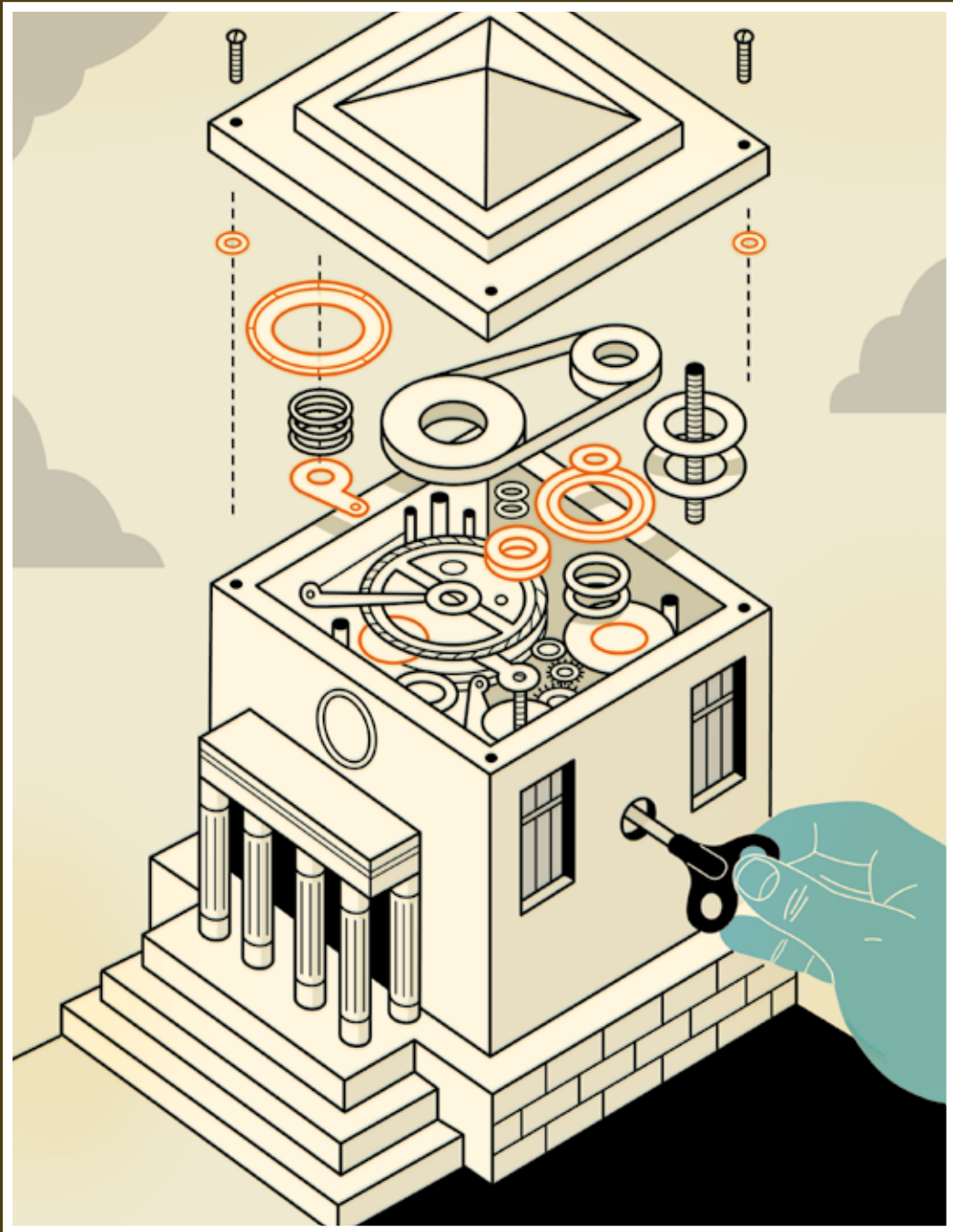


Independence + Accountability

Why the Fed Is a Well-Designed Central Bank

ANNUAL REPORT 2009



FEDERAL RESERVE BANK *of* ST. LOUIS
CENTRAL to AMERICA'S ECONOMY™

STLOUISFED.ORG

FEDERAL RESERVE BANK OF ST. LOUIS

Annual Report

2009



CENTRAL
to
AMERICA'S
ECONOMY™

STLOUISFED.ORG

President's Message

James Bullard
President and CEO
Federal Reserve Bank of St. Louis



Amid the many goals of financial and regulatory reform wending their way through Congress, a common theme has recently emerged: curb the independence of the Fed.

The sentiment for such change is understandable. The Fed's actions in financial markets during the financial crisis—lending more than \$1.5 trillion to financial institutions, buying \$1.25 trillion in mortgage-backed securities—are without precedent. Why should the Fed be free to engage in actions of this scale without the consent of Congress or the U.S. president?

The answer, as this year's annual report essay makes clear, is that giving the central bank independence is the best method for governments to prevent themselves from printing money for short-term political gain. Governments throughout the world, including our own, have chosen to tie their own hands institutionally to prevent the misuse of monetary policy. Here's why:

Money allows trade to occur more efficiently. Governments have the great power to print money. But printing money to pay for goods is a dangerous temptation with an enormous consequence. When the government prints too much money, the result is hyperinflation and that money becomes worthless. Germany, Hungary, Ecuador, Bolivia, Peru and, most recently, Zimbabwe have been among the casualties of this phenomenon over the previous century.

To avoid such catastrophes and to make themselves credible stewards of their nation's economic interests, most governments have delegated control of their nation's money supply to nonelected officials. By distancing the control of money from politics, they are, in a sense, backing up their pledge to do the right thing.

Such institutional power, however, requires accountability to the electorate. In the United States, the Federal Reserve was given a complicated system of checks and balances to ensure that monetary policy was conducted in a way that protected all interests. In short, the goal is not to make the central bank independent of the democratic process, but to keep it "at arm's length" from partisan politics.

What are these checks and balances?

To simplify,

1. The Federal Reserve is a central banking system. It includes the Board of Governors in Washington, D.C., and 12 regional Reserve

banks. This arrangement spreads input into monetary policy decisions around the country, making it more likely that such decisions will be made on economic rather than political grounds.

2. The 19 Fed policymakers are *a balance of political and nonpolitical appointees*. The seven members of the Board of Governors are appointed by the president and confirmed by the Senate. The 12 regional Reserve Bank presidents are chosen by a local board of directors, subject to approval by the Board of Governors.
3. The Fed has *budget autonomy* from Congress, but must return any income outside of operating expenses over to the U.S. Treasury.
4. Congress created *long terms of office* for the Board of Governors (14 years) and staggered the governors' terms. This makes the Board more independent of the political process.
5. Finally, Congress required the Fed to *report regularly* on its actions. In return, Congress would not interfere in the Fed's day-to-day activities.

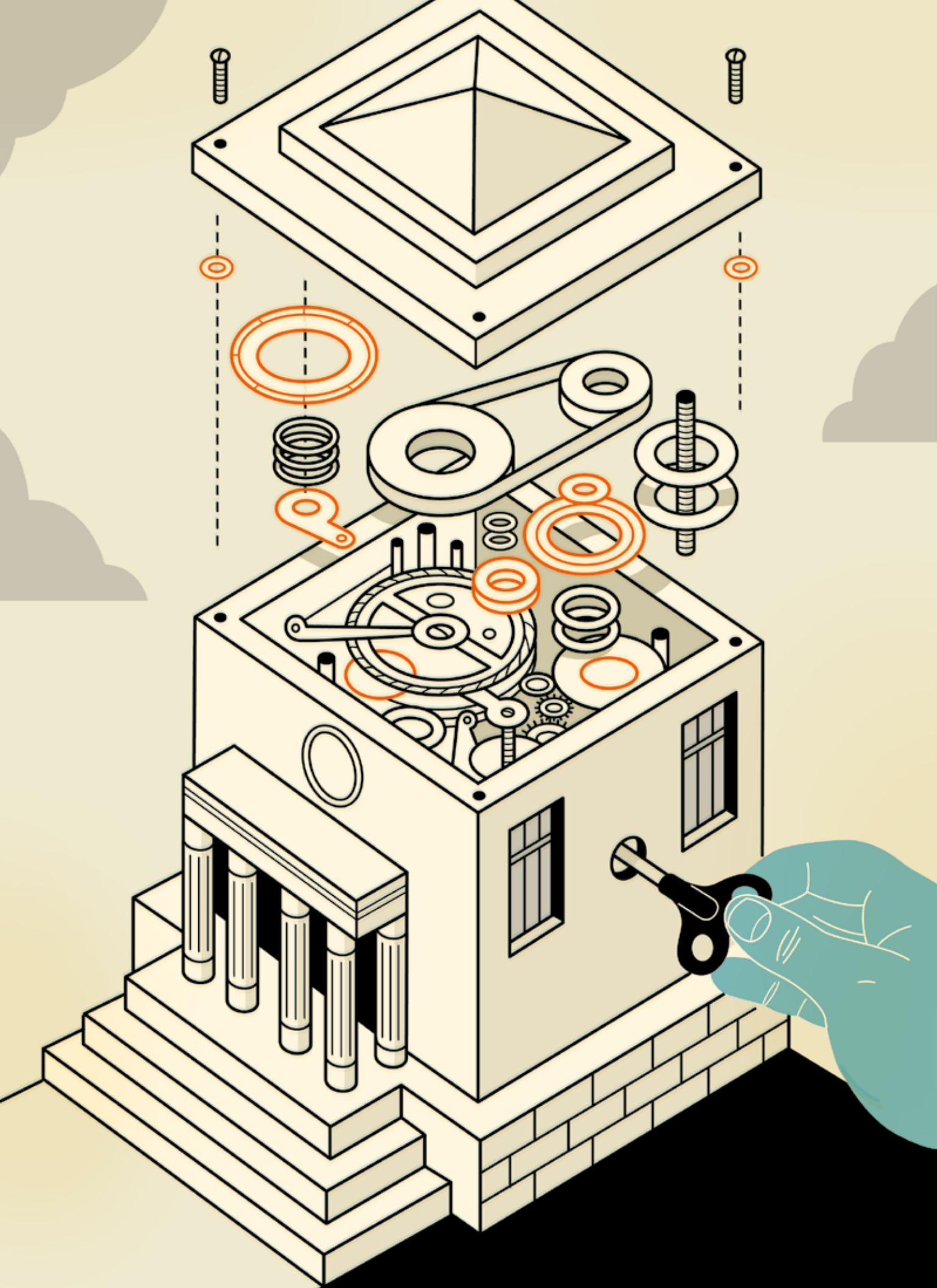
This year's annual report essay describes in greater detail how and why these arrangements have worked.

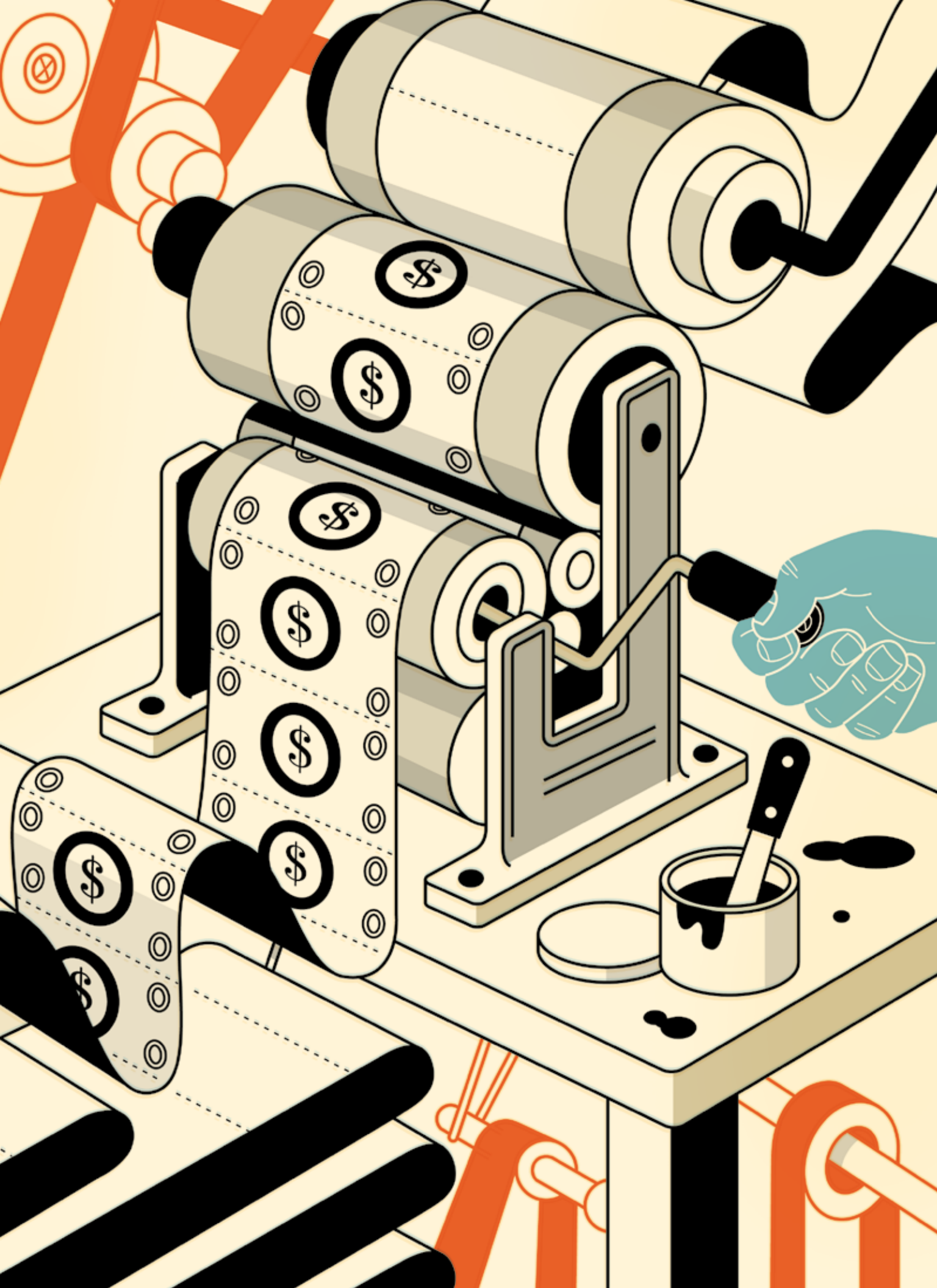
As we emerge from one of the worst economic and financial crises in a generation, it is appropriate for the nation to scrutinize the structure and responsibilities of the Federal Reserve System. In a democracy, that's how it's done. But, as the debate ensues about how best to improve the Fed, we should consider change carefully. In creating the Fed, Congress understood that to ensure good monetary policy, the incentives needed to be right. Independence with accountability in the structure of the Federal Reserve System, in my opinion, was the right approach.

Why the Fed Is a Well-Designed Central Bank

The Federal Reserve has taken unprecedented actions in the financial markets since the advent of the financial crisis. Noteworthy examples include lending more than \$1.5 trillion to financial institutions and buying \$1.25 trillion of mortgage-backed securities to stabilize the economy. The large scale of these interventions has brought intense public scrutiny of the Federal Reserve's powers and institutional structure. In particular, many have questioned why the Fed has the freedom to engage in such actions without the explicit consent from Congress or the president. This freedom from political interference is commonly referred to as "central bank independence."

The focus of this essay is to review why Congress made the Federal Reserve independent when it created the Fed in 1913. The essay also addresses the fundamental tension that comes with an independent central bank: how to ensure that these policymakers are accountable to the electorate without losing that independence. The key point to remember is that giving the central bank independence is the best method for governments to tie their own hands and prevent them from misusing monetary policy for short-term political reasons.





The Power of Money

Money is obviously a vital part of an economy because it allows trade to occur more efficiently. Governments have a great power that no one else in the economy has—the ability to print money. Thus, the government can acquire more goods by printing more money, a process known as seigniorage. This power, however, brings with it a dangerous temptation. Imagine that you had this power; just think of what you could do with it! You could live a great life, feed the hungry and house the homeless. And all of this could be achieved simply by printing more money. This sounds wonderful. How can it be dangerous?

If the government prints too much money, people who sell things for money raise the prices for their goods, services and labor. This lowers the purchasing power and value of the money being printed. In fact, if the government prints too much money, the money becomes worthless. We have seen many governments give in to this temptation, and the result is a hyperinflation. Hyperinflations were observed in the 20th century in Germany (twice), Hungary, Ecuador, Bolivia and Peru, with Zimbabwe as the most recent casualty. Such episodes of high inflation can greatly impair the functioning of the economy or collapse it altogether. Thus, having the power to print money brings with it great responsibility to respect that power.

It is important to remember that the temptation to print money is not restricted to less-developed countries. In fact, the United States has suffered from high inflation several times. In pre-revolutionary days, many colonies had the right to print money and fell prey to their own excesses. The Continental Congress did the same during the Revolutionary War. In 1775, it gave the colonies the authority to issue Continental dollars to finance the war. Overissuance and counterfeiting by the British led to such dramatic increases in paper currency that by 1779, the value of a Continental dollar was 1/25th of its original value (giving rise to the phrase “not worth a continental”). During the Civil War, the Confederate government also succumbed to the temptation of printing money to buy goods. From 1861 to 1864, the stock of Confederate dollars increased 10-fold, and prices increased the same. Financing government spending via the printing press also occurred in the 20th century. Shortly after the founding of the Federal Reserve, the U.S. Treasury adopted policies that induced the Fed to monetize government debt.¹ This led to a spike in U.S. inflation following World War I. These examples show that the

¹ Monetizing debt means the government borrows money to buy goods and then repays its debt by printing more money. This is equivalent to simply printing money in the first place to buy goods.

A well-designed central bank needs to be 1) credible, 2) independent, 3) accountable and 4) transparent.

U.S. government has a history of resorting to the printing press to pay for government expenditures.

Most governments have taken steps to discipline themselves and impose restraints on their ability to print money to pay for goods. A time-honored method of restraint was to tie the value of the currency to a commodity such as gold. Because the government did not control gold production, the amount of money it could print was limited by its holdings of gold. Although this restrained the government's ability to create seigniorage, it also unfortunately tied its hands during periods of high demand for currency, such as financial crises (a time in which people wanted to hold the government's currency rather than other assets) or during planting season (a time in which farmers needed cash to pay for seed, etc.). Other problems also occurred: New gold discoveries, such as during the California gold rush, led to an inflow of gold and new currency issue, which caused inflation. Conversely, if the economy grew faster than the supply of gold, then prices of goods and services would fall, leading to deflation. Finally, it is very costly to mine gold simply to hold it in storage to back up pieces of paper money. For these reasons and others, governments began to realize that using a gold standard to control the nation's money supply was too restrictive and costly.

As a result, governments slowly moved to a fiat currency system, one in which the money was not backed by a commodity but rather by the "full faith and credit" of the government. Under such a system, the government promises its citizens that it will discipline itself and not resort to seigniorage to finance government spending. In short, citizens have to trust that the government will do the right thing. But trust can be abused; therefore, the citizenry demanded institutional arrangements that backed up the government's pledge.

That is why most governments took steps to tie their own hands and make themselves credible stewards of their nation's economic interests. It became very clear that if elected government officials had direct control of the money supply, then they could cut taxes and print money to pay for goods to win votes. Consequently, promises by elected officials would not be seen as credible. To achieve credibility and avoid this abuse of public power for private gain, the control of the money supply had to be delegated to a nonelected group of individuals. These officials were to run the institution responsible for monetary policy, known as the "central bank." It was important that central bankers be independent of the political process to ensure that they could not be manipulated by elected officials. However, having such great power meant that central bankers had to be accountable to the electorate in some fashion, and accountability required the central bank to behave in a transparent manner. Thus a well-designed central bank needed to be 1) credible, 2) independent, 3) accountable and 4) transparent.

Central Bank Independence and Inflation

One of macroeconomics' key axioms is that sustained high growth rates of a nation's money stock in excess of its production of goods and services eventually produces high and rising inflation rates. This axiom was nicely phrased by Milton Friedman when he said that "inflation is always and everywhere a monetary phenomenon." Economic history is littered with countries that ran afoul of this axiom. A recent example is Zimbabwe, which saw its annual inflation rate rise from 24,411 percent in 2007 to an estimated 89.7 sextillion percent in mid-November 2008.¹ That's 89,700,000,000,000,000,000,000 percent.

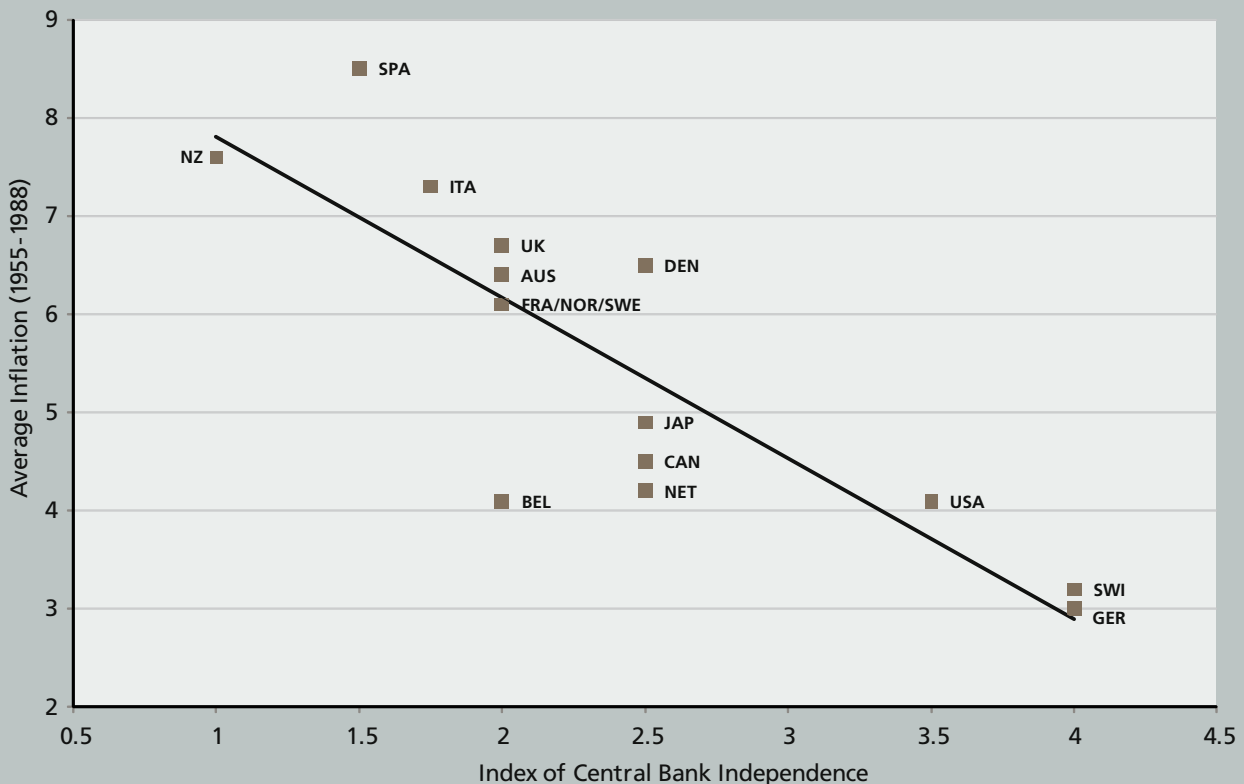
The willingness of governments to force their central banks to print excessive amounts of money, or put in place policies that lead to higher inflation rates over time, has been termed the "inflation bias" of discretionary monetary policymaking.² To minimize this bias, many governments have decided to give their central bank legal independence (CBI). But do countries with independent central banks also have lower inflation? To answer this question properly requires a country-specific measure of central bank independence. Many economists have constructed measures of CBI from a variety of legal indicators, many of which are discussed in this essay. In a now famous article that was published in 1993, Alesina and Summers found that developed (advanced) countries with high levels of central bank independence also experienced lower average levels of inflation from 1955-1988. Figure 1 reprints the chart from their paper, which clearly shows this negative relationship.

continued on page 10

¹ See Hanke and Kwok.
² See Walsh.

FIGURE 1

Central Bank Independence versus Average Inflation



Central Bank Independence and Inflation

(continued from Page 9)

More recently, as the top chart in Figure 2 on Page 11 shows, global inflation has slowed sharply since the mid-1990s. However, as the bottom two charts indicate, the rapid descent in global inflation was due primarily to developments in emerging market and developing countries. In the advanced countries, the slowing occurred much earlier, in the early 1980s. There were many reasons for the global decline in inflation since the late 1980s, including stronger commitments to price stability (better monetary policies), higher rates of productivity growth and the forces of globalization that increased competition and enhanced the flexibility of labor and product markets.³ As suggested by Alesina and Summers, increased central bank independence appears to be another key reason for the decline in inflation worldwide. As shown in the table below, there was a marked increase in central bank independence between the period 1980-89 and 2003. Although this trend was apparent among advanced countries, it was especially apparent among emerging market and developing countries.⁴ Indeed, many of the reforms that enhanced central bank independence occurred during the 1990s and were in response to high rates of inflation.⁵ The movement toward greater central bank independence undoubtedly helps to explain the sharp slowing in inflation in many countries.

There was also an increase in CBI in advanced countries. However, the movement from weak and moderate independence to strong independence stemmed mostly from those countries that joined the European Union, and thus became members of the European Central Bank (ECB). Because of the Maastricht Treaty, the ECB is deemed to be strongly independent. Interestingly, while the trend over the past 20 years or so is toward increasing CBI, the Federal Reserve has not become more independent, according to the measure shown in the table. Still, the U.S. inflation rate has slowed markedly since the 1970s and 1980s. This suggests that CBI may be necessary but not sufficient to produce good inflation performance over time—a result that seems to hold for other advanced countries as well. However, central bank independence seems to have been much more important for helping to explain the sharp decline in inflation rates since the 1980s for emerging market and developing economies.

³ See Rogoff.

⁴ The data are published in Crowe and Meade.

⁵ See Cukierman.

TABLE

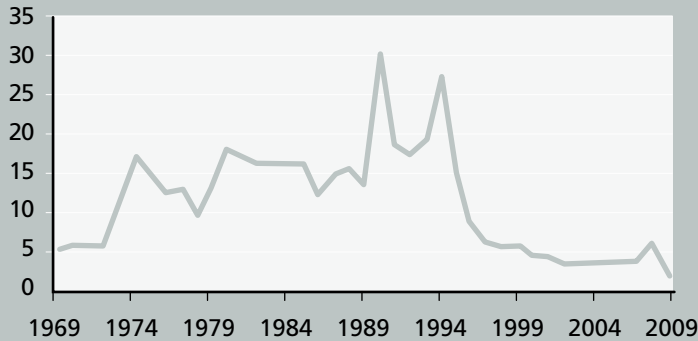
Measures and Frequency Distribution of Central Bank Independence

	Advanced Economies			Emerging & Developing Economies		
	1980-89	2003	Net Change	1980-89	2003	Net Change
Weak Independence	13	8	-5	32	6	-26
Moderate Independence	8	5	-3	19	49	30
Strong Independence	0	13	13	0	15	15

NOTE: Crowe and Meade measure central bank independence on a numerical scale from 0 (no independence) to 1 (complete independence). For this table, weak CBI is defined to include those banks with a scale from 0 to less than 0.4; moderate independence is defined as those banks from 0.4 to 0.8; strong independence is for banks with a CBI measure of 0.8 or above. The Federal Reserve's ranking on this scale is 0.47, and the ECB's ranking is 0.83.

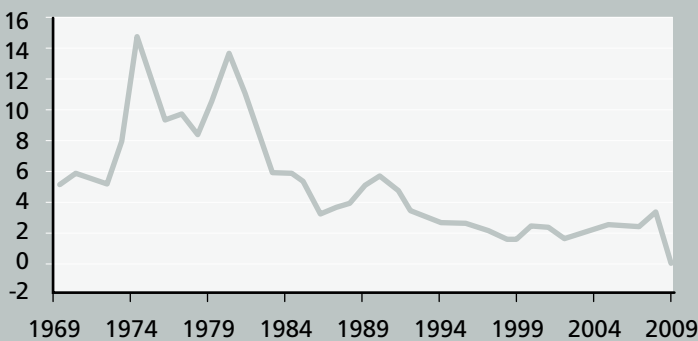
FIGURE 2

World CPI Inflation



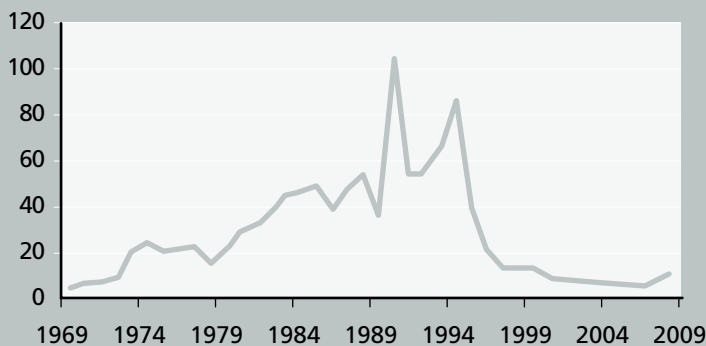
SOURCE: International Monetary Fund

CPI Inflation in the Advanced Countries



SOURCE: International Monetary Fund

CPI Inflation in Emerging and Developing Countries



SOURCE: International Monetary Fund

REFERENCES

Alesina, Alberto; and Summers, Lawrence H. "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence." *Journal of Money, Credit, and Banking*, Vol. 25, No. 2, May 1993, pp. 151-62.

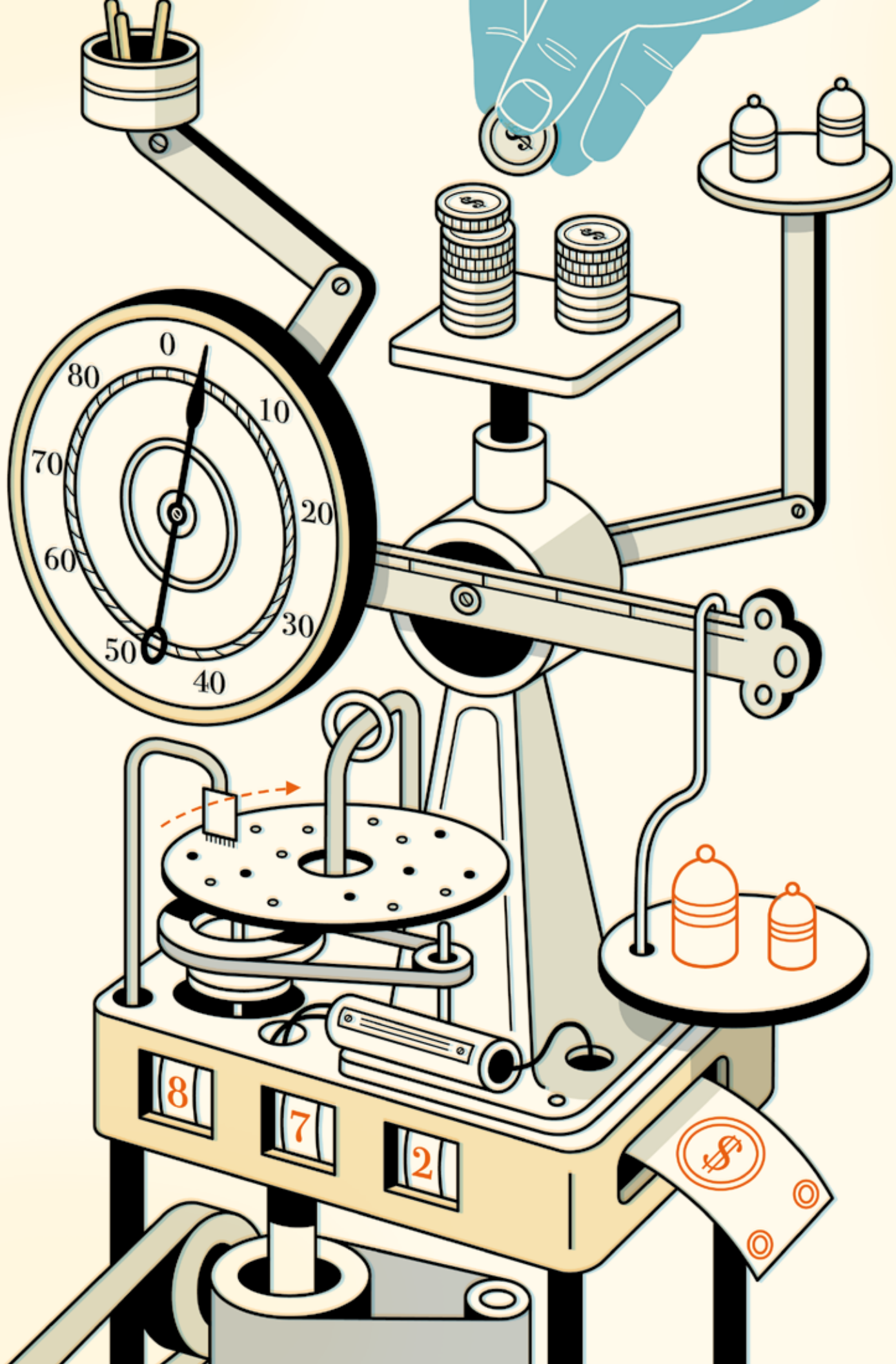
Crowe, Christopher; and Meade, Ellen E. "The Evolution of Central Bank Governance around the World." *Journal of Economic Perspectives*, Vol. 21, No. 4, Fall 2007, pp. 69-90.

Cukierman, Alex. "Central Bank Independence and Monetary Policymaking Institutions—Past, Present and Future." *European Journal of Political Economy*, Vol. 24, 2008, pp. 722-36.

Hanke, Steve H.; and Kwok, Alex K.F. "On the Measurement of Zimbabwe's Hyperinflation." *Cato Journal*, Vol. 29, No. 2, Spring/Summer 2009, pp. 353-64.

Rogoff, Kenneth. "Globalization and Global Disinflation." Proceedings from the Federal Reserve Bank of Kansas City Economic Symposium, 2003, pp. 77-112.

Walsh, Carl E. "Central Bank Independence." *The New Palgrave Dictionary of Economics*. Second Edition. Eds. Steven N. Durlauf and Lawrence E. Blume. Palgrave Macmillan, 2008. *The New Palgrave Dictionary of Economics Online*. Palgrave Macmillan. 16 March 2010 http://www.dictionaryofeconomics.com/article?id=pde2008_C000081.



A Series of Checks and Balances

The tricky issue is that accountability means being subject to some political oversight, which weakens the perception that the central bank is independent. So, there is an inherent tension between having independence to conduct policy and being accountable to the electorate. Furthermore, if central bankers are not elected, then they must be chosen in another way. The question was, by whom?

In the United States, there has long been a tension between the states and the federal government. States were leery of giving too much power to the federal government out of fear that this power would be abused. Yet, the federal government was the body charged with the welfare of the entire nation. In response to this conflict between the states and the federal government, a series of checks and balances was implemented to ensure that policy was conducted in a way that protected both interests. So, it is not surprising that similar checks and balances would come into play when deciding who selects the non-elected officials to run monetary policy and to whom they would be accountable. Thus, while the Federal Reserve was created to run monetary policy, it was given a complicated system of checks and balances to deal with conflicts between the states and the federal government, as well as between the legislative and executive branches of the federal government.

What are these checks and balances?

First, rather than have a single central bank, the founders created a system of central banks. This system includes the Board of Governors in Washington, D.C., and 12 regional Reserve banks. This arrangement avoided the problem of having strong federal government control of the central bank. The idea behind the regional banks is that the further these policymakers are from the day-to-day political process, the more likely that monetary policy decisions would be made on economic grounds rather than political considerations. Furthermore, the policymakers would be less susceptible to pressures to create seigniorage. The opposite concern is that the regional banks would focus too much on their own districts. Therefore, the Board of Governors (seven members) was created to ensure that the entire nation's welfare was considered. Thus, policy was to be set by the 12 presidents of the regional banks (those who served as direct contacts with the states) and the seven members of the Board of Governors (those who were intended to have more of a national view).

Second, who would choose these 19 policy-makers? One concern of the founders was that if all of the central bankers are political appointees of the president or Congress, then the Fed would not have the independence it needed to conduct policy in an appropriate manner. It therefore was decided that the presidents of the regional banks would not be political appointees but would be chosen by the citizenry of the district in a nonelectoral manner. This ensured that the presidents would be independent of the political process and less likely to engage in seigniorage creation. One method of choosing regional presidents in a nonelectoral manner was to create a local board of directors for each of the 12 regional banks. Each board, in turn, would select its regional bank president. To achieve a broad perspective on the economic well-being of each district, the board was to be composed of individuals from a wide range of sectors. This ensured that the regional bank presidents would be chosen based on their professional qualifications as opposed to their political connections or sectoral ties.

On the other hand, because 12 of the 19 policymakers were not political appointees, there was concern that there was not enough accountability to the electorate. Thus, it was decided that the seven members of the Board of Governors should be political appointees. The president would have the power to nominate the governors, and the Senate would have the power to confirm them. Consequently, this procedure for selecting the 19 central bankers of the Federal Reserve System provided for both independence and accountability.

Third, a common method for politicians to entice government agencies to carry out specific political agendas is to threaten to cut the agencies' budgets. Thus, no matter how far the presidents of the regional banks were from Washington, D.C., or how they were chosen, if the Federal Reserve did not have budget autonomy, then Congress could always threaten to cut its budget to get the Fed to carry out monetary policies that Congress desired. This power of the purse strings would undermine the Fed's independence and credibility to keep money creation low and stable. To counteract this possibility, Congress gave the Federal Reserve budget

autonomy when it created the Fed in 1913. The Fed was given the power to earn its own income and spend it without government interference.² However, recognizing that the Fed was creating seigniorage for the nation as a whole, Congress directed the Fed to return any excess income to the federal government. To guarantee that excess income was returned, the Fed's income statement and balance sheet had to be transparent and auditable, not by Congress, but by an independent auditing agency to prevent political machinations. Again, checks and balances prevailed.

Fourth, to ensure the credibility of Fed promises to keep money creation under control, Congress created long terms of office for the Board of Governors (14 years) and staggered the governors' terms (one expires every two years). This effectively guaranteed that one president could not appoint all of the members of the Board and therefore "stack" the Fed. Long terms also made the Board more independent of the political process because members did not have to worry about reappointment. Finally, long terms made the Board members more accountable: Policymakers who made promises today would likely still be in office in the future and could be brought to task for failing to live up to earlier promises. As a result, long terms gave current Board members an incentive to carry out promises.

Lastly, to prevent the Fed from making decisions that benefited a particular industry or region, Congress required the Fed to report on its actions. But to ensure that the Fed maintained its independence, Congress restrained itself from making frequent intrusions. The Fed was therefore required to report regularly to Congress; in return, Congress would not try to influence Fed decisions on a day-to-day or month-to-month basis. This reporting structure again gave the Fed independence, yet made it accountable and transparent to the electorate.

² It is interesting to note that, in effect, the members of Congress in 1913 ensured that in the future, Congress could not threaten the Fed with budget cuts. Thus, an earlier generation of politicians implemented checks and balances on future generations of Congressional representatives.

Will the Financial Crisis Further Limit the Fed's Independence? Should It?

The recent recession and financial crisis were, in many respects, the worst since the 1930s.¹ In response, some economists and policymakers have begun to examine the Fed's policies prior to and during the financial crisis to see if its goals, responsibilities or its institutional structure should be changed to help prevent another financial calamity.

The Federal Reserve Act of 1913 was designed to balance the competing interests of the public and private sector. Some were afraid of excessive government intervention in private capital markets, while others were worried that the financial sector would have too much influence on the nation's economic well being. In this spirit, the Act also sought to balance the interests of Wall Street (financial) and Main Street (business and agricultural). This system, by and large, has served the country well. Fast forward to 2010. In response to the financial crisis and recession, some people argue that power should be further consolidated in Washington, D.C., to avoid another financial calamity. However, as St. Louis Fed President James Bullard and other Federal Reserve officials and private-sector economists have pointed out, moving the levers of monetary policy even closer to the hub of politics could eventually lead to an erosion of the Fed's independence and, eventually, poor economic performance.²

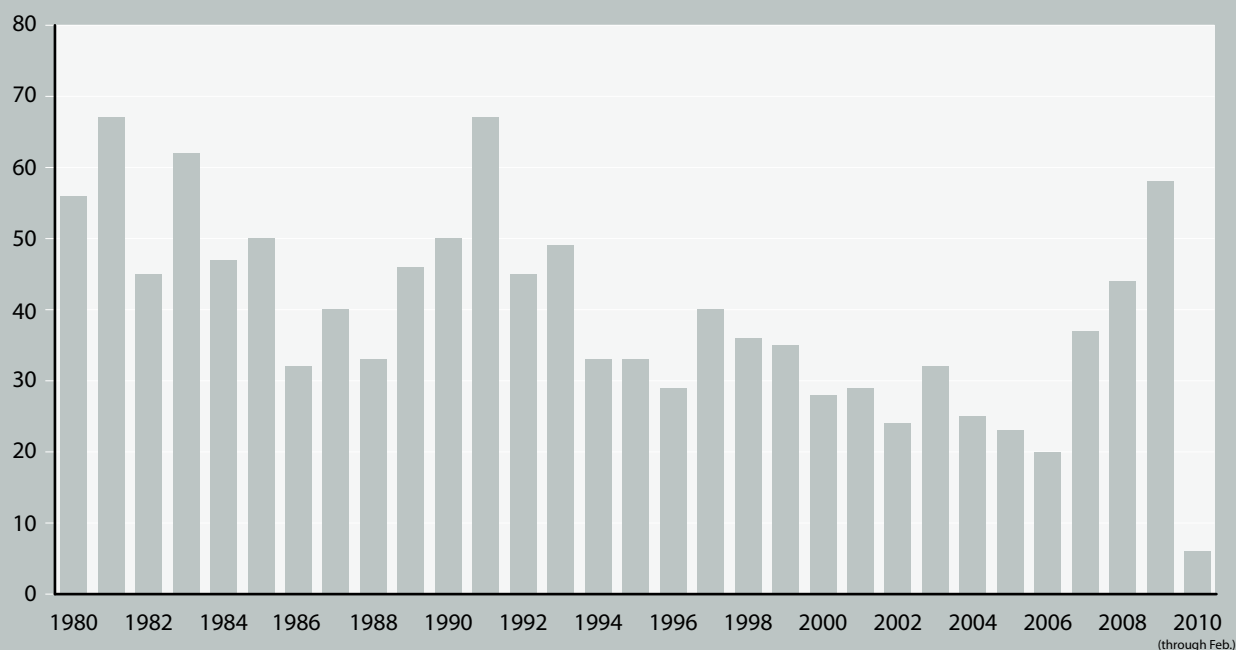
Clearly, part of the desire to subject the Federal Reserve to greater political oversight is natural in a democracy—and may even be a healthy rebalancing to correct misplaced priorities or policies. Few would quibble with the argument that, in a democracy, central banks should be held accountable for their policies. Indeed, if the central bank puts in place policies that run counter to its stated goals, then that will damage the credibility of the bank. And to a central bank, credibility is something that is valued highly. If a central bank's policies are not credible, then the bank will eventually lose the support of the nation's policymakers, and maybe its independence.

As part of the Fed's accountability to the public, senior Federal Reserve officials testify regularly before Congress. As the accompanying chart shows, the number of Congressional appearances by Federal Reserve officials has increased significantly over the past few years. This development is probably not too surprising given the recent financial market turbulence. In addition, appearances by Federal Reserve officials also tend to be higher during recessions, such as the early 1980s and the early 1990s. Although part of the increase in Congressional appearances over time may reflect a general increase in the number of hearings, it is nonetheless clear that Congress actively scrutinizes the Fed's policies both during times of tranquility and periods of turmoil. The number of appearances over the past three years (2008-2010) is on pace to be the largest in about 20 years.

¹ The causes and consequences of the financial crisis have been studied in depth. See the collection of articles and papers listed on the St. Louis Fed's Financial Crisis timeline at <http://timeline.stlouisfed.org/index.cfm?p=articles>.

² See President Bullard's presentation "The Fed at a Crossroads," at <http://research.stlouisfed.org/econ/bullard/BullardWinterInstituteFinal.pdf>.

Congressional Appearances and Testimonies by Federal Reserve Officials, 1980-2010

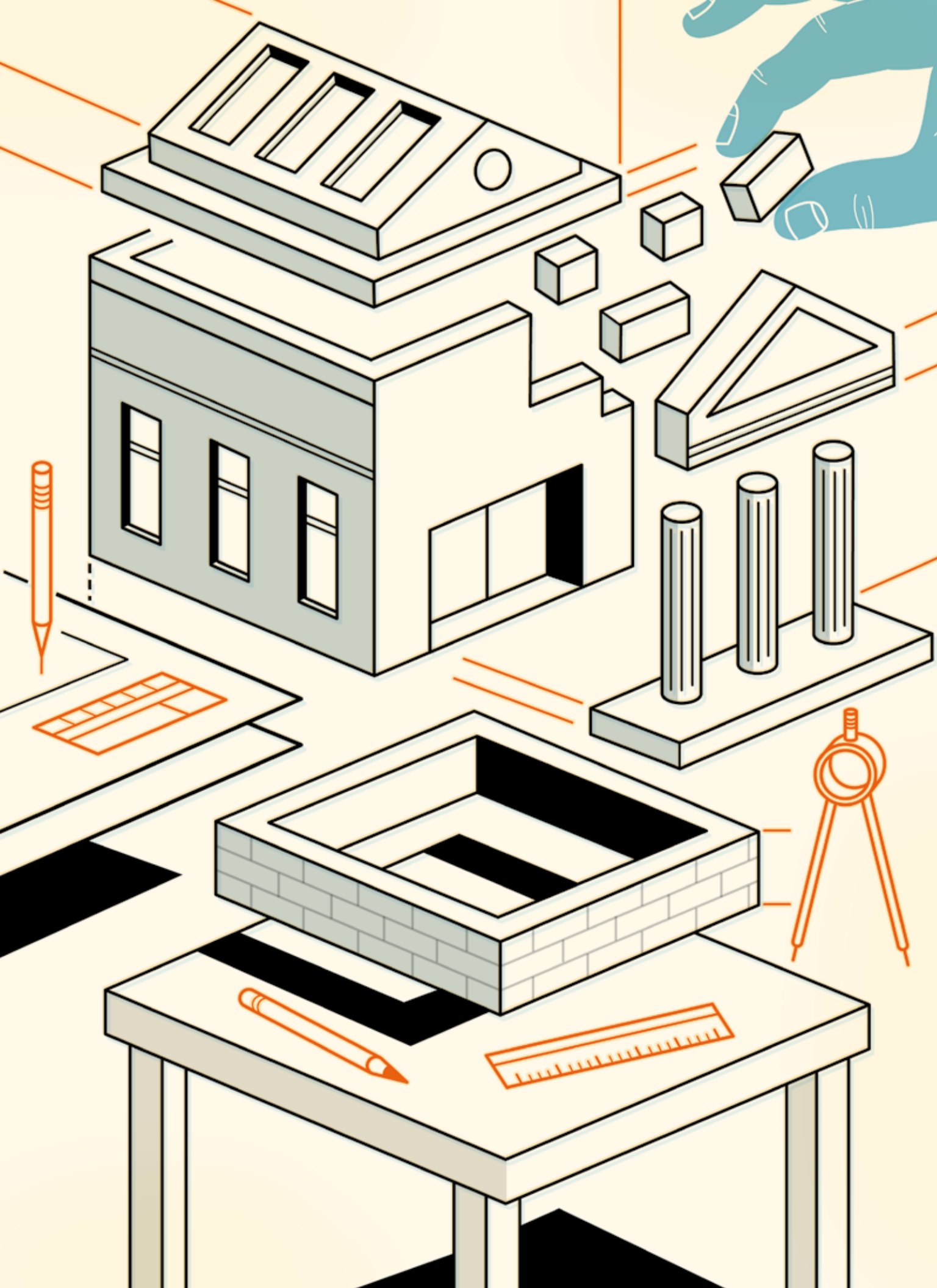


SOURCE: Data compiled by the Federal Reserve Bank of St. Louis using the Lexis-Nexis Congressional database.

A Well-Designed Institution

Over the years, there have been changes in the Fed's structure to improve its independence, credibility, accountability and transparency. These changes have led to a better institutional design that makes U.S. policy credible and based on sound economic reasoning, as opposed to politics. In times of financial and economic crisis, there is a tendency to reexamine the structure of the Federal Reserve System. To the uninformed observer, the Fed's structure is in many ways mind-boggling. In particular, it seems counter-intuitive that, in a democracy, the central bank should have independence from Congress. Yet, this independence is the result of Congress trying to avoid making monetary policy mistakes for political gain. Of course, accountability of public policymakers is a fundamental principle in a democracy. It is the tension between independence and accountability that led to the design of the Federal Reserve, and it has been an ever-present force in U.S. monetary policy for the last century.

In the end, the Federal Reserve System is a well-designed institution, created by Congress, that keeps the government from relying on the printing press to finance public spending. It is independent, credible, accountable and transparent. It is a nearly 100-year-old success story that has served the nation well.



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 have recently retired. Our appreciation and best wishes go out to the following:

Gordon B. Guess

David R. Pirsein

David P. Rumbarger Jr.

L. Clark Taylor Jr.

A. Rogers Yarnell II

Little Rock



C. Sam Walls, Chairman
CEO
Arkansas Capital Corp.
Little Rock, Ark.



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



Sharon Priest
Executive Director
Downtown Little Rock Partnership
Little Rock, Ark.



William C. Scholl
President
First Security Bancorp
Little Rock, Ark.



Cal McCastlain

Partner
Dover Dixon Horne PLLC
Little Rock, Ark.



Kaleybra Mitchell Morehead

Associate Vice President of College
Affairs/Institutional Advancement
Southeast Arkansas College
Pine Bluff, Ark.



Robert A. Young III

Chairman
Arkansas Best Corp.
Fort Smith, Ark.

Louisville



Gary A. Ransdell, Chairman
President
Western Kentucky University
Bowling Green, Ky.



John A. Hillerich IV
President and CEO
Hillerich & Bradsby Co.
Louisville, Ky.



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



Kevin Shurn
President and Owner
Superior Maintenance Co.
Elizabethtown, Ky.



Jon A. Lawson
President, CEO and Chairman
Bank of Ohio County
Beaver Dam, Ky.



Barbara Ann Popp
CEO
Schuler Bauer Real Estate Services
New Albany, Ind.



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

Memphis



Lawrence C. Long, Chairman

Partner
St. Rest Planting Co.
Indianola, Miss.



Charles S. Blatteis

Partner
Burch, Porter & Johnson PLLC
Memphis, Tenn.



Thomas G. Miller

President
Southern Hardware Co. Inc.
West Helena, Ark.



Clyde Warren Nunn

Chairman and President
Security Bancorp of Tennessee Inc.
Halls, Tenn.



Allegra C. Brigham
CEO and General Manager
4-County Electric Power Association
Columbus, Miss.



Nick Clark
Partner
Clark & Clark
Memphis, Tenn.



Susan S. Stephenson
Co-Chairman and President
Independent Bank
Memphis, Tenn.

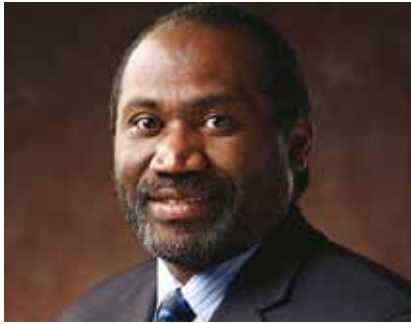
St. Louis



Steven H. Lipstein, Chairman
President and CEO
BJC HealthCare
St. Louis



Ward M. Klein, Deputy Chairman
CEO
Energizer Holdings Inc.
Town & Country, Mo.



Gregory M. Duckett
Senior Vice President and Corporate Counsel
Baptist Memorial Health Care Corp.
Memphis, Tenn.



Sharon D. Fiehler
Executive Vice President and
Chief Administrative Officer
Peabody Energy
St. Louis



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



William E. Chappel
President and CEO
The First National Bank
Vandalia, Ill.



Paul T. Combs
President
Baker Implement Co.
Kennett, Mo.



Sonja Yates Hubbard
CEO
E-Z Mart Stores Inc.
Texarkana, Texas



Robert G. Jones
President and CEO
Old National Bancorp
Evansville, Ind.

Agribusiness

Ray C. Dillon

President and CEO
Deltic Timber Corp.
El Dorado, Ark.

Sam J. Fiorello

Chief Operating Officer and
Senior Vice President
Donald Danforth Plant Science Center
St. Louis

Timothy J. Gallagher

Executive Vice President
Bunge North America Inc.
St. Louis

Keith Glover

President and CEO
Producers Rice Mill Inc.
Stuttgart, Ark.

Bert Greenwalt

Professor of Agricultural Economics
Arkansas State University
State University, Ark.

Leonard J. Guarraia

Chairman
World Agricultural Forum
St. Louis

Ted C. Huber

Owner
Huber's Orchard & Winery
Starlight, Ind.

Richard M. Jameson

Owner
Jameson Family Farms Partnership
Brownsville, Tenn.

John C. King III

Owner
King Farms
Helena, Ark.

Steven M. Turner

CEO
Turner Dairies LLC
Memphis, Tenn.

Lyle B. Waller II

Owner
L.B. Waller and Co.
Morganfield, Ky.

David Williams

Founder and Co-owner
Burkman Feeds
Danville, Ky.

Health Care

Calvin Anderson

Vice President of Corporate and
Government Affairs
Blue Cross Blue Shield of Tennessee
Memphis, Tenn.

Steven J. Bares

President and Executive Director
Memphis Bioworks Foundation
Memphis, Tenn.

Jeffrey B. Bringardner

President of Kentucky Market
Humana-Kentucky Inc.
Louisville, Ky.

Robert S. Gordon

Executive Vice President and
Chief Administration Officer
Baptist Memorial Health Care
Memphis, Tenn.

Paul Halverson, M.D.

Director, State Health Officer
Arkansas Department of Health
Little Rock, Ark.

Russell D. Harrington Jr.

President and CEO
Baptist Health
Little Rock, Ark.

Dick Pierson

Vice Chancellor for Clinical Programs
University of Arkansas for Medical Sciences
Little Rock, Ark.

Sister Mary Jean Ryan

President and CEO
SSM Health Care
St. Louis

Jan C. Vest

CEO
Signature Health Services Inc.
St. Louis

Stephen A. Williams

President and CEO
Norton Health Care
Louisville, Ky.

Real Estate

H. Collins Haynes

CEO
Haynes Limited
Rogers, Ark.

Joseph D. Hegger

Director
Jeffrey E. Smith Institute of Real Estate,
University of Missouri-Columbia
Columbia, Mo.

J. Scott Jagoe

Owner
Jagoe Homes Inc.
Owensboro, Ky.

Larry K. Jensen

President and CEO
Commercial Advisors LLC
Memphis, Tenn.

Gregory J. Kozicz

President and CEO
Alberici Corp.
St. Louis

Steven P. Lane

Principal
Colliers International
Bentonville, Ark.

Jack McCray

Executive Vice President of
Real Estate Acquisition and Development
Bank of the Ozarks
Little Rock, Ark.

John J. Miranda

Partner
Pinnacle Properties of Louisville LLC
Louisville, Ky.

William M. Mitchell

Vice President and Principal Broker
Crye-Leike Realtors
Memphis, Tenn.

David W. Price

Vice President and General Manager
Whittaker Builders Inc.
St. Louis

E. Phillip Scherer III

President
Commercial Kentucky Inc.
Louisville, Ky.

Mary R. Singer

President
CresaPartners Commercial Realty Group
Memphis, Tenn.

Transportation

Charles L. Ewing Sr.

President
Ewing Moving Service and Storage Inc.
Memphis, Tenn.

Gene Huang

Chief Economist
FedEx Corp.
Memphis, Tenn.

Robert M. Blocker

Director of Planning
and Business Development
AEP River Operations LLC
Chesterfield, Mo.

Robert L. Lekites

President
UPS Airlines
Louisville, Ky.

Dennis B. Oakley

President
Bruce Oakley Inc.
North Little Rock, Ark.

John F. Pickering

Chief Operations Officer
Cass Information Systems Inc.
Chesterfield, Mo.

Roger Reynolds

President
Reynolds Group LLC
Louisville, Ky.

Mike P. Ryan

President and CEO
American Commercial Lines Inc.
Jeffersonville, Ind.

Donald H. Sanders Jr.

President
Nightline Express Inc.
St. Louis

David L. Summitt

President
Summitt Trucking LLC
Clarksville, Ind.

Kirk Thompson

President and CEO
J.B. Hunt Transport Services Inc.
Lowell, Ark.

Philip H. Trenary

President and CEO
Pinnacle Airlines Corp.
Memphis, Tenn.

Community Development Advisory Council

Tim Bolding

Executive Director
United Housing Inc.
Memphis, Tenn.

Rev. Adrian M. Brooks

Senior Pastor, Memorial Baptist Church
Founder, Memorial Community Development Corp.
Evansville, Ind.

Brian Dabson

President and CEO, Rural Policy Research Institute
Research Professor, Truman School of Public Affairs
University of Missouri-Columbia
Columbia, Mo.

David Jackson

Senior Program Officer
Mid South Delta LISC
Greenville, Miss.

Leslie Lane

Senior Vice President
Arkansas Economic Acceleration Foundation
Little Rock, Ark.

Trinita Logue

President and CEO
IFF
Chicago

W. Thomas Reeves

President
Pulaski Bank
St. Louis

Kevin Smith

President and CEO
Community Ventures Corp.
Lexington, Ky.

Ben Steinberg

Sr. Vice President
Southern Bancorp
Washington, D.C.

Stephanie Streett

Executive Director
William J. Clinton Presidential
Foundation
Little Rock, Ark.

Emily Trenholm

Executive Director
Community Development
Council of Greater Memphis
Memphis, Tenn.

Marita W. Willis

Vice President and Community
Consultant
PNC Bank Corp.
Louisville, Ky.

John J. Wuest

President and CEO
St. Louis Equity Fund
St. Louis

Federal Advisory Council Member

Lewis F. Mallory Jr.

Chairman and CEO
Cadence Financial Corp.
Starkville, Miss.

Bank Officers

Management Committee



James Bullard
President and Chief Executive Officer



David A. Sapanaro
First Vice President and
Chief Operating Officer



Mary H. Karr
Senior Vice President,
General Counsel and Secretary



Kathleen O. Paese
Senior Vice President



Christopher J. Waller
Senior Vice President and Director of Research



Robert H. Rasche
Executive Vice President and
Senior Policy Adviser



Karl W. Ashman
Senior Vice President



Robert J. Schenk
Senior Vice President



Julie L. Stackhouse
Senior Vice President

Bank Officers

ST. LOUIS

James Bullard
President and CEO

David A. Sapenaro
First Vice President and COO

Robert H. Rasche
Executive Vice President and
Senior Policy Adviser

Karl W. Ashman
Senior Vice President

Mary H. Karr
Senior Vice President,
General Counsel & Secretary

Kathleen O'Neill Paese
Senior Vice President

Michael D. Renfro
Senior Vice President

Robert J. Schenk
Senior Vice President

Julie L. Stackhouse
Senior Vice President

Christopher J. Waller
Senior Vice President and
Director of Research

David Andolfatto
Vice President

Richard G. Anderson
Vice President

John P. Baumgartner
Vice President

Timothy A. Bosch
Vice President

Daniel P. Brennan
Vice President

Timothy C. Brown
Vice President

Fontaine LaMare Chapman
Vice President

Marilyn K. Corona
Vice President

Cletus C. Coughlin
Vice President

Susan K. Curry
Vice President

William T. Gavin
Vice President

Susan F. Gerker
Vice President

Roy A. Hendin
Vice President

James L. Huang
Vice President

Vicki L. Kosydor
Vice President

Jean M. Lovati
Vice President

Michael J. Mueller
Vice President

Kim D. Nelson
Vice President

Arthur A. North II
Vice President

James A. Price
Vice President

Steven N. Silvey
Vice President

Daniel L. Thornton
Vice President

Matthew W. Torbett
Vice President

Howard J. Wall
Vice President

David C. Wheelock
Vice President

Jonathan C. Basden
Assistant Vice President

Dennis W. Blase
Assistant Vice President

Raschelle S. Burton
Assistant Vice President

Winchell S. Carroll
Assistant Vice President

Hillary B. Debenport
Assistant Vice President

William R. Emmons
Assistant Vice President

William M. Francis
Assistant Vice President

Kathy A. Freeman
Assistant Vice President

Thomas A. Garrett
Assistant Vice President

Massimo Guidolin
Assistant Vice President

Anna M. Helmering Hart
Assistant Vice President

Paul M. Helmich
Assistant Vice President

Joel H. James
Assistant Vice President

Debra E. Johnson
Assistant Vice President

Visweswara R. Kaza
Assistant Vice President

Catherine A. Kusmer
Assistant Vice President

Raymond McIntyre
Assistant Vice President

John W. Mitchell
Assistant Vice President

Christopher J. Neely
Assistant Vice President

Glen M. Owens
Assistant Vice President

Kathy A. Schildknecht
Assistant Vice President

Philip G. Schlueter
Assistant Vice President

Harriet Siering
Assistant Vice President

Diane Adele Smith
Assistant Vice President

Scott B. Smith
Assistant Vice President

Katrina L. Stierholz
Assistant Vice President

Kristina L.C. Stierholz
Assistant Vice President

Yi Wen
Assistant Vice President

Glenda Joyce Wilson
Assistant Vice President

Subhayu Bandyopadhyay
Research Officer

Jane Anne Batjer
Assistant Counsel

Diane E. Berry
Assistant Counsel

Mary C. Francone
Learning Technology Officer

Cathryn L. Hohl
Assistant Counsel

Michael W. McCracken
Research Officer

Michael Thomas Owyang
Research Officer

Scott M. Trilling
Operations Officer

Carl D. White
Supervisory Officer

LITTLE ROCK

Robert A. Hopkins
Vice President

LOUISVILLE

Maria G. Hampton
Vice President

Ronald L. Byrne
Vice President

MEMPHIS

Martha L. Perine Beard
Vice President

Ranada Y. Williams
Assistant Vice President

Financial Statements

For the years ended December 31, 2009 and 2008

In 2009, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks and the consolidated financial statements of the limited liability companies (LLCs) that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the Federal Reserve Bank of New York. Fees for D&T's services are estimated to be \$9.6 million, of which approximately \$2.0 million were for the audits of the LLCs. Each LLC will reimburse the Board of Governors for the fees related to the audit of its financial statements from the entity's available net assets. To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T 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 Reserve Banks, or in any other way impairing its audit independence. In 2009, the Bank did not engage D&T for any non-audit services.

April 21, 2010

To the Board of Directors:

The management of the Federal Reserve Bank of St. Louis ("FRBSTL") is responsible for the preparation and fair presentation of the Consolidated Statements of Condition, Consolidated Statements of Income and Comprehensive Income, and Consolidated Statements of Changes in Capital as of December 31, 2009 (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 as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and, as such, include some amounts, that are based on management judgments and estimates. 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.

The management of the FRBSTL is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of the Financial Statements in accordance with the Manual. Internal control contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal control are reported to management and appropriate corrective measures are implemented.

Even effective internal control, 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. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The management of the FRBSTL assessed its internal control over financial reporting 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. Based on this assessment, we believe that the FRBSTL maintained effective internal control over financial reporting as it relates to the Financial Statements.

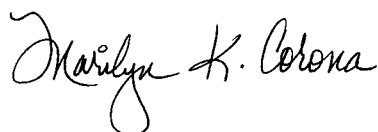
Federal Reserve Bank of St. Louis



James Bullard, President and Chief Executive Officer



David A. Sapenaro, First Vice President and Chief Operating Officer



Marilyn K. Corona, Vice President, Chief Financial Officer

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 ("FRB St. Louis") as of December 31, 2009 and 2008 and the related statements of income and comprehensive income, and changes in capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRB St. Louis as of December 31, 2009, 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 these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on FRB St. Louis' internal control over financial reporting based on our audits.

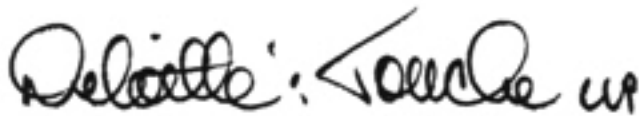
We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

FRB St. Louis' internal control over financial reporting is a process designed by, or under the supervision of, FRB St. Louis' principal executive and principal financial officers, or persons performing similar functions, and effected by FRB St. Louis' board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. FRB St. Louis' internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of FRB St. Louis; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System, and that receipts and expenditures of FRB St. Louis are being made only in accordance with authorizations of management and directors of FRB St. Louis; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of FRB St. Louis' assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As described in Note 4 to the financial statements, FRB St. Louis has prepared these financial statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the Financial Accounting Manual for Federal Reserve Banks, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such financial statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 4.

In our opinion, such financial statements present fairly, in all material respects, the financial position of FRB St. Louis as of December 31, 2009 and 2008, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, FRB St. Louis maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.



St. Louis, Missouri

April 21, 2010

STATEMENTS OF CONDITION*(in millions)*

	As of December 31,	
	2009	2008
ASSETS		
Gold certificates	\$ 329	\$ 344
Special drawing rights certificates	150	71
Coin	32	43
Items in process of collection	19	17
Loans to depository institutions	619	5,152
System Open Market Account:		
Securities purchased under agreements to resell	-	2,765
Treasury securities, net	31,575	16,637
Government-sponsored enterprise debt securities, net	6,557	717
Federal agency and government-sponsored enterprise mortgage-backed securities, net	36,000	-
Investments denominated in foreign currencies	251	242
Central bank liquidity swaps	102	5,401
Accrued interest receivable	495	210
Interdistrict settlement account	-	3,210
Bank premises and equipment, net	151	144
Other assets	30	33
Total assets	\$ 76,310	\$ 34,986
LIABILITIES AND CAPITAL		
Federal Reserve notes outstanding, net	\$ 26,948	\$ 25,912
System Open Market Account:		
Securities sold under agreements to repurchase	3,045	3,053
Other liabilities	24	-
Deposits:		
Depository institutions	10,315	5,446
Other deposits	3	6
Deferred credit items	67	47
Accrued interest on Federal Reserve notes	59	4
Interdistrict settlement account	35,273	-
Interest due to depository institutions	1	1
Accrued benefit costs	85	88
Other liabilities	10	9
Total liabilities	75,830	34,566
Capital paid-in	240	210
Surplus (including accumulated other comprehensive loss of \$11 million and \$20 million at December 31, 2009 and 2008, respectively)	240	210
Total capital	480	420
Total liabilities and capital	\$ 76,310	\$ 34,986

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

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(in millions)

For the years ended December 31,

	2009	2008
INTEREST INCOME		
Loans to depository institutions	\$ 8	\$ 49
System Open Market Account:		
Securities purchased under agreements to resell	-	64
Treasury securities	874	858
Government-sponsored enterprise debt securities	79	3
Federal agency and government-sponsored enterprise mortgage-backed securities	793	-
Investments denominated in foreign currencies	3	6
Central bank liquidity swaps	22	35
Total interest income	1,779	1,015
INTEREST EXPENSE		
System Open Market Account:		
Securities sold under agreements to repurchase	4	25
Depository institution deposits	17	3
Total interest expense	21	28
Net interest income	1,758	987
NON-INTEREST INCOME:		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	36	124
Foreign currency gains, net	2	13
Compensation received for services provided	7	15
Reimbursable services to government agencies	105	110
Other income	5	28
Total non-interest income	155	290
OPERATING EXPENSES:		
Salaries and other benefits	107	104
Occupancy expense	13	12
Equipment expense	5	6
Assessments by the Board of Governors	21	22
Other expenses	87	99
Total operating expenses	233	243
Net income prior to distribution	1,680	1,034
Change in funded status of benefit plans	9	(2)
Comprehensive income prior to distribution	\$ 1,689	\$ 1,032
Distribution of comprehensive income:		
Dividends paid to member banks	\$ 14	\$ 11
Transferred to surplus and change in accumulated other comprehensive loss	30	30
Payments to Treasury as interest on Federal Reserve notes	1,645	991
Total distribution	\$ 1,689	\$ 1,032

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

STATEMENTS OF CHANGES IN CAPITAL

For the years ended December 31, 2009, and December 31, 2008
(in millions, except share data)

	Capital Paid-In	Surplus		Total Surplus	Total Capital
		Net Income Retained	Accumulated Other Comprehensive Income (Loss)		
Balance at January 1, 2008 (3,598,990 shares)	\$ 180	\$ 198	\$ (18)	\$ 180	\$ 360
Net change in capital stock issued (594,737 shares)	30	-	-	-	30
Transferred to surplus and change in accumulated other comprehensive income (loss)	-	32	(2)	30	30
Balance at December 31, 2008 (4,193,727 shares)	\$ 210	\$ 230	\$ (20)	\$ 210	\$ 420
Net change in capital stock issued (611,886 shares)	30	-	-	-	30
Transferred to surplus and change in accumulated other comprehensive income (loss)	-	21	9	30	30
Balance at December 31, 2009 (4,805,613 shares)	\$ 240	\$ 251	\$ (11)	\$ 240	\$ 480

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

NOTES TO FINANCIAL STATEMENTS**NOTE 1****STRUCTURE**

The Federal Reserve Bank of St. Louis ("Bank") is part of the Federal Reserve System ("System") and is one of the twelve Federal 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 serves 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 is 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 of the Federal Reserve System ("Board of Governors") to represent the public, 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. 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.

In addition to the 12 Reserve Banks, the System also consists, in part, of the 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 Reserve Banks perform a variety of services and operations. These functions include participating in formulating and conducting monetary policy; participating in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distributing coin and currency; performing fiscal agency functions for the U.S. Department of the Treasury ("Treasury"), certain Federal agencies, and other entities; serving as the federal government's bank; providing short-term loans to depository institutions; providing loans to individuals, partnerships, and corporations in unusual and exigent circumstances; serving consumers and communities by providing educational materials and information regarding financial consumer protection rights and laws and information on community development programs and activities; and supervising bank holding companies, state member banks, and U.S. offices of foreign banking organizations.

Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, Federal agency and government-sponsored enterprise ("GSE") debt securities, Federal agency and GSE mortgage-backed securities ("MBS"), the purchase of these securities under agreements to resell, and the sale of these securities under agreements to repurchase. The FRBNY executes these transactions at the direction of the FOMC and holds the resulting securities and agreements in a portfolio known as the System Open Market Account ("SOMA"). The FRBNY is authorized to lend the Treasury securities and Federal agency and GSE debt securities that are held in the SOMA.

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes the FRBNY to execute operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities. Specifically, the FOMC authorizes and directs the FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, fourteen foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements ("FX swaps") with two central banks and to "warehouse" foreign currencies for the Treasury and the Exchange Stabilization Fund ("ESF"). The FRBNY is also authorized and directed by the FOMC to maintain U.S. dollar currency liquidity swap arrangements with fourteen central banks. The FOMC has also authorized the FRBNY to maintain foreign currency liquidity swap arrangements with four foreign central banks.

Although the Reserve Banks are separate legal entities, they collaborate in the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function 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 Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks.

Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by 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 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, accounting and collateral monitoring functions.

NOTE 3

FINANCIAL STABILITY ACTIVITIES

The Reserve Banks have implemented the following programs that support the liquidity of financial institutions and foster improved conditions in financial markets.

EXPANDED OPEN MARKET OPERATIONS AND SUPPORT FOR MORTGAGE RELATED SECURITIES

The Single-Tranche Open Market Operation Program allows primary dealers to initiate a series of 28-day term repurchase transactions while pledging Treasury securities, Federal agency and GSE debt securities, and Federal agency and GSE MBS as collateral.

The Federal Agency and GSE Debt Securities and MBS Purchase Program provides support to the mortgage and housing markets and fosters improved conditions in financial markets. Under this program, the FRBNY purchases housing-related GSE debt securities and Federal agency and GSE MBS. Purchases of housing-related GSE debt securities began in November 2008 and purchases of Federal agency and GSE MBS began in January 2009. The FRBNY is authorized to purchase up to \$200 billion in fixed rate, non-callable GSE debt securities and up to \$1.25 trillion in fixed rate Federal agency and GSE MBS. The activities of both of these programs are allocated to the other Reserve Banks.

CENTRAL BANK LIQUIDITY SWAPS

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which may be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements.

U.S. dollar liquidity swap arrangements were authorized with fourteen foreign central banks to provide liquidity in U.S. dollars to overseas markets. Such arrangements were authorized with the following central banks: the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, the Sveriges Riksbank, and the Swiss National Bank. The maximum amount that could be drawn under these swap arrangements varied by central bank. The authorization for these swap arrangements expired on February 1, 2010.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. Such arrangements were authorized with the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. The maximum amount that could be drawn under the swap arrangements varied by central bank. The authorization for these swap arrangements expired on February 1, 2010.

NOTES TO FINANCIAL STATEMENTS

LENDING TO DEPOSITORY INSTITUTIONS

The Term Auction Facility (“TAF”) promotes the efficient dissemination of liquidity by providing term funds to depository institutions. Under the TAF, Reserve Banks auction term funds to depository institutions against any collateral eligible to secure primary, secondary, and seasonal credit less a margin, which is a reduction in the assigned collateral value that is intended to provide the Banks additional credit protection. All depository institutions that are considered to be in generally sound financial condition by their Reserve Bank and that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All loans must be collateralized to the satisfaction of the Reserve Banks.

LENDING TO PRIMARY DEALERS

The Term Securities Lending Facility (“TSLF”) promoted liquidity in the financing markets for Treasury securities. Under the TSLF, the FRBNY could lend up to an aggregate amount of \$200 billion of Treasury securities held in the SOMA to primary dealers secured for a term of 28 days. Securities were lent to primary dealers through a competitive single-price auction and were collateralized, less a margin, by a pledge of other securities, including Treasury securities, municipal securities, Federal agency and GSE MBS, non-agency AAA/Aaa-rated private-label residential MBS, and asset-backed securities (“ABS”). The authorization for the TSLF expired on February 1, 2010.

The Term Securities Lending Facility Options Program (“TOP”) offered primary dealers, through a competitive single-price auction, to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program enhanced the effectiveness of the TSLF by ensuring additional liquidity during periods of heightened collateral market pressures, such as around quarter-end dates. The program was suspended effective with the maturity of the June 2009 TOP options and the program authorization expired on February 1, 2010.

OTHER LENDING FACILITIES

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (“AMLF”) provided funding to depository institutions and bank holding companies to finance the purchase of eligible high-quality asset-backed commercial paper (“ABCP”) from money market mutual funds. The program assisted money market mutual funds that hold such paper to meet the demands for investor redemptions and to foster liquidity in the ABCP market and money markets more generally. The Federal Reserve Bank of Boston (“FRBB”) administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. All loans extended under the AMLF were non-recourse and were recorded as assets by the FRBB, and if the borrowing institution settles to a depository account in the Eighth Federal Reserve District, the funds were credited to the depository institution account and settled between the Reserve Banks through the interdistrict settlement account. The credit risk related to the AMLF was assumed by the FRBB. The authorization for the AMLF expired on February 1, 2010.

NOTE 4

SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of a nation’s central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* (“Financial Accounting Manual” or “FAM”), which is issued by the Board of Governors. The Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the FAM and the financial statements have been prepared in accordance with the FAM.

Limited differences exist between the accounting principles and practices in the FAM and generally accepted accounting principles 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 SOMA securities holdings at amortized cost rather than the fair value presentation required by GAAP. Treasury securities, GSE debt securities, Federal agency and GSE MBS, and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis rather than the trade-date basis required by GAAP. The cost basis of Treasury securities, GSE debt securities, and foreign government debt instruments is adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank’s securities holdings given the System’s unique responsibility to conduct monetary policy. Accounting for these securities on a settlement-date basis more appropriately reflects the timing of the transaction’s effect on the quantity of reserves in the banking system. Although the application of fair value measurements to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value have no direct effect 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 securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

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 Reserve Banks’ unique powers and responsibilities. Other information regarding the Bank’s activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the FAM and GAAP.

Preparing the financial statements in conformity with the FAM 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. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. Unique accounts and significant accounting policies are explained below.

A. GOLD AND SPECIAL DRAWING RIGHTS CERTIFICATES

The Secretary of the 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 Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold of the Treasury. The Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the Treasury. At such time, the Treasury’s account is charged, and the Reserve Banks’ gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at \$42 2/9 per fine troy ounce. The Board of Governors allocates the gold certificates among the Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund (the “Fund”) to its members in proportion to each member’s quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks’ SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the 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 the Reserve Banks based upon each Reserve Bank’s Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2008, and in 2009 the Treasury issued \$3 billion in SDR certificates to the Reserve Banks, of which \$79 million was allocated to the Bank.

B. LOANS TO DEPOSITORY INSTITUTIONS

Loans are reported at their outstanding principal balances and interest income is recognized on an accrual basis.

Loans are impaired when, based on current information and events, it is probable that the Bank will not receive the principal or interest that is due in accordance with the contractual terms of the loan agreement. Loans are evaluated to determine whether an allowance for loan loss is required. The Bank has developed procedures for assessing the adequacy of any allowance for loan losses using all available information to reflect the assessment of credit risk. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers and, as appropriate, evaluating collateral values for each program. Generally, the

Bank discontinues recognizing interest income on impaired loans until the borrower’s repayment performance demonstrates principal and interest will be received in accordance with the term of the loan agreement. If the Bank discontinues recording interest on an impaired loan, cash payments are first applied to principal until the loan balance is reduced to zero; subsequent payments are applied as recoveries of amounts previously deemed uncollectible, if any, and then as interest income.

C. SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL, SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE, AND SECURITIES LENDING

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (“repurchase transactions”). These repurchase transactions are typically executed through a tri-party arrangement (“tri-party transactions”). Tri-party transactions are conducted with two commercial custodial banks that manage the clearing, settlement, and pledging of collateral. The collateral pledged must exceed the principal amount of the transaction. Acceptable collateral under tri-party repurchase transactions primarily includes Treasury securities; pass-through mortgage securities of Fannie Mae, Freddie Mac, and Ginnie Mae; STRIP Treasury securities; and “stripped” securities of Federal agencies. The tri-party transactions are accounted for as financing transactions with the associated interest income accrued over the life of the transaction. Repurchase transactions are reported at their contractual amount as “System Open Market Account: Securities purchased under agreements to resell” in the Statements of Condition and the related accrued interest receivable is reported as a component of “Accrued interest receivables.”

The FRBNY may engage in sales of securities with primary dealers under agreements to repurchase (“reverse repurchase transactions”). These reverse repurchase transactions may be executed through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international accounts. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts in the Statements of Condition and the related accrued interest payable is reported as a component of “Other liabilities.”

Treasury securities and GSE debt securities held in the SOMA are lent to primary dealers to facilitate the effective functioning of the domestic securities market. Overnight securities lending transactions are fully collateralized by other Treasury securities. TSLF transactions are fully collateralized with investment-grade debt securities, collateral eligible for tri-party repurchase agreements arranged by the FRBNY or both. The collateral taken in both overnight and term securities lending transactions is in excess of the fair value of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of “Other income.” In addition, TOP fees are reported as a component of “Other income.”

Activity related to securities purchased under agreements to resell, securities sold under agreements to repurchase, and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April each year. The settlement also equalizes Reserve Bank gold

NOTES TO FINANCIAL STATEMENTS

certificate holdings to Federal Reserve notes outstanding in each District.

D. TREASURY SECURITIES; GOVERNMENT-SPONSORED ENTERPRISE DEBT SECURITIES; FEDERAL AGENCY AND GOVERNMENT-SPONSORED ENTERPRISE MORTGAGE-BACKED SECURITIES; INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES; AND WAREHOUSING AGREEMENTS

Interest income on Treasury securities, GSE debt securities, and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Interest income on Federal agency and GSE MBS is accrued using the interest method and includes amortization of premiums, accretion of discounts, and paydown gains or losses. Paydown gains or losses result from scheduled payment and prepayment of principal and represent the difference between the principal amount and the carrying value of the related security. Gains and losses resulting from sales of securities are determined by specific issue based on average cost.

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (“dollar rolls”), which primarily involve an initial transaction to purchase or sell “to be announced” (“TBA”) MBS combined with an agreement to sell or purchase TBA MBS on a specified future date. The FRBNY’s participation in the dollar roll market furthers the MBS Purchase Program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets. The FRBNY accounts for outstanding commitments to sell or purchase TBA MBS on a settlement-date basis. Based on the terms of the FRBNY dollar roll transactions, transfers of MBS upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*, (previously SFAS 140), and the related outstanding commitments are accounted for as sales or purchases upon settlement.

Activity related to Treasury securities, GSE debt securities, and Federal agency and GSE MBS, including the premiums, discounts, and realized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies, including the premiums, discounts, and realized and unrealized gains and losses, 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.

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 gains, net” in the Statements of Income and Comprehensive Income.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the 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 Treasury and ESF for financing purchases of foreign currencies and related international operations.

Warehousing agreements are designated as held-for-trading purposes and are valued daily at current market exchange rates. Activity related to these agreements 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.

E. CENTRAL BANK LIQUIDITY SWAPS

Central bank liquidity swaps, which are transacted between the FRBNY and a foreign central bank, may be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements.

Activity related to U.S. dollar and foreign currency swap transactions, including the related income and expense, 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. Similar to investments denominated in foreign currencies, the foreign currency amounts associated with these central bank liquidity swap arrangements are revalued at current foreign currency market exchange rates.

U.S. DOLLAR LIQUIDITY SWAPS

At the initiation of each U.S. dollar liquidity swap transaction, the foreign central bank transfers a specified amount of its currency to a restricted account for the FRBNY in exchange for U.S. dollars at the prevailing market exchange rate. Concurrent with this transaction, the FRBNY and the foreign central bank agree to a second transaction that obligates the foreign central bank to return the U.S. dollars and the FRBNY to return the foreign currency on a specified future date at the same exchange rate as the initial transaction. The Bank’s allocated portion of the foreign currency amounts that the FRBNY acquires is reported as “Central bank liquidity swaps” on the Statements of Condition. Because the swap transaction will be unwound at the same U.S. dollar amount and exchange rate that were used in the initial transaction, the recorded value of the foreign currency amounts is not affected by changes in the market exchange rate.

The foreign central bank compensates the FRBNY based on the foreign currency amounts held for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as “Interest income: Central bank liquidity swaps” in the Statements of Income and Comprehensive Income.

FOREIGN CURRENCY LIQUIDITY SWAPS

At the initiation of each foreign currency liquidity swap transaction, the FRBNY will transfer, at the prevailing market exchange rate, a specified amount of U.S. dollars to an account for the foreign central bank in exchange for its currency. The foreign currency amount received would be reported as a liability by the Bank. Concurrent with this transaction, the FRBNY and the foreign central bank agree to a second transaction that obligates the FRBNY to return the foreign currency and the foreign central bank to return the U.S. dollars on a specified future date. The FRBNY compensates the foreign central bank based on the foreign currency transferred to the FRBNY. For each foreign currency swap transaction with a foreign central bank it is anticipated that the FRBNY will enter into a corresponding transaction with a U.S. depository institution in order to provide foreign

currency liquidity to that institution. No foreign currency liquidity swap transactions occurred in 2008 or 2009.

F. INTERDISTRICT SETTLEMENT ACCOUNT

At the close of business each day, each Reserve Bank aggregates the payments due to or from other Reserve Banks. These payments result from transactions between the Reserve Banks and transactions that involve depository institution accounts held by other Reserve Banks, such as Fedwire funds and securities transfers and check and ACH transactions. The cumulative net amount due to or from the other Reserve Banks is reflected in the "Interdistrict settlement account" in the Statements of Condition.

G. 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 the estimated useful lives of the assets, which range from two to fifty years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

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

Capitalized assets, including software, buildings, leasehold improvements, furniture, and equipment, are impaired and an adjustment is recorded when events or changes in circumstances indicate that the carrying amount of assets or asset groups is not recoverable and significantly exceeds the assets' fair value.

H. FEDERAL RESERVE NOTES

Federal Reserve notes are the circulating currency of the United States. These notes, which are identified as issued to a specific Reserve Bank, must be fully collateralized. Assets eligible to be pledged as collateral security include all of the Bank's assets. The collateral value is equal to the book value of the collateral tendered with the exception of securities, for which the 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 outstanding 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 issued to 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, Federal Reserve

notes are obligations of the United States Government. At December 31, 2009 and 2008, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of \$4,106 million and \$3,405 million at December 31, 2009 and 2008, respectively.

I. ITEMS IN PROCESS OF COLLECTION AND DEFERRED CREDIT ITEMS

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

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. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

By law, each Reserve 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. To reflect the Federal Reserve Act requirement that annual dividends be deducted from net earnings, dividends are presented as a distribution of comprehensive income in the Statements of Income and Comprehensive Income.

K. SURPLUS

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to other postretirement benefit plans that, under GAAP, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

L. INTEREST ON FEDERAL RESERVE NOTES

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to U.S. Treasury as interest on Federal Reserve notes" in the Statements of Income and Comprehensive

NOTES TO FINANCIAL STATEMENTS

Income. The amount due to the Treasury is reported as “Accrued interest on Federal Reserve notes” in the Statements of Condition. If overpaid during the year, the amount is reported as “Prepaid interest on Federal Reserve notes” in the Statements of Condition. Payments are made weekly to the Treasury.

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

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 Treasury in the following year.

M. INTEREST ON DEPOSITORY INSTITUTION DEPOSITS

On October 9, 2008, the Reserve Banks began paying interest to depository institutions on qualifying balances held at the Banks. The interest rates paid on required reserve balances and excess balances are determined by the Board of Governors, based on an FOMC-established target range for the effective federal funds rate.

N. INCOME AND COSTS RELATED TO TREASURY SERVICES

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Department of the Treasury has appropriations to pay for these services. During the years ended December 31, 2009 and 2008, the Bank was reimbursed for all services provided to the Department of the Treasury as its fiscal agent.

O. COMPENSATION RECEIVED FOR SERVICES PROVIDED

The Federal Reserve Bank of Atlanta (“FRBA”) has overall responsibility for managing the Reserve Banks’ provision of check and ACH services to depository institutions and, as a result, recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. Similarly, the FRBNY manages the Reserve Banks’ provision of Fedwire funds and securities services and recognizes total System revenue for these services on its Consolidated Statements of Income and Comprehensive Income. The FRBA and the FRBNY compensate the applicable Reserve Banks for the costs incurred to provide these services. The Bank reports this compensation as “Compensation received for services provided” in the Statements of Income and Comprehensive Income.

P. 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 as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred by the Treasury to produce 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 prior year.

Q. 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 \$1 million for each of the years ended

December 31, 2009 and 2008, and are reported as a component of “Occupancy expense.”

R. RESTRUCTURING CHARGES

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Bank commits to a formalized restructuring plan or executes the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 14 describes the Bank’s restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY.

The Bank had no significant restructuring activities in 2008 and 2009.

S. RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2008, FASB issued FSP SFAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions*, (codified in FASB ASC Topic 860 (ASC 860), *Transfers and Servicing*). ASC 860 requires that an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of, the initial transfer be evaluated together as a linked transaction unless certain criteria are met. These provisions of ASC 860 are effective for the Bank’s financial statements for the year beginning on January 1, 2009 and have not had a material effect on the Bank’s financial statements. The requirements of this standard have been reflected in the accompanying footnotes.

In June 2009, FASB issued SFAS 166, *Accounting for Transfers of Financial Assets – an amendment to FASB Statement No. 140*, (codified in ASC 860). The new guidance modifies existing guidance to eliminate the scope exception for qualifying special purpose vehicles (“SPVs”) and clarifies that the transferor must consider all arrangements of the transfer of financial assets when determining if the transferor has surrendered control. These provisions of ASC 860 are effective for the Bank’s financial statements for the year beginning on January 1, 2010, and earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Bank’s financial statements.

In May 2009, FASB issued SFAS No. 165, *Subsequent Events*, (codified in FASB ASC Topic 855 (ASC 855), *Subsequent Events*), which establishes general standards of accounting for and disclosing events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 sets forth (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and

(iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date, including disclosure of the date through which an entity has evaluated subsequent events and whether that represents the date the financial statements were issued or were available to be issued. The Bank adopted ASC 855 for the period ended December 31, 2009 and the required disclosures are reflected in Note 15.

In June 2009, the FASB issued SFAS No. 168, *The Statement of Financial Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a replacement of SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles* (SFAS 168). SFAS 168 establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP. The ASC does not change current GAAP, but it introduces a new structure that organizes the authoritative standards by topic. SFAS 168 is effective for financial statements issued for periods ending after September 15, 2009. As a result, both the ASC and the legacy standard are referenced in the Bank's financial statements and footnotes.

NOTE 5

LOANS

The loan amounts outstanding at December 31 were as follows (in millions):

	2009	2008
Primary, secondary, and seasonal credit	\$ 26	\$ 454
TAF	593	4,698
Loans to depository institutions	\$ 619	\$ 5,152

LOANS TO DEPOSITORY INSTITUTIONS

The Bank offers primary, secondary, and seasonal credit to eligible borrowers. Each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every fourteen days by the board of directors of the Bank, subject to review and determination by the Board of Governors. Primary and secondary credit are extended on a short-term basis, typically overnight, whereas seasonal credit may be extended for a period of up to nine months.

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; ABS; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Bank, which is typically fair value or face value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program are also eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process,

subject to a minimum bid rate. TAF loans are extended on a short-term basis, with terms ranging from 28 to 84 days. All advances under the TAF program must be collateralized to the satisfaction of the Bank. Assets eligible to collateralize TAF loans include the complete list noted above for loans to depository institutions. Similar to the process used for primary, secondary, and seasonal credit, a lending value is assigned to each asset that is accepted as collateral for TAF loans reduced by a margin.

Loans to depository institutions are monitored on a daily basis to ensure that borrowers continue to meet eligibility requirements for these programs. The financial condition of borrowers is monitored by the Bank and, if a borrower no longer qualifies for these programs, the Bank will generally request full repayment of the outstanding loan or, for primary and seasonal credit lending, may convert the loan to a secondary credit loan.

Collateral levels are reviewed daily against outstanding obligations and borrowers that no longer have sufficient collateral to support outstanding loans are required to provide additional collateral or to make partial or full repayment.

The remaining maturity distributions of loans outstanding at December 31 were as follows (in millions):

2009		
	Primary, secondary, and seasonal credit	TAF
Within 15 days	\$ 26	\$ 593
Total loans	\$ 26	\$ 593

2008		
	Primary, secondary, and seasonal credit	TAF
Within 15 days	\$ 348	\$ 4,345
16 days to 90 days	106	353
Total loans	\$ 454	\$ 4,698

At December 31, 2009 and 2008, the Bank did not have any impaired loans and no allowance for loan losses was required.

NOTE 6

TREASURY SECURITIES; GOVERNMENT-SPONSORED ENTERPRISE DEBT SECURITIES; FEDERAL AGENCY AND GOVERNMENT-SPONSORED ENTERPRISE MORTGAGE-BACKED SECURITIES; SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL; 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 3.918 percent and 3.456 percent at December 31, 2009 and 2008, respectively.

NOTES TO FINANCIAL STATEMENTS

The Bank's allocated share of Treasury securities, GSE debt securities, and Federal agency and GSE MBS, excluding accrued interest, held in the SOMA at December 31 was as follows (in millions):

2009						
	Treasury securities				GSE debt securities	Federal agency and GSE MBS
	Bills	Notes	Bonds	Total Treasury securities		
Par	\$ 722	\$ 22,265	\$ 7,437	\$ 30,424	\$ 6,264	\$ 35,587
Unamortized premiums	-	256	958	1,214	294	474
Unaccreted discounts	-	(39)	(24)	(63)	(1)	(61)
Total amortized cost	\$ 722	\$ 22,482	\$ 8,371	\$ 31,575	\$ 6,557	\$ 36,000
Fair Value	\$ 722	\$ 22,841	\$ 9,039	\$ 32,602	\$ 6,560	\$ 35,818

2008						
	Treasury securities				GSE debt securities	Federal agency and GSE MBS
	Bills	Notes	Bonds	Total Treasury securities		
Par	\$ 636	\$ 11,569	\$ 4,241	\$ 16,446	\$ 681	\$ -
Unamortized premiums	-	9	232	241	37	-
Unaccreted discounts	-	(29)	(21)	(50)	(1)	-
Total amortized cost	\$ 636	\$ 11,549	\$ 4,452	\$ 16,637	\$ 717	\$ -
Fair Value	\$ 637	\$ 12,361	\$ 5,855	\$ 18,853	\$ 721	\$ -

The total of the Treasury securities, GSE debt securities, and Federal agency and GSE MBS, net, excluding accrued interest held in the SOMA at December 31 was as follows (in millions):

2009						
	Treasury securities				GSE debt securities	Federal agency and GSE MBS
	Bills	Notes	Bonds	Total Treasury securities		
Amortized Cost	\$ 18,423	\$ 573,877	\$ 213,672	\$ 805,972	\$ 167,362	\$ 918,927
Fair Value	18,423	583,040	230,717	832,180	167,444	914,290

2008						
	Treasury securities				GSE debt securities	Federal agency and GSE MBS
	Bills	Notes	Bonds	Total Treasury securities		
Amortized Cost	\$ 18,422	\$ 334,217	\$ 128,810	\$ 481,449	\$ 20,740	\$ -
Fair Value	18,422	357,709	169,433	545,564	20,863	-

The fair value amounts in the above tables are presented solely for informational purposes. Although the fair value of security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. Fair value was determined by reference to quoted market values for identical securities, except for Federal agency and GSE MBS for which fair values were determined using a model-based approach based on observable inputs for similar securities.

The fair value of the fixed-rate Treasury securities, GSE debt securities, and Federal agency and GSE MBS in the SOMA's holdings is subject to market risk, arising from movements in market variables, such as interest rates and securities prices. The fair value of Federal agency and GSE MBS is also affected by the rate of prepayments of mortgage loans underlying the securities.

The following table provides additional information on the amortized cost and fair values of the Federal agency and GSE MBS portfolio at December 31, 2009 (in millions):

Distribution of MBS holdings by coupon rate	Amortized cost	Fair value
Allocated to the Bank:		
4.0%	\$ 6,665	\$ 6,493
4.5%	17,016	16,910
5.0%	7,656	7,695
5.5%	4,050	4,097
6.0%	498	505
Other ¹	115	118
Total	\$ 36,000	\$ 35,818
System total:		
4.0%	\$ 170,119	\$ 165,740
4.5%	434,352	431,646
5.0%	195,418	196,411
5.5%	103,379	104,583
6.0%	12,710	12,901
Other ¹	2,949	3,009
Total	\$ 918,927	\$ 914,290

¹ Represents less than one percent of the total portfolio

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31, 2009 and 2008, was as follows (in millions):

	Securities purchased under agreements to resell		Securities sold under agreements to repurchase	
	2009	2008	2009	2008
Allocated to the Bank:				
Contract amount outstanding, end of year	\$ -	\$ 2,765	\$ 3,045	\$ 3,053
Average daily amount outstanding, during the year	125	2,939	2,561	1,876
Maximum month-end balance outstanding, during the year	-	4,112	3,045	3,406
Securities pledged, end of year	-	-	3,050	2,726
System total:				
Contract amount outstanding, end of year	\$ -	\$ 80,000	\$ 77,732	\$88,352
Average daily amount outstanding, during the year	3,616	86,227	67,837	55,169
Maximum month-end balance outstanding, during the year	-	119,000	77,732	98,559
Securities pledged, end of year	-	-	77,860	78,896

The Bank has revised its disclosure of securities purchased under agreements to resell and securities sold under agreements to repurchase from a weighted average calculation, disclosed in 2008, to the simple daily average calculation, disclosed above. The previously reported System total 2008 weighted average amount outstanding for securities purchased under agreements to resell was \$97,037 million, of which \$3,353 million was allocated to the Bank. The previously reported System total 2008 weighted average amount outstanding for securities sold under agreements to repurchase was \$65,461 million, of which \$2,262 million was allocated to the Bank.

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value.

NOTES TO FINANCIAL STATEMENTS

The remaining maturity distribution of Treasury securities, GSE debt securities, Federal agency and GSE MBS bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2009, was as follows (in millions):

	Treasury securities (Par value)	GSE debt securities (Par value)	Federal agency and GSE MBS (Par value)	Securities purchased under agreements to resell (Contract amount)	Securities sold under agreements to repurchase (Contract amount)
Within 15 days	\$ 455	\$ 3	\$ -	\$ -	\$ 3,045
16 days to 90 days	1,130	119	-	-	-
91 days to 1 year	1,989	844	-	-	-
Over 1 year to 5 years	12,806	3,894	1	-	-
Over 5 years to 10 years	8,373	1,324	1	-	-
Over 10 years	5,671	80	35,585	-	-
Total allocated to the Bank	\$ 30,424	\$ 6,264	\$ 35,587	\$ -	\$ 3,045

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2009, which differs from the stated maturity primarily because it factors in prepayment assumptions, is approximately 6.4 years.

At December 31, 2009 and 2008, Treasury securities and GSE debt securities with par values of \$21,610 million and \$180,765 million, respectively, were loaned from the SOMA, of which \$847 million and \$6,247 million, respectively, were allocated to the Bank.

At December 31, 2009, the total of other investments was \$5 million, of which the Bank's allocated share was immaterial. Other investments consist of cash and short-term investments related to the Federal agency and GSE MBS portfolio.

At December 31, 2009, the total of other liabilities was \$601 million, of which \$24 million was allocated to the Bank. These other liabilities, which are related to purchases of Federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the Bank has ownership of and records its investments in the MBS securities as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Bank's obligation to pay for the securities when delivered.

The FRBNY enters into commitments to buy Federal agency and GSE MBS and records the related MBS on a settlement-date basis. As of December 31, 2009, the total purchase price of the Federal agency and GSE MBS under outstanding commitments was \$160,099 million, of which \$32,838 million was related to dollar roll transactions. The amount of outstanding commitments allocated to the Bank was \$6,272 million, of which \$1,286 million was related to dollar roll transactions. These commitments, which had contractual settlement dates extending through March 2010, are primarily for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to market and counterparty risks that result from their future settlement. As of December 31, 2009, the fair value of Federal agency and GSE MBS under outstanding commitments was \$158,868 million, of which \$6,224 million was allocated to the Bank. During the year ended December 31, 2009, the Reserve Banks recorded net gains from dollar roll related sales of \$879 million, of which \$36 million was allocated to the Bank. These net gains are reported as "Non-Interest Income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

NOTE 7

INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. These investments are guaranteed as to principal and interest by the issuing foreign governments. In addition, the FRBNY enters into transactions to purchase foreign-currency-denominated government-debt securities under agreements to resell for which the accepted collateral is the debt instruments issued by the governments of Belgium, France, Germany, Italy, the Netherlands, and Spain.

The Bank's allocated share of investments denominated in foreign currencies was approximately .995 percent and .975 percent at December 31, 2009 and 2008, respectively.

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

	2009	2008
Euro:		
Foreign currency deposits	\$ 73	\$ 54
Securities purchased under agreements to resell	26	40
Government debt instruments	49	45
Japanese yen:		
Foreign currency deposits	34	34
Government debt instruments	69	69
Total allocated to the Bank	\$ 251	\$ 242

At December 31, 2009 and 2008, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was \$254 million and \$244 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the Treasury securities, GSE debt securities, and Federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

Total Reserve Bank investments denominated in foreign currencies were \$25,272 million and \$24,804 million at December 31, 2009 and 2008, respectively. At December 31, 2009 and 2008, the fair value of the total Reserve Bank investments denominated in foreign currencies, including accrued interest, was \$25,480 million and \$25,021 million, respectively.

The remaining maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2009 was as follows (in millions):

	Euro	Japanese yen	Total
Within 15 days	\$ 60	\$ 36	\$ 96
16 days to 90 days	25	5	30
91 days to 1 year	24	23	47
Over 1 year to 5 years	39	39	78
Total allocated to the Bank	\$148	\$103	\$251

At December 31, 2009 and 2008, the authorized warehousing facility was \$5 billion, with no balance outstanding.

In connection with its foreign currency activities, the FRBNY may enter into transactions that contain varying degrees of off-balance-sheet market risk that result from their future settlement and counterparty credit risk. The FRBNY controls these risks by obtaining credit approvals, establishing transaction limits, receiving collateral in some cases, and performing daily monitoring procedures.

NOTE 8

CENTRAL BANK LIQUIDITY SWAPS

U.S. DOLLAR LIQUIDITY SWAPS

The Bank's allocated share of U.S. dollar liquidity swaps was approximately .995 percent and .975 percent at December 31, 2009 and 2008, respectively.

At December 31, 2009 and 2008, the total Reserve Bank amount of foreign currency held under U.S. dollar liquidity swaps was \$10,272 million and \$553,728 million, respectively, of which \$102 million and \$5,401 million, respectively, was allocated to the Bank.

The remaining maturity distribution of U.S. dollar liquidity swaps that were allocated to the Bank at December 31 was as follows (in millions):

	2009			2008		
	Within 15 days	16 days to 90 days	Total	Within 15 days	16 days to 90 days	Total
Australian dollar	\$ -	\$ -	\$ -	\$ 98	\$ 125	\$ 223
Danish krone	-	-	-	-	146	146
Euro	65	-	65	1,473	1,369	2,842
Japanese yen	5	-	5	467	730	1,197
Korean won	-	-	-	-	101	101
Mexican peso	32	-	32	-	-	-
Norwegian krone	-	-	-	21	59	80
Swedish krona	-	-	-	98	146	244
Swiss franc	-	-	-	187	58	245
U.K. pound	-	-	-	1	322	323
Total	\$ 102	\$ -	\$ 102	\$ 2,345	\$ 3,056	\$ 5,401

NOTES TO FINANCIAL STATEMENTS

FOREIGN CURRENCY LIQUIDITY SWAPS

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2008 and 2009.

NOTE 9

BANK PREMISES, EQUIPMENT, AND SOFTWARE

Bank premises and equipment at December 31 were as follows (in millions):

	2009	2008
Bank premises and equipment:		
Land	\$ 12	\$ 12
Buildings	146	88
Building machinery and equipment	20	20
Construction in progress	3	53
Furniture and equipment	37	35
Subtotal	218	208
Accumulated depreciation	(67)	(64)
Bank premises and equipment, net	\$ 151	\$ 144
Depreciation expense, for the years ended December 31	\$ 9	\$ 8

The Bank leases space to outside tenants with remaining lease terms of less than one year. Rental income from such leases was immaterial for the years ended December 31, 2009 and 2008. Future minimum lease payments that the Bank will receive under agreements in existence at December 31, 2009, were immaterial.

The Bank had capitalized software assets, net of amortization, of \$2 million and \$3 million at December 31, 2009 and 2008, respectively. Amortization expense was \$2 million and \$3 million for the years ended December 31, 2009 and 2008, respectively. Capitalized software assets are reported as a component of "Other assets" in the Statements of Condition and the related amortization is reported as a component of "Other expenses" in the Statements of Income and Comprehensive Income.

NOTE 10

COMMITMENTS AND CONTINGENCIES

In the normal course of its operations the Bank enters into contractual commitments, normally with fixed expiration dates or termination provisions, at specific rates and for specific purposes.

At December 31, 2009, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from two 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 for each of the years ended December 31, 2009 and 2008. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2009, are as follows (in thousands):

	Operating leases
2010	\$ 545
2011	478
2012	390
2013	413
2014	210
Thereafter	17
Future minimum rental payments	\$2,053

At December 31, 2009, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks 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 of a Reserve Bank's capital paid-in 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 the agreement at December 31, 2009 or 2008.

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 11

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 employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System ("OEB") participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP") and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Bank ("SERP").

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and OEB. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not reimbursed by other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2009 and 2008, and for the years then ended, were not material.

THRIFT PLAN

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank matches employee contributions based on a specified formula. For the year ended December 31, 2008 and for the first three months of the year ended December 31, 2009, the Bank matched 80 percent of the first 6 percent of employee contributions for employees with less than five years of service and 100 percent of the first 6 percent of employee contributions for employees with five or more years of service. Effective April 1, 2009, the Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provided an automatic employer contribution of one percent of eligible pay. The Bank's Thrift Plan contributions totaled \$4 million for each of the years ended December 31, 2009 and 2008, and are

reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

NOTE 12

POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS

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 the beginning and ending balances of the benefit obligation (in millions):

	2009	2008
Accumulated postretirement benefit obligation at January 1	\$ 80.6	\$ 73.7
Service cost benefits earned during the period	2.5	2.4
Interest cost on accumulated benefit obligation	4.7	4.8
Net actuarial (gain) loss	(9.7)	3.0
Curtailement gain	-	(0.6)
Contributions by plan participants	1.1	0.7
Benefits paid	(4.0)	(3.7)
Medicare Part D subsidies	0.3	0.3
Accumulated postretirement benefit obligation at December 31	\$ 75.5	\$ 80.6

At December 31, 2009 and 2008, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.75 percent and 6.00 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):

	2009	2008
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	2.6	2.7
Contributions by plan participants	1.1	0.7
Benefits paid	(4.0)	(3.7)
Medicare Part D subsidies	0.3	0.3
Fair value of plan assets at December 31	\$ -	\$ -
Unfunded obligation and accrued postretirement benefit cost	\$ 75.5	\$ 80.6
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 4.5	\$ 7.6
Net actuarial loss	(16.1)	(28.4)
Deferred curtailment gain	0.2	0.5
Total accumulated other comprehensive loss	\$ (11.4)	\$ (20.3)

NOTES TO FINANCIAL STATEMENTS

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs" in the Statements of Condition.

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

	2009	2008
Health care cost trend rate assumed for next year	7.50%	7.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2015	2014

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, 2009 (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	\$ 0.7	\$ (0.7)
Effect on accumulated postretirement benefit obligation	6.5	(6.3)

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

	2009	2008
Service cost for benefits earned during the period	\$ 2.5	\$ 2.4
Interest cost on accumulated benefit obligation	4.7	4.8
Amortization of prior service cost	(3.1)	(3.1)
Amortization of net actuarial loss	2.5	3.5
Total periodic expense	6.6	7.6
Curtailment gain	(0.2)	(0.6)
Net periodic postretirement benefit expense	\$ 6.4	\$ 7.0
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2010 are shown below:		
Prior service cost	\$ (3.1)	
Net actuarial loss	1.0	
Total	\$ (2.1)	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2009 and 2008, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 6.00 percent and 6.25 percent, respectively.

Net periodic postretirement benefit expense is reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

A net curtailment gain associated with restructuring programs that are described in Note 14 was recognized in net income in the year ended December 31, 2009, related to employees who terminated employment during 2009. A deferred curtailment gain was recorded in 2007 as a component of accumulated other comprehensive loss; the gain will be recognized in net income in future years when the related employees terminate employment.

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 under 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 are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were \$.4 million and \$.2 million in the years ended December 31, 2009 and 2008, respectively. Expected receipts in 2010, related to benefits paid in the years ended December 31, 2009 and 2008, are \$.1 million.

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

	Without subsidy	With subsidy
2010	\$ 4.2	\$ 3.8
2011	4.6	4.2
2012	4.9	4.5
2013	5.3	4.8
2014	5.6	5.0
2015 - 2019	31.5	27.6
Total	\$ 56.1	\$ 49.9

POSTEMPLOYMENT BENEFITS

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 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, 2009 and 2008, were \$7 million and \$5 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2009 and 2008 operating expenses were \$2 million and \$1 million, respectively, and are recorded as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

NOTE 13

ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive loss (in millions):

	Amount related to postretirement benefits other than retirement plans
Balance at January 1, 2008	\$ (18)
Change in funded status of benefit plans:	
Prior service costs arising during the year	1
Net actuarial loss arising during the year	(3)
Amortization of deferred curtailment gain	(1)
Amortization of prior service cost	(3)
Amortization of net actuarial loss	4
Change in funded status of benefit plans - other comprehensive loss	(2)
Balance at December 31, 2008	\$ (20)
Change in funded status of benefit plans:	
Net actuarial gain arising during the year	\$ 10
Amortization of prior service cost	(3)
Amortization of net actuarial loss	2
Change in funded status of benefit plans - other comprehensive loss	9
Balance at December 31, 2009	\$ (11)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 12.

NOTE 14

BUSINESS RESTRUCTURING CHARGES

The Bank incurred various restructuring charges prior to 2008 related to the restructuring of the check processing infrastructure and restructuring plans associated with the U.S. Treasury's Collections and Cash Management Modernization initiative.

Following is a summary of financial information related to the restructuring plans (in millions):

	2007 and prior restructuring plans
<i>Information related to restructuring plans as of December 31, 2009:</i>	
Total expected costs related to restructuring activity	\$ 3.9
Estimated future costs related to restructuring activity	0.1
Expected completion date	2012
<i>Reconciliation of liability balances:</i>	
Balance at January 1, 2008	\$ 3.4
Employee separation costs	0.3
Adjustments	(1.0)
Payments	(1.5)
Balance at December 31, 2008	\$ 1.2
Adjustments	0.9
Payments	(0.9)
Balance at December 31, 2009	\$ 1.2

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period to termination. Restructuring costs related to employee separations are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

Adjustments to the accrued liability are primarily due to changes in the estimated restructuring costs and are shown as a component of the appropriate expense category in the Statements of Income and Comprehensive Income.

Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 11.

NOTE 15

SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2009. Subsequent events were evaluated through April 21, 2010, which is the date that the Bank issued the financial statements.

CREDITS

Christopher J. Waller

Author

Kevin L. Kliesen

Contributor

Steve Greene

Editor

Brian Ebert

Designer

Barb Passiglia

Production

Steve Smith Studios

Photography

Harry Campbell

Illustrator

For additional copies, contact:

Public Affairs

Federal Reserve Bank of St. Louis

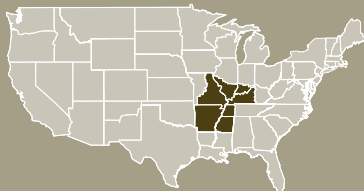
Post Office Box 442

St. Louis, MO 63166

or send an e-mail to pubtracking@stls.frb.org.

This report is also available online at:

www.stlouisfed.org/publications/ar.



The Federal Reserve Bank of St. Louis is one of 12 regional Reserve banks that, together with the Board of Governors, make up the nation's central bank. The St. Louis Fed serves the Eighth Federal Reserve District, which includes all of Arkansas, eastern Missouri, southern Illinois and Indiana, western Kentucky and Tennessee, and northern Mississippi. The Eighth District offices are in Little Rock, Louisville, Memphis and St. Louis.



FEDERAL RESERVE BANK *of* ST. LOUIS
CENTRAL to AMERICA'S ECONOMY™

STLOUISFED.ORG

**Federal Reserve Bank
of St. Louis**

One Federal Reserve Bank Plaza
Broadway and Locust Street
St. Louis, MO 63102
314-444-8444

Little Rock Branch

Stephens Building
111 Center St., Suite 1000
Little Rock, AR 72201
501-324-8205

Louisville Branch

National City Tower
101 S. Fifth St., Suite 1920
Louisville, KY 40202
502-568-9200

Memphis Branch

200 N. Main St.
Memphis, TN 38103
901-579-2404

Follow the St. Louis Fed on Twitter and YouTube. Go to twitter.com/stlouisfed and youtube.com/stlouisfed.