# LOOKING BACK: A RETROSPECTIVE CONVERSATION WITH WILLIAM POOLE | FEDERAL RESERVE BANK OF ST. LOUIS ANNUAL REPORT 2007

# CHAIRMAN'S MESSAGE | 2007

# Bon Voyage, Captain Poole

I can't think of a better way to characterize Bill Poole's 10-year presidency at the Federal Reserve Bank of St. Louis than to summon an old expression: When sailing through rough waters, keep a steady hand at the wheel.

Whether we're talking about the national and international economic scene or the changing operating environment here at the Bank, choppy surf has been the rule rather than the exception over the past decade—a period during which the St. Louis Fed was fortunate to have Bill, an avid sailor, at the helm. On the Federal Open Market Committee, Bill's steady hand proved invaluable during crises such as the Asian financial meltdown, the 9/11 terrorist attacks and the recent subprime mortgage debacle.

What assuredly will be one of Bill's lasting legacies was his advocacy of clear communications—keeping surprises to a minimum while helping the markets understand the underlying principles behind FOMC decisions. Practicing what he preaches, Bill gave nearly 150 speeches during his presidency, often speaking on the record with reporters afterward to answer their questions and help eliminate confusion. Sometimes the Federal Reserve is accused of being overly and unnecessarily mysterious. Through his actions, Bill sought to alleviate any misunderstandings or misconceptions about the Fed.

Despite serving as the Bank's CEO for 10 years, Bill likes to say that he is always an academic at heart. And it's the teacher in him that the Bank's directors, both past and present, really appreciated. Typically, we board members are neither economists nor experts on the inner workings of the Federal Reserve. We rely on the president to educate us on the ramifications of FOMC actions, as well as the best options for us to consider on decisions we need to make. In this role, Professor Poole was unfailingly helpful to us.

I have been a member of the Bank's board of directors since 2005 and have observed Bill deal with change in a calm, yet nimble, manner that befits a seasoned executive more than it does a career academic. In fact, from the time Bill arrived in 1998, he encountered a rapidly evolving business model—one that private sector companies are used to, but the Fed was not. Nevertheless, Bill and his management team embraced the changes and made decisions that proved beneficial both to the Eighth District and the Federal Reserve System. An example of an innovative efficiency during Bill's tenure occurred in 2002, when the St. Louis and Cleveland Reserve banks formed a joint partnership to share sales and marketing functions.

In support of System-generated efficiencies, the St. Louis Fed was an early advocate of efforts to reduce redundancies across Reserve banks by converting to common software platforms for human resources and certain accounting functions. Bill also contributed to the System by serving a term as chairman of the Information Technology Oversight Committee, whose responsibilities include approving overall technology strategies and budgets for the Federal Reserve. Identifying efficiencies, though, is only one part of the story of Bill's success. The Bank can also boast of many areas of growth and leadership during the Poole era. Three worth noting are:

- **U.S. Treasury support:** Since 2001, the St. Louis Fed has been the home of the Fed's Treasury Relations and Support Office, which oversees all of the System's U.S. Treasury-related responsibilities and manages the relationship between the two organizations. In addition, the St. Louis Bank provides a wide range of tax collection and cash management applications and services for the Treasury.

- **World-class economic data:** The Research division's robust sets of online economic information and data services are renowned and relied upon worldwide. Led by the popular FRED (Federal Reserve Economic Data) database, Research's web pages received around 60 million visits in 2007.

- **Community connections:** Under Bill, the four offices in the District have redoubled their focus on areas such as regional economic research, community development and economic education. Maintaining a strong link between the Fed and local communities is critical. As we have learned with the subprime mortgage crisis, many consumers have a dire need for greater understanding of economic and personal financial issues.

Before Bill embarked on his next journey—which will include being a distinguished scholar in residence at the University of Delaware and a senior fellow at the Cato Institute, and, naturally, sailing on the Chesapeake Bay near his new Maryland home—we caught up with him for a final interview. Here in the St. Louis Fed's 2007 Annual Report, I invite you to read Bill's reflections.

Bill, on behalf of my fellow directors and the rest of the crew here in the Eighth District, I thank you for steering us through 10 often tumultuous years. We will miss your guidance, insight and wisdom, and we wish all the best to you and your wife, Gerie.

Irl F. Engelhardt
*Chairman*
*Board of Directors*
*Federal Reserve Bank of St. Louis*

# LOOKING BACK:
## A RETROSPECTIVE CONVERSATION WITH WILLIAM POOLE

**ANNUAL REPORT** | 2007

# ACKLOOKING BACKLOOKIN

**The decade that you spent as president of the Federal Reserve Bank of St. Louis was marked by a series of crises, such as the Asian financial meltdown of the late 1990s, the 9/11 attacks and the current subprime mortgage crisis. How would you characterize the turbulent era during which you served?**

I used to think of monetary policy as dealing with generally normal periods interrupted by shocks. I've decided that it's really the other way around. In fact, the Fed has had to face a whole series of shocks interrupted by occasional periods that we call "normal." If you were to take the 10 years as a whole and divide it between periods of shocks or the threat of shocks vs. the "normal" periods, I think you'd find a lot more months in the first category.

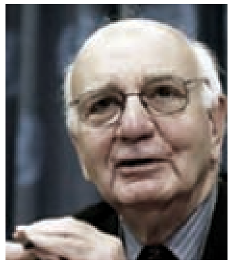
**What have you learned about the best role for the Federal Reserve to play during times of crisis?**

To start with, central bank credibility and low and stable inflation expectations are of critical importance. Earning that confidence is the most important thing the Fed can do in dealing with shocks as they occur. If the Fed doesn't have that underlying confidence, then all sorts of things can go wrong and, indeed, the Fed may find itself willy-nilly taking policy actions intended to maintain or restore credibility rather than dealing

**Bill Poole's seminal contributions in the area of monetary theory and policy are widespread and span four decades. Whether it be his contributions on monetary policy under uncertainty, his early investigations of simple rules for setting the federal funds rate, or his analysis of rational expectations models of the term structure for monetary policy, his theoretical contributions provided fundamental insights and played an important role in developing what we now view as the core of modern monetary theory. He has continued his contributions to monetary policy as a member of the FOMC, bringing the same sound, thoughtful and consistent economic analysis to policy deliberations. I have known Bill for nearly three decades and have learned a great deal from him.**

**Charles I. Plosser**
*President*
*Federal Reserve Bank of Philadelphia*

Recent chairmen of the Federal Reserve Board



Paul Volcker
1979-1987

Alan Greenspan
1987-2006

Ben Bernanke
2006-

with the current problem, whatever it might be. So, most of the work in dealing with the crises comes before they even happen. Where the Fed is now is a consequence of earning that credibility starting with Paul Volcker and then dealing successfully with a whole series of issues during the **Volcker, Greenspan** and now **Bernanke** eras.

**Does the public expect too much from the Fed in response to crises?**

You can probably address that question on several levels. There's a natural tendency for people in the markets to look to government to help them. And, often, it's very self-interested. They want to be bailed out—it's just that simple. They want someone to fix their mistakes. You see it across the board. People think that if the government will give them some money, why not take it. … It seems that the people who most often talk about regulation tying them in knots and being costly are some of the first to come asking for help and to be bailed out. So, there is nothing Fed leaders can do except make sure to have a correct, disciplined policy and then be visible in explaining the rationale for the policies they want to follow. You have to be prepared to resist pressures from Congress and make use of the independence that the Federal Reserve structure provides.

**Could you give a broad historical overview of what you refer to as the monetarist vs. fiscalist debate?**

The word "monetarism" refers to the way the debates were framed in the 1960s and '70s. Fundamentally, the argument at that time was about a few propositions that have been largely resolved. It's also important to understand that

**"THERE IS NOTHING FED LEADERS CAN DO EXCEPT MAKE SURE TO HAVE A CORRECT, DISCIPLINED POLICY AND THEN BE VISIBLE IN EXPLAINING THE RATIONALE FOR THE POLICIES THEY WANT TO FOLLOW."**

the debate was really a **pre-rational expectations debate**. (See explanation on page 23.) One of the issues being argued was the relative power or influence of monetary policy and fiscal policy. The **Keynesian tradition** (page 23) coming out of the 1930s was that monetary policy was pretty much a sideshow, and the aggregate economy was controlled by fiscal policy. **Milton Friedman** (page 23) disagreed. He said that monetary policy was central to understanding the business cycle.

**How did the monetarists and fiscalists differ when it came to their views on inflation?**

The monetarists thought that inflation was costly and damaging to the economy. The fiscalists argued that inflation wasn't all that costly. … The fiscalists believed that there could be a constructive tradeoff in that you could actually obtain lower unemployment if you were willing to accept somewhat higher inflation. That view was resisted at a somewhat intuitive level and then at a very, very explicit theoretical level by Friedman in his presidential address to the American Economic Association in December of 1966. There continued to be an argument for a while. The fiscalists would say, "We understand Friedman's theory, but the world doesn't really work quite that way, and, in fact, there *is* a tradeoff." The view that there was a tradeoff had a great deal to do with Federal Reserve policy mistakes because that was the prevailing view of the Federal Reserve—with the lone exception of St. Louis. … There was a whole series of policy mistakes that led to gradually rising inflation—sometimes not so gradual—at costs greater than anticipated, including, lo and behold, costs in terms of employment and certainly economic stability. So, over the course of the '70s, the debate was resolved in favor of what had been the monetarist position.

**Four decades later, where does the theory of monetarism stand? Furthermore, have you changed your views about monetarism over the years?**

Monetarism has become mainstream economics. We know now the following: Inflation is costly, only the central bank is responsible for inflation, the **Phillips Curve** (page 23) is vertical in the long

Bill Poole (seated at far end) at a recent FOMC meeting. Chairman Ben Bernanke is seated at the center of the facing side of the table.

run, and there is no inflation/employment tradeoff. Those are all part of macroeconomics today. … There is another issue that was not directly connected with monetarism, but you might say was sort of a fellow-traveler issue: Friedman was very much a believer in the market system and distrustful of government. He had great respect for market efficiency and great skepticism about government efficiency. So, the people who were on the monetarist side of the debate tended to have that same view. I don't know of any activist government interveners who are monetarists. They just didn't ever go together. Monetarists generally have great respect for markets. It's not to say that market decisions are infallible, but you will ask a question two, three, four times before you decide that markets are making a mistake. And I think that part of it certainly survives as being extremely important in my thinking. The immediate successors of the monetarist debate of the '60s are people like **Bob Lucas and Tom Sargent** (page 23) and the rational expectations theorists. They were the immediate intellectual heirs of the debate. I certainly come from that tradition, and a lot of my speeches have been oriented toward developing the practical application of those ideas to understanding and managing monetary policy. I don't think my views on monetarism have changed in particular. Those views are still very much a part of my thinking.

**Does the Federal Reserve's decentralized structure still make as much sense now as it did when the Fed was created?**

I think the rationale has changed over time. Part of the rationale was that regional Reserve banks could pursue different monetary policies to address differing regional needs. That argument has disappeared—there can be only one national monetary policy. But part of the original rationale has survived. If you look back at the Federal Reserve Act in 1913, there was tremendous distrust of Washington and New York. That's one reason why you had Reserve banks spread around the country—so that you would have decentralized power. The argument for decentralized authority still stands, but this case is not very well appreciated by the general public. A lot of people think of a centralized system as being more efficient, perhaps more democratic, if it's run out of Washington. I think those views are fundamentally wrong because I believe that the original conception of not having all the authority concentrated in New York as the financial center or Washington as the political center remains valid.

**Has the FOMC reached a good state in terms of its communication, or do you think there is more work to be done?**

There is more work to be done. One of the biggest innovations came in 1994 when the FOMC began to disclose what its policy decision was after each meeting. The communication since then, however, has sometimes been a bit muddled. I don't think there is a settled view in the FOMC about the value of essentially forecasting policy, or trying to give hints about where you're going to go. I've become skeptical of that approach because I think the correlation between where you go and where you can see yourself going in advance is very low. … I also think that there is unfinished business with regard to clarity of objectives. I've been an advocate since the first day I came here of a formal inflation target, and that issue is still unresolved. There is a huge amount of unfinished business in trying to define and communicate the Fed's **reaction function** (page 23). … One of the problems right now is that the FOMC itself doesn't have its reaction function very well specified. I think more discussion about regularity of the reaction function would be very helpful and would help the communication strategy by narrowing the range of uncertainty so that the FOMC has more predictable policy.

**What can the FOMC do to further demystify its actions and decisions?**

In the public relations profession, where there is a lot of concentration on communications strategies, people will tell you that you have to be sure of what your message is. You don't just throw a whole lot of information out there. What are

*Continued on Page 14*

RDON THE RECORDONTHERE

# ON THE RECORD

EXCERPTS FROM SOME OF BILL POOLE'S SPEECHES

**SYNCHING, NOT SINKING, THE MARKETS (1999)**
Speaking at a meeting of the Philadelphia Council for Business Economics: "When the markets and the Fed are in synch, both will have a common reaction to incoming data, and the markets will correctly anticipate Fed policy actions. An environment in which markets correctly anticipate Fed actions implies a situation in which Fed policy is widely understood, regular and predictable. The fact that Fed policy actions sometimes take the markets by surprise shows that we have not reached 'perfection' yet."

**CENTRAL BANK TRANSPARENCY: WHY AND HOW (2001)**
During a session at the Philadelphia Fed Policy Forum about how transparent a central bank should be: "The case for *why transparency* is clear. Transparency promotes accountability, improves market efficiency and probably improves the clarity of policymaking itself. *How transparency* is just plain hard. It is easy to find communications gaps, but not at all easy to fill them."

**HOUSING IN THE MACROECONOMY (2003)**
In a speech at the Office of Federal Housing Enterprise Oversight Symposium in Washington, D.C., Poole said the housing market could be at risk because government-sponsored enterprises like Fannie Mae and Freddie Mac, the biggest players in the mortgage market, are also the least capitalized. "Just three firms—Fannie Mae, Freddie Mac and Ginnie Mae—account for over 40 percent of the residential mortgage market. Ginnie Mae is backed by the full faith and credit of the U.S. government. Fannie Mae and Freddie Mac are not so backed and hold capital far below that required of regulated banking institutions. Should either firm be rocked by a mistake or by an unforecastable shock, in the absence of robust contingency arrangements the result could be a crisis in U.S. financial markets that would inflict considerable damage."

**THE FED'S MONETARY POLICY RULE (2005)**
Speaking at the Cato Institute in Washington, D.C.: "At a minimum, the FOMC can and should aspire to policy statements that are clear and do not themselves create uncertainty and ambiguity. The record since 2000 suggests that the balance-of-risks statement and more recently the 'forward-looking' language included in the press releases have provided consistent signals about

the direction of future policy actions. … Federal Reserve policy has become highly predictable in recent years, and in the future this predictability will, I am sure, be seen as one of the hallmarks of the Greenspan era."

**INFLATION TARGETING (2006)**

In a speech at the Junior Achievement of Arkansas Inc. in Little Rock: "I believe that having a formal inflation objective will further enhance the Fed's credibility and, consequently, its ability to engage in countercyclical monetary policy. The reason is simple. The more open and precise the Fed is about its long-run inflation objective, the more confident the public will be that the Fed will meet that objective."

**THINKING LIKE A CENTRAL BANKER (2007)**

In a speech at Market News International in New York City: "A central bank cannot fix the level of employment or its rate of growth, or the average rate of unemployment. However, the central bank can contribute to employment stability. Avoiding, or at least cushioning, recessions is an important goal. This goal should not be viewed as in conflict with price stability. The most serious employment disaster in U.S. history was the Great Depression, which was a consequence of monetary policy mistakes that led to ongoing serious deflation. Similarly, the period of the Great Inflation saw four recessions in 14 years. Price stability is an essential precondition for overall economic stability."

**DOLLARS AND SENSE (2008)**

Speaking to the Financial Planning Association of Missouri and Southern Illinois in St. Louis: "Will housing sector problems push the economy into recession? It is too early to tell right now, but what we can do is to examine the current situation closely and try to learn from it. Perhaps 'relearn' is a better word, because the mistakes that brought us to this point have been made before. There are no new lessons here. The lessons are familiar ones that need to be more forcefully driven home and incorporated in standard financial practice in the future. … If borrowers, lenders and investors can refocus on financial basics and re-emphasize critical lessons about credit and risk, the financial future can be brighter than the second half of 2007."

*For the full text of all of Bill Poole's speeches, visit www.stlouisfed.org/news/speeches.html.*

**"WHAT WE NEED TO DO IS NOT INCREASE THE MATERIAL THAT WE PUT OUT THERE, BUT WE NEED TO INCREASE THE INTERPRETATION AND EXPLANATION, AND WE NEED TO CLARIFY THE MESSAGE."**

St. Louis Mayor Francis Slay congratulates Bill Poole during the grand opening of the Bank's pedestrian plaza in 2005.

*Continued from Page 11*

you trying to convey? I think that, to too great an extent, we've been throwing information out there without being clear in our minds what the message is. … And the way I've made this point in several speeches is that the issue is not transparency, but communication. Transparency implies that you throw back a curtain and let everybody look in. We too often dump the data without explaining what to make of it and why we're doing it. What we need to do is not increase the material that we put out there, but we need to increase the interpretation and explanation, and we need to clarify the message. I don't think there is enough of that happening.

**Speaking of communication, you have had a reputation as one of the more outspoken Reserve bank presidents, whether it be your willingness to speak on record with the media or the nearly 150 speeches you have given. Why do you feel it has been so important for you to maintain such high visibility?**

When I came here and began to give speeches, I asked myself: What exactly am I trying to do? And what purpose is being served? Here I am, out there representing the Federal Reserve, knowing that expectations are very important. And while expectations are obviously intimately connected with policy decisions of the Federal Reserve, they also to some extent reflect what comes out of the mouths, or pens, of Federal Reserve officials. So, I started to think through what to do and how to do it.

Another question I asked myself was: What can I infer and interpret from fluctuations in financial data about inflation expectations or expectations about monetary policy? These are things that are important to Federal Reserve decision-making. I came to the view that I can only make sense of all this if I put it in very simple abstract terms. And that's where the speech came from in 1999 that was called "Synching, not Sinking, the Markets." (See page 12.) I said, let's go back to the basic literature of the 1970s and the basic macro-economic model—the rational expectations equilibrium. The desirable equilibrium is that the central bank behaves as the market expects, and the market behaves as the central bank expects. That's the nature of the equilibrium: When there is new information, such as data on industrial production or housing starts, the equilibrium requires that the Federal Reserve and the markets respond to the same data in the same way. A number of my speeches have been oriented around that theme, and that provides a unifying theoretical view that ties together lots of different problems. For one thing, this view gives me a very easy way to address the questions that keep coming, such as: "How's the Fed going to set interest rates at its next meeting? What are you guys going to do?" Then I can say, "What we're going to do will depend on what the new information is. I can't predict unpredictable information. And you would not want me to commit—you would not want the FOMC to commit—as to what it is going to do come hell or high water. It wouldn't make any sense for us to ignore important new information."

I always tell people, "I'm not being coy with you. I'm telling you that I can't predict what the inflation rate is going to be in next week's CPI report. If it's an outsized shock, with no extenuating circumstances to it, then the Fed needs to take that into account when forming its inflation outlook, and that ought to affect our policy decision."

**When we hired Bill 10 years ago, we knew that he was an outstanding economist and would be a valued participant on the FOMC. My perception is that he has more than lived up to that expectation. What we did not know is whether he would be able to adapt to a major executive role in leading such a large institution as the St. Louis Federal Reserve Bank. He has, in fact, exceeded our expectations in that capacity, which just proves that an old academic can learn new tricks.**

**John F. McDonnell**
*James S. McDonnell Foundation*
*Former Chairman of the Federal Reserve Bank of St. Louis Board of Directors*

**Bill Poole has had an enormous impact on the Eighth District and the Federal Reserve System as a leading economist. I also had the opportunity to see Bill excel in another Fed role, as a participant in the System's strategic direction project during my time as chairman. There, he helped define the evolving roles of the Reserve banks and helped bring clarity to the principal governance issues associated with the evolving role of the Reserve banks and the Board of Governors. Bill was a leader in setting a framework to help the banks and the governors achieve the mission of the System for the next decade. His respect for and understanding of the history and the future of the Fed served our Bank well.**

**Walter L. Metcalfe Jr.**
*Bryan Cave LLP*
*Former Chairman of the Federal Reserve Bank of St. Louis Board of Directors*

The rational expectations model says that the market has to understand what the central bank is doing. The market understands what the central bank is doing, in part and maybe even mostly, through inferences from observed central bank actions—how we set the federal funds rate. But the communications strategy can deepen the market's understanding of what we're doing and why we're doing it, and that helps to produce a better equilibrium. That's the reason to be as open and forthright as possible.

**Earlier, you mentioned inflation targeting. Is the announcement of an inflation target being hamstrung and hung up by concern about the Federal Reserve's dual mandate?**

Probably. I think that, putting political pressures, which are real, aside, it's possible to explain all this easily within the framework of the **dual mandate** (page 23). If you look back in history, you see that the largest problems on the employment front have come from inflation and price instability. You look at deflation during the Great Depression, the biggest economic disaster in U.S. history by far, and then you look at the '60s and '70s, when inflation was rising, the business cycle fluctuations became more extreme, and the average rate of unemployment rose—and I don't think it's an accident that price-level stability and employment levels are connected. So, we ought to be able to explain that achieving sustained, high and stable employment requires inflation stability. We can assist in maintaining inflation stability if we have great clarity as to the objective. That's an argument that I believe and that I've made in some of my speeches. And I don't see any reason why the FOMC shouldn't adopt that as its official view.

# Poole Continued the St. Louis Fed Tradition


During his 10 years as president of the Federal Reserve Bank of St. Louis, Bill Poole was widely regarded as one of the more influential members of the Federal Open Market Committee. His speeches received frequent notice in the press, and he gave many interviews throughout his tenure. Following a tradition of St. Louis Fed presidents, Poole has been an outspoken advocate of directing monetary policy toward achieving the goal of price stability. Dating back to the term of Darryl Francis, who was president of the St. Louis Bank from 1966 to 1976, St. Louis Fed presidents have consistently advocated policies to achieve and maintain low inflation.

President Francis led the St. Louis Fed during a time of generally rising, but also highly variable, inflation—a period many people now refer to as the Great Inflation. At the time, many economists and policymakers blamed the inflation on rising costs, the exercise of monopoly power and government budget deficits. Francis, however, was convinced that the Fed was responsible for inflation. Citing research from his team of economists as supporting evidence, Francis argued that inflation would not end until the growth of the money stock was brought under control. Francis' forceful advocacy of controlling inflation by limiting the growth of money, and the supporting evidence produced by the St. Louis Fed's Research department, marked the St. Louis Bank as a maverick.

The St. Louis Fed is no longer regarded as a maverick institution. Although presidents of the Bank have consistently held the monetary view of inflation and advocated policies directed toward price stability, these positions are now very much in the mainstream. President Poole built upon and continued the St. Louis Fed tradition through his unwavering and outspoken advocacy of establishing price stability as the paramount objective of monetary policy. It is his view that a central bank can best promote a stable financial system and maximum sustainable economic growth through a firm, credible commitment to price stability.

**In the late 1960s and early 1970s, St. Louis Fed President Darryl Francis and Research Director Homer Jones consistently and vociferously argued that price stability could only be restored if the Fed articulated and implemented a systematic policy that restrained monetary growth. The St. Louis Bank became known as the "monetarist bank."**

**By the 1990s, economists understood that, in principle, other systematic approaches to monetary policy can provide a nominal anchor for the economy. Critical for the success of such approaches to policy is that consumers and firms believe that future inflation will be low and stable. For policy to succeed, the general public must understand the Fed's long-run inflation objective and how the FOMC will respond to short-run economic fluctuations. Bill Poole has been a leader, perhaps *the* leader, within the Federal Reserve System in pushing for greater policy transparency by the FOMC and a clearer articulation of a systematic implementation of monetary policy aimed at achieving price stability. In this sense, Bill has adapted and carried on the tradition of the St. Louis Fed in the 21st century.**

**Robert H. Rasche**
*Senior Vice President and Director of Research*
*Federal Reserve Bank of St. Louis*

**Switching to an issue that brought a lot of attention to you a few years ago: government-sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac. You made a speech in March of 2003 (page 12) in which you questioned the long-term financial viability of these agencies. Where does this issue stand today?**

That speech caused a little stir. I don't think anything constructive by way of reform has happened since. I don't take credit for disclosing the accounting irregularities, but when I look back, is there something I wish I had said or not said? The answer is no. One of the reasons I went down that track is that I have a vivid memory when I was at the Council of Economic Advisers in Washington. We had many discussions and were all very well aware of the problems being covered up in the savings and loan industry. That experience led me to rather deep regret that I had not raised that issue publicly. I might not have been in a position to do it because it was a very politically difficult issue, and many people were trying to cover it up, sweep it under the rug and ignore it. But I wish I would have somehow found a way to raise that issue and improve public consciousness. If I had been able to do that in 1982 or 1983, and if there had been some earlier action, it

"… HISTORICALLY YOU DON'T FIND SIGNIFICANT CHANGES IN MONETARY ARRANGEMENTS IN THE UNITED STATES ABSENT OF A BIG PROBLEM OR SCREW-UP OF SOME SORT."

might have saved taxpayers quite a bit of money. It probably wouldn't have made any difference, but I would have felt better.

So, part of the reason that I did push the GSE issue was a feeling that I was in a position to understand the issue and the potential gravity of it. And that's exactly what an office like this is for. I have an audience simply by virtue of speaking from this office that I would not have had as a Brown University professor; so, why not? That's consistent with my predecessors. That's what Darryl Francis did. (See sidebar on page 18.) He went out campaigning about the inflation issue and about monetary policy. He did not change policy at the time, but I think he had very substantial long-run influence on the national debate and on the Federal Reserve System. He had much more impact on dealing with monetary policy issues than I have had to date on the GSE issue.

**Looking at the operating environment of the St. Louis Fed itself, what do you regard as the most significant changes that affected the Bank during your tenure?**

There's no question in terms of the scale of the effects, it's the consolidation in financial services that led to ending check and cash operations in two branches (Little Rock and Louisville) and selling the buildings there. That was an enormous change, going from branches that each had 150 employees down to about eight. We have more of that coming in St. Louis and Memphis because

we'll be closing down check operations in these locations. And there is consolidation in other services, too; so, we are much less a stand-alone company than we were 10 years ago. Some IT and HR services that used to be here, for example, are now elsewhere. What's happened here is not unlike what's happened to a lot of companies that have outsourced support operations. It's not unique to the Fed.

**What do you think the Federal Reserve might look like 10 to 20 years from now?**

Who is it that said, "Forecasting is difficult, especially about the future?" How do I come to grips with that question, beyond saying that there's always uncertainty, and if anyone looks back at this annual report, they'll probably laugh at what I'll say, but that's the way these things always are. First of all, historically you don't find significant changes in monetary arrangements in the United States absent of a big problem or screw-up of some sort. … I would not expect the Federal Reserve Act to be opened and revised in any important respect in the absence of a significant monetary problem.

That means that we'll probably have the same basic framework in the law. It seems to me that the main thing that the Reserve banks need to do and probably will do is to manage themselves efficiently enough—which I think we do a pretty good job of doing—and provide public services through economic education, economic research and so forth that are regarded in the public debate as being worth what we spend on them. From time to time, there will probably be some attacks on us from Congress. That happens. But if we continue to perform pretty well on the macroeconomic front, I don't think we're going

**The most important aspect of the Federal Reserve System is its decentralized structure. In this system, the job of regional Reserve bank president encompasses many duties, but among the most important is serving as the connection between the business and industry of the individual districts and the Federal Reserve's national monetary policy mission. In his tenure at the St. Louis Federal Reserve Bank, Bill has been very much committed to his role in the monetary policy process, bringing his insight and analysis to the deliberations.**

**Thomas M. Hoenig**
*President*
*Federal Reserve Bank of Kansas City*

to be very vulnerable, and the attacks that occur from time to time will not have any material effect on the law. That means that the Federal Reserve banks will shrink in terms of their operating responsibilities. I think we need to get used to the prospect of Reserve banks being smaller in terms of employment, and more vigorous and more rigorous in terms of our intellectual output.

**What will you miss most about being president of the St. Louis Fed?**

I'll miss the excitement and challenge of the monetary policy process. That's been very interesting to observe and be part of.

**Least?**

I don't think anybody likes doing performance reviews and some of that administrative stuff (laughter). Fortunately, though, the scale of it is pretty small. I have said to many people, and I really believe it, that there is nothing I've done here that is as awful as grading a huge stack of exams over winter break. I'm glad I left that behind.

**Are there any closing comments you would like to make?**

I am through and through an academic, and I had no managerial experience coming into this job. I really enjoyed learning about a lot of modern management practices, and I felt fortunate to have some very good people do all the hard work. There are a lot of really good people here. ■

# An explanation of key terms

**Pre-rational Expectations Debate** – In the 1970s, macroeconomic models of how monetary and fiscal policies affect the economy began to focus on how the public forecasts future values of economic data and policies. Macroeconomic models that incorporate rational expectations assume that the public uses all relevant information when making projections about future values of data and policy actions. Thus, in such models, monetary and fiscal policies have no permanent effects on output or employment because the public will anticipate and, acting in its best interest, take actions that offset the impact of policy on the growth of output and employment.

**Keynesian Tradition** – Refers to John Maynard Keynes (1883-1946), an English economist who proposed that high unemployment, being a result of insufficient capital spending by business, could be relieved by government-sponsored programs. He also advocated deficit spending by governments to stimulate economic activity.

**Milton Friedman** – The 20th century's most prominent economist advocate of free markets. A winner of the 1976 Nobel Prize in Economics, Friedman (1912-2006) was noted as a proponent of monetarism and for his opposition to government intervention in the economy.

**Phillips Curve** – An inverse relationship between inflation and unemployment first observed in data for the United Kingdom by the economist A.W. Phillips. Monetarists argued, and most macroeconomists now agree, that there is no long-run relationship between inflation and unemployment, and that monetary policy cannot affect the unemployment rate in the long run.

**Lucas and Sargent** – Refers to Robert Lucas, Nobel Prize winner and professor of economics at the University of Chicago, and Thomas Sargent, professor of economics at New York University. Both were leading proponents of macroeconomic models that incorporate the rational expectations assumption.

**Reaction Function** – Refers to how policymakers adjust their policies in response to new economic data and other information.

**Dual Mandate** – Refers to the fact that the Federal Reserve Act (as amended) directs the Federal Reserve to pursue monetary policies to achieve the goals of both maximum employment and stable prices.

## 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:

**MEMPHIS**
Levon Mathews

**ST. LOUIS**
Cynthia J. Brinkley
Jay Fitzsimmons
Lewis F. Mallory Jr.

Note: Lewis Mallory now serves as the Bank's Federal Advisory Council member.

**Cal McCastlain**

*Chairman*
Partner
Pender & McCastlain P.A.
Little Rock, Ark.

**Phillip N. Baldwin**

President and CEO
Southern Bancorp
Arkadelphia, Ark.

**Sonja Yates Hubbard**

CEO
E-Z Mart Stores Inc.
Texarkana, Texas

**Sharon Priest**

Executive Director
Downtown Little Rock Partnership
Little Rock, Ark.

**William C. Scholl**

President
First Security Bancorp-Searcy
First Security Bank
Little Rock, Ark.

**C. Sam Walls**

CEO
Arkansas Capital Corp.
Little Rock, Ark.

**Robert A. Young III**

Chairman
Arkansas Best Corp.
Fort Smith, Ark.

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

**Gordon B. Guess**
Consultant
Marion, Ky.

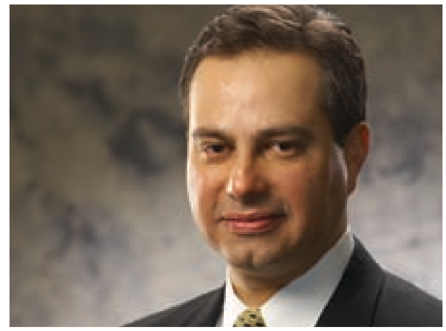
**John L. Huber**
Consultant
Louisville, Ky.

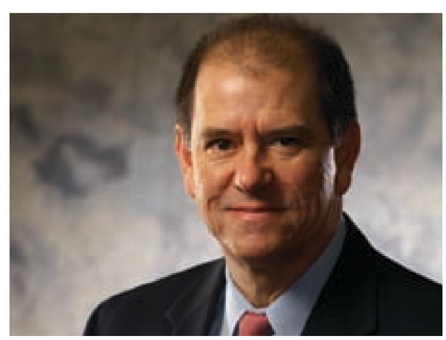
**Barbara Ann Popp**
CEO
Schuler Bauer Real
Estate Services
New Albany, Ind.

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

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

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





**Nick Clark**
*Chairman*
Partner
Clark & Clark
Memphis, Tenn.

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

**Charles S. Blatteis**
Member (Partner)
The Bogatin Law Firm PLC
Memphis, Tenn.

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

**David P. Rumbarger Jr.**
President and CEO
Community Development Foundation
Tupelo, Miss.

**Hunter Simmons**
President and CEO
First South Bank
Jackson, Tenn.

Not pictured:

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

# BOARDS OF DIRECTORS | **ST. LOUIS**

**Irl F. Engelhardt**
*Chairman*
Chairman
Patriot Coal Corp.
St. Louis

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

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

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

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

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

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

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

**Larry Clarke**
Bunge North America Inc.
St. Louis

**Sam J. Fiorello**
Donald Danforth
Plant Science Center
St. Louis

**Keith Glover**
Producers Rice Mill Inc.
Stuttgart, Ark.

**Richard Jameson**
Jameson Farms
Brownsville, Tenn.

**David Williams, Ph.D.**
Burkmann Feeds
Danville, Ky.

**John King III**
King Farms
Helena, Ark.

Not pictured:

**Bert Greenwalt, Ph.D**
Arkansas State University
State University, Ark.

**Leonard Guarraia, Ph.D.**
World Agricultural Forum
St. Louis

**Ted Huber**
Huber's Orchard & Winery
Starlight, Ind.

**Jeffrey B. Bringardner**
Humana-Kentucky Inc.
Louisville, Ky.

**Jan C. Vest**
Signature Health Services Inc.
St. Louis

**Bob Gordon**
Baptist Memorial Health Care
Memphis, Tenn.

**Calvin Anderson**
Blue Cross Blue Shield
of Tennessee
Memphis, Tenn.

**Stephen A. Williams**
Norton Healthcare
Louisville, Ky.

Not pictured:

**Russell D. Harrington Jr.**
Baptist Health
Little Rock, Ark.

**Dick Pierson**
University of Arkansas for
Medical Sciences
Little Rock, Ark.

**Sister Mary Jean Ryan**
SSM Health Care System
St. Louis

**Mary Singer**
CresaPartners Memphis
Memphis, Tenn.

**David Price**
Whittaker Builders Inc.
St. Louis

**Jack McCray**
Bank of the Ozarks
Little Rock, Ark.

**John J. Miranda**
Pinnacle Properties
of Louisville, LLC
Louisville, Ky.

**Kevin Huchingson**
Colliers Dickson Flake
Little Rock, Ark.

**William Mitchell**
Memphis Area
Association of Realtors
Memphis, Tenn.

Not pictured:

**Greg Kozicz**
Alberici Constructors
St. Louis

**E. Phillip Scherer III**
Commercial Kentucky Inc.
Louisville, Ky.

**Robert L. Lekites**
UPS
Louisville, Ky.

**Mark Knoy**
MEMCO Barge Line
Chesterfield, Mo.

**Kirk Thompson**
J.B. Hunt Transport Services Inc.
Lowell, Ark.

Not pictured:

**T. Michael Glenn**
FedEx Corp.
Memphis, Tenn.

**Charlie W. Johnson**
C.W. Johnson Xpress
Louisville, Ky.

**Dennis Oakley**
Bruce Oakley Inc.
North Little Rock, Ark.

**Joseph Tracy**
Dot Transportation Inc.
Mt. Sterling, Ill.

**Phil Trenary**
Pinnacle Airlines Inc.
Memphis, Tenn.

## MANAGEMENT COMMITTEE | ST. LOUIS

**William Poole**
President and CEO

**Dave Sapenaro**
First Vice President
and COO

**Karl Ashman**
Senior Vice President

**Judie Courtney**
Senior Vice President

**Mary Karr**
Senior Vice President

**Robert Rasche**
Senior Vice President

**Robert Schenk**
Senior Vice President

**Julie Stackhouse**
Senior Vice President








# MESSAGE FROM MANAGEMENT

Now, it's our turn. In the previous pages, Chairman Engelhardt shared his thoughts on Bill Poole, as did past chairmen and a few of Mr. Poole's colleagues around the Federal Reserve System. And, of course, our past president himself offered his reflections in the main essay. We, the Bank's senior management team, would also like to express our appreciation to President Poole for his wise guidance and counsel over the last decade.

The Bank is a much different place than it was when we welcomed Mr. Poole in 1998. In the past 10 years, as changes have occurred both inside and outside the Federal Reserve, we have remained agile enough to develop new capabilities and skillful enough to emerge as a System leader in several areas.

Mr. Poole saw the need for the Bank to, in a sense, redefine itself. For example, our check operations at all four offices had historically performed very well. But that didn't change an environment that witnessed more and more people switching to electronic forms of payment—a trend that the Federal Reserve has encouraged. As we have reduced, and continue to reduce, our check operations, we have bolstered areas of the Bank that Mr. Poole liked to refer to as our "intellectual presence."

By that, he meant sharing our knowledge about the economy, monetary policy and personal finance with traditional and nontraditional audiences alike. We are doing this throughout our District through programs like economic forums, education workshops, and meetings with bankers and business, government and community leaders. Bill Poole was an ardent supporter of these efforts and traveled both far and frequently to meet with the Bank's constituents. During the past decade, we have also greatly enhanced the already formidable amount of economic data on the Research portion of the Bank's web site. We are currently in the process of revamping the rest of our web site and plan to launch the new site later this year.

Chairman Engelhardt touched on the St. Louis Fed's relationship with the U.S. Treasury. That is certainly true. We are extremely proud of the partnership we have forged with the Treasury in recent years. In 2007, the Fed's Treasury Relations and Support Office, based in St. Louis, continued to provide effective monitoring and support for the System's Treasury-related objectives. In addition, our District's Treasury operations were awarded additional Treasury responsibilities in 2007, ensuring that the District will continue to be a leading Reserve bank in terms of serving the U.S. Treasury.

The District's banking supervision function last year successfully met all safety and soundness, consumer affairs, and applications processing mandates, and provided effective supervision and monitoring of District state member banks and bank holding companies. In addition, the District continued to expand its supervisory portfolio.

Despite all of these positive developments, we have also been forced to make some difficult decisions in recent years. Restructuring decisions in departments like Check, Cash and even Treasury have lowered our employment levels in those areas. We had to bid farewell to many dedicated, talented employees. Perhaps there used to be a feeling here that the Federal Reserve was immune to employment pressures that private companies routinely face. That is no longer the case.

As we prepare to welcome a new president to the St. Louis Fed, we are excited about taking on the challenges that lie ahead. It is clear that Mr. Poole left the Bank solidly positioned to face the continuing evolutions in the economy, the banking sector and the Federal Reserve System.

**"IN THE PAST 10 YEARS, AS CHANGES HAVE OCCURRED BOTH INSIDE AND OUTSIDE THE FEDERAL RESERVE, WE HAVE REMAINED AGILE ENOUGH TO DEVELOP NEW CAPABILITIES AND SKILLFUL ENOUGH TO EMERGE AS A SYSTEM LEADER IN SEVERAL AREAS."**

# FINANCIAL STATEMENTS | 2007

For the years ended December 31, 2007 and 2006

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2007 was Deloitte & Touche LLP (D&T). Fees for these services totaled $4.7 million. 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 the Reserve Banks, or in any other way impairing its audit independence. In 2007, the Bank did not engage D&T for any material advisory services.

**TO THE BOARD OF DIRECTORS:**

March 20, 2008

The management of the Federal Reserve Bank of St. Louis ("FRBSTL") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statements of Income and Comprehensive Income, and Statement of Changes in Capital as of December 31, 2007 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and as such, include amounts, some of which are based on 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

William Poole

**William Poole**, President and Chief Executive Officer

David A. Sapenaro

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

Marilyn K. Corona

**Marilyn K. Corona**, Vice President, Chief Financial Officer

**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 statement of condition of the Federal Reserve Bank of St. Louis ("FRB St. Louis") as of December 31, 2007 and the related statements of income and comprehensive income and changes in capital for the year 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, 2007, 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 audit. The financial statements of FRB St. Louis for the year ended December 31, 2006 were audited by other auditors whose report, dated March 12, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the 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 audit 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 audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides 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 3 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 3.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FRB St. Louis as of December 31, 2007, and the results of its operations for the year then ended, on the basis of accounting described in Note 3. Also, in our opinion, FRB St. Louis maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Deloitte & Touche LLP

St. Louis, Missouri

March 20, 2008

**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 statement of condition of the Federal Reserve Bank of St. Louis (the "Bank") as of December 31, 2006, and the related statements of income and changes in capital for the year then ended, which have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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. An audit includes 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. We believe that our audit provides a reasonable basis for our opinion.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2006, and the results of its operations for the year then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 12, 2007

**STATEMENTS OF CONDITION**

(*in millions*)

| | As of December 31, 2007 | 2006 |
|---|---|---|
| **ASSETS** | | |
| Gold certificates | $ 326 | $ 328 |
| Special drawing rights certificates | 71 | 71 |
| Coin | 50 | 40 |
| Items in process of collection | 13 | 196 |
| Loans to depository institutions | 1,050 | - |
| Securities purchased under agreements to resell | 1,486 | - |
| U.S. government securities, net | 23,831 | 24,897 |
| Investments denominated in foreign currencies | 513 | 223 |
| Accrued interest receivable | 205 | 214 |
| Interdistrict settlement account | 3,742 | 1,807 |
| Bank premises and equipment, net | 127 | 96 |
| Other assets | 42 | 45 |
| **Total assets** | **$ 31,456** | **$ 27,917** |
| **LIABILITIES AND CAPITAL** | | |
| Liabilities: | | |
| Federal Reserve notes outstanding, net | $ 29,212 | $ 25,994 |
| Securities sold under agreements to repurchase | 1,406 | 941 |
| Deposits: | | |
| Depository institutions | 289 | 434 |
| Other deposits | 13 | 7 |
| Deferred credit items | 38 | 103 |
| Interest on Federal Reserve notes due to U.S. Treasury | 42 | 16 |
| Accrued benefit costs | 80 | 80 |
| Other liabilities | 16 | 10 |
| **Total liabilities** | **$ 31,096** | **$ 27,585** |
| Capital: | | |
| Capital paid-in | 180 | 166 |
| Surplus (including accumulated other comprehensive loss of $18 million and $21 million at December 31, 2007 and 2006, respectively) | 180 | 166 |
| **Total capital** | **360** | **332** |
| **Total liabilities and capital** | **$ 31,456** | **$ 27,917** |

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

**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

(*in millions*)

| | For the year ended December 31, 2007 | 2006 |
|---|---|---|
| Interest income: | | |
| Interest on U.S. government securities | $ 1,235 | $ 1,112 |
| Interest on securities purchased under agreements to resell | 45 | - |
| Interest on investments denominated in foreign currencies | 6 | 4 |
| Interest on loans to depository institutions | 3 | 1 |
| **Total interest income** | **1,289** | **1,117** |
| Interest expense: | | |
| Interest expense on securities sold under agreements to repurchase | 54 | 42 |
| **Net interest income** | **1,235** | **1,075** |
| Other operating income: | | |
| Compensation received for services provided | 26 | 22 |
| Reimbursable services to government agencies | 115 | 116 |
| Foreign currency gains, net | 20 | 13 |
| Other income | 3 | 2 |
| **Total other operating income** | **164** | **153** |
| Operating expenses: | | |
| Salaries and other benefits | 104 | 94 |
| Occupancy expense | 10 | 10 |
| Equipment expense | 7 | 8 |
| Assessments by the Board of Governors | 23 | 20 |
| Other expenses | 108 | 107 |
| **Total operating expenses** | **252** | **239** |
| **Net income prior to distribution** | **1,147** | **989** |
| Change in funded status of benefit plans | 3 | - |
| **Comprehensive income prior to distribution** | **$1,150** | **989** |
| Distribution of comprehensive income: | | |
| Dividends paid to member banks | $ 10 | $ 10 |
| Transferred to surplus and change in accumulated other comprehensive loss | 14 | 43 |
| Payments to U.S. Treasury as interest on Federal Reserve notes | 1,126 | 936 |
| **Total distribution** | **$ 1,150** | **$ 989** |

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

**STATEMENTS OF CHANGES IN CAPITAL**

*For the years ended December 31, 2007, and December 31, 2006*
(*in millions*)

| | | Surplus | | | |
|---|---|---|---|---|---|
| | Capital Paid-In | Net Income Retained | Accumulated Other Comprehensive Loss | Total Surplus | Total Capital |
| Balance at January 1, 2006 (2.9 million shares) | $ 144 | $ 144 | $ – | $ 144 | $ 288 |
| Net change in capital stock issued (0.4 million shares) | 22 | – | – | – | 22 |
| Transferred to surplus | – | 43 | – | 43 | 43 |
| Adjustment to initially apply SFAS No. 158 | – | – | (21) | (21) | (21) |
| Balance at December 31, 2006 (3.3 million shares) | $ 166 | $ 187 | $ (21) | $ 166 | $ 332 |
| Net change in capital stock issued (0.3 million shares) | 14 | – | – | – | 14 |
| Transferred to surplus and change in accumulated other comprehensive loss | – | 11 | 3 | 14 | 14 |
| **Balance at December 31, 2007 (3.6 million shares)** | **$ 180** | **$ 198** | **$ (18)** | **$ 180** | **$ 360** |

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

NOTE 1

### STRUCTURE

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

In accordance with the Federal Reserve Act, supervision and control of the Bank 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 in the System. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

The System also consists, in part, of the Board of Governors 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. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government's bank; provision of short-term loans to depository institutions; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of 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 the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY for its execution of transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of U.S. government securities, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. The FRBNY executes these open market transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account ("SOMA").

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

Although the Reserve Banks are separate legal entities, in the interests of greater efficiency and effectiveness they collaborate in the delivery of certain operations and services. The collaboration takes the form of centralized 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 Bank providing the service and the other eleven Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are billed for services provided to them by another Reserve Bank.

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

**NOTE 3**

## SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by 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, which differ significantly from those of the private sector. These accounting principles and practices are documented in the Financial Accounting Manual for Federal Reserve Banks ("Financial Accounting Manual"), which is issued by the Board of Governors. All of the Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual and the financial statements have been prepared in accordance with the Financial Accounting Manual.

Differences exist between the accounting principles and practices in the Financial Accounting Manual and 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 securities holdings at amortized cost, rather than using the fair value presentation required by GAAP. U.S. government securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. While the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct 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, market values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate 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. A Statement of Cash Flows, therefore, would not provide additional meaningful information. 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 Financial Accounting Manual and GAAP.

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

### A. GOLD AND SPECIAL DRAWING RIGHTS CERTIFICATES

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

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

SDR certificates are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. 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 United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2007 or 2006.

### B. LOANS TO DEPOSITORY INSTITUTIONS

Depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in regulations issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Bank. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. The Bank offers three discount window programs to depository institutions: primary credit, secondary credit, and seasonal credit, each with its own interest rate. Interest is accrued using the applicable discount rate established at least every fourteen days by the board of directors of the Reserve Bank, subject to review and determination by the Board of Governors.

In addition, depository institutions that are eligible to borrow under the Reserve Bank's primary credit program are also eligible to participate in the temporary Term Auction Facility ("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. All advances under the TAF must be fully collateralized.

Outstanding loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established.

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

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

Activity related to U.S. government securities, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of 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 is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

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

The FRBNY may engage in tri-party purchases of securities under agreements to resell ("tri-party agreements"). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities, pass-through mortgage securities of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association, STRIP securities of the U.S. Government, and "stripped" securities of other government agencies. The tri-party agreements are accounted for as financing transactions, with the associated interest income accrued over the life of the agreement.

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

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

Activity related to 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. On February 15, 2007 the FRBNY began allocating to the other Reserve Banks the activity related to securities purchased under agreements to resell.

**E. FX SWAP ARRANGEMENTS AND WAREHOUSING AGREEMENTS**

FX swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, whereby the parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to the foreign currencies it may need to support its international operations and give the authorized foreign central bank temporary access to dollars. Drawings under the FX swap arrangements can be initiated by either party and must be agreed to by the other party. The FX swap arrangements are structured so that the party initiating the transaction bears the exchange rate risk upon maturity. Foreign currencies received pursuant to these agreements are reported as a component of "Investments denominated in foreign currencies" in the Statements of Condition.

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

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

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

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over 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, either developed internally or acquired for internal use, are capitalized based on the cost of direct services and materials associated with designing, coding, installing, or testing software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from 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 when events or changes in circumstances indicate that the carrying amount of assets or asset groups is not recoverable and significantly exceeds their fair value.

**G. INTERDISTRICT SETTLEMENT ACCOUNT**

At the close of business each day, each Reserve Bank assembles the payments due to or from other Reserve Banks. These payments result from transactions between 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.

**H. FEDERAL RESERVE NOTES**

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

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 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, 2007, 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 $3,770 million and $3,175 million at December 31, 2007 and 2006, 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, and 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 are 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. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital.

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 defined benefit pension plans and other postretirement benefit plans that, under accounting standards, 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 9 and 10.

The Bank initially applied the provisions of SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Statements of Condition, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard required applying the provisions as of the end of the year of initial implementation, and the effect as of December 31, 2006 is recorded as "Adjustment to initially apply SFAS No. 158" in the Statements of Changes in Capital.

**L. INTEREST ON FEDERAL RESERVE NOTES**

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. 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 Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

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

In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the U.S. Treasury in the following year.

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

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. During the years ended December 31, 2006 and 2007, the Bank was reimbursed for all services provided to the Department of Treasury.

**N. 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 transfer services, and recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. The FRBA and FRBNY compensate the other 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.

**O. 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 for the U.S. Treasury to prepare 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.

**P. 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, 2007 and 2006, and are reported as a component of "Occupancy expense."

**Q. 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 11 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain of the Bank's assets are discussed in Note 6. 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.

**R. RECENTLY ISSUED ACCOUNTING STANDARDS**

In September, 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and expands on required disclosures about fair value measurement. SFAS No. 157 is generally effective for the Bank on January 1, 2008, though the effective date of some provisions is January 1, 2009. The provisions of SFAS No. 157 will be applied prospectively and are not expected to have a material effect on the Bank's financial statements.

NOTE 4

**U.S. GOVERNMENT 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 3.196 percent and 3.177 percent at December 31, 2007 and 2006, respectively.

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

| | 2007 | 2006 |
|---|---|---|
| **Par value:** | | |
| U.S. government: | | |
| Bills | $ 7,282 | $ 8,801 |
| Notes | 12,841 | 12,784 |
| Bonds | 3,548 | 3,162 |
| **Total par value** | **23,671** | **24,747** |
| Unamortized premiums | 255 | 277 |
| Unaccreted discounts | (95) | (127) |
| **Total allocated to the Bank** | **$ 23,831** | **$ 24,897** |

At December 31, 2007 and 2006, the fair value of the U.S. government securities allocated to the Bank, excluding accrued interest, was $24,838 million and $25,287 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government securities, net, held in the SOMA was $745,629 million and $783,619 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the fair value of the U.S. government securities held in the SOMA, excluding accrued interest, was $777,141 million and $795,900 million, respectively, as determined by reference to quoted prices for identical securities.

Although the fair value of security holdings can be substantially greater 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 central bank, to meet their financial obligations and responsibilities, and should not be misunderstood as representing a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31, 2007, was as follows (in millions):

| | Securities Purchased under agreements to resell | Securities Sold under agreements to repurchase |
|---|---|---|
| Allocated to the Bank: | | |
| Contract amount outstanding, end of year | $ 1,486 | $ 1,406 |
| Weighted average amount outstanding, during the year | 1,121 | 1,114 |
| Maximum month-end balance outstanding, during the year | 1,646 | 1,406 |
| Securities pledged, end of year | | 1,408 |
| System total: | | |
| Contract amount outstanding, end of year | $ 46,500 | $ 43,985 |
| Weighted average amount outstanding, during the year | 35,073 | 34,846 |
| Maximum month-end balance outstanding, during the year | 51,500 | 43,985 |
| Securities pledged, end of year | | 44,048 |

At December 31, 2006, the total contract amount of securities sold under agreements to repurchase was $29,615 million, of which $941 million was allocated to the Bank. The total par value of SOMA securities that were pledged for securities sold under agreements to repurchase at December 31, 2006 was $29,676 million, of which $943 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.

The maturity distribution of U.S. government securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2007, was as follows (in millions):

| | U.S. Government Securities (Par value) | Securities Purchased Under Agreements to Resell (Contract amount) | Securities Sold Under Agreements to Repurchase (Contract amount) |
|---|---|---|---|
| Within 15 days | $ 872 | $ 1,486 | $ 1,406 |
| 16 days to 90 days | 4,785 | | |
| 91 days to 1 year | 4,867 | | |
| Over 1 year to 5 years | 7,689 | | |
| Over 5 years to 10 years | 2,619 | | |
| Over 10 years | 2,839 | | |
| **Total allocated to the Bank** | **$ 23,671** | **$ 1,486** | **$ 1,406** |

At December 31, 2007 and 2006, U.S. government securities with par values of $16,649 million and $6,855 million, respectively, were loaned from the SOMA, of which $532 million and $218 million, respectively, were allocated to the Bank.

**NOTE 5**

### INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

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

The Bank's allocated share of investments denominated in foreign currencies was approximately 1.085 percent and 1.089 percent at December 31, 2007 and 2006, respectively.

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

| | 2007 | 2006 |
|---|---|---|
| Euro: | | |
| Foreign currency deposits | $ 298 | $ 68 |
| Securities purchased under agreements to resell | 28 | 24 |
| Government debt instruments | 51 | 45 |
| Japanese Yen: | | |
| Foreign currency deposits | 30 | 28 |
| Government debt instruments | 62 | 58 |
| Swiss franc: | | |
| Foreign currency deposits | 44 | – |
| **Total allocated to the Bank** | **$ 513** | **$ 223** |

At December 31, 2007, the total amount of foreign currency deposits held under FX contracts was $24,381 million, of which $264 million was allocated to the Bank. At December 31, 2006, there were no open foreign exchange contracts.

At December 31, 2007 and 2006, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was $513 million and $222 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 U.S. government securities discussed in Note 4, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were $47,295 million and $20,482 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was $47,274 million and $20,434 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2007, was as follows (in millions):

| | European Euro | Japanese Yen | Swiss Franc | Total |
|---|---|---|---|---|
| Within 15 days | $ 54 | $ 32 | – | $ 86 |
| 16 days to 90 days | 251 | 4 | 44 | 299 |
| 91 days to 1 year | 30 | 22 | – | 52 |
| Over 1 year to 5 years | 42 | 34 | – | 76 |
| **Total allocated to the Bank** | **$ 377** | **$ 92** | **$ 44** | **$ 513** |

At December 31, 2007 and 2006, the authorized warehousing facility was $5,000 million with no balance outstanding.

NOTE 6

**BANK PREMISES, EQUIPMENT, AND SOFTWARE**

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

| | 2007 | 2006 |
|---|---|---|
| Bank premises and equipment: | | |
| Land | $ 11 | $ 11 |
| Buildings | 74 | 69 |
| Building machinery and equipment | 20 | 18 |
| Construction in progress | 50 | 18 |
| Furniture and equipment | 40 | 43 |
| Subtotal | 195 | 159 |
| Accumulated depreciation | (68) | (63) |
| Bank premises and equipment, net | $ 127 | 96 |
| **Depreciation expense, for the year ended December 31** | **$ 8** | **$ 8** |

The Bank leases space to outside tenants with lease terms of less than one year. Rental income from such leases was immaterial for the years ended December 31, 2007, and 2006. Future minimum payments under agreements in existence at December 31, 2007, were immaterial.

The Bank has capitalized software assets, net of amortization, of $6 million and $8 million at December 31, 2007 and 2006, respectively. Amortization expense was $3 million for each of the years ended December 31, 2007 and 2006. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses." Software assets of $3 million were written off in 2006. The majority of the write-offs were reimbursed by the Department of the Treasury.

Assets impaired as a result of the Bank's restructuring plan, as discussed in Note 11, include check processing equipment. Asset impairment losses of $2 million and $1 million for the periods ending December 31, 2007 and 2006, respectively, were determined using fair values based on quoted market values or other valuation techniques and are reported as a component of "Other expenses." The impairment loss for the period ending December 31, 2006, represents a further write down of the Little Rock facility, which was available for sale and reported as a component of "Other assets."

NOTE 7

**COMMITMENTS AND CONTINGENCIES**

At December 31, 2007, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from one to approximately three 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, 2007 and 2006. 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, 2007 are as follows (in thousands):

| | Operating |
|---|---|
| 2008 | $ 628 |
| 2009 | 535 |
| 2010 | 75 |
| **Future minimum rental payments** | **$ 1,238** |

At December 31, 2007, there were no material unrecorded unconditional purchase commitments or long-term obligations in excess of one year.

At December 31, 2007, the Bank had commitments of approximately $15 million for the construction and acquisition of additional building space at the St. Louis facility. Expected payments related to these commitments are $15 million for the year ending December 31, 2008.

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, 2007 or 2006.

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

NOTE 8

**RETIREMENT AND THRIFT PLANS**

**RETIREMENT PLANS**

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

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and the Office of

Employee Benefits of the Federal Reserve Employee Benefits System. The FRBNY, on behalf of the System, recognizes the net asset and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2007 and 2006, and for the years then ended, were not material.

#### THRIFT PLAN

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $4 million and $3 million for the years ended December 31, 2007 and 2006, respectively, and are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income. The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2007 and 2006, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service.

NOTE 9

## POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

#### POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

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

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

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

| | 2007 | 2006 |
|---|---|---|
| Accumulated postretirement benefit obligation at January 1 | $ 73.0 | $ 66.2 |
| Service cost-benefits earned during the period | 2.6 | 1.7 |
| Interest cost on accumulated benefit obligation | 4.3 | 3.3 |
| Net actuarial (gain) loss | (1.7) | 19.9 |
| Curtailment gain | (1.0) | – |
| Contributions by plan participants | 0.6 | 0.5 |
| Benefits paid | (4.4) | (3.6) |
| Medicare Part D subsidies | 0.3 | 0.3 |
| Plan amendments | – | (15.3) |
| **Accumulated postretirement benefit obligation at December 31** | **$ 73.7** | **$ 73.0** |

At December 31, 2007 and 2006, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 6.25 percent and 5.75 percent, respectively.

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

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

| | 2007 | 2006 |
|---|---|---|
| Fair value of plan assets at January 1 | $ – | $ – |
| Contributions by employer | 3.5 | 2.8 |
| Contributions by plan participants | 0.6 | 0.5 |
| Benefits paid, net of Medicare Part D subsidies | (4.1) | (3.3) |
| **Fair value of plan assets at December 31** | **$ –** | **$ –** |
| **Unfunded obligation and accrued postretirement benefit cost** | **$ 73.7** | **$ 73.0** |
| Amounts included in accumulated other comprehensive loss are shown below: | | |
| Prior service cost | $ 10.4 | $ 15.1 |
| Net actuarial loss | (29.2) | (36.3) |
| Deferred curtailment gain | 1.1 | – |
| **Total accumulated other comprehensive loss** | **$ (17.7)** | **$ (21.2)** |

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:

| | 2007 | 2006 |
|---|---|---|
| Health care cost trend rate assumed for next year | 8.00% | 9.00% |
| 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 | 2013 | 2012 |

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, 2007 (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 | 5.6 | (5.9) |

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

| | 2007 | 2006 |
|---|---|---|
| Service cost-benefits earned during the period | $ 2.6 | $ 1.7 |
| Interest cost on accumulated benefit obligation | 4.3 | 3.3 |
| Amortization of prior service cost | (3.4) | (3.4) |
| Amortization of net actuarial loss | 4.2 | 2.3 |
| Total periodic expense | 7.7 | 3.9 |
| Curtailment gain | (0.1) | – |
| **Net periodic postretirement benefit expense** | **$ 7.6** | **$ 3.9** |

| | |
|---|---|
| Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2008 are shown below: | |
| Prior service cost | $ (3.1) |
| Net actuarial loss | 2.8 |
| **Total** | **$ (0.3)** |

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2007 and 2006, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 5.50 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 was recognized in net income in the year ended December 31, 2007 related to employees who terminated employment during 2007. 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, retroactive to January 1, 2004, are reflected in actuarial gain in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

There were no receipts of federal Medicare Part D subsidies in the year ended December 31, 2006. Receipts in the year ending December 31, 2007, related to benefits paid in the years ended December 31, 2006 and 2007, were $0.3 million and $0.2 million, respectively. Expected receipts in 2008, related to benefits paid in the year ended December 31, 2007, are $0.1 million.

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

| | Without Subsidy | With Subsidy |
|---|---|---|
| 2008 | $ 4.3 | $ 3.9 |
| 2009 | 4.7 | 4.3 |
| 2010 | 5.1 | 4.6 |
| 2011 | 5.5 | 5.1 |
| 2012 | 5.9 | 5.4 |
| 2013-2017 | 33.8 | 30.2 |
| **Total** | **$ 59.3** | **$ 53.5** |

#### 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, 2007 and 2006 were $5 million for each year. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2007 and 2006 operating expenses were $1 million and $213 thousand, respectively, and are recorded as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

**NOTE 10**

## 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 Pensions |
|---|---|
| Balance at January 1, 2006 | $ – |
| Adjustment to initially apply SFAS No. 158 | (21) |
| **Balance at December 31, 2006** | **$ (21)** |
| Change in funded status of benefit plans: | |
| Prior service costs arising during the year | (1) |
| Net actuarial gain arising during the year | 2 |
| 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 income | 3 |
| **Balance at December 31, 2007** | **$ (18)** |

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 9.

NOTE 11

**BUSINESS RESTRUCTURING CHARGES**

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure will involve consolidation of operations into four regional Reserve Bank processing sites in Philadelphia, Cleveland, Atlanta, and Dallas. Additional announcements in 2007 included restructuring plans associated with the U.S. Treasury's Collections and Cash Management Modernization initiative.

In 2006, the Bank announced restructuring plans related to additional consolidation and restructuring initiatives in the check adjustment operations.

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

| | 2006 Restructuring Plans | 2007 Restructuring Plans | Total |
|---|---|---|---|
| *Information related to restructuring plans as of December 31, 2007:* | | | |
| Total expected costs related to restructuring activity | $ 0.3 | $ 4.6 | $ 4.9 |
| Estimated future costs related to restructuring activity | – | 1.1 | 1.1 |
| Expected completion date | 2007 | 2011 | |
| *Reconciliation of liability balances:* | | | |
| Balance at January 1, 2006 | $ – | $ – | $ – |
| Employee separation costs | 0.4 | – | 0.4 |
| Balance at December 31, 2006 | $ 0.4 | $ – | $ 0.4 |
| Employee separation costs | – | 3.5 | 3.5 |
| Adjustments | (0.1) | – | (0.1) |
| Payments | (0.3) | (0.1) | (0.4) |
| **Balance at December 31, 2007** | **$ –** | **$ 3.4** | **$ 3.4** |

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.

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.

Restructuring costs associated with the impairment of certain Bank assets, including software, buildings, leasehold improvements, furniture, and equipment, are discussed in Note 6.

Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 8.

**NOTE 12**

## SUBSEQUENT EVENTS

In March 2008, the Board of Governors announced several initiatives to address liquidity pressures in funding markets and promote financial stability, including increasing the Term Auction Facility (see Note 3b) to $100 billion and initiating a series of term repurchase transactions (see Notes 3d and 4) that may cumulate to $100 billion. In addition, the Reserve Banks' securities lending program (see Notes 3d and 4) was expanded to lend up to $200 billion of Treasury securities to primary dealers for a term of 28 days, secured by federal agency debt, federal agency residential mortgage-backed securities, agency collateralized mortgage obligations, non-agency AAA/Aaa-rated private-label residential mortgage-backed securities, and AAA/Aaa-rated commercial mortgage-backed securities. The FOMC also authorized increases in its existing temporary reciprocal currency arrangements (see Notes 3e and 5) with specific foreign central banks. These initiatives will affect 2008 activity related to loans to depository institutions, securities purchased under agreements to resell, U.S. government securities, net, and investments denominated in foreign currencies, as well as income and expenses. The effects of the initiatives do not require adjustment to the amounts recorded as of December 31, 2007.

The facility in Little Rock, including associated furnishings, was sold for $4 million on March 11, 2008.

## Federal Advisory Council Member

**Lewis F. Mallory Jr.**
CHAIRMAN AND CEO
CADENCE FINANCIAL CORP.
STARKVILLE, MISS.

## Bank Officers

### ST. LOUIS OFFICE

**William Poole**
PRESIDENT AND CEO

**David A. Sapenaro**
FIRST VICE PRESIDENT AND COO

**Karl W. Ashman**
SENIOR VICE PRESIDENT

**Judith A. Courtney**
SENIOR VICE PRESIDENT

**Mary H. Karr**
SENIOR VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY

**Robert H. Rasche**
SENIOR VICE PRESIDENT AND DIRECTOR OF RESEARCH

**Michael D. Renfro**
SENIOR VICE PRESIDENT

**Robert J. Schenk**
SENIOR VICE PRESIDENT

**Julie L. Stackhouse**
SENIOR VICE PRESIDENT

**Richard G. Anderson**
VICE PRESIDENT

**John P. Baumgartner**
VICE PRESIDENT

**Timothy A. Bosch**
VICE PRESIDENT

**Timothy C. Brown**
VICE PRESIDENT

**James B. Bullard**
VICE PRESIDENT

**Ronald L. Byrne**
VICE PRESIDENT

**Marilyn K. Corona**
VICE PRESIDENT

**Cletus C. Coughlin**
VICE PRESIDENT

**William T. Gavin**
VICE PRESIDENT

**Susan F. Gerker**
VICE PRESIDENT

**Roy A. Hendin**
VICE PRESIDENT, DEPUTY GENERAL COUNSEL AND ASSISTANT SECRETARY

**Vicki L. Kosydor**
VICE PRESIDENT

**Jean M. Lovati**
VICE PRESIDENT

**Michael J. Mueller**
VICE PRESIDENT

**Kim D. Nelson**
VICE PRESIDENT

**Kathleen O'Neill Paese**
VICE PRESIDENT

**Todd J. Purdy**
VICE PRESIDENT

**Steven N. Silvey**
VICE PRESIDENT

**Randall C. Sumner**
VICE PRESIDENT

**Daniel L. Thornton**
VICE PRESIDENT

**Howard J. Wall**
VICE PRESIDENT

**Jonathan C. Basden**
ASSISTANT VICE PRESIDENT

**Dennis W. Blase**
ASSISTANT VICE PRESIDENT

**Daniel P. Brennan**
ASSISTANT VICE PRESIDENT

**Winchell S. Carroll**
ASSISTANT VICE PRESIDENT

**Susan K. Curry**
ASSISTANT VICE PRESIDENT

**Hillary B. Debenport**
ASSISTANT VICE PRESIDENT

**William M. Francis Jr.**
ASSISTANT VICE PRESIDENT

**Kathy A. Freeman**
ASSISTANT VICE PRESIDENT

**Thomas A. Garrett**
ASSISTANT VICE PRESIDENT

**Massimo Guidolin**
ASSISTANT VICE PRESIDENT

**Elizabeth A. Hayes**
ASSISTANT VICE PRESIDENT

**Paul M. Helmich**
ASSISTANT VICE PRESIDENT

**Edward A. Hopkins**
ASSISTANT VICE PRESIDENT

**James L. Huang**
ASSISTANT VICE PRESIDENT

**Debra E. Johnson**
ASSISTANT VICE PRESIDENT

**Visweswara R. Kaza**
ASSISTANT VICE PRESIDENT

**Carrie E. Keen**
ASSISTANT VICE PRESIDENT

**William D. Little**
ASSISTANT VICE PRESIDENT

**Raymond McIntyre**
ASSISTANT VICE PRESIDENT

**John W. Mitchell**
ASSISTANT VICE PRESIDENT

**Christopher J. Neely**
ASSISTANT VICE PRESIDENT

**Edward M. Nelson**
ASSISTANT VICE PRESIDENT

**Arthur A. North**
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 A. Smith**
ASSISTANT VICE PRESIDENT

**Scott B. Smith**
ASSISTANT VICE PRESIDENT

**Leisa J. Spalding**
ASSISTANT VICE PRESIDENT

**James E. Stephens**
ASSISTANT VICE PRESIDENT

**Kristina L.C. Stierholz**
ASSISTANT VICE PRESIDENT

**Matthew W. Torbett**
ASSISTANT VICE PRESIDENT

**Yi Wen**
ASSISTANT VICE PRESIDENT

**David C. Wheelock**
ASSISTANT VICE PRESIDENT

**Glenda Joyce Wilson**
ASSISTANT VICE PRESIDENT

**Subhayu Bandyopadhyay**
RESEARCH OFFICER

**Jane Anne Batjer**
ASSISTANT COUNSEL

**Diane B. Camerlo**
ASSISTANT COUNSEL

**Joseph C. Elstner**
PUBLIC AFFAIRS OFFICER

**William R. Emmons**
SUPERVISORY OFFICER

**Anna M. Helmering Hart**
INFORMATION TECHNOLOGY OFFICER

**Cathryn L. Hohl**
ASSISTANT COUNSEL

**Joel H. James**
BANK RELATIONS OFFICER

**Michael T. Owyang**
RESEARCH OFFICER

**Michael R. Pakko**
RESEARCH OFFICER

**Christopher H. Wheeler**
RESEARCH OFFICER

### LITTLE ROCK BRANCH

**Robert A. Hopkins**
SENIOR BRANCH EXECUTIVE

### LOUISVILLE BRANCH

**Maria G. Hampton**
SENIOR BRANCH EXECUTIVE

### MEMPHIS BRANCH

**Martha L. Perine Beard**
SENIOR BRANCH EXECUTIVE

**James A. Price**
ASSISTANT VICE PRESIDENT

**Editor:** Stephen Greene

**Contributor:** David C. Wheelock

**Designer:** Kathie Lauher

**Web Design:** Becca Marshall

**Production:** Barb Passiglia

**Photography:** Steve Smith Studios
Mark Gilliland Photography

For additional print copies, contact:
Public Affairs
Federal Reserve Bank of St. Louis
Post Office Box 442
St. Louis, Missouri 63166,
or send an e-mail to pubtracking@stls.frb.org

This report is also available on the
Federal Reserve Bank of St. Louis web site:
www.stlouisfed.org

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

**FEDERAL RESERVE BANK OF ST. LOUIS**
One Federal Reserve Bank Plaza
Broadway and Locust Street
St. Louis, Missouri 63102
314-444-8444

**LITTLE ROCK BRANCH**
Stephens Building
111 Center Street, Suite 1000
Little Rock, Arkansas 72201
501-324-8300

**LOUISVILLE BRANCH**
National City Tower
101 South Fifth Street, Suite 1920
Louisville, Kentucky 40202
502-568-9200

**MEMPHIS BRANCH**
200 North Main Street
Memphis, Tennessee 38103
901-523-7171