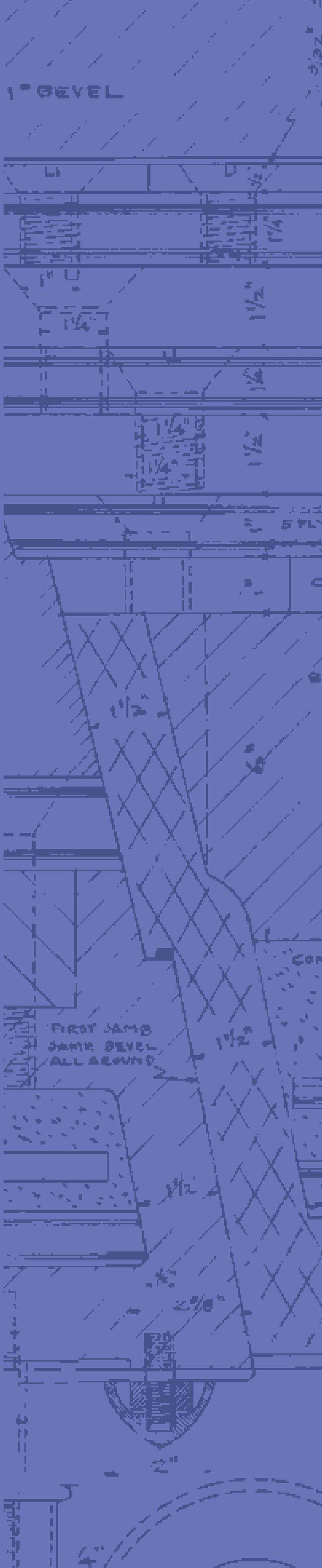
1997 Annual Report

Federal Reserve Bank of Kansas City

A Building Plan for the Future



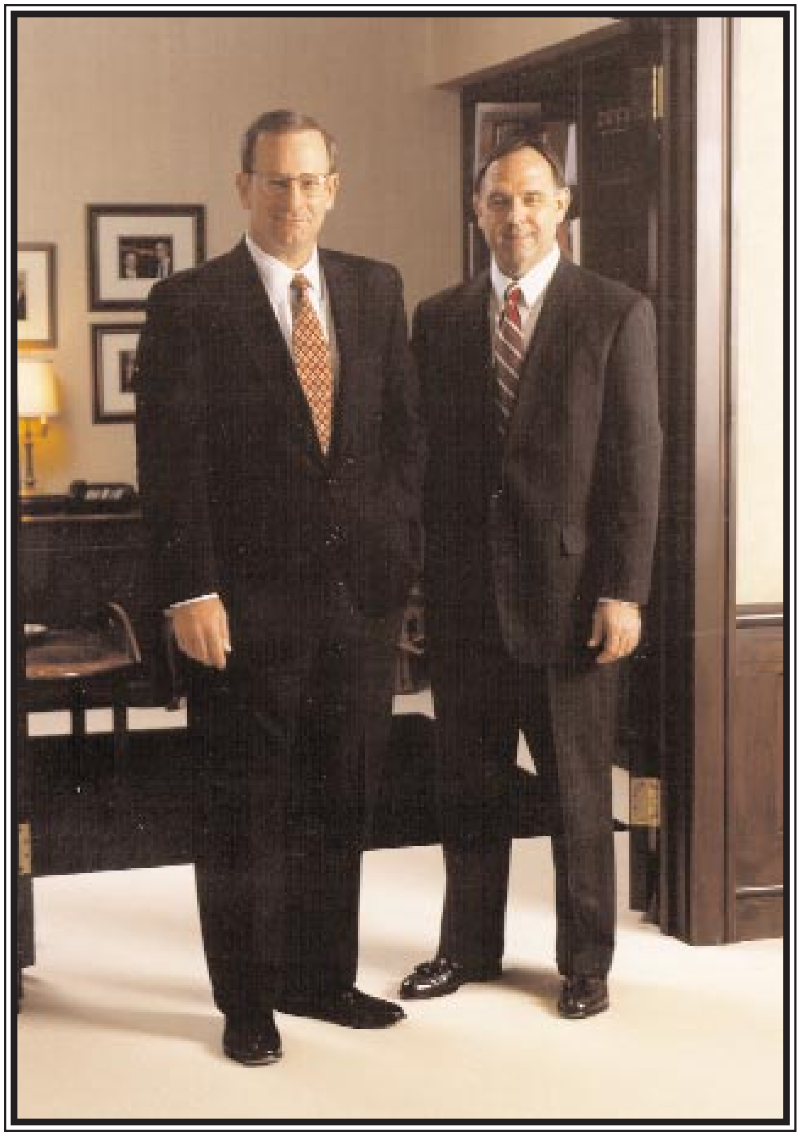
The Federal Reserve Bank of Kansas City is one of 12 regional Reserve Banks which, together with the Board of Governors in Washington, D.C., make up the nation's central bank.

As part of the Federal Reserve System, we are responsible for formulating and conducting monetary policy, supervising banks and bank holding companies, and providing payments services to depository institutions, the federal government, and the public.

The Kansas City Bank has served the Tenth Federal Reserve District since 1914. Although our responsibilities have remained fundamentally the same, how we conduct business has changed over time in response to evolving external forces.

Today, such factors seem to be changing our operating environment more rapidly than ever before. New technologies, banking consolidation, as well as the shift toward a more global district economy are transforming all our business areas.

Last year, in a move to adapt to change, we expanded our strategic planning process. As a result, this Annual Report not only addresses our 1997 accomplishments, but it also translates how our strategic plan—"A Building Plan for the Future"—will guide the way we carry out our central bank role.



As we look forward, we will need a strong, active central bank . . . one that provides leadership to both large interstate organizations and thousands of smaller local banks . . . one that is aware of and responsive to differences in economic activity across our country and around our world. The Federal Reserve Bank of Kansas City is proud to take its place in these efforts.

Thomas M. Hoenig
President
and Chief Executive Officer

Richard K. Rasdall, Jr.
First Vice President
and Chief Operating Officer

A BUILDING PLAN FOR THE FUTURE

—Thomas M. Hoenig

Tom Hoenig,
President and
Chief Executive Officer

A central bank is unique in the role it plays in a nation's economy. Yet, in many ways, the Federal Reserve Bank of Kansas City is like many other organizations trying to adapt to dramatic change in an evolving business environment. While change presents challenge, taking advantage of the opportunities change brings is essential to our success. As British mathematician and philosopher Alfred North Whitehead wrote, "The art of progress is to preserve order amid change and to preserve change amid order." In looking back at 1997, this definition of progress was what we sought to achieve.

As the national and regional economies posted exceptional performance, so too did our organization . . .

By almost every measure, 1997 was a stellar year for the Federal Reserve Bank of Kansas City. As the national and regional economies posted exceptional performance, so too did our organization by meeting and often exceeding the benchmark goals we set for ourselves. In the financial services arena, we surpassed our expectations in furthering the use of electronic check presentment and the Automated Clearing House (ACH). Moreover, by restructuring our bank supervision function, we introduced a more effective risk-focused approach to financial examinations, enabling our examiners to provide more individualized and consistent service.

Remarkably, such achievements were realized with an operating budget that was almost $3 million less than the previous year.

Our successes were particularly satisfying because they were achieved in an environment of accelerating change, much of it fueled by technological advancements, interstate banking, and further globalization of the district's economy. We were successful in adapting to these factors because our directors, officers, and employees continuously recognized and managed change throughout the organization.

This report highlights some of the steps taken this past year to address the environmental factors impacting the Kansas City Reserve Bank's role in monetary policy, the payments system, and bank supervision.

We were fortunate that our strong operational and fiscal performance coincided with solid economic performance. The national economy was exceptionally robust in 1997. Not only did the economy post strong growth, but it did so in an environment of low unemployment and modest inflation. Such a sanguine economic environment, however, is neither automatic nor assured—meaning it is essential that we continue to focus the Bank's research efforts to the contribution of sound regional input into the formulation of national monetary policy.

Monitoring the regional economy—a key element of our monetary policy input—is no small feat considering the enormous changes facing the Tenth District. While our region's economy posted solid economic gains in 1997, it was profoundly influenced by external forces. Not only are consolidation and interstate banking continuing to remake the banking industry, but a new wave of technologies is transforming businesses generally.

Global markets beckon to the products of the Heartland as never before, opening vast new opportunities for our region. Although these changes bring promising prospects to our district, significant challenges remain in representing a region that is becoming increasingly linked to national and global markets.

These same forces continue to impact how we carry out other central bank responsibilities and evoke change within our organization. As we respond to further technological advancements in our role as a financial services provider, the Federal Reserve is committed to informing banks of payments system developments and assisting them as they adapt to these changes. And, in doing so, we remain diligent in our effort to promote secure and efficient disbursement mechanisms for consumer, commercial, and government payments.

In the area of bank supervision, consolidation and the advent of new financial instruments and new payment methods are driving realignments in our supervisory structure. In response, we have modified our examination processes and increased our use of automation to share information and better understand the risks posed by complex financial transactions. By adjusting our supervisory practices to be more risk-focused, we have become not only more responsive and anticipatory, but less burdensome on the institutions we supervise.

We were successful in adapting to these factors because our directors, officers, and employees continuously recognized and managed change throughout the organization.

In spite of all the factors influencing our course of action, our fundamental mission remains the same—to foster the stability, integrity, and efficiency of the national monetary, financial, and payments systems to promote optimal economic performance.

Although we have "preserved order amid change" thus far, we are keenly aware it would be unwise to rest on our record. That is why in 1997 we revamped and expanded our strategic planning process to broaden its scope and make the process more meaningful to employees throughout the district. What resulted was our Strategic Planning Framework—"A Building Plan for the Future." This document describes the Bank's organizational philosophy and our vision to inspire trust and confidence in everything we do. This message also clearly defines, for all employees, the factors critical to our future success.

Because this framework will guide how we carry out our central bank charge, we thought it only appropriate to share elements of this strategic plan and insights into its development. In light of this, our Annual Report is a departure from past years. While it conveys our 1997 accomplishments, it also identifies the changes affecting our organization and defines how we are planning to meet the challenges that remain ahead for the Federal Reserve Bank of Kansas City as well as the financial services industry.

Tom Hoenig has been president and chief executive officer of the Federal Reserve Bank of Kansas City since October 1991. He is only the eighth chief executive in the bank's 84-year history. In addition to directing Federal Reserve activities in the seven-state Tenth Federal Reserve District, he is a member of the Federal Open Market Committee, the key body with authority over national monetary policy. He currently serves as board chairman for Benedictine College, as a member of the board of directors for the University of Missouri-Kansas City, as a member of the banking advisory boards at UMKC and at the University of Missouri-Columbia, and as a trustee of Midwest Research Institute. He received his undergraduate degree from Benedictine College and his M.A. and Ph.D. degrees in economics from Iowa State University.

Securing the Future: Economic Activity, Low Inflation, and Monetary Policy

—Craig S. Hakkio

Craig Hakkio, Senior Vice President and Director of Research

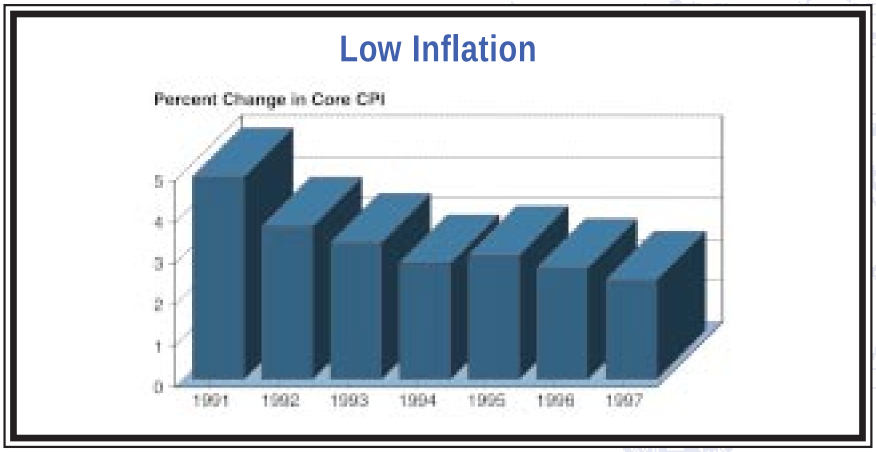
U.S. economic performance has been very strong recently. But the economies of nations throughout the world are undergoing such rapid change that policymakers everywhere, particularly within the Federal Reserve, must understand the forces of globalization, financial innovation, and advancing technology. And they must appreciate how these forces are reshaping our world. An essential element in developing this understanding is the research and policy advice provided by the staffs at Federal Reserve Banks.

U.S. Economic Performance and Monetary Policy

To date, the U.S. economy has coped quite well with these changes. By almost any measure, the U.S. economy performed at an exceptional level last year. Current estimates show that real GDP grew 3.7 percent in 1997. Reflecting this strong growth, the unemployment rate fell to 4.7 percent by yearend. At the same time, inflation declined over the year, with the consumer price index rising just 1.9 percent and core CPI up just 2.2 percent.

Virtually all sectors of the economy performed well last year. Brisk consumer spending, faster inventory accumulation, and a surge in investment spending helped sustain the nation's economic expansion in 1997. Net exports represent the only sector that did not contribute to the nation's strong performance.

While it is tempting to focus on the strengths of 1997, it is illuminating to consider the current expansion as a whole. The expansion began seven years ago in 1991 and has been remarkable in that as the economy has grown, both inflation and unemployment have fallen. After averaging 5.8 percent in the 1980s, core CPI inflation fell from 4.4 percent in 1991 to 2.2 percent last year, the lowest level in almost 35 years. And after averaging 7.3 percent in the 1980s, unemployment fell from 6.8 percent in 1991 to 4.6 percent in November of last year, before inching back up to 4.7 percent in December. The last time the unemployment rate reached such low levels was in October 1973.



The trend in core CPI, which excludes the volatile food and energy sectors, is unmistakable. While prices continue to rise, they are rising at a slower, far more steady rate.

An important contributor to economic activity during this expansion has been strong investment. During the expansion real business fixed investment has grown at an average rate of 6.9 percent annually, while real GDP has grown 2.8 percent. As a result, in the second half of 1997 real business fixed investment as a share of GDP was 12.1 percent, the highest level in the post-World War II period.

While many factors have contributed to the strength in investment spending, the current low inflation environment is one of the reasons investment demand has been so strong throughout the expansion. Economists have long warned of the harmful effects of rising prices. Inflation interferes with the efficient allocation of resources by confusing price signals. This confusion is harmful because it increases uncertainty and reduces economic welfare.

For these reasons, the low inflation environment of the 1990s has undoubtedly helped boost investment spending, increased productive capacity, and enabled firms to meet increased demand without raising prices.

History has shown that there is less volatility in low inflation times than in higher inflation times. The associated reduction in inflation uncertainty has surely been a positive factor for investment in plant and equipment during the current expansion. Increased investment spending, in turn, has enhanced the economy's capacity to produce goods and services, hire more workers, and raise standards of living.

Economic Research at the Kansas City Fed

The Bank's Economic Research staff plays an important role in helping President Tom Hoenig prepare for his participation in Federal Open Market Committee (FOMC) meetings. Made up of the seven governors of the Federal Reserve Board and five of the 12 Reserve Bank presidents, the FOMC meets eight times a year to determine the appropriate monetary policy stance. By law, the FOMC is charged to oversee open market operations, the principal tool of national monetary policy. The FOMC also directs opera-

Low inflation also reduces the distortionary effects on the tax code. Inflation increases the effective tax rate to firms and households in many ways. For example, inflation reduces the value of depreciation allowances, thereby increasing the effective tax rate on businesses. For individuals, inflation causes the taxes levied on the nominal capital gains and nominal interest income to rise. But low inflation decreases the effective tax rate on capital income and thus encourages capital formation and long-term economic growth.

For these reasons, the low inflation environment of the 1990s has undoubtedly helped boost tions undertaken by the Federal Reserve in foreign exchange markets.

The Kansas City Fed's economic research area includes professionals specializing in a number of relevant fields, including monetary policy and macroeconomics, international economics, financial markets and institutions, and regional economics. The economists also advise the Bank's management and directors on economic developments and monetary policy issues. The key to providing effective advice is to ensure the Bank's research staff is a leading source of innovative research on issues relevant to the Tenth District and the Federal Reserve as a whole.

investment spending, increased productive capacity, and enabled firms to meet increased demand without raising prices. These conditions should help prolong the current low inflation environment.

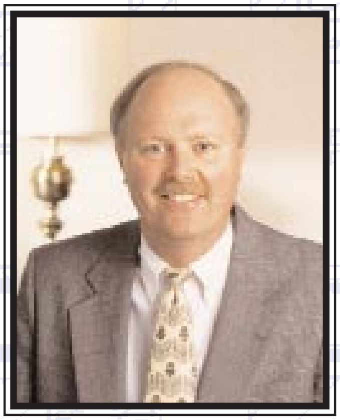
Investor confidence in U.S. financial markets is another factor contributing to the long economic expansion. This confidence is a reflection of the country's macroeconomic and financial stability, which, in turn, is partly attributable to effectiveness of Federal Reserve monetary policy.

By continuing the move toward low inflation, the credibility of U.S. monetary policy has been enhanced. Given the many benefits of price stability, it is crucial that the Federal Reserve maintain a vigilant policy stance.

One element of this effort is that monetary policy must remain forward-looking because policy actions affect the economy with long and variable lags. For example, in 1994 monetary policy was tightened despite some evidence of slack in the economy. The Federal Reserve acted based on its forecast that rapid growth would be eliminating the slack and ultimately produce inflationary pressures. Monetary policy was also forward-looking in 1995 when the Federal Reserve reversed course and began to ease policy.

Monetary policy actions such as these have contributed to the strong performance of the economy. In addition, they have helped sustain the confidence of investors in the Federal Reserve's commitment to keep inflation low while maintaining a balanced policy stance.

As a senior vice president and director of research, Craig Hakkio serves as the chief economist for the Bank and an economic adviser to the FOMC. He was a senior staff economist for President Reagan's Council of Economic Advisers in 1987 and 1988. He holds an A.B. degree from Kenyon College and M.S. and Ph.D. degrees from the University of Chicago.



Mark Drabenstott,
Vice President
and Economist

The Tenth District Economy in a Changing World

—Mark R. Drabenstott

The Tenth District economy has always been as resilient as the tough-minded people who conquered the prairies and mountains to make this a vital part of our nation. Yet the district economy has never faced such a sweeping set of forces more likely to change it.

Headed into the 21st century, the district is changing how it does business, who it does business with, and what businesses it is in. The scope and speed of the changes now under way and in prospect are remarkable. In future years these changes may well be viewed as the mark of a new era for the region's economy.

Three changes will define this new era. First, the district's financial markets are being reborn, with interstate banking and consolidation redrawing the banking industry. Second, the district is sharing in a wave of new technologies that are revolutionizing the region's mainstay industries while bringing a whole new breed of businesses into the district. And third, the globalization of markets is opening new gateways to countries hungry for the food and wares produced by people in the Heartland.

A New Banking Industry

The district's financial industry is undergoing sweeping changes. The most obvious change is a sharp decline in the number of financial institutions. Closings in the 1980s and continued consolidation have winnowed the ranks to the strong and the survivors.

The number of financial institutions in the district has fallen more than a third since 1980. Moreover, within commercial banks, control has been shifting to the larger banks. Banks under $500 million in deposits held fully 70 percent of total district deposits in 1980, but just 50 percent in 1996.

In short, the district banking industry has become more bipolar. Once dominated by smaller banks, financial assets today are increasingly held by large institutions, in many cases institutions with national reach. On the other hand, the district is still home to a large number of small banks.

What do these changes mean for the district economy? The emergence of larger institutions, along with the advent of interstate banking, clearly puts district businesses in touch with broader money markets. This should provide substantial long-term dividends to a region that has often wondered if the capital would be sufficient to fuel the region's economy. These benefits come at a price, however, as the district has less control over its financial institutions. The share of deposits held by out-of-district companies has leaped from 3 percent in 1980 to more than 30 percent today. Still, with a great number of strong community banks, the district may be able to find the best of both worlds: a ready pipeline to capital markets, yet the personal service that many small businesses need to survive.

New Technology

A more pervasive force shaping the district economy is the wave of new technology. This wave is manifest in so many ways in our district that it defies generalization. Information technology, biotechnology, telecommunications technology, industrial technology, medical technology all are part of the mix. While a name is lacking, the impact is not. Technology is having three potent effects on the district economy. It is creating new industries. It is making other industries better. And it is creating footloose industries that are putting down roots in our region for the first time.

"High tech" is often the starting point in any discussion of technology and the economy. Indeed, high technology has had a powerful impact on the district, among other things creating a high-tech corridor that now stretches from Fort Collins to Albuquerque. But the impact is not confined to the Rocky Mountains. Many other parts of the district have sprouted new high-tech businesses of one kind or another.

Concentrated mainly in computer and other electronic equipment, the high-tech industry has grown rapidly in the district during the 1990s. Since the late 1980s, a growing stream of investments by high-tech companies has led to burgeoning sales, both domestically and abroad. The job gains in this capital intensive industry have not been huge, but other results have been. For instance, district high-tech exports have quadrupled since 1987 versus a doubling for exports by firms in the nation as a whole.

The biggest impact has come in the myriad ways in which a host of new technologies. . . have made all district industries more efficient.

Impressive as it has been, the emergence of a high-tech industry has not been the biggest impact of technology on the district economy. The biggest impact has come in the myriad ways in which a host of new technologies—computers being just one—have made all district industries more efficient. These impacts are extremely difficult to quantify. Yet in the aggregate, we can begin to appreciate how impressive the gains have been. One measure of the gains in productivity afforded by technology is the additional value added per worker. Since the early 1980s, the value added per employee has jumped 55 percent. Of note, the gains have been broadly shared across durable and nondurable industries.

The final impact of technology in the district has been through the emergence of footloose companies. Telecommunication and information technologies have made it possible for firms like telemarketers and Internet companies to locate just about anywhere. Increasingly, that anywhere includes the wide open spaces of the Tenth District. Historically, the long distances separating many parts of the district from the nation's urban centers had been a deterrent to firms thinking about locating here. But the new technologies make distance moot. Omaha, for example, has made a strong foothold in the computer service industry, doubling the number of such firms since 1987.

As never before, a global market beckons to district firms. And as never before, the region is answering that call.

Globalization

Technology is also a contributor to the final force driving the district into the 21st century—globalization. Much of the information beaming into the district comes from the four corners of the earth, literally. As never before, a global market beckons to district firms. And as never before, the region is answering that call.

Globalization defines the integration of national markets into global markets for goods and services. The emergence of world markets is aided and abetted by telecommunication technology, including the Internet, which instantly puts district sellers in touch with global buyers. An equally important component, however, is the mounting appetite of consumers for world-class products. We in the United States are long accustomed to the luxury of choice, but many in the world are just now acquiring the wherewithal and the stores to buy at will. The combination of rapid population gains and rising incomes in regions like Southeast Asia and Latin America have created the potential for dramatic growth in global demand for food and many other products grown in the region.

District firms are opening more and more gateways to this new world of customers. Sales are being made via the Internet. Joint ventures are being struck with foreign partners to gain entree to foreign markets. New subsidiaries are being formed. Underlying this general expansion of contacts is a trade and regulatory environment that makes it easier to conduct commerce globally. The North American Free Trade

Agreement (NAFTA), for example, has been a significant boon to district trade with Mexico. The Telecommunications Act of 1996, which deregulated the phone industry, has fostered a new round of global business partnerships in the industry.

Once in the global market, district firms find their products highly competitive. In the case of manufacturing, the district now sells in world markets everything from computer chips to pharmaceuticals to steel grain bins. Added together, manufactured exports from the district surged more than 230 percent from 1988 to 1996. Equally impressive has been a rising tide of farm products flowing to world consumers. Though good data on agricultural exports by state are not available, the district has clearly shared in the 1990s boom in food sales abroad, especially through a rapid rise in meat exports.

Looking ahead, global markets offer great promise for the district economy. U.S. farm exports, for instance, are projected to climb by one-third by 2005 and, if realized, the district will be a major supplier of the added sales. In agriculture and elsewhere, district firms are increasingly investing in Asia and Latin America, markets where economic growth is likely to surpass that in Europe and North America. While these emerging markets will no doubt continue to have occasional downturns, as Mexico did in 1995 and as Southeast Asia is now encountering, the fundamentals point to bright, long-term prospects for district firms.

The District Economy in the New Century

The ultimate effect of the forces reshaping the district economy is far from certain. Still, a handful of effects merit watching as the new century dawns.

Looking ahead, global markets offer great promise for the district economy.

First, the district economy is likely to perform somewhat more like the nation in the future. Historically, the district economy has performed in almost a counter-cyclical way, mainly due to the strong presence of agriculture and energy. Since the twin recessions in those industries in the mid-1980s, however, the district has been diversifying its economic base. The new technologies will only hasten that broadening.

Second, the district has a growing stake in the world market and in policies that promote its growth. The region's farmers have long appreciated the benefits of free trade, but they are joined today by a long list of compatriots. The district has a huge stake in seeing additional trade negotiations that free world trade, raise world incomes, and boost the demand for Heartland products.

Finally, technology and globalization will place new demands on a wide array of public institutions. In a very real sense, business is becoming more complex while moving faster. Thus, businesses are listing staffing as job one to meet these bigger challenges. The region's educational institutions—from primary and secondary schools to universities—are going to be held to a higher standard to produce workers in the next century.

While uncertainty is always the companion of change, the district economy seems likely to adapt well to the new era, and indeed, its prospects in the new century may be the brightest it has known.

In addition, there will be an ongoing debate on the role of public versus private research. Everyone agrees that technology will drive the economy of the next century, but no one agrees on who should pay for it. And as the globe shrinks, the role of the public in supporting market information and expansion will no doubt be discussed. In the case of agriculture, there was broad support for past programs that helped farmers sell more commodities abroad. But with bigger companies controlling more of the trade, the public role has become harder to define.

While uncertainty is always the companion of change, the district economy seems likely to adapt well to the new era, and indeed, its prospects in the new century may be the brightest it has known. The new financial industry brings our district in touch with more capital, always the lifeblood of economic progress. The new technology will make our region more attractive as a business location while keeping our businesses world class. With bountiful horizons of countries with growing populations and rising incomes, consumers throughout the world seem likely to buy more and more of our products.

Mark Drabenstott is a vice president and economist and is responsible for overseeing the Bank's research on the seven-state Tenth Federal Reserve District. He received his B.A. degree from Earlham College and his M.S. and Ph.D. degrees from Iowa State University.

THE DISTRICT ECONOMY'S RECENT PERFORMANCE

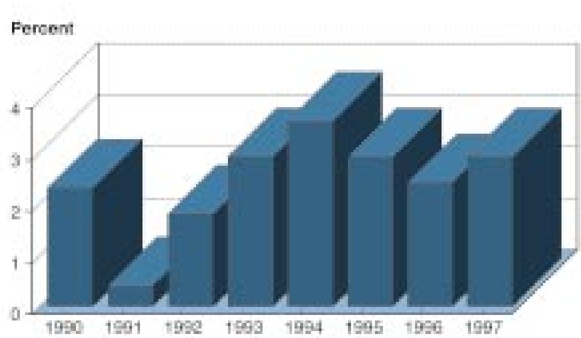
The district economy remains strong, extending its healthy run of recent years. For all of 1997, district employment grew 2.9 percent, somewhat faster than the previous year. The solid performance marked the 10th straight year that job growth in the district outpaced the nation.

The continued strength of the district economy reflects both its diversity and the strong demand for the goods and services produced here. The district's diverse economic character continues to boost growth. The service sector is booming, manufacturing and agriculture are strong, construction activity is healthy, and the energy sector continues a steady upward climb. The good economic times have led to the tightest job markets in recent memory. Indeed, the biggest challenge facing most businesses in our region is finding enough qualified workers.

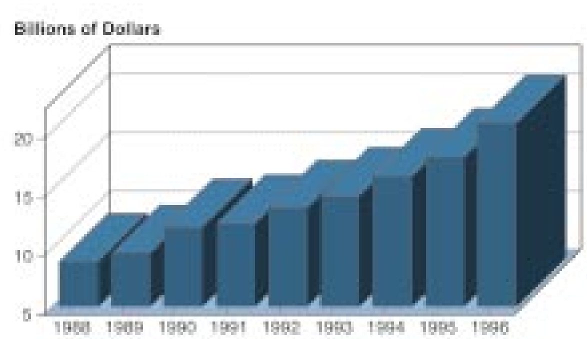
Another feature of the recent string of good news is that the growth is reasonably well-balanced across the seven states of the district. Colorado, Nebraska, and Kansas all grew at a strong pace in 1997. Growth was moderate in Oklahoma, Missouri, and New Mexico. Growth was slow in Wyoming, which still searches for another engine of growth besides energy.

Looking ahead, the district economy promises to remain strong. Manufacturing has slowed slightly in recent months, but district plants are essentially running at full capacity, and continued growth in the U.S. economy may offset weaker demand from Asian countries. District agriculture had strong earnings in 1997, and a solid outlook for the livestock industry should maintain profits into next year. Finally, strong consumer spending throughout the region should maintain the healthy momentum present in the service and construction sectors.

Job Growth



Manufactured Exports



Job growth in the Tenth District peaked at 3.6 percent in 1994 and has remained strong in recent years. As another sign of strength in the district economy, manufactured exports surged more than 230 percent in the eight years from 1988 to 1996.

Enis Alldredge,
Senior Vice President,
Operations

The Payments System's Role in an Evolving District Economy

—Enis Alldredge, Jr.

Dramatic advances in worldwide research and development are generating new payments system techniques. Virtually every week we see media accounts of advances in smart card technology, home banking, or banking on the Internet. As these new technologies emerge, central bankers around the world face a similar challenge—how to generate and champion prudent techniques for making high-risk cross-border payments.

An equally critical challenge faces Tenth District financial institutions—how to remain important players in a changing payments arena.

Currently, the payments system is still primarily the province of banking. But banks must change to remain an integral part of the payments system.

Debate continues on whether the banking industry will keep its franchise for operating the payments system, or lose market share as it has in the areas of deposit taking and loan origination. Currently, the payments system is still primarily the province of banking. But banks must change to remain an integral part of the payments system.

A New Competitive Environment

While no one can predict the future, it is clear that the nation's 10,000 banks will see increasing competition from nonbanks to supply payments services. Banking trade journals repeatedly feature companies like Microsoft, First Data Corporation, Checkfree, Intuit, Cybercash, or telecommunications companies as they aggressively work to develop new payments techniques.

As bank customers become more involved in the global marketplace, they are demanding more sophisticated payments services. Banks, from the largest to the smallest, must continue to prove to their customers they are payments experts. New expertise will be essential to effectively advise clients on payments alternatives and to offer the products that best fit the changing strategic needs of their clients.

Amid this changing marketplace, banks across the nation are consolidating. Still, the heritage of locally owned banks in the Tenth District remains strong—with some 2,300 financial institutions needing access to payments mechanisms in order to serve their communities and customers.

As most people would agree, the large banks have the resources and sophistication they need to compete in a global economy. But are the thousands of community banks in this country ready to compete with both large banks and nonbanks?

This question is compounded by another change in the new payments environment—electronic payments initiatives like those driven by the U.S. government. For instance, the Electronic Federal Tax Payment System (EFTPS) put into effect last year mandates that most employers' tax payments be made electronically. And new legislation (the so-called EFT 99) will require the federal government to make nearly all of its payments electronically by 1999.

Ensuring Integrity, Efficiency, and Accessibility

None of the nation's largest banks are headquartered in the Tenth District. In light of this, we at the Kansas City Fed believe our role is to serve and advise our regional banks as they adapt to emerging payments system innovations. In carrying out this role, our payments system mission is to assure the integrity, efficiency, and accessibility of the nation's payments mechanisms. A number of efforts are under way to achieve these goals.

Safety is paramount when establishing a payments system structure. As payments have become more and more electronic, we have become experts in safety measures such as data encryption. We have also worked with banks to help them employ fraud prevention techniques. And, as always, our bank examiners are on the alert for payments practices that may be risky.

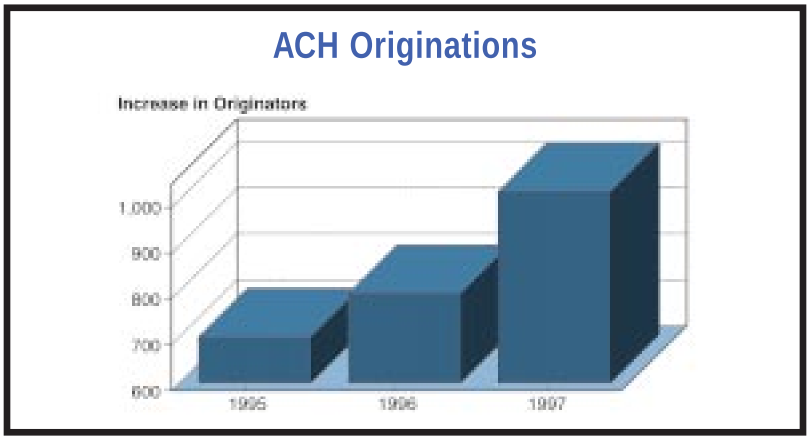
Enhancing payments efficiency is also a vital goal—both for our own operations and those of our banking constituents. After several years of significant investment in new technologies, our efficiency gains are beginning to pay dividends. For instance, we have significantly reduced the fees we charge for check processing and ACH services.

We at the Kansas City Fed believe our role is to serve and advise our regional banks as they adapt to emerging payments system innovations.

We will see even further efficiency gains as the payments system becomes more electronic—a move that is especially important for the continued viability of remote banks. Currently, the Kansas City Fed is electronically presenting checks to more than a third of the depository institutions we serve.

As a leader in the Federal Reserve System's efficiency efforts, the Kansas City Fed emphasizes equipping Tenth District financial institutions with the ability to send as well as to receive ACH payments. Institutions have been receiving these payments for a number of years, but until recently ACH origination was largely the province of large banks. Today, we have more than 1,000 institutions originating ACH payments in the Tenth District.

In addition to promoting safety and efficiency, automated payments should provide greater accessibility to banks. Some banks would say that the Federal Reserve's most important job is to ensure that all financial institutions have access to the payments system. This is especially true in the Heartland, where so many banks are hundreds of miles from the nearest major metropolitan area. We try to ensure accessibility in many ways, but none is more important than working to automate payments.



Previously the province of large banks, today the number of institutions originating ACH payments is steadily increasing. In 1997 alone, the Tenth District added 258 new originators.

Perhaps the most powerful tool we have to automate payments and overcome remoteness is Fedline. An inexpensive, PC-based communication network, Fedline enables the 1,150 depository institutions connected to it to send and receive funds transfers and ACH.

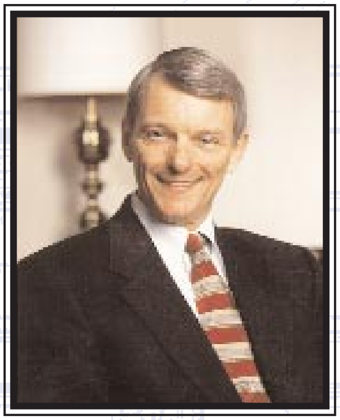
We are continually expanding Fedline to meet the needs of our banks. For example, in 1997 we began work to increase the networks' capabilities to accommodate electronic data interchange (EDI) transactions. EDI will enable financial institutions, regardless of size, to decipher a computer payment message, such as an invoice, and translate it into a form that can be used by corporate customers.

Of course, advanced technology is beneficial only to the extent that it can be understood and used by those who need it. The Federal Reserve is not the only entity to provide advice on accessing and using the new payments system, but we are an important contributor, especially to community banks. And, we remain committed to helping these institutions take advantage of this new and exciting payments environment.

Enis Alldredge is a senior vice president and head of the Operations Division, which includes responsibility for cash services, check collection, electronic payments, and securities as well as customer relations and support for Tenth District offices. He also has oversight responsibility for the Bank's branch offices in Denver, Oklahoma City, and Omaha. He is a graduate of the University of Nebraska and the Graduate School of Banking at the University of Wisconsin.

Supervision Embraces Changes in Tenth District Banking

—John E.Yorke



John Yorke, Senior Vice President, Bank Supervision and Structure

Some of the same forces at work in the electronic payments system environment are also present in the financial services industry. Advances in computer and communication technologies are profoundly affecting competition among financial firms. Technology is changing the way banks deliver their services, the services they provide, and the way they manage risk. These changes, coupled with consolidation, are redefining the structure of banking. In turn, the Kansas City Fed is refocusing its supervision of Tenth District financial institutions.

District Banking Structure Shifts

In Tenth District banking, two structural changes are notable—there are fewer banks and fewer large banks. The fall in the number of banks in our district mirrors national merger trends and is largely tied to competitive pressures and the growing cost of technology. The loss of larger institutions reflects the acquisition of large district banks by out-of-district banking organizations— a trend that is likely to continue with full interstate bank branching.

Technology and tougher competition have also caused banks to offer a broader range of financial services and to place more emphasis on noninterest revenue sources. Commissions, fees, and service charges on nonloan products are becoming an important revenue source for banks across the country. For example, Tenth District banks are selling mutual funds and insurance, providing customer risk management, and securitizing loans. These trends will surely accelerate if financial modernization bills to expand banking powers become law.

New technologies are also changing the way banks operate. For example, ATMs, telephone services, and Internet banking are cutting costs and delivering financial services more efficiently. And, like banks across the nation, Tenth District banks are managing risk by using financial instruments, simulation models, secondary market sales, and credit scoring models.

In Tenth District banking, two structural changes are notable—there are fewer banks and fewer large banks.

New Supervision Strategy

The changes in Tenth District banking have required us to strategically adjust the way we operate as well, including the way we supervise banks. With fewer large banking organizations under our jurisdiction, our supervisory practices focus on the regional community banks. Facing intense competition, these institutions need new ways to control costs, deliver financial services, and manage risks.

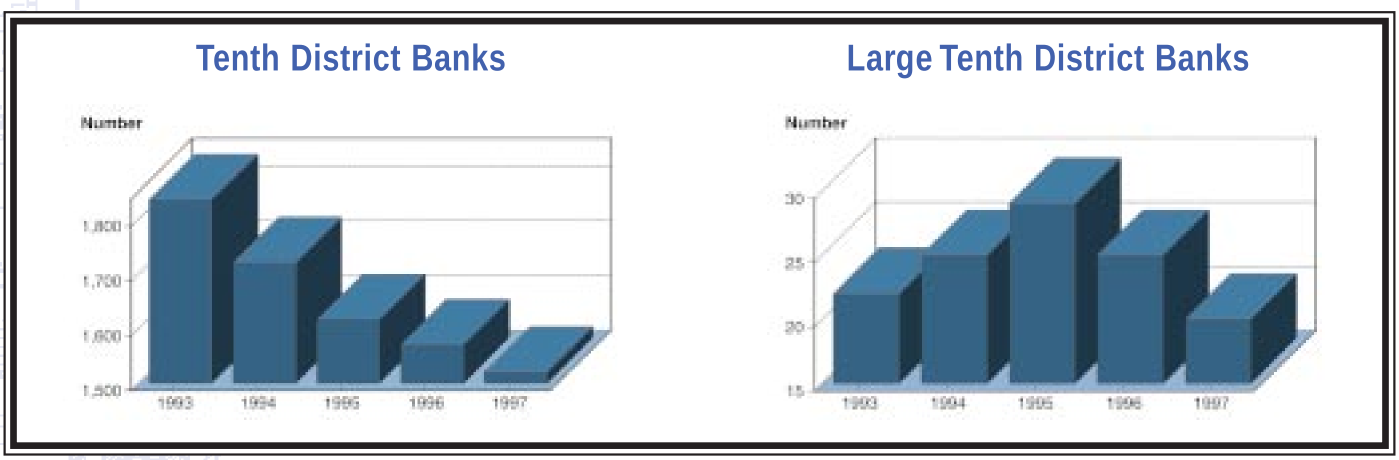
As a regulator, we must allow financial institutions the flexibility to evolve while maintaining a safe and sound banking structure. To accomplish this, we have adjusted our supervisory structure, modified our examination processes, improved our information flows, and sharpened our staff expertise.

One of the reasons the regional Reserve Bank structure has been so successful is that it permits bank supervision to adjust to circumstances occurring in each region. In essence, each Reserve Bank is structured so it can develop an intimate familiarity with the business activities and operating methods of the institutions it supervises.

Last year, we made this arrangement even more advantageous to banks and bank holding companies by dedicating an examiner to each institution. To further enhance our knowledge and service, we grouped our supervisory assignments geographically. This enables our examiners to become uniquely familiar with the environmental factors that influence the performance of the organizations they supervise. This portfolio approach simultaneously allows for more flexibility and individual attention.

Now that banks are able to operate across state lines and district boundaries, it is increasingly important that we work closely with our fellow regulators to carry out our shared supervisory responsibilities. To that end, we place special emphasis on establishing supervisory arrangements between federal and state regulators, a cooperative structure that makes shared supervision more effective yet more transparent and less of a burden.

Another key supervision strategy change involved re-engineering our examination processes and procedures.



Bank mergers, in particular the acquisition of larger banks by out-of-district organizations, has redefined the Tenth District's banking landscape. This is reflective of national trends and is largely tied to competitive pressures and the growing cost of technology.

We conducted an intense internal review, which led to the implementation of a risk-focused examination approach. Because this approach concentrates our efforts on areas of greatest risk, we have become more responsive to the greatest needs of the banks we examine—and less burdensome.

We have also automated our examination process. Information about banks being examined can be in the hands of our examiners almost instantly. And automation gives our examiners the advanced analytical tools they need to understand today's more complex financial transactions and the risks they pose.

As the district's banking environment changes and becomes more complex, small banks are relying on us for advice on regulatory compliance and managing risk. In response, we have stepped up our continuous education program for our supervision staff. For example, we have added courses on leadership dynamics, agriculture, emerging technologies, and, of course, issues affecting the banking industry.

Similarly, we offer more direct help to banks in the form of outreach seminars on regulatory developments, supervisory concerns, bank director responsibilities, and emerging technologies. Through efforts such as these, our goal is to make banks more proficient in self-compliance. Over time, we expect examinations to become even more streamlined, making the process more efficient both for banks and examiners.

We have become more responsive to the greatest needs of the banks we examine—and less burdensome.

These are some of the environmental factors that continue to redefine the Tenth District's financial services industry. As the industry changes, the Kansas City Federal Reserve will continue to refocus its supervision strategy. As always, our goal is clear: to strike the delicate balance between maintaining a safe and sound banking system and permitting financial institutions the flexibility they need to evolve.

John Yorke is a senior vice president and head of the Division of Bank Supervision and Structure, which is responsible for the supervision and regulation of state member banks and bank holding companies in the Tenth Federal Reserve District. He graduated from the University of Kansas with degrees in accounting and law. He is also a graduate of the Northwestern University Graduate Trust School, the Stanford University Management Program, and the Stonier Graduate School of Banking at Rutgers University.

Strategic Planning Framework: Our Blueprint for the Future

—Richard K. Rasdall, Jr.

Rich Rasdall,
First Vice President and
Chief Operating Officer

As our district's economy becomes increasingly linked to the global marketplace and technological advances continue to fuel the pace of change, strategic planning takes on even greater significance. Our approach to strategic planning has served the Bank very well over the years. We revisit our Strategic Direction Statement annually, reassessing the environmental influences and updating our strategies to respond to those influences.

Our blueprint . . . familiarizes each employee with the key principles that will guide our organization's actions now and in the future.

Although this approach has proven to be effective as a senior management tool, we recognized there has been a missing link in the process—communicating our plans effectively to our staff at all four of our offices. We realized that our ability to respond appropriately to a quickly changing banking landscape depends solely on successfully tapping the talent and energies of our staff. It became abundantly clear that we needed to identify a mechanism to make our plans more meaningful to our staff. We decided that it was crucial to communicate who we are, why we exist, and what we must do to be successful in the long run.

After considerable discussion and debate, the Bank's Management Committee developed a Strategic Planning Framework, subtitled "A Building Plan for the Future." Our blueprint, as we refer to it, familiarizes each employee with the key principles that will guide our organization's actions now and in the future.

Although our blueprint is a new approach to communicating our philosophies and plans to employees, the basic concepts and principles have been a part of the Federal Reserve Bank of Kansas City since its inception in 1914. Our mission, set forth in the Federal Reserve Act, states that we exist to foster the stability, integrity, and efficiency of the national monetary, financial, and payments systems to promote optimal economic performance.

We expanded on this mission statement in our blueprint, relating it more specifically to our primary areas of responsibility—monetary policy, supervision and regulation, and financial services. By expanding the explanation of our mission, we believe it more clearly defines our principal responsibilities for our employees.

We are particularly proud of our vision statement, which says, "By being a premier employer, we will be known for the quality of our employees, who will inspire trust and confidence." In everything we do, and to all the constituencies we serve, we want to be known for our commitment to high standards.

We want the public to be confident that we will act in their best interest in monetary policy considerations, bank supervision and regulation matters, and payments systems functions. To the banking industry, we want to be known as an outstanding provider of payments system services and supervisor of financial institutions. And, we want to be widely known for our expertise in serving community banks. To our Federal Reserve colleagues, we want to be viewed as leading contributors to the formulation of policies and the pursuit of System initiatives.

In developing this blueprint, it was obvious that commonalities exist across our three business areas. Accordingly, we identified six Critical Success Factors that we believe are essential to our success and must be met in everything we do:

- ***Attract, Retain, and Develop Top-Performing Staff—*** recruiting and retaining top-notch employees and providing opportunities for them to reach their fullest potential.

- ***Continuous Improvement—*** sharing the responsibility for improving on what we do today and promoting positive change throughout our organization.

- ***Efficiency—*** continuously seeking the most cost-effective approaches to carrying out our work.

- ***Empowerment—*** encouraging employees to take ownership for their work and endowing responsibility for making decisions and effecting change.

- ***Leadership—*** providing leadership not only within our organization and the Federal Reserve System, but to other regulators, the Treasury Department, and financial services industry groups.

- ***Valuing Diversity and Teamwork—*** striving for an environment that welcomes and encourages different ideas and backgrounds and fosters open communication in the pursuit of common goals.

As a major component of our Strategic Planning Framework, these factors—teamed with our mission, vision, and management philosophy and values—serve as the foundation on which to build our future. Our management philosophy, which is centered on the belief that the Bank's staff is its most important and valued resource, will guide us as we carry out our responsibilities. And, we believe, it will commit us to doing so in a way that will continually deserve your trust and confidence in today's rapidly changing world.

Architects of the Strategic Planning Framework were members of the Management Committee: (clockwise from left) Enis Alldredge, Carl Gambs, Kent Scott, Tom Hoenig, Rich Rasdall, John Yorke, and Craig Hakkio.

As first vice president and chief operating officer, Rich Rasdall directs the Bank's operations throughout the Tenth Federal Reserve District and the activities of some 1,600 employees in Kansas City and at branch offices in Denver, Oklahoma City, and Omaha. He is a graduate of Kansas State University and the Graduate School of Banking at the University of Wisconsin.

Strengthening Our Customer Service Foundation

By designing and implementing our "Building Plan for the Future," the Kansas City Fed took an important step toward achieving its vision. In 1997, with our organizational philosophy clearly defined, we advanced many initiatives to more effectively serve our customers. Here are a few examples:

We led the Federal Reserve System's **Century Date Change Project** to ensure that all of our computer systems and networks are ready for the year 2000 and are properly tested in advance with our customers.

We guided System efforts to select financial **Electronic Data Interchange** (EDI) translation software. Available in 1998, the EDI software will help financial institutions translate computer-readable EDI messages, attached to automated clearinghouse items, into a form their customers can read. The EDI software will help financial institutions comply with legislation mandating that all government payments be made electronically beginning in 1999, and with a National Automated Clearing House Association rule that requires all depository institutions to be financial EDI-capable by September 1998.

We took part in more than 30 **Federal Reserve System initiatives** ensuring that our staff can provide timely advice on emerging banking issues. Customers can consult us on issues such as interstate banking, the System's new single account structure, and the uniform operation of the Federal Reserve System credit and risk management activity.

We conducted a follow-up survey of our customers to see how we were doing in the areas of **quality, price, image, and customer service.** The survey results showed that our customers believe we have made a number of sound improvements to enhance service levels, such as offering new automated systems and new customer-oriented products.

We converted all Tenth District depository institutions to the new **Expanded Funds Format** software. Customers now have a more flexible format that is compatible with other payments systems and makes it easier to comply with Treasury regulations.

We instituted a new **automated response system for savings bond pricing.** Customers now have the option to price their bonds through FedFone without having to wait for a customer service representative. FedFone is a toll-free telephone-based service that gives customers convenient access to our various financial services.

We promoted **electronic transmission of savings bond applications** to depository institutions that handle significant volume.

We **lowered check collection fees** for 1998. Lower fees were made possible by improving the efficiency of our check processing systems.

We helped develop **streamlined and risk-focused examination strategies** to reduce costs and ease the supervisory burden on banks. We now focus examiner resources on areas that pose the greatest risk to the financial institution, the deposit insurance fund, and the payments system. Many examination activities are now conducted off-site.

We played a key role in Federal Reserve efforts to **overhaul the System's application procedures.** The revised procedures dramatically reduce the filing burdens for well-run and well-managed organizations.

Kansas City Board: (left to right) Mr. Barrett, Ms. Hernandez, Mr. Helmerich, Ms. Dancik, Mr. Baird, Mr. McQuillan, Mr. Jennings, Mr. Potenziani, Mr. Nichols.

Kansas City Board of Directors

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Kansas City Power & Light Company
Kansas City, Missouri
—Chairman and Federal Reserve Agent

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Office Managing Partner
Ernst & Young LLP
Denver, Colorado
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Superior, Nebraska

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FirstBank Holding Company of Colorado
Lakewood, Colorado

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Tulsa, Oklahoma

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Kansas City Neighborhood Alliance
Kansas City, Missouri

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Greeley, Nebraska

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Arnett, Oklahoma

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M&T Trust
Albuquerque, New Mexico

Federal Advisory Council Member

Charles E. Nelson
Chairman
Bank One, Oklahoma, N.A.
Oklahoma City, Oklahoma

DENVER BRANCH: *(from left)*
Ms. Paul, Mr. Mammel, Mr. Wold, Ms. McBride, Mr. Ledbetter, Mr. Kirk (not pictured: Mr. Yates)

OKLAHOMA CITY BRANCH:
(from left) Ms. Shaull, Mr. Schock, Mr. Mitchell, Mr. Eller, Mr. Brummett, Mr. Braum (not pictured: Mr. Samis)

OMAHA BRANCH: *(from left)*
Mr. Olson, Mr. Shoener, Mr. Leu, Mr. Gottsch, Ms. Johnston (not pictured: Mr. Lauritzen, Mr. Peterson)

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Partner
Wold Oil & Gas Company
Casper, Wyoming—Chairman

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President and CEO
First National Bank of Gillette
Gillette, Wyoming

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President and CEO
First National Bank of Farmington
Farmington, New Mexico

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President and CEO
The Bank of Cherry Creek, N.A.
Denver, Colorado

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Albuquerque, New Mexico

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Kaiser Permanente
Denver, Colorado

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Colorado State University
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Braum Ice Cream Co.
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Ardmore, Oklahoma

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Consumer Credit Counseling Services
Tulsa, Oklahoma

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President-Elect and Director
Bank of Cushing and Trust Company
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Gottsch Feeding Corporation
Hastings, Nebraska

GLADYS STYLES JOHNSTON
Chancellor
University of Nebraska at Kearney
Kearney, Nebraska

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President
First National Bank of Omaha
Omaha, Nebraska

DONALD A. LEU
President and CEO
Consumer Credit Counseling Services
Omaha, Nebraska

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First National Bank
Sidney, Nebraska

ROBERT L. PETERSON
Chairman, President, and CEO
IBP, Inc.
Dakota City, Nebraska

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Economic Advisory Council

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Director of Research and Collective Bargaining Services
International Brotherhood of Boilermakers
Kansas City, Kansas

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Co-Owner, Crook Farm
Nebraska City, Nebraska

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VICORP Restaurants, Inc.
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Flint Hills Foods, Inc.
Alma, Kansas

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Blue Cross & Blue Shield of Kansas City, Missouri

Karen A. Hiller
Executive Director
Housing and Credit Counseling, Inc.
Topeka, Kansas

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Chairman and CEO
The Bama Companies
Tulsa, Oklahoma

A. F. Raimondo
President and CEO
Behlen Manufacturing Company
Columbus, Nebraska

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Executive Director
Colorado Rural Development Council
Dillon, Colorado

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Chairman and CEO
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Denver, Colorado

Gerald L. Schleich
Chairman
Austin Realty Group
Lincoln, Nebraska

Ray D. Sena
President
Shuttlejack, Inc.
Santa Fe, New Mexico

G. W. Swisher, Jr.
Chairman & CEO
CMI Corporation
Oklahoma City, Oklahoma

Richard E. Wheeler
Chief Executive Officer
Wyoming Machinery Company
Casper, Wyoming

Barry Wilkinson
Secretary-Treasurer
Western Missouri and Kansas Laborers' District Council
Kansas City, Missouri

Financial Services Customer Advisory Council

Kansas City

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President and CEO
Midwest Independent Bank
Jefferson City, Missouri

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Executive Vice President
Emprise Bank
Wichita, Kansas

Danny Little
Executive Vice President
Lamar Bank and Trust Company
Lamar, Missouri

Bruce B. Morgan
President and CEO
The Valley State Bank
Atchison, Kansas

Bruce A. Schriefer
President and CEO
Bankers' Bank of Kansas
Wichita, Kansas

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Senior Executive Vice President
Bank Midwest
Kansas City, Missouri

Larry L. Snyder
President and CEO
The Hamilton Bank
Hamilton, Missouri

Leland M. Walker
Mercantile Bank
Kansas City, Missouri

Denver

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Vice President
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Farmington, New Mexico

J. Paul Boushelle
Executive Vice President
First Security Bank of New Mexico, N.A.
Albuquerque, New Mexico

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Englewood, Colorado

Jack W. Calabrese
Senior Vice President
First Data Corporation
Englewood, Colorado

Don A. Childears
President and CEO
The Colorado Bankers Association
Denver, Colorado

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Norwest Services, Inc.
Denver, Colorado

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Vice President
First Bank Operations Center
St. Paul, Minnesota

Roger R. Reiling
President
Bankers' Bank of the West.
Denver, Colorado

Barbara M. A. Walker
Executive Manager
Independent Bankers of Colorado
Denver, Colorado

Oklahoma City

Don Abernathy
President and CEO
The Bankers Bank
Oklahoma City, Oklahoma

Kerby E. Crowell
Executive Vice President
Stillwater National Bank & Trust Co.
Stillwater, Oklahoma

Dennis L. Gerhard
Vice President
Operations Department
Central National Bank & Trust Co.
Enid, Oklahoma

Robert R. Gilbert
President and COO
F & M Bank & Trust Co.
Tulsa, Oklahoma

J. L. Miller
President, CEO, and COO
Bank of Chelsea
Chelsea, Oklahoma

Omaha

J. Sid Dinsdale
President
Pinnacle Bank
Papillion, Nebraska

Alice M. Dittman
Chairman
Cornhusker Bank
Lincoln, Nebraska

Alan L. Fosler
Senior Vice President and Cashier
Union Bank and Trust Company
Lincoln, Nebraska

Donald G. Johnson
President and CEO
Farmers National Bank
Pilger, Nebraska

Lloyd R. Kitrell
President
Hastings State Bank
Hastings, Nebraska

Gerald E. Wortman
President and CEO
Sherman County Bank
Loup City, Nebraska

Financial Services Customer Advisory Council membership as of December 31, 1997.

Tenth District Officers

Kansas City

Thomas M. Hoenig
President

Richard K. Rasdall, Jr.
First Vice President

Enis Alldredge, Jr.
Senior Vice President

Craig S. Hakkio
Senior Vice President and Director of Research

Kent M. Scott
Senior Vice President

Dick H. Woods, Jr.
Senior Vice President, General Counsel, and Adviser to the Management Committee

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Vice President, Associate General Counsel, and Secretary

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General Auditor

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Assistant Vice President and Economist

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Assistant Vice President

Kathryn A. Webster
Assistant Vice President

John A. Wood
Assistant Vice President

Catherine A. Zeigler
Assistant Vice President

Federal Reserve Bank of Kansas City's Official Staff as of December 31, 1997.

Denver

Carl M. Gambs
Senior Vice President and Branch Manager

Randy M. Schartz
Vice President and Assistant Branch Manager

Maryann F. Hunter
Vice President

Pamela L. Weinstein
Vice President

Thomas P. Bennett
Assistant Vice President

Gary E. Darby
Assistant Vice President

Debbie L. Meyers
Assistant Vice President

S. Andrew Thompson, Jr.
Assistant Vice President

Oklahoma City

Kelly J. Dubbert
Vice President and Branch Manager

Dwayne E. Boggs
Assistant Vice President and Assistant Branch Manager

Tara B. Koenigs
Assistant Vice President

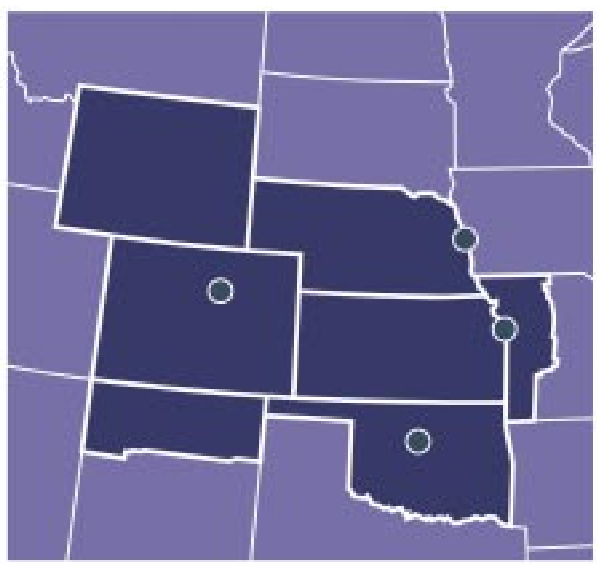
Robert W. Toler
Assistant Vice President

Omaha

Steven D. Evans
Vice President and Branch Manager

Ronald M. Ryan
Assistant Vice President and Assistant Branch Manager

Tenth Federal Reserve District



FEDERAL RESERVE BANK OF KANSAS CITY

KANSAS CITY 925 Grand Boulevard Kansas City, Missouri 64198	**OKLAHOMA CITY BRANCH** 226 Dean A. McGee Oklahoma City, Oklahoma 73125
DENVER BRANCH 1020 16th Street Denver, Colorado 80202	**OMAHA BRANCH** 2201 Farnam Street Omaha, Nebraska 68102

Financial Statement

Statement of Income

	1997	1996
Interest income:		
Interest on U.S. government securities	$ 737,992,741	$ 783,759,786
Interest on foreign currencies	14,264,223	16,927,827
Interest on loans to depository institutions	1,589,659	1,132,022
TOTAL INTEREST INCOME	$ 753,846,623	$ 801,819,635
Other operating income (loss):		
Income from services	$ 53,675,247	$ 50,787,341
Reimbursable services to government agencies	18,634,708	19,087,772
Foreign currency (losses), net	(98,463,460)	(63,832,062)
Government securities gains, net	378,712	1,129,151
Other income	270,617	260,678
TOTAL OTHER OPERATING INCOME (LOSS)	$ (25,504,176)	$ 7,432,880
Operating expenses:		
Salaries and other benefits	$ 76,623,002	$ 78,308,205
Occupancy expense	6,993,447	7,337,158
Equipment expense	7,422,913	6,980,082
Cost of unreimbursed Treasury services	2,404,629	2,624,738
Assessments by Board of Governors	16,832,404	18,685,611
Other expenses	48,020,650	50,394,333
TOTAL OPERATING EXPENSES	$ 158,297,045	$ 164,330,127
NET INCOME PRIOR TO DISTRIBUTION	$ 570,045,402	$ 644,922,388
Distribution of net income:		
Dividends paid to member banks	$ 9,014,200	$ 10,052,800
Transferred to (from) surplus	(47,818,950)	23,005,650
Payments to U.S. Treasury as interest on Federal Reserve notes	0	457,250,081
Payments to U.S. Treasury as required by statute	608,850,152	154,613,857
	$ 570,045,402	$ 644,922,388

Statement of Condition

	1997	1996
Assets		
Gold certificates	$ 286,000,000	$ 321,000,000
Special drawing rights certificates	247,000,000	280,000,000
Coin	35,556,563	55,804,100
Items in process of collection	439,732,408	843,294,858
Loans to depository institutions	12,770,000	7,115,000
U.S. government and federal agency securities, net	12,392,581,948	12,349,450,830
Investments denominated in foreign currencies	647,484,298	737,300,775
Accrued interest receivable	117,209,818	111,403,267
Interdistrict settlement account	879,925,921	(650,155,425)
Bank premises and equipment, net	76,579,358	78,489,286
Other assets	14,987,495	12,916,394
TOTAL ASSETS	$ 15,149,827,809	$ 14,146,619,085
Liabilities and Capital		
Liabilities:		
Federal Reserve notes outstanding, net	$ 13,540,862,871	$ 12,434,974,495
Deposits:		
Depository institutions	760,745,775	816,865,472
Other deposits	8,181,325	9,148,673
Deferred credit items	472,557,575	462,596,938
Statutory surplus transfer due U.S. Treasury	60,724,346	17,510,696
Accrued benefit cost	55,297,890	54,305,603
Other liabilities	5,663,225	5,720,599
TOTAL LIABILITIES	$ 14,904,033,007	$ 13,801,122,476
Capital:		
Capital paid-in	$ 126,957,350	$ 174,776,300
Surplus	118,837,452	170,720,309
TOTAL CAPITAL	$ 245,794,802	$ 345,496,609
TOTAL LIABILITIES AND CAPITAL	$ 15,149,827,809	$ 14,146,619,085

Statement of Changes in Capital

For the Years Ended December 31, 1997 and December 31, 1996

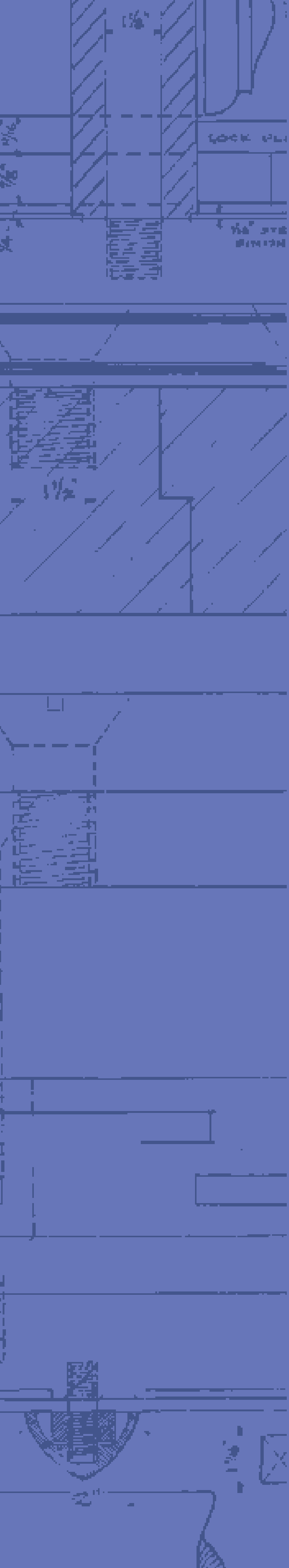
	CAPITAL PAID-IN	SURPLUS	TOTAL CAPITAL
Balance at January 1, 1996			
(3,035,413 shares)	$ 151,770,650	$ 151,770,650	$ 303,541,300
Net income transferred to surplus	—	23,005,650	23,005,650
Net change in capital stock issued (460,113 shares issued)	23,005,650	—	23,005,650
Surplus transferred to the U.S. Treasury as required by statute	—	(4,055,991)	(4,055,991)
Balance at December 31, 1996			
(3,495,526 shares)	$ 174,776,300	$ 170,720,309	$ 345,496,609
Net income transferred (from) surplus	—	(47,818,950)	(47,818,950)
Net change in capital stock (redeemed) (956,379 shares redeemed)	(47,818,950)	—	(47,818,950)
Surplus transferred to the U.S. Treasury as required by statute	—	(4,063,907)	(4,063,907)
Balance at December 31, 1997			
(2,539,147 shares)	$ 126,957,350	$ 118,837,452	$ 245,794,802

These statements are prepared by Bank Management.
Copies of full financial statements complete with footnotes are available by contacting the Public Affairs Department of the Federal Reserve Bank of Kansas City, 925 Grand Boulevard, Kansas City, Missouri, 64198-0001.

Volume of Principal Operations

	1997	1996
Loans and Discounts, Daily Average	$ 28,846,000	$ 21,239,000
Number of Institutions Borrowing	147	156
Commercial Checks	$ 813,387,000,000	$ 751,239,000,000
Commercial Checks Collected	1,331,658,000	1,289,297,000
Currency Receipts and Payments	$ 31,659,385,000	$ 31,445,190,000
Pieces	2,336,388,000	2,268,061,000
Coin Receipts and Payments	$ 629,238,000	$ 710,610,000
Bags	1,080,000	1,139,000
Issues and Redemption of U.S.Government Securities	$ 52,136,397,000	$ 56,196,978,000
Funds Transfers	$ 9,046,713,000,000	$ 9,822,872,000,000
Numbers	6,556,000	6,531,000

This annual report is also available on the Federal Reserve Bank of Kansas City's Web site located at **www.kc.frb.org**.



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