Annual Report 1990

Federal Reserve Bank of Boston

A Message from the President

Any reflections on the past year—from this Reserve Bank's perspective—are dominated by two major problems affecting New England: the sharp decline of economic activity and the related impact on the region's financial institutions. Both problems created extraordinary burdens on the Bank and its staff, and I am proud of the way they responded during very trying times. Last year was also the tenth anniversary of the passage of the Monetary Control Act of 1980 which made fundamental changes to the role and operations of the Federal Reserve Banks. A pioneer and leader in the formulation of those changes and their implementation has been Bob Eisenmenger, First Vice President of this Bank. Bob will retire in June of this year after 36 years of service to the Federal Reserve System and the banking community.

The Regional Economy

1990 was an exceptionally difficult year for New Englanders, as regional economic problems were exacerbated by a national recession. The change came with startling swiftness; only two years ago New England's prosperity was the envy of the country. Yet 1990 saw widespread layoffs, rising unemployment rates, bankruptcies and foreclosures, and ballooning state government deficits; no sector escaped the recession's touch.

New England is suffering the aftermath of a real estate and construction boom which obscured a decline in manufacturing activity since the mid-1980s. Because of the weakness of manufacturing and slow population growth, the region was unable to sustain the high level of construction activity or absorb all the new properties added to the market. The result was falling real estate values and plummeting construction employment. In addition, mainly because of the collapse of the real estate market, the region's banks and thrift institutions saw increases in nonperforming loans and decreases in earnings and capital. Faced with a deterioration in their own performance and a weakening economy, banks became more cautious. Credit became more difficult to obtain, particularly for small and medium-sized businesses, and the New England "credit crunch" became a prime topic of public discussion, legislative hearings, and research analysis.

While 1990 began badly and ended worse, the first few months of 1991 have brought a few promising developments. A great relief has been the Allies' quick success in ousting Iraq from Kuwait. Consumer confidence has picked up in response; and with the threat of higher oil prices greatly reduced, the inflation outlook is much improved. Home sales seem to be picking up in both the nation and New England, suggesting that the national recession will be moderate, as most forecasters predict, and that New England will share in the national upturn. Higher unemployment rates, as painful as they are, have already removed a major impediment to manufacturers' expanding in New England—the difficulty of finding labor—and future wage increases are likely to be moderate. Space costs have come down dramatically. These cost reductions should enable New England manufacturers and other companies serving national and international markets to compete more effectively. Lastly, recently proposed regulatory changes and completion of the Bank of New England acquisition should help the banking system accommodate the credit needs of the recovery.

Problems of the regional economy were described clearly to national policymakers, as New England provided an early warning of the economic weakness which was to spread to most other parts of the country. Research attention to the region's economy and banking conditions was intensified, in the hope that a better understanding of recent changes which have taken place may help to identify remedies and prevent a recurrence of such problems.

Banking Problems

In 1990 the First District experienced its two most serious banking problems in over 50 years. Many Reserve Bank resources were directed to the events leading up to the closing of 45 Rhode Island banking institutions on January 1st of this year, and the seizure by the FDIC only five days later of the three Bank of New England subsidiaries. These dramatic events took place as many other institutions, operating in the same economic environment, faced similar problems and required greatly increased supervisory, regulatory, and research attention.

The deterioration of the condition of Bank of New England during 1990 required a redeployment and augmentation of resources all year long, as this Reserve Bank initiated two large-scale operations that had never before been undertaken in this District: the administration of a Cease and Desist Order issued by the Board of Governors, and the establishment of field warehouses to hold and process collateral related to large-scale borrowing from the Federal Reserve Bank. The level of the borrowing was unprecedented in this Bank's history, and the warehouse operation was staffed by employees from all areas of the Bank. Administration of the Cease and Desist Order required Reserve Bank review, oversight, and approval of nearly all aspects of the bank holding company's operations and strategies and involved coordination with other regulators on a continuing basis.

Near the end of a demanding year, the Reserve Bank was drawn into an unfolding crisis involving Rhode Island institutions, primarily credit unions. Forty-five institutions were closed on January 1, 1991 because of the insolvency of their private insurer. Because of the potential for a liquidity crisis and the possibility that the Federal Reserve System would be involved as a lender of last resort, a crash program of financial reviews of the large institutions was undertaken, and field warehouses were established for processing collateral should lending be required. A cash depot was established in the Providence area to assist the institutions which re-opened—after they had been approved for federal insurance—and accounting and other operational programs were put in place to minimize the disruption to the payments system. Many depositors of the closed institutions had government payments—including Social Security payments—made directly to their accounts. Special measures were taken by the Reserve Bank to make certain that those payments were available to the depositors. The handling of checks drawn on frozen accounts presented another unusual challenge to the Reserve Bank. Our operations departments worked extensively with state government offices and bankers in Rhode Island to keep payments flowing and to mitigate the impact of the closings on the public.

While the Bank of New England and Rhode Island problems attracted the most attention, the deterioration of the New England economy created pressures for many institutions and the number of examinations and inspections conducted increased sharply. The seriousness of the region's banking problem is illustrated by the fact that in 1990 twenty-three institutions were closed or seized by regulators, the most in any year since the Great Depression. That number was exceeded in the first quarter of 1991 alone.

Priced Financial Services

The Monetary Control Act went into effect 10 years ago and profoundly affected the operations of Federal Reserve Banks. Before its implementation, the Boston Reserve Bank provided free financial services to its 171 member banks—their only cost was that of owning stock in the Reserve Bank. The Act mandated that services must be available to all depository institutions with reservable liabilities, at prices which covered Reserve Bank costs and imputed costs which other services providers would incur. The Reserve Banks were thrust into a competitive environment in which they were subjected to the test of the market. As a result, even though our level of operations is basically unchanged, the Bank now serves directly over 600 financial institutions and we have become more efficient, flexible, and oriented to serving our customers' needs. These changes, for the entire Federal Reserve System, have not come easily, but they have been achieved, and a key person in leading the Federal Reserve System into the new world of priced services was Bob Eisenmenger.

As early as 1974, while he was Director of Research, Bob was a co-author of an important and provocative article which explored a system in which uniform reserve requirements were coupled with access to Federal Reserve services for all depository institutions. This transpired with the Monetary Control Act of 1980. Prior to its passage, Bob led a System effort to develop appropriate price structures, and after 1980 he was instrumental in introducing clearing balances as a way for institutions to pay for services. When he became First Vice President and Chief Operating Officer of this Reserve Bank in 1984, he continued his leadership role with regard to priced services, first as the System's Check Product Director and more recently as Executive Director for all priced services provided by the Federal Reserve System. As his retirement approaches, Bob can feel very proud of his numerous contributions to the Bank and to the Federal Reserve System. His role in transforming the Federal Reserve Banks into effective providers of priced services was especially crucial, and the tributes included on the following page reflect the views of his many System colleagues.

Richard F. Syron

RICHARD F. SYRON
PRESIDENT

Bob Eisenmenger . . . 36 years of service to the Federal Reserve System

It was my privilege to be closely associated with Bob Eisenmenger for 20 years, while he was Research Director and, subsequently, First Vice President. Bob is a superb administrator. His unique attribute is that he always viewed solving difficult problems as fun. When I think of Bob, I think of the zest which he brought to the Bank's work, his laid-back style, and the always-present humor which infected those who worked with him. The biggest problem he was asked to solve was to move the Federal Reserve System into the priced services regime. He thought that was the most fun of all.

FRANK E. MORRIS
PRESIDENT OF THE FEDERAL RESERVE BANK OF BOSTON, 1968–1988

Working with Bob on the Federal Reserve System's Pricing Policy Committee was a marvelous experience. He did an outstanding job as Executive Director. In addition to being able to balance a variety of divergent interests and viewpoints with great skill, Bob was always forward-thinking in his approach. Because of his ability to sense oncoming developments and suggest responses long before the events, we are—and will be—solidly positioned to deal with future challenges.

SILAS KEEHN
PRESIDENT OF THE FEDERAL RESERVE BANK OF CHICAGO AND CHAIRMAN OF THE SYSTEM PRICED SERVICES COUNCIL

I have known and worked with Bob for many years as he performed in many roles, and he has always commanded my highest respect. One area in which we worked together very closely involved the pricing of Federal Reserve payment services, which introduced the biggest change to Reserve Bank operations during my tenure as Chairman. Bob was a System leader in the complex process of developing price structures, modifying services and melding market requirements with our central bank role. He combined a unique perspective as an economist with an understanding of the Federal Reserve as a service provider, making his contributions extremely valuable.

PAUL A. VOLCKER
CHAIRMAN OF THE FEDERAL RESERVE BOARD, 1979–1987

When I joined the Federal Reserve Board several years ago, I was quickly and deeply impressed with the level of skill and dedication to be found among the career staff across the System. Bob Eisenmenger is in the forefront of this group. He knows central banking intimately, is a highly skilled manager, possesses the highest level of integrity, is intensely loyal to the Federal Reserve, and dedicated to public service. The Fed and the American people are in his debt for his many years of fruitful service.

EDWARD W. KELLEY, JR.
MEMBER OF THE FEDERAL RESERVE BOARD

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Statement of Condition

Assets	*December 31, 1990*	*December 31, 1989*
Gold Certificate Account	$ 750,000,000	$ 699,000,000
Special Drawing Rights Certificate Account	711,000,000	531,000,000
Coin	41,167,153	26,281,429
Loans and Securities:		
Loans to Depository Institutions	13,475,000	5,300,000
Fed. Agency Obligations Bought Outright	426,035,114	406,004,603
U.S. Gov't Securities–System Account	15,793,666,328	14,111,463,318
Total Loans and Securities	16,233,176,442	14,522,767,921
Cash Items in Process of Collection	287,016,463	469,884,141
Bank Premises (net)	89,699,854	90,940,632
Other Assets	1,493,742,585	1,407,849,339
Interdistrict Settlement Account	1,908,894,616	2,705,027,286
Total Assets	$21,514,697,113	$20,452,750,748
Liabilities		
Federal Reserve Notes (net)	$18,878,788,969	$17,165,574,526
Deposits:		
Depository Institutions	2,109,035,166	2,509,661,255
Foreign	5,550,000	5,250,000
Other	3,075,250	52,047,084
Total Deposits	2,117,660,416	2,566,958,339
Deferred Credit Items	131,586,403	375,466,120
Other Liabilities	192,098,325	178,217,563
Total Liabilities	$21,320,134,113	$20,286,216,548
Capital Accounts		
Capital Paid-In	$ 97,281,500	$ 83,267,100
Surplus	97,281,500	83,267,100
Total Capital Accounts	194,563,000	166,534,200
Total Liabilities & Capital Accounts	$21,514,697,113	$20,452,750,748

Statement Of Earnings and Expenses

	December 31, 1990	December 31, 1989
Current Earnings:		
Advances to Depository Institutions	$ 40,249,682	$ 2,569,813
Invested Foreign Currency	96,019,740	36,218,306
U.S. Gov't Securities & Agency Obligations-System Account	1,306,870,543	1,236,135,580
Income from Services	49,907,873	48,019,383
Penalties on Deficiencies in Required Balances	208,589	160,787
Penalties on Overdrafts	39,882	112,511
Treasury Securities Transfer Fees	1,198,167	271,745
Total Current Earnings	1,494,494,476	1,323,488,125
Less: Current Expenses	78,907,815	76,844,990
Cost of Earnings Credits	9,265,041	9,605,023
Current Net Earnings	1,406,321,620	1,237,038,112
Additions to Current Net Earnings:		
Net Profit on Sale of U.S. Gov't Securities	4,232,356	823,379
Net Profit on Foreign Exchange Transactions	79,157,471	45,075,533
All Other	718	4,230
Total Additions	83,390,545	45,903,142
Deductions from Current Net Earnings:		
Net Loss on Foreign Exchange Transactions	-0-	-0-
Cost of Unreimbursed Treasury Services	4,836,318	1,776,930
All Other	561	1,241
Total Deductions	4,836,879	1,778,171
Net Addition (Deduction) to Net Earnings	78,553,666	44,124,971
Assessments by the Board:		
Board Expenditures	3,832,500	3,207,100
Federal Reserve Currency Costs	13,705,231	10,871,391
Net Earnings before Payments to U.S. Treasury	$1,467,337,555	$1,267,085,592

Distribution of Net Earnings

Dividends Paid	$ 5,235,308	$ 4,737,306
Payments to U.S. Treasury (Interest on Federal Reserve Notes)	1,448,087,847	1,254,035,286
Transferred to Surplus	14,014,400	8,312,000
	$1,467,337,555	$1,267,084,592

Summary of Operations

Services to Depository Institutions	Calendar Year, 1990 Daily Average Volume	Calendar Year, 1990 Daily Dollar Value of Transactions	Calendar Year, 1989 Daily Average Volume	Calendar Year, 1989 Daily Dollar Value of Transactions
Wire Transfer of Funds	28,100 transfers	$73.5 billion	27,400 transfers	$65.0 billion
Automated Clearing House	450,000 items	$1,366 million	386,000 items	$1,309 million
Commercial ACH Items	347,000 items	$1,263 million	295,000 items	$1,235 million
Government ACH Items (Direct Deposit)	103,000 items	$ 103 million	91,000 items	$ 74 million
Check Processing				
Total Volume	5.45 million checks	$3.7 billion	5.3 million checks	$3.5 billion
Processed Volume	3.85 million checks	$3.0 billion	3.8 million checks	$2.9 billion
Fine Sort Volume	1.6 million checks	$ .7 billion	1.5 million checks	$ .7 billion
Cash Operations				
Cash Shipped	5.9 million notes	$73 million	5.6 million notes	$70 million
Cash Received	5.5 million notes	$65 million	5.1 million notes	$61 million
Services to U.S. Treasury				
Electronic Book Entry Transfers	5,000 transfers	$88.5 billion	4,200 transfers	$68.7 billion
Savings Bonds Issued	5,200 bonds	$ 1.1 million	4,800 bonds	$ 1.2 million

Design: Kristen A. Taylor Photos: Bachrach Studios, Ralph Ragsdale

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