MAKING CLEAR PROGRESS

Balance | Transparency | Flexibility | Stability | Consistency

FEDERAL RESERVE BANK OF PHILADELPHIA

2011 Annual Report

PRESIDENT'S MESSAGE

Making Clear Progress

Charles I. Plosser, President and Chief Executive Officer, Federal Reserve Bank of Philadelphia

The theme of this year's annual report is "Making Clear Progress," which highlights the visible actions the Federal Reserve Bank of Philadelphia has taken to support the Third District and the Federal Reserve System as a whole. Yet, more meaningfully, our theme also conveys the bold steps the Federal Open Market Committee (FOMC) has taken to add clarity to communications about monetary policy.

In this year's essay, "Toward Clarity in Monetary Policy," I discuss the benefits of transparency and clarity about monetary policy, which I believe enhances the central bank's commitment, credibility, and accountability. During 2011, I served with Vice Chair Janet Yellen, Governor Sarah Bloom Raskin, and Chicago Fed President Charles Evans on a communications subcommittee that developed two important changes in communications adopted by the FOMC in January 2012. I want to thank Loretta Mester, executive vice president and director of research, for her tremendous support to the subcommittee on this effort.

In the pages that follow, starting with First Vice President Blake Prichard's message, we provide an overview of the accomplishments and contributions of our Bank during 2011, which included a lot of hard work to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act. For the Philadelphia Fed, this has meant adding responsibility for close to 70 savings and loan holding companies, not only Third District institutions but those from the adjoining Second District as well.

The Philadelphia Fed also led the efforts by the Federal Reserve to use data to identify and monitor financial risks. Our Bank has worked closely with the Kansas City Fed to create, staff, and manage a System program called Risk Assessment, Data Analysis, and Research (RADAR).

Board of Directors

Among the citizens who get to see our progress up close are the nine business leaders who serve on the Reserve Bank's board of directors. These directors by law fulfill not only a governance role in providing oversight for the Bank's performance but also a guidance role by providing valuable insight on economic and financial conditions in the District.

On behalf of our Bank, I sincerely thank all of them for their public service. In particular, I thank Charles P. Pizzi, former president and CEO of Tasty Baking Company, and Michael F. Camardo, retired executive vice president of Lockheed Martin, who both completed their terms in 2011.

At the start of 2012, Jeremy Nowak, president and CEO of the William Penn Foundation, and James E. Nevels, chairman and founder of The Swarthmore Group, began their terms as chairman and deputy chairman, respectively, of our board of directors. The Bank also welcomed two new directors: Michael J. Angelakis, vice chairman and chief financial officer of Comcast Corp., and Patrick T. Harker, president of the University of Delaware. Frederick C. "Ted" Peters II, chairman and CEO of Bryn Mawr Trust Company, was also reelected to a second three-year term.

Our Advisory Councils

I also want to acknowledge the business and community leaders who participate on the Bank's Economic Advisory Council (EAC) and the Community Depository Institutions

Advisory Council (CDIAC), two important groups pictured on the pages following our board of directors. The EAC includes representatives from diverse industries as well as nonprofits and organized labor in the Third District. The CDIAC brings together representatives from commercial banks, thrift institutions, and credit unions from around the Third District. One member from each Reserve Bank's CDIAC also serves on the Federal Reserve Board's CDIAC to share insights with peers from around the Federal Reserve System. I want to thank Richard J. Green, vice chairman and CEO of Firstrust Bank, for serving in this role in 2011.

I also thank Bharat Masrani, president and CEO of TD Bank, N.A., for his continued service in 2011 as the Third District's representative to the Federal Advisory Council, which meets quarterly with the Board of Governors in Washington, D.C.

Conversations with our directors, advisory councils, and others help bring Main Street perspectives to the national policy table at meetings of the FOMC. By law, votes are cast at the FOMC by the members of the Board of Governors, along with five of the 12 Reserve Bank presidents: the president of the New York Fed and four other presidents, who serve one-year terms on a rotating basis, as I did in 2011. Whether we vote or not, though, all Reserve Bank presidents attend the FOMC meetings, participate in the discussions, and contribute to the Committee's assessment of the economy and policy options.


Charles Plosser

Closing Thoughts

Finally, I offer my sincere thanks to the employees of the Philadelphia Fed, who, indeed, made clear progress during 2011. I especially want to acknowledge Michael E. Collins, who led the Supervision, Regulation and Credit (SRC) Department until his retirement on June 1, 2011, after 37 years with the Philadelphia Fed. We promoted William W. Lang, senior vice president and lending officer, to lead SRC.

I trust you will find this annual report informative, shedding light on our role as a part of the nation's decentralized central bank. Transparency and clarity about central banking are still evolving. I have described the process of improving our communications as more of a journey than an end. I invite you to continue that journey with us, by engaging in discussions with our staff on issues that matter to you and your economy.

Charles Plosser

Charles I. Plosser
President and Chief Executive Officer
April 2012

ESSAY | 2011 Annual Report

Toward Clarity in Monetary Policy

by Charles I. Plosser

Over the last few years, I have spoken and written frequently about the need to improve the transparency surrounding our monetary policy decision-making and to bring the framework we use for making those decisions into the 21st century.[1] The Federal Reserve is accountable to the public, so it needs to clearly communicate its goals and its approach to making policy decisions. In this essay, I discuss recent steps taken by the Federal Open Market Committee (FOMC) to strengthen the framework for U.S. monetary policy through enhanced commitment, credibility, and communication. I also explain how these steps help improve economic stability.

In my view, the monetary policy framework is stronger when the central bank:

- Commits to a set of clearly articulated objectives that can be feasibly achieved by monetary policy.
- Is transparent and clear in its communications.
- Conducts monetary policy in a systematic or rule-like manner.
- Sets monetary policy independently from the fiscal authorities.

To its credit, the Federal Reserve has sought to strengthen its monetary policy framework, particularly with respect to increased transparency about its actions and its policies during the tenure of Chairman Ben Bernanke. For instance, in an effort to improve its communications to the public, the FOMC decided in 2007 to release its Summary of Economic Projections (SEP) four times a year instead of semi-annually. In 2011, Chairman Bernanke introduced press briefings to provide additional context for the FOMC's policy decisions and the projections. Increased transparency is an ongoing process.

The Federal Reserve is accountable to the public, so it needs to clearly communicate its goals and its approach to making policy decisions.

Early last summer, Chairman Bernanke asked Vice Chair Janet Yellen, Governor Sarah Bloom Raskin, Chicago Fed President Charles Evans, and me to serve on a communications subcommittee whose task was to develop recommendations to improve the FOMC's communications. In January 2012, the FOMC adopted two initiatives brought forward by the subcommittee. Both initiatives are important steps forward for the FOMC and are intended to serve the Committee and the public over the longer term.

Enhancing the Content of the Summary of Economic Projections

The first initiative improves our communications about FOMC participants' economic projections in the SEP by summarizing individual participants' views of the appropriate path of monetary policy. Until January, the SEP summarized the individual FOMC policymakers' views on the economy as reflected in several key economic variables, including output, inflation, and unemployment, but it did not include any information on the monetary policy assumptions that underlay those projections. It is important to recognize that the projections from this exercise are not forecasts in the usual sense. Each policymaker's projections are conditioned on the policymaker's assessment of "appropriate policy," that is, the policy path he or she believes will yield the best outcomes for the economy in the absence of further economic shocks.

There is often a diversity of views about the best path for policy going forward. That leads to valuable discussions and, ultimately, better decision-making. So, the FOMC economic projections differ from those of private-sector forecasters who try to predict what the Fed's next move might be. Instead, each policymaker makes economic projections based on an assessment of the best policy path to achieve the most desirable outcomes.

Without information on what the appropriate paths assumed by the participants were, it was difficult for the public to interpret the SEP. For example, participants may project the same value of inflation or the unemployment rate, but they may believe it will take different policy paths to achieve those outcomes. Thus, what appear to be similar projections in terms of outcomes can actually reflect very different views about the evolution of monetary policy.

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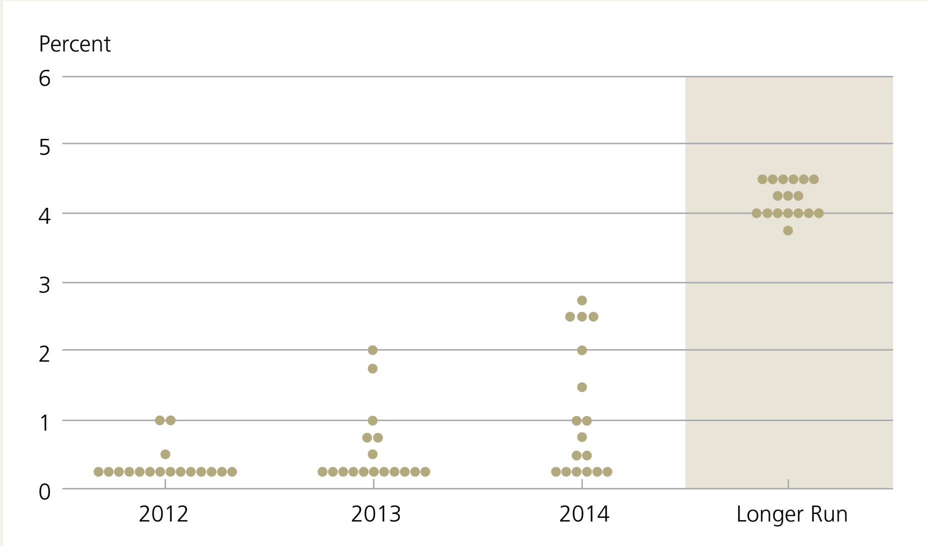
The FOMC has, at times, communicated assessments about the expected path of policy, or what central bankers call "forward guidance." For example, the Committee has used phrases like "extended period," or, in the Greenspan era, it talked about policy moving at a "measured pace." In the second half of 2011, the Committee indicated that rates were likely to be kept low until a specific date in the calendar. Yet, these approaches are not very satisfactory. "Extended period" is vague and can be interpreted differently by Committee members or market participants, and using calendar dates can be misinterpreted by the markets as suggesting that monetary policy is no longer contingent on how the economy evolves.

I believe a better and more informative way for the public to assess the likely future course of monetary policy is provided in the underlying policy paths assumed by participants as provided in the enhanced SEP. These policy paths are now summarized in two charts. The most relevant chart (on the next page) displays the level of the federal funds rate assumed by each participant at the end of each calendar year over the next three years and for the longer run. This information provides a useful picture of the range of views of future policy assumed by policymakers based on current economic conditions.

Adding policymakers' assumptions to the SEP has two main advantages over using a calendar date. First, it illustrates the full range of views and, in doing so, underlines the uncertainty that truly exists about future policy. Second, it reveals information about how policymakers' views of policy evolve as economic conditions change – this is what economists call the policymaker's reaction function. The new enhanced SEP thus adds an important perspective not just of prospective policy at a point in time but of how the policy projections are influenced as economic conditions change. Such communication will prove useful in periods such as the current unusual circumstances but also in more normal times as well.

Target Federal Funds Rate at Year End



Each shaded circle indicates the value (rounded to the nearest 1/4 percent) of an individual participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run.

Source: http://www.federalreserve.gov/monetarypolicy/fomcminutes20120125ep.htm#chtop2

Clarifying the Goals and Objectives of Monetary Policy

The second important communications initiative adopted by the FOMC in January was to issue a consensus statement of the longer-run goals and policy strategy. When households, firms, and markets have a better understanding of what to expect from monetary policy, they can make better financial plans and better spending and labor market decisions. Thus, greater clarity helps monetary policy become more effective at promoting its goals.

The consensus statement makes four very significant points in clarifying our policy objectives.

Reaffirming our commitment to our statutory mandate.
First, the statement reaffirms the Committee's commitment to its congressional mandate to promote "maximum employment, stable prices and moderate long-term interest rates."[2] Because moderate long-term interest rates follow so directly from the price stability mandate, many people have come to refer to the Fed as having a "dual mandate" – price stability and maximum employment.

The statement then gives texture to those objectives.

Clarifying and making explicit our inflation objective.
The statement's second significant point stresses that inflation over the longer run is mainly determined by monetary policy. In this sense, the FOMC acknowledges what every economist has known for over two centuries: inflation is a monetary phenomenon. Therefore, it is appropriate and feasible for a central banker to set an inflation goal and to be held accountable for achieving it.

The Committee adopted a long-term inflation goal of 2 percent, as measured by the year-over-year change in the overall personal consumption expenditures (PCE) chain-weighted price index. By establishing an explicit inflation target, the Federal Reserve is adopting a practice used by most major central banks and one that is acknowledged as a best practice by academics and central bankers. Making such a clear and explicit statement should give the public confidence in the credibility of the Fed's commitment to price stability and provide a tangible metric by which the Fed can be held accountable to the public.

Also, stabilizing inflation expectations and increasing the credibility of the central bank to maintain stable prices can actually change the inflation process itself. In particular, inflation will become less responsive or sensitive to short-run supply and demand disturbances. This means less volatility in monetary policy and less volatility in output and employment.

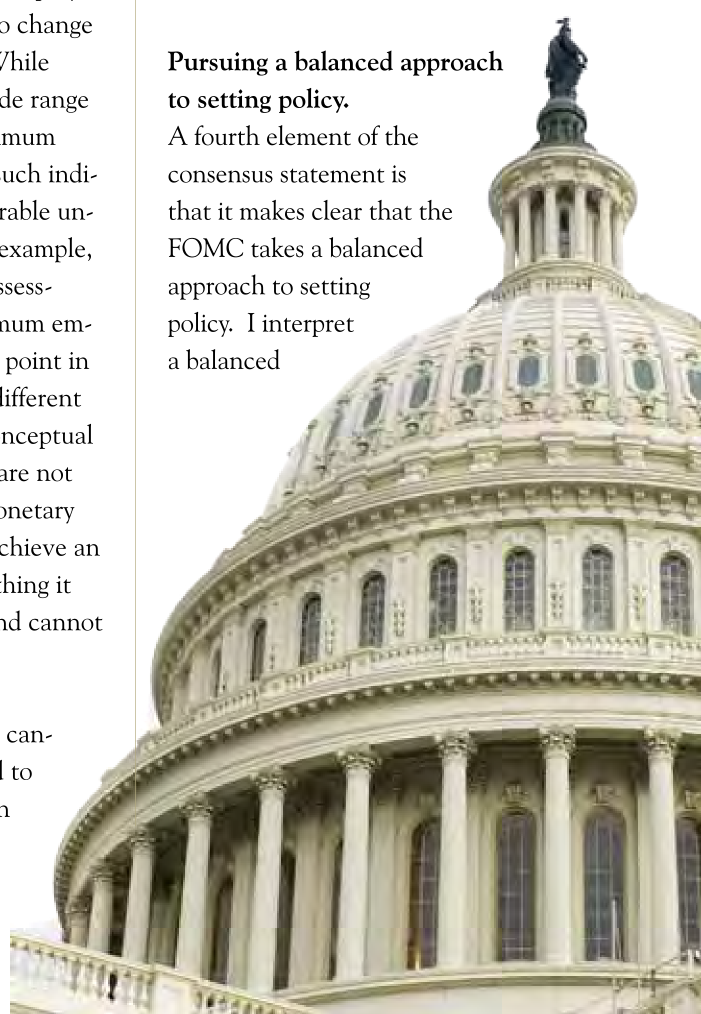
Monetary policy should not seek to achieve an explicit objective for something it does not directly control and cannot accurately measure.

Explaining why the FOMC cannot set a fixed numerical objective for employment.
A third important point made in the statement is that it is not appropriate for the Fed to set an explicit numerical goal for the maximum employment part of its mandate. This is not because the Fed does not seek maximum employment or because it wants to disregard or downplay its importance. Rather, it reflects the differences between the economic determinants of the inflation and employment parts of our mandate. Over the longer run, the economy's inflation rate is primarily determined by monetary policy. So, the FOMC is able to set a longer-run numerical goal for inflation and should be held accountable for achieving that goal.

On the other hand, maximum employment is largely determined by factors that are beyond the direct control of monetary policy. These factors include such things as demographics, technological innovation and productivity, the structure of the labor market, and various governmental policies, including taxes and other policies that impact the level of employment. Since these factors change over time, the concept of maximum employment can also change over time. While policymakers consider a wide range of indicators to assess maximum employment, the value of such indicators is subject to considerable uncertainty. Economists, for example, often have very different assessments of the level of maximum employment attainable at any point in time. This arises because different models suggest different conceptual definitions, most of which are not directly observable. So, monetary policy should not seek to achieve an explicit objective for something it does not directly control and cannot accurately measure.

Moreover, monetary policy cannot and should not be used to offset longer-run changes in maximum employment. Even in the near term, the modern approach to macroeconomics recognizes that employment will fluctuate with forces that affect supply and demand, such as oil price shocks, earthquakes, or decisions by households to save more, or deleverage, perhaps due to a fall in the stock market or in house prices. In my view, it is generally neither desirable nor efficient for monetary policy to try to prevent markets from making adjustments in response to economic events, even if they have consequences for employment. Instead, I believe monetary policy should be set in a way that allows the economy to efficiently use its resources given the economic disturbances it has experienced, thus allowing for the best economic outcome given the environment.

Pursuing a balanced approach to setting policy.
A fourth element of the consensus statement is that it makes clear that the FOMC takes a balanced approach to setting policy. I interpret a balanced



approach as one that promotes all of our congressionally mandated objectives of maximum employment, stable prices, and moderate long-term interest rates and does not favor one over the other.

Many people think the employment and price stability parts of the mandate conflict with one another, but in fact, they are complementary. Economists have come to understand that achieving price stability is the most effective means for monetary policy to promote the other goals. Price stability contributes to the economy's growth and employment prospects in the longer term and helps to moderate the variability of output and employment in the short to medium term. Price stability allows the economy to function more efficiently and more productively by giving individuals and businesses more confidence that the purchasing power of the dollar will not erode. Price stability also helps to foster financial stability and moderates long-term interest rates by minimizing the inflation premium that investors demand to hold long-term assets.

Failing to maintain price stability can often lead to more instability in employment and output. If inflation rises to unacceptable levels, as it did in the 1970s, monetary policy may be forced to react to restore price stability. This, in turn, could lead to an increase in unemployment as it did in the recession early in the 1980s. Thus, increases in inflation in the near term risk creating unemployment in the future; as a result, we end up with less stability, not more.

The consensus statement does not provide answers for all the hard policy choices. How best to implement this balanced approach requires judgments that may well differ across policymakers who may have different models of the economy. Thus, policymakers may have different assessments of the appropriate policy even as they work to promote the same long-term goals.

Overall, the enhancements to our SEP and the articulation of our long-run goals and objectives clarify and strengthen the Fed's monetary policy framework. In so doing they move us closer to the modern textbook view of how to conduct monetary policy. This view is commonly referred to as flexible inflation targeting. The approach combines a credible commitment to a medium-term inflation objective, which, in turn, allows monetary policy to adjust to economic shocks in a manner that helps promote the return of output or employment to a more desirable value without undermining inflation expectations. It emphasizes clear and transparent communication with the public about policymakers' views of current economic conditions, the economic outlook, and its decision-making framework.

Flexible inflation targeting is widely practiced by major central banks around the world. While details often differ, key themes include a commitment to an explicit medium-term inflation objective and transparent communication about the economic outlook and the policy process. It also increases accountability to the public. It is harder to make commitments that you will be unable or unwilling to keep if you know the public can call you to task for failing to meet your commitments.

Economic research in the past 30 years has shown that setting monetary policy in a systematic or rule-like manner leads to better economic outcomes – lower and less volatile inflation and greater economic stability in general.

By being more explicit about its objectives and more transparent and systematic about its decision-making framework, the central bank enhances its credibility.

More to Do

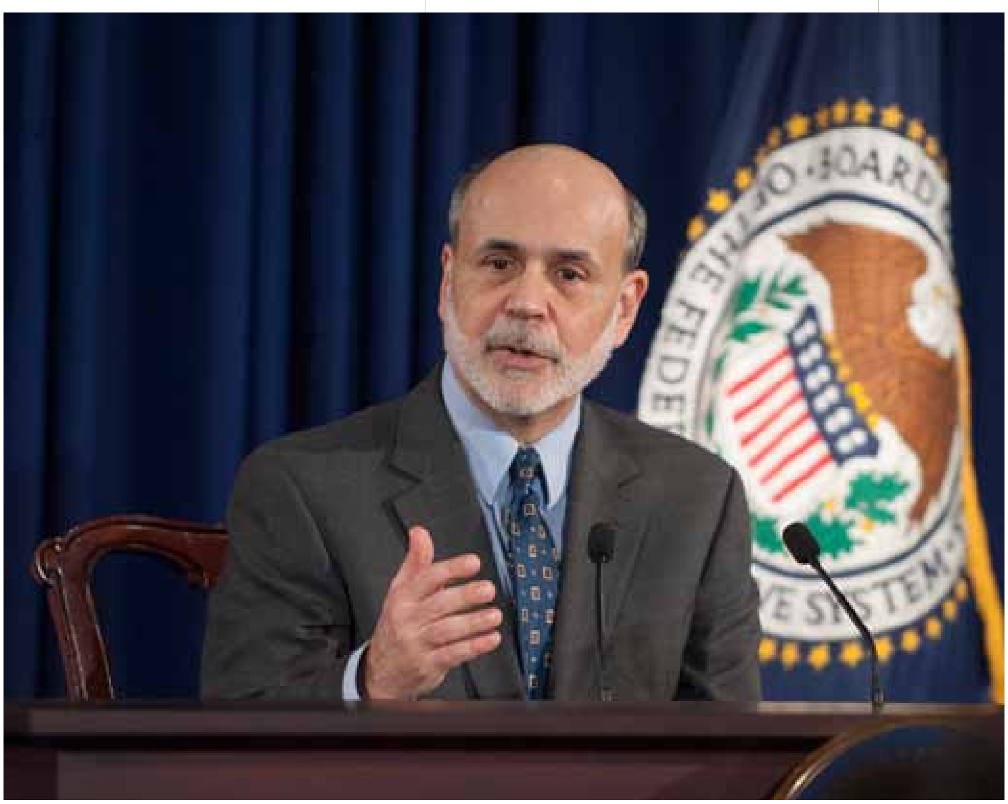
Improving the transparency of our communications and strengthening our policy framework is a work in progress. More can be done and here I would like to focus on two possible steps.

First, I believe the Federal Reserve could further improve communication by publishing a more comprehensive monetary policy report four times a year. Currently, the Chairman testifies before Congress twice a year and submits an accompanying written report. In addition, the Chairman holds press briefings four times a year to summarize the SEP and the subsequent minutes further elaborate and discuss policymakers' views on the economy. I think there is an opportunity to combine these efforts to create a more comprehensive report on monetary policy. Most central banks that have adopted an inflation target have also sought to improve communication and transparency through the publication of a regular policy report. In the U.K., for example, the Bank of England issues a quarterly Inflation Report. Other countries produce a Monetary Policy Report that discusses the central bank's forecasts and the longer-term context of policy.

I think the Fed should consider producing a similar report to elaborate and reinforce its policy framework and how it relates to economic conditions. These reports will help improve the public's understanding of policy, which will help make policy more effective and the central bank more accountable.

Second, I believe the FOMC should adopt clearer guidelines on how policy evolves with economic conditions. The better the public and the markets understand how policy is likely to be adjusted as the economy changes, the more predictable policy becomes, which promotes price stability and better economic outcomes.

The history of U.S. monetary policy is filled with stops and starts and changes in direction, yet the Fed has communicated little about what drives those decisions. Indeed, historically, central bankers have tended not to reveal such information, since they have preferred discretionary policy over systematic policy. But economic research in the past 30 years has shown that setting monetary policy in a systematic or rule-like manner leads to better economic outcomes – lower and less volatile inflation and greater economic stability in general.[3] As I have discussed on many occasions, there is value in conducting policy in a systematic manner in both good times and bad.[4] This means making policy decisions using available economic information in a consistent and predictable manner.



Federal Reserve Chairman Ben Bernanke at the January 25, 2012 press briefing explaining the Federal Open Market Committee's policy decisions.

Of course, policymakers do not know with any degree of certainty how economic conditions will evolve. So they cannot and should not say with any certainty what policy will be in the future. But policymakers can provide information about the factors that will influence their policy decisions and so be more systematic about how they use economic data in formulating their policy. Some call this a policy rule. Milton Friedman advocated a rule in the form of a k-percent growth rate of the money supply. John Taylor devised a rule that depends on a measure of inflation relative to a target and some measure of resource utilization. Other versions of the Taylor rule involve a degree of smoothing to minimize sharp swings in the policy rate. A policy rule is also called a reaction function or response function because it describes how policy will evolve as key economic conditions evolve.

I believe that the Fed should provide more information about its reaction function. The practice of using systematic rules as guides to monetary policy imposes an important discipline on policymaking and improves communication and transparency. This is because systematic rules make policy more predictable and therefore help the public and markets make better decisions. Moreover, if policymakers choose to deviate from the guidelines, they are forced to explain why and how they anticipate returning to normal operating practices. Systematic policy also reduces the temptation to engage in discretionary policies.

The practice of using systematic rules as guides to monetary policy imposes an important discipline on policymaking and improves communication and transparency.

I believe the FOMC is still some way from agreeing on one systematic policy rule or reaction function. Such choices will involve elaborate discussions and agreement on the appropriate class of models and an agreed-upon loss function. One way to move toward a more systematic policy would be to describe the variables that are important for our reaction function. The academic literature suggests using rules that respond aggressively to deviations of inflation from the central bank's target and less aggressively to deviations of output from some concept of "potential output." Research has found that such rules perform fairly well in a variety of models and frameworks.[5]

Timeline to Transparency

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1975
The Federal Reserve presents testimony twice each year to Congress on the conduct of monetary policy.

1979
The FOMC releases the first semiannual economic projections.

1983
The Federal Reserve publishes the first "Beige Book," which summarizes economic conditions in each Federal Reserve District.

1994
The FOMC begins to release a statement disclosing changes in the federal funds rate target.

2000
The FOMC begins releasing a statement after every meeting and starts to include an assessment of the balance of risks to achieving its objectives.

Thus, it is reasonable and feasible for the Fed to describe policy in terms of the variables in a rule that is robust across models. We would not have to articulate a precise mathematical rule but would provide the key variables and then communicate policy decisions in terms of changes in these key variables. If policy were changed, then we would explain that change based on how the variables in our response function have changed. If we choose a consistent set of variables and systematically use them to describe our policy choices, the public will have a greater ability to form judgments about the likely course of policy. This would reduce uncertainty about policy and promote stability.

Maintaining the Independence of Monetary Policy

There is one more item on my list of things to do. At the beginning of this essay, I noted that the fourth principle of sound central banking is maintaining the independence of the central bank. Unfortunately, over the past few years, the combination of a financial crisis and sustained fiscal imbalances has led to a breakdown in the accepted barriers between monetary and fiscal policy. The pressure has come from both sides. Governments are pushing central banks to exceed their monetary boundaries and central banks are stepping into areas not previously viewed as acceptable for an independent central bank.

While monetary policy and fiscal policy are intertwined through the government's budget constraint, there are good reasons to maintain clear boundaries between the two. Specifically, in a world where fiscal discipline is lacking, governments without the institutional or constitutional guarantees of an independent central bank often resort to money creation as a solution to fiscal problems. This, of course, is a recipe for high rates of inflation and, in the extreme, hyperinflation. For this reason, countries throughout the world have moved over the last 60 years to strengthen the independence of their central banks. It is simply good governance to keep a healthy degree of separation between those responsible for tax and spending policies and those responsible for monetary creation.

The pressure on independence stems, in part, from fiscal imbalances and the inability of governments to develop credible and sustainable plans to finance public expenditures. In turn, the pressure can manifest itself in calls for higher inflation or for central banks to act as lenders of last resort for failing governments. Governments can also pressure central banks to

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2002
The results of the FOMC roll-call vote are added to the post-meeting statement.

2004
The FOMC speeds up the release of its minutes: Now there is only a three-week lag, instead of waiting until after the next regularly scheduled meeting, which meant a lag of about six weeks.

2007
The FOMC decides to release its economic projections four times a year.

2010
Congress passes the Dodd-Frank Wall Street Reform and Consumer Protection Act in response to the financial crisis.

2011
The Chairman of the Federal Reserve begins to hold press briefings four times a year to present the FOMC's current economic projections and to provide additional context for policy decisions.

2012
The FOMC expands the Summary of Economic Projections to include information about policymakers' assumed path for monetary policy. The Committee also issues a consensus statement of longer-run goals and policy strategy.

engage in lending to the private sector as a means to avoid the explicit appropriation of funds by the fiscal authorities.

Yet central banks have also contributed to the breakdown of the boundaries by engaging in credit allocations to particular sectors, such as housing, and bailouts to particular firms, such as Bear Stearns. Thus, both the fiscal authorities and the supposedly independent central banks have acted in ways that undermine central bank independence. We need to restore the boundaries.

In last year's essay, I outlined a framework for a "new accord" between the Federal Reserve and the Treasury. It would enable the central bank to act in emergencies when requested by the Treasury or the fiscal authorities, but it would be clear up front that any non-Treasury assets that accrued on the central bank's balance sheet would be swapped for government securities within a specified period of time. This would ensure that fiscal policy decisions remain under the purview of the fiscal authorities, not the central bank.

Summary

To summarize, the FOMC has taken significant actions toward greater transparency, most recently with the historic steps adopted in January 2012. These steps in turn help to promote better public understanding of the rationale behind the FOMC's decisions. First, we released a statement clarifying the long-run goals of monetary policy and our policymaking strategy. Second, we began releasing information about the policy paths that underlie our economic projections.

Yet, I believe more can be done. We can and should improve our discussion of the economy and our approach to policy through the publication of a more comprehensive monetary policy report to the public. We can also better define our reaction function, to enable the public to better understand and anticipate future policy actions. Economic research has shown that increased transparency can improve the effectiveness of monetary policy, as well as the Fed's accountability with the public. But the benefit depends on the public's understanding of the policymaking framework.

Lastly, I believe that we must seek ways to ensure that our central bank preserves its independence and that the boundaries between monetary and fiscal policy are restored. Thus, I remain committed to working to increase the clarity of the Fed's public communications about current economic conditions, the economic outlook, and our policymaking framework.

ENDNOTES

[1] This essay is based on recent speeches by the author. The views expressed here are the author's and not necessarily those of the Federal Reserve Board or colleagues on the Federal Open Market Committee.

[2] Congress set these goals of monetary policy in a 1977 amendment to the Federal Reserve Act and then reaffirmed them in 2000.

[3] See Kydland and Prescott (1977).

[4] See, for example, Plosser (2008) or Plosser (2010).

[5] See Orphanides and Williams (2002).

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FIRST VICE PRESIDENT'S MESSAGE

Blake Prichard

2011: A Year in Review

D. Blake Prichard, First Vice President and Chief Operating Officer, Federal Reserve Bank of Philadelphia

The year 2011 brought significant change for both the Bank and the Federal Reserve System, and the Philadelphia Fed's employees proved equal to the task of dealing with those changes. I am especially proud of our many outstanding employees who accomplished their tasks in spite of significant resource constraints. I will describe here just a few of the Bank's 2011 accomplishments.

The Dodd-Frank Act created significant new responsibilities in bank supervision, including oversight of close to 70 savings and loan holding companies. Our supervision and regulation staff also led the Federal Reserve System's model validation efforts, which will help to ensure the quality of supervisory models used in stress testing. In compliance with the provisions of the Dodd-Frank Act, we formalized our Office of Diversity and Inclusion. This unit, which is housed in Human Resources, enhances our long-standing commitment to supplier diversity, proactive diversity in recruitment, and a continued focus on promoting an inclusive workplace.

Our Treasury Services Department assumed responsibility for the Treasury Collateral Management and Monitoring system, and the Collateral Management System had a major release mid-year. The Treasury Check Information System further improved efficiency in the U.S. Treasury's operations by adding new functionality to the system. In addition, we assumed responsibility for printing and distributing savings bonds. All of these projects were carried out in partnership with Information Technology Services. Further, IT Services managed major infrastructure upgrades and consolidations for a more efficient use of resources.

We had noteworthy changes in our official ranks, with a new senior officer in Supervision, Regulation and Credit and a new leader for Information Technology Services. I believe both have adapted well to their new responsibilities and are continuing to focus on highly effective services.

In addition to our work-related activities, our volunteers in PhillyFedCARES were generous with their time and talents in service to others in our community. They led reading and math programs for schoolchildren in a local elementary school and once again were energetically engaged in our United Way "Days of Caring" events.

All in all, 2011 was a challenging year but a successful one for the Bank and its staff. I thank all of our employees for their hard work and dedication, and I am confident that they will continue to make important contributions to the Federal Reserve System and all of the stakeholders we support. I have touched on only a few examples of our activities and achievements. You can read more details in the Bank Highlights section that follows.

BANK HIGHLIGHTS

CONDUCTING RESEARCH TO SUPPORT POLICY

Economists and staff in the Philadelphia Fed's **Research Department** completed a full year of research studies and briefings to President Plosser on monetary policy, financial stability, and regulation. Much of this important and timely research was also published in leading economics and finance journals to share knowledge about the evolving economy.

The department organized several conferences and workshops, including its biennial Philadelphia Fed Policy Forum, which in 2011 focused on "Budgets on the Brink: Perspectives on Debt and Monetary Policy."

Loretta Mester, executive vice president and director of research, supported the Federal Open Market Committee's (FOMC) Subcommittee on Communications, which included President Plosser, as they worked on proposals to improve the clarity of communications about policy decisions. She also worked with her counterpart at the Chicago Fed to coordinate a briefing on labor market dynamics to the FOMC.

Economists Keith Sill, vice president and director of the Real-Time Data Research Center, and Michael Dotsey, senior policy advisor, helped to coordinate and lead a System work group that developed economic models and forecasts that support the FOMC.

Two other Bank economists, Mitchell Berlin, vice president and head of the Banking and Financial Markets section, and Leonard Nakamura, vice president and head of the Regional and Microeconomics section, coordinated the Bank's semiannual Financial Stability Report and briefed senior management. The report was also shared with the Office of Financial Stability Policy and Research at the Board of Governors.

Berlin and a colleague from the San Francisco Fed led the Federal Reserve System's Quantitative Surveillance project and completed a report evaluating the arguments for different levels of disclosure of stress test results. Ronel Elul, Wenli Li, and Chenyang (Jason) Wei helped validate models used for the System's bank holding company stress tests and capital reviews mandated by the Dodd-Frank Act.

State budgets were discussed at one of the sessions at the 2011 Philadelphia Fed Policy Forum.

PROVIDING INSIGHT INTO THE PAYMENTS SYSTEM

For more than a decade, the Bank's **Payment Cards Center** (PCC) has provided meaningful insights into developments in consumer credit and payments. The PCC also coordinates a Bank-wide Program in Consumer Credit & Payments that makes payments-related information available to the industry, businesses, academia, policymakers, and the public at large.

In 2011, the PCC hosted a conference on economic and policy issues related to the use of payment cards by federal and state governments and, in conjunction with staff in the Bank's Research Department, organized the sixth biennial research conference on Recent Developments in Consumer Credit and Payments.

The center also released five new articles on a variety of topics, such as the use of payment cards for business-to-business payments, the management of insolvency risk in prepaid card programs, and the options available to consumers seeking a workout of their unsecured debts.

IMPLEMENTING DODD-FRANK, EXPANDING SUPERVISION

The implementation of the Dodd-Frank Act (DFA) was the major focus of the Bank's **Supervision, Regulation and Credit Department (SRC)** in 2011. Bank examiners integrated Dodd-Frank-related changes into the supervisory process, adding approximately 70 new savings and loan holding companies (SLHCs) to the Bank's supervisory responsibilities.

Left to right: Bill Lang, Paul Calem, Larry Cordell, and Elisabeth Levins

The DFA also requires the Federal Reserve to evaluate whether certain large bank holding companies and nonbank financial institutions supervised by the Fed have sufficient capital to absorb losses under adverse economic conditions. SRC officers also participated in the ongoing work to model potential losses that could cause future risks. Paul Calem is leading a team as part of the 2012 Comprehensive Capital Analysis and Review (CCAR) that is developing models to assess retail credit risk in such areas as mortgages, home equity lines of credit, and student loans. Other staff members from the Retail Risk Analysis unit and the Risk Assessment, Data Analysis, and Research (RADAR) group are instrumental to this effort. In addition, Bill Lang, senior vice president, and other SRC staff have been actively involved in model validation efforts related to the CCAR.

RADAR, a System resource created by the Philadelphia and Kansas City Feds, is a key driver in the Federal Reserve's efforts to optimize the use of data to identify and monitor financial risks. It consists of two major components: the data warehouse and the Securities Evaluation Service, which moved from pilot stage to full operation in 2011. The data warehouse centralizes a wide array of key consumer data sets and provides authorized personnel throughout the Federal Reserve System with direct access to that information, including robust data on more than 30 million active mortgages. The RADAR team also provides securities evaluation expertise to examiners System-wide.

PROMOTING COMMUNITY DEVELOPMENT, INCREASING ECONOMIC LITERACY

Community Development Studies and Education (CDS&E) hosted 20 events in 2011 on such topics as foreclosure prevention, the housing market for the disabled, and organizational strategies for community development corporations.

CDS&E also introduced a quarterly Community Outlook Survey, which assesses the needs of low- and moderate-income households. The results of this survey are analyzed by staff for emerging trends and compared with similar results from other Reserve Banks to assess broader conditions. Map Your Community, an interactive mapping widget available on the Bank's website, has become a popular national destination for those seeking community profiles of current and historical economic and demographic trends. Information is available for many socioeconomic variables, including poverty levels, census tract income levels, lending activity, and educational attainment. The widget enables community developers and others to create custom maps with data from The Reinvestment Fund's PolicyMap service.

CDS&E researchers served as co-editors for two new publications released in 2011 by Penn Press. Harriet Newburger co-edited *Neighborhood and Life Chances: How Place Matters in Modern America*, and Marvin Smith co-edited *The American Mortgage System: Crisis and Reform.* Both books contained research presented at past Reinventing Older Communities conferences hosted by the Bank. They were also the result of our partnership with the University of Pennsylvania's Institute for Urban Research. In addition, the department published three papers on Federal Housing Administration lending.

REACHING OUT TO THE THIRD DISTRICT AND BEYOND

Bank officers and staff continued to share the Bank's information with stakeholders during 2011. The Bank's senior officers briefed the District's bankers and their boards of directors during the 66th Annual Field Meetings, organized by the Bank's **Financial Institutions Relations Department.**

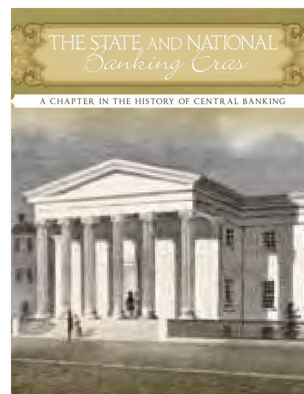
Anthony Scafide and Tom Lombardo, both assistant vice presidents in the department, also met with senior executives at more than 90 percent of Third District financial institutions to discuss current business trends, credit conditions, legislation, and the national and regional economy. In addition, Scafide and Lombardo orchestrated the establishment of the Bank's Community Depository Institutions Advisory Council (CDIAC), which includes representatives from commercial banks, thrift institutions, and credit unions. The new council met with Bank executives twice in 2011 and then sent a representative to the Board of Governors' CDIAC to share banking and business conditions in the Third District with the Governors and representatives from other Federal Reserve Districts.

The Bank's economic education staff reached more than 600 Third District teachers with courses and programs designed to help K-12 teachers understand economic concepts, the Federal Reserve System, monetary policy, and personal financial education.

KEEPING THE PUBLIC INFORMED

As President Plosser and Federal Reserve leaders focus on ways to increase transparency and improve communications, the Philadelphia Fed's **Public Affairs Department** set strategies for supporting and leveraging policy communications to our observers, constituents, and the public. Marilyn Wimp, media relations manager, set up numerous interviews for President Charles Plosser with the *Wall Street Journal*, the *Financial Times*, and CNBC, among others. Links to many of these interviews have been posted on the Bank's website along with the president's public speeches, which help provide perspectives on monetary policy, Fed independence and accountability, financial and policy risks, and alternatives for enhancing communications from the FOMC.

President Charles Plosser was interviewed by CNBC's Steve Liesman, live from the Philadelphia Fed Policy Forum on December 2, 2011.



The Bank is fortunate to reside in Philadelphia's historic area, which helps provide context in educating the public about the role of banking in Philadelphia's history and the purposes and functions of the Federal Reserve. The Bank published the third booklet in its series on the history of U.S. central banking: *The State and National Banking Eras: A Chapter in the History of Central Banking*, written by Sally Burke, publications manager. Last year, the Bank's free Money in Motion exhibit about the Fed, monetary policy, currency and coin, and the payments system welcomed more than 26,000 visitors, including school groups and tourists visiting the Independence Mall area.

PROVIDING SERVICES TO THE U.S. TREASURY

As the nation's central bank, the Fed acts as the fiscal agent for the U.S. Treasury. The Philadelphia Fed's **Treasury Services Department** provides support in two main areas, collateral management and payments, building on the expertise the Bank has developed over the years in these areas. The Bank developed and implemented a new Treasury Collateral Management and Monitoring (TCMM) application to track all collateral posted for U.S. Treasury programs. Additionally, an on-site support team monitors collateral eligibility and assists federal agencies, financial institutions, and the Treasury with collateral activities.

Philadelphia leveraged its leadership in managing a similar Collateral Management System (CMS), which tracks all collateral posted for Federal Reserve credit risk programs. The Bank also enhanced the CMS in 2011 to support the Board of Governors' revised Payment System Risk policy.

The Philadelphia Fed also oversees the Treasury Check Information System (TCIS), which manages the Treasury's checkbook and reconciles approximately 160 million checks yearly and processes over 1.5 million check claims and inquiries per year. In 2011, TCIS completed two upgrades that allowed the Treasury to retire an older application and gave government agencies increased capabilities to view paperless transactions.

Robin Myers, assistant vice president, and Ken Benton, senior specialist/consumer regulations, received the William Taylor Award for Excellence in Bank Supervision from the Board of Governors for their contributions to *Consumer Compliance Outlook*, a Federal Reserve System publication, published here in Philadelphia.

FEDERAL RESERVE BANK OF PHILADELPHIA

Board of Directors

Michael Camardo, Charles Pizzi, Keith Campbell, and Deborah Fretz

Charles P. Pizzi (Chairman) (a,d)
Retired President & CEO, Tasty Baking Company

Jeremy Nowak (Deputy Chairman) (a,c,d)
President & CEO,William Penn Foundation

Michael F. Camardo (a,c)
Retired Executive Vice President, Lockheed Martin Information & Technology Services

Keith S. Campbell (a,b,d)
Chairman, Mannington Mills, Inc.

Deborah M. Fretz (a,c)
Retired President & CEO, Sunoco Logistics

Scott Smith, Aaron Groff, and Ted Peters

Jeremy Nowak and James Nevels

Aaron L. Groff, Jr. (a,b,d)
Chairman, President & CEO, Ephrata National Bank

James E. Nevels (a,b)
Chairman & Founder, The Swarthmore Group

Frederick C. "Ted" Peters II (a,b)
Chairman & CEO, Bryn Mawr Trust Company

R. Scott Smith, Jr. (a,c)
Chairman & CEO, Fulton Financial Corporation

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a) Executive Committee
b) Audit Committee
c) Management & Budget Committee
d) Nominating & Governance Committee

FEDERAL RESERVE BANK OF PHILADELPHIA

Economic Advisory Council

Teresa Bryce Bazemore*
President
Radian Guaranty, Inc.
Philadelphia, PA

John A. Dawkins III
President and CEO
Jo-Dan Enterprises
Bala Cynwyd, PA

Daniel Falasca, Jr.
President
Falasca Mechanical
Vineland, NJ

Cheryl Feldman*
Executive Director
District 1199C Training & Upgrading Fund
Philadelphia, PA

Kevin Flemming
President
Integrity Personnel
Allentown, PA

Edward J. Graham*
Chairman, President, and CEO
South Jersey Industries
Folsom, NJ

Robert Laskowski
President and CEO
Christiana Care Health System
Wilmington, DE

Rose Lee
President
Saint-Gobain Crystals
Valley Forge, PA

Seated left to right: Kevin Flemming, Edward Graham, and Valerie Sill. Standing left to right: Cheryl Feldman, Rodman Ward, RoseAnn Rosenthal, and John Dawkins. Not pictured: Teresa Bryce Bazemore, Daniel Falasca, Jr., Robert Laskowski, Rose Lee, and Robert McMahon

Robert A. McMahon
Senior Vice President
U.S. Commercial Operations
Merck & Co., Inc.
North Wales, PA

RoseAnn B. Rosenthal
President and CEO
Ben Franklin Technology Partners of Southeastern PA
Philadelphia, PA

Valerie J. Sill
President and CEO
DuPont Capital Management
Wilmington, DE

Rodman Ward III
President and CEO
Corporation Service Company
Wilmington, DE

*Began term in September 2011

FEDERAL RESERVE BANK OF PHILADELPHIA

Community Depository Institutions Advisory Council

Steven Ackmann
Formerly, President
Bank of Princeton
Princeton, NJ

Martin J. Banecker
President and CEO
Campbell Employees Federal Credit Union
Cherry Hill, NJ

Stephen Cimo
President and CEO
Delaware State Police Federal Credit Union
Georgetown, DE

Dennis D. Cirucci
President, CEO, and Director
Alliance Bancorp Inc. of Pennsylvania, and Alliance Bank
Broomall, PA

Gerard P. Cuddy
President and CEO
Beneficial Bank
Philadelphia, PA

Robert A. Dorsey
President and CEO
Audubon Savings Bank
Audubon, NJ

Richard J. Green
Vice Chairman and CEO
Firstrust Bank
Philadelphia, PA

David M. Lobach, Jr.
Co-founder, Chairman, and CEO
Embassy Bank for the Lehigh Valley
Bethlehem, PA

Lynda Messick
President and CEO
Community Bank Delaware
Lewes, DE

Vito S. Pantilione
President and CEO
Parke Bank
Sewell, NJ

Evelyn F. Smalls
President and CEO
United Bank of Philadelphia
Philadelphia, PA

Glenn L. Wilson
President and CEO
AmeriServ Financial, Inc.
Johnstown, PA

Seated left to right: David Lobach, Martin Banecker, Evelyn Smalls, and Richard Green. Standing left to right: Lynda Messick, Gerard Cuddy, Dennis Cirucci, Glenn Wilson, Steven Ackmann, and Stephen Cimo.
Not pictured: Robert Dorsey and Vito Pantilione

FEDERAL RESERVE BANK OF PHILADELPHIA

Management and Policy Committee

Charles I. Plosser
President and
Chief Executive Officer

D. Blake Prichard
First Vice President and
Chief Operating Officer

Loretta J. Mester
Executive Vice President and
Director of Research

Donna L. Franco
Senior Vice President and
Chief Financial Officer

Terry E. Harris
Senior Vice President and
Chief Information Officer

Mary Ann Hood
Senior Vice President and
EEO Officer

Arun K. Jain
Senior Vice President

William W. Lang
Senior Vice President and
Lending Officer

Jeanne R. Rentezelas
Vice President and
General Counsel

Milissa M. Tadeo
Senior Vice President of
Corporate Affairs

Herbert E. Taylor
Vice President and
Corporate Secretary

Seated clockwise from front: Charles Plosser, Arun Jain, Mary Ann Hood, Terry Harris, Milissa Tadeo, Donna Franco, Herb Taylor, and Blake Prichard. Standing left to right: Jeanne Rentezelas, William Lang, and Loretta Mester.

FEDERAL RESERVE BANK OF PHILADELPHIA

Current Bank Officers

Charles I. Plosser
President and
Chief Executive Officer

D. Blake Prichard
First Vice President and
Chief Operating Officer

Loretta J. Mester
Executive Vice President and
Director of Research

Donna L. Franco
Senior Vice President and
Chief Financial Officer

Terry E. Harris
Senior Vice President and
Chief Information Officer
Information Technology
Services

Mary Ann Hood
Senior Vice President, EEO
Officer, and Director, Office of
Diversity and Inclusion
Human Resources

Arun K. Jain
Senior Vice President
Treasury and Financial Services

William W. Lang
Senior Vice President and
Lending Officer
Supervision, Regulation &
Credit

Richard A. Sheaffer
Senior Vice President and
General Auditor
Audit

Milissa M. Tadeo
Senior Vice President
Corporate Affairs

John D. Ackley
Vice President
Treasury Services

John G. Bell
Vice President
Financial Statistics

Mitchell Berlin
Vice President and Economist
Research

Donna L. Brenner
Vice President
Enterprise Risk Management

Jennifer E. Cardy
Vice President
Financial Management Services

Larry Cordell
Vice President
Supervision, Regulation &
Credit

Michael Dotsey
Vice President and Senior
Economic Policy Advisor
Research

James S. Ely
Vice President
Public Affairs

Gregory Fanelli
Vice President
Information Technology
Services

Robert Hunt
Vice President and Director
Payment Cards Center

Alice Kelley Menzano
Vice President
Groupware Leadership Center

Leonard Nakamura
Vice President and Economist
Research

James M. Nason
Vice President and Economist
Research

A. Reed Raymond III
Vice President and Chief
Administrative Officer
Supervision, Regulation &
Credit

Patrick M. Regan
Vice President
Information Technology
Services

Jeanne R. Rentezelas
Vice President and General
Counsel
Legal

Michelle M. Scipione
Vice President
Cash Services

Keith Sill
Vice President and Director,
Real-Time Data Research
Center
Research

Theresa Y. Singleton
Vice President and Community
Affairs Officer
Community Development
Studies and Education

Herbert E. Taylor
Vice President and Corporate
Secretary
Office of the Secretary

Vish P. Viswanathan
Vice President and Discount
Officer
Supervision, Regulation &
Credit

Constance H. Wallgren
Vice President and Chief
Examinations Officer
Supervision, Regulation &
Credit

James K. Welch
Vice President
Law Enforcement and Facilities
Management

Brian Calderwood
Assistant Vice President
Groupware Leadership Center

Paul Calem
Assistant Vice President
Supervision, Regulation &
Credit

Kori Connelly
Assistant Vice President &
Counsel
Legal

Maryann T. Connelly
Assistant Vice President &
Counsel
Legal

Frank Doto
Assistant Vice President
Supervision, Regulation &
Credit

Michael T. Doyle
Assistant Vice President
Treasury Payments

Suzanne W. Furr
Assistant Vice President and
Assistant General Auditor
Audit

Stephen G. Hart
Assistant Vice President
Human Resources

Christopher Henderson
Assistant Vice President
Supervision, Regulation &
Credit

John P. Kelly
Assistant Vice President
Treasury Services

Elisabeth V. Levins
Assistant Vice President
Supervision, Regulation &
Credit

Thomas J. Lombardo
Assistant Vice President
Financial Institutions Relations

Robert F. Mucerino
Assistant Vice President
Treasury Services

John J. Munera III
Assistant Vice President
Supervision, Regulation &
Credit

Robin P. Myers
Assistant Vice President
Supervision, Regulation &
Credit

Camille M. Ochman
Assistant Vice President
Cash Services

Anthony T. Scafide, Jr.
Assistant Vice President
Financial Institutions Relations

Stanley Sienkiewicz
Assistant Vice President
Research

Stephen J. Smith
Assistant Vice President and
Counsel
Legal

Eric A. Sonnheim
Assistant Vice President
Supervision, Regulation &
Credit

H. Robert Tillman
Assistant Vice President
Supervision, Regulation &
Credit

Patrick F. Turner
Assistant Vice President
Groupware Leadership Center

William T. Wisser
Assistant Vice President
Supervision, Regulation &
Credit

Joanne M. Branigan
Examining Officer
Supervision, Regulation &
Credit

Christopher Ivanoski
Facilities Officer
Facilities - Plant Operations

Charles Kirkland
Financial Statistics Officer
Financial Statistics

Keith Morales
IT Services and Information
Security Officer
Information Technology
Services

Wanda Preston
Information Services and
Support Officer
Supervision, Regulation &
Credit

Gregory Ramick
WPO Officer
Wholesale Product Office

Gail L. Todd
Credit Officer
Supervision, Regulation &
Credit

Includes promotions through March 2012

FEDERAL RESERVE BANK OF PHILADELPHIA

Operating Statistics

In 2011, Philadelphia maintained its role as a major processor of cash in the Federal Reserve System. Because of technical improvements in the hardware and software systems, the volume of currency processed increased by 7.5 percent from 2010. The actual dollar value of currency processed increased marginally by 1.6 percent. In 2011, the volume of coin bags processed on-site decreased 26 percent, and the value of processed coin decreased 23 percent. This was due to changes in the handling of coin by area financial institutions and companies. Off-site coin handling experienced a volume decline of 13 percent for reasons similar to those for on-site coin activity.

In 2011, discount window lending activity at the Reserve Bank declined to a level similar to that before the financial crisis. The substantial year-over-year reduction in discount window loans in 2011 was influenced by the continuing stabilization in financial markets and the increased level of reserve balances held by depository institutions. Unlike in previous years, the discount window offered no special lending programs in 2011.

SERVICES TO DEPOSITORY INSTITUTIONS

	2011 Volume	2011 Dollar Value	2010 Volume	2010 Dollar Value
Cash operations:				
Currency processed	1,638.2 million notes	$25.2 billion	1,523.5 million notes	$24.8 billion
Coin paid and received on-site	280.0 thousand bags	$148.3 million	379.0 thousand bags	$192.5 million
Coin paid and received off-site	1,044.8 thousand bags	$803.4 million	1,205.7 thousand bags	$917.0 million
Loans to depository institutions during the year	80 loans	$679 million	525 loans	$62.5 billion

Statement of Auditor Independence

In 2011, the Board of Governors engaged Deloitte & Touche LLP (D&T) to audit the combined and individual financial statements of the Reserve Banks and those of the consolidated LLC entities.[1] In 2011, D&T also conducted audits of internal control over financial reporting for each of the Reserve Banks and the consolidated LLC entities. Fees for D&T's services totaled $8 million, of which $2 million was for the audits of the consolidated LLC entities. To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audits. 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 2011, the Bank did not engage D&T for any non-audit services.

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[1] Each LLC will reimburse the Board of Governors for the fees related to the audit of its financial statements from the entity's available net assets.

Financial Report Contents

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

FEDERAL RESERVE BANK
OF PHILADELPHIA

March 20, 2012

To the Board of Directors

The management of the Federal Reserve Bank of Philadelphia (Bank) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2011 and 2010, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (the financial statements). The financial statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the financial statements are, in all material respects, fairly presented in conformity with the accounting principles, policies, and practices documented in the FAM and include all disclosures necessary for such fair presentation.

The management of the Bank is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the financial statements. The Bank's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with the FAM. The Bank's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the Bank's assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with FAM and that the Bank's receipts and expenditures are being made only in accordance with authorizations of its management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on its financial statements.

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 Bank assessed its internal control over financial reporting 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 Bank maintained effective internal control over financial reporting.

Charles I. Plosser, President and Chief Executive Officer

D. Blake Prichard, First Vice President

Donna L. Franco, Senior Vice President and Chief Financial Officer

Deloitte.

Deloitte & Touche LLP
1700 Market Street
Philadelphia, PA 19102-3984
USA

Tel: +1 215 246 2300
Fax: +1 215 569 2441
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Governors of the Federal Reserve System
and the Board of Directors of the Federal Reserve Bank of Philadelphia:

We have audited the accompanying Statements of Condition of the Federal Reserve Bank of Philadelphia ("FRB Philadelphia") as of December 31, 2011 and 2010, and the related Statements of Income and Comprehensive Income, and of Changes in Capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRB Philadelphia as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRB Philadelphia's management is responsible for these Financial Statements, for maintaining effective internal control over financial reporting, and for its assertion 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 Philadelphia's internal control over financial reporting based on our audits.

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

FRB Philadelphia's internal control over financial reporting is a process designed by, or under the supervision of, FRB Philadelphia's principal executive and principal financial officers, or persons performing similar functions, and effected by FRB Philadelphia's 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 Philadelphia's 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 Philadelphia; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of Financial Statements in accordance with the accounting

INDEPENDENT AUDITORS' REPORT

principles established by the Board of Governors of the Federal Reserve System, and that receipts and expenditures of FRB Philadelphia are being made only in accordance with authorizations of management and directors of FRB Philadelphia; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the FRB Philadelphia's assets that could have a material effect on the Financial Statements.

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

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

In our opinion, such Financial Statements present fairly, in all material respects, the financial position of the FRB Philadelphia as of December 31, 2011 and 2010, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, the FRB Philadelphia maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Deloitte + Touche LLP

March 20, 2012

ABBREVIATIONS

ACH	Automated clearinghouse
AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
FAM	*Financial Accounting Manual for Federal Reserve Banks*
FASB	Financial Accounting Standards Board
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
FRBNY	Federal Reserve Bank of New York
GAAP	Accounting principles generally accepted in the United States of America
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
MBS	Mortgage-backed securities
OEB	Office of Employee Benefits of the Federal Reserve System
OFR	Office of Financial Research
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
STRIP	Separate Trading of Registered Interest and Principal of Securities
TAF	Term Auction Facility
TBA	To be announced
TDF	Term Deposit Facility
TIPS	Treasury Inflation-Protected Securities
TOP	Term Securities Lending Facility Options Program
TSLF	Term Securities Lending Facility

STATEMENTS OF CONDITION

As of December 31, 2011 and December 31, 2010 (in millions)

	2011	2010
ASSETS		
Gold certificates	$ 432	$ 404
Special drawing rights certificates	210	210
Coin	160	172
System Open Market Account:		
Treasury securities, net	59,958	24,916
Government-sponsored enterprise debt securities, net	3,694	3,572
Federal agency and government-sponsored enterprise mortgage-backed securities, net	29,058	23,463
Foreign currency denominated assets, net	2,514	2,847
Central bank liquidity swaps	9,669	8
Accrued interest receivable	677	332
Bank premises and equipment, net	87	89
Items in process of collection	53	74
Interdistrict settlement account	-	12,748
Other assets	29	29
Total assets	**$ 106,541**	**$ 68,864**
LIABILITIES AND CAPITAL		
Federal Reserve notes outstanding, net	$ 39,763	$ 40,533
System Open Market Account:		
Securities sold under agreements to repurchase	3,422	1,394
Other liabilities	47	-
Deposits:		
Depository institutions	30,250	21,083
Other deposits	8	5
Interest payable to depository institutions	4	3
Accrued benefit costs	101	94
Deferred credit items	109	271
Accrued interest on Federal Reserve notes	78	334
Interdistrict settlement account	28,084	-
Other liabilities	9	9
Total liabilities	**101,875**	**63,726**
Capital paid-in	2,333	2,569
Surplus (including accumulated other comprehensive loss of $25 million and $24 million December 31, 2011 and 2010, respectively)	2,333	2,569
Total capital	**4,666**	**5,138**
Total liabilities and capital	**$ 106,541**	**$ 68,864**

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

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

For the years ended December 31, 2011 and December 31, 2010 (in millions)

	2011	2010
INTEREST INCOME		
Loans to depository institutions	$ -	$ 1
System Open Market Account:		
Treasury securities, net	1,336	557
Government-sponsored enterprise debt securities, net	94	74
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,184	945
Foreign currency denominated assets, net	24	24
Central bank liquidity swaps	4	1
Total interest income	2,642	1,602
INTEREST EXPENSE		
System Open Market Account: Securities sold under agreements to repurchase	1	2
Deposits:		
Depository institutions	122	82
Term Deposit Facility	1	-
Total interest expense	124	84
Net interest income	2,518	1,518
NON-INTEREST INCOME		
System Open Market Account:		
Treasury securities gains, net	77	-
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	-	15
Foreign currency gains, net	15	61
Compensation received for service costs provided	1	7
Reimbursable services to government agencies	35	34
Other	4	4
Total non-interest income	132	121
OPERATING EXPENSES		
Salaries and benefits	105	103
Occupancy	14	14
Equipment	10	9
Assessments:		
Board of Governors operating expenses and currency costs	79	78
Bureau of Consumer Financial Protection	22	4
Office of Financial Research	4	1
Other	34	31
Total operating expenses	268	240
Net income prior to distribution	2,382	1,399
Change in actuarial gains (losses) and prior service costs related to benefit plans	(1)	6
Comprehensive income prior to distribution	**$ 2,381**	**$ 1,405**
Distribution of comprehensive income:		
Dividends paid to member banks	$ 144	$ 171
Transferred from surplus and change in accumulated other comprehensive loss	(236)	(233)
Payments to Treasury as interest on Federal Reserve notes	2,473	1,467
Total distribution	**$ 2,381**	**$ 1,405**

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

STATEMENTS OF CHANGES IN CAPITAL

For the years ended December 31, 2011 and December 31, 2010 (in millions, except share data)

		Surplus			
	Capital paid-in	Net income retained	Accumulated other comprehensive loss	Total surplus	Total capital
Balance at January 1, 2010 (56,039,067 shares)	$ 2,802	$ 2,832	$ (30)	$ 2,802	$ 5,604
Net change in capital stock issued (4,654,911 shares)	(233)	-	-	-	(233)
Transferred from surplus and change in accumulated other comprehensive loss	-	(239)	6	(233)	(233)
Balance at December 31, 2010 (51,384,156 shares)	$ 2,569	$ 2,593	$ (24)	$ 2,569	$ 5,138
Net change in capital stock issued (4,721,638 shares)	(236)	-	-	-	(236)
Transferred from surplus and change in accumulated other comprehensive loss	-	(235)	(1)	(236)	(236)
Balance at December 31, 2011 (46,662,518 shares)	$ 2,333	$ 2,358	$ (25)	$ 2,333	$ 4,666

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

NOTES TO FINANCIAL STATEMENTS

1. STRUCTURE

The Federal Reserve Bank of Philadelphia (Bank) is part of the Federal Reserve System (System) and is one of the 12 Federal Reserve Banks (Reserve Banks) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank serves the Third Federal Reserve District, which includes Delaware and portions of New Jersey and Pennsylvania.

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

In addition to the 12 Reserve Banks, the System also consists, in part, of the Board of Governors and the Federal Open Market Committee (FOMC). The Board of Governors, an independent federal agency, is charged by the Federal Reserve Act with a number of specific duties, including general supervision over the Reserve Banks. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York (FRBNY), and, on a rotating basis, four other Reserve Bank presidents.

2. OPERATIONS AND SERVICES

The Reserve Banks perform a variety of services and operations. These functions include participating in formulating and conducting monetary policy; participating in the payment system, including large-dollar transfers of funds, automated clearinghouse (ACH) operations, and check collection; distributing coin and currency; performing fiscal agency functions for the U.S. Department of the Treasury (Treasury), certain federal agencies, and other entities; serving as the federal government's bank; providing short-term loans to depository institutions; providing loans to participants in programs or facilities with broad-based eligibility in unusual and exigent circumstances; serving consumers and communities by providing educational materials and information regarding financial consumer protection rights and laws and information on community development programs and activities; and supervising bank holding companies, state member banks, savings and loan holding companies, and U.S. offices of foreign banking organizations pursuant to authority delegated by the Board of Governors. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which was signed into law and became effective on July 21, 2010, changed the scope of some services performed by the Reserve Banks. Among other things, the Dodd-Frank Act established a Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that has supervisory authority over some institutions previously supervised by the Reserve Banks under delegated authority from the Board of Governors in connection with those institutions' compliance with consumer protection statutes; limited the Reserve Banks' authority to provide loans in unusual and exigent circumstances to lending programs or facilities with broad-based eligibility or to designated financial market utilities; and vested the Board of Governors with all supervisory and rule-writing authority for savings and loan holding companies.

NOTES TO FINANCIAL STATEMENTS

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

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes the FRBNY to conduct operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities. Specifically, the FOMC authorizes and directs the FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, 14 foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of $2 billion and $3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund.

Although the Reserve Banks are separate legal entities, they collaborate on the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks. Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by the other Reserve Banks include Collateral Management System, Electronic Cash Letter System, Groupware Leadership Center, Treasury Check Information Services Central Business Administration Function, Treasury Direct Central Business Administration Function and Video Conferencing Network.

3. FINANCIAL STABILITY ACTIVITIES

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

Large-Scale Asset Purchase Programs and Reinvestment of Principal Payments

On March 18, 2009, the FOMC authorized and directed the FRBNY to purchase $300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The FRBNY began the purchases of these Treasury securities in March 2009 and completed them in October 2009. On August 10, 2010, the FOMC announced that the Federal Reserve would maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in longer-term Treasury securities. On November 3, 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional $600 billion and completed these purchases in June 2011. On June 22, 2011, the FOMC announced that the Federal Reserve would maintain its existing policy of reinvesting principal payments from all domestic securities in Treasury securities. On September 21, 2011, the FOMC announced that the Federal Reserve intends to purchase, by the end of June 2012, $400 billion par value of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less, of which $133 billion has been purchased and $134 billion sold as of December 31, 2011. In addition, the FOMC announced that it will maintain its existing policy of rolling over maturing Treasury securities at auction and, rather than reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in Treasury securities, such payments will be reinvested in federal agency and GSE MBS.

The FOMC authorized and directed the FRBNY to purchase GSE debt securities and federal agency and GSE MBS, with a goal to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally. The FRBNY was authorized to purchase up to $175 billion in fixed-rate, non-callable GSE debt securities and $1.25 trillion in fixed-rate federal agency and GSE MBS. Purchases of GSE debt securities began in November 2008, and purchases of federal agency and GSE MBS began in January 2009. The FRBNY completed the purchases of GSE debt securities and federal agency and GSE MBS in March 2010. The settlement of all federal agency and GSE MBS transactions was completed by August 2010. As discussed above, on September 21, 2011, the FOMC announced that the Federal Reserve will begin to reinvest principal payments from its holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS.

Central Bank Liquidity Swaps

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

In May 2010, U.S. dollar liquidity swap arrangements were re-authorized with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank through January 2011. Subsequently, these arrangements were extended through February 1, 2013. There is no specified limit to the amount that may be drawn by the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank under these swap arrangements; the Bank of Canada may draw up to $30 billion under the swap arrangement with the FRBNY. In addition to the central bank liquidity swap arrangements, the FOMC has authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico, as discussed in Note 2.

Foreign currency liquidity swap arrangements were authorized with 4 foreign central banks and provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. The authorization for these swap arrangements expired on February 1, 2010. In November 2011, as a contingency measure, the FOMC agreed to establish temporary bilateral liquidity swap arrangements with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank so that liquidity can be provided in any of their currencies if necessary. The swap lines are authorized until February 1, 2013.

Lending to Depository Institutions

The Term Auction Facility (TAF) promoted the efficient dissemination of liquidity by providing term funds to depository institutions. The last TAF auction was conducted on March 8, 2010, and the related loans matured on April 8, 2010.

Lending to Primary Dealers

The Term Securities Lending Facility (TSLF) promoted liquidity in the financing markets for Treasury securities. Under the TSLF, the FRBNY could lend up to an aggregate amount of $200 billion of Treasury securities held in the SOMA to primary dealers on a secured basis for a term of 28 days. The authorization for the TSLF expired on February 1, 2010.

NOTES TO FINANCIAL STATEMENTS

The Term Securities Lending Facility Options Program (TOP) offered primary dealers the opportunity to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program was suspended effective with the maturity of the June 2009 TOP options, and authorization for the program expired on February 1, 2010.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) provided funding to depository institutions and bank holding companies to finance the purchase of eligible high-quality asset-backed commercial paper (ABCP) from money market mutual funds. The Federal Reserve Bank of Boston administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. The authorization for the AMLF expired on February 1, 2010.

4. SIGNIFICANT ACCOUNTING POLICIES

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

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States of America (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost and the recording of SOMA securities on a settlement-date basis. Amortized cost, rather than the fair value presentation, more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Although the application of fair value measurements to the securities holdings may result in values substantially greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, better reflects the timing of the transaction's effect on the quantity of reserves in the banking system. The cost bases of Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP.

In addition, the Bank does not present a Statement of Cash Flows as required by GAAP because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities as a central bank. 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, and the accompanying notes to the financial statements. There are no other significant differences, other than those described above, between the policies outlined in the FAM and GAAP.

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

a. Consolidation
The Dodd-Frank Act established the Bureau as an independent bureau within the System, and section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the System. Section 152 of the Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury. The Board of Governors funds the Bureau and OFR through assessments on the Reserve Banks as required by the Dodd-Frank Act. The Reserve Banks reviewed the law and evaluated the design of and their relationships to the Bureau and the OFR and determined that neither should be consolidated in the Bank's financial statements.

b. Gold and Special Drawing Rights Certificates
The Secretary of the Treasury is authorized to issue gold and special drawing rights (SDR) certificates to the Reserve Banks. Upon authorization, the Reserve Banks acquire gold certificates by crediting equivalent amounts in dollars to the account established for the Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold owned by the Treasury. The Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the Treasury. At such time, the Treasury's account is charged, and the Reserve Banks' gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 per fine troy ounce. The Board of Governors allocates the gold certificates among the Reserve Banks once a year based on the average Federal Reserve notes outstanding at each Reserve Bank.

SDR certificates are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. SDRs are recorded by the Bank at original cost. There were no SDR transactions during the years ended December 31, 2011 and 2010.

c. Coin
The amount reported as coin in the Statements of Condition represents the face value of all United States coin held by the Bank. The Bank buys coin at face value from the U.S. Mint in order to fill depository institution orders.

d. Loans
Loans to depository institutions are reported at their outstanding principal balances, and interest income is recognized on an accrual basis.

Loans are impaired when current information and events indicate that it is probable that the Bank will not receive the principal and interest that are due in accordance with the contractual terms of the loan agreement. Impaired loans are

NOTES TO FINANCIAL STATEMENTS

evaluated to determine whether an allowance for loan loss is required. The Bank has developed procedures for assessing the adequacy of any allowance for loan losses using all available information to identify incurred losses. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers and, as appropriate, evaluating collateral values. Generally, the Bank would discontinue recognizing interest income on impaired loans until the borrower's repayment performance demonstrates principal and interest would be received in accordance with the terms of the loan agreement. If the Bank discontinues recording interest on an impaired loan, cash payments are first applied to principal until the loan balance is reduced to zero; subsequent payments are applied as recoveries of amounts previously deemed uncollectible, if any, and then as interest income.

e. Securities Purchased Under Agreements to Resell, Securities Sold Under Agreements to Repurchase, and Securities Lending

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a triparty arrangement. In a triparty arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the Bank and counterparty. The collateral pledged must exceed the principal amount of the transaction by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including TIPS and STRIP Treasury securities); direct obligations of several federal and GSE-related agencies, including Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac); and pass-through MBS of Fannie Mae, Freddie Mac, and Government National Mortgage Association. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction.

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and, beginning August 2010, with selected money market funds. The list of eligible counterparties was subsequently expanded to include GSEs, effective in May 2011, and bank and savings institutions, effective in July 2011. These reverse repurchase transactions may be executed through a triparty arrangement as an open market operation, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, and federal agency and GSE MBS that are held in the SOMA. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts as "System Open Market Account: Securities sold under agreements to repurchase" and the related accrued interest payable is reported as a component of "Other liabilities" in the Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. The amortized cost basis of securities lent continues to be reported as "Treasury securities, net" or "Government-sponsored enterprise debt securities, net," as appropriate, in the Statements of Condition. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Non-interest income: Other" in the Statements of Income and Comprehensive Income.

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

f. Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Foreign Currency Denominated Assets; and Warehousing Agreements

Interest income on Treasury securities, GSE debt securities, and foreign currency denominated assets comprising the SOMA is accrued on a straight-line basis. Interest income on federal agency and GSE MBS is accrued using the interest method and includes amortization of premiums, accretion of discounts, and gains or losses associated with principal paydowns. Premiums and discounts related to federal agency and GSE MBS are amortized over the term of the security to stated maturity, and the amortization of premiums and accretion of discounts are accelerated when principal payments are received. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Treasury securities, GSE debt securities, and federal agency and GSE MBS are reported net of premiums and discounts in the Statements of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts in the Statements of Income and Comprehensive Income.

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell "to be announced" (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. In 2010, the FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. During the year-ended December 31, 2010, the FRBNY's participation in the dollar roll and coupon swap markets furthered the MBS purchase program goals of providing support to the mortgage and housing markets and of fostering improved conditions in financial markets more generally. During the year-ended December 31, 2011, the FRBNY executed dollar rolls primarily to facilitate settlement. The FRBNY accounts for outstanding commitments under dollar roll and coupon swaps as purchases or sales on a settlement-date basis. Net gains resulting from dollar roll and coupon swap transactions are reported as "Non-interest income: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

Foreign currency denominated assets, which can include foreign currency deposits, securities purchased under agreements to resell, and government debt instruments, 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 foreign currency denominated assets are reported as "Non-interest income (loss): System Open Market Account: Foreign currency gains, net" in the Statements of Income and Comprehensive Income.

Activity related to Treasury securities, GSE debt securities, and federal agency and GSE MBS, including the premiums, discounts, and realized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in the second quarter of each year. Activity related to foreign currency denominated assets, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31.

Warehousing is an arrangement under which the FOMC has approved the exchange, at the request of the Treasury, of U.S. dollars for foreign currencies held by the Treasury over a limited period. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury for financing purchases of foreign currencies and related international operations. Warehousing agreements are designated as held-for-trading purposes and are valued daily at current market exchange rates. Activity related to these agreements is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31.

NOTES TO FINANCIAL STATEMENTS

g. Central Bank Liquidity Swaps

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

Central bank liquidity swaps activity, including the related income and expense, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31. The foreign currency amounts associated with these central bank liquidity swap arrangements are revalued daily at current foreign currency market exchange rates.

U.S. dollar liquidity swaps

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

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The Bank's allocated portion of the amount of compensation received during the term of the swap transaction is reported as "Interest income: System Open Market Account: Central bank liquidity swaps" in the Statements of Income and Comprehensive Income.

Foreign currency liquidity swaps

The structure of foreign currency liquidity swap transactions involves the transfer by the FRBNY, at the prevailing market exchange rate, of a specified amount of U.S. dollars to an account for the foreign central bank in exchange for its currency. The foreign currency amount received would be reported as a liability by the Bank.

h. 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 2 to 50 years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

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

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

i. Interdistrict Settlement Account

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

j. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes, which are identified as issued to a specific Reserve Bank, must be fully collateralized. All of the Bank's assets are eligible to be pledged as collateral. 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 sold under agreements to repurchase is deducted from the eligible collateral value.

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

"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 $6,177 million and $4,826 million at December 31, 2011 and 2010, respectively.

At December 31, 2011 and 2010, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2011, all gold certificates, all special drawing right certificates, and $1,018 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2011, no investments denominated in foreign currencies were pledged as collateral.

k. Deposits

Depository Institutions

Depository institutions' deposits represent the reserve and service-related balances, such as required clearing balances, in the accounts that depository institutions hold at the Bank. The interest rates paid on required reserve balances and excess balances are determined by the Board of Governors, based on an FOMC-established target range for the federal funds rate. Interest payable is reported as "Interest payable to depository institutions" in the Statements of Condition.

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as "Interest payable to depository institutions" in the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2011 and 2010.

NOTES TO FINANCIAL STATEMENTS

Other

Other deposits include foreign central bank and foreign government deposits held at the FRBNY that are allocated to the Bank.

l. Items in Process of Collection and Deferred Credit Items

"Items in process of collection" 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" is the counterpart liability to items in process of collection. The amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can vary significantly.

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

n. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in. On a daily basis, surplus is adjusted to equate the balance to capital paid-in. Accumulated other comprehensive income is reported as a component of "Surplus" in the Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

o. Interest on Federal Reserve Notes

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

If earnings during the year are not sufficient to provide for the costs of operations, payment of dividends, and equating surplus and capital paid-in, payments to the Treasury are suspended. A deferred asset is recorded that represents the amount of net earnings a Reserve Bank will need to realize before remittances to the Treasury resume. This deferred asset is periodically reviewed for impairment.

p. Income and Costs Related to Treasury Services

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depositary of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2011 and 2010, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

The Treasury and other government agencies reimbursement process for all Reserve Banks is centralized at the Bank. Each Reserve Bank transfers its Treasury reimbursement receivable to the Bank. The reimbursement receivable is reported in "Other assets" and totaled $2 million in both years at December 31, 2011 and 2010. The cost of unreimbursed Treasury services is reported as "Operating expenses: Other" and was none for years ended December 31, 2011 and 2010.

q. Compensation Received for Service Costs 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 in its Statements of Income and Comprehensive Income. Similarly, the FRBNY manages the Reserve Banks' provision of Fedwire funds and securities services and recognizes total System revenue for these services in its Consolidated Statements of Income and Comprehensive Income. The FRBA and the FRBNY compensate the applicable Reserve Banks for the costs incurred to provide these services. The Bank reports this compensation as "Non-interest income: Compensation received for service costs provided" in the Statements of Income and Comprehensive Income.

r. Assessments

The Board of Governors assesses the Reserve Banks to fund its operations, the operations of the Bureau and, for a two-year period following the July 21, 2010 effective date of the Dodd-Frank Act, the OFR. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year for the Board of Governors' operations and as of the most recent quarter for the Bureau and OFR operations. The Board of Governors also assesses each Reserve Bank for the expenses incurred by the Treasury to produce and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

During the period prior to the Bureau transfer date of July 21, 2011, there was no limit on the funding provided to the Bureau and assessed to the Reserve Banks; the Board of Governors was required to provide the amount estimated by the Secretary of the Treasury needed to carry out the authorities granted to the Bureau under the Dodd-Frank Act and other federal law. The Dodd-Frank Act requires that, after the transfer date, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governors' 2009 annual report, which totaled $4.98 billion. The fixed percentage of total 2009 operating expenses of the System is 10 percent ($498.0 million) for 2011, 11 percent ($547.8 million) for 2012, and 12 percent ($597.6 million) for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act. The Bank's assessment for Bureau funding is reported as "Assessments: Bureau of Consumer Financial Protection" in the Statements of Income and Comprehensive Income.

The Board of Governors assesses the Reserve Banks to fund the operations of the OFR for the two-year period following enactment of the Dodd-Frank Act; thereafter, the OFR will be funded by fees assessed on bank holding companies and nonbank financial companies that meet the criteria specified in the Dodd-Frank Act.

s. 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 $2 million for each of the years ended December 31, 2011 and 2010 and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

t. Restructuring Charges

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business

NOTES TO FINANCIAL STATEMENTS

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

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

The Bank had no significant restructuring activities in 2011 and 2010.

u. Recently Issued Accounting Standards

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-20, *Receivables* (Topic 310)*: Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires additional disclosures about the allowance for credit losses and the credit quality of loan portfolios. The additional disclosures include a rollforward of the allowance for credit losses on a disaggregated basis and more information, by type of receivable, on credit quality indicators, including the amount of certain past-due receivables and troubled debt restructurings and significant purchases and sales. The adoption of this update is effective for the Bank for the year ended December 31, 2011, and did not have a material effect on the Bank's financial statements.

In April 2011, the FASB issued ASU 2011-02, *Receivables* (Topic 310): *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which clarifies accounting for troubled debt restructurings, specifically clarifying creditor concessions and financial difficulties experienced by borrowers. This update is effective for the Bank for the year ended December 31, 2012, and is not expected to have a material effect on the Bank's financial statements.

In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicing* (Topic 860): *Reconsideration of Effective Control for Repurchase Agreements*, which reconsidered the effective control for repurchase agreements. This update prescribes when the Bank may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. This determination is based, in part, on whether the Bank has maintained effective control over the transferred financial assets. This update is effective for the Bank for the year ended December 31, 2012, and is not expected to have a material effect on the Bank's financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income* (Topic 220): *Presentation of Comprehensive Income***,** which requires a reporting entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. The update is intended to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items by presenting the components reported in other comprehensive income. The Bank has adopted the update in this ASU effective for the year ended December 31, 2011, and the required presentation is reflected in the Bank's financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet* (Topic 210): *Disclosures about Offsetting Assets and Liabilities*. This update will require a reporting entity to present enhanced disclosures for financial instruments and derivative instruments that are offset or subject to master netting agreements or similar such agreements. This update is effective for the Bank for the year ended December 31, 2013, and is not expected to have a material effect on the Bank's financial statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income* (Topic 220): *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.* This update indefinitely defers the requirements of ASU 2011-05 related to presentation of reclassification adjustments.

5. LOANS

The Bank had no loans outstanding at December 31, 2011 and 2010.

Loans to Depository Institutions

The Bank offers primary, secondary, and seasonal loans to eligible borrowers, and each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every 14 days by the Bank's board of directors, subject to review and determination by the Board of Governors. Primary and secondary loans are extended on a short-term basis, typically overnight, whereas seasonal loans may be extended for a period of up to nine months.

Primary, secondary, and seasonal loans are collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; asset-backed securities; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Bank, which is typically fair value reduced by a margin. Loans to depository institutions are monitored daily to ensure that borrowers continue to meet eligibility requirements for these programs. The financial condition of borrowers is monitored by the Bank and, if a borrower no longer qualifies for these programs, the Bank will generally request full repayment of the outstanding loan or, for primary or seasonal loans, may convert the loan to a secondary credit loan. Collateral levels are reviewed daily against outstanding obligations and borrowers that no longer have sufficient collateral to support outstanding loans are required to provide additional collateral or to make partial or full repayment.

Allowance for Loan Loss

At December 31, 2011 and 2010, the Bank did not have any impaired loans and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2011 and 2010.

6. TREASURY SECURITIES; GOVERNMENT-SPONSORED ENTERPRISE DEBT SECURITIES; FEDERAL AGENCY AND GOVERNMENT-SPONSORED ENTERPRISE MORTGAGE-BACKED SECURITIES; SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL; SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE; AND SECURITIES LENDING

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 3.426 percent and 2.335 percent at December 31, 2011 and 2010, respectively.

NOTES TO FINANCIAL STATEMENTS

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

	2011				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 631	$ -	$ -	$ 631	$ 631
Notes	44,065	918	(42)	44,941	47,596
Bonds	12,287	2,102	(3)	14,386	17,426
Total Treasury securities	$ 56,983	$ 3,020	$ (45)	$ 59,958	$ 65,653
GSE debt securities	$ 3,562	$ 132	$ -	$ 3,694	$ 3,913
Federal agency and GSE MBS	$ 28,696	$ 398	$ (36)	$ 29,058	$ 30,676

	2010				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 430	$ -	$ -	$ 430	$ 430
Notes	18,058	328	(18)	18,368	18,792
Bonds	5,366	765	(13)	6,118	6,767
Total Treasury securities	$ 23,854	$ 1,093	$ (31)	$ 24,916	$ 25,989
GSE debt securities	$ 3,444	$ 129	$ (1)	$ 3,572	$ 3,661
Federal agency and GSE MBS	$ 23,169	$ 330	$ (36)	$ 23,463	$ 23,960

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

	2011		2010	
	Amortized cost	Fair value	Amortized cost	Fair value
Bills	$ 18,423	$ 18,423	$ 18,422	$ 18,422
Notes	1,311,917	1,389,429	786,575	804,703
Bonds	419,937	508,694	261,955	289,757
Total Treasury securities	$ 1,750,277	$ 1,916,546	$ 1,066,952	$ 1,112,882
GSE debt securities	$ 107,828	$ 114,238	$ 152,972	$ 156,780
Federal agency and GSE MBS	$ 848,258	$ 895,495	$ 1,004,695	$ 1,026,003

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

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

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

	2011		2010	
Distribution of MBS holdings by coupon rate	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
3.0%	$ 45	$ 46	$ -	$ -
3.5%	665	674	8	8
4.0%	5,532	5,815	3,916	3,933
4.5%	13,924	14,770	11,622	11,882
5.0%	6,252	6,600	5,404	5,547
5.5%	2,288	2,400	2,175	2,239
6.0%	313	329	302	312
6.5%	39	42	36	39
Total	$ 29,058	$ 30,676	$ 23,463	$ 23,960
Total SOMA:				
3.0%	$ 1,313	$ 1,336	$ -	$ -
3.5%	19,415	19,660	341	352
4.0%	161,481	169,763	167,675	168,403
4.5%	406,465	431,171	497,672	508,798
5.0%	182,497	192,664	231,420	237,545
5.5%	66,795	70,064	93,119	95,873
6.0%	9,152	9,616	12,910	13,376
6.5%	1,140	1,221	1,558	1,656
Total	$ 848,258	$ 895,495	$1,004,695	$1,026,003

NOTES TO FINANCIAL STATEMENTS

There were no transactions related to securities purchased under agreements to resell during the years ended December 31, 2011 and 2010. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	2011	2010
Allocated to the Bank:		
Contract amount outstanding, end of year	$ 3,422	$ 1,394
Average daily amount outstanding, during the year	2,294	1,235
Maximum balance outstanding, during the year	4,265	1,573
Securities pledged (par value), end of year	2,949	1,019
Securities pledged (market value), end of year	3,422	1,394
Total SOMA:		
Contract amount outstanding, end of year	$ 99,900	$ 59,703
Average daily amount outstanding, during the year	72,227	58,476
Maximum balance outstanding, during the year	124,512	77,732
Securities pledged (par value), end of year	86,089	43,642
Securities pledged (market value), end of year	99,900	59,703

The contract amounts for securities sold under agreements to repurchase approximate fair value. FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed to temporarily drain reserve balances from the banking system and as part of a service offering to foreign official and international account holders.

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2011, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	$ 557	$ 929	$ 3,079	$22,256	$22,263	$ 7,899	$56,983
GSE debt securities (par value)	85	172	675	2,076	474	80	3,562
Federal agency and GSE MBS (par value)[1]	-	-	-	1	1	28,694	28,696
Securities sold under agreements to repurchase (contract amount)	3,422	-	-	-	-	-	3,422

[1] The par amount shown for federal agency and GSE MBS is the remaining principal balance of the underlying mortgages.

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2011, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, is approximately 2.4 years.

The amortized cost and par value of Treasury securities and GSE debt securities that were loaned from the SOMA at December 31 was as follows (in millions):

	Allocated to the Bank			
	Amortized cost		Par value	
	2011	2010	2011	2010
Treasury securities	$ 518	$ 528	$ 479	$ 516
GSE debt securities	44	39	42	38

	Total SOMA			
	Amortized cost		Par value	
	2011	2010	2011	2010
Treasury securities	$ 15,121	$ 22,627	$ 13,978	$ 22,081
GSE debt securities	1,276	1,686	1,216	1,610

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the Treasury securities under outstanding commitments was $3,200 million. The total purchase price of outstanding commitments allocated to the Bank was $110 million. These commitments had contractual settlement dates extending through January 3, 2012. As of December 31, 2011, the fair value of Treasury securities under outstanding purchase commitments was $3,208 million, of which $110 million was allocated to the Bank.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was $41,503 million, of which $513 million was related to dollar roll transactions. The total purchase price of outstanding purchase commitments allocated to the Bank was $1,422 million, of which $18 million was related to dollar roll transactions. As of December 31, 2011, the total sales price of the federal agency and GSE MBS under outstanding sales commitments was $4,430 million, all of which was related to dollar roll transactions. The total sales price of outstanding sales commitments allocated to the Bank was $152 million, all of which was related to dollar roll transactions. These commitments, which had contractual settlement dates extending through February 2012, are for the purchase and sale of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. As of December 31, 2011, the fair value of federal agency and GSE MBS purchases and sales, net under outstanding commitments was $41,873 million and $4,473 million, respectively, of which $1,434 million and $153 million, respectively, was allocated to the Bank. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

NOTES TO FINANCIAL STATEMENTS

Other liabilities, which are related to federal agency and GSE MBS purchases and sales, includes the FRBNY's obligation to return cash margin posted by counterparties as collateral under commitments to purchase and sell federal agency and GSE MBS. In addition, other liabilities includes obligations that arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the FRBNY has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount included in other liabilities represents the FRBNY's obligation to pay for the securities when delivered. The amount of other liabilities allocated to the Bank and held in the SOMA at December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2011	2010	2011	2010
Cash margin	$ 44	$ -	$ 1,271	$ -
Obligations from MBS transaction fails	3	-	97	-
Total	$ 47	$ -	$ 1,368	$ -

During the years ended December 31, 2011 and 2010, the Reserve Banks recorded net gains from federal agency and GSE MBS transactions of $10 million and $782 million, respectively, of which $333 thousand and $15 million, respectively, were allocated to the Bank. These net gains are reported as "Non-interest income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the year ended December 31, 2011, is summarized as follows (in millions):

	Allocated to the Bank					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2010	$ 430	$ 18,369	$ 6,117	$ 24,916	$ 3,572	$ 23,463
Purchases[1]	7,469	21,378	5,008	33,855	-	1,444
Sales[1]	-	(4,718)	-	(4,718)	-	-
Realized gains, net[2]	-	77	-	77	-	-
Principal payments and maturities	(7,469)	(2,128)	-	(9,597)	(1,308)	(6,095)
Amortization of premiums and discounts	-	(141)	(158)	(299)	(51)	(98)
Inflation adjustment on inflation-indexed securities	-	40	35	75	-	-
Annual reallocation adjustment[3]	201	12,065	3,383	15,649	1,481	10,344
Balance December 31, 2011	$ 631	$ 44,942	$ 14,385	$ 59,958	$ 3,694	$ 29,058
Supplemental information - par value of transactions:						
Purchases	$7,469	$20,820	$3,937	$ 32,226	$ -	$ 1,403
Proceeds from sales	-	(4,619)	-	(4,619)	-	-

	Total SOMA					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2010	$ 18,422	$ 786,575	$ 261,954	$ 1,066,951	$ 152,972	$ 1,004,695
Purchases[1]	239,487	731,252	161,876	1,132,615	-	42,145
Sales[1]	-	(137,733)	-	(137,733)	-	-
Realized gains, net[2]	-	2,258	-	2,258	-	-
Principal payments and maturities	(239,494)	(67,273)	-	(306,767)	(43,466)	(195,413)
Amortization of premiums and discounts	8	(4,445)	(4,985)	(9,422)	(1,678)	(3,169)
Inflation adjustment on inflation-indexed securities	-	1,283	1,092	2,375	-	-
Balance December 31, 2011	$ 18,423	$1,311,917	$ 419,937	$ 1,750,277	$ 107,828	$ 848,258
Supplemental information - par value of transactions:						
Purchases	$ 239,494	$ 713,878	$ 127,802	$ 1,081,174	$ -	$ 40,955
Proceeds from sales	-	(134,829)	-	(134,829)	-	-

[1] Purchases and sales are reported on a settlement-date basis and include payments and receipts related to principal, premiums, discounts, and inflation compensation included in the basis of inflation-indexed securities. The amount reported as sales also includes realized gains, net.

[2] Adjustments for realized gains, net is required because these amounts do not affect the reported amount of the related securities. Excludes gains and losses that result from net settled MBS TBA transactions.

[3] Reflects the annual adjustment to the Bank's allocated portion of the related SOMA securities that results from the annual settlement of the interdistrict settlement account, as discussed in Note 4f.

NOTES TO FINANCIAL STATEMENTS

7. FOREIGN CURRENCY DENOMINATED ASSETS

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

The Bank's allocated share of foreign currency denominated assets was approximately 9.686 percent and 10.928 percent at December 31, 2011 and 2010, respectively.

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

	2011	2010
Euro:		
Foreign currency deposits	$ 907	$ 771
Securities purchased under agreements to resell	-	270
German government debt instruments	183	202
French government debt instruments	255	301
Japanese yen:		
Foreign currency deposits	386	424
Japanese government debt instruments	783	879
Total allocated to the Bank	$ 2,514	$ 2,847

At December 31, 2011 and 2010, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was $2,530 million and $2,865 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 Treasury securities, GSE debt securities, and federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

Total Reserve Bank foreign currency denominated assets were $25,950 million and $26,049 million at December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, the fair value of the total Reserve Bank foreign currency denominated assets, including accrued interest, was $26,116 million and $26,213 million, respectively.

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2011, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
Euro	$ 518	$ 284	$ 205	$ 338	$ 1,345
Japanese yen	405	64	305	395	1,169
Total	$ 923	$ 348	$ 510	$ 733	$ 2,514

At December 31, 2011 and 2010, the authorized warehousing facility was $5 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2011 and 2010.

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2011.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2011, there were $216 million of outstanding commitments to purchase Euro-denominated government debt instruments, of which $21 million was allocated to the Bank. These securities settled on January 4, 2012, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date. As of December 31, 2011, the fair value of Euro-denominated government debt instruments under outstanding commitments was $216 million of which $21 million was allocated to the Bank.

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

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 9.686 percent and 10.928 percent at December 31, 2011 and 2010, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2011 and 2010, was $99,823 million and $75 million, respectively, of which $9,669 million and $8 million, respectively, was allocated to the Bank.

NOTES TO FINANCIAL STATEMENTS

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

	2011			2010	
	Within 15 days	16 days to 90 days	Total	Within 15 days	Total
Euro	$ 3,328	$ 4,948	$ 8,276	$ 8	$ 8
Japanese yen	875	480	1,355	-	-
Swiss franc	31	7	38	-	-
Total	$ 4,234	$ 5,435	$ 9,669	$ 8	$ 8

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2011 and 2010.

9. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2011	2010
Bank premises and equipment:		
Land and land improvements	$ 8	$ 8
Buildings	104	102
Building machinery and equipment	18	17
Construction in progress	1	1
Furniture and equipment	63	62
Subtotal	194	190
Accumulated depreciation	(107)	(101)
Bank premises and equipment, net	$ 87	$ 89
Depreciation expense, for the years ended December 31	$ 10	$ 10

The Bank leases space to an outside tenant with remaining lease term of one year. Rental income from such lease was $2 million for each of the years ended December 31, 2011 and 2010 and is reported as a component of "Non-interest income: Other" in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under the noncancelable lease agreement in existence at December 31, 2011, are $2 million for the year 2012.

The Bank had capitalized software assets, net of amortization, of $8 million and $6 million at December 31, 2011 and 2010, respectively. Amortization expense was $2 million for each of the years ended December 31, 2011 and

2010. Capitalized software assets are reported as a component of "Other assets" in the Statements of Condition and the related amortization is reported as a component of "Operating expenses: Other" in the Statements of Income and Comprehensive Income.

10. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2011, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 8 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indexes. One lease provides for increased rental payments based upon increases in operating quantity.

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 $1 million for each of the years ended December 31, 2011 and 2010. Certain of the Bank's leases have options to renew. The Bank has no capital leases.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2011, are as follows (in thousands):

	Operating leases
2012	$ 611
2013	434
2014	445
2015	457
2016	468
Thereafter	1,013
Future minimum rental payments	$ 3,428

At December 31, 2011, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain losses in excess of 1 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, 2011 and 2010.

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 legal actions and claims will be resolved without material adverse effect on the financial position or results of operations of the Bank.

NOTES TO FINANCIAL STATEMENTS

11. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). Under the Dodd-Frank Act, newly hired Bureau employees are eligible to participate in the System Plan and transferees from other governmental organizations can elect to participate in the System Plan. In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP) and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP).

The System Plan provides retirement benefits to employees of the Reserve Banks, Board of Governors, OEB, and certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the year ended December 31, 2011, certain costs associated with the System Plan were reimbursed by the Bureau. During the year ended December 31, 2010, costs associated with the System Plan were not reimbursed by other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2011 and 2010, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. The Bank's Thrift Plan contributions totaled $4 million for each of the years ended December 31, 2011 and 2010 and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

12. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

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

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

	2011	2010
Accumulated postretirement benefit obligation at January 1	$ 83.0	$ 83.7
Service cost benefits earned during the period	2.3	2.2
Interest cost on accumulated benefit obligation	4.3	4.6
Net actuarial loss (gain)	3.4	(2.4)
Contributions by plan participants	1.8	1.6
Benefits paid	(5.7)	(5.9)
Medicare Part D subsidies	0.4	0.5
Plan amendments	-	(1.3)
Accumulated postretirement benefit obligation at December 31	$ 89.5	$ 83.0

At December 31, 2011 and 2010, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 4.50 percent and 5.25 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):

	2011	2010
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	3.5	3.8
Contributions by plan participants	1.8	1.6
Benefits paid	(5.7)	(5.9)
Medicare Part D subsidies	0.4	0.5
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$ 89.5	$ 83.0
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (1.8)	$ (2.2)
Net actuarial loss	(23.6)	(21.8)
Total accumulated other comprehensive loss	$ (25.4)	$ (24.0)

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

NOTES TO FINANCIAL STATEMENTS

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

	2011	2010
Health-care cost trend rate assumed for next year	7.50 %	8.00 %
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	2017	2017

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A 1 percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2011 (in millions):

	1 percentage point increase	1 percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 0.1	$ (0.2)
Effect on accumulated postretirement benefit obligation	0.5	(3.8)

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

	2011	2010
Service cost-benefits earned during the period	$ 2.3	$ 2.2
Interest cost on accumulated benefit obligation	4.3	4.6
Amortization of prior service cost	0.3	-
Amortization of net actuarial loss	1.6	2.4
Net periodic postretirement benefit expense	$ 8.5	$ 9.2

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2012 are shown below:

Prior service cost	$ 0.5
Net actuarial loss	2.1
Total	$ 2.6

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2011 and 2010, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.25 percent and 5.75 percent, respectively.

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

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

Federal Medicare Part D subsidy receipts were $300 thousand in each of the years ended December 31, 2011 and 2010. Expected receipts in 2012, related to benefits paid in the years ended December 31, 2011 and 2010, are $200 thousand.

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

	Without subsidy	With subsidy
2012	$ 4.6	$ 4.2
2013	4.9	4.5
2014	5.2	4.8
2015	5.6	5.0
2016	5.9	5.3
2017 - 2021	33.3	29.6
Total	$ 59.5	$ 53.4

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, 2011 and 2010 were $7.0 million and $7.1 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2011 and 2010 operating expenses were $.6 million and $1.7 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount related to postretirement benefits other than retirement plans
Balance at January 1, 2010	$ (30.0)
Change in funded status of benefit plans:	
Prior service costs arising during the year	1.3
Amortization of prior service cost	(0.1)
Change in prior service costs related to benefit plans	1.2
Net actuarial gain arising during the year	2.4
Amortization of net actuarial loss	2.4
Change in actuarial gain related to benefit plans	4.8
Change in funded status of benefit plans - other comprehensive loss	6.0
Balance at December 31, 2010	$ (24.0)
Change in funded status of benefit plans:	
Amortization of prior service cost	0.4
Change in prior service costs related to benefit plans	0.4
Net actuarial loss arising during the year	(3.4)
Amortization of net actuarial loss	1.6
Change in actuarial losses related to benefit plans	(1.8)
Change in funded status of benefit plans - other comprehensive loss	(1.4)
Balance at December 31, 2011	$ (25.4)

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

14. BUSINESS RESTRUCTURING CHARGES

The Bank had no business restructuring charges in 2011 or 2010.

Before 2010, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites: one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing.

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

		2009 and prior restructuring plans
Information related to restructuring plans as of December 31, 2011:		
Total expected costs related to restructuring activity	$	3.3
Expected completion date		2009
Reconciliation of liability balances:		
Balance at January 1, 2010	$	2.3
Adjustments		(0.3)
Payments		(1.9)
Balance at December 31, 2010	$	0.1
Adjustments		(0.1)
Balance at December 31, 2011	$	-

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 "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

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

15. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2011. Subsequent events were evaluated through March 20, 2012, which is the date that the Bank issued the financial statements.

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