1999 Annual Report

Federal reserve Bank of Kansas city

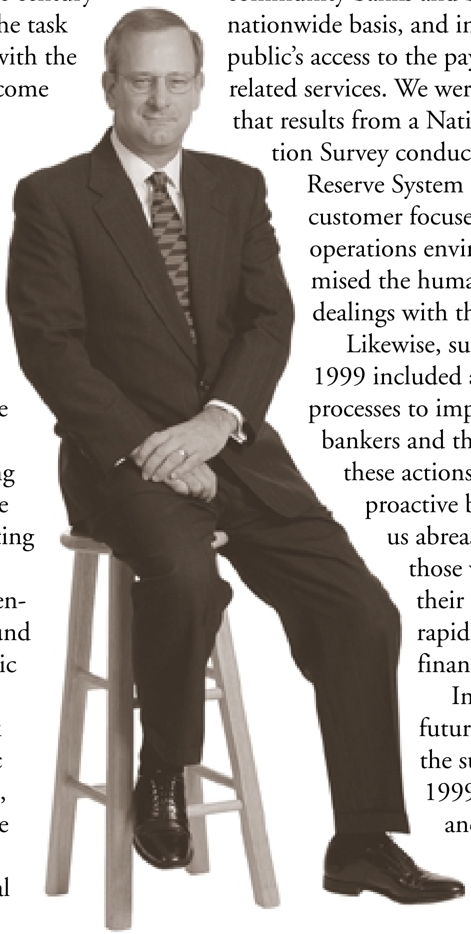
Inside

President

Thomas M. Hoenig

Technology is bringing customers from across the seven states and nearly half a million square miles that comprise the Tenth District closer together – literally at the speed of light. The resulting interdependence of markets and burgeoning digital-global economy make the Federal Reserve's role of promoting the stability of the financial system and our nation's economy, as important and as difficult today as at any point in our 86-year history.

Last year, the eyes of the world were transfixed on the U.S. payments system and the challenge we faced to manage century date change concerns. Though the task was formidable, it was handled with the confidence and resolve that has come to be expected from the Federal Reserve System. This diligent preparation for the year 2000 is indicative of our dedication to providing quality services into the next century. The following pages detail some of the Federal Reserve Bank of Kansas City's efforts to meet the digital economy head on with that same determination.



Our commitment to keeping abreast of economic trends in the global marketplace includes hosting a distinguished group of central bankers, financial market representatives, and academics from around the world at our annual economic symposium in Jackson Hole, Wyoming. And in order to track major developments in domestic rural and agricultural economies, the Tenth District established the Center for the Study of Rural America, a unique source of rural information for the public.

As a regional center of the central bank, we have committed ourselves to understanding and adapting technology to better serve financial institutions and the public. If 1999 was a harbinger of the changes to come in the banking industry, we believe 2000 may find our customers virtually awash in technological advances. The Tenth District's Financial Services Division strives to remain accessible to both community banks and banks operating on a nationwide basis, and in the process assure the public's access to the payments system and related services. We were very pleased to find that results from a National Customer Satisfaction Survey conducted by the Federal Reserve System indicated that we remain customer focused and that a high-speed operations environment has not compromised the human element in our dealings with them.

Likewise, supervisory initiatives in 1999 included altering our supervisory processes to improve interactions with bankers and the public. We believe these actions will help us remain a proactive bank supervisor, keeping us abreast of emerging risks for those we supervise and assuring their sound operation in a rapidly evolving digital financial world.

In order to ensure a bright future, we must build upon the successes of the past. 1999 bore witness to changes and achievements throughout the district and will serve as a fitting cornerstone for 2000 and beyond.

Thomas M. Hoenig

THOMAS M. HOENIG
President and
Chief Executive Officer

Monetary Policy

New challenges for monetary policy

As the final year of the century closed, the nation's economic expansion was poised to enter its ninth consecutive record-setting year. Midway through the year, the Federal Reserve embarked on a series of gradual, deliberate steps aimed at keeping inflation tame and the economy strong.

During the past three decades, the Federal Reserve Bank of Kansas City has enhanced the understanding of new policy issues by bringing together a distinguished group of the world's central bankers, policy analysts, and financial market experts at our annual Jackson Hole Symposium. The 1999 program, "New Challenges for Monetary Policy," was especially timely in today's global environment.

The 1999 economy

The nation's economy was strong again in 1999 — some might even say it boomed. Growth was solid, unemployment and inflation stayed at their lowest levels in decades, and, not surprisingly, consumer confidence continued to soar.

This remarkable mix of rapid growth, high employment, and low inflation was the outcome of two divergent trends — one domestic and the other foreign. Strong demand at home was tempered by weak demand abroad.

Real gross domestic product grew 4.6 percent in 1999, a momentum that should help launch our economy into the new millennium. Personal consumption grew rapidly, business investment expanded at double-digit rates, and sales of new and existing homes were solid. The performance of the U.S. stock market, meanwhile, continued to make great strides.

As other nations recovered slowly from the world financial crisis of the year before, our export performance was less than stellar. Our foreign trade deficit swelled to $343 billion, reaching its largest mark ever.

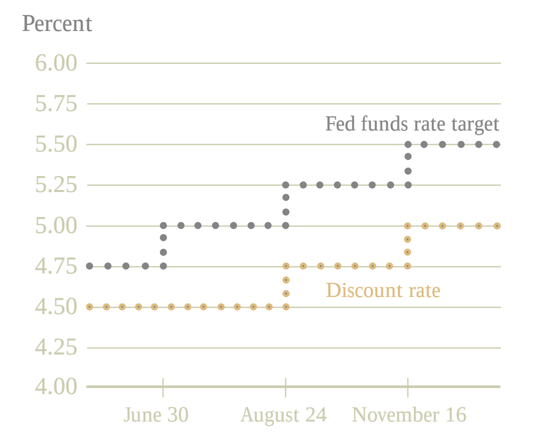
Without such a sharp drop in net exports, GDP growth in 1999 may well have exceeded 5 percent. So, in effect, our weakness in net exports helped provide a safety valve for what might otherwise have been an overheated U.S. economy.

The FOMC tightened three times

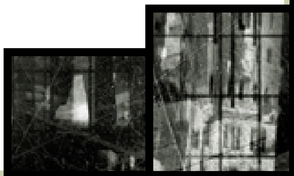
The Federal Open Market Committee (FOMC), the Federal Reserve's principal policymaking body, acted three times during the year to keep inflation at bay.

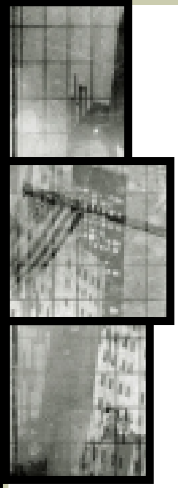
By raising its target for the federal funds rate a quarter point in June, August, and November, and by raising the discount rate a quarter point the latter two times, the FOMC reversed its 1998 actions to provide liquidity in the wake of the Asian financial crisis. With its June and August moves, the FOMC cited firming foreign economies, financial markets functioning more normally, tightening labor markets, and domestic demand holding strong.

Signs of "slowing in some interest-sensitive sectors of the economy and of accelerating productivity" appeared late in the year, but "growth of demand continued to outpace that of supply," as evidenced by the shrinking pool of workers willing to take jobs. In November, the FOMC described this trend as one "that must eventually be contained if inflationary imbalances are to remain in check and economic expansion continue."



FEDERAL RESERVE POLICY MOVES - 1999





Symposium highlights

Many developments and events in today's dynamic global economy are transforming the environment for monetary policy. Prices at home and throughout much of the industrialized world have become relatively stable. The stock market in the United States keeps booming, despite fears that it may be overvalued. And economic gyrations in the farthest corners of the world can sway U.S. financial markets overnight, thanks to the speed and ease of trading in today's e-economy.

This year's Jackson Hole Symposium, "New Challenges for Monetary Policy," explored whether, in today's global environment, policymakers enjoy greater flexibility in meeting their goals, or whether they now face a whole new set of operational challenges.

Federal Reserve Chairman Alan Greenspan discussed how asset prices might influence the performance of the economy. He noted that central bankers need a better understanding of how asset prices are set and how changes in their value shape economic activity.

Ben Bernanke and Mark Gertler, professors at Princeton and New York University, respectively, explored why policymakers should care about the volatility of asset prices. They argued that central banks should adjust monetary policy to offset changes in expected inflation. One implication of this is that policy should respond to asset price changes only insofar as they signal changes in expected inflation.

Willem Duisenberg, president of the European Central Bank, identified the key challenges the ECB faces upon completion of its first year of operation. He stressed the need to maintain a strong commitment to price stability, to develop a better understanding of the structure of the euro area's economy, and to communicate effectively with the public.

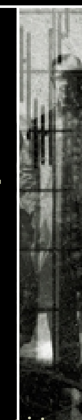
Mervyn King, deputy governor of the Bank of England, described a number of challenges to policymakers in today's new environment. He also endorsed the idea that targeting the price level might be more effective in stabilizing prices than targeting the inflation rate.

Lars Svensson, professor at Stockholm University, examined a number of operational issues central bankers face in a low-inflation environment. He compared the relative merits of conducting monetary policy using simple rules, targeting an inflation forecast, and targeting a monetary aggregate, concluding that inflation forecast targeting is the best way for central banks to maintain price stability.

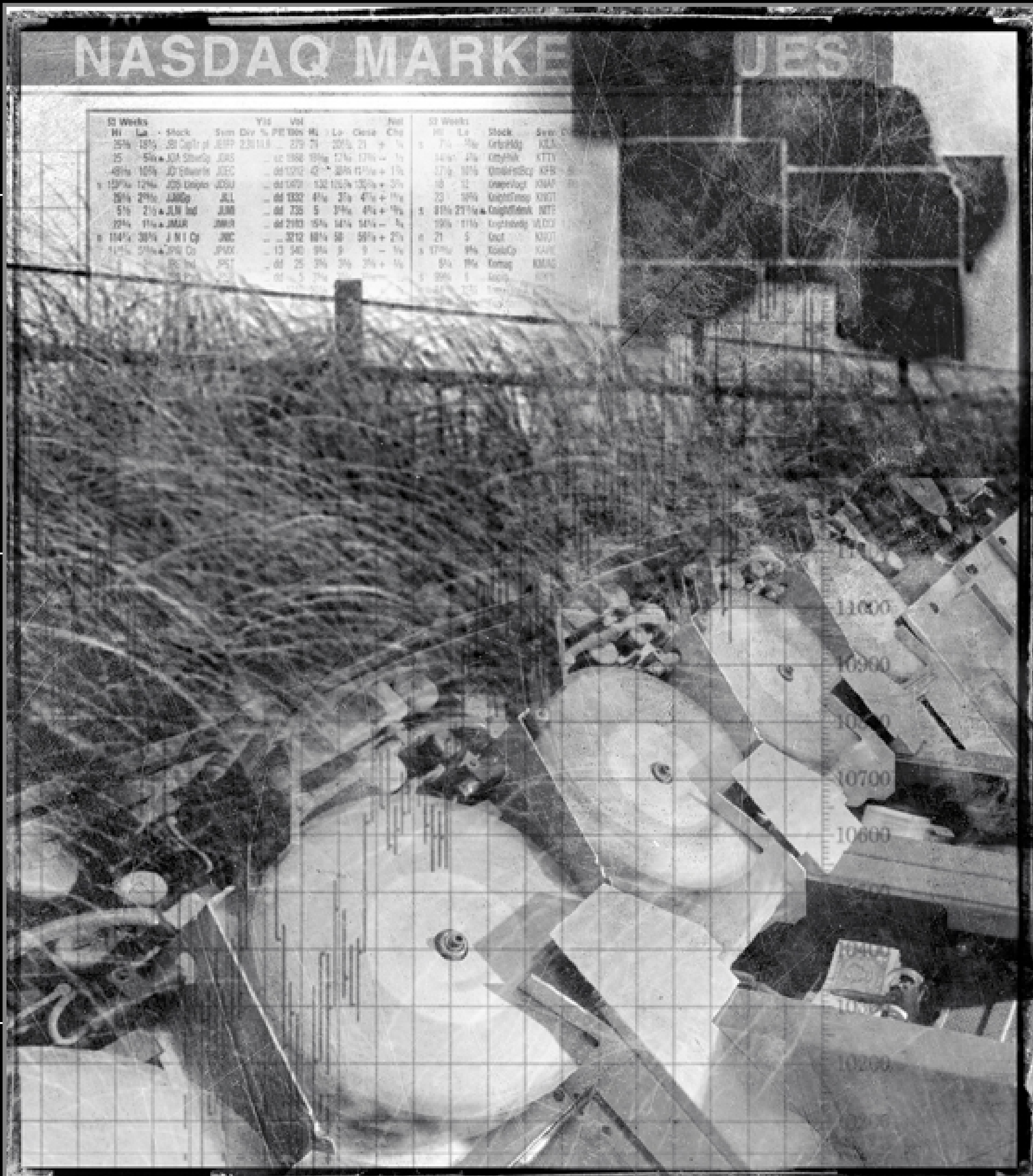
A debate arose on the choice of an exchange-rate regime for emerging open economies in Asia, Latin America, and Central Europe. Barry Eichengreen, professor at the University of California-Berkeley, Ricardo Hausmann, chief economist at the Inter-American Development Bank, and Rudiger Dornbusch, professor at MIT, argued many countries should seriously consider dollarizing or adopting a currency board.

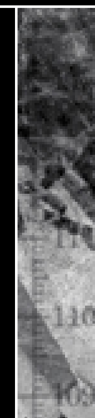
Martin Feldstein, president of the National Bureau of Economic Research, took the opposite view, suggesting that most exchange rate crises have been caused by fundamental structural policy errors. He argued that adopting flexible exchange rates and increasing international liquidity would provide a more stable environment for small open economies.

For the full text of the papers and commentary presented at the symposium, as well as transcripts of the discussions, visit our web site (*www.kc.frb.org*) or contact our Public Affairs Department.



Regional Economy





The regional economy: building a solid foundation for the future

The Tenth District economy kept up a steady pace in 1999, avoiding setbacks that many believed were sure to come from the Asian crisis and the century date change. Construction activity set a new record, productivity gains boosted factory output, and strong consumer demand kept district retailers busy. Meanwhile, government subsidies cushioned the blow from low crop prices, and rising oil and gas prices helped revive the energy industry.

Despite these gains, the district economy still faces serious challenges as the new century begins, not the least of which will be coping with a growing shortage of workers.

Economic threats in 1999

As 1999 began, three issues threatened to slow growth in the Tenth District: turmoil in Asian economies, the countdown to Y2K, and the tightest labor markets in decades.

The Asian crisis and the century date change turned out to be far less troublesome than feared. The Asian economies turned the corner on their economic woes, limiting the decline in district exports. Meanwhile, the only ill effects from Y2K surfaced in the computer software industry, where firms reported a temporary slowdown in sales in the second half of the year, a trend that is expected to be reversed in early 2000.

While most district businesses were able to shake off the "Asian flu" of 1998 and prevent Y2K computer glitches, it was more difficult for many industries to hide from the region's dire shortage of workers. Many area firms had trouble finding workers and keeping jobs filled in 1999. All kinds of workers proved to be elusive, especially skilled building craftsmen, information technology specialists, and entry-level retail workers.

As a result, district unemployment averaged 3.4 percent for the year, well below the national rate. Unemployment in most district states also fell faster than the national average, meaning the pool of available workers became relatively tighter.

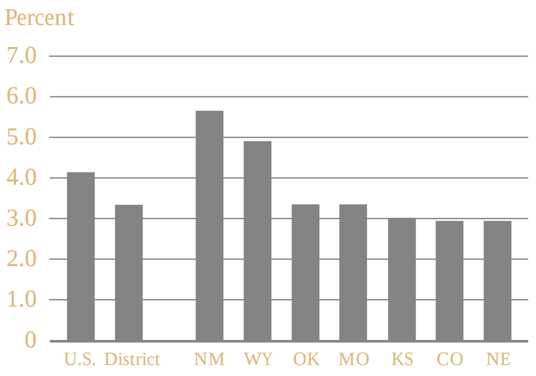
While the squeeze on labor markets had surprisingly little effect on wage and price inflation, it did keep many firms from expanding payrolls. Job growth in the district measured just 1.8 percent for the year, following growth of at least 2.4 percent in each of the last six years. In contrast, national job growth was similar to the 1992-1998 annual average of 2.3 percent.

A solid year overall

Worker shortages aside, most economic sectors of the district fared well in 1999.

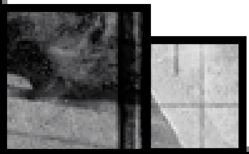
Consumer spending remained strong throughout most of the year, especially during the holiday season, when retailers posted their largest gains in recent memory.

Manufacturing activity in the region remained solid. The number of factory jobs slipped, as it did in the nation, but output continued to grow as productivity improved.



TENTH DISTRICT UNEMPLOYMENT RATES
1999

Residential construction slowed somewhat during the year but remained exceptionally strong. Home sales began to slide about the same time mortgage rates turned upward. Still, housing inventories remained lean and home prices continued to rise, suggesting that some of the slowdown in sales was due to lack of housing supply rather than weak demand. Consistent with this view, many builders



reported the completion of new homes was delayed because of labor and material shortages.

Commercial real estate also stayed healthy in 1999. Office vacancy rates edged up because of a surge in construction early in the year, but fears about overbuilding eased as construction cooled in the second half of the year.

Higher oil and gas prices helped energy activity to rebound. By year's end, the rig count in the district had more than doubled from the March low. Most of the increased drilling was for natural gas, as uncertainty about OPEC actions discouraged new investment in oil extraction.

District agriculture had a trying year but remained far better off than during the farm crisis of the 1980s. Crop prices in 1999 remained low, as foreign demand was too sluggish to absorb bountiful harvests at home and abroad. The blow to district farmers was cushioned, however, by another round of generous government subsidies. Meanwhile, low feed costs and rising cattle prices boosted livestock profits. Overall, district farm income actually improved for the year, and farm balance sheets stayed relatively healthy.

The future looks bright

The regional economy is based on more solid footing than it was during the last economic boom in the early 1980s—primarily because it has avoided the excesses of that period.

Lenders are generally more cautious. Property prices have stayed at realistic heights. And, the district economy is more diversified and less dependent on energy and agriculture than in the past.

Still, challenges remain

While the region has built a solid foundation for future economic growth, several issues may continue to perplex businesses and policymakers in the years ahead.

In parts of the district, much of the recent growth in employment has been in low-paying jobs, keeping some states from raising their per capita incomes to the national average.

Elsewhere, firms have recruited well-paid professionals from other states, but this inflow has driven up the cost of local services, causing affordability problems for low-income residents.

Workers proved to be elusive in 1999 as unemployment rates fell below the national average.

Meanwhile, fast-growing areas of the district face the dilemma of maintaining economic growth without jeopardizing local amenities.

Finally, with labor in such tight supply, district firms must continue to make workers more productive. Replacing labor with capital is one way — for example, some supermarkets have replaced cashiers with self-service check-out lines. Other ways include putting more resources into training and working with local schools to improve education.

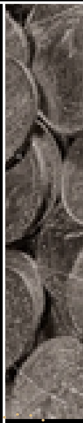
Meeting these challenges of rapid economic growth will not be easy. But it seems a small price to pay for the exceptional prosperity the district economy has enjoyed during the last decade.

1999 Annual Report

Financial Services

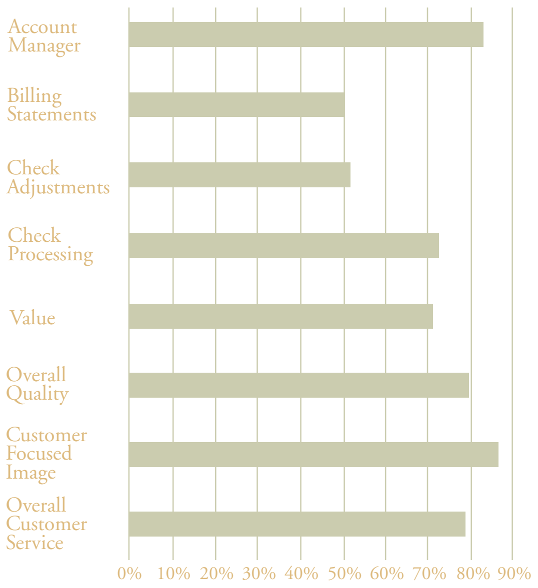
High tech *and* High touch: Financial Services

In a technology-driven financial services industry where rapid change is the only constant, the challenges of the new millennium only began with our efforts to ensure a smooth transition through Y2K. Industry consolidation, increased competition from banks and non-banks, and emerging payments technologies are but a few of the issues confronting the community banks that comprise the majority of the Tenth District's customer base. We fulfilled our responsibilities to depository institutions throughout the district by delivering services that are produced efficiently and meet the standards of quality that we expect of ourselves and are desired by our customers.



Setting the standard for service

To ensure that the human element is not neglected in this age of automation, one of the Tenth District's highest priorities is providing depository institutions with top-notch customer service. Several months ago, the district had the opportunity to benchmark its service proficiency on a Systemwide scale by participating in the Federal Reserve System's first nationwide customer satisfaction survey.



% customers rating the Tenth District excellent or very good

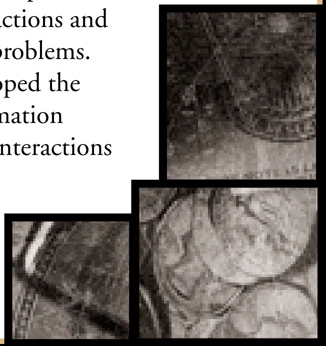
Designed to explore customers' perceptions of quality of the Federal Reserve's payments products and services, the survey was conducted through telephone interviews with customers across the System. The results indicated that we are providing service of superior quality and are performing exceptionally well compared with other districts on nearly all measures. The Tenth District received the System's highest scores in two categories and exceeded the overall Fed average in several others. We are especially proud of our account managers, who received the highest marks in the System in carrying out their responsibilities.

The district's success in the area of customer service is no accident, but rather the result of a dedicated, well-trained staff, who focus on continuous improvement, and are committed to follow through on customer feedback. Staff in district customer service units have been trained to take "ownership" of customer problems and have taken to heart the results of regional phone surveys conducted in 1994 and 1997, in raising the level and quality of the Bank's services. The Bank's investment in the human resources and technology necessary to facilitate greater customer care continues to pay dividends, as comments received from customers throughout the district are consistent with the high marks received on the recent survey.

Because every interaction counts

Our Bank is committed to enhancing customer interactions by retaining experienced, knowledgeable, and caring staff, as opposed to replacing them with high-tech substitutes. Automated tools are quite useful, but only as they position employees to use them to respond efficiently and effectively to customer needs.

Building strong customer relationships is a continuous process and is dependent upon the ability to learn from customer interactions and to track solutions to questions and problems. As a result, the Tenth District developed the Automated Customer Service Information System or "ACSIS." This tool logs interactions



with customers and provides our staff with automated access to customer profile information, and the ability to track problems from an initial phone call to resolution. Recognizing the value of this type of information, in expediting problem resolution, the Federal Reserve System adopted ACSIS for use at its electronic access help desks across the nation last year.

Putting a face on the Fed

While technology can simplify day-to-day business processes and manage data more efficiently, we know it's the people who make the difference in service. The Bank's account managers focus on relationship building as they consult with depository institutions to explain the Bank's service options. During visits to banks throughout the district, the account managers relay information about Fed services, changing industry practices, and opportunities for banks to add value and efficiency to their existing services.

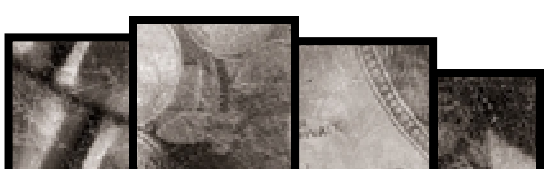
This hands-on approach is also used in the Automated Clearing House's (ACH) Customer Calling Program. The program was created to evaluate customer ACH needs, recognize emerging payment technologies, and identify barriers to increasing electronic payments. The ACH staff's visits included the added benefit of providing customers with the opportunity to pick up operational tips and take advantage of promotional materials to help grow their ACH business.

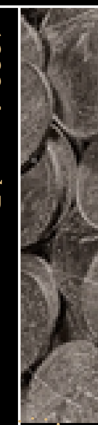
It's simply better business

The results of the nationwide customer satisfaction survey indicated that a customer-focused image is the most important factor driving customer loyalty. This came as no surprise to our Bank where the concept of service has been integrated into the core of our management philosophy and values. A focus on customer perspectives has driven communication, customer contact, and innovation in our financial services functions for years. Though district staff supported more than 1,200 customers as they tested interfaces and prepared for Y2K, other important initiatives were also pursued to leverage the combined benefits of service, innovation, and technology to our customers' advantage.

During 1999, our Financial Services staff developed new service options that focused on the needs of our constituency — including expanding the explicit float pricing option, introducing a single-priced mixed deposit product, and improving the availability of mixed deposits. Based on customer input, check truncation products were enhanced to include a short-term image archival option, and the Internet Image Retrieval option was expanded to all offices in the district. Savings bond processing was re-engineered to take advantage of efficiencies available with optical scanning technology to read issue applications. Tenth District staff also supported customer pilots integral to the process of gaining customer feedback to enhance System product development efforts for FedLine for Windows and the Web. Staff in Wholesale Payments increased their service outreach as the Tenth District became one of only two sites processing funds and book-entry securities transfers for offline customers Systemwide.

The one constant we can depend on is change. The Federal Reserve Bank of Kansas City is committed to continuous improvement of our products and services to turn the challenges associated with change into opportunities to better support our community bank constituency.





Supervision and Regulation

Strategies for more *effective* supervision and regulation

Technological advances and deregulation are quickly transforming the face of the community banks and bank holding companies we supervise, changing the nature of their operations and introducing new risks. To meet our responsibilities in the face of this change, in 1999 we continued to alter our supervisory processes, exploit new technologies, enhance staff development, and improve communication flows to bankers and the public. We believe the actions we undertook in these areas made our supervision more effective, more efficient, and less burdensome.

A double-edged sword

Technology is a double-edged sword for banks, offering both risks and rewards. New and more cost-effective digital technologies permit banks to provide products and services more economically to a larger and geographically dispersed customer base. And automation breakthroughs, when coupled with advances in financial engineering, permit better risk management.

New technologies can also mean increased operational risks. The century date change was a conspicuous example of this. During the course of several years, culminating on December 31, 1999, our examination and credit and risk management staff worked closely with the region's banking organizations and independent service providers to minimize the potential negative effects of Y2K and instill public confidence in our preparedness. When the new century rolled through international and then district time zones, meticulous preparation paid dividends when none of the region's banks encountered any significant operating problems.

Gramm-Leach-Bliley

New technologies also reduce communication costs and improve information flows, eroding geographic barriers and increasing competition. Intense competition has, in turn, provided an impetus for bank deregulation. Passed in late 1999, the Gramm-Leach-Bliley Act is a major overhaul of the nation's banking laws and the latest in a series of laws passed to reduced restrictions on banking. Gramm-Leach-Bliley expands bank powers and permits affiliation among banks, securities broker/dealers, and insurance companies. Like deposit deregulation and interstate banking legislation before it, the new law is likely to intensify competition among financial services firms and, in the process, prompt rapid changes for banking organizations. These changes will pose a strategic challenge for banks and holding companies as they seek to identify their role in an evolving industry.

Enhanced processes

Myriad changes at banking organizations necessitate update of our supervisory processes and continuous staff development. To meet our mandate of promoting a safe and sound banking system, we've continued to integrate "risk-focused" processes into our examinations. Using a risk-focused approach, our examiners identify and review banks' risk exposures and the adequacy of their control systems to better determine their ability to manage change and adapt to competitive challenges. In 1999, we continued to integrate these processes with our examinations to obtain a more prospective view of those we supervise.

> Myriad changes at banks necessitate diligent update of our supervisory process.

An important adjunct to on-site examination work is off-site monitoring of individual banks and the industry to help us keep abreast of changing banking conditions. We took steps throughout the year to enhance these efforts by partnering with other Reserve Banks to develop and improve the economic data available to our examiners. In addition, we moved forward with plans to create a supervisory presence at our

Omaha Branch and establish relationship managers as central points of contact for the institutions we supervise.

To assist examiners, we have also continued to refine our use of automated tools. Last year, our examiners utilized improved software to analyze bank-lending patterns, aid in loan reviews, document examinations, record examination findings, and expedite report preparation. We believe that as these tools evolve they will also enhance our efficiency.

Education and outreach

Process improvements alone cannot ensure supervisory success. It also takes a talented, dedicated staff, with the skill set necessary to assess the safety and soundness and compliance of rapidly changing institutions. In 1999, our staff attended numerous schools, seminars, and programs to keep updated on current banking issues, law and regulatory changes, economic conditions, new technologies, accounting pronouncements, financial innovations, and payments system developments. They also shared their expertise by participating as instructors and presenters in Federal Reserve System and interagency schools and in programs sponsored by others in the banking industry.

By sharing our knowledge of banking regulations and management practices with bankers and the public, the Federal Reserve can improve regulatory compliance and bank management, while reducing the demands on our supervisory resources. For this reason, education and outreach are vital components of bank supervision and regulation.

In 1999, we held regional meetings to update bankers on changes in bank regulations and to discuss current operational problem areas. We also presented a variety of seminars on bank oversight to bank directors and officers and conducted sessions on fair lending for compliance officers. Our staff hosted community development roundtables in each of the district's seven states, sponsored community development workshops, and spoke at forums sponsored by others. And our Community Affairs staff developed 1stSource (*www.1stsource.kc.frb.org*), an interactive Internet site to provide easy public access to information on federal programs that assist community development projects.

2000

As the banking industry becomes more complex, our supervisory role becomes even more challenging. While it is difficult to predict what the future holds for the banking industry, we must, nevertheless, press forward with the programs and services that will add to our effectiveness in the year to come.

In 2000, we will open a new bank supervision office at the Omaha Branch to expand our service in the region. We will continue to evaluate the impact of the Gramm-Leach-Bliley Act and, where necessary, take actions to adjust our processes and practices to provide a coordinated approach for supervising financial holding companies created under the Act. We will participate in Federal Reserve System initiatives on community bank supervision, bank consumer compliance, supervisory use of information systems and web-based technologies, and development of staff training. And we will continue to promote compliance with banking laws and regulations, as well as economic and community development, through seminars, programs, publications, electronic media, and other outreach efforts.

Tenth District *Highlights*

A new focus on rural America in the Federal Reserve System

While it is true that some rural communities have been swept along by the nation's long-running expansion, many other communities have simply been left behind.

Many of the keys to the future of rural America are still not completely understood. For instance, which industries hold the greatest promise for rural America? What market innovations will improve the flow of capital to rural businesses? And how should governments and entrepreneurs work together to improve the rural digital infrastructure?

Finding answers to key questions like these will be a challenge — but one well worth meeting for rural America's 55 million people.

That's why the Federal Reserve Bank of Kansas City created the Center for the Study of Rural America. Launched in October 1999, the Center began its important job of tracking the shifting currents of the farm and rural economies. To draw attention to the day's most important issues, the Center began publishing its monthly newsletter, *The Main Street Economist*.

And to help sort out the key policy issues facing rural America as the new century opens, the Center announced its first national conference in April 2000: "Beyond Agriculture: New Policies for Rural America."

The Center plans to release its first annual report in January 2001.

Mark Drabenstott
Vice President and Director
Center for the Study of Rural America

Tom Hoenig
President, Federal Reserve Bank of Kansas City, with Rural Center launch attendees.

Other district highlights

- Banking Supervision and Regulation staff conducted 70 commercial bank examinations, 78 bank holding company inspections, 50 specialized exams, and 322 risk assessments of small shell bank holding companies.

- The district gained a net of 27 electronic check presentment customers last year and achieved a 44 percent endpoint penetration rate — the highest rate in the Federal Reserve System. We also topped the System in the percentage of items presented electronically.

- Wholesale Payments staff completed the Systemwide effort to consolidate the System's off-line funds transfer and book-entry securities operations at the Kansas City and Boston Reserve Banks. These transactions are completed on behalf of banks that do not maintain a computer-to-computer connection with the Federal Reserve and were previously performed at each Reserve Bank.

- The System's Support Function Office selected our locally developed Automated Customer Service Information System as the tool that will be used by electronic access help desks across the Federal Reserve System.

- Staff in our Information Technology area enhanced the operation and security of the district's local area network. Initiatives were aimed at improving the operating environment and, thus, the functionality of our LAN backbone, and upgrading data storage equipment that had reached its capacity.

- Credit and Risk Management staff provided discount window assistance to 150 institutions and increased their effectiveness in administering the Bank's payment system risk policies as evidenced by a 20 percent decline in the number of daylight and final overdrafts per account during 1999.

- In total, Tenth District staff chaired or otherwise contributed to the important work of more than 200 System work groups or task forces during 1999.

Kansas City

Board

From left to right: Dennis E. Barrett (FirstBank Holding Co. of Colorado, Lakewood, CO.); Bruce A. Schriefer (Bankers' Bank of Kansas, Wichita, KS); Charles W. Nichols, (Davison and Sons Cattle Co., Arnett, OK); Colleen D. Hernandez (Kansas City Neighborhood Alliance, Kansas City, MO); Jeffrey L. Gerhart (First National Bank, Newman Grove, NE); Frank A. Potenziani (M&T Trust, Albuquerque, NM); Terrence P. Dunn, Deputy Chairman (J.E. Dunn Construction Co., Kansas City, MO); Hans C. Helmerich (Helmerich & Payne, Inc., Tulsa, OK); Jo Marie Dancik, Chairman (Ernst & Young LLP, Denver, CO).

Denver

Board

From left to right: James A. King (BT Incorporated, Riverton, WY); C.G. Mammel (The Bank of Cherry Creek, N.A., Denver, CO); Kathryn A. Paul, Chairman (Retired from Kaiser Permanente, Denver, CO); Robert M. Murphy (Sandia Properties Ltd., Co., Albuquerque, NM); John W. Hay III (Rock Springs National Bank, Rock Springs, WY); Albert C. Yates (Colorado State University, Fort Collins, CO); Teresa N. McBride (McBride & Associates, Inc., Albuquerque, NM)

Oklahoma City

Board

From left to right: Patricia B. Fennell (Latino Community Development Agency, Oklahoma City, OK); Carlisle Mabrey (Citizens Bank & Trust Company, Okmulgee, OK); Larry W. Brummett, Chairman (ONEOK, Inc., Tulsa, OK); Michael S. Samis (Macklanburg-Duncan Co., Oklahoma City, OK); William H. Braum (W. H. Braum Inc. & Retail Buildings, Inc., Oklahoma City, OK); Betty Bryant Shaull (Bank of Cushing and Trust Co., Cushing, OK). (Not Pictured: David Kruse, American Airlines Maintenance & Engineering Center, Tulsa, OK)

Omaha

Board

From left to right: A.F. "Tony" Raimondo (Behlen Mfg. Co., Columbus, NE); H.H. Kosman (Platte Valley National Bank, Scottsbluff, NE); Bill L. Fairfield (Dreamfield Partners, Inc., Omaha, NE); Frank L. Hayes (Hayes & Associates, LLC, Omaha, NE); Gladys Styles Johnston, Chairman (University of Nebraska at Kearney, Kearney, NE); Bob L. Gottsch (Gottsch Feeding Corp., Hastings, NE).
(Not Pictured: Bruce R. Lauritzen, First National Bank of Omaha, Omaha, NE)

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Atchison Casting Corporation
Atchison, Kansas

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

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Cozad, Nebraska

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The Bama Companies
Tulsa, Oklahoma

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Wichita, Kansas

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Lamar, Missouri

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The Valley State Bank
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Bruce Schriefer
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Bankers' Bank of Kansas
Wichita, Kansas

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Senior Executive Vice President
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Kansas City, Missouri

Larry Snyder
President and CEO
The Hamilton Bank
Hamilton, Missouri

Denver

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Vice President
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New Mexico, N.A.
Albuquerque, New Mexico

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Denver, Colorado

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First Data Corporation
Englewood, Colorado

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The Colorado Bankers Association
Denver, Colorado

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Community First Service Corporation
Fargo, North Dakota

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Bankers' Bank of the West
Denver, Colorado

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Independent Bankers of Colorado
Denver, Colorado

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The Bankers Bank
Oklahoma City, Oklahoma

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Legacy Bank
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Stillwater National Bank & Trust Co.
Stillwater, Oklahoma

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Executive Vice President and
Chief Information Officer
Bank of Oklahoma
Tulsa, Oklahoma

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F&M Bank & Trust Co.
Tulsa, Oklahoma

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MidFirst Bank
Oklahoma City, Oklahoma

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Bank of Chelsea
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Omaha

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Oklahoma City Branch

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President and Chief Executive Officer

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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

Alan D. Barkema
Vice President and Economist

G. Will Cook
General Auditor

Mark R. Drabenstott
Vice President and Director,
Center for the Study of Rural America

Esther L. George
Vice President

Roberta E. Hearn
Vice President

Carol A. Hefley
Vice President

James H. Jonson
Vice President

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Vice President and Economist

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Vice President

Larry G. Meeker
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Vice President and
Assistant Secretary

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Vice President and
Public Information Officer

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Assistant Vice President

Todd E. Clark
Assistant Vice President
and Economist

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

James R. Deis
Assistant Vice President

Andrew Filardo
Assistant Vice President
and Economist

C. Alan Garner
Assistant Vice President
and Economist

Leesa M. Guyton
Assistant Vice President

Sharon Kozicki
Assistant Vice President
and Economist

D. Michael Manies
Assistant Vice President

John M. Mitchell
Assistant Vice President

Dawn B. Morhaus
Assistant Vice President

Stacey Schreft
Assistant Vice President
and Economist

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Assistant Vice President

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Assistant Vice President

John A. Wood
Assistant Vice President
and Community Affairs Officer

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Assistant Vice President

Susan E. Zubradt
Assistant Vice President

Denver

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Senior Vice President
and Branch Manager

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Vice President and Assistant
Branch Manager

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Assistant Vice President

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Assistant Vice President

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Assistant Vice President

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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

Official staff as of 12/31/99.

Tenth Federal Reserve District

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 (FRBKC) 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, 1999 ("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 the FRBKC is responsible for maintaining an effective process of internal controls over financial reporting including 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. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the FRBKC assessed its process of internal controls over financial reporting, including 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, management of the FRBKC believes that the FRBKC maintained an effective process of internal controls over financial reporting, including 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 3, 2000

PRICEWATERHOUSECOOPERS

Report of Independent Accountants

PricewaterhouseCoopers LLP
1055 Broadway
10th Floor
Kansas City MO 64105
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 ("FRBKC") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the Financial Statements as of December 31, 1999, 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 FRBKC maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the Financial Statements as of December 31, 1999, 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 3, 2000

PRICEWATERHOUSECOOPERS

Report of Independent Accountants

PricewaterhouseCoopers LLP
1055 Broadway
10th Floor
Kansas City MO 64105
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 (the "Bank") as of December 31, 1999 and 1998, 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 accounting principles generally accepted in the United States.

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, 1999 and 1998, 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 3, 2000

Financial *Statements*

Federal Reserve Bank of Kansas City
Statements of Condition (in millions)

As of December 31, 1999 and 1998

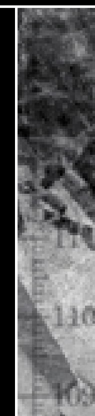
	1999	1998
Assets		
Gold certificates	$ 313	$ 289
Special drawing rights certificates	175	247
Coin	17	24
Items in process of collection	474	496
Loans to depository institutions	11	2
U.S. government and federal agency securities, net	14,511	12,668
Investments denominated in foreign currencies	381	456
Accrued interest receivable	146	120
Interdistrict settlement account	3,969	1,324
Bank premises and equipment, net	74	76
Other assets	15	15
Total assets	$ 20,086	$ 15,717
Liabilities and Capital		
Liabilities:		
Federal Reserve notes outstanding, net	$ 18,829	$ 14,256
Deposits:		
Depository institutions	480	652
Other deposits	4	25
Deferred credit items	340	414
Surplus transfer due U.S. Treasury	15	29
Accrued benefit cost	54	55
Other liabilities	6	6
Total liabilities	19,728	15,437
Capital:		
Capital paid-in	179	140
Surplus	179	140
Total capital	358	280
Total liabilities and capital	$ 20,086	$ 15,717

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, 1999 and 1998

	1999	1998
Interest Income:		
Interest on U.S. government and federal agency securities	$ 804	$ 742
Interest on foreign currencies	5	10
Interest on loans to depository institutions	1	1
Total interest income	810	753
Other operating income:		
Income from services	60	55
Reimbursable services to government agencies	22	23
Foreign currency gains (losses), net	(12)	43
U.S. government securities gains (losses), net	(1)	1
Other income	2	-
Total other operating income	71	122
Operating expenses:		
Salaries and other benefits	84	77
Occupancy expense	7	7
Equipment expense	9	8
Assessments by Board of Governors	19	16
Other expenses	50	49
Total operating expenses	169	157
Net income prior to distribution	$ 712	$ 718
Distribution of net income:		
Dividends paid to member banks	$ 10	$ 8
Transferred to surplus	39	21
Payments to U.S. Treasury as interest on Federal Reserve notes	663	210
Payments to U.S. Treasury as required by statute	-	479
Total distribution	$ 712	$ 718

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, 1999 and 1998

	Capital Paid-in	Surplus	Total Capital
BALANCE AT JANUARY 1, 1998			
(2.5 million shares)	$ 127	$ 119	$ 246
Net income transferred to surplus	-	21	21
Net change in capital stock issued (0.3 million shares)	13	-	13
BALANCE AT DECEMBER 31, 1998			
(2.8 million shares)	140	140	280
Net income transferred to surplus	-	39	39
Net change in capital stock issued (0.8 million shares)	39	-	39
BALANCE AT DECEMBER 31, 1999			
(3.6 million shares)	$ 179	$ 179	$ 358

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 in the United States ("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.

The Board of Governors established a Special Liquidity Facility (SLF) to make discount window credit readily available to depository institutions in sound financial condition around century date change (October 1, 1999, to April 7, 2000) in order to meet unusual liquidity demands and to allow institutions to confidently commit to supplying loans to other institutions and businesses over this period. Under SLF, collateral requirements are unchanged from normal discount windows activity and loans are made at a rate of 150 basis points above FOMC's target federal funds rate.

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.

Effective April 26, 1999 FRBNY was given the sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in the 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 FRBNY 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 FRBNY on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA. Prior to April 26, 1999 all Reserve Banks were authorized to engage in such lending activity.

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 and federal agency 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 "U.S. Government securities gains (losses), 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. Effective April 26, 1999 income from securities lending transactions undertaken by FRBNY was also allocated to each Reserve Bank. Securities purchased under agreements to resell 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.

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, 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. The Reserve Banks have entered into an agreement which provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. 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 $5,769 million, and $2,958 million at December 31, 1999 and 1998, 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.

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 ended on September 30, 1998 and 1997, 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. Payments made to the U.S. Treasury after September 30, 1998, represent payment of interest on Federal Reserve notes outstanding.

The Consolidated Appropriations Act of 1999 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $3,752 million during the Federal Government's 2000 fiscal year. The Reserve Banks will make this payment prior to September 30, 2000.

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. Income and Cost Related to 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 immaterial and included in "Other expenses."

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 2.999% and 2.774% at December 31, 1999 and 1998, respectively.

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

	1999	1998
Par value:		
Federal agency	$ 5	$ 9
U.S. government:		
Bills	5,293	5,403
Notes	6,551	5,213
Bonds	2,488	1,927
Total par value	14,337	12,552
Unamortized premiums	274	205
Unaccreted discounts	(100)	(89)
Total allocated to Bank	$ 14,511	$ 12,668

Total SOMA securities bought outright were $483,902 million and $456,667 million at December 31, 1999 and 1998, respectively.

The maturities of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 1999, were as follows (in millions):

	Par value		
Maturities of Securities Held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 139	$ -	$ 139
16 days to 90 days	2,756	1	2,757
91 days to 1 year	4,194	1	4,195
Over 1 year to 5 years	3,723	-	3,723
Over 5 years to 10 years	1,533	3	1,536
Over 10 years	1,987	-	1,987
Total	$ 14,332	$ 5	$ 14,337

At December 31, 1999 and 1998, matched sale-purchase transactions involving U.S. government securities with par values of $39,182 million and $20,927 million, respectively, were outstanding, of which $1,175 million and $581 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 2.359% and 2.307% at December 31, 1999 and 1998, 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):

	1999	1998
German Marks:		
Foreign currency deposits	$ -	$ 241
Government debt instruments including agreements to resell	-	55
European Union Euro:		
Foreign currency deposits	102	-
Government debt instruments including agreements to resell	60	-
Japanese Yen:		
Foreign currency deposits	8	15
Government debt instruments including agreements to resell	210	143
Accrued interest	1	2
Total	$ 381	$ 456

Total investments denominated in foreign currencies were $16,140 million and $19,769 million at December 31, 1999 and 1998, respectively. The 1998 balance includes $15 million in unearned interest 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, 1999, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies

Within 1 year	$ 356
Over 1 year to 5 years	12
Over 5 years to 10 years	13
Total	$ 381

At December 31, 1999 and 1998, there were no foreign exchange contracts or outstanding F/X swaps.

At December 31, 1999 and 1998, 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):

	1999	1998
Bank premises and equipment:		
Land	$ 12	$ 12
Buildings	48	47
Building machinery and equipment	17	17
Construction in progress	1	1
Furniture and equipment	58	53
	136	130
Accumulated depreciation	(62)	(54)
Bank premises and equipment, net	$ 74	$ 76

Depreciation expense was $9 million for each of the years ended December 31, 1999 and 1998, respectively.

7. Commitments and Contingencies:

At December 31, 1999, the Bank was obligated under any noncancelable leases for premises or equipment with terms ranging from one to approximately three years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs or selected price indices.

Future minimum rental payments under noncancelable operating leases and capital leases, net or sublease rentals, with terms of one year or more, at December 31, 1999, were not material.

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, 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 paid-in of the claiming Reserve Bank, up to 50% of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in 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, 1999 or 1998.

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.

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, 1999 and 1998, 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 each of the years ended December 31, 1999 and 1998, 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):

	1999	1998
Accumulated postretirement benefit obligation at January 1	$ 27.7	$ 27.0
Service cost-benefits earned during the period	0.8	0.7
Interest cost of accumulated benefit obligation	1.6	1.5
Actuarial (gain)	(4.8)	(0.3)
Contributions by plan participants	0.2	0.3
Benefits paid	(1.7)	(1.5)
Accumulated postretirement benefit obligation at December 31	$ 23.8	$ 27.7

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):

	1999	1998
Fair value of plan assets at January 1	$ -	$ -
Actual return on plan assets	-	-
Contributions by the employer	1.5	1.2
Contributions by plan participants	0.2	0.3
Benefits paid	(1.7)	(1.5)
Fair value of plan assets at December 31	$ -	$ -
Unfunded postretirement benefit obligation	$ 23.8	$ 27.7
Unrecognized prior service cost	22.1	24.1
Unrecognized net actuarial gain (loss)	3.3	(1.6)
Accrued postretirement benefit cost	$ 49.2	$ 50.2

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, 1999 and 1998 was 7.5% and 6.25%, respectively.

For measurement purposes, an 8.75% annual rate of increase in the cost of covered health care benefits was assumed for 2000. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.50% 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, 1999 (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	$ (0.1)
Effect on accumulated postretirement benefit obligation	0.9	(0.9)

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

	1999	1998
Service cost-benefits earned during the period	$ 0.8	$ 0.7
Interest cost of accumulated benefit obligation	1.6	1.5
Amortization of prior service cost	(2.0)	(1.9)
Net periodic postretirement benefit cost	$ 0 .4	$ 0.3

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, 1999 and 1998, were $5 million for both years. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 1999 and 1998 operating expenses were $1 million for both years.

Volume of Principal Operations (Unaudited)

		1999		1998
Loans and Discounts, Daily Average	$	24,745,000	$	16,597,000
Number of Institutions Borrowing		150		130
Commercial Checks	$	1,041,760,000,000	$	939,708,000,000
Commercial Checks Collected		1,482,924,000		1,364,172,000
Currency Receipts and Payments	$	46,643,189,000	$	34,214,349,000
Pieces		2,965,343,000		2,383,362,000
Coin Receipts and Payments	$	308,889,000	$	456,546,000
Bags		638,000		800,000
Issues and Redemption of U.S. Government Securities	$	111,801,200,000	$	76,275,731,000
Funds Transfers	$	5,625,860,000,000	$	5,687,656,000,000
Numbers		3,873,000		3,718,000
Automated Clearing House	$	399,546,000,000	$	331,725,000,000
Numbers		264,389,000		233,911,000

Volume of Principal Operations numbers were not included in PricewaterhouseCoopers audit

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Federal Reserve
Bank *of*
Kansas City

Kansas City
925 Grand Boulevard
Kansas City, Missouri 64198

Denver Branch
1020 16th Street
Denver, Colorado 80202

Oklahoma City Branch
226 Dean A. McGee
Oklahoma City, Oklahoma 73125

Omaha Branch
2201 Farnam Street
Omaha, Nebraska 68102