SIA RESEARCH

REPORTS

Volume V, No. 5 May 17, 2004

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Prepared by SIA Research Department •ISSN 1532-6667

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U.S. MONETARY POLICY OUTLOOK

Summary

Real gross domestic product (GDP) increased at an annual rate of 4.2% in 1Q 2004, up slightly from the 4.1% growth rate in the final quarter of 2003. Over the last four quarters (2Q'03 – 1Q'04) growth has averaged 4.9%, which is well above the economy's long-run historical average of 3.1%, and, apparently, above a rate at which inflationary pressures can be contained. A clear pickup in inflation, a surge in job creation, signs that slack capacity in the economy is being absorbed, and numerous statements from the Federal Reserve Board suggest that the accommodative stance of monetary policy will not last much longer. A series of short-term interest rate increases are expected and growth should slow through the remainder of this year. How far and how fast the Fed moves to raise rates is of paramount importance to the economy and financial markets, and is the focus of intense speculation. However, the magnitude of the rate hikes required to contain nascent inflationary pressures might prove to be less than either financial markets are currently assuming or than would be indicated by policy "guideposts" employed by the Fed. Unfortunately, growth this year is also expected to be below the consensus forecast.

What a Difference a Year Makes

Just a year ago, the principal concern of the Federal Reserve appeared to be the threat of deflation, while today, just the opposite appears to be true.[1] Although the increase in consumer prices was just 0.2% in April from March, the smallest monthly increase thus far in 2004, it sparked concern and may well prompt the Fed to move more quickly to raise interest rates and forestall higher inflation. Although the Consumer Price Index (CPI) rose 2.6% at an annual rate in April and was just 2.3% higher than a year ago, the increase was limited by a seasonal adjustment that capped the increase in energy prices in April at just 0.1%. Without this adjustment, energy prices rose 2.0% last month.

Inflation appears to be accelerating and unfortunately it is not solely due to recent, higher energy prices, which are expected to persist. Consumer prices excluding food and energy were up 3.1% at an annual rate in April and were 1.8% higher than in April 2003. Similarly, the median CPI (which is computed by the Federal Reserve Bank of Cleveland) showed an increase of 4.1% in April and 2.4% over the last 12 months. Were it not for flat apparel prices and nearly flat transportation prices, the numbers would have been higher still. Although the Fed appears poised to act, given the long lags (12 to 24 months) before inflation responds to interest rate increases and the expectation that the Fed will take a "measured" or gradualist approach to raising rates, trend inflation, which is now about 2.5%, is expected to top 3% this summer and continue rising into 2005.

At its last meeting on May 4, the Federal Open Market Committee (FOMC) voted to keep the target federal funds rate[2] at 1%, where it has been since June 2003, but a shift in key language signaled the Fed's intention to raise rates sooner rather than later. The key shift was from:

[1] Deflation can be defined as a sustained decline in the general level of prices of current goods and services or, similarly, as a persistent decline in the average of a set of prices. For more information about the past perception of that threat, see Frank Fernandez, "The Threat of Deflation: There Be Dragons Here," SIA *Research Reports*, Vol. IV, No. 6, June 12, 2003, pp. 3-21.

[2] The federal funds rate is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight. While the Federal Open Market Commit-

"With inflation quite low and resource use slack, the Committee believes that it can be patient in removing its policy accommodation" in the statement following its March meeting, to:

"At this juncture, with inflation low and resource use slack, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured" in its May 4 statement.

This statement, along with no less than a dozen speeches by Fed officials in recent weeks, indicate to market analysts that the Fed would not wait until all the slack was removed from labor markets before beginning to raise rates, but would raise rates in a gradual or "measured" fashion, so as to avoid a sharp correction in bond markets as occurred when the Fed carried out a similar round of rate increases in 1994.

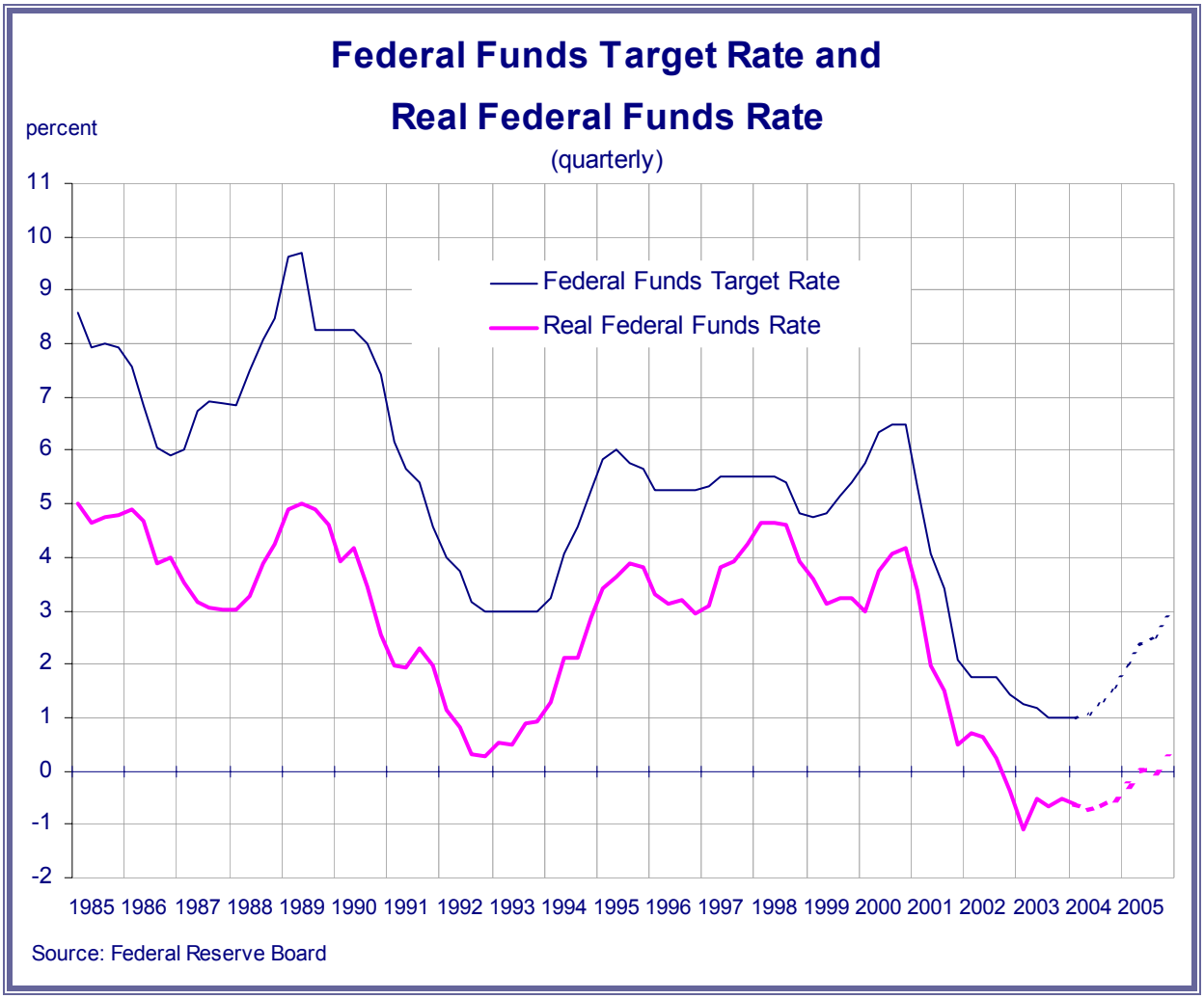
The current federal funds rate reached this level after 13 successive rate cuts, beginning on January 3, 2001, which brought the rate down from 6%. The real federal funds rate[3] has been at or below zero since late 2001. While a low real rate, or a negative real rate in the current case, "in itself does not signify easy money or an accommodative policy stance, other measures currently support that interpretation."[4] Virtually every member of the FOMC has said publicly "the current federal funds rate, at 1%, is too low to be sustainable. At some point, preserving price stability will require the FOMC to move the funds rate back up to keep monetary policy neutral with respect to inflation. Failure to respond in a timely fashion puts our [the FOMC's] hard-won credibility at risk."[5] How fast and how far the Fed moves in raising interest rates, to squelch this perceived inflationary threat, is of paramount importance and the subject of widespread speculation.

tee (FOMC) sets a target for the federal funds rate, the actual or effective federal funds rate is set in the open market. In recent years the difference between the two has been small. On a daily basis the average difference between the target and actual rates is less than one basis point, although on rare occasions it is appreciably higher.

[3] Defined as the effective federal funds rate deflated by the core Personal Consumption Expenditure (PCE) Chain Price Index.

[4] See "Economic Trends," The Federal Reserve Bank of Cleveland, May 2004, p. 4.

[5] Sandra Pianalto, "A Perspective on Monetary Policy," Federal Reserve Bank of Cleveland Commentary, May 1, 2004. Remarks to the Forecaster's Club of New York on April 22, 2004. Sandra Pianalto is the president and chief executive officer of the Federal Reserve Bank of Cleveland.



Taking the Punch Bowl Away – How Far, How Fast

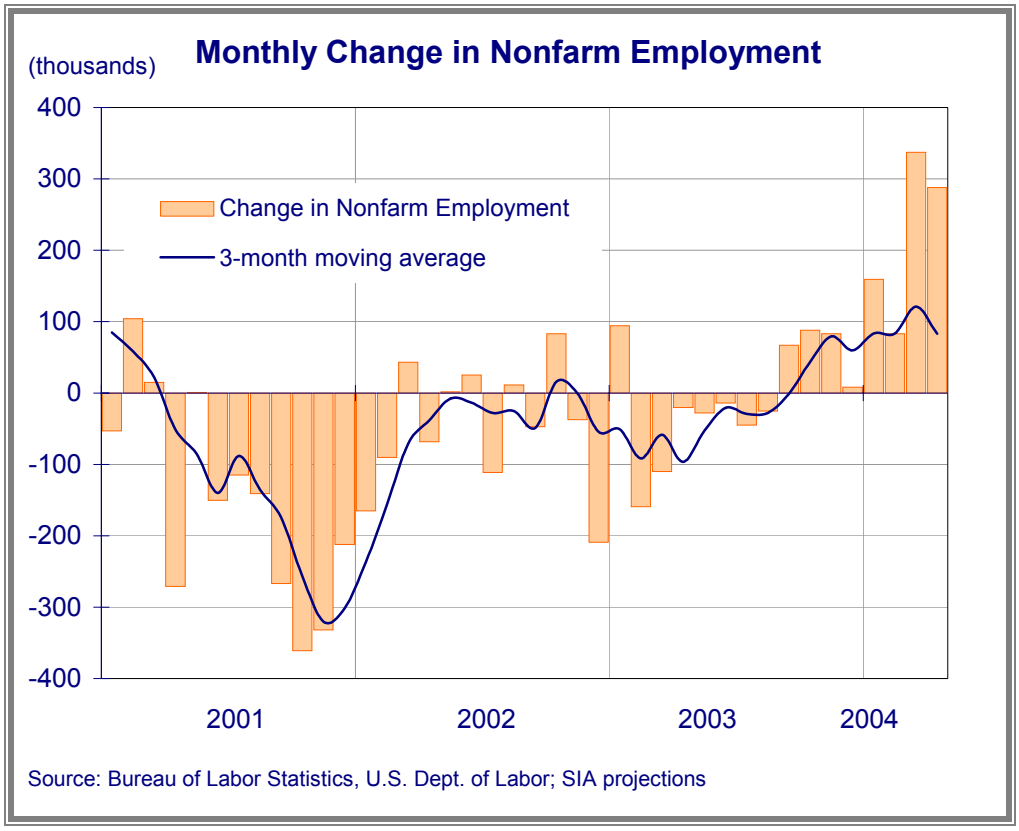
Former Fed Chairman William McChesney Martin, who ran the U.S. central bank for an unmatched 19 years from 1951 to 1970, is often quoted as saying that a central banker's duty is "to take away the punch bowl when the party gets going." For the past six months, the Fed has been moving closer to that punch bowl, and doing so in a very transparent manner. In our last foray into economic forecasting, released at end-January 2004, we expressed the belief that "a tightening phase of monetary policy will begin with a 25 basis point (a quarter of a percentage point) increase in base interest rates in August 2004, followed by one or two matching increases, raising the fed funds rate to 1.5% or 1.75% by year end. When the Fed actually moves depends on whether (our) assumptions about the evolution of several variables in the first half of this year prove to be correct. These assumptions include that the recent rise in leading indicators of inflation actually results in some acceleration in core consumer prices and that there is a clear, sustained pickup in the job market reflecting the continued solid growth outlined above."[6]

Thus far our assumptions have proven correct: the recently released first or "advance" estimate of real GDP growth of 4.2% exactly matched our January forecast[7]; the change in non-farm

[6] Frank Fernandez, "Economic Update and Outlook," SIA *Research Reports*, Vol. V, No. 1, January 31, 2004, p. 18.

[7] Ibid, p. 13.

employment over the last six months slightly exceeded our expectations;[8] and, both inflation and inflationary expectations have risen in the current quarter and are approaching 3%[9]. When the Fed actually begins raising interest rates, how far and how fast successive rate increases will arrive depends on the evolution of economic data on employment and inflation in the coming months. Fortunately, anticipating the Fed's action is not nearly as hard as it used to be. In recent years the Fed has expressed the view, along with other central banks, that it can be more effective when it acts "systematically and transparently."[10]



[8] Frank Fernandez, "Economic and Securities Industry Outlook," SIA *Research Reports*, Vol. IV, No. 9, October 6, 2003, p. 1. In that report we present a chart that projects growth of non-farm payrolls averaging 125,000 per month over the last eight months. The labor market showed a slightly stronger rebound, with the increase in non-farm payrolls averaging 139,125 per month over the last eight months. April's robust increase in employment followed an even stronger posting in March, making March and April the largest two-month employment increase in four years. Payroll employment rose 288,000 in April on top of a cumulative upward revision of 66,000 for the previous two months. Since August, the economy has created 1,113,000 jobs according to the payroll survey, and 1,256,000 jobs according to the household survey (based on the population-control-adjusted series recommended by the Bureau of Labor Statistics).

[9] Indicators of inflationary expectations include: the recently introduced CPI futures contract; the difference between the yield on the 5-year nominal Treasury bond and the yield on the 10-year TIIS bond; and the Berk rate, which is calculated as the 30-year GNMA yield plus the 10-year TIIS yield minus the 10-year nominal Treasury yield. The median five to ten year expectations in the University of Michigan survey increased to 2.9% in May from 2.7% in April and 2.7% on average during 2003. The median one-year inflation expectation was 3.2% in early May, unchanged from April, but up from 2.5% in 2003.

[10] Pianalto, op.cit. 6, p. 4.

Taylor Rules

One key "behavior" that has made the FOMC policy more effective has been its consistency with policy shifts that follow the Taylor Rule, or more correctly, Taylor Rules, as a guidepost (rather than a prescription) for monetary policy.[11] A Taylor Rule is an interest-rate rule in which the federal funds rate is changed in a consistent fashion whenever current inflation and the current output gap change. More recently, it has come to refer to any simple funds-rate rule.

The rule is named after John Taylor, the current undersecretary of the Treasury, who, eleven years ago[12] as a Stanford University professor, claimed that adhering to a simple rule or strategy whereby the central bank sets the federal funds rate in response to two variables — deviations of inflation from a target rate and deviations of actual output in the economy from potential output, sometimes called the output gap, is a useful way to conduct monetary policy. The two "arguments" in the rule – inflation and the output gap – reflect the goals legislated for monetary policy, namely stabilizing real GDP around its trend in the short run and controlling inflation in the longer term. It is generally conceded that this rule "describes reasonably well what this committee [the FOMC] has done since 1986….I think the Greenspan Fed has done very well following such a rule, and I think that is what sensible central banks do."[13]

For example, the rule can be written as follows:

(1) $r - p = i + ay + b(p - p^*)$, where:

"r" is the nominal fed funds rate, "i" is the equilibrium real fed funds rate when the economy is at full employment (y=0), "y" is the percentage output gap (the difference between output and potential output), "p" is the actual inflation rate, "p*" is the target inflation, and "a" and "b" are the weights given to the deviations in output and inflation. Restating the rule in terms of the nominal funds rate by moving "p" to the right-hand side of the equation yields:

(2) $r = i + p + ay + b(p - p^*)$

Under the rule, the FOMC would move the nominal funds rate (r) to yield a real funds rate (r – p) consistent with an equilibrium real rate (i) when the economy is at full employment (e.g., when actual and potential output are equal (y = 0)) and has attained its inflation target (p = p*).

Taylor assumed that the equilibrium real interest rate (i) and the inflation target (p*) were both equal to 2%, and that the Fed assigned equal weights (0.5) to the deviations of output (a) and inflation (b). Substituting these values in our equation yields:

(3) $r = 2\% + p + 0.5y + 0.5(p - 2\%)$

[11] Charles T. Carlstrom and Timothy S. Fuerst, "The Taylor Rule: A Guidepost for Monetary Policy?," Federal Reserve Bank of Cleveland, July 2003.

[12] John B. Taylor, "Discretion Versus Policy Rules in Practice," Carnegie-Rochester Conference Series on Public Policy 39, 1993, pp. 195-214.

[13] Remarks by then-Federal Reserve Governor Janet Yellen at the January 1995 FOMC meeting.

The Congressional Budget Office's calculation for potential output was nearly 1.4% above actual output in 1Q'04. Using this "output gap," and assuming, conservatively, that current "trend" inflation (p) is 2%, the rule can be stated as:

(4) r = 2.0% + 2.0% + 0.5(-1.4%) + 0.5(1.8% - 2.0%) = 4.0% - 0.7% - 0.1%= 3.2%

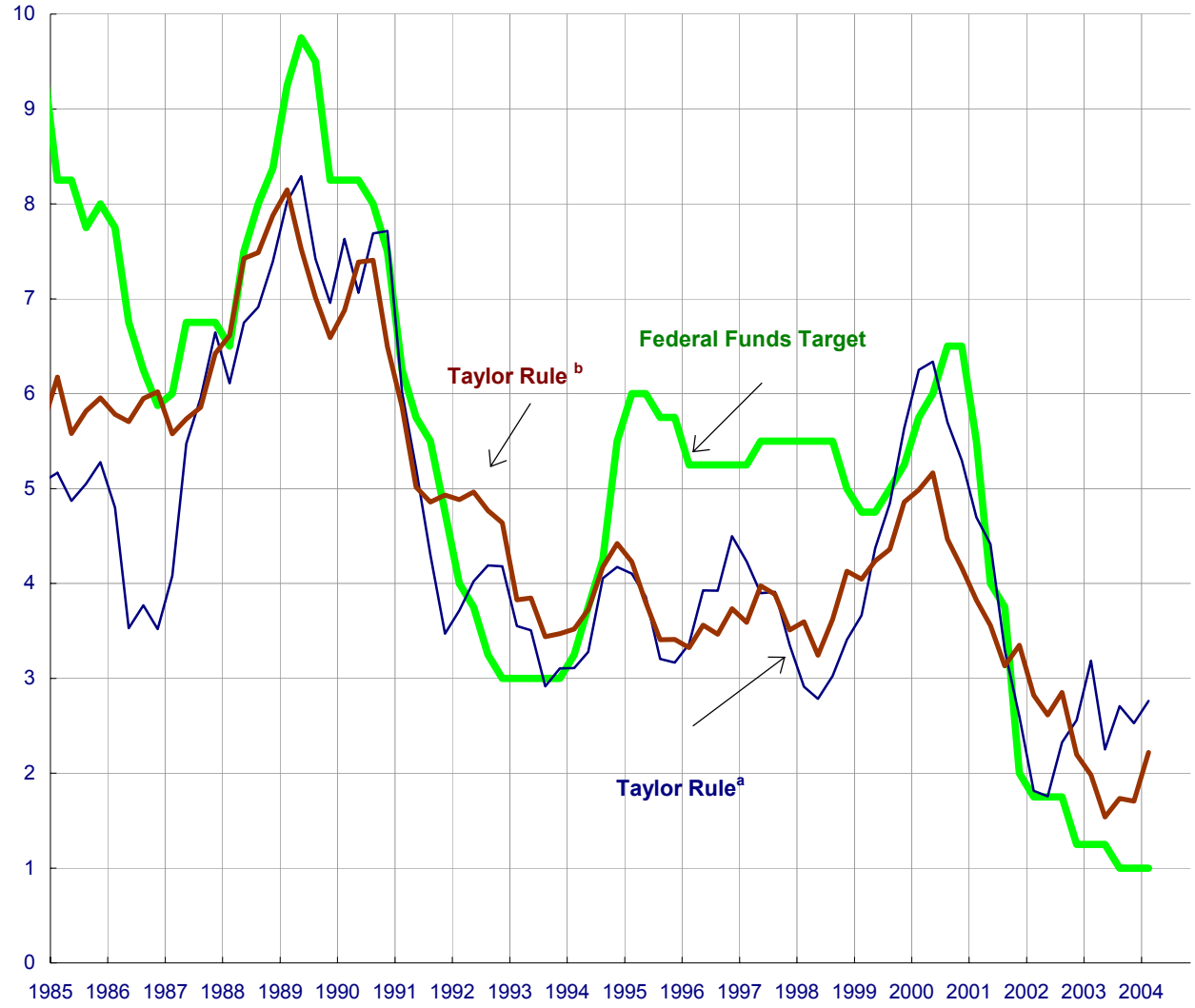
Under these assumptions the Fed needs to raise the fed funds rate by 2.2 percentage points, to 3.2%, to reach a level consistent with the Taylor Rule.

There are a number of ways to state the Taylor Rule. Depending on which variables one uses for inflation and activity, and what assumptions one makes about (i) and (p*), a range of values for (r) are obtained, most falling within a range of 2.5% to 4.0%. One version substitutes the unemployment gap for the output gap, with the unemployment gap defined as the difference between NAIRU (the non-accelerating inflation rate of unemployment), which is currently estimated at 5.2%, and the current unemployment rate.[14] However, all measures indicate that short-term interest rates currently are too low. Two simple forms of the rule are depicted in the chart below, graciously supplied by Erkin Y. Sahinoz of the research department of the Federal Reserve Bank of Cleveland. The chart shows the actual fed funds rate and two versions of the Taylor Rule, which differ only in the choice of inflation indexes: the personal consumption expenditure (PCE) deflator and the core PCE. It can be seen that the Taylor Rule clearly and, generally closely, tracks movements in the federal funds rate. Just as clearly, the largest and most persistent divergence between what the rule would prescribe and the actual fed funds rate during Alan Greenspan's tenure as Fed chairman is the divergence that has occurred in the past year and which persists today. With inflation clearly moving up, real growth continuing above its long-run average and job growth picking up, there is little reason not to begin increasing interest rates.

Financial markets have already "priced in" such a move. The implied yield on fed funds futures reflects the view that a quarter point hike in base rates is more likely than not in June and a virtual certainty by August. Longer term, the Eurodollar futures suggest that interest-rate increases will continue into 2005. The markets, which appear to mirror the consensus view of pundits and forecasters, have pushed up long-term rates in anticipation of a Fed move. The yield on the 10-year Treasury bond, for example, is currently 4.77%, a full percentage point higher than recent lows reached in mid-March. The markets expect the Greenspan Fed to take a gradualist approach ("interest rate smoothing") in raising interest rates – taking a series of small steps toward a desired rate setting, or in the parlance of the Taylor Rule, to "lean against the wind" — raising interest rates when the inflation rate over the past year is higher than its long-term rate.

[14] See, for example, Laurence H. Meyer, Monetary Policy Insights, August 15, 2002, on www.macroadvisers.com.

Taylor Rule vs. Federal Funds Target Rate



a. Inflation is measured from the Personal Consumption Expenditures Chain Type Price Index, four-quarter change. The output gap is calculated as the percent deviation of potential GDP from Real GDP as measured by the CBO and BEA respectively.

b. Inflation is measured from the Core PCE Chain Type Price Index, four-quarter change. The output gap is calculated as the percent deviation of potential GDP from Real GDP as measured by the CBO and BEA respectively.

Source: chart prepared by Federal Reserve Bank of Cleveland

Taylor Principle: Leaning Against the Wind May Not Be Enough

The Taylor Rule prescribes that the Fed "lean against the wind" when setting interest rates: raising rates when current output exceeds potential and/or when inflation over the past year is higher than the long-run target. However, Taylor cautioned that in the case of the response to inflation, that might not be enough: interest rates must rise by ***more than*** the increase in inflation. "Given that nominal interest rates naturally increase one for one with movements in anticipated inflation, just increasing the rate one for one with inflation is like treading water. Therefore, the Fed must increase the real funds rate with inflation to make any headway in reducing inflation."[15] This is known as the Taylor principle, which prescribes that the real fed funds rate should be made greater than the natural rate of interest whenever inflation is above target. Failure to do so may open up the economy to inflationary spirals. Some economists suggest that part of the reason for the inflationary problems of the 1970s was that the Fed did not react aggressively enough to inflation when it appeared, which required still more aggressive action beginning in 1979 under the stewardship of Paul Volcker.

Some Fed-watchers charge that the Fed is already "behind the curve," given the surprisingly strong recent economic data emerging on jobs, capacity utilization and inflation and the concern that Greenspan might move too cautiously in an attempt to engineer a "soft landing" for the bond market and secure his legacy. Although the Fed appears poised to act, perhaps as early as June, given the long lags (12 to 24 months) before inflation responds to interest-rate increases and the expectation that the Fed will take a "measured" approach to raising rates, trend inflation, which is now about 2.5%, is expected to top 3% this year and continue rising into 2005. Under such a scenario, inflation could easily move above 4% before the impact of higher interest rates is felt.

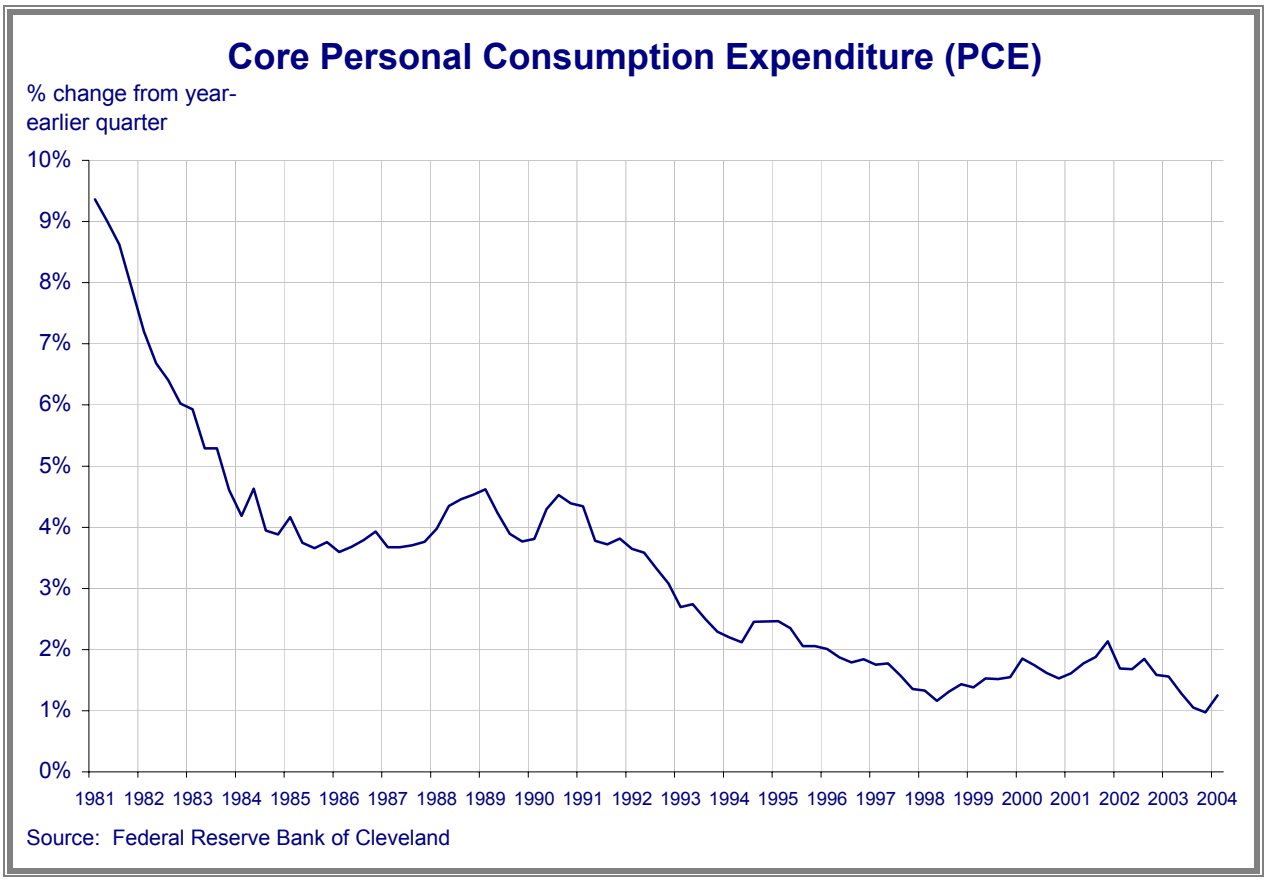
Others argue just the opposite: that substantially smaller interest-rate increases than those indicated by the Taylor principle will be sufficient to slow the economy and contain inflation. "The Fed had to raise the funds rate by only a cumulative 175 basis points between June 1999 and May 2000 to bring the U.S. economy to its knees. With the household sector even deeper in debt today and with housing even more expensive, we suspect that the U.S. economy will have cracked long before the fed funds rate reached 4.5%."[16] The point is well taken. Despite the near-record low mortgage rates, monthly mortgage payments now absorb 18.32% of after-tax income, which is only 41 basis points below its record high and 131 basis points above its long-run average. Personal bankruptcy filings and credit card delinquencies are at record highs and are likely to soar given the expected increases in base interest rates.

Our Outlook: Spitting Into the Wind

We anticipate that the Fed will raise rates 75 basis points in the remainder of 2004, in equal quarter point increments in June, August and November. This will likely be followed by a similar series of moves in the first half of 2005, bringing the fed funds rate to 2.5% by this time next year. We think these actions should be sufficient to slow the economy to its long-run average growth rate of 3%, but insufficient to contain inflation. The core PCE, one benchmark indicator of inflation, is expected to rise from an average of 1.3% in 2003 to 2.0% this year and 2.5% in 2005.

[15] Carlstrom and Fuerst, op. cit 11.

[16] Paul L. Kasriel and Asha G. Bangalore, U.S. Economic and Interest Rate Outlook, The Northern Trust Company, Economic Research Department, p. 4, May 7, 2004.



Two factors could reinforce the Fed's action: sustained high-energy prices and weakening consumer sentiment. Consumer spending has started 2Q'04 on a weak note, with light vehicle sales in April 1.5% below March and 4.5% (seasonally adjusted annual rate) below 1Q'04 levels, while retail sales rose less than expected. Higher fuel bills are eroding consumer purchasing power and should continue to do so at least through the summer. Mortgage rates (30-year fixed) are already at 6.34% per annum (p.a.), up from a recent low of 5.38% on March 18. Expected increases in the 10-year Treasury yields could lift mortgage rates 150 basis points higher over the next 12 months. Mortgage equity withdrawals, which injected almost $200 billion into the economy last year, have plummeted as interest rates have risen. Since the week of March 19, new refinancing applications have plunged 56% and are down 78% from the record high reached at the end of May 2003. Most of the boost to consumer spending provided by last year's tax cuts has already arrived and been spent, and there is little chance of further fiscal stimulus. Absent these sources of stimulus, real GDP growth is expected to gradually decelerate over the near term.

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CRITICAL ACCOUNTING DISCLOSURES IN ANNUAL REPORTS

Over the past several years the Securities and Exchange Commission has been studying disclosures in annual reports and recommending enhanced disclosure particularly in the enlarged Management Discussion and Analysis (MD&A) section of the reports. In December 2003, the SEC issued interpretative guidance[1] regarding MD&A disclosures that was "intended to elicit more meaningful disclosure in MD&A in a number of areas, including the overall presentation and focus of MD&A … and specific guidance on disclosures about … critical accounting estimates." Below is a review of the critical accounting disclosures in 19 U.S. and global financial institutions' 2003 annual reports, which attempts to evaluate both how well the firms' disclosures adhere to the SEC's stated guidelines and the usefulness of those disclosures.

SEC Guidance

While new rules broadening the scope of critical accounting estimate disclosures currently required were still under consideration, the SEC issued guidance that, when preparing disclosure under current rules, companies "should consider whether they have made accounting estimates or assumptions where:

- the nature of the estimates or assumptions is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimates and assumptions on financial conditions or operating performance is material.

If so, companies should provide disclosure about those critical accounting estimates or assumptions in their MD&A."[2]

Companies are urged to use such disclosure to add to, not duplicate, accounting policy descriptions that are already included in the notes to the financial statements. The disclosures should provide insight and analysis of how and why the particular accounting estimates and assumptions are critical and subject to change. Further, to the extent it is reasonably available and will add materially to information provided to investors, quantitative disclosure and analysis should also be provided. The guidance was not issued as a set of new rules, but was intended to elaborate on existing rules and aid firms in adhering to them.

Description of the Sample of Firms

Annual reports of 19 financial firms were surveyed (see Appendix 1 for a list of firms). They range from globally active financial conglomerates to domestically active U.S. banks, but most are or contain a large U.S. broker-dealer and therefore have similar critical accounting issues to discuss. Eleven of the firms participated in the 2001 Shipley Group work on enhanced risk disclosure and formed a logical nucleus. The other eight were added because of the size and/or scope of their businesses.

[1] Securities and Exchange Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, [Release Nos. 33-8350; 34-48960; FR-72], Effective Date: December 29, 2003. ("SEC Interpretation")

[2] SEC Interpretation, p. 18.

Adherence to the Guidelines

Almost all of the firms provide a separate section in the MD&A concerning critical accounting policies or estimates. Non-U.S. firms not subject to SEC requirements generally provide similar information, although sometimes in a different part of the annual report. Only one non-U.S. firm did not provide such disclosure. There was a great deal of variability, especially in the level of detail, of the critical accounting disclosures provided. However, two areas were considered critical by a significant majority of the firms: valuation of financial assets and allowance for loss. Goodwill and intangible identifiable assets, taxes, pensions, and other areas subject to significant estimates were also disclosed by many of the firms.

> Valuation of Financial Instruments/Fair Value: All but one of the institutions rank the valuation of financial instruments among their most critical accounting estimates. They also, for the most part, provide fairly detailed descriptions of fair value and when it is applied. Many of the firms go so far as describing how the portfolios are broken up for valuation purposes and the basic variables that are considered in the determination of fair value.
>
> Loan loss allowances/provisions for credit losses: Most of the institutions, and all of the banks, list allowance for credit loss as a critical accounting estimate. There is some description of the types of provisions taken and the basis on which such decisions are made.
>
> Goodwill and other intangible assets: Roughly half of the institutions list the accounting for goodwill and other identifiable intangible assets among their critical accounting estimates.

The U.S. firms included separate critical accounting estimate disclosures within their MD&A section that go much farther than the notes to the financial statements in describing the types of estimates used. The disclosures generally match the SEC guidance in that they focus on the uncertainty involved in the particular parts of the financial statements and types of businesses. In contrast to financial statements in general that tend to make everything appear very precise and calculated, the critical accounting disclosures are clear in their description of uncertainty and the level of judgment and subjectivity that goes into the preparation of the financial statements.

Usefulness of Disclosure

Some of the disclosures are extremely useful in understanding how and where uncertainty and judgment are most prevalent in the financial statements of financial firms. The firms with fewer major business lines are able to offer the clearest and most succinct descriptions of their critical accounting estimates and policies. Some firms practically offer tutorials on the valuation of financial instruments, which are very useful in understanding the financial statements. The larger, more diverse financial conglomerates have to balance covering all the critical areas without drowning the reader in detail – not an easy task.

The critical accounting disclosures do, for the most part, provide a supplement to the existing accounting disclosures in the notes to the financial statements, although in some cases there is repetition. As with any new and developing disclosure requirement, there is the risk that firms will deem it better to disclose too much, rather than too little. This case is no exception. Accrual accounting in general requires estimates, and many of those estimates, if incorrect, would have a material impact on the financial statements and the health of firms. Therefore there are many potentially critical estimates and policies to discuss. Reports that reflect the "better too much, than too little" philosophy run the risk of providing so much detail that readers skim the disclosures in just the area where they should be paying careful attention. Since the SEC has not released its final rules on the subject, it is too early to say if it is content with the current disclosures, but one can hope any further guidance will be towards succinctness rather than more detail.

Appendix 1

List of Firms in Alphabetical Order

Institution	Report*
Bank of America	10-K
Bank One	Annual Report
Barclays	Annual Report
Bear Stearns	Annual Report
Citigroup	Annual Report
Commerzbank	Annual Report
Credit Suisse Group	20-F
Deutsche Bank	Annual Report
Goldman Sachs	Annual Report
HSBC	Annual Report
JPMorganChase	10-K
Lehman Brothers	Annual Report
Merrill Lynch	Annual Report
Morgan Stanley	10-K
RBC	Annual Report
Societe Generale	Annual Report
TD Bank Financial Group	Annual Report
UBS	Annual Report
Wells Fargo	Annual Report

* All reports are 2003, except for the Credit Suisse Group's 20-F, which is 2002, as the 2003 report is not due until June 2004.

Appendix 2

Summary of Disclosures of Critical Accounting Policies ("CAP")

Firm	CAP Description	Summary
1 U.S. B/D	CAPs are those policies that are the most important to the financial statements and/or those that require significant management judgment related to matters that are uncertain.	Valuation of financial instruments is identified as a CAP due to the complex nature of certain of its products, the degree of judgment required to appropriately value these products and the pervasive impact of such valuation on the financial condition of the Company. There are three broad categories of financial instruments: (1) those whose fair value (FV) is based on quoted market prices or for which the Company has an independent external valuations; (2) those whose FV is determined based on readily observable price levels for similar instruments and/or models or methodologies that employ data that are observable from objective sources; and (3) those whose FV is estimated based on internally developed models or methodologies utilizing significant assumptions and other data that are generally less readily observable from objective sources. Controls over financial instruments valuation and merchant banking are also discussed.
2 U.S. B/D	N/A	The use of fair value (FV) to measure financial instruments, with related unrealized gains and losses recognized immediately in our results of operations, is fundamental to our financial statements and is our most critical accounting policy. In determining FV we separate financial instruments into three categories – cash trading instruments, derivative contracts and principal investments. There follows a detailed description of the use of FV for the three categories along with numbers. Several tables are provided including a table of OTC derivative assets and liabilities by product and remaining contractual maturity. Price transparency for OTC derivative model inputs varies depending on, among other factors, product type, maturity and complexity of the contract. Controls over valuation of financial instruments, goodwill and identifiable intangible assets are also discussed.
3 U.S. B/D	The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity.	Financial instruments (long and short) are recorded at fair value (FV) in the consolidated statements of financial condition, and gains and losses are reflected in principal trading revenues in the consolidated statements of income. Price transparency will determine the degree of judgment involved in determining FV of financial instruments. Financial products are categorized as either cash or derivative products and derivative products are further broken into listed and OTC. A substantial percentage of the FV of financial instruments is based on observable market prices, observable market parameters, or is derived from such prices or parameters. Examples are provided, along with a description of control processes. Transfers of financial assets, allowance for consumer loan losses and aircraft under operating leases are also discussed. The disclosure refers to further discussion of pricing transparency and tables for OTC derivatives (long and short), by product and maturity.

Firm	CAP Description	Summary
4 U.S. B/D	The determination of fair value is a CAP that is fundamental to the financial condition and results of operations.	Financial statements are prepared in accordance with GAAP, which requires the use of estimates and assumptions. The determination of fair value (FV) is a critical accounting policy that is fundamental to the financial condition and results of operations. The Company records its inventory positions including securities and other inventory positions at market or FV, with unrealized gains and losses reflected in principal transactions in the income statement. A significant majority of the assets and liabilities are recorded at amounts for which significant management estimates are not used. Inventory is categorized as derivatives or cash instruments and the methods of determining fair value, as well as descriptions by level of transparency, are provided. A summary balance sheet and a table on OTC derivatives' FV are included. Private equity and other principal transactions; high yield bonds; mortgages, mortgage-backed securities and real estate inventory; non-investment grade retained interests; real estate charges; and identifiable intangible assets and goodwill are also discussed.
5 U.S. Bank	The accounting policies and use of estimates are integral to understanding the reported results. The most complex accounting estimates require management's judgment to ascertain the valuation of assets and liabilities.	The allowance for credit losses covers commercial/consumer loan portfolios and commercial lending-related commitments portfolio. A portion of the assets and liabilities are carried at fair value (FV), including trading assets and liabilities, available-for-sale securities (AFS) and private equity investments. Held-for-sale loans and mortgage servicing rights (MSR) are carried at the lower of FV or cost. The valuation process takes into consideration factors such as liquidity and concentration concerns, and for derivative products, counterparty credit risk. Management determines the factors used in the valuation process such as limited data available for large or aged positions, less readily observable external parameters, model assumptions, market dislocations, and unexpected correlations. Although substantially all of the positions are valued based on quoted market prices, certain securities are not, and those valuations require judgment, including recording FV adjustments. A table summarizing trading and AFS portfolios by valuation methodology is provided. Loans held-for-sale, private equity, MSRs and certain other retained interest are also discussed. Tables of the changes in FV and maturities of non-exchange-traded commodity contracts are provided.
6 U.S. Bank	The significant accounting principles are essential in understanding MD&A.	Some of the accounting principles require significant judgment in estimating values and in applying complex accounting principles to complicated transactions to determine the most appropriate treatment. Key judgments include (1) risk weightings for pools of commercial loans; (2) market and collateral values and discount rates for loans; (3) product type classifications; (4) loss rates; and, (5) adjustments made to assess current events and conditions. Trading account assets and liabilities are recorded at fair value (FV), which is primarily based on actively traded markets and which considers liquidity of specific positions as an important factor. Where market price quotes are not available, FV is derived from the market information available and from the issuers' financial statements and rating agencies' ratings. OTC derivatives' FV is determined using quantitative models that require market inputs including rates, prices and indices. Estimation risk is greater for derivative positions that are either option-based or have longer maturity dates. FV of derivatives include adjustments for market liquidity, counterparty credit quality, future servicing costs and other deal specific factors. Also discussed are excess spread certificates, principal investing, accrued taxes and goodwill.

Firm	CAP Description	Summary
7 U.S. Bank	The CAPs are highly dependent upon subjective or complex judgments, assumptions and estimates.	The allowance for credit losses consists of three components: asset-specific reserves, reserves based on expected loss estimates, and reserves based on stress test analysis. The underlying assumptions, estimates and assessments used to determine the components are continually updated to reflect the current view of overall economic conditions and relevant factors impacting credit quality and inherent losses. Securitizations require the use of estimates and assumptions to determine the value of retained interests, which are generally based on projections of finance charges and fees related to the securitized assets, net credit losses, average life, the contractual fee to service the loans, a discount rate commensurate with the risk and contractual interest paid to third party investors. The majority of financial instruments that require fair value (FV) measurements are determined based on quoted market prices. If restricted, FV is estimated using quoted market prices adjusted for market liquidity, position size and sales restrictions other than time. FV of non-publicly traded instruments may be based on the investee's financial results, conditions and prospect, values of comparable public companies, market liquidity and sale restrictions. Others require the use of a discounted cash flow model or other modeling techniques utilizing observable market information to the extent available to estimate FV. Also discussed are insurance policy and claims reserves, stock option compensation, pensions and FASB Int. no. 46.
8 Non-U.S. Bank	CAPs require management's judgments and estimates.	Accounting for loan losses is an area of importance given the significant size of the loan portfolio. There are three types of allowances – specific, general and sectoral, all which require significant judgment. General allowances also depend on judgment, assessment of business and economic conditions, historical and expected loss experience, loan portfolio composition and other relevant indicators. Trading securities and derivatives are carried at fair value (FV) on the consolidated balance sheet with the resulting realized and unrealized P&L recognized immediately in other income. FV of exchange traded financial instruments are based on quoted market rates plus or minus daily margin settlement. If listed prices or quotes are not available, management applies judgment in the determination of FV using valuation models that incorporate prevailing market rates and prices on underlying instruments with similar maturities and characteristics, and takes into account factors such as counterparty credit quality, liquidity and concentration concerns. Investment securities are carried at cost or amortized cost and are adjusted to recognize other than temporary impairment. Also discussed are accounting for income taxes, securitizations, valuation of goodwill and intangible assets and pensions and post-retirement benefits.
9 U.S. Bank	The significant accounting policies are fundamental to understanding our results of operations and financial condition.	Three policies are critical, as they require difficult, subjective and complex judgments that are inherently uncertain. These policies govern the allowance for loan losses, the valuation of mortgage servicing rights and pension accounting. There is an established process, using several analytical tools and benchmarks, to calculate a range of possible outcomes and determine the adequacy of the allowance. Mortgage servicing rights (MSRs), both purchased and originated, are carried at the lower of (1) the capitalized amount, net of accumulated amortization and hedge accounting adjustments, or (2) fair value (FV). The FV of MSRs is determined using a valuation model that incorporates assumptions including estimates of prepayment speeds, discount rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. We use four variables to calculate our annual pension cost: (1) size of employee population; (2) actuarial assumptions; (3) expected long-term rate of return on plan assets; and (4) discount rate.

Firm	CAP Description	Summary
10 U.S. Bank	Certain of the accounting policies as well as estimates made by management are considered to be important to the portrayal of the Company's financial condition.	Estimates require difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Investments and trading account assets and liabilities are carried at fair value (FV) if they are considered to be available-for-sale or trading securities. For a substantial majority of the investments and trading account assets and liabilities, FV is determined based upon quoted prices or validated models with externally verifiable model inputs. Changes in values of available-for-sale securities are recognized in a component of stockholders' equity net of taxes, unless the value is impaired and the impairment is not considered to be temporary. Impairment losses that are not considered temporary and changes in FV of trading account assets and liabilities and private equity are recognized in earnings. If quoted markets prices are not available, the Company discounts the expected cash flows. Alternatively, matrix or model pricing, which take into account various factors, such as: time value and volatility; underlying options, warrants and derivatives; price activity for equivalent synthetic instruments; counterparty credit quality; the potential impact on market prices or FV of liquidating the position in an orderly manner over a reasonable period of time under current market conditions; and derivative transaction maintenance costs. Trade-date gains or losses on derivative transactions are deferred until market data becomes observable or over the life of the transaction. Private equity, allowance for credit loss, securitizations, and legal reserves are also discussed.
11 Non-U.S. Bank	We use accounting policies and estimation techniques believed to be the most appropriate in the circumstances for the purpose of giving a true and fair view of the state of affairs, profit and cash flow.	The estimates described are considered to be the most complex and involve significant amounts of judgment. For bad and doubtful debts, the estimation of potential credit losses is inherently uncertain and depends upon many factors, including economic conditions, changes in customer's circumstances, structural changes within industries, and other external factors such as legal and regulatory requirements. Some of the financial instruments (FIs) are carried at fair value (FV), including derivatives debt securities held for trading. FIs entered into as trading transactions, together with any associated hedging, are measured at FV. FIs are either priced with reference to a quoted market price or by using a valuation model. The pricing models discount the expected cash flows using independently sourced market parameters, including yield curves, equities and commodities prices, option volatilities and FX rates. The calculation of FV for any FI may require adjustment to reflect the cost of credit risk, hedging costs, and illiquidity, when not otherwise accounted for in the market price or valuation model. Other discussions include goodwill, pensions, interest in retail long-term assurance fund and tax.
12 Non US Bank	N/A	No critical accounting section. Descriptions of accounting policies are in the notes to the financial statements, including the fair value of financial instruments.

Firm	CAP Description	Summary
13 Non-U.S. Bank	The results are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its consolidated financial statements.	The policies described are deemed critical to the results and financial position in terms of materiality and the degree of judgment and estimation involved. Provisions for bad and doubtful debt are reflected in the P&L report and include specific provisions and general provisions. The Company reviews (and makes any necessary adjustments to) goodwill whenever there is an indication that impairment may have taken place. Indications of impairment include any events or changes in circumstance that cast doubt on the recoverability of the carrying amount of goodwill. The Company carries debt and equity securities held for trading purposes at fair value (FV). Debt and equity securities not held for trading purposes are carried at amortised historical cost, and consideration as to whether any such asset should be written down to reflect a permanent impairment takes into account FV. FV for unquoted and illiquid debt and equity securities reflects management's assessment of the value of these securities, and may look to a valuation of comparable securities for which an independent price can be established, use a discounted cash flow model, or model the valuation based on a components approach where independent pricing is available for the underlying components. FV calculations also consider the size of the position relative to market liquidity and prevailing market conditions, and when considered appropriate, the assessed FV is reduced to reflect the amount which management estimates could be realized on their sale.
14 Non-U.S. Bank	Certain significant accounting policies require critical accounting estimates that involve complex and subjective judgments and the use of assumptions.	Quoted market prices in active markets are the most reliable measure of fair value (FV), but may not be available for non-exchange traded contracts, venture capital companies and non-marketable securities, for example. In such cases FV is determined based upon discounted cash flow analysis, comparison to similar observable market transactions, or the use of financial models. Such models are dependent upon time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market prices and transaction prices for underlying instruments. Pricing adjustments consider liquidity, credit exposure, concentration risks, hedging strategies, quality of model inputs and other factors. FV estimates are considered critical accounting estimates. The estimate of the allowance for loan losses is also considered a critical accounting estimate, and is regularly evaluated, and certain other assets are also subject to impairment review. There is also a discussion of the deferred tax assets valuation allowance.
15 U.S. B/D	Of particular importance to the financial statements is the valuation of financial instruments.	Because valuation of financial instruments may involve significant estimation where observable prices are not available, financial assets and liabilities are categorized and included in a table that reflects liquidity of the instruments and the amount of estimation required in determining value recorded in the Consolidated Financial Statements. The categories from most to least liquid are: (1) highly liquid cash and derivative instruments for which quoted market prices are readily available; (2) liquid instruments, including (a) cash instruments for which quoted market prices are available but which may trade less frequently such that there is not complete price transparency across all market cycles, (b) derivative instruments that are valued using a model where inputs to the model are directly observable, (c) instruments that are priced with reference to financial instruments whose parameters can be directly observed and (d) all consumer and small- and middle-market business loans as well as performing commercial loans held for investment purposes; and (3) less liquid instruments that are valued using management's best estimate of fair value (FV), and instruments valued using a model, where either the inputs to the model and/or the models themselves require significant judgment by management. A table categorizes all financial assets and liabilities accounted for at FV on the balance sheet.

Firm	CAP Description	Summary
16 Non-U.S. Bank	Critical accounting policies involve the most complex judgments and estimates.	The values of most financial instruments are based on either fair value (FV) or the lower of original cost and FV. FV may be objective, as is the case of exchange-traded instruments, for which quoted prices in price-efficient and liquid markets generally exist. FV may also be subject to varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks. There are exchange traded derivatives, the FV of which is typically derived from observable prices and/or observable market parameters and OTC instruments, the FV of which are determined on the basis of internally developed proprietary models using input parameters. For the majority of the derivatives held in the consolidated balance sheet, the determination of FV involves only limited subjectivity. For other more complex derivatives, subjectivity relating to the determination of input parameters reduces price transparency. Securities held in the trading portfolio are held at FV. The majority of these instruments have prices that are generally available through quoted markets, which are typically liquid. For the minority, market prices are not available, and valuation models are used to determine FV. The valuation of loans held for sale; money market papers and repo and reverse repo agreements; financial instruments from the banking business; and investments from the insurance business are also discussed. Impairment on investment securities, technical provisions from the insurance business, contingencies and loss provisions, goodwill impairment, and deferred tax assets are also discussed.
17 Non-U.S. Bank	Some significant accounting policies are CAPs because they require particularly subjective or complex judgments about matters that are inherently uncertain.	Critical accounting policies relate to the allowance for credit losses and the fair value (FV) of certain financial instruments. The Company determines and maintains the allowance based on a comprehensive and systematic review of our lending and off-balance sheet portfolio, which is determined based on the identification and evaluation of problem accounts and estimation of probable losses that may exist in the remaining portfolio. The allowance is made up of: (1) allocated specific allowance; (2) allocated general allowance; and (3) unallocated allowance. The FV of the majority of the financial instruments in our portfolios is determined based on their quoted market price. If such a price is not available, we use internal or external financial valuation models to estimate FV, which may be further adjusted by a provision due to insufficient liquidity or model risk, reflecting judgment based on quantitative research and analysis, and industry practice. A table is provided which summarizes significant financial assets and liabilities by three valuation methodologies: (1) quoted market prices; (2) pricing models with significant observable market parameters; and (3) pricing models with significant unobservable market parameters.

Firm	CAP Description	Summary
18 Non-U.S. Bank	The existence of alternatives and the application of judgment mean that a selection of different alternatives or estimates would cause our reported results to differ.	Many of the judgments which we make in applying accounting principles depend on an assumption of sufficient liquidity to hold positions or investments until a particular trading date, i.e. that we do not need to realize positions at unfavorable prices in order to fund immediate cash needs. Assets and liabilities in our trading portfolio are recorded at fair value (FV), which requires judgment. For substantially all of our portfolios, FVs are based on the quoted market price for the specific instrument, comparisons with other highly similar financial instruments, or the use of models. Factors considered by our models include time value, volatility, counterparty credit quality, activity in similar instruments in the market, administrative costs over the life of the transaction, and liquidity considerations. IAS allows a company to use hedge accounting if it fully complies with specific hedge criteria. Applying hedge accounting means that changes in the fair value of the designated hedging instruments affect reported net profit only to the extent that each hedge is ineffective. Credit default swaps do not qualify for hedge accounting, so they are carried on the balance sheet at fair value, which may add volatility to net profit. Financial investments available for sale, or private equity investments, are mid-to-long term investments and are carried on the balance sheet at FV. FV is determined by recognized valuation techniques, the standard method being multiples of cash flows, on a case-by-case basis. Other discussions include goodwill and other intangible assets, allowances and provisions for credit losses, securitizations and special purpose entities, equity compensation, deferred tax, and segment reporting.
19 Non-U.S. Bank	N/A	No separate critical accounting section, but there is a very detailed discussion of accounting principles and valuation methods used in the Notes. Overall, the majority of transactions are recorded using valuation methods that take into account the purpose for which they were made. In financial intermediation transactions, assets and liabilities are carried at historical cost, and provisions are booked when counterparty risk arises. Revenues and expenses are recorded over the life of the transaction in accordance with the time period concept. Transactions on financial futures carried out for hedging purposes or to manage overall interest rate risk are accounted for using the same principles. Trading transactions are generally marked to market at year-end. Except for loans, borrowings and short-term investment securities, which are recorded at their face value. When instruments are traded on illiquid markets, the market value used is reduced for reasons of prudence. Moreover, a provision for risks is booked to cover valuations established on the basis of in-house models, which is determined according to the complexity of the model used and the life of the financial instrument. Other areas, including, but not limited to: amounts due from banks; customer loans guarantees and endorsements; lease financing and similar agreements; securities portfolio; premises, equipment and other fixed assets; provisions for general risks and commitments; general reserves for banking risks; transactions denominated in foreign currencies; forward financial instruments; and pension and retirement costs are discussed.

THE PATRIOT ACT AND THE SECURITIES INDUSTRY

The *USA Patriot Act of 2001*,[1] while aimed at giving the government new powers in the war on terrorism, imposes significant requirements on broker-dealers and other financial institutions well beyond traditional notions of anti-money laundering compliance. The rules implementing the *Patriot Act* are numerous and now almost complete. The long lasting implication for broker-dealers, banks and other financial institutions is that they will be required to devote more resources than ever before to anti-money laundering efforts.

The *Patriot Act* requires anti-money laundering compliance programs, suspicious activity reporting, verification of new accounts, certain recordkeeping for "correspondent accounts" with foreign banks, special due diligence for correspondent and private banking accounts, and prohibits correspondent accounts with foreign shell banks.

Anti-Money Laundering Compliance Programs

Broker-dealers were required to establish comprehensive anti-money laundering programs by April 24, 2002.[2] The NASD and New York Stock Exchange (NYSE) (collectively referred to as self-regulatory organizations, or SROs) issued rules that set forth the requirements for these programs.[3] The rules require: written internal policies, procedures, and internal controls to achieve compliance with the *Bank Secrecy Act*; the designation of a compliance officer; an ongoing employee-training program for appropriate personnel; and an independent audit by firm personnel or a qualified outside party to test the programs. These anti-money laundering (AML) programs must be approved by a member of senior management. The commission has also recognized that anti-money laundering compliance programs "will evolve over time" as firms find "new ways to combat money laundering and to detect suspicious activity."[4] The SROs' anti-money laundering program rules also require firms to establish reasonable procedures and internal controls to identify and report suspicious activity.

Suspicious Activity Reporting

Recent press reports regarding money laundering compliance failures at Riggs National Bank have focused attention on the requirement for financial institutions to file suspicious activity reports (SARs). Reports indicate that Riggs, a Washington D.C.-based bank that made its name by providing banking services to Washington's foreign embassies, may face millions of dollars in fines for having lax anti-money laundering controls. The inquiry into Riggs began after the September 11 terrorist attacks, when government investigators were looking at Saudi Arabian accounts at the bank and discovered that Riggs had failed to file numerous SARs.

Suspicious activity reporting is an important part of a firm's AML program. The SAR rule for broker-dealers was issued on July 1, 2002 by the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), under Section 356 of the *Patriot Act*. The rule, which took ef-

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[1] Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Pub. L. No. 107-56) (the "*Patriot Act*" or the "Act").

[2] Anti-money laundering programs are required by Section 352 of the *Patriot Act*.

[3] The NYSE (SR-NYSE-2002-10) and NASD (SR-NASD-2002-24) AML rules were issued by the SEC on April 22, 2002. See Rel. No. 34-4378.

[4] *Id.*

fect on January 1, 2003, applies to any broker or dealer located within the United States, and those firms registered as broker-dealers simply to permit the sale of variable annuities. The rule also applies to the activities of futures commission merchants registered as broker-dealers that involve securities products over which the SEC or any federal agency other than the Commodity Futures Trading Commission.

A broker-dealer must report a transaction (of at least $5,000) if it is conducted or attempted by, at, or through the broker-dealer, and the broker-dealer knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions): (1) involves funds derived from illegal activity, or is intended or conducted to hide or disguise funds or assets derived from illegal activity; (2) is designed, whether through structuring or other means, to evade the requirements of the *Bank Secrecy Act*; (3) has no business or apparent lawful purpose, or is not the sort in which the particular customer would be expected to engage, and the broker-dealer knows of no reasonable explanation after examining the available facts; or (4) involves use of the broker-dealer to facilitate criminal activity.[5] The reporting requirements apply even to transactions that do not involve currency.

Suspicious activity reports are to be filed on a form "SAR-SF" with FinCEN. The SAR must be filed within 30 days of the broker-dealer becoming aware of facts that may constitute a basis for filing. If a firm is unable to identify a suspect, filing may be delayed for an additional 30 days in order to identify a suspect. In situations involving violations that require immediate attention, such as terrorist financing or ongoing money laundering schemes, the broker-dealer must immediately notify the appropriate law enforcement agency by telephone in addition to filing a SAR.

The rule requires firms to maintain copies of all SARs filed and the original supporting documentation for five years from the date of the filing. In addition, the supporting documentation must be made available to law enforcement or authorized regulatory agencies and the SROs for purposes of examining for compliance with the rule.

Firms that file a SAR are prohibited from notifying any person involved in the transaction about which the SAR has been filed. This prohibition does not apply to requests from law enforcement or regulatory agencies.[6] Lastly, firms are protected from liability for reporting suspicious activity and for failing to disclose such reporting.[7]

Customer Identification and Verification

The Treasury and the SEC issued final rules on May 9, 2003 requiring broker-dealers to establish procedures to verify the identity of new accountholders, which is one of most significant *Patriot Act* provisions.[8] Similar rules were also issued by other federal regulatory agencies for banks, credit unions, mutual funds, futures commission merchants and introducing brokers.

The rules require a broker-dealer to adopt a written Customer Identification Program (CIP) appropriate for its size and business that enables it to form a reasonable belief that it knows the true identity of the customer. The CIP must be part of a firm's overall anti-money laundering

[5] 66 Fed. Reg. 67,676 (to be codified at 31 C.F.R. pt. 103).

[6] 31 U.S.C. § 5318(g)(2).

[7] 31 U.S.C. § 5318(g)(3).

[8] The verification requirement arises under Section 326 of the *Patriot Act*.

compliance program required under Section 352 of the Act. A firm's program should be based on the institution's assessment of the risks presented (e.g., its size, location, customer base, types of accounts and transactions, methods of opening accounts, and types of identifying information available). The CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable, as described more fully below.

Firms are required to have procedures for opening an account that specify the identifying information required from each customer. Firms are required, at a minimum, to obtain the following information prior to opening an account: (1) name; (2) date of birth (for individuals); (3) residential or business street address for individuals, or principal place of business, local office or other physical location for persons other than individuals; and (4) identification number – for a U.S. person, taxpayer identification number (TIN); or for a non-U.S. person, a TIN, a passport number and country of issuance, an alien identification card number or the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard. Firms may have procedures for opening an account for a customer that has applied for, but not received, a TIN.

Broker-dealers are required to have procedures for verifying the identity of each customer within a reasonable amount of time before or after the account is opened. The customer identification program must specify when the institution will verify a customer's identity through documents, including identifying the documents that will be used, and when the firm will verify through nondocumentary methods, or a combination of both. Nondocumentary methods may include contacting the customer, comparing information from the customer with information from a consumer reporting agency, public database, or other source, and checking references. The CIP must also address situations when the broker-dealer should not open an account, when an account should be closed because the firm is unable to verify the customer, and when a SAR should be filed.

A firm must also have procedures for making and maintaining records of all information obtained in verifying a customer's identity. The records must include all identifying information about the customer and a description (not a copy) of any document relied upon to verify identity. The records must also include a description of the methods and the results of any measures undertaken to verify the identity of a customer, including the resolution of any discrepancies discovered. Identifying customer information must be maintained for five years after the account is closed. Records relating to how a firm verified the identity of a customer must be maintained for five years after the records are made.

In addition to requiring the verification of customer identification, the rules require financial institutions to adopt procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any federal government agency and designated as such by Treasury in consultation with the functional federal regulators. Firms will receive notification regarding the lists that must be consulted for purposes of this provision. Procedures must also ensure that the institution follows all federal directives issued in connection with such lists. Firms must also have procedures for providing customers with adequate notice that the institution is requesting information to verify their identities.

The final rule includes sample language that a firm may follow.

Correspondent and Private Account Due Diligence

Of all of the rules rolled out by Treasury, those that perhaps impose the greatest burden – at least on those firms with substantial international clientele – are the due diligence procedures under Section 312 to detect money-laundering for private-banking accounts and corresponding accounts for non-U.S. persons and offshore banks.[9] The proposed rule requires "covered financial institutions" to establish (1) due diligence policies, procedures and controls to detect money laundering through correspondent accounts with foreign covered financial institutions; (2) enhanced due diligence policies, procedures and controls for correspondent accounts for certain foreign banks with offshore banking licenses and for all banks licensed by jurisdictions that have been determined to pose a high risk of money laundering; and (3) due diligence policies, procedures and controls for accounts for foreign "private banking" clients, including "senior foreign political figures."

Treasury's proposed rule defines a "correspondent account" and "foreign financial institution" so broadly that the rule could be interpreted to cover virtually all accounts that U.S. financial institutions have with foreign financial institutions. For example, correspondent accounts are defined as accounts that "receive deposits from, make payments on behalf of ... or handle other financial transactions" for a foreign financial institution. Because the broad definitions in the proposed rule cover an array of accounts used to conduct ordinary business transactions with foreign financial institutions, U.S. institutions would thus be expending resources on accounts that do not raise "red flags."

In response to issues raised by SIA and others in comment letters, Treasury postponed the issuance of a final rule under Section 312. Instead, Treasury issued an interim rule advising firms of their compliance obligations until the issuance of a final rule. Under the interim rule, broker-dealers are required only to comply with the enhanced due diligence requirements for private-banking clients.[10] For private-banking accounts that meet this definition, pending the adoption of a final rule, the interim rule provides that firms should focus on those accounts that present a high risk of money laundering. The due diligence for these accounts should be consistent with guidance for private-banking issued by the Federal Reserve and Treasury.

Shell Bank Prohibitions

The rule regarding foreign shell banks implements two key provisions (Sections 313 and 319(b)) of the *Patriot Act*. Section 313 prohibits U.S. financial institutions from providing correspondent accounts to foreign shell banks, and requires them to take reasonable steps to ensure that correspondent accounts are not used indirectly for foreign shell banks. Section 319(b) requires financial institutions that provide correspondent accounts to foreign banks to keep records of the foreign banks' owners and agents to accept service of legal process in the United States.

The final rule provides that a broker-dealer: (1) may not establish a correspondent account in the United States for, or on behalf of, a foreign shell bank; (2) must take reasonable steps to ensure that any correspondent account established by a broker-dealer in the United States for a

[9] The rule, which implements Section 312 of the *Patriot Act*, was proposed on May 30, 2002. See 67 Fed. Reg. 37,736 (May 30, 2002).

[10] A private-banking account is defined as an account of at least $1 million for one or more individuals who have a direct or beneficial interest in the account, and managed by an officer, employee or agent of a financial institution "acting as a liaison between the financial institution and the direct or beneficial owner of the account."

foreign bank is not being used by the foreign bank to indirectly provide banking services to a foreign shell bank; and (3) maintain records — for all correspondent accounts in the U.S. for a foreign bank — that identify the owners of each foreign bank whose shares are not publicly traded and the foreign bank's U.S. agent authorized to accept service of legal process.

Firms are permitted to use a certification form, provided in the rule, to comply with the shell-bank prohibition and the requirement to identify a foreign bank's owners and agent for service of process. The certification must be obtained at least once every three years. Firms have 30 days from when an account is opened to obtain the certification. If a certification is not obtained within the required time, a broker-dealer must close all correspondent accounts with the foreign bank within a commercially reasonable time.

Sharing of Information

Treasury issued a final rule under Section 314 of the Act, which is aimed at encouraging greater cooperation among financial institutions, regulators, and law enforcement in efforts against money laundering and the financing of terrorism. Under the rule, Treasury's FinCEN, acting on behalf of a federal law enforcement agency investigating money laundering or terrorist activity, may require any financial institution to search its records to determine whether the financial institution maintains or has maintained accounts for, or has engaged in transactions with, named individuals, entities, or organizations. Firms must search their records for any current account and any account maintained for a named suspect during the preceding 12 months. A firm is required to search for transactions that are required to be recorded and are conducted during the preceding six months by, or on behalf of, a named suspect.

The rule also establishes procedures for voluntary information sharing between or among financial institutions. The sharing of information must be for the purpose of identifying and reporting activities that may involve money laundering or terrorist activity. A firm that shares information pursuant to the rule is protected under the *Patriot Act* from any liability for such sharing or for any failure to provide notice of such sharing.

A financial institution that intends to share information under the rule must file a notice with FinCEN using the form set forth in the rule. An institution is required to submit a new form to FinCEN each year. A firm is also required to take reasonable steps to verify that the institution with which it intends to share information has also filed the required notice with FinCEN. FinCEN maintains a list of institutions that have submitted the required notice and are thus qualified to share information.

In summary, the *Patriot Act* provisions are far reaching and will require new levels of compliance by all financial institutions. The securities industry has had a long history of working with U.S. officials to counter money laundering, and is committed to continuing that effort.

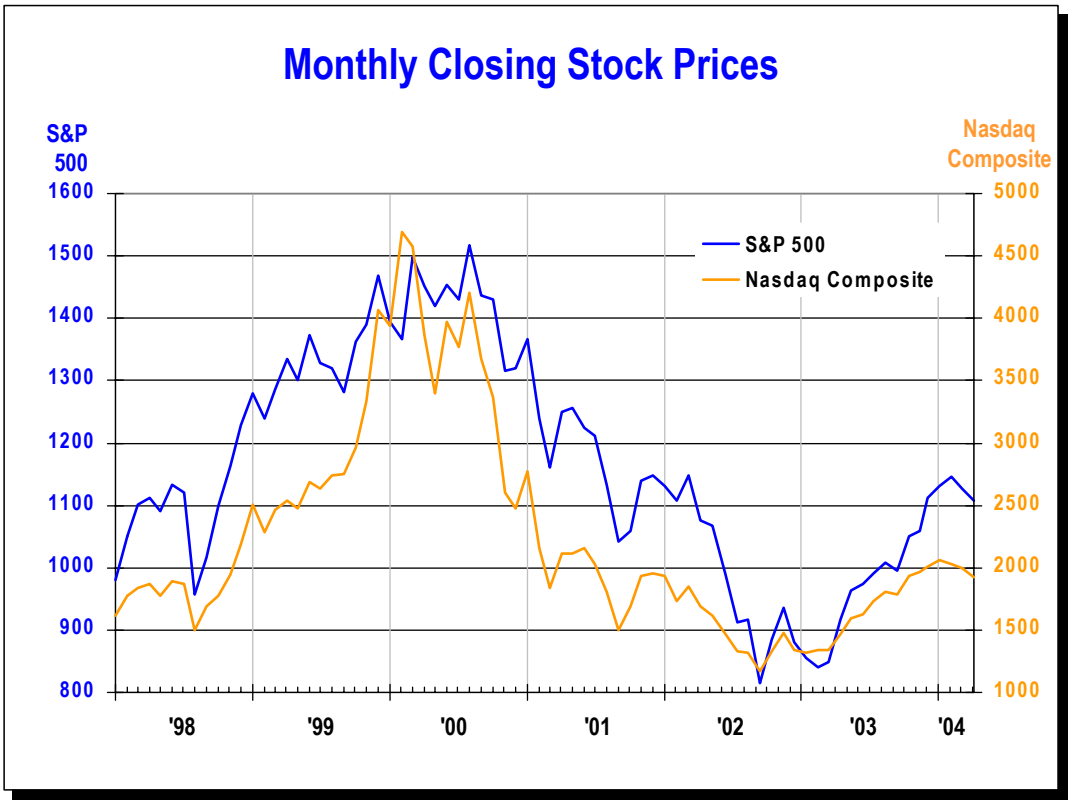
Alan E. Sorcher
Associate General Counsel

MONTHLY STATISTICAL REVIEW

U.S. Equity Market Activity

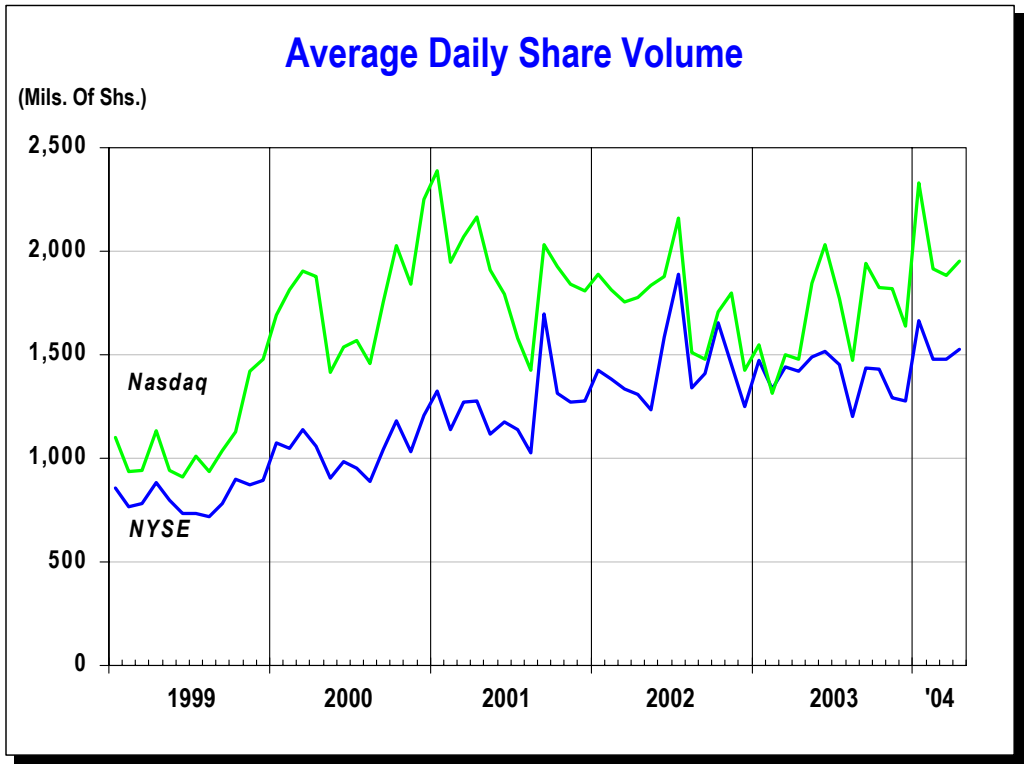
Stock Prices – Major U.S. stock indices declined in April on fears that the Fed will begin raising short-term interest rates a lot sooner than many investors had anticipated, resulting in slower corporate earnings growth. First quarter earnings for S&P 500 companies have exceeded analysts forecasts and are currently estimated to have increased 27.0% over last year, although profit growth is expected to slow to 17.7% in the second quarter and 12.6% in the third, according to Thomson Financial.

In April, the Dow Jones Industrial Average slipped 1.3% and the S&P 500 fell 1.7% after falling 2.1% and 1.6%, respectively, in March. This represents the first back-to-back monthly drops in these indices since January-February 2003. Meanwhile, the tech-laden Nasdaq Composite fell 3.7%, its largest monthly decline since December 2002 and its third consecutive monthly loss. Year-to-date, all three major market gauges are in negative territory. The DJIA is down 2.2%, the S&P 500 0.4%, and the Nasdaq Composite 4.2%.



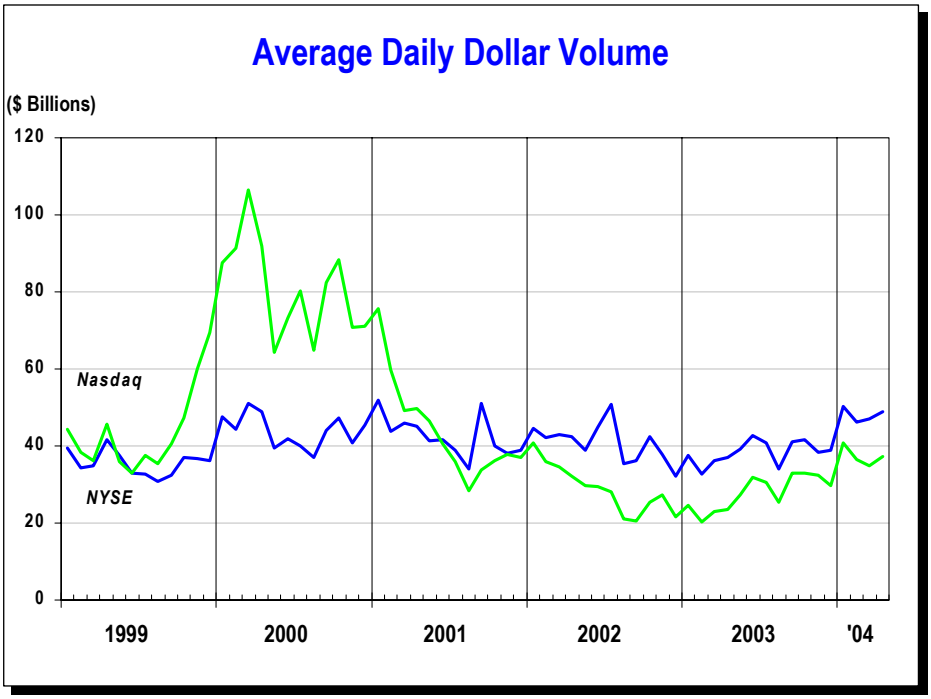
Share Volume – Trading volume on the major exchanges rose slightly in April after witnessing declines in the two previous months. On the NYSE, average daily share volume increased 3.2% in April, from March's level to 1.52-billion shares. Nasdaq daily share volume rose 3.7% in April to 1.95-billion shares.

Through the first four months of 2004, daily share volume on Nasdaq averaged 2.02 billion, 19.6% higher than 2003's daily average of 1.69 billion. Meanwhile, NYSE average daily share volume was up 9.8% to 1.54 billion from 1.40-billion shares daily in 2003.

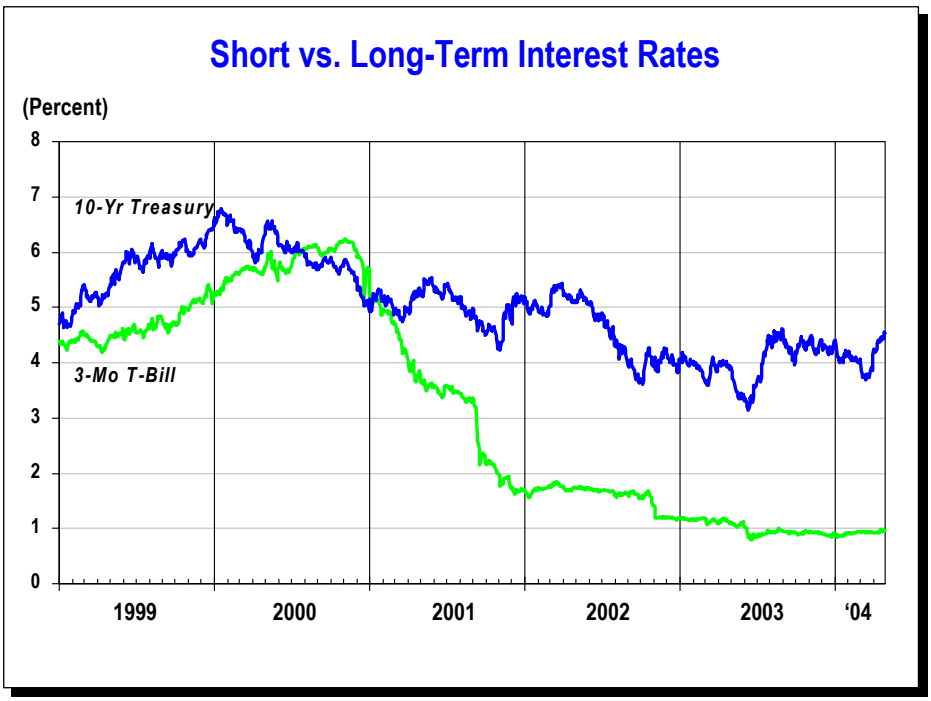


Dollar Volume – Increased trading activity, along with an increase in the average price per share traded, led to higher dollar volumes on both the NYSE and Nasdaq in April. The average daily value of shares traded on the NYSE rose 4.0% from March's level to $49.0 billion in April. Nasdaq average daily dollar volume increased 6.9% in April to $37.3 billion from $34.9 billion in March.

Year-to-date, NYSE dollar volume averaged $48.2 billion daily, up 25.2% from $38.5 billion daily in 2003, and 9.8% above 2000's record $43.9 billion daily pace. Nasdaq dollar volume year-to-date, at $37.3 billion daily, is one-third higher than 2003's $28.0 billion daily average, yet remains 53.9% short of the record $80.9 billion daily average set in 2000.

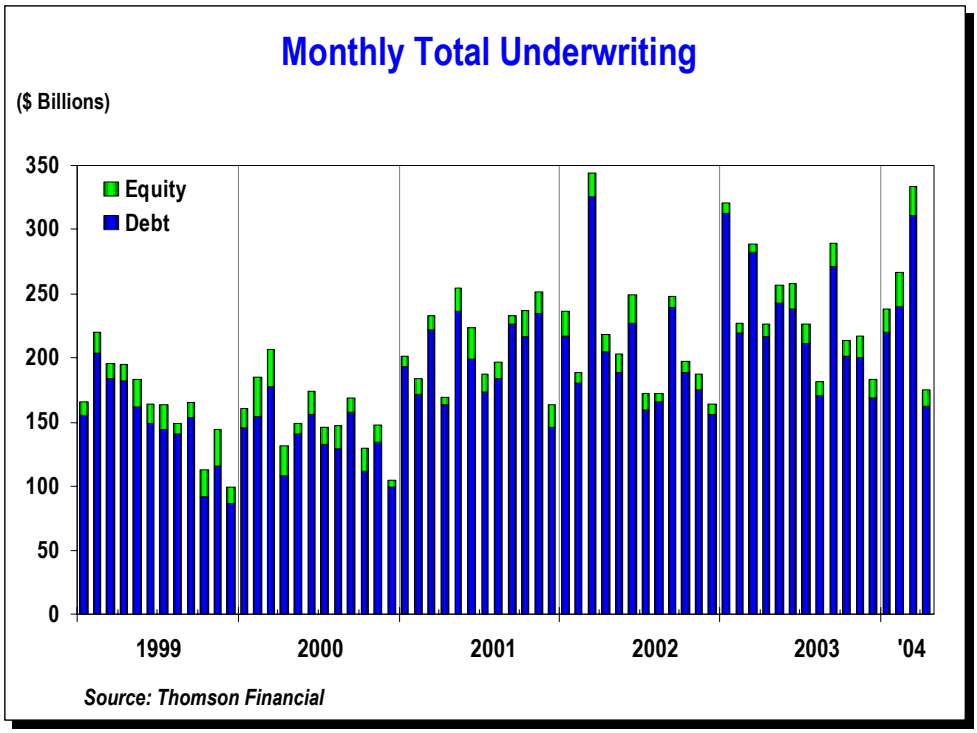


Interest Rates – Yields on 10-year Treasury notes moved sharply higher in April and reached highs not seen since last September as signs of inflation (a 0.5% increase in the CPI in March, mainly due to higher oil prices) and unexpectedly strong jobs data (308,000 non-farm payroll jobs added in March) boosted expectations for a rate increase. The 10-year Treasury yield ended April at 4.53%, up 67 basis points from 3.86% a month earlier and substantially above its recent low of 3.7% in mid-March.



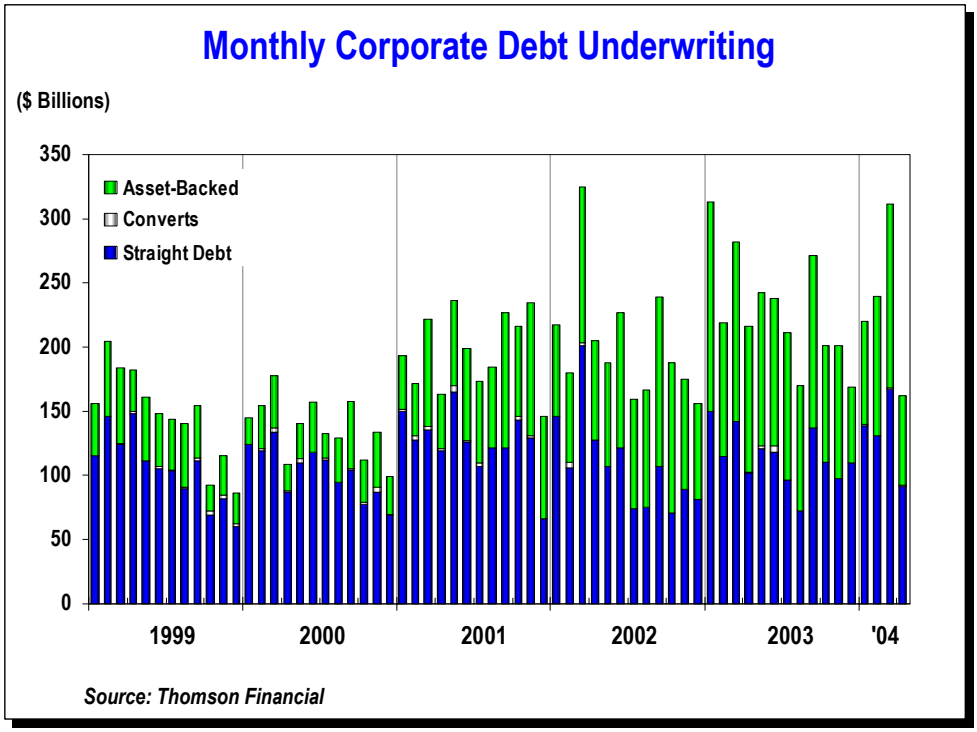
U.S. Underwriting Activity

Total Underwriting – New issuance of corporate stocks and bonds weakened in April to its lowest level since December 2002 amid a sluggish stock market and the sudden surge in long-term interest rates. After climbing for three straight months to $333.4 billion in March, total underwriting activity plummeted 47.5% in April to $175.0 billion. Declines were seen across all investment products. Year-to-date, new issuance activity is down 4.8% to $1.01 trillion from $1.06 trillion in last year's comparable period.

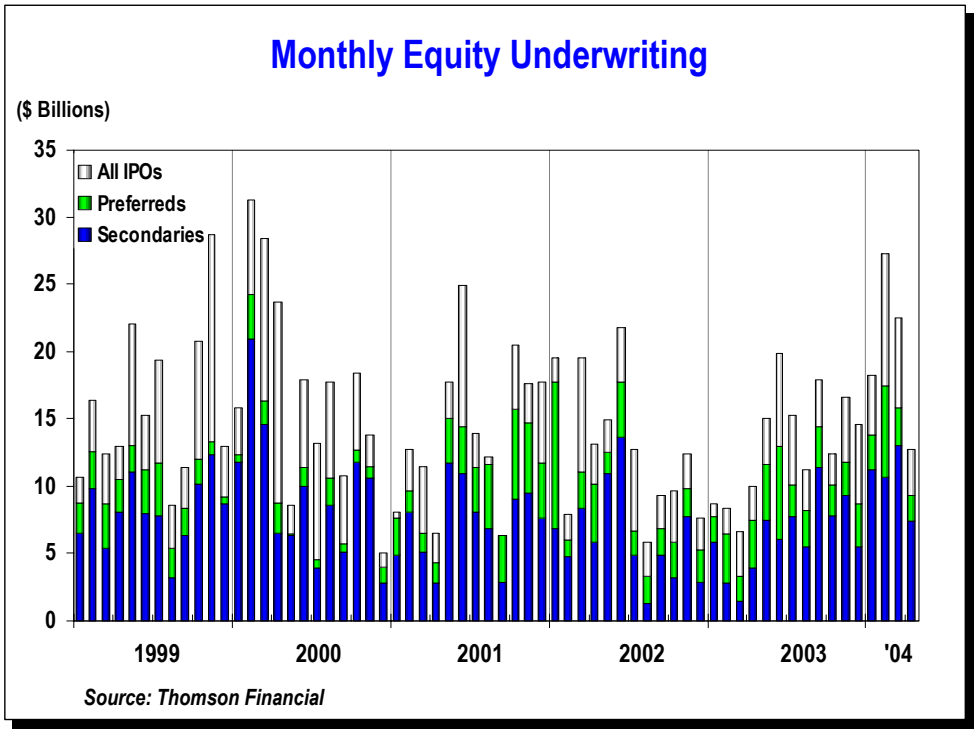


Corporate Bond Underwriting – After many issuers rushed to market in March ahead of an expected interest rate increase, the surge in long-term interest rates dampened activity in this market in April. Total corporate bond underwriting activity plunged 47.8% in April to $162.2 billion from $310.8 billion in March. Through the first four months of 2004, total U.S. debt issuance was down 9.5% to $932 billion from $1.03 trillion last year.

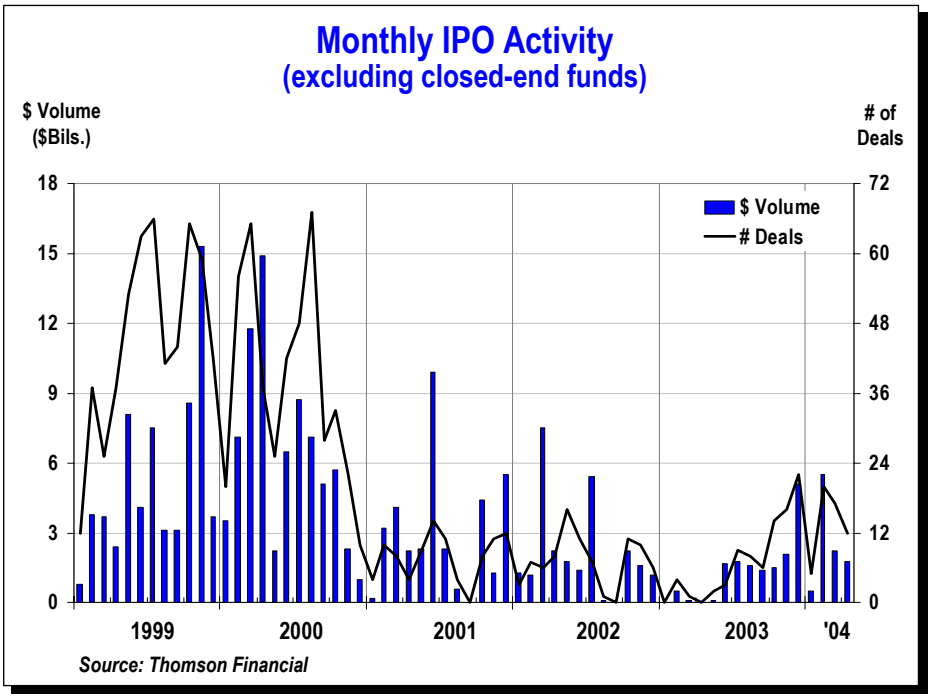
Asset-backed securities issuance for the month of April was $70.2 billion, just half of March's total of $142.7 billion. Year-to-date, asset-backed securities offerings are running 22.9% below levels seen in last year's comparable period.



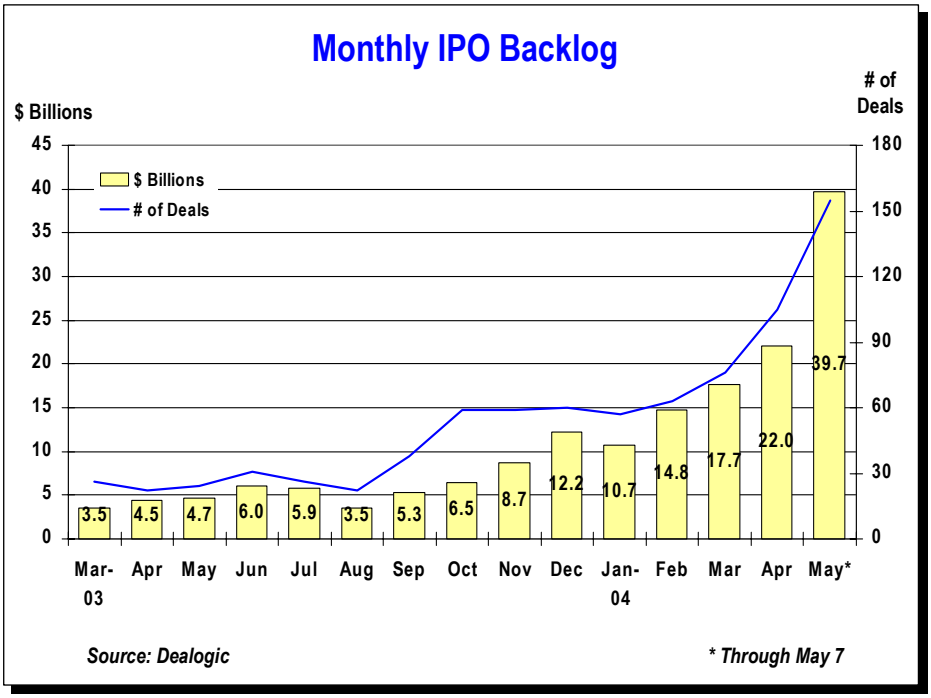
Equity Underwriting – Total equity issuance tumbled 43.4% to $12.8 billion in April from $22.6 billion in March, marking the second consecutive month of declines in both common and preferred stock offerings. Nevertheless, new equity issuance year-to-date is nearly more than double last year's pace, with $80.7 billion issued through the first four months of 2004 versus $33.6 billion issued in the same period during 2003.



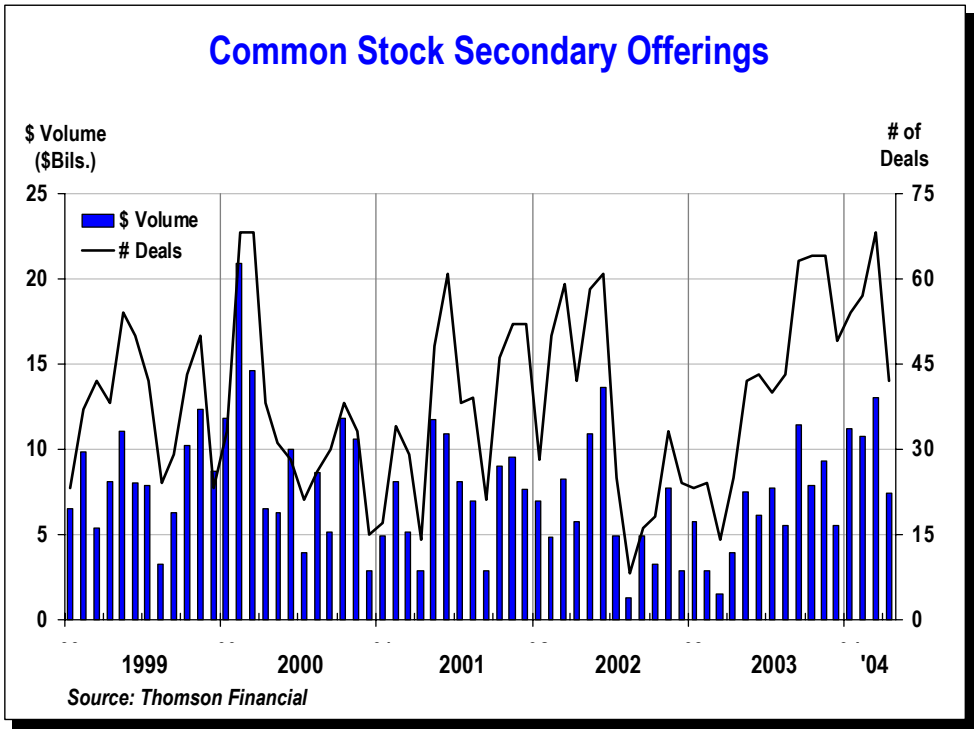
IPO Market – Initial Public Offering (IPO) activity also declined for a second month in a row to $1.8 billion in April from $2.2 billion in March. Even so, year-to-date, deal and dollar volumes are running well ahead of last year's pace. So far this year, there have been 54 IPOs that raised $9.9 billion, compared with five deals that raised a mere $644 million in last year's same period.



An encouraging sign for this market going forward is the recent pickup in the IPO backlog, which has risen to $39.7 billion in early May compared to $22.0 billion in April and $4.7 billion in May 2003.



Common stock secondary offerings plunged 43.1% in April to $7.4 billion from a 22-month peak of $13.0 billion in March. Despite the monthly decline, the total year-to-date secondary issuance of $42.2 billion is triple the $14.0 billion issued in the same period a year ago.



Grace Toto
Vice President and Director, Statistics

U.S. CORPORATE UNDERWRITING ACTIVITY

(In $ Billions)

	Straight Corporate Debt	Con-vertible Debt	Asset-Backed Debt	TOTAL **DEBT**	Common Stock	Preferred Stock	TOTAL **EQUITY**	All IPOs	"True" IPOs	Secondaries	**TOTAL UNDER-WRITINGS**
1985	76.4	7.5	20.8	104.7	24.7	8.6	33.3	8.5	8.4	16.2	138.0
1986	149.8	10.1	67.8	227.7	43.2	13.9	57.1	22.3	18.1	20.9	284.8
1987	117.8	9.9	91.7	219.4	41.5	11.4	52.9	24.0	14.3	17.5	272.3
1988	120.3	3.1	113.8	237.2	29.7	7.6	37.3	23.6	5.7	6.1	274.5
1989	134.1	5.5	135.3	274.9	22.9	7.7	30.6	13.7	6.1	9.2	305.5
1990	107.7	4.7	176.1	288.4	19.2	4.7	23.9	10.1	4.5	9.0	312.3
1991	203.6	7.8	300.0	511.5	56.0	19.9	75.9	25.1	16.4	30.9	587.4
1992	319.8	7.1	427.0	753.8	72.5	29.3	101.8	39.6	24.1	32.9	855.7
1993	448.4	9.3	474.8	932.5	102.4	28.4	130.8	57.4	41.3	45.0	1,063.4
1994	381.2	4.8	253.5	639.5	61.4	15.5	76.9	33.7	28.3	27.7	716.4
1995	466.0	6.9	152.4	625.3	82.0	15.1	97.1	30.2	30.0	51.8	722.4
1996	564.8	9.3	252.9	827.0	115.5	36.5	151.9	50.0	49.9	65.5	979.0
1997	769.8	8.5	385.6	1,163.9	120.2	33.3	153.4	44.2	43.2	75.9	1,317.3
1998	1,142.5	6.3	566.8	1,715.6	115.0	37.8	152.7	43.7	36.6	71.2	1,868.3
1999	1,264.8	16.1	487.1	1,768.0	164.3	27.5	191.7	66.8	64.3	97.5	1,959.8
2000	1,236.2	17.0	393.4	1,646.6	189.1	15.4	204.5	76.1	75.8	112.9	1,851.0
2001	1,511.2	21.6	832.5	2,365.4	128.4	41.3	169.7	40.8	36.0	87.6	2,535.1
2002	1,303.2	8.6	1,115.4	2,427.2	116.4	37.6	154.0	41.2	25.8	75.2	2,581.1
2003	1,370.7	10.6	1,352.3	2,733.6	118.5	37.8	156.3	43.7	15.9	74.8	2,889.9
2003											
Jan	150.3	0.0	162.5	312.7	6.8	1.9	8.8	1.0	0.0	5.8	321.5
Feb	114.7	0.0	104.1	218.8	4.7	3.6	8.3	1.9	0.5	2.8	227.1
Mar	141.9	0.1	140.2	282.3	4.8	1.8	6.5	3.3	0.1	1.5	288.8
Apr	101.5	1.3	113.6	216.5	6.4	3.6	10.0	2.5	0.0	3.9	226.5
May	120.7	3.0	118.7	242.4	10.9	4.1	15.0	3.4	0.1	7.5	257.4
June	118.0	5.1	114.7	237.9	13.1	6.8	19.9	7.0	1.7	6.1	257.8
July	96.4	0.4	114.0	210.8	12.9	2.4	15.3	5.2	1.8	7.7	226.1
Aug	72.7	0.0	97.5	170.3	8.4	2.7	11.1	3.0	1.6	5.5	181.4
Sept	137.4	0.0	133.9	271.3	14.9	3.0	17.9	3.5	1.4	11.4	289.2
Oct	110.5	0.1	90.6	201.2	10.2	2.3	12.4	2.3	1.5	7.8	213.6
Nov	97.4	0.0	103.1	200.6	14.0	2.5	16.6	4.8	2.1	9.3	217.1
Dec	109.1	0.6	59.3	169.0	11.3	3.2	14.5	5.9	5.1	5.5	183.5
2004											
Jan	138.5	1.4	79.9	219.8	15.6	2.6	18.2	4.4	0.5	11.2	238.0
Feb	130.8	0.3	108.4	239.5	20.4	6.8	27.2	9.8	5.5	10.7	266.7
Mar	167.5	0.6	142.7	310.8	19.7	2.8	22.6	6.7	2.2	13.0	333.4
Apr	91.7	0.3	70.2	162.2	10.9	1.9	12.8	3.5	1.8	7.4	175.0
May											
June											
July											
Aug											
Sept											
Oct											
Nov											
Dec											
YTD '03	508.4	1.4	520.4	1,030.3	22.7	10.9	33.6	8.7	0.6	14.0	1,063.9
YTD '04	528.6	2.6	401.2	932.4	66.6	14.1	80.7	24.4	9.9	42.2	1,013.1
% Change	4.0%	80.8%	-22.9%	-9.5%	194.0%	29.0%	140.3%	180.2%	1438.8%	202.7%	-4.8%

Note: IPOs and secondaries are subsets of common stock. "True" IPOs exclude closed-end funds.
Source: Thomson Financial

MUNICIPAL BOND UNDERWRITINGS

(In $ Billions)

INTEREST RATES

(Averages)

	Compet. Rev. Bonds	Nego. Rev. Bonds	**TOTAL REVENUE BONDS**	Compet. G.O.s	Nego. G.O.s	**TOTAL G.O.s**	**TOTAL MUNICIPAL BONDS**	3-Mo. T Bills	10-Year Treasuries	SPREAD
1985	10.2	150.8	161.0	17.6	22.8	40.4	201.4	7.47	10.62	3.15
1986	10.0	92.6	102.6	23.1	22.6	45.7	148.3	5.97	7.68	1.71
1987	7.1	64.4	71.5	16.3	14.2	30.5	102.0	5.78	8.39	2.61
1988	7.6	78.1	85.7	19.2	12.7	31.9	117.6	6.67	8.85	2.18
1989	9.2	75.8	85.0	20.7	17.2	37.9	122.9	8.11	8.49	0.38
1990	7.6	78.4	86.0	22.7	17.5	40.2	126.2	7.50	8.55	1.05
1991	11.0	102.1	113.1	29.8	28.1	57.9	171.0	5.38	7.86	2.48
1992	12.5	139.0	151.6	32.5	49.0	81.5	233.1	3.43	7.01	3.58
1993	20.0	175.6	195.6	35.6	56.7	92.4	287.9	3.00	5.87	2.87
1994	15.0	89.2	104.2	34.5	23.2	57.7	161.9	4.25	7.09	2.84
1995	13.5	81.7	95.2	27.6	32.2	59.8	155.0	5.49	6.57	1.08
1996	15.6	100.1	115.7	31.3	33.2	64.5	180.2	5.01	6.44	1.43
1997	12.3	130.2	142.6	35.5	36.5	72.0	214.6	5.06	6.35	1.29
1998	21.4	165.6	187.0	43.7	49.0	92.8	279.8	4.78	5.26	0.48
1999	14.3	134.9	149.2	38.5	31.3	69.8	219.0	4.64	5.65	1.01
2000	13.6	116.2	129.7	35.0	29.3	64.3	194.0	5.82	6.03	0.21
2001	17.6	164.2	181.8	45.5	56.3	101.8	283.5	3.39	5.02	1.63
2002	19.5	210.5	230.0	52.3	73.1	125.4	355.4	1.60	4.61	3.01
2003	21.1	215.8	236.9	54.7	87.7	142.4	379.3	1.01	4.02	3.00
2003										
Jan	1.4	16.8	18.2	4.4	4.3	8.8	27.0	1.17	4.05	2.88
Feb	1.8	15.6	17.4	5.1	7.6	12.8	30.2	1.17	3.90	2.73
Mar	2.0	16.4	18.4	4.2	5.5	9.7	28.1	1.13	3.81	2.68
Apr	1.6	18.4	20.1	4.6	10.2	14.8	34.9	1.13	3.96	2.83
May	3.0	20.3	23.3	5.5	7.1	12.6	35.8	1.07	3.57	2.50
June	2.1	22.6	24.7	6.6	17.1	23.7	48.4	0.92	3.33	2.41
July	2.2	18.5	20.6	6.5	6.1	12.6	33.3	0.90	3.98	3.08
Aug	1.1	17.6	18.7	3.9	3.4	7.2	25.9	0.95	4.45	3.50
Sept	1.4	17.6	18.9	3.6	3.2	6.8	25.7	0.94	4.27	3.33
Oct	1.6	16.7	18.4	3.8	12.2	16.0	34.3	0.92	4.29	3.37
Nov	1.3	16.2	17.5	4.1	4.2	8.3	25.8	0.93	4.30	3.37
Dec	1.7	19.1	20.7	2.3	6.8	9.1	29.8	0.90	4.27	3.37
2004										
Jan	0.7	11.0	11.7	3.6	5.6	9.2	20.8	0.88	4.15	3.27
Feb	1.0	11.2	12.3	5.6	8.4	14.0	26.3	0.93	4.08	3.15
Mar	2.7	19.6	22.4	4.9	10.6	15.5	37.8	0.94	3.83	2.89
Apr	1.0	14.1	15.0	3.5	6.5	10.0	25.0	0.94	4.35	3.41
May										
June										
July										
Aug										
Sept										
Oct										
Nov										
Dec										
YTD '03	6.9	67.3	74.1	18.4	27.7	46.1	120.2	1.15	3.93	2.78
YTD '04	5.4	55.9	61.3	17.6	31.1	48.7	110.0	0.92	4.10	3.18
% Change	-20.9%	-16.9%	-17.3%	-4.4%	12.1%	5.5%	-8.5%	-19.8%	4.4%	14.4%

Sources: Thomson Financial; Federal Reserve

	STOCK MARKET PERFORMANCE INDICES (End of Period)				STOCK MARKET VOLUME (Daily Avg., Mils. of Shs.)			VALUE TRADED (Daily Avg., $ Bils.)	
	Dow Jones Industrial Average	S&P 500	NYSE Composite	Nasdaq Composite	NYSE	AMEX	Nasdaq	NYSE	Nasdaq
1985	1,546.67	211.28	1,285.66	324.93	109.2	8.3	82.1	3.9	0.9
1986	1,895.95	242.17	1,465.31	348.83	141.0	11.8	113.6	5.4	1.5
1987	1,938.83	247.08	1,461.61	330.47	188.9	13.9	149.8	7.4	2.0
1988	2,168.57	277.72	1,652.25	381.38	161.5	9.9	122.8	5.4	1.4
1989	2,753.20	353.40	2,062.30	454.82	165.5	12.4	133.1	6.1	1.7
1990	2,633.66	330.22	1,908.45	373.84	156.8	13.2	131.9	5.2	1.8
1991	3,168.83	417.09	2,426.04	586.34	178.9	13.3	163.3	6.0	2.7
1992	3,301.11	435.71	2,539.92	676.95	202.3	14.2	190.8	6.9	3.5
1993	3,754.09	466.45	2,739.44	776.80	264.5	18.1	263.0	9.0	5.3
1994	3,834.44	459.27	2,653.37	751.96	291.4	17.9	295.1	9.7	5.8
1995	5,117.12	615.93	3,484.15	1,052.13	346.1	20.1	401.4	12.2	9.5
1996	6,448.27	740.74	4,148.07	1,291.03	412.0	22.1	543.7	16.0	13.0
1997	7,908.25	970.43	5,405.19	1,570.35	526.9	24.4	647.8	22.8	17.7
1998	9,181.43	1,229.23	6,299.93	2,192.69	673.6	28.9	801.7	29.0	22.9
1999	11,497.12	1,469.25	6,876.10	4,069.31	808.9	32.7	1,081.8	35.5	43.7
2000	10,786.85	1,320.28	6,945.57	2,470.52	1,041.6	52.9	1,757.0	43.9	80.9
2001	10,021.50	1,148.08	6,236.39	1,950.40	1,240.0	65.8	1,900.1	42.3	44.1
2002	8,341.63	879.82	5,000.00	1,335.51	1,441.0	63.7	1,752.8	40.9	28.8
2003	10,453.92	1,111.92	6,440.30	2,003.37	1,398.4	67.1	1,685.5	38.5	28.0
2003									
Jan	8,053.81	855.70	4,868.68	1,320.91	1,474.7	62.9	1,547.6	37.5	24.7
Feb	7,891.08	841.15	4,716.07	1,337.52	1,336.4	53.6	1,311.4	32.8	20.4
Mar	7,992.13	848.18	4,730.21	1,341.17	1,439.3	64.7	1,499.9	36.3	23.0
Apr	8,480.09	916.92	5,131.56	1,464.31	1,422.7	54.7	1,478.2	37.1	23.5
May	8,850.26	963.59	5,435.37	1,595.91	1,488.6	69.6	1,847.9	39.2	27.4
June	8,985.44	974.50	5505.17	1,622.80	1,516.3	79.5	2,032.2	42.7	32.0
July	9,233.80	990.31	5,558.99	1,735.02	1,451.1	67.4	1,771.7	40.7	30.5
Aug	9,415.82	1,008.01	5,660.16	1,810.45	1,200.3	57.7	1,470.8	34.1	25.3
Sept	9,275.06	995.97	5,644.03	1,786.94	1,436.7	83.9	1,943.2	41.1	33.0
Oct	9,801.12	1,050.71	5,959.01	1,932.21	1,430.0	68.6	1,827.1	41.7	33.1
Nov	9,782.46	1,058.20	6,073.02	1,960.26	1,293.3	71.7	1,821.0	38.5	32.4
Dec	10,453.92	1,111.92	6,440.30	2,003.37	1,275.7	70.4	1,637.0	38.9	29.7
2004									
Jan	10,488.07	1,131.13	6,551.63	2,066.15	1,663.1	79.8	2,331.7	50.3	40.9
Feb	10,583.92	1,144.94	6,692.37	2,029.82	1,481.2	75.5	1,917.2	46.3	36.5
Mar	10,357.70	1,126.21	6,599.06	1,994.22	1,477.5	76.7	1,880.6	47.1	34.9
Apr	10,225.57	1,107.30	6,439.42	1,920.15	1,524.7	78.3	1,950.8	49.0	37.3
May									
June									
July									
Aug									
Sept									
Oct									
Nov									
Dec									
YTD '03	8,480.09	916.92	5,131.56	1,464.31	1,420.3	59.1	1,462.9	36.0	23.0
YTD '04	10,225.57	1,107.30	6,439.42	1,920.15	1,535.0	77.6	2,015.4	48.2	37.3
% Change	20.6%	20.8%	25.5%	31.1%	8.1%	31.3%	37.8%	33.9%	62.4%

MUTUAL FUND ASSETS

($ Billions)

	Equity	Hybrid	Bond	Money Market	**TOTAL ASSETS**
1985	116.9	12.0	122.6	243.8	495.4
1986	161.4	18.8	243.3	292.2	715.7
1987	180.5	24.2	248.4	316.1	769.2
1988	194.7	21.1	255.7	338.0	809.4
1989	248.8	31.8	271.9	428.1	980.7
1990	239.5	36.1	291.3	498.3	1,065.2
1991	404.7	52.2	393.8	542.5	1,393.2
1992	514.1	78.0	504.2	546.2	1,642.5
1993	740.7	144.5	619.5	565.3	2,070.0
1994	852.8	164.5	527.1	611.0	2,155.4
1995	1,249.1	210.5	598.9	753.0	2,811.5
1996	1,726.1	252.9	645.4	901.8	3,526.3
1997	2,368.0	317.1	724.2	1,058.9	4,468.2
1998	2,978.2	364.7	830.6	1,351.7	5,525.2
1999	4,041.9	383.2	808.1	1,613.1	6,846.3
2000	3,962.0	346.3	811.1	1,845.2	6,964.7
2001	3,418.2	346.3	925.1	2,285.3	6,975.0
2002	2,667.0	327.4	1,124.9	2,272.0	6,391.3
2003	3,684.8	436.7	1,240.9	2,051.7	7,414.1
2003					
Jan	2,597.7	324.7	1,138.2	2,273.6	6,334.2
Feb	2,537.8	322.9	1,171.1	2,236.2	6,268.0
Mar	2,551.3	325.3	1,183.3	2,204.7	6,264.6
Apr	2,770.3	346.8	1,210.5	2,157.7	6,485.3
May	2,958.5	365.8	1,238.7	2,140.6	6,703.6
June	3,031.1	373.6	1,248.4	2,164.4	6,817.5
July	3,126.0	376.4	1,212.1	2,152.5	6,867.0
Aug	3,238.5	382.3	1,209.4	2,141.0	6,971.2
Sept	3,228.5	388.2	1,231.3	2,100.0	6,948.0
Oct	3,440.4	405.9	1,226.6	2,080.1	7,153.0
Nov	3,513.3	416.4	1,232.7	2,071.7	7,234.1
Dec	3,684.8	436.7	1,240.9	2,051.7	7,414.1
2004					
Jan	3,805.1	447.8	1,249.9	2,034.3	7,537.1
Feb	3,896.3	458.6	1,262.4	2,016.6	7,633.9
Mar	3,886.8	455.8	1,278.6	2,006.4	7,627.6
Apr					
May					
June					
July					
Aug					
Sept					
Oct					
Nov					
Dec					
YTD '03	2,551.3	325.3	1,183.3	2,204.7	6,264.6
YTD '04	3,886.8	455.8	1,278.6	2,006.4	7,627.6
% Change	52.3%	40.1%	8.1%	-9.0%	21.8%

MUTUAL FUND NET NEW CASH FLOW*

($ Billions)

	Equity	Hybrid	Bond	Money Market	**TOTAL**	Total Long-Term Funds
1985	8.5	1.9	63.2	-5.4	68.2	73.6
1986	21.7	5.6	102.6	33.9	163.8	129.9
1987	19.0	4.0	6.8	10.2	40.0	29.8
1988	-16.1	-2.5	-4.5	0.1	-23.0	-23.1
1989	5.8	4.2	-1.2	64.1	72.8	8.8
1990	12.8	2.2	6.2	23.2	44.4	21.2
1991	39.4	8.0	58.9	5.5	111.8	106.3
1992	78.9	21.8	71.0	-16.3	155.4	171.7
1993	129.4	39.4	73.3	-14.1	228.0	242.1
1994	118.9	20.9	-64.6	8.8	84.1	75.2
1995	127.6	5.3	-10.5	89.4	211.8	122.4
1996	216.9	12.3	2.8	89.4	321.3	232.0
1997	227.1	16.5	28.4	102.1	374.1	272.0
1998	157.0	10.2	74.6	235.3	477.1	241.8
1999	187.7	-12.4	-5.5	193.6	363.4	169.8
2000	309.4	-30.7	-49.8	159.6	388.6	228.9
2001	31.9	9.5	87.7	375.6	504.8	129.2
2002	-27.7	8.6	140.3	-46.7	74.5	121.2
2003	151.4	33.3	31.3	-258.5	-42.5	216.1
2003						
Jan	-0.3	1.1	12.9	-1.1	12.6	13.7
Feb	-10.9	0.1	19.6	-39.5	-30.7	8.8
Mar	0.0	0.9	10.5	-32.3	-20.9	11.4
Apr	16.1	2.7	10.5	-53.8	-24.4	29.4
May	11.9	3.1	8.9	-17.8	6.1	23.9
June	18.6	4.0	5.1	22.1	49.9	27.7
July	21.4	3.5	-10.8	-12.9	1.2	14.1
Aug	23.4	3.3	-12.6	-20.3	-6.1	14.2
Sept	17.3	3.7	-5.9	-50.5	-35.3	15.1
Oct	25.3	4.1	-1.3	-22.1	6.0	28.1
Nov	14.9	3.0	-2.6	-7.6	7.8	15.3
Dec	14.2	3.6	-3.3	-22.6	-8.1	14.6
2004						
Jan	43.0	5.5	-0.3	-19.8	28.4	48.2
Feb	26.2	5.0	1.5	-21.0	11.8	32.8
Mar	15.8	4.8	7.7	-10.9	17.4	28.3
Apr						
May						
June						
July						
Aug						
Sept						
Oct						
Nov						
Dec						
YTD '03	-11.1	2.1	43.0	-72.9	-39.0	34.0
YTD '04	85.0	15.3	8.9	-51.6	57.6	109.2
% Change	NM	645.6%	-79.4%	NM	NM	221.7%

* New sales (excluding reinvested dividends) minus redemptions, combined with net exchanges
Source: Investment Company Institute

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