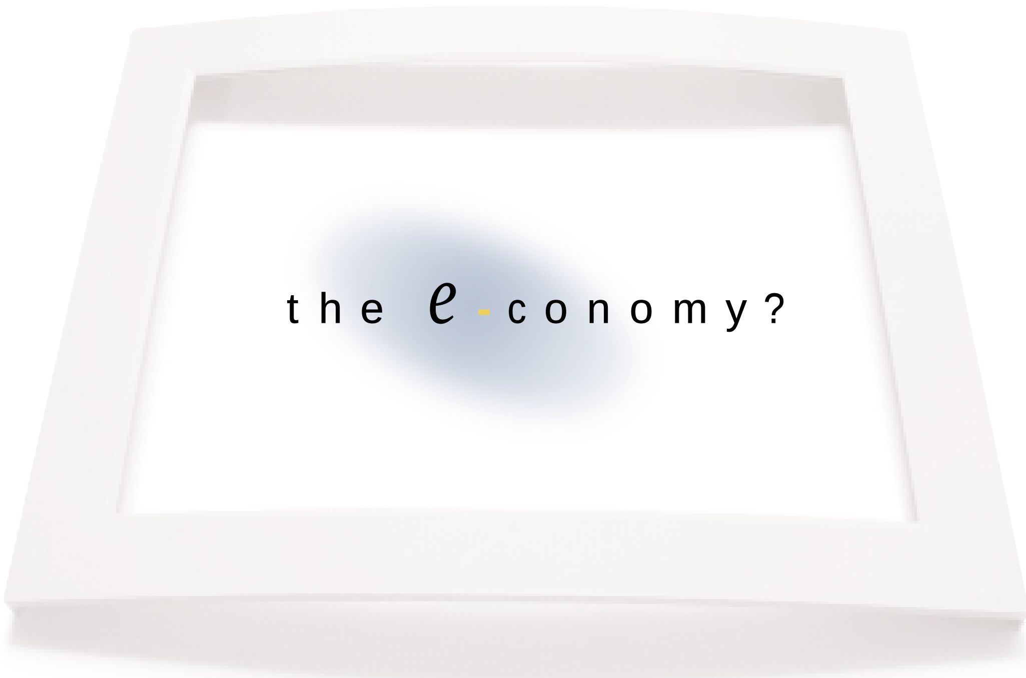


FEDERAL RESERVE BANK OF CHICAGO

1999 ANNUAL REPORT

E-commerce Is Changing How We Work and Live

CONTENTS

PRESIDENT'S MESSAGE

Is "economy.com" the wave of the future? It is clear that technology is changing how we do our jobs, how firms interact with each other, and how businesses sell to their customers. If the 1990s was the decade of the Internet, the decade during which our eyes were opened to amazing new possibilities, then this may be the decade in which those new possibilities are more fully realized — the decade of "e-commerce."

In just six years, we've seen an explosion of online commercial sites directed at consumers and other businesses. E-commerce is certainly a new development, but it is also the latest installment in the history of technology-driven advancement. Like other major technological breakthroughs of the past, e-commerce has the potential to bring the market economy a step closer to its theoretical potential.

The cornerstone of the market economy is competition, which gives us the opportunity to choose the best product at the best price and forces us to become more efficient and productive. The result is a higher overall standard of living over time. Despite the major economic progress of the past century, however, we have not harnessed the full potential of competition to improve our lives.

From left: Deputy Chairman Arthur Martinez, Chairman Lester McKeever, President Michael Moskow, and First Vice President William Conrad

One missing ingredient has been adequate information—the fuel that drives competition. A century and a half ago, a factory owner had a limited amount of information about customers and about potential suppliers and their products. Access to such information was limited by distance and the speed of a horse and buggy. Consumers faced the same limitations in choosing goods and services. As technology improved during the course of the last century, a factory owner could gain information from several different sources within minutes...simply by picking up the phone, or later, by sending a fax. Today, thanks to the Internet, the amount of information available is enormous and the process is closer to being instantaneous.

Businesses are using the Internet to find the best price and quality for their inputs. The Internet also enables producers to better monitor customers' buying patterns and streamline their production process by accurately tracking inventories and flows of material. Some companies are using the Internet to strengthen information links among suppliers, allowing greater customization of products based on customers' preferences. The Internet has affected the demand side of the economy as well. Consumers now have more choices by accessing the vast, networked marketplace created by the Internet.

Of course, the economy may never, in practice, exhibit all the characteristics inherent in the textbook description of perfectly competitive markets. Even the Internet cannot offer us a 100 percent fully-informed choice. There will even be some self-imposed limitations. For example, the question of how to balance the benefits of free flowing information with privacy rights will continue to be a critical issue for the nation and for individuals. Technology and the market are shaping solutions to this dilemma every day, and governmental institutions have also begun to weigh in on the issue. Resolving this and other questions democratically will require the public to become increasingly informed and involved. But whatever path we choose, the Internet will reduce some of the inevitable limitations of any physical market.

It's too early to tell if e-commerce is just an important innovation, or a revolution in the making. Either way, e-commerce is already having a profound impact on how we work and live. The Internet can already bring buyers and sellers together far more efficiently than ever before. And we could potentially see one universally accessible market for a certain product instead of many disparate markets. How our society shapes, and is shaped by, e-commerce today, will have a lasting impact on our nation and our economy.

The dramatic advances in information technology certainly played a role in the healthy economic growth that the U.S. experienced during much of the 1990s. And 1999 provided an appropriate flourish to the end of the decade. Growth in real Gross Domestic Product (GDP) over the four quarters of 1999 was above 4 percent for the fourth straight year, and the unemployment rate averaged 4.2 percent, the lowest since 1969. However, the outcome for inflation, as measured by the Consumer Price Index (CPI), was not as favorable in 1999 as in 1998. The CPI rose 2.6 percent over the four quarters of 1999, up from 1.5 percent in 1998, with the increase largely the result of rising energy prices.

The year 1999 marked a successful conclusion of the decade for the Chicago Fed, as well as the economy. The Bank's highest priority for 1999 was to prepare for Y2K, and I would like to thank our staff for their dedication in ensuring that we were successful in meeting this and many other challenging goals. A listing of the Bank's key accomplishments can be found on pages 16-19.

The Bank's success in 1999 also reflects the outstanding leadership and counsel of our directors in Chicago and Detroit. I would like to extend my special appreciation to Lester McKeever, who served as the Bank's chairman from 1997 through 1999. Lester is stepping down as chair in keeping with the Federal Reserve practice of periodically rotating the position. Lester's wisdom, dedication, support, and leadership have been especially valuable throughout his service on the board, and particularly during his time as chairman. Fortunately, the Bank will continue to benefit from his counsel and insight as he will remain a director during 2000.

I would also like to acknowledge Florine Mark, who completed the maximum of six years as a director on the Detroit Branch in 1999, including serving as chair for three full years. Florine's energy, enthusiasm and expertise will be sorely missed.

Finally, I would like to welcome Connie Evans to the Chicago board and Elizabeth Bunn and Edsel Ford to the Detroit board. Each brings important areas of knowledge and experience to our board deliberations.

The Chicago Fed had an eventful and successful year in 1999, and we expect that 2000 and the decade following will be even more promising, challenging and full of change. As we enter this new decade, all of us at the Chicago Fed will continue to be guided by our vision, which reaffirms our mission to serve the public interest and commits us to setting the standard of excellence in the Federal Reserve System and providing services of unmatched value to our customers and stakeholders.

Michael H. Moskow

MICHAEL H. MOSKOW
PRESIDENT AND CHIEF EXECUTIVE OFFICER
MARCH 20, 2000

E-commerce Is Changing How We Work and Live

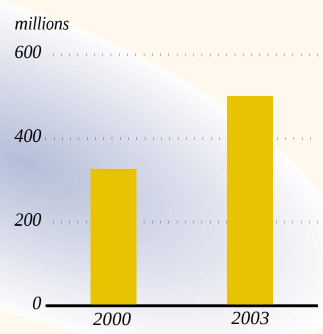
E-COMMERCE. AN ECONOMIC REVOLUTION or an over-hyped fad? Without question, the growth of the Internet has consistently surpassed the expectations of most observers. In 1995, for example, most experts projected that the Internet would have a worldwide user population of about 35 million by 1998. The actual number exceeded 100 million users. Today an estimated 200 million people use the Internet.

The astounding growth of the Internet has created a huge and constantly expanding market for businesses involved in electronic commerce directed at consumers as well as other businesses. Experts estimate that Internet users worldwide will spend $2.78 trillion online during the next five years. The U.S. has been the most enthusiastic participant in the surge of e-commerce activity, accounting for 44 percent of the global Web population using the Internet. The U.S. should continue to be the leading market worldwide, with estimates that e-commerce will represent 8 to10 percent of U.S. Gross Domestic Product (GDP) by 2003. However, there is an increasing number of people outside the U.S. using the Internet, and they are expected to account for 65 percent of worldwide Internet usage within five years.

While Amazon.com and other online sites directed at consumers have captured most of the headlines, the predominant users of e-commerce are businesses selling to other businesses. According to the International Data Corporation, 70 percent of the transactions conducted globally on the Internet in 1998 were business-to-business, with this percentage expected to increase to 86 percent by 2003. Forrester Research estimates that annual worldwide revenue for business-to-business sites will reach $1.3 trillion by 2003 as compared with $108 billion for e-commerce sites aimed at consumers.

INTERNET USER FORECAST
How many Web users there are projected to be worldwide at year-end

Source: ICMM V6.1, IDC 2000



U.S. companies are responding to the growing acceptance of the Internet. More than 56 percent of U.S. companies were expected to sell their products online to both businesses and private consumers by 2000, up from 24 percent in 1998.

The declining prices of telecommunications, along with decreasing hardware costs, should continue to accelerate e-commerce growth. Increased competition among Internet service providers will put downward pressure on telecommunication prices, affecting costs both in the U.S and abroad, where telecommunication charges are often three times more expensive than in the U.S. The declining prices for computer hardware are also driving e-commerce growth. The price for processing speed and storage has plummeted over the years, a trend reflected in the price of personal computers.

In addition, an estimated 2 billion networked hand-held devices, such as personal digital assistants and intelligent cell phones, will provide access to the Internet by 2003. The proliferation of secure online payment methodologies, along with traditional payment mechanisms such as the credit card, has established a sense of trust, albeit tenuous, among online users. Security continues to be a focal point of most naysayers. However, it is estimated that only 2 to 3 percent of Web sales to consumers involved bad payments or fraudulent transactions, which is comparable to figures for other sales channels.

The sheer impact of e-commerce is forcing businesses to reshape their corporate strategies and redesign their business models. By integrating Web-based technology, companies are becoming more efficient, reducing overhead costs, improving labor productivity, and finding new sources of revenue. Competitive pressures generated by the Web are forcing businesses to adapt while creating opportunities for a host of highly specialized companies. It is clear that the Internet is beginning to have a major impact on the way the world does business.

e-conomy

AND YOU

E-commerce has had an impact on the lives of many. Just ask the Wheatleys of Greenfield, Indiana.

LESLEE WHEATLEY, her husband, GREG, and their children ASHLEY, 13; JACOB, 8; ALLISON, 7; NOAH, 3; and MAX, 2.

■ Greg, who develops training programs for a large Indianapolis firm, uses the Internet to buy equipment and get information and tips on technical matters related to his work.

■ Leslee buys on the Internet often. She shopped heavily online over the holidays because it was convenient after the kids went to bed. She also buys drugstore items such as shaving cream and soap, occasionally groceries, collectibles such as die-cast cars for her son, even replacement parts for appliances.

■ The kids use the Internet for homework projects or to play games, and Leslee corresponds with the children's teachers via e-mail.

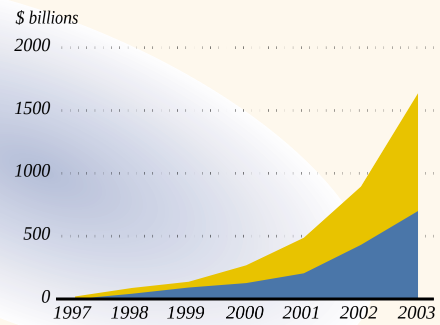
Is E-commerce Making the Economy More Efficient?

HOW WILL E-COMMERCE AFFECT the economy and how we work and live? The potential of the Internet is tremendous. In the not too distant future, a billion people may be connected in a vast global network that is accessed by perhaps half a million PCs and a trillion intelligent devices ranging from digital personal assistants to smart cards to products such as cars and major household appliances embedded with computer chips. Despite these dramatic changes, however, the basic principles of how the economy operates will still apply—the law of supply and demand and Adam Smith's invisible hand will be as relevant as always. In fact, these principles should be even more relevant as technological innovations move our market-based economy closer to its theoretical potential.

"In the end," according to Fed Chairman Alan Greenspan, "it is clear that all economic progress rests on competition." But competition is only possible if buyers have choices and the information necessary to make an economic decision. The function of a market is to bring together buyers and sellers and provide them with access to the information they need to complete a transaction. Prices are the most important information. Businesses and households use prices to make purchasing decisions, which ultimately determine how resources are allocated. Sellers use prices to help determine the level of interest in their good or service and whether they can make an adequate profit.

While competition is the defining feature of a free-market economy, there are always frictions that impede competition, such as search costs—the resources required to identify alternative choices. E-commerce has the potential to heighten competition by increasing the quality and quantity of information available to buyers, both consumers and producers making purchases from their suppliers. The traditional role of the physical marketplace, with all of its inherent limitations of time and place, is being broadened and reshaped by the Internet. Online sites directed at consumers and other businesses provide more options, resulting in more competition. At the same time, producers are increasingly using the Internet to improve their internal efficiency, reducing their costs and enhancing their ability to contain price increases. The result may be an economy that operates more efficiently than in the past.

COMMERCE ON THE WEB
Non U.S.
U.S.
Source: ICMM V6.1, IDC 2000



BENEFITS FOR CONSUMERS

E-commerce has brought a number of well-publicized benefits to consumers, providing better access to a greater variety of goods and services. The traditional barriers of time and location are less of a concern. Consumers have access to a huge, ever-expanding global marketplace that is open for business 24 hours a day, 7 days a week. A multitude of goods from any international time zone can be ordered from the comfort of home. Many services, such as long-distance learning, are provided directly to consumers via the Internet.

Perhaps the greatest benefit for consumers is the reduced search costs involved in making economic decisions. Consumers' increased ability to do "comparison shopping" is indicated by the development of specialized Web sites that offer "shopping bots"—software that locates merchandise available online and allows buyers to compare prices, products, and availability. With just a few clicks of a mouse, a consumer looking online for, say, a pink umbrella can find the cheapest price in a matter of minutes.

Midwestern manufacturers are embracing e-commerce.
A good example is Michigan-based Ford Motor Company.

Human Resources Associate JOYCE JORDAN and Final Area Maintenance Superintendent GARY SCHELDBERG, employees at a Ford assembly plant in Chicago. Ford is involved in a number of Web-based initiatives to operate more efficiently. Edsel B. Ford II, former president and COO of Ford Motor Credit Co. and currently a Ford director, is also a director of the Chicago Fed's Detroit Branch.

- Ford is partnering with GM and Daimler Chrysler to form a business-to-business integrated supplier exchange through a single global Internet portal. It will be open to all auto manufacturers around the world and their respective market of suppliers, partners and dealers. This will continue automakers' aggressive efforts to streamline supply chain management functions, including capacity planning, demand forecasting, and production planning.

- Ford is taking part in numerous Web-based joint ventures. One is CarPoint.com, the first online build-to-order system to link consumer-configured orders directly with a manufacturer's supply and delivery systems. This will let consumers order cars to their exact specification, receive immediate feedback on availability, and schedule delivery and service at their local dealership.

- Internet technology is also facilitating distribution through dealers. The Dealer Web Hub allows dealers to log on to a single site and instantly obtain a full range of information, including customer viewpoint reports, recall notices, incentives, pricing, ordering guidelines, sales programs and training.

These information services extend to products that are not necessarily purchased online. Sites such as Autobytel.com and Autoweb.com, for example, provide prices and other information for car buyers. Approximately 30 percent of vehicle buyers use the Internet in some form to facilitate the purchasing process. Internet "middlemen" also provide pricing information on different but related services from a variety of sources. For example, Travelocity, an online travel service provider, allows consumers to compare prices for airplane tickets, rental cars, and hotels, and purchase all these services online.

Consumers benefit from the efforts of many organizations to use e-commerce to deal directly with customers, bypassing the traditional intermediaries and often reducing costs in the process. Consider CarPoint.com, the first online system that links consumers ordering autos directly with a manufacturer's supply and delivery systems. The site allows consumers to order a car to their exact specification, receive immediate feedback on availability, and schedule delivery and service at their local dealership.

Airlines and hotels are using the Internet to bypass traditional intermediaries and auction off unsold seats and rooms. Even some universities that have not met their enrollment targets have used the Internet to accept bids on tuition from students. Online auction sites such as eBay eliminate the middleman in a different way, conducting person-to-person online auctions 24 hours a day, 7 days a week.

BENEFITS FOR BUSINESSES

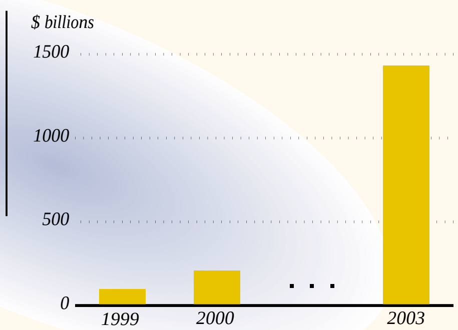
Consumer sites tend to dominate the business news, but it is the less glamorous business-to-business activity that is expected to experience the most dramatic growth and have the most profound effect on the economy. According to most experts, the sales of business-to-business online sites are roughly 10 times larger than those of consumer sites, and that trend is expected to continue.

Like consumers, businesses benefit from greater access to a larger variety of goods and services. Many firms are also using e-commerce and other Web-based applications to increase their efficiency and contain production costs.

Most business-to-business sites act as intermediaries between buyers and sellers, providing pricing and other information to producers and potential suppliers. Many e-commerce sites provide information to buyers and sellers with similar needs and interests. Examples include sites specializing in metals, petrochemicals, plastics, semiconductors, and tools. Most vertical sites simply list available products and prices, but some feature an auction process, similar to consumer sites such as eBay. Business-to-business sites may also focus horizontally on a specific business process or function that spans different industries or products.

E-COMMERCE BUSINESS-TO-BUSINESS WORLDWIDE TRANSACTIONS

Source: ICMM V6.1, IDC 2000



Businesses are also using Web-based technology to increase their efficiency by improving communications internally and among suppliers. Dell Computer, for example, uses e-commerce to improve its supply chain management. During 1999 Dell gave its suppliers direct access to information such as inventory levels, product defect rates, and technological plans. Working directly with suppliers in this way enabled Dell to reduce its inventory levels to six days, as compared with the levels of nine days and 23 days for two of its competitors. Ford uses the Web to provide its intermediaries with direct access to current information. The Dealer Web Hub allows dealers to log onto a single site and instantly obtain a full range of information, including customer viewpoint reports, incentives, pricing, sales programs and training.

Firms that provide customers the ability to order products online have also experienced cost savings and increased efficiency. Cisco Systems found that problem orders dropped from 25 percent to 2 percent when it moved to online ordering, resulting in significant savings.

DISADVANTAGES OF E-COMMERCE

Are there any disadvantages to the e-commerce boom? Like any major technological change, the Internet will inevitably cause dislocations among workers and companies. The need for workers to be more adaptable and keep up with technology will only increase as companies use the Web to eliminate low-value, repetitive operations. In addition, some industries will face pressure. Firms providing intermediary services in sectors such as travel, insurance, and real estate are finding the information they provide more readily available on the Internet. In 1996, for example, travel agents handled 80 percent of U.S. airline reservations. Just two years later that share had fallen to 53 percent as airlines began dealing with customers directly through the Web and telephone services.

Some companies will find that moving to the Web is a business imperative. Increasingly, traditional Fortune 500 firms are joining the Internet fray. However, the Internet offers some special challenges for traditional firms due to the increased ability of online consumers to compare prices, the competition from Internet companies that have lower overhead costs, the willingness of some firms to price aggressively to gain market share, and the need to adapt distribution systems to the needs of the Web marketplace. Increasingly, companies are taking a "clicks and bricks" approach, which involves partnerships between online and offline firms.

E-commerce also presents new challenges for small businesses. On the one hand, a small business may use e-commerce as a way to level the playing field with larger companies. A small start-up firm does not have as many barriers to entry on the Web as it would have in the physical marketplace. And it is easier to achieve economies of scale and scope on the Web as a business grows. On the other hand, unless a small firm is selling an unusual or highly specialized product, it may find it tough to compete on the Web with better-known, larger companies, according to some experts. Physical location, the great equalizer in the world of brick and mortar for smaller firms, is not a factor on the Internet. In addition, having a well-recognized brand can be important because of the multitude of choices on the Internet and consumers' inability to hand-inspect a product prior to purchase. Forrester Research estimated in a recent report that online small businesses will continue to experience dramatic sales growth, but that their share of total online sales will fall to 6 percent in 2003 from 9 percent in 1998.

REDUCING THE FOG

How has e-commerce affected the overall economy? While e-commerce has experienced astounding growth, it does not directly affect the vast majority of business transactions. International e-commerce sales are expected to easily exceed $1 trillion in the next few years, but that would still be less than 10 percent of all business transactions worldwide, according to one estimate.

One important way information technology such as Web-based applications has affected the economy is by increasing the amount of "real-time" information available to firms. Fed Chairman Alan Greenspan has noted that businesses use information in "an effort to reduce the fog surrounding the future outcome of current decisions." In the past, firms were confronted with a lack of current information about customers' needs and the status of their own complex production process. Firms were forced to dedicate resources to protect against the unknown or unexpected. The result was redundancies, such as inventory safety stocks. With new information technology, firms have been able to better control inventories, coordinate with buyers and suppliers, and reduce production costs.

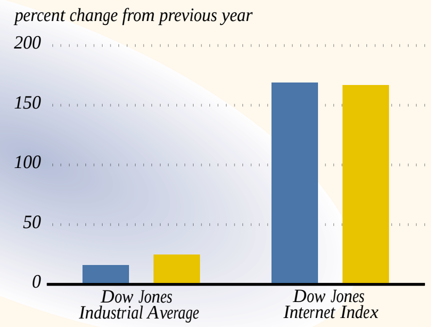
The increase in “real-time” data is not solely an Internet phenomenon. A variety of new technologies such as Electronic Data Interchange (EDI) and satellite communications have resulted in dramatic improvements in recent years. However, e-commerce and other Web-based applications provide a valuable and more flexible tool in this process, one that is more accessible to smaller firms than EDI.

The technological improvements that have increased the amount of “real time” information appear to have played a role in the surge of U.S. productivity growth during the past five years. The Internet has contributed to this process, and the increased proliferation of Web-based applications should help producers continue to make their operations more efficient in the future. However, it is always difficult to predict how long a particular innovation will have a beneficial effect on productivity growth. The only confident prediction that can be made is that increases in the rate of productivity growth from any technological advance are not without limits.

The increased growth of e-commerce should place some downward pressure on prices, all other things being equal. All buyers, both consumers and businesses, will have more choices. A substitute is only a mouse click away. Firms may face added pressure to control their costs and contain price increases as much as possible.

E-commerce may also play a role in shaping the way that payments are made. Consumers generally use credit cards to make payments on the Web, due to advantages such as a well-established dispute resolution process. However, from the merchant’s point of view, the credit card is not as efficient for small-dollar transactions. In addition, there is not a widely accepted alternative for individuals to make credit card or debit card payments to other individuals via the Web. The market is already providing choices. Services by Bank One Corp. and by Wells Fargo Bank and eBay, both announced in March 2000, provide person-to-person payments services by credit and debit cards, providing additional competition for companies such as PayPal.com that provide a similar service. The wide acceptance of a Web-based payment alternative could play a major role in propelling the growth of electronic payments.

THE INTERNET EXPLOSION
The Dow Jones Internet Index shows impressive performance by Internet stocks
1998
1999
Source: Dow Jones Indexes



How will e-commerce affect the overall economy? Certainly consumers and businesses should benefit from services that are faster, better and cheaper. And the unusually high price-to-earnings ratio of many e-commerce stocks represents a vote of confidence from the marketplace. The early returns indicate that e-commerce should help to make our economy more efficient. Like other major technological breakthroughs of the past, e-commerce has the potential to foster higher productivity growth, which would ultimately result in increased real incomes and a higher standard of living. It does appear that e-commerce has worked to strengthen Adam Smith’s invisible hand, but the full extent of the change is impossible to measure. Nevertheless, the promise and potential of a networked world and global economy is an exciting prospect as we enter the new millennium.

e-conomy

AND BUSINESS

Wisconsin-based Johnson Controls is using e-commerce to improve service to customers, business partners and employees.

Wisconsin-based Johnson Controls is a global market leader in automotive interiors and facility management and controls. Chief Information Officer SAM VALANJU (right) and MARK HALBUR, director of controls product distribution sales and marketing, are at the forefront of a variety of e-commerce efforts to operate more efficiently.

- Johnson Controls uses a sophisticated Intranet to enable employees to share knowledge on a variety of topics, including best practices, technology, business processes, training, and benefits. Johnson Chairman and Chief Executive Officer James Keyes is a member of the Chicago Fed's Board of Directors.

- The company uses e-commerce Web technology to let customers order control products on-line, making them more accessible and ensuring that customers receive the latest technical information and pricing.

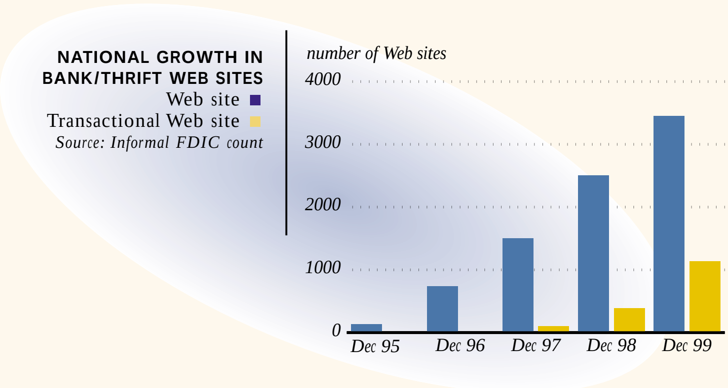
- A major supplier to the auto industry, Johnson Controls relies heavily on Electronic Data interchange (EDI) to communicate with automakers, enabling the company to assemble and deliver complete seat systems for installation in new cars in as little as four hours from the time the order was received.

How Is E-commerce Affecting Banking?

LIKE OTHER MAJOR SECTORS OF THE U.S. ECONOMY, the banking industry is increasingly turning to electronic commerce to conduct business more efficiently and better serve customers.

Across the country and throughout the Seventh Federal Reserve District, more and more financial institutions are creating Web sites to market their services or offer online transactions. Keeping pace, the Chicago Fed's Supervision & Regulation Department in 1999 created a special team of senior examiners and technology experts devoted exclusively to Internet banking and information technology.

Consider the rapidly increasing rate in which U.S. financial institutions are embracing the Internet. The number of U.S. banks and thrifts with Web sites more than doubled in the last two years, according to the Federal Deposit Insurance Corporation. At the same time, banks and thrifts with transactional Web sites (typically allowing account inquiry and transfer as well as other information transfer capabilities) have jumped eleven-fold. By December of 1999, approximately 3,450 U.S. banks and thrifts had Web sites, and of those, 1,134 were transactional.



The situation is no different with the state member banks regulated by the Chicago Fed — both large and small — in the Seventh District. By the end of 1999, roughly 100 of these banks had Web sites, and 34 were offering some form of Internet banking, according to Chicago Fed data.* The bank's research also shows that many more state member banks will begin offering Internet banking in 2000.

The 1999 total is significantly more than 1998, when 46 state member banks had Web sites, and 13 offered Internet banking. Even many relatively small state member banks now have a Web presence. As of year-end 1999, approximately 18 in the Seventh District with less than $50 million in total assets had Web sites.

INTERNET BANKING UNIT

The Chicago Fed Internet banking unit is made up of Internet banking experts and senior examiners. It focuses primarily on two goals: educating examiners on how to identify and assess Internet banking risks at individual banks and throughout the industry, and conducting reviews of Seventh District organizations offering the most complex Internet-based products and services. The approach is to identify the issues that pose the most risk to the institution.

During 2000, unit members will train all examiners who serve as the central contacts for institutions offering Internet banking. These central contacts will perform risk assessments of the Internet banking offerings, and the appropriate supervisory program will be implemented.

The Internet unit also features a test laboratory offering examiners a "hands-on" opportunity to understand better the hardware and software used by Seventh District financial institutions and Internet banking vendors/service providers. The laboratory will help examiners evaluate and understand important industry-security products such as intrusion-detection systems and vulnerability-assessment tools, and also will be used to conduct attacks on simulated networks and host computers. The test laboratory will also provide Internet unit staff with the skills necessary to identify and discuss vulnerabilities associated with commonly used Internet banking networks, systems, hardware, and software.

** When information technology is centralized in a multi-bank organization, only the lead bank is included in these totals. Consequently, District-wide Internet banking activity is actually greater than what's reflected in these numbers.*

Chicago Fed creates new unit devoted to Internet banking and information technology.

EILEEN MALONEY, (left to right) TOM ANDERSON and PAUL NEFF of the Federal Reserve Bank of Chicago are part of a new team of senior examiners and technology experts devoted exclusively to Internet banking and information technology.

How Is the Chicago Fed Taking Advantage of Web Technology?

A CHICAGO FED PRIORITY IN 2000 will be to increase its focus on using technology to find better, more efficient ways of doing business.

"We need to do things wildly different because we're in very different times," said Senior Vice President Bill Barouski of Information Technology Services. "The market and world are showing that we need to be continually recreating ourselves through innovation and risk-taking."

At the forefront of that effort is a high-priority initiative called FRB.ORG, in which a team of employees will research and analyze ways to incorporate more Web-based and related technology into the Bank's daily business practices.

"The bottom line is we need to change, and this whole concept to create a small group of individuals dedicated to this idea is a way to do that," Barouski said.

Team members will identify areas where technology can be creatively applied, targeting processes affecting depository institutions served by the Bank, as well as internal functions. Goals include finding innovative ways to reduce costs, improving communication or service delivery, or revamping administrative processes.

Senior Vice President Jerry John of Corporate and Support Services calls the team a creative catalyst, explaining, "The FRB.ORG team not only will work full time to identify business changes we need to make for success in the future, but also will spur the creation of virtual teams to quickly implement those ideas throughout the Bank."

OTHER INITIATIVES UNDERWAY

- The Federal Reserve System plans to provide customers with a less expensive, more flexible electronic-access option for conducting transactions. This means customers will soon be able to access savings bonds, check image, check adjustments, and cash-ordering applications through the Internet.
- A Web-based recruiting tool is being used to enhance Chicago Fed hiring efforts, allowing potential job applicants to submit résumés through the Bank's public Web site. A computer application scans all résumés and candidate profiles for matches with open Fed positions.
- The Chicago Fed is investigating the feasibility of a Web site that would make it easier for consumers to sign up for making direct payments to businesses, such as utility companies. Direct Payment is a service that automatically deducts bill payments from a consumer's checking account. Currently, consumers must contact billers individually and fill out the appropriate paperwork. As part of the Fed's effort to promote the migration to electronic payments, the Web site would also educate consumers about the service and its benefits.
- The Fed's financial services Web site offers timely and accurate information about the financial services and products available to all financial institutions in the United States. Customers can access information about both national and local services offered by the 12 Reserve Banks. The next step is to increase the site's interactive capabilities. Plans for 2000 include online registration for seminars and password-protected areas that customers could access to receive customized information or software upgrades.
- Members of the Bank's Emerging Payments Initiative continue to work closely and collaboratively with providers and users of the payments system to better understand the barriers and incentives associated with electronic payments and to develop recommendations for future payment options where appropriate. The Bank is leading a variety of projects to promote the migration to electronic payments.

Web technology plays a significant role in improving productivity and customer service.

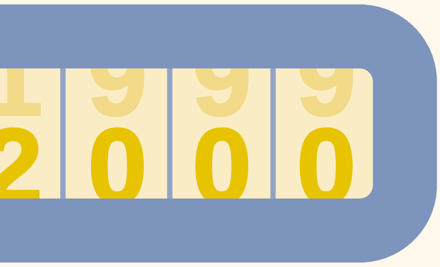
Applications Consultant TODD AADLAND is one of many Chicago Fed employees helping to incorporate more Web-based and related technology into the Bank's daily business practices.

BEV SCHATTE, a program manager in the National Business Development Office, is spearheading efforts to help increase the interactive capabilities of the Financial Services Web site. This includes online registration for seminars and password-protected areas that customers can access to receive customized information or software upgrades. Administered by the Business Development Office located at the Chicago Fed, the Financial Services Web site currently provides customers nationwide with quick and easy access to a wide variety of service information. The ultimate Federal Reserve goal is to allow customers to initiate financial transactions using Web-based technology.

■ A high-priority initiative is underway at the Chicago Fed called FRB.ORG, in which a team of employees will research and analyze ways to incorporate more Web-based and related technology into the Bank's daily business practices.

A REVIEW OF OUR ACTIVITIES
AND ACCOMPLISHMENTS

Chicago Fed Highlights of '99



While 1999 was marked by many notable accomplishments, none is more significant than the contribution the Chicago Fed made to the general public and financial community through its extensive Y2K preparations and contingency planning. Staff members from throughout the District contributed their support, cooperation and hard work to this effort, which was designated as the Bank's highest priority for the year.

THE FOLLOWING ARE SOME OF THE Y2K MILESTONES REACHED ON THE JOURNEY TO 2000:

- Information Technology Services completed testing of all of the Bank's internal systems, as well as completed testing with all external customers on schedule.
- Supervision & Regulation implemented a comprehensive supervisory program addressing the potential Y2K risks associated with more than 280 District financial institutions.
- Seventh District Cash operations worked to ensure that depository institutions had access to more-than-enough cash nationwide during the century rollover.
- The Bank spearheaded a Districtwide Y2K communications campaign that included news conferences, public service announcements, op-ed pieces, internal town-hall meetings and an assortment of other communications designed to strengthen public confidence in the financial industry's Y2K preparedness.
- The Customer Service Unit assisted customers with Y2K testing during 16 weekends and handled 14,282 Y2K-related inquiries.

1st Quarter

- Supervision and Regulation launched a successful year in which more than 1,200 inspections, examinations, and risk assessments were carried out.
- The Customer Service Unit handled 28,720 inquiries from financial-institution customers during the first quarter. By year-end, that number had risen to 98,927, up 16 percent from 1998.
- The Seventh District Cash Department was rated the Federal Reserve System's most efficient currency processor in the first quarter, a distinction it earned overall for 1999.

2nd Quarter

■ Generally regarded as the leading conference of its kind, the 35th annual Conference on Bank Structure and Competition focused on global financial crises and the resulting implications for banking and regulation.

■ The Bank launched the Payment System Research Database (PSRD) and the Consumer and Economic Development Research and Information Center (CEDRIC), increasing its Web resources on public-policy issues.

■ The Chicago Fed fostered the public's understanding of the Federal Reserve System through more than 1,400 speeches, conferences and workshops.

■ The Bank enhanced its information-security program by implementing an improved security-liaison program, developing an information-security page on the employee intranet and expanding security-awareness training.

■ The Bank promoted the migration to electronic payments through joint Direct Deposit/Direct Payment campaigns with five local Automated Clearing House (ACH) associations.

3rd Quarter

■ As the permanent new home for the leadership development conference for Federal Reserve System executives, the Bank successfully developed and executed its first conference called "A Mandate for Leadership."

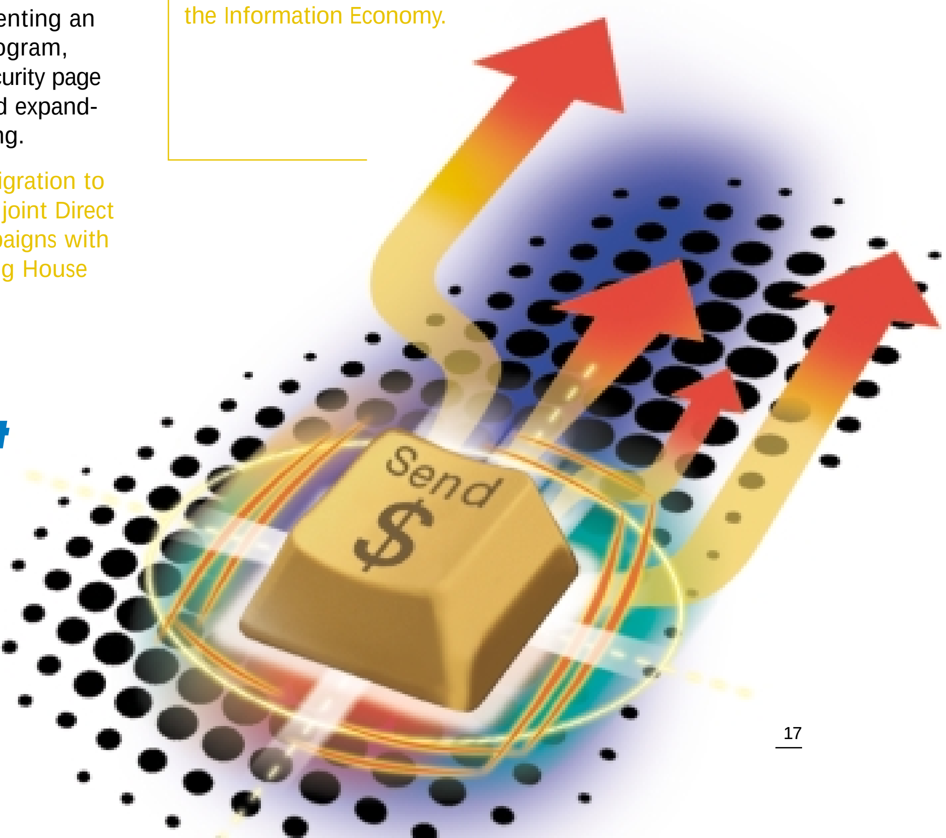
■ College students affiliated with the National Financial Management Association toured the Bank, making them among the more than 13,200 visitors who toured the Chicago Fed during the year.

■ Economist Daniel Aaronson explored the effect of an increased minimum wage on prices in a research paper, one of 32 working papers published by Economic Research during the year.

■ The System's Business Development Office, housed in Chicago, coordinated the Fed's first-ever National Customer Satisfaction Survey with more than 2,500 customers.

■ The Bank launched the Small Enterprise Capital Access Partnership (SECAP) to provide traditionally underserved small-business owners with fair access to credit and capital.

■ The Bank co-hosted the Electronic Payments Symposium with the University of Michigan Program for Research on the Information Economy.



LESSONS FROM RECENT GLOBAL FINANCIAL CRISES

CHICAGO, ILLINOIS SEPTEMBER 30–OCTOBER 2, 1999

4th Quarter

■ Overall check volume for 1999 increased nearly 10 percent, the Bank's largest annual percentage increase of the decade.

■ A total of 160 million check items were presented electronically to 434 Seventh District financial institutions for the year, an increase of 30 percent over 1998.

■ The Des Moines, Indianapolis, Milwaukee and Peoria offices successfully converted to the System's fully automated check-adjustments system to process checks more efficiently.

■ More than 40 percent of the checks processed in the District used the Electronic Cash Letter (ECL) deposit option in 1999, making the Bank the System leader in ECL deposits. Chicago's ECL deposits account for 70 percent of the System's ECL volume.

■ The Seventh District's Automated Clearing House (ACH) operation generated $10.2 million in service revenue for the year as a result of significant growth in commercial ACH volume and new originators.

■ The Statistics Division enjoyed a productive year, meeting 100 percent of its deadlines for submitting reports on banking conditions to the Board of Governors and the New York Fed.

■ In 1999, the System's "Sell Direct" program, located at the Chicago Fed, reached milestones with a total of more than $1 billion in Treasury Direct transactions and more than $1 million in Treasury fees since the program's inception in 1998. Sell-Direct is a service for individuals who are holding securities in a Treasury Direct account and want to sell them on the secondary market.

■ The Research Department hosted an October conference entitled "Lessons from the Recent Global Financial Crises" with the Bank for International Settlements.

■ The Bank brought together 120 leaders from the financial services industry to evaluate the prospects for migration to an electronic payment system through a two-day workshop co-sponsored with the Illinois Institute of Technology.

■ The System's Business Development Office, located in Chicago, implemented a national communications strategy to announce pricing plans and to cross-sell the Federal Reserve's services to all customers in a consistent, coordinated manner.

■ For the second straight year, the Detroit Branch was recognized for its quality management and performance excellence by the Michigan Quality Leadership Award program.

■ The Bank's financial-service operations in 1999 ranked as the fourth most efficient among those of the 12 Fed Banks.

■ Economic Research staff analyzed 295 bank/bank-holding-company merger applications in 1999 on behalf of the Board of Governors to ensure that they would not substantially lessen competition.

■ One-hundred percent of new employees attended diversity-awareness training during the year.

Below at right, Sandra Kwasa, Applications Consultant (left), and Ennedy Toledo-Bologna, Senior Analyst, help build a new playground at Chicago's Carol Robertson Center for Learning during one of the many community-service projects Chicago Fed employees took part in during 1999. Below at left, David Blatchley, Economic Education Specialist, reads to students at the center.

A Year of Service

At the Chicago Fed, volunteerism means helping people, strengthening our communities, and creating partnerships with groups outside the Bank. In 1999, more than 200 Chicago Fed volunteers participated in roughly 60 community-service projects throughout the Seventh Federal Reserve District. Projects included:

- Teaching economics-related topics to hundreds of elementary and high school students via our long-standing relationship with Junior Achievement of Metropolitan Chicago.
- Helping the Detroit-based Fort Street Presbyterian Church's "Open Door" program offer meals, clothing, and counseling to those in need.
- Helping community-service organizations in central Illinois collect food, clothing, toys and child-care items for distribution to those in need.
- Assisting low-income families in Illinois in the preparation of their tax returns through the Tax Counseling Project.
- Providing 626 pounds of food for the Milwaukee Hunger Task Force.
- Sorting and packaging food for the needy at the Greater Chicago Food Depository and helping collect food from major food conventions.
- Collecting clothing and toys in Des Moines during the holiday season for the local Salvation Army.
- Preparing and serving meals to the homeless at a Chicago soup kitchen.
- Partnering with the Focus HOPE program in Detroit to adopt needy families during the winter holiday season and help provide them with food and gifts.
- Helping build a Habitat for Humanity home on Chicago's West Side.
- Participating in a variety of walk-a-thons to raise funds for charities.
- Re-planting a neighborhood garden in Chicago's Humbolt Park.

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Hoffman Estates, Illinois

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Chief Executive Officer
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The Hall-Perrine Foundation
Cedar Rapids, Iowa

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Migdalia Rivera*
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and Ohnward Bancshares
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Managing Director and
Chief Executive Officer
First Bank and Trust
Evanston, Illinois

**Inactive*

One new director, Connie E. Evans, President, Women's Self-Employment Project, Chicago, Illinois, joined the board in 2000. She replaces Migdalia Rivera, whose term as director expired on December 31, 1999.

1999 Board of Directors, Federal Reserve Bank of Chicago, from left to right: Robert Darnall, Verne Istock, Lester McKeever, Arthur Martinez, Jack Evans, James Keyes, Alan Tubbs and Robert Yohanan.

Board of Directors
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David J. Wagner
Chairman, President
and Chief Executive Officer
Old Kent Financial
Corporation
Grand Rapids, Michigan

Two directors joined the Detroit Branch Board in 2000: Edsel B. Ford II, Director, Ford Motor Company, Dearborn, Michigan and Elizabeth Bunn, Vice President, International Union UAW, Detroit, Michigan. Respectively, they replaced directors Denise Ilitch and Florine Mark, whose terms ended on December 31, 1999.

1999 Board Of Directors, Detroit Branch, from left to right: Timothy Leuliette, David Wagner, Denise Ilitch, Florine Mark, Stephen Polk, Irma Elder, and Richard Bell

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Seventh District Representative

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President and Chief Executive Officer
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Chicago, Illinois

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Wisconsin Agri-Service Association

Alan Garner
Mason, Michigan
Michigan Farm Bureau

Brad Glenn
Stanford, Illinois
Illinois Soybean Association

Brent Halling
Perry, Iowa
Iowa Pork Producers Association

John Howell
Bryant, Indiana
Indiana State Poultry Association

Charles Shaw
Hope, Indiana
Milk Promotion Services of Indiana

John Whipple
Shenandoah, Iowa
Iowa Corn Growers Association

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Troy, Michigan
Kelly Services, Inc.
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John Challenger
Chicago, Illinois
Challenger, Gray & Christmas, Inc.
Member-at-Large

Linda Ewing
Detroit, Michigan
International Union, UAW

David Newby
Milwaukee, Wisconsin
Wisconsin State AFL-CIO

Steve Redfield
Chicago, Illinois
STRIVE/Chicago Employment Council
Member-at-Large

James Rohan
Chicago, Illinois
Sullivan, Cotter and Associates
Member-at-Large

Ronald Willis
Chicago, Illinois
Chicago Federation of Labor

Lloyd Falconer
Seward, Illinois
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Columbus, Indiana
Indiana Chamber of Commerce

Manuel T. Gonzalez
Indianapolis, Indiana
United States Hispanic Chamber of Commerce

Richard T. Koenings
Elm Grove, Wisconsin
Independent Business Association

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Chicago, Illinois
National Association of Women Business Owners (NAWBO)

James Michael Schultz
Effingham, Illinois
Illinois State Chamber of Commerce

Billie Jo Wanink
Royal Oak, Michigan
National Association of Women Business Owners (NAWBO)

Alan C. Young, CPA
Detroit, Michigan
Booker T. Washington Business Association

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First Busey Corporation
Urbana, Illinois

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Capstone Bank
Watseka, Illinois

Thelma J. Smith
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Lafayette, Indiana

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Fairmount, Indiana

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Bankers Trust Company
Des Moines, Iowa

Dwight Seegmiller
Hills Bank & Trust Company
Hills, Iowa

Paul Swenson
Iowa Trust & Savings Bank
Oskaloosa, Iowa

Richard A. Waller
Security National Bank
Sioux City, Iowa

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Marshall, Michigan

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First State Bank of East Detroit
St. Clair Shores, Michigan

Robert E. Churchill
Citizens National Bank of Cheboygan
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Bankers' Bank
Madison, Wisconsin

Richard A. Hansen
Johnson International, Inc.
Johnson Bank
Racine, Wisconsin

Bradley O. Yocum
State Bank of Howards Grove
Howards Grove, Wisconsin

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Southside Trust & Savings Bank
Peoria, Illinois

Dale Baraks
Southeast National Bank of Moline
Moline, Illinois

Pete Jain
Citizens Equity Federal Credit Union
Peoria, Illinois

Wilbur R. Lancaster
Union Planters Bank
Decatur, Illinois

Linda Little
BankIllinois
Champaign, Illinois

Mike McKenzie
First Capital Bank
Peoria, Illinois

Mitch Bormeman
Heritage Bank of Central Illinois
Trivoli, Illinois

Randall Ross
First Mid-Illinois Bank & Trust, N.A.
Mattoon, Illinois

Jerald Sarnes
The Havana National Bank
Havana, Illinois

Donald Schlorff
Busey Bank
Urbana, Illinois

Diane McCluskey
Independent Bankers' Bank of Illinois
Springfield, Illinois

John McEvoy
Metro Bank
East Moline, Illinois

Michael King
First National Bank of Decatur
Decatur, Illinois

Chicago Metropolitan

Diane Anderson
Financial Federal Trust & Savings Bank
Olympia Fields, Illinois

John Collins
Great Lakes Credit Union
Great Lakes, Illinois

John Bailey
Baxter Credit Union
Deerfield, Illinois

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Oak Brook Terrace, Illinois

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AMCORE Financial, Inc.
Rockford, Illinois

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Peoples Bank SB
Munster, Indiana

James Constantine
Sears, Roebuck and Co.
Hoffman Estates, Illinois

Chuck Monroe
National City Midway Services Center
Chicago, Illinois

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American Chartered Bank
Schaumburg, Illinois

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Merchants National Bank
Aurora, Illinois

Savannah Hannah
Financial Federal Trust & Savings Bank
Chicago Ridge, Illinois

Barbara Yeates
Cole Taylor Bank
Chicago, Illinois

Deborah Schneider
First Midwest, N.A.
Joliet, Illinois

Charles Sanger
Bank Calumet
Hammond, Indiana

Indiana

H. Matthew Ayers
State Bank of Lizton
Lizton, Indiana

Steven Bailey
Decatur Bank and Trust
Decatur, Indiana

Lynn Bierlein
Salin Bancshares, Inc.
Indianapolis, Indiana

Debbie L. Cox
Irwin Union Bank & Trust
Columbus, Indiana

Cliffe Godsey
National City Bank
Indianapolis, Indiana

Steven D. Flowers
Bank One
Indianapolis, NA
Indianapolis, Indiana

Pamela S. Gossett
DeMotte State Bank
DeMotte, Indiana

Dee Ann Hammel
First Federal Savings Bank
Huntington, Indiana

Stan V. Hart
Terre Haute First National Bank
Terre Haute, Indiana

Sherri Jones
Phillips Federal Credit Union
Fort Wayne, Indiana

Robert J. Ralston
Lafayettte Bank & Trust Company
Lafayette, Indiana

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Security National Bank
Sioux City, Iowa

Linda Donner
First American Bank
Fort Dodge, Iowa

Dale C. Froehlich
Community State Bank
Ankeny, Iowa

Nelson Klavitter
Dubuque Bank & Trust
Dubuque, Iowa

Bill Logan
State Central Bank
Keokuk, Iowa

Victor Quinn
Quad City Bank & Trust
Bettendorf, Iowa

Marti T. Rodamaker
First Citizens
National Bank
Mason City, Iowa

Steve Ollenberg
Principal Bank
Des Moines, Iowa

Robert A. Steen
Bridge Community Bank
Mechanicsville, Iowa

Steve Tscherter
Lincoln Savings Bank
Reinbeck, Iowa

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Belinda Baker
The Empire
National Bank
of Traverse City
Traverse City, Michigan

Barbara Gurn
The Empire
National Bank
of Traverse City
Traverse City, Michigan

Kathleen Alford
The Empire
National Bank
of Traverse City
Traverse City, Michigan

Sally Gapinski
First National Bank
of Gaylord
Gaylord, Michigan

Kathleen Taskey
First National Bank
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Gaylord, Michigan

Kenneth Sterling
First Community Bank
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Michigan

Marilyne Joy
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Victoria Sager
Central State Bank
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Nikki Bright
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Frankfort, Michigan

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Huron Community
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Sharla Leach
Alden State Bank
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St. Charles, Michigan

Sandra Koenig
First Federal Savings
of Alpena
Alpena, Michigan

Lorri Rondeau
First Federal Savings
of Alpena
Alpena, Michigan

Sue Meredith
Honor State Bank
Honor, Michigan

Nancy Sorensen
West Shore Bank
Scottsville, Michigan

Western Michigan

Robert De Jonge
Grand Bank
Grand Rapids, Michigan

Patricia Lunog
Alliance Banking
Company
New Buffalo, Michigan

D. Scott Hines
The First National Bank
Three Rivers, Michigan

Linda Comps-Klinge
State Bank of Caledonia
Caledonia, Michigan

Jaylen T. Johnson
Southern Michigan
Bank & Trust
Coldwater, Michigan

Wendell Stoeffler
Ionia County
National Bank
Ionia, Michigan

Debra S. Smith
Hillsdale County
National Bank
Hillsdale, Michigan

Joan Heffelbower
Hastings City Bank
Hastings, Michigan

Emily Stafford
Hastings City Bank
Hastings, Michigan

Leslie Reagle
Southern Michigan
Bank & Trust
Coldwater, Michigan

Cindy Dwyer
Hillsdale County
National Bank
Hillsdale, Michigan

Linda Kaminski
Kalamazoo County
State Bank
Schoolcraft, Michigan

Linda Grouleau
Eaton Federal
Savings Bank
Charlotte, Michigan

Brad Slagh
Byron Center
State Bank
Byron Center, Michigan

Karla Bultinck
Byron Center
State Bank
Byron Center, Michigan

Brian Hoggatt
Sturgis Bank & Trust
Sturgis, Michigan

Detroit Metropolitan

Michael McMinn
Metrobank
Farmington Hills,
Michigan

Laird Kellie
Lapeer County Bank
& Trust Co.
Lapeer, Michigan

Joseph Hallman
Citizens State Bank
New Baltimore,
Michigan

Richard Bauer
Fidelity Bank
Birmingham, Michigan

Stephen M. Mazurek
Bank of Lenawee
Adrian, Michigan

Paul Fuller
Republic Bank
Ann Arbor, Michigan

Aleta Bame
Metrobank
Farmington Hills,
Michigan

Peggy Bachli
Bank of Ann Arbor
Ann Arbor, Michigan

Mark Slade
Bank of Ann Arbor
Ann Arbor, Michigan

David Robertson
Blissfield State Bank
Blissfield, Michigan

Vonda Zuhlke
Tri-County Bank
Brown City, Michigan

Gordon Bade
Capac State Bank
Capac, Michigan

Kendall Rieman
Thumb National Bank
Pigeon, Michigan

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Sterling Bank & Trust
Southfield, Michigan

Sue Harmon
Onsted State Bank
Onsted, Michigan

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Capital Area School
Employees CU
Lansing, Michigan

Jaquetta Jones
Capital Area School
Employees CU
Lansing, Michigan

Cathy Burnham
Credit Union One
Ferndale, Michigan

Linda Clark
Kellogg FCU
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Michele Myrick
E&A CU
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Kim Lysinger
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Lisa Tyrell
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M&I Data Services
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Thomas Smith
Heritage Bank and Trust
Racine, Wisconsin

Leonard Steele
Associated Data Services
Green Bay, Wisconsin

Werner Kant
Educators Credit Union
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Vice President and
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Regional Economic Programs

William A. Testa
Vice President and
Economic Advisor

Financial Markets Regulation and Payments Issues

Douglas D. Evanoff
Vice President and
Economic Advisor

Elijah Brewer III
Assistant Vice President
and Economic Advisor

James T. Moser
Research Officer and
Economic Advisor

Robert R. Bliss
Senior Economist and
Economic Advisor

Robert DeYoung
Senior Economist and
Economic Advisor

David A. Marshall
Senior Economist and
Economic Advisor

Macroeconomic Policy Research

Charles L. Evans
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Economic Advisor

Anne Marie L. Gonczy
Assistant Vice President
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William A. Strauss
Senior Economist and
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Microeconomic Policy Research

Daniel G. Sullivan
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Paula R. Worthington
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Statistics

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Michael R. Jarrell
Director

Bank and Bank Holding Company Supervision

Richard C. Cahill
Vice President and
Division Leader

A. Raymond Bacon
Special Exams Director

Robert A. Bechaz
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Jeffrey A. Jensen
Regional Director – Iowa

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Joseph Turk
Director, Supervisory
Resource Group

Compliance/Community Reinvestment Act

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Vice President and
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Regional Director – Wisconsin

Paulette M. Myrie-Hodge
Regional Director – Illinois

Global Supervision

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Vice President and
Division Leader

Adrian B. D'Silva
Director

Philip G. Jackson
Director

Mark H. Kawa
Director

Catharine M. Lemieux
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Anne M. Phillips
Director

Barbara A. Werner
Director

Human Resource Development and Technology

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Vice President
and Division Leader

Gregory J. Bartnicki
Director

Margaret M. Beutel
Director

Catherine M. Bourke
Director

Karen M. Whalen-Ward
Director

** Includes directors and senior economist and economic advisors as well as officers.*

Federal Reserve Bank of Chicago Management Committee, from left to right: Charles Furbee, Michael Moskow, William Conrad, Jerome John, William Hunter, Deirdre Gehant, John Wixted, Glenn Hansen, Nancy Goodman, Richard Anstee, Carl Vander Wilt, William Barouski, David Allardice, Barbara Benson, Thomas Ciesielski, William Gram.

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Business Development Office

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Vice President

Strategic Marketing and Customer Service

Kathleen H. Williams
Vice President

Rosemarie V. Gould
Administrative Officer

Financial Services

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Senior Vice President

Retail Services

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Vice President

Cynthia L. Rasche
Assistant Vice President

Eve M. Boboch
Operations Officer

Katherine McDonald
Retail Payments Officer

Check Services

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Tyler K. Smith
Assistant Vice President

Electronic and Fiscal Services

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James M. Rudny
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L. Edward Ketchmark
Assistant Vice President

Indianapolis Office
Donna M. Yates
Assistant Vice President

Milwaukee Office
Michael J. Hoppe
Operations Officer

Peoria Facility
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Assistant Vice President

Branch Operations and Cash Operations

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and Branch Manager

Cash Operations

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Vice President

Guadalupe Garcia
Assistant Vice President

Detroit Branch

Brian D. Egan
Vice President

Valerie Van Meter
Vice President

Patrick A. Garrean
Assistant Vice President

Linda S. McDonald
Operations Officer

SUPPORT FUNCTIONS

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Senior Vice President
and Secretary

Consumer and Community Affairs

Alicia Williams
Vice President

Corporate Communications

James R. Holland
Corporate Communications
Officer and Assistant
Vice President

Robert W. Lapinski
Corporate Communications
Officer and Assistant
Vice President

Corporate and Support Services

Jerome F. John
Senior Vice President

Facilities Management and Protection

Wayne R. Baxter
Vice President

General Services

Kristi L. Zimmermann
Assistant Vice President

Corporate Services

Jeffery B. Marcus
Assistant Vice President

Culture Transformation

Deirdre A. Gehant
Cultural Transformation Leader
and Equal Employment
Opportunity Officer

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Vice President

Margaret K. Koenigs
Assistant Vice President

Richard F. Opalinski
Assistant Vice President

Information Technology Services

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Information
Technology Officer

Human Capital

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Network Services

R. Steve Crain
Assistant Vice President

Thomas M. Matsumoto
Assistant Vice President

Business Resumption, CDC, Asset Management, Budget and Facilities

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Assistant Vice President

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Senior Vice President
and General Counsel

Legal Services

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Vice President and
Associate General Counsel

Elizabeth A. Knospe
Assistant Vice President and
Assistant General Counsel

Anna M. Voytovich
Assistant Vice President and
Assistant General Counsel

Financial Management Services, Accounting, Loans, Payment System Risk and Reserves and Financial Markets

Carl E. Vander Wilt
Senior Vice President and
Chief Financial Officer

Loans, Accounting, Payment System Risk and Reserves

Gerard J. Nick
Vice President

William J. O'Connor
Assistant Vice President

Ellen J. Bromagen
Assistant Vice President

Robert A. Lyon
Loans Officer

Financial and Management Services

Jeffrey S. Anderson
Assistant Vice President

Office of the General Auditor

Glenn C. Hansen
General Auditor

Robert M. Casey
Assistant General Auditor

Joseph B. Green
Assistant Vice President

As of December 31, 1999

Directors

Members of the Federal Reserve Bank of Chicago's board of directors are selected to represent a cross section of the Seventh District economy, including consumers, industry, agriculture, the service sector, labor, and commercial banks of various sizes.

The board consists of nine members. Member banks elect three bankers and three nonbankers. The Board of Governors appoints three additional nonbankers and designates the Reserve Bank chair and deputy chair from among its three appointees.

The Detroit Branch has a seven-member board of directors. The Board of Governors appoints three nonbankers and the Chicago Reserve Bank board appoints four additional directors. The Branch board selects its own chair each year, with the approval of the Chicago board. All Reserve Bank and Branch directors serve three-year terms, with a two-term maximum.

Director appointments and elections at the Chicago Reserve Bank and its Detroit Branch effective in 1999 were:

- Lester H. McKeever, Jr. redesignated Chairman.
- Arthur C. Martinez reappointed to a second three-year term and redesignated Deputy Chairman.
- James H. Keyes, Chairman and Chief Executive Officer, Johnson Controls, Inc., Milwaukee, Wisconsin, and Alan R. Tubbs, President, Maquoketa State Bank and Ohnward Bancshares, Maquoketa, Iowa, elected to three-year terms as directors replacing Donald Schneider and Arnold Schultz.
- Florine Mark redesignated Branch Chair.
- Richard M. Bell, President and Chief Executive Officer, The First National Bank of Three Rivers, Three Rivers, Michigan, and Stephen R. Polk, Chairman and Chief Executive Officer, R.L. Polk & Co., Southfield, Michigan, reappointed to second three-year terms as Branch Directors.

At year-end 1999 the following appointments and elections to terms beginning in 2000 were announced:

- Arthur C. Martinez designated Chairman.
- Robert J. Darnall reappointed to a second three-year term and designated Deputy Chairman.
- Verne G. Istock, President, Bank One Corporation, Chicago, Illinois, re-elected to a second three-year term.
- Connie E. Evans, President, Women's Self-Employment Project, Chicago, Illinois, elected to a three-year term, replacing Migdalia Rivera.
- Timothy D. Leuliette designated Branch Chair.
- Irma B. Elder reappointed to a second three-year term as Branch director.
- Edsel B. Ford II, Director, Ford Motor Company, Dearborn, Michigan, and Elizabeth Bunn, Vice President, International Union UAW, Detroit, Michigan, appointed to three-year terms as Branch directors, replacing Denise Ilitch and Florine Mark.

Advisory Councils

The Federal Advisory Council, which meets quarterly to discuss business and financial conditions with the Board of Governors in Washington, D.C., is comprised of one banker from each of the 12 Federal Reserve Districts. Each year the Chicago Reserve Bank's board of directors selects a representative to this group. Norman R. Bobins was appointed to serve a second one-year term beginning January 1, 1999.

Members of the Community Bank Council served the second year of their terms in 1999. Members of the Advisory Council on Agriculture, Labor and Small Business, who are selected from nominations by Seventh District organizations, served the third year of their terms in 1999. The councils provide a vital communication link between the Bank and these important sectors.

Officers

The Bank's board of directors acted on the following promotions during 1999:

- Lysette R. Bailey to Assistant Vice President, Information Technology Services.
- Joseph B. Green to Assistant Vice President, Audit Department.
- Jerome F. John to Senior Vice President, Corporate and Support Services.

New officers appointed by the board in 1999 were:

- Eve M. Boboch to Operations Officer, Financial Services
- Richard C. Cahill to Vice President, Supervision & Regulation

	Dollar Amount		Number of Items	
	1999	1998	1999	1998
Check & Electronic Payments				
Checks, NOWs, & share drafts processed	1.6 trillion	1.5 trillion	2.2 billion	2.0 billion
Fine sort & packaged checks handled	26.6 billion	46.7 billion	49.1 million	76.0 million
U.S. government checks processed	39.5 billion	43.7 billion	36.1 million	41.8 million
Automated Clearing House (ACH) items processed	2.5 trillion	2.5 trillion	824.8 million	744.3 million
Transfer of funds	53.8 trillion	46.8 trillion	20.4 million	20.5 million
Cash Operations				
Currency received and counted	41.9 billion	39.4 billion	3.0 billion	2.8 billion
Unfit currency destroyed	5.4 billion	6.6 billion	587.8 million	629.6 million
Coin bags received and processed	1.0 billion	1.0 billion	3.6 million	3.4 million
Securities Services for Depository Institutions				
Safekeeping balance December 31:				
Definitive securities[1]	143.8 billion	20.7 billion	8.5 thousand	14.4 thousand
Book Entry securities	278.9 billion	273.4 billion	761.7 thousand	876.1 thousand
Purchase & Sale	1.7 billion	3.4 billion	6.5 thousand	7.0 thousand
Book Entry government securities	4.8 trillion	7.4 trillion	760.8 thousand	876.1 thousand
Loans to Depository Institutions				
Total loans made during year	4.6 billion	2.5 billion	1.2 thousand	0.8 thousand
Services to U.S. Treasury and Government Agencies				
Redemptions of definitive government securities	8.2 million	33.3 million	0.1 thousand	0.8 thousand
Government coupons paid	1.9 million	2.5 million	5.3 thousand	9.2 thousand
Federal tax deposits processed	12.3 billion	11.0 billion	612.7 thousand	703.0 thousand
Food stamps redeemed	743.1 million	832.3 million	146.3 million	166.3 million
Sell Direct transactions processed	581.2 million	510.6 million	15.7 thousand	16.2 thousand

[1]1998 volume represents number of pieces which are no longer available. 1999 volume represents number of receipts.

Management Assertion

February 10, 2000
To the Board of Directors of The Federal Reserve Bank of Chicago:
The management of the Federal Reserve Bank of Chicago (FRBC) 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 (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 the FRBC 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 FRBC 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, the management of the FRBC believes that the FRBC maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.

Federal Reserve Bank of Chicago

Michael Moskow
President and Chief Executive Officer

Federal Reserve Bank of Chicago

William Conrad
First Vice President and Chief Operating Officer

PRICEWATERHOUSECOOPERS

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203 North LaSalle Street
Chicago, IL 60601-1210
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Report of Independent Accountants

To the Board of Directors of The Federal Reserve Bank of Chicago:
We have examined management's assertion that the Federal Reserve Bank of Chicago ("FRB Chicago") 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 FRB Chicago 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

March 3, 2000

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Report of Independent Accountants

**To the Board of Governors of the Federal Reserve System
and the Board of Directors of the Federal Reserve Bank of Chicago**

We have audited the accompanying statements of condition of The Federal Reserve Bank of Chicago (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

March 3, 2000

Statement of Condition (in millions) As of December 31,	**1999**	**1998**
Assets		
Gold Certificates	$ 993	$ 998
Special Drawing Rights Certificates	549	900
Coin	32	35
Items in Process of Collection	753	794
Loans to Depository Institutions	34	3
U.S. Government and Federal Agency Securities, Net	45,448	43,841
Investments Denominated in Foreign Currencies	1,581	1,911
Accrued Interest Receivable	457	414
Interdistrict Settlement Account	23,292	1,838
Bank Premises and Equipment, Net	141	141
Other Assets	33	28
Total Assets	$ 73,313	$ 50,903
Liabilities and Capital		
Liabilities:		
Federal Reserve Notes Outstanding, Net	$ 68,385	$ 44,608
Deposits:		
Depository Institutions	2,970	4,282
Other Deposits	4	78
Deferred Credit Items	637	609
Surplus Transfer Due U.S. Treasury	54	56
Accrued Benefit Cost	83	79
Other Liabilities	24	25
Total Liabilities	$ 72,157	$ 49,737
Capital:		
Capital Paid-In	578	583
Surplus	578	583
Total Capital	$ 1,156	$ 1,166
Total Liabilities and Capital	$ 73,313	$ 50,903

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

Statements of Income (in millions) For the years ended December 31,		**1999**		**1998**
Interest Income:				
Interest on U.S. Government and Federal Agency Securities	$	2,587	$	2,625
Interest on Foreign Currencies		22		43
Interest on Loans To Depository Institutions		2		1
Total Interest Income	$	2,611	$	2,669
Other Operating Income:				
Income from Services		97		95
Reimbursable Services to Government Agencies		22		22
Foreign Currency (Losses) Gains, Net		(49)		181
U.S.Government Securities (Losses) Gains, Net		(2)		4
Other Income		7		5
Total Other Operating Income	$	75	$	307
Operating Expenses:				
Salaries and Other Benefits		139		129
Occupancy Expense		19		18
Equipment Expense		19		19
Cost of Unreimbursed Treasury Services		1		1
Assessments by Board of Governors		65		53
Other Expenses		96		97
Total Operating Expenses	$	339	$	317
Net Income Prior to Distribution	$	2,347	$	2,659
Distribution of Net Income:				
Dividends Paid to Member Banks	$	36	$	33
Transferred (from) to Surplus		(5)		81
Payments to U.S. Treasury as Interest on Federal Reserve Notes		2,316		770
Payments to U.S. Treasury as Required by Statute		–		1,775
Total Distribution	$	2,347	$	2,659

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

Statements of Changes in Capital (in millions)

For the years ended December 31, 1999 and December 31, 1998	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 1998 (10.5 million shares)	$ 527	$ 502	$ 1,029
Net Income Transferred to Surplus		81	81
Net Change in Capital Stock Issued (1.2 million shares)	$ 56	$ –	$ 56
Balance at December 31, 1998 (11.7 million shares)	$ 583	$ 583	$ 1,166
Net Income Transferred from Surplus		(5)	(5)
Net Change In Capital Stock Redeemed (0.1 million shares)	(5)	–	(5)
Balance at December 31, 1999 (11.6 million shares)	$ 578	$ 578	$ 1,156

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

1. Organization

The Federal Reserve Bank of Chicago ("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 branch in Detroit, Michigan, serve the Seventh Federal Reserve District, which includes Iowa and portions of Michigan, Illinois, Wisconsin and Indiana. 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

3. Significant Accounting Policies, continued

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 the 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 during this period. Under the SLF, collateral requirements are unchanged from normal discount window 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

3. Significant Accounting Policies, continued
d. U.S.Government and Federal…, continued

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 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 counterparty 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

3. Significant Accounting Policies, continued

d. U.S.Government and Federal…, continued

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 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 $10,920 million, and $9,506 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

3. Significant Accounting Policies, continued
i. Surplus, continued

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 to the U.S. Treasury made 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 may vary significantly.

j. Income and Cost of 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 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 9.392% and 9.600% 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	$ 17	$ 32
U.S. Government:		
Bills	16,579	18,699
Notes	20,518	18,038
Bonds	7,793	6,670
Total Par Value	**$ 44,907**	**$ 43,439**
Unamortized Premiums	855	709
Unaccreted Discounts	(314)	(307)
Total allocated to Bank	**$ 45,448**	**$ 43,841**

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	$ 435	$ –	$ 435
16 days to 90 days	8,633	3	8,636
91 days to 1 year	13,136	2	13,138
Over 1 year to 5 years	11,662	1	11,663
Over 5 years to 10 years	4,800	11	4,811
Over 10 years	6,224	–	6,224
Total	**$ 44,890**	**$ 17**	**$ 44,907**

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 $3,680 million and $2,009 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 9.795% and 9.660% 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	$ –	$ 1,010
Government debt instruments including agreements to resell	–	229
European Union Euro:		
Foreign currency deposit	424	–
Government debt instruments including agreements to resell	249	–
Japanese Yen:		
Foreign currency deposits	32	64
Government debt instruments including agreements to resell	872	599
Accrued interest	4	9
Total	**$ 1,581**	**$ 1,911**

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	$ 1,476
Over 1 year to 5 years	49
Over 5 years to 10 years	56
Total	**$ 1,581**

At December 31, 1999 and 1998, there were no open 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	$ 5.8	$ 5.8
Buildings	129.1	124.9
Building machinery and equipment	18.6	17.7
Construction in progress	0.3	1.0
Furniture and equipment	98.8	100.1
	$ 252.6	$ 249.5
Accumulated depreciation	111.6	108.7
Bank premises and equipment, net	**$ 141.0**	**$ 140.8**

Depreciation expense was $14.7 million and $14.5 million for the years ended December 31, 1999 and 1998, respectively.

Bank premises and equipment at December 31 include the following amounts for leases that have been capitalized (in millions):

	1998
Bank premises and equipment	$ 3
Accumulated depreciation	(1)
Capitalized leases, net	**$ 2**

At December 31, 1999 the Bank had no capitalized leases outstanding.

6. Bank Premises and Equipment, continued

The Bank leases unused space to outside tenants. Those leases have terms ranging from 1 to 12 years. Rental income from such leases was $3 million and $2 million for the years ended December 31, 1999 and 1998, respectively. Future minimum lease payments under agreements in existence at December 31, 1999, were (in millions):

2000	$	3
2001		2
2002		2
2003		2
2004		3
Thereafter		7
	$	**19**

7. Commitments and Contingencies

At December 31, 1999, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from 1 to approximately 7 years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $2 million for each of the years ended December 31, 1999 and 1998. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 1999, were (in thousands):

	Operating
2000	$ 1,203
2001	973
2002	649
2003	416
2004	385
Thereafter	645
	$ 4,271

At December 31, 1999, the Bank had no other material commitments or long-term obligations in excess of one year outstanding.

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 $4.3 million and $4.0 million for the years ended December 31, 1999 and 1998, respectively, 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.

9. Postretirement Benefits…, continued

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

	1999	1998
Accumulated postretirement benefit obligation at January 1	$ 74.6	$ 63.3
Service cost-benefits earned during the period	1.6	1.4
Interest cost of accumulated benefit obligation	4.6	4.5
Actuarial (gain) loss	(3.1)	8.4
Contributions by plan participants	0.2	0.3
Benefits paid	(3.5)	(3.3)
Plan amendments, acquisitions, foreign currency exchange rate changes, business combinations, divestitures, curtailments, settlements, special termination benefits	(7.1)	–
Accumulated postretirement benefit obligation at Dec. 31	**$ 67.3**	**$ 74.6**

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	3.3	3.0
Contributions by plan participants	0.2	0.3
Benefits paid	(3.5)	(3.3)
Fair value of plan assets at December 31	$ –	$ –
Unfunded postretirement benefit obligation	$ 67.3	$ 74.6
Unrecognized prior service cost	15.2	8.9
Unrecognized net actuarial (loss)	(9.4)	(12.8)
Accrued postretirement benefit cost	**$ 73.1**	**$ 70.7**

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

The weighted-average assumption 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	$ 1.3	$ (1.0)
Effect on accumulated postretirement benefit obligation	10.1	(8.5)

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	$ 1.6	$ 1.4
Interest cost of accumulated benefit obligation	4.6	4.4
Amortization of prior service cost	(0.9)	(0.9)
Recognized net actuarial loss	0.3	–
Net periodic postretirement benefit cost	**$ 5.6**	**$ 4.9**

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 Bank were $9 million for each of the years ended December 31, 1999 and 1998. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 1999 and 1998 operating expenses were $2 million for each year.

OUR MISSION

The Federal Reserve Bank of Chicago is one of 12 regional Reserve Banks across the United States that, together with the Board of Governors in Washington, D.C., serve as the nation's central bank. The role of the Federal Reserve System, since its establishment by an act of Congress passed in 1913, has been to foster a strong economy, supported by a stable financial system.

To this end, the Federal Reserve Bank of Chicago participates in the formulation and implementation of national monetary policy, supervises and regulates state-member banks, bank holding companies and foreign bank branches, and provides financial services to depository institutions and the U.S. government. Through its head office in Chicago, branch in Detroit, regional offices in Des Moines, Indianapolis and Milwaukee, and facility in Peoria, the Federal Reserve Bank of Chicago serves the Seventh Federal Reserve District, which includes major portions of Illinois, Indiana, Michigan and Wisconsin, plus all of Iowa.

OUR VISION

- Further the public interest by fostering a sound economy and stable financial system
- Provide products and services of unmatched value to those we serve
- Set the standard for excellence in the Federal Reserve System
- Work together, value diversity, communicate openly, be creative and fair
- Live by our core values of integrity, respect, responsibility and excellence

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In addition to the sources cited in the text, this publication has drawn on a variety of others, including: "The Economist," various issues; "The Chicago Tribune," special section on ebusiness; various speeches by Alan Greenspan, Chairman, Federal Reserve Board; various speeches by Lou Gerstner, Chairman and Chief Executive Officer, IBM.

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