

# *Annual Report: Budget Review*



*Board of Governors of the Federal Reserve System*

*1990-91*

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## *Introduction*

This report describes the budgeted expenses of the Federal Reserve System for 1991 and compares them with expenses for 1989 and 1990. For 1991, the Federal Reserve System has budgeted net operating expenses of \$675.4 million. During this year, the System expects to realize \$779.4 million, or 48 percent of its total operating expenses, from its priced services. Total operating expenses are budgeted at \$1,613.6 million, an increase of 6.2 percent over 1990 estimated expenses.

This report discusses the System's Banking and Supervision Enhancement Program, which was initiated in 1985. The goals of this program have been to help identify banking problems early at state member banks and bank holding companies through examinations and inspections; to help correct these problems; and to aid in preventing further problems by strengthening prudential standards. Besides these basic objectives, the goals of the program have been to augment the size and improve the training of supervisory staff and to promote greater coordination with other federal and state supervisory agencies. The special analysis in part II outlines this program in greater detail.

The Federal Reserve System consists of the Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches, the Federal Open Market Committee, and three advisory groups—the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council.

The System was created by the Federal Reserve Act, passed by the Congress in 1913 to establish a safer and more flexible

monetary and banking system. After the inception of the Federal Reserve System, it became clear that these original purposes were part of broader national economic and financial objectives. Stability and growth of the economy, stability in the purchasing power of the dollar, and reasonable balance in transactions with foreign countries have come to be recognized as primary objectives of governmental economic policy. Over the years, such objectives have been articulated by the Congress in legislation giving the Federal Reserve more authority and responsibility.

As the nation's central bank, the Federal Reserve, through its conduct of monetary policy, attempts to ensure growth of the economy consistent with price stability. As the nation's lender of last resort, the Federal Reserve also has the responsibility to forestall national liquidity crises.

Because a sound financial structure is essential to an effective monetary policy and a growing and prosperous economy, the Congress has entrusted the Federal Reserve with a variety of bank supervisory and regulatory functions. Among other things, the Federal Reserve administers the laws that regulate all bank holding companies; it supervises state-chartered banks that are members of the Federal Reserve System; it regulates the foreign activities of U.S. banks and the U.S. activities of foreign banks; and it establishes rules to ensure that consumers are informed adequately and treated fairly in credit transactions.

The Federal Reserve System also plays a major role in the nation's payments mechanism. Federal Reserve Banks distribute currency and coin, provide both

wire and automated clearinghouse transfers of funds and securities, and process 32 percent of all domestic checks. The Federal Reserve serves as the fiscal agent for the U.S. Treasury and provides a variety of other financial services for the Treasury and other government agencies.

To carry out these responsibilities in 1990, the Federal Reserve System spent an estimated \$1.5 billion and earned an estimated \$905 million in revenue from priced services, reimbursements, and other income, for a 1990 total of \$614 million in net operating expenses. The major source of Federal Reserve income is earnings on the portfolio of U.S. government securities in the System Open Market Account, estimated at \$20 billion in 1990. The System uses purchases and sales from this portfolio to implement monetary policy. Gains on foreign exchange transactions approximated \$2.2 billion.

Each year the Federal Reserve returns to the U.S. Treasury its earnings in excess of expenses, dividends, and surplus—in 1990, an estimated \$23.6 billion. These earnings are treated as receipts in the U.S. budget accounting system; projections of these earnings by the Office of Management and Budget appear in the U.S. budget.

Part I of this report discusses Federal Reserve budgeted expenses for 1991 for the System as a whole and for the Board of Governors and the Reserve Banks taken separately. Part II is a special analysis of changes in the Federal Reserve's supervision and regulation program. Appendixes provide additional information on System operations, budget processes, special categories of System expense, sources and uses of funds, Federal Reserve System audits, and trends in Bank expenses and employment.

This report, a complete discussion of the System's budget, is a companion to the Board's *77th Annual Report, 1990*. That document covers activities and initiatives of the Federal Reserve System during the year. ■

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# *Part I*

## *The 1991 Budgets*

## Chapter 1

# Federal Reserve System

For 1991, the Federal Reserve System has budgeted net operating expenses of \$675.4 million. It expects to realize \$779.4 million, or 48 percent of total budgeted operating expenses, from revenues for priced services. Total operating expenses are budgeted at \$1,613.6 million, an increase of 6.2 percent over 1990 estimated expenses. The budgeted operating expenses of the System comprise those of the Reserve Banks, \$1,501.0 million, and the Board of Governors, \$112.6 million (tables 1.1 and 1.2).

Not included in these costs are special projects, budgeted at \$7.6 million for 1991, up from \$6.6 million estimated for 1990.<sup>1</sup> Also excluded is the budgeted cost of currency at \$259.2 million for 1991, an increase of 36.3 percent from the estimated 1990 cost of \$190.1 million.<sup>2</sup> When special projects and the cost of currency are added to operating expenses, the Reserve Banks account for 79.8 percent of the total; the Board, 6.0 percent; special projects, 0.4 percent; and currency, 13.8 percent (chart 1.1). This distribution of expenses is similar to that in 1990.

1. As research and development efforts, special projects are separate from the continuing operations of the System and, therefore, are not included in System operating expenses. These relatively costly, short-term projects are expected to benefit both the System and the banking industry as a whole. A description of the special projects for 1991 appears in appendix C.

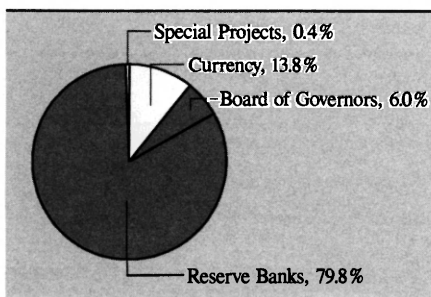
2. The Federal Reserve bears the cost associated with the printing of new currency at the Bureau of Engraving and Printing. Because this cost is determined largely by public demand for new currency, it is not included in Federal Reserve operating expenses. See appendix C.

## Net Expenses

The System expects to recover 58 percent of the expenses it incurs during 1991. The following items are deducted from System operating expenses to derive the net cost: (1) receipts for payments mechanism services provided to depository institutions, (2) other income for services on behalf of the U.S. Treasury that are charged to depository institutions using the services, and (3) expenses that are reimbursable by the U.S. Treasury and other government agencies for fiscal agency services. After deducting these items, the net expenses of the System of \$675.4 million show an increase of 10.1 percent over net System operating expenses for 1990.

As required by the Monetary Control Act, receipts for priced services represent fees that are set to recover the full cost of providing these services to depository institutions, including the imputed costs of float and the return on capital that would have been provided and the taxes

Chart 1.1  
Distribution of Expenses of the  
Federal Reserve System, 1991<sup>1</sup>



1. See text notes 1 and 2.



that would have been paid had a commercial entity in the private sector furnished the services. The revenue from priced services is detailed in table 1.3; the constraint imposed on Federal Reserve budgets by the need to keep such services competitive and the calculation of fees are discussed in appendix C. All sources and uses of funds are presented in appendix D; the audits of the System are listed in appendix E.

The category "other income" in table 1.2 includes fees from services such as the transfer of U.S. Treasury book-entry securities in the secondary market, the settlement of such transfers among depository institutions, and wire transfer of funds between a depository institution and the Treasury.

Claims for reimbursement represent the expenses incurred by Reserve Banks in providing fiscal agency services to the

*Table 1.1*

**Operating Expenses, Special Projects, and Cost of Currency of the Federal Reserve System, 1989-91<sup>1</sup>**

Millions of dollars, except as noted

Entity and type of expense	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Reserve Banks <sup>2</sup> .....	1,350.5	1,414.6	1,501.0	4.7	6.1
Personnel .....	851.3	901.5	969.1	5.9	7.5
Nonpersonnel .....	499.2	513.1	531.8	2.8	3.7
Board of Governors <sup>3</sup> .....	96.0	104.4	112.6	8.8	7.9
Personnel .....	70.2	79.0	86.0	12.5	8.9
Nonpersonnel .....	25.8	25.4	26.6	-1.5	4.7
<b>System operating expenses</b> .....	<b>1,446.5</b>	<b>1,519.0</b>	<b>1,613.6</b>	<b>5.0</b>	<b>6.2</b>
Personnel .....	921.5	980.5	1,055.1	6.4	7.6
Nonpersonnel .....	525.0	538.5	558.5	2.6	3.7
Special projects <sup>4</sup> .....	7.5	6.6	7.6	...	...
Currency <sup>5</sup> .....	174.4	190.1	259.2	9.0	36.3

1. In this and subsequent tables in this volume, details may not sum to totals and may not yield percentage changes shown because of rounding.

2. For detailed information, see chapter 3.

3. Includes expenses of the Office of Inspector General. For detailed information, see chapter 2.

4. See text note 1 and appendix C.

5. See text note 2 and appendix C.

*Table 1.2*

**Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 1989-91**

Millions of dollars, except as noted

Item	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Total System operating expenses .....	1,446.5	1,519.0	1,613.6	5.0	6.2
LESS					
Revenue from priced services .....	718.7	754.9	779.4	5.0	3.2
Other income .....	18.9	18.3	17.9	-3.2	-2.2
Claims for reimbursement <sup>1</sup> .....	127.1	132.2	140.9	4.1	6.5
<b>EQUALS</b>					
<b>Net System operating expenses</b> .....	<b>581.8</b>	<b>613.6</b>	<b>675.4</b>	<b>5.5</b>	<b>10.1</b>

1. The costs of fiscal agency services to the U.S. Treasury and other government agencies for which the

agencies have agreed to reimburse the Federal Reserve. In practice, not all these claims are paid.

Table 1.3

## Revenue from Priced Services, 1989–91

Millions of dollars

Service	1989 actual	1990 estimate	1991 budget
Funds transfer and net settlement .....	77.6	80.2	82.6
Automated clearinghouse .....	49.5	52.8	57.7
Commercial check .....	549.3	580.3	596.9
Book-entry securities .....	10.4	10.8	11.2
Definitive securities .....	6.0	5.4	4.9
Noncash collection .....	11.3	10.6	10.5
Cash services .....	14.6	14.7	15.6
<b>Total .....</b>	<b>718.7</b>	<b>754.9</b>	<b>779.4</b>

U.S. Treasury or to other government agencies and for which the agencies have agreed to reimburse the Federal Reserve.

### Trends in Expenses and Employment

From expenditures in 1981 to the level budgeted for 1991, the expenses of the Federal Reserve System have increased an average of 5.5 percent per year in current dollars and 3.8 percent when adjusted for inflation (chart 1.2). Over the same ten-year period, System employment has increased by only 114 (chart 1.3).

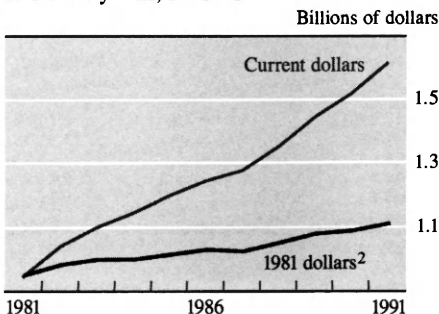
Over the past decade, the Monetary Control Act of 1980 (MCA) has greatly

affected System expenses and employment. By extending reserve requirements to all nonmember banks and thrift institutions, it required the Federal Reserve to establish new systems for collecting data and maintaining deposit accounts. The MCA also extended access to Federal Reserve services to all depository institutions. Accordingly, System employment rose significantly during 1980 and 1981.

From 1982, when the transition to the requirement of the MCA was completed, through 1984, System expenses remained essentially flat when adjusted for inflation, and employment declined. In 1985, the Federal Reserve increased the staff in a pronounced effort to strengthen supervision and regulation of member banks and bank holding companies. The System was able partially to offset the increase in staff through reductions in employment in other areas, primarily in services to financial institutions and the public and in support and overhead.

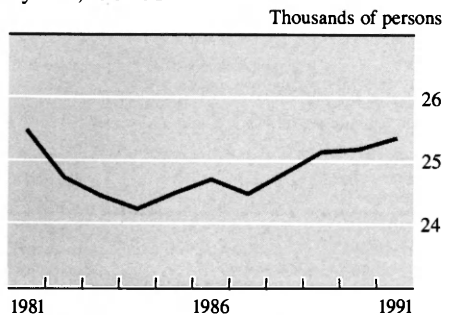
In 1988, the Expedited Funds Availability Act (title VI of Public Law 100–86, the Competitive Equality Banking Act of 1987) became effective. The act requires the Federal Reserve to issue regulations to ensure the prompt availability of funds and the expeditious return of checks.

Chart 1.2

Operating Expenses of the Federal Reserve System, 1981–91<sup>1</sup>

1. For 1990, estimate; for 1991, budget.
2. Calculated with the GNP price deflator.

Chart 1.3

Employment in the Federal Reserve System, 1981–91<sup>1</sup>

1. For 1989, estimate; for 1990, budget.

Increases in staff throughout the System in 1988 and 1989 resulted from implementing the provisions of this legislation.

In 1990, several major factors influenced expenses and staffing levels in the System. The System continued to expand nationwide the Regional Delivery System to centralize the issuance of over-the-counter savings bonds. An increase in the number and complexity of examinations, greater attention to problem institutions, and the passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) caused spending on bank supervision to expand.

## Operational Areas

Federal Reserve expenses are classified for budgeting purposes according to the four major operational areas of the System: monetary and economic policy, services to the U.S. Treasury and other government agencies, services to finan-

cial institutions and the public, and supervision and regulation (table 1.4). Costs for support and overhead are redistributed or allocated to these four areas. Only the Reserve Banks perform services for the Treasury and other government agencies. The operational area unique to the Board of Governors, System policy direction and oversight, is considered an overhead expense of the System (see chapter 2).

## 1991 Budget Initiatives

Several major initiatives will continue or will begin in 1991. The move toward nationwide implementation of the Regional Delivery System for savings bonds continues in 1991, with full implementation scheduled for 1993.

The System will continue to improve facilities at several head office and branch buildings. Recently completed projects will be subject to real estate tax increases.

*Table 1.4*

Operating Expenses of the Federal Reserve System, by Operational Area, 1989-91<sup>1</sup>

Millions of dollars, except as noted

Operational area and entity	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Monetary and economic policy .....	156.9	167.1	177.7	6.5	6.3
Reserve Banks .....	93.6	99.7	107.5	6.5	7.9
Board of Governors .....	63.3	67.4	70.2	6.5	4.2
Services to the U.S. Treasury and other government agencies <sup>2</sup> .....	145.5	156.1	167.2	7.3	7.1
Services to financial institutions and the public .....	919.3	947.6	995.7	3.1	5.1
Reserve Banks .....	916.3	944.4	992.1	3.1	5.0
Board of Governors .....	3.0	3.2	3.6	6.7	12.5
Supervision and regulation .....	224.8	248.2	273.0	10.4	10.0
Reserve Banks .....	195.1	214.4	234.2	9.9	9.2
Board of Governors .....	29.7	33.8	38.8	13.8	14.8
<b>Total</b> .....	<b>1,446.5</b>	<b>1,519.0</b>	<b>1,613.6</b>	<b>5.0</b>	<b>6.2</b>
Reserve Banks .....	<b>1,350.5</b>	<b>1,414.6</b>	<b>1,501.0</b>	<b>4.7</b>	<b>6.1</b>
Board of Governors <sup>3</sup> .....	<b>96.0</b>	<b>104.4</b>	<b>112.6</b>	<b>8.8</b>	<b>7.9</b>

1. Operating expenses reflect all allocations for support and overhead and exclude capital outlays. The operational area unique to the Board of Governors, System policy direction and oversight, which is shown separately in chapter 2, has been allocated across the operational areas shown above. As a result, the numbers in chapter 2 for the

operational areas are not the same as the ones listed in this table.

2. Reserve Banks only. The Board of Governors does not provide these services.

3. Includes expenses of the Office of Inspector General.

Automation projects related to contingency, expansion of computer capacity, and office automation will continue. Several offices that upgraded CPUs in 1990 will incur higher operating expenses.

The upward pressures on expenses and staffing associated with supervision and regulation activities will carry over from 1990 into 1991.

Finally, in 1991 several Reserve Banks will upgrade cash operations and software to improve the efficiency of check processing.

Besides these initiatives, the continued rise in health care costs and an increase in the matching contribution under the thrift plan for System employees have contributed to the 1991 budget increase.

## Chapter 2

# *Board of Governors*

The 1991 budget of the Board of Governors totals \$110.2 million for its four operational areas, \$0.6 million for extraordinary items, and \$1.8 million for the Office of Inspector General (OIG). The Board authorized 1,557 positions for its operational areas and 19 for the OIG. The authorized positions in the operational areas increased by three despite reductions in support and overhead largely because of increases in supervision and regulation and in System policy direction and oversight. These increases resulted from continued growth in workload due to problems in the financial industry, continuing implementation of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), and changes occurring in the payments system mechanism. The number of positions authorized for the OIG, which expanded late in 1990 to handle an increase in the scope and depth of coverage it gives to Board operations, has not changed in the 1991 budget.

Beginning in 1990, the OIG budget was approved separately in a more formal recognition of the OIG's budgetary independence. In the analysis that follows, the 1988, 1989, and 1990 expenses of the OIG have been removed from the Board's regular operating expenses to ensure the consistent presentation of data.

### **Major Initiatives**

The proposed budget contains sufficient funding to meet the major Board objectives in each division, including expanding the Board's oversight of the condition of the nation's financial institutions; implementing risk-based capital standards; supporting FIRREA; improv-

ing payments system operations while reducing payments system risk; continuing to invest in productivity initiatives, including office automation and records management; developing the National Information Center to provide relevant banking-structure data; and maintaining a safe and effective working environment.

Funding for initiatives amounted to approximately half the level that the divisions requested. Initiatives to perform additional electronic-data-processing audits and to improve automation, the management of distributed processing, and the appearance of facilities could not be fully funded within the level of funding acceptable to the Board.

### **Extraordinary Items**

As of 1991, the costs of extraordinary items are no longer subsumed under the Board's basic operating accounts. Despite good reasons for the practice, the Board's funding of certain System-related expenses, coupled with the costs of items such as large interagency surveys, has created undue swings in the budget and has resulted in competition for funds between these initiatives and the requirements of the Board's basic mission. It has also distorted the analyses of the Board's stewardship of resources in conducting its own operations. Therefore, this budget presents three such items separately: a survey of System officers' salaries, an audit by an outside firm of one Reserve Bank, and Board participation in a Census Bureau survey of plant capacity.

As part of a System project to ensure appropriate levels of compensation, a periodic survey of officer salaries is

conducted. According to the schedule, the next survey is to be accomplished in 1991 and will review the salaries of positions in industry similar to those of officers at the twelve Reserve Banks and the Board to promote consistency with local markets.

The second project will be an audit of one Reserve Bank by a public accounting firm. The Financial Examinations Program in the Division of Reserve Bank Operations and Payment Systems will audit the remaining Banks as usual. The objective of the outside audit is to assure the Board, through an independent audi-

tor, that controls and procedures are being maintained in accordance with industry standards.

The final project is to participate in a survey of plant capacity being conducted by the Census Bureau. This effort reflects the Board's interest in the economic data to be collected.

## Operational Areas

The Board's activities fall into four broadly defined operational areas: monetary and economic policy, supervision and regulation of financial institutions, system policy direction and oversight, and support and overhead.

*Table 2.1*

Expenses of the Board of Governors for Operational Areas and Office of Inspector General, 1989-91<sup>1</sup>

Thousands of dollars, except as noted

Type of expense	1989 actual	1990 estimate	1991 budget	1989-90 change		1990-91 change	
				Amount	Percent	Amount	Percent
Monetary and economic policy .....	50,200	52,000	54,242	1,800	3.6	2,242	4.3
Supervision and regulation ..	23,532	28,946	32,781	5,414	23.0	3,835	13.2
Services to financial institutions and the public .....	2,462	2,626	2,872	164	6.7	246	9.4
System policy direction and oversight .....	19,099	19,509	20,320	410	2.1	811	4.2
<b>Total, operational areas ...</b>	<b>95,293</b>	<b>103,081</b>	<b>110,215</b>	<b>7,788</b>	<b>8.2</b>	<b>7,134</b>	<b>6.9</b>
Office of Inspector General ..	718	1,382	1,773	664	92.5	391	28.3

1. Operating expenses include allocations for support and overhead.

*Table 2.2*

Positions Authorized at the Board of Governors for Operational Areas, Support and Overhead, and Office of Inspector General, 1989-91

Type of expense	1988 actual	1989 estimate	1990 budget	1989-90 change		1990-91 change	
				Amount	Percent	Amount	Percent
Monetary and economic policy .....	398	399	399	1	.3	0	0
Supervision and regulation ..	264	277	285	13	4.9	8	2.9
Services to financial institutions and the public .....	20	20	22	0	0	2	0
System policy direction and oversight .....	152	155	153	3	2.0	-2	-1.3
Support and overhead .....	722	703	698	-19	-2.6	-15	-.7
<b>Total .....</b>	<b>1,556</b>	<b>1,554</b>	<b>1,557</b>	<b>-2</b>	<b>-.1</b>	<b>3</b>	<b>.2</b>
Office of Inspector General ..	9	19	19	10	111.1	0	0

services to financial institutions and the public, and System policy direction and oversight (see also chapter 1 and appendix A). The costs include those for support and overhead, allocated to each operational area according to its proportion of total direct expenses. Tables 2.1 and 2.2 display respectively the operating expenses and the number of authorized positions in each of the operational areas for 1989–91.

For 1991, the Board of Governors has budgeted operating expenses of \$110.2 million, an increase of \$7.1 million, or 6.9 percent, over estimated expenses for 1990. This amount does not include the budget for the Office of Inspector General or the extraordinary items.

The growth in Board expenses between 1990 and 1991 is less than the 1989–90 increase. The 1991 budget increase is influenced by the need to strengthen supervision and regulation further, to raise the level of salaries to remain competitive in the marketplace, and to meet increased expenses for health insurance, Medicare, and the Board's thrift plan.

### Monetary and Economic Policy

Under its monetary and economic policy function, the Board monitors and analyzes developments in the money and credit markets, sets reserve requirements, approves changes in the discount rate, participates in the deliberations of the Federal Open Market Committee, and otherwise manages the nation's monetary policy. This function is expected to cost \$54.2 million in 1991, an increase of \$2.2 million, or 4.3 percent, over 1990. Most of this change results from the increase in pay and benefits and the 1991 component of the automation plan supporting this function. Despite continuing growth in the workload, no new positions are budgeted for this function.

Besides maintaining the quality of economic analyses and forecasts, this budget continues major commitments of resources to implement FIRREA, develop the National Information Center (NIC), and support analyses of changes in the economy and the financial system.

The enactment of FIRREA has required substantial resources on issues relating to deposit insurance, monitoring of the savings and loan industry, and support to the Oversight Board of the Resolution Trust Corporation.

Development of the NIC, discussed in detail under supervision and regulation, will continue to require resources from the monetary and economic policy area. During 1990, requirements and plans for modifying current software to gain access to the NIC database will be finalized, and some software will be modified.

The economic and financial situation in 1991 will demand particularly close monitoring and accurate analysis in support of monetary policy. At the same time, the structure and regulation of the nation's financial system are under review, and the research divisions are analyzing the policy issues. Such support and policy analyses are also important in the Board's efforts to improve payments system operations and reduce payments system risk.

The growth of expenses in the monetary and economic policy area is held down because earlier investments in distributed processing systems have reduced the costs of centrally provided automation services. The successful automation program has also limited the growth of costs by allowing the existing staff to carry the increasing workload.

### Supervision and Regulation

Supervision of financial institutions includes reviews of examination and inspection reports on state member banks

prepared by the Reserve Banks, special studies related to international applications, the direction of enforcement actions, and the regulation of trust activities. Regulation includes the formulation of regulations; the oversight of mergers, foreign banking activities, and compliance with consumer regulations; and the regulation of securities credit.

The 1991 budget funds considerable growth in this operational area. The budget of \$32.8 million is \$3.8 million, or 13.2 percent, greater than estimated expenses for 1990. Eight new positions have been added, related primarily to development and implementation of policy, supervision of money center banks, and increased consumer compliance. Most of the positions are related to FIRREA and to underlying problems and new developments in the financial industry.

Besides the direct cost associated with the new positions, the budget continues to fund the Board's share of the automation costs for the development of the NIC. In 1988, the Board approved the creation of the NIC to provide a database on the structure and finances of the nation's banks and bank holding companies. The staff has made substantial progress since 1988 to define the requirements of the project and to develop the database. The 1991 budget provides funds to complete the establishment of the NIC by May. Further efforts in this important area will continue in 1991 as current software is revised to operate using the NIC database. This project, as the only source of consolidated structure and financial data, is needed for proper supervision and regulation of the banking and financial industry. It will reduce Systemwide costs, improve the integrity of the data, and lead to more timely and meaningful analysis of applications, merger requests, and other actions in a rapidly changing environment.

The office automation networks supporting this functional area will be substantially upgraded during 1991. The budget includes funds for improving document storage and retrieval facilities and database management facilities on the network. On a much smaller scale, the Division of Consumer and Community Affairs will also replace old and inefficient microcomputers.

### Services to Financial Institutions and the Public

This operational area is composed of programs supporting the payments mechanism function of the Federal Reserve System. Its budget of \$2.9 million is \$246,000, or 9.4 percent, higher than 1990 estimated expenses.

A major factor in the higher costs is the continued emphasis on reducing risk in the payments system and ensuring that the payments system responds quickly and efficiently to changes in the financial system. The budget includes two new positions to develop policies and procedures to reduce payments system risk by analyzing characteristics and risks associated with national and international payment and settlement systems.

A large project to develop software for managing currency orders and cash shipments was completed in 1990. Although this project will not result in operating savings for the Board, it will yield savings for the Reserve Banks from smaller orders for currency and reduced costs for transportation. The completion of this project in 1990 limits the overall increase in the 1991 budget.

### System Policy Direction and Oversight

This budgetary area includes resources for supervising System and Board programs; it has been partially redefined as a



result of the removal of the budget of the Office of Inspector General. The financial data reflect this adjustment.

The \$20.3 million budget for System policy direction and oversight in 1991 is \$811,000, or 4.2 percent, more than estimated 1990 expenses. It has no major increases for mission. Staffing for Reserve Bank examinations continues to increase with the addition of an electronic-data-processing auditor, which has been added to help ensure that internal controls over the major automation systems of the Reserve Banks are adequate.

The budget for this area funds the replacement of old microcomputer equipment and some initiatives relating to the network in the Division of Federal Reserve Bank Operations.

### Objects of Expense

In the 1991 budget, the most significant increase in expenses relates to salary. The increase, \$5.0 million, is significantly less than that in 1990 when the new compensation program was implemented. The successful implementation of the compensation program has reduced the number of vacancies and thus has increased projections of salary costs for 1991.

The largest element of the salary increase is \$4.2 million for the merit pay raises. Reduced lapse, associated with a higher percentage of filled positions in 1991, adds \$0.6 million. The cost of the salaries for eleven new positions exceeded the savings of \$0.3 million associated with the deletion of eight unrelated positions. A small amount is for routine reclassifications and promotions. A higher level of income for reimbursement for services to the FFIEC reduces the budgeted increase by \$0.2 million.

Retirement costs are up \$884,400, or 19.8 percent, primarily because of the increases in the Board's matching contri-

bution to the thrift plan, in the wage base subject to social security taxes, and in the proportion of staff covered by social security.

For the third consecutive year, health insurance costs have risen sharply. The increase for 1991 is \$0.8 million, or 15.7 percent. The cost of medical insurance for retirees, which has gone from \$362,000 in 1990 to \$529,000 in the 1991 budget, has also had an effect. A further cause of the increase was the increase in the salary base subject to the 1.45 percent Medicare tax from \$51,300 to \$125,000.

### Capital Outlays

The capital budget request is \$5,131,700, which is \$1.1 million more than 1990 estimated expenditures. The budget funds requirements in the areas of automation and telecommunication, facilities improvements, and equipment replacements.

A major element of the capital budget is \$1.0 million to replace the analog telephone switching equipment with a digital private branch exchange. Maintenance of the old equipment has become excessive, and the risk to the Board from failure of this equipment is unacceptable.

Continued investment in the workstation, network, and office automation systems throughout the Board will require \$2,275,000. Such investments, which have been critical in limiting the need for additional staff to meet the Board's increasing workload, are in line with the Board's automation-telecommunication plan. Within the \$2.3 million total, the largest element is the workstation network in the Divisions of Research and Statistics and Monetary Affairs, which will cost \$950,000. These funds will provide new equipment to improve communications over the backbone network and will replace equipment that is

physically worn out or technologically obsolete. The funds will also be used to acquire equipment that will improve the security and backup capabilities of the system. The network provides a less-expensive way for the divisions to perform certain kinds of research computing. The Division of Banking Supervision and Regulation has been allocated \$450,000 to improve its network capabilities and to replace aging microcomputers that cannot process the division's large volumes of data and text on a timely basis. The records management project will require \$250,000 to automate and improve the Board's ability to store, retrieve, and index official records. Smaller automation requests throughout the Board account for the remaining \$625,000.

Improvements of facilities require a total of \$1,080,000. The replacement of the Martin Building roof will cost \$430,000. The replacement of heat exchange equipment and corroded steam coils will cost \$320,000. The dishwasher conveyor system in the cafeteria will be replaced at a cost of \$160,000. The fire and intrusion alarm system, begun in 1990, will be completed at a 1991 cost of \$170,000. This system will improve security and safety while reducing staffing requirements in the guard force.

## Ten-Year Trend

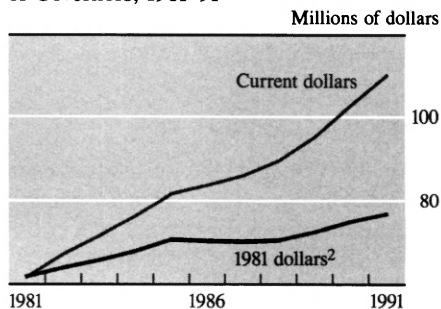
From 1981 through 1991, the Board's operating expenses have grown from \$61.8 million to \$110.2 million, an average increase of 6.0 percent per year in current dollars and 2.2 percent in constant dollars (chart 2.1). During this period, the costs for personnel have increased at an average of 6.0 percent per year in current dollars (chart 2.2), while expenses for goods and services have increased by 5.7 percent a year (chart 2.3). When measured in constant dollars,

expenses for personnel rose more quickly relative to those for goods and services, 2.3 percent per year and 1.9 percent per year respectively. The faster pace for personnel costs reflects the substantial investment in the Board's new compensation program.

The size of the actual annual increases in expenses has varied greatly (chart 2.4): Periods of major growth in the workload have required additional resources, which have then been scaled

*Chart 2.1*

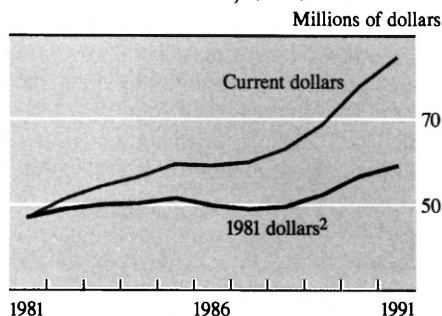
Operating Expenses of the Board of Governors, 1981-91<sup>1</sup>



1. Excludes the Office of Inspector General and 1991 extraordinary items. For 1990, estimate; for 1991, budget.
2. Calculated with the GNP price deflator.

*Chart 2.2*

Expenses for Personnel Services at the Board of Governors, 1981-91<sup>1</sup>



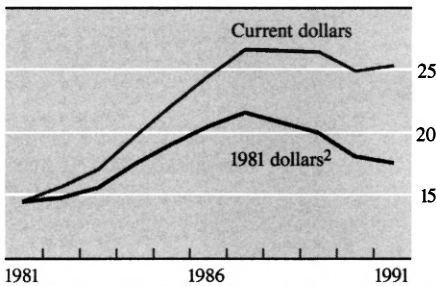
1. Excludes the Office of Inspector General. For 1990, estimate; for 1991, budget.
2. Calculated with the GNP price deflator.

back as the new work has been assimilated, productivity-enhancing technology acquired, and lower-priority tasks discontinued. This variation is reflected also in the changes in staffing during the first half of the ten-year period (chart 2.5). While staffing has been lower during the latter portion of the period, the workload of Board staff has continued to increase. Staffing has been controlled because of productivity gains from office automation.

Chart 2.3

Expenses for Goods and Services at the Board of Governors, 1981-91<sup>1</sup>

Millions of dollars

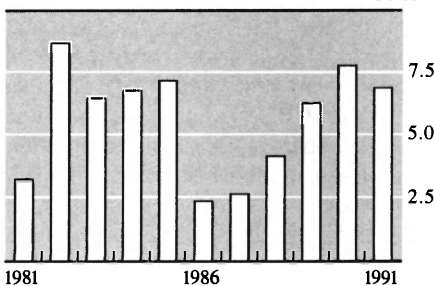


1. Excludes the Office of Inspector General and 1991 extraordinary items. For 1990, estimate; for 1991, budget.
2. Calculated with the GNP price deflator.

Chart 2.4

Annual Rate of Change in Operating Expenses of the Board of Governors, 1981-91<sup>1</sup>

Percent



1. Excludes the Office of Inspector General. For 1990, estimate; for 1991, budget.

The following discussion breaks the ten years from 1981 through 1991 into three segments: 1981-84, when resources, particularly for data collection and storage, were added to meet the requirements of major legislation; 1985-87, when adjustments by the Board reduced the number of positions added during the previous period; and 1988-91, when the year-to-year decreases associated with the position reductions of the earlier period ended and the new compensation program, with its correction of salary levels, caused the rate of increase to return to a more normal pace.

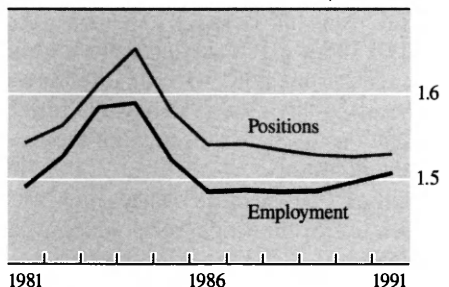
### 1981-84

Expenses rose sharply during this period. Federal pay increases during these years, although markedly below those in the private sector, were high compared with the federal increases approved later in the decade. More significant, however, were the costs of resources added to meet the requirements of new legislation. The average increase in expenses for these years, 7.4 percent, derived from legislation such as the Monetary Control Act

Chart 2.5

Employment and Positions at the Board of Governors, 1981-91<sup>1</sup>

Number, in thousands



1. Year-end data. Excludes summer intern and youth positions, the Office of Inspector General, and the FFIEC. For 1990, estimate; for 1991, budget.

(MCA), the International Banking Act (IBA), and the Financial Institutions Regulatory and Interest Rate Control Act (FIRA) and was at its highest point during the ten-year period.

Under the MCA, the number of institutions directly or indirectly reporting financial data to the Federal Reserve tripled, from about 14,000 to about 45,000, and the number of items all institutions were required to report grew substantially. This surge in the volume of work handled at the Federal Reserve required a new mainframe computer and large additions to the staff for data processing. The requirement of the MCA that the Federal Reserve price many services it had previously provided without explicit charge and expand their availability also imposed costs of implementation. During this period, also, deregulation and other changes in the banking industry arising from the Financial Institutions Regulatory and Interest Rate Control Act required additional staff in the supervisory function throughout the System. To meet all of these requirements, the number of positions grew from 1,543 to 1,653, an average increase of 2.3 percent per year, over the period.

### 1985-87

In mid-1984, the Board established the Program Improvement Project (PIP) with the goal of reducing the number of positions at the Board 7 percent by the end of 1986. PIP made large changes in the structure and size of the data-processing divisions; somewhat fewer reductions occurred throughout the rest of the Board.

Under PIP, careful consideration was given to exempting areas addressing problems such as the trade deficit and the debt positions of developing countries; however, the only area excluded from the overall reduction program was super-

vision and regulation. Six positions supporting lower-priority functions in the supervision and regulation area were abolished, and twenty-nine positions were added to the programs directly concerned with the growing problems in the nation's banking industry. Even with this increase, the net decrease in positions at the Board in 1985 was seventy-three.

The one-time costs of implementing PIP, plus greater efforts to automate critical functions, limited the effect of these reductions on the Board's expenses in 1985. In 1986, PIP decreased staffing by another forty positions. The effect of these reductions was clearly evident in 1986 and 1987, when the growth of expenses was 2.4 percent and 2.0 percent respectively.

### 1988-91

Without the legislative demands of the earlier years of the decade or the one-time increment in savings from the staff reductions of the middle years, increases in the Board's expenses returned to a more normal average of 5.4 percent per year in 1988 and 1989.

In mid-1989, management of the Contingency Processing Center (CPC), the relocation facility for the Board and the backup data-processing facility for the System, was transferred from the Board to the Federal Reserve Bank of Richmond. The decision for the transfer was based on the increasing Reserve Bank requirements for backup facilities and support. The decision reduced Board expenses in 1989 and 1990. It also allowed ten CPC positions to be abolished from the Board's 1989 budget and eight positions to be abolished from the Board's 1990 budget.

In 1990, expenses rose because of the full implementation of the compensation program, the added legislative requirements associated with FIRREA, and the

continued pressures in supervision. Ten positions were authorized in supervision in 1990 although, because of the redirection of staff resources and positions, Board employment has remained essentially constant. Pressure in other areas, such as programs dealing with financial markets, has been met through overtime and a reduction in long-term research that is funded within the budget.

The 1991 budget has returned to the lower levels of growth seen in recent years. Even with the lower percentage growth level, resource demands in supervision and regulation and in services to financial institutions and the public grew for reasons discussed earlier.

The Office's 1991 budget provides for no increase in staffing, which remains at nineteen positions, the level attained when four positions were added in late 1990.

The \$391,000 increase is tied largely to staff increases and the full-year cost of four positions added late in 1990. An increase of \$55,000 in the travel budget is associated with auditing functions delegated by the Board to Reserve Banks.

### **Budget of the Office of Inspector General**

The Board created the Office of Inspector General in July 1987. In 1989, the OIG's reporting relationships, duties, and responsibilities were formalized by the Inspector General Act Amendments of 1988. The OIG's budget is managed differently from the other Board budgets to ensure its independence. It is also presented to the Board separately from the regular operating budget. It is, however, subject to the same administrative processes and the same schedule of submission that other Board budgets are.

The 1991 budget for the OIG is \$1.8 million, which is \$391,000, or 28.3 percent, more than estimated 1990 expenses. The increased resources are necessary to phase-in broader audit and investigation coverage of the Board's mission areas and to review new and existing laws and regulations for their effect on the economy and efficiency of Board programs and operations.

## Chapter 3

# Federal Reserve Banks

The 1991 operating budget approved by the Board of Governors for the Federal Reserve Banks is \$1,501.0 million, an increase of \$86.4 million, or 6.1 percent, over 1990 estimated expenses. The operating budget of the Reserve Banks excludes the Systemwide costs of special research and development projects relating to the digital imaging of checks (\$3.7 million) and the authentication of currency (\$3.9 million). Including the costs of these special projects, the System's 1991 budget is \$1,508.6 million, an increase of \$87.4 million (table 3.1).

Employment excluding the staff associated with the special projects is budgeted at 23,861 average number of personnel (ANP), an increase of 163, or 0.7 percent, over estimated 1990 employment.<sup>1</sup> Including the special projects, total budgeted employment is 23,862.

Expenses for personnel, which consist of salaries and benefits, account for \$969.1 million, or 65 percent, of Reserve Bank expense in 1991—an increase of \$67.6 million, or 7.5 percent, over 1990. Of the increases in overall benefits, medical insurance is increasing \$10.6 million, or 16.2 percent. Nonpersonnel expenses are budgeted at \$531.9 million, an increase of \$18.8 million, or 3.7 percent. These expenses are influenced

primarily by automation and building projects (table 3.2).

The following two sections discuss the major initiatives and the budget objective for the Reserve Banks in 1991. Subsequent sections provide details for the four operational areas as well as objects of expense, capital outlays, and long-term trends. Appendix C gives details on capital outlays, special projects, and other special categories of expense. Appendix F gives further data by District and by operational area.

### Major Initiatives

The 1991 increase in total expenses includes \$30.0 million in Reserve Bank initiatives (table 3.3):

- Projects to enhance facilities at head offices and branches
- Expanded programs for the U.S. Treasury Department
- Enhanced automation efforts
- Increased supervisory examinations and inspections of banks and bank holding companies
- Enhanced check and cash operations.

Improvements in facilities throughout the System will add \$8.2 million in 1991. Of this increase, projects relating to buildings account for \$2.7 million. Transitional costs associated with New York's East Rutherford Operations Center (EROC) are largely responsible for this increase. Other contributors are greater operating expenses at the Charlotte Branch and ongoing projects to improve facilities at the Cleveland, St. Louis, and Kansas City offices. Projected increases

1. The term *average number of personnel* describes levels and changes in employment at the Reserve Banks. ANP measures the number of employees in terms of full-time positions for the time period. For instance, a full-time employee who starts work July 1 counts as 0.5 ANP for that year; two half-time employees who start January 1 count as one ANP. The ANP for any given year is the average number of full-time employees (measured in this way) in the months of that year.

in real estate taxes, due primarily to recently completed building projects, will add \$5.5 million in building-related expenses.

Expenses for fiscal services are projected to increase \$4.9 million. Of the overall increase, \$4.2 million will be incurred as the System moves toward nationwide implementation of the Regional Delivery System (RDS), which involves centralized issuance of over-the-counter savings bonds. Full implementation of this project will continue through 1993. A staff increase of 141 ANP is expected in 1991, and a total staff increase of 350 ANP is projected by the time the RDS project is fully implemented. Increases in RDS staff will be partially offset by decreases in staff in other savings bond activities. Expense in-

creases relating to improved services for the Treasury include (1) an additional 15 ANP to handle the processing of savings bonds at the Pittsburgh Branch on high-speed check-processing equipment (EZ Clear) and (2) expense increases related to the continued growth in the Masterfile program in Minneapolis. This Masterfile program involves the centralized processing for corporations of payroll deductions for savings bonds. Expenses incurred in connection with the savings bond initiatives are fully reimbursable.

The System will partially offset increased expenses related to fiscal services by improvements in operations and by the centralization of definitive and noncash operations. These initiatives will reduce expenses by \$1.2 million and staffing by 35 ANP in 1991. Most savings

**Table 3.1**

Expenses and Employment at the Federal Reserve Banks, 1990-91<sup>1</sup>

Category	1990 estimate	1991 budget	Change	
			Amount	Percent
<i>Expenses (millions of dollars)</i>				
Operations <sup>2</sup> .....	1,414.6	1,501.0	86.4	6.1
Special projects .....	6.6	7.6	1.0	. . .
Total .....	1,421.2	1,508.6	87.4	6.1
<i>Employment (average number of personnel)<sup>3</sup></i>				
Operations <sup>2</sup> .....	23,698	23,861	163	.7
Special projects .....	26	1	-25	. . .
Total .....	23,724	23,862	138	.6

1. Excludes capital outlays.

2. Includes support and overhead (see appendix F, table F.3, note 1, for definition).

3. See text note 1 for the definition of average number of personnel.

**Table 3.2**

Operating Expenses of the Federal Reserve Banks, by Object, 1989-91<sup>1</sup>

Thousands of dollars, except as noted

Object	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Personnel .....	851,330	901,463	969,121	5.9	7.5
Nonpersonnel .....	499,156	513,102	531,844	2.8	3.7
Total .....	1,350,486	1,414,565	1,500,965	4.7	6.1

1. Includes the costs of support and overhead (see appendix F, table F.3, note 1, for definitions).

are due to operational improvements in San Francisco resulting primarily from continued efforts at centralization.

The System will continue automation projects relating to contingency, increased computer capacity, and office automation. These initiatives are projected to increase 1991 expenses \$4.7 million. A computer upgrade will occur at Richmond. The New York, Chicago, and Minneapolis offices will have increased operating expenses associated with new control processing units (CPUs) purchased in 1990.

Several Reserve Banks have identified initiatives in supervision and regulation. Totalling \$4.0 million, these initiatives stem primarily from the need for additional staff to handle increases in workloads due to the greater complexity of examinations, more holding company examinations, increased examination of foreign banks, and more problem institutions. Related expenses, such as travel, will also contribute to the increase in this area.

*Table 3.3*

**Operating Expenses Budgeted  
for Major Initiatives of the Federal  
Reserve Banks in 1991**

Area of initiative	Millions of dollars	Percent of 1991 operating budget
Facility improvements .....	8.2	.6
Fiscal initiatives .....	4.9	.3
Fiscal consolidation efforts ...	-1.2	-.1
Contingency and automation initiatives .....	4.7	.3
Supervision and regulation .....	4.0	.3
Enhanced check operations ...	5.5	.4
Check operational improvements .....	-2.8	-.2
Currency initiatives .....	2.2	.2
Thrift plan .....	4.5	.3
<b>Total .....</b>	<b>30.0</b>	<b>2.1</b>
<b>MEMO</b>		
Increase in total operating expenses, 1990 estimate to 1991 budget .....	86.4	6.1

Five Banks have budgeted a total of \$4.5 million to upgrade existing check system software to improve efficiency. In addition, San Francisco has budgeted \$1.0 million to improve check-processing operations through programs for developing efficiency and effectiveness and through the expanded use of automation in adjustments. The increase in the cost in check operations is partially offset by staff reductions of 97 ANP resulting from the experience gained in the handling of return items, reductions in adjustment backlogs, automated adjustment systems, and the pilot on return-item intermingling in Minneapolis and Dallas.

The System anticipates spending \$2.2 million in 1991 related to expanded initiatives in currency processing. Increases are primarily in San Francisco for expansion in processing and storage capacity in response to continued growth in volume and for cash-automation projects to improve custody controls and management information.

The increase in the Reserve Banks' share of the matching contribution for the thrift plan is estimated to add \$4.5 million to System expenses in 1991.

## 1991 Budget Objective

Earlier this year, the Board approved a 1991 objective for Reserve Bank budgets that targeted the increase in total operating expenses over 1990 projected expenses at 6.6 percent. This objective excluded two special projects, check imaging and counterfeit deterrence, whose expenses were projected to increase slightly in 1991. Including the costs of the special projects did not change the overall projected growth in expenses.

The 1991 budget increase compares favorably with the budget objective. Total operating expenses are projected to increase by \$86.4 million, or 6.1 percent,



**Table 3.4**

Comparison of 1991 Budget Objective and Budget of the Reserve Banks with 1990 Estimated Expenses<sup>1</sup>

Change, percent

Item	1991 budget objective	1991 budget
Operating expenses.....	6.6	6.1
Special projects .....	0.0	0.0
<b>Total.....</b>	<b>6.6</b>	<b>6.1</b>

1. See data on expenses in table 3.1.

and the expenses associated with the special projects are increasing by \$1.0 million (tables 3.1 and 3.4). Overall, the increase in the 1991 budget is \$6.9 million less than projected when the Board approved the budget objective, which had not included sufficient funding for supervision and regulation. Also, a project to rewrite the software of the planning and control system (PACS), which was not included in the System budget objective, is now planned for 1991.

The increase in the expense for supervision and regulation is \$6.0 million more than projected during the 1991 budget objective setting. The condition of banks in the Northeast and the expansion of examination programs throughout the System will require additional staff and

office space for supervision. However, the increase in expenses for financial services, which is \$10.8 million less than projected in the budget objective, more than offsets the incremental increase in supervision and regulation.

The System plans in 1991 to rewrite its software to account for operating expenses. PACS provides a uniform accounting and reporting structure so that the operating expenses of all Federal Reserve Banks will be collected and reported on a comparable basis. The budget objective had not included funds for rewriting the PACS software, and this project is expected to increase System expenses in 1991 by \$1.0 million.

## Operational Areas

Tables 3.5 and 3.6 summarize Reserve Bank expenses and employment in each of the four operational areas. Tables 3.7 through 3.10 show expense details for each area.

## Monetary and Economic Policy

The 1991 budget increase of \$7.9 million, or 7.9 percent, above the 1990 estimate of expense reflects an increase in staff of 14 ANP, salary administration actions, increased equipment and data-processing costs associated with automation initia-

**Table 3.5**

Operating Expenses of the Federal Reserve Banks, by Operational Area, 1989-91

Thousands of dollars, except as noted

Operational area	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Monetary and economic policy .....	93,554	99,660	107,512	6.5	7.9
Services to the U.S. Treasury and other government agencies .....	145,546	156,137	167,223	7.3	7.1
Services to financial institutions and the public .....	916,310	944,392	992,076	3.1	5.0
Supervision and regulation .....	195,076	214,376	234,155	9.9	9.2
<b>Total.....</b>	<b>1,350,486</b>	<b>1,414,565</b>	<b>1,500,965</b>	<b>4.7</b>	<b>6.1</b>

tives, and the allocated costs of various System Projects (Fedline II, Automation Consolidation, and the National Information Center). The addition of personnel brings the 1991 level of staff to that approved in the 1990 budget. The 1990 estimate is below the approved budget because of attrition and the lag in finding qualified replacements.

At the District level, New York has budgeted for automation initiatives that include equipment upgrades to its office and analytical support system (OSS), increased maintenance costs for the new security trading and clearing system (STACS), and the development of a foreign exchange replacement system.

### Services to the U.S. Treasury and Other Government Agencies

The 1991 budget is projected to be \$11.1 million, or 7.1 percent, greater than the 1990 estimate of expenses. Staffing levels are expected to increase by 75 ANP. The major initiative driving the increases in both expenses and staff is the nationwide expansion of the RDS, which consolidates the issuance of over-the-counter savings bonds at one office in each District. RDS volume is expected to increase by 5.4 million bonds in 1991. Partially offsetting this increase is the shift of the volume of retired savings bonds from the fiscal area to the other

*Table 3.6*

### Employment at the Federal Reserve Banks, by Activity, 1989-91

Average number of personnel, except as noted <sup>1</sup>

Activity	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
<i>Operational areas</i>					
Monetary and economic policy .....	783	773	786	-1.2	1.7
Services to the U.S. Treasury and other government agencies .....	1,771	1,837	1,912	3.7	4.1
Services to financial institutions and the public .....	9,423	9,304	9,227	-1.3	-.8
Supervision and regulation .....	2,198	2,229	2,305	1.4	3.4
<i>Support and overhead<sup>2</sup></i>					
Support .....	4,552	4,583	4,646	.7	1.4
Overhead .....	4,948	4,973	4,986	.5	.3
<b>Total .....</b>	<b>23,674</b>	<b>23,698</b>	<b>23,861</b>	<b>.1</b>	<b>.7</b>

1. See text note 1 for the definition of average number of personnel.

2. See appendix F, table F.3, note 1, for definitions.

*Table 3.7*

### Expenses of the Federal Reserve Banks for Monetary and Economic Policy, 1989-91

Thousands of dollars, except as noted

Service	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Economic policy determination .....	76,865	81,232	87,574	5.7	7.8
Open market trading .....	16,689	18,428	19,938	10.4	8.2
<b>Total .....</b>	<b>93,554</b>	<b>99,660</b>	<b>107,512</b>	<b>6.5</b>	<b>7.9</b>

check area (EZ Clear Activity). This shift in cost occurs because savings bonds under EZ Clear are processed on check equipment. The processing of redeemed bonds through EZ Clear becomes mandatory on February 1, 1991.

### Services to Financial Institutions and the Public

The 1991 budget for these services, which include both the priced and non-priced operations, is expected to total \$992.1 million, an increase of \$47.7 million, or 5.0 percent, above 1990

estimates. Staffing levels are to be reduced 77 ANP, primarily in commercial check processing (-97 ANP) and non-cash collection (-11 ANP). These decreases are partially offset by staff increases in other check processing (30 ANP) associated with the government check and the EZ Clear operations.

Commercial check processing is by far the largest component of this category of services (\$492.0 million); it composes half of the category's budgeted expenses and employs 5,686 ANP. The anticipated increase in expenses is \$15.5 million, or 3.3 percent, over estimated 1990 levels.

*Table 3.8*

Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies, 1989-91

Thousands of dollars, except as noted

Service	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Savings bonds.....	40,512	40,085	39,117	-1.1	-2.4
Central operations, savings bonds.....	5,075	13,554	21,676	167.1	59.9
Other Treasury issues.....	16,474	15,803	16,288	-4.1	3.1
Central operations, other Treasury issues ..	1,439	1,425	1,369	-1.0	-4.0
Central Treasury and agency services.....	22,601	21,987	22,452	-2.7	2.1
Government accounts.....	21,616	23,455	23,878	8.5	1.8
Food coupons.....	13,328	14,887	15,562	11.7	4.5
Other.....	24,501	24,941	26,880	1.8	7.8
<b>Total.....</b>	<b>145,546</b>	<b>156,137</b>	<b>167,223</b>	<b>7.3</b>	<b>7.1</b>

*Table 3.9*

Expenses of the Federal Reserve Banks for Services to Financial Institutions and the Public, 1989-91

Thousands of dollars, except as noted

Service	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Currency and coin.....	147,717	157,316	166,656	6.5	5.9
Special cash.....	13,693	13,500	14,734	-1.4	9.1
Commercial checks.....	470,200	476,516	492,044	1.3	3.3
Other checks.....	21,098	25,074	27,521	18.8	9.8
Funds transfers.....	63,153	64,672	70,035	2.4	8.3
Automated clearinghouse.....	74,364	78,840	83,437	6.0	5.8
Book-entry securities transfers.....	29,145	30,117	34,157	3.3	13.4
Definitive securities safekeeping and noncash collection.....	16,048	14,884	14,470	-7.3	-2.8
Loans to members and others.....	15,135	15,216	15,911	.5	4.6
Public programs.....	42,471	44,764	48,704	5.4	8.8
Other.....	23,286	23,492	24,408	.9	3.9
<b>Total.....</b>	<b>916,310</b>	<b>944,392</b>	<b>992,076</b>	<b>3.1</b>	<b>5.0</b>

The reduction of 97 ANP in commercial check processing results from experience gained in the handling of return items, reductions in adjustment backlogs, efficiencies gained through the implementation of automated adjustment systems in several Districts, and the return item intermingling pilot in Minneapolis and Dallas. Also contributing to the low expense growth is the return to a more normal level of check write-offs associated with unlocated differences, primarily at the Federal Reserve Bank of Philadelphia. Commercial check volume and unit cost are both budgeted to increase 1.3 percent.

Expenses for the currency service are expected to increase \$8.1 million, or 6.1 percent. Staffing levels will increase 6 ANP primarily because of increases in San Francisco (16 ANP) and Cleveland (4 ANP) that are associated with adding shifts to process currency. Partially offsetting these increases are productivity gains in several other Districts. The major initiative affecting this service is the second generation currency equipment project.

The automated clearinghouse (ACH) service is budgeted to increase \$4.6 million, or 5.8 percent. Total ACH volume is projected to have an increase of 15.0 percent in 1991, which will result in a 7.5 percent decrease in unit cost. Major initiatives affecting this service are the

conversion to an all-electronic ACH and the Future ACH System project.

Expenses for the transfer of reserve account balances are expected to increase by \$5.4 million, or 8.3 percent. The staff level will increase by 3 ANP. The increase in costs results primarily from increases in personnel costs; increases in data communications costs due to a change in the accounting rules; and procedural changes resulting from the implementation of the UCC-4A regulations, which will require the Federal Reserve to improve its security procedures for off-line banks.

### Supervision and Regulation

The expense increase of \$19.8 million, or 9.2 percent, is centered on the addition of 76 ANP and on increases in compensation, travel, training, and automation. The effect over a full year of special salary adjustments given examiners in several Districts during 1990 also contributes to the year-over-year increase in expense. The additional demands on the Federal Reserve's examination staff have necessitated increases in personnel. These increased demands on staff include expanded bank examination programs, improved supervision of foreign banking agencies in the United States, the broadening level of detail covered in the examination process, compliance with

Table 3.10

Expenses of the Federal Reserve Banks for Supervision and Regulation, 1989-91

Thousands of dollars, except as noted

Service	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-91	1990-91
Supervision of District financial institutions .....	119,983	133,874	146,597	11.6	9.5
Administration of laws and regulations related to banking .....	64,899	69,305	75,663	6.8	9.2
Studies of banking and financial market structures .....	10,194	11,197	11,895	9.8	6.2
<b>Total .....</b>	<b>195,076</b>	<b>214,376</b>	<b>234,155</b>	<b>9.9</b>	<b>9.2</b>

the Financial Institution Referral and Recovery Enforcement Act (FIRREA) and Bank Secrecy Act, intensified surveillance of problem financial institutions, and increased focus on the requirements of the Community Reinvestment Act. Expenses are also affected by the initiative addressing payments system risk and that addressing daylight overdraft pricing.

## Objects of Expense

Personnel expenses are composed of salaries for officers and employees, other compensation to personnel, and retirement and other benefits. Total personnel costs account for 64.5 percent of Reserve

Bank expenses and are expected to increase 7.5 percent in 1991 (table 3.11).

Salaries and other personnel expenses account for nearly 52.2 percent of 1991 budgeted expenses and anticipated growth is \$45.8 million, or 6.2 percent. Salaries are expected to increase \$47.5 million, or 6.5 percent, and will be partially offset by a decline of \$1.7 million in other personnel expenses resulting from the decreasing use of outside agency help. Merit pay increases of \$37.1 million, or 5.1 percent, are the primary reason for salary expense growth. Also contributing to additional salary expenses are promotions, reclassifications, structure adjustments, and increases in staffing levels. These increases are partially offset by

*Table 3.11*

### Operating Expenses of the Federal Reserve Banks, by Object, 1989-91

Thousands of dollars, except as noted

Object	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
PERSONNEL					
Officers' salaries .....	68,114	73,470	79,280	7.9	7.9
Employees' salaries .....	617,745	652,894	694,599	5.7	6.4
Other personnel <sup>1</sup> .....	14,946	11,352	9,633	-24.0	-15.1
Retirement and benefits .....	150,524	163,748	185,610	8.8	13.4
Total personnel .....	851,330	901,463	969,121	5.9	7.5
NONPERSONNEL					
Forms and supplies .....	54,372	54,275	55,682	-.2	2.6
Equipment .....	158,131	163,229	174,525	3.2	6.9
Software .....	-	31,433	31,497	-	.2
Shipping .....	82,159	83,789	86,920	2.0	3.7
Travel .....	27,214	29,506	30,471	8.4	3.3
Buildings					
Insurance .....	661	737	770	11.6	4.4
Taxes on real estate .....	23,302	22,594	28,529	-3.0	26.3
Property depreciation .....	30,712	34,022	37,087	10.8	9.0
Utilities .....	24,831	26,346	27,443	6.1	4.2
Rent .....	21,245	22,065	23,861	3.9	8.1
Other .....	19,734	18,536	18,647	-6.1	.6
Total buildings .....	120,485	124,300	136,336	3.2	9.7
Recoveries .....	-34,609	-34,289	-35,265	-.9	2.8
All other <sup>2</sup> .....	91,404	60,860	51,678	-33.4	-15.1
Total nonpersonnel .....	499,155	513,102	531,844	2.8	3.7
Total .....	1,350,486	1,414,565	1,500,965	4.7	6.1

1. Expenses for certain contractual arrangements, and miscellaneous personnel expenses.

2. Communications, fees, contra-expenses, shared

costs received, shared costs distributed, support cost distributed, support cost received, and other.

short-term position vacancies due to lags in hiring and by reductions in expenses for overtime.

Expenses for retirement and other benefits, which account for 12.3 percent of Reserve Bank budgets, are anticipated to increase \$21.9 million, or 13.4 percent, in 1991. This increase is the result of continued escalation in hospital and medical costs, a rise in the Social Security tax, and an increase in the thrift plan match in 1991.

Nonpersonnel expenses account for 35.5 percent of Reserve Bank expenses and are projected to increase 3.7 percent in 1991.

Equipment expenses are expected to increase 6.9 percent and account for 11.6 percent of total expenses in 1991. The \$9.7 million, or 11.4 percent, increase in depreciation results from acquisitions to expand data-processing and data-communications capabilities because of increased workloads and the full-year effect of equipment purchased in 1990.

Shipping costs account for 5.8 percent of the 1991 budget and are projected to increase 3.7 percent in 1991. The increase is primarily the result of a substantial increase in postal rates scheduled for early 1991, an increase in the shared cost of operating the interdistrict transportation system (ITS), and some cost in-

creases that result from rebidding local transportation contracts.

Building expenses, which account for 9.1 percent of total expenses, are expected to increase 9.7 percent in 1991 because of higher real estate taxes in several Districts and the full-year effect of recently completed capital projects.

Recoveries are expected to increase \$1.0 million, or 2.8 percent, in 1991. Other nonpersonnel expenses are projected to decrease \$6.7 million, or 3.8 percent.

### Capital Outlays

Capital outlays are budgeted at \$328.4 million, an increase of \$68.7 million, or 26.5 percent, above the 1990 estimate (table 3.12). The Reserve Banks' capital budgets continue to be dominated by outlays for data-processing and data-communications equipment and for building projects.

Outlays for data-processing and data-communications equipment total \$77.0 million in 1991, approximately 23 percent of total capital outlays. These expenses include outlays for storage devices such as tapes and disks (\$20.3 million); for CPUs, including processors, channels, and memory (\$12.2 million); and

Table 3.12

Capital Outlays of the Federal Reserve Banks, by Class of Outlay, 1989-91

Thousands of dollars, except as noted

Class of outlay	1989 actual	1990 estimate	1991 budget	Percent change	
				1989-90	1990-91
Data-processing and data-communications equipment .....	62,183	114,657	77,043	84.4	-32.8
Buildings .....	36,645	73,170	139,514	99.7	90.7
Furniture, furnishings, and fixtures .....	14,664	13,390	16,746	-8.7	25.1
Other equipment .....	10,940	18,106	21,331	65.5	17.8
Land and other real estate .....	25,297	29,754	42,733	17.6	43.6
Building machinery and equipment .....	8,454	9,840	27,605	16.4	180.5
Leasehold improvements .....	1,652	754	3,437	-54.4	355.8
<b>Total .....</b>	<b>159,834</b>	<b>259,671</b>	<b>328,408</b>	<b>62.5</b>	<b>26.5</b>

for check equipment (\$7.7 million) in several Districts. In addition, Chicago has budgeted \$6.9 million for the purchase and installation of modems, dynamic bandwidth management controllers, and technical control equipment as part of the development of the new Fednet communications system.

Building outlays total \$139.5 million in 1991, about 42.5 percent of total capital outlays. Two major construction projects are budgeted in 1991: the new Dallas building (\$55.0 million) and the New York operations center in East Rutherford (\$50.5 million). The rest of the outlays are in additions or improvements to existing buildings. Also, the Boston, Cleveland, Richmond, Chicago, and San Francisco Banks have budgeted a total of \$5.0 million for tenant improvements.

Furniture and other equipment purchases are budgeted for \$38.1 million. Major outlays are planned in Boston, New York, Atlanta, Chicago, St. Louis, Kansas City, Dallas, and San Francisco for various refurbishment and relocation efforts. In addition, Cleveland, Richmond, Chicago, Minneapolis, and Dallas are installing uninterruptible-power-supply systems to support computer operations should a power outage occur, at a total cost of \$1.3 million. Materials-handling systems will be installed at the East Rutherford Operations Center (\$2.8 million), San Francisco (\$0.3 million), and Los Angeles (\$0.3 million). New York will install second-generation currency equipment (\$1.1 million).

Building machinery and equipment outlays are budgeted for \$27.6 million. The majority of these outlays are related to the Dallas building project (\$16.2 million). The remaining outlays are planned in several Districts to upgrade or replace existing machinery and equipment, such as security systems (\$1.5 million), elevators (\$1.8 million), and

emergency systems to support the building's power supply (\$2.6 million).

Land and other real estate purchases are budgeted for \$42.7 million, of which \$35 million is for land for the new Minneapolis building. Also, \$3.3 million is budgeted for a building expansion in Cleveland, \$1.8 million for the new building project in Dallas, and \$1.4 million for the East Rutherford Operations Center.

Outlays for leasehold improvements are \$3.4 million, of which \$2.4 million is for renovation of the supervision and regulation work spaces in New York.

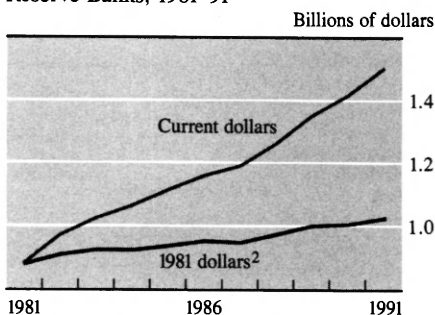
## Trends in Expenses and Employment

For the ten years ending in 1991, expenses of the Reserve Banks will have increased an average of 5.4 percent per year (chart 3.1). From 1986 to 1991, the System's expense growth has been lower (5.3 percent per year). Increases in expenses were slightly higher (5.6 percent) in the early 1980s as Banks began implementing the requirements of the Monetary Control Act (MCA).

Over the past decade, the number of employees at the Reserve Banks has

Chart 3.1

Operating Expenses of the Federal Reserve Banks, 1981-91<sup>1</sup>

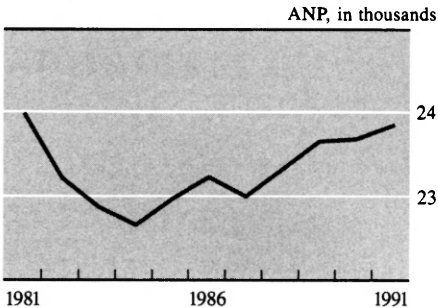


1. For 1990, estimate; for 1991, budget.

2. Calculated with the GNP price deflator.

Chart 3.2

Employment at the Federal Reserve Banks, 1981–91<sup>1</sup>



1. For 1990, estimate; for 1991, budget. See text note 1 for definition of ANP.

decreased from 23,989 in 1981 to 23,861 in 1991, a reduction of 128 ANP (chart 3.2). Since 1981, staff has decreased in overhead services (759 ANP) and services to financial institutions and the public (252 ANP) because of a System-wide effort to increase productivity in overhead services and because of staff reductions in priced services associated with the post-implementation phase of the MCA. These reductions are partially offset with staffing increases in supervision and regulation (571 ANP) and support services (212 ANP) associated with the additional requirements for resources related to the expanding responsibilities in these areas.

### Volume and Unit Costs

Volume for all measured operations is expected to increase 2.7 percent over that for 1990, while unit costs are expected to rise 2.2 percent (table 3.13). Over the five years from 1986 to 1991, the average annual growth rate will be 3.4 percent for volume and 0.4 percent for unit costs. The increase in unit costs expected for 1991 reflects a rise in unit costs in all areas except ACH. Unit costs for commercial check processing, the largest

Table 3.13

Changes from 1990 to 1991 in Volume and Unit Costs of Federal Reserve Bank Services

Percent

Service	Volume	Unit cost
Payments .....	3.5	.4
Commercial checks .....	1.3	1.3
Automated clearinghouse .....	15.0	-7.5
Funds transfers .....	4.8	3.2
Other checks .....	3.6	5.0
Cash .....	1.6	4.5
Fiscal .....	2.3	5.9
Securities and noncash .....	-2.6	10.9
All .....	2.7	2.2

operational area, are expected to increase 1.3 percent.

In 1991, the expected volume increase for the payments areas is 3.5 percent, an increase close to the five-year overall average. However, the lower growth anticipated for volume in cash and fiscal services (1.6 percent and 2.3 percent respectively) and the decrease anticipated for securities and noncash services (2.6 percent) result in an overall anticipated increase for 1991 of 2.7 percent, which is lower than the anticipated average.

### 1990 Budget Performance

In December 1989, the Board approved the 1990 Reserve Bank budgets at a total of \$1,419.0 million, an expected increase of \$77.6 million, or 5.8 percent, over estimated 1989 expenses. In January 1990, the approved budget was reduced \$4.1 million in the spirit of Gramm-Rudman-Hollings (GRH).

The Reserve Banks now estimate that 1990 expenses will be \$1,414.6 million, \$0.3 million under the GRH-adjusted budget. At this level of spending, the increase over the actual 1989 level will be 4.7 percent. For 1990, only the



Philadelphia Reserve Bank expects a budget overrun; it does so primarily because of unanticipated check write-offs and salary expenses resulting from forward and return item adjustments that were higher than anticipated. All but three Banks expect underruns of approximately 1 percent or less of the approved budgets. Cleveland expects an underrun of \$1.6 million, or 1.9 percent. This underrun is due mostly to lower-than-expected medical claims and to delays in the acquisition of major pieces of equipment. Chicago now projects an underrun of \$3.2 million, or 1.9 percent, due primarily to a 1990 real estate tax bill lower than originally budgeted. Minneapolis anticipates an underrun of \$1.4 million, or 2.0 percent, due to a 1989 refund on real estate taxes received in 1990. The refund was based on the decline in market value of the Minneapolis building and is partially offset by the acceleration to 1990 of some 1991 plans. ■

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## *Part II*

# *Special Analysis*

## Chapter 4

# *The Federal Reserve Bank Supervision Enhancement Program*

In 1985, the Federal Reserve initiated a program to improve the effectiveness of its supervision and regulation of banking organizations. The program had the following basic goals:

- Early identification of banking problems through more frequent on-site examinations of state member banks and inspections of bank holding companies and more intensive off-site surveillance of these organizations
- Expeditious correction of problems identified in examinations and inspections through clear and succinct oral and written communication with the management and boards of directors of organizations and, when necessary, through appropriate enforcement actions
- More effective prevention of problems by strengthening prudential standards that banking organizations must meet.

The program had two other important elements: augmenting the size and improving the training of supervisory staff and promoting greater coordination with other federal and state supervisory agencies.

### **Intensified Frequency of Examinations and Inspections and Cooperation with State Agencies**

In late 1985, the Board adopted a policy specifying a general increase in the required frequency of examinations of state member banks and inspections of bank holding companies. System require-

ments had been that state member banks judged to be in sound condition on their most recent examination were to be examined at least every eighteen months and that bank holding companies were to be inspected once every three years (except for small, trouble-free, shell holding companies which were visited when time permitted). The new policy mandated that state member banks and bank holding companies must be examined or inspected at least once each year; and the largest institutions and those with significant problems, every six months. The policy specified exceptions for the smallest companies, which are selected for inspection on a sampling basis, and for intermediate-sized, noncomplex holding companies, which are inspected every two to three years.

Coincident with the adoption of the new policy regarding examinations and inspections, the Board instructed Reserve Bank officials to promote greater cooperation with the state banking authorities in their Districts. To that end, meetings were held with state bank supervisors to reaffirm existing cooperative arrangements for examining and otherwise supervising state-chartered banks and bank holding companies and to establish new arrangements where possible. These arrangements call for a Reserve Bank and a state agency either to alternate years in examining institutions and to share resulting reports or to conduct examinations jointly and to prepare a common report. In either case, both parties are directly involved in supervising an organization and are informed about its condition. At the same time, the

avoidance of duplicated work results in economies.

The Reserve Bank officials also informed the state supervisors of the Federal Reserve's intention to provide financial assistance for the training of state examiners. Subsequently, the Board gave contributions to the Education Foundation of State Bank Supervisors, and the Reserve Banks financially assisted state examiners to attend training courses offered by the Federal Reserve and by the Federal Financial Institutions Examination Council (FFIEC).

In 1990, the Federal Reserve Banks completed, independently or jointly with the states, 764 examinations of state member banks. The states, under alternate-year arrangements, independently completed another 301 examinations of state member banks. Reflecting the mandate that large and troubled organizations are to be examined more than once annually, the total examinations in 1990 exceeded the number of state member banks (1,047). The Federal Reserve also completed 2,080 bank holding company inspections in 1990, somewhat exceeding the number mandated by the System's inspection policy.

In recent years, the Federal Reserve, in carrying out its central banking role, has on occasion diverted examiner resources to assist in resolving important problems in the thrift industry. In 1985, the Federal Reserve sent a large team of examiners to Ohio to help the state with state-insured thrift institutions. Later the same year, the Federal Reserve sent examiners to help resolve similar problems that had arisen with state-insured savings and loan institutions in Maryland. As a result of these experiences, the System established, as an element of the enhanced supervision program, a Special Examination Response team. In 1989, this team helped examine troubled thrift institutions before they were placed in

conservatorship first by the Federal Savings and Loan Insurance Corporation and then by its successor in this activity, the Resolution Trust Corporation. It has also been used when the System has needed to marshal its resources to deal with acute problems in a single District.

### **Communication with Management and Boards of Directors**

The Federal Reserve has long had examiners prepare written reports on their examinations and inspections for distribution to the institution's management and board of directors. As part of the supervisory enhancement program, the Board strengthened these procedures by instructing that the summary section of examination reports be written with more precision and by requiring that a separate "Summary of Findings," which spelled out identified problems clearly and succinctly, be distributed to each member of an organization's board of directors. The Board also directed that, when problems of large organizations were deemed to be relatively serious, meetings traditionally held with an institution's management and board of directors following an examination or inspection be attended not only by examiners but also by senior Reserve Bank officials. The purpose of these initiatives was to make sure that directors as well as senior management were fully informed of problems uncovered in the examination or inspection of their institution and to emphasize their responsibility to take immediate steps to correct the problems.

### **Examiner Training**

To enhance the ability of examiners to communicate, the Federal Reserve introduced an effective writing course in its

examiner training. The FFIEC added to its training program a course on making effective oral presentations to boards of directors. The Federal Reserve also bolstered the traditional "core" courses in its examiner training program by adding a range of new topics, including risk-based capital, derivative products, asset and liability management, and lending related to real estate; and it introduced a seminar for senior examiners on current supervisory issues and problems.

### **Prudential Supervision Policies**

The Board adopted many policies over the latter half of the decade to strengthen its supervision program. Of considerable importance was the adoption of a policy that added emphasis to the System's traditional policy that dividend payments should be made only from current and recently retained earnings, not from borrowings or nonrecurring sources of income. It was also stressed that, in formulating their dividend policy, banking organizations should carefully consider their overall financial condition, particularly the sufficiency of their capital base, and that bank holding companies should review the adequacy of their subsidiary banks' capital before declaring dividends to the parent company.

The policy in the supervision enhancement program of perhaps the greatest importance and with the farthest reaching consequences is the International Risk-based Capital Standard. The Federal Reserve cooperated with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) to develop an early version of this standard, and subsequently the three agencies worked with members of the Basle Supervisors Committee on a version that would be acceptable to countries in the Group of Ten (G-10). The Central Bank Governors in the G-10

reviewed and endorsed the proposal in mid-1988; and, by year-end 1988, all G-10 countries plus Luxembourg had adopted it.

This standard offers several advantages over the primary capital standard that it replaces. It broadly differentiates among the relative riskiness of banking assets and takes into account off-balance-sheet risk exposures of banking organizations. Also, because many countries in addition to those in the G-10 have adopted the standard, it will be applicable to banking organizations in all countries with important financial centers and will thus help to promote a level playing field for U.S. organizations as they compete with banks in other countries. The first phase of the standard was introduced at year-end 1990, and the standard is scheduled to be fully phased in at year-end 1992.

The risk-based standard has been refined and supplemented since its adoption. Of most significance, a leverage ratio that compares a bank's capital position, as defined under the risk-based standard, with its total assets has been adopted by the Federal Reserve and the OCC and is under final consideration by the FDIC. The leverage ratio addresses certain banking risks not captured by the risk-based standard. Also, the Basle Supervisors Committee is studying ways to incorporate a measure for interest rate risk into the risk-based capital framework.

The Board has adopted other important supervisory policies as part of the supervision enhancement program, including a policy on defining heavily leveraged transaction; a policy on less-developed-country debt that, among other elements, established strict conditions for taking such debt out of nonaccrual status; and a policy to discourage holding companies from inappropriately relying on commercial paper and other short-term debt in funding their operations.

**Resource Allocations**

When approving the supervision enhancement program in 1985, the Board recognized that to implement and carry out the expanding supervisory activities would require a major augmentation of supervisory resources. Reserve Banks have thus been encouraged to increase supervision staff, in particular examiner staff. The Board also authorized a sizable increase

in staff in its Division of Banking Supervision and Regulation.

As table 4.1 shows, Federal Reserve resources devoted to bank supervision and regulation increased materially between 1985 and 1990. The Federal Reserve has budgeted further sizable increases for 1991 because of the heavy workload resulting from the continued problems in the banking industry.

*Table 4.1*  
Expenses and Personnel of the Federal Reserve System, for Supervision, 1985-91

Entity	1985 actual	1990 actual	1991 budget	Average annual percent change	
				1985-90	1990-91
	Expenses (millions of dollars, except as noted)				
Reserve Banks .....	152	214	235	7.4	9.8
Percent of total .....	13.6	15.2	15.6	... ..	... ..
Board of Governors <sup>1</sup> .....	5.9	11.8	13.3	14.0	12.7
Percent of total .....	7.2	11.4	12.1	... ..	... ..
	Personnel (number, except as noted)				
Reserve Banks .....	1,192	2,228	2,304	3.1	3.4
Percent of total .....	8.3	9.4	9.7	... ..	... ..
Examiners .....	835	1,016	1,075	4.0	5.8
Board of Governors <sup>1</sup> .....	138	174	181	4.6	4.0
Percent of total .....	8.6	11.2	11.6	... ..	... ..

1. Division of Banking Supervision and Regulation in the Consumer Affairs, Legal, and Research Divisions.  
only. Excludes supervision-related expenses and personnel

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# *Appendixes*

## *Appendix A*

# *Mission and Operational Areas of the Federal Reserve System*

The Federal Reserve Banks and the Board of Governors have established four major operational areas to account for their activities: monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, and services to the U.S. Treasury and other government agencies.<sup>1</sup> This appendix describes each of these areas in detail.

## **Monetary and Economic Policy**

The Federal Reserve contributes to the attainment of the nation's economic and financial goals through its ability to influence money and credit in the economy. The System has several tools to affect the availability and cost of the nation's money and credit: setting reserve requirements; setting the discount rate (which affects the cost of borrowing); and the primary tool of monetary policy, open market operations.

The seven-member Board of Governors sets reserve requirements, and it acts on requests from the Federal Reserve Banks to adjust the discount rate. The Federal Open Market Committee (FOMC) meets in Washington eight times per year, usually twice each business quarter, to set policies for System open market operations; it comprises the

Board, the President of the Federal Reserve Bank of New York, and, on a rotating basis, the presidents of four other Reserve Banks.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public in weekly and monthly statistical releases in such areas as the monetary aggregates, interest rates, bank credit, and exchange rates. The research staffs at the Board and the Reserve Banks use this information, along with data collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background for the Board and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. In addition, they conduct longer-run economic studies of issues at the regional, national, and international levels.

## **Services to the U.S. Treasury and Other Government Agencies**

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Federal Reserve Banks, the government issues its checks and payments and collects its receipts. The Reserve Banks also process wire transfers of funds and automated clearinghouse payments and give the Treasury daily statements of account activity.

Beyond these typical depository activities, the Federal Reserve Banks provide

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1. Services to the U.S. Treasury and other government agencies is an operational area unique to the Federal Reserve Banks. The fourth operational area for the Board of Governors, System policy direction and oversight, provides resources for the supervision of Board and Bank programs and is discussed in chap. 2.



several unique services to the government. They monitor the tax receipts deposited in the 12,833 tax and loan accounts maintained by depository institutions designated to perform this function, they hold the collateral that those institutions pledge to support those and other government deposits, and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable Treasury securities as well as all U.S. savings and retirement plan bonds. In another unique fiscal service, the Reserve Banks redeem food coupons for the Department of Agriculture and destroy them.

### **Services to Financial Institutions and the Public**

The Federal Reserve System plays a central role in the nation's payments mechanism, which consists of many independent systems designed to move funds among financial institutions across the country. The Federal Reserve distributes currency and coin, processes checks for collection, operates electronic funds transfer networks, and provides for transfers of securities and for coupon collection.

Ensuring that the supply of currency and coin meets the public's demand for cash is the responsibility of the Federal Reserve. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions. The Banks use highly sophisticated equipment to count cash, identify counterfeits, and destroy currency that is unfit for circulation. In 1990 the Reserve Banks paid out \$277.8 billion in currency and \$4.4 billion in coin and destroyed \$65.9 billion of unfit currency.

The Reserve Banks collect and clear checks under the specific authority of the Federal Reserve Act of 1913. The Banks, Branches, and regional check-processing centers currently clear approximately 18.5 billion checks each year with an average daily value of more than \$50 billion. Most checks deposited with the Federal Reserve by financial institutions are collected on the day they are deposited or on the next business day.

The Federal Reserve also plays a central role in the nation's payments mechanism through its wire transfer system, Fedwire. Depository institutions can draw on their reserves or clearing accounts at the Reserve Banks through Fedwire and transfer funds anywhere in the country. Approximately 6,653 depository institutions use Fedwire through direct computer connections with Federal Reserve Banks, and another 4,696 institutions use Fedwire through off-line means such as telephone. During 1990, approximately 64 million transfers valued at about \$199 trillion were sent over Fedwire, an average of \$3.1 million per transfer and \$793 billion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing-account balances. Users of net settlement service include local check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds and securities transfer networks. In 1990, approximately 850,000 net settlement entries were processed by the Reserve Banks.

Approximately 29,700 depository institutions participate in the Federal Reserve's ACH service, which makes one-time and recurring payments electronically instead of by check. The depository institutions use the ACH for credit transactions, primarily to pay

salaries and pensions, and for debit transactions such as preauthorized bill payments and cash concentration debits. Of the approximately 12,300 ACH endpoints, 2,600 have electronic connections with the Federal Reserve; the others receive payment data via magnetic tapes or paper registers. In 1990 the Reserve Banks processed more than 1.3 billion ACH transactions valued at about \$4.3 trillion; thirty-seven percent of the transactions were for the federal government, and the rest were commercial.

The securities services provided by the Reserve Banks cover the handling of book-entry securities and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables holders of government agency securities to transfer them electronically to other institutions throughout the country. The Reserve Banks maintained approximately 15,600 book-entry accounts in 1990 and processed approximately 10.9 million securities transfers.

In the definitive securities service, the Banks store physical securities ineligible for maintenance on the Federal Reserve's book-entry system. The Federal Reserve held about \$18.4 billion of such securities in priced accounts at the end of 1990.

In its noncash collection service, the Federal Reserve presents coupons, bonds, and miscellaneous items, such as bankers acceptances and certain checks and drafts, for collection. Coupon collection, which accounts for approximately 98 percent of the transactions in this service, amounted to 3.2 million coupon envelopes in 1989 and about 2.9 million coupon envelopes in 1990.

## Supervision and Regulation

Under the authority of the Federal Reserve Act and the Bank Holding Com-

pany Act, the Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. Under the Bank Holding Company Act, the Board is responsible for ensuring that all activities of bank holding companies are "closely related to banking and a proper incident thereto." The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies; review applications for mergers, acquisitions, and changes in control from banks and bank holding companies; and take formal supervisory actions. The System makes available to the public nonidentifying information it periodically collects on the condition and income of banks and bank holding companies.

Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

During 1990 the System maintained the intensified supervision program for state member banks and bank holding companies that was implemented five years ago as a result of the increase in the number of bank failures and problem banks. In 1990 the Board and the Reserve Banks examined approximately 764 state member banks, inspected approximately 2,173 bank holding companies and their subsidiaries, and reviewed approximately 2,676 international and domestic applications.

The Board enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1990 the System con-

ducted approximately 550 compliance examinations.

The Board's supervisory responsibilities also extend to foreign operations of U.S. banks and, under the International Banking Act, to U.S. operations of foreign banks. ■

## *Appendix B*

### *Budget Processes*

As a group, the Reserve Banks follow a budgeting process distinct from that of the Board of Governors. This appendix surveys those processes and explains PACS, the planning and control system that the Banks use for accounting.

#### **The Budget and Control Process of the Board of Governors**

The Board involves all levels of its management in a planning, budget, and control process based on the calendar year. Under authority delegated by the Chairman, the administrative governor oversees the process to ensure that all elements are coordinated, objectives are achieved, and duplication of effort is avoided.

The Board structures its budget in four operational areas: economic and monetary policy, supervision and regulation of financial institutions, services to financial institutions and the public, and System policy direction and oversight. Costs for data processing are distributed to the four major areas according to usage. Expenses for other elements of support and overhead are allocated to the four areas in proportion to the share of direct costs attributable to each area.

#### **The Budget Schedule**

In the spring, each division at the Board reviews its goals and resource requirements by obtaining guidance from functional oversight committees made up of Board Members, by participating in System planning sessions, and by conducting division planning sessions. The management of each division lists events likely to affect the division's budget and

estimates budget changes associated with those events. Simultaneously, the Office of the Controller prepares a budget estimate based on the current level of operation, taking into account known or anticipated factors such as wage and benefit increases and changes in costs for goods and services. The controller uses this projection of expenses, with the estimates from the other divisions and guidance from the Board's oversight committees, to estimate a budget guideline. The Chairman and the administrative governor review the proposed guideline before it is submitted to the Board in June. Using the staff analyses, the Board approves a guideline in an open meeting, and the divisions use the guideline to develop their budgets.

During the summer, the divisions prepare their budgets, and first the Board's controller and staff director for management and then the appropriate functional oversight committees review them. These reviews usually result in adjustments to the proposed budgets. The administrative governor then presents the consolidated budget proposal to the Chairman for his review and comments. In early December, at an open meeting, the budget is presented to the Board of Governors for action.

#### **The Budget of the OIG**

The Board's Office of Inspector General (OIG), in accordance with its statutory independence, prepares its proposed budget apart from the oversight and guideline process just described and submits it directly to the Board without formal staff review. The Board may seek staff assistance in reviewing the budget of

the OIG before reviewing and approving it at the same open meeting as the regular budget.<sup>1</sup>

### Treatment of Capital Expenditures

In 1985 the Board began capitalizing certain assets and depreciating their value over appropriate time periods, instead of expensing them in their year of purchase. Capitalizing, which is in accordance with generally accepted accounting principles, more closely aligns the cost of capital assets with their periods of service and is consistent with the accounting practices followed by the Reserve Banks.

### Assessments

After the Board adopts its budget, the cash requirement for the first half of the year is estimated. The administrative governor reviews and approves this estimate in early January and, as the Federal Reserve Act provides, the required amount is raised by an assessment on each of the Reserve Banks in proportion to its capital stock and surplus. The cash requirement for the second half of the year is estimated in June, and the second assessment is made in July. To minimize cash balances held by the Board, funds are transferred quarterly.

### Financial Monitoring and Control

All levels of Board management monitor and review Board expenses throughout the budget year. To facilitate this process, each division constructs quarterly operating plans. Administrative management observes performance against these plans

monthly and submits quarterly reports to the Board.

At midyear, the controller and staff director for management review current expenses with each division director, estimate expenses for the entire year, and submit the estimate to the Board with any recommendations for reallocations. The midyear review helps control current expenses and provides a baseline for analyzing budget requests. At the beginning of the next year, the controller and the staff director for management report to the Board on the previous year's performance against budget and operating goals.

### The Budget and Control Process of the Federal Reserve Banks

Each year the Federal Reserve Banks, like the Board, establish major operating goals for the calendar year, devise strategies for their attainment, estimate required resources, and monitor results of current operations and financial performance.

### The Budget Process

A task force drawn from staff members of the Board and the Reserve Banks develops a proposed budget guideline for the coming year based on forecasts of changes in workload and productivity at the Reserve Banks. The Conference of First Vice Presidents and the Conference of Presidents of the Reserve Banks review the work of the task force and, if necessary, revise it before sending it to the Board of Governors. The Board determines the appropriateness of the proposed level of spending and at about midyear communicates the budget objective to the Reserve Banks for their guidance in developing plans and budgets. To plan for priced services, the

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1. Operations of the OIG are also discussed in chapter 2 and appendix E.

Banks update a multiyear strategic statement.

The management of each Bank department develops its budget based on workloads, required initiatives, and the budget objective. Senior Bank officials review the departmental requests and, with the president and first vice president, determine priorities for the overall budget level to be recommended to the Bank's board of directors. In the fall, the Board of Governors approves the budget of each Reserve Bank as well as the fee schedule for priced services, which is developed simultaneously with the budget data.

### The Capital Budget Process

The Reserve Banks account for capital expenditures in accordance with generally accepted accounting principles and, therefore, include depreciation of capital assets in expenses. Technical staff members at the Board review all plans for large capital expenditures, whether for buildings, automation equipment, furnishings, or land. The staff members then make recommendations to the director of the Division of Reserve Bank Operations and Payment Systems or to the Board of Governors, depending on the significance of the item or project.

### Review at the Board of Governors

In the fall, analysts at the Board review the budgets of each Reserve Bank and note Systemwide issues to be addressed during the budget review. They analyze the executive summary and the statement of objectives in each budget in light of the Bank's own trends, plans at the other Banks, the System budget objective and the cost-recovery objectives for priced services. The product directors and the

Pricing Policy Committee examine the budgets for priced services.<sup>2</sup> A committee of three governors reviews the budget of each Reserve Bank and meets directly with the president and first vice president of each Bank to discuss issues and directions. Following review by the committee of three governors, all Bank budgets are sent to the Board of Governors for action at a public meeting in December.

### Special Projects

Special projects are those few research and development efforts that have the potential for a major improvement in the nation's payments mechanism or in the Federal Reserve's ability to provide services. Because of their long-range importance, special projects are approved separately from the process described above, which focuses on operational costs. Although not included in the budget objective, these projects are individually approved by the conference of presidents and the Board of Governors, and their effect on total system outlays is carefully reviewed. Two such projects, described in appendix C, have been approved for 1991.

### The Planning and Control System

The Planning and Control System (PACS), implemented by the Reserve Banks in 1977, is the fundamental cost accounting system for all the services provided by the Banks, whether priced or

2. The product directors are the first vice presidents at selected Reserve Banks with responsibility for day-to-day policy guidance over specific Systemwide priced services. The Pricing Policy Committee comprises one governor, the Board's staff director for Federal Reserve Bank activities, the presidents of two Reserve Banks, and the first vice presidents of two other Reserve Banks.

nonpriced, special or routine. Under PACS, budgets can be compared with actual expenses by service and object, and the Board of Governors can compare the financial and operating performances of the Reserve Banks.

PACS groups all costs by major services, shown here under the four operational areas and support and overhead (see the accompanying list). The costs of support and overhead, in turn, are fully allocated to the four operational areas. PACS offers a detailed analysis of all these services and activities, including productivity statistics (primarily unit costs and items per employee-hour),

“environmental” statistics (to clarify the differences among the Banks’ operating environments), and “quality” statistics (to measure performance).

PACS affords the Banks a review of expenses, an audit trail, and expense accountability. Through periodic on-site reviews, the Board confirms that the Reserve Banks are complying with PACS instructions and also with System guidelines set by the Board. In addition, the General Accounting Office and an outside public accounting firm have determined in independent examinations that PACS is an appropriate and effective accounting mechanism for the Federal Reserve.

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#### Federal Reserve Bank Services

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##### OPERATIONAL AREAS

*Monetary and economic policy*  
Economic policy determination  
Open market trading

*Services to the U.S. Treasury  
and other government agencies*  
Savings bonds  
Centralized operations—savings bonds  
Other Treasury issues  
Centralized operations—other Treasury issues  
Centrally provided Treasury and agency services  
Government agency issues  
Other Treasury and government agency services  
Treasury and other government coupons  
Food coupons  
Government accounts

*Services to financial institutions and the public*  
Special cash service  
Currency  
Coin  
Transfer of account balances  
Automated clearinghouse  
Commercial check  
Other check  
Book-entry securities  
Definitive securities  
Loans to depository institutions and others  
Noncash collection  
Public programs  
Other

*Supervision and regulation*  
Supervision of District financial institutions  
Administration of laws and regulations  
related to banking  
Studies of banking and financial market structure

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##### SUPPORT AND OVERHEAD

*Support*  
Data services  
Centrally provided support  
Occupancy service  
Printing and supplies  
Centralized planning  
District projects

*Overhead*  
Administration  
System projects and contingency processing center  
Special projects  
Mail  
Legal  
General books and budget and expense control  
Files and records storage  
Personnel  
Purchasing  
Protection  
Motor vehicles  
Library  
Telephone  
Audit

## Appendix C

# *Special Categories of System Expense*

This appendix discusses System expenses for priced services, capital assets, special projects, and currency.

## **Priced Services**

The Monetary Control Act of 1980 (MCA) requires the Federal Reserve to make available to all depository institutions, for a fee, certain services that the Federal Reserve had previously provided without explicit charge and only to member banks. As the act requires, the cost of providing these services includes all direct and indirect costs, the interest on items credited before actual collection (float), and the private sector adjustment factor (PSAF). The PSAF is the return on capital that would have been provided and the taxes that would have been paid had the services been furnished by a private business firm.

The Federal Reserve has developed an annual pricing process, which involves a review of Reserve Bank expenses in addition to the one required by the budget process, to meet the requirements for the full recovery of costs. Use of the budgets is an integral part of the pricing exercise because most of the recoverable costs of priced services consist of direct and indirect costs as determined by the budgets. To assist depository institutions in their planning to provide or use correspondent banking services, the Federal Reserve usually sets each year's prices only once, in the fourth quarter of the preceding year.

Fees for Federal Reserve services must be approved by the product director for the respective service, by the Pricing Policy Committee, and ultimately by the

Board of Governors.<sup>1</sup> If fees for any service are set so that the full recovery of costs is not anticipated, the Board announces the rationale.

The cost of float is estimated by applying the current federal funds rate to the level of float expected in the coming year. Estimates for income taxes and the return on capital are based on tax and financing rates derived from a model of the fifty largest U.S. bank holding companies; these rates are applied to the assets the Federal Reserve expects to use in providing priced services in the coming year. The other components of the PSAF are derived from the budgets of the Reserve Banks: the imputed sales tax (based on budgeted outlays for materials, supplies, and capital assets); the assessment for insurance by the Federal Deposit Insurance Corporation (FDIC) on expected clearing balances and on deferred funds for items deposited for collection with the Reserve Banks; and the portion of the expenses of the Board of Governors that is related directly to the development of priced services.

The inclusion of all these costs means the Federal Reserve offers its priced services on a basis comparable to that in the private sector, and the discipline of the market ensures that the prices charged will be no higher than necessary.

## **Calculation of the PSAF for 1991**

In 1990 the Board approved a 1991 private sector adjustment factor of \$85.8

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1. See appendix B, note 2, for a description of the position of product director and of the Pricing Policy Committee.



million, an increase of \$6.4 million, or 8.1 percent, from the PSAF of \$79.4 targeted for 1990.

### *Asset Base*

The estimated value of Federal Reserve assets to be used in providing priced services in 1991 is \$6,203.0 million (table C.1). The value of assets assumed to be financed through debt and equity is \$530.7 million in 1991, an increase of \$43.0, or 8.8 percent, from 1990

(table C.2). This increase results largely from capital expenditures for bank premises planned by the Reserve Banks next year and from an increase in short- and long-term prepayments of equipment maintenance costs.

### *Cost of Capital and Taxes and Other Imputed Costs*

For 1991, a pretax rate of return on equity of 14.5 percent is planned. Other required PSAF recoveries for 1991—

*Table C.1*

Pro Forma Balance Sheet for Federal Reserve Priced Services, 1990-91<sup>1</sup>

Millions of dollars

Asset or liability	1990	1991
<b>ASSETS</b>		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances .....	286.3	244.1
Investment in marketable securities .....	2,099.4	1,790.4
Receivables <sup>2</sup> .....	32.0	32.8
Materials and supplies <sup>2</sup> .....	7.1	8.2
Prepaid expenses <sup>2</sup> .....	9.6	13.7
Items in process of collection <sup>3</sup> .....	3,838.9	3,637.5
Total short-term assets .....	6,273.3	5,726.7
<i>Long-term assets</i>		
Premises <sup>2,3</sup> .....	295.5	305.3
Furniture and equipment <sup>2</sup> .....	141.5	146.8
Leasehold improvements and long-term prepayments <sup>2</sup> .....	2.0	23.9
Capital leases .....	1.9	.3
Total long-term assets .....	440.9	476.3
<b>Total assets</b> .....	<b>6,714.2</b>	<b>6,203.0</b>
<b>LIABILITIES</b>		
<i>Short-term liabilities</i>		
Clearing balances and balances arising		
from early credit of uncollected items .....	2,838.7	2,466.7
Deferred-credit items .....	3,385.9	3,205.3
Short-term debt <sup>4</sup> .....	48.7	54.7
Total short-term liabilities .....	6,273.3	5,726.7
<i>Long-term liabilities</i>		
Obligations under capital leases .....	2.0	.3
Long-term debt <sup>4</sup> .....	139.1	154.8
Total long-term liabilities .....	141.0	155.1
Total liabilities .....	6,414.3	5,881.8
Equity <sup>4</sup> .....	299.9	321.2
<b>Total liabilities and equity</b> .....	<b>6,714.2</b>	<b>6,203.0</b>

1. Data are averages for the year.

2. Financed through the PSAF; other assets are self-financing.

3. Includes allocations of Board of Governors' assets to

priced services of \$0.3 million for 1990 and \$0.5 million for 1991.

4. Imputed figures representing the source of financing for certain priced-service assets.

imputed sales taxes, FDIC insurance, and Board expenses—total \$19.9 million, up from \$15.9 million approved for 1990 (table C.2). The increase in the PSAF of \$4.9 million is attributable primarily to a rise in the rate assessed against deposits in computing the imputed FDIC insurance assessment. It is offset partially by a reduction of \$1.2 million in imputed sales taxes because of a lower assumed rate of capital investment.

## Capital Outlays

In accordance with generally accepted accounting principles (GAAP), the Federal Reserve System depreciates the cost of fixed assets over their estimated useful lives. In the federal government, where no requirement exists for depreciation accounting, the cost of fixed assets is typically recorded as an expense at the time of purchase. However, the *Policy*

Table C.2

Derivation of the Private Sector Adjustment Factor, 1990–91

Millions of dollars, except as noted

Item	1990	1991
<b>PSAF COMPONENTS</b>		
<i>Assets to be financed</i> <sup>1</sup>		
Short-term .....	48.7	54.7
Long-term <sup>2</sup> .....	439.0	476.0
Total .....	487.7	530.7
<i>Cost of capital (percent)</i> <sup>3</sup>		
Short-term debt .....	7.3	8.6
Long-term debt .....	9.6	9.4
Pretax return on equity <sup>4</sup> .....	15.5	14.5
Weighted average .....	13.6	12.9
<i>Capital structure (percent)</i>		
Short-term debt .....	10.0	10.3
Long-term debt .....	28.5	29.2
Equity .....	61.5	60.5
Total .....	100.0	100.0
Tax rate (percent) <sup>4</sup> .....	27.8	30.5
<b>REQUIRED PSAF RECOVERIES</b>		
<i>Capital costs</i> <sup>5</sup>		
Short-term debt .....	3.5	4.7
Long-term debt .....	13.3	14.5
Equity .....	46.6	46.7
Total .....	63.5	65.9
<i>Other costs</i>		
Sales taxes .....	9.9	8.7
Assessment for federal deposit insurance .....	4.3	9.2
Expenses of Board of Governors .....	1.7	2.0
Total .....	15.9	19.9
<b>Total PSAF recoveries</b>		
Millions of dollars .....	79.4	85.8
As a percent of capital .....	16.3	16.2
As a percent of expenses .....	14.2	14.7

1. The asset base for priced services is directly determined.

2. Total long-term assets less capital leases that are self-financing.

3. All short-term assets are assumed to be financed by short-term debt. Of the total long-term assets, 33 percent are assumed to be financed by long-term debt and 67 percent by equity. The data are average rates paid by the bank holding companies included in the sample.

4. The pretax rate of return on equity is based on average after-tax rates of return on equity, adjusted by the effective tax rate to yield the pretax rate of return on equity for each bank holding company for each year. These data are then averaged over the five years 1985–89 to yield the pretax return on equity for use in the PSAF.

5. The calculations underlying these data use the dollar value of assets to be financed, divided as described in note 3, and the rates for the cost of capital.

and Procedures Manual for Guidance of Federal Agencies of the General Accounting Office, which governs accounting procedures in the federal government, specifies in title 2 the use of depreciation accounting for business types of operations and for activities that recover costs from reimbursements or user charges. Certain activities of the Federal Reserve meet both of these criteria. Under GAAP, the cost of acquiring an asset that is expected to benefit an entity over future periods should be allocated over those periods. Such treatment allows a more realistic measurement of operating performance.

The Banks capitalize and depreciate all assets that cost \$1,500 or more; they can either capitalize or expense assets costing less. The capitalization guideline for the Board is \$1,000.

The Banks maintain a multiyear plan for capital spending. The Board, in turn, requires the Banks to budget annually for capital outlays by capital class to estimate the effect of total operating and capital spending. During the budget year, the Banks must submit proposed major purchases of assets to the Board for further review and approval. The Board of Governors reviews capital expenditures for the Board.

## Special Projects

For 1990 the Board of Governors has approved research and development for two projects intended to provide long-range benefits to the Federal Reserve and the banking industry. Because the spending on such projects is relatively high and short-term, the Federal Reserve accounts for it separately from its operating expenses.

## Digital Imaging of Checks

In mid-1985 the Conference of First Vice Presidents authorized the testing of digital

technologies to record check images for use in various check processing functions. The applications chosen for the testing were the archiving of check payment information for the Department of the Treasury and the processing of return items. These check processes involve the storage of large amounts of data and require a high level of quality in the retrieved image.

The research and development project on the processing of check images will continue to build upon the first five years of results. The focus during 1991 will be on the systems development of a high-speed government-check archival system; of personal computer systems for potential applications such as return item processing; and of low-speed systems that will be efficient in very low-volume applications in the near term. The 1991 budget for these efforts is \$3.7 million.

## Authentication of Currency

In 1988 the Federal Reserve initiated a special project for the development of an optical counterfeit-detection system (OCDS). During 1989 the project was renamed "Development of Cur-

*Table C.3*

Currency in Circulation, New Notes Issued, and Notes Destroyed, 1990 Estimate

Millions of pieces

Dollar denomination	Notes in circulation <sup>1</sup>	New notes paid out <sup>2</sup>	Notes destroyed <sup>2</sup>
1 .....	4,776	3,185	3,061
2 .....	415	16	4
5 .....	1,170	889	834
10 .....	1,172	792	791
20 .....	3,249	1,704	1,632
50 .....	643	176	128
100 .....	1,327	319	112
<b>Total .....</b>	<b>12,752</b>	<b>7,081</b>	<b>6,562</b>

1. As of September 1990.

2. Based on actual levels through November 1990 and expected levels for December 1990. Notes paid out do not include additions to inventory at the Reserve Banks.

rency Authentication Systems" because research efforts included not only OCDS but also other alternatives for authentication.

OCDS is an effort to improve capabilities for counterfeit detection for enhancing the currency service provided to financial institutions and the public. Other development efforts under way in counterfeit deterrence include long- and short-term authentication alternatives that are expected to increase the Federal Reserve's ability to detect counterfeit currency. All of these efforts should produce counterfeit detector devices to be placed on the Federal Reserve's high speed currency-processing equipment.

The 1991 special project budget includes \$3.9 million in support of these efforts.

### Currency Printing

The Bureau of Engraving and Printing produces currency; the Federal Reserve

Banks put it into circulation through depository institutions and destroy it as it wears out. The Federal Reserve Act stipulates that the costs of producing currency, as well as the costs of putting it into circulation and destroying it, are to be assumed by the Federal Reserve System (table C.3).

New currency is printed to replace worn notes and to accommodate increases in the demand for circulating currency (table C.4). Notes are also required for inventories held by the Reserve Banks to meet changes in demand.

To minimize the number of new notes ordered and the cost of their printing, the Board consults with the Bureau of Engraving and Printing to ensure that it uses efficient methods, maintains System guidelines on the quality of notes, and sees that Reserve Banks do not destroy notes prematurely. The Board and the Banks also monitor all related costs, such as those for transportation and packaging.

*Table C.4*

Costs to the Federal Reserve of New Currency, 1989-91

Millions of dollars, except as noted

Item	1989 actual	1990 estimated	1991 budget	Percent change, 1990-91
Printing <sup>1</sup> .....	168.2	183.7	252.0	37.2
Shipping from Washington .....	4.0	5.0	5.5	10.0
Reimbursement to the Treasury for issuance and retirement .....	2.0	1.4	1.7	21.4
<b>Total costs of currency</b> .....	<b>174.4</b>	<b>190.1</b>	<b>259.2</b>	<b>36.3</b>

1. Based on 6.3 billion notes in 1989, 7 billion notes in 1990, and 8 billion notes in 1991.

## Appendix D

### *Sources and Uses of Funds*

The Federal Reserve System, in accordance with generally accepted accounting principles, accrues income and expenses and capitalizes acquisitions of assets whose useful lives extend over several years (see appendix C).

The System derives its income primarily from U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. These earnings account for approximately 85 percent of current income (table D.1).

The current expenses of the Reserve Banks consist of their operating expenses

and the costs of the earnings credits granted to depository institutions on clearing balances held with the Reserve Banks (table D.2). The Reserve Banks record extraordinary adjustments to current net income in a profit and loss account. The primary entries in the account are for gains or losses on the sale of U.S. government securities and for gains or losses that result either from the sale of assets denominated in foreign currencies or from the revaluation of those assets at market exchange rates.

The Reserve Banks retain a surplus to cushion unexpected losses, much as commercial establishments retain earnings. The Board of Governors requires that the surplus equal the capital paid in by the member banks. Since the end of 1964, the Board's policy has been to transfer to the Treasury all net income after paying the statutory dividend to member banks and the amount necessary to equate surplus to paid-in capital. The amount transferred is classified as interest on Federal Reserve notes. Such payments were \$21.6 billion in 1989 and are estimated to be \$23.6 billion in 1990.

*Table D.1*

Income of the Federal Reserve System,  
1990-91

Millions of dollars

Source	1989 actual	1990 estimate
Loans .....	396.9	117.9
U.S. government securities ...	20,064.6	19,994.5
Foreign currencies .....	1,037.4	2,603.8
Priced services .....	702.4	729.5
Other.....	47.9	28.9
<b>Total.....</b>	<b>22,249.3</b>	<b>23,474.6</b>

Table D.2

## Distribution of the Income of the Federal Reserve System, 1989-90

Millions of dollars

Item	1989 actual	1990 estimate
Current income <sup>1</sup> .....	22,249	23,475
LESS		
<i>Current expenses of Reserve Banks</i> <sup>2</sup>		
Operating expenses .....	1,184	1,211
Costs of earnings credits .....	148	134
EQUALS		
Current net income .....	20,917	22,130
PLUS		
Net additions to, or deductions from (-), current net income <sup>3</sup> .....	1,296	2,220
LESS		
Cost of unreimbursed Treasury services <sup>4</sup> .....	41	100
<i>Assessments by Board</i>		
Board expenses .....	90	104
Cost of currency .....	175	193
<i>Other distributions</i>		
Dividends paid to member banks <sup>5</sup> .....	130	141
Transfers to, or from (-), surplus <sup>6</sup> .....	131	180
EQUALS		
<b>Payment to U.S. Treasury</b> .....	<b>21,646</b>	<b>23,633</b>

1. See table D.1.

2. Net of reimbursements due from the U.S. Treasury and other government agencies. Reflects reductions of \$46.7 million in 1989 and \$60.5 million in 1990 in credits for net periodic pension cost.

3. This account is the same as that reported under the same name in the table "Income and Expenses of the Federal Reserve Banks," in the Statistical Tables section of the Board's *Annual Report* and includes gains and losses on foreign exchange transactions due primarily to revaluations at market exchange rates; gains and losses on sales of U.S.

government securities; and miscellaneous gains and losses.

4. The cost of services provided to the U.S. Treasury that are reimbursable under agreements with the Treasury and for which reimbursement is not anticipated.

5. The Federal Reserve Act requires the Federal Reserve to pay dividends to member banks at the rate of 6 percent of paid-in capital.

6. Each year the Federal Reserve transfers to its surplus account an amount sufficient to equate surplus to paid-in capital to provide a reserve against losses.

## Appendix E

### Federal Reserve System Audits

The Board of Governors, each of the Reserve Banks taken separately, and the Federal Reserve System as a whole are all subject to several levels of audit and review. At each Federal Reserve Bank, a full-time staff of auditors under the direction of a general auditor reports directly to the Bank's board of directors. The Board's Division of Federal Reserve Bank Operations, acting on behalf of the Board of Governors, regularly audits the financial operations of each of the Banks and periodically reviews all other Bank operations. The Office of Inspector General conducts audits, operations reviews, and investigations of the programs and operations of the Board and those Board functions delegated to the Federal Reserve Banks. The OIG retains an independent auditor each year to certify the fairness of the Board's financial

statements and its compliance with laws and regulations affecting those financial statements.

#### General Accounting Office

The 1978 passage of the Federal Banking Agency Audit Act (Public Law 95-320) brought most of the operations of the Federal System under the purview of the General Accounting Office (GAO). The GAO, which currently has 21 projects in various stages of completion, since 1979 has completed 81 reports on selected aspects of Federal Reserve operations (tables E.1 and E.2). The GAO has also involved the Federal Reserve in about 61 other reviews not directly related to the System and has terminated 35 others before completion. The reports are available directly from the GAO.

Table E.1

Active GAO Projects Relating to the Federal Reserve

Subject	Date initiated
Proposals for dealing with the international debt crisis	10/27/88
Economic sanctions imposed on Panama	1/19/89
Foreign direct investment	2/9/89
International money laundering	3/8/89
Capital adequacy	10/6/89
Fraud backlog cases	11/8/89
East-West financial relations	12/1/89
Deposit insurance outside the United States	12/15/89
Deposit insurance issues	12/20/89
Anticompetitive service contracts	2/21/90
Capital adequacy standards for international banks	3/14/90
Capital adequacy standards for securities brokers-dealers	3/14/90
Foreign affiliates of U.S. brokers-dealers	3/14/90
Expedited funds availability requirement	3/28/90
Federal tax deposit system	4/9/90
Agencies' information collecting of foreign economies and trade	4/19/90
CCC control over foreign institutions	5/15/90
Federal agencies' drug-testing programs	8/8/90
Collecting and disseminating thrift and bank call report data	9/4/90
Criminal cases from financial-institution fraud	11/2/90
GSE's capital and regulation	12/5/90

Table E.2

## Completed GAO Reports Relating to the Federal Reserve System

Report	Number	Date
Comparing Policies and Procedures of the Three Bank Regulatory Agencies .....	GGD-79-27	3/29/79
Are OPEC Financial Holdings a Danger to U.S. Banks or the Economy? ..	EMD-79-45	6/11/79
Federal Systems Not Designed to Collect Data on All Foreign Investments in U.S. Depository Institutions .....	GGD-79-42	6/19/79
Considerable Increase in Foreign Banking in United States since 1972 ...	GGD-79-75	8/1/79
Investment Policies, Practices and Performance of Federal Retirement Systems .....	FPCD-79-17	8/31/79
Federal Supervision of Bank Holding Companies Needs Better, More Formalized Supervision .....	GGD-80-20	2/12/80
The Federal Reserve Should Assure Compliance with the 1970 Bank Holding Company Act Amendments .....	GGD-80-21	3/12/80
Federal Agencies' Initial Problems with the Right to Financial Privacy Act of 1978 .....	GGD-80-64	5/29/80
Internal Auditing Can Be Strengthened in the Federal Reserve System Despite Positive Effects, Further Foreign Acquisitions of U.S. Banks Should Be Limited until Policy Conflicts Are Fully Addressed .....	GGD-80-59	8/8/80
	GGD-80-66	8/26/80
Federal Examinations of Financial Institutions: Issues That Need to Be Resolved .....	GGD-81-12	1/6/81
Examinations of Financial Institutions Do Not Assure Compliance with Consumer Credit Laws .....	GGD-81-13	1/21/81
Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings .....	AFMD-81-27	1/23/81
An Economic Overview of Bank Solvency Regulation .....	PAD-81-25	2/13/81
Federal Reserve Security over Currency Transportation Is Adequate .....	GGD-81-27	2/23/81
The Federal Structure for Examining Financial Institutions Can Be Improved .....	GGD-81-21	4/24/81
Response to Questions Bearing on the Feasibility of Closing the Federal Reserve Banks .....	GGD-81-49	5/21/81
Bank Secrecy Act Reporting Requirements Have Not Met Expectations, Suggesting Need for Amendment .....	GGD-81-80	7/23/81
Federal Reserve Could Improve the Efficiency of Bank Holding Company Inspections .....	GGD-81-79	8/18/81
Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of their Examination and Supervision Activities .....	GGD-82-5	10/19/81
Information on Selected Aspects of Federal Reserve System Expenditures ..	GGD-82-33	2/12/82
Federal Review of Intrastate Branching Can Be Reduced Despite Improvements, Recent Bank Supervision Could Be More Effective and Less Burdensome .....	GGD-82-31	2/24/82
	GGD-82-21	2/26/82
Issues to Be Considered while Debating Interstate Bank Branching .....	GGD-82-36	4/9/82
The Federal Reserve Should Move Faster to Eliminate Subsidy of Check-Clearing Operations .....	GGD-82-22	5/7/82
Information about Depository Institutions' Ancillary Activities Is Not Adequate for Policy Purposes .....	GGD-82-57	6/1/82
Bank Merger Process Should Be Modernized and Simplified .....	GGD-82-53	8/16/82
An Analysis of Fiscal and Monetary Policies .....	PAD-82-45	8/31/82
Bank Examination for Country Risk and International Lending .....	ID-82-52	9/2/82
Credit Insurance Disclosure Provisions of the Truth-in-Lending Act Consistently Enforced Except When Decisions Appealed .....	GGD-83-3	10/25/82
Survey of Investor Protection and the Regulation of Financial Intermediaries .....	GGD-83-30	7/13/83
Financial Institutions Regulatory Agencies Can Make Better Use of Consumer Complaint Information .....	GGD-83-13	8/25/83
Expediting Tax Deposits Can Increase the Government's Interest Earnings .....	GGD-84-14	11/21/83
Unauthorized Disclosure of the Federal Reserve's Monetary Policy Decision .....	GGD-84-40	2/3/84
Federal Financial Institutions Examination Council Has Made Limited Progress toward Accomplishing Its Mission .....	GGD-84-4	2/3/84
Control Improvements Needed in Accounting for Treasury Securities at the Federal Reserve Bank of New York .....	AFMD-84-10	5/2/84
Statutory Requirements for Examining International Banking Institutions Need Attention .....	GGD-84-39	7/11/84



Table E.2

Continued

Report	Number	Date
Supervisory Examinations of International Banking Facilities Need to Be Improved .....	GGD-84-65	9/30/84
An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check-Clearing Activities .....	GGD-85-9A	1/14/85
Difficulties in Evaluating the Effectiveness of the Community Reinvestment Act .....	OCE-86-1	11/4/85
International Coordination of Bank Supervision: The Record to Date .....	NSIAD-86-40	2/6/86
Implementation of the Export Trading Company Act of 1982 .....	NSIAD-86-42	2/27/86
Information on Independent Public Accountant Audits of Financial Institutions .....	GGD-84-44FS	4/21/86
An Analysis of Two Types of Pooled Investment Funds .....	GGD-86-63	5/12/86
How the Markets Are Developed and How They Are Regulated .....	GGD-86-26	5/15/86
U.S. Banking Supervision and International Supervisory Principles .....	NSIAD-86-93	7/25/86
Financial Institution Regulators' Compliance Examination .....	GGD-86-94	8/1/86
The Market's Structure, Risks, and Regulation .....	GGD-86-80BR	8/20/86
Dealer Views on Market Operations and Federal Reserve Securities Transfer System .....	GGD-86-147FS	9/29/86
Questions about the Federal Reserve's Securities Transfer System .....	GGD-87-15BR	10/20/86
Federal Reserve Board Opposition to Credit Card Interest Rate Limits ...	GGD-87-38BR	4/7/87
Insulating Banks from the Potential Risk of Expanded Activities .....	GGD-87-35	4/14/87
The Federal Reserve Response Regarding Its Market-Making Standard ..	GGD-87-55FS	4/21/87
Change in Fees and Deposit Account Interest Rates since Deregulation ..	GGD-87-70	7/13/87
An Examination of Views Expressed about Access to Brokers' Services ..	GGD-88-8	12/18/87
Issues Related to Repeal of the Glass-Steagall Act .....	GGD-88-37	1/22/88
Preliminary Observations on the October 1987 Crash .....	GGD-88-38	1/26/88
Supervision of Overseas Lending Is Inadequate .....	NSIAD-88-87	5/5/88
Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom and the United States .....	NSIAD-88-171	6/2/88
Administrative Expenses at FHLBB and FRB for 1985 and 1986 .....	AFMD-88-33	6/15/88
Government in the Sunshine Act Compliance at Selected Agencies .....	GGD-88-97	7/20/88
Trends in Commercial Bank Performance, December 1976-June 1987 ..	GGD-88-106BR	7/28/88
U.S. Commercial Banks' Securities Activities in London .....	NSIAD-88-238	9/8/88
Lending to Troubled Sectors .....	GGD-88-126BR	9/26/88
Government Check-Cashing Issues .....	GGD-89-12	10/7/88
Conflict of Interest: Abuses in Commercial Banking Institutions .....	GGD-89-35	1/27/89
Competitive Fairness Is an Elusive Goal .....	GGD-89-61	5/12/89
Independent Audits Needed to Strengthen Internal Control and Bank Management .....	AFMD-89-25	5/31/89
Information on the System's Check Collection Service .....	GGD-90-17	12/15/89
Oversight of Critical Banking Systems Should Be Strengthened .....	IMTEC-90-14	1/14/90
Activities of Securities of Bank Holding Companies .....	GGD-90-48	3/14/90
The Stock, Options, and Futures Markets Are Still at Risk .....	GGD-90-33	4/11/90
Update on U.S. Commercial Banks' Securities in London .....	NSIAD-90-98	5/7/90
U.S. Financial Services' Competitiveness under the Single Market Program .....	NSIAD-90-99	5/21/90
Limited Public Demand for New Dollar Coin or Elimination of Pennies ..	GGD-90-88	5/23/90
Oversight of Automation Used to Clear and Settle Trades Is Uneven ....	IMTEC-90-47	7/12/90
The Government's Exposure to Risks .....	GGD-90-97	8/15/90
Office of Inspector General Operations at Financial Regulatory Agencies ..	AFMD-90-55FS	8/24/90
Additional Reserves and Reform Needed to Strengthen the Fund .....	AFMD-90-100	9/11/90
More Transaction Information and Investor Protection Measures Are Needed .....	GGD-90-114	9/14/90
Issues Relating to Banks' Selling Insurance .....	GGD-90-113	9/25/90

## Office of Inspector General

The Board's Office of Inspector General functions in accordance with the Inspec-

tor General Act of 1978, as amended. The OIG provides policy direction for audits, operations reviews, and investigations of the programs and operations of

the Board and its delegated functions at the Federal Reserve Banks, and plans and conducts them. The OIG also reviews existing and proposed legislation and regulations for economy and efficiency, and it recommends policies and supervises and conducts activities that promote economy and efficiency and that prevent and detect waste, fraud, and abuse in Board and Board-delegated programs and operations. In addition, it coordinates its efforts with other governmental and nongovernmental agencies to promote economy and efficiency and detect and prevent fraud and abuse in activities administered or financed by the Board. The OIG keeps the Congress and the Chairman of the Board fully informed about serious abuses and deficiencies and about the status of any corrective actions.

During 1990, the OIG reported on six audits and four operations reviews, closed out four investigations, and conducted 584 legislative and regulatory reviews. Audit reports issued during 1990 addressed the Board's information security program; its computer-operating system and the software to control computer access; its revised compensation program for regular staff; sensitive payments to members of the Board and senior staff; and the fairness of the financial statements of the Board and the Federal Financial Institutions Examination Council and each agency's compliance with applicable laws and regulations. Operations review reports were issued on the Offices of the Staff Director for Federal Reserve Bank Activities and the Executive Director for Information Resources Management and on the Divisions of Federal Reserve Bank Operations and Applications Development and Statistical Services. ■

## Appendix F

# Expenses and Employment at the Federal Reserve Banks

Table F.1

Operating Expenses of the Federal Reserve Banks, by District, 1990-91<sup>1</sup>

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	83,548	88,742	5,194	6.2
New York .....	274,843	296,931	22,088	8.0
Philadelphia .....	86,577	82,398	-4,179	-4.8
Cleveland .....	83,141	87,956	4,815	5.8
Richmond .....	110,083	116,644	6,561	6.0
Atlanta .....	134,365	143,128	8,763	6.5
Chicago .....	160,038	171,018	10,979	6.9
St. Louis .....	65,037	69,261	4,224	6.5
Minneapolis .....	66,560	70,520	3,960	5.9
Kansas City .....	91,881	97,753	5,873	6.4
Dallas .....	92,570	98,680	6,109	6.6
San Francisco .....	165,921	177,935	12,014	7.2
<b>Total, all Districts .....</b>	<b>1,414,565</b>	<b>1,500,965</b>	<b>86,400</b>	<b>6.1</b>
Special projects .....	6,617	7,647	1,031	. . .
<b>Total .....</b>	<b>1,421,182</b>	<b>1,508,612</b>	<b>87,430</b>	<b>6.1</b>

1. Excludes capital outlays.

Table F.2

Employment at the Federal Reserve Banks, by District, 1990-91

Average number of personnel, except as noted<sup>1</sup>

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	1,466	1,485	20	1.4
New York .....	4,059	4,080	20	.5
Philadelphia .....	1,329	1,366	37	2.8
Cleveland .....	1,487	1,499	12	.8
Richmond .....	2,045	2,073	28	1.4
Atlanta .....	2,342	2,387	45	1.9
Chicago .....	2,611	2,628	18	.7
St. Louis .....	1,219	1,222	3	.2
Minneapolis .....	1,108	1,099	-9	-.8
Kansas City .....	1,707	1,697	-10	-.6
Dallas .....	1,697	1,714	18	1.0
San Francisco .....	2,629	2,611	-18	-.7
<b>Total, all Districts .....</b>	<b>23,698</b>	<b>23,861</b>	<b>163</b>	<b>.7</b>
Special projects .....	26	1	-25	. . .
<b>Total .....</b>	<b>23,725</b>	<b>23,862</b>	<b>138</b>	<b>.6</b>

1. See chapter 3, note 1, for the definition of average number of personnel (ANP).

*Table F.3*

## Expenses of the Federal Reserve Banks, by Operational Area, 1990-91

Thousands of dollars, except as noted

Operational area	1990 estimate	1991 budget	Change	
			Amount	Percent
Monetary and economic policy .....	99,660	107,512	7,852	7.9
Services to the U.S. Treasury and other government agencies .....	156,137	167,223	11,086	7.1
Services to financial institutions and the public .....	944,392	992,076	47,683	5.0
Supervision and regulation .....	214,376	234,155	19,779	9.2
<b>Total .....</b>	<b>1,414,564</b>	<b>1,500,965</b>	<b>86,400</b>	<b>6.1</b>
MEMO <sup>1</sup>				
Support .....	443,939	479,070	35,131	7.9
Overhead .....	389,081	411,811	22,731	5.8

1. Costs of support and overhead included in expenses by operational area. Support refers to activities, such as data processing, whose costs can be charged to users

according to the amount of use. Overhead refers to activities, such as auditing, whose costs are charged according to the users' shares of total direct costs.

*Table F.4*Expenses of the Federal Reserve Banks  
for Monetary and Economic Policy, by District, 1990-91

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	4,954	5,169	215	4.3
New York <sup>1</sup> .....	38,776	41,828	3,052	7.9
Philadelphia .....	3,962	4,293	331	8.3
Cleveland .....	4,782	5,071	289	6.0
Richmond .....	4,869	5,361	492	10.1
Atlanta .....	5,998	6,607	609	10.2
Chicago .....	7,504	7,855	352	4.7
St. Louis .....	5,231	5,389	159	3.0
Minneapolis .....	4,988	5,369	381	7.6
Kansas City .....	4,751	5,055	304	6.4
Dallas .....	5,504	6,105	600	10.9
San Francisco .....	8,340	9,409	1,069	12.8
<b>Total .....</b>	<b>99,660</b>	<b>107,512</b>	<b>7,852</b>	<b>7.9</b>

1. Expenses of open market trading operations, located in the District, are \$18.4 million for 1990 and \$19.9 million for 1991.

*Table F.5*

Expenses of the Federal Reserve Banks  
for Services to the U.S. Treasury and Other Government Agencies, by District, 1990-91

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	7,447	8,459	1,012	13.6
New York .....	34,964	37,209	2,246	6.4
Philadelphia .....	17,843	18,512	669	3.8
Cleveland .....	13,441	13,595	154	1.1
Richmond .....	10,115	10,600	484	4.8
Atlanta .....	12,286	13,440	1,154	9.4
Chicago .....	15,332	16,638	1,306	8.5
St. Louis .....	7,413	8,367	953	12.9
Minneapolis .....	5,319	6,154	835	15.7
Kansas City .....	9,349	10,070	721	7.7
Dallas .....	7,601	8,862	1,261	16.6
San Francisco .....	15,028	15,319	291	1.9
<b>Total .....</b>	<b>156,137</b>	<b>167,223</b>	<b>11,086</b>	<b>7.1</b>

*Table F.6*

Expenses of the Federal Reserve Banks  
for Services to Financial Institutions and the Public, by District, 1990-91

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	61,169	63,418	2,249	3.7
New York .....	153,850	164,850	11,000	7.1
Philadelphia .....	54,163	47,574	-6,589	-12.2
Cleveland .....	54,480	58,302	3,822	7.0
Richmond .....	82,595	87,473	4,878	5.9
Atlanta .....	99,193	104,303	5,110	5.1
Chicago .....	108,050	115,093	7,043	6.5
St. Louis .....	43,832	46,450	2,618	6.0
Minneapolis .....	45,542	47,177	1,635	3.6
Kansas City .....	59,428	62,649	3,221	5.4
Dallas .....	62,361	65,714	3,353	5.4
San Francisco .....	119,730	129,073	9,343	7.8
<b>Total .....</b>	<b>944,392</b>	<b>992,076</b>	<b>47,683</b>	<b>5.0</b>

**Table F.7****Expenses of the Federal Reserve Banks  
for Supervision and Regulation, by District, 1990-91**

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	9,978	11,696	1,719	17.2
New York .....	47,254	53,044	5,791	12.3
Philadelphia .....	10,609	12,019	1,410	13.3
Cleveland .....	10,438	10,988	550	5.3
Richmond .....	12,504	13,210	706	5.6
Atlanta .....	16,888	18,778	1,890	11.2
Chicago .....	29,153	31,432	2,279	7.8
St. Louis .....	8,561	9,055	493	5.8
Minneapolis .....	10,711	11,821	1,109	10.4
Kansas City .....	18,353	19,979	1,626	8.9
Dallas .....	17,104	17,999	895	5.2
San Francisco .....	22,823	24,134	1,311	5.7
<b>Total .....</b>	<b>214,376</b>	<b>234,155</b>	<b>19,779</b>	<b>9.2</b>

**Table F.8****Expenses of the Federal Reserve Banks  
for Salaries of Officers and Employees, by District, 1990-91**

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	47,233	50,827	3,594	7.6
New York .....	143,686	154,174	10,488	7.3
Philadelphia .....	39,050	42,320	3,270	8.4
Cleveland .....	41,745	43,957	2,213	5.3
Richmond .....	56,255	60,261	4,006	7.1
Atlanta .....	65,865	70,317	4,452	6.8
Chicago .....	80,178	84,806	4,628	5.8
St. Louis .....	33,324	35,367	2,043	6.1
Minneapolis .....	32,827	34,721	1,895	5.8
Kansas City .....	49,464	52,524	3,061	6.2
Dallas .....	50,262	52,995	2,732	5.4
San Francisco .....	86,474	91,607	5,133	5.9
<b>Total .....</b>	<b>726,363</b>	<b>773,878</b>	<b>47,515</b>	<b>6.5</b>

Table F.9

Factors in the 1990-91 Change in Salaries  
of Officers and Employees of the Federal Reserve Banks by District

Percentage points

District	Merit adjust- ment	Structure adjust- ment	Promotion and reclassi- fication	Change in staffing	Turnover and lag <sup>1</sup>	Overtime	Other	Total change
Boston .....	4.5	.2	1.6	1.9	-.3	-.1	.0	7.6
New York .....	5.5	.0	1.6	1.3	-1.7	.2	.2	7.3
Philadelphia .....	5.7	.3	.4	3.1	-.4	-.8	.0	8.4
Cleveland .....	4.0	.2	.5	2.1	-1.4	-.2	.1	5.3
Richmond .....	4.9	.0	1.7	2.4	-1.5	-.5	.0	7.1
Atlanta .....	5.4	.0	1.1	1.7	-1.3	-.2	.0	6.8
Chicago .....	4.9	.0	.8	.9	-.8	-.1	.1	5.8
St. Louis .....	4.6	.2	.8	.0	.5	-.3	.2	6.1
Minneapolis .....	4.7	.5	1.0	-.4	.0	-.1	.0	5.8
Kansas City .....	6.1	.3	1.3	.1	-1.5	-.1	.0	6.2
Dallas .....	4.9	.1	.5	1.2	-1.0	-.3	.0	5.4
San Francisco .....	5.0	.0	1.7	-.4	-.1	-.4	.0	5.9
<b>Total .....</b>	<b>5.1</b>	<b>.1</b>	<b>1.2</b>	<b>1.1</b>	<b>-.9</b>	<b>-.2</b>	<b>.1</b>	<b>6.5</b>

1. Turnover is the replacement of a departing employee with one having a lower pay grade. Lag is the time during which a position remains vacant.

Table F.10

Capital Outlays of the Federal Reserve Banks, by District, 1990-91

Thousands of dollars, except as noted

District	1990 estimate	1991 budget	Change	
			Amount	Percent
Boston .....	9,904	8,303	-1,601	-16.2
New York .....	47,743	86,513	38,770	81.2
Philadelphia .....	24,370	6,820	-17,550	-72.0
Cleveland .....	13,419	12,446	-973	-7.2
Richmond .....	17,516	14,291	-3,225	-18.4
Atlanta .....	19,851	16,280	-3,572	-18.0
Chicago .....	21,243	28,737	7,494	35.3
St. Louis .....	13,905	5,877	-8,028	-57.7
Minneapolis .....	12,725	39,208	26,483	208.1
Kansas City .....	7,395	6,583	-813	-11.0
Dallas .....	51,596	80,415	28,819	55.9
San Francisco .....	20,005	22,935	2,931	14.7
<b>Total .....</b>	<b>259,671</b>	<b>328,408</b>	<b>68,737</b>	<b>26.5</b>

**Table F.11****Budget Performance of the Federal Reserve Banks,  
Operating Expenses, by District, 1990<sup>1</sup>**

Thousands of dollars, except as noted

District	1990 budget	1990 estimate	Change	
			Amount	Percent
Boston .....	84,492	83,548	-944	-1.1
New York .....	276,013	274,843	-1,170	-.4
Philadelphia .....	76,577	86,577	10,000	13.1
Cleveland .....	84,789	83,141	-1,648	-1.9
Richmond .....	110,180	110,083	-97	-.1
Atlanta .....	134,560	134,365	-195	-.1
Chicago .....	163,192	160,038	-3,154	-1.9
St. Louis .....	65,673	65,037	-636	-1.0
Minneapolis .....	67,939	66,560	-1,379	-2.0
Kansas City .....	92,289	91,881	-409	-.4
Dallas .....	92,590	92,570	-20	.0
San Francisco .....	166,551	165,921	-630	-.4
<b>Total .....</b>	<b>1,414,845</b>	<b>1,414,564</b>	<b>-281</b>	<b>.0</b>

1. The 1990 approved budget includes the Gramm-Rudman-Hollings reductions.

**Table F.12****Budget Performance of the Federal Reserve Banks,  
Employment, by District, 1990**Average number of personnel, except as noted<sup>1</sup>

District	1990 budget	1990 estimate	Change	
			Amount	Percent
Boston .....	1,471	1,466	-6	-.4
New York .....	4,093	4,059	-34	-.8
Philadelphia .....	1,336	1,329	-7	-.5
Cleveland .....	1,519	1,487	-32	-2.1
Richmond .....	2,057	2,045	-12	-.6
Atlanta .....	2,392	2,342	-50	-2.1
Chicago .....	2,658	2,611	-47	-1.8
St. Louis .....	1,230	1,219	-11	-.9
Minneapolis .....	1,117	1,108	-9	-.8
Kansas City .....	1,716	1,707	-9	-.5
Dallas .....	1,708	1,697	-11	-.6
San Francisco .....	2,594	2,629	35	1.3
<b>Total .....</b>	<b>23,890</b>	<b>23,698</b>	<b>-192</b>	<b>-.8</b>

1. See chapter 3, note 1, for the definition of average number of personnel.



Table F.13

## Expenses of the Federal Reserve Banks, by Operational Area, 1986-91

Thousands of dollars, except as noted

Year	Monetary and economic policy	Services to the U.S. Treasury and other government agencies	Services to financial institutions and the public	Supervision and regulation	Total
1986 .....	90,570	136,789	770,016	163,915	1,161,290
1987 .....	86,484	135,693	799,227	170,428	1,191,832
1988 .....	87,283	141,524	848,481	185,090	1,262,379
1989 .....	93,553	145,547	916,310	195,076	1,350,487
1990 estimate .....	99,660	156,137	944,392	214,376	1,414,564
1991 budget .....	107,512	167,223	992,076	234,155	1,500,965
<b>MEMO</b>					
Average annual change, percent .....	3.5	4.1	5.2	7.4	5.3

Table F.14

## Employment at the Federal Reserve Banks, by Operational Area, 1986-91

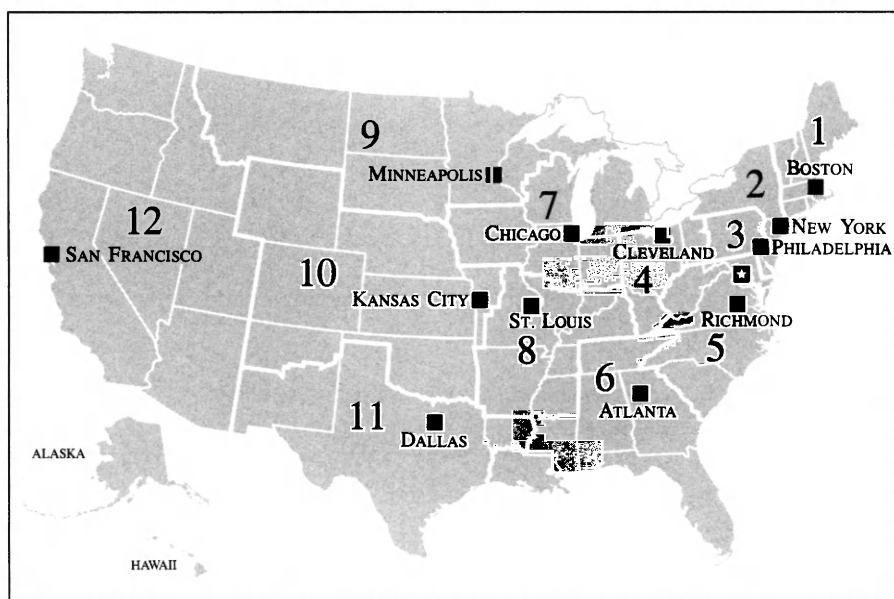
Average number of personnel, except as noted <sup>1</sup>

Year	Monetary and economic policy	Services to the U.S. Treasury and other government agencies	Services to financial institutions and the public	Supervision and regulation	Support <sup>2</sup>	Overhead <sup>2</sup>	Total
1986 .....	791	1,820	8,800	2,088	4,470	5,275	23,243
1987 .....	776	1,837	8,777	2,148	4,452	5,026	23,014
1988 .....	766	1,819	9,033	2,209	4,562	4,961	23,348
1989 .....	783	1,771	9,423	2,198	4,552	4,948	23,674
1990 estimate .....	773	1,837	9,304	2,229	4,584	4,973	23,698
1991 budget .....	786	1,912	9,227	2,305	4,646	4,986	23,861
<b>MEMO</b>							
Average annual change, percent .....	-.1	1.0	1.0	2.0	.8	-1.1	.5

1. See chapter 3, note 1, for the definition of average number of personnel.

2. See table F.3, note 1, for definition.

## Maps of the Federal Reserve System



### LEGEND

#### Both pages

- Federal Reserve Bank city
- Board of Governors of the Federal Reserve System

#### Facing page

- Federal Reserve Branch city
- Branch boundary

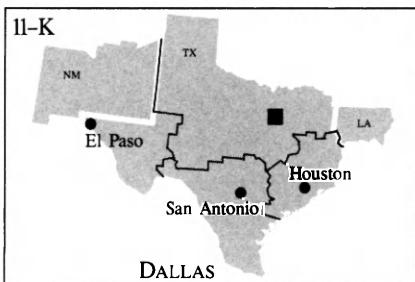
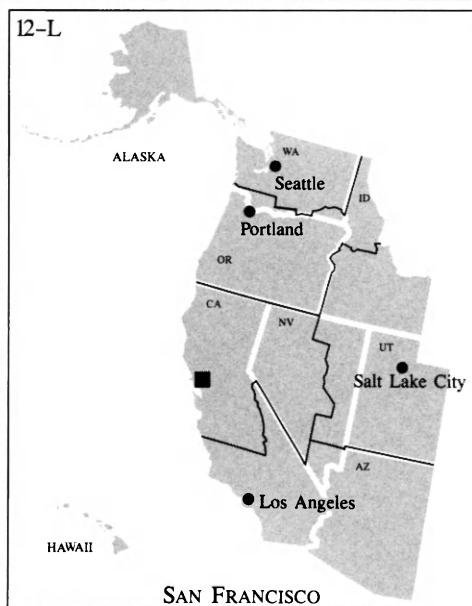
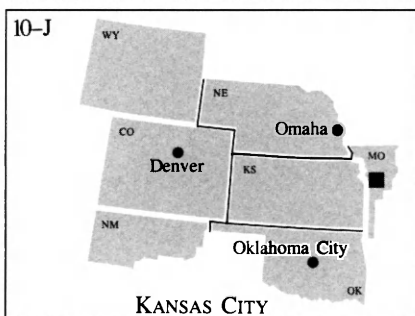
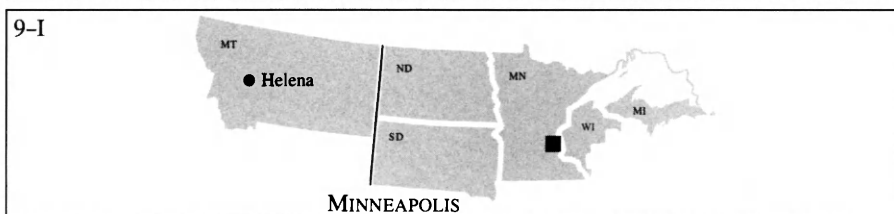
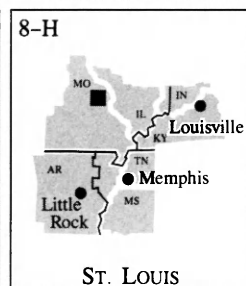
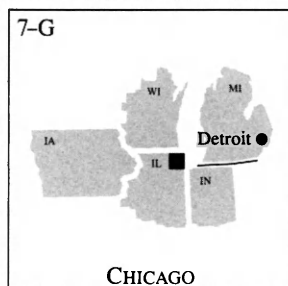
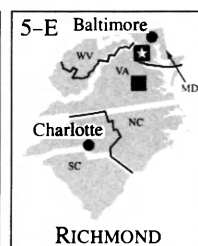
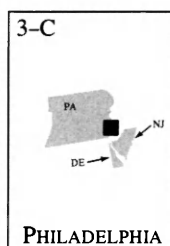
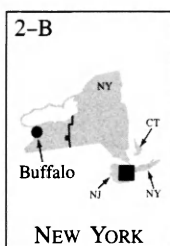
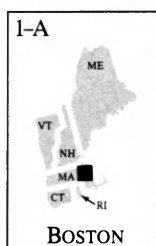
### NOTE

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 boundaries of the System most recently in August 1986.



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