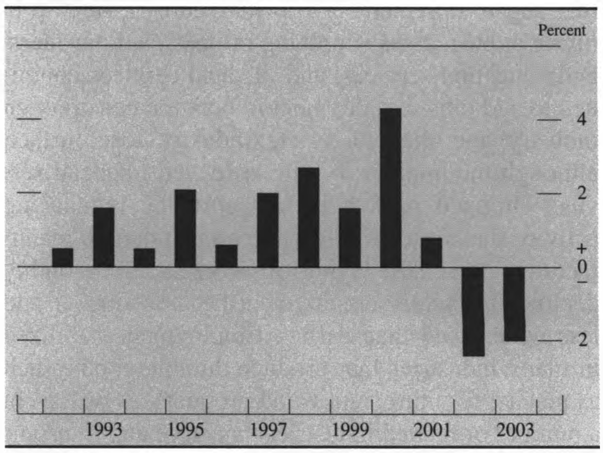
Most of the acceleration in hourly compensation in 2003 was the result of larger increases in the costs of employee benefits. The ECI for wages and salaries rose 3 percent—up slightly from the pace in 2002 but still well below the rates of increase in the preceding six years. Wage gains last year likely were restrained by persistent slack in the demand for labor as well as by the pressure on employers to control overall labor costs in the face of the rapidly rising cost of benefits. Employer costs for benefits, which had risen 4¾ percent in 2002, climbed another 6½ percent in 2003. The cost of health insurance as measured by the ECI has been moving up at close to a double-digit rate for three consecutive years. In addition, in late 2002 and early 2003, employers needed to substantially boost their contributions to defined-benefit retirement plans to cover the declines in the market value of plan assets.

Prices

Headline consumer price inflation in 2003 was maintained by an acceleration in food prices and another sizable increase in energy prices, but core rates of inflation fell for a second year. Although the strong upturn in economic activity in the second half of last year began to reduce unemployment and to boost industrial utilization rates, considerable slack in labor and product markets continued to restrain inflation throughout the year. A further moderation in the costs of production also helped to check inflation: As a result of another rapid rise in productivity, businesses saw their unit labor costs decline in 2003 for a second consecutive year. In contrast, prices for imported goods excluding petroleum, computers, and semiconductors increased at about the same rate as prices more generally; between 1996 and 2002, these import prices fell relative to overall prices for personal consumption expenditures (PCE). The chain-type price index for PCE excluding food and energy rose just under 1 percent in 2003, about ¾ percentage point less than in 2002. A broader measure of inflation, the chain-type price index for GDP, increased 1½ percent in 2003, the same slow pace as in 2002. Both measures of inflation were roughly a percentage point lower than in 2001.

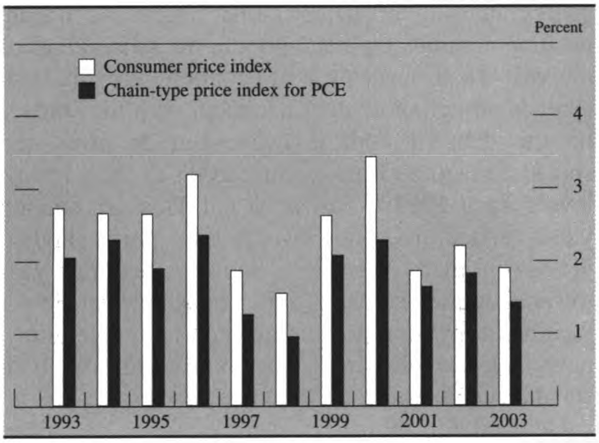
Consumer energy prices fluctuated widely over the four quarters of 2003, and the PCE index for energy was up 7¼ percent over the period. In the first quarter of the year, the combination of a further rise in the cost of crude oil, increased wholesale margins for gasoline, and unusually tight supplies of natural

Change in unit labor costs



NOTE. Nonfarm business sector.

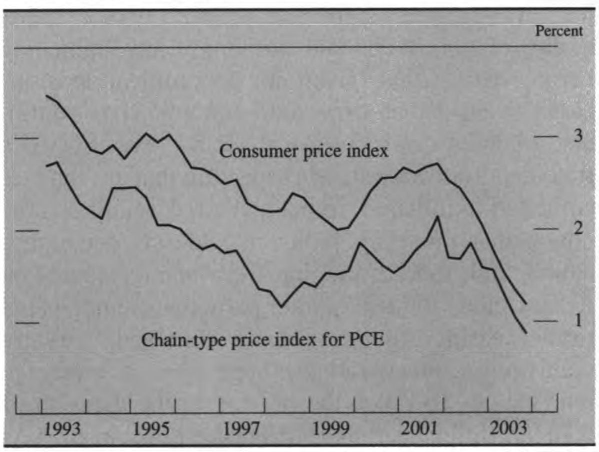
Change in consumer prices



gas pushed up consumer energy prices sharply. Although the prices of petroleum-based products turned down when the price of crude oil fell back in March, a number of supply disruptions in late summer resulted in another temporary run-up in the retail price of gasoline. In the spring, the price of natural gas began to ease as supplies improved, but it remained high relative to the level in recent years. Electricity prices also moved up during 2003, in part because of the higher input costs of natural gas. In January 2004, a cold wave in the Northeast, together with the rise in the price of crude oil since early December, once again led to spikes in the prices of gasoline and natural gas.

The PCE price index for food and beverages increased 2¾ percent in 2003 after having risen just 1¼ percent a year earlier. Much of the acceleration can be traced to strong demand for farm products, but prices paid by consumers for food away from home—which depend much more heavily on the cost of labor than on prices of food products—were up 3 percent in 2003, also somewhat more than overall consumer price inflation. Poor harvests abroad, especially in Europe, contributed importantly to the heightened demand for U.S. farm products. Thus, despite a bumper crop of corn and some other grains in the United States, world stocks were tight and prices remained high. In addition, the U.S. soybean crop was crimped by late-season heat and dryness, which further tightened world supplies. Concerns about the cases of mad cow disease that were identified in herds in Japan and Canada supported strong domestic and export demand for U.S. beef for most of last year while supplies edged down. But, at year-end, when a case of mad cow disease was discovered in a domestic herd, export demand for U.S. beef plunged and drove the price of live cattle down sharply. A portion of the drop in cattle prices likely will show through to consumer prices for beef early this year.

Change in consumer prices excluding food and energy



NOTE. Change is over four quarters, and the data extend through 2003:Q4.

The decline in core inflation in 2003 was broadly based. Prices of core consumer goods fell somewhat faster than a year earlier; the declines were led by larger cuts in prices of apparel, motor vehicles, electronic equipment, and a variety of other durable goods. At the same time, prices of non-energy services rose less rapidly. The deceleration in core consumer prices measured by the CPI is somewhat greater than that measured by the PCE index. In each index, the costs of housing services to tenants and owners rose less in 2003 than in 2002, but because these costs receive a larger weight in the CPI, their slowing contributed a greater amount to the CPI's deceleration. In addition, the different measurement of the prices of medical services in the two series contributed to the smaller deceleration in non-energy services in the PCE. The medical services component of the CPI, which measures out-of-pocket expenses paid by consumers, increased 4 percent in 2003, down from 5½ percent a year earlier. Alternatively, the PCE for medical services is a broader measure that uses producer price indexes (PPI) to capture the costs of services provided by hospitals and doctors; it continued to increase more slowly than the CPI for medical services last year, 3¼ percent, but it was up slightly from its increase of 2½ percent in 2002.

Survey measures of expected inflation were little changed, on balance, in 2003. According to the Federal Reserve Bank of Philadelphia's survey of professional forecasters, expectations for CPI inflation ten years ahead remained at 2½ percent last year. As measured by the Michigan Survey Research Center survey of households, median five- to ten-year inflation expectations, which averaged 3 percent in 2001, were steady at 2¾ percent in 2003 for a second

Alternative measures of price change
Percent

Price measure	2001	2002	2003
Chain-type			
Gross domestic product	2.4	1.4	1.5
Gross domestic purchases	1.6	1.7	1.6
Personal consumption expenditures	1.6	1.8	1.4
Excluding food and energy	2.1	1.6	.9
Chained CPI	1.5	1.8	1.4
Excluding food and energy	2.1	1.6	.6
Fixed-weight			
Consumer price index	1.8	2.2	1.9
Excluding food and energy	2.7	2.1	1.2

NOTE. Changes are based on quarterly averages and are measured to the fourth quarter of the year indicated from the fourth quarter of the preceding year.

consecutive year. Inflation compensation as measured by the spread between the yield on nominal Treasury securities and their indexed counterparts varied over a wide range in 2003, settling at just under 2½ percent at year-end. Shorter-term inflation expectations also posted some wide swings during 2003; year-ahead expectations in the Michigan SRC survey spiked early in the year with the sharp increase in energy prices and dipped briefly to an unusually low level at midyear as actual inflation eased in response to lower energy prices. However, year-ahead inflation expectations settled back to just over 2½ percent at the end of the year, about the same as at the end of 2002.

The PPI for crude materials excluding food and energy products, which had dropped 10 percent in 2001, rose 11¾ percent in 2002 and another 17½ percent in 2003. The upswing was driven by the pickup in demand associated with the acceleration in both domestic and worldwide industrial activity and by the pass-through of higher energy costs. Such wide cyclical swings in commodity prices have only a small effect on movements in the prices of intermediate and finished goods. At later stages of production and distribution, commodity costs represent only a small share of overall costs, and some portion of the change in commodity prices tends to be absorbed in firms' profit margins. Thus, the recent pickup in prices at the intermediate stage of processing has been more muted; after having fallen almost 1½ percent in 2001, the PPI for core intermediate materials rose 1¼ percent in 2002 and 2 percent in 2003.

U.S. Financial Markets

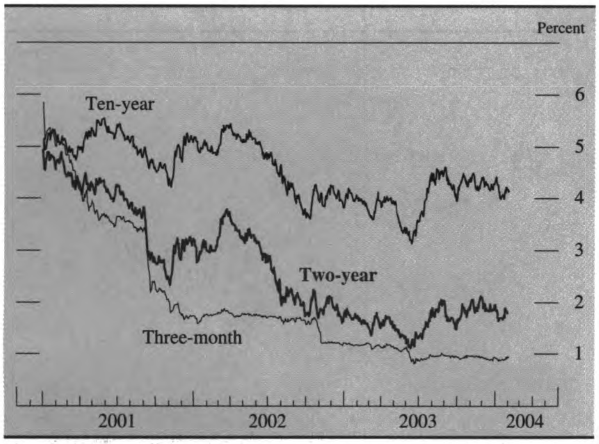
On balance, financial market conditions became increasingly supportive of growth over 2003 as investors became more assured that the economy was on solid footing. Equity prices marched up after the first quarter of the year in response to the initiation and swift conclusion of major combat operations in Iraq, positive earnings reports, and—in the second half of the year—a stronger pace of economic growth. Risk spreads on corporate debt declined, with the spreads on the debt of both investment-grade firms and speculative-grade firms ending 2003 at their lowest levels since 1998. Thus, although Treasury coupon yields ended the year 30–40 basis points higher, yields on many corporate bonds ended the year lower. Commercial banks appeared somewhat slower than bond investors to lend at more favorable terms; nevertheless, by late in the year, banks had eased both standards and terms on C&I loans.

Demand for short-term debt, however, remained very weak, and business loans and outstanding commercial paper continued to run off. In response to a widening budget deficit and a rapid expansion of federal debt, the Treasury increased the frequency of its debt auctions. Declines in mortgage interest rates over the first half of the year led to an extraordinary increase in mortgage debt, as originations for home purchase and for refinancings both climbed to record levels.

Interest Rates

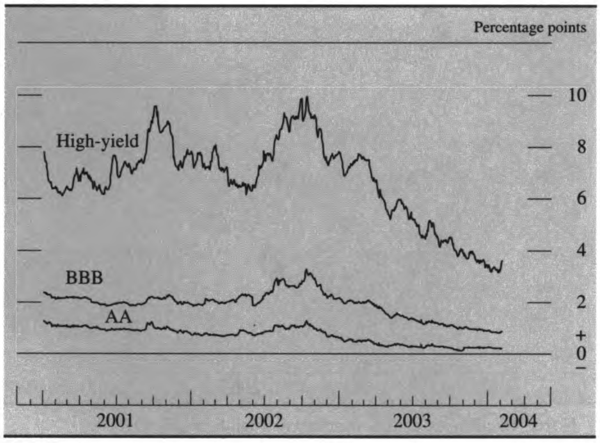
Interest rates fell for most of the first half of 2003, primarily in response to continuing weak economic data and an associated marking down of expectations for the federal funds rate. Global uncertainty ran high, particularly surrounding the timing of military intervention in Iraq, which elevated safe-haven demands and depressed yields on Treasury securities. Moreover, the weak March employment report and other disappointing news about economic activity seemed to cause a substantial shift in views about monetary policy. Data from the federal funds futures market suggested a significant probability of a further easing of policy and did not imply any tightening before early 2004. Even as geopolitical tensions eased, weaker-than-expected economic data continued to hold down Treasury yields. The FOMC's statement following its May meeting that an "unwelcome fall in inflation" remained a risk reinforced the notion that monetary policy would stay accommodative, and, indeed, judging from market quotes on federal funds futures, market participants anticipated further easing. Mortgage rates followed Treasury yields lower, precipitating a huge surge of mortgage refinancing. To offset the decline in the duration of their portfolios stemming from the jump in prepayments, mortgage investors reportedly bought large

Interest rates on selected Treasury securities



NOTE. The data are daily and extend through February 4, 2004.

Spreads of corporate bond yields over the ten-year Treasury yield

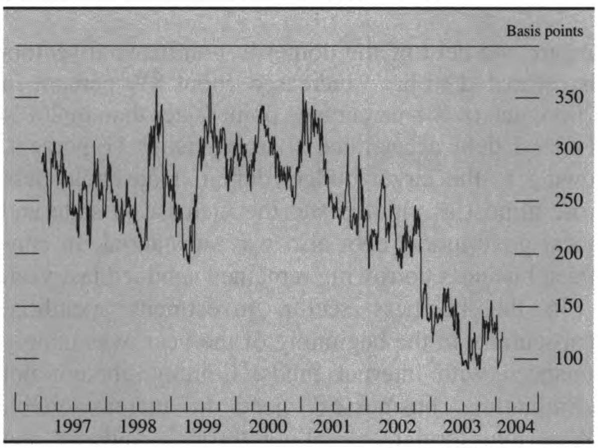


NOTE. The data are daily and extend through February 4, 2004. The spreads compare the yields on the Merrill Lynch AA, BBB, and 175 high-yield indexes with the yield on the ten-year off-the-run Treasury note.

quantities of longer-dated Treasuries, amplifying the fall in yields. Interest rates on corporate bonds also declined in the first half of the year, prompting many firms to issue long-term debt to pay down other, more expensive forms of debt and build up cash assets. Growing confidence that the frequency and severity of corporate accounting scandals were waning likely contributed to the narrowing in risk spreads. By the end of spring, default rates on corporate bonds had begun to decline, and corporate credit quality appeared to stabilize.

By the time of the June FOMC meeting, federal funds futures data implied that market participants had generally come to expect an aggressive reduction in the target federal funds rate, so the Committee's decision to lower the target rate by only 25 basis points came as a surprise to some. In addition, some investors were reportedly disappointed that the statement following this meeting included no mention of "unconventional" monetary policy actions that would be aimed at lowering longer-term yields more directly than through changes in the federal funds rate target alone. As a result, market interest rates backed up, with the move probably amplified by the unwinding of mortgage-related hedging activity. The Chairman's monetary policy testimony in July, and the FOMC's statements at subsequent meetings that noted that policy could remain accommodative for "a considerable period," apparently provided an anchor for the front end of the yield curve. At the same time, increasingly positive economic reports bolstered confidence in the markets, and longer-dated Treasury securities ended the year about 40 basis points above their year-earlier levels. But, with the expansion evidently gaining traction and investors becoming more willing to take on risk, corporate risk spreads, particularly those on speculative-grade issues, continued to fall over the second half of the year. Treasury yields fell early in 2004, largely in response to the weaker-than-expected December labor market report. After the release of the Committee's statement following its January meeting, Treasury yields backed up a bit as futures market prices implied an expectation of an earlier onset of tightening than had been previously anticipated.

Implied volatility of short-term interest rates

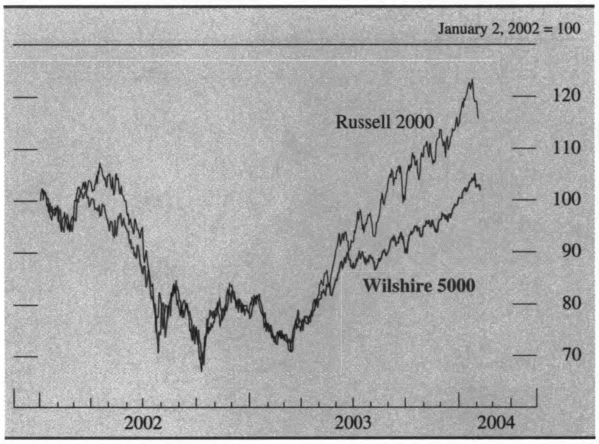


NOTE. The data are daily and extend through February 4, 2004. The series shown is the implied volatility of the three-month eurodollar rate over the coming four months, as calculated from option prices.

Equity Markets

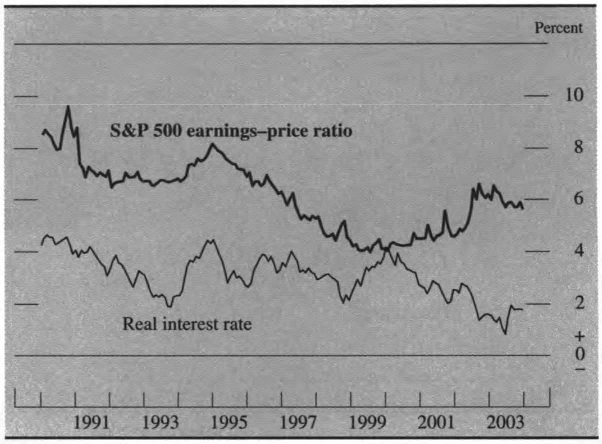
Broad equity price indexes ended the year 25 percent to 30 percent higher. Early in the year, stock prices were buffeted by mixed news about the pace of

Major stock price indexes



NOTE. The data are daily and extend through February 4, 2004.

S&P 500 forward earnings–price ratio and the real interest rate

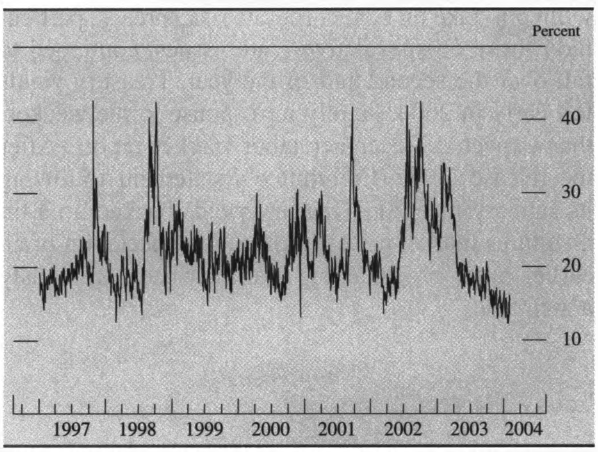


NOTE. The data are monthly and extend through December 2003. The forward earnings–price ratio is based on I/B/E/S consensus estimates of earnings over the coming year. The real interest rate is estimated as the difference between the ten-year Treasury rate and the expected ten-year inflation rate reported in the survey by the Federal Reserve Bank of Philadelphia.

economic expansion and by heightened geopolitical tensions. Rising oil prices boosted the shares of energy companies very early in the year while, by and large, stocks in other sectors were stumbling. By spring, however, positive news on corporate earnings—often exceeding expectations—and easing of geopolitical tensions associated with the initiation of military action in Iraq boosted equity prices significantly. Subsequently, the swift end to major combat operations in Iraq caused implied volatility on the S&P 500 index to fall substantially. Over the rest of the year, increasingly positive earnings results contributed to a sustained rally in stock prices, and implied volatility in equity markets fell further. Corporate scandals—albeit on a smaller scale than in previous years—continued to emerge in 2003, but these revelations appeared to leave little lasting imprint on broad measures of stock prices. For the year as a whole, the Russell 2000 index of small-cap stocks and the technology-laden Nasdaq composite index, which rose 45 percent and 50 percent, respectively, noticeably outpaced broader indexes. To date in 2004, equity markets have continued to rally.

With the sustained rise in stock prices, the ratio of expected year-ahead earnings to stock prices for firms in the S&P 500 edged down over 2003. The gap between this ratio and the real ten-year Treasury yield—a crude measure of the equity risk premium—narrowed a bit over the course of the year, though it remains in the upper part of the range observed over the past two decades.

Implied S&P 500 volatility



NOTE. The data are daily and extend through February 4, 2004. The series shown is the implied volatility of the S&P 500 stock price index as calculated from the prices of options that expire over the next several months.

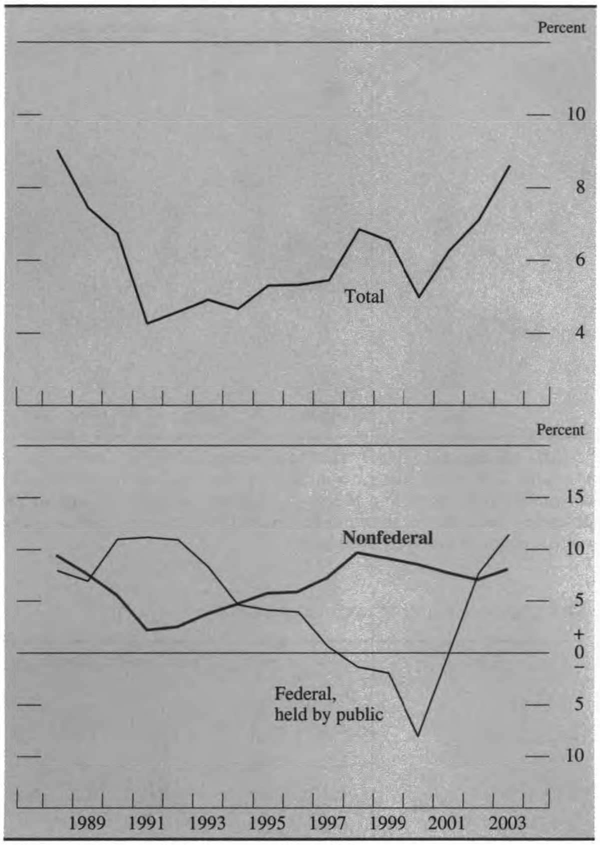
SOURCE. Chicago Board Options Exchange.

Debt and Financial Intermediation

Aggregate debt of the domestic nonfinancial sectors is estimated to have increased about 8¼ percent in 2003, just over a percentage point faster than in 2002. Federal debt accelerated sharply, rising 11 percent, owing to the larger budget deficit. Household debt rose almost as rapidly, and the increase in state and local government debt also was substantial. In contrast, business borrowing remained subdued last year.

In the business sector, investment spending, particularly in the beginning of the year, was mainly financed with internal funds, limiting, though not eliminating, businesses' need to increase debt. With long-term rates falling through midyear and credit spreads—especially for riskier borrowers—narrowing, corporate treasurers shifted their debt

Change in domestic nonfinancial debt

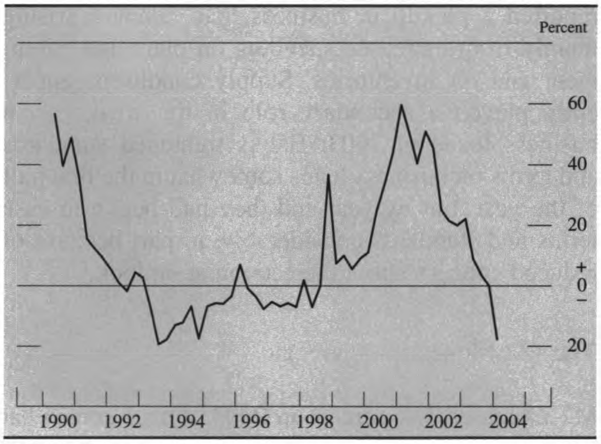


NOTE. For 2003, change is from 2002:Q4 to 2003:Q3 at an annual rate. For earlier years, the data are annual and are computed by dividing the annual flow for a given year by the level at the end of the preceding year. The total consists of nonfederal debt and federal debt held by the public. Nonfederal debt consists of the outstanding credit market debt of state and local governments, households, nonprofit organizations, and nonfinancial businesses. Federal debt held by the public excludes securities held as investments of federal government accounts.

issuance toward bond financing and away from shorter-term debt. Household borrowing also shifted in response to lower longer-term rates. Mortgage rates followed Treasury rates lower in the spring, and mortgage originations for both home purchases and refinancings surged. Refinancing activity appears to have held down growth of consumer credit as households extracted equity from their homes and used the proceeds, in part, to pay down higher-cost consumer debt. Nevertheless, consumer credit posted a moderate advance in 2003, buoyed by heavy spending on autos and other durables. A substantial widening of the federal deficit forced the Treasury to increase its borrowing significantly. To facilitate the pickup in borrowing, the Treasury altered its auction cycle to increase the frequency of certain issues and reintroduced the three-year note.

Depository credit rose 6 percent in 2003 and was driven by mortgage lending and the acquisition of

Net percentage of domestic banks tightening standards on commercial and industrial loans to large and medium-sized firms

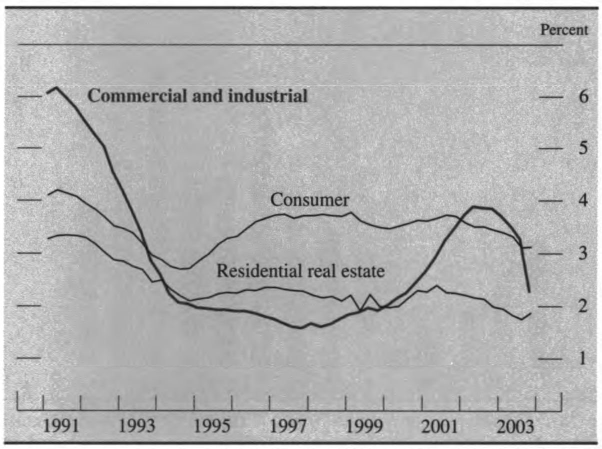


NOTE. The data are based on a survey generally conducted four times per year; the last reading is from the January 2004 survey. Large and medium-sized firms are those with annual sales of $50 million or more. Net percentage is the percentage reporting a tightening less the percentage reporting an easing.

SOURCE. Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices.

mortgage-backed securities by both banks and thrift institutions. Consumer lending also was substantial, as lower interest rates and auto incentives spurred spending on durable goods. In contrast, business loans fell 7¼ percent over 2003, a drop similar to the runoff in 2002. Survey evidence suggests that the decline in business lending at banks was primarily the result of decreased demand for these loans, with respondent banks often citing weak investment and inventory spending. Moreover, the contraction was concentrated at large banks, whose customers tend to be larger corporations that have access to bond mar-

Delinquency rates on selected types of loans at banks



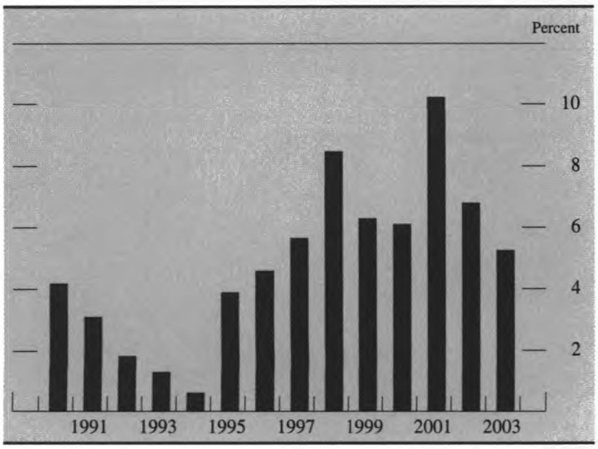
NOTE. The data, from bank Call Reports, are quarterly, seasonally adjusted, and extend through 2003:Q4.

kets, and the proceeds of bond issuance were apparently used, in part, to pay down bank loans. The January 2004 Senior Loan Officer Opinion Survey reported a pickup in business loan demand arising mainly from increased spending on plant and equipment and on inventories. Supply conditions apparently played a secondary role in the weakness in business loans in 2003. Banks tightened standards and terms on business loans somewhat in the first half of the year, but by year-end they had begun to ease terms and standards considerably, in part because of reduced concern about the economic outlook.

The M2 Monetary Aggregate

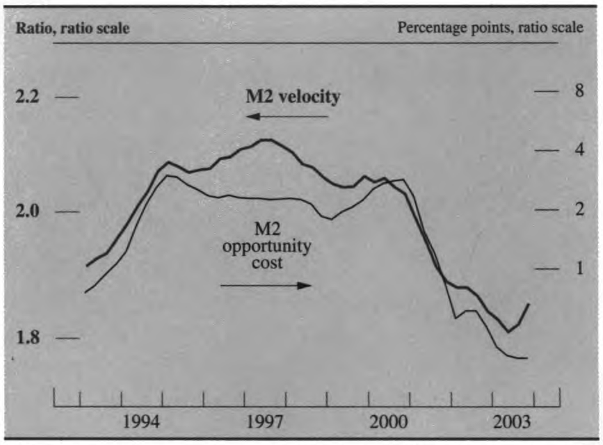
M2 increased 5¼ percent in 2003, a pace somewhat slower than in 2002 and a bit below the rate of expansion of nominal income. The deceleration in M2 largely reflected a considerable contraction in the final quarter of the year after three quarters of rapid growth. The robust growth in money around mid-year was concentrated in liquid deposits and likely resulted in large part from the wave of mortgage refinancings, which tend to boost M2 as the proceeds are temporarily placed in non-interest-bearing accounts pending disbursement to the holders of mortgage-backed securities. Moreover, around the middle of the year, the equity that was extracted from home values during refinancings probably provided an additional boost to deposits for a time, as households temporarily parked these funds in M2 accounts before paying down other debt or spending them. In the fourth quarter, M2 contracted at an annual rate of 2 percent, the largest quarterly decline since consistent data collection began in 1959. As mortgage rates backed up and the pace of refinancing slowed, the funds that had been swelling deposits flowed out, depressing M2. The sustained rally in equity markets after the first quarter of the year may also have slowed M2 growth, as expectations of continued higher returns led households to shift funds from M2 assets to equities, a view reinforced by the strong flows into equity mutual funds.

M2 growth rate



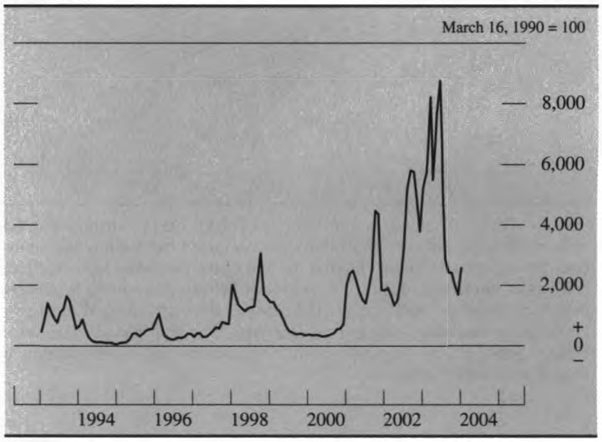
NOTE. M2 consists of currency, travelers checks, demand deposits, other checkable deposits, savings deposits (including money market deposit accounts), small-denomination time deposits, and balances in retail money market funds.

M2 velocity and opportunity cost



NOTE. The data are quarterly and extend through 2003:Q4. The velocity of M2 is the ratio of nominal gross domestic product to the stock of M2. The opportunity cost of holding M2 is a two-quarter moving average of the difference between the three-month Treasury bill rate and the weighted average return on assets included in M2.

Mortgage refinancing application index



NOTE. The data are monthly and extend through January 2004.
SOURCE. Mortgage Bankers Association.

International Developments

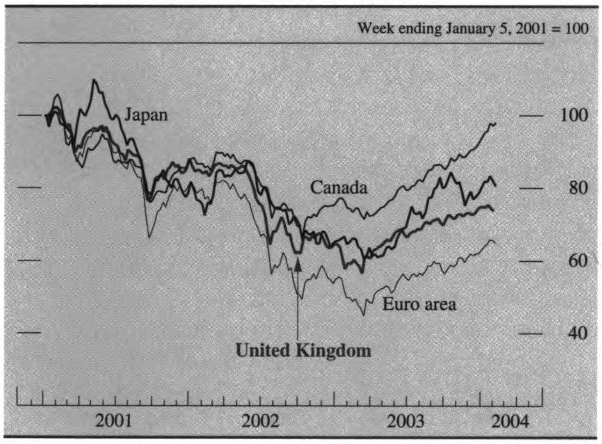
Economic growth abroad rebounded in the second half of last year as factors that weighed on the global economy in the first half—including the SARS epidemic and uncertainty surrounding the war in Iraq—dissipated. Foreign growth also was boosted by the strong rebound in the U.S. economy, the revival of the global high-tech sector, and, in many countries, ample policy stimulus.

Strong second-half growth in China stimulated activity in other emerging Asian economies and Japan by raising the demand for their exports. Growth in Japan also was spurred by a recovery in private spending there on capital goods. Economic activity in Europe picked up in the second half, as export growth resumed. Economic growth in Latin America has been less robust; the Mexican economic upturn has lagged that of the United States, and Brazil's economy has only recently begun to recover from the effects of its 2002 financial crisis.

Monetary authorities abroad generally eased their policies during the first half of 2003 as economic activity stagnated. In the second half, market participants began to build in expectations of eventual monetary tightening abroad, and official interest rates were raised by year-end in the United Kingdom and Australia. Canadian monetary policy followed a different pattern; the Bank of Canada raised official interest rates in the spring as inflation moved well above its 1 percent to 3 percent target range but cut rates later in the year and again early this year as slack emerged and inflation moderated. Similarly, lower inflation in Mexico and Brazil allowed authorities to ease monetary policy during 2003. The Bank of Japan maintained official interest rates near zero and continued to increase the monetary base.

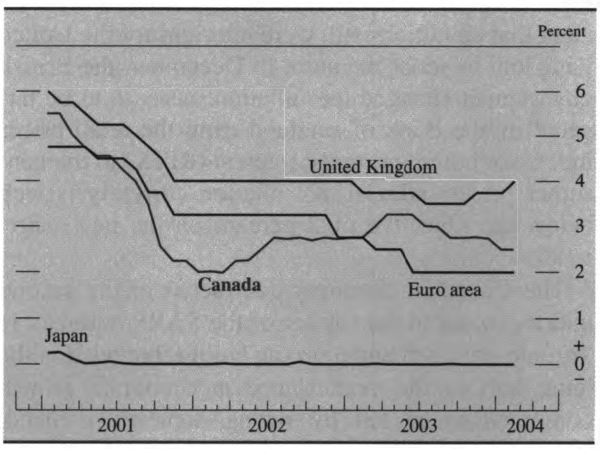
In foreign financial markets, equity prices fell, on average, until mid-March but since then have risen in reaction to indications of stronger-than-expected global economic activity. Emerging-market equity indexes outpaced those in the industrial countries in 2003, with markets in Latin America posting particularly strong gains. Around midyear, long-term interest rates declined to multiyear lows in many countries as economic growth slowed and inflationary pressures diminished, but those rates moved higher in the second half as growth prospects improved. Bond spreads came down substantially during the year, both for industrial-country corporate debt and for emerging-market sovereign debt; spreads of the J.P. Morgan Emerging Market Bond Index (EMBI+) over U.S. Treasury securities fell to their lowest levels since before the Russian crisis of 1998. Gross capital flows to emerging markets, however, remained well below their 1997 peak.

Equity indexes in selected foreign industrial countries



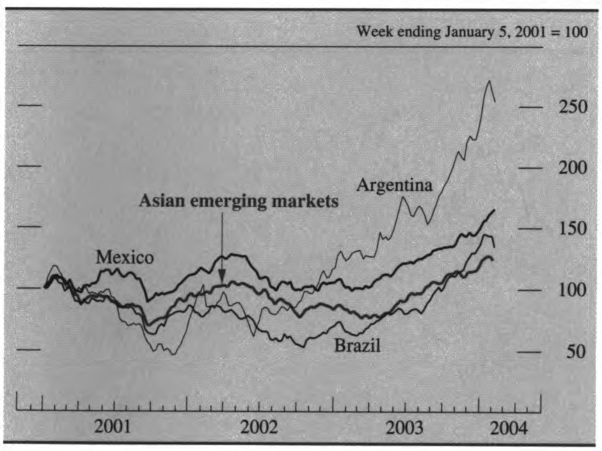
NOTE. The data are weekly. The last observations are the average of trading days through February 4, 2004.

Official interest rates in selected foreign industrial countries



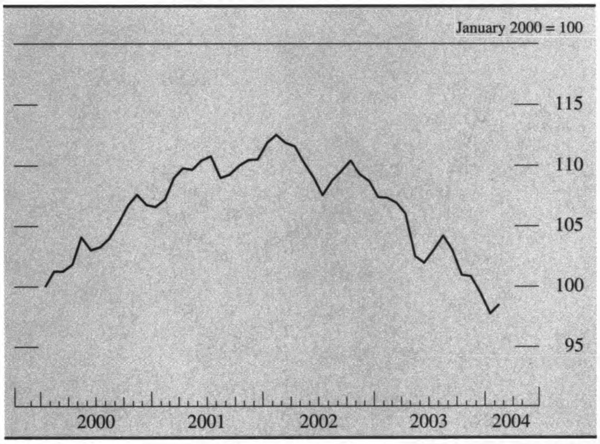
NOTE. The data are as of month-end; the last observations are for February 5, 2004, when the Bank of England raised its official rate. The data shown are the call money rate for Japan, the overnight rate for Canada, the refinancing rate for the euro area, and the repurchase rate for the United Kingdom.

Equity indexes in selected emerging markets



NOTE. The data are weekly. The last observations are the average of trading days through February 4, 2004. Asian emerging markets are China, Hong Kong, India, Indonesia, Malaysia, Pakistan, the Philippines, Singapore, South Korea, Taiwan, and Thailand.

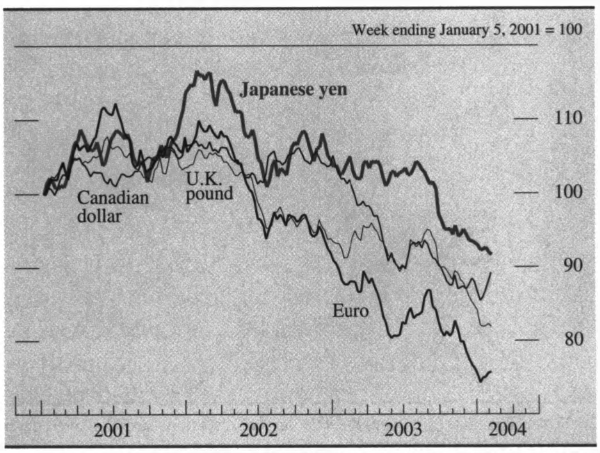
U.S. dollar nominal exchange rate, broad index



NOTE. The data are monthly and are in foreign currency units per dollar. The last observation is the average of trading days through February 4, 2004. The broad index is a weighted average of the foreign exchange values of the U.S. dollar against the currencies of a large group of major U.S. trading partners. The index weights, which change over time, are derived from U.S. export shares and from U.S. and foreign import shares.

The foreign exchange value of the dollar continued to decline last year as concerns over the financing of the large and growing U.S. current account deficit took on greater prominence. The dollar declined 18 percent against the Canadian dollar, 17 percent against the euro, and 10 percent against the British pound and the Japanese yen. In contrast, the value of the dollar was little changed, on net, against the currencies of our other important trading partners, in part because officials of China and of some other emerging Asian economies managed their exchange rates so as to maintain stability in terms of the dollar. Among Latin American currencies, the dollar declined against the Brazilian and Argentine currencies but appreciated against the Mexican peso. On balance, the dollar depreciated 9 percent during 2003 on a trade-weighted basis against the currencies of a broad group of U.S. trading partners.

U.S. dollar exchange rate against selected major currencies



NOTE. The data are weekly and are in foreign currency units per dollar. Last observations are the average of trading days through February 4, 2004.

Industrial Economies

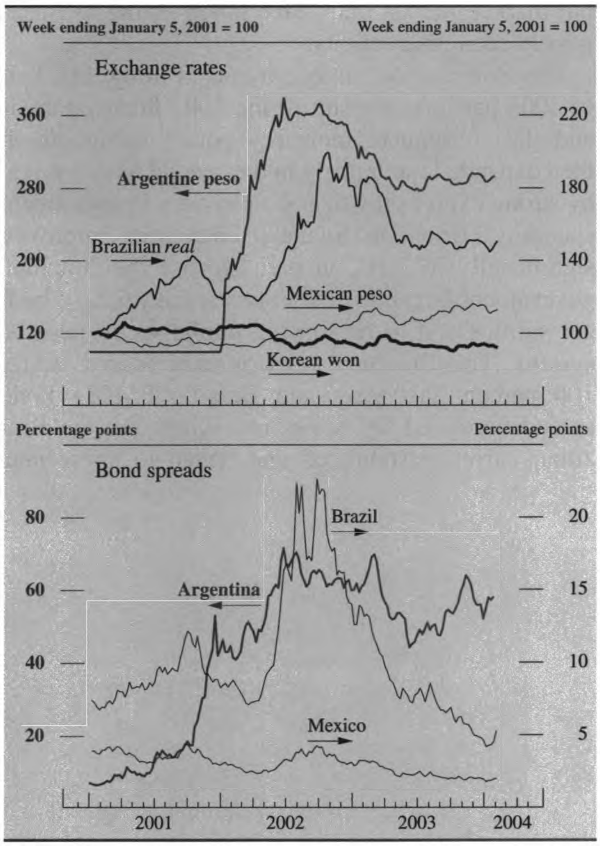
The euro-area economy contracted in the first half of 2003, weighed down in part by geopolitical uncertainty and higher oil prices. In the second half, economic activity in the euro area began to grow as the global pickup in activity spurred a recovery of euro-area exports despite the continued appreciation of the euro. The monetary policy of the European Central Bank (ECB) was supportive of growth, with the policy interest rate lowered to 2 percent by midyear. Consumer price inflation slowed to around 2 percent, the upper limit of the ECB's definition of price stability. Despite increased economic slack, inflation moved down only a little, partly because the summer drought boosted food prices. For the second straight year, the governments of Germany and France each recorded budget deficits in excess of the 3 percent deficit-to-GDP limit specified by the Stability and Growth Pact. However, in light of economic conditions, European Union finance ministers chose not to impose sanctions.

After a sluggish first quarter, the U.K. economy expanded at a solid pace for the remainder of 2003, supported by robust consumption spending and considerable government expenditure. The Bank of England cut rates in the first half of the year but reversed some of that easing later in the year and early this year as the economy picked up and housing prices continued to rise at a rapid, albeit slower, pace. In June, the British government announced its assessment that conditions still were not right for the United Kingdom to adopt the euro. In December, the British government changed the inflation measure to be targeted by the Bank of England from the retail prices index excluding mortgage interest (RPIX) to the consumer prices index. U.K. inflation currently is well below the objective of 2 percent on the new target index.

The Canadian economy contracted in the second quarter owing to the impact of the SARS outbreak in Toronto on travel and tourism, but it rebounded in the latter half of the year. Canadian economic growth continued to be led by strong domestic demand; consumption remained robust and investment spending accelerated, offsetting the negative effect of Canadian dollar appreciation on both exports and import-competing industries. Canadian consumer price inflation swung widely last year, rising to 4½ percent on a twelve-month basis in February before falling to 1½ percent in November and ending the year at 2 percent. The swing partly reflected movements in energy prices, but changes in auto insurance premiums and cigarette taxes also played an important role.

Japanese real GDP recorded significant growth in 2003 for the second straight year. Private investment spending made the largest contribution to the expansion. Consumer spending remained sluggish as labor market conditions continued to be soft. However, nominal wages stabilized following a sharp drop in 2002, and leading indicators of employment moved higher. Despite an appreciation of the yen late in the year, Japanese exports posted a strong increase in 2003 primarily because of gains in exports to China and other emerging Asian economies. With consumer prices continuing to decline, the Bank of Japan (BOJ) maintained its policy interest rate near zero and eased monetary policy several times during 2003 by increasing the target range for the outstanding balance of reserve accounts held by private financial institutions at the BOJ. The BOJ also took other initiatives last year to support the Japanese economy, including launching a program to purchase securities backed by the assets of small- and medium-sized enterprises. Japanese banks continued to be weighed down by large amounts of bad debt, but some progress was made in resolving problems of insufficient bank capital and in reducing bad-debt levels from their previous-year highs.

U.S. dollar exchange rates and bond spreads for selected emerging markets



NOTE. The data are weekly averages. Last observations are the average of trading days through February 4, 2004. Exchange rates (top panel) are in foreign currency units per dollar. Bond spreads (bottom panel) are the spreads of the J.P. Morgan Emerging Market Bond Index (EMBI+) over U.S. Treasury securities.

Emerging-Market Economies

Growth in the Asian developing economies rebounded sharply in the second half of 2003 after having contracted in the first half. The outbreak of SARS in China and its spread to other Asian economies was the primary factor depressing growth in the first half, and the subsequent recovery of retail sales and tourism after the epidemic was contained was an important factor in the sharp rebound. The pattern of Asian growth also reflected the sharp recovery of the global high-tech sector in the second half after a prolonged period of weakness. Exports continued to be the main engine of growth for the region. However, domestic demand contributed importantly to growth in China, where state-sector investment increased at a rapid clip and a boom in construction activity continued. Supply problems caused food prices and overall consumer prices in China to rise on a twelve-month basis last year, following a period of price deflation during the previous year. In addition, concerns emerged that some sectors of the Chinese economy, particularly the property markets in Beijing and Shanghai, may be overheating.

Korean economic growth turned negative in the first half, as the high level of household debt, labor unrest, and concerns over North Korea's nuclear development depressed private-sector spending. A sharp rise in exports spurred a revival of growth in the second half even as domestic demand remained subdued.

The Mexican economy remained sluggish through much of the year but recently has shown some signs of improvement. After lagging the rise in U.S. production, Mexican industrial production posted strong gains in October and November, although it remains well below the peak it reached in 2000. Exports rose late last year to almost the peak they had reached in 2000. Consumer price inflation came down over the course of 2003 to 4 percent, the upper bound of the 2 percent to 4 percent target range. The Bank of

Mexico has left policy unchanged since tightening five times between September 2002 and March 2003, but market interest rates have fallen owing to weakness in economic activity.

The Brazilian economy contracted in the first half of 2003 partly as a result of the 2002 financial crisis and the consequent monetary policy tightening. It then expanded moderately in the second half, boosted by strong export growth and a recovery in investment spending. Brazilian financial indicators improved significantly in 2003, in part because the Brazilian government began to run a substantial primary budget surplus and to reform the public-sector pension system. The Brazilian stock market soared nearly 100 percent last year, and Brazil's EMBI+ bond spread narrowed by nearly two-thirds. As the Brazilian currency stabilized and began to appreciate, Brazil's inflation outlook improved, allowing the central bank to reverse fully its earlier rate hikes and to reduce the overnight interest rate to a multi-year low, although real interest rates remained high.

The Argentine economy rebounded in 2003 from the sharp contraction that occurred in the wake of its financial crisis in 2001–02. Still, economic activity remains far below pre-crisis levels, and many of Argentina's structural problems have not been addressed. With the government still in default to its bondholders, the country's sovereign debt continued to carry a very low credit rating, and its EMBI+ spread remained extremely high. Even so, the Argentine peso appreciated on balance in 2003, and the Merval stock index nearly doubled over the course of the year. □

Summary of Papers Presented at the Second Conference of the International Research Forum on Monetary Policy

Gregg Forte, of the Board's Division of Research and Statistics, prepared this article.

The International Research Forum on Monetary Policy held its second conference on November 14 and 15, 2003. The organization is sponsored by the European Central Bank (ECB); the Board of Governors of the Federal Reserve System (FRB); the Center for German and European Studies (CGES), at Georgetown University, in Washington, D.C.; and the Center for Financial Studies (CFS), at the Goethe University, in Frankfurt. It was formed to encourage research on monetary policy issues that are relevant from a global perspective, and it organizes conferences that are held alternately in the euro area and the United States.

The 2003 conference, held in Washington, D.C., featured ten papers.[1] Among the topics examined were the Great Inflation of the 1970s in the United States and the influence of learning, or adjustment of expectations, on policy outcomes; the tradeoffs between rules-based and discretionary monetary policy; the 1999 formation of the European Economic and Monetary Union and whether it altered the degree of economic integration between the United States and the euro area; the potential benefits of greater competition in the euro area; and optimal monetary policy in an international setting. This summary discusses the papers in the order presented at the conference.[2]

Information and Learning

In the conference's first session, "Information and Learning," two papers considered the conduct of monetary policy during the high inflation and high unemployment (stagflation) of the 1970s. In both papers, the authors note the wide agreement today that underlying productivity growth had fallen in the early 1970s and that monetary policy was too accommodative given the resultant narrowing of the output and unemployment gaps. Fabrice Collard and Harris Dellas create a model that can explain the conduct of monetary policy in the 1970s if the central bank is fairly insensitive both to expectations of rising inflation and to any perception of a wide output gap and is also highly uncertain about potential output.

Athanasios Orphanides and John C. Williams trace the high-inflation episode to monetary policy mistakes that had started earlier, in the mid-1960s. They argue that, from the mid-1960s through the late 1970s, the Federal Reserve paid excessive attention to stabilizing output and employment around levels that later proved to have been too high. This policy mistake loosened inflation expectations and gave rise to the stagflation of the 1970s. The authors believe that the recognition of this error at the end of the decade led policymakers to place greater emphasis on the stabilization of prices and of inflation expectations.

Collard and Dellas

In their paper, "The Great Inflation of the 1970s," Collard and Dellas evaluate three alternative explanations of the loose policy of the 1970s:

NOTE. The author of this article thanks Dale Henderson and the authors of the conference papers for their assistance in its preparation and Christopher J. Erceg, Glenn Follette, Christopher J. Gust, Daniel E. Sichel, and Robert J. Tetlow for helpful comments.

1. The organizers of the forum's 2003 conference were Ignazio Angeloni (ECB), Matthew Canzoneri (CGES), Dale Henderson (FRB), and Volker Wieland (CFS).

2. A list of the papers appears at the end of this article along with an alphabetical list of authors and their affiliations at the time of the conference. For a limited period, the papers will be available at www.federalreserve.gov/events/conferences/irfmp2003/default.htm. In addition, a revised version of each conference paper will be available in one of the following series of working papers: the Federal Reserve Board's International Finance Discussion Papers (www.federalreserve.gov/pubs/ifdp/2004/default.htm), the European Central Bank's Working Paper Series (www.ecb.int/pub/wp/wp.htm), and the Center for Financial Research's CFS Working Paper series (www.ifk-cfs.de/English/homepages/h-cfsworkingpaper.htm).

1. Policy was biased toward creating inflation surprises as a means of lowering unemployment (or "policy opportunism," for short)
2. Policy reacted strongly to increases in expected inflation but suffered from erroneous information that hid the actual drop in underlying productivity growth and hence in potential output; thus, policy was only inadvertently loose ("imperfect information")
3. Policy reacted weakly to increases in expected inflation ("weak reaction to inflation")

The authors employ a New Neoclassical Synthesis model, specified to produce a unique equilibrium, in which policymakers follow a standard Henderson–McKibbin–Taylor rule to set the policy rate. Finding the conditions under which such a model will generate the 1970s volatility in inflation and in other macroeconomic variables such as output and investment, the authors say, may indicate which of the policy explanations is most relevant.

In the monetary policy rule, the policy variable set by the authority in the present period is a function of three other variables: the policy variable in the preceding period, the inflation gap (the gap between inflation expected in the next period and the steady-state rate), and the output gap (the gap between current output and potential output). Potential output is not observable, and the monetary authority learns only gradually about shocks to it.

In looking for a specification of their model that will reproduce the conditions of the 1970s, the authors vary the shocks to, and the degree of uncertainty about, potential output and the speed at which the monetary authority responds to changes in the inflation gap and the output gap. In the first (baseline) trial, the authors assume a reaction speed about the same as that commonly associated with the Volcker–Greenspan era, that is, a coefficient of 1.5 on the inflation gap and 0.5 on the output gap. (A value of at least 1 for the coefficient on the inflation gap is necessary for the model to avoid an indeterminate equilibrium—that is, the possibility of reaching various stable but undesirable economic outcomes.) They select a supply shock—a reduction in productivity growth—sufficient to generate an increase of 5–6 percentage points in the inflation rate. They find that with a supply shock of about 30 percent and a high degree of uncertainty about the output gap, the model produced the desired increase in inflation. Moreover, this specification is quite successful in predicting the volatility in variables such as investment, output, and inflation. Its main weakness is in its exaggeration of the severity of the predicted recession and in its requirement of a very large shock.

The authors also examine the performance of the model under perfect information and a specification of the Henderson–McKibbin–Taylor rule that contains a reaction to inflation that is too weak and thus leads to indeterminate equilibriums. This specification also performs quite well: It generates a large and persistent increase in the inflation rate after a large productivity slowdown (a supply shock of about 12 percent) and predicts an amount of macroeconomic volatility comparable to that observed in the real world. The main weakness of this specification is, again, its exaggeration of the severity of the predicted recession.

The results from these two specifications suggest that one need not appeal to the first explanation (policy opportunism) to explain the inflation of the 1970s. The results also suggest that it may not be possible to discriminate between the second explanation (substantial imperfect information plus strong reaction to expected inflation) and the third (good information but weak reaction to expected inflation)—the data lend considerable support to both. The third explanation implies that economic outcomes would have been much better had the central bank's reaction to inflation been stronger, whereas the second explanation implies that, given uncertainty about the true output gap, even a strong reaction to inflation would not have sufficed to keep inflation in check in the face of a very large, unobserved productivity slowdown.

Orphanides and Williams

In "The Decline of Activist Stabilization Policy: Natural Rate Misperceptions, Learning, and Expectations," Orphanides and Williams reexamine the sources of U.S. stagflation in the 1970s and of the subsequent improvement in macroeconomic performance.

The authors trace the policy failure of the 1970s to what they term the "activist" approach to macroeconomic policy—the so-called New Economics, which became popular during the 1960s. According to this approach, the management of aggregate demand could counteract any shortfalls or excesses relative to the economy's potential and thus attain the dual goals of macroeconomic policy: sustained prosperity and price stability. The enviable performance of the U.S. economy in the first half of the 1960s appeared to validate the promise of the New Economics. But in the second half of the 1960s, the prosperity was purchased at the cost of rising inflation; and by the 1970s, the economy had fallen into stagflation—high unemployment accompanied by high inflation.

Orphanides and Williams argue that in the 1960s and 1970s the Federal Reserve attempted a tight stabilization of the unemployment rate near an estimate of the natural rate that was far too low. The resulting gradual rise of inflation adversely influenced private agents' expectations, which in turn put further upward pressure on prices. This combination, rather than only adverse supply shocks such as a drop in productivity, explains much of the performance of the U.S. economy in the 1970s. That is, the misperception of the natural rate caused policymakers to be far too optimistic about how low they could push the unemployment rate without generating inflation pressures. Policy, influenced by the New Economics, remained excessively stimulative and contributed to rising inflation. The rise in inflation expectations amplified and propagated this initial policy error and led to stagflation.

In the authors' model, private agents have only imperfect knowledge of the structure of the economy and of policy, but in a process of perpetual "learning," they continually update their beliefs. This learning process causes the direct effects of policy errors to alter inflation expectations and thereby to further influence the economy. According to the model, the combination of stimulative monetary policy and rising inflation during the late 1960s and 1970s contributed to public confusion regarding the Federal Reserve's objectives and the behavior of inflation. Inflation expectations were initially well anchored because of the price stability of the 1950s and early 1960s; but they changed during the late 1960s, when policy errors and the resulting rise in inflation caused them to drift upward. By the time that the supply shocks of the 1970s hit, expectations of rising inflation exacerbated the effects of the shocks and contributed to stagflation.

The authors point out that, although some observers suggest that monetary policy was inherently destabilizing in the pre-1979 period, the results in their paper do not rely on such a condition. They note that their policy rule for the pre-1979 period, which is based on real-time data and forecasts, features a response of nominal rates to inflation that is greater than one-for-one, a result consistent with stability in the model economy.

Orphanides and Williams show that, had monetary policy not reacted as aggressively to perceived unemployment gaps as it did, inflation expectations would have remained stable, and the stagflation of the 1970s would have been avoided despite the dramatic increases in oil prices and the productivity slowdown during that period. According to the model, a less aggressive reaction to the unemployment gap would have done a better job of stabilizing inflation *and* unemployment in the 1970s.

By end of the 1970s, according to the authors, monetary policy makers appeared to recognize the nature of the problem. Faced with high and rising inflation, they changed course, turning away from the fine-tuning of demand management advocated by the New Economics and concentrating instead on the goal of price stability. After the costly disinflation of the early 1980s, the change in focus contributed to a new era of relatively stable inflation and unemployment.

Monetary and Fiscal Policy

In the conference's second session, "Monetary and Fiscal Policy," three papers addressed the design of optimal policy. In the first paper, Pierpaolo Benigno and Michael Woodford propose a model that can address simultaneously the basic policy problems (including sticky prices and incentives-distorting taxes) of the monetary and fiscal authorities. In the second paper, Susan Athey, Andrew Atkeson, and Patrick J. Kehoe consider a compromise between the desirability of allowing the central bank discretion to act on private information and the desirability of preventing the central bank from stimulating output with unexpected inflation. And in the third, Jordi Galí, J. David López-Salido, and Javier Vallés attempt to reconcile the fact that a rise in government spending leads to higher consumption with predictions to the contrary from neoclassical theory and real-business-cycle models.

Benigno and Woodford

In "Optimal Monetary and Fiscal Policy: A Linear-Quadratic Approach," Benigno and Woodford observe that models of optimal policy for the two types of stabilization are typically developed in mutual isolation. Monetary policy models typically ignore the consequences of monetary policy for the government budget. This approach can be justified under the assumption that nondistorting sources of government revenue exist, but it is inappropriate if, as emphasized in the literature on optimal tax policy, all available sources of revenue create distortions. Likewise, models of optimal fiscal policy at most include elements of monetary policy only under the simplifying assumption that prices are flexible and hence clear markets, so that tax rates affect output without regard to aggregate demand. Investigations of optimum monetary policy, however, confront the excesses and deficiencies created by prices that do not immediately adjust.

The authors propose to determine how the results of these two types of model would need to be modified if they are combined as two aspects of a single general-equilibrium model and if each aspect includes the more realistic concerns of the other. The authors point out that they approach the task differently from some recent papers that have combined optimal monetary and fiscal policy with sticky prices. The differences are that the present paper (1) uses staggered pricing of the sort appearing in models with explicit microfoundations and in some empirical work on the monetary transmission mechanism, (2) obtains analytical and not purely numerical results by virtue of the linear-quadratic approach, (3) derives optimal targeting rules for monetary and fiscal policy that yield a single rational-expectations equilibrium and optimal policy responses to any shock.

The authors find that, in their model, the volatility of inflation and tax rates is highly sensitive to the frequency with which prices change (the degree of stickiness). In their baseline case, prices change at just less than six-month intervals (a rate they say is consistent with survey results). Under fully flexible prices, the optimal response of inflation to a fiscal shock is eighty times as large as in the baseline case, and the long-run tax rate has no response. Even if sticky prices adjust as frequently as every five weeks, the optimal response of inflation and of the long-run tax rate are much closer to those in the baseline case than those under fully flexible prices. Likewise, in contrast to the monetary policy literature with lump-sum taxes, the authors find that, in their model, a government spending shock creating fiscal stress affects the optimal path of inflation and the output gap.

The authors set up targeting rules for the monetary and fiscal authorities in the form of commitments to maximize social welfare by adjusting the short-term interest rate and the tax rate, respectively. And each authority simultaneously makes the projected paths of inflation and the output gap (the target variables) satisfy the attainment of a unique, nonexplosive, rational-expectations equilibrium. Both monetary and fiscal policy can be used to stabilize an output gap that measures the perturbations from sticky prices and from distortionary taxes (taxes that are scaled to some payer variable such as income and that therefore influence, or distort, the payer's economic decisions); and fiscal policy can be used to address inflation because distortionary taxes affect real marginal costs and thus aggregate supply. Hence, monetary policy should take account of the requirements for government solvency, and fiscal policy should attend to its influence on inflation.

Athey, Atkeson, and Kehoe

In "The Optimal Degree of Monetary Policy Discretion," Athey, Atkeson, and Kehoe note that, according to most of the academic literature, there is no justification for policy discretion unless the central bank has important private information, information not available to the private sector. Acting to maximize social welfare, the central bank achieves the best outcomes when it follows a rule based on publicly observable data. There is scope for debate about the optimal degree of discretion if the central bank does have information. The question is this: How much risk of policy opportunism (boosting output through inflation surprises) should be tolerated to allow the central bank discretion to act on its private information?

In the authors' model, the central bank has private information on the state of the economy that determines society's preferred level of inflation. If this state is low, society desires low inflation; if it is high, society desires high inflation. In each period, private agents set their nominal wages before the monetary authority sets the inflation rate. This timing gives the central bank an incentive to engineer surprise inflation to reduce real wages and thereby lower unemployment toward its optimal level.

The optimal policy takes the form of an inflation cap. The benefit of reducing the cap is a decrease in the latitude for policy opportunism. The cost is a decrease in the scope for the central bank to use its private information to stabilize the economy. The cap is chosen low enough so that the cost of any further reduction just matches the benefit. One interpretation of the cap is that it is the optimal inflation target.

The main theoretical contribution of the paper is to make clear what information is required to choose the optimal (time-varying) inflation cap. It is remarkable that under some common assumptions the level of the cap depends only on the central bank's report on the current state of the economy. Otherwise it depends on reports on both current and past states.

The main practical contribution is to forcefully restate the argument that the case for central bank discretion rests on the assumption that the central bank has important private information.

Galí, López-Salido, and Vallés

In most macroeconomic models, say Galí, López-Salido, and Vallés in "Understanding the Effects of Government Spending on Consumption," a rise in government purchases of goods and services will tend to expand output. But the strength of that tendency varies greatly across types of models. The differences are rooted in alternative assumptions about how consumers react to the rise in current income attributable to the rise in government spending. In neoclassical (real-business-cycle, or RBC) models, consumers are assumed to spend according to a measure of their lifetime resources. A further common assumption is that, when government spending rises, these consumers will look ahead, in so-called Ricardian fashion, and anticipate that the present value of their after-tax lifetime income will fall because taxes will rise at some point to finance the higher government spending. Their anticipation of lower future income causes them to reduce their consumption immediately. But the supply of labor grows, real wages fall, and employment and output grow.

In traditional Keynesian models, consumers are not forward looking. They spend according to their current disposable income rather than their estimate of lifetime resources. Thus, an increase in government spending can directly increase output because higher demand from government need not be offset by lower demand from consumers. If the higher government spending is sufficiently financed by borrowing, it raises consumer income and is thus augmented by an increase in consumer demand. If the money supply is fixed, interest rates rise and investment falls; in contrast, an accommodation of the output expansion by the central bank will, depending on the extent of the policy easing, moderate or eliminate the investment decline.

In a review of the empirical evidence and through an investigation of their own, the authors find that, indeed, a rise in government spending leads to a significant increase in consumption and to little change, or a fall, in investment. They propose a general equilibrium model in which Ricardian and non-Ricardian consumers coexist and prices are sticky. The authors argue that both price stickiness and the existence of non-Ricardian consumers are necessary for an increase in government spending to raise consumption. Price stickiness lowers markups and allows real wages to rise along with employment; in turn, non-Ricardian consumers will respond to their higher income by increasing their consumption. The authors find that, for plausible settings for the proportion of non-Ricardian consumers, the degree of price stickiness, and the extent of debt financing, their model's results accord with empirical findings.

The model assumes that the taxes imposed to finance the rise in government spending are lump-sum, that is, they are the same dollar amount for each taxpayer. The authors leave to future research the question of how the model would respond if taxpayer liability varied with income.

INTERNATIONAL LINKAGES

The conference's third session, "International Linkages," featured three papers on the consequences of various economic policies and market structures in open economies. Nicoletta Batini, Paul Levine, and Joseph Pearlman look for the conditions under which central banks in open economies could effectively set policy according to a rule based on expected inflation. Tamim Bayoumi, Douglas Laxton, and Paolo Pesenti consider the efficiency gains in the industrial countries that could be expected from an increase in competition among businesses and workers in the euro area. And Michael Ehrmann and Marcel Fratzscher investigate whether the interdependence of the U.S. and euro-area money markets has increased since the advent of the European Economic and Monetary Union in 1999.

Batini, Levine, and Pearlman

Much work has been devoted to modeling closed economies in which the monetary authority changes interest rates in response to changes in expected, rather than current, inflation. Such policy behavior matches that in the inflation-forecasting models maintained at the central banks of Canada and New Zealand and appears to be consistent with recent monetary policy in the United States and the euro area. A criticism of a rule that responds to expected inflation is that of indeterminacy—it can lead to any of several equilibriums, some of which have undesirable outcomes for household welfare. In "Indeterminacy with Inflation-Forecast-Based Rules in a Two-Bloc Model," Batini, Levine, and Pearlman extend existing work on indeterminacy under such rules to the case in which economies are open.

Their study uses a New Keynesian (that is, sticky nominal wages and prices) general equilibrium model based on microeconomic foundations with two country blocs. In each bloc the monetary authority follows the same inflation-forecast-based (IFB) rule. The model includes two features—habit persistence in consumption and backward-looking wage and price indexing—to improve its ability to mimic fluctuations in output, prices, and nominal interest rates in the euro area and the United States; and it includes one feature—home bias in consumption patterns—that improves its tracking of real exchange rate fluctuations between the two blocs. The authors show that if the monetary authorities respond to inflation forecasts too far ahead, the IFB rule produces an indeterminate equilibrium no matter how aggressive the response is. They also find that indeterminacy arises more readily in an open economy than in a closed one. Finally, they find that indeterminacy in an open economy is more likely if the monetary authorities respond to expected consumer price inflation rather than to expected producer price inflation.

The authors consider the results arising from alternative choices of inflation horizons and of inflation indexes for use in the policy rule to be an important warning for the central banks of the United States and the euro area. The reason is that both authorities seem to focus primarily on medium-term consumer price inflation expectations, thereby compounding the possibility of indeterminacy.

Bayoumi, Laxton, and Pesenti

Overregulation in Europe's product and labor markets is currently a leading explanation for the euro area's lower income per capita relative to the United States, and the reduction of such impediments has become a major policy topic in Europe. Bayoumi, Laxton, and Pesenti employ a version of the Global Economy Model (GEM) of the International Monetary Fund to examine the potential benefits from such deregulation. GEM provides for imperfect competition through markups in prices and wages above marginal costs and marginal output; the markups decrease as the substitutability of goods and inputs (that is, competition) increases. In the authors' two-bloc version of GEM, one bloc is calibrated with euro-area data, and the other, which represents the rest of the industrialized world, is calibrated with U.S. data.

The resulting study, "When Leaner Isn't Meaner: Measuring Benefits and Spillovers of Greater Competition in Europe," simulates greater competition in the euro area by lowering euro-area markups in the model to the level of those in United States. With greater competition, businesses and workers in the euro area are less able to restrict their respective supplies. Accordingly, output and consumption increase strongly in the euro area; in the rest of the industrialized world, output increases somewhat, and consumption increases more than output because of an improvement in the terms of trade. Moreover, the authors show that, because greater competition improves the flexibility of wages and prices in the euro area, the central bank there faces an improved tradeoff between inflation and the output gap.

The markups employed in the model are based on empirically estimated data from both the United States and Europe, and the simulation results cover ten years. The authors emphasize that the quantitative results represent only an initial estimate subject to further refinements. These results show that, over the ten-year period, euro-area output per capita rises about 12½ percent above baseline (the level of output per capita if markups are not changed), and U.S.-calibrated output rises about 1 percent above baseline. The combined result closes about one-half of the per capita output gap between the two blocs. Euro-area consumption per capita rises about 8 percent above baseline. Accounting for the disutility of the rise in labor effort, welfare increases about 2½ percent. Consumption and welfare in the other bloc rise about 1¼ percent because of an improvement in the terms of trade with the euro area. Finally, the tradeoff facing the euro-area monetary authority also improves because of a one-third reduction, relative to baseline, in the sacrifice ratio—the amount of output lost by lowering inflation 1 percentage point. Robustness checks indicate that the effect on the euro area economy is relatively invariant to alternative assumptions about key parameters but that the spillovers to the rest of the world are sensitive to these assumptions.

Ehrmann and Fratzscher

An extensive literature has documented the influence of domestic economic news on domestic interest rates and asset prices. In "Equal Size, Equal Role? Interest Rate Interdependence between the Euro Area and the United States," Ehrmann and Fratzscher investigate the international extent of such influence by looking at economic news and the behavior of interest rates in Germany and the United States from 1993 through 1998 and in the euro area and the United States from 1999 through February 2003. The paper attempts to measure the degree to which *foreign* news moves financial markets and whether U.S. and European financial markets have become more interdependent since the 1999 launch of the European Economic and Monetary Union (EMU). By examining the correlation of announcements of economic fundamentals in the two regions, the authors also assess whether greater financial interdependence reflects a broader increase in economic interdependence between the two regions.

In studying daily money market rates for the 1993–2003 period, the authors find that money market linkages have strongly increased with the arrival of the EMU. During trading hours, the changes in money market rates in the euro area generally spill over to the United States and vice versa. Although developments in one market are not completely reflected in the other market, the linkage is highly significant in statistical tests. Moreover, the EMU has changed this relationship between markets in two dimensions. First, the systematic reaction of U.S. markets to developments in Europe can be found only with the start of the EMU. Through statistical testing methods, this increased linkage can be dated to June 1998, the time by which markets were certain that the EMU would become a reality. Second, the extent to which market movements in the United States are reflected in the euro-area money market has increased. This effect, too, is linked with the formation of the EMU.

The authors go beyond the linkages that can be observed each trading day to study the extent to which markets react to the release of macroeconomic news or monetary policy decisions in the other economy. European markets are found to react to certain macroeconomic news about the U.S. economy. This phenomenon can be identified particularly for releases of U.S. data on retail sales, consumer confidence, industrial production, and the survey from the National Association of Purchasing Management—that is, mostly announcements that are known as leading indicators for the U.S. economy. Importantly, this reaction of euro-area money markets started only with the advent of the EMU.

The results raise the question of why the U.S. and euro-area money markets have become so much more interdependent and, in particular, why some U.S. news has become an important determinant of euro-area interest rates. This finding may reflect growing real integration and interdependence between the two economies. A second interpretation ties the result to the timing of the news releases in each economy—U.S. macroeconomic news is released significantly ahead of the corresponding news in Germany and the euro area. Testing for this hypothesis, the authors show that U.S. announcements have, over time, become strong leading indicators for the euro-area economy. Accordingly, investors in recent years may be paying increasing attention to U.S. news to learn about the prospects of the euro-area economy. In short, according to the authors, their findings suggest that the U.S. and euro-area money markets have become significantly more interdependent since the start of the EMU, a development at least partly due to an increase in the real integration of the U.S. and euro-area economies in recent years.

Optimal Monetary Policy

The fourth and final session of the conference, "Optimal Monetary Policy," featured two papers. In the first paper, Robert G. King and Alexander L. Wolman investigate the problem of multiple equilibriums under a discretionary monetary policy. In the second, Ester Faia and Tommaso Monacelli consider optimal monetary policy in a world in which policymakers in each country have an incentive to improve the welfare of domestic residents by manipulating the terms of trade in their own favor.

King and Wolman

Those who advocate policy rules criticize discretionary monetary policy mainly because, through attempts to stimulate output with surprise policy easings, it leads to higher average inflation than does a policy rule. In neoclassical models, such attempts can be futile because private-sector agents come to expect the behavior; as a result, inflation is higher, but output remains essentially unchanged. The inflationary bias of discretionary monetary policy can also be derived from New Keynesian models, in which output is inefficiently low because of imperfect competition, prices are set for a fixed length of time, and agents have differing repricing schedules (staggered pricing).

In their paper, "Monetary Discretion, Pricing Complementarity, and Dynamic Multiple Equilibria," King and Wolman demonstrate, in a New Keynesian setting, that besides producing high inflation, discretion has a further adverse consequence. It can produce multiple equilibriums that lead to excess volatility in prices and output because of changing beliefs of private agents. The volatility arises because forward-looking price setting by firms interacts with discretionary behavior by a monetary authority attempting to maximize private welfare.

In the authors' model, firms set prices for two periods by applying a markup to their nominal marginal costs in the current period and their expected nominal marginal costs in the next period. In each period, one-half of all firms set their prices, and the other half hold them steady at the level set in the preceding period. Optimal behavior on the part of the discretionary monetary authority implies that it chooses the size of the money stock in each period to be proportional to prices set by firms in the previous period.

If firms resetting prices in the current period expect the money supply to be higher in the next period, they will raise their prices because the increase in the money stock in the next period will act to increase their nominal marginal costs in the next period. The expectation of a higher money stock can be self-fulfilling because the monetary authority will increase the stock in the next period precisely because prices were raised in the current period. Hence, besides discretionary policy's having an inflationary bias, the interaction of beliefs and discretionary policy sets off inefficient fluctuations in economic activity.

Faia and Monacelli

In "Ramsey Monetary Policy and International Relative Prices," Faia and Monacelli examine optimal monetary policy in a two-country New Keynesian model (sticky prices, imperfect competition). The authors use a Ramsey framework, familiar from the optimal-taxation literature, which, they note, is not often deployed in analyses of monetary and exchange rate policy in open economies. The Ramsey approach allows the authors to consider a much more general specification of household preferences than previously considered. Moreover, the authors incorporate a dynamic specification of price-setting that affords them a more coherent framework for assessing the benefits of policies that are set according to rules rather than discretion.

In the authors' model, policymakers maximize the welfare of domestic residents subject to the constraints of the competitive economy. Because prices are sticky, policymakers in each country have an incentive to implement policies that manipulate the terms of trade in their own country's favor (that is, improve the domestic tradeoff between consumption and production by raising the price of home goods relative to that of foreign goods).

The authors show that the equilibrium behavior that emerges when domestic policymakers act in such an uncoordinated manner is quite different from that which would obtain if a single "world social planner" formulated policy for the two countries. In particular, prices are much less stable than if there were a world social planner. Moreover, only under the coordinated policy would both countries target the same allocation of resources that would occur under flexible prices.

The authors indicate three restrictions of the model that could be amended in future work to allow more realistic adjustments in the current account: (1) The law of one price holds continuously, (2) households fully share risk via international financial markets, and (3) households invest in only financial, not physical, assets.

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King, Robert G., and Alexander L. Wolman. "Monetary Discretion, Pricing Complementarity, and Dynamic Multiple Equilibria."

Orphanides, Athanasios, and John C. Williams. "The Decline of Activist Stabilization Policy: Natural Rate Misperceptions, Learning, and Expectations."

AUTHORS

Affiliations are as of the time of the conference.

Susan Athey
Stanford University and *National Bureau of Economic Research*

Andrew Atkeson
University of California–Los Angeles, Federal Reserve Bank of Minneapolis, and *National Bureau of Economic Research*

Nicoletta Batini
Bank of England

Tamim Bayoumi
International Monetary Fund

Pierpaolo Benigno
New York University

Fabrice Collard
Groupe de Recherche en Economie Mathématique et Quantitative (Université de Toulouse and *Centre National de la Recherche Scientifique)*

Harris Dellas
University of Bern

Michael Ehrmann
European Central Bank

Ester Faia
Universitat Pompeu Fabra

Marcel Fratzscher
European Central Bank

Jordi Galí
Centre de Recerca en Economia Internacional and *Universitat Pompeu Fabra*

Patrick J. Kehoe
Federal Reserve Bank of Minneapolis, University of Minnesota, and *National Bureau of Economic Research*

Robert G. King
Boston University and *National Bureau of Economic Research*

Douglas Laxton
International Monetary Fund

Paul Levine
University of Surrey

J. David López-Salido
Banco de España

Tommaso Monacelli
Innocenzo Gasparini Institute for Economic Research (Università Bocconi) and *Centre for Economic Policy Research*

Athanasios Orphanides
Board of Governors of the Federal Reserve System

Joseph Pearlman
London Metropolitan University

Paolo Pesenti
Federal Reserve Bank of New York and *National Bureau of Economic Research*

Javier Vallés
Banco de España

John C. Williams
Federal Reserve Bank of San Francisco

Alexander L. Wolman
Federal Reserve Bank of Richmond

Michael Woodford
Princeton University □

Profits and Balance Sheet Developments at U.S. Commercial Banks in 2003

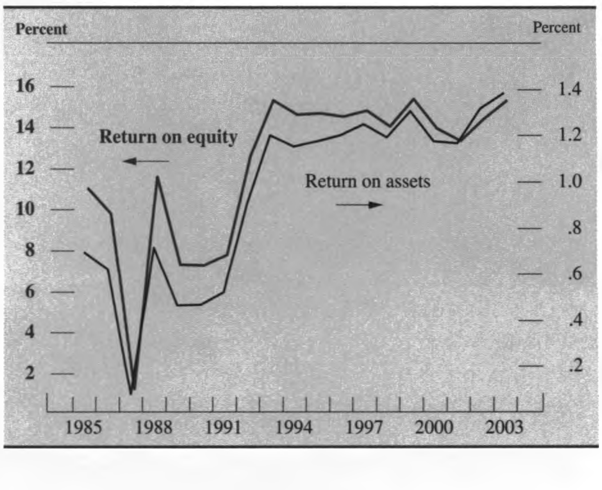
Mark Carlson and Roberto Perli, of the Board's Division of Monetary Affairs, prepared this article. Thomas C. Allard assisted in developing the database underlying much of the analysis. Jason Grimm and Steve Piraino provided research assistance.

The U.S. commercial banking industry remained highly profitable in 2003. The return on assets at banks surpassed the previous year's record level, and the return on equity approached the top of its recent range (chart 1). Banks' profits and balance sheets were shaped in part by the financial and economic conditions that prevailed during the year. Perhaps most important, monetary policy remained highly accommodative. The Federal Reserve reduced the intended federal funds rate at midyear from an already low level; and with short-term rates anchored by policy, longer-term interest rates, although volatile, generally remained low (chart 2). Home mortgage interest rates dropped to very low levels in the first half of the year, and yields on many corporate bonds, especially non-investment-grade bonds, fell noticeably as risk spreads contracted to the lowest levels in more than five years.

This supportive interest rate backdrop, coupled with stimulative fiscal policy, helped broaden and strengthen the economic expansion last year. Household spending continued to be strong. Low residential mortgage rates spurred home sales to record levels, and mortgage refinancing swelled. Low interest rates, along with the attractive incentives for automobile purchases, contributed to a pickup in spending on consumer durables. Also, many corporations took advantage of attractive costs of funds to strengthen their balance sheets, often by issuing long-term debt and using the proceeds to pay down commercial paper and bank loans. The pickup in aggregate spending, together with continued favorable productivity trends, boosted corporate profits. And in the second half of the year, brighter business prospects finally began to show through to equipment spending, which had been anemic for several quarters.

These economic developments left an imprint on banks' balance sheets. The strength of the housing market and the record levels of refinancing activity boosted the share of total bank assets accounted for by residential mortgages and mortgage-backed securities to 28.5 percent by the end of 2003. Business loans declined for the third consecutive year as businesses used the proceeds of bond issuance to pay

1. Measures of bank profitability, 1985–2003

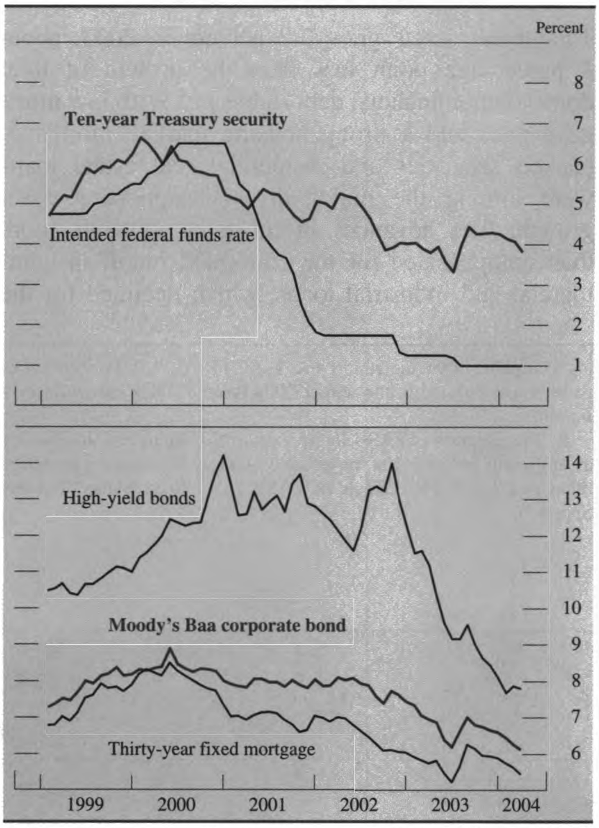


NOTE. Except where otherwise indicated, data in this article are from the quarterly Reports of Condition and Income (Call Reports) for insured domestic commercial banks and nondeposit trust companies (hereafter, banks). The data consolidate information from foreign and domestic offices and have been adjusted to take account of mergers. For additional information on the adjustments to the data, see the appendix in William B. English and William R. Nelson, "Profits and Balance Sheet Developments at U.S. Commercial Banks in 1997," *Federal Reserve Bulletin*, vol. 84 (June 1998), p. 408. Size categories, based on assets at the start of each quarter, are as follows: the ten largest banks, large banks (those ranked 11 through 100), medium-sized banks (those ranked 101 through 1,000), and small banks. At the start of the fourth quarter of 2003, the approximate asset sizes of the banks in those groups were as follows: the ten largest banks, more than $92 billion; large banks, $7.2 billion to $92 billion; medium-sized banks, $398 million to $7.1 billion; and small banks, less than $398 million.

Many of the data series reported here begin in 1985 because the Call Reports were significantly revised in 1984. Data for 1984 and earlier years are taken from the Federal Deposit Insurance Corporation, *Historical Statistics on Banking*, 1999. The pre-1985 data reported here are also available on the Internet at www2.fdic.gov/hsob/index.asp.

Data shown in this article may not match data published in earlier years because of revisions and corrections. In the tables, components may not sum to totals because of rounding. Appendix table A.1 reports income statement data for all banks. Appendix table A.2, A–E, reports portfolio composition, income, and expense items, all as a percentage of overall net consolidated assets.

2. Selected interest rates, 1999–2004:Q1



SOURCE. Data are monthly. For the intended federal funds rate, Federal Reserve Board (www.federalreserve.gov/fomc/fundsrate.htm); for Treasury security rates, mortgage rate, and Moody's bond rates, Federal Reserve Board, Statistical Release H.15, "Selected Interest Rates" (www.federalreserve.gov/releases/h15); for high-yield bond rates, Merrill Lynch Master II index.

down short-term debt and financed many of their investment outlays with internal funds. But the runoff was slower in 2003 than in 2001 and 2002, and as equipment spending recovered and inventories were built up late in the year, demand for business loans showed signs of turning around. Inflows of core deposits remained strong, as deposit rates fell less than market yields and households responded to the low opportunity cost of holding liquid assets.

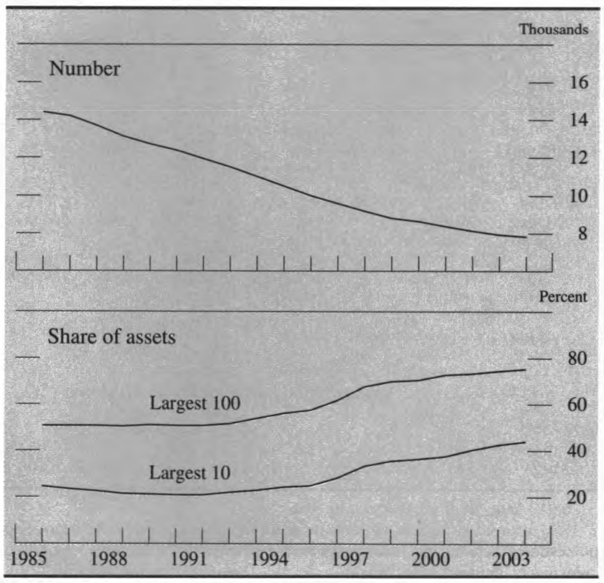
Economic developments also significantly affected banks' profitability. The wave of residential mortgage refinancing led to a surge in income from fees associated with the origination, sale, and servicing of these loans. An elevated level of corporate bond issuance supported investment banking income. Debt refinancing led to a reduction in borrowers' debt-service burdens, which in turn lowered delinquency rates. The decline in interest rates, especially during the first half of the year, allowed banks to realize gains by selling some of their investment securities; however, it also likely contributed to a further narrowing of net interest margins.

With increasing business profitability and lower business debt-service burdens, delinquency rates on commercial and industrial loans, which had risen in the previous three years, dropped back notably. Because of lower residential mortgage interest rates and increased house prices, households could extract equity from their homes by taking out cash through either refinancing or home equity loans; the proceeds were used partly to pay down higher-rate debt. With the credit quality of their loan portfolios improving considerably during the year, banks were able to reduce loan–loss provisions; such reduction was a substantial contributor to the increase in bank profitability.

The number of commercial banks in the United States moved down to 7,825 at the end of 2003 from 7,936 a year earlier—the smallest decrease in more than a decade (chart 3).[1] The decline occurred as the number of mergers—which fell to 245, also the smallest number in more than a decade—continued to exceed the number of new bank charters, which was slightly higher last year. According to the Federal Deposit Insurance Corporation, only three banks failed in 2003. These banks held \$1.1 billion in assets at the time of failure, a tiny fraction of industry assets and less than half the assets at failed banks during 2002. The shares of industry assets held by

1. This count of commercial banks may vary slightly from measures, such as those in the Federal Reserve's *Annual Report*, that are based on the definition of a bank given in the Bank Holding Company Act and implemented in the Federal Reserve's Regulation Y.

3. Number of banks and share of assets at the largest banks, 1985–2003



NOTE. For the definition of bank size, see the text note.

the 10 largest banks and 100 largest banks both edged up 1 percentage point, to 44 percent and 75 percent respectively.

Mergers were also restrained at the bank holding company (BHC) level. Top-tier BHCs—that is, BHCs that are not a subsidiary of another BHC—increased by 17, to 5,152: The number of newly formed BHCs slightly exceeded the number of mergers. The share of assets held by the top fifty BHCs was about 73.7 percent. The number of domestic financial holding companies, a subset of BHCs with a greater scope of allowed activities under the Gramm–Leach–Bliley Act, ticked down to 601, and the share of BHC assets held by these financial holding companies moved down to 89.5 percent.[2]

Balance Sheet Developments

Total bank assets grew 7.2 percent in 2003, about 1 percentage point less than the growth of total domestic nonfinancial debt (table 1).[3] With low mortgage rates and a strong housing market, mortgage-backed securities and residential real estate loans were among the major drivers supporting asset growth. The advances in those components more than compensated for the continued runoff in commercial and industrial loans, which declined for the

2. The Federal Reserve Board provides quarterly reports on the condition of the banking industry from the perspective of bank holding companies that file report FR Y–9C/FR Y–9LP. Publication of these reports started in the winter 2004 issue of the *Federal Reserve Bulletin*.

3. The adoption of FASB Interpretation No. 46, or FIN 46, boosted asset growth last year, but the effect was likely less than 1 percentage point (see box "The Effects of FASB FIN 46 on Banks' Balance Sheets").

1. Annual rates of growth of balance sheet items, 1994–2003
Percent

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	MEMO: Dec. 2003 (billions of dollars)
Assets	8.06	7.57	6.10	9.23	8.26	5.44	8.75	5.12	7.20	7.20	7,456
Interest-earning assets	5.28	7.80	5.79	8.67	8.28	5.84	8.65	3.96	7.54	7.29	6,432
Loans and leases (net)	9.82	10.58	8.12	5.34	8.89	8.04	9.24	1.82	5.90	6.53	4,259
Commercial and industrial	9.34	12.25	7.24	12.02	12.94	7.88	8.54	–6.73	–7.29	–4.56	863
Real estate	7.94	8.28	5.45	9.30	7.99	12.22	10.74	7.94	14.43	9.77	2,249
Booked in domestic offices	7.68	8.43	5.51	9.53	7.97	12.36	11.02	8.02	14.85	9.68	2,214
One- to four-family residential	10.14	10.01	4.66	9.67	6.36	9.70	9.28	5.70	19.85	10.04	1,267
Other	4.38	6.21	6.75	9.32	10.29	16.06	13.30	10.96	8.81	9.21	946
Booked in foreign offices	18.35	2.81	3.18	.34	8.79	6.28	–1.62	3.97	–7.41	15.52	36
Consumer	15.89	9.86	4.90	–2.19	.99	–1.47	8.05	4.17	6.58	9.33	710
Other loans and leases	5.29	14.22	22.28	–7.91	13.95	6.71	6.99	–2.00	–.26	8.35	513
Loan-loss reserves and unearned income	–2.27	.38	–.06	–.50	3.47	2.35	7.97	13.17	5.74	–2.72	77
Securities	–4.14	.56	.86	8.85	8.40	5.11	6.33	7.25	16.20	9.43	1,662
Investment account	–1.73	–1.58	–1.10	8.66	12.06	6.68	2.82	8.91	13.54	8.70	1,422
U.S. Treasury	n.a.	–19.21	–14.28	–8.85	–25.17	–1.89	–32.74	–40.25	41.92	14.18	72
U.S. government agency and corporation obligations	n.a.	6.42	3.63	14.18	17.00	1.83	3.71	12.89	18.10	9.66	903
Other	n.a.	4.19	1.83	11.20	26.99	20.90	13.38	12.18	2.72	5.99	447
Trading account	–20.46	18.51	14.44	10.00	–13.32	–6.93	37.16	–3.72	36.02	14.03	240
Other	3.30	8.61	1.04	38.55	3.80	–8.37	10.29	13.00	–2.91	6.93	511
Non-interest-earning assets	31.62	6.05	8.28	13.03	8.12	2.90	9.44	12.81	5.11	6.60	1,024
Liabilities	8.31	7.20	5.96	9.12	8.14	5.58	8.58	4.46	7.13	7.25	6,781
Core deposits	–.15	3.94	4.13	4.52	7.04	.23	7.53	10.55	7.58	7.12	3,666
Transaction deposits	–.31	–3.11	–3.44	–4.55	–1.41	–8.98	–1.31	10.20	–5.12	2.19	716
Savings and small time deposits	–.06	8.35	8.35	9.04	10.73	3.80	10.54	10.66	11.42	8.39	2,949
Managed liabilities[1]	17.53	10.56	9.66	13.84	9.64	15.54	8.77	–2.71	5.36	7.24	2,605
Deposits booked in foreign offices	30.89	5.13	4.27	11.13	8.71	14.60	7.79	–10.92	4.49	12.63	741
Large time	8.73	19.60	21.17	20.15	9.09	14.19	19.37	–3.65	5.05	1.43	579
Subordinated notes and debentures	9.23	6.61	17.74	21.05	17.00	5.07	13.98	9.56	–.59	5.84	100
Other managed liabilities	12.80	11.52	8.21	12.23	9.97	17.76	3.89	2.48	6.59	7.15	1,186
Other	79.17	20.48	2.60	23.79	8.59	–6.37	15.39	3.11	13.55	8.30	511
Equity capital	5.23	12.04	7.74	10.45	9.58	3.92	10.65	12.32	7.84	6.63	674
MEMO											
Commercial real estate loans[2]	4.02	6.32	7.67	10.13	11.37	15.42	12.15	13.10	6.82	9.01	944
Mortgage-backed securities	n.a.	.66	2.06	14.16	22.12	–3.34	3.28	29.06	15.56	10.09	761

NOTE. Data are from year-end to year-end.

1. Measured as the sum of deposits in foreign offices, large time deposits in domestic offices, federal funds purchased and securities sold under repurchase agreements, demand notes issued to the U.S. Treasury, subordinated notes and debentures, and other borrowed money.

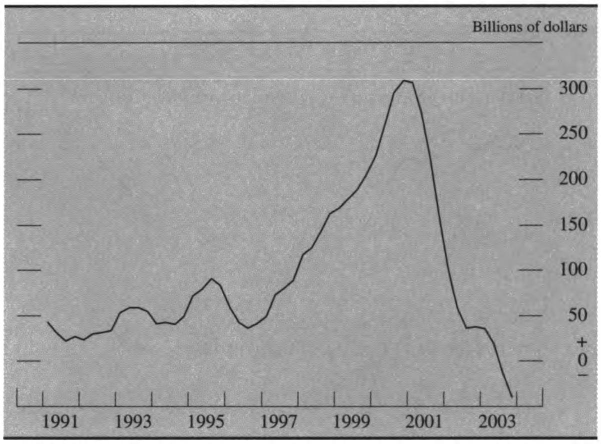
2. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties; real estate loans secured by multifamily residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

third straight year as nonfinancial firms relied heavily on capital markets and internal funds to finance their activities. Overall, total loans and leases increased 6.5 percent, and securities expanded 9.4 percent.

On the liability side of the balance sheet, banks were again able to attract strong inflows of core deposits, especially into savings and money market deposit accounts, because banks reduced deposit rates less than money market yields declined; consequently, the opportunity costs for households of holding liquid deposits fell further. Nonetheless, banks also had to increase their managed liabilities to finance asset growth.

Banks continued to add to their capital in 2003, and their overall capital positions remained robust. While equity capital increased somewhat more slowly than assets did, risk-based regulatory capital ratios still edged up a bit, an uptick driven both by a shift in asset composition toward assets with low risk weights—such as government and agency-related mortgage-backed securities and residential real estate loans—and by the brisk expansion of tier 1 capital.

4. Financing gap at nonfarm nonfinancial corporations, 1991–2003



NOTE. The data are four-quarter moving averages. The financing gap is the difference between capital expenditures and internally generated funds.

SOURCE. Federal Reserve Board, Statistical Release Z.1, "Flow of Funds Accounts of the United States," table F. 102 (www.federalreserve.gov/releases/z1).

Loans to Businesses

Commercial and industrial (C&I) loans declined 4.6 percent in 2003, a fair bit less than in 2001 and 2002.[4] Issuance of bonds, particularly those rated below investment grade, was strong last year, as low interest rates and declining risk spreads offered corporations the opportunity to lock in low-cost long-term financing. The proceeds were used, in part, to pay down short-term obligations, including C&I loans. Because the customers of large banks are more likely to be large corporations with access to bond markets, the erosion in C&I lending was concentrated at large banks (those ranked in the top 100 in terms of assets, which account for about three-fourths of total C&I loans). At smaller banks, on a merger-adjusted basis, commercial loan portfolios actually expanded, although their growth was about flat before adjustment.

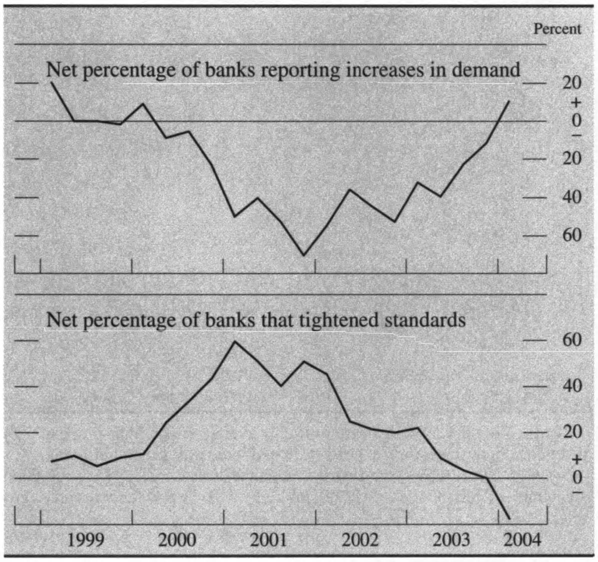
The improved profitability of nonfinancial firms also damped loan demand, as substantial gains in profits outpaced the growth of firms' capital expenditures; consequently, the financing gap—the difference between investment outlays and internally generated funds—fell and became negative in 2003 (chart 4). A boost in inventory spending by nonfinancial firms late last year, however, likely helped limit the contraction in business loans.

Responses to the Senior Loan Officer Opinion Survey on Bank Lending Practices (BLPS) also suggest that the drop in aggregate business loans resulted primarily from decreased demand. Survey responses, especially early in the year, often pointed to weak investment and inventory spending by businesses and to the shift to other forms of financing as factors explaining the drop in C&I loans. However, the margin by which respondent banks reporting decreases in demand exceeded those reporting increases in demand diminished over 2003, and a small net fraction reported stronger demand in the January 2004 BLPS (chart 5, top panel). According to respondent banks, the strengthening of demand was spurred by spending on plant and equipment and by increased funding needs to finance accounts receivable and inventories.

Supply conditions apparently played only a secondary role in the weakness of C&I loans. In the first part of 2003, banks reported tightening both standards and terms somewhat; but by the end of the year, a substantial net fraction of respondents had begun easing terms, and in the January 2004 BLPS a significant net fraction reported easier standards (chart 5, bottom panel). The reasons cited most often for the increased willingness to lend were more-aggressive competition from other banks and nonbanks and an improved economic outlook. According to the Survey of Terms of Business Lending (STBL), banks also appeared to perceive a reduction in the risk of their C&I borrowers for most of the year, a pos-

4. For a more detailed analysis of recent trends in C&I lending, see William Bassett and Egon Zakrajšek, "Recent Developments in Business Lending by Commercial Banks," *Federal Reserve Bulletin*, vol. 89 (December 2003), pp. 477–92.

5. Supply and demand conditions for C&I loans at selected banks, large and medium-sized borrowers, 1999:Q1–2004:Q1



NOTE. Data are quarterly. Net percentage is the percentage of banks reporting an increase in demand or a tightening of standards less, in each case, the percentage reporting the opposite. The definition for firm size suggested for, and generally used by, survey respondents is that large and medium-sized firms have sales greater than $50 million.

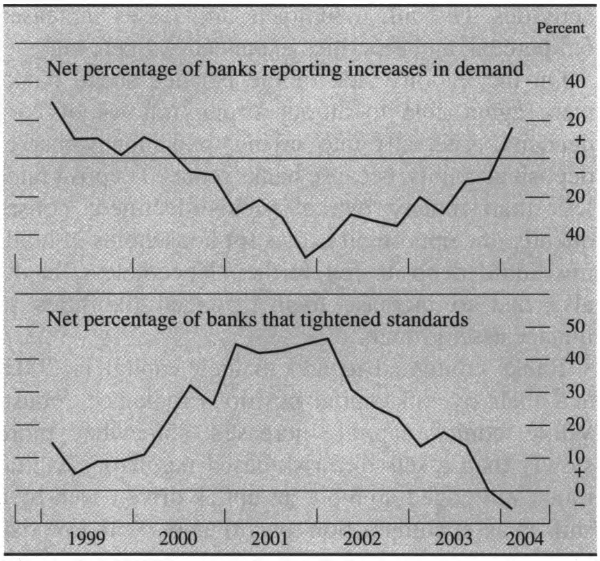
SOURCE. Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices."

sible sign of banks' increasingly positive assessment of economic prospects. The shift may also have reflected banks' reduced willingness to lend to riskier customers. Supporting this interpretation, the trend toward lower loan risk ratings was partially reversed in the February 2004 STBL as some banks were easing lending standards.

Unlike C&I loans, commercial real estate (CRE) loans continued to expand solidly in 2003. Growth in loans secured by nonfarm nonresidential properties was only slightly lower than in 2002. Despite persistent high vacancy rates and declining rates in the market for office rentals, growth of loans for construction and land development nearly doubled last year. Growth in the other components of CRE lending—including loans secured by multifamily properties and by farmland—remained brisk at about the same pace as that of the previous year. As has been the pattern for the past several years, CRE loans grew much faster at smaller banks: At the top 100 banks, such loans grew only 2.6 percent; at banks ranked outside the top 100, they expanded more than 16 percent. At the end of 2003, as a result, smaller banks held more total CRE loans in aggregate than did larger banks.

According to responses to the BLPS, which surveys mainly large banks, changes in both the demand

6. Supply and demand conditions for commercial real estate loans at selected banks, 1999:Q1–2004:Q1



NOTE. See notes to chart 5.

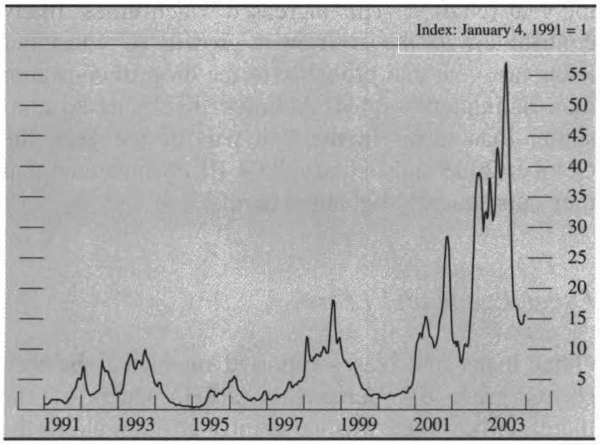
SOURCE. Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices."

for and the supply of CRE loans improved in 2003. In a pattern similar to that for C&I loans, the net percentages of banks reporting an increase in demand and an easing of lending standards on CRE loans turned positive in the January 2004 BLPS (chart 6). Also, some banks—about 20 percent of the respondents, on net—increased the maximum size of the CRE loans that they were willing to extend during 2003, according to responses to a special question in the January 2004 BLPS. A similar percentage indicated that they became willing to provide CRE loans with longer maturities. As was the case for C&I loans, the most frequently cited reasons for easing terms were more-aggressive competition from other commercial banks or nonbank lenders and improved conditions in, and outlook for, the commercial real estate market.

Loans to Households

Lending to households grew rapidly in 2003; the strong pace reflected robust consumer spending, the high level of housing activity, and a surge of mortgage refinancing that occurred in the first half of the year caused by a drop in long-term interest rates. Indeed, the Mortgage Bankers Association's index of refinancing activity rose at midyear to levels even higher than the peaks seen in 2001 and 2002 (chart 7). In this environment, banks continued to briskly expand both their revolving home equity and

7. Index of home mortgage refinancing activity, 1991–2003

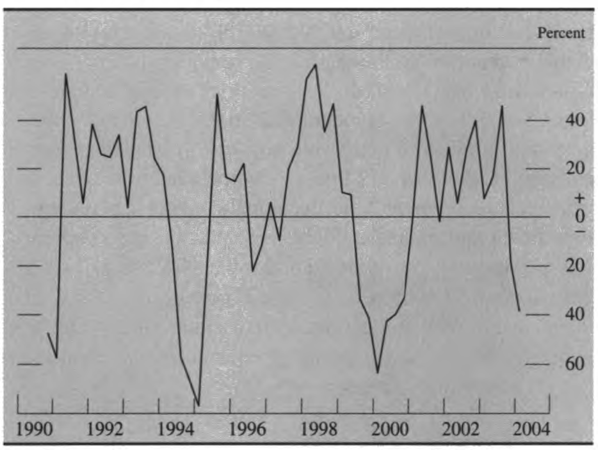


NOTE. Data are weekly.
SOURCE. Mortgage Bankers Association.

their other one- to four-family mortgage lending in the first two quarters of 2003.

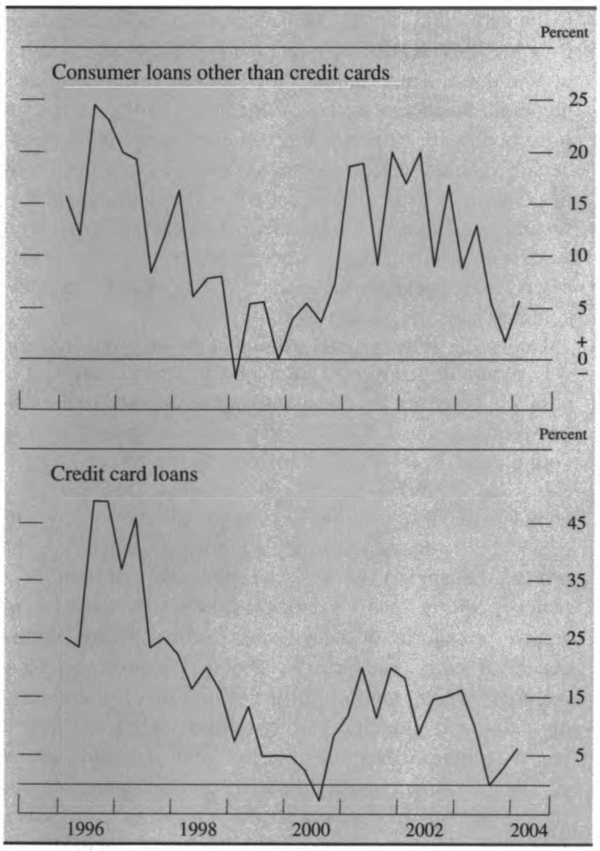
As bond yields and mortgage rates rebounded sharply starting in mid-June, however, the demand for one- to four-family mortgages appeared to decline, consistent with responses to the October 2003 and January 2004 BLPSs (chart 8). Given the continued brisk pace of home sales, however, much of the fall in reported demand presumably reflected the drop-off in refinancing rather than a decline in the demand for mortgages to purchase homes. But because of the decline of mortgage originations from their previous record pace and the resulting reduction in mortgage loans temporarily held for later sale in the secondary market, residential mortgage loans on banks' balance sheets actually contracted in the fourth quarter. Revolving home equity loans, however, continued to grow swiftly. One reason for their rapid growth was the sustained increase in residential real estate values. Another possible reason is that most home equity loans carry variable interest rates—tied to short-term rates—that remained very low last year and even declined a bit in the second half after the easing of monetary policy in June. On net, total residential mortgage loans on banks' books expanded 10 percent in 2003. As in 2002, the expansion was accompanied by a reduction of close to 19 percent in the volume of residential mortgages securitized or sold, but for which banks retained servicing rights or provided credit enhancements. Because banks do not report securitized loans for which they provide neither servicing rights nor credit enhancements, a portion of the decline in reported securitizations may simply reflect a relative increase in loans securitized without recourse.

8. Net percentage of selected banks reporting stronger demand for residential mortgages, 1990:Q4–2004:Q1



NOTE. Data are quarterly. Net percentage is the percentage of banks that reported stronger demand less the percentage that reported weaker demand.
SOURCE. Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices."

9. Net percentage of selected banks tightening standards for consumer lending, 1996:Q1–2004:Q1



NOTE. Data are quarterly. Net percentage is the percentage of banks that reported tighter standards less the percentage that reported easier standards.
SOURCE. Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices."

Many households that refinanced mortgages reportedly cashed out some of the equity in their homes. The proceeds were likely used, at least in part, to pay down higher-cost consumer debt and to fund purchases of durable goods. Consumer loans rose 9.3 percent for the year; however, that aggretate rate was boosted significantly by a large bank's purchase of a sizable credit card portfolio from a nonbank financial institution. Excluding that transaction, the expansion in consumer loans on banks' books, at about 5 percent, was fairly modest given the robust pace of consumer spending last year. Besides paydowns from cash-out refinancing, the brisk expansion in consumer loans that were securitized—mostly credit card receivables—and for which banks retained servicing rights or provided credit enhancements may have restrained the growth rate.

As with businesses, banks maintained a cautious lending posture toward households in 2003. Responses to the BLPS showed that the net percentage of banks that reported tightening standards for all types of consumer loans was never negative during the year (chart 9). This increased watchfulness likely contributed to the restrained growth in consumer loans last year and probably to the drop in consumer loan delinquency rates. Although banks eased consumer loan terms in the first part of the year, the October 2003 and January 2004 BLPS indicated that they subsequently tightened them.

Other Loans and Leases

Other loans and leases reported on banks' balance sheets grew 8.4 percent in 2003. Much of the increase, however, was apparently attributable to the new reporting requirements under FIN 46, as many of the assets previously held off balance sheet in variable-interest entities that were consolidated onto banks balance sheets during 2003 were classified in the "other loans" category (see box "The Effects of FASB FIN 46 on Banks' Balance Sheets").

The Effects of FASB FIN 46 on Banks' Balance Sheets

In January 2003, the U.S. Financial Accounting Standards Board (FASB) issued Interpretation No. 46, "Consolidation of Variable Interest Entities," or FIN 46. Under this interpretation, business enterprises, including banks, must consolidate onto their balance sheets the assets and liabilities of certain variable-interest entities (VIEs). VIEs are legal entities that are usually created for a specific purpose, such as securitizing assets. For example, banks commonly sponsor asset-backed commercial paper conduits, which purchase assets from several corporations and then issue to investors commercial paper backed by those assets.

Under the rules in effect before FIN 46, consolidation was generally determined by majority voting control. It is possible, however, for the sponsor to be exposed to the risk and return associated with a VIE without having majority voting control. In an effort to remedy the perceived deficiency in reporting such exposures, FIN 46 requires a company to consolidate the assets and liabilities of any VIE of which it is deemed to be the "primary beneficiary." The primary beneficiary of a VIE is the one that absorbs a majority of the entity's expected losses, if they occur; receives a majority of the expected residual returns, if they occur; or both. The primary beneficiary need not have majority voting control of the VIE. Also, a company must disclose, although not consolidate, VIEs in which it has a significant variable interest. For the purposes of FIN 46, a variable interest is defined as an interest that is subject to and fluctuates with the VIE's net asset value. Examples include equity as well as various types of derivatives, senior beneficial interests, variable service contracts, and leases.

When first released, FIN 46 was scheduled to take effect for most U.S. companies no later than the beginning of the first interim or annual reporting period that started after June 15, 2003. The rule was later amended, and its required adoption was pushed to the close of the first reporting period ending after December 15, 2003.[1] Most large U.S. banks implemented the new rule by the end of 2003. Most small banks are not affected because they do not commonly have interests in VIEs.

The effects of FIN 46 on banks' balance sheets can be estimated from the weekly bank credit data collected by the Federal Reserve and the remarks provided by individual banks on unusual weekly changes in bank credit components. These estimates suggest that, by year-end 2003, U.S. banks had consolidated roughly $67 billion in assets—less than 1 percent of total assets—that previously had not been reported on balance sheet. The majority of that amount—about $42 billion—was included in the "other loans" category and provided a noticeable boost to that balance sheet component. Another $17 billion was included in the "securities" category, an amount that equaled about 1 percent of investment and trading account securities on banks' books. Assets were also consolidated under the "C&I loans" category (about $7 billion, less than 1 percent of total C&I loans) and a small amount under "consumer loans." On the liability side, the vast majority of consolidation was in the "other borrowing" category.

1. On December 23, 2003, FASB issued interpretation FIN 46-R, a revision of FIN 46, that clarified some of its provisions, exempted certain entities from its requirements, and reduced the value of VIE assets and liabilities to be consolidated.

While loans to other depository institutions and to states and other political subdivisions increased, lease financing receivables declined for the second straight year. Since many leases are made to businesses, the weak performance was likely attributable, in part, to some of the same factors that depressed C&I loans.

Securities

Securities held on banks' balance sheets expanded strongly in 2003. At 9.4 percent, the growth rate was less than the extraordinary 16.2 percent of 2002, but it was still the second-highest in the past ten years. Securities in both investment accounts and trading accounts expanded briskly. As a share of total bank assets, securities continued to increase; the rise is an extension of a trend initiated in 2001 (chart 10).

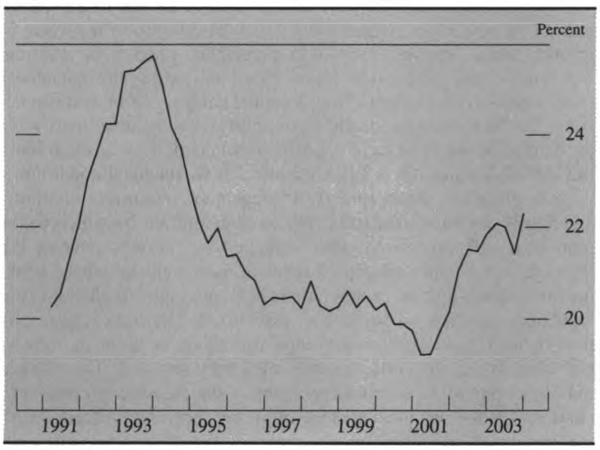
Mortgage-backed securities (MBS) held in investment accounts posted a solid advance—in excess of 10 percent—for the third consecutive year, and Treasury and non-mortgage-backed agency securities grew even faster. Banks accumulated MBS at a particularly rapid rate in the first half of the year, as interest rates declined and refinancing picked up. When long-term rates rose sharply in the summer, however, and the pace of refinancing slowed, banks responded by paring back their MBS positions considerably, and securities reported on their balance sheets actually contracted for the first time since the first quarter of 2001. Growth in banks' securities holdings resumed, however, as rates stabilized in the fall.

Liabilities

Core deposits increased 7.1 percent in 2003. Banks reduced the rates they paid on savings and money market deposit accounts by less than the decline in money market yields. As a result, those liquid deposits grew substantially, rising to more than 38 percent of total domestic liabilities by the end of the year (chart 11). By contrast, yields on small time deposits dropped more sharply than those on liquid deposits last year, a possible factor in the slight acceleration of their ongoing declining trend. Moreover, with market interest rates already low and the stock market recovering from its 2002 trough, some households may have chosen to invest in long-term mutual funds, which experienced strong net inflows last year, rather than locking in the low rates offered by time deposits. Transaction deposits grew a good bit in the first half of the year but then fell in the third quarter as the flows associated with mortgage refinancing slowed substantially; on net, such deposits rose only a bit during the year.

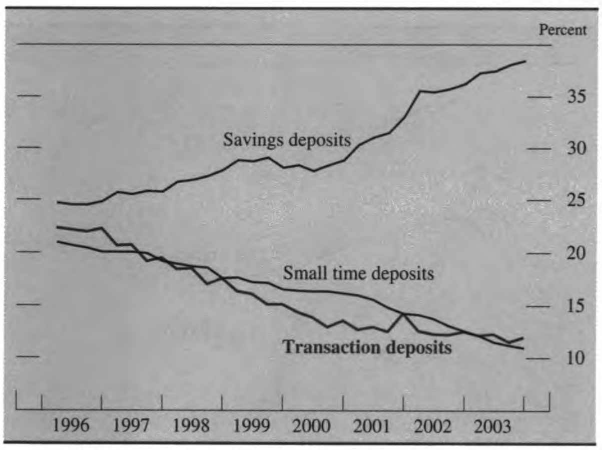
Even with the growth in core deposits, banks expanded their managed liabilities 7.2 percent last year. This increase was especially notable for banks outside the top 100, which experienced stronger growth in assets. Across all banks, deposits booked in foreign offices rose 12.6 percent, while the growth of subordinated notes and debentures, which had been briefly interrupted by a slight contraction the previous year, resumed. Large time deposits edged higher.

10. Bank holdings of securities as a share of total bank assets, 1991–2003



NOTE. Data are quarterly.

11. Selected domestic liabilities at banks as a share of their total domestic liabilities, 1996–2003



NOTE. Data are quarterly. Savings deposits include money market deposit accounts.

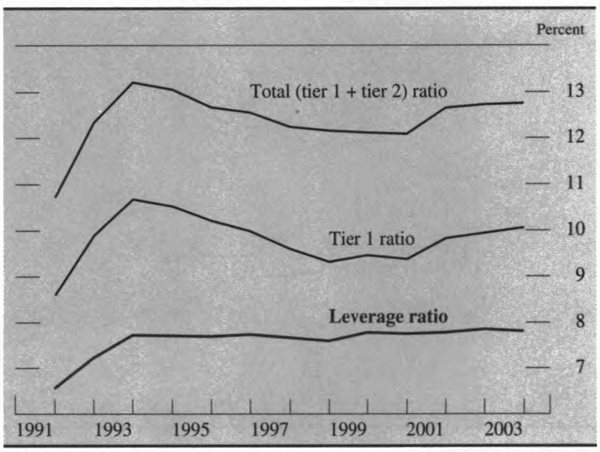
Capital

Banks' capital positions strengthened further in 2003. Equity capital increased 6.6 percent, slightly less than assets. Paid-in capital rose a good bit, in part as a result of mergers; retained earnings grew notably faster in 2003 than in the previous year, a reflection of banks' higher profitability and relatively stable dividend payout ratio. By contrast, accumulated other comprehensive income slumped; the decrease was due to the sharp decline in unrealized gains on available-for-sale securities, which occurred in the second half of the year and was likely induced by the turnaround in long-term interest rates.

Tier 1 capital increased 7.6 percent for the year, while tier 2 capital increased 2.8 percent. Risk-weighted assets grew more slowly than total assets, as the growth of assets with low risk weights, such as agency-related MBS, Treasury securities, and residential mortgages, outpaced that of assets with higher risk weights. The tier 1 ratio moved up to just above 10 percent, and the total ratio also rose a bit. The leverage ratio changed little (chart 12).[5] The share of industry assets held by banks that were considered well capitalized for regulatory purposes was about unchanged and remained near its very high levels of the previous several years. The average margin by which banks were considered well capitalized was substantial, although it edged down a bit from 2002 (chart 13).[6]

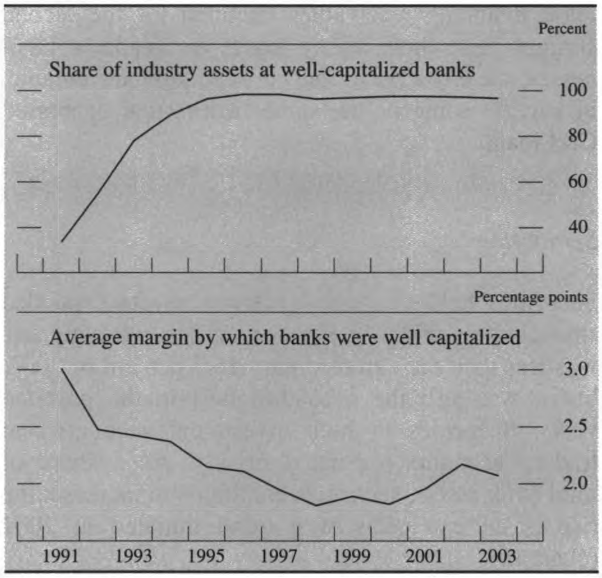
5. Tier 1 and tier 2 capital are regulatory measures. Tier 1 capital consists primarily of common equity (excluding intangible assets such as goodwill and excluding net unrealized gains on investment account securities classified as available for sale) and certain perpetual preferred stock. Tier 2 capital consists primarily of subordinated debt, preferred stock not included in tier 1 capital, and loan–loss reserves up to a cap of 1.25 percent of risk-weighted assets. Risk-weighted assets are calculated by multiplying the amount of assets and the credit-equivalent amount of off-balance-sheet items (an estimate of the potential credit exposure posed by the items) by the risk weight for each category. The risk weights rise from 0 to 1 as the credit risk of the assets increases. The tier 1 ratio is the ratio of tier 1 capital to risk-weighted assets; the total ratio is the ratio of the sum of tier 1 and tier 2 capital to risk-weighted assets. The leverage ratio is the ratio of tier 1 capital to average tangible assets. Tangible assets are equal to total assets less assets excluded from common equity in the calculation of tier 1 capital.

12. Regulatory capital ratios, 1991–2003



NOTE. For the components of capital ratios, see text note 5.

13. Assets and regulatory capital at well-capitalized banks, 1991–2003



NOTE. For the definitions of "well capitalized" and of the margin by which banks remain well capitalized, see text note 6.

Derivatives

The notional principal amount of derivatives contracts held by banks surged nearly 27 percent in 2003, to about $71 trillion. The market value of a derivatives contract, however, is typically much

6. Well-capitalized banks are those with a total risk-based capital ratio of 10 percent or greater, a tier 1 risk-based ratio of 6 percent or greater, and a leverage ratio of 5 percent or greater. In addition, supervisors can, when appropriate based on safety and soundness considerations, downgrade a bank's capital category from well capitalized. To take account of this possibility, we assume that well-capitalized banks must have CAMELS ratings of 1 or 2. Each letter in CAMELS stands for a key element of bank financial condition—Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risks. The average margin by which banks remained well capitalized was computed as follows. Among the leverage, tier 1, and total capital ratios of each well-capitalized bank, the institution's tightest capital ratio is defined as the one closest to the regulatory standard for being well capitalized. The bank's margin is then defined as the percentage point difference between its tightest capital ratio and the corresponding regulatory standard. The average margin among all well-capitalized banks—the measure referred to in chart 13—is the weighted average of all the individual margins, with the weights being each bank's share of the total assets of well-capitalized banks.

smaller than its notional value. Banks enter into derivatives contracts both for their own account (to manage their own market and credit risks) and in their role as dealers. When acting in the second role, banks often enter into at least partially offsetting contracts with different counterparties. Such offsetting transactions appear to constitute a substantial fraction of banks' activities in derivatives. At the end of 2003, the fair market value of contracts with positive value was $1.173 trillion, about unchanged from the previous year, and the fair market value of contracts with negative market value was $1.150 trillion, slightly more than in 2002. The net fair value was thus $23 billion, down about $4 billion from the year before. Consistent with previous years, large banks held the bulk of derivatives contracts, with the top ten banks by assets accounting for 96 percent of the total.

Interest rate swaps—agreements in which two parties agree to exchange a stream of floating-interest-rate payments for a stream of fixed-interest-rate payments based on a notional principal amount—are the most common derivatives held by banks. The share of interest rate contracts in the total notional principal amount of all bank derivatives contracts climbed to 59 percent in 2003, up more than 4 percentage points from the previous year. Investors often use interest rate swaps to hedge interest rate risk. The growing presence of interest-sensitive assets, particularly MBS and mortgages, in investors' portfolios, along with the volatility of long-term interest rates last summer, may have boosted investor demand for interest rate swaps last year, thereby increasing banks' holdings of those contracts in their role as dealers in that market. Interest rate futures, forwards, and options; foreign exchange derivatives; and equity derivatives accounted for almost 40 percent of the total notional amount of banks' derivatives contracts at the end of 2003.

The remaining derivatives contracts that banks held were credit derivatives—agreements in which the risk of default of a certain reference entity is transferred from one party (the beneficiary) to another (the guarantor). Use of credit derivatives has grown rapidly in recent years, and the notional amount held by banks surged more than 56 percent in 2003, to slightly more than $1 trillion. As is the case for other derivatives, however, banks are both buyers and sellers of these contracts. At the end of last year, the notional quantity of banks' positions as beneficiaries amounted to about $530 billion, and their positions as guarantors totaled about $471 billion. On net, therefore, banks were recipients of credit protection, as they have typically been in the past. Like other derivatives, the market for credit derivatives is dominated by the largest institutions, with the top ten banks by assets holding almost 96 percent of the total notional amount outstanding. However, the share held by banks outside the top ten, while still quite small, nearly doubled in 2003; on balance, those banks are also net receivers of credit protection.

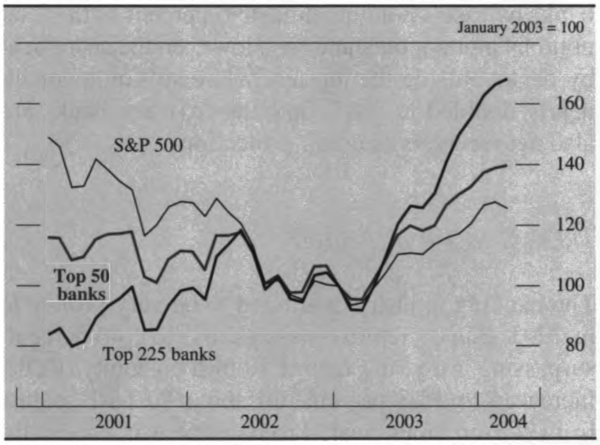
Trends in Profitability

The banking industry continued to be very profitable in 2003. Bank's return on assets rose to 1.40 percent, surpassing last year's record. Return on equity (ROE) increased to 15.3 percent, up about 90 basis points from the previous year. Profitability was especially strong at the ten largest banks, where ROE jumped 2.8 percentage points, to 16 percent, the highest level since 1993. While the largest banks stood out, banks of all sizes posted high returns. The proportion of banks with negative net income declined for the second consecutive year, to 6 percent, and these banks held only 0.7 percent of industry assets, the lowest share since 1997.

The improvement in profitability last year reflected a reduction in expenses and an increase in some income items. Better credit quality—which was due in part to low interest rates, the strengthening economy, and improved corporate profitability—allowed banks to substantially reduce loss provisioning. The reduction in loss provisioning was most pronounced at the ten largest banks, where it had increased the most in recent years, and contributed significantly to their exceptional performance last year. Non-interest expense grew at a moderate pace as banks held down the growth of non-salary-related expenses. Non-interest income rose at its fastest rate since 1999 because of increased earnings from the sale and securitization of loans as well as from fees for fiduciary and investment banking services. Realized gains on securities continued to boost income, particularly as medium-term and long-term interest rates fell in the first half of the year. Profitability was restrained, however, by a further narrowing of net interest margins.

Bank profitability was notably affected in 2003 by the wave of debt refinancing by households and businesses that resulted from the decline in long-term interest rates. Fees associated with the origination, sale, and servicing of refinanced residential mortgages bolstered banks' non-interest income. Underwriting income increased as businesses issued bonds to lock in long-term financing at favorable rates and to pay down C&I loans and other short-term debt.

14. Indexes of bank stock prices and the S&P 500, 2001–March 2004

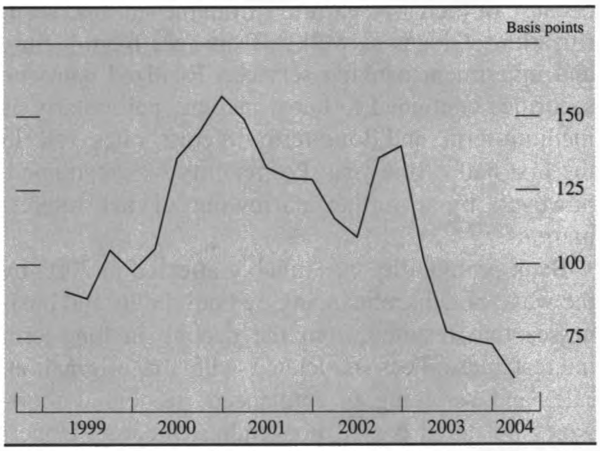


NOTE. Data are monthly. Banks are ranked by market value, and stock prices are weighted by market value.
SOURCE. Standard & Poor's and *American Banker*.

The resultant strengthening of household and business balance sheets contributed to marked declines in delinquency and charge-off rates and loan–loss provisioning. At the same time, however, the lowered interest payments on residential mortgages and lost earnings on paid-off C&I loans held down banks' interest income and contributed to the narrowing of net interest margins.

Robust earnings allowed dividend payments, made primarily to parent holding companies, to grow at double-digit rates for the second consecutive year even as dividends were little changed as a share of net income. As noted earlier, however, retained earnings also grew rapidly and boosted equity capital. With the strong profitability, bank holding company stocks considerably outperformed the S&P 500 during 2003 (chart 14). Subordinated debt spreads of the largest banks, which had risen in 2002 because of concerns about large banks' exposure to major corporate bankruptcies, narrowed markedly in 2003 and ended the year at quite low levels (chart 15).

15. Average subordinated debt spread at selected bank holding companies, 1999:Q1–2004:Q1



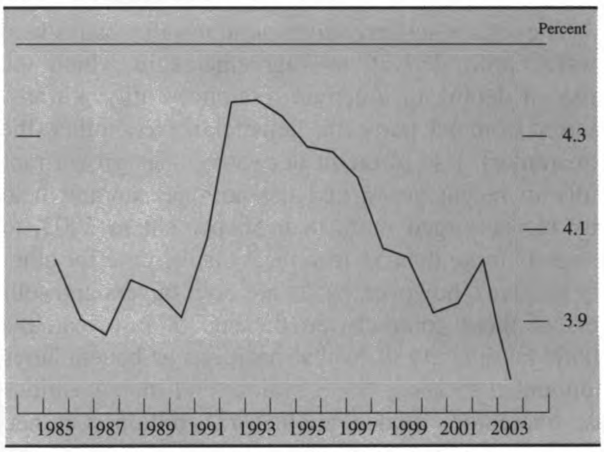
NOTE. Data are quarterly. Spreads are for twelve large bank holding companies and are weighted by 2003:Q4 assets. Spreads are over comparable Treasury securities.
SOURCE. Merrill Lynch bond data.

Interest Income and Expense

The fall in the average rate earned on banks' assets exceeded the decline in the average rate paid on their liabilities last year, and net interest margins narrowed further. At about 3.8 percent, the industry net interest margin—defined as net interest income as a percentage of interest-earning assets—reached its lowest level in more than a decade (chart 16). However, the downward slide in net interest margins, which began in the first quarter of 2002, reversed a little during the final quarter of 2003 with the rise in market interest rates.

The declines in rates earned by banks were most pronounced for household assets, a reflection of the heightened pace of mortgage refinancing. Besides depressing yields on residential mortgages and on MBS, cash-out refinancing and home equity borrowing enabled households to pay down some higher-yielding consumer loans. Rates earned on credit card loans moved down less than those on other consumer loans, possibly as contractual interest-rate floors on these loans became binding. As a result, banks that specialized in credit card loans had smaller declines in their net interest margins than did other banks during 2003, and their profitability increased by more than that of the industry as a whole. Credit card

16. Net interest margin, for all banks, 1985–2003



NOTE. Net interest margin is net interest income divided by average interest-earning assets.

The Role of Non-Interest-Bearing Instruments in the Net Interest Margin

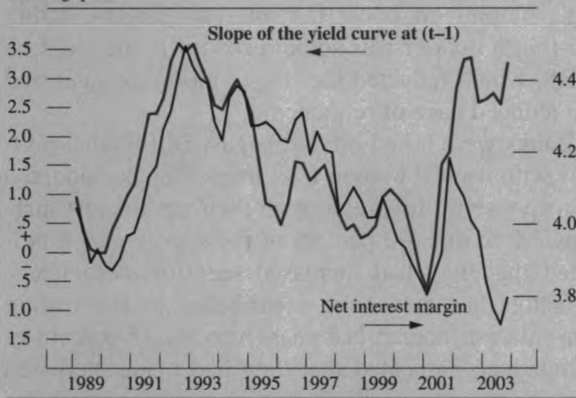
For most of the past fifteen years, the net interest margin has moved fairly closely with the slope of the yield curve (chart A), a relationship that reflects banks' intermediation across maturities. The recent decline in the net interest margin while the yield curve has remained steep represents a substantial divergence from this pattern.

To help understand this development, we decompose the net interest margin into two parts (figure). One component is the spread between the average return on bank assets and the average rate paid on interest-bearing liabilities times the share of interest-earning assets funded by these liabilities. The second component is the average rate on assets times the share of assets funded with non-interest-bearing liabilities and capital (calculated as 1 minus the share of interest-earning assets funded by interest-bearing liabilities). The second component depends on the level of the return on bank assets rather than the spread between the average rate on assets and the average rate on liabilities since non-interest-bearing instruments, by definition, have no explicit interest expense. Last year, about 15 percent of interest-earning assets were funded with non-interest-bearing instruments.[1]

The sharp decline in interest rates to historically low levels over the past few years reduced the contribution of the second component to the net interest margin (chart B). This decrease accounted for slightly less than half of the reduction in the net interest margin in 2003 and has accounted for a somewhat larger fraction of the decline since the end of 2001. Although the first component decreased between 2002 and 2003, it remained above its level in the late 1990s, when the yield curve was significantly flatter. Thus, the recent decline in the net interest margin reflected importantly the decline in the level of interest rates, whereas the steep yield curve continued to support the net interest margin.

1. While the separation of the net interest margin into these two components provides some useful insights about the importance of the level of interest rates and banks' funding mix, it describes only one facet of a bank's overall interest rate sensitivity. Perhaps especially when interest rates are very low, banks' earnings can be affected by balance sheet shifts, including shifts in the composition of funding.

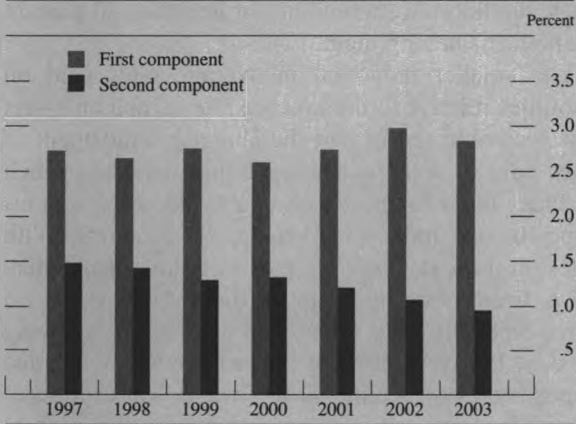
A. Net interest margin and the slope of the yield curve, 1989–2003



NOTE. Data are quarterly. The net interest margin is net interest income as a share of average interest-earning assets. The slope of the yield curve is the difference between the average ten-year Treasury yield and the three-month bill yield. The slope of the yield curve is lagged one quarter.

SOURCE. Call Report and Federal Reserve Board, Statistical Release H.15, "Selected Interest Rates" (www.federalreserve.gov/releases/h15).

B. Components of net interest margin, 1997–2003



NOTE. Data are annual. The sum of the two components is the net interest margin.

Decomposition of the net interest margin

$$\text{Net interest margin} = \frac{\text{net interest income}}{\text{interest-earning assets}}$$

$$= \underbrace{(\text{rate earned} - \text{rate paid}) \times \left[\frac{\text{interest-bearing liabilities}}{\text{interest-earning assets}}\right]}_{\textit{First component}}$$

$$+ \underbrace{(\text{rate earned}) \times \left[1 - \frac{\text{interest-bearing liabilities}}{\text{interest-earning assets}}\right]}_{\textit{Second component}}$$

lending also played a role in raising net interest margins for the industry during the fourth quarter. Not only did the rate of return on these loans pick up, but also the share of bank assets accounted for by these loans rose, an increase that was due largely to the purchase of a nonbank's credit card portfolio. Also helping to boost net interest margins during the fourth quarter was some recovery in the yield on MBS, which reflected the rise in mortgage rates and the reduced pace of refinancing.[7]

Banks were asked on the August BLPS what policies with respect to their C&I loans they had adopted in response to the pressure on their net interest margins. More than 60 percent of the survey panel indicated that they had increased fees for these loans, a factor that may have contributed to the rise in non-interest income last year. Another 45 percent of respondents indicated that they had made increased use of interest rate floors, which would restrain the decline in rates earned on variable rate loans. Nevertheless, the effect of such floors appears to have been limited. About 90 percent of respondents indicated that fewer than 15 percent of their C&I loans had interest rate floors. Furthermore, almost 70 percent of banks reported that, despite the low level of interest rates, the floors were binding for less than 20 percent of the loans having them.

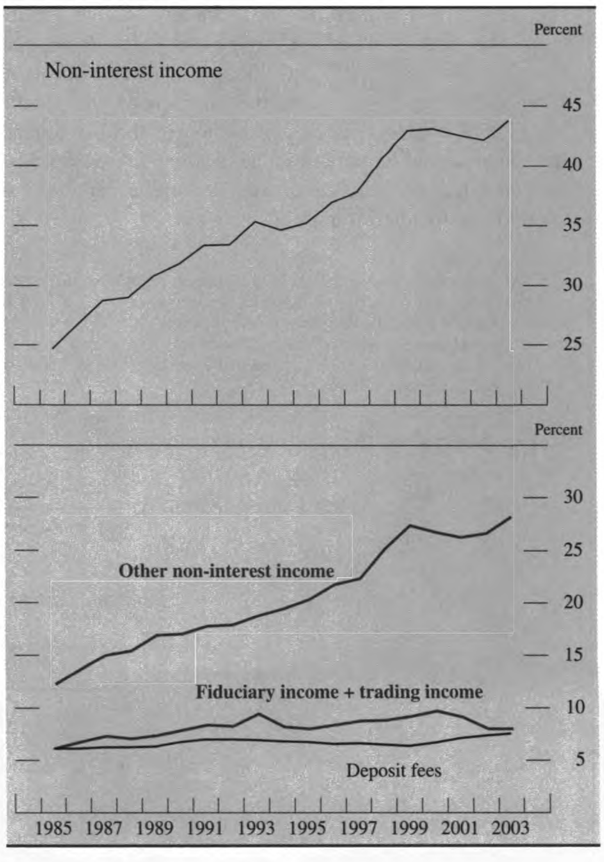
The smaller reduction in average rates paid on liabilities relative to the average rate earned on assets last year reflected in part the sluggish adjustment of rates paid on interest-bearing liquid deposits, which includes interest-bearing checkable deposits, savings deposits, and money market deposit accounts. With rates on these deposits already quite low, banks may have been hesitant to push them further toward zero, especially at a time when assets were growing briskly. Partly countering this tendency for average deposit rates to decline slowly was a substitution of liquid deposits, which expanded rapidly, for higher-rate small time deposits, which ran off. Net interest margins were also held down because low interest rates reduced the funding advantage offered by non-interest-bearing funding instruments (See box "The Role of Non-Interest-Bearing Instruments in Net Interest Margins.")

7. The increase in the rate of return on MBS in the fourth quarter in response to the rise in interest rates reflects in part the way in which banks record income related to their securities. Banks are required to amortize premiums paid for MBS over the expected life of the securities and deduct this amount from interest income. The rise in mortgage rates during the latter part of the year increased the expected life of these securities, which lengthened the amortization period and reduced the amount to be deducted.

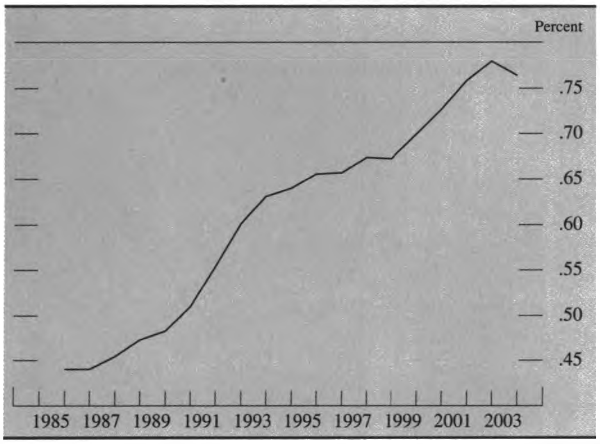
Non-interest Income and Expense

Non-interest income increased to a record 44 percent of total revenue in 2003, up from 42 percent during the preceding year (chart 17). Important contributors were gains from the sales of loans, especially during the third quarter, and a rise in securitization activity, both of which were likely related to new residential mortgages created by the surge in refinancing last summer. Non-interest income also benefited from investment banking activities as fees and commissions from underwriting securities grew smartly in 2003, presumably in part because of strong corporate bond issuance. Fiduciary income expanded during the year, although not as fast as total revenue. Fiduciary income advanced mainly during the second and fourth quarters, periods coinciding with large gains in equity prices that likely boosted the value of assets held in bank trusts. Trading income also increased in 2003, a rise that probably reflected in part banks' burgeoning derivatives activities. Deposit fee income continued to grow in 2003, but the rate of expansion was a bit slower than during previous years despite the rapid growth of deposits. Indeed, the ratio of fees to deposits, which had previously risen or held about

17. Income items as a share of revenue, 1985–2003



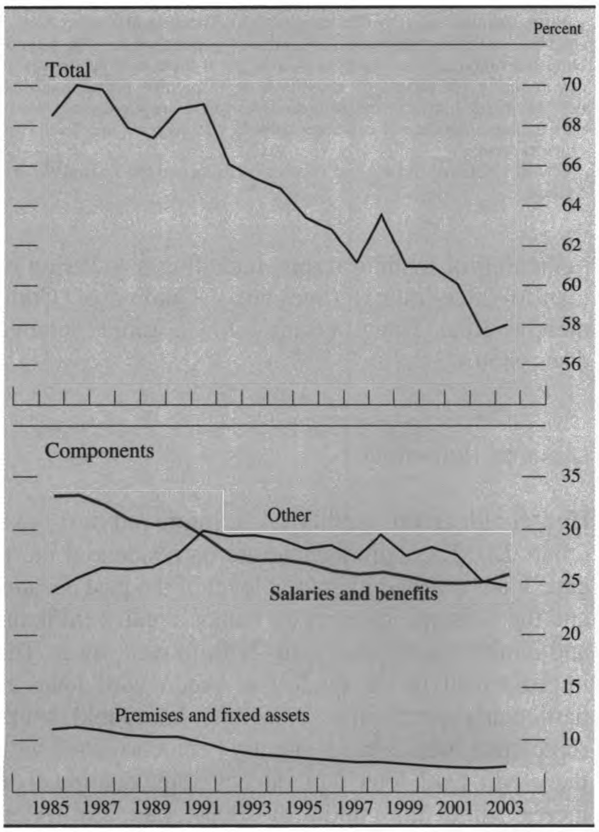
18. Ratio of deposit fee income to total domestic deposits, 1985–2003



steady in every year during the past two decades, dropped back somewhat in 2003 (chart 18).

Non-interest expense grew moderately during 2003 and ticked up slightly relative to total revenue, a partial reversal of the sharp decline of the previous year (chart 19). The growth in non-interest expense was due mainly to higher pay per employee, which advanced at its fastest pace since 1996. The number

19. Non-interest expense as a proportion of revenue, 1985–2003



of bank employees rose at about the average rate of the past five years. The ratio of expenses for banks' premises to total revenue continued to be little changed. Other components of non-interest expense grew, but at a slower pace than total revenue.

Loan Performance and Loss Provisioning

With interest rates low and the economic expansion gaining traction during the year, credit quality improved considerably in 2003. Delinquency rates for nearly all types of loans and leases fell, and by year-end the delinquency rate for all loans and leases was near the low levels of the late 1990s. C&I loans showed the largest improvement, with much of the deterioration posted in the previous few years being reversed. Overall, charge-off rates also moved down significantly but remained above the average level of the middle and late 1990s.

C&I Loans

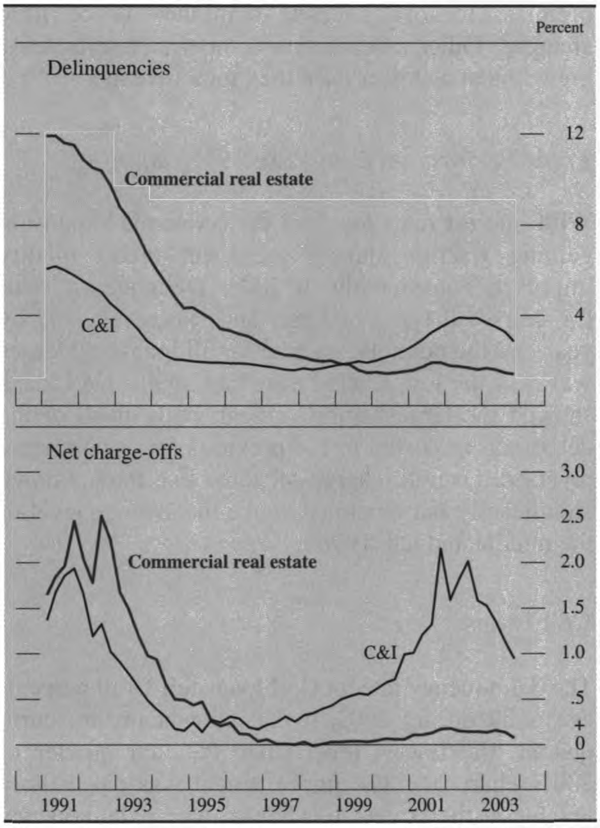
The delinquency rate on C&I loans fell 1 full percentage point during 2003, to 2.9 percent in the fourth quarter, the lowest level since the first quarter of 2001 (chart 20). The improvement was particularly notable at the largest 100 banks, where delinquency rates had risen the most. Charge-off rates on these loans also moved down sharply throughout the year.

Respondents to the April 2003 BLPS pointed to lower debt-service burdens as the most important reason for the stabilization in C&I loan quality. Firms' restructuring of balance sheets to take advantage of low interest rates, as well as the rebound in corporate profits, resulted in a notable decline in business debt-service burdens (chart 21). Banks also cited their own aggressive tightening of lending standards and terms during previous years as a reason for a reduced incidence of problem loans. Indeed, banks first reported tightening C&I loan standards in 1998, before delinquency rates had begun to rise, and they had tightened standards further, on net, until recently.

Sales by banks of their adversely rated loans to nonbanks was also a likely factor holding down delinquency rates, but charge-offs may have been boosted as banks booked losses on the loans being sold.[8] Of the largest banks that responded to the October 2003 BLPS, more than 90 percent stated that they had sold at least some adversely rated credits in the secondary

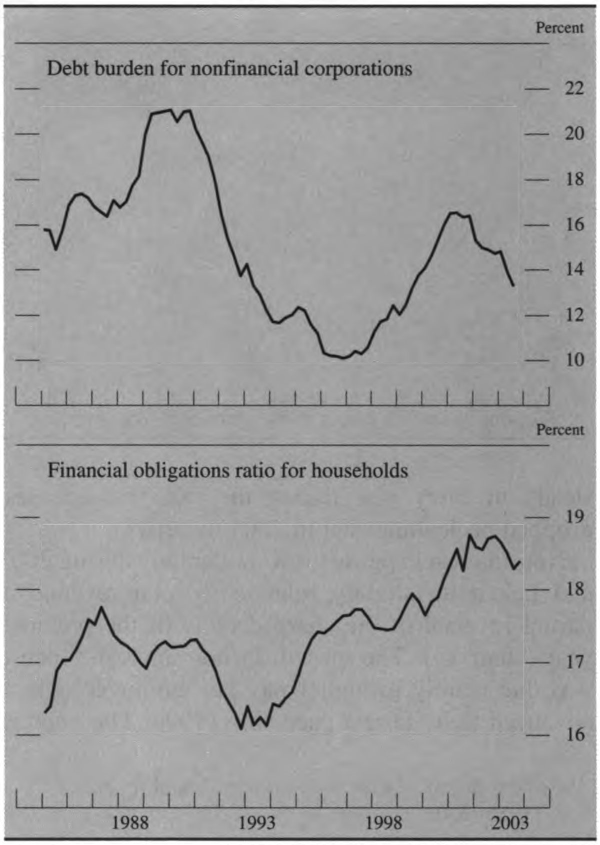
8. Adversely rated loans are loans rated as special mention or classified as substandard, doubtful, or loss. When a bank sells a problem asset, it must charge off the difference between the book value and the selling price.

20. Delinquency and charge-off rates for loans to businesses, by type of loan, 1991–2003



NOTE. Data are quarterly and seasonally adjusted. Delinquent loans are loans that are not accruing interest and those that are accruing interest but are more than thirty days past due. The delinquency rate is the end-of-period level of delinquent loans divided by the end-of-period level of outstanding loans. The net charge-off rate is the annualized amount of charge-offs over the period, net of recoveries, divided by the average level of outstanding loans over the period.

21. Debt burdens and financial obligations for businesses and households, 1985–2003



NOTE. Data are quarterly. The debt burden for nonfinancial corporations is calculated as interest payments as a percentage of cash flow. The financial obligations ratio for households is an estimate of the rate of debt payments and recurring obligations of households to disposable personal income; debt payments and recurring obligations consist of required payments on outstanding mortgage and consumer debt, as well as rent, auto leases, and property taxes.

SOURCE. National income and product accounts and the Federal Reserve System.

loan market during the previous two years, and 17 percent reported having sold at least 10 percent of such loans. BLPS respondents reported that many of these loans had been sold to investment banks and other nonbank financial institutions. Consistent with this report, the Shared National Credit Survey shows a substantial increase in the share of adversely rated loan commitments held by nonbank lenders in recent years.

Commercial Real Estate Loans

Both delinquency and charge-off rates on commercial real estate loans moved down during 2003, although rents on office buildings declined further and vacancy rates remained elevated. Banks reported on the April 2003 BLPS that the high credit quality of commercial real estate loans reflected the reduction in borrowers' debt-service burdens through refinancing and the tightening of lending terms, including a lowering of loan-to-value ratios. (See box "Quality of Commercial Real Estate Loans" for a more detailed discussion.)

Loans to Households

Household credit quality also improved last year (chart 22). The delinquency rate on residential mortgage loans reached its lowest level of the past decade, and the delinquency rates on banks' credit card loans and on other consumer loans both moved lower. The improvement in the quality of credit card loans is particularly noteworthy since the household bankruptcy rate, which has generally been correlated with the credit card loan delinquency rate, continued to increase until the middle of 2003 (chart 23). (After

Quality of Commercial Real Estate Loans

Conditions in the commercial real estate market have deteriorated during the past few years. Vacancy rates for office buildings began to increase in 2001 and remained near historical highs in 2003 (chart A). Rents on office buildings began to fall in 2001 and tumbled a total of 20 percent through 2003, a larger decline than the one during the downturn in the early 1990s (chart B). Rents on retail properties also declined, though by considerably less.

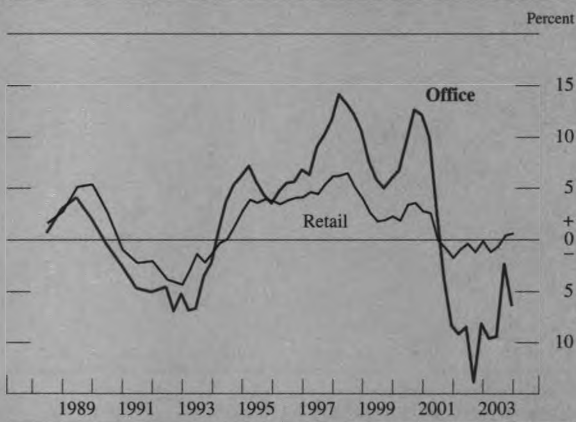
Despite the deterioration in market conditions, the delinquency rate on commercial mortgages held by banks dropped last year to about 1.5 percent. This rate is well below the nearly 12 percent levels of the early 1990s and is also below the levels of the mid-1990s, when vacancy rates were low and rents were increasing.

The delinquency rate has remained low for two possible reasons. First, many borrowers have been able to refinance or roll over their previous mortgages at lower interest rates. Yields on commercial mortgages, in general, have trended down since early 2000 (chart C), so refinancing would have helped borrowers meet their payment obligations. Although still low, the delinquency rate on commercial real estate loans used to back commercial-mortgage-backed securities has risen since 2001. On the January 2004 BLPS, banks reported that the greater difficulty in refinancing such loans, which tend to feature larger prepayment penalties and other prepayment restrictions, was an important reason for the increase in the delinquency rate on securitized loans relative to that on the loans held on banks' books.

A. Vacancy rates on office real estate, 1987:Q4–2003:Q4

NOTE. Data are quarterly.
SOURCE. Torto Wheaton Research.

B. Change in rent for office and retail space, 1988–2003



NOTE. The data are four-quarter rates of change. Data before 1991:Q2 are plotted at their available biannual frequency.
SOURCE. National Real Estate Index: Market Monitor.

six quarters of decline, the delinquency rate on credit card loans held by banks rose in the fourth quarter of last year, apparently the result of a large bank's acquisition from a nonbank finance company of a sizable portfolio of credit card receivables with a delinquency rate higher than that of the banking system as a whole.) Household balance sheets improved last year as homeowners refinanced their mortgages at lower interest rates, with many extracting equity from their homes through cash-out refinancing or home equity loans and using part of those funds to pay down other, more-expensive debt.

Loss Provisioning

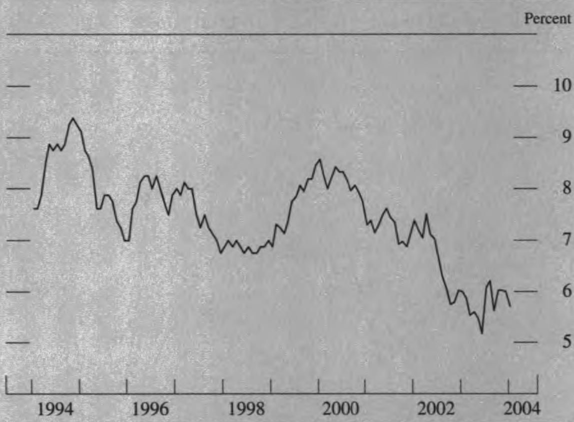
With the improvement in overall credit quality, banks cut back their loan–loss provisioning in 2003, both in dollar terms and in relation to total revenue (chart 24). The decline was most pronounced at the largest banks, where the ratio had been highest and where credit quality was most improved last year. As loans continued to expand, the ratio of provisioning to loans also declined.

With provisioning just outpacing charge-offs, loan–loss reserves grew 2 percent in 2003—the slowest pace since 1997. The significant improvement in credit quality, however, caused the ratio of loan–loss reserves to delinquent loans to rise 6 percentage points, to 75 percent (chart 25). The ratio of reserves to charge-offs also rose last year, but it remained near the low end of its range over the past decade. With bank balance sheets expanding moderately, reserves as a proportion of total loans slipped to 1.8 percent from 1.9 percent the previous year.

Quality of Commercial Real Estate Loans—Continued

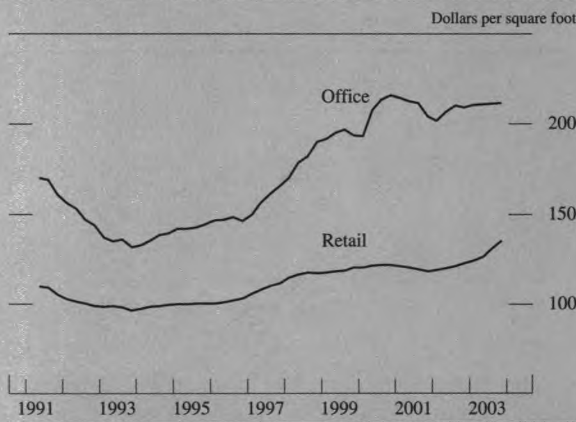
The second possible reason for the generally low delinquency rate on commercial real estate loans held by banks is tighter loan standards and terms. After the severe problems in the commercial real estate market during the early 1990s, market participants reportedly reformed industry practices and tightened standards for commercial real estate projects. Also, banks started tightening their lending standards on these loans in 1998, well before the decline in rents and the increase in vacancy rates began. As a result, banks may have avoided riskier projects. According to the January 2002 BLPS and the April 2003 BLPS, banks also tightened their lending terms for commercial real estate loans. One way that banks did so was by limiting borrowers' leverage. Borrowers with more equity in their properties have a stronger incentive to keep loans current and have a larger cushion if conditions deteriorate. These effects may have been especially important in the recent period because the price of office space has been fairly stable, on net, and the price of retail space has trended higher, possibly because of strong retail sales (chart D). By contrast, in the early 1990s the price of office space dropped markedly and the price of retail space declined, factors that likely increased pressure on borrowers.

C. Commercial mortgage yields, 1994–January 2004



NOTE. Data are monthly.
SOURCE. Barron's/John B. Levy & Company.

D. Prices for commercial property, 1991:Q2–2003:Q4



NOTE. Data are quarterly.
SOURCE. National Real Estate Index: Market Monitor.

International Operations of U.S. Commercial Banks

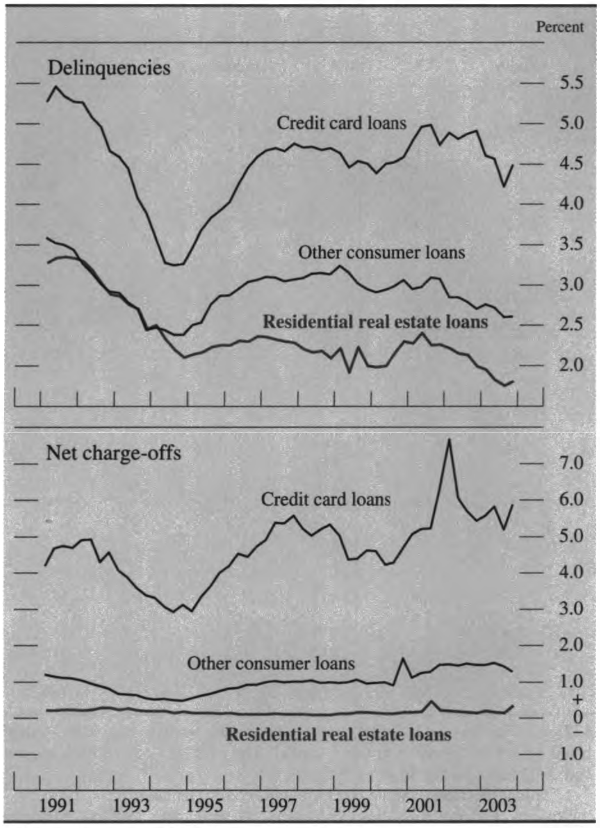
In 2003, after declining for five consecutive years, the share of bank assets booked in foreign offices moved up slightly, to 11 percent. Although they moved down some relative to capital, exposures (measured in dollars) to both Eastern Europe and Asia increased (table 2). The increase in exposure to Eastern Europe was entirely accounted for by operations in Russia, where economic growth was relatively rapid. Exposure to selected Southeast Asian countries expanded nearly 8 percent. Total exposure to these countries is now higher than it has been for five years, although exposure as a share of bank capital has moved down a bit. Lending to India also expanded rapidly. Operations in Latin America contracted for the second consecutive year both in dollar terms and as a share of capital. Lending to Argentina drifted down and exposure to several other large countries in the region diminished.

With the rise in the share of bank assets booked in foreign offices, the share of bank income derived from foreign operations moved up slightly in 2003, to 7 percent, although it remained below the levels posted in the mid-1990s. The growth in income occurred during the first half of the year. Earnings from foreign operations dropped off in the latter part of the year, partly because of an increase in loss provisioning for foreign loans.

Recent Developments

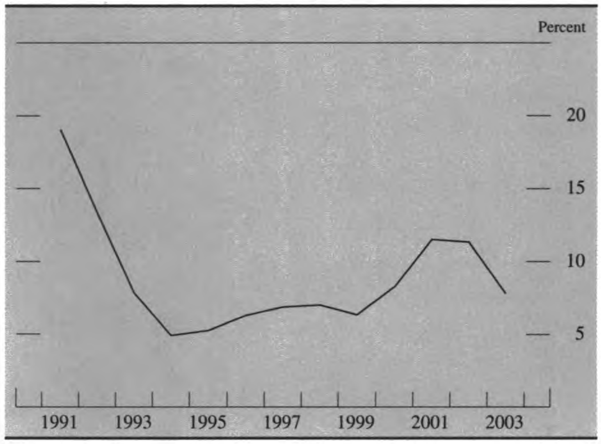
Information drawn from the Federal Reserve's weekly H.8 statistical release indicates that banks' asset growth picked up in the first quarter of 2004. Holdings of securities, especially mortgage-backed securities, increased sharply. Although C&I loans continued to decine, overall loan growth was strong because of robost real estate and consumer lending.

22. Delinquency and charge-off rates for loans to households, by type of loan, 1991–2003



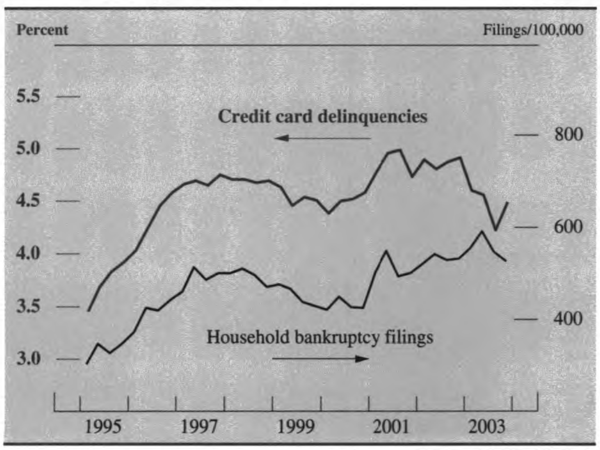
NOTE. See note to chart 20.

24. Provisioning for loan and lease losses as a percentage of total revenue, 1991–2003



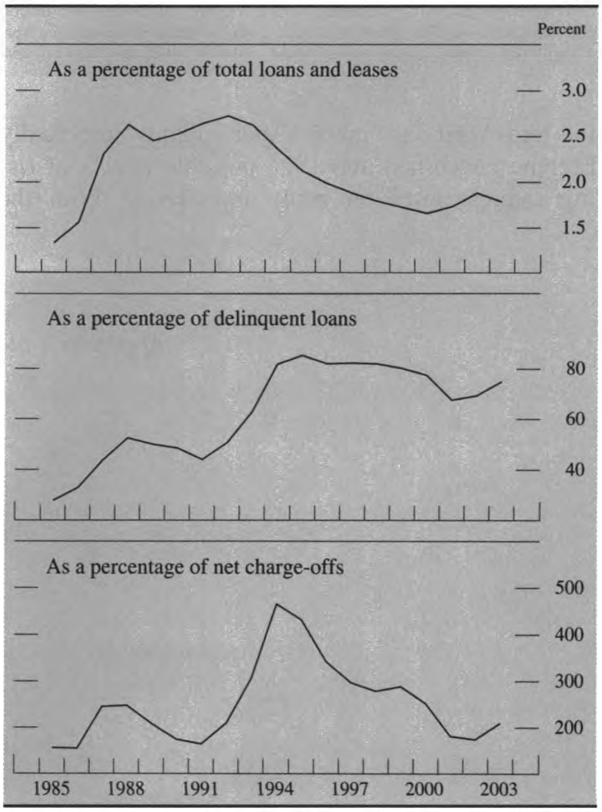
First-quarter earnings statements of several large bank holding companies suggest that bank profitability remained strong in early 2004. These institutions indicated that the trends of the previous year continued. Improvements in credit quality allowed for further reductions in loss provisioning. Noninterest income benefited from increased fees from trust and investment services. With net interest margins still under pressure, growth in net interest income remained sluggish. Stock prices of bank holding companies generally moved with the Wilshire 5000 during the first quarter before falling

23. Credit card delinquency rate and household bankruptcy filings, 1995–2003



NOTE. Data are quarterly.
SOURCE. Call Report and Visa Bankruptcy Notification Service.

25. Reserves for loan and lease losses, 1985–2003



NOTE. For definitions of delinquencies and net charge-offs, see note to chart 20.

2. Exposure of banks to selected economies at year-end relative to tier 1 capital, by bank size, 1998–2003

Percent

Bank and year	Selected Asian countries[1]	India	Eastern Europe		Latin America				Total
			All	Russia	All	Mexico	Argentina	Brazil	
All									
1998	15.49	2.35	3.49	.43	42.93	9.88	9.66	11.27	64.26
1999	14.37	2.39	2.85	.37	39.00	9.50	9.40	10.49	58.61
2000	13.17	2.63	4.35	.49	37.88	9.08	8.41	11.15	58.03
2001	12.09	2.55	4.29	.60	54.06	25.97	6.61	2.99	72.99
2002	11.44	2.74	5.53	1.06	38.90	20.80	2.44	8.36	58.61
2003	11.15	3.86	5.44	1.48	32.85	17.95	1.73	6.77	53.30
Money center and other large banks									
1998	24.02	4.19	5.61	.68	64.20	14.10	15.19	17.04	98.02
1999	20.73	3.56	4.25	.55	53.90	12.62	13.63	14.53	82.44
2000	19.98	4.14	6.83	.77	54.98	12.69	12.68	16.40	85.93
2001	17.88	3.86	6.47	.91	79.08	34.54	9.79	18.74	107.29
2002	16.96	4.18	8.17	1.63	57.32	31.14	3.65	12.38	86.63
2003	16.98	5.93	8.41	2.29	49.19	27.13	2.64	10.02	80.51
Other banks									
1998	2.08	.05	.16	.00	9.51	3.24	.97	.00	11.80
1999	1.75	.07	.08	.01	9.41	3.31	1.01	2.47	11.31
2000	1.41	.03	.08	.00	8.35	2.84	1.04	2.08	9.87
2001	1.07	.06	.14	.00	6.45	2.04	.57	2.05	7.72
2002	1.03	.08	.65	.00	5.00	1.86	.02	.96	6.76
2003	.90	.24	.21	.06	4.20	1.53	.13	1.05	5.55
MEMO									
Total exposure (billions of dollars)									
1998	37.87	5.43	8.53	1.05	104.69	24.15	23.62	27.55	156.52
1999	37.45	6.23	7.43	.95	101.63	24.77	24.51	27.34	152.74
2000	37.30	7.46	12.33	1.39	107.31	25.71	23.82	31.59	164.40
2001	36.32	7.66	12.88	1.80	162.39	78.00	19.87	39.01	219.25
2002	36.32	8.70	17.55	3.37	123.53	66.15	7.75	26.55	186.10
2003	37.93	13.55	19.07	5.20	115.23	62.98	6.07	23.74	185.78

NOTE. For the definition of tier 1 capital, see text note 5. Exposures consist of lending and derivatives exposures for cross-border and local-office operations. Respondents may file information on one bank or on the bank holding company as a whole.

At year-end 2003, "all reporting" banks consisted of seventy-two institutions with a total of $350.8 billion in tier 1 capital; of these institutions, ten were "large" banks (five money center banks and five other large banks) with $223.4 billion in tier 1 capital, and the remaining seventy-two were "other" banks with $127.5 billion in tier 1 capital. The average "other" bank at year-end 2003 had $26 billion in assets.

1. Indonesia, Korea, Malaysia, Philippines, and Thailand.

SOURCE. Federal Financial Institutions Examination Council Statistical Release E.16, "Country Exposure Survey," available at www.ffiec.gov/E16.htm.

in mid-April as market participants reportedly became concerned about the possible effects of rising interest rates on bank profitability. With the announcements of several large mergers in early 2004, industry consolidation, which had been relatively subdued in 2003, appeared to be picking up. □

Appendix tables start on page 181

A.1. Report of income, all U.S. banks, 1994–2003
Millions of dollars

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Gross interest income	256,854	302,202	313,240	338,216	359,138	366,123	423,823	404,564	350,217	329,765
Taxable equivalent	259,610	304,838	315,700	340,648	361,601	368,750	426,459	407,246	352,965	332,548
Loans	189,567	227,049	239,395	255,492	270,904	278,524	326,789	311,858	270,070	258,160
Securities	48,286	51,029	50,631	52,659	56,596	62,115	67,659	63,064	59,316	53,310
Gross federal funds sold and reverse repurchase agreements	6,415	9,744	9,272	13,658	14,999	12,327	13,546	12,647	6,222	5,122
Other	12,587	14,382	13,944	16,406	16,637	13,155	15,829	16,994	14,610	13,176
Gross interest expense	110,785	147,909	150,097	164,511	178,021	174,939	222,146	188,793	118,915	94,419
Deposits	79,086	105,326	107,512	117,350	125,217	119,665	151,138	132,368	81,894	62,705
Gross federal funds purchased and repurchase agreements	12,474	18,424	16,780	20,439	22,182	21,130	26,859	19,583	9,919	7,590
Other	19,224	24,158	25,806	26,721	30,620	34,143	44,151	36,841	27,101	24,125
Net interest income	146,069	154,293	163,143	173,705	181,117	191,184	201,677	215,771	231,302	235,346
Taxable equivalent	148,825	156,929	165,603	176,137	183,580	193,811	204,313	218,453	234,050	238,129
Loss provisioning	10,930	12,570	16,211	19,176	21,249	21,182	29,381	43,236	45,297	32,682
Non-interest income	77,231	83,846	95,305	105,628	123,516	144,400	153,154	160,297	168,540	183,520
Service charges on deposits	15,279	16,056	17,050	18,558	19,769	21,497	23,719	26,873	29,631	31,692
Fiduciary activities	12,148	12,889	14,296	16,584	19,268	20,502	22,220	21,989	21,637	22,306
Trading revenue	6,249	6,337	7,525	8,018	7,693	10,429	12,235	12,547	10,734	11,444
Other	43,556	48,563	56,433	62,468	76,786	91,972	94,980	98,886	106,536	118,077
Non-interest expense	144,837	151,077	162,450	170,880	193,701	204,625	216,423	226,025	230,331	243,184
Salaries, wages, and employee benefits	60,884	63,996	67,796	72,310	79,503	86,150	89,034	94,234	100,483	108,437
Occupancy	18,972	19,758	20,888	22,074	24,160	25,865	26,764	27,940	29,317	31,313
Other	64,982	67,323	73,765	76,495	90,038	92,610	100,626	103,852	100,529	103,433
Net non-interest expense	67,606	67,231	67,145	65,252	70,185	60,225	63,269	65,728	61,791	59,664
Gains on investment account securities	−573	481	1,123	1,825	3,090	250	−2,280	4,624	6,415	5,639
Income before taxes	66,959	74,974	80,907	91,101	92,774	110,028	106,746	111,427	130,502	148,537
Taxes	22,427	26,221	28,448	31,973	31,872	39,202	37,250	37,112	42,973	48,446
Extraordinary items, net of income taxes	−17	28	88	56	506	169	−31	−324	−78	428
Net income	44,515	48,780	52,550	59,184	61,408	70,996	69,464	73,992	87,451	100,520
Cash dividends declared	28,167	31,106	39,419	42,752	41,205	51,955	52,547	54,821	67,218	77,750
Retained income	16,347	17,676	13,131	16,433	20,202	19,042	16,917	19,171	20,233	22,770

A.2. Portfolio composition, interest rates, and income and expense, all U.S. banks, 1994–2003

A. All banks

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	87.10	86.97	87.38	87.15	86.76	87.03	87.13	86.48	86.42	86.06
Loans and leases, net	56.05	58.37	59.89	58.69	58.31	59.34	60.48	58.95	57.83	56.87
Commercial and industrial	14.52	15.20	15.60	15.78	16.37	17.07	17.16	16.08	14.08	12.20
U.S. addressees	12.36	12.87	13.07	13.18	13.62	14.43	14.67	13.69	12.04	10.49
Foreign addressees	2.16	2.33	2.53	2.60	2.75	2.64	2.49	2.39	2.04	1.70
Consumer	11.40	12.08	12.21	11.44	10.36	9.71	9.38	9.23	9.35	9.06
Credit card	4.19	4.68	4.87	4.55	3.96	3.51	3.52	3.63	3.78	3.55
Installment and other	7.22	7.39	7.34	6.89	6.39	6.20	5.87	5.60	5.57	5.51
Real estate	24.44	25.02	25.06	25.02	24.86	25.44	27.04	27.10	28.39	29.91
In domestic offices	23.81	24.37	24.43	24.41	24.29	24.87	26.49	26.60	27.91	29.46
Construction and land development	1.65	1.59	1.63	1.73	1.86	2.18	2.51	2.85	2.98	2.99
Farmland	.57	.56	.56	.55	.55	.56	.56	.55	.56	.54
One- to four-family residential	13.74	14.42	14.43	14.42	14.26	14.10	14.96	14.67	15.40	16.96
Home equity	1.90	1.88	1.85	1.94	1.89	1.76	1.96	2.18	2.80	3.40
Other	11.84	12.54	12.57	12.48	12.37	12.34	13.00	12.49	12.60	13.56
Multifamily residential	.79	.81	.85	.83	.82	.88	.99	.97	1.02	1.05
Nonfarm nonresidential	7.07	6.97	6.96	6.88	6.81	7.15	7.48	7.56	7.95	7.91
In foreign offices	.63	.65	.63	.61	.57	.57	.54	.50	.48	.46
To depository institutions and acceptances of other banks	1.47	1.92	2.33	1.93	1.91	1.96	1.87	1.83	1.87	1.97
Foreign governments	.41	.30	.26	.18	.15	.16	.12	.10	.09	.08
Agricultural production	1.00	.96	.92	.90	.89	.83	.78	.75	.70	.63
Other loans	3.29	3.11	3.32	2.80	2.78	2.75	2.58	2.34	2.06	1.98
Lease-financing receivables	1.03	1.19	1.51	1.87	2.13	2.52	2.63	2.58	2.44	2.12
LESS: Unearned income on loans	−.16	−.14	−.12	−.09	−.07	−.06	−.05	−.04	−.05	−.04
LESS: Loss reserves[1]	−1.35	−1.26	−1.21	−1.13	−1.07	−1.04	−1.02	−1.04	−1.11	−1.04
Securities	24.32	21.94	21.01	20.41	20.38	20.40	20.01	19.53	21.27	21.89
Investment account	21.61	19.39	18.20	17.25	17.49	18.33	17.59	16.82	18.30	18.96
Debt	21.22	18.98	17.75	16.75	16.94	17.73	16.93	16.48	17.99	18.72
U.S. Treasury	6.72	5.25	4.20	3.38	2.71	2.14	1.66	.85	.78	.90
U.S. government agency and corporation obligations	10.26	9.81	9.75	9.74	10.28	10.85	10.31	10.08	11.46	12.26
Government-backed mortgage pools	4.70	4.47	4.80	4.94	5.17	5.24	4.75	5.13	6.09	6.75
Collateralized mortgage obligations	3.19	2.67	2.11	1.94	2.12	2.15	1.92	1.95	2.35	2.34
Other	2.36	2.68	2.83	2.86	2.99	3.46	3.63	2.99	3.02	3.17
State and local government	2.01	1.80	1.68	1.59	1.57	1.62	1.52	1.49	1.49	1.48
Private mortgage-backed securities	.64	.62	.61	.50	.67	.88	.95	1.09	1.25	1.30
Other	1.56	1.49	1.51	1.54	1.71	2.24	2.48	2.98	3.01	2.78
Equity[2]	.39	.41	.45	.50	.55	.61	.66	.34	.31	.25
Trading account	2.71	2.55	2.81	3.16	2.90	2.06	2.43	2.72	2.97	2.93
Gross federal funds sold and reverse RPs	3.83	3.93	3.82	5.18	5.37	4.61	4.12	5.11	4.81	4.85
Interest-bearing balances at depositories	2.90	2.73	2.66	2.86	2.69	2.68	2.52	2.89	2.51	2.45
Non-interest-earning assets	12.90	13.03	12.62	12.85	13.24	12.97	12.87	13.52	13.58	13.94
Revaluation gains held in trading accounts[3]	2.95	2.90	2.25	2.59	2.95	2.57	2.28	2.37	2.42	2.70
Other	9.95	10.12	10.38	10.26	10.29	10.40	10.58	11.15	11.16	11.23
Liabilities	92.12	91.99	91.73	91.57	91.51	91.52	91.58	91.25	90.85	90.96
Interest-bearing liabilities	71.85	71.86	71.62	71.36	71.33	72.52	73.30	72.47	71.20	70.50
Deposits	57.36	56.31	55.87	55.01	54.65	54.79	54.66	54.59	53.87	53.31
In foreign offices	9.39	10.28	10.01	10.02	10.15	10.46	10.92	10.17	8.92	8.90
In domestic offices	47.97	46.03	45.86	44.99	44.50	44.33	43.74	44.42	44.95	44.40
Other checkable deposits	7.80	6.63	4.75	3.62	3.11	2.81	2.46	2.36	2.39	2.47
Savings (including MMDAs)	19.60	17.48	18.71	19.12	19.91	21.00	20.64	22.28	24.92	26.10
Small-denomination time deposits	15.33	16.15	15.97	15.17	14.15	13.10	12.49	11.59	10.13	8.65
Large-denomination time deposits	5.23	5.77	6.42	7.08	7.33	7.42	8.16	8.18	7.51	7.18
Gross federal funds purchased and RPs	7.60	7.71	7.18	8.13	7.99	7.97	7.83	7.95	7.77	7.75
Other	6.89	7.85	8.56	8.21	8.69	9.76	10.81	9.92	9.56	9.45
Non-interest-bearing liabilities	20.27	20.13	20.11	20.21	20.18	19.00	18.28	18.78	19.65	20.46
Demand deposits in domestic offices	13.49	12.68	12.82	12.16	11.00	9.78	8.61	8.00	7.67	7.22
Revaluation losses held in trading accounts[3]	2.69	2.88	2.14	2.64	2.97	2.52	2.29	2.21	2.09	2.30
Other	4.56	4.57	5.14	5.42	6.21	6.70	7.37	8.57	9.90	10.94
Capital account	7.88	8.01	8.27	8.43	8.49	8.48	8.42	8.75	9.15	9.04
MEMO										
Commercial real estate loans	9.94	9.83	9.92	9.99	10.12	10.87	11.58	12.09	12.57	12.48
Other real estate owned	.36	.19	.14	.11	.08	.06	.05	.05	.06	.06
Managed liabilities	29.60	32.08	32.73	34.09	34.94	36.58	38.83	37.42	35.05	34.66
Average net consolidated assets (billions of dollars)	3,862	4,147	4,376	4,733	5,145	5,439	5,906	6,334	6,635	7,249

A.2.—Continued

A. All banks

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Effective interest rate (percent)[4]									
Rates earned										
Interest-earning assets	7.61	8.33	8.14	8.15	7.99	7.70	8.22	7.36	6.08	5.27
Taxable equivalent	7.69	8.40	8.22	8.22	8.06	7.76	8.26	7.44	6.17	5.35
Loans and leases, gross	8.62	9.24	9.00	9.01	8.85	8.47	9.00	8.16	6.91	6.16
Net of loss provisions	8.32	8.92	8.56	8.50	8.30	7.97	8.33	7.15	5.86	5.48
Securities	5.97	6.51	6.46	6.54	6.45	6.27	6.47	6.08	4.98	3.99
Taxable equivalent	6.20	6.73	6.66	6.73	6.63	6.46	6.65	6.26	5.14	4.13
Investment account	5.80	6.35	6.39	6.50	6.38	6.25	6.45	6.05	5.04	4.00
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.76	4.42	3.29
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.45	5.44	4.24
Other	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.60	4.74	4.08
Trading account	7.41	7.73	6.86	6.75	6.85	6.47	6.63	6.34	4.59	3.94
Gross federal funds sold and reverse RPs	4.26	5.63	5.21	5.45	5.29	4.78	5.56	3.86	1.93	1.43
Interest-bearing balances at depositories	5.71	6.84	6.20	6.23	6.32	5.95	6.48	4.01	2.79	2.09
Rates paid										
Interest-bearing liabilities	4.01	4.99	4.82	4.92	4.88	4.47	5.17	4.15	2.54	1.87
Interest-bearing deposits	3.53	4.47	4.34	4.39	4.31	3.87	4.45	3.61	2.12	1.48
In foreign offices	5.59	6.12	5.54	5.44	5.66	4.91	5.61	3.94	2.38	1.64
In domestic offices	3.14	4.11	4.07	4.16	4.01	3.63	4.17	3.54	2.07	1.45
Other checkable deposits	1.85	2.06	2.04	2.25	2.29	2.08	2.34	1.96	1.06	.77
Savings (including MMDAs)	2.58	3.19	3.00	2.93	2.79	2.49	2.86	2.19	1.13	.74
Large time deposits[5]	4.09	5.47	5.39	5.45	5.22	4.92	5.78	5.04	3.38	2.58
Other time deposits[5]	4.17	5.44	5.40	5.54	5.48	5.09	5.69	5.43	3.73	2.91
Gross federal funds purchased and RPs	4.18	5.65	5.12	5.17	5.19	4.73	5.77	3.83	1.88	1.30
Other interest-bearing liabilities	7.25	7.46	6.93	6.94	6.89	6.48	6.97	5.92	4.32	3.57
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	6.65	7.29	7.16	7.15	6.98	6.73	7.18	6.39	5.28	4.55
Taxable equivalent	6.72	7.35	7.21	7.20	7.03	6.78	7.22	6.43	5.32	4.59
Loans	4.91	5.47	5.47	5.40	5.27	5.12	5.53	4.92	4.07	3.56
Securities	1.25	1.23	1.16	1.11	1.10	1.14	1.15	1.00	.89	.74
Gross federal funds sold and reverse RPs	.17	.23	.21	.29	.29	.23	.23	.20	.09	.07
Other	.33	.35	.32	.35	.32	.24	.27	.24	.18	.15
Gross interest expense	2.87	3.57	3.43	3.48	3.46	3.22	3.76	2.98	1.79	1.30
Deposits	2.05	2.54	2.46	2.48	2.43	2.20	2.56	2.09	1.23	.86
Gross federal funds purchased and RPs	.32	.44	.38	.43	.43	.39	.45	.31	.15	.10
Other	.50	.58	.59	.56	.60	.63	.75	.58	.41	.33
Net interest income	3.78	3.72	3.73	3.67	3.52	3.51	3.41	3.41	3.49	3.25
Taxable equivalent	3.85	3.78	3.78	3.72	3.57	3.56	3.46	3.45	3.53	3.28
Loss provisioning[6]	.28	.30	.37	.41	.41	.39	.50	.68	.68	.45
Non-interest income	2.00	2.02	2.18	2.23	2.40	2.65	2.59	2.53	2.54	2.53
Service charges on deposits	.40	.39	.39	.39	.38	.40	.40	.42	.45	.44
Fiduciary activities	.31	.31	.33	.35	.37	.38	.38	.35	.33	.31
Trading revenue	.16	.15	.17	.17	.15	.19	.21	.20	.16	.16
Interest rate exposures	n.a.	n.a.	.09	.08	.05	.07	.08	.10	.08	.06
Foreign exchange rate exposures	n.a.	n.a.	.06	.08	.09	.09	.08	.07	.07	.07
Other commodity and equity exposures	n.a.	n.a.	.02	*	.01	.03	.04	.03	.01	.02
Other	1.13	1.17	1.29	1.32	1.49	1.69	1.61	1.56	1.61	1.63
Non-interest expense	3.75	3.64	3.71	3.61	3.77	3.76	3.66	3.57	3.47	3.35
Salaries, wages, and employee benefits	1.58	1.54	1.55	1.53	1.55	1.58	1.51	1.49	1.51	1.50
Occupancy	.49	.48	.48	.47	.47	.48	.45	.44	.44	.43
Other	1.68	1.62	1.69	1.62	1.75	1.70	1.70	1.64	1.52	1.43
Net non-interest expense	1.75	1.62	1.53	1.38	1.36	1.11	1.07	1.04	.93	.82
Gains on investment account securities	−.01	.01	.03	.04	.06	*	−.04	.07	.10	.08
Income before taxes and extraordinary items	1.73	1.81	1.85	1.92	1.80	2.02	1.81	1.76	1.97	2.05
Taxes	.58	.63	.65	.68	.62	.72	.63	.59	.65	.67
Extraordinary items, net of income taxes	*	*	*	*	.01	*	*	−.01	*	.01
Net income	1.15	1.18	1.20	1.25	1.19	1.31	1.18	1.17	1.32	1.39
Cash dividends declared	.73	.75	.90	.90	.80	.96	.89	.87	1.01	1.07
Retained income	.42	.43	.30	.35	.39	.35	.29	.30	.30	.31
MEMO: Return on equity	14.63	14.69	14.53	14.84	14.05	15.39	13.97	13.35	14.41	15.34

* In absolute value, less than 0.005 percent.

n.a. Not available. MMDA Money market deposit account. RP Repurchase agreement. CD Certificate of deposit.

1. Includes allocated transfer risk reserves.
2. As in the Call Report, equity securities were combined with "other debt securities" before 1989.
3. Before 1994, the netted value of revaluation gains and losses appeared in "trading account securities" if it was a gain and in "other non-interest-bearing liabilities" if it was a loss.
4. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Reports.
5. Before 1997, large time open accounts included in other time deposits.
6. Includes provisions for allocated transfer risk.

A.2. Portfolio composition, interest rates, and income and expense, all U.S. banks, 1994–2003

B. Ten largest banks by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	77.26	77.12	80.12	81.84	81.25	81.49	82.23	81.74	81.68	81.35
Loans and leases, net	49.91	50.05	53.51	50.91	50.76	53.37	55.22	53.86	53.60	52.17
Commercial and industrial	16.43	16.16	17.17	16.90	18.07	19.20	19.87	18.82	16.16	13.01
U.S. addressees	9.16	8.66	9.59	10.24	11.76	13.14	13.95	13.42	11.69	9.43
Foreign addressees	7.27	7.50	7.59	6.66	6.31	6.06	5.92	5.41	4.47	3.59
Consumer	6.59	6.60	6.22	6.40	6.04	5.94	5.43	6.17	7.82	7.96
Credit card	2.28	1.96	1.23	1.34	1.30	1.36	1.34	1.64	2.90	2.81
Installment and other	4.31	4.65	4.99	5.06	4.74	4.58	4.09	4.53	4.92	5.15
Real estate	16.21	15.82	16.53	17.42	16.51	16.96	19.82	19.23	20.78	22.68
In domestic offices	13.80	13.48	14.44	15.69	15.08	15.55	18.48	18.05	19.70	21.74
Construction and land development	.84	.58	.51	.68	.77	.90	.98	1.27	1.42	1.36
Farmland	.06	.06	.06	.09	.09	.10	.11	.11	.12	.10
One- to four-family residential	9.69	9.62	10.43	11.02	10.33	10.77	13.37	12.41	13.51	16.03
Home equity	1.40	1.40	1.53	1.70	1.72	1.54	1.61	1.78	2.35	2.96
Other	8.29	8.22	8.90	9.31	8.61	9.22	11.76	10.63	11.17	13.07
Multifamily residential	.41	.38	.38	.39	.38	.43	.60	.51	.55	.47
Nonfarm nonresidential	2.79	2.83	3.05	3.52	3.51	3.35	3.42	3.76	4.09	3.78
In foreign offices	2.41	2.35	2.09	1.73	1.43	1.41	1.34	1.18	1.08	.94
To depository institutions and acceptances of other banks	3.49	5.04	6.14	4.20	4.05	4.34	3.78	3.23	3.20	3.51
Foreign governments	1.27	.90	.69	.45	.35	.38	.28	.20	.20	.17
Agricultural production	.25	.21	.23	.31	.28	.26	.23	.28	.23	.19
Other loans	6.32	5.76	6.34	4.15	3.74	3.96	3.75	3.51	2.94	2.84
Lease-financing receivables	1.14	1.14	1.59	2.24	2.81	3.40	3.07	3.43	3.44	2.87
LESS: Unearned income on loans	−.16	−.14	−.11	−.07	−.06	−.05	−.04	−.04	−.08	−.06
LESS: Loss reserves[1]	−1.63	−1.45	−1.30	−1.08	−1.01	−1.03	−.97	−.97	−1.12	−1.02
Securities	20.61	19.53	19.83	20.00	19.72	18.34	18.98	17.81	20.54	21.22
Investment account	11.68	10.65	10.60	10.97	12.12	13.08	13.71	12.14	14.36	15.31
Debt	11.29	10.27	10.22	10.55	11.64	12.57	13.03	11.88	14.13	15.11
U.S. Treasury	2.06	2.03	1.93	1.56	1.70	1.98	1.96	.68	.59	.82
U.S. government agency and corporation obligations	5.08	4.46	4.59	5.34	6.31	6.35	6.59	6.84	8.69	9.20
Government-backed mortgage pools	2.79	2.89	3.58	4.26	5.13	5.03	4.88	4.99	6.38	7.59
Collateralized mortgage obligations	2.22	1.50	.95	.93	.93	.79	.93	1.11	1.52	.91
Other	.06	.08	.06	.15	.26	.52	.78	.74	.79	.70
State and local government	.61	.49	.39	.51	.47	.45	.51	.55	.59	.59
Private mortgage-backed securities	.43	.32	.30	.32	.60	.57	.51	.58	.92	1.10
Other	3.03	2.97	3.01	2.81	2.57	3.22	3.47	3.22	3.34	3.40
Equity[2]	.39	.38	.38	.42	.47	.51	.68	.26	.22	.20
Trading account	8.93	8.88	9.23	9.03	7.60	5.25	5.26	5.67	6.18	5.91
Gross federal funds sold and reverse RPs	2.68	3.20	3.10	7.56	7.81	6.64	5.02	6.38	5.26	5.79
Interest-bearing balances at depositories	4.05	4.34	3.68	3.37	2.96	3.14	3.01	3.69	2.28	2.18
Non-interest-earning assets	22.74	22.88	19.88	18.16	18.75	18.51	17.77	18.26	18.32	18.65
Revaluation gains held in trading accounts[3]	11.23	10.77	7.63	7.36	7.62	6.66	5.66	5.48	5.40	5.79
Other	11.51	12.11	12.25	10.80	11.13	11.85	12.11	12.78	12.93	12.86
Liabilities	93.42	93.59	93.04	92.61	92.58	92.28	92.36	92.14	91.53	91.94
Interest-bearing liabilities	64.33	63.37	64.45	65.83	65.81	66.87	67.81	66.76	65.42	65.55
Deposits	48.20	47.49	47.87	47.36	47.65	48.79	49.27	49.09	48.96	49.01
In foreign offices	26.10	28.36	26.41	22.18	20.17	21.04	21.62	19.22	16.27	15.68
In domestic offices	22.10	19.12	21.46	25.18	27.48	27.76	27.66	29.88	32.70	33.34
Other checkable deposits	2.91	2.30	1.61	1.21	.99	.72	.74	.90	.95	1.01
Savings (including MMDAs)	12.70	10.56	12.31	14.26	15.83	16.84	16.73	19.23	22.81	24.22
Small-denomination time deposits	3.98	4.04	4.68	5.82	6.03	5.66	5.38	5.11	4.71	3.67
Large-denomination time deposits	2.51	2.23	2.86	3.89	4.62	4.54	4.80	4.63	4.22	4.43
Gross federal funds purchased and RPs	5.83	6.17	5.88	10.26	9.78	8.84	8.89	9.04	8.83	8.60
Other	10.29	9.71	10.69	8.20	8.37	9.24	9.65	8.62	7.64	7.93
Non-interest-bearing liabilities	29.09	30.22	28.59	26.78	26.77	25.41	24.56	25.38	26.10	26.40
Demand deposits in domestic offices	10.15	8.88	9.73	8.98	8.46	7.83	7.28	7.50	7.40	6.64
Revaluation losses held in trading accounts[3]	10.22	10.68	7.27	7.53	7.67	6.51	5.69	5.10	4.63	4.88
Other	10.51	10.66	11.59	10.27	10.65	11.06	11.59	12.79	14.07	14.87
Capital account	6.58	6.41	6.96	7.39	7.42	7.72	7.64	7.86	8.47	8.06
MEMO										
Commercial real estate loans	4.65	4.40	4.65	5.45	5.61	5.69	5.87	6.68	6.92	6.31
Other real estate owned	.58	.27	.18	.13	.09	.06	.04	.04	.03	.03
Managed liabilities	46.21	47.94	47.39	46.02	44.42	45.49	46.84	43.41	38.90	38.69
Average net consolidated assets (billions of dollars)	949	1,051	1,189	1,514	1,820	1,935	2,234	2,527	2,785	3,148

A.2.—Continued

B. Ten largest banks by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Effective interest rate (percent)[4]									
Rates earned										
Interest-earning assets	8.15	8.20	7.72	7.55	7.54	7.35	7.77	6.82	5.81	5.00
Taxable equivalent	8.18	8.22	7.74	7.60	7.57	7.39	7.78	6.89	5.89	5.06
Loans and leases, gross	8.89	8.84	8.32	8.25	8.21	7.99	8.46	7.52	6.54	5.78
Net of loss provisions	8.66	8.88	8.31	8.10	7.77	7.65	7.92	6.56	5.32	5.21
Securities	7.09	7.40	6.80	6.78	6.83	6.58	6.48	6.36	5.14	4.23
Taxable equivalent	7.19	7.47	6.85	6.85	6.89	6.65	6.55	6.44	5.21	4.29
Investment account	6.57	7.04	6.70	6.76	6.78	6.59	6.40	6.23	5.30	4.26
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.01	3.74	2.62
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.42	5.55	4.51
Other	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.34	5.30	4.28
Trading account	7.79	7.83	6.90	6.81	6.92	6.56	6.70	6.66	4.75	4.15
Gross federal funds sold and reverse RPs	4.52	5.20	4.92	5.45	5.20	4.52	4.93	3.86	2.20	1.66
Interest-bearing balances at depositories	7.27	7.15	6.71	6.91	7.16	7.22	7.43	3.73	3.40	2.49
Rates paid										
Interest-bearing liabilities	5.43	5.88	5.44	5.41	5.29	4.79	5.37	4.09	2.55	1.86
Interest-bearing deposits	4.32	4.99	4.57	4.54	4.40	3.82	4.40	3.27	1.95	1.36
In foreign offices	6.04	6.07	5.62	5.52	5.83	4.99	5.67	4.02	2.59	1.76
In domestic offices	2.35	3.42	3.32	3.69	3.39	3.04	3.51	2.85	1.68	1.20
Other checkable deposits	1.10	1.29	1.32	1.97	1.67	1.44	1.61	1.67	.93	.87
Savings (including MMDAs)	2.35	3.11	2.76	2.68	2.45	2.11	2.43	1.92	1.02	.73
Large time deposits[5]	3.12	3.73	4.62	5.17	4.53	4.36	5.32	4.40	3.26	2.36
Other time deposits[5]	2.80	5.08	4.58	5.45	5.21	4.95	5.53	5.14	3.55	2.86
Gross federal funds purchased and RPs	4.05	5.22	4.93	5.02	5.18	4.53	5.47	3.81	2.02	1.39
Other interest-bearing liabilities	10.87	9.80	8.86	9.13	8.85	8.61	8.15	7.00	5.39	4.20
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	6.37	6.42	6.26	6.31	6.21	6.01	6.39	5.56	4.78	4.06
Taxable equivalent	6.40	6.43	6.27	6.33	6.22	6.03	6.41	5.58	4.80	4.08
Loans	4.49	4.44	4.48	4.31	4.27	4.35	4.74	4.14	3.58	3.05
Securities	.77	.75	.71	.73	.81	.85	.88	.72	.73	.63
Gross federal funds sold and reverse RPs	.15	.21	.18	.45	.42	.30	.25	.25	.12	.10
Other	.97	1.00	.88	.82	.70	.51	.51	.43	.34	.27
Gross interest expense	3.52	3.74	3.52	3.55	3.48	3.16	3.60	2.69	1.65	1.20
Deposits	2.15	2.43	2.26	2.26	2.20	1.97	2.33	1.74	1.06	.75
Gross federal funds purchased and RPs	.24	.35	.31	.54	.54	.40	.49	.35	.18	.13
Other	1.13	.95	.95	.75	.74	.79	.78	.59	.41	.33
Net interest income	2.86	2.68	2.73	2.76	2.73	2.84	2.78	2.87	3.13	2.86
Taxable equivalent	2.88	2.70	2.75	2.79	2.75	2.86	2.80	2.89	3.15	2.88
Loss provisioning[6]	.26	.11	.11	.16	.31	.26	.38	.59	.73	.35
Non-interest income	2.33	2.16	2.34	2.12	2.15	2.55	2.54	2.23	2.32	2.31
Service charges on deposits	.26	.25	.28	.32	.33	.37	.40	.44	.48	.46
Fiduciary activities	.36	.30	.31	.34	.32	.31	.27	.29	.26	.27
Trading revenue	.53	.46	.52	.43	.33	.46	.48	.43	.32	.30
Interest rate exposures	n.a.	n.a.	.30	.23	.10	.17	.20	.21	.15	.12
Foreign exchange rate exposures	n.a.	n.a.	.17	.20	.20	.19	.18	.14	.14	.14
Other commodity and equity exposures	n.a.	n.a.	.05	*	.03	.09	.11	.08	.03	.04
Other	1.18	1.15	1.23	1.04	1.17	1.41	1.39	1.06	1.25	1.29
Non-interest expense	3.56	3.32	3.57	3.24	3.47	3.45	3.31	3.13	3.16	3.02
Salaries, wages, and employee benefits	1.65	1.58	1.57	1.45	1.45	1.57	1.46	1.38	1.41	1.39
Occupancy	.55	.50	.50	.47	.47	.50	.47	.45	.46	.45
Other	1.36	1.24	1.50	1.33	1.54	1.38	1.39	1.30	1.28	1.18
Net non-interest expense	1.23	1.16	1.23	1.12	1.32	.90	.77	.90	.84	.71
Gains on investment account securities	.02	.03	.04	.08	.11	.03	−0.03	.08	.13	.11
Income before taxes and extraordinary items	1.39	1.44	1.44	1.56	1.22	1.71	1.60	1.46	1.69	1.91
Taxes	.48	.55	.52	.58	.44	.66	.60	.48	.57	.62
Extraordinary items, net of income taxes	*	*	*	*	*	*	*	−.01	*	*
Net income	.91	.88	.92	.98	.78	1.05	1.00	.97	1.12	1.29
Cash dividends declared	.58	.57	.70	.82	.53	.79	.86	.66	1.05	.99
Retained income	.33	.31	.21	.15	.25	.26	.13	.31	.07	.30
MEMO: Return on equity	13.86	13.78	13.21	13.22	10.53	13.58	13.04	12.34	13.24	16.01

* In absolute value, less than 0.005 percent.

n.a. Not available. MMDA Money market deposit account. RP Repurchase agreement. CD Certificate of deposit.

1. Includes allocated transfer risk reserves.
2. As in the Call Report, equity securities were combined with "other debt securities" before 1989.
3. Before 1994, the netted value of revaluation gains and losses appeared in "trading account securities" if it was a gain and in "other non-interest-bearing liabilities" if it was a loss.
4. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Reports.
5. Before 1997, large time open accounts included in other time deposits.
6. Includes provisions for allocated transfer risk.

A.2. Portfolio composition, interest rates, and income and expense, all U.S. banks, 1994–2003

C. Banks ranked 11 through 100 by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	88.58	88.71	88.26	87.50	87.87	88.41	88.67	88.08	88.34	88.10
Loans and leases, net	58.56	62.68	64.24	63.89	64.38	64.23	64.88	62.14	60.00	59.48
Commercial and industrial	18.04	19.26	18.95	19.01	18.92	19.40	18.19	15.84	13.27	11.96
U.S. addressees	16.99	18.10	17.71	17.78	17.59	18.18	17.64	15.36	12.94	11.66
Foreign addressees	1.04	1.16	1.24	1.22	1.33	1.22	.55	.48	.33	.30
Consumer	12.62	14.23	15.67	15.62	14.52	13.57	13.79	13.20	12.79	12.57
Credit card	5.99	7.34	8.26	8.50	7.67	6.78	6.97	6.97	6.56	6.35
Installment and other	6.63	6.89	7.40	7.12	6.86	6.79	6.82	6.23	6.22	6.21
Real estate	22.26	23.25	23.26	22.99	24.59	24.80	26.21	27.29	28.94	30.67
In domestic offices	22.17	23.10	23.10	22.85	24.42	24.62	26.12	27.21	28.88	30.54
Construction and land development	1.63	1.50	1.55	1.69	2.03	2.43	3.00	3.31	3.36	3.21
Farmland	.14	.13	.13	.14	.17	.19	.22	.23	.22	.20
One- to four-family residential	12.98	14.16	14.15	13.88	14.86	14.15	14.51	15.51	17.05	18.79
Home equity	2.33	2.19	2.08	2.22	2.17	2.08	2.49	2.90	3.92	4.74
Other	10.65	11.97	12.07	11.65	12.69	12.07	12.02	12.60	13.13	14.04
Multifamily residential	.71	.77	.89	.93	1.00	1.02	1.11	1.16	1.20	1.33
Nonfarm nonresidential	6.72	6.54	6.37	6.21	6.36	6.82	7.28	6.99	7.05	7.01
In foreign offices	.09	.15	.16	.15	.18	.19	.09	.09	.06	.13
To depository institutions and acceptances of other banks	1.52	1.61	1.53	1.30	1.09	.93	1.05	1.40	1.44	1.21
Foreign governments	.28	.20	.20	.09	.06	.06	.03	.03	.02	.02
Agricultural production	.29	.26	.28	.29	.33	.33	.37	.32	.27	.23
Other loans	3.45	3.29	3.27	3.18	3.35	2.99	2.57	2.03	1.80	1.58
Lease-financing receivables	1.60	1.96	2.41	2.70	2.72	3.29	3.82	3.18	2.65	2.35
LESS: Unearned income on loans	−.07	−.07	−.06	−.05	−.04	−.04	−.03	−.02	−.02	−.02
LESS: Loss reserves[1]	−1.41	−1.32	−1.27	−1.24	−1.16	−1.11	−1.12	−1.13	−1.17	−1.10
Securities	21.19	18.64	16.87	15.80	16.66	17.79	17.32	19.00	20.30	21.16
Investment account	19.81	17.88	16.06	15.07	16.13	17.28	16.10	17.71	19.17	20.09
Debt	19.49	17.51	15.62	14.58	15.58	16.64	15.50	17.32	18.82	19.88
U.S. Treasury	6.86	4.82	3.34	2.81	2.25	1.70	1.12	.67	.74	.95
U.S. government agency and corporation obligations	9.37	9.40	9.12	8.98	9.93	10.57	9.70	10.09	11.45	12.99
Government-backed mortgage pools	5.40	5.06	5.42	5.17	4.98	5.12	4.31	5.19	6.00	6.08
Collateralized mortgage obligations	3.04	2.82	2.16	2.13	2.83	2.89	2.55	2.42	2.79	3.72
Other	.94	1.51	1.54	1.68	2.12	2.56	2.84	2.48	2.65	3.19
State and local government	1.20	1.11	.99	.88	.92	.99	.96	.99	.97	.95
Private mortgage-backed securities	.95	1.02	.96	.73	.96	1.35	1.66	2.01	2.13	2.14
Other	1.22	1.16	1.21	1.18	1.53	2.02	2.06	3.56	3.53	2.85
Equity[2]	.32	.37	.44	.49	.55	.65	.60	.39	.34	.21
Trading account	1.38	.76	.80	.73	.54	.51	1.22	1.29	1.13	1.07
Gross federal funds sold and reverse RPs	5.11	4.52	4.26	4.38	3.57	3.34	3.76	4.06	4.71	4.21
Interest-bearing balances at depositories	3.72	2.87	2.89	3.43	3.24	3.06	2.71	2.88	3.33	3.26
Non-interest-earning assets	11.42	11.29	11.74	12.50	12.13	11.59	11.33	11.92	11.66	11.90
Revaluation gains held in trading accounts[3]	.60	.50	.51	.69	.75	.56	.40	.55	.47	.60
Other	10.81	10.78	11.23	11.81	11.38	11.03	10.92	11.37	11.19	11.30
Liabilities	92.47	92.23	92.02	91.85	91.63	91.66	91.57	91.15	90.79	90.65
Interest-bearing liabilities	72.85	74.05	73.14	72.60	73.40	74.97	76.46	75.98	74.70	73.22
Deposits	53.03	52.32	51.81	51.45	51.50	51.50	51.57	51.94	50.48	49.81
In foreign offices	8.05	8.12	7.52	7.85	8.15	7.96	7.34	6.86	6.09	6.33
In domestic offices	44.98	44.20	44.30	43.60	43.35	43.53	44.23	45.08	44.39	43.48
Other checkable deposits	6.91	5.62	3.06	1.95	1.75	1.60	1.32	1.20	1.17	1.33
Savings (including MMDAs)	20.13	18.78	20.76	21.08	21.40	22.46	22.34	24.36	26.45	27.53
Small-denomination time deposits	13.26	14.24	14.09	13.43	12.84	11.85	11.80	10.66	8.78	7.47
Large-denomination time deposits	4.68	5.55	6.39	7.15	7.36	7.62	8.77	8.86	7.98	7.16
Gross federal funds purchased and RPs	11.49	11.37	10.00	9.36	9.48	9.77	9.28	9.71	9.66	9.71
Other	8.34	10.36	11.32	11.79	12.43	13.70	15.61	14.32	14.55	13.70
Non-interest-bearing liabilities	19.62	18.18	18.89	19.24	18.23	16.70	15.12	15.17	16.09	17.43
Demand deposits in domestic offices	15.28	14.26	14.47	14.17	12.39	10.52	8.61	7.17	6.32	5.94
Revaluation losses held in trading accounts[3]	.57	.49	.49	.68	.76	.58	.41	.52	.44	.56
Other	3.89	3.43	3.93	4.39	5.07	5.59	6.09	7.49	9.34	10.93
Capital account	7.53	7.77	7.98	8.15	8.37	8.34	8.43	8.85	9.21	9.35
MEMO										
Commercial real estate loans	9.69	9.42	9.38	9.44	10.11	11.00	12.06	12.06	12.24	12.11
Other real estate owned	.25	.13	.08	.06	.04	.03	.03	.04	.05	.06
Managed liabilities	32.89	35.68	35.60	36.60	38.11	39.83	41.98	40.81	39.48	38.15
Average net consolidated assets (billions of dollars)	1,204	1,338	1,450	1,604	1,745	1,881	2,031	2,130	2,124	2,287

A.2.—Continued

C. Banks ranked 11 through 100 by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Effective interest rate (percent)[4]									
Rates earned										
Interest-earning assets	7.29	8.31	8.16	8.31	8.10	7.84	8.46	7.53	6.00	5.26
Taxable equivalent	7.36	8.37	8.23	8.36	8.17	7.88	8.48	7.58	6.07	5.33
Loans and leases, gross	8.22	9.10	8.88	9.03	8.82	8.50	9.14	8.26	6.80	6.11
Net of loss provisions	7.87	8.67	8.21	8.27	8.15	7.80	8.25	6.96	5.59	5.11
Securities	5.75	6.38	6.49	6.55	6.31	6.32	6.64	5.96	4.79	3.80
Taxable equivalent	5.92	6.56	6.66	6.70	6.46	6.46	6.77	6.08	4.91	3.91
Investment account	5.75	6.35	6.49	6.57	6.33	6.34	6.66	6.04	4.86	3.87
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.83	4.28	3.17
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.60	5.34	4.20
Other	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.13	4.22	3.61
Trading account	5.75	7.27	6.53	6.05	5.86	5.58	6.25	4.83	3.59	2.62
Gross federal funds sold and reverse RPs	4.31	5.91	5.31	5.45	5.46	5.12	6.06	3.86	1.68	1.14
Interest-bearing balances at depositories	4.69	6.78	5.82	5.76	5.67	4.81	5.49	4.38	2.46	1.93
Rates paid										
Interest-bearing liabilities	3.71	4.94	4.70	4.79	4.77	4.38	5.22	4.16	2.41	1.79
Interest-bearing deposits	3.25	4.35	4.15	4.22	4.15	3.76	4.42	3.60	1.96	1.35
In foreign offices	4.60	6.30	5.29	5.23	5.22	4.70	5.38	3.67	1.70	1.22
In domestic offices	3.03	4.01	3.96	4.04	3.96	3.60	4.26	3.60	1.99	1.37
Other checkable deposits	1.61	1.89	1.78	2.01	2.41	2.03	2.57	2.32	.94	.67
Savings (including MMDAs)	2.46	3.10	2.91	2.84	2.76	2.49	2.94	2.30	1.08	.66
Large time deposits[5]	4.21	5.70	5.50	5.47	5.32	4.96	5.88	5.11	3.36	2.70
Other time deposits[5]	4.17	5.35	5.26	5.43	5.35	5.03	5.73	5.42	3.68	2.95
Gross federal funds purchased and RPs	4.28	5.86	5.19	5.29	5.22	4.87	6.02	3.86	1.73	1.20
Other interest-bearing liabilities	5.24	6.43	5.95	5.85	5.81	5.41	6.36	5.30	3.54	3.01
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	6.46	7.40	7.24	7.26	7.16	6.98	7.54	6.70	5.31	4.67
Taxable equivalent	6.51	7.45	7.28	7.30	7.19	7.02	7.57	6.73	5.34	4.70
Loans	4.91	5.79	5.80	5.87	5.79	5.56	6.05	5.28	4.15	3.72
Securities	1.13	1.13	1.03	.98	1.00	1.10	1.09	1.06	.90	.75
Gross federal funds sold and reverse RPs	.21	.27	.23	.22	.19	.18	.22	.15	.08	.04
Other	.21	.21	.18	.19	.18	.14	.18	.15	.11	.08
Gross interest expense	2.67	3.62	3.39	3.41	3.45	3.26	3.96	3.14	1.77	1.30
Deposits	1.73	2.29	2.18	2.23	2.23	2.02	2.41	2.01	1.09	.77
Gross federal funds purchased and RPs	.51	.67	.55	.51	.51	.51	.56	.38	.17	.12
Other	.43	.66	.66	.68	.71	.74	.99	.75	.51	.41
Net interest income	3.79	3.78	3.84	3.85	3.71	3.72	3.58	3.56	3.54	3.37
Taxable equivalent	3.84	3.84	3.89	3.89	3.74	3.75	3.61	3.59	3.57	3.40
Loss provisioning[6]	.32	.39	.54	.60	.54	.55	.68	.91	.80	.67
Non-interest income	2.25	2.38	2.61	2.76	3.07	3.36	3.18	3.36	3.30	3.28
Service charges on deposits	.45	.44	.44	.44	.42	.41	.42	.42	.42	.42
Fiduciary activities	.39	.40	.43	.44	.49	.48	.52	.42	.42	.37
Trading income	.08	.09	.08	.08	.09	.08	.07	.08	.08	.09
Interest rate exposures	n.a.	n.a.	.03	.02	.03	.02	.02	.04	.04	.04
Foreign exchange rate exposures	n.a.	n.a.	.04	.05	.06	.05	.04	.03	.04	.04
Other commodity and equity exposures	n.a.	n.a.	.01	*	*	*	*	*	*	.01
Other	1.33	1.45	1.67	1.79	2.07	2.39	2.18	2.44	2.37	2.40
Non-interest expense	3.86	3.79	3.85	3.85	4.03	4.12	4.00	3.95	3.73	3.63
Salaries, wages, and employee benefits	1.50	1.47	1.51	1.51	1.53	1.53	1.44	1.47	1.49	1.47
Occupancy	.47	.47	.48	.46	.46	.45	.43	.42	.40	.41
Other	1.89	1.85	1.86	1.88	2.04	2.14	2.14	2.07	1.84	1.76
Net non-interest expense	1.61	1.41	1.24	1.10	.96	.76	.82	.59	.43	.35
Gains on investment account securities	–.01	.02	.02	.02	.03	–.01	–.05	.09	.10	.06
Income before taxes and extraordinary items	1.85	2.01	2.09	2.18	2.24	2.40	2.02	2.15	2.41	2.41
Taxes	.63	.70	.75	.77	.78	.86	.70	.74	.82	.82
Extraordinary items, net of income taxes	*	*	*	*	*	*	*	*	*	*
Net income	1.22	1.31	1.34	1.42	1.45	1.54	1.32	1.40	1.59	1.59
Cash dividends declared	.86	.85	1.07	.93	.96	1.16	.94	.96	.99	1.05
Retained income	.36	.46	.26	.48	.50	.38	.38	.44	.60	.54
MEMO: Return on equity	16.27	16.84	16.78	17.36	17.38	18.46	15.72	15.79	17.26	17.01

* In absolute value, less than 0.005 percent.

n.a. Not available. MMDA Money market deposit account. RP Repurchase agreement. CD Certificate of deposit.

1. Includes allocated transfer risk reserves.
2. As in the Call Report, equity securities were combined with "other debt securities" before 1989.
3. Before 1994, the netted value of revaluation gains and losses appeared in "trading account securities" if it was a gain and in "other non-interest-bearing liabilities" if it was a loss.
4. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Reports.
5. Before 1997, large time open accounts included in other time deposits.
6. Includes provisions for allocated transfer risk.

A.2. Portfolio composition, interest rates, and income and expense, all U.S. banks, 1994–2003

D. Banks ranked 101 through 1,000 by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	90.89	90.97	91.10	91.32	91.36	91.68	91.50	91.16	91.36	91.34
Loans and leases, net	59.71	62.18	62.63	62.22	61.13	61.49	62.15	62.46	61.46	61.33
Commercial and industrial	12.08	12.70	12.79	12.43	12.48	12.64	12.95	13.03	12.38	11.52
U.S. addressees	11.92	12.54	12.61	12.19	12.16	12.32	12.60	12.65	12.06	11.21
Foreign addressees	.16	.16	.18	.23	.32	.32	.35	.38	.31	.31
Consumer	15.75	16.25	15.88	14.03	12.28	10.79	10.19	9.76	8.13	6.80
Credit card	5.95	6.30	6.66	5.52	4.48	3.37	3.27	3.61	2.64	1.82
Installment and other	9.80	9.95	9.22	8.52	7.80	7.41	6.92	6.15	5.50	4.97
Real estate	29.45	30.82	31.37	33.23	33.94	35.90	36.94	37.64	38.92	40.96
In domestic offices	29.43	30.80	31.34	33.21	33.92	35.88	36.91	37.62	38.90	40.91
Construction and land development	2.08	2.21	2.38	2.69	2.88	3.49	4.15	4.90	5.40	5.90
Farmland	.36	.40	.46	.53	.56	.58	.65	.66	.73	.80
One- to four-family residential	16.27	17.50	17.34	18.14	18.19	18.26	17.17	16.18	15.39	15.71
Home equity	2.33	2.37	2.30	2.30	2.15	1.99	2.10	2.21	2.51	2.92
Other	13.94	15.14	15.03	15.84	16.05	16.27	15.06	13.97	12.88	12.79
Multifamily residential	1.13	1.21	1.29	1.29	1.26	1.44	1.58	1.69	1.83	2.00
Nonfarm nonresidential	9.58	9.48	9.87	10.56	11.03	12.12	13.36	14.18	15.55	16.51
In foreign offices	.03	.02	.02	.02	.02	.02	.02	.02	.03	.05
To depository institutions and acceptances of other banks	.42	.36	.50	.59	.53	.46	.37	.38	.37	.37
Foreign governments	.02	.02	.02	.02	.03	.03	.03	.03	.02	.02
Agricultural production	.62	.69	.71	.74	.80	.78	.82	.85	.86	.83
Other loans	1.98	1.78	1.68	1.47	1.30	1.25	1.22	1.22	1.18	1.22
Lease-financing receivables	.83	.90	1.01	.99	.99	.78	.75	.74	.76	.69
LESS: Unearned income on loans	–.15	–.12	–.10	–.10	–.09	–.08	–.08	–.07	–.06	–.06
LESS: Loss reserves [1]	–1.30	–1.22	–1.22	–1.18	–1.13	–1.06	–1.04	–1.12	–1.10	–1.02
Securities	25.74	23.09	22.67	23.45	24.26	25.17	24.34	22.81	23.86	24.36
Investment account	25.43	22.88	22.55	23.35	24.15	25.09	24.25	22.70	23.80	24.22
Debt	24.99	22.42	22.03	22.74	23.46	24.33	23.46	22.27	23.30	23.79
U.S. Treasury	8.18	6.48	5.61	4.96	3.92	2.53	1.80	1.32	1.22	1.00
U.S. government agency and corporation obligations	12.77	12.23	12.66	13.97	15.13	16.29	15.56	14.70	15.85	16.96
Government-backed mortgage pools	5.64	5.42	5.69	6.22	6.46	6.72	6.22	6.27	6.55	7.03
Collateralized mortgage obligations	4.34	3.56	3.12	3.01	3.22	3.52	3.04	3.08	3.69	3.69
Other	2.79	3.25	3.85	4.73	5.44	6.05	6.30	5.35	5.60	6.24
State and local government	2.30	2.13	2.24	2.44	2.70	2.91	2.91	2.90	2.89	2.95
Private mortgage-backed securities	.73	.68	.76	.59	.65	1.00	.99	.94	.99	.87
Other	.99	.89	.76	.78	1.06	1.60	2.19	2.42	2.34	2.01
Equity [2]	.43	.47	.52	.61	.69	.77	.80	.43	.50	.43
Trading account	.31	.20	.12	.10	.11	.08	.09	.11	.06	.14
Gross federal funds sold and reverse RPs	3.64	3.92	3.87	3.60	4.17	3.35	3.40	4.20	4.15	3.85
Interest-bearing balances at depositories	1.79	1.78	1.93	2.05	1.80	1.68	1.60	1.68	1.89	1.81
Non-interest-earning assets	9.11	9.03	8.90	8.68	8.64	8.32	8.50	8.84	8.64	8.66
Revaluation gains held in trading accounts [3]	.02	.05	.02	*	*	.01	.02	.01	.01	*
Other	9.09	8.99	8.88	8.68	8.63	8.31	8.49	8.84	8.64	8.65
Liabilities	91.62	91.36	91.06	90.78	90.55	90.90	90.95	90.32	89.93	89.69
Interest-bearing liabilities	74.76	75.00	75.06	75.19	75.42	76.76	77.43	77.01	76.35	75.79
Deposits	60.45	59.68	59.98	61.47	62.40	61.94	62.67	63.10	62.83	61.95
In foreign offices	1.69	1.71	1.33	1.23	1.31	1.20	1.27	1.23	.88	.64
In domestic offices	58.75	57.97	58.65	60.25	61.09	60.74	61.40	61.86	61.95	61.31
Other checkable deposits	9.72	8.54	6.21	4.96	4.23	3.75	3.32	3.25	3.32	3.55
Savings (including MMDAs)	22.94	20.75	22.49	23.59	25.65	27.35	27.03	27.67	30.17	31.42
Small-denomination time deposits	19.31	21.12	21.61	22.03	21.22	19.61	19.44	18.80	16.83	15.04
Large-denomination time deposits	6.79	7.56	8.34	9.66	9.99	10.03	11.61	12.14	11.63	11.29
Gross federal funds purchased and RPs	8.46	8.31	8.19	7.09	6.16	6.90	6.30	5.76	5.27	5.35
Other	5.86	7.00	6.88	6.62	6.86	7.92	8.45	8.15	8.25	8.49
Non-interest-bearing liabilities	16.86	16.36	16.00	15.60	15.13	14.15	13.52	13.31	13.58	13.90
Demand deposits in domestic offices	14.59	14.07	13.84	13.15	11.90	10.19	8.97	8.23	8.05	7.97
Revaluation losses held in trading accounts [3]	.02	.05	.02	.01	.01	.01	*	.01	.01	*
Other	2.26	2.24	2.14	2.44	3.22	3.95	4.55	5.08	5.52	5.93
Capital account	8.38	8.64	8.94	9.22	9.45	9.10	9.05	9.68	10.07	10.31
MEMO										
Commercial real estate loans	13.06	13.19	13.83	14.77	15.38	17.28	19.32	21.03	23.05	24.62
Other real estate owned	.28	.17	.13	.11	.09	.08	.07	.08	.10	.11
Managed liabilities	22.83	24.61	24.78	24.66	24.46	26.32	28.01	27.75	26.57	26.40
Average net consolidated assets (billions of dollars)	1,030	1,092	1,075	968	935	972	986	1,002	1,022	1,072

A.2.—Continued

D. Banks ranked 101 through 1,000 by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Effective interest rate (percent)[4]									
Rates earned										
Interest-earning assets	7.57	8.42	8.41	8.49	8.32	7.83	8.50	7.82	6.40	5.56
Taxable equivalent	7.67	8.51	8.50	8.59	8.44	7.92	8.56	7.94	6.51	5.67
Loans and leases, gross	8.63	9.43	9.38	9.48	9.37	8.74	9.42	8.76	7.33	6.56
Net of loss provisions	8.28	8.93	8.76	8.76	8.76	8.26	8.75	7.87	6.57	6.02
Securities	5.68	6.24	6.34	6.43	6.31	6.03	6.45	5.96	4.93	3.80
Taxable equivalent	5.93	6.50	6.60	6.69	6.57	6.29	6.71	6.24	5.19	4.05
Investment account	5.68	6.24	6.34	6.43	6.30	6.03	6.45	5.96	4.93	3.82
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.85	4.54	3.42
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.33	5.38	3.95
Other	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.40	4.51	4.07
Trading account	5.29	5.55	5.94	6.37	6.84	7.33	9.30	6.60	3.82	1.67
Gross federal funds sold and reverse RPs	4.05	5.45	5.29	5.42	5.31	4.98	6.15	3.91	1.73	1.27
Interest-bearing balances at depositories	4.28	6.07	5.69	5.44	5.76	5.07	5.76	3.93	1.79	1.27
Rates paid										
Interest-bearing liabilities	3.57	4.64	4.58	4.66	4.60	4.19	4.93	4.11	2.54	1.88
Interest-bearing deposits	3.31	4.26	4.27	4.34	4.28	3.84	4.46	3.81	2.28	1.60
In foreign offices	4.31	5.94	5.72	5.42	5.55	5.07	6.12	4.27	2.14	1.43
In domestic offices	3.28	4.21	4.23	4.32	4.25	3.82	4.43	3.81	2.28	1.61
Other checkable deposits	1.87	2.02	1.96	2.16	2.15	1.99	2.27	1.81	1.06	.74
Savings (including MMDAs)	2.64	3.24	3.11	3.08	2.97	2.65	3.07	2.22	1.17	.75
Large time deposits[5]	4.23	5.62	5.48	5.56	5.51	5.17	6.00	5.27	3.34	2.57
Other time deposits[5]	4.40	5.53	5.57	5.57	5.64	5.11	5.74	5.51	3.77	2.86
Gross federal funds purchased and RPs	4.12	5.61	5.16	5.21	5.14	4.83	5.95	3.82	1.83	1.29
Other interest-bearing liabilities	4.92	6.28	5.90	6.09	6.00	5.36	6.45	5.41	4.17	3.59
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	6.89	7.68	7.68	7.75	7.63	7.19	7.79	7.16	5.85	5.07
Taxable equivalent	6.98	7.76	7.75	7.83	7.71	7.27	7.86	7.24	5.93	5.15
Loans	5.25	5.98	5.99	6.00	5.85	5.47	5.96	5.59	4.58	4.07
Securities	1.45	1.43	1.42	1.50	1.50	1.51	1.57	1.33	1.15	.91
Gross federal funds sold and reverse RPs	.14	.21	.20	.19	.22	.17	.21	.16	.07	.05
Other	.06	.07	.06	.06	.06	.04	.04	.04	.02	.01
Gross interest expense	2.65	3.46	3.40	3.47	3.44	3.20	3.79	3.14	1.92	1.41
Deposits	2.01	2.56	2.57	2.70	2.71	2.44	2.87	2.48	1.49	1.04
Gross federal funds purchased and RPs	.35	.46	.43	.37	.32	.34	.38	.22	.09	.07
Other	.29	.44	.40	.40	.41	.42	.54	.44	.34	.30
Net interest income	4.24	4.23	4.27	4.28	4.19	3.99	4.00	4.02	3.93	3.67
Taxable equivalent	4.33	4.31	4.35	4.36	4.27	4.07	4.07	4.10	4.00	3.74
Loss provisioning[6]	.32	.43	.50	.56	.48	.39	.52	.65	.55	.40
Non-interest income	1.86	1.84	1.88	2.08	2.25	2.31	2.35	2.37	2.37	2.31
Service charges on deposits	.42	.42	.41	.40	.39	.38	.36	.39	.41	.41
Fiduciary activities	.28	.27	.29	.32	.37	.38	.44	.40	.35	.31
Trading income	.02	.03	.02	.01	.02	.02	.01	*	*	.01
Interest rate exposures	n.a.	n.a.	.01	.01	.01	.01	.01	−.01	*	.01
Foreign exchange rate exposures	n.a.	n.a.	.01	*	*	*	*	*	*	*
Other commodity and equity exposures	n.a.	n.a.	*	*	*	*	*	*	*	*
Other	1.14	1.12	1.16	1.34	1.47	1.53	1.55	1.58	1.61	1.59
Non-interest expense	3.77	3.68	3.69	3.73	3.86	3.70	3.84	3.88	3.73	3.59
Salaries, wages, and employee benefits	1.49	1.44	1.44	1.50	1.57	1.56	1.59	1.61	1.64	1.64
Occupancy	.46	.45	.45	.46	.47	.47	.47	.46	.45	.43
Other	1.83	1.79	1.80	1.76	1.83	1.68	1.78	1.81	1.64	1.53
Net non-interest expense	1.92	1.84	1.81	1.65	1.61	1.39	1.48	1.52	1.36	1.28
Gains on investment account securities	−.05	−.01	.02	.02	.04	−.01	−.04	.05	.04	.05
Income before taxes and extraordinary items	1.96	1.96	1.98	2.10	2.14	2.19	1.96	1.90	2.06	2.04
Taxes	.67	.67	.69	.73	.73	.74	.67	.66	.67	.66
Extraordinary items, net of income taxes	*	*	*	*	.06	.01	*	.01	*	.03
Net income	1.29	1.28	1.29	1.37	1.46	1.46	1.29	1.25	1.38	1.40
Cash dividends declared	.81	.87	1.04	1.09	1.01	1.06	.92	1.33	1.19	1.64
Retained income	.48	.41	.25	.28	.45	.40	.37	−.08	.19	−.24
MEMO: Return on equity	15.42	14.82	14.45	14.90	15.49	16.11	14.22	12.95	13.74	13.62

* In absolute value, less than 0.005 percent.

n.a. Not available. MMDA Money market deposit account. RP Repurchase agreement. CD Certificate of deposit.

1. Includes allocated transfer risk reserves.
2. As in the Call Report, equity securities were combined with "other debt securities" before 1989.
3. Before 1994, the netted value of revaluation gains and losses appeared in "trading account securities" if it was a gain and in "other non-interest-bearing liabilities" if it was a loss.
4. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Reports.
5. Before 1997, large time open accounts included in other time deposits.
6. Includes provisions for allocated transfer risk.

A.2. Portfolio composition, interest rates, and income and expense, all U.S. banks, 1994–2003

E. Banks not ranked among the 1,000 largest by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	92.48	92.48	92.45	92.44	92.64	92.55	92.52	92.25	92.22	92.13
Loans and leases, net	54.64	56.61	57.38	58.75	59.11	59.75	62.31	62.67	62.72	62.33
Commercial and industrial	9.31	9.65	9.98	10.16	10.33	10.64	11.09	11.10	10.71	10.43
U.S. addressees	9.27	9.59	9.90	10.08	10.25	10.55	11.02	11.02	10.65	10.37
Foreign addressees	.05	.06	.07	.08	.08	.08	.07	.08	.06	.05
Consumer	9.38	9.54	9.42	8.98	8.46	8.15	7.97	7.42	6.76	6.16
Credit card	.96	1.01	1.04	.85	.70	.68	.58	.57	.49	.51
Installment and other	8.41	8.53	8.38	8.14	7.76	7.47	7.39	6.85	6.28	5.64
Real estate	32.18	33.55	34.10	35.55	36.04	36.84	39.30	40.31	41.52	42.31
In domestic offices	32.18	33.54	34.10	35.54	36.04	36.84	39.29	40.30	41.52	42.31
Construction and land development	2.14	2.38	2.61	2.82	3.02	3.28	3.70	4.23	4.51	4.99
Farmland	2.34	2.48	2.55	2.69	2.83	2.95	3.06	3.04	3.08	3.12
One- to four-family residential	16.94	17.45	17.48	18.16	18.04	17.66	18.43	18.25	17.91	17.10
Home equity	1.21	1.20	1.20	1.24	1.21	1.17	1.28	1.37	1.62	1.80
Other	15.73	16.25	16.28	16.92	16.84	16.49	17.15	16.87	16.29	15.30
Multifamily residential	.93	.95	.92	.95	.93	.98	1.04	1.06	1.16	1.28
Nonfarm nonresidential	9.83	10.28	10.54	10.92	11.21	11.97	13.06	13.72	14.86	15.82
In foreign offices	*	*	*	*	*	*	*	*	*	*
To depository institutions and acceptances of other banks	.17	.19	.21	.20	.14	.14	.12	.12	.10	.09
Foreign governments	.01	*	*	*	*	.01	.01	*	*	*
Agricultural production	3.89	3.95	3.92	4.05	4.28	4.06	3.85	3.76	3.64	3.39
Other loans	.77	.72	.69	.67	.67	.67	.69	.67	.65	.66
Lease-financing receivables	.20	.22	.23	.25	.24	.26	.27	.27	.31	.26
LESS: Unearned income on loans	−.31	−.30	−.27	−.24	−.20	−.15	−.11	−.09	−.07	−.06
LESS: Loss reserves[1]	−.95	−.93	−.90	−.87	−.86	−.87	−.88	−.88	−.90	−.92
Securities	32.90	30.51	29.53	28.25	26.70	26.92	25.40	22.81	23.34	23.46
Investment account	32.86	30.48	29.50	28.21	26.66	26.88	25.38	22.80	23.33	23.42
Debt	32.43	30.03	29.01	27.69	26.12	26.35	24.82	22.49	23.06	23.11
U.S. Treasury	10.75	9.19	7.85	6.70	5.05	3.34	2.12	1.33	1.04	.90
U.S. government agency and corporation obligations	15.25	15.13	15.67	15.58	15.43	16.89	16.95	15.27	16.07	16.22
Government-backed mortgage pools	4.73	4.19	4.21	4.01	3.90	3.95	3.47	3.78	4.54	4.84
Collateralized mortgage obligations	3.05	2.76	2.46	2.19	2.02	2.00	1.70	1.94	2.30	2.20
Other	7.47	8.19	9.00	9.38	9.51	10.94	11.78	9.56	9.23	9.18
State and local government	5.00	4.70	4.62	4.60	4.80	4.96	4.64	4.51	4.56	4.73
Private mortgage-backed securities	.26	.20	.18	.19	.16	.26	.23	.27	.26	.21
Other	.96	.82	.68	.61	.68	.89	.88	1.11	1.12	1.05
Equity[2]	.43	.45	.49	.52	.54	.53	.56	.30	.27	.31
Trading account	.04	.03	.03	.03	.04	.03	.02	.01	.01	.03
Gross federal funds sold and reverse RPs	3.42	3.91	4.04	3.95	5.13	4.17	3.22	5.00	4.26	4.27
Interest-bearing balances at depositories	1.52	1.45	1.51	1.49	1.72	1.71	1.59	1.77	1.89	2.08
Non-interest-earning assets	7.52	7.52	7.55	7.56	7.36	7.45	7.48	7.75	7.78	7.87
Revaluation gains held in trading accounts[3]	*	*	*	*	*	*	*	*	*	*
Other	7.52	7.52	7.55	7.56	7.36	7.45	7.48	7.75	7.78	7.87
Liabilities	90.43	90.04	89.81	89.63	89.54	89.75	89.89	89.60	89.73	89.58
Interest-bearing liabilities	76.18	75.74	75.58	75.47	75.35	75.90	76.05	76.00	76.01	75.47
Deposits	73.14	72.70	72.47	72.05	71.77	71.41	70.54	70.94	70.50	69.82
In foreign offices	.09	.11	.10	.09	.07	.07	.05	.06	.06	.05
In domestic offices	73.05	72.59	72.37	71.96	71.70	71.34	70.48	70.88	70.45	69.77
Other checkable deposits	13.31	12.37	11.75	11.39	11.18	11.07	10.57	10.19	10.42	10.60
Savings (including MMDAs)	23.23	20.41	19.58	18.98	19.01	19.69	19.03	19.14	20.99	22.00
Small-denomination time deposits	28.83	30.92	31.28	31.09	30.42	29.07	28.42	28.08	25.91	24.20
Large-denomination time deposits	7.67	8.89	9.76	10.50	11.10	11.50	12.47	13.48	13.13	12.97
Gross federal funds purchased and RPs	1.89	1.78	1.71	1.67	1.49	1.79	2.06	1.55	1.51	1.52
Other	1.16	1.25	1.41	1.74	2.09	2.70	3.45	3.51	4.00	4.13
Non-interest-bearing liabilities	14.25	14.30	14.23	14.16	14.19	13.86	13.84	13.59	13.71	14.11
Demand deposits in domestic offices	13.34	13.23	13.12	13.09	13.08	12.80	12.64	12.16	12.24	12.57
Revaluation losses held in trading accounts[3]	*	*	*	*	*	*	*	*	*	*
Other	.90	1.07	1.10	1.06	1.10	1.06	1.20	1.43	1.47	1.53
Capital account	9.57	9.96	10.19	10.37	10.46	10.25	10.11	10.40	10.27	10.42
MEMO										
Commercial real estate loans	13.02	13.72	14.18	14.80	15.26	16.33	17.92	19.15	20.68	22.23
Other real estate owned	.35	.25	.20	.16	.13	.11	.11	.12	.14	.15
Managed liabilities	10.83	12.05	12.99	14.02	14.76	16.08	18.08	18.66	18.79	18.78
Average net consolidated assets (billions of dollars)	679	666	661	647	644	651	655	674	704	742

A.2.—Continued

E. Banks not ranked among the 1,000 largest by assets

Item	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
	Effective interest rate (percent)[4]									
Rates earned										
Interest-earning assets	7.58	8.38	8.36	8.49	8.33	8.05	8.46	7.91	6.80	5.92
Taxable equivalent	7.72	8.53	8.50	8.63	8.48	8.18	8.56	8.05	6.93	6.06
Loans and leases, gross	9.01	9.80	9.75	9.80	9.69	9.28	9.51	9.03	7.87	7.10
Net of loss provisions	8.81	9.54	9.47	9.49	9.34	8.89	9.14	8.59	7.42	6.75
Securities	5.61	6.10	6.14	6.26	6.04	5.88	6.15	5.86	5.02	3.86
Taxable equivalent	5.99	6.49	6.52	6.65	6.46	6.29	6.54	6.28	5.43	4.26
Investment account	5.61	6.10	6.14	6.26	6.04	5.89	6.15	5.86	5.02	3.87
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.97	4.80	3.74
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6.20	5.47	3.58
Other	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.29	4.87	4.43
Trading account	6.03	6.12	6.47	6.33	5.26	3.60	4.01	6.43	4.80	.66
Gross federal funds sold and reverse RPs	4.09	5.95	5.34	5.51	5.35	4.96	6.25	3.83	1.63	1.08
Interest-bearing balances at depositories	4.64	5.88	5.63	5.62	5.67	5.69	6.38	4.56	2.68	1.96
Rates paid										
Interest-bearing liabilities	3.49	4.46	4.49	4.60	4.60	4.28	4.80	4.40	2.92	2.13
Interest-bearing deposits	3.44	4.39	4.44	4.53	4.53	4.22	4.67	4.32	2.78	2.02
In foreign offices	3.92	5.73	5.34	4.77	5.08	4.34	5.13	4.04	1.67	.85
In domestic offices	3.44	4.39	4.44	4.53	4.53	4.22	4.67	4.32	2.79	2.02
Other checkable deposits	2.30	2.50	2.41	2.46	2.45	2.28	2.47	1.97	1.16	.78
Savings (including MMDAs)	2.83	3.32	3.26	3.36	3.39	3.21	3.56	2.81	1.72	1.13
Large time deposits[5]	4.12	5.55	5.48	5.53	5.53	5.22	5.89	5.53	3.61	2.78
Other time deposits[5]	4.28	5.51	5.61	5.66	5.63	5.25	5.70	5.60	3.88	2.96
Gross federal funds purchased and RPs	4.11	5.60	5.12	5.23	4.99	4.73	5.69	3.92	1.84	1.31
Other interest-bearing liabilities	5.02	6.45	5.77	6.31	6.45	5.63	6.22	5.74	5.31	4.06
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	7.02	7.78	7.77	7.90	7.75	7.48	7.83	7.35	6.33	5.48
Taxable equivalent	7.16	7.91	7.89	8.02	7.87	7.60	7.95	7.45	6.43	5.58
Loans	4.99	5.63	5.68	5.86	5.80	5.62	5.99	5.75	5.03	4.49
Securities	1.84	1.86	1.80	1.76	1.59	1.58	1.57	1.32	1.16	.89
Gross federal funds sold and reverse RPs	.15	.25	.24	.24	.29	.22	.21	.20	.07	.05
Other	.04	.04	.04	.04	.06	.06	.05	.05	.03	.03
Gross interest expense	2.65	3.37	3.39	3.48	3.46	3.26	3.64	3.34	2.23	1.60
Deposits	2.52	3.19	3.22	3.28	3.25	3.03	3.30	3.08	1.98	1.41
Gross federal funds purchased and RPs	.07	.10	.08	.08	.07	.08	.12	.06	.03	.02
Other	.06	.08	.08	.11	.13	.15	.21	.20	.21	.17
Net interest income	4.36	4.41	4.38	4.42	4.28	4.22	4.20	4.01	4.10	3.88
Taxable equivalent	4.50	4.54	4.50	4.54	4.41	4.35	4.31	4.12	4.21	3.98
Loss provisioning[6]	.19	.24	.25	.27	.29	.31	.31	.36	.35	.29
Non-interest income	1.30	1.38	1.42	1.42	1.52	1.44	1.32	1.31	1.39	1.46
Service charges on deposits	.44	.44	.44	.44	.42	.42	.43	.44	.45	.43
Fiduciary activities	.17	.22	.19	.20	.23	.26	.21	.25	.27	.28
Trading income	*	.01	*	*	*	*	.01	*	*	*
Interest rate exposures	n.a.	n.a.	*	*	*	*	*	*	*	*
Foreign exchange rate exposures	n.a.	n.a.	*	*	*	*	*	*	*	*
Other commodity and equity exposures	n.a.	n.a.	*	*	*	*	*	*	*	*
Other	.69	.71	.79	.77	.86	.75	.67	.62	.67	.75
Non-interest expense	3.79	3.80	3.70	3.69	3.74	3.73	3.58	3.55	3.57	3.55
Salaries, wages, and employee benefits	1.75	1.79	1.77	1.80	1.82	1.82	1.78	1.79	1.82	1.82
Occupancy	.49	.50	.49	.49	.49	.49	.47	.47	.46	.45
Other	1.55	1.51	1.44	1.40	1.43	1.42	1.32	1.29	1.28	1.28
Net non-interest expense	2.48	2.42	2.28	2.28	2.23	2.29	2.26	2.24	2.18	2.09
Gains on investment account securities	−.03	*	.01	.01	.02	*	−.01	.04	.05	.04
Income before taxes and extraordinary items	1.66	1.75	1.85	1.89	1.79	1.62	1.61	1.45	1.60	1.53
Taxes	.51	.55	.59	.59	.53	.46	.45	.39	.41	.38
Extraordinary items, net of income taxes	*	*	*	*	*	*	*	*	−.01	*
Net income	1.15	1.20	1.26	1.30	1.26	1.15	1.17	1.06	1.18	1.14
Cash dividends declared	.57	.62	.64	.74	.82	.68	.79	.64	.68	.67
Retained income	.58	.58	.62	.56	.44	.48	.38	.42	.50	.47
MEMO: Return on equity	12.03	12.05	12.37	12.53	12.02	11.25	11.53	10.17	11.47	10.98

* In absolute value, less than 0.005 percent.

n.a. Not available. MMDA Money market deposit account. RP Repurchase agreement. CD Certificate of deposit.

1. Includes allocated transfer risk reserves.
2. As in the Call Report, equity securities were combined with "other debt securities" before 1989.
3. Before 1994, the netted value of revaluation gains and losses appeared in "trading account securities" if it was a gain and in "other non-interest-bearing liabilities" if it was a loss.
4. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Reports.
5. Before 1997, large time open accounts included in other time deposits.
6. Includes provisions for allocated transfer risk.

Report on the Condition of the U.S. Banking Industry: Fourth Quarter, 2003

The assets of reporting bank holding companies expanded roughly $130 billion, or 1.6 percent, in the fourth quarter. Securities and money market assets accounted for most of the increase, rising about $120 billion after having declined in the third quarter. Bank holding companies added to their holdings of mortgage pass-through securities and direct obligations of U.S. government agencies. Loans grew 1.4 percent, a more modest pace than in recent periods, tempered by continuing declines in commercial and industrial lending and some shrinkage in the stock of residential mortgage loans held for sale to securitization vehicles (related to slower mortgage originations). Deposits and borrowings increased 2.3 percent and 2.4 percent, respectively, in part compensating for a decline in other liabilities.

Undrawn commitments to lend rose more than $200 billion, or 5.4 percent, in the quarter and reached the $4.0 trillion level for the first time. Most of the increase was in the credit card category, due in large part to the acquisition during the quarter of large credit card portfolios from non-bank-holding-company firms.

Asset quality showed further signs of improvement. Nonperforming assets continued to decline—both in absolute terms and as a share of loans—as they have since late 2002. The net charge-off ratio increased slightly in the fourth quarter, to 0.83 percent of average loans, but remained well below year-earlier levels.

Net income rose overall to $28.3 billion for the fourth quarter, bringing full-year profits to $100 billion for the first time. Net interest income accounted for much of the quarterly improvement and was fueled by healthy growth in securities holdings and a rebound in yields on mortgage-backed securities—the latter related to slower prepayments. Net interest margins inched up to 3.46 percent of period-average earning assets, representing at the least a pause in the steady contraction that margins have sustained since late 2001. Non-interest income recovered 4.5 percent after a small third-quarter decline, supported by higher fees from asset management, mortgage servicing, and investment banking. Non-interest expense, which often jumps in the final quarter of a year, increased only modestly in this case and continued to represent roughly 62 percent of pretax revenue.

All of the quarterly gain in aggregate earnings occurred at the "fifty large" bank holding companies. For "all other" bank holding companies, aggregate earnings declined slightly in the fourth quarter as they had in the third quarter. Non-interest costs at these smaller bank holding companies expanded nearly 6 percent in the fourth quarter, while non-interest income slipped slightly. The net charge-off ratio rose significantly at smaller institutions in the fourth quarter, although at 0.49 percent of average loans it was still only half the level of the "fifty large" bank holding companies.

Tables start on page 193.

1. Financial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio [1, 2]	1999	2000	2001	2002	2003	2002			2003			
						Q2	Q3	Q4	Q1	Q2	Q3	Q4
Balance sheet												
Total assets	**6,205,131**	**6,682,719**	**7,439,323**	**7,930,057**	**8,819,467**	**7,623,734**	**7,776,519**	**7,930,057**	**8,165,955**	**8,661,400**	**8,683,368**	**8,819,467**
Loans	3,381,377	3,693,963	3,800,958	4,041,220	4,393,666	3,828,026	3,908,801	4,041,220	4,109,272	4,261,680	4,332,719	4,393,666
Securities and money market	2,075,524	2,177,628	2,554,074	2,846,398	3,285,907	2,761,576	2,847,808	2,846,398	3,000,025	3,207,814	3,166,019	3,285,907
Allowance for loan losses	−54,336	−58,709	−66,705	−71,914	−72,206	−69,361	−70,264	−71,914	−71,668	−71,955	−71,369	−72,206
Other	802,566	869,837	1,150,997	1,114,353	1,212,100	1,103,494	1,090,174	1,114,353	1,128,327	1,263,861	1,255,999	1,212,100
Total liabilities	**5,742,150**	**6,172,225**	**6,858,551**	**7,295,544**	**8,123,613**	**7,012,587**	**7,156,132**	**7,295,544**	**7,517,055**	**7,988,409**	**8,003,351**	**8,123,613**
Deposits	3,500,632	3,748,468	4,001,377	4,326,602	4,674,108	4,050,023	4,157,546	4,326,602	4,420,283	4,565,704	4,570,537	4,674,108
Borrowings	1,762,964	1,964,922	2,057,607	2,223,501	2,610,429	2,176,850	2,260,137	2,223,501	2,311,491	2,504,626	2,549,138	2,610,429
Other [3]	478,555	458,835	799,568	745,441	839,076	785,714	738,450	745,441	785,282	918,082	883,677	839,076
Total equity	**462,981**	**510,494**	**580,773**	**634,513**	**695,854**	**611,147**	**620,387**	**634,513**	**648,900**	**672,991**	**680,017**	**695,854**
Off-balance-sheet												
Unused commitments to lend [4]	3,095,397	3,297,511	3,481,744	3,650,669	4,097,594	3,547,956	3,610,928	3,650,669	3,714,160	3,756,486	3,887,356	4,097,594
Securitizations outstanding [5]	n.a.	n.a.	276,717	295,001	298,348	282,556	287,846	295,001	284,429	285,286	290,328	298,348
Derivatives (notional value, billions) [6]	37,786	43,483	48,261	57,734	72,870	52,614	55,464	57,734	63,993	68,222	69,411	72,870
Income statement												
Net income [7]	76,649	72,055	65,377	84,534	106,614	21,382	21,499	18,694	24,740	26,312	27,228	28,334
Net interest income	187,103	195,079	221,406	242,645	254,212	60,787	60,093	61,626	62.209	63,106	63,846	65,051
Provisions for loan losses	20,067	26,864	39,522	42,922	31,532	10,372	11,149	11,541	8.573	8,429	7,113	7,417
Non-interest income	173,041	195,995	214,061	215,826	245,029	52,637	53,635	56,738	57.485	61,785	61,495	64,265
Non-interest expense	224,044	253,165	297,108	291,948	311,032	71,172	71,522	79,002	74.268	77,631	78,122	81,011
Security gains or losses	3,114	−588	4,294	4,493	5,770	519	1,772	1,633	1.850	2,671	579	670
Ratios (percent)												
Return on average equity	17.50	15.15	11.79	14.04	16.23	14.25	14.17	12.12	15.64	16.12	16.41	16.71
Return on average assets	1.30	1.12	.91	1.10	1.26	1.13	1.12	.94	1.22	1.25	1.25	1.30
Net interest margin [8]	3.72	3.57	3.59	3.72	3.49	3.77	3.68	3.63	3.58	3.50	3.43	3.46
Efficiency ratio [7]	60.87	62.57	65.77	62.42	61.53	62.23	62.75	65.67	62.05	62.64	62.25	62.32
Nonperforming assets to loans and related assets	.84	1.07	1.45	1.46	1.16	1.53	1.65	1.46	1.43	1.34	1.24	1.16
Net charge-offs to average loans	.54	.65	.89	1.02	.81	1.01	1.09	1.03	.84	.80	.75	.83
Loans to deposits	96.59	98.55	94.99	93.40	94.00	94.52	94.02	93.40	92.96	93.34	94.80	94.00
Regulatory capital ratios												
Tier 1 risk-based	8.78	8.81	8.91	9.21	9.55	9.30	9.33	9.21	9.33	9.29	9.51	9.55
Total risk-based	11.71	11.78	11.91	12.29	12.58	12.35	12.38	12.29	12.42	12.30	12.52	12.58
Leverage	7.00	6.80	6.65	6.69	6.84	6.84	6.79	6.69	6.72	6.74	6.73	6.84
Number of reporting bank holding companies	1,647	1,727	1,842	1,979	2,133	1,907	1,946	1,979	2,036	2,064	2,120	2,133

Footnotes appear on p. 196.

2. Financial characteristics of fifty large bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio[2, 9]	1999	2000	2001	2002	2003	2002			2003			
						Q2	Q3	Q4	Q1	Q2	Q3	Q4
Balance sheet												
Total assets	**5,037,884**	**5,404,222**	**5,746,706**	**6,066,493**	**6,666,488**	**5,877,749**	**5,969,920**	**6,066,493**	**6,220,563**	**6,589,174**	**6,600,308**	**6,666,488**
Loans	2,642,839	2,874,638	2,878,573	3,043,955	3,249,806	2,884,503	2,937,799	3,043,955	3,076,486	3,168,988	3,222,116	3,249,806
Securities and money market	1,739,572	1,818,397	2,009,620	2,220,356	2,553,531	2,185,616	2,242,632	2,220,356	2,331,105	2,492,101	2,460,249	2,553,531
Allowance for loan losses	−44,054	−47,171	−53,904	−57,642	−57,004	−55,914	−56,363	−57,642	−57,049	−56,938	−56,135	−57,004
Other	699,527	758,358	912,417	859,824	920,156	863,544	845,852	859,824	870,022	985,023	974,078	920,156
Total liabilities	**4,674,181**	**5,004,053**	**5,311,719**	**5,596,714**	**6,159,340**	**5,421,428**	**5,510,255**	**5,596,714**	**5,742,702**	**6,096,082**	**6,101,096**	**6,159,340**
Deposits	2,635,845	2,795,936	2,966,151	3,191,827	3,427,923	2,978,617	3,049,718	3,191,827	3,247,738	3,360,549	3,353,428	3,427,923
Borrowings	1,586,963	1,777,262	1,821,140	1,960,517	2,242,425	1,937,932	2,013,970	1,960,517	2,023,682	2,161,088	2,204,271	2,242,425
Other[3]	451,373	430,855	524,428	444,370	488,992	504,880	446,568	444,370	471,283	574,446	543,398	488,992
Total equity	**363,703**	**400,169**	**434,987**	**469,778**	**507,148**	**456,321**	**459,665**	**469,778**	**477,861**	**493,092**	**499,212**	**507,148**
Off-balance-sheet												
Unused commitments to lend[4]	2,870,114	3,065,766	3,226,898	3,373,532	3,781,455	3,284,565	3,335,157	3,373,532	3,423,912	3,452,041	3,574,967	3,781,455
Securitizations outstanding[5]	n.a.	n.a.	269,056	279,632	280,221	270,738	274,012	279,632	267,113	271,626	274,294	280,221
Derivatives (notional value, billions)[6]	37,746	43,416	47,833	57,320	72,295	52,220	55,011	57,320	63,536	67,636	68,799	72,295
Income statement												
Net income[7]	63,666	58,801	50,202	65,442	82,953	16,621	16,513	13,949	19,319	20,423	20,829	22,382
Net interest income	144,859	149,598	160,597	176,014	182,758	44,051	42,896	45,009	44,896	45,179	45,978	46,704
Provisions for loan losses	17,173	23,167	34,434	36,981	26,799	9,041	9,660	9,839	7,438	7,198	5,871	6,292
Non-interest income	154,461	176,137	167,136	164,079	185,195	40,345	41,043	42,058	43,737	46,952	46,020	48,485
Non-interest expense	185,306	210,902	216,214	206,447	218,514	50,241	50,420	55,787	52,153	54,456	55,419	56,485
Security gains or losses	2,219	−585	4,099	4,474	5,104	552	1,651	1,672	1,775	2,353	450	525
Ratios (percent)												
Return on average equity	18.68	15.82	12.01	14.56	17.21	14.76	14.62	12.20	16.55	17.08	17.11	18.03
Return on average assets	1.33	1.13	.89	1.11	1.28	1.14	1.12	.92	1.24	1.28	1.26	1.35
Net interest margin[8]	3.59	3.42	3.34	3.51	3.30	3.56	3.42	3.46	3.38	3.29	3.25	3.28
Efficiency ratio[7]	60.45	62.48	63.04	59.42	58.63	58.92	60.01	62.81	59.17	59.58	60.16	58.92
Nonperforming assets to loans and related assets	.89	1.16	1.53	1.55	1.18	1.64	1.80	1.55	1.52	1.43	1.31	1.18
Net charge-offs to average loans	.61	.74	1.03	1.19	.95	1.20	1.29	1.18	1.02	.95	.87	.96
Loans to deposits	100.27	102.81	97.05	95.37	94.80	96.84	96.33	95.37	94.73	94.30	96.08	94.80
Regulatory capital ratios												
Tier 1 risk-based	8.06	8.14	8.17	8.43	8.68	8.56	8.57	8.43	8.54	8.45	8.70	8.68
Total risk-based	11.29	11.42	11.55	11.92	12.11	12.01	12.05	11.92	12.04	11.87	12.12	12.11
Leverage	6.61	6.40	6.19	6.18	6.27	6.38	6.29	6.18	6.19	6.20	6.20	6.27

Footnotes appear on p. 196.

3. Financial characteristics of all other reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account[1, 10]	1999	2000	2001	2002	2003	2002			2003			
						Q2	Q3	Q4	Q1	Q2	Q3	Q4
Balance sheet												
Total assets	**1,129,948**	**1,235,593**	**1,342,167**	**1,473,670**	**1,627,879**	**1,387,618**	**1,438,498**	**1,473,670**	**1,524,324**	**1,573,027**	**1,583,049**	**1,627,879**
Loans	722,961	801,474	854,000	922,055	1,014,025	877,180	903,953	922,055	942,134	970,419	985,317	1,014,025
Securities and money market	315,988	336,212	374,253	426,523	474,916	395,588	414,565	426,523	455,721	469,932	464,299	474,916
Allowance for loan losses	−10,085	−11,306	−12,350	−13,725	−14,706	−12,962	−13,433	−13,725	−14,133	−14,437	−14,697	−14,706
Other	101,084	109,214	126,264	138,817	153,644	127,812	133,414	138,817	140,602	147,112	148,130	153,644
Total liabilities	**1,033,372**	**1,128,098**	**1,221,663**	**1,337,591**	**1,478,068**	**1,258,648**	**1,304,740**	**1,337,591**	**1,383,242**	**1,427,605**	**1,438,006**	**1,478,068**
Deposits	858,101	945,865	1,020,435	1,113,679	1,214,285	1,053,692	1,089,210	1,113,679	1,148,153	1,176,226	1,186,247	1,214,285
Borrowings	154,126	156,722	174,063	191,267	227,532	175,973	182,911	191,267	199,804	214,356	216,481	227,532
Other[3]	21,145	25,512	27,165	32,645	36,251	28,983	32,619	32,645	35,286	37,023	35,278	36,251
Total equity	**96,576**	**107,495**	**120,504**	**136,079**	**149,811**	**128,970**	**133,759**	**136,079**	**141,082**	**145,422**	**145,043**	**149,811**
Off-balance-sheet												
Unused commitments to lend[4]	213,740	223,142	243,485	264,028	295,535	250,464	262,323	264,028	275,666	285,583	291,655	295,535
Securitizations outstanding[5]	n.a.	n.a.	4,567	4,942	4,893	4,350	4,178	4,942	4,994	5,205	5,116	4,893
Derivatives (notional value, billions)[6]	28	54	92	92	99	94	111	92	103	110	104	99
Income statement												
Net income[7]	12,777	13,174	14,448	17,463	18,887	4,313	4,546	4,270	4,688	4,915	4,798	4,486
Net interest income	41,923	45,233	47,754	52,925	55,173	13,291	13,601	13,331	13,580	13,774	13,700	14,118
Provisions for loan losses	2,798	3,552	4,599	5,246	4,451	1,194	1,394	1,486	1,051	1,137	1,098	1,166
Non-interest income	16,774	17,921	23,142	25,412	28,772	6,005	6,425	6,820	6,876	7,559	7,230	7,107
Non-interest expense	37,103	40,393	45,582	48,296	52,893	11,982	12,083	12,719	12,689	13,326	13,072	13,807
Security gains or losses	826	−10	796	729	1,073	164	263	185	301	431	132	209
Ratios (percent)												
Return on average equity	13.26	13.03	12.45	13.68	13.26	13.78	13.94	12.80	13.54	13.81	13.50	12.22
Return on average assets	1.17	1.12	1.13	1.26	1.22	1.26	1.29	1.18	1.26	1.28	1.23	1.12
Net interest margin[8]	4.28	4.26	4.16	4.25	3.98	4.27	4.35	4.12	4.06	4.01	3.91	3.94
Efficiency ratio[7]	62.47	62.36	63.45	60.73	62.33	62.37	59.89	62.72	61.49	63.05	62.08	64.77
Nonperforming assets to loans and related assets	.68	.76	.96	1.02	.97	.97	1.02	1.02	1.13	1.09	1.03	.97
Net charge-offs to average loans	.30	.32	.43	.46	.38	.42	.45	.53	.32	.37	.36	.49
Loans to deposits	84.25	84.73	83.69	82.79	83.51	83.25	82.99	82.79	82.06	82.50	83.06	83.51
Regulatory capital ratios												
Tier 1 risk-based	12.19	11.85	12.18	12.42	12.53	12.53	12.53	12.42	12.57	12.54	12.54	12.53
Total risk-based	13.64	13.32	13.77	14.06	14.26	14.15	14.16	14.06	14.25	14.23	14.26	14.26
Leverage	8.59	8.54	8.74	8.87	9.00	8.96	8.97	8.87	8.96	8.94	8.95	9.00
Number of other reporting bank holding companies	1,569	1,661	1,786	1,923	2,077	1,851	1,890	1,923	1,980	2,008	2,064	2,077

Footnotes appear on p. 196.

4. Nonfinancial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account	1999	2000	2001	2002	2003	2002			2003			
						Q2	Q3	Q4	Q1	Q2	Q3	Q4
Bank holding companies that qualify as financial holding companies [11, 12]												
Domestic												
Number	n.a.	299	388	434	451	411	415	434	437	440	448	451
Total assets	n.a.	4,494,270	5,436,785	5,916,835	6,605,627	5,643,267	5,706,966	5,916,835	6,061,677	6,433,712	6,447,116	6,605,627
Foreign-owned [13]												
Number	n.a.	9	10	11	12	11	11	11	11	11	11	12
Total assets	n.a.	502,506	621,442	616,254	710,443	656,344	689,804	616,254	648,017	732,695	729,244	710,443
Total U.S. commercial bank assets [14]	5,673,702	6,129,534	6,415,909	6,897,447	7,398,689	6,572,090	6,762,780	6,897,447	7,031,480	7,325,659	7,294,142	7,398,689
By ownership												
Reporting bank holding companies	5,226,027	5,657,210	5,942,575	6,429,738	6,941,741	6,107,717	6,296,385	6,429,738	6,578,067	6,863,642	6,842,982	6,941,741
Other bank holding companies	226,916	229,274	230,464	227,017	219,402	226,558	226,602	227,017	222,670	222,997	217,038	219,402
Independent banks	220,759	243,050	242,870	240,692	237,546	237,815	239,793	240,692	230,743	239,020	234,122	237,546
Assets associated with nonbanking activities [12, 15]												
Insurance	n.a.	n.a.	426,462	350,633	411,927	386,590	338,384	350,633	359,968	384,000	398,379	411,927
Securities broker–dealers	n.a.	n.a.	n.a.	630,851	636,854	695,814	703,738	630,851	709,839	656,919	667,455	636,854
Thrift institutions	117,699	102,218	91,170	107,422	133,057	53,938	56,063	107,422	126,375	124,640	143,578	133,057
Foreign nonbank institutions	78,712	132,629	138,977	145,344	170,600	149,674	144,814	145,344	154,812	160,515	162,789	170,600
Other nonbank institutions	879,793	1,234,714	1,674,267	561,712	705,949	466,371	493,780	561,712	524,697	740,215	755,056	705,949
Number of bank holding companies engaged in nonbanking activities [12, 15]												
Insurance	n.a.	n.a.	143	86	102	92	91	86	91	92	101	102
Securities broker–dealers	n.a.	n.a.	n.a.	47	51	47	47	47	48	50	46	51
Thrift institutions	57	50	38	32	27	37	37	32	31	31	29	27
Foreign nonbank institutions	25	25	32	37	41	35	38	37	38	40	39	41
Other nonbank institutions	559	633	743	880	1,034	798	835	880	911	944	989	1,034
Foreign-owned bank holding companies [13]												
Number	18	21	23	26	28	24	24	26	26	27	28	28
Total assets	535,024	636,669	764,411	762,901	934,781	787,998	827,867	762,901	799,540	946,847	947,932	934,781
Employees of reporting bank holding companies (full-time equivalent)	1,775,418	1,859,930	1,985,981	1,992,559	2,034,551	2,000,084	1,979,260	1,992,559	2,000,168	2,019,953	2,031,029	2,034,551
Assets of fifty large bank holding companies [9, 17]												
Fixed panel (from table 2)	5,037,884	5,404,222	5,746,706	6,066,493	6,666,488	5,877,749	5,969,920	6,066,493	6,220,563	6,589,174	6,600,308	6,666,488
Fifty large as of reporting date	4,809,785	5,319,129	5,732,621	6,032,000	6,666,488	5,861,542	5,951,115	6,032,000	6,203,000	6,587,000	6,602,255	6,666,488
Percent of all reporting bank holding companies	77.50	79.60	77.10	76.10	75.60	76.90	76.50	76.10	76.00	76.10	76.00	75.60

NOTE. All data are as of the most recent period shown. The historical figures may not match those in earlier versions of this table because of mergers, significant acquisitions or divestitures, or revisions of bank holding company restatements to financial reports. Data for the most recent period may not include all late-filing institutions.

1. Covers top-tier bank holding companies except (1) those with consolidated assets of less than $150 million and with only one subsidiary bank and (2) multibank holding companies with consolidated assets of less than $150 million, with no debt outstanding to the general public and not engaged in certain nonbanking activities.

2. Data for all reporting bank holding companies and the fifty large bank holding companies reflect merger adjustments to the fifty large bank holding companies. Merger adjustments account for mergers, acquisitions, other business combinations and large divestitures that occurred during the time period covered in the tables so that the historical information on each of the fifty underlying institutions depicts, to the greatest extent possible, the institutions as they exist in the most recent period. In general, adjustments for mergers among bank holding companies reflect the combination of historical data from predecessor bank holding companies.

The data for the fifty large bank holding companies have also been adjusted as necessary to match the historical figures in each company's most recently available financial statement.

In general, the data are not adjusted for changes in generally accepted accounting principles.

3. Includes minority interests in consolidated subsidiaries.

4. Includes credit card lines of credit as well as commercial lines of credit.

5. Includes loans sold to securitization vehicles in which bank holding companies retain some interest, whether through recourse or seller-provided credit enhancements or by servicing the underlying assets. Securitization data were first collected on the FR Y-9C report for June 2001.

6. The notional value of a derivative is the reference amount of an asset on which an interest rate or price differential is calculated. The total notional value of a bank holding company's derivatives holdings is the sum of the notional values of each derivative contract regardless of whether the bank holding company is a payor or recipient of payments under the contract. The actual cash flows and fair market values associated with these derivative contracts are generally only a small fraction of the contract's notional value.

7. Income statement subtotals for all reporting bank holding companies and the fifty large bank holding companies exclude extraordinary items, the cumulative effects of changes in accounting principles, and discontinued operations at the fifty large institutions and therefore will not sum to Net income. The efficiency ratio is calculated excluding nonrecurring income and expenses.

8. Calculated on a fully-taxable-equivalent basis.

9. In general, the fifty large bank holding companies are the fifty largest bank holding companies as measured by total consolidated assets for the latest period shown. Excludes a few large bank holding companies whose commercial banking operations account for only a small portion of assets and earnings.

10. Excludes predecessor bank holding companies that were subsequently merged into other bank holding companies in the panel of fifty large bank holding companies. Also excludes those bank holding companies excluded from the panel of fifty large bank holding companies because commercial banking operations represent only a small part of their consolidated operations.

11. Exclude qualifying institutions that are not reporting bank holding companies.

12. No data related to financial holding companies and only some data on nonbanking activities were collected on the FR Y-9C report before implementation of the Gramm–Leach–Bliley Act in 2000.

13. A bank holding company is considered "foreign-owned" if it is majority-owned by a foreign entity. Data for foreign-owned companies do not include data for branches and agencies of foreign banks operating in the United States.

14. Total assets of insured commercial banks in the United States as reported in the commercial bank Call Report (FFIEC 031 or 041, Reports of Condition and Income). Excludes data for a small number of commercial banks owned by other commercial banks that file separate call reports yet are also covered by the reports filed by their parent banks. Also excludes data for mutual savings banks.

15. Data for thrift, foreign nonbank, and other nonbank institutions are total assets of each type of subsidiary as reported in the FR Y-9LP report. Data cover those subsidiaries in which the top-tier bank holding company directly or indirectly owns or controls more than 50 percent of the outstanding voting stock and that has been consolidated using generally accepted accounting principles. Data for securities broker–dealers are net assets (that is, total assets, excluding intercompany transactions) of broker–dealer subsidiaries engaged in activities pursuant to the Gramm–Leach–Bliley Act, as reported on schedule HC-M of the FR Y-9C report. Data for insurance activities are all insurance-related assets held by the bank holding company as reported on schedule HC-I of the FR Y-9C report.

Beginning in 2002:Q1, insurance totals exclude intercompany transactions and subsidiaries engaged in credit-related insurance or those engaged principally in insurance agency activities. Beginning in 2002:Q2, insurance totals include only newly authorized insurance activities under the Gramm–Leach–Bliley Act.

16. Aggregate assets of thrift subsidiaries were affected significantly by the conversion of Charter One's thrift subsidiary (with assets of $37 billion) to a commercial bank in the second quarter of 2002 and the acquisition by Citigroup of Golden State Bancorp (a thrift institution with assets of $55 billion) in the fourth quarter of 2002.

17. Changes over time in the total assets of the time-varying panel of fifty large bank holding companies are attributable to (1) changes in the companies that make up the panel and (2) to a small extent, restatements of financial reports between periods.

n.a. Not available

SOURCE. Federal Reserve Reports FRY-9C and FR Y-9LP, Federal Reserve National Information Center, and published financial reports.

Announcements

FEDERAL OPEN MARKET COMMITTEE STATEMENTS

The Federal Open Market Committee decided on January 28, 2004, to keep its target for the federal funds rate at 1 percent.

The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity. The evidence accumulated over the intermeeting period confirms that output is expanding briskly. Although new hiring remains subdued, other indicators suggest an improvement in the labor market. Increases in core consumer prices are muted and expected to remain low.

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation. With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation.

Voting for the FOMC monetary policy action were the following: Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Ben S. Bernanke; Susan S. Bies; Roger W. Ferguson, Jr.; Edward M. Gramlich; Thomas M. Hoenig; Donald L. Kohn; Cathy E. Minehan; Mark W. Olson; Sandra Pianalto; and William Poole.

The Federal Open Market Committee decided on March 16, 2004, to keep its target for the federal funds rate at 1 percent.

The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity. The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid pace. Although job losses have slowed, new hiring has lagged. Increases in core consumer prices are muted and expected to remain low.

The Committee perceives the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation. With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation.

Voting for the FOMC monetary policy action were Alan Greenspan, Chairman; Timothy F. Geithner, Vice Chairman; Ben S. Bernanke; Susan S. Bies; Roger W. Ferguson, Jr.; Edward M. Gramlich; Thomas M. Hoenig; Donald L. Kohn; Cathy E. Minehan; Mark W. Olson; Sandra Pianalto; and William Poole.

BOARD AGREES TO SEEK COMMENT ON REVISIONS TO REGULATION BB

The Board of Governors of the Federal Reserve System agreed on January 21, 2004, to seek comment on an interagency proposal to revise regulations (Regulation BB, Community Reinvestment) that implement the Community Reinvestment Act (CRA).

The Community Reinvestment Act is intended to encourage depository institutions to help meet credit needs in their communities, including low- and moderate-income neighborhoods. The agencies proposed limited amendments to the regulation in two areas. First, the definition of *small institution*, a category of institutions entitled to streamlined CRA evaluations, would be amended to include banks and thrift institutions with total assets of less than $500 million (the threshold is now $250 million), and eliminate consideration of an institution's holding company size (now, an institution is not *small* if its holding company is larger than $1 billion).

Second, the proposal would specify when unlawful discrimination, other illegal credit practices, or abusive asset-based lending by a bank or its affiliate might adversely affect the bank's CRA rating.

The agencies also proposed enhancements to the loan data they disclose in CRA public evaluations and CRA disclosure statements.

A notice of the proposed rulemaking will be published jointly after it has been acted upon by all of the banking agencies with CRA supervisory responsibilities.

Agencies Publish Proposed Rulemaking Regarding the Community Reinvestment Act and Regulation BB

The federal bank and thrift institution regulatory agencies published in the *Federal Register* on February 6, 2004, a joint interagency notice of proposed rulemaking (NPR) regarding the Community Reinvestment Act (CRA).

The CRA directs the agencies to assess an insured depository institution's record of meeting the credit needs of its entire community, and to consider that record when acting on certain applications for branches, office relocations, mergers, consolidations, and other corporate activities. The NPR is the product of an interagency review of the CRA regulations that fulfilled the commitment the agencies made when they adopted the current CRA regulations in 1995 to review the regulations (Regulation BB, Community Reinvestment) to determine whether they were producing objective, performance-based CRA evaluations without imposing undue burden on institutions.

The proposed rulemaking, which is being published by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, underscores the agencies' conclusion that the CRA regulations are essentially sound, but need to be updated to keep pace with changes in the financial services industry.

This proposed rule was developed after the agencies' review of the CRA regulations, which included an analysis of about four hundred comments received on the Advance Notice of Proposed Rulemaking.

The agencies are proposing amendments to the CRA regulations in two areas.

First, to reduce unwarranted burden consistent with the agencies' ongoing efforts to identify and reduce regulatory burden, the agencies are proposing to amend the definition of *small institution* to mean an institution with total assets of less than $500 million, without regard to any holding company assets.

This change would take into account substantial institutional asset growth and consolidation in the banking and thrift institution industries since the definition was adopted. The proposal would increase the number of institutions that are eligible for evaluation under the small institution performance standards, while only slightly reducing the portion of the nation's bank and thrift institution assets that is subject to evaluation under the large retail institution performance standards.

Second, to better address abusive lending practices in CRA evaluations, the agencies proposed to amend the regulations to provide explicitly that an institution's CRA evaluation will be adversely affected by evidence of specified discriminatory, illegal, or abusive practices by the institution or by an affiliate whose loans were considered in the evaluation as part of the institution's own CRA record.

In addition, the agencies also proposed several enhancements to the loan data disclosed in CRA public evaluations and CRA disclosure statements.

Approval of Final Rules to Establish Effective Dates for the FACT Act

The Federal Reserve Board on February 5, 2004, announced its approval of final rules to establish effective dates for all provisions of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) that do not have a statutorily prescribed effective date. These regulations are being issued jointly with the Federal Trade Commission (FTC).

The recently enacted FACT Act amended the Fair Credit Reporting Act (FCRA) and required the Board and the FTC to adopt final rules establishing the effective dates for certain provisions of the FACT Act. In mid-December, the Board and the FTC jointly adopted interim final rules that established December 31, 2003, as the effective date for the preemption provisions of the FACT Act as well as provisions authorizing the agencies to adopt rules or take other actions to implement the FACT Act. The agencies now have adopted final joint rules with the same schedule of effective dates contained in the interim rules.

Also in mid-December, the Board and the FTC jointly issued for comment proposed joint rules that would establish a schedule of effective dates for other provisions of the FACT Act that do not contain effective dates. After reviewing the comments on the proposal, the agencies adopted joint final rules that established March 31, 2004, as the effective date for the provisions of the FACT Act that do not require significant changes to business procedures. With respect to other provisions that likely entail significant changes to business procedures, the joint final rules make these provisions effective on December 1, 2004, to allow industry a reasonable time to establish systems to comply with the statute.

AMENDMENTS TO REGULATION CC

The Federal Reserve Board on March 2, 2004, announced amendments to appendix A of Regulation CC (Availability of Funds and Collection of Checks), effective May 15, 2004, that reflect the restructuring of the Federal Reserve's check processing operations in the Eleventh District. These amendments are part of a series of amendments to appendix A that will take place through the end of 2004, associated with the previously announced restructuring of the Reserve Banks' check processing operations.

Appendix A provides a routing number guide that helps depository institutions determine the maximum permissible hold periods for most deposited checks. As of May 15, 2004, the El Paso office of the Federal Reserve Bank of Dallas no longer processes checks, and banks previously served by that office for check processing purposes have been reassigned to the Reserve Bank's head office in Dallas. To reflect this operational change, the final rule deletes the reference in appendix A to the El Paso office and reassigns the routing numbers listed thereunder to the Reserve Bank's head office. As a result of this change, some checks deposited in the affected regions that previously were nonlocal checks are now local checks that are subject to shorter permissible hold periods.

The Federal Reserve Board on April 9, 2004, announced amendments to appendix A of Regulation CC, effective June 26, 2004, that reflect the restructuring of the Federal Reserve's check processing operations in the Fourth and Fifth Districts. These amendments are part of a series of amendments to appendix A that will take place through the end of 2004, associated with the previously announced restructuring of the Reserve Banks' check processing operations.

Appendix A provides a routing number guide that helps depository institutions determine the maximum permissible hold periods for most deposited checks. As of June 26, 2004, the Charleston office of the Federal Reserve Bank of Richmond no longer will process checks, and banks currently served by that office for check processing purposes will be reassigned to the Cincinnati office of the Federal Reserve Bank of Cleveland. To reflect this operational change, the final rule deletes the reference in appendix A to the Charleston office and reassigns the routing numbers listed thereunder to the Cleveland Reserve Bank's Cincinnati office. As a result of this change, some checks deposited in the affected regions that currently are nonlocal checks will become local checks that are subject to shorter permissible hold periods.

COMMENT REQUESTED ON PROPOSED CHANGES TO PUBLIC DISCLOSURE TABLES

The Federal Reserve Board on March 18, 2004, requested public comment on proposed changes to the public disclosure tables that are used to report data collected by lenders under the Home Mortgage Disclosure Act (HMDA).

The proposal would revise some of the existing disclosure tables, delete one set of existing tables, and add new tables.

Recent revisions to Regulation C (Home Mortgage Disclosure), the Board regulation that implements HMDA, require lending institutions to report new data, including loan pricing information (the rate spread between the annual percentage rate on the loan and the yield on Treasury securities of comparable maturity); whether the loan is subject to the Home Ownership and Equity Protection Act (HOEPA); whether manufactured housing is involved; whether the loan is subject to a first or subordinate lien on the property; and certain information about requests for pre-approval. These data items would be reflected on the proposed new tables.

The proposed revisions to the existing tables are primarily to reflect the itemization of data on manufactured housing and changes to the race and ethnicity categories adopted by the Board to conform to standards established by the Office of Management and Budget.

The first year for which the new data will be reported is 2004. Data from institutions must be submitted to the federal financial regulatory agencies no later than March 1, 2005, and the data will be reflected in the public disclosures scheduled to be released in the summer of 2005.

REVISIONS TO REGULATION Z

The Federal Reserve Board on March 26, 2004, issued revisions to Regulation Z (Truth in Lending), which implements the Truth in Lending Act, and to the official staff commentary that applies and interprets the requirements of the regulation.

Regulation Z was revised to add an interpretative rule of construction to clarify that where the word "amount" is used in the regulation to describe disclosure requirements, it refers to a numerical amount. In addition, revisions to the staff commentary provide guidance on consumers' exercise of rescission rights for certain home-secured loans.

The Board also published several technical revisions to the commentary. The revisions were effective April 1, 2004. The date for mandatory compliance is October 1, 2004.

Proposed Amendments to Regulation V

The Federal Reserve Board on April 7, 2004, issued proposed amendments to Regulation V (Fair Credit Reporting), which implements the Fair Credit Reporting Act (FCRA). The amendments would add a model form for financial institutions to use when they furnish negative information to consumer reporting agencies.

Under the Fair and Accurate Credit Transactions Act (FACT Act) amendments to the FCRA, the Board is required to publish, after notice and comment, a concise model form (not to exceed thirty words in length) that financial institutions may use to comply with the notice requirement for furnishing negative information to consumer reporting agencies. The model form must be issued in final form by June 4, 2004.

The FACT Act provides that if any financial institution (1) extends credit regularly and in the ordinary course of business furnishes information to a nationwide consumer reporting agency, and (2) furnishes negative information to such an agency regarding credit extended to a customer, the institution must provide a clear and conspicuous notice about furnishing negative information, in writing, to the customer. "Negative information" means information concerning a customer's delinquencies, late payments, insolvency, or any form of default.

The FACT Act defines the term "financial institution" to have the same meaning as in the Gramm–Leach–Bliley Act, which generally is "any institution the business of which is engaging in financial activities as described in section 4(k) of the Bank Holding Company Act of 1956."

The Board's model form could be used by all financial institutions, as defined by the act.

Establishment of a Working Group to Implement a Dormant Bank

The Federal Reserve Board announced on January 30, 2004, that it had established a private-sector Working Group on NewBank Implementation to further develop the concept of a dormant bank that would be available for activation, if necessary, to clear and settle U.S. government securities.

In a report released on January 7, 2004, a previous private-sector panel, the Working Group on Government Securities Clearance and Settlement, recommended nine steps to mitigate risks to the financial system from the interruption or termination of the services of a clearing bank as the result of either operational or non-operational problems.

All of the major participants in the U.S. government securities markets depend on one of two commercial banks to settle their trades and facilitate financing of their positions. The September 11, 2001, terrorist attacks demonstrated how operational disruptions to a clearing bank's services could disrupt the trading, clearance, and settlement of government securities.

One of the first working group's nine recommendations, which were endorsed by the Board, called for the Board to establish a second panel focused on developing NewBank, a limited-purpose, dormant entity, ready for activation in the event that one of the two major clearing banks permanently exited the business, voluntarily or involuntarily, and no well-qualified bank stepped forward to purchase the exiting bank's clearing business.

The Board has asked the new working group to flesh out the NewBank concept and address any challenges to implementing it. Once those challenges have been successfully addressed, those that have agreed to own NewBank should take the necessary steps to implement the concept, including obtaining a limited-purpose bank charter. The Board asked the working group to prepare a report by late this year that summarizes its progress, identifies the remaining challenges that need to be addressed before a charter application can be submitted, and sets out a timetable for meeting those remaining challenges.

Michael Urkowitz, Senior Adviser to Deloitte Consulting, the chairman of the previous working group, has agreed to serve as chairman of the NewBank panel. The NewBank Working Group will include senior representatives of the two major clearing banks (J.P. Morgan Chase and The Bank of New York), the Fixed Income Clearing Corporation, The Bond Market Association, the Investment Company Institute, Cantor Fitzgerald Securities, Federated Investors, Fidelity Investments, Goldman Sachs & Co., Lehman Brothers, Merrill Lynch, Morgan Stanley & Co., Salomon Smith Barney (Citigroup), State Street Bank & Trust Co., and UBS Investment Bank.

Staff members of the Federal Reserve, the Securities and Exchange Commission, the Department of the Treasury, the Federal Deposit Insurance Corporation, and the New York State Banking Department will participate as observers and technical advisers.

Changes to Policy Statement on Payments System Risk

The Federal Reserve Board on February 5, 2004, announced that it intends, beginning in July 2006, to require Reserve Banks to release interest and redemption payments on securities issued by government-sponsored enterprises and international organizations only when the issuer's Federal Reserve account contains sufficient funds to cover these payments.

The Reserve Banks have been processing and posting these payments to depository institutions' Federal Reserve accounts by 9:15 a.m. eastern time, the same posting time as for U.S. Treasury securities' interest and redemption payments, even if the issuer has not fully funded its payments.

However, the rising level of intraday credit in recent years has prompted a reassessment of this practice, which is inconsistent with that of private issuing and paying agents for their customers' securities. In general, these issuing and paying agents do not allow payments to be made for a securities issuer before the issuer has fully funded its payments.

The Board requested comment by April 16, 2004, on how best to promote a smooth market adjustment while implementing this change in its Policy Statement on Payments System Risk. The Board first adopted the policy statement in 1985 and has modified and expanded it periodically. Its objectives are to reduce risk and increase efficiency in the payments system, including minimizing intraday float. To that end, the Board introduced fees for daylight overdrafts in 1994 but granted a temporary exemption to government-sponsored enterprises until after market participants adjusted to the introduction of fees for depository institutions. The Board completed a broad review of the policy statement on Payments System Risk two years ago and found that market participants have adjusted to the fees, permitting reconsideration of the temporary exemption.

Concurrent with the change for interest and redemption payments on the securities of government-sponsored enterprises and international organizations, the Board also plans to align its policy treatment of the general corporate account activity of these entities with the treatment of activity of other account holders that do not have regular access to the discount window. Such treatment would include applying a penalty fee to daylight overdrafts resulting from these entities' general corporate payment activity.

By law, Reserve Banks act as fiscal agents for these government-sponsored enterprises and international organizations: the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, entities of the Federal Home Loan Bank System, the Farm Credit System, the Federal Agricultural Mortgage Corporation, the Student Loan Marketing Association, the International Bank for Reconstruction and Development (World Bank), the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank.

Removal of All Fifty-One Stocks from List of Foreign Margin Stocks

The Federal Reserve Board on March 3, 2004, announced that it was removing all fifty-one stocks from its current List of Foreign Margin Stocks because they had not been recertified as required under procedures approved by the Board in 1990. The list is one of two methods for foreign securities to qualify as margin securities under Regulation T (Credit by Brokers and Dealers).

The list, which has been published twice each year by the Board since 1999, is composed of certain foreign equity securities that qualify as margin securities under Regulation T. Stocks on the list qualify as margin securities by meeting certain financial requirements specified in Regulation T.

In determining the qualification of particular foreign equity securities, the Board has relied on a list of proposed margin stocks submitted by the New York Stock Exchange (NYSE). The eligibility of the stocks must be certified by at least two NYSE members under procedures adopted by the NYSE and approved by the Board in 1990.

Foreign securities may also qualify as margin securities if they are deemed by the Securities and Exchange Commission (SEC) to have a "ready market" under its net capital rule. This includes all foreign stocks in the FTSE World Index Series.

The stocks being removed from the list are named in the *Federal Register*, viewable on the Board's web site at www.federalreserve.gov/boarddocs/press/bcreg/2004/20040303/attachment.pdf. The Board will publish a new list of foreign margin stocks if eligible securities are identified pursuant to the existing listing procedures.

PUBLIC MEETING HELD ON PROPOSED MERGER BETWEEN J.P. MORGAN CHASE & CO. AND BANK ONE CORPORATION

The Federal Reserve Board on March 26, 2004, announced that public meetings would be held in April in New York and Chicago on the proposal by J.P. Morgan Chase & Co. to merge with Bank One Corporation.

The purpose of these meetings is to collect information relating to factors that the Board is required to consider under the Bank Holding Company Act. These factors are the effects of the proposal on the financial and managerial resources and future prospects of the companies and banks involved in the proposal, competition in the relevant markets, and the convenience and needs of the communities to be served. Convenience and needs considerations include the records of performance of J.P. Morgan Chase and Bank One under the Community Reinvestment Act.

The specific dates, times, and locations of the meetings were the following:

• New York—Thursday, April 15, 2004, at 9:00 a.m. EDT at the Federal Reserve Bank of New York, 33 Liberty Street, New York, New York 10045.

• Chicago—Friday, April 23, 2004, at 8:30 a.m. CDT at the Federal Reserve Bank of Chicago, 230 South LaSalle Street, Chicago, Illinois 60604.

The Federal Reserve Board also announced that the period for public comment of the proposal would be extended through the close of business on Friday, April 23, 2004.

APPOINTMENT OF DR. JANET L. YELLEN AS PRESIDENT, FEDERAL RESERVE BANK OF SAN FRANCISCO

Dr. Janet L. Yellen has been appointed President and Chief Executive Officer of the Federal Reserve Bank of San Francisco, according to an announcement on April 12, 2004, by George M. Scalise, Chairman of the San Francisco Federal Reserve Bank's Board of Directors. Dr. Yellen is the Eugene E. and Catherine M. Trefethen Professor of Business at the Haas School of Business and professor of economics at the University of California—Berkeley.

Dr. Yellen will assume her new position on June 14, 2004, succeeding current President and Chief Executive Officer Robert T. Parry, who last September announced his intention to retire at mid-year after serving for eighteen years. Scalise said the appointment was made by the directors of the Federal Reserve Bank of San Francisco, and approved by the Board of Governors of the Federal Reserve System in Washington, D.C.

"We conducted a nationwide search," Scalise said, "and identified a slate of highly qualified candidates. Dr. Yellen rose to the top as our pick because of her extraordinary combination of monetary policy expertise, experience as a Federal Reserve Board Governor in Washington, fiscal policy experience at the White House, and her extensive academic, international trade, finance and economic experience, and research background."

"I'm honored to have been chosen for this key position, and I look forward to meeting employees and community leaders throughout the highly diverse states that comprise the largest District in the Federal Reserve System," Yellen said. "It will be a pleasure to return to Washington for monetary policy meetings representing the critical economic forces embodied in the Federal Reserve Bank of San Francisco's Twelfth District."

Outgoing President and Chief Executive Officer Robert T. Parry said, "I've known and worked with Janet for a number of years. She is an outstanding economist, and she made very significant contributions to the monetary policy process during her tenure as a Governor of the Federal Reserve Board. I know that Janet will be a superb President of the Federal Reserve Bank of San Francisco."

Federal Reserve Chairman Alan Greenspan said, "I am pleased to welcome Dr. Yellen back to the Federal Reserve System. She has distinguished herself through consistently incisive analysis, impressive skill, and unwavering integrity. We benefited greatly from her exceptional service as a Federal Reserve Board Governor and I look forward to the many contributions she will bring in her new role, to both the San Francisco Bank and the Federal Open Market Committee."

Dr. Yellen, 57, holds a BA in economics from Brown University, and a PhD in economics from Yale University. She was awarded honorary doctorates in humane letters and laws, by Bard College and Brown University respectively. She has been affiliated with the Haas School of Business at the University of California—Berkeley since 1980. In addition, she served as chair of the President's Council of Economic Advisers from 1997 to

1999, and was a member of the Federal Reserve System's Board of Governors from 1994 to 1997. She has taught at Harvard and at the London School of Economics and Political Science. Dr. Yellen serves as president of the Western Economics Association and vice president of the American Economic Association. She is a fellow of the Yale Corporation. She is also the recipient of numerous honors and awards, and her research has been widely published. She has collaborated professionally with her husband, George Akerlof, a University of California—Berkeley Nobel prize-winning economist, on topics ranging from labor market, income, wage, and employment issues to a variety of socioeconomic issues.

More of Dr. Yellen's biography is also on the Board's web site at www.federalreserve.gov/boarddocs/press/other/2004/20040412.

Agencies Launch Web Site on Call Report Modernization Initiative

The federal bank regulatory agencies on February 12, 2004, announced the availability of a web site that provides information on the Federal Financial Institutions Examination Council's (FFIEC) Call Report Modernization initiative. The FFIEC Call Report agencies (the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency) are building a central data repository (CDR) to modernize and streamline the way the agencies collect, process, and distribute bank financial data.

The web site features a timeline, progress reports, frequently asked questions and answers, and highlights of future process changes. It provides details about project participants and ways that financial institutions and software vendors can participate in the initiative. The site also contains information outlining the technology supporting the new reporting process.

The FIND (Financial INstitutions Data—Bank Call Reports) web site provides details on the initiative in the months leading up to the implementation of the CDR and will continue to provide guidance after completion of the initiative. Implementation of the CDR is slated for the fall of 2004, and banks will first use the CDR to submit their September 30, 2004, Call Report data to the agencies. The web site can be accessed at www.FFIEC.gov/find.

Interagency Guidance Issued on Unfair or Deceptive Acts or Practices by State-Chartered Banks

The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation on March 11, 2004, issued guidance outlining standards they will apply to determine when acts or practices by state-chartered banks are unfair or deceptive. Such practices are illegal under section 5 of the Federal Trade Commission (FTC) Act.

To respond to questions raised by institutions under the agencies' supervision, the statement also provides guidance on steps that state-chartered banks can take to avoid engaging in unfair or deceptive acts or practices. The approach outlined in the statement is based on long-established standards used by the FTC to enforce section 5 of the FTC Act against nonbank entities.

In 2002, the Board and the FDIC affirmed their authority to apply the prohibition against unfair or deceptive acts or practices to the activities of state-chartered banks. At that time, the agencies also announced their intention to issue further guidance for state-chartered banks with respect to the prohibition.

Improvements to the Federal Reserve Board's Web Site

The Federal Reserve Board on February 10, 2004, announced a number of improvements to its web site, including the capability to view and submit comments on regulatory proposals.

In addition, the Board has expanded the offerings on its Freedom of Information Act (FOIA) web pages.

The Board also established two special sections on its web site. One section contains Federal Reserve documents relating to the proposed Basel II Capital Accord under the heading *Banking Information and Regulation.* Updates related to Basel II, as well as historical documentation, can be found at www.federalreserve.gov/generalinfo/basel2/default.htm.

The second section is dedicated to the Federal Reserve System's financial education efforts and contains educational tools on personal finance gathered from across the Federal Reserve System. Users have easy access to multiple resources, including information on e-banking, shopping for a mortgage, preventing identity theft, consumer credit protections, and economic education. The site is at www.federalreserveeducation.org/fined/index.cfm.

Federal Agencies Publish Spanish-Language Version of Consumer Brochure on Predatory Lending

The Federal Reserve Board announced on April 13, 2004, that the federal Interagency Task Force on Fair Lending has published a Spanish-language version of a brochure that alerts consumers to potential borrowing pitfalls, including high-cost home loans, and provides tips for getting the best financing deal possible. The brochure, *Utilizar su hogar como garantía para un préstamo es arriesgado (Putting Your Home on the Loan Line Is Risky Business)*, warns that regardless of whether a home equity loan is for a home repair, bill consolidation, or some other purpose, it's important to shop around.

Borrowing from an unscrupulous lender, especially one that offers a high-cost loan using the home as security, could result in the loss of the borrower's home and money. The brochure cautions that certain lenders—often called *predatory lenders*—target homeowners, including the elderly, with low incomes or credit problems by deceiving them about loan terms or giving them loans they cannot afford to repay. Before signing the credit contract, consumers are encouraged to do the following:

- Think about their financing options
- Do their homework
- Think twice before they sign a loan contract
- Know that they have rights under the law

The brochure notes that many consumers may have other options for meeting their financial needs, including housing counseling and social service programs.

If consumers decide that a loan is right for them, the brochure suggests talking with several lenders; comparison shopping for interest rates, payments, term of the loan, points and fees, and other costs of the loan; and having a knowledgeable friend, attorney, or housing counselor review the loan documents. A shopping checklist is included with the brochure.

The publication also reminds consumers that if they are refinancing or using their home as security for a home equity loan (or for a second mortgage loan or a line of credit), federal law gives them three business days after signing the loan papers to cancel the deal. The cancellation must be submitted in writing, after which the lender is required to return any money the consumer has paid to date.

If the three-day period has already passed and consumers believe they have been misled, the brochure suggests that they contact a state or local bar association, a local consumer protection agency, or a local fair housing or housing counseling agency.

The members of the Interagency Task Force are the Department of Housing and Urban Development, the Department of Justice, the Federal Deposit Insurance Corporation, the Federal Housing Finance Board, the Federal Reserve Board, the Federal Trade Commission, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Federal Housing Enterprise Oversight, and the Office of Thrift Supervision.

The brochure is available on the agencies' web sites listed below. A PDF (portable document format) version is provided on the web site so that consumer groups, financial institutions, agencies, and other organizations can download and print copies for distribution to their clients and customers.

Single copies of the brochure in English or Spanish are available free of charge from the following agencies:

Department of Housing and Urban Development: The department's web site at www.hud.gov or U.S. Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, DC 20410; Customer Service Center: (800) 767-7468.

Department of Justice: The department's web site at www.usdoj.gov/crt/housing/index_esp.html or contact the U.S. Department of Justice, Civil Rights Division, 950 Pennsylvania Ave., N.W., Housing and Civil Enforcement Section, NWB, Washington, DC 20530; (202) 514-4713.

Federal Deposit Insurance Corporation: The FDIC's web site at www.fdic.gov or the FDIC's Public Information Center, 801 17th Street, N.W., Room 100, Washington, DC 20434; (877) 275-3342 or (202) 416-6940.

Federal Housing Finance Board: The Board's web site at www.fhfb.gov and from the Federal Housing Finance Board, 1777 F Street, N.W., Washington, DC 20006.

Federal Reserve Board: The Board's web site at www.federalreserve.gov/pubs/riskyhomeloans/riskyspanish.htm and from Publications Fulfillment, Stop 127, Federal Reserve Board, 20th &

C Streets, N.W., Washington, DC 20551; (202) 452-3245.

Federal Trade Commission: The FTC's web site at www.ftc.gov and from the FTC's Consumer Response Center, 600 Pennsylvania Avenue, N.W., Washington, DC 20580; toll free: 1-877-FTC-HELP (1-877-382-4357); TTY for the hearing impaired (866) 653-4261.

National Credit Union Administration: NCUA's web site at www.ncua.gov or contact Cliff Northup, Director of Public and Congressional Affairs, National Credit Union Administration, 1775 Duke Street, Alexandria, VA. 22314; (703) 518-6330.

Office of Federal Housing Enterprise Oversight: OFHEO's web site at www.ofheo.gov/consInfo.asp. E-mail requests for individual copies should be sent to ofheoinquiriesofheo.gov or call (202) 414-6922.

Office of the Comptroller of the Currency: The OCC's web site at www.occ.treas.gov and from Communications, Mail Stop 3-2, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, DC 20219; (202) 874-4700.

Office of Thrift Supervision: The OTS's web site at www.ots.treas.gov or contact Louise Batdorf, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552; (202) 906-7087.

Release of Minutes to Discount Rate Meetings

The Federal Reserve Board on February 5, 2004, released the minutes of its discount rate meetings from November 10, 2003, through December 8, 2003.

On March 25, 2004, the Federal Reserve Board, released the minutes of its discount rate meetings from December 15, 2003, through January 26, 2004.

Meeting of the Consumer Advisory Council

The Federal Reserve Board announced on March 5, 2004, that the Consumer Advisory Council would hold its next meeting on Thursday, March 25, 2004. The meeting occurred in Dining Room E, Terrace level, in the Board's Martin Building. The session began at 9:00 a.m. EST and was open to the public.

The Council's function is to advise the Board on the exercise of its responsibilities under various consumer financial services laws and on other matters on which the Board seeks its advice.

Enforcement Actions

The Federal Reserve Board on February 4, 2004, announced the issuance of a consent order to cease and desist against Dominique Bazy, a former executive with Credit Lyonnais, S.A., Paris, France.

Mr. Bazy, without admitting to any allegations, consented to the issuance of the order based on his alleged participation in alleged violations of the Bank Holding Company Act and its regulations relating to the "Executive Life" matter. In December 2003 and January 2004, Credit Lyonnais consented to the issuance of enforcement actions resolving allegations relating to its participation in this matter.

In addition to the Board's order, the U.S. attorney in Los Angeles also announced on February 4, that Mr. Bazy had agreed to plead guilty to a criminal charge relating to this matter.

The Board's order restricts Mr. Bazy's participation in the conduct of the affairs of foreign banks in the United States. The Board's order supplements automatic restrictions imposed upon Mr. Bazy upon acceptance of his guilty plea to the criminal charge. By law, Mr. Bazy will be prohibited from participating in the conduct of the affairs of domestic insured depository institutions without the Federal Deposit Insurance Corporation's approval.

The Federal Reserve Board on February 9, 2004, announced the issuance of a consent order of assessment of a civil money penalty against Hocking Valley Bank, Athens, Ohio, a state member bank. Hocking Valley Bank, without admitting to any allegations, consented to the issuance of the order in connection with its alleged violations of the Board's Regulations implementing the National Flood Insurance Act.

The order requires Hocking Valley Bank to pay a civil money penalty of $9,500, which will be remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

The Federal Reserve Board on March 4, 2004, announced the issuance of a cease and desist order against Cowboy State Bancorp, Inc., Ranchester, Wyoming, a bank holding company, and its subsidiary bank, the Cowboy State Bank, Ranchester, Wyoming.

The consent cease and desist order was jointly issued by the Federal Reserve Board and the Wyoming State Banking Commissioner on February 24, 2004.

The Federal Reserve Board and the New York State Banking Department announced on March 10, 2004, the issuance of a joint order to cease and desist and an order of assessment of a civil money penalty and monetary payment against Credit Agricole, S.A., Paris, France; and its affiliates in Paris, Credit Agricole Indosuez and Credit Lyonnais, S.A.; and its offices and affiliates in New York, the New York branches of Credit Agricole Indosuez; and Credit Lyonnais, S.A. The order assesses fines totaling $13 million.

The order addresses deficiencies in the operational controls, risk management, and compliance with laws and regulations by the New York branch of Credit Agricole Indosuez. The order resolves allegations that Credit Agricole, S.A., Credit Agricole Indosuez, and the New York branch of Credit Agricole Indosuez failed to fully comply with a written agreement entered into with the Federal Reserve and the New York State Banking Department in November 2000; failed to maintain accurate and complete books and records for the operations of the New York branch of Credit Agricole Indosuez; and violated New York State law relating to the banks' obligation to maintain accurate books and records and to submit reports to the New York State Banking Department.

The joint order includes Credit Lyonnais, S.A. and the New York branch of Credit Lyonnais, S.A., because Credit Agricole, S.A. plans to reorganize its U.S. operations and consolidate certain business operations of its affiliates' New York branches through the New York branch of Credit Lyonnais, S.A. Credit Agricole, S.A., and its affiliates, without admitting to any allegations, consented to the issuance of the order.

Credit Agricole, S.A., Credit Agricole Indosuez, and the New York branch of Credit Agricole Indosuez were assessed $10 million in fines under the joint order. They will pay $5 million to the U.S. Department of the Treasury (through the Board of Governors) and $5 million to the state of New York under applicable federal and state laws.

Credit Agricole, S.A., also agreed to pay a $3 million fine to the Board of Governors to resolve allegations that Credit Agricole, S.A. acquired certain shares of Credit Lyonnais, S.A. and Credit Lyonnais Securities (USA), Inc., in 2002, without prior Federal Reserve approval as required by the Bank Holding Company Act. The Board will remit this fine to the U.S. Department of the Treasury.

Written Agreements

The Federal Reserve Board on February 24, 2004, announced the execution of a written agreement by and among The Custar State Bank, Custar, Ohio; the Ohio Division of Financial Institutions, Columbus, Ohio; and the Federal Reserve Bank of Cleveland.

The Federal Reserve Board on March 24, 2004, announced the execution of a written agreement by and among Midwest Banc Holdings, Inc., Melrose Park, Illinois; the Midwest Bank and Trust Company, Elmwood Park, Illinois; the State of Illinois Office of Banks and Real Estate, Springfield, Illinois; and the Federal Reserve Bank of Chicago.

The Federal Reserve Board on March 24, 2004, announced the execution of a written agreement by and between the Planters Bank and Trust Company, Staunton, Virginia, and the Federal Reserve Bank of Richmond.

The Federal Reserve Board on March 24, 2004, announced the execution of a written agreement by and between the Virginia Heartland Bank, Fredericksburg, Virginia, and the Federal Reserve Bank of Richmond.

Termination of Enforcement Actions

The Federal Reserve Board on April 7, 2004, announced the termination of the enforcement action listed below. The Federal Reserve's enforcement actions web site, www.federalreserve.gov/boarddocs/enforcement, reports the terminations as they occur.

- Fifth Third Bancorp and Fifth Third Bank, Cincinnati, Ohio
  Written agreement dated March 26, 2003
  Terminated April 6, 2004

The Federal Reserve Board, on April 15, 2004, announced the termination of the enforcement action listed below.

- Community First Bank and Trust, Celina, Ohio
  Written agreement dated July 25, 2002
  Terminated February 4, 2004

CHANGES IN BOARD STAFF

Dolores S. Smith, Director of the Division of Consumer and Community Affairs, retired on March 31, 2004, after more than twenty-eight years of service with the Board.

The Board of Governors on March 18, 2004, approved the promotion of Alice Patricia White to deputy associate director and the appointment of Michael Gibson to assistant director and chief of the Trading Risk Analysis Section, in the Division of Research and Statistics.

Pat White will take on broader responsibilities for handling policy assignments for the Board. Ms. White began her career in the Financial Structure Section in the Division of Research and Statistics in 1979. After a brief stint as special assistant to Governor Wallich in 1982, she transferred to the Capital Markets Section. The Trading Risk Analysis Section was created in 1993 and Ms. White was selected the first chief of that section. She was made line officer of the Trading Risk Analysis Section in 2000. Ms. White will continue to provide support to the Board in its participation in the domestic and international policy arena especially related to derivatives, margin requirements, and securities clearance and settlement arrangements. Ms. White received her doctoral degree from Yale University in 1979.

Michael Gibson will have direct oversight responsibility for the Trading Risk Analysis Section. This section is responsible for analyzing the risks arising in the trading and positioning of securities, commodities, and derivative instruments. Mr. Gibson began his career at the Board in the International Banking Section of the Division of International Finance in 1992, where he had principal responsibility for following the Japanese banking system. He subsequently spent two years as a visiting assistant professor of business economics at the University of Chicago Graduate School of Business. Mr. Gibson moved to the Trading Risk Analysis Section in the Division of Research and Statistics in 1999 and was selected chief of that section in 2000. Mr. Gibson received his doctoral degree from the Massachusetts Institute of Technology in 1993.

The Board of Governors on March 19, 2004, approved the appointment of Stacy Coleman as assistant director for Operational and Information Technology (IT) Risk and Special Activities, Division of Banking Supervision and Regulation; and a change in officer responsibilities for Lisa Hoskins, Assistant Director, Division of Reserve Bank Operations and Payment Systems to assume oversight responsibilities for the Payment System Risk program.

Stacy Coleman will oversee the Operational and IT Risk and Special Activities areas, which provide the focal point for the Federal Reserve's supervision of operational risk in banking organizations. These functions support supervision by providing guidance and technical assistance in areas involving business continuity, IT, fiduciary activities, and emerging activities such as insurance.

Ms. Coleman joined the Federal Reserve Board in 1993 as a research assistant in the Flow of Funds Section in the Division of Research and Statistics. She returned to the Board in 1996 as a senior financial services analyst in the Division of Reserve Bank Operations and Payment Systems. In 2001, she was promoted to manager of the Payment System Risk (PSR) program. Ms. Coleman holds a bachelor of arts degree from Kalamazoo College and an MBA from Johns Hopkins University.

Lisa Hoskins, Assistant Director, will assume oversight responsibilities for the Payment System Risk (PSR) program in addition to her responsibilities for division administration and Information Systems. Ms. Hoskins joined the Federal Reserve System in 1985 as a management intern with the New Orleans Branch of the Federal Reserve Bank of Atlanta. She transferred to the Board in 1998 as a financial services analyst in the Division of Bank Operations and Payment Systems. Ms. Hoskins was appointed to the official staff in 2003 and has served as co-secretariat to the Committee on Employee Benefits. She received her BBA and MBA degrees from Loyola University.

The Federal Reserve Board on March 22, 2004, announced the appointment of Sandra F. Braunstein as director of the Division of Consumer and Community Affairs, effective April 1, 2004.

Ms. Braunstein succeeds Dolores S. Smith, who retired after twenty-eight years of service at the Board, including six years as division director.

In 1998, Ms. Braunstein was appointed to the Board's official staff as assistant director and community affairs officer. She was named senior associate director of the Division of Consumer and Community Affairs in 2003. She currently oversees the implementation of Federal Reserve System policies and programs regarding community and economic development. She also serves as the Board's liaison to the Consumer Advisory Council and provides leadership to various consumer education and research activities.

Before joining the Federal Reserve Board in 1987, Ms. Braunstein held positions in economic and community development for nonprofit, government, and private sector organizations. She is a graduate of the American University.

Richard D. Porter, Senior Adviser in the Division of Monetary Affairs, retired from the Board on April 30, 2004, after more than thirty years of service. In May, Mr. Porter joins the Federal Reserve Bank of Chicago as senior policy adviser.

Revision to the Money Stock Data

Measures of the money stock and components were revised in January 2004 to incorporate the results of the annual seasonal factor review. Data in tables 1.10 and 1.21 in the *Statistical Supplement to the Federal Reserve Bulletin* reflect these changes beginning with the February issue.

Seasonally adjusted measures of the monetary stock and components incorporate revised seasonal factors produced from not-seasonally-adjusted data through December 2003. Monthly seasonal factors were estimated using the X-12-ARIMA procedure. The revisions to seasonal factors raised M2 and M3 growth rates in the first and fourth quarters of 2003, although lowering them in the other quarters of the year.

Historical data, updated each week, are available through the Federal Reserve's web site (www.federalreserve.gov/releases/) with the H.6 statistical release. Current and historical data are also on the Economic Bulletin Board of the U.S. Department of Commerce. For paid electronic access to the Economic Bulletin Board, call STAT-USA at 1-800-782-8872 or 202-482-1986.

1. Monthly seasonal factors used to construct M1, January 2003–March 2005

Year and month	Currency	Nonbank travelers checks	Demand deposits	Other checkable deposits[1]	
				Total	At banks
2003—January	.9968	.9955	1.0020	1.0110	1.0386
February	.9998	.9947	.9720	.9832	.9913
March	1.0014	.9903	.9920	1.0057	1.0065
April	1.0022	.9824	1.0011	1.0282	1.0256
May	1.0031	.9875	.9860	.9952	.9866
June	1.0020	1.0160	.9976	.9999	.9928
July	1.0011	1.0369	1.0034	.9959	.9898
August	.9994	1.0243	1.0004	.9919	.9803
September	.9950	1.0067	.9952	.9915	.9863
October	.9960	.9963	.9929	.9892	.9892
November	.9984	.9819	1.0058	.9895	.9786
December	1.0046	.9886	1.0507	1.0221	1.0381
2004—January	.9967	.9970	1.0018	1.0097	1.0383
February	1.0002	.9954	.9737	.9831	.9916
March	1.0011	.9918	.9884	1.0050	1.0071
April	1.0023	.9834	.9991	1.0244	1.0196
May	1.0031	.9881	.9916	.9949	.9839
June	1.0023	1.0135	.9962	.9991	.9935
July	1.0018	1.0346	1.0052	.9961	.9904
August	.9980	1.0245	1.0027	.9948	.9815
September	.9950	1.0061	.9920	.9932	.9901
October	.9970	.9952	.9963	.9898	.9885
November	.9972	.9831	1.0038	.9898	.9773
December	1.0051	.9889	1.0470	1.0219	1.0400
2005—January	.9964	.9976	1.0053	1.0099	1.0380
February	.0000	.9956	.9724	.9824	.9916
March	1.0012	.9919	.9853	1.0040	1.0077

1. Seasonally adjusted other checkable deposits at thrift institutions are derived as the difference between total other checkable deposits, seasonally adjusted, and seasonally adjusted other checkable deposits at commercial banks.

2. Monthly seasonal factors used to construct M2 and M3, January 2003–March 2005

Year and month	Savings and MMDA deposits[1]	Small-denomination time deposits[1]	Large-denomination time deposits[1]	Money market mutual funds		RPs	Eurodollars
				In M2	In M3 only		
2003—January	.9953	1.0004	.9922	1.0061	1.0262	.9943	1.0037
February	.9939	1.0001	.9967	1.0098	1.0233	1.0140	1.0136
March	1.0002	.9994	1.0006	1.0166	1.0112	1.0162	1.0148
April	1.0043	.9994	1.0006	1.0081	.9872	1.0074	1.0142
May	.9944	.9998	1.0096	.9872	.9848	1.0269	1.0129
June	.9982	.9998	1.0065	.9868	.9928	1.0237	.9911
July	.9977	.9996	1.0011	.9928	.9882	1.0014	.9844
August	1.0026	.9998	.9987	.9998	.9884	.9927	.9859
September	1.0033	.9999	1.0008	.9959	.9817	.9744	.9877
October	1.0010	1.0002	1.0005	.9993	.9874	.9753	.9946
November	1.0074	1.0008	.9982	1.0000	1.0090	.9856	1.0039
December	1.0041	1.0001	.9973	1.0018	1.0238	.9875	1.0017
2004—January	.9957	1.0001	.9906	1.0041	1.0238	.9925	1.0029
February	.9932	.9998	.9957	1.0079	1.0216	1.0116	1.0102
March	.9977	.9996	1.0001	1.0140	1.0097	1.0170	1.0109
April	1.0033	1.0000	.9996	1.0071	.9867	1.0119	1.0101
May	.9937	1.0004	1.0096	.9867	.9836	1.0282	1.0093
June	.9980	1.0005	1.0058	.9874	.9921	1.0234	.9903
July	.9998	1.0000	1.0010	.9939	.9896	1.0004	.9863
August	1.0014	.9997	.9994	1.0019	.9899	.9916	.9892
September	1.0041	.9996	1.0017	.9973	.9850	.9745	
October	1.0033	.9998	1.0018	1.0004	.9896	.9767	.9985
November	1.0067	1.0002	.9996	1.0006	1.0078	.9867	1.0051
December	1.0045	.9998	.9973	1.0009	1.0219	.9860	1.0031
2005—January	.9953	1.0000	.9896	1.0029	1.0229	.9907	1.0030
February	.9927	.9997	.9948	1.0069	1.0211	1.0109	1.0076
March	.9964	.9998	.9998	1.0127	1.0088	1.0178	1.0077

1. Seasonal factors are applied to deposit data at both commercial banks and thrift institutions.

3. Weekly seasonal factors used to construct M1, December 1, 2003–April 4, 2005

Week ending	Currency	Nonbank travelers checks	Demand deposits	Other checkable deposits[1]	
				Total	At banks
2003—December 1	1.0012	.9785	1.0904	1.0239	1.0145
8	1.0000	.9824	.9517	.9963	.9816
15	1.0016	.9863	1.0068	.9866	.9940
22	1.0082	.9902	1.0719	1.0301	1.0564
29	1.0113	.9942	1.1455	1.0607	1.1047
2004—January 5	1.0050	.9981	1.0545	1.0487	1.0680
12	.9950	.9975	.9668	.9973	1.0296
19	.9960	.9970	.9851	.9933	1.0268
26	.9945	.9964	1.0041	1.0073	1.0382
February 2	.9960	.9959	1.0370	1.0189	1.0404
9	1.0008	.9956	.9456	.9804	.9847
16	1.0022	.9954	.9651	.9641	.9694
23	.9994	.9952	.9685	.9788	.9895
March 1	.9989	.9950	1.0011	1.0025	1.0134
8	1.0029	.9937	.9453	.9923	.9905
15	1.0014	.9925	.9658	.9861	.9790
22	1.0011	.9913	.9869	1.0043	1.0067
29	.9998	.9900	1.0404	1.0262	1.0400
April 5	1.0041	.9888	.9892	1.0287	1.0288
12	1.0042	.9860	.9561	1.0058	.9938
19	1.0020	.9832	1.0323	1.0350	1.0341
26	1.0001	.9804	1.0259	1.0328	1.0301
May 3	1.0013	.9777	1.0077	1.0265	1.0154
10	1.0041	.9823	.9544	.9857	.9627
17	1.0022	.9869	.9877	.9760	.9663
24	1.0029	.9916	.9858	.9912	.9852
31	1.0024	.9962	1.0341	1.0136	1.0115
June 7	1.0049	1.0027	.9406	.9976	.9848
14	1.0037	1.0092	.9674	.9801	.9641
21	1.0019	1.0156	1.0043	.9930	.9930
28	1.0006	1.0221	1.0589	1.0177	1.0217
July 5	1.0058	1.0286	.9852	1.0059	1.0024
12	1.0028	1.0316	.9597	.9782	.9642
19	1.0010	1.0346	1.0038	.9859	.9780
26	.9988	1.0376	1.0468	1.0023	1.0002

3.—Continued

Week ending	Currency	Nonbank travelers checks	Demand deposits	Other checkable deposits[1]	
				Total	At banks
August 2	.9986	1.0406	1.0521	1.0223	1.0254
9	1.0026	1.0340	.9490	.9915	.9749
16	.9994	1.0273	.9864	.9759	.9560
23	.9963	1.0206	1.0076	.9914	.9785
30	.9941	1.0140	1.0542	1.0110	1.0039
September 6	.9986	1.0073	.9598	.9969	.9859
13	.9955	1.0067	.9536	.9808	.9701
20	.9945	1.0060	.9789	.9935	.9899
27	.9928	1.0054	1.0606	1.0014	1.0068
October 4	.9956	1.0047	.9977	.9922	.9973
11	1.0000	1.0003	.9399	.9722	.9663
18	.9973	.9958	.9860	.9785	.9772
25	.9951	.9913	1.0212	.9947	.9943
November 1	.9936	.9869	1.0594	1.0199	1.0209
8	.9979	.9854	.9558	.9760	.9573
15	.9963	.9839	.9748	.9677	.9468
22	.9955	.9824	1.0033	.9863	.9767
29	.9999	.9808	1.0712	1.0194	1.0170
December 6	.9999	.9793	.9829	1.0099	1.0058
13	1.0018	.9844	.9865	.9893	.9860
20	1.0058	.9895	1.0556	1.0213	1.0411
27	1.0130	.9946	1.1255	1.0531	1.0961
2005—January 3	1.0050	.9997	1.1079	1.0471	1.0835
10	.9987	.9988	.9748	1.0092	1.0350
17	.9952	.9979	.9789	.9977	1.0255
24	.9929	.9969	.9963	1.0049	1.0336
31	.9936	.9960	1.0298	1.0126	1.0425
February 7	.9994	.9958	.9573	.9895	1.0039
14	1.0008	.9957	.9616	.9655	.9667
21	1.0012	.9955	.9658	.9786	.9858
28	.9986	.9954	1.0051	.9961	1.0099
March 7	1.0027	.9941	.9606	.9977	.9940
14	1.0018	.9929	.9587	.9841	.9767
21	1.0016	.9916	.9839	1.0007	1.0073
28	1.0006	.9904	1.0123	1.0188	1.0352
April 4	1.0024	.9891	1.0050	1.0286	1.0317

1. Seasonally adjusted other checkable deposits at thrift institutions are derived as the difference between total other checkable deposits, seasonally adjusted, and seasonally adjusted other checkable deposits at commercial banks.

4. Weekly seasonal factors used to construct M2 and M3, December 1, 2003–April 4, 2005

Week ending	Savings and MMDA deposits[1]	Small-denomination time deposits[1]	Large-denomination time deposits[1]	Money market mutual funds		RPs	Eurodollars
				In M2	In M3 only		
2003—December 1	1.0000	1.0011	.9933	1.0007	1.0182	.9810	1.0082
8	1.0180	1.0006	.9965	1.0035	1.0240	.9873	.9973
15	1.0161	1.0002	1.0046	1.0051	1.0379	.9897	.9970
22	.9989	.9997	1.0008	1.0022	1.0233	.9860	.9980
29	.9851	.9998	.9946	.9987	1.0182	.9936	1.0109
2004—January 5	1.0109	1.0014	.9950	.9943	.9971	.9670	1.0098
12	1.0112	1.0007	.9974	1.0035	1.0227	.9864	1.0052
19	.9980	1.0001	.9925	1.0085	1.0320	.9961	1.0041
26	.9767	.9992	.9799	1.0074	1.0360	1.0016	.9978
February 2	.9787	.9993	.9915	1.0041	1.0259	1.0094	.9968
9	1.0011	.9997	.9976	1.0059	1.0213	1.0177	1.0009
16	.9994	.9999	1.0002	1.0070	1.0222	1.0162	1.0086
23	.9868	.9998	.9944	1.0102	1.0253	1.0045	1.0186
March 1	.9884	.9998	.9912	1.0100	1.0131	1.0081	1.0165
8	1.0082	.9997	.9976	1.0129	1.0113	1.0187	1.0003
15	1.0073	.9997	1.0000	1.0143	1.0136	1.0175	1.0080
22	.9951	.9996	.9990	1.0159	1.0105	1.0204	1.0123
29	.9832	.9993	1.0034	1.0144	1.0018	1.0166	1.0213
April 5	1.0125	1.0001	1.0056	1.0117	.9848	1.0038	1.0107
12	1.0179	1.0004	.9998	1.0162	.9959	1.0077	1.0030
19	1.0086	.9999	.9960	1.0115	.9831	1.0086	1.0069
26	.9845	.9995	.9959	1.0014	.9787	1.0184	1.0150

4.—Continued

Week ending		Savings and MMDA deposits[1]	Small-denomination time deposits[1]	Large-denomination time deposits[1]	Money market mutual funds: In M2	Money market mutual funds: In M3 only	RPs	Eurodollars
May	3	.9852	1.0001	1.0041	.9878	.9733	1.0240	1.0177
	10	1.0044	1.0003	1.0099	.9870	.9784	1.0258	1.0088
	17	.9989	1.0003	1.0111	.9853	.9831	1.0276	1.0047
	24	.9838	1.0005	1.0099	.9874	.9885	1.0264	1.0096
	31	.9844	1.0005	1.0101	.9868	.9832	1.0349	1.0102
June	7	1.0123	1.0007	1.0087	.9885	.9836	1.0301	1.0004
	14	1.0104	1.0007	1.0025	.9896	.9904	1.0311	.9900
	21	.9967	1.0003	1.0089	.9875	.9842	1.0218	.9844
	28	.9784	1.0002	1.0049	.9852	.9869	1.0164	.9868
July	5	1.0089	1.0005	.9996	.9836	.9806	1.0028	.9889
	12	1.0117	1.0002	1.0012	.9933	.9946	.9966	.9863
	19	.9989	1.0000	.9981	.9951	.9926	.9997	.9843
	26	.9840	.9997	1.0014	.9977	.9934	1.0011	.9870
August	2	.9917	.9996	1.0057	.9979	.9844	1.0037	.9861
	9	1.0151	.9998	1.0092	1.0022	.9910	1.0080	.9838
	16	1.0108	.9998	.9997	1.0033	.9973	.9965	.9824
	23	.9925	.9997	.9937	1.0037	.9997	.9795	.9915
	30	.9867	.9996	.9932	1.0002	.9958	.9807	1.0010
September	6	1.0186	.9999	1.0002	.9976	.9859	.9765	.9869
	13	1.0218	.9998	1.0051	1.0012	.9953	.9795	.9872
	20	1.0054	.9993	.9999	.9988	.9895	.9773	.9879
	27	.9819	.9992	.9989	.9944	.9867	.9699	.9970
October	4	1.0067	.9999	1.0071	.9909	.9753	.9626	.9925
	11	1.0152	1.0005	1.0102	.9993	.9935	.9692	.9945
	18	1.0072	1.0000	1.0000	1.0040	.9954	.9782	.9968
	25	.9881	.9995	.9963	1.0035	.9970	.9790	1.0028
November	1	.9890	.9993	.9972	1.0003	.9940	.9905	1.0055
	8	1.0144	.9998	1.0012	1.0001	.9972	1.0003	1.0016
	15	1.0186	1.0003	1.0030	.9995	1.0054	.9863	1.0044
	22	1.0030	1.0003	.9995	1.0019	1.0143	.9796	1.0066
	29	.9923	1.0005	.9956	1.0006	1.0207	.9797	1.0095
December	6	1.0154	1.0005	.9967	1.0027	1.0214	.9888	1.0038
	13	1.0171	1.0000	1.0047	1.0050	1.0346	.9905	.9993
	20	1.0048	.9994	1.0002	1.0029	1.0236	.9865	1.0000
	27	.9887	.9992	.9929	.9987	1.0204	.9874	1.0046
2005—January	3	.9983	1.0003	.9877	.9911	.9961	.9701	1.0104
	10	1.0131	1.0008	.9874	.9997	1.0140	.9780	1.0020
	17	1.0035	1.0004	.9927	1.0056	1.0280	.9893	1.0046
	24	.9850	.9996	.9877	1.0067	1.0339	.9962	1.0019
	31	.9713	.9992	.9915	1.0046	1.0286	1.0084	.9991
February	7	.9970	.9996	.9978	1.0049	1.0193	1.0113	.9972
	14	.9958	.9998	.9997	1.0056	1.0197	1.0130	1.0057
	21	.9916	.9997	.9932	1.0083	1.0225	1.0069	1.0127
	28	.9866	.9998	.9885	1.0089	1.0205	1.0123	1.0138
March	7	1.0081	.9997	.9934	1.0112	1.0124	1.0179	.9978
	14	1.0060	.9998	.9998	1.0119	1.0135	1.0196	1.0026
	21	.9983	.9998	.9999	1.0142	1.0081	1.0177	1.0073
	28	.9843	.9998	1.0030	1.0142	1.0025	1.0221	1.0209
April	4	1.0032	1.0004	1.0071	1.0117	.9865	1.0035	1.0108

1. Seasonal factors are applied to deposit data at both commercial banks and thrift institutions.

Legal Developments

ORDERS ISSUED UNDER BANK HOLDING COMPANY ACT

Orders Issued Under Section 4 of the Bank Holding Company Act

J.P. Morgan Chase & Co.
New York, New York

Order Approving Acquisition of a Savings Association

J.P. Morgan Chase & Co. ("Morgan Chase"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval to acquire all the voting shares of Chase FSB, Newark, Delaware, a *de novo* federal savings bank, pursuant to section 4(c)(8) and 4(j) of the Bank Holding Company Act (12 U.S.C. §1843(c)(8) and 1843(j)) ("BHC Act") and section 225.24 of the Board's Regulation Y (12 C.F.R. 225.24).[1]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (68 *Federal Register* 68,925 (2003)), and the time for filing comments has expired. The Board has considered the proposal and all comments received in light of the factors set forth in section 4 of the BHC Act.

Morgan Chase, with total consolidated assets of $771 billion, is the second largest banking organization in the United States.[2] Morgan Chase controls $194.5 billion in deposits in depository institutions nationwide, representing approximately 4 percent of the total deposits in insured depository institutions in the United States.[3] Morgan Chase proposes to operate Chase FSB as a direct subsidiary that will market and originate certain retail and consumer finance products currently offered by other Morgan Chase subsidiaries. Morgan Chase has represented that it intends for Chase FSB to principally serve the national market, which Morgan Chase describes as the United States outside the tristate area of New York, New Jersey, and Connecticut. Morgan Chase would continue to serve its retail banking customers in the tri-state area principally through JPMorgan Chase Bank, New York, New York ("JPMCB"), Morgan Chase's lead subsidiary bank. Chase FSB's activities would initially focus on home mortgage lending, marketing of credit cards, and automotive finance.[4] To facilitate these activities, 302 offices throughout the United States of Chase Manhattan Mortgage Corporation, Edison, New Jersey ("CMMC"), which is Morgan Chase's principal mortgage lending subsidiary, would become offices of Chase FSB.[5]

The Board previously has determined by regulation that the operation of a savings association by a bank holding company is closely related to banking for purposes of section 4(c)(8) of the BHC Act.[6] The Board is required to review each proposal by a bank holding company to acquire a savings association.[7] In reviewing the proposal, the Board is required by section 4(j)(2)(A) of the BHC Act to determine that the acquisition of Chase FSB by Morgan Chase "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[8] As part of its evaluation of a proposal under these public interest factors, the Board reviews the financial and managerial resources of the companies involved as well as the effect of the proposal on competition in the relevant markets.[9] In acting on notices to acquire a savings association, the Board also reviews the records of performance of the relevant insured depository institutions under the Community Reinvestment Act (12 U.S.C. §2901 *et seq.*) ("CRA").[10]

Competitive Considerations

As part of its consideration of the public interest factors under section 4 of the BHC Act, the Board has considered

1. Morgan Chase has previously received the required approvals to establish Chase FSB from the Office of Thrift Supervision ("OTS") on November 28, 2003, and from the Federal Deposit Insurance Corporation on December 3, 2003.

2. Asset data for Morgan Chase are as of December 31, 2003, and nationwide ranking data are as of September 30, 2003.

3. Deposit data are as of September 30, 2003. In this context, depository institutions include commercial banks, savings banks, and savings associations.

4. Chase FSB will market credit cards issued by Chase Manhattan Bank USA, N.A., Newark, Delaware ("Chase USA"), which currently issues all Morgan Chase credit cards. Chase USA's automotive finance business will be transferred to Chase FSB.

5. Of these 302 offices, 19 will be administrative offices not open to the public. The remainder will be loan production offices of Chase FSB.

6. 12 C.F.R. 225.28(b)(4)(ii).

7. 12 U.S.C. §1843(j) and 1843(k)(6)(B).

8. 12 U.S.C. §1843(j)(2)(A).

9. 12 C.F.R. 225.26.

10. *See, e.g., Banc One Corporation, Inc.*, 83 *Federal Reserve Bulletin* 602 (1997).

carefully the competitive effects of the proposal in the relevant markets in light of all the facts of record. The proposal involves the formation of a *de novo* savings association that would operate nationwide.

Commencement of activities *de novo* is presumed under Regulation Y to result in benefits to the public through increased competition in the market for banking and similar services.[11] The proposed acquisition would have no adverse effect on the concentration of banking resources in any relevant banking market. Moreover, the Board has received no objections to the proposal from the Department of Justice or any federal banking agency. In light of all the facts of record, the Board concludes that consummation of the proposed transaction would not result in a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market, and that competitive factors are consistent with approval.

Financial and Managerial Factors

In reviewing the proposal under section 4 of the BHC Act, the Board also has carefully reviewed the financial and managerial resources of Morgan Chase and Chase FSB. The Board has reviewed these factors in light of all the facts of record, including confidential reports of examination assessing the financial and managerial resources of Morgan Chase and its subsidiary banks, information provided by Morgan Chase, and public comments on the proposal.[12] In addition, the Board has consulted with the OTS, which will be the primary federal regulator of Chase FSB. The Board notes that Morgan Chase and its subsidiary depository institutions currently are well capitalized and are expected to remain so after consummation of the proposal. Chase FSB also would be well capitalized at consummation. Based on all the facts of record, the Board concludes that the financial and managerial resources of the institutions involved are consistent with approval of the proposal.[13]

Records of Performance Under the Community Reinvestment Act

As previously noted, the Board reviews the records of performance under the CRA of the relevant insured depository institutions when acting on a notice to acquire any insured depository institution, including a savings association. The CRA requires the Board to assess each insured depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the institution's safe and sound operation, and to take this record into account in evaluating bank holding company notices.[14]

The Board has carefully considered the CRA performance records of each subsidiary insured depository institution of Morgan Chase in light of all the facts of record, including public comments on the proposal. A commenter opposing the proposal has alleged, based on data reported under the Home Mortgage Disclosure Act ("HMDA"), [15] that CMMC denied home mortgage loan applications from minorities more frequently than it denied applications from nonminorities in certain Metropolitan Statistical Areas ("MSAs").[16]

A. CRA Performance Examinations

An institution's most recent CRA performance evaluation is a particularly important consideration in the notice process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate supervisor.[17] JPMCB and Chase USA have each received "Outstanding" ratings from their respective regulators at their most recent examinations for CRA performance.[18] Examiners commended the community development lending of both JPMCB and Chase USA. JPMCB was also found to have an excellent level of qualified investments and to be a leader in providing community development services. Examiners also

11. *See* 12 C.F.R. 225.26(c).

12. A commenter opposing the proposal cited press reports of Morgan Chase's connection to investigations, lawsuits, and settlements relating to Enron Corp. and asserted that these issues reflected unfavorably on the managerial resources of JPMCB. The commenter also provided press reports of litigation involving the acquisition of a small number of mortgage loans from a mortgage broker by CMMC and asserted that Morgan Chase and CMMC lacked adequate policies and procedures for monitoring the acquisition of loans on the secondary market. The Board previously has considered these comments in the context of a recent application by JPMCB to acquire trust deposits from subsidiary banks of Bank One Corporation, Chicago, Illinois, and hereby adopts the findings in that case. *See JPMorgan Chase Bank*, 89 *Federal Reserve Bulletin* 511, 512 (2003) ("*JPMCB/Bank One Order*").

In addition, the commenter raised concerns about an investigation by the Oregon Department of Justice ("Oregon DOJ") into the alleged use by borrowers of fraudulent Social Security numbers in three mortgage loans underwritten by CMMC. By a letter dated June 10, 2003, to CMMC, the Oregon DOJ closed its inquiry into this matter due to "insufficient evidence."

13. After consulting with the OTS and reviewing all the facts of record, including in particular its approval of Morgan Chase's application to form Chase FSB (OTS Order No. 2003-60 (Nov. 28, 2003)), the Board also has determined that, on consummation of the proposal, Chase FSB would be well managed for purposes of section 4(*l*) of the BHC Act (12 U.S.C. § 1843(*l*)).

14. 12 U.S.C. § 2903.

15. 12 U.S.C. § 2801 *et seq.*

16. The commenter expressed concern that the formation of Chase FSB would permit Morgan Chase to transfer its retail lending operations to an OTS-regulated institution with the result that consumer protection laws of the individual states would be preempted. As noted above, bank holding companies are permitted by law to own and control federal savings associations. 12 C.F.R. 225.28(b)(4)(ii). The applicability of state laws to federal savings associations is a matter within the jurisdiction of the OTS to determine.

The commenter also alleged that CMMC's purchase of certain mortgage loans on the secondary market enabled predatory lending by an unaffiliated consumer lender. The Board previously considered the remedial steps taken by CMMC in this matter and hereby adopts its conclusions in that case. *See JPMCB/Bank One Order* at 512.

17. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

18. Ratings as of November 12, 2001, by the New York State Banking Department and March 3, 2003, by the Office of the Comptroller of the Currency, respectively.

praised Chase USA's flexible loan programs and found it to be very responsive to the credit and community development needs of its assessment area.

The record of Morgan Chase in operating these insured depository institutions indicates that it has the experience and expertise to establish and implement appropriate CRA policies and programs at Chase FSB. The OTS will evaluate Chase FSB's record of CRA-related lending based on its actual lending performance after Chase FSB opens for business. Chase FSB intends to invest in funds that develop low-income residential rental properties in states where it is a major mortgage lender and to seek community development service opportunities in its assessment area.[19] Chase FSB also intends to provide grants to community development organizations in its assessment area and to large regional and national organizations that are active in Chase FSB's top national markets.

B. HMDA Data and Fair Lending Record

The Board has carefully considered the lending records and HMDA data of JPMCB, CMMC, and Chase USA in light of the comments received.[20] Based on 2002 HMDA data, the commenter alleged that CMMC disproportionately excluded or denied African-American and Hispanic applicants for home mortgage loans in various MSAs in twelve states and the District of Columbia.[21] The commenter asserted that CMMC's denial rates for minority applicants were higher than the rate for nonminority applicants, and that CMMC's denial disparity ratios compared unfavorably with those ratios for the aggregate of lenders in the MSAs.[22] In the *JPMCB/Bank One Order*, the Board considered substantially similar comments about Morgan Chase's HMDA data for MSAs in eight of these states and the District of Columbia, and the Board's analysis of Morgan Chase's HMDA data in that order is incorporated by reference.[23]

For the MSAs cited by the commenter in Colorado, Mississippi, Oregon, and Washington, the denial disparity ratios reflected in the 2002 HMDA data reported by JPMCB, CMMC, and Chase USA generally were more favorable than or comparable with the ratios reported by the aggregate of lenders in three of the four markets reviewed. The denial disparity ratio approximated, but was somewhat less favorable than, the ratio for the aggregate in the Portland MSA for African Americans.

The HMDA data do not indicate that JPMCB, CMMC, or Chase USA has excluded any segment of the population or any geographic area on a prohibited basis. The Board, nevertheless, is concerned when the record of an institution indicates disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of race or income level. The Board recognizes, however, that HMDA data alone provide an incomplete measure of an institution's lending in its community because these data cover only a few categories of housing-related lending. HMDA data, moreover, provide only limited information about covered loans.[24] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has not assisted adequately in meeting its community's credit needs or has engaged in illegal lending discrimination.

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by JPMCB and its predecessor bank, Chase Manhattan Bank, New York, New York.[25] Examiners found no evidence of prohibited discrimination or other illegal credit practices at JPMCB, Chase Manhattan Bank, Chase USA, or CMMC.

As noted in the *JPMCB/Bank One Order*, JPMCB and CMMC have taken several affirmative steps to ensure compliance with fair lending laws. Management at JPMCB and CMMC conduct comparative file reviews for most of their loan products. JPMCB and CMMC have a secondary review process that includes regression analysis of all applications to identify possible instances or indications of disparate treatment, and JPMCB indicated that it acts promptly to correct inappropriate underwriting decisions that are identified, including sending offers of credit to individuals whose applications were denied in error. In addition, an independent review team, under the direction

19. In approving Morgan Chase's application to organize Chase FSB, the OTS concluded that Chase FSB has satisfactorily demonstrated that it will meet its CRA objectives. OTS Order No. 2003-60 (Nov. 28, 2003).

20. The Board has reviewed HMDA data reported by JPMCB, CMMC, and Chase USA in 2001 and 2002 in the markets of concern to the commenter. The Board included data submitted by Chase USA in its review because, as noted above, Chase USA was the parent of CMMC until March 2002. CMMC is now a subsidiary of JPMCB.

21. In response, JPMCB noted that the commenter's analysis was based on data from only a few MSAs and included only conventional home purchase loans originated by CMMC in 2002, and that the sample, therefore, was too small to represent JPMCB's overall mortgage lending performance.

22. The denial disparity ratio equals the denial rate for a particular racial category (for example, African American) divided by the denial rate for whites.

23. The MSAs reviewed by the Board in the *JPMCB/Bank One Order* were Benton Harbor and Detroit, both in Michigan; Boston, Massachusetts; Dallas, Texas; Memphis, Tennessee; Raleigh, North Carolina; Richmond, Virginia; San Francisco, California; St. Louis, Missouri; and Washington, DC. The new MSAs reviewed in connection with this order are Denver, Colorado; Jackson, Mississippi; Portland, Oregon; and Seattle, Washington.

24. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

25. JPMCB was formed in the fourth quarter of 2001 by the merger of Chase Manhattan Bank and Morgan Guaranty Trust Company. The CRA performance of Chase Manhattan Bank was last evaluated by the Federal Reserve Bank of New York as of July 9, 2001.

of the fair lending unit, reviews applications identified by the regression analysis and reports its findings to the audit department quarterly.

The Board also has considered the HMDA data in light of other information, including the CRA performance records of JPMCB, Chase Manhattan Bank, and Chase USA. The Board concludes that, in light of the entire record, the HMDA data indicate that JPMCB's record of performance in helping to serve the credit needs of its community is consistent with approval of the proposal.

C. Conclusion on CRA Performance Records

The Board has carefully considered all the facts of record, including reports of examination of CRA records of the institutions involved, information provided by Morgan Chase, all comments received and responses to the comments, and confidential supervisory information. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that the CRA performance records of the institutions involved are consistent with approval.

Other Considerations

As part of its evaluation of the public interest factors, the Board also has carefully reviewed the public benefits and possible adverse effects of the proposal. The record indicates that consummation of the proposal would result in benefits to consumers and businesses. The proposal would enable Morgan Chase to streamline the way in which it provides consumer finance products and services to customers throughout the national market, by creating a single institution through which customers can obtain home and automobile financing and credit card products and services now offered by different Morgan Chase affiliates. Morgan Chase expects that additional retail products and services will eventually also be offered in the national market through Chase FSB. Based on all the facts of record, the Board has determined that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects under the standard of section 4(j)(2) of the BHC Act.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the notice should be, and hereby is, approved. The Board's approval is specifically conditioned on compliance by Morgan Chase with all the commitments made in connection with the notice and all the conditions in this order. The Board's determination also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c) (12 C.F.R. 225.7 and 225.25(c)), and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders thereunder. For purposes of this action, the commitments and conditions relied on by the Board in reaching its decision are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors, effective January 30, 2004.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

UBS AG
Zurich, Switzerland

Order Approving Notice to Engage in Activities Complementary to a Financial Activity

UBS AG ("UBS"), a foreign bank that is treated as a financial holding company ("FHC") for purposes of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 4 of the BHC Act (12 U.S.C. § 1843) and the Board's Regulation Y (12 C.F.R. Part 225) to retain all the voting shares of UBSW Energy LLC, Stamford, Connecticut ("UBS Energy"), and to continue to engage in physical commodity trading in the United States. UBS currently conducts physical commodity trading in the United States pursuant to temporary grandfather authority provided by the BHC Act and Regulation Y.[1]

Regulation Y currently authorizes bank holding companies ("BHCs") to engage as principal in derivative contracts based on financial and nonfinancial assets ("Commodity Derivatives"). Under Regulation Y, a BHC may conduct Commodity Derivatives activities subject to certain restrictions that are designed to limit the BHC's activity to trading and investing in financial instruments rather than dealing directly in physical nonfinancial commodities. Under these restrictions, a BHC generally is not allowed to take or make delivery of nonfinancial commodities underlying Commodity Derivatives. In addition, BHCs generally are not permitted to purchase or sell nonfinancial commodities in the spot market.

The BHC Act, as amended by the Gramm–Leach–Bliley Act ("GLB Act"), permits a BHC to engage in activities that the Board had determined were closely related to banking, by regulation or order, prior to November 12,

1. UBS's grandfather rights expire on February 8, 2004. UBS conducts its U.S. energy trading business through UBSW Energy and UBS's London branch.

1999.[2] The BHC Act permits a FHC to engage in a broad range of activities that are defined in the statute to be financial in nature.[3] Moreover, the BHC Act allows FHCs to engage in any activity that the Board determines, in consultation with the Secretary of the Treasury, to be financial in nature or incidental to a financial activity.[4]

In addition, the BHC Act permits FHCs to engage in any activity that the Board (in its sole discretion) determines is complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.[5] This authority is intended to allow the Board to permit FHCs to engage on a limited basis in an activity that appears to be commercial rather than financial in nature, but that is meaningfully connected to a financial activity such that it complements the financial activity.[6] The BHC Act provides that any FHC seeking to engage in a complementary activity must obtain the Board's prior approval under section 4(j) of the BHC Act.[7]

UBS has requested that the Board permit it to purchase and sell physical commodities in the spot market and to take and make delivery of physical commodities to settle Commodity Derivatives ("Commodity Trading Activities"). The Board previously has determined that Commodity Trading Activities involving a particular commodity complement the financial activity of engaging regularly as principal in BHC-permissible Commodity Derivatives based on that commodity.[8] UBS regularly engages as principal in BHC-permissible Commodity Derivatives based on a variety of commodities, including natural gas and electricity. Based on the foregoing and all other facts of record, the Board believes that Commodity Trading Activities are complementary to the Commodity Derivatives activities of UBS.

In order to authorize UBS to engage in Commodity Trading Activities as a complementary activity under the GLB Act, the Board also must determine that the activities do not pose a substantial risk to the safety or soundness of depository institutions or the U.S. financial system generally.[9] In addition, the Board must determine that the performance of Commodity Trading Activities by UBS "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[10]

Approval of the proposal likely would benefit UBS's customers by enhancing the ability of the bank to provide efficiently a full range of commodity-related services. Approving Commodity Trading Activities for UBS also would enable the company to improve its understanding of physical commodity and commodity derivatives markets and its ability to serve as an effective competitor in physical commodity and commodity derivatives markets.

UBS has established and maintains policies for monitoring, measuring, and controlling the credit, market, settlement, reputational, legal, and operational risks involved in its Commodity Trading Activities. These policies address key areas such as counterparty credit risk, value-at-risk methodology and internal limits with respect to commodity trading, new business and new product approvals, and identification of transactions that require higher levels of internal approval. The policies also describe critical internal control elements, such as reporting lines, and the frequency and scope of internal audit of Commodity Trading Activities.

The Board believes that UBS has integrated the risk management of Commodity Trading Activities into the bank's overall risk management framework. Based on the above and all the facts of record, the Board believes that UBS has the managerial expertise and internal control framework to manage adequately the risks of taking and making delivery of physical commodities as proposed.

In order to limit the potential safety and soundness risks of Commodity Trading Activities, as a condition of this order, the market value of commodities held by UBS as a result of Commodity Trading Activities must not exceed 5 percent of UBS's consolidated tier 1 capital (as calculated under its home country standard).[11] UBS also must notify the Federal Reserve Bank of New York if the market value of commodities held by UBS as a result of its Commodity Trading Activities exceeds 4 percent of its tier 1 capital.

In addition, UBS may take and make delivery only of physical commodities for which derivative contracts have been authorized for trading on a U.S. futures exchange by the Commodity Futures Trading Commission ("CFTC") (unless specifically excluded by the Board) or which have been specifically approved by the Board.[12] This require-

2. 12 U.S.C. § 1843(c)(8).

3. The Board determined by regulation before November 12, 1999, that engaging as principal in Commodity Derivatives, subject to certain restrictions, was closely related to banking. Accordingly, engaging as principal in BHC-permissible Commodity Derivatives is a financial activity for purposes of the BHC Act. *See* 12 U.S.C. § 1843(k)(4)(F).

4. 12 U.S.C. § 1843(k)(1)(A).

5. 12 U.S.C. § 1843(k)(1)(B).

6. *See* 145 Cong. Rec. H11529 (daily ed. Nov. 4, 1999) (Statement of Chairman Leach) ("It is expected that complementary activities would not be significant relative to the overall financial activities of the organization.").

7. 12 U.S.C. § 1843(j).

8. *See Citigroup Inc.*, 89 *Federal Reserve Bulletin* 508 (2003). For example, Commodity Trading Activities involving all types of crude oil would be complementary to engaging regularly as principal in BHC-permissible Commodity Derivatives based on Brent crude oil.

9. 12 U.S.C. § 1843(k)(1)(B).

10. 12 U.S.C. § 1843(j).

11. UBS would be required to include in this 5 percent limit the market value of any commodities held by UBS as a result of a failure of its reasonable efforts to avoid taking delivery under section 225.28(b)(8)(ii)(B) of Regulation Y.

12. The particular commodity derivative contract that UBS takes to physical settlement need not be exchange-traded, but (in the absence of specific Board approval) futures or options on futures on the commodity underlying the derivative contract must have been authorized for exchange trading by the CFTC.

The CFTC publishes annually a list of the CFTC-authorized commodity contracts. *See* Commodity Futures Trading Commission, ment is designed to prevent UBS from becoming involved in dealing in finished goods and other items, such as real estate, that lack the fungibility and liquidity of exchange-traded commodities.

To minimize the exposure of UBS to additional risks, including storage risk, transportation risk, and legal and environmental risks, UBS may not:

(i) own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities; or

(ii) process, refine, or otherwise alter commodities. In conducting its Commodity Trading Activities, UBS will be expected to use appropriate storage and transportation facilities owned and operated by third parties.[13]

UBS and its Commodity Trading Activities also remain subject to the general securities, commodities, and energy laws and the rules and regulations (including the anti-fraud and anti-manipulation rules and regulations) of the Securities and Exchange Commission, the CFTC, and the Federal Energy Regulatory Commission.

Permitting UBS to engage in the limited amount and types of Commodity Trading Activities described above, on the terms described in this order, would not appear to pose a substantial risk to UBS, depository institutions, or the U.S. financial system generally. Through its existing authority to engage in Commodity Derivatives, UBS already may incur the price risk associated with commodities. Permitting UBS to buy and sell commodities in the spot market or physically settle Commodity Derivatives would not appear to increase significantly the organization's potential exposure to commodity price risk.

For these reasons, and based on UBS's policies and procedures for monitoring and controlling the risks of Commodity Trading Activities, the Board concludes that consummation of the proposal does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally and can reasonably be expected to produce benefits to the public that outweigh any potential adverse effects.

Based on all the facts of record, including the representations and commitments made by UBS in connection with the notice, and subject to the terms and conditions set forth in this order, the Board has determined that the notice should be, and hereby is, approved. The Board's determination is subject to all the conditions set forth in Regulation Y, including those in section 225.7 (12 C.F.R. 225.7), and to the Board's authority to require modification or termination of the activities of a BHC or any of its subsidiaries as the Board finds necessary to ensure compliance with, or to prevent evasion of, the provisions and purposes of the BHC Act and the Board's regulations and orders issued thereunder. The Board's decision is specifically conditioned on compliance with all the commitments made in connection with the notice, including the commitments and conditions discussed in this order. The commitments and conditions relied on in reaching this decision shall be deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order of the Board of Governors, effective January 27, 2004.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Orders Issued Under Sections 3 and 4 of the Bank Holding Company Act

Bank of America Corporation
Charlotte, North Carolina

FleetBoston Financial Corporation
Boston, Massachusetts

Order Approving the Merger of Bank Holding Companies

Bank of America Corporation, Charlotte, North Carolina ("Bank of America"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act (12 U.S.C. § 1842) to merge with FleetBoston Financial Corporation, Boston, Massachusetts ("FleetBoston"), and to acquire FleetBoston's subsidiary banks, Fleet National Bank, Providence, Rhode Island ("Fleet Bank"), and Fleet Maine, National Association, South Portland, Maine ("Fleet Maine").[1] Bank of America also has filed notices under section 4(c)(13) of the BHC Act (12 U.S.C. § 1843(c)(13)), sections 25 and 25A of the Federal Reserve Act (12 U.S.C. §§ 601 *et seq.* and 611 *et seq.*), and the Board's Regulation K (12 C.F.R. 211) to acquire certain foreign operations and the Edge Act subsidiaries of FleetBoston.[2]

FY 2002 Annual Report to Congress 124. With respect to granularity, the Board intends this requirement to permit Commodity Trading Activities involving all types of a listed commodity. For example, Commodity Trading Activities involving any type of coal or coal derivative contract would be permitted, even though the CFTC has authorized only Central Appalachian coal.

13. Approving Commodity Trading Activities as a complementary activity, subject to limits and conditions, would not in any way restrict the existing authority of UBS to deal in foreign exchange, precious metals, or any other bank-eligible commodity.

1. Bank of America also proposes to acquire the nonbanking subsidiaries of FleetBoston in accordance with section 4(k) of the BHC Act (12 U.S.C. § 1843(k)), including Fleet Bank (RI), National Association, Providence, Rhode Island ("Fleet Bank (RI)"), a nationally chartered credit card bank that is not considered a "bank" for purposes of the BHC Act.

2. Bank of America and FleetBoston also have requested the Board's approval to hold and exercise an option that allows Bank of America to purchase up to 19.9 percent of FleetBoston's common stock and FleetBoston to purchase up to 19.9 percent of Bank of America's common stock, if certain events occur. Both options would

Bank of America, with total consolidated assets of approximately $736.5 billion, is the third largest commercial banking organization in the United States, controlling approximately 7.4 percent of total assets of insured banking organizations in the United States.[3] Bank of America operates subsidiary depository institutions in 22 states and the District of Columbia, and it engages nationwide in numerous permissible nonbanking activities.

FleetBoston, with total consolidated assets of approximately $201.5 billion, operates depository institutions in Connecticut, Florida, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, and Rhode Island. FleetBoston is the eighth largest commercial banking organization in the United States, controlling approximately 2.2 percent of total assets of insured banking organizations in the United States. It also engages in a broad range of permissible nonbanking activities nationwide.

On consummation of the proposal, Bank of America would become the second largest commercial banking organization in the United States, with total consolidated assets of approximately $938 billion. The combined organization would operate under the name of Bank of America Corporation and control approximately 9.6 percent of total assets of insured banking organizations in the United States.

Factors Governing Board Review of the Transaction

The BHC Act enumerates the factors the Board must consider when reviewing the merger of bank holding companies or the acquisition of banks. These factors are the competitive effects of the proposal in the relevant geographic markets; the financial and managerial resources and future prospects of the companies and banks involved in the transaction; the convenience and needs of the communities to be served, including the records of performance under the Community Reinvestment Act (12 U.S.C. §2901 *et seq.*) ("CRA") of the insured depository institutions involved in the transaction; and the availability of information needed to determine and enforce compliance with the BHC Act. In cases involving interstate bank acquisitions, the Board also must consider the concentration of deposits nationwide and in certain individual states, as well as compliance with other provisions of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle–Neal Act").[4]

Public Comment on the Proposal

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (68 *Federal Register* 65,070, 65,932, and 75,565 (2003)), and the time for filing comments has expired. The Board extended the initial period for public comment to accommodate the broad public interest in this proposal, providing interested persons more than 60 days to submit written comments.

Because of the extensive public interest in the proposal, the Board held public meetings in Boston, Massachusetts, and San Francisco, California, to provide interested persons an opportunity to present oral testimony on the factors that the Board must review under the BHC Act.[5] More than 180 people testified at the public meetings, and many of the commenters who testified also submitted written comments.

In total, approximately 2200 individuals and organizations submitted comments on the proposal through oral testimony, written comments, or both.[6] Comments were submitted by organizations, individuals, and representatives from several states where the companies operate. Commenters included members of Congress, state and local government officials, community groups, nonprofit organizations, customers of Bank of America and FleetBoston, and other interested organizations and individuals. Commenters filed information and expressed views supporting and opposing the merger.

A large number of commenters supported the proposal and commended Bank of America and FleetBoston for their commitment to local communities and for their leadership in community development activities. These commenters praised Bank of America's and FleetBoston's records of providing affordable mortgage loans, investments, grants and loans in support of economic and community revitalization projects, and charitable contributions in local communities. Some commenters also noted favorably the small business activities of both organizations, which included lending, educational seminars, and technical assistance. Many of the commenters also praised Bank of America's nationwide $750 billion, 10-year community economic development plan ("Community Development Initiative") and stated that the plan would increase the availability of loans and investments to support community development and affordable housing activities.

A large number of commenters opposed the proposal, requested that the Board approve the proposal subject to certain conditions, expressed concern about some aspect of the CRA performance of Bank of America or FleetBoston, or argued that the proposal might lead to a reduction in banking services in particular communities or regions of the country. Many of these commenters focused on Bank of America's and FleetBoston's records of lending to small businesses and minorities and in low- and moderate-income ("LMI") and rural areas. A number of commenters from New England and other states currently served

expire on consummation of the proposal by Bank of America to merge with FleetBoston.

3. Asset data are as of December 31, 2003, and have been adjusted to account for FleetBoston's acquisition of Progress Financial Corp., Blue Bell, Pennsylvania ("Progress"), on February 1, 2004. National ranking data are as of September 30, 2003.

4. Pub. L. No. 103-328, 108 Stat. 2338 (1994).

5. The Boston public meeting was held on January 14, 2004, and the San Francisco public meeting was held on January 16, 2004.

6. Comments included 1,400 identical e-mail messages from members of an organization that expressed concerns about whether large bank mergers were good for consumers, 300 identical letters about the alleged involvement of a FleetBoston predecessor in the illegal slave trade, and more than 500 other comments on the proposal.

by FleetBoston expressed concern that Bank of America might not serve the diverse credit needs of their local communities as well or might terminate relationships or programs that FleetBoston has developed to meet the credit needs of its communities, such as FleetBoston's First Community Bank and the FleetBoston Foundation. In addition, many commenters criticized Bank of America's Community Development Initiative, stating that the initiative was not enforceable and did not provide specific lending commitments for individual states or regions or for particular loan products or programs.

Some commenters believed that the merger would reduce competition for banking services, substantially increase concentration in the banking industry, result in the loss of local control over lending and investment decisions, or exceed the nationwide deposit cap in the BHC Act. Other commenters expressed concern about Bank of America's investment in mortgage-backed securities pools that include subprime loans, the potential adverse effects that might result from branch closings, the loss of a major financial institution headquartered in New England, or job losses. Some commenters expressed concerns about Bank of America's or FleetBoston's managerial resources in light of certain lawsuits and investigations involving one or both companies and their securities and mutual fund affiliates.

In evaluating the statutory factors under the BHC Act, the Board carefully considered the information and views presented by all commenters, including the testimony at the public meetings and the information and views submitted in writing. The Board also considered all the information presented in the applications, notices, and supplemental filings by Bank of America and FleetBoston; various reports filed by the relevant companies; publicly available information; and other reports. In addition, the Board reviewed confidential supervisory information, including examination reports on the bank holding companies and the depository institutions involved and information provided by other federal banking agencies, the Securities and Exchange Commission ("SEC"), and the Department of Justice ("DOJ"). After a careful review of all the facts of record, and for the reasons discussed in this order, the Board has concluded that the statutory factors it is required to consider under the BHC Act and other relevant banking statutes are consistent with approval of the proposal.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Bank of America is North Carolina,[7] and FleetBoston's subsidiary banks are located in Connecticut, Florida, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, and Rhode Island.[8]

The Board may not approve an interstate proposal under section 3(d) if the applicant controls, or upon consummation of the proposed transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States ("nationwide deposit cap"). The nationwide deposit cap was added to section 3(d) when Congress broadly authorized interstate acquisitions by bank holding companies and banks in the Riegle–Neal Act. The intended purpose of the nationwide deposit cap was to help guard against undue concentrations of economic power.[9] Although the nationwide deposit cap prohibits interstate acquisitions by a company that controls deposits in excess of the cap, it does not prevent a company from exceeding the nationwide deposit cap through internal growth and effective competition for deposits or through acquisitions entirely within the home state of the acquirer.

Several commenters questioned whether the proposed acquisition would violate the nationwide deposit cap and presented differing views on how the deposit cap should be calculated. Some commenters challenged Bank of America's computation of its *pro forma* share of total deposits in the United States provided in the application, suggested that the Board rely on the Summary of Deposits ("SOD") data collected annually by the Federal Deposit Insurance Corporation ("FDIC"), or argued that certain geographies or types of deposits or types of institutions should be excluded from the calculations.

As required by section 3(d), the Board has carefully considered whether Bank of America controls, or upon consummation of the proposed transaction would control, a total amount of deposits in excess of the nationwide deposit cap. Not all of the terms used in defining the nationwide deposit cap are specifically defined in the BHC Act. The Federal Deposit Insurance Act ("FDI Act") contains an identical nationwide deposit cap applicable to bank-to-bank mergers, and, consequently, many of the terms used in the nationwide deposit cap in the BHC Act refer to terms or definitions contained in the FDI Act.

In particular, the BHC Act adopts the definition of "insured depository institution" used in the FDI Act. The FDI Act's definition includes all banks (whether or not the institution is a bank for purposes of the BHC Act), savings banks and savings associations that are insured by the FDIC, and insured U.S. branches of foreign banks, as each of those terms is defined in the FDI Act.[10]

7. *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

8. For purposes of the Riegle–Neal Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B).

9. *See* S. Rep. No. 102-167 at 72 (1991).

10. A number of commenters have asserted that deposits held by insured depository institutions in Puerto Rico and the U.S. territories should not be included in the deposit calculation because these areas are not "States." The terms "State" and "United States" are not defined in the BHC Act. The Board believes that the term "United States" include the States, the District of Columbia, Puerto Rico,

Section 3(d) also specifically adopts the definition of "deposit" in the FDI Act.[11] Each insured bank in the United States must report its total deposits in accordance with this definition on the institution's Consolidated Report of Condition and Income ("Call Report"). Each insured savings association must similarly report its total deposits on the institution's Thrift Financial Report ("TFR"). Deposit data for FDIC-insured U.S. branches of foreign banks and Federal branches of foreign banks are obtained on the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks ("RAL"). These data are reported on a quarterly basis to the FDIC and are publicly available.

The Call Report, TFR, and RAL reflect data based on the FDI Act's definition of "deposit" and represent the best and most complete data reported by all insured depository institutions in the United States. Consequently, the Board has relied on the data collected in these reports to calculate the total amount of deposits of insured depository institutions in the United States and the total amount of deposits held by Bank of America, both before and upon consummation of the proposed transaction, for purposes of applying the nationwide deposit cap in this case.[12] The items on the Call Report, TFR, and RAL used to calculate the total amount of deposits of insured depository institutions in the United States are enumerated in Appendix A. These items, combined as explained in Appendix A, conform the data collected on the Call Reports and TFR as closely as possible to the statutory definition of deposits in the FDI Act and BHC Act. The Board has developed this formulation in consultation with the staff of the FDIC, which collects and uses these data for purposes of applying the same definition of deposits for deposit insurance purposes and the nationwide deposit cap in the FDI Act.

Based on the latest Call Report, TFR, and RAL data available for all insured depository institutions, the total amount of deposits of insured depository institutions in the United States is approximately $5.33 trillion. Also based on the latest Call Report, Bank of America (including all of its insured depository institution affiliates) controls deposits of approximately $394.8 billion and FleetBoston (including all of its insured depository institution affiliates) controls deposits of approximately $133.5 billion.[13] Bank of America, therefore, currently controls approximately 7.4 percent of total U.S. deposits. Upon consummation of the proposed transaction, Bank of America would control approximately 9.904 percent of the total amount of deposits of insured depository institutions in the United States.

Thus, the Board finds that Bank of America does not now control, and upon consummation of the proposed transaction would not control, an amount of deposits that would exceed the nationwide deposit cap.

Section 3(d) also prohibits the Board from approving a proposal if, on consummation of the proposal, the applicant would control 30 percent or more of the total deposits of insured depository institutions in any state in which both the applicant and the organization to be acquired operate an insured depository institution, or such higher or lower percentage that is established by state law.[14] Bank of America would control less than 30 percent, and less than the appropriate percentage established by applicable state law, of total deposits of insured depository institutions in Florida and New York, the states in which Bank of America currently operates a bank or branch and would assume additional deposits on consummation of the proposal.[15] All other requirements of section 3(d) of the BHC Act also would be met after consummation of the pro-

Guam, American Samoa, the Virgin Islands, the Northern Mariana Islands, the islands formerly referred to as the Trust Territory of the Pacific Islands, and any territory of the United States. This definition of "United States" is consistent with the purpose of the nationwide deposit cap. All banks operating in these areas are eligible for FDIC deposit insurance and are subject to the jurisdiction of the FDIC in the same manner as other FDIC-insured banks. If these areas are not included in the definition of "United States" for purposes of the nationwide deposit cap, an institution such as Bank of America could expand in these areas without limit, thereby increasing its control of FDIC-insured deposits. This definition is also consistent with the definition of "United States" contained in the Board's Regulation Y, which governs applications under section 3 of the BHC Act.

11. 12 U.S.C. § 1842(d)(2)(E) (incorporating the definition of "deposit" at 12 U.S.C. § 1813(*l*)).

12. Some commenters argued that the SOD collected by the FDIC should be used for applying the deposit cap to the proposal. SOD data disclose an institution's deposits broken out by branch office. However, SOD data are not, and are not intended to be, an exact representation of deposits as defined in the FDI Act. Rather, these data are intended to provide a useful proxy for the size of each institution's presence in various banking markets primarily for the purpose of conducting examinations and performing competitive analysis in local banking markets. Consequently, SOD data require a variety of adjustments, most of which would be based on Call Report data, if SOD data are to be used to better approximate total deposits as defined in the FDI Act and the BHC Act. Moreover, SOD data are collected only once each year at the end of the second quarter, which means that the most recent SOD data provide an estimation of deposits held by institutions more than eight months ago. Call Report data, on the other hand, are collected each quarter, with the most recent data representing deposits as of December 31, 2003. Given the limitations of SOD data, the Board believes that Call Report data, rather than SOD data, provide a more complete and accurate representation of the amount of deposits held by the institutions involved in this transaction and in all insured depository institutions in the United States as of the date the Board has considered the proposal.

A number of commenters noted the Board's past use of SOD data in concluding a proposal was within the Riegle–Neal Act's nationwide deposit cap. *See, e.g., Fleet Financial Corporation*, 85 *Federal Reserve Bulletin* 747 (1999); *NationsBank*, 84 *Federal Reserve Bulletin* 858, 860 (1998) ("*NationsBank*"). In these proposals, the Board used information from the FDIC's SOD reports as an approximation of nationwide deposits. To date, the largest concentration of nationwide deposits was approximately 8.1 percent (*see NationsBank*) and the use of SOD data was a sufficient first screen in light of these proposals' clear compliance with the nationwide deposit cap.

13. FleetBoston' s deposits include approximately $770 million in deposits held by Progress.

14. 12 U.S.C. § 1842(d)(2)(B)–(D).

15. On consummation, Bank of America would control less than 30 percent of total deposits in insured depository institutions in Florida. *See* Fla. Stat. ch. 658.295(8)(b) (2003). New York does not have a deposit cap applicable to this proposal, and Bank of America currently does not control an insured depository institution in Connecticut, Massachusetts, Maine, New Hampshire, New Jersey, Pennsylvania, or Rhode Island.

posal.[16] In view of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly. It also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[17] The Board has carefully considered the competitive effects of the proposal in light of all the facts of record, including public comments on the proposal.

A number of commenters argued that the proposed merger would have adverse competitive effects. Many of these commenters expressed concern that large bank mergers in general, or the proposed merger of Bank of America and FleetBoston in particular, would have adverse effects on competition nationwide. Some commenters also contended that the proposed merger would result in higher fees and costs.

To determine the effect of a proposed transaction on competition, it is necessary to designate the area of effective competition between the parties, which the courts have held is decided by reference to the relevant "line of commerce" or product market and a geographic market. The Board and the courts have consistently recognized that the appropriate product market for analyzing the competitive effects of bank mergers and acquisitions is the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) offered by banking institutions.[18] Several studies support the conclusion that businesses and households continue to seek this cluster of services.[19] Consistent with these precedents and studies, and on the basis of the facts of record in this case, the Board concludes that the cluster of banking products and services represents the appropriate product market for analyzing the competitive effects of this proposal.

In defining the relevant geographic market, the Board and the courts have consistently held that the geographic market for the cluster of banking products and services is local in nature. The appropriate geographic markets for considering the competitive effects of this proposal are the four local banking markets in which the subsidiary banks of Bank of America and FleetBoston compete directly.[20] Bank of America and FleetBoston both operate in the Metropolitan New York–New Jersey banking market, and in the Florida banking markets of West Palm Beach, Fort Pierce, and Sarasota.[21]

The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. These considerations include the number of competitors that would remain in the markets, the relative share of total deposits in depository institutions controlled by Bank of America and FleetBoston in the markets ("market deposits"),[22] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[23] and other characteristics of the markets.

16. Bank of America is adequately capitalized and adequately managed as defined in the Riegle–Neal Act. 12 U.S.C. § 1842(d)(1)(A). FleetBoston's subsidiary banks have been in existence and operated for the minimum age requirements established by applicable state law. *See* 12 U.S.C. § 1842(d)(1)(B). All other requirements under section 3(d) of the BHC Act also would be met on consummation of the proposal.

17. 12 U.S.C. § 1842(c)(1).

18. *See Chemical Banking Corporation*, 82 *Federal Reserve Bulletin* 239 (1996) ("*Chemical*") and the cases and studies cited therein. The Supreme Court has emphasized that it is the cluster of products and services that, as a matter of trade reality, makes banking a distinct line of commerce. *See United States v. Philadelphia National Bank*, 374 U.S. 321, 357 (1963) ("*Philadelphia National*"); *accord United States v. Connecticut National Bank*, 418 U.S. 656 (1974); *United States v. Phillipsburg National Bank*, 399 U.S. 350 (1969) ("*Phillipsburg National*").

19. Cole and Wolken, *Financial Services Used by Small Businesses: Evidence from the 1993 National Survey of Small Business Finance*, 81 *Federal Reserve Bulletin* 629 (1995); Elliehausen and Wolken, *Banking Markets and the Use of Financial Services by Households*, 78 *Federal Reserve Bulletin* 169 (1992); Elliehausen and Wolken, *Banking Markets and the Use of Financial Services by Small- and Medium-Sized Businesses*, 76 *Federal Reserve Bulletin* 726 (1990).

20. *See Phillipsburg National; Philadelphia National*, 374 U.S. at 357. *See also*, *First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998); *Chemical*; and *St. Joseph Valley Bank*, 68 *Federal Reserve Bulletin* 673 (1982) ("*St. Joseph*"). In delineating the relevant geographic market in which to assess the competitive effects of a bank merger or acquisition, the Board reviews population density; worker commuting patterns; the usage and availability of banking products; advertising patterns of financial institutions; the presence of shopping, employment, and other necessities; and other indicia of economic integration and transmission of competitive forces among banks. *See Crestar Bank*, 81 *Federal Reserve Bulletin* 200, 201, n.5 (1995); *Pennbancorp*, 69 *Federal Reserve Bulletin* 548 (1983); and *St. Joseph*.

21. These markets are described in Appendix B.

22. Deposit and market share data are based on SOD reports filed as of June 30, 2003, and on calculations in which the deposits of thrift institutions are included at 50 percent. The Board has indicated previously that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the calculation of market share on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

23. Under the DOJ Guidelines, 49 *Federal Register* 26,823 (1984), a market is considered unconcentrated if the post-merger HHI is under 1000 and moderately concentrated if the post-merger HHI is between 1000 and 1800. The DOJ has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher than normal HHI thresholds for screening bank mergers for anticompetitive effects implicitly recognize the competitive effects of limited-purpose lenders and other nondepository financial institutions.

After consummation of the proposal, the Metropolitan New York–New Jersey banking market would remain unconcentrated, and the Fort Pierce, Sarasota, and West Palm Beach banking markets would remain moderately concentrated, as measured by the HHI.[24] Numerous competitors would remain in each banking market.

Consummation of the proposal would be consistent with Board precedent and the DOJ Guidelines in each of the banking markets. In addition, no agency has indicated that competitive issues are raised by the proposal. Based on these and all other facts of record, the Board concludes that consummation of the proposal is not likely to result in a significantly adverse effect on competition or on the concentration of banking resources in the four banking markets noted above or in any other relevant banking market. Accordingly, based on all the facts of record, the Board has determined that the competitive effects are consistent with approval of the proposal.

Financial, Managerial, and Other Supervisory Factors

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors. The Board has carefully considered the financial and managerial resources and future prospects of Bank of America, FleetBoston, and their respective subsidiary banks in light of all the facts of record. In reviewing the financial and managerial factors, the Board has considered, among other things, confidential reports of examination and other supervisory information received from the primary federal supervisors of the organizations involved and the Federal Reserve System's confidential supervisory information. In addition, the Board has consulted with the relevant supervisory agencies, including the Office of the Comptroller of the Currency ("OCC"), which is the primary supervisor of Bank of America's and FleetBoston's banks, and the SEC. The Board also has considered publicly available financial and other information on the organizations and their subsidiaries and all the information on the proposal's financial and managerial aspects submitted by Bank of America and FleetBoston during the application process.

The Board received several comments on the proposal criticizing the financial and managerial resources of Bank of America or FleetBoston and their respective subsidiaries.[25] Some commenters questioned whether the Board and other federal agencies would have the ability to supervise the combined organization, or whether the combined organization would present special risks to the federal deposit insurance funds or the financial system in general. In addition, some commenters asserted that the Board should postpone consideration of the proposal in light of various investigations into certain investment banking, investment advisory, and corporate finance practices of Bank of America and its affiliates and should conduct its own inquiry into these matters.[26]

In evaluating financial factors in expansion proposals by banking organizations, the Board consistently has considered capital adequacy to be an especially important factor.[27] Bank of America and FleetBoston and their subsidiary banks are well capitalized and would remain so on consummation of the proposal. The Board has considered that the proposed merger is structured as a share-for-share transaction and would not increase the debt service requirements of the combined company. The Board also has carefully reviewed other indicators of the financial strength and resources of the companies involved, including the earnings performance and asset quality of the institutions.

In addition, the Board has considered the managerial resources of the entities involved and of the proposed combined organization. Bank of America, FleetBoston, and their subsidiary depository institutions are considered well managed overall.[28] The Board has considered the

24. In the Metropolitan New York–New Jersey banking market, the HHI would increase 9 points to 983. The HHI would increase 35 points to 1,349 in the West Palm Beach banking market; remain unchanged at 1,259 in the Fort Pierce banking market; and increase 4 points to 1,252 in the Sarasota banking market. The effect of the proposal on the concentration of banking resources in each market is described in Appendix C.

25. More than 300 commenters expressed concern about accusations that a predecessor bank of FleetBoston financed slave trading allegedly conducted by one of its founders, after Congress outlawed the importation of slaves. The Board has carefully reviewed its authority under the federal banking laws and the extent that the matters raised by commenters relate to the factors that the Board is authorized to consider. The Board also notes that these concerns relate to instances that occurred more than 125 years ago and that have been the subject of substantial and repeated court proceedings. The Board believes that the matter primarily involves subjects of public concern that are not within the Board's limited jurisdiction to adjudicate or do not relate to the factors that the Board may consider when reviewing an application or notice under the BHC Act. *See Deutsche Bank AG*, 85 *Federal Reserve Bulletin* 509 (1999); *Union Bank of Switzerland*, 84 *Federal Reserve Bulletin* 684 (1998); *Norwest Corporation*, 82 *Federal Reserve Bulletin* 580 (1996). *See also, Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

26. Some commenters cited press reports about investigations into the mutual fund industry generally, and Bank of America's mutual fund activities specifically, as well as structured financing transactions and other securities-related matters. As noted below, the Board has and will continue to consult with the SEC on these matters. The Board also received comments asserting that Bank of America, N.A., Charlotte, North Carolina ("BA Bank"), and other subsidiaries of Bank of America lack sufficient policies and procedures and other resources to prevent money laundering. The Board has reviewed confidential supervisory information on the policies, procedures, and practices of Bank of America to comply with the Bank Secrecy Act and has consulted with the OCC, the appropriate federal financial supervisory agency of BA Bank. Three commenters alleged that a predecessor institution of FleetBoston engaged in illegal tying in several loan transactions, and they criticized the behavior of FleetBoston's counsel in the ensuing litigation. The dispute involves several individual transactions that have been previously cited by the commenters. The Board and the OCC have the matter under review, and together they have sufficient supervisory authority to address any violation of law that may be determined.

27. *See, e.g., First Union Corporation*, 87 *Federal Reserve Bulletin* 663, 688 (2001).

28. Several commenters from Hawaii requested that the Board postpone action on the proposal until Bank of America fulfills two "commitments" it made to state and local governments and community groups in 1994. *See BankAmerica Corporation* 80 *Federal*

supervisory experience and assessments of management by the various bank supervisory agencies and the organizations' records of compliance with applicable banking law. In addition, the Board has reviewed carefully the examination records of Bank of America and its subsidiary depository institutions, including assessments of their risk management systems and other policies. Senior management of the combined organization would draw from the senior executives of Bank of America and FleetBoston based on the individual management strengths of each company. In this case, senior executives of the two companies have formed a transition team to plan and manage the integration of the bank holding companies and their subsidiaries. Bank of America and FleetBoston have had experience with large mergers and have indicated that they are devoting significant resources to address all aspects of the merger process.

The Board is monitoring the various federal and state investigations of Bank of America's and FleetBoston's securities-related activities that are being conducted by agencies and other authorities with jurisdiction over these matters and is consulting with the SEC and other relevant authorities. Bank of America has cooperated with all regulatory authorities and has conducted an internal investigation into these matters. Importantly, Bank of America has demonstrated a willingness and ability to take actions to address concerns raised in these investigations, which include enhancing corporate governance capabilities, improving its monitoring of mutual fund operations, and providing more stringent disclosure requirements for structured-finance clients.

The Board has broad supervisory authority under the banking laws to require Bank of America to take steps necessary to address deficiencies identified in these investigations and examinations of Bank of America's and FleetBoston's securities-related and other activities after these reviews have been completed. This authority is in addition to authority vested in the SEC and other agencies to take appropriate action to determine and address violations of applicable securities and other laws.

The Board and other financial supervisory agencies have extensive experience supervising Bank of America, FleetBoston and their subsidiary depository institutions, as well as other banking organizations that operate across multiple states or multiple regions. The Board has already instituted an enhanced supervisory program that permits the Board to monitor and supervise the combined organization effectively on a consolidated basis. This program involves, among other things, continuous holding company supervision, including both on- and off-site reviews, of the combined organization's material risks on a consolidated basis and across business lines; access to and analyses of the combined organization's internal reports for monitoring and controlling risks on a consolidated basis; and frequent contact with the combined organization's senior management. It also includes reviews of the policies and procedures in place at the holding company for assuring compliance with applicable banking, consumer, and other laws.[29] Consistent with the provisions of section 5 of the BHC Act as amended by the Gramm–Leach–Bliley Act, the Board relies on the SEC and other appropriate functional regulators to provide examination and other supervisory information regarding functionally regulated subsidiaries in order that the Board can fulfill its responsibilities as holding company supervisor of the combined entity.[30]

Based on these and all the facts of record, including review of all the comments received,[31] the Board concludes that considerations relating to the financial and managerial resources and future prospects of Bank of America, FleetBoston, and their respective subsidiaries are consistent with approval of the proposal. The Board also finds that the other supervisory factors that the Board must consider under section 3 of the BHC Act are consistent with approval.

Convenience and Needs Considerations

As previously discussed, section 3 of the BHC Act requires the Board to consider the effects of the proposal on the

Reserve Bulletin 623, 628 (1994) ("*Liberty Bank*"); and *NationsBank* at 876. A commenter also asserted that Bank of America's alleged failure to meet its Hawaii lending program "commitments" reflects adversely on its managerial resources and that the Board should take enforcement action. As also discussed below in considering the convenience and needs factor, Bank of America's public announcement of its Hawaii lending programs and goal for mortgage lending to Native Hawaiians on Hawaiian Home Lands was not a commitment to the Board and it is not enforceable by the Board. Bank of America has made progress toward meeting its announced lending goal and has represented that its assumptions for achieving the goal within the original time frame proved to be unrealistic because of unexpected complexities in the lending process and competition with other lenders. Bank of America recently affirmed its intent to complete the goal for mortgage lending on Hawaiian Home Lands and has announced steps to enhance its ability to meet that goal, including actions that have been coordinated with the State of Hawaii Department of Hawaiian Home Lands.

29. Some commenters have questioned whether the securitization activities of Bank of America promote the origination of predatory loans. As described more fully below in footnote 35, the Board has considered the policies and programs in place at Bank of America to help ensure that the subprime loans it purchases and securitizes are in compliance with applicable state and federal consumer protection laws.

30. For additional information concerning the Board's supervisory program for large, complex banking organizations, such as Bank of America, *see Supervision of Large Complex Banking Organizations*, 87 *Federal Reserve Bulletin* 47 (2001).

31. Commenters also expressed concern about the following matters:

(1) the number of minorities serving in Bank of America's senior management,
(2) whether Bank of America's supplier diversity program is effectively serving minority- and women-owned businesses,
(3) Bank of America's financing of various activities and projects worldwide that might damage the environment or cause other social harm,
(4) Bank of America's alleged opposition to legislation addressing "predatory" lending, and
(5) interchange fees charged by Visa and Mastercard. These contentions and concerns are outside the limited statutory factors that the Board is authorized to consider when reviewing an application under the BHC Act. *See Western Bancshares*.

convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the CRA. The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of local communities in which they operate, consistent with their safe and sound operation, and it requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including LMI neighborhoods, in evaluating bank expansionary proposals. The Board has carefully considered the convenience and needs factor and the CRA performance records of the subsidiary depository institutions of Bank of America and FleetBoston, including public comments on the effect the proposal would have on the communities to be served by the resulting organization.

A. Summary of Public Comments on Convenience and Needs

In response to the Board's request for public comment on this proposal, approximately 300 commenters submitted comments or testified at the public meetings in support of the proposal. These commenters generally commended Bank of America or FleetBoston for the financial and technical support provided to their community development organizations or related their favorable experiences with specific programs or services offered by Bank of America. Many of these commenters also expressed their support for Bank of America's Community Development Initiative.

Approximately 190 commenters submitted comments that expressed concern about the lending records of Bank of America or FleetBoston, recommended approval only if subject to conditions suggested by the commenter, or expressed concern about large bank mergers in general.[32] Other commenters alleged that lending, customer service, and philanthropy have declined at Bank of America and FleetBoston after their previous mergers. Some commenters neither supported nor opposed the proposal, but provided information about Bank of America's and FleetBoston's performance in their communities.

Many of the commenters who opposed or expressed concern about the proposal alleged that Bank of America's level of home mortgage lending to LMI or minority borrowers or in LMI or predominantly minority communities was low in various parts of the country, including California and North Carolina. In addition, several commenters criticized FleetBoston's home mortgage lending record. Some commenters alleged that Bank of America's small business lending in California or other markets was inadequate, particularly to businesses in LMI or predominantly minority communities.[33] Several commenters criticized Bank of America's general efforts toward small business lending, especially its level of lending to microenterprises.[34] Several commenters criticized Bank of America's due diligence with respect to its purchase and securitization of subprime loans.[35] Other commenters expressed concern that Bank of America's corporate decisions would not take into account the diversity and community reinvestment needs of New England, California, or North Carolina. Some commenters expressed doubts that Bank of America would assign local representatives to its community reinvestment and development programs.[36]

In addition, some commenters expressed concern that consummation of the proposal would result in branch closures in LMI or predominantly minority communities, or they criticized the percentage of Bank of America and FleetBoston branches in LMI areas. Many commenters asserted that Bank of America should augment the array or adjust the pricing of banking services that it provides, particularly to LMI individuals.[37] Some commenters sug-

32. Several commenters contended that a greater risk exists that larger banking organizations may improperly share customer information among affiliates. One commenter questioned FleetBoston's procedures for safeguarding accounts from unauthorized access, based on her experiences with the bank. This comment has been forwarded to the OCC, which is the primary federal regulator for Fleet Bank. Bank of America has policies and procedures in place to address the sharing and safeguarding of customer information.

33. Some commenters also criticized FleetBoston's level of small business lending for being too low.

34. These commenters defined a microenterprise as a business with five or fewer employees and less than $35,000 in capital.

35. Several commenters maintained that Bank of America purchases subprime loans and securitizes them without performing adequate due diligence to screen for "predatory" loans, and some commenters urged Bank of America to adopt particular factors or methods for such screening. Several commenters also criticized Bank of America for its recent investment in a subprime lending company, Oakmont Mortgage Company, Woodland Hills, California ("Oakmont"), after Bank of America had publicly announced that it would not originate subprime mortgage loans. None of these commenters, however, provided evidence that Bank of America had originated, purchased, or securitized "predatory" loans or otherwise engaged in abusive lending practices. Bank of America provides warehouse lines of credit to, and purchases subprime mortgage loans from, subprime lenders through BA Bank, and securitizes pools of subprime mortgage loans. Bank of America has policies and procedures, including sampling loans in the pool, to help ensure that the subprime loans it purchases and securitizes are in compliance with applicable state and Federal consumer protection laws. It also conducts a due diligence review of firms from which it purchases subprime loans, and the loan servicer firms selected for each securitization, to help prevent the purchase and securitization of loans that are not in compliance with applicable state and Federal consumer protection laws. As the Board previously has noted, subprime lending is a permissible activity and provides needed credit to consumers who have difficulty meeting conventional underwriting criteria. The Board continues to expect all bank holding companies and their affiliates to conduct their subprime-lending-related operations free of any abusive lending practices and in compliance with all applicable law, including fair lending laws. *See Royal Bank of Canada*, 88 *Federal Reserve Bulletin* 385, 388 n.18 (2002). The Board notes that the OCC has responsibility for enforcing compliance with fair lending laws by national banks and that the Federal Trade Commission, Department of Housing and Urban Development ("HUD"), and DOJ have responsibility for enforcing such compliance by nondepository institutions.

36. Other commenters expressed concern that Bank of America's board of directors and senior management would not include local representation.

37. One commenter contended that Bank of America and FleetBoston have failed to serve the needs of LMI communities

gested that Bank of America should provide more culturally sensitive retail banking services and hire more minorities, including Native Americans.

Several commenters contended that data submitted under the Home Mortgage Disclosure Act (12 U.S.C. § 2801 *et seq.*) ("HMDA") suggested that Bank of America and FleetBoston engaged in disparate treatment of minority individuals in home mortgage lending. Many commenters in several states criticized the terms of Bank of America's recent Community Development Initiative. Other commenters criticized Bank of America's performance under its previous community reinvestment pledges or its refusal to enter into or renew written agreements with their respective community groups. In addition, some commenters expressed concern about the loss of FleetBoston as an independent organization, which they contended had a better overall CRA performance record than Bank of America.

B. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the appropriate federal supervisors' examinations of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[38]

Bank of America's lead bank, BA Bank, received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of December 31, 2001. Fleet Bank also received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of July 23, 2001. All other subsidiary banks of Bank of America and FleetBoston received either "outstanding" or "satisfactory" ratings at their most recent CRA performance evaluations by the OCC.[39]

Bank of America stated that it would identify the best products and services currently offered by either Bank of America or FleetBoston and aim to make them available to all customers and that it has no current plans to discontinue any products or services of FleetBoston.

C. CRA Performance of BA Bank

Overview

As noted above, BA Bank received an overall "outstanding" rating for performance under the CRA.[40] The bank also received an "outstanding" rating under the lending test. Examiners commended BA Bank's overall lending performance, which they described as demonstrating excellent or good lending test results in all its rating areas. During the evaluation period, BA Bank originated more than 828,200 HMDA-reportable home mortgage loans, totaling more than $112 billion throughout its assessment areas.[41] Examiners reported that rating areas in which the distribution of HMDA-reportable mortgage loans among areas of different income levels was good.

In addition, examiners commended BA Bank for developing mortgage loan programs with flexible underwriting standards, such as its Neighborhood Advantage programs, and they reported that these programs assisted in meeting the credit needs of its assessment areas. The Neighborhood Advantage programs include the Neighborhood Advantage Zero Down loan product, which is tailored for LMI applicants who have good credit histories but are unable to make a down payment. The Neighborhood Advantage Credit Flex program is another affordable mortgage product tailored for LMI borrowers, or borrowers who live in low-income census tracts, who pay their bills on time but who do not have established credit histories. Although this product requires a 3 percent down payment, examiners reported that the borrower is required to contribute only one-third of the down payment and the remainder may be provided from "gifts or other sources."

During the evaluation period, BA Bank originated more than 142,480 small business and small farm loans, totaling $12.4 billion, in its assessment areas.[42] Examiners reported

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adequately under the CRA because they have discontinued the deposit accounts of check-cashing businesses. The Board previously addressed this allegation in its order approving the merger of FleetBoston and Summit Bancorp. *FleetBoston Financial Corporation*, 87 *Federal Reserve Bulletin* 252 (2001). Other commenters criticized Bank of America for extending loans to payday lenders.

38. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

39. Bank of America, National Association (USA), Phoenix, Arizona, received a "satisfactory" rating, as of December 31, 2001; Fleet Bank (RI) received an "outstanding" rating, as of February 3, 2003. Fleet Maine is a limited-purpose bank that is not subject to the CRA.

40. At the time of the 2001 performance evaluation, BA Bank had 218 assessment areas, 34 of which received a full-scope review. The overall rating for BA Bank is a composite of its state/multistate ratings. In the 2001 performance evaluation, examiners provided detailed narratives with respect to BA Bank's performance in certain assessment areas examiners selected as "primary rating areas." These areas represented 69 percent of the bank's deposits during the review period. Examiners determined that BA Bank's primary rating areas were California, the Charlotte–Gastonia–Rock Hill (NC–SC) Multistate Metropolitan Statistical Area ("Charlotte MSA"), Florida, and Texas. The evaluation period was January 1, 2001, through December 31, 2001.

41. In BA Bank's 2001 performance evaluation, home mortgage lending data included loans originated and purchased.

42. Commenters contended that BA Bank has a poor record of lending to small businesses, especially small businesses owned by women and minorities or operating in LMI areas. Commenters urged Bank of America to increase its small business lending in these communities. Bank of America represented that, in 2002 and 2003, it was ranked as the number-one Small Business Administration ("SBA") lender in terms of the number of loans originated nationwide. Bank of America represented that BA Bank also is a SBA "Preferred Lender" in every state where it has retail branches, which helps to ensure an accelerated application process for small business customers. According to the SBA, Bank of America's average loan size is approximately $37,000, which is smaller than the average SBA

that the bank's small business lending was excellent or good in the majority of its rating areas. They also noted that the distribution of small business loans among businesses of different sizes was good in several of BA Bank's assessment areas.[43]

Examiners noted that in many instances BA Bank originated community development loans in greater amounts than expected to achieve excellent performance.[44] BA Bank originated more than 970 community development loans, totaling $2.3 billion, in its assessment areas during the evaluation period.[45] Examiners reported that letters of credit originated by the bank contributed significantly to BA Bank's community development goals because these activities supported the creation of an additional 13,622 affordable homes.

BA Bank received an "outstanding" rating overall under the investment test.[46] During the review period, the bank made more than 3,500 investments totaling $1.3 billion in the states in which it has a banking presence. Examiners reported that BA Bank consistently demonstrated strong investment test performance, noting that its performance was excellent or good in the majority of its assessment areas.[47] Throughout its assessment areas, BA Bank funded more than 17,000 housing units for LMI families through its community development investments.[48] Examiners commended BA Bank for taking a leadership role in developing and participating in complex investments that involved multiple participants and both public and private funding. In addition, examiners noted that BA Bank frequently extended grants to assist organizations that are incapable of supporting additional debt or providing a sufficient investment return.

Overall, BA Bank received a "high satisfactory" rating under the service test.[49] Examiners commended BA Bank's service performance throughout its assessment areas.[50] They reported that the bank's retail delivery systems were generally good and that the bank's distribution of branches among geographies of different income levels was adequate.[51] Examiners also commended BA Bank for its community development services, which typically responded to the needs of the communities the bank served throughout its assessment areas.

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loan, and it provides needed loans to businesses that have a more difficult time obtaining credit.

43. Florida was among BA Bank's assessment areas cited by examiners as demonstrating excellent performance in the distribution of small business and small farm loans among businesses and farms of different revenue sizes.

44. Some commenters expressed concern about Bank of America's performance under its community development program for rural communities and Native Americans. Bank of America established the Rural 2000 Initiative in 1997 to increase its lending in rural LMI areas and communities with large Native-American populations. *See NationsBank.* Bank of America represented that for the period 1999 through November 2003, it provided $28 billion for affordable housing, $9.1 billion for small business/small farm lending, $3.4 billion for consumer lending, and $466 million in economic development loans in these areas. Bank of America represented that between 2000 and 2003, it originated $120.8 million in loans to Indian Country (census tracts with a Native-American population of 50 percent or more) and it provided loans to improve the infrastructure on Native American lands.

45. In June 2003, Bank of America began a new nationwide loan program to support the construction of 15,000 new affordable housing units in the next three years.

46. Several commenters maintained that Bank of America should be required to donate a specified percentage of its pre-tax income to charities. Bank of America represented that it has a record of providing significant corporate philanthropic donations in all the communities that it serves. One commenter also asserted that Bank of America allocates a disproportionate share of its charitable giving to health, education, and the arts and that its contributions to community development are insufficient. The Board notes that neither the CRA nor the agencies' implementing rules require that institutions engage in charitable giving.

47. One commenter asserted that Bank of America financially rewards community groups that comment or testify in support of Bank of America merger proposals and refuses to invest in or lend to organizations that oppose its merger proposals. The CRA does not authorize the Board to direct Bank of America's community development investment or lending activities to specific groups, individuals, or projects.

48. Bank of America also has provided grants to nonprofit organizations, such as ACCION and the New Mexico Community Development Loan Fund, that originate microloans starting at $500 and promote SBA programs.

49. Several commenters in California and other locations criticized BA Bank for not providing low-cost money orders, and they criticized its basic checking account as ill-suited for LMI customers. BA Bank offers the "My Access" account, which features a low opening deposit of $25 and free checking with direct deposit. Other commenters urged Bank of America to offer specific services, such as Interest on Lawyer Trust Accounts at certain rates. Bank of America stated that no decisions have been made at this time about the products and services to be offered after the merger. As previously noted, Bank of America has represented that it would identify the best products and services offered by either organization and proposes to make them available to customers throughout the franchise. Although the Board has recognized that banks can help to serve the banking needs of communities by making certain products or services available on certain terms or at certain rates, the CRA neither requires an institution to provide any specific types of products or services nor prescribes the costs charged for them.

50. Some commenters criticized Bank of America for charging recipients of public assistance fees to access their electronic benefits at Bank of America ATMs. Bank of America represented that it offers Electronic Transfer Accounts ("ETAs") through a program with the Department of the Treasury and that it does not impose fees on its ETA customers for accessing their benefits through that program at Bank of America ATMs. In addition, Bank of America stated that it offers electronic benefit transfer accounts ("EBTAs") through programs with state and local governments. Under current Bank of America policy, EBTA customers are assessed a standard ATM surcharge to access their cash benefits at Bank of America ATMs except in Illinois. Bank of America is in the process of evaluating its current practices as part of its review of products and services offered by both organizations in light of the fact that FleetBoston does not impose ATM access fees for participation in EBTAs. Although the Board has recognized that banks help to serve the banking needs of their communities by making basic banking services available at a nominal or no charge, the CRA does not require that banks limit the fees charged for services.

51. Several commenters alleged that mergers have had a negative impact on the retail banking services provided by Bank of America and FleetBoston to minorities and LMI individuals in several states, including California, New Jersey, New York, North Carolina, Rhode Island, and Georgia.

California

1. *Lending Test.* In California, BA Bank received an "outstanding" rating under the lending test.[52] Examiners described the bank's lending in the full-scope California assessment areas as reflecting excellent responsiveness to the credit needs of these communities. During the evaluation period, BA Bank originated more than 264,100 HMDA-reportable home mortgage loans totaling almost $46 billion in the California assessment areas.

Examiners commended BA Bank for its distribution of home mortgage loans among geographies of different income levels and for offering bankwide flexible lending programs and innovative lending products during the evaluation period. Examiners reported that, in the Los Angeles–Long Beach and San Francisco MSAs, the proportion of BA Bank's home purchase and refinance loans originated to borrowers in LMI census tracts approximated or exceeded the percentage of owner-occupied units in those areas, and the bank's market share of such loans in LMI census tracts approximated or exceeded the bank's overall market share of those types of loans in the MSAs. In addition, examiners noted that its market share of home purchase and refinance loans originated to LMI borrowers generally exceeded the bank's overall market share of those types of loans in the Los Angeles–Long Beach MSA. In the San Francisco MSA, the bank's market share of home purchase loans originated to LMI borrowers was less than the bank's overall market share of such loans within the MSA, but its market share of refinance loans originated to LMI borrowers approximated or exceeded its overall market share of such loans in the MSA.

Since the 2001 performance evaluation, BA Bank has maintained a substantial level of home mortgage lending. It originated more than 220,890 HMDA-reportable home mortgage loans in California, totaling almost $60 billion, in 2002.[53]

During the evaluation period, BA Bank originated more than 51,300 small loans to businesses,[54] totaling $3.5 billion, in its California assessment areas. In the Los Angeles–Long Beach MSA, the percentage of BA Bank loans to small businesses exceeded the percentage of those businesses in the MSA. Examiners reported that the bank's geographic distribution of small loans to businesses in the Los Angeles–Long Beach and San Francisco MSAs was excellent. They noted that the number of BA Bank's small loans to businesses in LMI areas represented 32 percent of its total number of such loans in the Los Angeles–Long Beach MSA and more than 34 percent of its total number of such loans in the San Francisco MSA. The majority of the bank's small loans to businesses in the Los Angeles–Long Beach and San Francisco MSAs were originated to small businesses.

Since the 2001 performance evaluation, BA Bank has continued to originate a significant number of small loans to businesses. In 2002, it originated more than 9,300 small loans to businesses in California, totaling more than $1 billion. Bank of America noted that, in 2002 and 2003, more than 30 percent of its total number of government-guaranteed small loans to businesses were made in California.

Examiners reported that BA Bank's community development lending had a positive impact on its lending performance in the state. The bank originated more than 250 community development loans, totaling more than $685 million, in its California assessment areas during the evaluation period. Examiners also noted that BA Bank originated 67 community development loans, totaling almost $135 million, in the Los Angeles–Long Beach MSA.[55] These loans supported affordable housing projects that created more than 1,000 LMI housing units. In the San Francisco MSA, BA Bank originated 15 community development loans, totaling $42.8 million, which provided 300 housing units for LMI households.

BA Bank has continued to originate a substantial amount of community development loans in California since the 2001 performance evaluation. Bank of America represented that BA Bank originated 150 community development loans in California, totaling $588 million, as of the third quarter of 2003. These community development loans included a $10.2 million loan in 2002 that funded the construction of an affordable housing development in the San Jose, California, MSA, and a $29 million loan in 2003 that funded the demolition of 86 units of public housing and the construction of 180 new units of affordable apartments for LMI families in the Oakland MSA.[56]

2. *Investment Test.* BA Bank received an "outstanding" rating under the investment test in the California assessment areas. In the Los Angeles–Long Beach and San Francisco MSAs, BA Bank made more than 300 community development investments, totaling approximately $219 million, during the review period, the majority of which supported the development of affordable housing. The bank also invested $31.6 million in Qualified Zone Academy Bonds ("QZABs"), which are issued in conjunction with a federal program designed to help strengthen schools serving large concentrations of low-income families.

52. Approximately 34 percent of BA Bank's total bank deposits were in California during the evaluation period. In evaluating BA Bank's California assessment areas, examiners conducted full-scope reviews in the Los Angeles–Long Beach and the San Francisco MSAs. The bank's other California assessment areas received limited-scope reviews.

53. BA Bank's 2002 HMDA-reportable loan data are for originations and purchases in the MSA portions of its assessment areas only.

54. In this context, "small loans to businesses" are loans with original amounts totaling $1 million or less, and "small businesses" are businesses with annual revenues of $1 million or less.

55. Some commenters urged Bank of America to provide additional financing for the construction of multifamily homes in LMI areas, particularly in California and Connecticut. These commenters also encouraged Bank of America to participate with more nonprofit affordable housing developers.

56. Bank of America represented that its affordable housing lending and investing also has increased from $9 billion in 1999 to $26.4 billion in 2003.

Since the 2001 performance evaluation, BA Bank has continued its strong community development investment activity in California. Bank of America represented that BA Bank made more than 160 qualified investments in California totaling, $125 million in 2002, and more than 110 qualified investments totaling $170 million, as of the third quarter of 2003. These investments in 2002 and 2003 included a $2.9 million investment in an affordable housing project in the Bakersfield, California, MSA and a $17 million investment to complete an affordable housing project providing 179 units for LMI families in the Oakland MSA.

3. *Service Test.* BA Bank received a "high satisfactory" rating under the service test in its California assessment areas. BA Bank operated 950 branches and more than 3,600 ATMs in California during the evaluation period. Examiners found that alternative delivery systems, such as electronic banking and telephone, improved access to retail banking services particularly by LMI individuals. In addition, examiners found that BA Bank's distribution of branches in LMI census tracts in the Los Angeles–Long Beach and San Francisco MSAs was reasonable in light of the percentage of the population residing in those geographies. Examiners also commended BA Bank for its community development services in the Los Angeles–Long Beach MSA during the review period, noting that the institution provided technical assistance to 57 organizations that pursued a variety of initiatives designed to assist LMI individuals and communities.

North Carolina and Charlotte MSA

Bank of America and BA Bank are headquartered in the Charlotte MSA. In evaluating BA Bank's CRA performance in North Carolina, the OCC reviewed and rated the Charlotte MSA separately from the bank's performance in the rest of the state because it is a multistate MSA.[57] Under the lending test, BA Bank received an "outstanding" rating in the Charlotte MSA and a "high satisfactory" rating in North Carolina.

1. *Lending Test.* BA Bank originated more than 42,500 HMDA-reportable home mortgage loans in its North Carolina assessment areas and the Charlotte MSA assessment area (collectively, "combined North Carolina assessment areas"), totaling more than $5 billion, during the review period.

Examiners reported that BA Bank's lending levels reflected good responsiveness to the credit needs in the Charlotte MSA and excellent responsiveness in the other North Carolina assessment areas. They found that the distribution of BA Bank's loans among geographies was good throughout its assessment areas. In particular, examiners noted that the proportion of BA Bank's home purchase and refinance loans made to borrowers in low-income geographies approximated or exceeded the percentage of owner-occupied units in those areas in the Charlotte MSA, and that the bank's market share of such loans in low-income geographies generally exceeded the bank's overall market share of such loans in the MSA. In addition, examiners found that the distribution of BA Bank's loans among borrowers of different income levels was good in the Charlotte MSA and that such distribution was adequate in the other North Carolina assessment areas. Examiners noted, however, that the bank's lending performance was excellent in the Greensboro MSA, including good geographic and borrower distribution of home mortgage loans. Examiners also particularly commended BA Bank's performance in the Asheville MSA as excellent and noted that it exceeded the bank's overall performance in North Carolina because of a more favorable distribution of loans among geographies of different income levels.

Since the 2001 performance evaluation, BA Bank has maintained a significant level of home mortgage lending in North Carolina, originating more than 20,000 HMDA-reportable loans that totaled more than $3 billion in its North Carolina assessment areas in 2002.[58] BA Bank originated more than 9,000 HMDA-reportable loans during 2002 in the Charlotte MSA, totaling $1.4 billion.

During the evaluation period, BA Bank originated more than 4,840 small loans to businesses, totaling more than $609 million, in its combined North Carolina assessment areas. Almost 1,500 of these loans, totaling $196.3 million, were originated to businesses in the Charlotte MSA. Examiners noted that the borrower distribution of BA Bank's small loans to businesses in the Charlotte MSA and Greensboro MSA was good during the evaluation period. They reported that the number of small loans to businesses in LMI areas in the Charlotte MSA represented more than 32 percent of the small loans to businesses originated in the MSA.

Since the 2001 performance evaluation, BA Bank has continued to provide substantial amounts of small loans to businesses in North Carolina. In 2002, BA Bank originated 1,334 small loans to businesses, totaling more than $288 million, in North Carolina.[59] In addition, Bank of America represented that BA Bank extended the largest number of SBA loans in North Carolina for the fifth consecutive year in 2003.

Examiners reported that BA Bank's community development lending had a significant positive impact on the bank's overall performance throughout the state. BA Bank originated 25 community development loans, totaling more

57. As previously noted, the examiners conducted a full-scope review of the Charlotte MSA, which includes a portion of South Carolina. In the rest of North Carolina, examiners conducted a fullscope review of the Greensboro–Winston-Salem–High Point MSA ("Greensboro MSA") and limitedscope reviews in the Asheville, Fayetteville, Goldsboro, Greenville, Hickory–Morganton–Lenoir, Jacksonville, Raleigh–Durham–Chapel Hill, and Wilmington MSAs.

58. These 2002 statewide data represent HMDA-reportable loans originated and purchased by BA Bank in the MSA portions of its assessment areas in North Carolina.

59. BA Bank's small business lending data for 2002 represent small business loans originated by BA Bank in its North Carolina assessment areas, including the North Carolina portions of the Charlotte MSA.

than $238 million, in its combined North Carolina assessment areas during the review period.[60] They noted that the majority of the bank's community development lending in the Charlotte MSA supported affordable housing projects. In addition, examiners reported that more than 1,000 housing units for LMI families were created as a result of BA Bank's community development lending activities in the Charlotte MSA during the evaluation period.

Since the 2001 performance evaluation, BA Bank has continued to engage in a substantial level of community development lending in North Carolina. Bank of America represented that BA Bank originated 46 community development loans, totaling more than $480 million, from 2001 through the third quarter of 2003 in the combined North Carolina assessment areas. These community development loans in 2002 and 2003 included a $4.3 million loan in the Greensboro MSA that provided 145 units of affordable housing, a $2 million loan that provided 50 units of housing for LMI families in Havelock, North Carolina, and a $37 million loan to finance a 336-unit affordable housing project in the Charlotte MSA that replaced 229 public housing units. In addition to providing 112 additional housing units for LMI families, this new housing development in the Charlotte MSA would include space for after-school childcare and computer classes.

2. *Investment Test.* BA Bank received an "outstanding" rating in its North Carolina assessment areas, but a "low satisfactory" rating in the Charlotte MSA, under the investment test. Examiners noted that the bank's volume of community development investments reflected an excellent level of responsiveness to the needs of its North Carolina assessment areas. BA Bank made more than 100 qualified investments in its combined North Carolina assessment areas, totaling more than $40 million, during the evaluation period that provided more than 500 housing units to LMI families. These community development investments included two Low-Income Housing Tax Credits ("LIHTCs"), totaling $4.4 million, that provided more than 85 units of housing for LMI families in the Greensboro MSA and more than $18 million in investments that included projects creating more than 425 housing units for LMI households in the Charlotte MSA.[61] Examiners reported that BA Bank's other community development investments included contributions to local or regional organizations that provide community development, housing, and financial services to LMI areas and individuals or funding for small business development.

BA Bank has continued its considerable level of community development investments in North Carolina since the 2001 performance evaluation. Bank of America represented that BA Bank originated 62 community development investments totaling $63 million, as of the third quarter of 2003. BA Bank's community development investments made in 2002 and 2003 included an LIHTC to complete an affordable housing project in an LMI neighborhood in the Raleigh MSA.

3. *Service Test.* Under the service test, BA Bank received an "outstanding" rating in the Charlotte MSA and a "high satisfactory" rating in North Carolina. Examiners reported that BA Bank operated 208 branches and 292 ATMs in the combined North Carolina assessment areas during the review period. In the Charlotte MSA, approximately 7 percent of the bank's branches were in low-income census tracts, which exceeded the percentage of the population living in such areas. In addition, more than 15 percent of the bank's branches were in moderate-income census tracts in the Charlotte MSA, which almost equaled the percentage of the population living in those areas. Examiners also reported that BA Bank's branch accessibility to LMI geographies was excellent in the Greensboro MSA.

Examiners also commended BA Bank for its community development services in the Charlotte MSA. These services included technical assistance to organizations providing community development, housing, and financial services to LMI individuals during the evaluation period.

D. CRA Performance of Fleet Bank

1. *Lending Test.* As previously noted, Fleet Bank received an overall "outstanding" rating for CRA performance from the OCC, as of July 23, 2001.[62] Fleet Bank also received an "outstanding" rating overall and under the lending test in the Boston MA–NH Multistate MSA ("Boston MSA"), which represented the largest share of the bank's deposits during the evaluation period.[63] During this period, Fleet Bank originated more than 216,900 HMDA-reportable

60. Two commenters asserted that Bank of America has only one community development officer serving North Carolina and South Carolina. Bank of America represented that seven associates from its Community Development Banking Group serve the needs of North Carolina and South Carolina.

61. One commenter criticized Bank of America's support of two Hope IV housing projects in Charlotte. One project provided a mix of public housing, low-income, and market-rate tenants and homeowners. Bank of America represented that its decisions regarding this project were made in concert with the Charlotte Housing Authority under HUD guidelines and that its involvement in the other project was very limited. As noted above, examiners reported that BA Bank engaged in numerous community development projects.

62. The evaluation period was January 1, 1998, through December 31, 2000; community development loans and qualified investments were considered from January 1, 1998, through June 30, 2001. In the 2001 performance evaluation, Fleet Bank's home mortgage lending data included loans originated and purchased. Fleet Bank requested that the OCC consider the loans, investment, and services originated or purchased by Fleet Mortgage Company, Fleet Development Ventures, BankBoston Development Company, Fleet CDC, Fleet Securities, and BankBoston Capital as part of the bank's CRA-related performance. Examiners noted that Fleet Bank merged with other institutions, including BankBoston, during the evaluation period. They also noted that, in connection with the merger with BankBoston in 1999, FleetBoston was required to divest 306 branches.

63. Fleet Bank also received "outstanding" overall ratings in New York; the multistate MSAs of Lawrence MA–NH; New London–Norwich CT–RI; and Providence–Fall River RI–MA ("Providence MSA"). Fleet Bank received "satisfactory" overall ratings in Connecticut, Florida, Maine, Massachusetts, New Hampshire, New Jersey, and the Portsmouth–Rochester NH–ME Mulitistate MSA.

loans in its assessment areas, totaling more than $22 billion. These loans included more than 28,500 HMDA-reportable loans, totaling $3.5 billion, in the Boston MSA and more than 10,690 home mortgage loans in the Providence MSA, totaling more than $950 million.[64] In addition, examiners reported that Fleet Bank originated 23,750 home mortgage loans, totaling $2.5 billion, in Connecticut and more than 66,840 home mortgage loans in New York, totaling $6.5 billion. They commended Fleet Bank for the excellent overall geographic and borrower distribution of its home mortgage lending throughout its assessment areas. In addition, examiners found that Fleet Bank's home purchase loans originated to LMI borrowers in LMI census tracts generally exceeded the bank's overall market share of such loans. They also noted that the opportunities for lending in LMI areas in several areas were limited because of the low percentage of owner-occupied units in those census tracts.[65]

Examiners commended Fleet Bank for developing flexible lending products and programs such as LMI Equity Loans, which are home equity products tailored for LMI borrowers or borrowers living in LMI areas, and Fleet Affordable Advantage, a program which offers home mortgages that feature a low down payment, no mortgage insurance, and no origination fee. In addition, they reported that Fleet Bank participated in several government-sponsored programs that offered flexible underwriting for home mortgages through secondary market providers. In partnership with four state mortgage financing agencies (Rhode Island, New Hampshire, New York, and New Jersey), Fleet Bank also originated loans through the Jumpstart program to cover down payment and closing costs at the time the agencies originated the first mortgage loans. Fleet Bank also offered flexible home mortgage loan products through the Massachusetts Soft Second Program, which features a below-market interest rate, no points, and no mortgage insurance.[66]

During the evaluation period, Fleet Bank originated more than 49,290 small loans to businesses, totaling more than $4 billion. Examiners reported that these loans included more than 10,700 small loans to businesses in the Boston MSA, totaling $811 million, and more than 4,000 small loans to businesses in the Providence MSA, totaling almost $400 million.[67] They also reported that Fleet Bank originated more than 6,900 small loans to businesses in Connecticut, totaling more than $560 million, and more than 12,640 small loans to businesses in New York, totaling more than $1.2 billion. Examiners noted, however, that the bank's market share of loans to small businesses was less than its overall market share of small loans to businesses in the Boston MSA. Examiners commended the bank for its excellent geographic distribution of loans to small businesses in the Hartford MSA. They reported that Fleet Bank also participated in government-sponsored programs offering flexible underwriting for small businesses through the SBA.

Examiners particularly commended Fleet Bank for its high level of community development lending throughout its assessment areas. They described Fleet Bank's community development lending as focused on assisting the development of affordable housing and promoting economic development to revitalize LMI areas in its assessment areas. During the review period, Fleet Bank originated more than 460 community development loans, totaling more than $1 billion, in its assessment areas. Examiners reported that Fleet Bank originated 76 community development loans in the Boston MSA, totaling $602 million, and 30 loans in the Providence MSA, totaling almost $36 million. They also reported that Fleet Bank originated almost 60 community development loans in Connecticut, totaling more than $147 million, and more than 190 loans in the State of New York, totaling more than $680 million.

These community development loans included a $3.1 million commercial real estate loan to finance the renovation of a building in an empowerment zone and multiple lines of credit ranging from $15 million to $44 million, which facilitated LIHTC activities by providing interim funding, in the Boston MSA. In the Providence MSA, the bank made a $3.1 million loan to fund the rehabilitation of an inactive factory building as part of a neighborhood revitalization plan in a low-income area. Examiners also reported that Fleet Bank originated a $14 million community development loan to finance the comprehensive revitalization of a low-income area in the Hartford MSA and a $25 million loan to finance the rehabilitation of a major apartment, condominium, and commercial complex in the Parkchester section of the Bronx.

2. *Investment Test.* Fleet Bank received an "outstanding" rating under the investment test. During the evaluation period, Fleet Bank made more than 2,400 community development investments in its assessment areas, totaling more than $870 million. Examiners reported that Fleet Bank made more than 350 qualified investments, totaling $22.4 million, in the Boston MSA and 115 investments in the Providence MSA, totaling more than $28 million. They also reported that the bank made more than 350 community development investments in Connecticut, totaling more than $42 million, and 887 investments in New York, totaling more than $120 million. These community development investments included a $2 million investment to fund an affordable housing organization's development activities in the Boston MSA; an LIHTC in Bristol,

64. Some commenters asserted that FleetBoston has neglected the lending and community reinvestment needs of Rhode Island because of its recent acquisitions and mergers.

65. These areas included the Boston, Albany–Schenectady, and Nassau–Suffolk MSAs. Examiners also noted that in the New York City MSA, housing affordability is a significant issue and housing is not generally affordable without a subsidy, even for middle-income borrowers.

66. Several commenters urged Bank of America to participate in the Massachusetts Soft Second program after it acquires FleetBoston. Other commenters suggested that Bank of America should continue FleetBoston's membership in the Federal Home Loan Bank of Boston and establish a Massachusetts community advisory board.

67. Examiners noted that, based on its volume of lending, Fleet Bank was recognized as the number-one SBA lender in 2000.

Rhode Island, totaling almost $6 million; and five LIHTCs, totaling $11 million, in the Hartford MSA. Examiners reported that the bank's community development investments have had a positive impact on the Boston MSA and they commended the bank's investment activities as demonstrating complexity, leadership, flexibility, or creativity.[68] In addition, examiners noted that the bank's community development investment activities were excellent in the Providence MSA and good in Connecticut and New York.

3. *Service Test.* Fleet Bank received an "outstanding" rating under the service test overall and in the Boston MSA. Examiners reported that Fleet Bank offered a full range of banking services at its branches and that its branch offices and delivery systems provided access to financial products and services for consumers of different income levels.[69] They noted that Fleet Bank offered specific products designed for LMI individuals and LMI areas.[70] These products included a checking account, savings account, and unsecured installment loan that feature low monthly fees and no minimum balance. Fleet Bank also offered an electronic transaction account to provide lower cost banking options to individuals receiving federal benefits and to those who have not historically had bank accounts. Examiners commended Fleet Bank for being the first major bank in the Northeast to offer the electronic transaction account, which they described as supporting the bank's commitment to serve LMI individuals while focusing on underserved customers. Fleet Bank also offered the "First Community Bank" line of products and services designed for small businesses in LMI urban areas. In addition, examiners noted that Fleet Bank's community development services included first-time homebuyer, small business, money management, and basic banking seminars.

E. HMDA Data and Fair Lending Record

The Board also has carefully considered the lending records of Bank of America and FleetBoston in light of comments on HMDA data reported by their subsidiaries.[71] The 2002 HMDA data indicate that Bank of America's percentage of total HMDA-reportable loan originations to borrowers in minority census tracts[72] generally was comparable with or exceeded that of lenders in the aggregate in the areas reviewed.[73] Although Bank of America's denial disparity ratios[74] for African-American applicants generally were comparable with those ratios for lenders in the aggregate for total HMDA-reportable loans in the areas reviewed, its denial disparity ratios for Hispanic applicants generally were less favorable than those ratios for lenders in the aggregate. However, the 2002 data indicate that, in the majority Bank of America's statewide assessment areas, the bank's percentage of total HMDA-reportable loans originated to Hispanic applicants exceeded the percentage for the aggregate of lenders. These data also indicate that the bank's percentage of total HMDA-reportable loans originated to African Americans also exceeded or was comparable with the percentage for the aggregate of lenders in the majority of BA Bank's statewide assessment areas.

The 2002 HMDA data indicate that FleetBoston's percentage of total HMDA-reportable loan originations to borrowers in minority census tracts generally exceeded or was comparable with the aggregate lenders' percentage in the states where the bank operated. In addition, the bank's denial disparity ratios for African-American and Hispanic applicants generally were slightly higher than or comparable with those ratios for lenders in the aggregate for HMDA-reportable loans in the markets reviewed.

Although the HMDA data may reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial groups and persons at different income levels in certain local areas, the HMDA data generally do not indicate that Bank of America or FleetBoston is excluding any race or income segment of the population or geographic areas on a prohibited basis. The Board nevertheless is concerned when HMDA data for an institution indicate disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of their race or income level. The Board recognizes, however, that HMDA data alone provide an incomplete measure of an institution's lending in its

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68. One commenter criticized FleetBoston's loans to redevelop certain areas in Rhode Island as detrimental to LMI communities. These loans provided financing for market-rate housing to help revitalize and stabilize certain LMI communities in the state.

69. One commenter criticized FleetBoston for delaying the opening of a mortgage loan center in South Providence. FleetBoston has opened the lending center to serve this area.

70. One organization expressed concerns about FleetBoston's branch distribution in LMI and predominantly minority areas in Philadelphia, Pennsylvania. FleetBoston entered the Philadelphia area in 2001 through its acquisition of Summit Bancorp, Princeton, New Jersey. FleetBoston proposes to open one *de novo* branch in Philadelphia in 2004 in a predominantly minority census tract. Through its recent acquisition of Progress, FleetBoston has acquired another branch in a predominantly minority census tract in the Philadelphia MSA. By the end of 2004, FleetBoston had planned to increase its branches in LMI areas in the Philadelphia MSA from 15 to 21.

71. The Board analyzed 2001 and 2002 HMDA data for BA Bank and Fleet Bank. The Board reviewed HMDA-reportable loan originations for various MSAs individually, as well as for the metropolitan portions of BA Bank's and Fleet Bank's assessment areas statewide. Commenters alleged that 2002 HMDA data indicate that BA Bank denied home mortgage loan applications from African Americans and Hispanics more frequently than applications from whites in MSAs in various states and the District of Columbia. Other commenters alleged that Fleet Bank denied home mortgage loan applications from African Americans and Hispanics more frequently than applications from whites in certain markets.

72. For purposes of this HMDA analysis, minority census tract means a census tract with a minority population of 80 percent or more.

73. The lending data of the lenders in the aggregate represent the cumulative lending for all financial institutions that have reported HMDA data in a particular area.

74. The denial disparity ratio equals the denial rate of a particular racial category (e.g., African Americans) divided by the denial rate for whites.

community because these data cover only a few categories of housing-related lending. HMDA data, moreover, provide only limited information about the covered loans.[75] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has not assisted adequately in meeting its community's credit needs or has engaged in illegal lending discrimination.

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide an onsite evaluation of compliance by the subsidiary depository institutions of Bank of America and FleetBoston with fair lending laws. Examiners noted no fair lending issues or concerns in the CRA performance evaluations of the depository institutions controlled by Bank of America or FleetBoston.

The record also indicates that Bank of America has taken steps to ensure compliance with fair lending laws. Bank of America has instituted corporate-wide policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations. Bank of America's compliance program includes compliance file reviews, an anti-predatory-lending policy, fair lending policy and product guides, testing the integrity of HMDA data, and quality assurance. In addition, Bank of America's consumer real estate associates receive compliance training that includes courses in fair lending laws, ethics, privacy, information security, and HMDA. Bank of America stated that its compliance program would be implemented at Fleet Bank after consummation of the proposal.

The Board also has considered the HMDA data in light of the programs described above and the overall performance records of Bank of America's subsidiary banks under the CRA. These established efforts demonstrate that the banks are active in helping to meet the credit needs of their entire communities.[76]

F. Branch Closings

Several commenters expressed concerns about the proposal's possible effect on branch closings.[77] The Board has carefully considered these comments on potential branch closings in light of all the facts of record. Bank of America has represented that any merger-related branch closings, relocations, or consolidations would be minimal because there is little geographic overlap with FleetBoston.[78] Bank of America also represented that no decision had been made on whether Bank of America's or FleetBoston's branch closure policy would be in effect after consummation of the proposed transaction. Under these policies, Bank of America and FleetBoston must review a number of factors before closing or consolidating a branch, including an assessment of the branch, the marketplace demographics, a profile of the community where the branch is located, and the effect on customers. The most recent CRA evaluations of BA Bank and Fleet Bank noted favorably the banks' records of opening and closing branches.[79]

The Board also has considered the fact that federal banking law provides a specific mechanism for addressing branch closings.[80] Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch. In addition, the Board notes that the OCC, as the appropriate federal supervisor of BA Bank, will continue to review BA Bank's branch closing record in the course of conducting CRA performance evaluations.

G. Other Concerns

Some commenters urged the Board not to approve the proposal until Bank of America meets certain "commitments" regarding its Hawaii lending programs and its goal for mortgage lending to Native Hawaiians on Hawaiian Home Lands that commenters alleged Bank of America

75. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

76. One commenter alleged that Bank of America has a substantially higher rate of home mortgage foreclosures in neighborhoods with predominantly minority and LMI populations and, generally, that these areas have the fewest Bank of America branches. Bank of America represented that it has policies and procedures in place to work with customers to minimize foreclosures. As previously noted, the OCC did not find fair lending issues or concerns when it conducted its fair lending law reviews during the CRA evaluations of the subsidiary depository institutions of Bank of America.

77. Some commenters expressed concern that, if consummation of the proposal caused Bank of America to control more than 10 percent of the deposits of insured depository institutions in the United States, Bank of America would divest branches in LMI areas to comply with section 3(d) of the BHC Act.

78. One commenter alleged that Bank of America has closed bank branches in the absence of market overlap after previous bank mergers. The commenter expressed concern that branches in LMI areas would be closed after consummation of this proposal.

79. Examiners stated that, in general, BA Bank's record of opening and closing branches did not adversely affect the accessibility of delivery systems, particularly in LMI geographies. BA Bank closed three branches in middle-income geographies in the Los Angeles–Long Beach MSA during the evaluation period. Examiners reported, however, that service delivery systems in the Los Angeles–Long Beach MSA were accessible to geographies and individuals of all income levels. Examiners stated that branch openings and closings in the Charlotte MSA did not adversely affect the accessibility of the bank's delivery systems in general or in LMI areas. BA Bank closed one branch in a low-income census tract in the Charlotte MSA during the review period, but another BA Bank branch was located less than one mile away. BA Bank also closed two branches in low-income census tracts and one branch in a moderate-income census tract in the Miami MSA.

80. Section 42 of the FDI Act (12 U.S.C. § 1831r-1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least 30-days notice and the appropriate federal supervisory agency with at least 90-days notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closure, consistent with the institution's written policy for branch closings.

made in 1994 in connection with the acquisition of Liberty Bank, Honolulu, Hawaii, by Bank of America, FSB, a predecessor of BA Bank.[81] Commenters alleged that the "commitments" were reaffirmed in *NationsBank*,[82] and that they were conditions to the Board's approval in both orders.

In connection with the acquisition of Liberty Bank, Bank of America publicly announced its plans to engage in certain lending programs in Hawaii. Although Bank of America styled these initiatives as "commitments" in its public statements, it did not make them as commitments to the Board, and these plans were not conditions to the Board's approvals in *Liberty Bank* or *NationsBank*.[83] The Board views the enforceability of such third party pledges, commitments, or agreements as matters outside the CRA. As the Board explained in *NationsBank*, to gain approval of a proposal to acquire an insured depository institution an applicant must demonstrate a satisfactory record of performance under the CRA without reliance on plans or commitments for future action.[84] Moreover, the Board has consistently found that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization.[85] Accordingly, in *Liberty Bank* and *NationsBank* and in this case as well, the Board has focused on the applicant's existing record of helping to meet the credit needs of its CRA assessment areas when reviewing a proposal under the convenience and needs factor of the BHC Act.[86]

As previously noted, many commenters criticized the terms of Bank of America's recently announced Community Development Initiative. Some criticized it for providing insufficient funding for loans, investments, or grants. Others requested that the Board not approve the proposal until Bank of America includes state-specific goals for certain loan products and programs or enters into specific agreements with certain states or community organizations. As discussed above, the Board views the enforceability of such third-party pledges, initiatives, and agreements as matters outside the CRA. Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that the applicant has in place to serve the credit needs of its CRA assessment areas at the time the Board reviews a proposal under the convenience and needs factor. The future activities of Bank of America's subsidiary depository institutions will be reviewed by the appropriate federal supervisors of those institutions in future CRA performance examinations, and the Board will consider that actual CRA performance record in future applications by Bank of America to acquire a depository institution.

H. Conclusion on Convenience and Needs Considerations

The Board recognizes that this proposal represents a significant expansion of Bank of America and its scope of activities. Accordingly, an important component of the Board's review of the proposal has been its consideration of the effects of the proposal on the convenience and needs of all communities served by Bank of America and FleetBoston.

In conducting its review, the Board has weighed the concerns expressed by commenters in light of all the facts of record, including the overall CRA records of the depository institutions of Bank of America and FleetBoston. A significant number of commenters have expressed support for the proposal based on the records of Bank of America and FleetBoston in helping to serve the banking needs, and in particular, the lending needs of their entire communities, including LMI areas. Other commenters have expressed concern about specific aspects of Bank of America's record of performance under the CRA in its current service areas and have expressed reservations about whether Bank of America and FleetBoston have been, and would be, responsive to the banking and credit needs of all their communities, especially in New England. The Board has carefully considered these concerns and weighed them against the overall CRA records of Bank of America and FleetBoston, reports of examinations of CRA performance, and information provided by Bank of America, including its responses to comments. The Board also considered information submitted by Bank of America and information from the OCC concerning BA Bank's performance under the CRA and compliance with fair lending laws since its last CRA performance evaluation.

As discussed in this order, all the facts of record demonstrate that the subsidiary depository institutions of Bank of America and FleetBoston have a record of meeting the credit needs of their communities. The Board expects the resulting organization to continue to help serve the banking needs of all its communities, including LMI neighborhoods.

Based on all the facts of record, and for reasons discussed above, the Board concludes that considerations

81. *See Liberty Bank* at 628.

82. *See NationsBank* at 876.

83. Some commenters misconstrued the Board's statements that the *Liberty Bank* and *NationsBank* orders were "specifically conditioned upon compliance with all of the commitments made by BankAmerica [or NationsBank] in connection with this application" as referencing commitments other than those that the applicants expressly made directly to the Board.

84. *See NationsBank* at 876; *see also Travelers Group Inc.*, 84 *Federal Reserve Bulletin* 985 (1998).

85. *See, e.g., Citigroup Inc.*, 88 *Federal Reserve Bulletin* 485 (2002); *Fifth Third Bancorp*, 80 *Federal Reserve Bulletin* 838, 841 (1994).

86. The CRA performance records of Bank of America FSB, which had branches in Hawaii at the time of the *Liberty Bank* order and until eight months prior to the *NationsBank* order, were rated by its primary federal supervisor, the Office of Thrift Supervision, as "satisfactory" (*Liberty Bank*) and as "outstanding" overall and "satisfactory" in Hawaii (*NationsBank*). Bank of America's CRA assessment areas have not included Hawaii since 1998, after it sold all its branches in that state. Under the interagency CRA regulation, the appropriate federal supervisor evaluates a bank's CRA performance record in its delineated assessment areas, which generally include the census tracts where its main office, branches, and deposit-taking ATMs are located, and the surrounding census tracts where the bank has originated or purchased a substantial portion of its loans. *See, e.g.*, 12 C.F.R. 228.41.

relating to the convenience and needs factor, including the CRA performance records of the relevant depository institutions, are consistent with approval of the proposal.

Foreign Activities

Bank of America also has requested the Board's consent under section 4(c)(13) of the BHC Act and section 211.9 of the Board's Regulation K (12 C.F.R. 211.9) to acquire certain FleetBoston foreign operations. In addition, Bank of America has provided notice under sections 25 and 25A of the Federal Reserve Act and sections 211.5 and 211.9 of Regulation K (12 C.F.R. 211.5 and 211.9) to acquire FleetBoston's companies organized under sections 25 and 25A of the Federal Reserve Act. The Board concludes that all the factors required to be considered under the Federal Reserve Act, the BHC Act, and the Board's Regulation K are consistent with approval of the proposal.

Requests for Additional Public Meetings

As noted above, the Board held public meetings on the proposal in Boston and San Francisco. A number of commenters requested that the Board hold additional public meetings or hearings, including at locations in Connecticut, Maine, New York, Pennsylvania, Rhode Island, and Hawaii. The Board has carefully considered these requests in light of the BHC Act, the Board's Rules of Procedure, and the substantial record developed in this case.[87]

As previously discussed, more than 180 interested persons appeared and provided oral testimony at the two public meetings held by the Board. These attendees included elected representatives, the attorney general of Connecticut, members of community groups, and representatives of businesses and business groups from cities and towns across the country. In addition, the Board provided a period of more than 60 days for interested persons to submit written comments on the proposal. More than 2000 interested persons who did not testify at the public meetings provided written comments.

In the Board's view, all interested persons had ample opportunity to submit their views on this proposal. Numerous commenters, in fact, submitted substantial materials that have been carefully considered by the Board in acting on the proposal. Commenters requesting additional public meetings have failed to show why their written comments do not adequately present their views, evidence, and allegations. They also have not shown why the public meetings in Boston and San Francisco and the more than 60-day comment period did not provide an adequate opportunity for all interested parties to present their views and concerns. For these reasons, and based on all the facts of record, the Board has determined that additional public meetings or hearings are not required and are not necessary or warranted to clarify the factual record on the proposal.[88] Accordingly, the requests for additional public meetings or hearings are hereby denied.

Conclusion

Based on the foregoing, and in light of all the facts of record, the Board has determined that the applications and notices should be, and hereby are, approved. In reaching this conclusion, the Board has carefully considered all oral testimony and the written comments regarding the proposal in light of the factors it is required to consider under the BHC Act and other applicable statutes.[89]

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87. Section 3(b) of the BHC Act does not require that the Board hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a timely written recommendation of denial of the application. 12 U.S.C. § 1842(b). In this case, the Board has not received such a recommendation from any state or federal supervisory authority.

88. A number of commenters requested that the Board delay action on the proposal or extend the comment period until:

(i) Bank of America provides more detail about its Community Development Initiative;
(ii) Bank of America enters into a written, detailed, and publicly verifiable CRA agreement negotiated with community groups;
(iii) Bank of America fulfills certain commitments to third parties other than the Board;
(iv) Bank of America enters into new CRA agreements with local community groups;
(v) pending lawsuits or investigations involving Bank of America and FleetBoston are resolved; or
(vi) alleged conflicts of interests are resolved.

The Board believes that the record in this case does not warrant postponement of its consideration of the proposal. During the application process, the Board has accumulated a significant record, including reports of examination, supervisory information, public reports and information, and considerable public comment. The Board believes this record is sufficient to allow it to assess the factors it is required to consider under the BHC Act. The BHC Act and the Board's rules establish time periods for consideration and action on proposals such as the current proposal. Moreover, as discussed more fully above, the CRA requires the Board to consider the existing record of performance of an organization and does not require that the organization enter into contracts or agreements with others to implement its CRA programs. For the reasons discussed above, the Board believes that commenters have had ample opportunity to submit their views and, in fact, they have provided substantial written submissions and oral testimony that have been considered carefully by the Board in acting on the proposal. Based on a review of all the facts of record, the Board concludes that delaying consideration of the proposal, granting another extension of the comment period, or denying the proposal on the grounds discussed above, including for informational insufficiency, is not warranted.

89. One commenter requested that certain Federal Reserve System staff and Board members recuse themselves from consideration of the applications or, alternatively, that the applications be dismissed, because of commenter's allegations that conflicts of interests exist between Federal Reserve System staff and Bank of America. The commenter claimed that federal ethics laws and/or rules were violated because an officer of the Federal Reserve Bank of Richmond or other staff, including an unidentified Board member, have mortgages on their residences from BA Bank. Federal law prohibits a bank examiner from accepting a loan from a bank or other covered entity that he or she examines. *See* 18 U.S.C. § 213. In this case, the individual in question has never examined a bank that is the subject of these applications, and review of an application is not itself an examination for purposes of 18 U.S.C. § 213. Neither the ethics rules governing Reserve Bank supervisory staff who participate in matters other than examinations and inspections nor the Board's ethics rules as promulgated by the Office of Government Ethics require an individual who already has a loan from an institution to be recused from considering

Approval of the applications and notices is specifically conditioned on compliance by Bank of America with all the commitments made to the Board in connection with the proposal and with the conditions stated or referred to in this order. For purposes of this transaction, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The acquisition of FleetBoston's subsidiary banks shall not be consummated before the fifteenth calendar day after the effective date of this order, and no part of the proposal shall be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Richmond, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 8, 2004.

Voting for this action: Chairman Greenspan and Governors Gramlich, Bies, Olson, Bernanke, and Kohn. Absent and not voting: Vice Chairman Ferguson.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Appendix A

Calculation of the Nationwide Deposit Cap

For purposes of applying the nationwide deposit cap, the total amount of deposits held by insured banks in the United States was computed by first calculating the sum of total deposits in domestic offices as reported on Schedule RC of the Call Report, interest accrued and unpaid on deposits in domestic offices as reported on Schedule RC-G of the Call Report, and adding the following items reported on Schedule RC-O of the Call Report: unposted credits, uninvested trust funds, deposits in insured branches in Puerto Rico and U.S. territories and possessions, unamortized discounts on deposits, the amount by which demand deposits would be increased if the reporting institution's reciprocal demand balances with foreign banks and foreign offices of other U.S. banks that were reported on a net basis had been reported on a gross basis, amount of assets netted against demand deposits, amount of assets netted against time and savings deposits, demand deposits of consolidated subsidiaries, time and savings deposits of consolidated subsidiaries and interest accrued and unpaid on deposits of consolidated subsidiaries. Then, subtract the amount of unpaid debits and unamortized premiums from this sum.

The total amount of deposits held by insured U.S. branches of foreign banks was computed by first calculating the sum of the following items reported on Schedule O of the RAL: total demand deposits in the branch, total time and savings deposits in the branch, interest accrued and unpaid on deposits in the branch, unposted credits, demand deposits of majority-owned depository subsidiaries and wholly owned nondepository subsidiaries, time and savings deposits of majority-owned depository subsidiaries and wholly owned nondepository subsidiaries, and interest accrued and unpaid on deposits of majority-owned depository subsidiaries and wholly owned nondepository subsidiaries, the amount by which demand deposits would be increased if the reporting institution's reciprocal demand balances with foreign banks and foreign offices of other U.S. banks that were reported on a net basis had been reported on a gross basis, amount of assets netted against demand deposits, amount of assets netted against time and savings deposits, demand deposits of consolidated subsidiaries, time and savings deposits of consolidated subsidiaries. Then, subtract the amount of unpaid debits from this sum.

The total amount of deposits held by insured savings associations in the United States was computed by taking the sum of total deposits in domestic offices as reported on Schedule SC of the TFR, deposits held in escrow and accrued interest payable-deposits, both as reported on Schedule SC of the TFR, plus the following items reported on Schedule SI of the TFR: time and savings deposits of consolidated subsidiaries, outstanding checks drawn against Federal Home Loan Banks and Federal Reserve Banks, demand deposits of consolidated subsidiaries, assets netted against demand deposits, and assets netted against time and savings deposits.

Because insured banks and savings associations that are subsidiaries of other insured banks and savings associations have been consolidated into their parent institution for reporting purposes, the individual data for these institutions have not been added in order to avoid double counting deposits held by these subsidiary insured depository institutions.

Appendix B

Banking Markets in which Bank of America and FleetBoston Compete Directly

A. Metropolitan New York–New Jersey

Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester Counties, all in New York; Bergen, Essex, Hudson, Hunterdon, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren Counties and the northern portions of Mercer County, all in New Jersey; Pike County, Pennsylvania; Fairfield County and portions of Litchfield and New Haven Counties, all in Connecticut.

an applications matter involving that institution or its affiliate. *See, e.g.*, 5 C.F.R. 6801.107–108. The Board has carefully considered this request and concludes that no conflicts of interests exist that require recusal or dismissal of the applications.

B. Fort Pierce, Florida

St. Lucie and Martin Counties, except the towns of Indiantown and Hobe Sound in Martin County.

C. Sarasota, Florida

Manatee and Sarasota Counties, except the portion of Sarasota County that is both east of the Myakka River and south of Interstate 75 (currently the town of Northport); the portion of Charlotte County that is west of both the harbor and the Myakka River (currently the towns of Englewood, Englewood Beach, New Point Comfort, Grove City, Cape Haze, Rotonda, Rotonda West, and Placida); and Gasparilla Island (the town of Boca Grande) in Lee County.

D. West Palm Beach, Florida

Palm Beach County east of Loxahatchee and the towns of Indiantown and Hobe Sound in Martin County.

Appendix C

Market Data

Metropolitan New York–New Jersey

Bank of America operates the 27th largest depository institution in the market, controlling deposits of approximately $2.9 billion, representing less than 1 percent of market deposits. FleetBoston operates the third largest depository institution in the market, controlling deposits of approximately $45.9 billion, representing approximately 8 percent of market deposits. On consummation of the proposal, Bank of America would operate the third largest depository institution in the market, controlling deposits of $48.9 billion, representing approximately 9 percent of market deposits. Two hundred and seventy one institutions would remain in the market. The HHI would increase 9 points to 983.

Florida

Fort Pierce

Bank of America operates the third largest depository institution in the market, controlling deposits of approximately $611 million, representing less than 1 percent of market deposits. FleetBoston opened a de novo branch in the market in January 2004. Bank of America has 18 branches in this banking market. FDIC deposit data reflecting the deposits of FleetBoston's branch are not yet available. The Board has considered Bank of America's deposits in the Fort Pierce banking market, the number of competing institutions, and the deposits controlled by those institutions, and the recent entry of FleetBoston's branch. Based on these factors, the Board concludes that consummation of the proposal would have a *de minimis* effect in the Fort Pierce banking market. The HHI is 1,259.

Sarasota

Bank of America operates the largest depository institution in the market, controlling deposits of approximately $3.2 billion, representing approximately 26 percent of market deposits. FleetBoston operates the 44th largest depository institution in the market, controlling deposits of approximately $8.6 million, representing less than 1 percent of market deposits. On consummation, Bank of America would continue to operate the largest depository institution in the market, controlling deposits of $3.2 billion, representing approximately 26.1 percent of the market deposits. Forty-seven depository institutions would remain in the banking market. The HHI would increase 4 points to 1,252.

West Palm Beach

Bank of America operates the second largest depository institution in the market, controlling deposits of approximately $4 billion, representing approximately 20 percent of market deposits. FleetBoston operates the 17th largest depository institution in the market, controlling deposits of approximately $166 million, representing less than 1 percent of market deposits. On consummation of the proposal, Bank of America would continue to operate the second largest depository institution in the market, controlling deposits of approximately $4.1 billion, representing approximately 21 percent of market deposits. Sixty depository institutions would remain in market. The HHI would increase 35 points to 1,349.

National City Corporation Cleveland, Ohio

Order Approving the Acquisition of a Bank Holding Company

National City Corporation ("National City"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act (12 U.S.C. §1842) to acquire Allegiant Bancorp, Inc. ("Allegiant") and its subsidiary bank, Allegiant Bank ("Allegiant Bank"), both in St. Louis, Missouri. National City also has requested the Board's approval under sections 4(c)(8) and 4(j) of the BHC Act (12 U.S.C. §§1843(c)(8) and 1843(j)) and sections 225.28(b)(2), (6) and (12) of the Board's Regulation Y (12 C.F.R. 225.28(b)(2), (6), and (12)) to acquire certain nonbanking subsidiaries of Allegiant and thereby engage in permissible activities related to extending credit, providing investment advice, and engaging in community development.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (68 *Federal Register* 68,626 (2003)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in sections 3 and 4 of the BHC Act.

National City is the 13th largest commercial banking organization in the United States with total consolidated assets of $113.9 billion, representing approximately 1.4 percent of total assets of insured banking organizations in the United States.[1] National City operates subsidiary insured depository institutions in Illinois, Indiana, Kentucky, Michigan, Ohio, and Pennsylvania. Allegiant, with assets of approximately $2.3 billion, is the eighth largest commercial banking organization in Missouri. On consummation of this proposal, National City would remain the 13th largest commercial banking organization in the United States with total consolidated assets of $116.2 billion, representing approximately 1.4 percent of total assets of insured banking organizations in the United States.

Interstate Analysis

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met.[2] For purposes of the BHC Act, the home state of National City is Ohio, and Allegiant Bank is located in Missouri. Based on a review of all the facts of record, including relevant state statutes, the Board finds that all the conditions for an interstate acquisition enumerated in section 3(d) are met in this case.[3]

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[4] National City and Allegiant do not compete directly in any relevant banking market. Accordingly, the Board concludes, based on all the facts of record, that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive considerations are consistent with approval.

Financial and Managerial Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors. The Board has carefully considered these factors in light of all the facts of record, including reports of examination, other confidential supervisory information received from the primary federal banking agency that supervises each institution, information provided by National City, and public comment on the proposal.

National City is and will remain well capitalized on consummation of the proposal. In addition, the Board has consulted with the Office of the Comptroller of the Currency ("OCC"), the primary federal supervisor of National City's lead banks, concerning the proposal.[5] The Board also has considered the managerial resources and the examination records of National City and Allegiant and the subsidiary depository institutions to be acquired, including their risk management systems and other policies.[6] Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of National City, Allegiant, and Allegiant Bank are consistent with approval, as are the other supervisory factors under the BHC Act.[7]

1. Asset data are as of December 31, 2003, and nationwide ranking data are as of September 30, 2003.

2. A bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on the later of July 1, 1966, or the date on which the company became a bank holding company. 12 U.S.C. § 1841(o)(4)(C). For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered, headquartered, or operates a branch.

3. *See* 12 U.S.C. §§ 1842(d)(1)(A) and (B), 1842(d)(2)(A) and (B). National City is adequately capitalized and adequately managed, as defined by applicable law. In addition, on consummation of the proposal, National City would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States. Missouri law prohibits a bank holding company from acquiring an insured depository institution in Missouri if, as a result of the acquisition, the bank holding company would control more than 13 percent of state deposits. *See* Mo. Rev. Stat. § 362.915. This transaction would meet Missouri's state deposit cap. Missouri law prohibits the interstate acquisition of a Missouri bank that has existed for fewer than 5 years. This transaction would meet Missouri's minimum age requirements. *See id.* at § 362.077. The other requirements of section 3(d) also would be met on consummation of the proposal.

4. 12 U.S.C. § 1842(c)(1).

5. A commenter cited press reports about a class-action lawsuit and other litigation concerning the consumer lending and trust activities of three National City subsidiaries. The Board notes that the class-action lawsuit was settled in 2002. In addition, National City has submitted information on pending material litigation relating to the consumer lending activities of National City and its affiliates. The Board has considered this information in light of confidential supervisory information and has consulted with the OCC.

6. The commenter also cited press reports noting that in 2003, the Securities and Exchange Commission ("SEC") directed National City to provide certain information on its mutual fund activities as part of an industry-wide review of practices. The Board notes that the SEC has taken no action against National City on this matter.

7. The commenter also criticized National City for lobbying against state and local efforts to enact and enforce anti-predatory lending laws and ordinances. In addition, the commenter, citing press reports, expressed concern that the proposal might result in a loss of jobs. The Board notes that the commenter does not allege and has provided no evidence that National City engaged in any illegal activity or other action that has affected, or may reasonably be expected to affect, the safety and soundness of the institutions involved in this proposal or the competitive or other factors that the Board must consider under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institution under the Community Reinvestment Act ("CRA").[8] The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.

The Board has considered carefully the convenience and needs factor and the CRA performance records of the banks of National City and Allegiant in light of all the facts of record, including public comment on the proposal. A commenter opposing the proposal asserted, based on data reported under the Home Mortgage Disclosure Act ("HMDA"),[9] that National City engages in discriminatory treatment of African-American and Hispanic individuals in its home mortgage lending operations. In addition, the commenter expressed concern about potential branch closings.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[10] At their most recent CRA evaluations by the OCC, National City Bank, Cleveland ("NC Bank"), National City's largest bank as measured by total deposits, received an "outstanding" rating, and National City Bank of Indiana, Indianapolis ("NC Indiana"), National City's largest bank as measured by total assets, received a "satisfactory" rating.[11] In addition, National City's five other subsidiary banks received either "outstanding" or "satisfactory" ratings at their most recent CRA evaluations.[12]

Allegiant Bank, Allegiant's only subsidiary bank, received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation ("FDIC"), as of March 1, 2002. National City has indicated that on consummation of the proposal, Allegiant Bank would have access to National City's CRA program, would offer certain National City CRA-related loan products, and would establish a CRA program comparable to those of National City's subsidiary banks. National City anticipates integrating Allegiant's community development activities with the National City Community Development Corporation. In addition, Allegiant Bank would be subject to National City's corporate-wide compliance program.

NC Bank's most recent CRA evaluation characterized its overall record of home mortgage and small business lending as excellent,[13] noting specifically the bank's excellent loan penetration among borrowers of different income levels, including LMI individuals. Examiners also praised the bank's level of community development lending and noted favorably the use of several flexible lending products designed to address affordable housing needs of LMI individuals. Examiners commended the bank's level of qualified investments and reported that these investments were highly responsive to the credit needs of its assessment area. In addition, examiners reported that NC Bank's community development services were excellent and praised the distribution of the bank's branches.

At NC Indiana's most recent CRA performance evaluation, examiners commended the bank's home lending record among borrowers of different income levels. In addition, examiners praised the bank's record of community development lending and its use of innovative loan products. NC Indiana's most recent evaluation also commended its strong level of qualified investments noting that the bank created opportunities for and engaged in complex and innovative investments in its assessment area. In addition, examiners characterized the distribution of NC Indiana's branches throughout its assessment area, including LMI geographies, as excellent.

Examiners at Allegiant Bank's most recent CRA performance evaluation concluded that the bank demonstrated a good record of serving the credit needs of its entire community, including the most economically disadvantaged portions of its assessment area. Examiners commended Allegiant Bank's home mortgage lending record and noted that in 2000, the percentage of loans extended by the bank in LMI geographies exceeded the percentage extended by the aggregate of lenders ("aggregate lenders").[14] Examiners also noted Allegiant Bank's significant level of qualified investments and reported that such investments supported a wide variety of programs to develop LMI housing.

8. 12 U.S.C. § 2901 *et seq.*

9. 12 U.S.C. § 2801 *et seq.*

10. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

11. Both ratings are as of February 22, 2000.

12. The Appendix lists the most recent CRA ratings of the National City subsidiary banks.

13. In evaluating the records of performance under the CRA of NC Bank and NC Indiana, examiners considered home mortgage loans by certain affiliates in the banks' assessment areas. The loans reviewed by examiners included loans reported by National City Mortgage Corporation, Miamisburg, Ohio ("NC Mortgage") (a subsidiary of NC Indiana); National City Mortgage Services, Kalamazoo, Michigan ("NC Mortgage Services") (a subsidiary of National City Bank of Michigan/Illinois, Bannockburn, Illinois); and other bank and nonbank affiliates of NC Bank.

14. The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that have reported HMDA data in a given area.

B. HMDA and Fair Lending Record

The Board has carefully considered the lending records of and HMDA data reported by National City in light of public comment. Based exclusively on a review of 2002 HMDA data, the commenter alleged that National City engages in discriminatory lending by directing minority customers to First Franklin Financial Corporation, San Jose, California ("First Franklin"), a subsidiary of NC Indiana that originates home mortgage loans that include subprime loans,[15] rather than to National City's subsidiary banks.[16] The commenter also alleged that the denial disparity ratios[17] of some of National City's subsidiary banks in certain markets indicated that the banks disproportionately denied African-American or Hispanic applicants for home mortgage loans.

The Board reviewed HMDA data reported by all of National City's bank and nonbank lending subsidiaries in the MSAs identified by the commenter, and focused its analysis on the data in the MSAs that include six major assessment areas of the banks. The Board compared the HMDA data of First Franklin with aggregate data submitted by the other subsidiaries of National City engaged in home mortgage lending, including its subsidiary banks, NC Mortgage, and NC Mortgage Services ("National City Lenders").

The 2002 HMDA data indicate that, although the National City Lenders extended a smaller percentage of their total HMDA-reportable loans to African-American borrowers than did First Franklin in the MSAs reviewed, they extended a larger number of such loans to African-American borrowers than did First Franklin in the majority of the MSAs. The data also indicate that the percentages of the National City Lenders' HMDA-reportable loans to Hispanics were comparable to or exceeded the percentages for First Franklin in each of the MSAs reviewed, and that they originated a larger number of HMDA-reportable loans to Hispanic borrowers than did First Franklin in each of the MSAs. In addition, the denial disparity ratios of the National City Lenders for African-American and Hispanic applicants for total HMDA-reportable loans approximated or were lower than those of aggregate lenders in a majority of the MSAs reviewed. Moreover, the National City Lenders' origination rates for total HMDA-reportable loans to Hispanics and African Americans were comparable to or exceeded the rates for aggregate lenders in each of the MSAs reviewed.[18]

The Board is concerned when the record of an institution indicates disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of race or income level. The Board recognizes, however, that HMDA data alone provide an incomplete measure of an institution's lending in its community because these data cover only a few categories of housing-related lending and provide only limited information about covered loans.[19] Moreover, HMDA data indicating that one affiliate is lending to minorities or LMI individuals more than another affiliate do not, without more information, indicate that either affiliate has engaged in illegal discriminatory lending activities.

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by National City's banks and their lending subsidiaries, including First Franklin. Examiners found no evidence of prohibited discrimination or other illegal credit practices at any of National City's subsidiary banks or the lending subsidiaries of these banks at their most recent CRA performance evaluations.

The record also indicates that National City has taken several affirmative steps to ensure compliance with fair lending laws. National City has a centralized compliance function and has implemented corporate-wide compliance policies and procedures to help ensure that all National City business lines, including First Franklin's, comply with all fair lending and other consumer protection laws and regulations. It employs compliance officers and staff responsible for compliance training and monitoring and conducts file reviews for compliance with federal and state consumer protection rules and regulations for all product lines and origination sources, including First Franklin. National City also regularly performs self-assessments of

15. As the Board previously has noted, subprime lending is a permissible activity that provides needed credit to consumers who have difficulty meeting conventional underwriting criteria. The Board continues to expect all bank holding companies and their affiliates to conduct their subprime lending operations without any abusive lending practices. *See Royal Bank of Canada*, 88 *Federal Reserve Bulletin* 385, 388 n.18 (2002). The Board also notes that the OCC has responsibility for enforcing compliance with fair lending laws by national banks and their subsidiaries.

16. Specifically, the commenter compared 2002 HMDA data reported by First Franklin and a National City subsidiary bank in the Metropolitan Statistical Areas ("MSAs") that include six of the largest assessment areas of National City's subsidiary banks (as determined by total deposits). These areas include the Chicago, Cleveland, Detroit, Indianapolis, Louisville, and Pittsburgh MSAs. The comparison did not include HMDA data reported by other National City lending subsidiaries operating in these areas. The commenter asserted that in 2002, First Franklin originated a higher volume and larger percentage of its HMDA-reportable loans to African-American or Hispanic borrowers than the National City subsidiary bank in each of the areas. The commenter made similar allegations concerning two MSAs outside the banks' assessment areas.

17. The denial disparity ratio equals the denial rate for a particular racial category (for example, African American) divided by the denial rate for whites.

18. The origination rate equals the total number of loans originated to applicants of a particular racial category divided by the total number of applications received by members of that racial category.

19. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was in fact creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

its fair lending law compliance and fair lending policy training for its employees.

The Board also has considered the HMDA data in light of other information, including the CRA performance records of National City's subsidiary banks. These records demonstrate that National City is active in helping to meet the credit needs of it entire community.

C. Branch Closings

The Board has considered the commenter's concerns about potential branch closings in light of all the facts of record. National City has provided the Board with its branch closing policy and has represented to the Board that it intends to open thirteen new branches in the St. Louis market over the next three years. The Board has considered carefully National City's branch closing policy and its record of opening and closing branches. Examiners reviewed National City's branch closing policy as part of the most recent CRA evaluations of each of National City's banks and found that it complied with federal law.

The Board also has considered the fact that federal banking law provides a specific mechanism for addressing branch closings.[20] Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory before closing a branch. In addition, the Board notes that the FDIC, as the appropriate federal supervisor of Allegiant Bank, will continue to review its branch closing record in the course of conducting CRA performance evaluations.

D. Conclusion on Convenience and Needs Factor

The Board has carefully considered all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by National City, public comment on the proposal, and confidential supervisory information. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor, including the CRA performance records of the relevant depository institutions, are consistent with approval.

Nonbanking Activities

National City also has filed a notice under sections 4(c)(8) and 4(j) of the BHC Act to acquire the nonbanking subsidiaries of Allegiant. The subsidiaries engage in activities related to extending credit, providing investment advice, and engaging in community development. The Board has determined by regulation that these activities are permissible for bank holding companies under the Board's Regulation Y,[21] and National City has committed to conduct these activities in accordance with the Board's regulations and orders for bank holding companies engaged in these activities.

To approve the notice, the Board must determine that the acquisition of the nonbanking subsidiaries of Allegiant and the performance of the proposed activities by National City "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[22] As part of its evaluation of these factors, the Board has considered the financial and managerial resources of National City and its subsidiaries, and the companies to be acquired, and the effect of the proposed transaction on those resources. For the reasons noted above, and based on all the facts of record, the Board has concluded that financial and managerial considerations are consistent with approval of the notice.

The Board also has considered the competitive effects of National City's proposed acquisition of the nonbanking subsidiaries of Allegiant in light of all the facts of record. National City and Allegiant compete directly in activities related to extending credit and providing investment advice. The markets for these activities are regional or national in scope and are unconcentrated.[23] The record in this case also indicates that there are numerous providers of these services. Based on all the facts of record, the Board concludes that consummation of the proposal would have a *de minimis* effect on competition for the proposed activities. Accordingly, the Board concludes that it is unlikely that significantly adverse competitive effects would result from the acquisition of Allegiant's nonbanking subsidiaries.

National City has indicated that the proposal would provide customers of the two organizations with access to services across a broader geographic area. National City has also asserted that customers of Allegiant would gain access to a broader variety of nonbanking services, such as trust and securities broker–dealer services. National City has represented that it intends to integrate Allegiant's community development operations with National City's community development subsidiary and expand such activities in the communities served by Allegiant.

Based on all the facts of record, the Board has determined that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects under the standard of section 4 of the BHC Act.

20. Section 42 of the Federal Deposit Insurance Act (12 U.S.C. § 1831r-1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least 30 days' notice and the appropriate federal supervisory agency and customers of the branch with at least 90 days' notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closure, consistent with the institution's written policy for branch closings.

21. *See* 12 C.F.R. 225.28(b)(2), (6), and (12).

22. *See* 12 U.S.C. § 1843(j)(2)(A).

23. In addition, National City and Allegiant engage in community development activities. The market for community development activities is local, but National City and Allegiant do not compete directly in any local market.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application and notice should be, and hereby are, approved.[24] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by National City with the conditions imposed in this order and the commitments made to the Board in connection with the application and notice, including compliance with state law. The Board's approval of the nonbanking aspects of the proposal also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c) (12 C.F.R. 225.7 and 225.25(c)), and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with and to prevent evasion of the provisions of the BHC Act and the Board's regulations and orders issued thereunder. The commitments made in the application process are deemed to be conditions imposed in writing by the Board in connection with its findings and decisions and, as such, may be enforced in proceedings under applicable law.

The acquisition of Allegiant Bank may not be consummated before the fifteenth calendar day after the effective date of this order, and the proposal may not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 15, 2004.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

24. A commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3(b) of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authorities. Under its regulations, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. 12 C.F.R. 225.16(e). Section 4 of the BHC Act and the Board's regulations provide for a hearing on a notice to acquire nonbanking companies if there are disputed issues of material fact that cannot be resolved in some other matter. 12 C.F.R. 225.25(a)(2). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter has had ample opportunity to submit its views and has submitted written comments that have been considered carefully by the Board in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present its evidence adequately and fails to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

Appendix

CRA Performance Evaluations of National City

Subsidiary Bank	CRA Rating	Date	Supervisor
1. National City Bank, Cleveland, Ohio	Outstanding	February 2000	OCC
2. National City Bank of Indiana, Indianapolis, Indiana	Satisfactory	February 2000	OCC
3. The Madison Bank and Trust Company, Madison, Indiana	Outstanding	October 1999	FDIC
4. National City Bank of Kentucky, Louisville, Kentucky	Satisfactory	February 2000	OCC
5. National City Bank of Michigan/Illinois, Bannockburn, Illinois	Outstanding	February 2000	OCC
6. National City Bank of Pennsylvania, Pittsburgh, Pennsylvania	Outstanding	February 2000	OCC
7. National City Bank of Southern Indiana, New Albany, Indiana	Satisfactory	February 2000	OCC

NewAlliance Bancshares, Inc.
New Haven, Connecticut

Order Approving the Formation of a Bank Holding Company and the Acquisition of a Bank Holding Company and a Savings Association

NewAlliance Bancshares, Inc. (In Formation) ("NewAlliance") has requested the Board's approval pursuant to section 3 of the Bank Holding Company Act (12 U.S.C. § 1842) ("BHC Act") to become a bank holding company by acquiring New Haven Savings Bank, New Haven, Connecticut ("NHSB"), and Alliance Bancorp of New England ("Alliance") and Tolland Bank ("Tolland Bank"), both in Vernon, Connecticut. NewAlliance also has requested the Board's approval pursuant to section 4(c)(8) and 4(j) of the BHC Act (12 U.S.C. § 4(c)(8) and 4(j)) and section 225.24 of the Board's Regulation Y (12 C.F.R. 225.24)[1] to acquire Connecticut Bancshares, Inc. and The Savings Bank of Manchester ("SBM"), both in Manchester, Connecticut.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (68 *Federal Register* 64,109 (2003)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act.

NHSB is the eighth largest depository organization in Connecticut and controls approximately $1.9 billion in deposits, representing approximately 2.7 percent of total deposits in depository institutions in the state ("state deposits").[3] SBM is the 11th largest depository organization in Connecticut, controlling approximately $1.7 billion in deposits, representing approximately 2.4 percent of state deposits. Tolland Bank is the 29th largest depository organization in Connecticut, controlling approximately $336 million in deposits, representing less than 1 percent of state deposits. On consummation of the proposal, NewAlliance would be the fifth largest depository organization in Connecticut, controlling approximately $3.9 billion in deposits, representing approximately 5.5 percent of state deposits.

1. NHSB, Tolland Bank, and SBM are chartered as Connecticut state savings banks. SBM does not meet the definition of "bank" for purposes of the BHC Act, because it is deemed to be a savings association under section 10(*l*) of the Home Owners' Loan Act. *See* 12 U.S.C. §§ 1467a(*l*), 1841(c) and (j).

2. This proposal involves the conversion of NHSB from mutual to stock form and the merger of SBM and Tolland Bank into NHSB under the new name NewAlliance Bank. The Federal Deposit Insurance Corporation ("FDIC") has notified NHSB of its intention not to object to the conversion of NHSB from mutual to stock form, and the Connecticut Department of Banking has approved the conversion of NHSB to stock form. NewAlliance has filed an application under the Bank Merger Act (12 U.S.C. § 1828(c)) with the FDIC and an application with the Connecticut Department of Banking to complete the various mergers.

3. State deposits and ranking data are as of June 30, 2003. In this context, depository institutions include commercial banks, savings associations, and savings banks.

Factors Governing Board Review of the Transaction

The BHC Act sets forth the factors that the Board must consider when reviewing the formation of a bank holding company or the acquisition of banks. These factors are the competitive effects of the proposal in the relevant geographic markets; the financial and managerial resources and future prospects of the companies and banks involved in the proposal; the convenience and needs of the community to be served, including the records of performance of insured depository institutions involved in the transaction under the Community Reinvestment Act (12 U.S.C. § 2901 *et seq.*) ("CRA"); and the availability of information needed to determine and enforce compliance with the BHC Act and other applicable law.[4]

The Board previously has determined by regulation that the operation of a savings association by a bank holding company is closely related to banking for purposes of section 4(c)(8) of the BHC Act.[5] In reviewing the proposal, the Board is required by section 4(j)(2)(A) of the BHC Act to determine that the acquisition of SBM by NewAlliance "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[6] As part of its evaluation of a proposal under these public interest factors, the Board reviews the financial and managerial resources of the companies involved and the effect of the proposal on competition in the relevant markets. In acting on notices to acquire a savings association, the Board also reviews the records of performance of the relevant insured depository institutions under the CRA.

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7] The Board also must consider the competitive effects of the proposal in the relevant markets under section 4 of the BHC Act in light of all the facts of record.

NewAlliance proposes to acquire SBM and Tolland Bank, which currently compete in the Hartford, Connecticut, banking market.[8] Consummation of the proposal would be consistent with the Department of Justice Merger

4. 12 U.S.C. § 1842(c).

5. 12 C.F.R. 225.28(b)(4)(ii).

6. 12 U.S.C. § 1843(j)(2)(A).

7. 12 U.S.C. § 1842(c)(1).

8. The Hartford banking market is defined as the Hartford–New Britain Ranally Metropolitan Area.

Guidelines ("DOJ Guidelines") and Board precedent.[9] Although the market would remain highly concentrated after consummation, as measured by the HHI, the change in market shares and market structure would be small and numerous competitors would remain in the market.[10] The Department of Justice has advised the Board that consummation of the proposal is not likely to have a significantly adverse effect on competition in any relevant banking market.

Based on the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in the Hartford banking market or any other relevant banking market, and that competitive considerations are consistent with approval.

Financial, Managerial, and Other Supervisory Factors

In applications and notices involving the acquisition of an insured depository institution, the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered, among other things, confidential reports of examination, other confidential supervisory information received from the primary federal banking agency that supervises each institution, and public comments.[11]

NHSB, SBM, and Tolland Bank are well capitalized and NewAlliance Bank would be well capitalized on consummation of the proposal. In addition, the Board has consulted with the FDIC, the primary federal supervisor of the relevant depository institutions, and the Connecticut Department of Banking concerning the proposal. Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of NewAlliance and the institutions involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on proposals under section 3 of the BHC Act, the Board is also required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the CRA. In addition, the Board reviews the records of performance under the CRA of the relevant insured depository institutions when acting on a notice under section 4 of the BHC Act to acquire an insured savings association. The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and it requires the appropriate supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating depository institution expansionary proposals.

The Board has considered carefully the convenience and needs factor and the CRA performance records of NHSB, SBM, and Tolland Bank in light of all the facts of record, including public comments on the proposal. A commenter opposing the proposal alleged, based on data reported under the Home Mortgage Disclosure Act (12 U.S.C. §2801 *et seq.*) ("HMDA"), that NHSB, SBM, and Tolland Bank disproportionately denied home mortgage credit to minorities in certain Metropolitan Statistical Areas ("MSAs"). In addition, the commenter expressed concern about possible branch closures and reductions in service after consummation of the proposal.[12]

9. Under the DOJ Guidelines, 49 *Federal Register* 26,823 (1984), a market is considered highly concentrated if the post-merger Herfindahl–Hirschman Index ("HHI") is more than 1800. The Department of Justice has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The Department of Justice has stated that the higher than normal HHI thresholds for screening bank mergers for anticompetitive effects implicitly recognize the competitive effects of limited-purpose lenders and other nondepository financial institutions.

10. On consummation of the proposal, NewAlliance would become the fifth largest depository institution in the Hartford banking market, controlling deposits of $2 billion, which represents approximately 4.8 percent of total deposits in insured depository institutions in the market. The HHI would increase 5 points to 2355. These calculations use deposit and market share data as of June 30, 2003, and weight the deposits of thrift institutions, including Connecticut state savings banks, at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984); *First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991). The proportion of commercial and industrial lending engaged in by SBM, Tolland Bank, and two other Connecticut state savings banks operating in the Hartford banking market constitutes more than 10 percent of the total loan portfolio of each institution and is comparable with the proportion of commercial and industrial lending of commercial banks operating in the market. If these institutions were weighted at 100 percent while other thrifts were weighted at 50 percent, the HHI would increase by 22 points to 2104.

11. A commenter suggested that the conversion of NHSB from mutual to stock form would result in the sale of the institution to a larger banking organization. Any subsequent proposed acquisition of NewAlliance and NewAlliance Bank would be subject to approval by the appropriate federal and state banking agencies at that time under applicable law.

12. Another commenter urged the Board to require as a condition of its approval that NewAlliance increase the amount of interest it pays on certain client trust accounts maintained by attorneys for the benefit of their clients. The Board notes that NewAlliance has represented that it would review the amount of interest NewAlliance Bank would pay on those accounts after consummation of the proposal. Moreover, although the Board has recognized that banks can help to serve the banking needs of communities by making certain products or services available at certain rates, the CRA does not require an institution to provide any specific types of products or services or prescribe the costs charged for them.

A. CRA Performance Evaluation

As provided for in the CRA, the Board has evaluated the convenience and needs factor in light of examinations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[13]

NHSB received an "outstanding" rating at its most recent CRA performance evaluation by the FDIC, as of July 8, 2002. NHSB's responsiveness to the credit needs of its community was found to be good. Examiners commended NHSB's record of home mortgage lending to borrowers of different income levels and its small business lending record. In addition, examiners commended the bank's record of community development lending and its level of qualified investments.

SBM received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of May 12, 2003. Examiners determined that SBM's CRA-related lending activities demonstrated a good responsiveness to the credit needs of its community and noted that SBM's home mortgage lending was particularly strong. In addition, examiners noted that SBM offered several flexible and innovative loan programs for individuals and small businesses. SBM also was found to have engaged in a significant level of qualified investments that benefited various programs, including affordable housing developments.

Tolland Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of November 15, 2001. Examiners commended Tolland Bank's record of CRA-related lending among borrowers of different income levels and business customers of different sizes. In addition, examiners noted that the percentage of home mortgage loans made by Tolland Bank to low-income borrowers in 1999 and 2000, and the percentage of such loans made by the bank in moderate-income communities in 2000, compared favorably with the percentages of these types of loans made by the aggregate lenders in the assessment area. Tolland Bank also was found to have provided strong retail banking and community development services.

NewAlliance has represented that the CRA policy of NewAlliance Bank would be modeled on the CRA policy of NHSB. The CRA record of NHSB indicates that NewAlliance has the experience and expertise to establish and implement appropriate CRA policies and programs at NewAlliance Bank. As part of its CRA program, NewAlliance has recently announced a five-year, $27.5 million initiative to expand and develop affordable housing opportunities for LMI borrowers and in LMI communities.

13. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

B. HMDA and Fair Lending Record

The Board also has carefully considered the lending records and HMDA data for NHSB, SBM, and Tolland Bank in light of comments received.[14] One commenter alleged that NHSB disproportionately denied African-American and Hispanic applicants for home mortgage loans in the Connecticut MSAs of Bridgeport, New Haven, and New London.[15] The commenter asserted that the denial disparity ratios for minority applications at NHSB[16] were higher than for nonminority applicants in these MSAs, and that those ratios compared unfavorably with the denial disparity ratios for lenders in the aggregate ("aggregate lenders").[17] The commenter also made the same allegations with regard to SBM's home purchase lending and criticized Tolland Bank's level of lending to minorities in the Hartford, Connecticut, MSA.

The 2001 and 2002 HMDA data indicate that NHSB and SBM had somewhat higher denial disparity ratios than aggregate lenders for total home mortgage lending to minority individuals in the Bridgeport, Hartford, New Haven, and New London MSAs. These data, however, indicate that NHSB and SBM demonstrated higher loan origination rates for mortgage loans to minority individuals in other areas. For example, NHSB's origination rate for HMDA-reportable loans to African-American and Hispanic applicants in New Haven exceeded the rate for aggregate lenders.[18] In addition, the 2002 HMDA data indicate that NHSB's denial disparity ratio for Hispanic applicants for refinance loans in New Haven was less than the ratio for aggregate lenders. The 2002 HMDA data indicate that SBM's denial disparity ratio for African-American applicants for all HMDA-reportable loans in Hartford was less than the ratio for aggregate lenders in 2002. The HMDA data also indicate that SBM's denial disparity ratios decreased between 2001 and 2002 in HMDA-reportable lending to African-American and Hispanic applicants when compared with those ratios for aggregate lenders.

The 2001 and 2002 HMDA data indicate a low volume of applications by minority individuals at Tolland Bank. As previously noted, Tolland Bank would be merged into NewAlliance Bank on consummation of the proposal. NewAlliance has indicated that NewAlliance Bank would implement NHSB's current outreach program to minor-

14. The Board has reviewed HMDA data reported by NHSB, SBM, and Tolland Bank in 2001 and 2002 in the area cited by the commenter.

15. The commenter also expressed concern that NHSB's volume of applications by minority individuals compares unfavorably with the volume of these applications for aggregate lenders.

16. The denial disparity ratio equals the denial rate for a particular racial category (for example, African-American) divided by the denial rate for whites.

17. In this context, the lending data of the aggregate lenders represent the cumulative lending for all financial institutions that have reported HMDA data in a given area.

18. The origination rate equals the total number of loans originated to applicants of a particular racial category divided by the number of applications received by members of that racial category.

ity individuals and would modify outreach efforts as appropriate.

Although the HMDA data reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial groups in some areas, the data generally do not indicate that NHSB, SBM, or Tolland Bank are excluding any race or income segment of the population or geographic areas on a prohibited basis. The Board nevertheless is concerned when the record of an institution indicates disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending, but also equal access to credit by creditworthy applicants regardless of their race, gender, or national origin. The Board recognizes, however, that HMDA data alone provide an incomplete measure of an institution's lending in its community because these data cover only a few categories of housing-related lending. HMDA data, moreover, provide only limited information about the covered loans.[19] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has not assisted adequately in meeting its community's credit needs or has engaged in illegal lending discrimination.[20]

Because of the limitations of HMDA data, the Board has considered these data carefully in light of other information, including examination reports that provide an on-site evaluation of compliance with fair lending laws by NHSB, SBM, and Tolland Bank. In the latest performance evaluations, examiners found no evidence of prohibited discrimination or other illegal credit practices or any substantive violations of fair lending laws at any of the institutions involved in the proposal.

The record also indicates that NHSB has taken a number of affirmative steps to ensure compliance with fair lending laws and, as previously indicated, would implement NHSB's compliance program as a model for NewAlliance Bank. NHSB has instituted compliance policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations, employed officers and staff responsible for monitoring compliance, and conducted regular audits and reviews of compliance. As part of its compliance monitoring program, all denied loan applications are subject to a second-review process. In addition, NHSB has made efforts to increase its outreach to minority individuals by placing advertisements in Spanish-language newspapers and other publications serving minority communities. NewAlliance has stated that it would establish a self-assessment process for NewAlliance Bank, which would be reviewed by the compliance department. Moreover, NewAlliance's compliance and internal audit staff would conduct training programs and independent compliance reviews of each NewAlliance Bank business unit with respect to certain regulations, including consumer compliance and fair lending laws and regulations.

The Board also has considered the HMDA data in light of the overall lending and community development activities of NHSB, SBM, and Tolland Bank, which, as discussed above, show that all three institutions significantly assist in helping to meet the credit needs of their entire communities, including LMI areas. These established efforts demonstrate that the banks actively help to meet the credit needs of their entire communities.

C. Branch Closings

A commenter expressed concern about possible branch closures after the consummation of the proposal and subsequent merger of NHSB, SBM, and Tolland Bank. NewAlliance has represented that it would adopt NHSB's branch closure policies on consummation of the proposal and that any consolidations or branch closings would comply with this policy and all applicable rules and regulations. Moreover, NewAlliance has indicated that it would remain in each market currently served by NHSB, SBM, and Tolland Bank, and would not close any branches of any bank as part of the proposal's consummation. Examiners at NHSB's most recent CRA performance evaluation reported that the bank's branch network adequately served the retail banking needs of its assessment area.

The Board also has considered the fact that federal banking law provides a specific mechanism for addressing branch closings.[21] Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisor before closing a branch. In addition, the Board notes that the FDIC, as the appropriate federal supervisor of NHSB, will continue to review its branch closing record in the course of conducting CRA performance evaluations.

19. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applications than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. Credit history problems and excessive debt levels relative to income (reasons most frequently cited for a credit denial) are not available from HMDA data.

20. A commenter asserted, based solely on HMDA data and without providing any other supporting facts, that NHSB violated the Equal Credit Opportunity Act (15 U.S.C. § 1691) ("ECOA") and HMDA. In evaluating the convenience and needs factors, the Board has considered confidential supervisory information and detailed information submitted by NewAlliance regarding NHSB's fair lending policies and procedures and its plans to implement those policies at the combined institution. In addition, ECOA and HMDA provide that enforcement authority under those statutes is granted to the primary federal supervisor of the institution, which is the FDIC in this case. The Board has forwarded the comments to the FDIC, and the FDIC has ample authority to enforce these provisions if violations are found.

21. Section 42 of the Federal Deposit Insurance Act (12 U.S.C. § 1831r-1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least 30 days' notice and the appropriate federal supervisory agency and customers of the branch with at least 90 days' notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closure, consistent with the institution's written policy for branch closings.

D. Conclusion on Convenience and Needs Considerations

In reviewing the effect of the proposal on the convenience and needs of the communities to be served, the Board has carefully considered the entire record, including comments received and responses to the comments; evaluations of the performance of NHSB, SBM, and Tolland Bank under the CRA; and confidential supervisory information. The Board also considered information submitted by NewAlliance concerning the performance of NHSB, SBM, and Tolland Bank under the CRA since their last CRA performance evaluations and the policies and procedures in place to ensure compliance with fair lending laws, HMDA, and other applicable laws.

Based on all the facts of record, and for reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor, including the CRA performance records of the relevant depository institutions, are consistent with approval of the proposal.

Other Considerations

As part of its evaluation of the public interest factors under section 4 of the BHC Act, the Board also has carefully reviewed the public benefits and possible adverse effects of the proposed acquisition of SBM. The record indicates that consummation of the proposal would result in benefits to SBM's consumer and business customers. The proposal would allow NewAlliance to provide customers of SBM, as well as those of Tolland Bank and NHSB, with access to a broader array of commercial banking products and services. Customers also would have access to expanded branch and ATM networks. Based on all the facts of record, the Board has determined that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects under the standard of section 4 of the BHC Act.

Conclusion

Based on the foregoing and in light of all the facts of record, the Board has determined that the applications and notice should be, and hereby are, approved.[22] In reaching this conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by NewAlliance with all the representations and commitments made in connection with this Order and the receipt of all other regulatory approvals. The Board's approval of the nonbanking aspects of the proposal also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c) of Regulation Y (12 C.F.R. 225.7 and 225.25(c)), and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. For purposes of this action the commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The banking acquisition shall not be consummated before the fifteenth calendar day after the effective date of this order, and the proposal may not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Boston acting pursuant to delegated authority.

By order of the Board of Governors, effective February 25, 2004.

Voting for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

ORDERS ISSUED UNDER INTERNATIONAL BANKING ACT

Gjensidige NOR Sparebank ASA
Oslo, Norway

Order Approving Establishment of a Branch

Gjensidige NOR Sparebank ASA ("Bank"), Oslo, Norway, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of

22. A commenter requested that the Board hold a public hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for any of the banks to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from any appropriate supervisory authority. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony. 12 C.F.R. 225.16(e). In addition, section 4 of the BHC Act and the Board's rules thereunder provide for a hearing on a notice to acquire a nonbanking company if there are disputed issues of material facts that cannot be resolved in some other manner. 12 C.F.R. 225.25(a)(2). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the public has had ample opportunity to submit comments on the proposal, and in fact, the commenter has submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to identify disputed issues of fact that are material to the Board's decisions that would be clarified by a public hearing or meeting. Moreover, the commenter's request fails to demonstrate why its written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the request for a public hearing or meeting on the proposal is denied.

the IBA (12 U.S.C. §3105(d)) to establish a branch in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in newspapers of general circulation in New York, New York (*New York Post*, July 18, 2003). The time for filing comments has expired, and all comments have been considered.

Bank, with total assets of $37.3 billion, is the third largest bank in Norway.[1] It is a wholly owned subsidiary of DnB NOR ASA ("DnB NOR"), which was formed as a result of a merger in 2003 of Bank's former parent, Gjensidige NOR ASA, with DnB Holding ASA, all in Oslo. DnB NOR is the holding company for Norway's largest financial services group. The government of Norway controls approximately 31.3 percent of the shares of DnB NOR.[2] In addition, Stiftelsen Gjensidige NOR Sparebank (a savings bank foundation) controls 10.3 percent and Gjensidige NOR Forsikring (an insurance company) controls 5.4 percent of the shares of DnB NOR. No other shareholder controls more than 5 percent of DnB NOR's voting shares. DnB NOR provides a wide variety of financial services, including retail and corporate banking, insurance, brokerage services, and asset management. Bank is primarily engaged in retail and corporate banking and real estate brokerage services. DnB NOR and Bank are qualifying foreign banking organizations pursuant to Regulation K.

Bank currently has no operations in the United States. However, Den norske Bank ASA ("Den norske Bank"), also in Oslo and a wholly owned subsidiary of DnB NOR, operates a branch in New York. DnB NOR intends to merge Den norske Bank into Bank, with Bank as the surviving entity. Bank's proposed New York branch would assume the banking activities of Den norske Bank's New York branch, which include lending, letters of credit and overdraft facilities, foreign exchange transactions, cash management, and financial advisory services.

In order to approve an application by a foreign bank to establish a branch in the United States, the IBA and Regulation K require the Board to determine that the foreign bank applicant engages directly in the business of banking outside of the United States and has furnished to the Board the information it needs to assess the application adequately. The Board also shall take into account whether the foreign bank and any foreign bank parent is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor (12 U.S.C. §3105(d)(2); 12 C.F.R. 211.24).[3] The Board may also take into account additional standards as set forth in the IBA and Regulation K (12 U.S.C. §3105(d)(3)–(4); 12 C.F.R. 211.24(c)(2)–(3)).

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home country authorities, the Board has previously determined, in connection with an election to be treated as a financial holding company, that another bank in Norway was subject to home country supervision on a consolidated basis.[4] Bank is supervised by Norway's home country supervisor, Kredittilsynet, on substantially the same terms and conditions as that other bank. Based on all the facts of record, it has been determined that Bank is subject to comprehensive supervision on a consolidated basis by its home country supervisor.

The Board has also taken into account the additional standards set forth in section 7 of the IBA and Regulation K (*see* 12 U.S.C. §3105(d)(3)–(4); 12 C.F.R. 211.24(c)(2)–(3)). Kredittilsynet has no objection to the establishment of the proposed branch.

Norway's risk-based capital standards are consistent with those established by the Basel Capital Accord. Bank's capital is in excess of the minimum levels that would be required by the Basel Capital Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of Bank also are considered consistent with approval, and Bank appears to have the experience and capacity to support the proposed branch. In addition, Bank has established controls and procedures for the proposed branch to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

Norway is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering. In accordance with these recommendations, Norway has enacted laws and created legislative and regulatory standards to deter money laundering.

1. Asset data are as of September 30, 2003.

2. In accordance with a decision by the Norwegian Parliament, the government is expected to increase its ownership interest to 34 percent by the end of 2004. The government holds its interest through a separate legal entity, the Government Bank Investment Fund ("Fund"). The Fund was established in 1991 as part of a package of measures intended to resolve Norway's banking crisis. The government intends to dissolve the Fund in 2004, after which the government's interest in DnB NOR will be held by Norway's Ministry of Trade and Industry.

3. In assessing this standard, the Board considers, among other factors, the extent to which the home country supervisors:

(i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide;
(ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise;
(iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic;
(iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis;
(v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. These are indicia of comprehensive, consolidated supervision. No single factor is essential, and other elements may inform the Board's determination.

4. *See* Board Letter dated November 19, 2003, to Robert D. Webster, Esq.

Money laundering is a criminal offense in Norway, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations. Bank's compliance with applicable laws and regulations is monitored by Bank's auditors and Kredittilsynet.

With respect to access to information about Bank's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which Bank operates and has communicated with relevant government authorities regarding access to information. Bank and its ultimate parent, DnB NOR, have committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank and its ultimate parent have committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, Kredittilsynet may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

On the basis of all the facts of record, and subject to the commitments made by Bank and its ultimate parent, as well as the terms and conditions set forth in this order, Bank's application to establish a branch is hereby approved.[5] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the commitments made in connection with this application and with the conditions in this order.[6] These commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with this decision and, as such, may be enforced in proceedings under applicable law against Bank and its affiliates.

By order, approved pursuant to authority delegated by the Board, effective January 16, 2004.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

5. Approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.

6. The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the State of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of New York to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

Membership of the Board of Governors of the Federal Reserve System, 1913–2003

APPOINTED MEMBERS[1]

Name	Federal Reserve District	Date initially took oath of office	Other dates and information relating to membership[2]
Charles S. Hamlin	Boston	Aug. 10, 1914	Reappointed in 1916 and 1926. Served until Feb. 3, 1936.[3]
Paul M. Warburg	New York	Aug. 10, 1914	Term expired Aug. 9, 1918.
Frederic A. Delano	Chicago	Aug. 10, 1914	Resigned July 21, 1918.
W.P.G. Harding	Atlanta	Aug. 10, 1914	Term expired Aug. 9, 1922.
Adolph C. Miller	San Francisco	Aug. 10, 1914	Reappointed in 1924. Reappointed in 1934 from the Richmond District. Served until Feb. 3, 1936.[3]
Albert Strauss	New York	Oct. 26, 1918	Resigned Mar. 15, 1920.
Henry A. Moehlenpah	Chicago	Nov. 10, 1919	Term expired Aug. 9, 1920.
Edmund Platt	New York	June 8, 1920	Reappointed in 1928. Resigned Sept. 14, 1930.
David C. Wills	Cleveland	Sept. 29, 1920	Term expired Mar. 4, 1921.
John R. Mitchell	Minneapolis	May 12, 1921	Resigned May 12, 1923.
Milo D. Campbell	Chicago	Mar. 14, 1923	Died Mar. 22, 1923.
Daniel R. Crissinger	Cleveland	May 1, 1923	Resigned Sept. 15, 1927.
George R. James	St. Louis	May 14, 1923	Reappointed in 1931. Served until Feb. 3, 1936.[4]
Edward H. Cunningham	Chicago	May 14, 1923	Died Nov. 28, 1930.
Roy A. Young	Minneapolis	Oct. 4, 1927	Resigned Aug. 31, 1930.
Eugene Meyer	New York	Sept. 16, 1930	Resigned May 10, 1933.
Wayland W. Magee	Kansas City	May 18, 1931	Term expired Jan. 24, 1933.
Eugene R. Black	Atlanta	May 19, 1933	Resigned Aug. 15, 1934.
M.S. Szymczak	Chicago	June 14, 1933	Reappointed in 1936 and 1948. Resigned May 31, 1961.
J.J. Thomas	Kansas City	June 14, 1933	Served until Feb. 10, 1936.[3]
Marriner S. Eccles	San Francisco	Nov. 15, 1934	Reappointed in 1936, 1940, and 1944. Resigned July 14, 1951.
Joseph A. Broderick	New York	Feb. 3, 1936	Resigned Sept. 30, 1937.
John K. McKee	Cleveland	Feb. 3, 1936	Served until Apr. 4, 1946.[3]
Ronald Ransom	Atlanta	Feb. 3, 1936	Reappointed in 1942. Died Dec. 2, 1947.
Ralph W. Morrison	Dallas	Feb. 10, 1936	Resigned July 9, 1936.
Chester C. Davis	Richmond	June 25, 1936	Reappointed in 1940. Resigned Apr. 15, 1941.
Ernest G. Draper	New York	Mar. 30, 1938	Served until Sept. 1, 1950.[3]
Rudolph M. Evans	Richmond	Mar. 14, 1942	Served until Aug. 13, 1954.[3]
James K. Vardaman, Jr.	St. Louis	Apr. 4, 1946	Resigned Nov. 30, 1958.
Lawrence Clayton	Boston	Feb. 14, 1947	Died Dec. 4, 1949.
Thomas B. McCabe	Philadelphia	Apr. 15, 1948	Resigned Mar. 31, 1951.
Edward L. Norton	Atlanta	Sept. 1, 1950	Resigned Jan. 31, 1952.
Oliver S. Powell	Minneapolis	Sept. 1, 1950	Resigned June 30, 1952.
Wm. McC. Martin, Jr.	New York	April 2, 1951	Reappointed in 1956. Term expired Jan. 31, 1970.
A.L. Mills, Jr.	San Francisco	Feb. 18, 1952	Reappointed in 1958. Resigned Feb. 28, 1965.
J.L. Robertson	Kansas City	Feb. 18, 1952	Reappointed in 1964. Resigned Apr. 30, 1973.
C. Canby Balderston	Philadelphia	Aug. 12, 1954	Served through Feb. 28, 1966.
Paul E. Miller	Minneapolis	Aug. 13, 1954	Died Oct. 21, 1954.
Chas. N. Shepardson	Dallas	Mar. 17, 1955	Retired Apr. 30, 1967.
G.H. King, Jr.	Atlanta	Mar. 25, 1959	Reappointed in 1960. Resigned Sept. 18, 1963.
George W. Mitchell	Chicago	Aug. 31, 1961	Reappointed in 1962. Served until Feb. 13, 1976.[3]
J. Dewey Daane	Richmond	Nov. 29, 1963	Served until Mar. 8, 1974.[3]
Sherman J. Maisel	San Francisco	Apr. 30, 1965	Served through May 31, 1972.
Andrew F. Brimmer	Philadelphia	Mar. 9, 1966	Resigned Aug. 31, 1974.
William W. Sherrill	Dallas	May 1, 1967	Reappointed in 1968. Resigned Nov. 15, 1971.
Arthur F. Burns	New York	Jan. 31, 1970	Term began Feb. 1, 1970. Resigned Mar. 31, 1978.
John E. Sheehan	St. Louis	Jan. 4, 1972	Resigned June 1, 1975.
Jeffrey M. Bucher	San Francisco	June 5, 1972	Resigned Jan. 2, 1976.
Robert C. Holland	Kansas City	June 11, 1973	Resigned May 15, 1976.
Henry C. Wallich	Boston	Mar. 8, 1974	Resigned Dec. 15, 1986.

Name	Federal Reserve District	Date initially took oath of office	Other dates and information relating to membership[2]
Philip E. Coldwell	Dallas	Oct. 29, 1974	Served through Feb. 29, 1980.
Philip C. Jackson, Jr.	Atlanta	July 14, 1975	Resigned Nov. 17, 1978.
J. Charles Partee	Richmond	Jan. 5, 1976	Served until Feb. 7, 1986.[3]
Stephen S. Gardner	Philadelphia	Feb. 13, 1976	Died Nov. 19, 1978.
David M. Lilly	Minneapolis	June 1, 1976	Resigned Feb. 24, 1978.
G. William Miller	San Francisco	Mar. 8, 1978	Resigned Aug. 6, 1979.
Nancy H. Teeters	Chicago	Sept. 18, 1978	Served through June 27, 1984.
Emmett J. Rice	New York	June 20, 1979	Resigned Dec. 31, 1986.
Frederick H. Schultz	Atlanta	July 27, 1979	Served through Feb. 11, 1982.
Paul A. Volcker	Philadelphia	Aug. 6, 1979	Resigned August 11, 1987.
Lyle E. Gramley	Kansas City	May 28, 1980	Resigned Sept. 1, 1985.
Preston Martin	San Francisco	Mar. 31, 1982	Resigned April 30, 1986.
Martha R. Seger	Chicago	July 2, 1984	Resigned March 11, 1991.
Wayne D. Angell	Kansas City	Feb. 7, 1986	Served through Feb. 9, 1994.
Manuel H. Johnson	Richmond	Feb. 7, 1986	Resigned August 3, 1990.
H. Robert Heller	San Francisco	Aug. 19, 1986	Resigned July 31, 1989.
Edward W. Kelley, Jr.	Dallas	May 26, 1987	Reappointed in 1990; resigned Dec. 31, 2001.
Alan Greenspan	New York	Aug. 11, 1987	Reappointed in 1992.
John P. LaWare	Boston	Aug. 15, 1988	Resigned April 30, 1995.
David W. Mullins, Jr.	St. Louis	May 21, 1990	Resigned Feb. 14, 1994.
Lawrence B. Lindsey	Richmond	Nov. 26, 1991	Resigned Feb. 5, 1997.
Susan M. Phillips	Chicago	Dec. 2, 1991	Served through June 30, 1998.
Alan S. Blinder	Philadelphia	June 27, 1994	Term expired Jan. 31, 1996.
Janet L. Yellen	San Francisco	Aug. 12, 1994	Resigned Feb. 17, 1997.
Laurence H. Meyer	St. Louis	June 24, 1996	Term expired Jan. 31, 2002.
Alice M. Rivlin	Philadelphia	June 25, 1996	Resigned July 16, 1999.
Roger W. Ferguson, Jr.	Boston	Nov. 5, 1997	Reappointed in 2001.
Edward M. Gramlich	Richmond	Nov. 5, 1997	
Susan S. Bies	Chicago	Dec. 7, 2001	
Mark W. Olson	Minneapolis	Dec. 7, 2001	
Ben S. Bernanke	Atlanta	Aug. 5, 2002	Reappointed in 2003.
Donald L. Kohn	Kansas City	Aug. 5, 2002	

Chairmen[4]

Charles S. Hamlin	Aug. 10, 1914–Aug. 9, 1916
W.P.G. Harding	Aug. 10, 1916–Aug. 9, 1922
Daniel R. Crissinger	May 1, 1923–Sept. 15, 1927
Roy A. Young	Oct. 4, 1927–Aug. 31, 1930
Eugene Meyer	Sept. 16, 1930–May 10, 1933
Eugene R. Black	May 19, 1933–Aug. 15, 1934
Marriner S. Eccles	Nov. 15, 1934–Jan. 31, 1948[5]
Thomas B. McCabe	Apr. 15, 1948–Mar. 31, 1951
Wm. McC. Martin, Jr.	Apr. 2, 1951–Jan. 31, 1970
Arthur F. Burns	Feb. 1, 1970–Jan. 31, 1978
G. William Miller	Mar. 8, 1978–Aug. 6, 1979
Paul A. Volcker	Aug. 6, 1979–Aug. 11, 1987
Alan Greenspan	Aug. 11, 1987–[6]

Vice Chairmen[4]

Frederic A. Delano	Aug. 10, 1914–Aug. 9, 1916
Paul M. Warburg	Aug. 10, 1916–Aug. 9, 1918
Albert Strauss	Oct. 26, 1918–Mar. 15, 1920
Edmund Platt	July 23, 1920–Sept. 14, 1930
J.J. Thomas	Aug. 21, 1934–Feb. 10, 1936
Ronald Ransom	Aug. 6, 1936–Dec. 2, 1947
C. Canby Balderston	Mar. 11, 1955–Feb. 28, 1966
J.L. Robertson	Mar. 1, 1966–Apr. 30, 1973
George W. Mitchell	May 1, 1973–Feb. 13, 1976
Stephen S. Gardner	Feb. 13, 1976–Nov. 19, 1978
Frederick H. Schultz	July 27, 1979–Feb. 11, 1982
Preston Martin	Mar. 31, 1982–Apr. 30, 1986
Manuel H. Johnson	Aug. 4, 1986–Aug. 3, 1990
David W. Mullins, Jr.	July 24, 1991–Feb. 14, 1994
Alan S. Blinder	June 27, 1994–Jan. 31, 1996
Alice M. Rivlin	June 25, 1996–July 16, 1999
Roger W. Ferguson, Jr.	Oct. 5, 1999–

Notes and list of ex officio members appear on page 251.

EX-OFFICIO MEMBERS[1]

Secretaries of the Treasury

W.G. McAdoo	Dec. 23, 1913–Dec. 15, 1918
Carter Glass	Dec. 16, 1918–Feb. 1, 1920
David F. Houston	Feb. 2, 1920–Mar. 3, 1921
Andrew W. Mellon	Mar. 4, 1921–Feb. 12, 1932
Ogden L. Mills	Feb. 12, 1932–Mar. 4, 1933
William H. Woodin	Mar. 4, 1933–Dec. 31, 1933
Henry Morgenthau, Jr.	Jan. 1, 1934–Feb. 1, 1936

Comptrollers of the Currency

John Skelton Williams	Feb. 2, 1914–Mar. 2, 1921
Daniel R. Crissinger	Mar. 17, 1921–Apr. 30, 1923
Henry M. Dawes	May 1, 1923–Dec. 17, 1924
Joseph W. McIntosh	Dec. 20, 1924–Nov. 20, 1928
J.W. Pole	Nov. 21, 1928–Sept. 20, 1932
J.F.T. O'Connor	May 11, 1933–Feb. 1, 1936

1. Under the provisions of the original Federal Reserve Act, the Federal Reserve Board was composed of seven members, including five appointed members, the Secretary of the Treasury, who was ex-officio chairman of the Board, and the Comptroller of the Currency. The original term of office was ten years, and the five original appointed members had terms of two, four, six, eight, and ten years respectively. In 1922 the number of appointed members was increased to six, and in 1933 the term of office was increased to twelve years. The Banking Act of 1935, approved Aug. 23, 1935, changed the name of the Federal Reserve Board to the Board of Governors of the Federal Reserve System and provided that the Board should be composed of seven appointed members; that the Secretary of the Treasury and the Comptroller of the Currency should continue to serve as members until Feb. 1, 1936; that the appointed members in office on the date of that act should continue to serve until Feb. 1, 1936, or until their successors were appointed and had qualified; and that thereafter the terms of members should be fourteen years and that the designation of Chairman and Vice Chairman of the Board should be for a term of four years.

2. Date following *Resigned* and *Retired* denotes final day of service.

3. Successor took office on this date.

4. Chairman and Vice Chairman were designated Governor and Vice Governor before Aug. 23, 1935.

5. Served as Chairman Pro Tempore from February 3, 1948, to April 15, 1948.

6. Served as Chairman Pro Tempore from March 3, 1996, to June 20, 1996.

Federal Reserve Board of Governors and Official Staff

ALAN GREENSPAN, *Chairman*
ROGER W. FERGUSON, JR., *Vice Chairman*
EDWARD M. GRAMLICH
SUSAN SCHMIDT BIES

OFFICE OF BOARD MEMBERS

MICHELLE A. SMITH, *Director*
WINTHROP P. HAMBLEY, *Assistant to the Board and Director for Congressional Liaison*
ROSANNA PIANALTO-CAMERON, *Special Assistant to the Board*
DAVID W. SKIDMORE, *Special Assistant to the Board*
LARICKE D. BLANCHARD, *Special Assistant to the Board for Congressional Liaison*

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SCOTT G. ALVAREZ, *Associate General Counsel*
RICHARD M. ASHTON, *Associate General Counsel*
STEPHANIE MARTIN, *Associate General Counsel*
KATHLEEN M. O'DAY, *Associate General Counsel*
ANN E. MISBACK, *Assistant General Counsel*
STEPHEN L. SICILIANO, *Assistant General Counsel*
KATHERINE H. WHEATLEY, *Assistant General Counsel*
CARY K. WILLIAMS, *Assistant General Counsel*

OFFICE OF THE SECRETARY

JENNIFER J. JOHNSON, *Secretary*
ROBERT DEV. FRIERSON, *Deputy Secretary*
MARGARET M. SHANKS, *Assistant Secretary*

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ROGER T. COLE, *Senior Associate Director*
MICHAEL G. MARTINSON, *Senior Adviser*
STEPHEN C. SCHEMERING, *Senior Adviser*
DEBORAH P. BAILEY, *Associate Director*
NORAH M. BARGER, *Associate Director*
BETSY CROSS, *Associate Director*
GERALD A. EDWARDS, JR., *Associate Director*
JAMES V. HOUPT, *Associate Director*
JACK P. JENNINGS, *Associate Director*
PETER J. PURCELL, *Associate Director*
MOLLY S. WASSOM, *Associate Director*
DAVID M. WRIGHT, *Associate Director*
HOWARD A. AMER, *Deputy Associate Director*
BARBARA J. BOUCHARD, *Deputy Associate Director*
ANGELA DESMOND, *Deputy Associate Director*
JAMES A. EMBERSIT, *Deputy Associate Director*
CHARLES H. HOLM, *Deputy Associate Director*
WILLIAM G. SPANIEL, *Deputy Associate Director*
STACY COLEMAN, *Assistant Director*
JON D. GREENLEE, *Assistant Director*
WALT H. MILES, *Assistant Director*
WILLIAM F. TREACY, *Assistant Director*
WILLIAM C. SCHNEIDER, JR., *Project Director, National Information Center*

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THOMAS A. CONNORS, *Associate Director*
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RICHARD T. FREEMAN, *Deputy Associate Director*
STEVEN B. KAMIN, *Deputy Associate Director*
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JOSEPH E. GAGNON, *Assistant Director*
WILLENE A. JOHNSON, *Adviser*
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D. NATHAN SHEETS, *Assistant Director*
RALPH W. TRYON, *Assistant Director*

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CHARLES S. STRUCKMEYER, *Associate Director*
ALICE PATRICIA WHITE, *Deputy Associate Director*
JOYCE K. ZICKLER, *Deputy Associate Director*
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BOOKS AND MISCELLANEOUS PUBLICATIONS

THE FEDERAL RESERVE SYSTEM—PURPOSES AND FUNCTIONS. 1994. 157 pp.

ANNUAL REPORT, 2002.

ANNUAL REPORT: BUDGET REVIEW, 2003.

FEDERAL RESERVE BULLETIN. Quarterly. $10.00 per year or $2.50 each in the United States, its possessions, Canada, and Mexico. Elsewhere, $15.00 per year or $3.00 each.

STATISTICAL SUPPLEMENT TO THE FEDERAL RESERVE BULLETIN. Monthly. $25.00 per year or $2.50 each in the United States, its possessions, Canada, and Mexico. Elsewhere, $35.00 per year or $3.50 each.

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REGULATIONS OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

ANNUAL PERCENTAGE RATE TABLES (Truth in Lending—Regulation Z) *Vol. I* (Regular Transactions). 1969. 100 pp. *Vol. II* (Irregular Transactions). 1969. 116 pp. Each volume $5.00.

GUIDE TO THE FLOW OF FUNDS ACCOUNTS. January 2000. 1,186 pp. $20.00 each.

FEDERAL RESERVE REGULATORY SERVICE. Loose-leaf; updated monthly. (Requests must be prepaid.)

Consumer and Community Affairs Handbook. $75.00 per year.

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STAFF STUDIES: Only Summaries Printed in the BULLETIN

Studies and papers on economic and financial subjects that are of general interest. Staff Studies 1–158, 161, 163, 165, 166, 168, and 169 are out of print, but photocopies of them are available. Staff Studies 165–175 are available online at www.federalreserve.gov/pubs/staffstudies. Requests to obtain single copies of any paper or to be added to the mailing list for the series may be sent to Publications.

159. New Data on the Performance of Nonbank Subsidiaries of Bank Holding Companies, by Nellie Liang and Donald Savage. February 1990. 12 pp.
160. Banking Markets and the Use of Financial Services by Small and Medium-Sized Businesses, by Gregory E. Elliehausen and John D. Wolken. September 1990. 35 pp.
162. Evidence on the Size of Banking Markets from Mortgage Loan Rates in Twenty Cities, by Stephen A. Rhoades. February 1992. 11 pp.
164. The 1989–92 Credit Crunch for Real Estate, by James T. Fergus and John L. Goodman, Jr. July 1993. 20 pp.
167. A Summary of Merger Performance Studies in Banking, 1980–93, and an Assessment of the "Operating Performance" and "Event Study" Methodologies, by Stephen A. Rhoades. July 1994. 37 pp.
170. The Cost of Implementing Consumer Financial Regulations: An Analysis of Experience with the Truth in Savings Act, by Gregory Elliehausen and Barbara R. Lowrey. December 1997. 17 pp.
171. The Cost of Bank Regulation: A Review of the Evidence, by Gregory Elliehausen. April 1998. 35 pp.
172. Using Subordinated Debt as an Instrument of Market Discipline, by Study Group on Subordinated Notes and Debentures, Federal Reserve System. December 1999. 69 pp.
173. Improving Public Disclosure in Banking, by Study Group on Disclosure, Federal Reserve System. March 2000. 35 pp.
174. Bank Mergers and Banking Structure in the United States, 1980–98, by Stephen Rhoades. August 2000. 33 pp.
175. The Future of Retail Electronic Payments Systems: Industry Interviews and Analysis, Federal Reserve Staff, for the Payments System Development Committee, Federal Reserve System. December 2002. 27 pp.

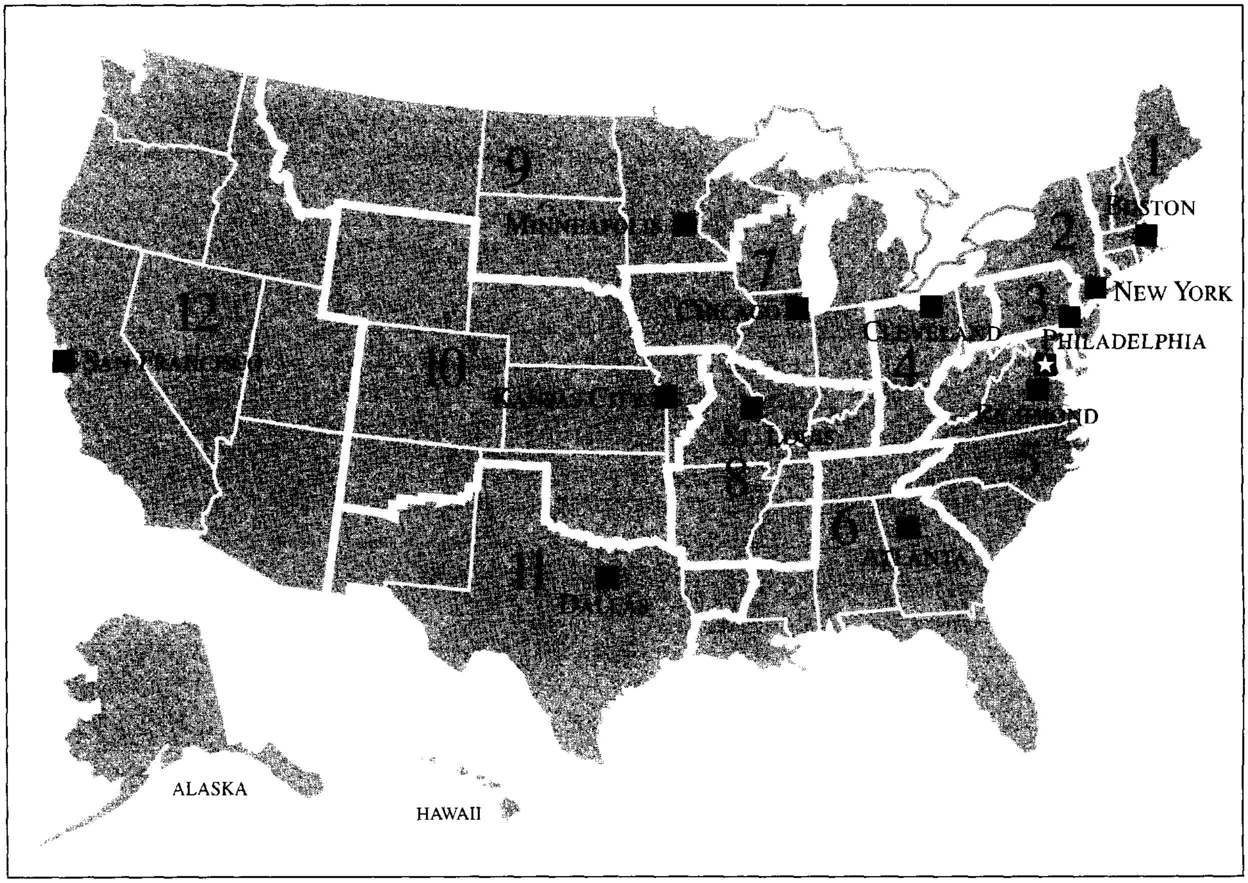
ANTICIPATED SCHEDULE OF RELEASE DATES FOR PERIODIC RELEASES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (PAYMENT MUST ACCOMPANY REQUESTS)

Release number and title		Annual mail rate	Annual fax rate	Approximate release days[1]	Period or date to which data refer	Corresponding *Bulletin* or *Statistical Supplement* table numbers[2]
Weekly Releases						
H.2.	Actions of the Board: Applications and Reports Received	$55.00	n.a.	Friday	Week ending previous Saturday	. . .
H.3.	Aggregate Reserves of Depository Institutions and the Monetary Base[3]	$20.00	n.a.	Thursday	Week ending previous Wednesday	1.20
H.4.1.	Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks[3]	$20.00	n.a.	Thursday	Week ending previous Wednesday	1.11, 1.18
H.6.	Money Stock Measures[3]	$35.00	n.a.	Thursday	Week ending Monday of previous week	1.21
H.8.	Assets and Liabilities of Commercial Banks in the United States[3]	$30.00	n.a.	Friday	Week ending previous Wednesday	1.26A–F
H.10.	Foreign Exchange Rates[3]	$20.00	$20.00	Monday	Week ending previous Friday	3.28
H.15.	Selected Interest Rates[3]	$20.00	$20.00	Monday	Week ending previous Friday	1.35
Monthly Releases						
G.5.	Foreign Exchange Rates[3]	$ 5.00	$ 5.00	First of month	Previous month	3.28
G.15.	Research Library—Recent Acquisitions	No charge	n.a.	First of month	Previous month	. . .
G.17.	Industrial Production and Capacity Utilization[3]	$15.00	n.a.	Midmonth	Previous month	2.12, 2.13
G.19.	Consumer Credit[3]	$ 5.00	$ 5.00	Fifth working day of month	Second month previous	1.55, 1.56
G.20.	Finance Companies[3]	$ 5.00	n.a.	End of month	Second month previous	1.51, 1.52

Release number and title		Annual mail rate	Annual fax rate	Approximate release days[1]	Period or date to which data refer	Corresponding *Bulletin* or *Statistical Supplement* table numbers[2]
Quarterly Releases						
E.2.	Survey of Terms of Business Lending[3]	$ 5.00	n.a.	Midmonth of March, June, September, and December	February, May, August, and November	4.23
E.11.	Geographical Distribution of Assets and Liabilities of Major Foreign Branches of U.S. Banks	$ 5.00	n.a.	15th of March, June, September, and December	Previous quarter	. . .
E.16.	Country Exposure Lending Survey[3]	$ 5.00	n.a.	January, April, July, and October	Previous quarter	. . .
Z.1.	Flow of Funds Accounts of the United States: Flows and Outstandings[3]	$25.00	n.a.	Second week of March, June, September, and December	Previous quarter	1.57, 1.58, 1.59, 1.60

1. Please note that for some releases, there is normally a certain variability in the release date because of reporting or processing procedures. Moreover, for all series unusual circumstances may, from time to time, result in a release date being later than anticipated.
2. Beginning with the Winter 2004 issue (vol. 90, no. 1) of the *Bulletin*, the corresponding table for the statistical release no longer appears in the *Bulletin*. Statistical tables are now published in the *Statistical Supplement to the Federal Reserve Bulletin*; the table numbers, however, remain the same.
3. These releases are also available on the Board's web site, www.federalreserve.gov/releases.
n.a. Not available.

Maps of the Federal Reserve System



LEGEND

Both pages

■ Federal Reserve Bank city

▣ Board of Governors of the Federal Reserve System, Washington, D.C.

Facing page

• Federal Reserve Branch city

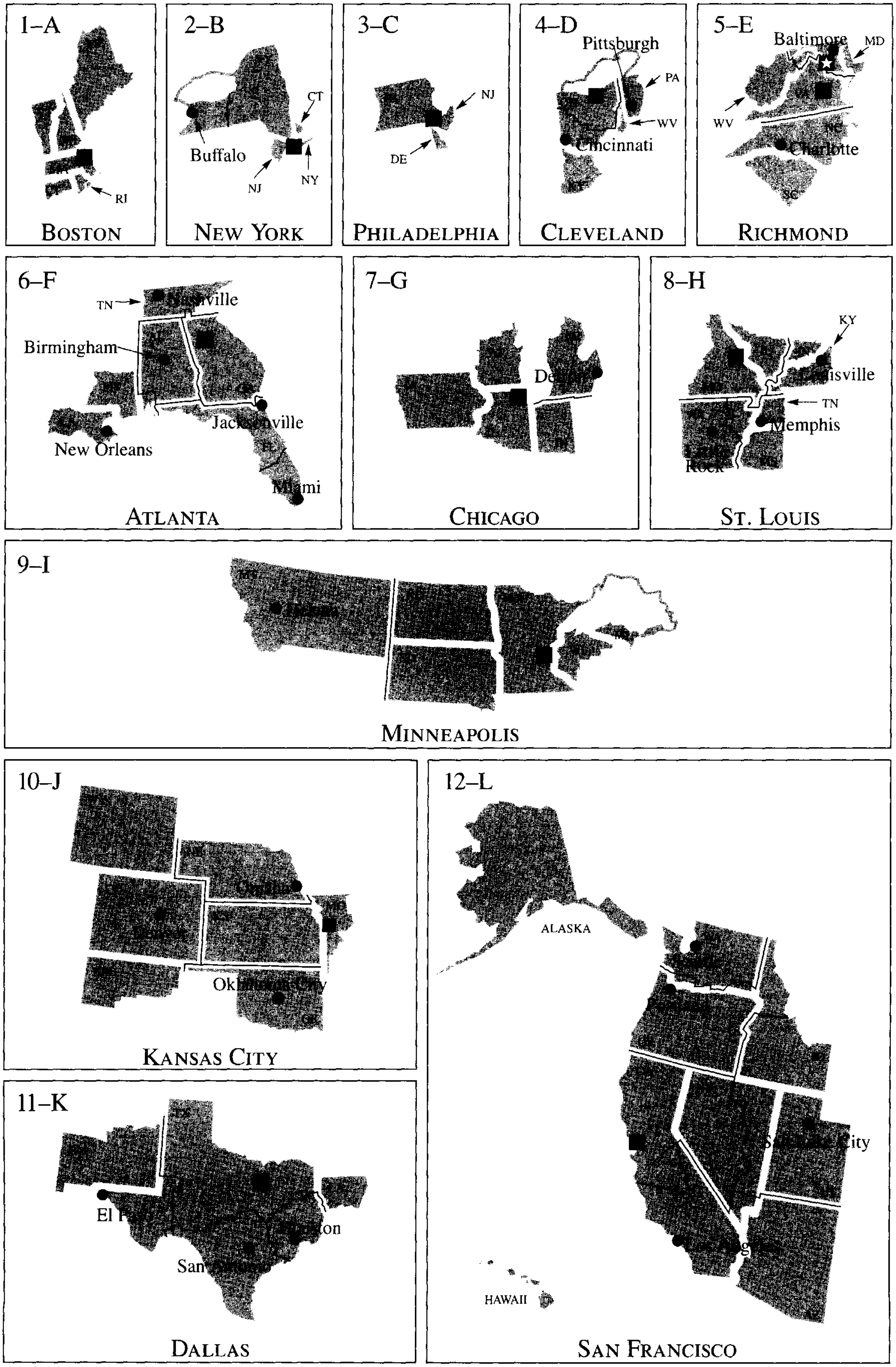
— Branch boundary

NOTE

The Federal Reserve officially identifies Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska, and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: the New York Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The Board of Governors revised the branch boundaries of the System most recently in February 1996.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8–H
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9–I
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10–J
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11–K
DALLAS
12–L
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Pittsburgh	15230	Roy W. Haley		Robert B. Schaub
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2. Executive vice president
3. Acting

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To promote public understanding of its regulatory functions, the Board publishes the *Federal Reserve Regulatory Service,* a four-volume loose-leaf service containing all Board regulations as well as related statutes, interpretations, policy statements, rulings, and staff opinions. For those with a more specialized interest in the Board's regulations, parts of this service are published separately as handbooks pertaining to monetary policy, securities credit, consumer affairs, and the payment system.

These publications are designed to help those who must frequently refer to the Board's regulatory materials. They are updated monthly, and each contains citation indexes and a subject index.

The Monetary Policy and Reserve Requirements Handbook contains Regulations A, D, and Q, plus related materials.

The Securities Credit Transactions Handbook contains Regulations T, U, and X, dealing with extensions of credit for the purchase of securities, together with related statutes, Board interpretations, rulings, and staff opinions. Also included is the Board's list of foreign margin stocks.

The Consumer and Community Affairs Handbook contains Regulations B, C, E, G, M, P, Z, AA, BB, and DD, and associated materials.

The Payment System Handbook deals with expedited funds availability, check collection, wire transfers, and risk-reduction policy. It includes Regulations CC, J, and EE, related statutes and commentaries, and policy statements on risk reduction in the payment system.

For domestic subscribers, the annual rate is $200 for the *Federal Reserve Regulatory Service* and $75 for each handbook. For subscribers outside the United States, the price including additional air mail costs is $250 for the service and $90 for each handbook.

The *Federal Reserve Regulatory Service* is also available on CD-ROM for use on personal computers. For a standalone PC, the annual subscription fee is $300. For network subscriptions, the annual fee is $300 for 1 concurrent user, $750 for a maximum of 10 concurrent users, $2,000 for a maximum of 50 concurrent users, and $3,000 for a maximum of 100 concurrent users. Subscribers outside the United States should add $50 to cover additional airmail costs. For further information, call (202) 452-3244.

All subscription requests must be accompanied by a check or money order payable to the Board of Governors of the Federal Reserve System. Orders should be addressed to Publications, mail stop 127, Board of Governors of the Federal Reserve System, Washington, DC 20551.

GUIDE TO THE FLOW OF FUNDS ACCOUNTS

A new edition of *Guide to the Flow of Funds Accounts* is now available from the Board of Governors. The new edition incorporates changes to the accounts since the initial edition was published in 1993. Like the earlier publication, it explains the principles underlying the flow of funds accounts and describes how the accounts are constructed. It lists each flow series in the Board's flow of funds publication, "Flow of Funds Accounts of the United States" (the Z.1 quarterly statistical release), and describes how the series is derived from source data. The *Guide* also explains the relationship between the flow of funds accounts and the national income and product accounts and discusses the analytical uses of flow of funds data. The publication can be purchased, for $20.00, from Publications, Mail Stop 127, Board of Governors of the Federal Reserve System, Washington, DC 20551.

Federal Reserve Statistical Releases Available on the Commerce Department's Economic Bulletin Board

The Board of Governors of the Federal Reserve System makes some of its statistical releases available to the public through the U.S. Department of Commerce's economic bulletin board. Computer access to the releases can be obtained by subscription. For further information regarding a subscription to the economic bulletin board, please call (202) 482-1986. The releases transmitted to the economic bulletin board, on a regular basis, are the following:

Reference Number	*Statistical release*	*Frequency of release*
H.3	Aggregate Reserves	Weekly/Thursday
H.4.1	Factors Affecting Reserve Balances	Weekly/Thursday
H.6	Money Stock	Weekly/Thursday
H.8	Assets and Liabilities of Insured Domestically Chartered and Foreign Related Banking Institutions	Weekly/Monday
H.10	Foreign Exchange Rates	Weekly/Monday
H.15	Selected Interest Rates	Weekly/Monday
G.5	Foreign Exchange Rates	Monthly/end of month
G.17	Industrial Production and Capacity Utilization	Monthly/midmonth
G.19	Consumer Installment Credit	Monthly/fifth business day
Z.1	Flow of Funds	Quarterly