# FED[ucation]

*Federal Reserve Bank of St. Louis Annual Report 2005*

*How the Federal Reserve Bank of St. Louis'*

ECONOMIC EDUCATION

*programs are shaping*

TODAY'S MINDS

*and*

TOMORROW'S ECONOMY

# CHAIRMAN'S [*message*]

*The Federal Reserve's mission of conducting monetary policy and maintaining a stable financial system depends upon the participation and support of an educated public.*

# [ *a message from the* ] CHAIRMAN

## Investing in Economic Education

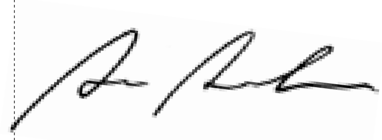
I am optimistic about the economic future of our nation. The prospects are excellent for continuing improvements in technology, increases in productivity, and innovations in banking and financial services—all of which bode well for our future standard of living. As we move forward, however, each and every American will face the challenge of making sound financial decisions in this extraordinarily complex economy. Sound financial decisions are critical not only to the prosperity and financial security of individuals, but also to the growth and efficiency of our overall economy.

Meeting the challenge of operating in today's economy is much easier if we have a working knowledge of how our economy functions and how it affects us. That is why economic education is such a critical component of the Federal Reserve's mission, as detailed in this 2005 annual report of the Federal Reserve Bank of St. Louis.

Economics affects every aspect of our lives. Each of us must understand how economics affects the decisions our government makes in order to participate fully in our democratic system as informed citizens and as informed voters. We must understand how economics affects the business world—especially if we choose careers in business and most especially if we take that bold step forward on our own as entrepreneurs. Ultimately, the most important reason to educate ourselves about economics and personal finance is to ensure that we make the right decisions to achieve financial security for ourselves and our loved ones.

The Federal Reserve's mission of conducting monetary policy and maintaining a stable financial system depends upon the participation and support of an educated public. Accomplishing this mission involves trade-offs and tough decisions. As the Fed pursues the monetary policy objectives that have been set out for us by Congress—to pursue price stability, maximum employment and moderate long-term interest rates—it is essential that the public understand our objectives and our actions. Educating the public about the reasoning behind our decisions helps build confidence in our economic system—another critical factor in keeping our economy running smoothly.

No matter what your age or educational background—whether you are a student, an entrepreneur, a homemaker or a professor—the Fed has resources to help you learn more about economics and to help you participate in the important national conversations we must have about these issues. In the end, I believe you will find that economic education is one of the best investments you can make for your own future and for the future of your family, your community and our nation. ■



Ben Bernanke
Chairman
Board of Governors of the
Federal Reserve System

# PRESIDENT'S [ *message* ]

*Today's minds will shape tomorrow's economy. Thus, education is one of the Federal Reserve's important missions.*

# [ *a message from the* ] PRESIDENT

## Economic Education: Our Commitment

When I left my previous career in higher education to become president of the Federal Reserve Bank of St. Louis, I moved into a job that carries with it an enormous responsibility. But in many ways, I took on just as much responsibility during my 25-plus years as an educator.

Teaching is about equipping people to make a difference in the world. The students learning now to read and write are the future authors and journalists. Those who are studying math and science today may be headed toward an engineering or biochemical career in adulthood. Today's students, no matter what they study, will be tomorrow's leaders in business and government, often with influence and responsibility that is worldwide in scope.

And what about teaching our students economics? Are we simply teaching a classroom of young people to debate the principles of supply and demand, or to analyze the benefits of price stability? In reality, there is a far greater purpose that lies at the heart of the St. Louis Fed's commitment to economic education, the subject of our 2005 annual report.

Economics, in its purest form, is about making decisions. Economics is the study of how people make sound choices. By studying how markets work, our young people also learn how to make efficient choices in managing their own scarce resources, such as time and money.

As this generation heads toward adulthood, the decisions people will have to make are becoming increasingly complex and difficult. As participants in a global economy, they will need the best tools we can provide to them to truly make informed choices. Given the Federal Reserve's own expertise, the Fed can be particularly helpful in fostering economic education to help people make good choices among a seemingly infinite array of financial services options, particularly in the face of the rapid growth of electronic payments. The Fed can also help to address the troublesome trends of low personal savings and increased accumulation of credit-card debt.

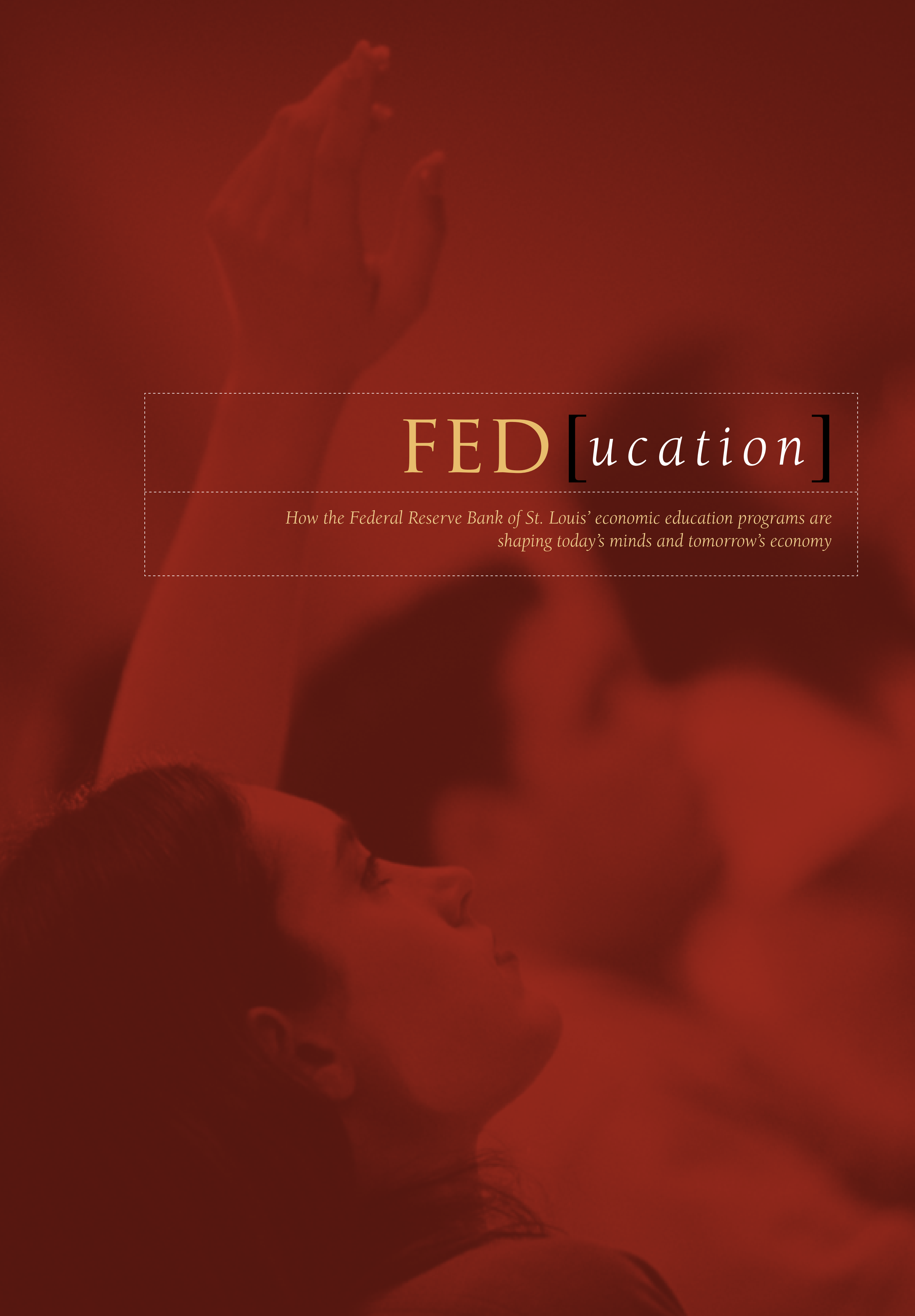
Economic education benefits the Fed, as well as the general public, by building support for the monetary policy actions we take. But the Fed's influence can only go so far. The true power of the free-market economy lies in the ability of our nation's citizens to make their own economic choices. That means teachers have enormous influence—and, therefore, responsibility—to provide young people with the knowledge they need to make informed, intelligent decisions now and in the future.

Throughout this annual report, you will read about the Fed's economic education programs, ranging from money and banking courses for teachers to our nationwide Fed Challenge competition that allows teenagers to step into the shoes of a monetary policymaker. Most important, you will hear from the folks who are on the front lines of this effort: the economic education experts who have devoted themselves to promoting this critical field of study; the teachers who have taken responsibility for shaping the economic minds of the future; and the students themselves who will be making these life-changing—and, in some cases, world-changing—decisions.

My hope is that reading their stories will not only entertain and inform you, but also persuade you of the critical importance of promoting economic education. In particular, if you're a parent or teacher reading this report, I hope you will be inspired to ask the tough but necessary questions of your educational institution: At what age are students learning about economics? How much economics is being taught? Are students really getting the economic background they need now to make the types of informed financial decisions they will face later in life?

Today's minds will shape tomorrow's economy. Thus, education is one of the Federal Reserve's important missions. We invite you to partner with us in continuing that mission in the years ahead. No less than our nation's economic future is at stake. ■

William Poole
President and CEO
Federal Reserve Bank
of St. Louis



# FED[ucation]

*How the Federal Reserve Bank of St. Louis' economic education programs are shaping today's minds and tomorrow's economy*

So, you're a typical, well-informed citizen, right? Ask yourself the following questions:

>> What does it mean to say that gross domestic product has increased?

>> What is a federal budget deficit?

>> What type of investment has the greatest risk of losing value due to inflation?

The answers, respectively, are:

>> The amount of final goods and services produced has increased.

>> The federal government's outlays for a year are greater than its revenue for that year.

>> Keeping your savings hidden as cash.

And if you got one or more answers wrong, don't feel bad. You have something in common with a majority of American adults, at least according to the National Council on Economic Education (NCEE), which asked these questions as part of a quiz included in its 2005 Standards in Economics Survey, given to 3,512 adults and 2,242 students.

Based on the results of the 20-question quiz, adults got an average grade of 70 (a C) for their knowledge of economics, while the average score of students was 53—a failing grade. In its executive summary of the survey, the NCEE remarked, "A majority of high school students do not understand basic concepts in economics."

Charles Wu, a senior at Marquette High School in west St. Louis County, Mo., isn't one of them.

## Taking the Fed Challenge

On an unseasonably warm afternoon in late January, while his classmates headed outdoors into the sunshine, Wu huddled in a classroom with five other students under the watchful eye of economics teacher Eva Johnston. Newspaper clippings were everywhere. Some of the students sat at computers, scrolling through web pages of economic data, while Wu and others used markers to add notes to an outline that already took up several pages of a giant flip pad.

It was a big day: In the final meeting conducted by outgoing Fed Chairman Alan Greenspan, the Federal Open Market Committee (FOMC) had just voted to again raise interest rates by one-quarter of a point, Wu and his classmates needed to decide what impact that action could have on the recommendation they would make if they were in the shoes of a monetary policymaker. They would be wearing those shoes in less than six weeks while they competed with other high school teams in the annual Fed Challenge event.

Fed Challenge, sponsored by the St. Louis Fed and other Reserve banks around the country, allows high school



CHARLES WU (CENTER) AND HIS MARQUETTE TEAMMATES ATTEND A FED CHALLENGE WORKSHOP SPONSORED BY THE FEDERAL RESERVE BANK OF ST. LOUIS.

students to take part in a mock FOMC meeting. They make a 15-minute presentation to a panel of judges and then spend an additional 15 minutes being questioned on their findings and recommendations on monetary policy.

The team that wins the St. Louis district competition heads to the national finals in Washington, D.C., where Wu doesn't need a tour guide. He and his classmates made the finals in each of his four years on the team, continuing Marquette's nine-year winning streak in the Eighth District competition.

Four for four is nice, but Wu is looking even further into his future as he ponders his career aspirations. "I'm planning to major in economics," he says. That's a far cry from how he felt when he first joined the team as a freshman on the recommendation of his math teacher, whose classroom is next door to Johnston's. "I really didn't know anything about economics," Wu says. "At the time, it was just something to do. There did come a point where I asked myself, 'What am I getting into?' Eventually, I built up my confidence."

EVA JOHNSTON


For every student like Charles Wu, however, there are many teenagers who won't learn enough about economics to gain that confidence—or even to acquire the knowledge they need to become a savvy adult in today's complex financial world. That fear—and the desire to make students like Wu the rule, rather than the exception—helps

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The students who participate in the Federal Reserve's Fed Challenge event each year have a chance to experience the real-life world of monetary policymaking. For Eli Wiseman, this experience became the springboard to a Federal Reserve job.

Wiseman, who participated on Marquette High School's Fed Challenge team during his senior year, is now a research associate at the Federal Reserve Bank of Kansas City. He assists the Kansas City Fed's director of research and its economists by gathering data, providing background information and helping to research monetary policy prior to the Federal Open Market Committee meetings.

Before joining Fed Challenge, "I had no interest in economics," Wiseman says. "I didn't even know what it was."

**Eli Wiseman** >> Research Associate, Federal Reserve Bank of Kansas City

Spurred on by Marquette economics teacher Eva Johnston, Wiseman got involved and found his economic knowledge transformed. "I think Fed Challenge was the first step toward the career that I ended up pursuing," he says.

Since then, Wiseman has found that his Fed Challenge experience has truly prepared him for real-world economics. "The thing I noticed after doing Fed Challenge was that I could actually understand some of these banking and financial programs that are on the news or in the Wall Street Journal," he says. "I think it's good to be informed both as a consumer and as someone in the business world—to know what the Fed is doing on a regular basis and to understand why they're doing it."


The St. Louis Fed offers a variety of economic education programs and resources.

*Some of the major economic education programs, conferences and publications offered by the Federal Reserve Bank of St. Louis include:*

**Annual Teachers Conference:** *Held at all four District offices, this conference focuses each year on a different topic that is of interest to teachers and students—and applies economic concepts to these topics. Previous conferences have dealt with the economics of the Great Depression, the economics of sports, and the issues surrounding the U.S. government's financial deficit and Social Security. The conference features presentations from District education specialists and St. Louis Fed Research economists as well as materials on how to share that topic in the classroom.*

**Professors Conference:** *This District-wide conference for college and university faculty (pictured above), held every February in St. Louis, has drawn increased interest in recent years. The main focus of each conference is the economic outlook, with faculty learning more about how to find and use the St. Louis Fed's economic data sources. An additional topic is covered each year, as well: The 2006 conference focused on economic relations between the United States and China.*

**Making Sense of Money and Banking:** *Elementary and secondary school teachers throughout the Eighth District are invited to attend this annual seven-day course in St. Louis to learn more about money and banking concepts, such as the difference between a stock and a bond, how the payments system works, how a bank creates money and what happens at an FOMC meeting. In addition to the lessons themselves, each day features a "How Do We Teach This?" segment, helping teachers apply the material in their classrooms.*

***Inside the Vault:*** *The St. Louis Fed publishes this economic education newsletter twice a year, with the content geared toward secondary school teachers and students. Each issue features an article adapted from one of the Fed's economic publications, such as* The Regional Economist *or* Review. *Also included are a question-and-answer segment on an economic topic and an "Economic Snapshot" explaining a current economic statistic in plain and simple terms, accompanied by a graphic.*

**Economic Education Essay Contest:** *Begun in 2004, the Eighth District's Essay Contest is open to students in grades 9-12 in each of the four District regions—St. Louis, Little Rock, Louisville and Memphis. The first-place student in each region wins a $500 savings bond. Topics vary each year. Last year's contest, titled "The Economics of Looking Good," asked students to weigh the trade-offs involved in spending money on new fashions and on enhancements to their appearance. The 2006 contest topic, "Finding Economics in Literature," asks students to discuss the economic principles and concepts they find in a novel of their choice.*

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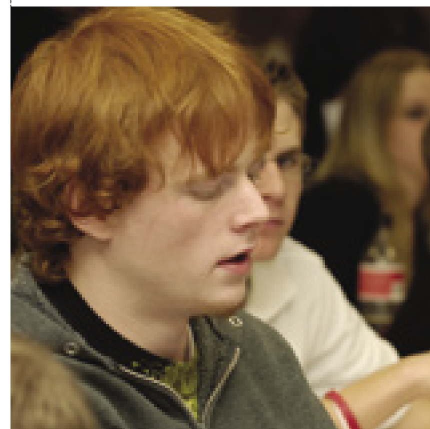
drive the passion of Dawn Griffitts, a former teacher who has managed the St. Louis Fed's economic education programs for more than 10 years.

"The Fed has the knowledge and the means to teach others about economics, and we certainly have a comparative advantage in teaching about the role of the Fed in the economy," says Griffitts. "If we don't get out and talk about economics and the Federal Reserve, who will?"

In this annual report, Griffitts and her St. Louis Fed co-workers join with economic education experts, teachers and students to share their thoughts on Fed Challenge and the many other St. Louis Fed courses and programs that promote economic education—and why shaping today's young minds is so critical to the Fed's economic mission of tomorrow.

## The Fed Enters the Classroom

The Eighth District has been a supporter of economic education for decades, hosting teacher meetings and providing expert speakers. That role became more proactive in the mid-1990s with the hiring of Griffitts, who began shaping a new direction for the program. The new direction



included providing economic education curriculum and lesson plans and instructing teachers in how to use those materials.

Today, teachers remain the primary target audience for the Fed's economic education programs. "Having been a teacher, I know that teachers teach what they know, and they don't teach what they don't know," Griffitts says. "If they don't understand economics, and they

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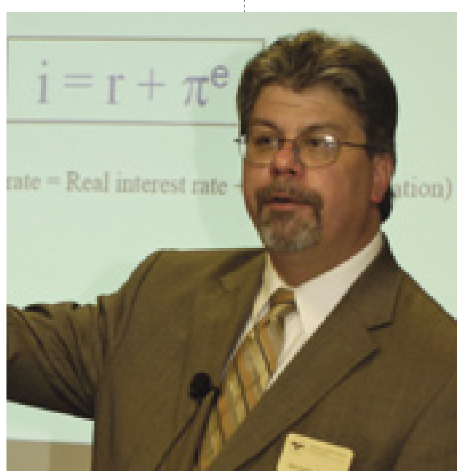
Last spring, when St. Louis Fed economist Mike Pakko traveled to Washington, D.C., for the weekend, he spent most of the time hunkered in a hotel room discussing economic data. He probably won't get much sightseeing done when he returns to the nation's capital this spring, either.

But Pakko considers that a small sacrifice compared with the hours of research and studying put in by his annual traveling companions—the winning team from the Eighth District Fed Challenge competition, representing the St. Louis Fed in D.C. at the national finals.

Since 1998, Pakko has served as a coach for the Eighth District high school teachers and students who participate in Fed Challenge, a national competition in which students take part in a mock Federal Open Market Committee (FOMC) meeting and make their own monetary policy recommendations.




**Mike Pakko** >> Research Economist, Federal Reserve Bank of St. Louis

Pakko joined the Fed in 1993. He helped initiate the Eighth District's Fed Challenge program after he heard about the New York Fed's involvement in the program.

Fed Challenge isn't the only educational endeavor on Pakko's resume; he teaches macroeconomics to college students at St. Louis University. The high school students he coaches for Fed Challenge compare favorably with their older counterparts, he says.

"These kids are definitely the cream of the crop," Pakko says. "And Fed Challenge is a great experience for them. They're getting practical insight into the world of economics by learning about the Federal Reserve. This isn't learning from textbooks; this is real life."

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don't understand issues, and they don't understand topics like the deficit and its impact on the economy, they're not going to talk about those subjects in the classroom."

And what happens in the classroom can have a ripple effect in society at large, as students grow up to be adult decision-makers, says St. Louis Fed Public Affairs Officer Joe Elstner.

"We have a democracy in which citizens make decisions, including economic decisions, based on the information they have," Elstner says. "But even people with plenty of education in the field of economics often don't really know the intricacies of monetary policy-making. At the Fed, that's an important function that we know the public needs to understand better."

The need for greater public understanding of economics in general and the Fed's monetary policy mission in particular is also apparent to economic education experts in the Eighth District, such as Mary Suiter, the director of the University of Missouri-St. Louis Center for Entrepreneurship and Economic Education.

"Both kids and adults have misconceptions about what the Fed is and what the Fed does," Suiter says. "Many believe the Fed is printing money and giving it to banks. What they hear and read through the media is sometimes inaccurate, too."

Suiter often works in tandem with another economic education specialist, Mary Anne Pettit, associate director of the Office of Economic Education and Business Research at Southern Illinois University in Edwardsville. They serve as advisers for Griffitts'

STUDENTS FROM BEAUMONT HIGH SCHOOL IN ST. LOUIS ATTEND A FED CHALLENGE WORKSHOP SPONSORED BY THE FEDERAL RESERVE BANK.

programs, helping her to shape curriculum and present material at events such as the economic education conference held throughout the District each fall and the "Making Sense of Money and Banking" course that takes place in St. Louis every summer.

"Society is not going to support and protect the Fed's role and its independence if they don't understand it," Pettit says. "That won't happen if they look at the Fed as a mysterious ivory tower. Our system works best if everyone understands how the Fed works and knows that they have a stake in the outcome."

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## The Fed's teacher advisory boards provide valuable input on economic education programs.

*Economics isn't a state requirement where Sam Rego teaches, at Butler Traditional High School in Louisville.*

*But the subject is an integral component of Rego's accounting classes—and by being a member of a St. Louis Fed teacher advisory board, Rego is helping to make economics the foundation of education in the Bluegrass State.*

*"It's a tough battle balancing between what the teachers are required to teach and what they want to teach," says Rego, "but it's easier to do that working with the Fed through its advisory boards."*

*Teacher advisory boards are a critical component of the Fed's economic education efforts, serving as the antennae for collecting input and opinions from teachers throughout the Eighth District.*

*Each advisory board is composed of approximately a dozen educators. (Some have businesspersons, as well.) The board's main function is to tell Federal Reserve education specialists what educators need, what works and what doesn't, and how educators and the Fed can better help each other.*

*Most board members are middle and high school teachers like Rego, because the bulk of the Fed's materials and assistance is geared toward those students. But some boards include a few primary and higher education teachers, such as Betty Evans, a second-grade teacher at Monticello Elementary School in Monticello, Ark.*

*"I think these advisory boards are one of the best things that could happen to spread the word to other educators that economics needs to be in the schools at all levels," says Evans. "It's especially critical now. With all the national emphasis on reading and math, we can't neglect the social studies, especially economics."*

*David Ballard, the St. Louis Fed's economic education specialist in the Louisville Branch, agrees, adding, "We'd never want the advice of these talented teachers to go to waste—they do this unpaid on their own time, after all—so, we make sure that we're doing everything we possibly can to help them advance economic education."*


BILLY BRITT (TOP RIGHT), ECONOMIC EDUCATION COORDINATOR AT THE ST. LOUIS FED'S LITTLE ROCK BRANCH, POSES WITH STUDENTS FROM LITTLE ROCK CATHOLIC HIGH SCHOOL FOR BOYS, WHICH WON THE BRANCH'S FED CHALLENGE AREA COMPETITION.

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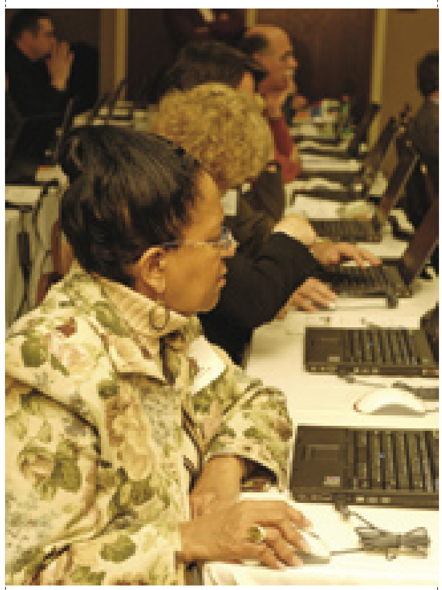
## "A Tremendous Resource for Teachers"

Coordinating a variety of publications and conferences throughout the year can be a tall order, particularly as the St. Louis Fed continues to add more economic education programs each year. Fortunately, Griffitts and her fellow economic education coordinators at the District branches have help.

For starters, they rely heavily on the advice, assistance and materials contributed by experts



MARY ANNE PETTIT

from state councils and centers on economic education, such as Suiter and Pettit. They also take advantage of the expertise of the Fed's own Research economists. In addition, they get a big boost from the District's teacher advisory boards—groups of teachers throughout the District's seven-state territory who meet with Fed staff regularly to share input on economic education programs.

"In all of our offices, we have contacts who can deliver hands-on activities that complement the raw knowledge we have available at the Fed from our economists," Griffitts says. "And our teacher advisory board members are wonderful in helping us to get ideas and to stay current with what's going on in the economic education field."

The Fed's courses, programs and materials are "a godsend" for teachers such as Peggy Pride of St. Louis University High School. She teaches advanced placement economics and relies heavily on the Fed's

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*Tom Zehnder doesn't go to many teacher education workshops. They remind him of a bad trip to the dentist.*

*"Just about all of them are about as fun as getting a root canal," says Zehnder, a long-time economics and history teacher at Trinity High School in Louisville and a part-time college professor. "They're painful. But the Fed workshops are different. I get so much out of them that I can use in the classroom."*

*The St. Louis Fed's annual teachers conference takes place in late summer or early fall. Teachers listen to Fed economists talk about the latest economic news. The economists encourage lots of discussion, and they bring plenty of handouts.*

*One year, after a guest economist complemented his talk with a PowerPoint presentation, Zehnder remembers photo-copying the PowerPoint and bringing it to a college classroom that evening—hot off the presses, so to speak.*

**Tom Zehnder** >> Economics and history teacher and part-time college professor at Trinity High School, University of Louisville and Bellarmine University, Louisville

*"One of the great things is that you're getting the latest information about international trade or monetary policy from an expert," Zehnder says. "The textbooks just can't do that."*

*Zehnder has attended the conference for several years. He likes that the information he gets is meaty enough not just for middle and high school students, but also for his college students at the University of Louisville and Bellarmine University.*

*Some lessons in economics, Zehnder confesses, can "bog down so much, it'd drive a saint mad." The Fed conference is not like that, he says. The economists offer real-life examples, not a bunch of theory. "It's practical," Zehnder says. "It's really good stuff."*

# Beyond the Classroom

## The St. Louis Fed's economic education specialists are connecting with teachers and organizations across the Eighth District.

St. Louis Fed Manager Dawn Griffitts has been sounding the charge for economic education for the past 10 years. In 2004, when the branch offices began changing their focus from financial services to public programs, Griffitts' efforts got a boost, with each branch hiring an economic education specialist: David Ballard in Louisville, Jeannette Bennett in Memphis and Billy Britt in Little Rock. Griffitts still covers the St. Louis zone and oversees the District's economic education efforts, working with branches on creating programs and contributing to the Federal Reserve System's initiatives.

"Teachers don't just stumble upon the Federal Reserve and our programs; we have to find them," Griffitts says. "Our three specialists are quite dedicated to that goal. Their past histories as educators give them a lot of credibility, which is a terrific asset when they meet with teachers."

To fulfill their mission, the three specialists:

- support District programs such as the annual teachers conference and the economic education essay contest;
- contribute to *Inside the Vault*, the District's economic education newsletter;
- host teacher economic education workshops;
- attend regional and national education conferences; and
- build contacts with teachers, organizations and state councils throughout their areas of responsibility.

Success is measured in how well they reach teachers. Since the expansion of the branch economic education programs in 2004, an increasing number of teachers have been using the District's resources, participating in workshops and signing up for the economic education mailing list, Griffitts says. "It shows that the Fed is fulfilling a need—and teachers are looking for what we're providing," she says.

To promote economic education—and to increase understanding of the Federal Reserve itself—the three specialists build contacts with teachers and educational organizations throughout their zones. Spreading the word involves more than holding workshops or passing out materials. It involves building contacts and relationships.

Ballard likes to get as creative as possible when talking to teachers, using such innovations as the Econ Café. Conceived as "the Starbucks of economic education," the Econ Café is a place where teachers can share resources and have meetings with Ballard. The cafes are located off-site from the Louisville Branch. They are operated by the Kentucky Council on Economic Education and funded by local businesses.

In the Memphis zone, Bennett plans to hold a third Mississippi statewide workshop in conjunction with the Atlanta Fed. "We work with other Reserve banks because, even though our boundaries cut through the middle of states, we're still dealing with the same situations as Chicago or Atlanta; so, it makes sense to pool resources with those banks," Bennett says.

The specialists also partner with as many state and teacher organizations as possible. For example, this year Britt will be presenting state banking history at an Arkansas history workshop in conjunction with the Arkansas Council on Economic Education. "Most everyone who attends these workshops or uses the materials is thrilled," Britt says. "One teacher even wished a workshop had been a full week."

Billy Britt, Little Rock

David Ballard, Louisville

Jeannette Bennett, Memphis

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publications, data, web sites and other materials.

"The Fed is a tremendous resource for teachers," she says. "If you are teaching any type or amount of economics in the classroom, there is just no way you won't benefit by relying on their materials."

Teachers like Pride are most grateful for not only the information that the Fed presents at its events and conferences, but also for the materials that help transform the subject matter into a classroom lesson for kids. "We give them lessons that they can literally take right back to school and plug into their teaching, usually with few changes," says Griffitts.

These events and resources educate teachers about not only the Fed and its mission, but also economics in general—a subject that, like the Fed itself, is often plagued by misunderstanding and misconceptions. With that bond in common, the Fed has joined forces with educators in a continuing campaign to persuade the public—and politicians—of the critical role of economics in school curriculums, even at the elementary level.

## Never Too Young to Learn

Say the word "economics" to a group of adults, and you're likely to inspire dreaded flashbacks of overhead projector slides and confusing line graphs. As a field of study, economics could use some PR help, Suiter admits.

"In general, economics gets a bad name," she says. "People think of it as just supply and demand charts. They ask us, 'How can you teach this to kids, and why do they need to know it?' My answer is that we're teaching kids how to make good decisions. We're teaching them that scarcity exists and that you can't have every-

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Sorry kids, but…

There is only so much ice cream in the world, and only so many factories that make it.

How to teach such lessons in scarcity to students is part of what teachers learn through the Arkansas Council on Economic Education, which hosts one-week workshops and other programs to help teachers in grades K-12 explain the economy to their students.

**Donna Wright >>** Associate Director, Arkansas Council on Economic Education, Little Rock

About 350 teachers in rural, urban and suburban school districts attend the workshops every year at one of six university-based Centers for Economic Education, says Donna Wright, associate director of the Arkansas Council.

"These are teachers who understand the value of teaching their students real-life skills," Wright says. "In kindergarten, you provide lessons that you can't have everything you want. As the students get older, the teachers talk about financial literacy, decision-making, entrepreneurship, and supply and demand."

High school students can compete in the Economics Challenge and test their knowledge of open markets, monetary policy and similar subjects. In the popular Stock Market game, students in grades 4-12 must make smart investment decisions as they manage hypothetical $100,000 portfolios.

"Students always want to know how they can apply what they're hearing in the classroom," Wright says. "In economics, they are learning financial literacy, how to keep a check record, the importance of investing and how to be a wise decision-maker today and tomorrow."

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thing you want. You have to prioritize and make choices.

"Economics provides a framework for making decisions. If more kids and adults had that framework, they would also make better political decisions and be more informed voters."

Most of the St. Louis Fed's programs are open to teachers at all levels, including elementary, middle and high school. Suiter and her co-workers at the UM-St. Louis center have developed programs for kids at every grade level, including a program for first- and second-graders called "Do a Zoo."

"Do a Zoo" invites children to bring in stuffed animals, classify them (as a fish, reptile or mammal) and choose which animals to include in a zoo display that will be attended by their classmates.

"In making choices, they're using economic decision-making and learning about opportunity cost and how to choose between scarce resources," says Suiter. "They also learn about capital resources when they set up the display."

At the elementary school level—and even when they're a few years older—kids have a tendency to believe that they can have everything, Pettit says.

"I don't think young people understand that

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ST. LOUIS FED ECONOMIC EDUCATION MANAGER DAWN GRIFFITTS (FOREGROUND) LEADS A TEACHER ADVISORY BOARD MEETING.

*The chess club is great. Varsity football gets the glory. But being on the Fed Challenge team, well, that's something extra-special.*

*"If you look at the time, dedication and the intellect that's required, it beats any activity on campus," says Camille Collins, an economics teacher at Germantown High School in suburban Memphis and an advisor to the school's Fed Challenge team.*

**Camille Collins >>** Economics teacher, Germantown High School, Memphis

*The students study, they do research and, then, at the annual Fed Challenge competition in the spring, they must answer complex questions about the economy.*

*A Fed economist asks the questions at the regional Challenge. St. Louis Bank President Bill Poole quizzes students at the Eighth District competition. So, the students better do their homework—and they do.*

*"We had one girl on our team, and this was amazing, but Dr. Poole asked her a question from a speech he had given earlier that week, and this girl recited the speech almost verbatim," Collins says.*

*Many of Collins' students major in economics in college. They certainly understand how important economics is in everyday life.*

*"Learning economics is one way to learn how to be a productive citizen," says Collins, who was honored as Tennessee's Economic Educator of the Year in 2001 by the University of Memphis' Department of Economics. "As for me, it helps me keep up with everything going on in the world."*

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you have to trade off and make choices," she says. "Studies show that kids have already made a lot of decisions by the time they get to sixth grade, such as what they're spending money on and what they're going to do. If you're going to make an impression on kids and their choices, you need to get to them early.

Simple programs such as "Do a Zoo" can get that lesson across in a fun and painless manner, Pettit says. "Sometimes we make things more complex than they are," she says. "You can't teach

monetary policy to second-graders, but you can teach opportunity cost. Taking economic concepts and making them simple is helpful for all of us. You're opening minds and turning lights on."

**Working Economics into the Classroom**

Even if teachers don't question the value of economics for young students, squeezing it into the curriculum presents more of a challenge. The old adage of "reading, 'riting and 'rithmetic" has taken on a new meaning in recent years. The U.S. government's No Child Left Behind Act of 2001 holds schools accountable for student test scores in reading and mathematics. President George W. Bush's recently announced American Competitiveness Initiative urges schools to focus more on math and science.

As a result, teachers are forced to focus on those areas at the expense of

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TEENAGERS LEARN ABOUT MANAGING PERSONAL FINANCES AT A ST. LOUIS FED *"YOUR PAYCHECK"* WORKSHOP IN QUINCY, ILL.

continued from Page 31

other subjects—such as economics, Suiter says. "So, if we want economics to be taught, our best hope is to find a relevant way to integrate it into the rest of the school curriculum."

At St. Louis Fed classes and conferences, teachers of economics-only usually find themselves in the minority, Griffitts says.

"We have social studies, history, government, business education, math and even some language arts teachers," Griffitts says.

For example, the St. Louis Fed's 2003 fall teachers conference focused on the economics of the Great Depression.

"We had lots of history teachers attend, many of whom had never heard the economic perspective on the Great Depression before," Griffitts says. "They had mostly heard only the historical perspective. We gave them another way to think about it and to teach it."

The annual Teach Children to Save Day event, in which volunteers from the Fed and community banks talk to elementary school children about the importance of personal savings, uses lessons based on children's books. This approach merges economics with reading.

In fact, economics can actually spice up other subjects for kids—rather than the other way around, Suiter says. "Kids are intrigued by money. If you can hook them by talking about money, you can infuse a lot more economics into the

material to improve their knowledge."

Integration of economics into other subjects is likely to remain the rule in American classrooms, with only about one-third of states requiring high school students to take economics. As a result, there is less incentive for districts to make room for pure economics classes on the schedule. There are some encouraging signs for the future, though. Illinois and Kentucky already require students to take a personal finance course prior to graduation. Mississippi and Arkansas both require a course to be offered. Missouri will now require high school students to earn a half-credit in personal finance, starting in fall 2006.



### Saving Our Future: Economics and Personal Finance

These new requirements are part of a growing trend among not just educators but community development experts, as well. Whether adults or children are the audience, educators are concerned about the lack of personal finance knowledge and skills, as evidenced by Americans' low rate of saving and high rate of credit-card debt and bankruptcy.

The Federal Reserve has taken a leading role in the personal finance education campaign, sponsoring programs for both adults and students and taking part in events such as Teach Children

*continued on Page 37*

ST. LOUIS FED RESEARCH DIRECTOR BOB RASCHE TALKS ABOUT THE FED'S ECONOMIC DATA SOURCES AT THE 2006 PROFESSORS CONFERENCE.

*The 105 high school seniors in Peggy Pride's advanced placement economics class at St. Louis University High School already have a strong background in social studies and history. They're ready to work hard and aim high in setting goals for their future—and to immerse themselves in the study of economics.*

**Peggy Pride** >> Advanced placement economics teacher, St. Louis University High School, St. Louis

*Pride has attended the St. Louis Fed's seminars and workshops and used the Fed's materials for more than a decade. She is a member of the teacher advisory board for the Fed's St. Louis office, helping to give feedback and make recommendations about economic education programs.*

*In October 2005, the Global Association of Teachers of Economics gave Pride its first-ever John Morton Teacher of the Year award.*

*The Fed's materials work for any level of economics and for any subject, whether it's history, social studies or government, Pride says. "You can tie all kinds of economic concepts to articles that appear in the Fed's publications."*

*And her students won't have to become economists to put those concepts into practice, she says.*

*"My major goal is to produce better citizens who are well-informed and have good thinking skills," Pride says. "Economics does that because it's about decision-making.*

*"You become a better voter and a better citizen in terms of what decisions you're making in the community, and you understand how your life is affected by your own personal decisions."*

# Life Lessons

As more adults struggle to manage their money, personal financial education for kids is a hot topic.

*Balancing a checkbook, opening a savings account and understanding a credit-card agreement are skills that are critical to adult success—but can be learned at a young age. These days, teachers are becoming more involved in introducing children to the world of personal finance.*

*"We can't assume that all children are taught practical economic skills; so, the responsibility often falls to public education to ensure kids learn those lessons," says St. Louis Fed Economic Education Manager Dawn Griffitts.*

*These days, unfortunately, the words of teachers might be a better guide than the example of adults. With debt at record-high levels and saving continuing to decline, personal financial education has become a hot issue not just in classrooms but also in communities. The Federal Reserve System took a high-profile role starting in 2002 when it rolled out "There's a Lot to Learn about Money," a national initiative to promote financial literacy and encourage more programs in schools and neighborhoods.*

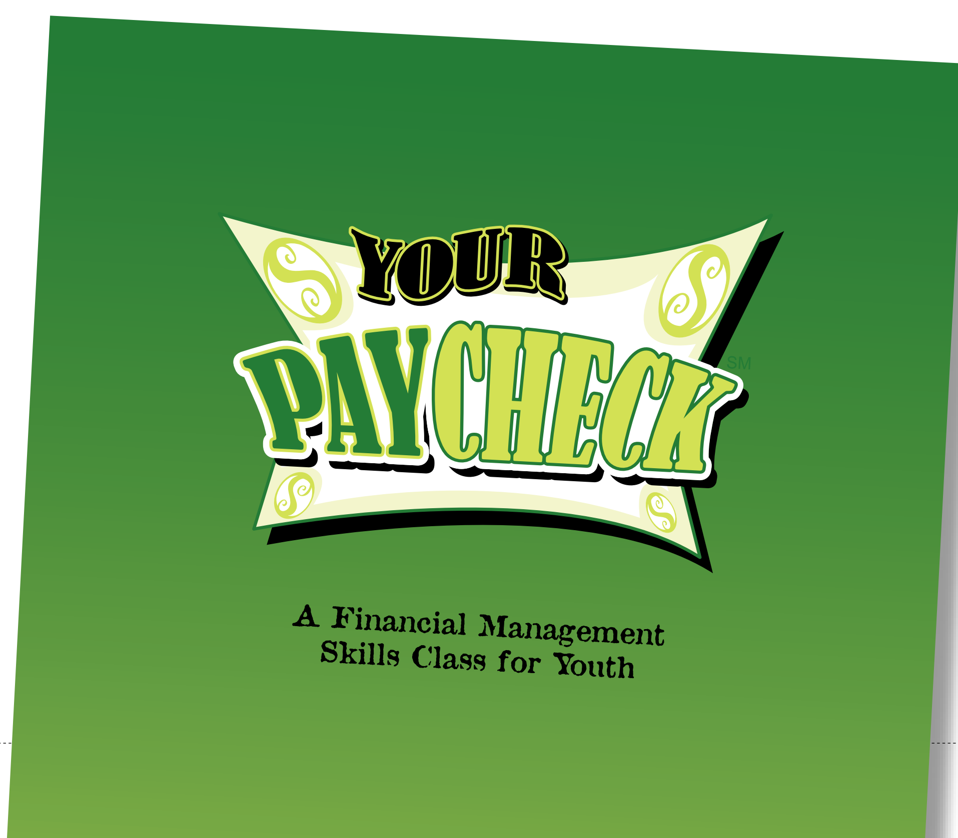
*Since then, the St. Louis Fed has stepped up its involvement in personal financial education in its own district, including efforts such as the following:*

- *The Fed joined the Teach Children to Save initiative, in which volunteers from banks visit area classrooms and talk with first-, second- and third-graders about budgeting, the importance of saving, recognizing needs and wants, and how interest makes money grow. The St. Louis Fed participated for the first time in 2005, with 46 employees visiting schools to talk to more than 2,300 kids, and will continue its involvement in 2006.*
- *St. Louis Fed employees helped to create and introduce the* Your Paycheck *program, a community initiative in which college student volunteers teach a two-hour course about managing personal finances to working teenagers who, in many cases, are earning their first regular paycheck. Fed employees created and produced the* Your Paycheck *curriculum and class materials and also trained college student volunteers from Quincy University in Quincy, Ill., and Culver-Stockton College in Canton, Mo.*
- *The St. Louis Fed's Community Affairs employees have launched adult personal financial education programs in cities throughout the District, covering topics ranging from getting out of debt to buying a home.*

*With financial services products and technology becoming more complex, the need for these programs will only increase in the future, says St. Louis Fed Community Affairs Officer Glenda Wilson.*

*"Our ultimate goal in supporting these programs," Wilson says, "is to ensure that kids and adults have the real-life skills they need to be knowledgeable consumers, responsible citizens and effective participants in the global economy."*





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to Save Day. "Personal finance is an application of economics," Griffitts says. "You have to make choices, and every choice you make incurs a cost. Clearly, that is the foundation for making good personal financial decisions."

Teaching children about saving money is taking on added urgency now given the mistakes adults have made, Suiter says, noting that the U.S. saving rate is now negative (with consumers spending $100.05 in 2005 for every $100 they made) for the first time since the Great Depression.

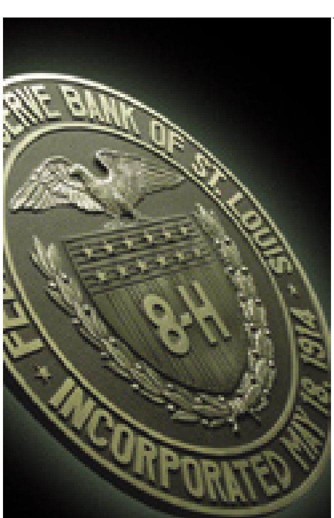
"You can't change the world in one day with one lesson, but we want to draw attention to the need to save," she says.

"The negative saving rate is a wake-up call: We have to help kids realize the importance of saving."

Ultimately, the key to successful economic education is to help students realize how it can improve not just the future of others, but their own economic outlook, says Pettit. Your next job, your career, fulfilling your lifelong dreams—all can revolve around the economic decisions you make.

"What we're hoping is that they will be more aware of the choices they're making and that life is a trade-off," Pettit says. "I'm not saying you have to have money to be happy, but with any path you choose, it's important to understand that you are making a choice and there is a cost. Economic education, done properly, makes that point." ■






## For more information:

• **on the St. Louis Fed's economic education programs:** *Go to our economic education web site at www.stlouisfed.org/education. Visit the "Teacher Resources" page to sign up for our economic education mailing list.*

• **on the Federal Reserve System's online economic education resources:** *Visit our economic education portal, www.federalreserveeducation.org. The site contains links to Fed publications, web sites and resources that can help educate the public about the Federal Reserve, economics and financial education.*

• **on the Fed's personal financial education resources:** *Visit our personal financial education site at www.federalreserveeducation.org/pfed/.*

# BOARDS [*of directors*]

# THANK YOU [ *retiring board members* ]

We bid farewell and express our gratitude to those members of the Eighth District boards of directors who retired in 2005. Our appreciation and best wishes go out to the following:

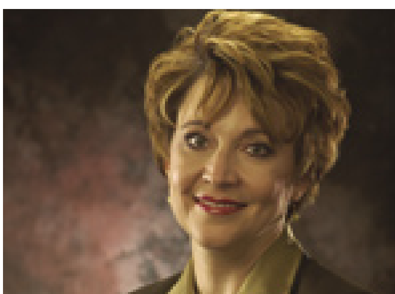
**Little Rock**
David R. Estes
Scott T. Ford

**Louisville**
Marjorie Z. Soyugenc

**Memphis**
James A. England

**St. Louis**
Lunsford W. Bridges
Gayle P.W. Jackson

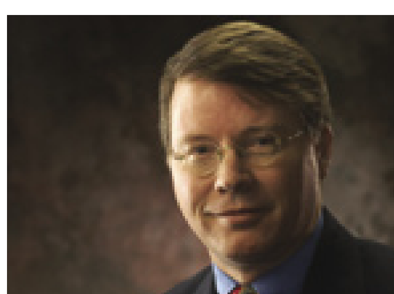
**Stephen M. Erixon**
CEO
Baxter Regional Medical Center
Mountain Home, Ark.



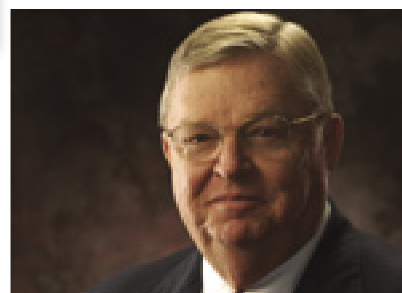


**Sonja Yates Hubbard**
*Chairman*

CEO
E-Z Mart Stores Inc.
Texarkana, Texas



**Phillip N. Baldwin**
President and CEO
Southern Bancorp
Arkadelphia, Ark.

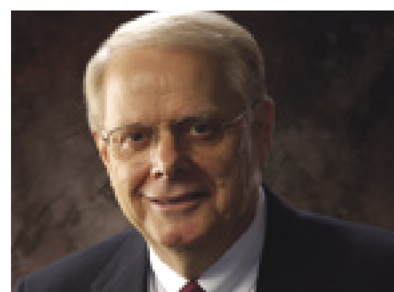


**Raymond E. Skelton**
Little Rock

**Robert A. Young III**
Chairman
Arkansas Best Corp.
Fort Smith, Ark.

**Sharon Priest**
Executive Director
The Downtown Partnership
Little Rock

**John L. Huber**
President and CEO
Louisville Water Co.
Louisville



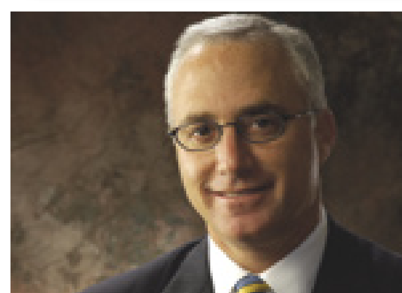


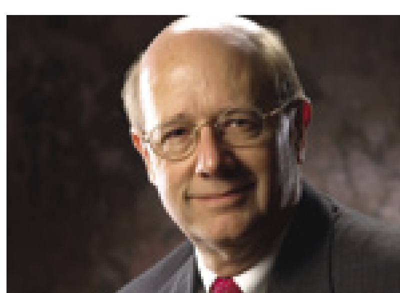
**Gordon B. Guess**
Chairman, President and CEO
The Peoples Bank
Marion, Ky.

**Cornelius A. Martin**
*Chairman*

President and CEO
Martin Management Group
Bowling Green, Ky.

**John Schroeder**
President
Wabash Plastics Inc.
Evansville, Ind.





**L. Clark Taylor Jr.**
CEO
Ephraim McDowell Health
Danville, Ky.

**Norman E. Pfau Jr.**
President and CEO
Geo. Pfau's Sons Co. Inc.
Jeffersonville, Ind.

**Steven E. Trager**
Chairman and CEO
Republic Bank & Trust Co.
Louisville

# [memphis] Board of Directors

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*Chairman*

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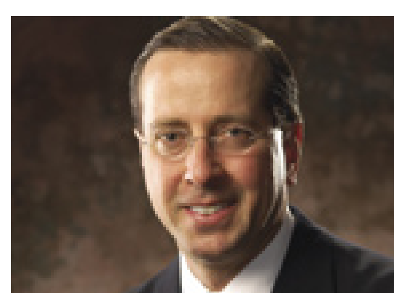
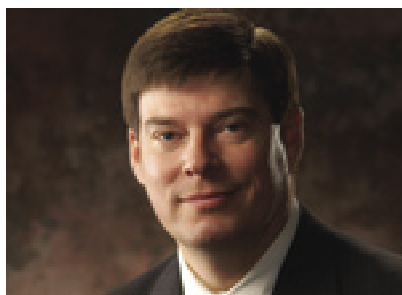
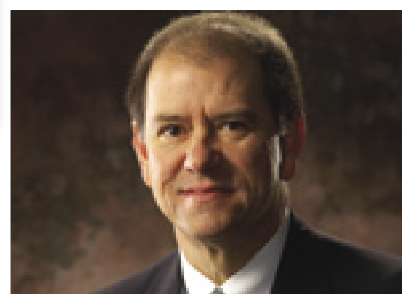
Gwatney Cos.
Memphis

**Meredith B. Allen**
Vice President, Marketing
Staple Cotton Cooperative Association
Greenwood, Miss.

**Levon Mathews**
President
Regions Bank
Memphis









**David P. Rumbarger Jr.**
President and CEO
Community Development Foundation
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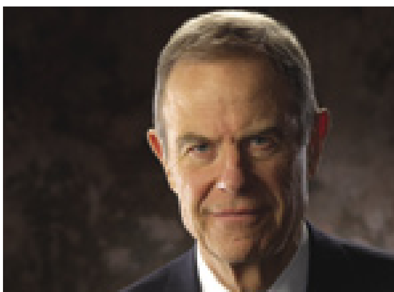
**Hunter Simmons**
President and CEO
First South Bank
Jackson, Tenn.

**Thomas G. Miller**
President
Southern Hardware Co. Inc.
West Helena, Ark.

# [st. louis] Board of Directors



**Walter L. Metcalfe Jr.**
*Chairman*

Partner
Bryan Cave LLP
St. Louis

**Irl F. Engelhardt**
*Deputy Chairman*

Chairman
Peabody Energy
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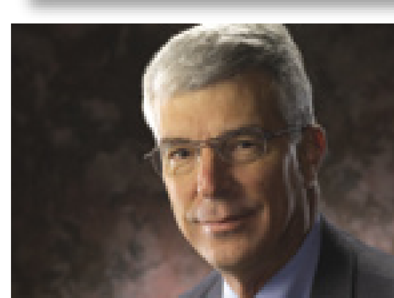
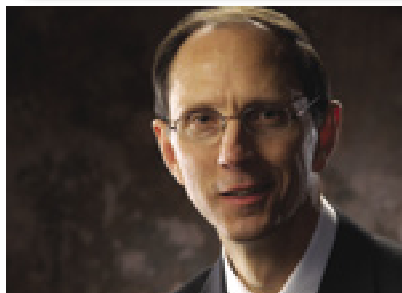
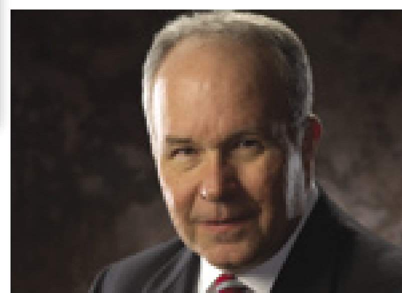
**Jay Fitzsimmons**
Senior Vice President of Finance
and Treasurer
Wal-Mart Stores Inc.
Bentonville, Ark.

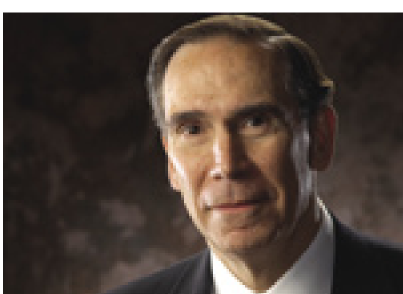






**J. Thomas May**
Chairman, President and CEO
Simmons First National Corp.
Pine Bluff, Ark.





**David R. Pirsein**
President and CEO
First National Bank in Pinckneyville
Pinckneyville, Ill.

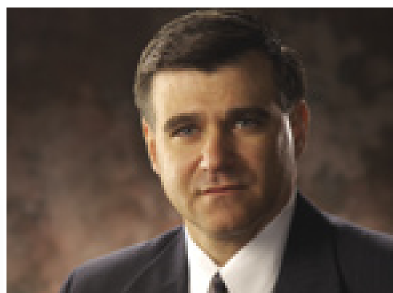
**A. Rogers Yarnell II**
President
Yarnell Ice Cream Co. Inc.
Searcy, Ark.

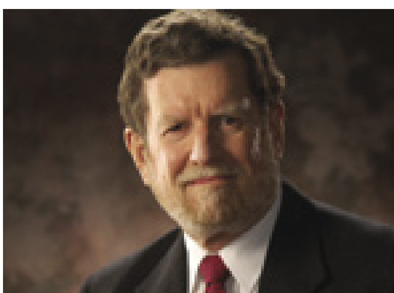
**Lewis F. Mallory Jr.**
Chairman and CEO
NBC Capital Corp.
Starkville, Miss.

# [st. louis] Management Committee

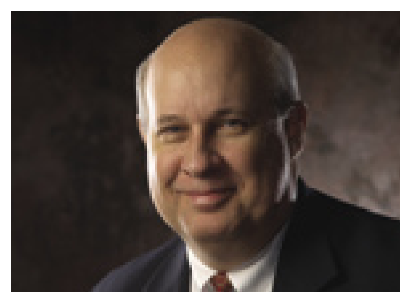
**Karl Ashman**
Senior Vice President

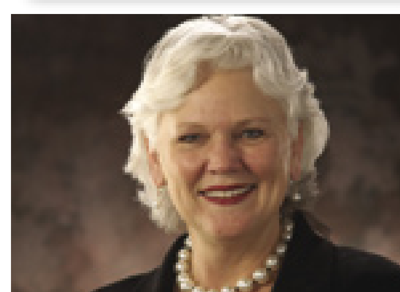
**Judie Courtney**
Senior Vice President







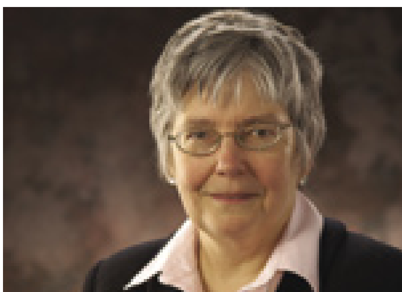


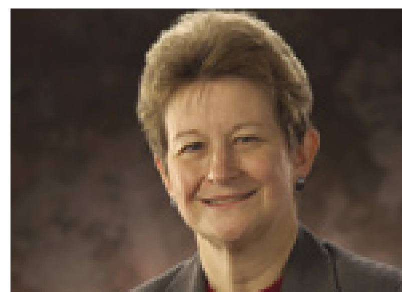


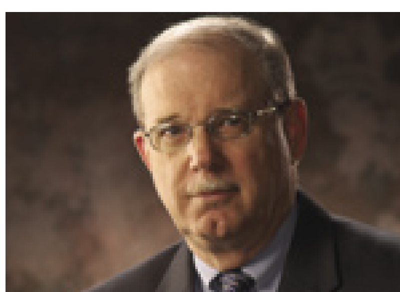
**Dave Sapenaro**
First Vice President
and COO

**William Poole**
President and CEO

**Robert Rasche**
Senior Vice President







**Mary Karr**
Senior Vice President

**Julie Stackhouse**
Senior Vice President

# [a message from] MANAGEMENT

For the Federal Reserve Bank of St. Louis, 2005 was a year marked by maintaining a standard of excellence in our day-to-day operations while also moving forward on some of the most important initiatives that are defining our present and our future.

The Treasury Relations and Support Office oversaw the successful completion of 24 of the Federal Reserve System's 25 Treasury-related key objectives for the year. One of the major success stories was the TRSO's launch of the national Go Direct campaign, focused on converting Social Security recipients to direct deposit.

The District's Branching Out initiative maintained and improved upon its 2004 success, with an increase in programs and attendance as the District continued its focus on community affairs, economic education, regional research and monetary policy in our branch cities.

The St. Louis check operation performed well, and significant progress was made in stabilizing the Memphis check operation after the office absorbed the Little Rock check volume in late 2004. The new Little Rock cash depot performed extremely well during its first full year of operation. Our Memphis office provided key contingency support to the New Orleans office as a "buddy branch" in the aftermath of Hurricane Katrina, providing paying and receiving services to the Sixth District via extended hours and weekend operations.

Our employees continued to focus on four Bank-wide initiatives begun in 1999-2000 to improve our performance and build our capability to do more in the future: risk management, customer service, staff development and employee communications. In addition, the Bank launched an organizational initiative in 2005 to improve innovation, with training and tools provided to employees to encourage a more innovative climate.

What follows are highlights of the District's 2005 accomplishments:

**Financial Services**

>> Exceeded its revenue target by $3.6 million, or 10.7 percent.

>> Check 21 activity grew significantly throughout the year, and the District was the first in the Federal Reserve System to implement the entire Check 21 product suite.

>> Successfully assumed volume from the Atlanta Treasury Check site as part of a consolidation that is projected to save the Treasury $600,000.

**U.S. Treasury Support**

>> Implemented 11 application releases on the Treasury Web Application Infrastructure (TWAI) and an additional five releases on other platforms outside the TWAI.

>> The Treasury more than doubled the amount of funds invested through the Term Investment Option program over the previous fiscal year, earning an additional $19.2 million over what would have been earned had the funds been invested in the Treasury Tax and Loan program.

**Public Affairs and Community Affairs**

>> Community Affairs conducted 34 sponsored meetings, which included the finale of a community development speaker series in Little Rock, a Hispanic immigrant event in Louisville, a summit on accessing community development capital in St. Louis and a major conference in Memphis on entrepreneurship.

>> In economic education, St. Louis and the other three branch offices conducted or participated significantly in 62 conferences, workshops, training courses, presentations and other outreach events.
>> Conducted five economic forums, allowing President Bill Poole to interact with business and banking audiences throughout the District.
>> Helped create the Your Paycheck program to support financial literacy efforts. The program, delivered through a two-hour class taught by college students, covers financial information of interest to working teens.

**Research/Monetary Policy Performance**

>> The number of articles published by Research staff (or accepted for publication) was 58, up from 41 during 2004. In addition, staff economists finished 75 new working papers, up from 34 in 2004, with more than 30 additional articles revised from previous years.
>> Introduced the Archival FRED System (ALFRED), which helped contribute to a 40 percent increase in traffic on the division's web pages compared with the previous year. ALFRED provides historical data of series already available in FRED (Federal Reserve Economic Data).
>> The Business and Economic Research Group (BERG) held its first meeting in the spring. The papers from the meeting were published in a new web-only research journal titled *Regional Economic Development*.
>> Held a conference on education finance, in conjunction with the Weidenbaum Center of Washington University.

**Banking Supervision, Credit and Center for Online Learning**

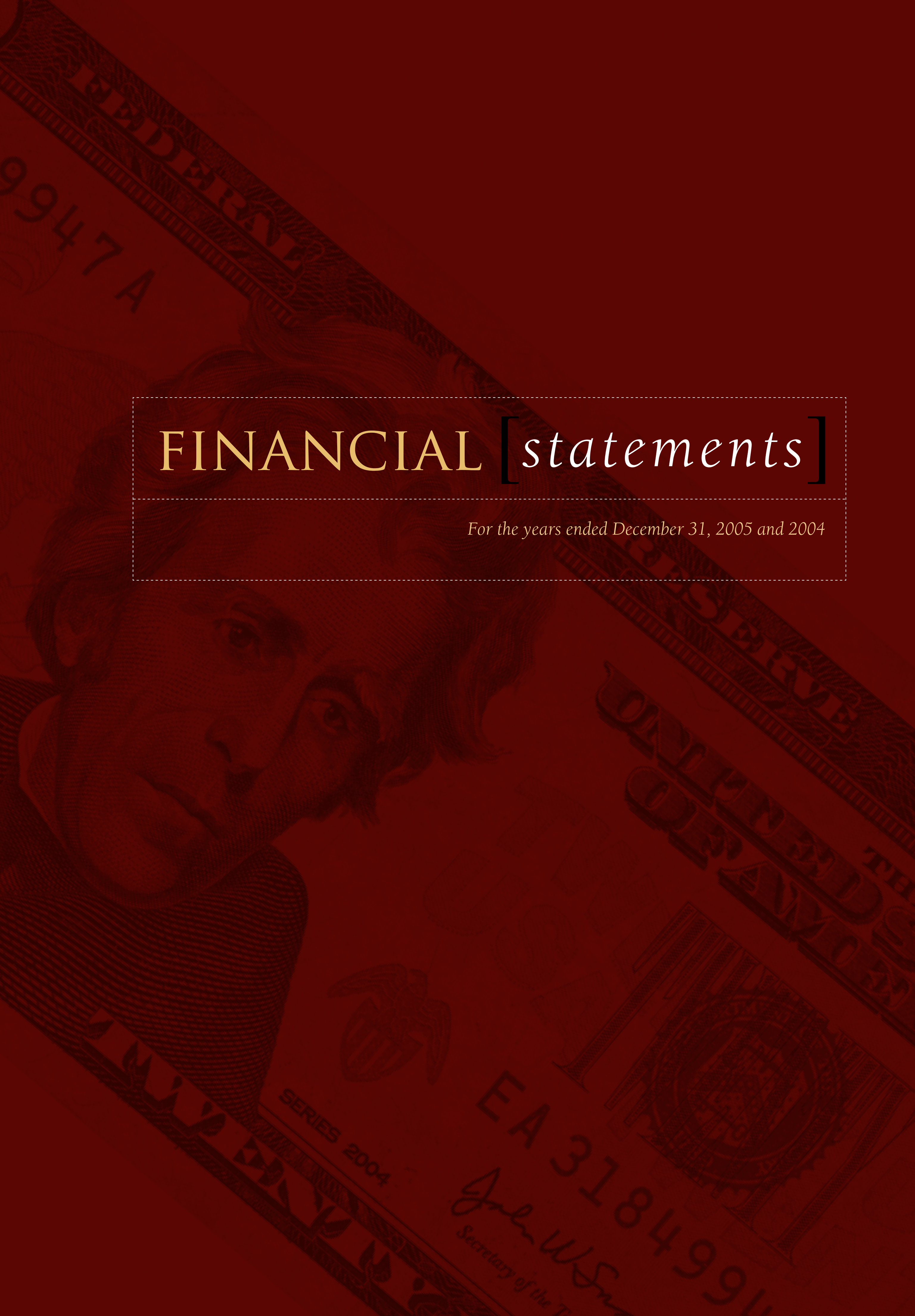
>> Successfully met all examination and inspection mandates and provided highly effective supervision of District state member banks and bank holding companies.
>> Consumer Affairs conducted all 36 mandated supervisory events in accordance with System requirements. All supervisory reports were processed and communicated to constituents in a timely manner—33 percent faster than System guidelines.
>> The Center for Online Learning provided eLearning consultation and development services to numerous business lines and also contributed significant leadership to a strategic effort to better align Supervision examiner training with changing business needs.

**Administrative Services**

>> Completed construction of the plaza and the new screening vestibule at the St. Louis office, as well as the design for the building addition in the second phase of the St. Louis remodeling project.
>> Constructed a new Protection command center.
>> Completed the renovation of the third floor of the Memphis branch.

**Organizational Initiatives**

>> Completed the rollout of the Enterprise Risk Management (ERM) initiative to nonfinancial reporting areas, with eight business areas assessing their risks using risk categories defined by the System's ERM work group.
>> Continued efforts through the Customer Service Program Office to sustain a service-oriented culture throughout the District, with all divisions exceeding customer service targets.
>> Continued the focus on leadership development by implementing a mentoring program and offering more leadership training. ■



# FINANCIAL [*statements*]

*For the years ended December 31, 2005 and 2004*

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2005 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled $4.6 million. To ensure auditor independence, the Board of Governors requires that PwC be independent in all matters relating to the audit. Specifically, PwC may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2005, the Bank did not engage PwC for any material advisory services.

**TO THE BOARD OF DIRECTORS:**

March 2, 2006

The management of the Federal Reserve Bank of St. Louis ("the Bank") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income and Statement of Changes in Capital as of December 31, 2005 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and as such, include amounts, some of which are based on judgments and estimates of management. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the Manual and include all disclosures necessary for such fair presentation. Also, we are not aware of any material fraud and any other fraud that, although not material, involves management or other employees who have a significant role in the Bank's internal control.

The management of the Bank is responsible for maintaining an effective process of internal controls over financial reporting, including the safeguarding of assets, as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well-designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the Bank assessed its process of internal controls over financial reporting, including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, we believe that the Bank maintained an effective process of internal controls over financial reporting, including the safeguarding of assets, as they relate to the Financial Statements.



Federal Reserve Bank of St. Louis

William Poole

**WILLIAM POOLE,**
President and Chief Executive Officer

David A. Sapenaro

**DAVID A. SAPENARO,**
First Vice President and Chief Operating Officer

Marilyn K. Corona

**MARILYN K. CORONA,**
Vice President, Chief Financial Officer

REPORT OF INDEPENDENT ACCOUNTANTS

**TO THE BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF ST. LOUIS:**

We have examined management's assertion, included in the accompanying Management Assertion, that the Federal Reserve Bank of St. Louis ("FRB St. Louis") maintained effective internal control over financial reporting and the safeguarding of assets as of December 31, 2005, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRB St. Louis' management is responsible for maintaining effective internal control over financial reporting and safeguarding of assets. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that FRB St. Louis maintained effective internal control over financial reporting and over the safeguarding of assets as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

This report is intended solely for the information and use of management and the Board of Directors and Audit Committee of FRB St. Louis, and any organization with legally defined oversight responsibilities, and is not intended to be and should not be used by anyone other than these specified parties.



PricewaterhouseCoopers LLP

March 8, 2006

St. Louis, Missouri

**TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM AND THE BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF ST. LOUIS:**

We have audited the accompanying statements of condition of the Federal Reserve Bank of St. Louis (the "Bank") as of December 31, 2005 and 2004, and the related statements of income and changes in capital for the years then ended, which have been prepared in conformity with the accounting principles, policies and practices established by the Board of Governors of the Federal Reserve System. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 3, these financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the Financial Accounting Manual for Federal Reserve Banks and constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2005 and 2004, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 8, 2006
St. Louis, Missouri

## STATEMENTS OF CONDITION

*(in millions)*

| | As of December 31, | |
|---|---|---|
| | 2005 | 2004 |
| **ASSETS** | | |
| Gold certificates | $ 327 | $ 325 |
| Special drawing rights certificates | 71 | 71 |
| Coin | 43 | 36 |
| Items in process of collection | 216 | 348 |
| Loans to depository institutions | - | 2 |
| U.S. government securities, net | 23,279 | 21,317 |
| Investments denominated in foreign currencies | 379 | 551 |
| Accrued interest receivable | 181 | 149 |
| Interdistrict settlement account | 2,010 | 1,401 |
| Bank premises and equipment, net | 87 | 85 |
| Other assets | 54 | 41 |
| **TOTAL ASSETS** | $ 26,647 | $ 24,326 |
| **LIABILITIES AND CAPITAL** | | |
| Liabilities: | | |
| Federal Reserve notes outstanding, net | $ 24,602 | $ 22,187 |
| Securities sold under agreements to repurchase | 947 | 904 |
| Deposits: | | |
| Depository institutions | 482 | 479 |
| Other deposits | 3 | 3 |
| Deferred credit items | 151 | 197 |
| Interest on Federal Reserve notes due U.S. Treasury | 106 | 21 |
| Accrued benefit costs | 57 | 54 |
| Other liabilities | 11 | 9 |
| **TOTAL LIABILITIES** | 26,359 | 23,854 |
| Capital: | | |
| Capital paid-in | 144 | 236 |
| Surplus | 144 | 236 |
| **TOTAL CAPITAL** | 288 | 472 |
| **TOTAL LIABILITIES AND CAPITAL** | $ 26,647 | $ 24,326 |

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

FEDERAL RESERVE BANK OF ST. LOUIS

**STATEMENTS OF INCOME**

*(in millions)*

| | As of December 31, 2005 | As of December 31, 2004 |
|---|---|---|
| Interest income: | | |
| Interest on U.S. government securities | $ 861 | $ 657 |
| Interest on investments denominated in foreign currencies | 6 | 7 |
| Interest on loans to depository institutions | 1 | - |
| **TOTAL INTEREST INCOME** | 868 | 664 |
| Interest expense: | | |
| Interest expense on securities sold under agreements to repurchase | 25 | 9 |
| **NET INTEREST INCOME** | 843 | 655 |
| Other operating income: | | |
| Income from services | - | 40 |
| Compensation received for check services provided | 22 | - |
| Reimbursable services to government agencies | 112 | 91 |
| Foreign currency (losses) gains, net | (57) | 31 |
| Other income | 3 | 2 |
| **TOTAL OTHER OPERATING INCOME** | 80 | 164 |
| Operating expenses: | | |
| Salaries and other benefits | 89 | 82 |
| Occupancy expense | 10 | 9 |
| Equipment expense | 7 | 9 |
| Assessments by the Board of Governors | 22 | 23 |
| Other expenses | 103 | 86 |
| **TOTAL OPERATING EXPENSES** | 231 | 209 |
| Net income prior to distribution | $ 692 | $ 610 |
| Distribution of net income: | | |
| Dividends paid to member banks | $ 16 | $ 13 |
| Transferred (from)/to surplus | (92) | 8 |
| Payments to U.S. Treasury as interest on Federal Reserve notes | 768 | 589 |
| **TOTAL DISTRIBUTION** | $ 692 | $ 610 |

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



FEDERAL RESERVE BANK OF ST. LOUIS

**STATEMENTS OF CHANGES IN CAPITAL**

*for the years ended December 31, 2005, and December 31, 2004*

*(in millions)*

| | CAPITAL PAID-IN | SURPLUS | TOTAL CAPITAL |
|---|---|---|---|
| Balance at January 1, 2004 | | | |
| (4.6 million shares) | $ 228 | $ 228 | $ 456 |
| Transferred to surplus | | 8 | 8 |
| Net change in capital stock issued | | | |
| (0.1 million shares) | 8 | | 8 |
| Balance at December 31, 2004 | | | |
| (4.7 million shares) | $ 236 | $ 236 | $ 472 |
| Transferred from surplus | | (92) | (92) |
| Net change in capital stock redeemed | | | |
| (1.8 million shares) | (92) | | (92) |
| Balance at December 31, 2005 | | | |
| (2.9 million shares) | $ 144 | $ 144 | $ 288 |

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

NOTE 1

### STRUCTURE

The Federal Reserve Bank of St. Louis ("Bank") is part of the Federal Reserve System ("System") and one of the twelve Reserve Banks ("Reserve Banks") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act"), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate and central bank characteristics. The Bank and its branches in Little Rock, Louisville and Memphis serve the Eighth Federal Reserve District, which includes Arkansas, and portions of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee.

In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a Board of Directors. The Federal Reserve Act specifies the composition of the Board of Directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Banks that are members of the System include all national banks and any state-chartered banks that apply and are approved for membership in the System. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

The System also consists, in part, of the Board of Governors of the Federal Reserve System ("Board of Governors") and the Federal Open Market Committee ("FOMC"). The Board of Governors, an independent federal agency, is charged by the Federal Reserve Act with a number of specific duties, including general supervision over the Reserve Banks. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY") and, on a rotating basis, four other Reserve Bank presidents.



NOTE 2

### OPERATIONS AND SERVICES

The System performs a variety of services and operations. Functions include formulating and conducting monetary policy; participating actively in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations and check processing; distributing coin and currency; performing fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies, state member banks and U.S. offices of foreign banking organizations; and administering other regulations of the Board of Governors. The System also provides certain services to foreign central banks, governments and international official institutions.

The FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY for its execution of transactions. FRBNY is authorized to conduct operations in domestic markets, including direct purchase and sale of U.S. government securities, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. FRBNY executes these open market transactions and holds the resulting securities, with the exception of securities purchased under agreements to resell, in the portfolio known as the System Open Market Account ("SOMA").

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. The FRBNY is authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange ("F/X") and securities contracts for nine foreign currencies, and to invest such foreign currency holdings, ensuring adequate liquidity is maintained. In addition, FRBNY is authorized to maintain reciprocal currency arrangements ("F/X swaps") with two central banks, and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks. In connection with its foreign currency activities, FRBNY may enter into contracts that contain varying degrees of off-balance-sheet market risk, because they represent contractual commitments involving future settlement and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits and performing daily monitoring procedures.

Although Reserve Banks are separate legal entities, in the interests of greater efficiency and effectiveness, they collaborate in the delivery of certain operations and services. The collaboration takes the form of centralized competency centers, operations sites, and product or service offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Bank providing the service and the other eleven Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, Reserve Banks are billed for services provided to them by another Reserve Bank.

Major services provided on behalf of the System by the Bank, for which the costs were not redistributed to the other Reserve Banks, include operation of the Treasury Relations and Support Office and the Treasury Relations and Systems Support Department, which provide services to the U.S. Treasury. These services include: relationship management, strategic consulting, and oversight for fiscal and payments related projects for the Federal Reserve System; and operational support for the Treasury's tax collection, cash management and collateral monitoring.

Beginning in 2005, the Reserve Banks adopted a new management model for providing check services to depository institutions. Under this new model, the Federal Reserve Bank of Atlanta ("FRBA") has the overall responsibility for managing the Reserve Banks' provision of check services and recognizes total System check revenue on its Statements of Income. FRBA compensates the other eleven Banks for the costs incurred to provide check services. This compensation is reported as "Compensation received for check services provided" in the Statements of Income. If the management model had been in place in 2004, the Bank would have reported $28 million as compensation received for check services provided, and $40 million in check revenue would have been reported by FRBA rather than the Bank.

NOTE 3

### SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the various accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared with the private sector. These accounting principles and practices are documented in the Financial Accounting Manual for Federal Reserve Banks ("Financial Accounting Manual"), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual, and the financial statements have been prepared in accordance with the Financial Accounting Manual.

Differences exist between the accounting principles and practices in the Financial Accounting Manual and those generally accepted in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all security holdings at amortized cost, rather than using the fair value presentation requirements in accordance with GAAP. Amortized cost more appropriately reflects the Bank's security holdings given its unique responsibility to conduct monetary policy. While the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct affect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding security and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate activities or policy decisions.

In addition, the Bank has elected not to present a Statement of Cash Flows because the liquidity and cash position of the Bank are not a primary concern, given the Bank's unique powers and responsibilities. A Statement of Cash Flows, therefore, would not provide any additional meaningful information. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Changes in Capital. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Unique accounts and significant accounting policies are explained below.

**A. GOLD AND SPECIAL DRAWING RIGHTS CERTIFICATES**

The Secretary of the U.S. Treasury is authorized to issue gold and special drawing rights ("SDR") certificates to the Reserve Banks.

Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged, and the Reserve Banks' gold certificate accounts are lowered. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year. There were no SDR transactions in 2005 or 2004.

**B. LOANS TO DEPOSITORY INSTITUTIONS**

All depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in regulations issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Bank. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve Bank, subject to review by the Board of Governors.

**C. U.S. GOVERNMENT SECURITIES AND INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES**

U.S. government securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis. Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency (losses) gains, net."



Activity related to U.S. government securities, including the related premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings that occurs in April of each year. The settlement equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments in foreign-currency-denominated assets is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

**D. U.S. GOVERNMENT SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND SECURITIES LENDING**

Securities sold under agreements to repurchase are accounted for as financing transactions and the associated interest expense is recognized over the life of the transaction. These transactions are carried in the Statements of Condition at their contractual amounts and the related accrued interest is reported as a component of "Other liabilities."

U.S. government securities held in the SOMA are lent to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements in order to facilitate the effective functioning of the domestic securities market. Securities-lending transactions are fully collateralized by other U.S. government securities and the collateral taken is in excess of the market value of the securities loaned. The FRBNY charges the dealer or bank a fee for borrowing securities and the fees are reported as a component of "Other Income" in the Statements of Income.

Activity related to U.S. government securities sold under agreements to repurchase and securities lending is allocated to each Reserve Bank on a percentage basis derived from the annual settlement of interdistrict clearings. Securities purchased under agreements to resell are allocated to FRBNY and not to the other Banks.

**E. FOREIGN CURRENCY SWAPS AND WAREHOUSING**

F/X swap arrangements are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. The parties agree to exchange their currencies up to a pre-arranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to the foreign currencies it may need to intervene to support the dollar and give the counterparty temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either FRBNY or the counterparty (the drawer) and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction bears the exchange rate risk upon maturity. FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the U.S. Treasury, U.S. dollars for foreign currencies held by the U.S. Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the U.S. Treasury and ESF for financing purchases of foreign currencies and related international operations.

Foreign currency swaps and warehousing agreements are revalued daily at current market exchange rates. Activity related to these agreements, with the exception of the unrealized gains and losses resulting from the daily revaluation, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Unrealized gains and losses resulting from the daily revaluation are allocated to FRBNY and not to the other Reserve Banks.

**F. BANK PREMISES, EQUIPMENT AND SOFTWARE**

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from one to fifty years. Major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts and are amortized over the remaining useful life of the asset. Maintenance, repairs and minor replacements are charged to operating expense in the year incurred. Capitalized assets including software, building, leasehold improvements, furniture and equipment are impaired when it is determined that the net realizable value is significantly less than book value and is not recoverable.

Costs incurred for software, either developed internally or acquired for internal use, during the application development stage are capitalized based on the cost of direct services and materials associated with designing, coding, installing or testing software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from one to five years.



**G. INTERDISTRICT SETTLEMENT ACCOUNT**

At the close of business each day, each Reserve Bank assembles the payments due to or from other Reserve Banks as a result of the day's transactions that involve depository institution accounts held by other Districts. Such transactions may include funds settlement, check clearing and ACH operations. The cumulative net amount due to or from the other Reserve Banks is reflected in the "Interdistrict settlement account" in the Statements of Condition.

**H. FEDERAL RESERVE NOTES**

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the Chairman of the Board of Directors of each Reserve Bank) to the Reserve Banks upon deposit with such agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be equal to the sum of the notes applied for by such Reserve Bank.

Assets eligible to be pledged as collateral security include all Bank assets. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the U.S. government.

The "Federal Reserve notes outstanding, net" account represents the Bank's Federal Reserve notes outstanding, reduced by the currency issued to the Bank but not in circulation, of $3,494 million and $2,819 million at December 31, 2005 and 2004, respectively.

**I. ITEMS IN PROCESS OF COLLECTION AND DEFERRED CREDIT ITEMS**

The balance in the "Items in process of collection" line in the Statements of Condition primarily represents amounts attributable to checks that have been deposited for collection by the payee depository institution and, as of the balance sheet date, have not yet been collected from the payor depository institution. Deferred credit items are the counterpart liability to items in process of collection, and the amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can fluctuate and vary significantly from day to day.

**J. CAPITAL PAID-IN**

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. These shares are nonvoting with a par value of $100 and may not be transferred or hypothecated. As a member bank's capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. By law, each Bank is required to pay each member bank an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

**K. SURPLUS**

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Pursuant to Section 16 of the Federal Reserve Act, Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury as interest on Federal Reserve notes excess earnings, after providing for the costs of operations, payment of dividends and reservation of an amount necessary to equate surplus with capital paid-in.

In the event of losses or an increase in capital paid-in at a Reserve Bank, payments to the U.S. Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in. Weekly payments to the U.S. Treasury may vary significantly.

In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the U.S. Treasury in the following year. This amount is reported as a component of "Payments to U.S. Treasury as interest on Federal Reserve notes."

**L. INCOME AND COSTS RELATED TO U.S. TREASURY SERVICES**

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services.

**M. ASSESSMENTS BY THE BOARD OF GOVERNORS**

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances. The Board of Governors also assesses each Reserve Bank for the expenses incurred for the U.S. Treasury to issue and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the previous year.

**N. TAXES**

The Reserve Banks are exempt from federal, state and local taxes, except for taxes on real property. The Bank's real property taxes were $545 thousand and $477 thousand for the years ended December 31, 2005 and 2004, respectively, and are reported as a component of "Occupancy expense."

**O. RESTRUCTURING CHARGES**

In 2003, the System began the restructuring of several operations, primarily check, cash and U.S. Treasury services. The restructuring included streamlining the management and support structures, reducing staff, decreasing the number of processing locations, and increasing processing capacity in the remaining locations. These restructuring activities continued in 2004 and 2005.

Footnote 10 describes the restructuring and provides information about the Bank's costs and liabilities associated with employee separations and contract terminations. The costs associated with the write-down of certain Bank assets are discussed in footnote 6. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all Reserve Banks are recorded on the books of the FRBNY and those associated with enhanced post-retirement benefits are discussed in footnote 9.

**NOTE 4**

## U.S. GOVERNMENT SECURITIES, SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE, AND SECURITIES LENDING

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 3.103 percent and 2.938 percent at December 31, 2005 and 2004, respectively.

The Bank's allocated share of U.S. government securities, net, held in the SOMA at December 31, was as follows (in millions):

| | 2005 | 2004 |
|---|---|---|
| **PAR VALUE:** | | |
| U.S. government: | | |
| Bills | $ 8,418 | $ 7,726 |
| Notes | 11,795 | 10,601 |
| Bonds | 2,881 | 2,762 |
| **TOTAL PAR VALUE** | 23,094 | 21,089 |
| Unamortized premiums | 273 | 276 |
| Unaccreted discounts | (88) | (48) |
| **TOTAL ALLOCATED TO BANK** | **$ 23,279** | **$ 21,317** |

The total of the U.S. government securities, net held in the SOMA was $750,202 million and $725,584 million at December 31, 2005 and 2004, respectively.

At December 31, 2005 and 2004, the total contract amount of securities sold under agreements to repurchase was $30,505 million and $30,783 million, respectively, of which $947 million and $904 million were allocated to the Bank. The total par value of the SOMA securities pledged for securities sold under agreements to repurchase at December 31, 2005 and 2004, was $30,559 million and $30,808 million, respectively, of which $948 million and $905 million were allocated to the Bank.

The maturity distribution of U.S. government securities bought outright and securities sold under agreements to repurchase, that were allocated to the Bank at December 31, 2005, was as follows (in millions):

| | U.S. Government Securities (Par Value) | Securities Sold Under Agreements to Repurchase (Contract Amount) |
|---|---|---|
| **MATURITIES OF SECURITIES HELD** | | |
| Within 15 days | $ 1,273 | $ 947 |
| 16 days to 90 days | 5,345 | - |
| 91 days to 1 year | 5,781 | - |
| Over 1 year to 5 years | 6,540 | - |
| Over 5 years to 10 years | 1,759 | - |
| Over 10 years | 2,396 | - |
| **TOTAL** | **$ 23,094** | **$ 947** |

At December 31, 2005 and 2004, U.S. government securities with par values of $3,776 million and $6,609 million, respectively, were loaned from the SOMA, of which $117 million and $194 million, respectively, were allocated to the Bank.

**NOTE 5**

## INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities purchased under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

The Bank's allocated share of investments denominated in foreign currencies was approximately 2.002 percent and 2.580 percent at December 31, 2005 and 2004, respectively.

The Bank's allocated share of investments denominated in foreign currencies, including accrued interest, valued at current foreign currency market exchange rates at December 31, was as follows (in millions):

| | 2005 | 2004 |
|---|---|---|
| European Union Euro: | | |
| Foreign currency deposits | $ 109 | $ 157 |
| Securities purchased under agreements to resell | 39 | 55 |
| Government debt instruments | 71 | 102 |
| Japanese Yen: | | |
| Foreign currency deposits | 52 | 40 |
| Government debt instruments | 108 | 197 |
| **TOTAL** | **$ 379** | **$ 551** |

Total System investments denominated in foreign currencies were $18,928 million and $21,368 million at December 31, 2005 and 2004, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2005, was as follows (in millions):

**MATURITIES OF INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES**

| | European Euro | Japanese Yen | **Total** |
|---|---|---|---|
| Within 15 days | $ 68 | $ 52 | **$ 120** |
| 16 days to 90 days | 52 | 14 | **66** |
| 91 days to 1 year | 42 | 20 | **62** |
| Over 1 year to 5 years | 57 | 74 | **131** |
| Over 5 years to 10 years | - | - | **-** |
| Over 10 years | - | - | **-** |
| **TOTAL** | **$ 219** | **$ 160** | **$ 379** |

At December 31, 2005 and 2004, there were no material open or outstanding foreign exchange contracts.

At December 31, 2005 and 2004, the warehousing facility was $5,000 million, with no balance outstanding.

**NOTE 6**

## BANK PREMISES, EQUIPMENT AND SOFTWARE



A summary of bank premises and equipment at December 31 is as follows (in millions):

| | Useful Life Range (in Years) | 2005 | 2004 |
|---|---|---|---|
| Bank premises and equipment: | | | |
| Land | N/A | $ 11 | $ 8 |
| Buildings | 1-50 | 67 | 66 |
| Building machinery and equipment | 1-20 | 17 | 20 |
| Construction in progress | N/A | 7 | 10 |
| Furniture and equipment | 1-19 | 46 | 48 |
| Subtotal | | $ 148 | $ 152 |
| Accumulated depreciation | | (61) | (67) |
| **BANK PREMISES AND EQUIPMENT, NET** | | **$ 87** | **$ 85** |
| **DEPRECIATION EXPENSE, FOR THE YEARS ENDED** | | **$ 8** | **$ 8** |

The Bank leases space to outside tenants with lease terms of less than one year. Future minimum lease payments under agreements in existence at December 31, 2005, were immaterial.

The Bank has capitalized software assets, net of amortization, of $11 million and $5 million at December 31, 2005 and 2004, respectively. Amortization expense was $3 million and $1 million for the years ended December 31, 2005 and 2004, respectively. Capitalized software assets are reported as a component of "Other assets" and related amortization is reported as a component of "Other expenses."

The facilities in Louisville and Little Rock were vacated on January 18, 2005, and February 22, 2005, respectively, as a result of the Bank's restructuring plan, as discussed in footnote 10. The facility in Louisville, including associated furnishings, was sold for $4 million on January 31, 2005, and the facility in Little Rock is available for sale and reported as a component of "Other assets."

**NOTE 7**

## COMMITMENTS AND CONTINGENCIES

At December 31, 2005, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately five years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $2 million and $1 million for the years ended December 31, 2005 and 2004, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases with terms of one year or more, at December 31, 2005, were (in thousands):

| | OPERATING |
|---|---|
| 2006 | $ 994 |
| 2007 | 736 |
| 2008 | 358 |
| 2009 | 348 |
| 2010 | 75 |
| Thereafter | - |
| | $ 2,511 |

At December 31, 2005, there were no other material commitments and long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each Reserve Bank has agreed to bear, on a per-incident basis, a pro rata share of losses in excess of one percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 2005 or 2004.

The Bank is involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

**NOTE 8**

## RETIREMENT AND THRIFT PLANS

### RETIREMENT PLANS

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). Employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP") and certain Bank officers participate in the Supplemental Employee Retirement Plan ("SERP").

The System Plan is a multi-employer plan with contributions fully funded by participating employers. Participating employers are the Federal Reserve Banks, the Board of Governors of the Federal Reserve System and the Office of Employee Benefits of the Federal Reserve System. No separate accounting is maintained of assets contributed by the participating employers. The FRBNY acts as a sponsor of the System Plan and the costs associated with the Plan are not redistributed to other participating employers. The Bank's benefit obligation and net pension costs for the BEP and the SERP at

December 31, 2005 and 2004, and for the years then ended, are not material.

#### THRIFT PLAN

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $3 million for each of the years ended December 31, 2005 and 2004, respectively, and are reported as a component of "Salaries and other benefits." The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2005 and 2004, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service.

NOTE 9

## POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

#### POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

In addition to the Bank's retirement plans, employees who have met certain age and length of service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets.

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

| | 2005 | 2004 |
|---|---|---|
| Accumulated postretirement benefit obligation at January 1 | $ 55.6 | $ 58.5 |
| Service cost-benefits earned during the period | 1.6 | 1.1 |
| Interest cost of accumulated benefit obligation | 3.4 | 3.1 |
| Actuarial loss (gain) | 8.4 | (2.2) |
| Special termination loss | - | 0.1 |
| Contributions by plan participants | 0.4 | 0.2 |
| Benefits paid | (3.2) | (2.7) |
| Plan amendments | - | (2.5) |
| **ACCUMULATED POSTRETIREMENT BENEFIT OBLIGATION AT DECEMBER 31** | **$ 66.2** | **$ 55.6** |

At December 31, 2005 and 2004, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.50 percent and 5.75 percent, respectively.

Discount rates reflect yields available on high quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due.

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation and the accrued postretirement benefit costs (in millions):

| | 2005 | 2004 |
|---|---|---|
| Fair value of plan assets at January 1 | $ - | $ - |
| Contributions by the employer | 2.8 | 2.5 |
| Contributions by plan participants | 0.4 | 0.2 |
| Benefits paid | (3.2) | (2.7) |
| **FAIR VALUE OF PLAN ASSETS AT DECEMBER 31** | **$ -** | **$ -** |
| | | |
| Unfunded postretirement benefit obligation | $ 66.2 | $ 55.6 |
| Unrecognized prior service cost | 3.3 | 3.8 |
| Unrecognized net actuarial loss | (18.7) | (11.2) |
| **ACCRUED POSTRETIREMENT BENEFIT COSTS** | **$ 50.8** | **$ 48.2** |

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs."

For measurement purposes, the assumed health care cost trend rates at December 31 are as follows:

| | 2005 | 2004 |
|---|---|---|
| Health care cost trend rate assumed for next year | 9.00 % | 9.00 % |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5.00 % | 4.75 % |
| Year that the rate reaches the ultimate trend rate | 2011 | 2011 |

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2005 (in millions):

| | One Percentage Point Increase | One Percentage Point Decrease |
|---|---|---|
| Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs | $ 0.8 | $ (0.7) |
| Effect on accumulated postretirement benefit obligation | 8.9 | (7.4) |

The following is a summary of the components of net periodic postretirement benefit costs for the years ended December 31 (in millions):

| | 2005 | 2004 |
|---|---|---|
| Service cost-benefits earned during the period | $ 1.6 | $ 1.1 |
| Interest cost of accumulated benefit obligation | 3.4 | 3.1 |
| Amortization of prior service cost | (0.5) | (0.7) |
| Recognized net actuarial loss | 0.9 | 0.1 |
| Total periodic expense | $ 5.4 | $ 3.6 |
| Curtailment gain | - | (6.3) |
| Special termination loss | - | 0.1 |
| **NET PERIODIC POSTRETIREMENT BENEFIT COSTS (CREDIT)** | **$ 5.4** | **$ (2.6)** |

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2005 and 2004, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 6.25 percent, respectively.

Net periodic postretirement benefit costs are reported as a component of "Salaries and other benefits."

A plan amendment that modified the credited service period eligibility requirements created curtailment gains. The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in footnote 10. The curtailment gain associated with restructuring programs announced in 2003 was recognized when employees left the Bank in 2004.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a prescription drug benefit under Medicare ("Medicare Part D") and a federal subsidy to sponsors of retiree health care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. The benefits provided by the Bank's plan to certain participants are at least actuarially equivalent to the Medicare Part D prescription drug benefit. The estimated effects of the subsidy, retroactive to January 1, 2004, are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit costs.

Following is a summary of expected benefit payments (in millions):

Expected benefit payments:

| | Without Subsidy | With Subsidy |
|---|---|---|
| 2006 | $ 3.2 | $ 2.9 |
| 2007 | 3.4 | 3.1 |
| 2008 | 3.5 | 3.2 |
| 2009 | 3.8 | 3.3 |
| 2010 | 4.0 | 3.5 |
| 2011-2015 | 23.2 | 20.4 |
| **TOTAL** | **$ 41.1** | **$ 36.4** |

**POSTEMPLOYMENT BENEFITS**

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31, 2005, measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2005 and 2004, were $5 million and $6 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2005 and 2004 operating expenses were $1 million for each year and are recorded as a component of "Salaries and other benefits."

NOTE 10



## BUSINESS RESTRUCTURING CHARGES

In 2003, the Bank announced plans for restructuring to streamline operations and reduce costs, including consolidation of check, check adjustment and cash operations and staff reductions in various functions of the Bank. In 2004, additional consolidation and restructuring initiatives were announced in the marketing and check operations. These actions resulted in the following business restructuring charges (in millions):

| | Total Estimated Costs | Accrued Liability 12/31/2004 | Total Charges | Total Paid | Accrued Liability 12/31/2005 |
|---|---|---|---|---|---|
| Employee separation | $ 4.1 | $ 1.0 | $ 0.1 | $ (1.1) | $ - |
| Other | .4 | - | - | - | - |
| **TOTAL** | **$ 4.5** | **$ 1.0** | **$ 0.1** | **$ (1.1)** | **$ -** |

Employee separation costs are primarily severance costs related to staff reductions of approximately 175, including 7 staff reductions related to restructuring announced in 2004. These costs are reported as a component of "Salaries and other benefits."

Restructuring costs associated with the write-downs of certain Bank assets, including software, buildings, leasehold improvements, furniture and equipment are discussed in footnote 6. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in footnote 8. Costs associated with enhanced postretirement benefits are disclosed in footnote 9.

The Bank substantially completed its announced plans on March 31, 2005.

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Summary of Key Operation Statistics for Services Provided to Depository Institutions and the U.S. Treasury (The following schedule is unaudited and has been included as supplemental information.)

| | NUMBER OF ITEMS | | DOLLAR AMOUNT (MILLIONS) | |
|---|---|---|---|---|
| | **2005** | **2004** | **2005** | **2004** |
| Government Checks Processed | 70,335,000 | 73,682,000 | 84,293 | 89,608 |
| Postal Money Orders Processed | 176,490,000 | 186,918,000 | 28,395 | 29,045(a) |
| Commercial Checks Processed | 690,564,000 | 951,391,000 | 568,262 | 677,151 |
| Currency Processed | 1,035,495,000 | 1,098,465,000 | 18,461 | 20,962 |
| Loans to Depository Institutions | 383 | 240 | 746 | 352 |
| Food Coupons Destroyed | 682,000 | 1,281,000 | 2 | 4 |

(a) $4,928 less than what was reported in the 2004 annual report due to an adjustment.

The Federal Reserve Bank of St. Louis is one of 12 regional Reserve banks which, together with the Board of Governors, make up the nation's central bank. The Fed carries out U.S. monetary policy, regulates certain depository institutions, provides wholesale-priced services to banks and acts as fiscal agent for the U.S. Treasury. The St. Louis Fed serves the Eighth Federal Reserve District, which includes all of Arkansas, eastern Missouri, southern Indiana, southern Illinois, western Kentucky, western Tennessee and northern Mississippi. Branch offices are located in Little Rock, Louisville and Memphis.

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