MINUTES OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DATE: September 30, 2002

TIME: 4:15 p.m.

LOCATION: Board Room

ATTENDANCE:

Mr. Greenspan, Chairman
Mr. Ferguson, Vice Chairman
Mr. Gramlich
Ms. Bies
Mr. Olson
Mr. Bernanke
Mr. Kohn

Office of the Secretary

Ms. Johnson, Secretary
Mr. Frierson, Deputy Secretary
Mrs. Beattie, Assistant to the Secretary
Mr. Hiratsuka, Technical Writer

Office of Board Members

Mr. Skidmore, Special Assistant to the Board

Legal Division

Mr. Mattingly, General Counsel
Mr. Alvarez, Associate General Counsel
Mr. Ashton, Associate General Counsel
Ms. O'Day, Associate General Counsel

Division of Research and Statistics

Mr. Ettin, Deputy Director

Division of Monetary Affairs

Mr. Reinhart, Director

Mr. Madigan, Deputy Director

Division of Banking Supervision and Regulation

Mr. Spillenkothen, Director

Mr. Schemering, Deputy Director

Mr. Biern, Senior Associate Director

Mr. Hoffman, Associate Director

Mr. Martinson, Associate Director

Ms. Cross, Deputy Associate Director

Ms. Bailey, Assistant Director

Mr. Wright, Assistant Director

Division of Consumer and Community Affairs

Ms. Smith, Director

Mr. Loney, Deputy Director

Other supporting staff

Federal Reserve Bank

Federal Reserve Bank of New York

Mr. Rutledge, Executive Vice President

Mr. Angelo, Assistant Vice President

Mr. Cirillo, Assistant Vice President

Mr. Hill, Assistant Vice President

BANK SUPERVISORY MATTER -- Update on supervisory matters related to Citigroup Inc. and J.P. Morgan Chase & Co., both in New York, New York, with respect to Enron Corporation.

Discussed.
September 30, 2002.

At today's meeting, the staff reported on recent developments in supervisory matters related to Citigroup Inc. and J.P. Morgan Chase & Co. and their relationships with Enron Corporation, Houston, Texas. The briefing and relevant materials discussed the status of the Enron review at Citigroup and J.P. Morgan Chase, the staff's findings to date, pending litigation and investigations, corporate and supervisory initiatives, and current supervisory assessments.

Chairman Greenspan observed that the information presented did not reveal wrongdoing by Citigroup or J.P. Morgan Chase and that, as a matter of fairness, their dealings with Enron should not influence the Board's judgment concerning these financial institutions or interfere with the Board's responsibility to maintain safety and soundness in the banking system. He also suggested that providing the Securities and Exchange Commission (SEC) with the System's perspective on Enron-related banking transactions would be consistent with this responsibility.

Vice Chairman Ferguson requested additional information on a Citigroup initiative called the net effect rule, which would require a counterparty in a financing transaction to be willing to provide complete disclosure of the full effect of the transaction on its financial condition. He commented that reasonable people might consider this requirement unfair and noted that no decision had been made on whether it was a good practice. Vice Chairman Ferguson cautioned against encouraging policies that would require banking institutions to second-guess the accounting practices of counterparties in financing transactions.

Governor Gramlich confirmed with the staff that the net effect rule might have brought to light the overall effect of the Enron-related transactions at issue and that these disclosures most likely would have been reported in filings with the SEC. He considered it plausible that banking regulators might be required at some point to determine whether Citigroup's initiative was a sound practice.

Governor Bies noted that the Enron transactions with Citigroup and J.P. Morgan Chase designed to enhance Enron's reported operating cash flow were at the core of the accounting debate. She hoped that large banking organizations would spend more time analyzing transactions with counterparties that used aggressive accounting techniques, but she agreed that those organizations should not have to audit a counterparty or second-guess its accounting practices.

Governor Olson commented that Citigroup's net effect rule appeared to be a business practice for selecting clients rather than a means of evaluating a client's accounting treatment of the transaction.

Governor Bernanke clarified that the staff's findings to date indicated that both institutions seemed to have understood the accounting objectives of their transactions with Enron, but that they also appeared attentive to the need to comply with generally accepted accounting principles.

Governor Kohn noted that Citigroup and J.P. Morgan Chase had had different types of business relationships with Enron and, therefore, might be subject to different standards of conduct associated with those relationships. He also reviewed with the staff the steps taken by the institutions to have adequate liquidity in light of the contingencies they faced.

At the conclusion of the discussion, it was understood that future developments would be presented to the Board.

Participating in this discussion: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Background: Handout, September 30, and staff memoranda, September 25 and 26 and August 21, 2002.

Implementation: None.