
Year in Review

Despite considerable domestic and international financial turbulence in the latter part of the year, the U. S. economy continued its robust growth in 1998. Unemployment fell to its lowest level since the early 1970s, real wages rose more rapidly than at any time since that period, and inflation remained low. The Fifth District's economy shared in the national prosperity, particularly in the areas of employment growth and construction activity – residential and commercial. Accompanying the region's strong economic conditions was substantial bank merger activity, including the creation of two of the nation's largest banking companies headquartered in the District. The Federal Reserve System's monetary policy strategy aimed at price-level stability helped set the stage and establish the financial framework for the national and Fifth District growth. Through its research and communication efforts, the Federal Reserve Bank of Richmond contributed to the support of this strategy as well as to banking and payments system policymaking. The Bank worked to achieve these and other System objectives not only through research and communications, but also its activities in public and community affairs, banking supervision, and financial services.

Economic Research and Public Outreach

The Bank continued to produce economic research relevant to Federal Reserve monetary and banking policy, the Fifth District economy, and the payments mechanism. Research staff analyzed current policy issues and advised Mr. Broaddus in preparation for Federal Open Market Committee meetings and presented monetary policy research in both Federal Reserve and academic forums. The Research Department also provided Mr. Broaddus and Mr. Varvel strong analytical support in meeting their banking and payment system responsibilities. In addition, the Bank provided valuable input to Systemwide understanding of the reserve accounting, Federal Reserve credit extension, data reporting, banking supervision, and payment policy needs of interstate banking organizations.

Public outreach efforts bolstered current initiatives and introduced new products and public programs. Mr. Broaddus continued to meet with business and community leaders around the District and maintained an active public speaking schedule. Direct contact with District businesses increased in 1998 to meet growing public demand for timely and comprehensive information about the region's economy.

The Bank used its publications and web site to communicate information about the Fifth District, the national economy, and Federal Reserve monetary policy. The Bank's business magazine, *Region Focus*, received several awards and increased its circulation. Articles from the *Economic Quarterly* earned media recognition and international acknowledgment. With new sections on economic education, financial services, and century date change preparations, the Bank's web site became a popular source of information. State Economic Profiles were reformatted on the web site to better meet user needs for information on state economic activity.

Continuing to build on established partnerships with economic education organizations around the District, the Bank helped establish a new national center for Economic Education at Gallaudet University in Washington, D.C., a four-year liberal arts college serving the deaf and hearing impaired. In addition, the District held three "Fed Challenge" competitions for high school students and one for college students.

The Bank also formed a new Community Development Advisory Council to increase communication between the Bank and consumer, community, and labor groups across the District. In other communication efforts, the Community Affairs Office sponsored more than 20 public seminars and distributed over 25,000 copies of its publications.

Banking Supervision

The financial condition of banking organizations in the Fifth District remained strong, and banking industry consolidation continued at a rapid pace. At year-end 1998, 220 Fifth District bank holding companies controlled total assets of \$1.1 trillion, an increase of \$420 billion from the previous year. This increase resulted from

several large bank acquisitions, most notably NationsBank Corporation's acquisition of Barnett Banks, Inc., and subsequent merger with BankAmerica Corporation; and First Union Corporation's purchase of CoreStates Financial Corp. Consolidation activity also spurred the opening of several *de novo* banks in the District. Seven new banks opened as state member banks during 1998, while four existing banks converted to state member status.

In response to increased supervisory responsibilities for three large interstate banking organizations headquartered in North Carolina, the Bank opened a new banking supervision and regulation office in Charlotte. Banking Supervision strengthened its new approach to conducting examinations that focuses on each institution's management and control of business risks. This risk-based supervisory approach and joint efforts with the Office of the Comptroller of the Currency and state banking authorities reduced the supervisory burden imposed on bank holding companies and state member banks.

Financial Services and Other Operations

The financial services areas continued to offer quality services to meet the needs of depository institutions and the U.S. Treasury. The Bank realized 105.8 percent cost recovery in 1998, exceeding its financial targets for priced services. Also, the financial services functions improved their unit cost and productivity measures and met their key quality targets. Surveys of the accounting, automated clearinghouse (ACH), check, customer support, funds transfer, and securities transfer areas indicated that customers were well satisfied with the Bank's services.

The Bank continued to pursue payment system efficiencies through the expansion of ACH, electronic check presentment and image-based services. Partnering with the District's three ACH associations, the ACH function conducted successful educational and promotional campaigns for direct deposit and direct bill payment programs. ACH also introduced new software to support financial electronic data interchange. Operating efficiencies permitted the Federal Reserve to further reduce the price of ACH services during the year and

to effect substantial reductions in funds transfer fees. In addition, government check processing operations were converted to a high-speed image capture platform in August 1998. Commercial electronic check presentment and truncation volume as a percentage of numbers of items processed grew from 8.7 percent at year-end 1997 to 13.6 percent at year-end 1998, resulting in the second highest check truncation volume in the System.

The Bank also provided extensive support to the U.S. Treasury in 1998. A senior Bank officer continued to serve as the System's Treasury Liaison; he coordinated 20 joint Treasury and Federal Reserve initiatives and provided consultative support. The Currency Technology Office supported the Treasury in introducing new currency and in counterfeit sampling, and assisted the Bureau of Engraving and Printing with the design of the new \$20 note. Finally, the Bank provided full support for the U.S. Treasury's Automated Standard Application for Payments and the Department of Agriculture's Account Management Agent applications, and served as one of five regional processing sites for savings bonds.

The Reserve Accounting and Loans areas played a major role in supporting the numerous account changes associated with bank mergers and in encouraging depository institutions to make preparations to borrow from the Fed's discount window should the need arise. Accounting and Control implemented a COSO-based framework for evaluating the adequacy of internal controls associated with the Bank's financial reporting. PricewaterhouseCoopers LLP reviewed and attested to the internal control evaluation performed by Bank management in 1998.

Preparations for the century date change (CDC) were intense. The Bank met end-of-year targets and milestones for its critical hardware and software systems. It also provided extensive automated systems test support for depository institutions and supervisory oversight for CDC preparations at bank holding companies and state member banks. During 1999, CDC preparations will include follow-up supervisory examinations, continued test support for institutions, and refinement of the Bank's contingency and event management plans.