ANNUAL REPORT

Federal Reserve Bank of
KANSAS CITY

INSIDE

The seven states of the Tenth Federal Reserve District are, to many people, the Heartland of America. With headquarters at the Federal Reserve Bank of Kansas City, the district encompasses western Missouri, Kansas, Nebraska, Oklahoma, Colorado, Wyoming, and northern New Mexico.

The district is rich in history and contrast. Its economy is as diverse as the landscape. Oil and gas, coal, uranium, and a variety of other minerals lie beneath its surface. Agriculture, livestock production, and attendant food-processing industries are important components of its economy, along with manufacturing, aerospace and aviation, and the growing presence of high-technology and telecommunications sectors. World demand for products from the Heartland has opened overseas markets and spawned a thriving export sector.

In this Annual Report for 1998, you will read of the relationships we, at the Federal Reserve Bank of Kansas City, have developed throughout the region as we endeavor to serve the nation and its financial interests. It is in this spirit of service that we celebrate the Heartland. ■

President

THOMAS M. HOENIG

One of the enduring aspects of the Federal Reserve structure is that it is at once public and private, centralized and decentralized. The 12 Reserve Banks that serve our nation's geographic districts represent the more private and decentralized character of the System. This regionalism makes each Reserve Bank unique. No two districts are alike.

In this year's Annual Report, we present the results of our efforts in the Tenth District to serve our region's constituents. More than ever before, we have involved the community we serve in our efforts to achieve our goals.

As always, we have sought to foster an environment that encourages innovation in the private sector. By forging new and lasting partnerships with the community, we are finding new ways to let innovation flourish – not only for today, but for the new century.

As you read the following pages, you will meet six people from our district who exemplify the kinds of relationships we are forging with leaders from banking, business, and communities across our vast region. They represent the kinds of people who are closely involved with the Federal Reserve Bank of Kansas City, as directors, customers, or advisors – often as all three.

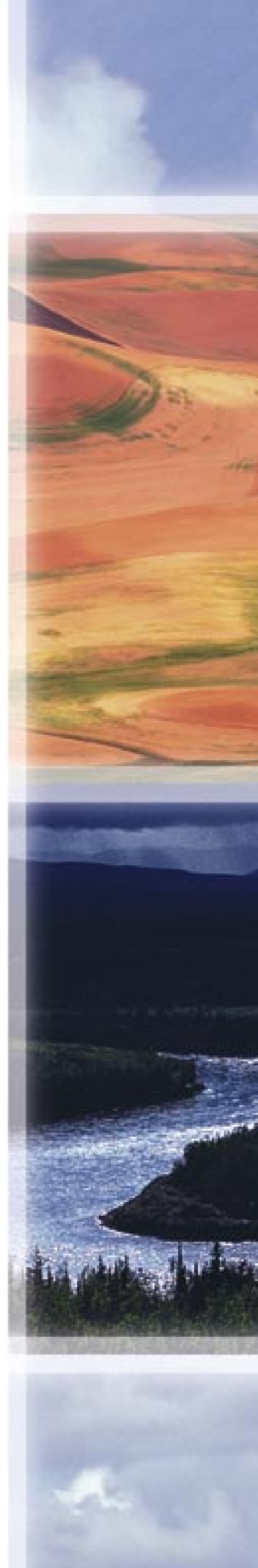
We will continue to foster our network of partnerships throughout the region.

We report on our efforts in monetary policy, financial services, and bank supervision over the past year. In these pages you will see how we responded to the Federal Reserve's Rivlin Report, which called on us to increase our efforts with the community to enhance the efficiency, effectiveness, and convenience of the retail payments system.

You will also see many other ways we are responding to the challenges of the 21st century. Our new Center for the Study of Rural America is one example. Our year 2000 testing program for on-line customers and our Basic Training program for bank directors are two others – to name just a few.

As we move closer to the year 2000, our sphere has clearly extended beyond our borders to the global economy. In 1998, we saw how quickly a financial crisis in one part of the world can spread to other continents, threatening healthy industrialized nations and developing nations alike.

The Federal Reserve acted promptly and decisively to ease monetary policy at home and prevent serious disruptions in the U.S. economy. But the lesson of 1998 was clear: No longer is there any doubt that we are all in this global,



interconnected marketplace together.

Here at home, we will continue to foster our network of partnerships throughout the region. With the help of our branch offices in Denver, Oklahoma City, and Omaha, we will continue to reach out to the communities we serve, to streamline our operations, and to provide an even higher level of service to our customers.

We have benefited in important ways from the oversight, advice, and practical experience of the directors who serve the Bank and its branches. These outstanding men and women from all over the region bring us perspectives that bolster our understanding and contribute to real-world solutions to the problems we all face. They have earned the thanks of everyone in the region for their service.

And we have benefited from the hard work and dedication of all our employees. It is through them that we are able to earn the trust and confidence of those we serve.

And so, once again, we report on a successful year – one that embraced the growing need for partnerships in a rapidly changing and expanding world. Together, we look forward to the challenges and opportunities that a new year and a new century will surely bring.

Thomas M. Hoenig

THOMAS M. HOENIG
President and
Chief Executive Officer

MONETARY *Policy*

Conducting monetary policy in today's global environment

The U.S. economy turned in another strong performance in 1998, despite turbulence in domestic financial markets and continued financial unrest around the world. It's hard to remember when so many economic developments – both here and abroad – have been in play at the same time. And seldom have global economic events been so critical to the U.S. economy and to monetary policy decisions.

A tale of two halves

As the year began, the economy entered its eighth year of expansion, making it one of the longest peacetime expansions in America's history.

In many ways, the first half of the year performed on cue. Spending in key economic sectors remained solid, even robust. Consumer spending barreled ahead, business investment in plant and equipment continued to rise at double-digit rates, and the housing market surged. Meanwhile, unemployment dipped to a 28-year low.

Against this backdrop of solid growth, inflation stayed surprisingly low.

Against this backdrop of solid growth, inflation stayed surprisingly low. Strong domestic demand was tempered by a weakened net export market, providing a safety valve for what otherwise might have been an overheated U.S. economy.

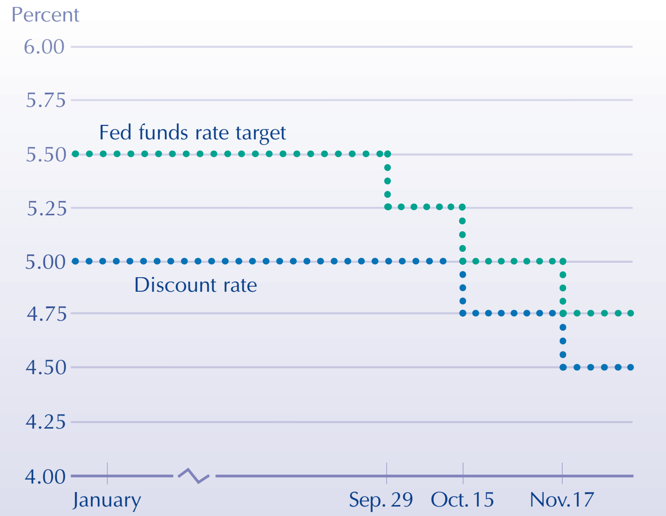
But midway through the year, the economic landscape began to change. Overseas, the Asian economies continued to struggle, especially Japan's. Russia found itself in a perilous situation. Then some Latin American countries, notably Brazil, experienced problems. Investors worldwide began to cast a more cautious eye.

Here at home, the stock market took notice. After cresting at 9,500 points in July, the Dow Jones began gyrating hundreds of points in response to global news, which in turn jostled foreign markets, making volatility around the world the daily norm. Compared with the previous 12 months, the volatility of daily stock returns roughly doubled.

Business confidence weakened somewhat but remained strong, and consumer confidence in the U.S. economy overall remained at its highest level in nearly 30 years.

In some ways, the U.S. economy actually benefited from the financial turmoil overseas. Many international investors, fleeing emerging markets abroad, viewed the United States as a safe haven for their assets and flooded the U.S. Treasuries market, pushing yields on 30-year Treasury bonds to record lows. Meanwhile, the prime rate and interest rates

In 1998, the Fed cut interest rates three times in seven weeks.



FEDERAL RESERVE POLICY MOVES – 1998

on highly rated corporate debt also fell. And 30-year fixed rates on home mortgages dipped to their lowest levels in a generation.

Developments like these kept demand for housing strong and allowed many consumers to improve their cash flow by refinancing existing mortgages. The low rates also helped lower the cost of credit card debt and home equity lines of credit.

Monetary policy moves

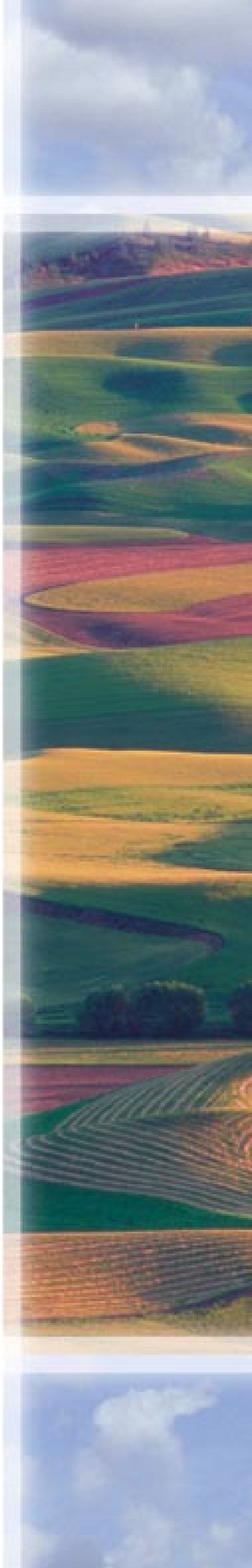
By late September, as the world's financial ills spread deeper and further than almost anyone had expected, the Federal Reserve decided to act. Citing a backdrop of "increasing weakness in foreign economies" and "less accommodative financial conditions domestically," the Federal Open Market Committee, the Fed's policymaking body, lowered the federal funds rate by a quarter-point. The move was "consistent with keeping inflation low and sustaining economic growth going forward."

The FOMC then acted again in October, citing "growing caution by lenders and unsettled conditions in financial markets more generally." This time the fed funds rate was lowered another quarter-point to 5 percent. Concurrently, the board of directors of the Federal Reserve Bank of Kansas City, along with seven other Reserve Banks, requested that the Board of Governors lower the discount rate. The Board of Governors approved a 25-basis-point cut, lowering the discount rate to 4.75 percent. Then, in November the Fed cut both rates another quarter-point.

An evolving policy environment

While the U.S. economy stayed strong in 1998, events showed how rapidly global disruptions can spread. Huge sums of money can be transferred almost instantaneously from market to market, and from country to country, creating a major impact on a country's financial markets and economic health.

The Tenth District is certainly not immune to such exposure. Consequently, a critical part of the policymaking process is knowing how and when economic events overseas are reshaping conditions here at home. ■



Profile

Jo Marie Dancik

Jo Marie Dancik's unique perspective on the economy helps monetary policymakers.

To help keep monetary policy on track, policymakers rely on a host of economic indicators and statistics – and on grass roots sources of information like Jo Marie Dancik.

When Jo Marie Dancik isn't climbing the Rockies or arbitrating a dispute between Fortune 500 companies, she is in close contact with her community's roots. "Knowing what's happening in our region is one of my passions," she says. She believes firmly that anecdotal information adds depth to the empirical data that economists use to gauge the health of the economy.

Jo Marie is chairman of the Kansas City Federal Reserve Bank's Board of Directors. Made up of nine banking, business, and community leaders, the board assesses current economic trends, emerging developments, and the impact of global events on the economy. The board also makes recommendations on the discount rate.

Jo Marie is a managing partner at Ernst & Young's Denver office. She is a trustee of Boy Scouts of America-Denver and recently chaired the Mile High United Way fund-raising campaign. In 1996, she was named Banking and Finance Executive of the Year by the *Denver Business Journal* and was selected by a community panel to help carry the Olympic Torch through Denver.

She points out that she is not the first woman to chair the Board of Directors. "Other women have chaired the Kansas City board and the boards at the branch offices," she says. "It's important that our boards reflect the diversity of the communities we serve."

The prominent role Jo Marie plays in her community gives her a unique perspective of the nation's economy. Through her many business and community contacts, she is able to discern how global and national events are reshaping business activity in her community – information she shares with policymakers. Assets such as these help make Jo Marie an invaluable contributor to sound monetary policy. ■

KANSAS CITY

Board

(From left) Mr. Schriefer, Mr. Helmerich, Mr. Nichols, Mr. Dunn, Ms. Hernandez, Mr. Barrett, Mr. Potenziani, Ms. Dancik, Mr. McQuillan.

Jo Marie Dancik
Area Managing Partner
Ernst & Young LLP
Denver, Colorado
– Chairman and Federal Reserve Agent

Terrence P. Dunn
President and CEO
J.E. Dunn Construction Company
Kansas City, Missouri
– Deputy Chairman

Dennis E. Barrett
President
FirstBank Holding Company of Colorado
Lakewood, Colorado

Hans C. Helmerich
President and CEO
Helmerich & Payne, Inc.
Tulsa, Oklahoma

Colleen D. Hernandez
Executive Director
Kansas City Neighborhood Alliance
Kansas City, Missouri

William L. McQuillan
President and CEO
City National Bank
Greeley, Nebraska

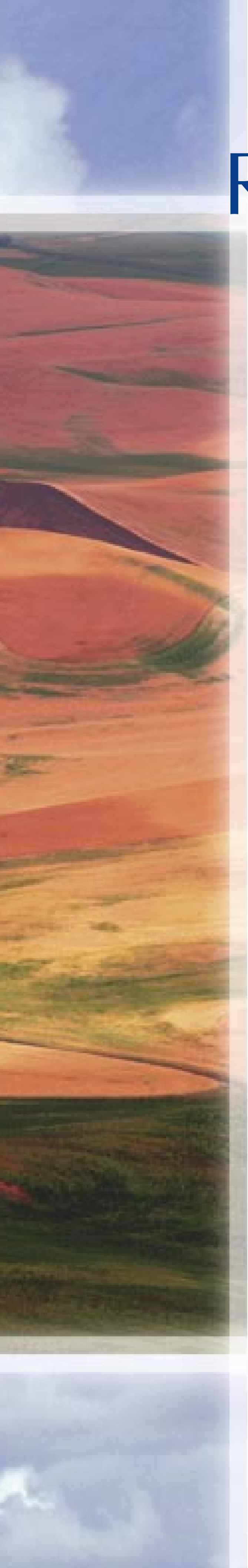
Charles W. Nichols
Managing Partner
Davison and Sons Cattle Company
Arnett, Oklahoma

Frank A. Potenziani
M&T Trust
Albuquerque, New Mexico

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

Federal Advisory Council Member

C.Q. Chandler
Chairman and CEO
INTRUST Financial Corporation
Wichita, Kansas



REGIONAL

Economy

A growing Tenth District economy – despite the Asian crisis

The district economy was solid again in 1998, although some pockets of weakness began to emerge. This weakness was largely due to the Asian economic crisis, which dampened demand for the region's key agricultural and industrial exports. The district's energy industry also suffered from generally low energy prices throughout the year.

While the Asian economic flu had a definite influence on the region, most district businesses reported another good year in 1998, as reflected in continued growth in sales, investment, and new jobs.

The district's expansion continues

The district's economic expansion continued for the twelfth straight year in 1998. Employment growth, an important yardstick of overall performance, posted a 2.2 percent advance for the year. While this growth was solid, it was slightly below the 2.3 percent growth in jobs across the country and down from the district's 2.8 percent advance in 1997.

With another year of solid gains in district payrolls, 1998 underscored the conclusion that the current expansion ranks among the region's best on record. Indeed, the region's solid growth in the 1990s has created the biggest problem facing most district businesses – tight labor markets. As the year came to a close, the district's unemployment rate stood at 3.7 percent, more than half a percentage point under the national rate. Labor markets were even tighter in many of the district's seven states.

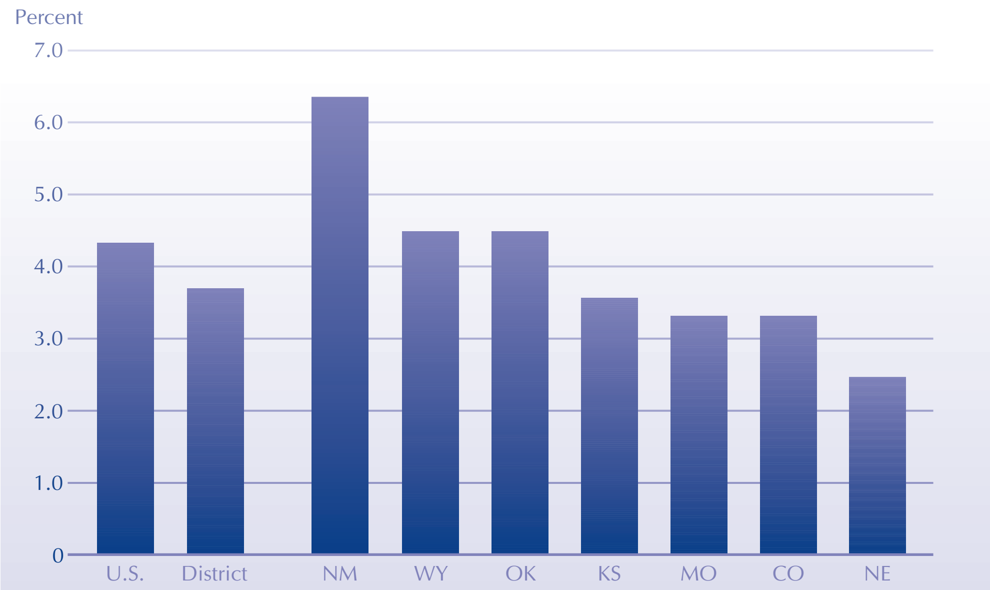
Economic growth was somewhat more uneven across district states in 1998, probably reflecting the varying impact of global economic uncertainties. Colorado remained the district front-runner, with 3.2 percent job growth for the year, while Oklahoma and Kansas also grew faster than the nation's pace of 2.3 percent. The remaining district states all grew more slowly than the nation. The biggest slowdown in 1998 took place in Missouri, which saw its important manufacturing sector hit hard by the Asian slowdown.

Throughout the year, the district's many farms and factories kept a wary eye as the Asian economic situation unfolded.

Effects of the Asian economic slump

In a climate of slowing but continued growth in 1998, the Asian crisis did take a certain toll on

Solid growth has created the biggest problem facing most district businesses – tight labor markets.



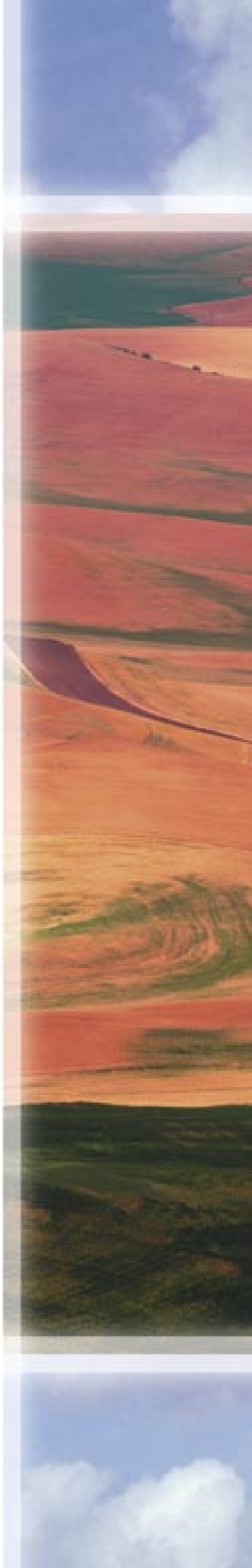
TENTH DISTRICT UNEMPLOYMENT RATES
DECEMBER 1998

the health of the Tenth District economy. Even though the district represents the Heartland, it still has strong trade links with Asia. District manufacturers ship roughly a quarter of their exports to Asian countries, while fully half of the region's food and agricultural exports are destined for Asian markets. Thus, throughout the year the district's many farms and factories kept a wary eye as the Asian economic situation unfolded.

The biggest impact of the Asian crisis was felt by district agriculture, which entered a major downturn in 1998. Commodity markets were weak all year due to the fall in global demand and especially large supplies of crops and livestock. The weak prices led to an overall drop in district farm earnings of about 15 percent, a drop that was tempered somewhat by a government assistance package passed in October before Congress adjourned.

Another sector that felt the effects of global events was the energy sector. Global demand for energy slumped in 1998, pushing prices down. Prices for West Texas Intermediate crude oil fell as low as $12 a barrel, the lowest point in several years. The soft prices, in turn, put a damper on both energy production and new exploration. While prices recovered some by yearend, many energy companies posted poor earnings.

Tracking the district's diverse economic performance is an important commitment for the Bank, since district conditions are a critical backdrop for monetary policy decisions. To stay in touch with economic developments, the Bank pays close attention to a wide range of economic indicators. And it listens closely to groups such as the Bank's Economic Advisory Council, important voices for agriculture, small business, and the U.S. consumer. ■



Profile

Paula Marshall-Chapman

Whether your business is hot apple pies or monetary policy, success often depends on nuances like timing and a touch of seasoning – and reaching out to the right people.

Getting quality input from successful business people like Paula Marshall-Chapman, CEO of The Bama Companies, Inc., is essential when crafting monetary policy. Paula, and the other members of the Kansas City Fed's Economic Advisory Council, serve as a reliable voice on how economic forces influence business activity around the district.

"Quality is a journey," Paula says. "In the pie business, we keep in touch with people along the way – our customers, our suppliers, our employees. Without hearing from them, how else can we be sure what quality is?"

For the last 35 years, The Bama Companies, Inc., has been the sole supplier of hot fruit pies to McDonald's restaurants. Today, Bama produces over a million pies and 3 million biscuits daily for McDonald's, Pizza Hut, QuikTrip, Olive Garden, and Cargill Foods. And Bama recently began putting hot apple pies on McDonald's tables in China.

In recognition of her commitment to quality, Paula was named one of Ten Outstanding Young Americans in 1992 by the U.S. Junior Chamber of

Listening to people like Paula Marshall-Chapman helps lay the groundwork for sound monetary policy.

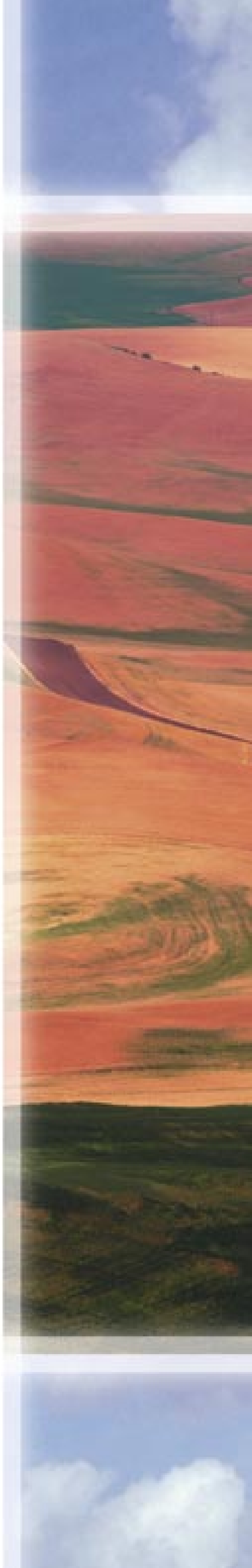
Commerce, and one of the top ten CEOs in America by *Industry Week* in 1993. In 1996, Bama Pies won McDonald's highest quality award for suppliers. And in 1997, Paula was named Entrepreneur of the Year by the Franklin Covey Company, based on her principle-centered leadership.

Unleashing such potential takes more than simply knowing how to bake great pies. "We aren't just in the pie business," Paula says. "We're in the people business, the relationship business. Success depends on helping those we do business with become successful, too – and that means opening a dialogue."

Those are the kinds of values Paula brings to the Economic Advisory Council: leadership, reaching out, open dialogue, quality input – key ingredients in anyone's recipe for success.

RURAL

America



New initiatives for the 21st century

The Bank undertook two major initiatives in 1998 aimed at helping rural America better achieve its economic potential in the next century. The Bank held a national conference on rural capital issues in Denver. And the Bank announced the creation of a new rural research center.

Equity for Rural America: From Wall Street to Main Street was held in Denver. The conference brought together experts and decision-makers to discuss rural access to equity capital. Equity is often the forgotten part of rural America's capital mix, yet rural America's economic future depends on the ability of rural entrepreneurs to access Wall Street.

How well do Wall Street and Main Street come together? Conference participants agreed that steps can be taken to more effectively bring Wall Street to rural America. Presenters shared examples of how rural equity capital institutions are bringing capital to rural businesses and boosting local economic growth in the process. While often successful, these institutions are not widespread. To replicate such institutions elsewhere in rural America, the challenge appears to be finding ways for public-private cooperation in the 21st century.

President Hoenig (left) and Center director Mark Drabenstott discuss equity capital markets with rural business leaders.

In October, the Bank also announced the creation of the ***Center for the Study of Rural America.*** Rural America is home to a quarter of the nation's people and more than half its banks – many of which are in the Tenth District. To better serve this vital part of our regional and national economy, the Bank is creating the Center to make sure rural America's unique economic and policy issues get the attention they deserve. The new Center, which will produce studies and analyses of rural issues, grows out of the Bank's significant tradition of excellence in research on these topics over many decades. The Center will open in mid-1999. ■

FINANCIAL

Services

Teaming up with the banking industry to enhance the retail payments system

For years now, the checkless society has seemed just around the corner. Today, we have a growing variety of electronic tools to pay our bills, quickly and efficiently, without having to write a single check – yet about three-fourths of all non-cash U.S. transactions are still made by check.

This reality presents a special challenge to the Federal Reserve. The paper-based system of check collection relies on a mature technology that is unlikely to see significant gains in efficiency. One of our vital goals has always been to enhance payments efficiency – both in our own operations and those of our banking customers and society.

The Rivlin Report

In January, the Federal Reserve's Rivlin Report concluded that we should enhance the efficiency, effectiveness, and convenience of check collection and automated clearing-house (ACH) services. The report recommended that Federal Reserve Banks work closely with private industry to help evolve strategies for electronifying the payments system.

With an electronic infrastructure well in place in 1998, the Kansas City Fed was well positioned to bring the Rivlin Report's recommendations to life. At the beginning of the year, more financial institutions were receiving electronic check presentments in the Tenth District than in any other Federal Reserve district.

In 1998, the Kansas City Fed was well positioned to bring the Rivlin Report's recommendations to life.

Check imaging for banking customers

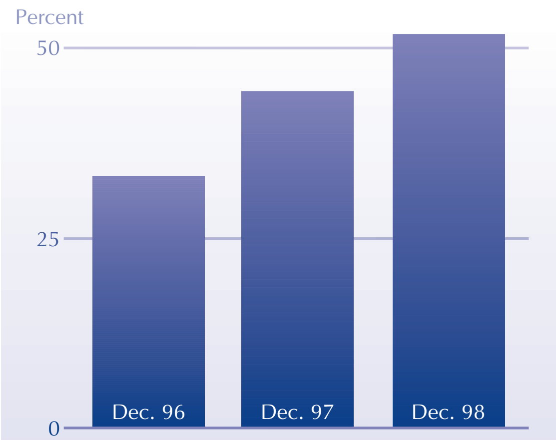
One way to increase the efficiency of clearing paper checks is truncation, a process that substitutes electronic information for the paper check during the collection process. Some banks have been reluctant to adopt truncation, however, because customers want quick and easy access to physical copies of their checks.

The Kansas City Bank was the first in the nation to offer banks access to digital images of checks over the Internet during the truncation process. Check imaging enables banks to take advantage of truncation and still offer their customers copies of checks, electronically or on paper.

Removing barriers to ACH use

ACH allows institutions, firms, and consumers to make a variety of direct deposits and payments, with no need to transport, process, and store billions

The Automated Payments Partnership helped heighten public awareness of the advantages of ACH.



SHARE OF DEPOSITORY INSTITUTIONS ORIGINATNG ACH
TENTH DISTRICT

of pieces of paper. Despite its advantages, ACH accounts for only about 5 percent of all noncash U.S. transactions.

With such enormous potential, why hasn't ACH caught on, especially in business-to-business transactions? One answer is that many banks simply lack the software to translate a transaction's accompanying invoice information into plain English for their corporate customers.

A Federal Reserve project team, headed by Tenth District staff, worked closely with industry experts and ACH users in 1998 to help solve this problem. Together, we developed a software package, FedEDI, which can translate this information. We began distributing FedEDI nationally and held training programs for users. ACH is now an attractive payments option for a much broader spectrum of banking customers.

Collaborating with private industry

A key to creating a more effective payments system is forging partnerships. The private sector has always provided technical innovation. As their partner, we have helped establish the basic conditions needed for fostering innovation.

In addition to FedEDI, another joint effort with private industry in 1998 was making sure our payments system would operate smoothly through the century date change. A majority of our on-line customers have already worked with us to test their use of our electronic payments services.

We also worked with other Federal Reserve Banks and private industry to heighten public awareness of ACH, a vital task given the federal government's EFT99 initiative to electronify most government payments in 1999. As the Automated Payments Partnership gathered steam, over 1,300 financial institutions and corporate partners helped us inform potential customers about the benefits of ACH. By yearend, 52 percent of our district's depository institutions were originating ACH payments.

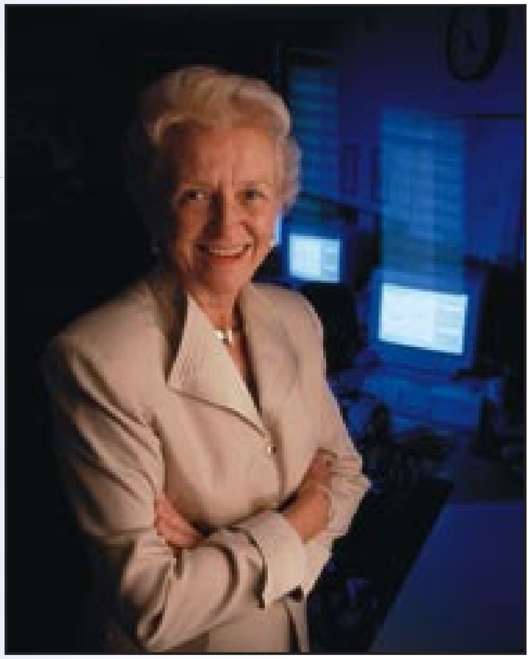
By forging active partnerships with private industry, we can help foster a competitive, productive environment for the birth of new products and ideas. In doing so, we can help satisfy two of our primary goals – a wider range of payments choices for consumers and businesses, and enhanced efficiency in all facets of the retail payments system. ■

Profiles

ALICE DITTMAN

Alice Dittman's banking career spans almost five decades, starting in the early 1950s with a check-filing job for 50 cents an hour. Since then, she and her late husband, Mark, have started two new banks, brought the total assets of the Cornhusker Bank in Lincoln, Nebraska, from $10.5 to $170 million, and received nearly every honor and award possible.

A member of the Kansas City Fed's Financial Services Customer Advisory Council, Alice is a strong proponent of technology. "We were the first Nebraska bank to go fully to an imaging format for our check operation," she says. She values the Federal Reserve's efforts to improve the efficiency of the payments system.



Cornhusker Bank's chairman is an advocate of technology in her drive for banking efficiency.

"The Federal Reserve continually strives to shorten presentment times, working hard to help all banks become more efficient in delivering services. Day to day, we as bankers rely on the Fed to clear the largest percentage of our checks in the most efficient manner possible. It's a great team. I'm excited about the Fed's entrance into imaging and look forward to the day we can receive our cash letter in this efficient format." ■

Nearly 400 Midwest banks receive Fed Services through correspondent relationships with MIB.

CAM FINE

Like bankers and business people around the world, Cam Fine, president and CEO of Midwest Independent Bank, is making sure his systems are year 2000 compliant.

Bankers give valued advice regarding Financial Services issues.

"It's the largest single issue there is," Cam says from his Jefferson City, Missouri office. "People are delaying other projects to make sure they're ready. We are testing our internal systems and the systems that interact with our correspondents through FedLine."

Taking care of their correspondent banks is the order of business for MIB, a banker's bank owned and directed by independent community banks. MIB provides these kinds of banks a wide range of technical and traditional correspondent banking services.

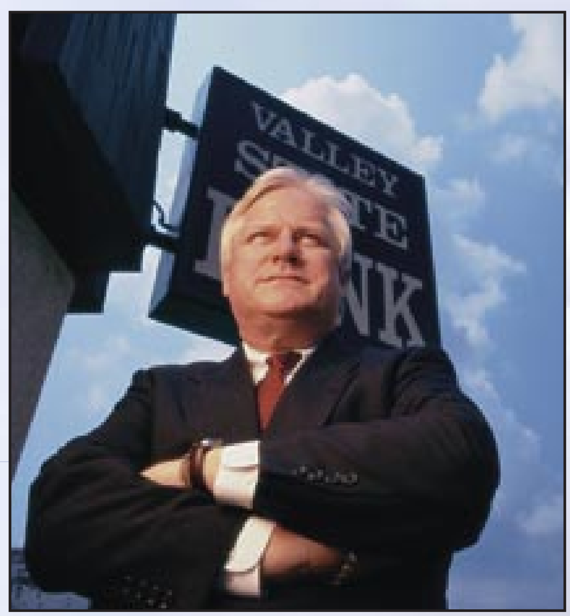
As one of the Kansas City Fed's largest customers and a member of the Customer Advisory Council, Cam meets frequently with the Bank's operations staff. This relationship has resulted in a number of innovative strategies for meeting the service needs of banks throughout the district. ■

BRUCE MORGAN

At Valley State Bank in Atchison, Kansas, community spirit is a given, and president and CEO Bruce Morgan wouldn't have it any other way. He believes it's important to keep the Federal Reserve user-friendly for the small community bank. "The Fed is an important correspondent banking partner," he says. His bank maintains a Fed account and subscribes to nearly all the Kansas City Fed's operations-related services.

Bruce has worked closely with the Kansas City Fed on several initiatives, serving on the Customer Advisory Council and in focus groups on electronic check presentment. He has served as a speaker and trainer at Federal Reserve Banks in Chicago and Atlanta, training senior-level bank examiners on the future of community banking.

Through his partnership with the Fed, Bruce hopes to ensure the viability of community banks. "The banking system reminds me of roads



Programs that focus on the future of community banking are important to Valley State Bank.

on a map," he says. "Despite all the merger mania, there will always be red highway banks and blue highway banks. I'm a blue highway banker." ■

SUPERVISION

and Regulation

Fed supervision reaches out to regional banks

Ongoing improvement is a key feature of the Bank's regulatory culture. Thus, our supervision and regulation function continued to reach out to banks in the region to improve the effectiveness of our supervisory role. For example, in 1998 we expanded our risk-focused approach to regional bank supervision. We also began to monitor and assist banks in preparing for the century date change. And we improved our understanding of the effects of mergers on banks in rural communities. Finally, the Bank bolstered an already active schedule of outreach programs, including those conducted through our Community Affairs function.

> *The Fed continued to be a catalyst for promoting fair and efficient markets.*

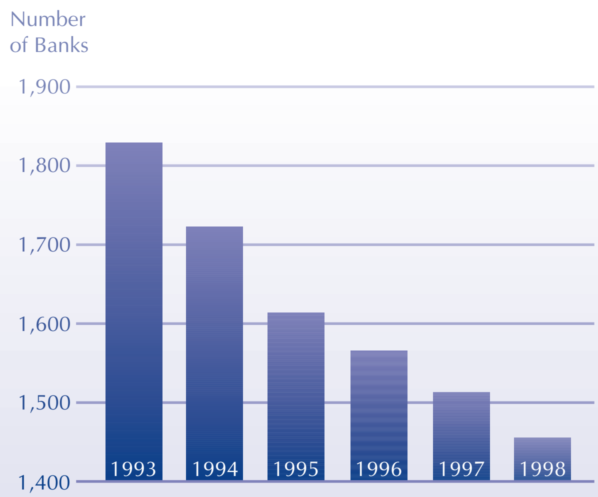
Regional bank supervision

As a regional bank supervisor, our primary focus is on the health of community banks, their environment, and the efficiency and effectiveness of our bank supervision. During 1998, we expanded the use of risk-focused examinations and implemented programs to improve the examination process and minimize supervisory burden. For example, our examiners fine-tuned their use of the risk-focused approach to allocate safety and soundness examination resources to areas posing the greatest risk at banks we examined. Additionally, they began applying the risk-focused approach to examinations for compliance with consumer laws and regulations. Besides these efforts, we enhanced sharing of examination best practice information among examiners and conducted forums to keep examiners abreast of economic conditions and banking activities that raise supervisory concerns and that deserve increased examiner attention. Together, we believe these initiatives increased our efficiency, improved our effectiveness, lessened burdens on those we supervise, and permitted us to better anticipate future challenges and be more proactive in our supervisory approach.

Century date change

We began the process of conducting supervisory reviews of financial institutions and service providers headquartered in the Tenth District to determine their year 2000 preparedness. The regulatory emphasis was on preparedness testing, customer awareness, and contingency planning. We also provided resources to assist financial institutions in informing their communities about century date change issues.

We conducted seminars for bank officers in all district states.



TENTH DISTRICT BANKS

The district's banking landscape has changed due to the acquisition of larger banks by out-of-district organizations and mergers of small community banks.

Bank mergers

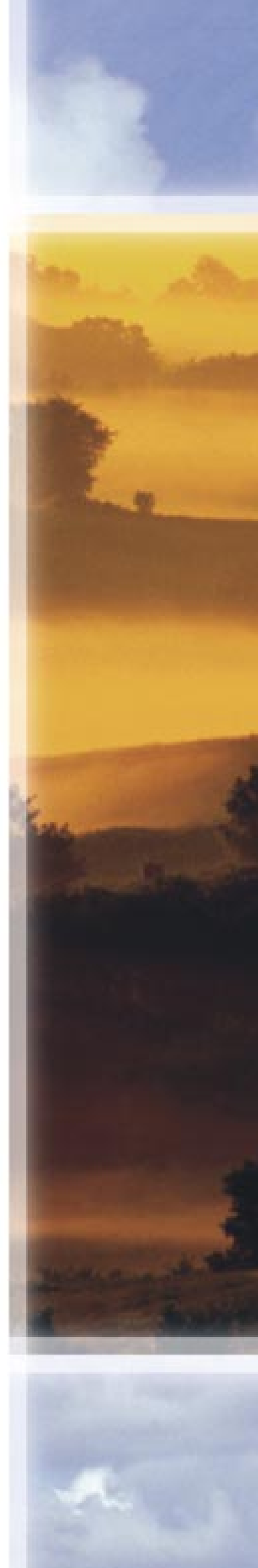
The brisk pace of banking merger and consolidation activities altered the number and size of the Tenth District's banks. An important issue associated with this consolidation has been its effect on banking competition and the impact of current regulatory standards on mergers of community banks operating in smaller markets. In a study completed in 1998, our staff concluded that mergers involving small banks in rural markets permitted them to become more efficient and profitable. These efficiency gains should be considered by regulators in their evaluation of small-bank mergers.

Outreach efforts

Risk management, regulatory burden, and costs of compliance with regulations are significant issues to district banking directors and managers, and to us. To address these concerns, we continued to develop and offer outreach programs to improve each organization's understanding of regulatory requirements.

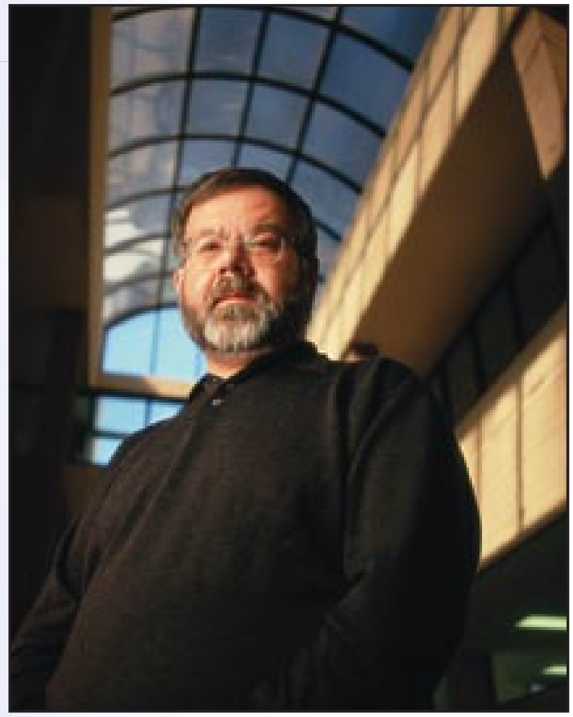
Basic Training for Bank Directors provided nonofficer bank directors with tools to judge risk-taking and the effectiveness of risk management in their institutions. In 1998, we presented the basic training program at 16 regional locations in conjunction with six state banking departments and two other Reserve Banks. In addition to this program for bank directors, we conducted seminars for bank officers in all district states. And we conducted eight banker roundtable meetings in five district states, during which Federal Reserve officers increased their understanding of the broad issues facing district banking organizations.

Through the Community Affairs function, the Bank continued to be a catalyst for promoting fair and efficient markets and improving access to credit and capital. With various public and nonprofit organizations and statewide banking associations, we co-sponsored workshops on community development and made presentations on issues such as community development financing, fair lending, and community assessment and planning. ■



Profile

MAC JONES



Colorado banker encourages others to use Fed services, especially the bank director training.

One of the primary objectives of the Bank's outreach programs is to share our supervisory expertise with community bankers to help promote banking safety. One such community banker is R.M. "Mac" Jones, president of Colorado Bank and Trust in La Junta, Colorado, population 8,500.

Mac is the kind of banker who makes it easy for his customers to tell him what's on their mind. He does it with "Hey Mac" folders strategically placed throughout the bank. Some may call Mac's approach folksy, but it fits his style. He types his own letters, never screens his phone calls, and vows never to resort to voice mail.

Organized in 1907, the Colorado Bank and Trust Company is the Jones family business. Mac's grandfather joined the bank in the 1930s. His father, R.H. Jones, came aboard in 1951, was president from 1968 to 1991, and now is chairman of the board. Mac started as a teller in 1969 and worked his way through various positions before succeeding his father as president.

Despite many opportunities to sell their stake in the bank, Mac vows the family will never do that. "We're just so determined to stay here and serve our customers – and one of the best ways of doing that is to take advantage of the Fed's outreach programs."

Mac is particularly enthusiastic about one of the Kansas City Fed's more recent offerings: the training program for bank directors.

"It was a great review and refresher course for Dad and me, our number two person, and our other directors and general counsel," Mac says. "It was just fantastic, a great benefit."

The program provides enlightenment about what it means to be a bank director and reinforces the purpose of serving on that board. "It puts it all in perspective," Mac says, "and gives some real hands-on, how-to-do-things experience."

The Fed trainers who went to his bank to provide the training drew praise for their presentation, which, in Mac's view, was clear, concise, nontechnical, and free of banker jargon. ■

BRANCH

Offices

Branches extend our reach in the region

The Tenth District spans the second-largest land area in the Federal Reserve System, from the Rocky Mountains to the Missouri River, and from Yellowstone Park to the Oklahoma oil fields.

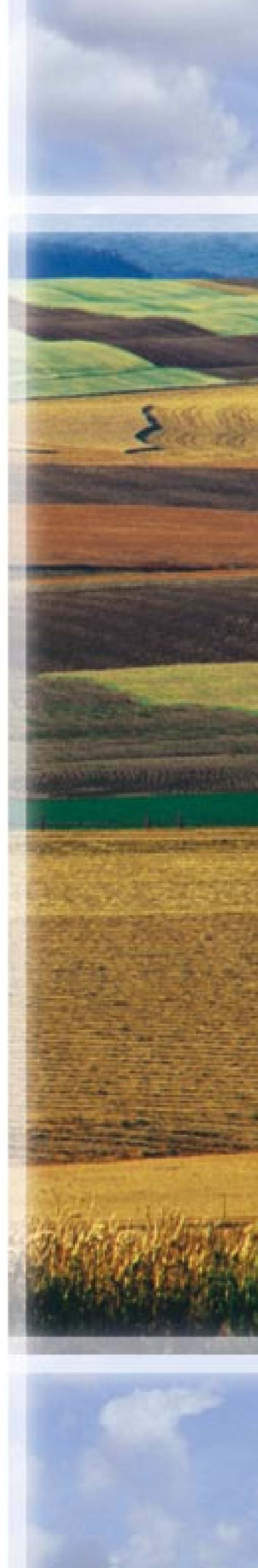
The economy of the region is equally diverse. The Tenth District is home to such disparate industries as financial and business services, aircraft and high-technology manufacturing, production agriculture, food processing, and mining.

In many ways, the vastness of our region and our economic diversity are a virtue. But our wide-open spaces also present special geographic challenges. As we collect economic information to aid in the formulation of monetary policy, supervise banks and holding companies, and provide payments services, we are fortunate to be able to rely on our branches in Denver, Oklahoma City, and Omaha.

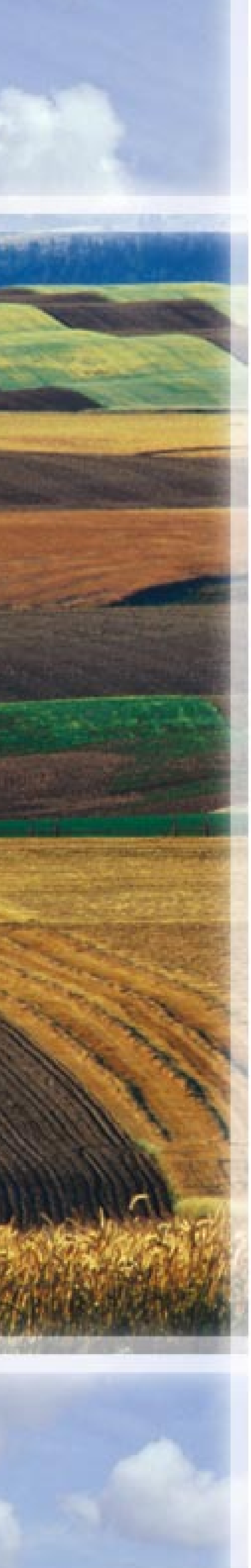
Senior Vice President and Research Director Craig Hakkio (left) and Omaha Branch Director Bruce Lauritzen discuss regional economic conditions.

A primary purpose of our branches is to help us provide financial services to customers throughout our vast region by serving as operations centers for checks and cash services. Each branch has a highly qualified staff to process checks for our customers. And the branches serve as cash distribution centers, helping to effectively meet the demand for coin and currency at financial institutions across the region.

The branches have also been instrumental in helping to enhance the efficiency of the payments system. All three branches have helped the district increase the acceptance rate of check truncation by providing digital images of checks to their bank customers. And investments in automation at the branches have helped improve the efficiency of



The branches have been instrumental in helping enhance the efficiency of the payments system.



Bank examiners in Oklahoma City support our supervision outreach.

cash operations throughout the district.

In another important branch function, members of our supervisory staff across the district help us fulfill our role in supervising and regulating banks. Both the Denver and Oklahoma City offices have bank examiners on hand to assist in carrying out our supervisory responsibilities.

Placing examination staff at the branches, closer to the financial institutions under their watch, allows us to better understand regional issues facing these institutions. Combined with our risk-focused approach to examinations, the branches support our effort to strengthen communication between examiners and banks in the field, bolstering our proactive supervisory process.

Our branches also play a key role in collecting accurate and timely information on the regional economy, which helps guide our input to monetary policy. The size and diversity of the region allow us to collect information on an array of industries in both metropolitan and rural areas.

On the following pages we feature the members of our branch boards of directors. These business leaders provide valuable first-hand knowledge of economic conditions in their respective communities and states. ■

An extensive renovation at the Denver office brought new efficiencies to check processing.

Denver

Board

(From left) Mr. Yates, Mr. Mammel, Mr. Wold, Ms. McBride, Ms. Paul, Mr. Hay, Mr. Murphy.

Peter I. Wold
Partner
Wold Oil & Gas Company
Casper, Wyoming – Chairman

John W. Hay III
President
Rock Springs National Bank
Rock Springs, Wyoming

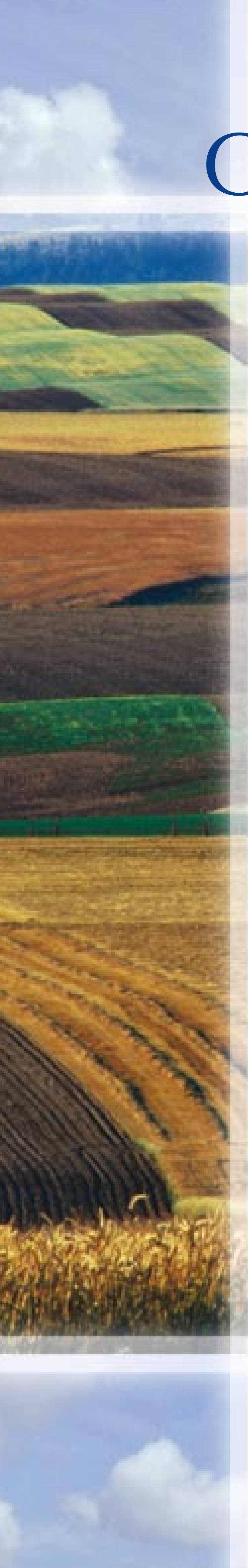
C.G. Mammel
President and CEO
The Bank of Cherry Creek, N.A.
Denver, Colorado

Teresa N. McBride
Chief Executive Officer
McBride and Associates, Inc.
Albuquerque, New Mexico

Robert M. Murphy
President
Sandia Properties Ltd. Company
Albuquerque, New Mexico

Kathryn A. Paul
Division President
Kaiser Permanente
Denver, Colorado

Albert C. Yates
President
Colorado State University
Fort Collins, Colorado



Oklahoma City

Board

(From left) Mr. Samis, Ms. Fennell, Mr. Braum, Mr. Mitchell, Ms. Shaull, Mr. Brummett, Mr. Eller.

Barry L. Eller
Senior Vice President
and General Manager
MerCruiser
Stillwater, Oklahoma – Chairman

William H. Braum
President
Braum Ice Cream Company
Oklahoma City, Oklahoma

Larry W. Brummett
Chairman, President, and CEO
ONEOK, Inc.
Tulsa, Oklahoma

Patricia B. Fennell
Executive Director
Latino Community Development
Agency
Oklahoma City, Oklahoma

Dennis M. Mitchell
Vice Chairman
Citizens Bank and Trust Company
Ardmore, Oklahoma

Michael S. Samis
President and CEO
Macklanburg-Duncan Company
Oklahoma City, Oklahoma

Betty Bryant Shaull
President-Elect and Director,
Bank of Cushing and Trust Company
Tulsa, Oklahoma

OMAHA

Board

(From left) Mr. Lauritzen, Mr. Gottsch, Mr. Hayes, Ms. Johnston, Mr. Shoener, Mr. Kosman. (Not pictured: Mr. Peterson)

Arthur L. Shoener
President
Shoener Consulting LLC
Omaha, Nebraska – Chairman

Bob L. Gottsch
Vice President
Gottsch Feeding Corporation
Hastings, Nebraska

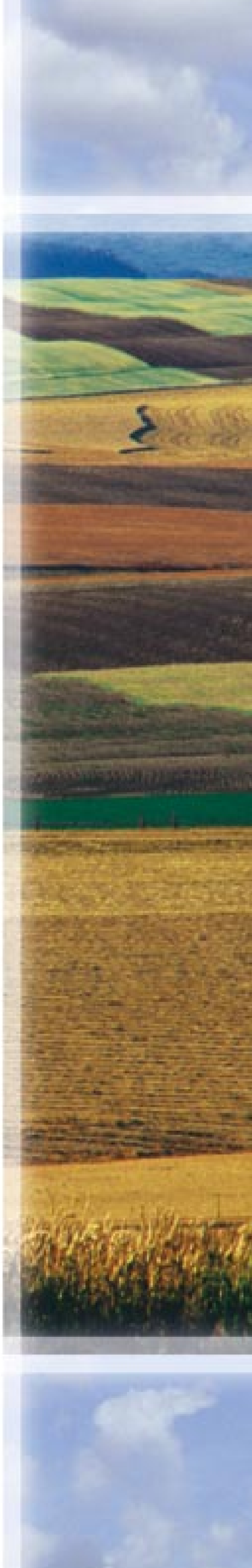
Frank L. Hayes
President
Hayes & Associates, LLC
Omaha, Nebraska

Gladys Styles Johnston
Chancellor
University of Nebraska at Kearney
Kearney, Nebraska

H.H. Kosman
Chairman, President, and CEO
Platte Valley National Bank
Scottsbluff, Nebraska

Bruce R. Lauritzen
Chairman and President
First National Bank of Omaha
Omaha, Nebraska

Robert L. Peterson
Chairman and CEO
IBP, Inc.
Dakota City, Nebraska



Advisory Councils

Economic Advisory Council

Leonard G. Beauchamp
Director of Research and Collective Bargaining Services
International Brotherhood of Boilermakers
Kansas City, Kansas

David W. Burkholder
Will Feed, Inc. and Island Dehy, Inc.
Cozad, Nebraska

Paula Marshall-Chapman
Chairman and CEO
The Bama Companies, Inc.
Tulsa, Oklahoma

Charles Frederickson
Chairman
VICORP Restaurants, Inc.
Denver, Colorado

Karon E. Harris Hicks
Executive Vice President
Blue Cross & Blue Shield of Kansas City
Overland Park, Kansas

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

Terry L. Moore
President
Omaha Federation of Labor, AFL-CIO
Omaha, Nebraska

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

Florine P. Raitano
Executive Director
Colorado Rural Development Council
Dillon, Colorado

Richard L. Robinson
Chairman and CEO
Robinson Dairy, Inc.
Denver, Colorado

Clint Roush
Clint Roush Farms, Inc.
Arapaho, Oklahoma

Gerald L. Schleich
Chairman
Austin Realty Group
Lincoln, Nebraska

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

G.W. "Bill" Swisher, Jr.
Chairman and CEO
CMI Corporation
Oklahoma City, Oklahoma

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

Financial Services Customer Advisory Council

Kansas City

Camden R. Fine
President and CEO
Midwest Independent Bank
Jefferson City, Missouri

Joye B. Haneberg
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
Valley State Bank
Atchison, Kansas

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

Rick Smalley
Senior Executive Vice President
Bank Midwest
Kansas City, Missouri

Larry Snyder
President and CEO
The Hamilton Bank
Hamilton, Missouri

Leland Walker
Mercantile Bank
Kansas City, Missouri

Denver

J.D. Aragon
Vice President of Operations
First National Bank of Farmington
Farmington, New Mexico

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

Jean L. Burr
Senior Vice President
Megabank of Arapahoe
Englewood, Colorado

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

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

Kevin B. Dabney
Senior Vice President and Manager
Norwest Services, Inc.
Denver, Colorado

Alan Lee
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 Company
Stillwater, Oklahoma

Dennis L. Gerhard
Vice President of Operations
Central National Bank & Trust Company
Enid, Oklahoma

Robert R. Gilbert
President and CEO
F&M Bank & Trust Company
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 & 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

Credit Union Advisory Council:

Oklahoma City Branch

Jack Carlow
Vice President
Tulsa Federal Employees Credit Union
Tulsa, Oklahoma

Marvin Cottom
President
WEOKIE Credit Union
Oklahoma City, Oklahoma

Dennis Emmons
President and CEO
Oklahoma City, Oklahoma

Gary M. Jones
President and CEO
Williams Employees Credit Union
Tulsa, Oklahoma

Mike Kloiber
President and CEO
Tinker Federal Credit Union
Oklahoma City, Oklahoma

Shirley R. McConnell
President and CEO
Oklahoma Federal Credit Union
Oklahoma City, Oklahoma

Jim M. Williams
President and CEO
Oklahoma Health Services Federal Credit Union
Oklahoma City, Oklahoma

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 Management Committee

John E. Yorke
Senior Vice President

Robert W. Allen
Vice President

Charles L. Bacon, Jr.
Vice President, Associate General Counsel, and Secretary

Bradley C. Cloverdyke
Vice President

G. Will Cook
General Auditor

Mark R. Drabenstott
Vice President and Economist

Esther L. George
Vice President

Roberta E. Hearn
Vice President

Carol A. Hefley
Vice President

James H. Jonson
Vice President

George A. Kahn
Vice President and Economist

Stephen E. McBride
Vice President

Larry G. Meeker
Vice President

Charles S. Morris
Vice President and Economist

Barbara S. Pacheco
Vice President

Barry K. Robinson
Vice President and Public Information Officer

Gordon H. Sellon, Jr.
Vice President and Economist

Harold L. Shewmaker
Vice President

John C. Vandermade, Jr.
Vice President

Stuart E. Weiner
Vice President and Economist

Janice K. Bartkowski
Assistant Vice President

Debra L. Bronston
Assistant Vice President

Harriet I. Chern
Assistant Vice President

Denise I. Connor
Assistant Vice President

Paul S.J. Coquillette
Assistant Vice President

Anita F. Costanza
Assistant Vice President

Kelley D. Courtright
Assistant Vice President and Assistant Secretary

James R. Deis
Assistant Vice President

C. Alan Garner
Assistant Vice President and Economist

Leesa M. Guyton
Assistant Vice President

D. Michael Manies
Assistant Vice President

John M. Mitchell
Assistant Vice President

Dawn B. Morhaus
Assistant Vice President

Linda S. Schroeder
Assistant Vice President

Tim R. Smith
Assistant Vice President

Wilmer R. Ullmann
Associate General Counsel

Kathryn A. Webster
Assistant Vice President

John A. Wood
Assistant Vice President

Catherine A. Zeigler
Assistant Vice President

Susan E. Zubradt
Assistant Vice President

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

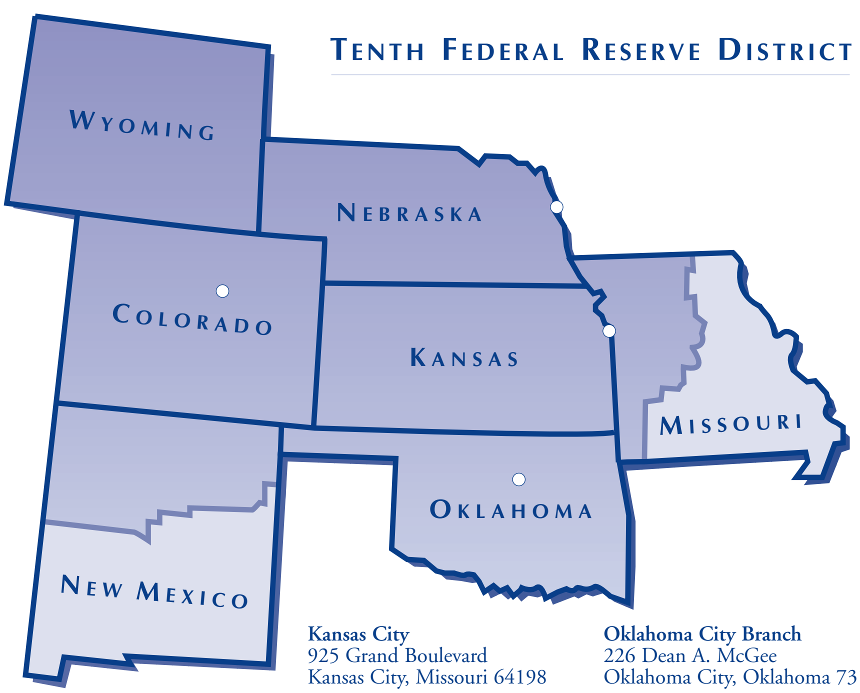
Tara B. Koenigs
Assistant Vice President

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



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

Federal Reserve Bank of Kansas City

925 Grand Boulevard
Kansas City, Missouri 64198-0001
(816) 881-2000

To the Board of Directors:

The management of the Federal Reserve Bank of Kansas City is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 1998 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks, and as such, include amounts, some of which are based on judgments and estimates of management.

The management of this Bank is responsible for maintaining effective internal controls over financial reporting and the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. These internal controls contain self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal controls are reported to management and appropriate corrective measures are implemented.

Even effective internal controls, no matter how well designed, have inherent limitations – including the possibility of human error and costs versus benefits considerations – and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of this Bank assessed its internal controls over financial reporting and the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, the Bank's management believes that we maintain effective internal controls over financial reporting and the safeguarding of assets as they relate to the Financial Statements.

Thomas M. Hoenig
President

Richard K. Rasdall, Jr.
First Vice President

Federal Reserve Bank of Kansas City
March 5, 1999

PRICEWATERHOUSECOOPERS

Report of Independent Accountants

PricewaterhouseCoopers LLP
1055 Broadway
10th Floor
Kansas City MO 64105-1595
Telephone (816) 472 7921
Facsimile (816) 218 1890

To the Board of Directors of the
Federal Reserve Bank of Kansas City:

We have examined management's assertion that the Federal Reserve Bank of Kansas City ("FRB Kansas City") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the Financial Statements as of December 31, 1998, included in the accompanying Management's Assertion.

Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants, and accordingly, included obtaining an understanding of the internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that the FRB Kansas City maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the Financial Statements as of December 31, 1998, is fairly stated, in all material respects, based upon criteria described in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

Kansas City, Missouri
March 5, 1999

PRICEWATERHOUSECOOPERS

Report of Independent Accountants

PricewaterhouseCoopers LLP
1055 Broadway
10th Floor
Kansas City MO 64105-1595
Telephone (816) 472 7921
Facsimile (816) 218 1890

To the Board of Governors of The Federal Reserve System
and the Board of Directors of The Federal Reserve Bank of Kansas City:

We have audited the accompanying statements of condition of The Federal Reserve Bank of Kansas City ("Bank") as of December 31, 1998 and 1997, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3, the financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of The Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of The Federal Reserve System, are set forth in the "Financial Accounting Manual for Federal Reserve Banks" and constitute a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 1998 and 1997, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

Kansas City, Missouri
March 5, 1999

FINANCIAL

Statements

Federal Reserve Bank of Kansas City

STATEMENTS OF CONDITION (in millions)

As of December 31, 1998 and 1997

	1998	1997
ASSETS		
Gold certificates	$ 289	$ 286
Special drawing rights certificates	247	247
Coin	24	36
Items in process of collection	496	440
Loans to depository institutions	2	13
U.S. government and federal agency securities, net	12,668	12,393
Investments denominated in foreign currencies	456	647
Accrued interest receivable	120	117
Interdistrict settlement account	1,324	880
Bank premises and equipment, net	76	76
Other assets	15	15
Total assets	$ 15,717	$ 15,150
LIABILITIES AND CAPITAL		
LIABILITIES:		
Federal Reserve notes outstanding, net	$ 14,256	$ 13,541
Deposits:		
Depository institutions	652	761
Other deposits	25	8
Deferred credit items	414	472
Surplus transfer due U.S. Treasury	29	61
Accrued benefit cost	55	55
Other liabilities	6	6
Total liabilities	15,437	14,904
CAPITAL:		
Capital paid-in	140	127
Surplus	140	119
Total capital	280	246
Total liabilities and capital	$ 15,717	$ 15,150

The accompanying notes are an integral part of these financial statements.

Federal Reserve Bank of Kansas City
STATEMENTS OF INCOME (in millions)
For the years ended December 31, 1998 and 1997

	1998	1997
INTEREST INCOME:		
Interest on U.S. government securities	$ 742	$ 738
Interest on foreign currencies	10	14
Interest on loans to depository institutions	1	2
Total interest income	753	754
OTHER OPERATING INCOME (LOSS):		
Income from services	55	54
Reimbursable services to government agencies	23	18
Foreign currency gains (losses), net	43	(98)
Government securities gains, net	1	—
Total other operating income (loss)	122	(26)
OPERATING EXPENSES:		
Salaries and other benefits	77	77
Occupancy expense	7	7
Equipment expense	8	7
Cost of unreimbursed Treasury services	—	2
Assessments by Board of Governors	16	17
Other expenses	49	48
Total operating expenses	157	158
Net income prior to distribution	$ 718	$ 570
DISTRIBUTION OF NET INCOME:		
Dividends paid to member banks	$ 8	$ 9
Transferred to (from) surplus	21	(48)
Payments to U.S. Treasury as interest on Federal Reserve notes	210	—
Payments to U.S. Treasury as required by statute	479	609
Total distribution	$ 718	$ 570

The accompanying notes are an integral part of these financial statements.

Federal Reserve Bank of Kansas City

Statements of Changes in Capital (in millions)

For the years ended December 31, 1998 and 1997

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 1997			
(3.5 million shares)	$ 175	$ 171	$ 346
Net income transferred (from) surplus	—	(48)	(48)
Statutory surplus transfer to the U.S. Treasury	—	(4)	(4)
Net change in capital stock (1.0 million shares redeemed)	$ (48)	$ —	$ (48)
Balance at December 31, 1997			
(2.5 million shares)	$ 127	$ 119	$ 246
Net income transferred to surplus	—	21	21
Net change in capital stock (0.3 million shares issued)	$ 13	$ —	$ 13
Balance at December 31, 1998			
(2.8 million shares)	$ 140	$ 140	$ 280

The accompanying notes are an integral part of these financial statements.

FINANCIAL

Notes

Federal Reserve Bank of Kansas City
Notes to Financial Statements

1. ORGANIZATION:

The Federal Reserve Bank of Kansas City ("Bank") is part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act") which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. Other major elements of the System are the Federal Open Market Committee ("FOMC"), and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY") and, on a rotating basis, four other Reserve Bank presidents.

Structure:

The Bank and its branches in Denver, Colorado, Oklahoma City, Oklahoma, and Omaha, Nebraska, serve the Tenth Federal Reserve District, which includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and a portion of Missouri and New Mexico. In accordance with the Federal Reserve Act, supervision and control of the Bank is exercised by a Board of Directors. Banks that are members of the System include all national banks and any state chartered bank that applies and is approved for membership in the System.

Board of Directors:

The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

2. OPERATIONS AND SERVICES:

The System performs a variety of services and operations. Functions include: formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse operations and check processing; distribution of coin and currency; fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies, and state member banks; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, and the lending of U.S. government securities. Additionally, the FRBNY is authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange and securities contracts in fourteen foreign currencies, maintain reciprocal currency arrangements ("F/X swaps") with various central banks, and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks.

3. SIGNIFICANT ACCOUNTING POLICIES:

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are documented in the "Financial Accounting Manual for Federal Reserve Banks" ("Financial Accounting Manual"), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and generally accepted accounting principles ("GAAP"). The primary differences are the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowings with pledged collateral, as is required by GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows or a Statement of Comprehensive Income. The Statement of Cash Flows has not been included as the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. The Statement of Comprehensive Income, which comprises net income plus or minus certain adjustments, such as the fair value adjustment for securities, has not been included because as stated above the securities are recorded at amortized cost and there are no other adjustments in the determination of Comprehensive Income applicable to the Bank. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows or a Statement of Comprehensive Income would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Unique accounts and significant accounting policies are explained below.

a. Gold Certificates

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged and the Reserve Banks' gold certificate accounts are lowered. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. The Board of Governors allocates each SDR transaction among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

c. Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is recorded on the accrual basis and is charged at the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve Banks, subject to review by the Board of Governors. However, Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

d. U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or other needs specified by the FOMC in carrying out the System's central bank responsibilities.

Purchases of securities under agreements to resell and matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Purchases under agreements to resell are transactions in which the FRBNY purchases a security and sells it back at the rate specified at the commencement of the transaction. Matched sale-purchase transactions are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction.

Reserve Banks are authorized by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires the lending Reserve Bank to take possession of collateral in amounts in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by the lending Reserve Bank on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA.

Foreign exchange contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with authorized foreign central banks. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed upon period of time (up to twelve months), at an agreed upon interest rate. These arrangements give the FOMC temporary access to foreign currencies that it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank, and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury and ESF for financing purchases of foreign currencies and related international operations.

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts which contain varying degrees of off-balance sheet market risk, because they represent contractual commitments involving future settlement, and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, earnings and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as "Interest on U.S. government securities" or "Interest on foreign currencies," as appropriate. Income earned on securities lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as "Government securities gains, net." Foreign currency denominated assets are revalued monthly at current market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains (losses), net". Foreign currencies held through F/X swaps, when initiated by the counter party, and warehousing arrangements are revalued monthly, with the unrealized gain or loss reported by the FRBNY as a component of "Other assets" or "Other liabilities," as appropriate.

Balances of U.S. government and federal agencies securities bought outright, investments denominated in foreign currency, interest income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Securities purchased under agreements to resell and the related premiums, discounts and income, and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks. Income from securities lending transactions is recognized only by the lending Reserve Bank.

e. Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from 2 to 50 years. New assets, major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs and minor replacements are charged to operations in the year incurred.

f. Interdistrict Settlement Account

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check clearing and automated clearinghouse ("ACH") operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the "Interdistrict settlement account."

g. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents to the Reserve Banks upon deposit with such Agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve Agent must be equal to the sum of the notes applied for by such Reserve Bank. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and agency securities, loans allowed under Section 13, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. To satisfy its obligation to provide sufficient collateral for its outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides that certain assets of the Reserve Banks are jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by cash held in the vaults of the Bank of $2,958 million, and $1,713 million at December 31, 1998 and 1997, respectively.

h. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6% of the capital and surplus of the member bank. As a member bank's capital and surplus changes, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of $100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6% on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

i. Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. Payments made after September 30, 1998 represent payment of interest on Federal Reserve notes outstanding.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66, Section 3002) codified the existing Board surplus policies as statutory surplus transfers, rather than as payments of interest on Federal Reserve notes, for federal government fiscal years 1998 and 1997 (which began on October 1, 1997 and 1996, respectively). In addition, the legislation directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $107 million and $106 million during fiscal years 1998 and 1997, respectively. Reserve Banks were not permitted to replenish surplus for these amounts during this time. The Reserve Banks made these transfers on October 1, 1997 and October 1, 1996, respectively. The Bank's share of the 1997 transfer is reported as "Surplus transfer to the U.S. Treasury."

In the event of losses, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury vary significantly.

j. Cost of Unreimbursed Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but will not be paid are reported as the "Cost of unreimbursed Treasury services."

k. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

4. U.S. GOVERNMENT AND FEDERAL AGENCY SECURITIES:

Securities bought outright and held under agreements to resell are held in the SOMA at the FRBNY. An undivided interest in SOMA activity, with the exception of securities held under agreements to resell and the related premiums, discounts and income, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 2.774% and 2.855% at December 31, 1998 and 1997, respectively.

The Bank's allocated share of securities held in the SOMA at December 31, that were bought outright, were as follows (in millions):

	1998	1997
Par value:		
Federal agency	$ 9	$ 20
U.S. government:		
Bills	5,403	5,629
Notes	5,213	4,974
Bonds	1,927	1,696
Total par value	12,552	12,319
Unamortized premiums	205	177
Unaccreted discounts	(89)	(103)
Total allocated to Bank	$ 12,668	$ 12,393

Total SOMA securities bought outright were $456,667 million and $434,001 million at December 31, 1998 and 1997, respectively.

The maturities of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 1998, were as follows (in millions):

	Par value		
Maturities of Securities Held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 32	$ —	$ 32
16 days to 90 days	2,750	1	2,751
91 days to 1 year	3,985	2	3,987
Over 1 year to 5 years	2,989	1	2,990
Over 5 years to 10 years	1,243	5	1,248
Over 10 years	1,544	—	1,544
Total	$ 12,543	$ 9	$ 12,552

At December 31, 1998, and 1997, matched sale-purchase transactions involving U.S. government securities with par values of $20,927 million and $17,027 million, respectively, were outstanding, of which $581 million and $486 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES:

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 2.307% and 3.798% at December 31, 1998 and 1997, respectively.

The Bank's allocated share of investments denominated in foreign currencies, valued at current exchange rates at December 31, were as follows (in millions):

	1998	1997
German Marks:		
Foreign currency deposits	$ 241	$ 314
Government debt instruments including agreements to resell	55	122
Japanese Yen:		
Foreign currency deposits	15	22
Government debt instruments including agreements to resell	143	186
Accrued interest	2	3
Total	$ 456	$ 647

Total investments denominated in foreign currencies were $19,769 million and $17,046 million at December 31, 1998 and 1997, respectively, which include $15 million and $3 million in unearned interest for 1998 and 1997 respectively, collected on certain foreign currency holdings that is allocated solely to the FRBNY.

The maturities of investments denominated in foreign currencies which were allocated to the Bank at December 31, 1998, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	$ 434
Over 1 year to 5 years	11
Over 5 years to 10 years	11
Total	$ 456

At December 31, 1998 and 1997, there were no foreign exchange contracts or outstanding F/X swaps.

At December 31, 1998 and 1997, the warehousing facility was $5,000 million, with nothing outstanding.

6. BANK PREMISES AND EQUIPMENT:

A summary of bank premises and equipment at December 31 is as follows (in millions):

	1998	1997
Bank premises and equipment:		
Land	$ 12	$ 12
Buildings	47	41
Building machinery and equipment	17	16
Construction in progress	1	6
Furniture and equipment	53	49
	130	124
Accumulated depreciation	(54)	(48)
Bank premises and equipment, net	$ 76	$ 76

Depreciation expense was $9 million and $8 million for the years ended December 31, 1998 and 1997, respectively.

7. COMMITMENTS AND CONTINGENCIES:

At December 31, 1998 and 1997, the Bank was not obligated under any noncancelable leases for premises or equipment.

Under the Insurance Agreement of the Federal Reserve Banks dated as of June 7, 1994, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1% of the capital of the claiming Reserve Bank, up to 50% of the total capital and surplus of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital bears to the total capital of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 1998 or 1997.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

There were no other commitments and long-term obligations in excess of one year at December 31, 1998.

8. RETIREMENT AND THRIFT PLANS:

Retirement Plans:

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 1998 and 1997, and for the years then ended, are not material.

Thrift Plan:

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $3 million for the years ended December 31, 1998 and 1997, and are reported as a component of "Salaries and other benefits."

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS:

Postretirement Benefits Other Than Pensions:

In addition to the Bank's retirement plans, employees who have met certain age and length of service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit cost is actuarially determined using a January 1 measurement date.

Following is a reconciliation of beginning and ending balances of the benefit obligation (in millions):

	1998	1997
Accumulated postretirement benefit obligation at January 1	$ 27.0	$ 39.0
Service cost-benefits earned during the period	0.7	0.9
Interest cost of accumulated benefit obligation	1.5	2.1
Actuarial (gain)	(0.3)	(0.3)
Contributions by plan participants	0.3	0.3
Benefits paid	(1.5)	(1.4)
Plan amendments, acquisitions, foreign currency exchange rate changes, business combinations, divestitures, curtailments, settlements, special termination benefits	—	(13.6)
Accumulated postretirement benefit obligation at December 31	$ 27.7	$ 27.0

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit cost (in millions):

	1998	1997
Fair value of plan assets at January 1	$ —	$ —
Actual return on plan assets	—	—
Contributions by the employer	1.2	1.1
Contributions by plan participants	0.3	0.3
Benefits paid	(1.5)	(1.4)
Fair value of plan assets at December 31	$ —	$ —
Unfunded postretirement benefit obligation	$ 27.7	$ 27.0
Unrecognized initial net transition asset	—	—
Unrecognized prior service cost	24.1	24.6
Unrecognized net actuarial (loss)	(1.6)	(0.4)
Accrued postretirement benefit cost	$ 50.2	$ 51.2

Accrued postretirement benefit cost is reported as a component of "Accrued benefit cost."

The weighted-average assumptions used in developing the postretirement benefit obligation as of December 31 are as follows:

	1998	1997
Discount rate	6.25%	7.00%

For measurement purposes, an 8.5% annual rate of increase in the cost of covered health care benefits was assumed for 1999. Ultimately, the health care cost trend rate is expected to decrease gradually to 4.75% by 2006, and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 1998 (in millions):

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit cost	$ 0.1	$ (0.2)
Effect on accumulated postretirement benefit obligation	(0.7)	(2.8)

The following is a summary of the components of net periodic postretirement benefit cost for the years ended December 31 (in millions):

	1998	1997
Service cost-benefits earned during the period	$ 0.7	$ 0.9
Interest cost of accumulated benefit obligation	1.5	2.1
Amortization of prior service cost	(1.9)	(1.5)
Recognized net actuarial loss	—	—
Net periodic postretirement benefit cost	$ 0.3	$ 1.5

Net periodic postretirement benefit cost is reported as a component of "Salaries and other benefits."

Postemployment benefits:

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Banks at December 31, 1998 and 1997, were $5 million and $4 million, respectively. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 1998 and 1997 operating expenses were $1 million for both years.

Volume of Principle Operations (Unaudited)

	1998	1997
Loans and Discounts, Daily Average	$ 16,597,000	$ 28,846,000
Number of Institutions Borrowing	130	147
Commercial Checks	$ 939,708,000,000	$ 813,387,000,000
Commercial Checks Collected	1,364,172,000	1,333,935,000
Currency Receipts and Payments	$ 34,214,349,000	$ 31,659,385,000
Pieces	2,381,284,000	2,336,388,000
Coin Receipts and Payments	$ 456,546,000	$ 629,238,000
Bags	838,000	1,080,000
Issues and Redemption of U. S. Government Securities	$ 76,275,731,000	$ 52,136,397,000
Funds Transfers	$5,687,656,000,000	$4,766,995,000,000
Numbers	3,718,000	3,529,000
Automated Clearing House	$ 331,725,000,000	$ 285,627,000,000
Numbers	233,911,000	222,994,000

Volume of Principle Operations numbers were not included in PricewaterhouseCoopers audit.

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