REFLECTIONS

FEDERAL RESERVE BANK OF PHILADELPHIA | ANNUAL REPORT 2014

REFLECTIONS

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PRESIDENT'S MESSAGE

CHARLES I. PLOSSER, PRESIDENT AND CEO

This annual report covers my last year as president and CEO of the Federal Reserve Bank of Philadelphia. I am writing this letter in advance of my retirement, effective March 1, 2015. It has been an honor to have led such a wonderful organization for more than eight years and to have worked with so many talented and dedicated people here in Philadelphia and around the Federal Reserve System.

I came to Philadelphia in 2006 after more than three decades in academia, where much of my research and teaching centered on the subjects of macroeconomics, monetary theory, and finance. Serving as president of the Philadelphia Fed has given me a rare opportunity to combine three roles: first, to lead an extraordinary organization of dedicated professionals committed to public service; second, to serve as a monetary policymaker, to put into practice what I had studied for all my

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career; and third, to continue a lifelong role as an educator, through my speeches and writings over the past eight years to help people understand the economy, monetary policy, and the role of the Fed.

The theme of this 2014 Annual Report is Reflections because I would like this report to serve not only as a reflection of the last full year of my service but also as a way for me to step back and offer some thoughts on the importance of this institution and its role as part of the nation's decentralized central bank.

My essay will offer "Reflections on Monetary Policy" to review a set of principles that I have shared in my speeches and writings during my term. I believe these principles would improve the framework for making monetary policy decisions. I explain the benefits of a central bank that commits to a set of clearly articulated objectives that can be feasibly achieved by monetary policy, that conducts monetary policy in a systematic or rule-like manner, that communicates its policies and actions to the public in a clear and transparent way, and that protects its independence, in its governance and its practice, by maintaining a distinct separation of monetary policy from fiscal policy.

The annual report also includes a message from First Vice President Blake Prichard about our Centennial year, which marked the first century of service since the opening day of our Bank on November 16, 1914. His letter is followed by Bank Highlights, which presents our achievements during 2014, including Centennial observances and our biennial Reinventing Older Communities conference held in May 2014.

Our long record of success would not have been possible without the community, banking, and business leaders who have served on the Bank's board of directors and advisory councils. The nine individuals who serve on our board of directors provide a traditional oversight role of directors everywhere, as well as contributing their sage counsel on the economy. I especially want to acknowledge Ted Peters, former chairman and CEO of the Bryn Mawr Trust, who completed six years of service as a Class A director, elected by the member banks in the District. I also want to thank Rosemary Turner for her service as a Class B director, elected by the member banks to represent the community. Soon after her term began in 2013, Rosemary was promoted by UPS as head of its North California District, based in Oakland, CA, which necessitated her resignation late in 2014.

To fill these two seats, two new directors were elected: Jon Evans, president and CEO of Atlantic Community Bankers Bank of Camp Hill, PA, as a Class A director, and Carol J. Johnson, president and COO of AlliedBarton Security Services of Conshohocken, PA, as a Class B director. Both joined the board as of January 2015. Patrick T. Harker, president of the University of Delaware, was reelected to a three-year term as a Class B director.

I thank Chairman James E. Nevels, founder and chairman of the Swarthmore Group, who completed his first year as chairman, and Michael J. Angelakis, vice chairman and CFO of Comcast Corp., who completed his first year as deputy chairman. As the year ended, Jim and Michael also took on the important task of leading the nonbanking directors through the process of selecting the next president of the Bank.

In addition to the directors, I must acknowledge the service of those citizens on our advisory councils. In 2014, we welcomed four executives to the Bank's Economic Advisory Council (EAC): Madeline Bell, president and COO, the Children's Hospital of Philadelphia; Varsovia Fernandez, president and CEO, Greater Philadelphia Hispanic Chamber of Commerce; Maria Rodale, chairman and CEO, Rodale, Inc.; and Lynn M. Utter, president and COO, Knoll Office, a unit of Knoll, Inc.

The Bank also welcomed five new representatives to the Community Depository Institutions Advisory Council (CDIAC), which includes representatives from commercial banks, thrift institutions, and credit unions in the Third District. In 2014, this council added Marcie Barber, president and CEO of Juniata Valley Financial Corporation and the Juniata Valley Bank, Mifflintown, PA; Anthony Biondi, CEO and director of MNB Corporation and Merchants Bank of Bangor; Ed Dietzler, president of The Bank of Princeton; Angela Snyder, vice chair and CEO of Fulton Bank of New Jersey, Mount Laurel, NJ; and Mark Turner, president and CEO of WSFS Financial Corporation and WSFS Bank, Wilmington, DE. In addition, Dennis D. Cirucci, president, CEO, and director of Alliance Bancorp Inc. and Alliance Bank, completed his service in 2014 as our Bank's representative on the Federal Reserve Board's CDIAC.

I also thank Scott V. Fainor, president and CEO of National Penn Bancshares, Inc. and National Penn Bank, for being our District's representative to the Federal Advisory Council, which meets quarterly with the Board of Governors in Washington, D.C.

Finally, I offer my sincere thanks to the talented and dedicated officers and employees at the Philadelphia Fed. The 100-year history of our Bank is a story of the people who have contributed to its success through their commitment to public service. Among the senior staff, I want to acknowledge Michael Dotsey, who was promoted to senior vice president and director of research in May. He succeeds Loretta Mester, who became president and CEO of the Federal Reserve Bank of Cleveland. I also want to recognize Richard A. Sheaffer, who retired at the end of 2014 as senior vice president and general auditor. Michelle Scipione was named vice president and general auditor as of January 1, 2015.

In closing, I would like to express my gratitude for having had the pleasure of national service in a truly esteemed institution under the leadership of two outstanding chairs. Ben Bernanke brought an academic openness to the conduct of the Federal Open Market Committee (FOMC), encouraging the exchange of ideas among participants, which has led us through challenging times and has helped the Fed move toward greater transparency.

Chair Janet Yellen has continued that academic openness and will be a strong and dedicated leader as the FOMC charts a policy course toward normalization. I'm honored to have had the opportunity to work with Chair Yellen as a colleague when she was president of the San Francisco Fed, as Vice Chair when we worked together on the communications subcommittee, and as she has led the Fed as its Chair during this past year.

I have been truly honored to share the FOMC table with these leaders and so many others from throughout the Federal Reserve System as we have strived to make this institution more transparent, to more clearly define its principles, including a specific inflation target, and to help guide monetary policy in the best interests of the American people and the American economy.

It has been an honor to lead the Philadelphia Fed as it completed its first 100 years of service, and I am confident that the people who serve here and around the System will be here through the years to serve the best interest of the American people for the century ahead.

Charles I. Plosser
President and CEO
February 27, 2015

FIRST VICE PRESIDENT'S MESSAGE

D. BLAKE PRICHARD, FIRST VICE PRESIDENT AND COO

When the Federal Reserve Bank of Philadelphia first opened its doors on November 16, 1914, the Bank and its employees embarked on a mission to promote stable economic growth, to supervise for a safer and more sound banking system, and to create an efficient payments system.

Operations began in rented office space at 406-408 Chestnut Street in Philadelphia with a board of directors, four officers, and 24 staff members to serve 758 member banks.

For the century that followed, the Philadelphia Fed and its counterpart Reserve Banks stayed true to the mission. We have been resilient, adaptive to change, attentive to the unique characteristics of industries within our respective boundaries, and responsive to the needs of our stakeholders. We also have evolved with the needs of a modern economy. Today, performance of the nation's payment system is no longer defined by time and distance. Manual check processing transitioned to automation, and this has made way for increased automated payments and easy payments via personal computers, mobile devices, and emerging new technologies. Our advanced communications and technology have evolved accordingly to support most Federal Reserve functions efficiently from anywhere in the nation.

As we entered 2015, we bid farewell to our president, Charles I. Plosser, thanking him for his eight-and-ahalf years of service. He has added immeasurably to our economic knowledge, especially in understanding business cycles and monetary policy choices. He served during a global financial crisis and the Great Recession that followed, shepherded a steady economic recovery, implemented Dodd-Frank regulations, presided during the centennial of the Federal Reserve, and witnessed a historic succession of Federal Reserve Board Chairs. But he may be best remembered for his thoughtful and sometimes outspoken views on what the Fed should and should not be doing to conduct monetary policy. In so doing, he exemplified the intent of the System's founders who wanted to ensure that the clearest voices on the Federal Open Market Committee were those that represented the real economy.

Our best hope for the next 100 years is to continue our focus on leadership, engagement, investments, and performance. Our leadership strengths will inform monetary policy, influence banking supervision for improved oversight in achieving safety and soundness in our financial institutions, and promote innovative payment systems that serve the needs of consumers, governments, and businesses. Our engagement with industry, academia, and community leaders will serve to inform, educate, and strengthen our capabilities and focus on what lies ahead. Our investments in people and technology will develop the talent to meet any challenge and to do so with the best tools available. And our performance will make us an essential part of the Federal Reserve System, an indispensable partner with Third District entities, and a top contributor in fulfilling the mission of the Federal Reserve System.

As you will see in our Bank Highlights on the pages that follow, we have many distinct examples of how we have continued to build on a century of service to the public. I hope that what we have learned during our first 100 years has helped us build a solid foundation for the next 100 years and beyond. As we commemorated our first century of operations, we marveled at the amazing changes that have occurred and can only imagine the change that is before us in our second century of service to America. We're ready!

D. Blake Prichard
First Vice President and
Chief Operating Officer
February 27, 2015

Our engagement with industry, academia, and community leaders will serve to inform, educate, and strengthen our capabilities and focus on what lies ahead.

2014 BANK HIGHLIGHTS

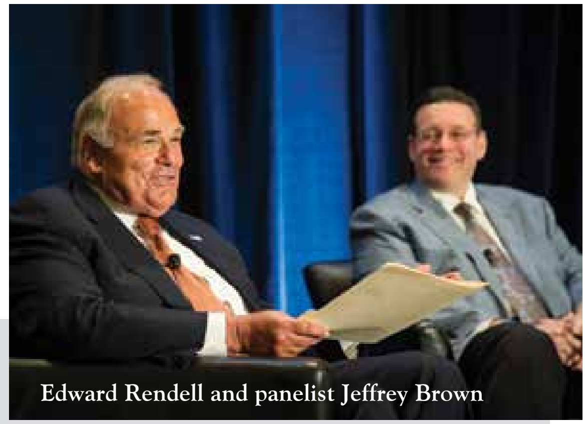
FEDERAL RESERVE BANK OF PHILADELPHIA

BRIDGING GROWTH AND OPPORTUNITY

The Community Development Studies and Education Department hosted the Bank's biennial Reinventing Older Communities (ROC) conference, titled Bridging Growth & Opportunity. The conference highlighted how communities can promote economic growth in ways that can benefit all residents. It included six plenary sessions, 20 concurrent sessions, and four neighborhood tours and activities with a record number 465 community developers, advocates, and planners, as well as bankers, government and business leaders, researchers, and foundation representatives from more than 25 states and the District of Columbia. Leading experts in the area of inclusive economic growth were among the speakers, who included Edward Rendell, former governor of Pennsylvania; M. Night Shyamalan, filmmaker and author of *I Got Schooled*; Raj Chetty, Harvard University economist; Leigh Gallagher, assistant managing editor of *Fortune*; Mark Zandi, chief economist at Moody's Analytics; and Jeremy Nowak, national community development expert and former chair of the Philadelphia Fed's board of directors.

The biennial Reinventing Older Communities conference is an example of how the Bank promotes research-informed practice and practice-informed research. The conference fosters an exchange of innovative strategies and emerging approaches to ensure all people and communities, particularly those of low- and moderate-income, have opportunities to benefit from economic growth.

Conference cosponsors included the Federal Reserve Banks of Boston, Chicago, Cleveland, New York, Richmond, and St. Louis; the Annie E. Casey Foundation; the Penn Institute for Urban Research; the Fund for Our Economic Future; and the Federal Home Loan Bank of Pittsburgh.



Edward Rendell and panelist Jeffrey Brown

M. Night Shyamalan

Leigh Gallagher

Jeremy Nowak

STREAMLINING CASH OPERATIONS

The Federal Reserve Bank of Philadelphia was one of nine cash offices in the Reserve System that participated in Evolving Operations field tests. These tests evaluated six business process changes that improve the efficiency and operational flexibility of Cash Operations while continuing to provide effective controls. Evolving Operations will continue to suggest operational improvements to keep pace with the changing business environment and to improve the efficiency of the cash supply chain.

RESEARCH DEPARTMENT TRACKS KEY INSIGHTS

In September, the Bank released the *Nonmanufacturing Business Outlook Survey* (*NBOS*), a monthly survey of nonmanufacturing firms. It complements the *Manufacturing Business Outlook Survey* (*MBOS*). The *MBOS* is one of the Federal Reserve's oldest regional surveys, first launched in 1968. Survey participants from the Third District provide data on the direction of change in their overall business activity and in the various measures of activity at their plants. Building upon the success of the *MBOS,* our Regional Economics team introduced the *NBOS*, which surveys nonmanufacturing firms about current and future overall business activity. The survey has been conducted monthly since March 2011 and has built enough data in this time series to take greater prominence in the economic outlook.

TRAINING FOR ALL AGES

Nearly 100 students and professors from 11 colleges and universities in the Third District attended the Bank's fourth annual College Seminar series in April. The curriculum included portions of *The Federal Reserve and You* video series, followed by a hands-on session that simulated the Fed's open market operations to demonstrate how the Fed adjusts short-term interest rates. The college audience also heard an economic outlook, an update on monetary policy, and participated in a Q&A session.

In July, more than 30 K–12 teachers from the Third District took advantage of their summer break to participate in the Bank's annual five-day Keys to Financial Success teacher-training program. The Bank's economic educators provided sessions that instructed educators in the best way to teach the course to their own students. In addition, 17 teachers enrolled in the annual five-day Making Sense of Money and Banking teacher-training course, which is designed to help educators integrate money and banking concepts into their classroom lessons.

The Keys to Financial Success attracted more than 30 teachers from the Third District in 2014.

MAKING PAYMENTS SAFER

The Payment Cards Center (PCC) staff worked with a team of researchers as part of the Federal Reserve System payment system improvement initiatives. As the team analyzed the U.S. payment security landscape, the PCC staff — with its expertise in payments security and the industrial organization of card-based payment systems — made significant contributions to the reports that identified security concerns as well as recommendations to the Financial Services Policy Committee for improving the security of U.S. payment systems.

UPDATES ON LEGACY TREASURY DIRECT

After nearly three decades of operating the Legacy Treasury Direct (LTD) on behalf of the U.S. Treasury's Bureau of the Fiscal Service, Bank staff led the effort to decommission the application. Major initiatives for 2014 included developing communications for investors, providing guidance to the Fiscal Service's information technology staff, supporting the transfer of the LTD print and mail function developing data files to support the replacement holdings system that the Fiscal Service developed, and organizing and scheduling closure procedures.

COMMUNITY OUTREACH

Throughout 2014, the Bank's PhillyFedCARES team organized several initiatives in which Bank employees volunteered their time and skills to local schools and organizations.

More than 30 volunteers rolled up their sleeves at the Andrew Jackson Elementary School in South Philadelphia in honor of Martin Luther King Jr. Day to help paint, clean closets and gardens, work in the library, and perform general maintenance. PhillyFedCARES also collected donations of school supplies and winter accessories for students.

In March, PhillyFedCARES sponsored an event at the Gen. George A. McCall Elementary School in Philadelphia. Bank employees read books by Dr. Seuss and other stories to students in grades K–3 as part of the National Education Association's Read Across America Day. The PhillyFedCARES team also volunteered at the Philabundance Hunger Relief Center, sorting and packing food that was distributed through the Philabundance programs as well as a network of nearly 500 food kitchens, shelters, and facilities.

PhillyFedCARES

VOLUNTEER

Bank volunteers read to students as part of the National Education Association's Read Across America Day; from top: Priscilla Lynch, Deborah Finley, and Blake Prichard.

STARTING OFF ON THE RIGHT FOOT

The Bank welcomed eight Cristo Rey Philadelphia High School students as part of the 2014 work-study program to extend outreach efforts to majority-minority and inner-city high schools. The eight interns worked in the Bank's Human Resources, Financial Management Services, and Information Technology Services departments. Cristo Rey partners with local organizations, businesses, and educators to create an innovative environment that blends academics with professional work experience.

Eight interns from the Cristo Rey Philadelphia High School participated in a work-study program at the Bank.

THE VALUE OF HOMEOWNERSHIP COUNSELING

The results of a five-year effort by the Federal Reserve Bank of Philadelphia to track the effectiveness of homeownership counseling were published in "The Effectiveness of Pre-Purchase Homeownership Counseling and Financial Management Skills," a comprehensive report that discusses the long-term and short-term benefits of counseling and followed the creditworthiness of study participants over time.

The study, which began in 2007, investigated the effectiveness of pre-purchase homeownership counseling over a five-year period using an experimental design with both a control and treatment group. For study participants, the report concludes that even a two-hour pre-purchase homeownership workshop and one-on-one pre-purchase counseling benefited those who later bought homes, and the counseling even improved the financial creditworthiness of those who did not become homeowners.

KEEPING UP WITH STANDARDS IN FINANCIAL REGULATIONS, MORTGAGES, AND MORE

The Bank's Supervision, Regulation & Credit Department hosted a conference on Enhancing Prudential Standards in Financial Regulations, cosponsored with the Wharton Financial Institutions Center and the *Journal of Financial Services Research*. Among the speakers were Franklin Allen, the Nippon Life professor of finance and professor of economics at the Wharton School of the University of Pennsylvania; George Kaufman, cochair of the Shadow Financial Regulatory Committee and the John F. Smith Professor of Finance and Economics at Loyola University Chicago; and Sandra Lawson, managing director of Goldman Sachs. Attendees in the fields of economics and supervision and regulation discussed prudential standards for bank capital and stress testing, issues in mortgage and housing finance, and the issue of financial institutions being "too big to fail."

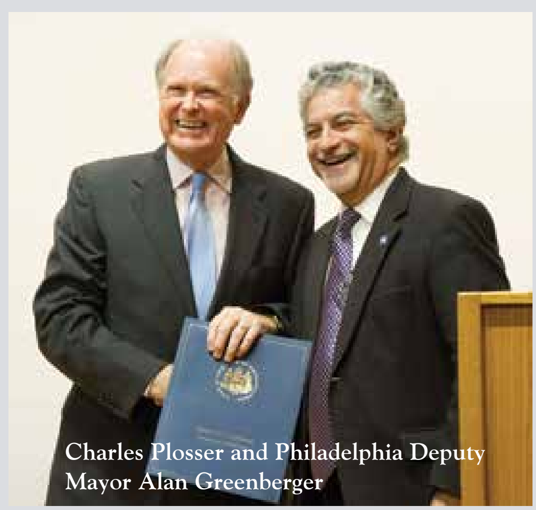
In another conference, the Bank's Community Development Studies and Education Department, along with the Urban Affairs Coalition Foreclosure Prevention Task Force and Philadelphia's Residential Mortgage Foreclosure Diversion Program, organized an event that highlighted the new rules that apply to bank and nonbank servicers of home mortgage loans. More than 100 servicing directors and senior staff from local financial institutions, attorneys specializing in foreclosure prevention, and housing counselors turned out to review the recent home mortgage servicing rules that went into effect in 2014.

A TRIBUTE TO 100 YEARS OF SERVICE

On November 16, 2014, the Bank invited its current and past employees and families to an open house to commemorate the Bank's first day of business on November 16, 1914. Former Philly Fed Presidents Edward Boehne and Anthony Santomero, along with President Charles Plosser, offered insights into the Bank's history and reflections on the distinctive events during the times in which they served. After the presentation, a panel discussion examined the history of the three-pillared functions of the Bank: monetary policy, payments systems, and supervision and regulation. Panelists Rick Lang, former executive vice president and one-time director of research, who worked for the Bank from 1984 to 2010, discussed the Bank's role in monetary policy; Bill Stone, the longest-serving first vice president (1987–2010), who worked for the Bank from 1971 to 2010, spoke on the history of payments systems at the Bank; and Connie Wallgren, current vice president and chief examination officer in the Supervision, Regulation & Credit Department, explained the nuances of supervision and regulation. The City of Philadelphia presented a proclamation to the Bank in recognition of its 100-year anniversary and a century of dedicated service.

Anthony Santomero, Charles Plosser, and Edward Boehne

Connie Wallgren, Rick Lang, and Blake Prichard



Charles Plosser and Philadelphia Deputy Mayor Alan Greenberger

GLOBAL IMPACT

The Office of Diversity and Inclusion (D&I) and the Talent Management (TM) Division of Human Resources hosted a forum titled Integrating Diversity and Inclusion with Talent Management to Create Sustainable Business Impact. More than 70 D&I and TM practitioners from companies and organizations from across the Third District and the Federal Reserve System listened to the keynote address by Stephen Frost, head of D&I for KPMG in London and author of *The Inclusion Imperative: How Real Inclusion Creates Better Business and Builds Better Societies.*

From left to right: Anilu Vazquez-Ubarri, Steve Hart, Stephen Frost, Karen Vaughn, Kelley F. Cornish, and Mary Ann Hood

A CENTENNIAL PORTRAIT

IMPROVING THE TREASURY'S PAYMENT SYSTEMS

The Bank recently launched the Post Payment System (PPS) that will modernize and integrate many previous U.S. Treasury systems. The new system includes advanced functionality to manage all Treasury-disbursed payments, adds additional fraud protection for these payments, and provides the capability for improved data analytics. After completing a pilot program, the Bank installed its initial PPS Release 1.0 on time and within budget, establishing the foundation for the overall system. In 2014, more than eight billion Treasury payment records were converted from legacy systems in this first phase.

When completed in 2018, the PPS will replace the legacy systems, boost the efficiency and effectiveness of Treasury payment processing, and provide enhanced analytical capabilities.

In 1919, the Federal Reserve Bank of Philadelphia gathered all of its employees for a group photo at a reception honoring the Bank's five-year anniversary. In the spirit of that historic photograph, today's Bank employees were organized into multiple group portraits to create three gigantic outlines of the numerals in the figure 100. The finished portrait, after working a little digital magic, pays tribute to the Bank's 100-year anniversary.

100 YEARS®
FEDERAL RESERVE SYSTEM

REFLECTIONS ON MONETARY POLICY

BY CHARLES I. PLOSSER*

The past eight years have been an extraordinary period in this nation's economic history, perhaps the most challenging since the Great Depression. I came to lead the Federal Reserve Bank of Philadelphia in 2006, looking forward to the opportunity to serve the American public after more than three decades in academic study, where much of my research and teaching centered on the subjects of macroeconomics, finance, and monetary policy.

When I accepted my position here in Philadelphia, I did not expect to face a global financial crisis, an ensuing recession, and a slow, steady recovery. Through it all, though, I can truly say the people who have worked alongside me here in Philadelphia and around the Federal Reserve System have strengthened my belief in this remarkable institution.

I would like to take this opportunity to reflect on the past eight years and describe how a set of principles of sound central banking have guided my thinking on monetary policy in these turbulent times.

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

- commits to a set of clearly articulated objectives that can be feasibly achieved by monetary policy;
- conducts monetary policy in a systematic or rule-like manner;
- communicates its policies and actions to the public in a clear and transparent way; and
- protects its independence, in its governance and its practice, by maintaining a distinct separation of monetary policy from fiscal policy.

These four principles are interrelated, and, as you will see, communication is a key ingredient for a sound policy framework. During my time in office, I have had the privilege of witnessing progress in each of these dimensions. Yet, I have described the process as a journey, not a destination.

While we have made strides over the past several decades, I also recognize that the journey has taken us into unchartered territory in recent years. Extraordinary actions by the Fed in response to the Great

Recession have presented unique communications challenges, which have made clarity more difficult. Yet, I believe we have made progress nonetheless.

THE JOURNEY THUS FAR

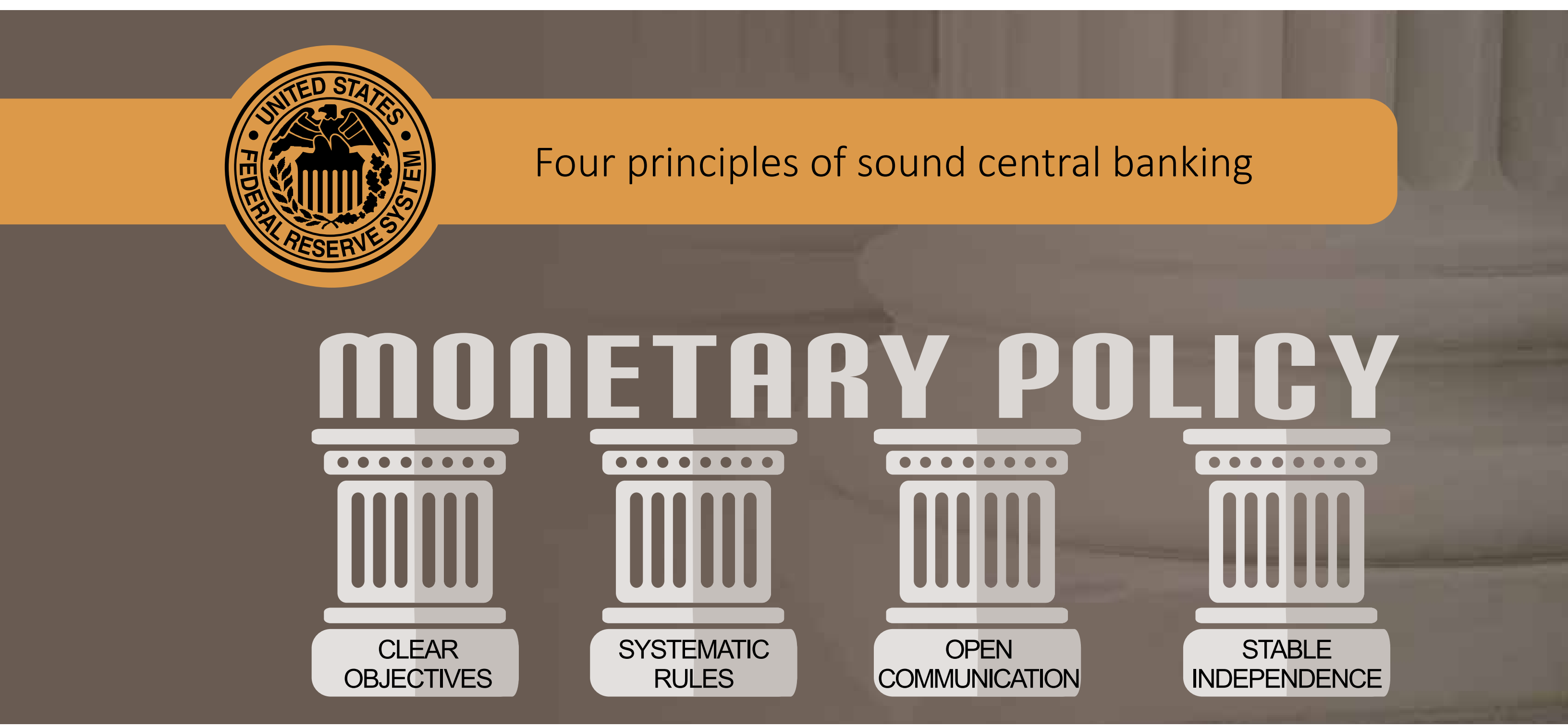
Just consider how far we have come. At one time, it was taken for granted that the central bank was supposed to be secretive and mysterious. The guiding principle was simple: The less said about monetary policy, the better. Indeed, it was not until 1994 that the Federal Open Market Committee (FOMC) began to announce policy changes made at its meetings. Before then, the markets were left to infer the policy action from the Fed's behavior in the market.[1] Since then, the FOMC has issued statements at each meeting, which include a vote tally, along with the views of the dissenters. The FOMC now expedites the release of the minutes, publishing them three weeks after each meeting. It also reports economic projections of Committee participants four times a year, including information about the appropriate path of policy that underlie the forecasts. These meetings are followed by press conferences with the chair of the FOMC. In 2012, the FOMC issued a statement clarifying our longer-run goals and strategy, including an explicit 2 percent target for inflation.

A number of these initiatives, including the statement of longer-run goals and objectives and the improvements in the Summary of Economic Projections were based on the recommendations of a subcommittee on communications led by then-Vice Chair Janet Yellen, which included President Charles Evans of Chicago, former Governor Sarah Bloom Raskin, and myself. Serving on this subcommittee and working with these colleagues to find a way for the FOMC to agree to a 2 percent inflation target after more than a decade of debate was one of the highlights of my term in office.

In 2014, Chair Yellen asked Vice Chair Stanley Fischer to lead a new subcommittee on communications — with Governor Jerome Powell, President John Williams of San Francisco, and President Loretta Mester of Cleveland. As I said, it is a journey, and I am pleased to see that others will continue to seek ways to improve communications after I leave.

CLEARLY ARTICULATING OBJECTIVES

Let's consider how communications support each of the four principles



of sound central banking, beginning with clearly articulating the objectives of monetary policy. But before doing so, it is useful to spell out exactly what the FOMC is supposed to do. The Federal Reserve Act calls on monetary policy to "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Since moderate long-term interest rates generally result when prices are stable, many have interpreted these goals as being a dual mandate to promote employment and price stability.

However, most economists are dubious of the ability of monetary policy to predictably control employment in the short run, and there is a strong consensus that monetary policy cannot determine employment in the long run. As the FOMC noted in its statement on longer-run goals adopted in 2012, the maximum level of employment is largely determined by nonmonetary factors, such as changing demographics, taxes, and productivity, which affect the structure and dynamics of the labor market.

The recognition that monetary policy has a limited ability to affect employment as reflected in the 2012 statement has led me to, at times, be skeptical of some of the FOMC's extraordinary efforts to remedy so many aspects of the labor market's challenges. On several occasions, I have noted that the benefits of such efforts are not likely to outweigh the costs.

In my view, excessive focus on short-run control of employment weakens the credibility and effectiveness of the Fed in achieving its price stability objective. We learned this lesson most dramatically during the 1970s when, despite the extensive efforts to reduce unemployment, the Fed essentially failed, and the nation experienced a prolonged period of high unemployment and high inflation. The economy paid the price in the form of a deep recession as the Fed sought to bring down inflation and restore the credibility of its commitment to price stability.

When establishing longer-term goals and objectives for any organization, and particularly those that serve the public, it is important that the goals be achievable. Assigning unachievable goals to organizations is a recipe for failure. For the Fed, it could mean a loss of public confidence. I fear that the public has come to expect too much from its central bank and too much from monetary policy in particular. We need to heed the words of Nobel Prize winner Milton Friedman. In his 1967 presidential address to the American Economic Association, he said, "we are in danger of assigning to monetary policy a larger role than it can perform, in danger of asking it to accomplish tasks that it cannot achieve, and as a result, in danger of preventing it from making the contribution that it is capable of making."[2]

In my view, the "dual mandate" has contributed to a view that monetary policy can accomplish far more than it is, perhaps, capable of achieving. Even though the FOMC's 2012 statement of objectives acknowledged that it is inappropriate to set a fixed goal for employment and that maximum employment is influenced by many nonmonetary factors, the FOMC's policy statements in recent years have increasingly given the impression that the FOMC wants to achieve an employment goal as quickly as possible through aggressive monetary accommodation.

I believe that assigning multiple objectives for the central bank opens the door to highly discretionary policies, which can be justified by shifting the focus or rationale for action from goal to goal. That is why I have argued that Congress should redefine the Fed's monetary policy goals to focus solely, or at least primarily, on price stability. I base this on two facts: Monetary policy has a very limited ability to influence real variables, such as employment. And, in a regime with fiat currency, only the central bank can ensure price stability. Indeed, it is the one goal that the central bank can achieve over the longer run.

Setting clear, achievable objectives is the first part of the framework. Asking policymakers to pursue those objectives in a systematic, rule-like approach is the second key principle.

THE BENEFITS OF SYSTEMATIC MONETARY POLICY

So, what do I mean by a systematic approach to policy? Quite simply, I mean conducting policy in a more rule-like manner. You often hear Fed officials say that policy decisions are "data dependent" and, indeed, they are. This means that future policy actions are conditional on how the economic data unfold. We may not know what the future holds or what future policy decisions will be, but we can choose to make those decisions in a systematic way based on the incoming economic data. This principle has led me to advocate a more "rule-like" approach to policymaking.[3]

> 'In my view, excessive focus on short-run control of employment weakens the credibility and effectiveness of the Fed in achieving its price stability objective.'

Of course, the alternative to rule-like policy is discretionary policy, in which policymakers are free to choose whatever action seems appropriate or convenient at the time. Rules act as restrictions on policymakers' choices — limiting the degree of discretion. But this is not a bad thing; rather, it can result in better economic outcomes in the long run. Dating as far back as 1936, Henry Simons discussed how rule-like behavior is preferable to pure discretion.[4] More recently, Finn Kydland and Ed Prescott in their Nobel Prize-winning work showed that a credible commitment by policymakers to behave in a systematic rule-like manner leads to better outcomes than discretion by reducing policy uncertainty.[5] Since then, numerous papers using a variety of models have investigated the benefits of rule-like behavior in monetary policy and found that there are indeed significant benefits.

One of the reasons that rules work better than discretion is that they are transparent and therefore allow for simpler and more effective communication of policy decisions.

Moreover, a large body of research over the past 40 years has emphasized the important role that expectations play in determining economic outcomes. That means more effective communication of the decision-making process leads to more accurate expectations. When policy is set systematically, the public and financial market participants can form more accurate expectations about policy. Policy is then less of a source of instability or uncertainty.

This allows households and businesses to more accurately form expectations and thus make better decisions. As a result, systematic policy promotes a more stable, predictable, and efficient economy.

The appropriate way to make policy systematic, or rule-like, is to base policy decisions on economic conditions. That is, policymakers should describe the reaction function that determines how the current and future policy rate will be set depending on economic data.

> ‘Monetary policy should be data dependent, not date dependent.’

However, on several occasions, I have noted that a reaction function does not mean a timetable or a threshold for action. Monetary policy should be data dependent, not date dependent. In my last vote as a member of the FOMC in December 2014, I dissented, in part because I believe the language of the statement was still trying to communicate policy in terms of time. Whether the Committee states that it will be "patient" or that it will wait a "considerable time," the language continued to stress the passage of time as a key determinant of policy rather than making clear that policy will depend on the data. Describing policy in terms of time could also risk limiting the Committee's flexibility to respond to the data if we continue to see an improving economy. I raised similar objections when the FOMC used time-dependent language to communicate when it might eventually raise rates with a series of moving calendar dates.

The use of data as a policy determinant must recognize that policymakers are no more certain about future economic conditions than anyone else is. Thus, the future path of policy will always be highly uncertain. However, a reaction function should explain how the policy rate will be determined in the future as a function of economic conditions.

I have also noted that a reaction function does not need to be mechanical. The science of monetary policy has not reached the point where we can specify a single optimal rule for setting policy and turn decision-making over to a computer. Judgment is still required.

The principle of systematic policy has also influenced my perspective on other central bank policy, including the programs for managing the lender-of-last-resort role and the programs for large-scale asset purchases. While these two aspects of central banking are different, the approach to policymaking ought to be the same — that is, systematic, consistent, transparent, and largely predictable.

The best guide to a systematic lender of last resort policy dates back to Walter Bagehot's simple rule of lending freely to solvent banks at a penalty rate against good collateral. Yet, early in the financial crisis, the Fed took extraordinary actions to ensure financial stability that have gone far beyond this concept. Some of these actions supported markets that were severely impaired; others supported the ongoing survival of institutions deemed too big to fail. The actions in those couple of years came so quickly that it is probably not surprising that policy reactions appeared, at times, erratic, rather than systematic.

INCREASING TRANSPARENCY

As I mentioned at the outset, communication has been the subject of considerable discussion in recent years, particularly as monetary policy ventured into unconventional policy. Since the nominal federal funds rate cannot go below zero, the FOMC has used alternative or unconventional policy tools, such as the large-scale asset purchase program, in an effort to provide further accommodation to support the recovery. We also had to figure out how and what to communicate about these new tools. The asset purchase program has had many dimensions, such as the overall volume of purchases, the pace of purchases, the kind of assets targeted for purchase, and the criteria for starting and stopping the purchases. Policymakers have tried to fine-tune the program along each dimension, so it is not surprising that communication is very complicated and challenging.

The task was further complicated because one of the unconventional measures employed by the FOMC was forward guidance, which is a central banker's term for communications about the future path of policy. One way to think of forward guidance is that it is just another step toward increased transparency and effective communication of monetary policy. However, another rationale for forward guidance is that it is a way of increasing accommodation in a period when the policy rate is at or near the zero lower bound. In this approach, it can be desirable to indicate that future policy rates will be kept "lower for longer" than might otherwise be the case. Such a commitment would tend to raise inflation expectations and lower long-term nominal rates, thereby inducing households and businesses to spend more today.

However, I believe this approach asks more of forward guidance than just articulating a reaction function. It requires policymakers to directly influence and manage the public's beliefs about the future policy path in ways that are different from how they may have behaved in the past. This approach to forward guidance can backfire if the policy is misunderstood.[6] For example, if the public hears that the policy rate will be lower for longer, it may interpret this news as policymakers saying that they expect the economy to be weaker for longer. If the message is interpreted in that way, then the forward guidance will not succeed and may even weaken current spending. It is also difficult to pull off this approach effectively because it requires the public to believe policymakers will commit to a behavior different from how they have acted in the past. Managing expectations is even more challenging when policymakers have not committed to a reaction function for normal times. How can policymakers credibly commit to deviate from something they have never committed to in the first place?

I believe we should think of forward guidance as part of a systematic approach to decision-making and not as an independent policy tool that attempts to bend expectations. As monetary policy becomes normalized, we have the opportunity to enhance the public's understanding that forward guidance is an integrated part of a systematic approach to policy.

So, what additional steps can we take to increase transparency? I believe that the FOMC could improve communication and transparency by publishing a more comprehensive monetary policy report on a regular basis, perhaps quarterly.[7]

At the end of December 2014, the Philadelphia Fed issued an example of what a portion of such a discussion might look like in a monetary policy report. We used a set of policy rules to benchmark the current stance and path of policy and discussed the implications.[8]

The report showed that the federal funds rate is no longer constrained by the zero lower bound under a number of these rules. In fact, the rules indicate that maintaining the federal funds rate at the zero lower bound is unusually accommodative by historical standards. The benchmarks suggest that as the economy transitions to full employment and moves closer to its long-run inflation target, we should begin to gradually reduce accommodation by raising the funds rate target. Delaying liftoff runs the risk of requiring more aggressive future monetary policy than would otherwise be needed.

However, if the Committee felt it was desirable to further delay the initiation of interest rate increases, such a report would provide the opportunity, indeed the obligation, for a thorough and thoughtful discussion about why discretionary deviations from the guideposts were appropriate.

Thus, publishing a monetary policy report with an assessment of the likely near-term path of policy rates, in conjunction with an economic forecast, would be a useful exercise and enhance communications. It would also provide added discipline for policymakers to stick to a systematic, rule-like approach. And it would force policymakers to think more deeply and systematically about policy. Communication about that path, in turn, should give the public a much deeper understanding of the analytical approach that guides monetary policy.

While I am discussing transparency, I also want to touch on another misconception. Some commentators express the view that dissent causes dissonance and therefore confuses the communications. In fact, letting the public know about our debates and differing views is more transparent than hiding behind false consensus.

Monetary policymaking is conducted by committee, and divergent views can and often do exist. While this can be clumsy at times, such governance mechanisms have great strength in preventing institutions from lapsing into groupthink by ensuring that various views are heard in an environment that promotes better decisions and outcomes. And they help to preserve the central bank's independence and accountability.

Open dialogue and diversity of views lead to better policy decisions and are the primary means by which new ideas are gradually incorporated into our monetary policy framework. Thus, I believe diversity of thought is a sign of thoughtful progress. I have often quoted the famous American journalist Walter Lippmann, who said, "Where all men think alike, no one thinks very much." I think it is healthy for the American public to know that we debate some of the same issues that those outside the Fed debate. Hiding such debate behind a unanimous vote does nothing to promote true transparency.

PRESERVING INDEPENDENCE

Finally, I believe that the fundamental American concept of a decentralized central bank has great merit, in part, because it helps to preserve the independence and maintain the public trust in the institution. Independence is essential if a central bank is to play its fundamental role in preserving the purchasing power of a fiat currency. History is replete with examples of governments using the power to print money as a substitute for making tough fiscal choices, and the results are almost always disastrous.

Central bank independence is a significant tenet of sound central banking and leads to better economic outcomes. But independence must be accompanied by accountability. And accountability is more easily achieved when there is transparency. The public can best hold a central bank accountable when its goals are clearly stated and achievable.

Broad, ill-defined goals, on the other hand, reduce accountability and invite discretionary policies that can undermine the public trust and thus jeopardize independence. This is one reason why I have been concerned about credit allocation initiatives by the Fed that treated some creditors more favorably than others in bailouts and that sought to provide special support to the housing sector through its purchases of mortgage-backed securities.

The decisions to acquire mortgage-backed assets, I believe, strayed into credit allocation that, in my view, should be the purview of fiscal authorities and not the central bank. In hindsight, a basic problem was that this approach offered no systematic view as to how and where the Fed would intervene — we lacked a well-communicated systematic approach. By pushing these boundaries, the Fed puts its independence at risk.

> 'I believe that the FOMC could improve communication and transparency by publishing a more comprehensive monetary policy report on a regular basis, perhaps quarterly.'

In 2009, I advocated that we establish a new accord between the U.S.

Treasury and the Federal Reserve, similar to the Treasury-Fed Accord of 1951 that freed the Fed from keeping long-term interest rates artificially low. The new accord would help ensure that, when the U.S. Treasury requests the Fed to undertake emergency actions that require the acquisition of private or non-Treasury securities, the Treasury would exchange such assets for Treasury assets. A new accord would return control of the Fed's all-Treasuries balance sheet to the Fed so that it can conduct independent monetary policy.

> 'Finally, I believe that the fundamental American concept of a decentralized central bank has great merit, in part, because it helps to preserve the independence and maintain the public trust in the institution.'

CONCLUSION

To summarize, my time as president of the Federal Reserve Bank of Philadelphia has been guided by these four principles. I have become even more convinced of the value of clear, achievable goals, pursued in a systematic way. Because systematic policy is easily communicated to the public, it will improve the transparency and predictability of monetary policy, which reduces policy surprises.

Equally important in my view is that greater clarity about policymakers' reaction function strengthens accountability. Thus, systematic policy, communicated transparently, strengthens accountability and serves to preserve the central bank's independence.

The FOMC's recent moves to publish guidelines on its longer-run goals and policy strategy and the policy assumptions that underlie FOMC projections have been great strides toward applying these principles. Yet, more can be done.

As we normalize policy, I believe we should follow these principles. The Fed should ensure that it has clearly articulated objectives that can be achieved by monetary policy, with price stability as the primary objective.

I believe the FOMC should continue to work toward increasing the public understanding of how policy will react systematically to changes in economic conditions. Furthermore, the FOMC should move forward to describe a reaction function and then communicate our actions and decisions in terms of this reaction function. A detailed monetary policy report could be a useful vehicle for such enhanced communication.

It has been a privilege to serve our nation's independent, decentralized central bank. I believe that continued focus on these principles would make our nation's central bank a stronger institution for the American people and its economy.

END NOTES

* The views expressed here are my own and not necessarily those of the Federal Reserve System or the FOMC.

[1] See the Federal Reserve Bank of Philadelphia, "Timeline to Transparency," www.philadelphiafed.org/about-the-fed/transparency/ (accessed October 9, 2014).

[2] See Milton Friedman, "The Role of Monetary Policy," *American Economic Review*, 58:1 (March 1968), pp. 1–17.

[3] See Charles I. Plosser, "The Benefits of Systematic Monetary Policy," a speech given to the National Association for Business Economics, Washington Economic Policy Conference, Washington, D.C. (March 3, 2008).

[4] Henry C. Simons, "Rules Versus Authorities in Monetary Policy," *Journal of Political Economy*, 44:1 (February 1936).

[5] Finn E. Kydland and Edward C. Prescott, "Rules Rather Than Discretion: The Inconsistency of Optimal Plans," *Journal of Political Economy*, 85 (June 1977), pp. 473–491.

[6] See Charles I. Plosser, "Forward Guidance," speech to the Stanford Institute for Economic Policy Research's (SIEPR) Associates Meeting, February 12, 2013, Stanford, CA.

[7] See Charles I. Plosser, "Systematic Monetary Policy and Communication," his remarks to the Economic Club of New York, New York, NY, June 24, 2014; and Charles I. Plosser, "Monetary Rules: Theory and Practice," his remarks to the Hoover Institution, Stanford, CA, May 30, 2014.

[8] See Michael Dotsey, Charles I. Plosser, and Keith Sill, "Monetary Policy Report: Using Rules for Benchmarking," December 2014, available at http://www.philadelphiafed.org/research-and-data/publications/special-reports/2014/1231-using-rules-for-benchmarking.pdf.

2014
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2014
STATEMENT OF AUDITOR INDEPENDENCE

FEDERAL RESERVE BANK OF PHILADELPHIA

The Federal Reserve Board engaged Deloitte & Touche LLP (D&T) to audit the 2014 combined and individual financial statements of the Reserve Banks and Maiden Lane LLC.[1]

In 2014, D&T also conducted audits of internal controls over financial reporting for each of the Reserve Banks. Fees for D&T's services totaled $7 million, of which $0.4 million was for the audit of Maiden Lane LLC. To ensure auditor independence, the Board 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 2014, the Bank did not engage D&T for any non-audit services.

[1] In addition, D&T audited the Office of Employee Benefits of the Federal Reserve System (OEB), the Retirement Plan for Employees of the Federal Reserve System (System Plan), and the Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The System Plan and the Thrift Plan provide retirement benefits to employees of the Board, the Federal Reserve Banks, the OEB, and the Consumer Financial Protection Bureau.

FINANCIAL STATEMENT CONTENTS

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

FEDERAL RESERVE BANK OF PHILADELPHIA

March 11, 2015

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, 2014 and 2013, 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 (2013)* 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.

D. Blake Prichard, Acting President and Chief Executive Officer/First Vice President

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

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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 financial statements of the Federal Reserve Bank of Philadelphia ("FRB Philadelphia"), which are comprised of the statements of condition as of December 31, 2014 and 2013, and the related statements of income and comprehensive income, and of changes in capital for the years then ended, and the related notes to the financial statements. We also have audited the FRB Philadelphia's internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management's Responsibility

The FRB Philadelphia's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles established by the Board of Governors of the Federal Reserve System (the "Board") as described in Note 3 to the financial statements. The Board has determined that this basis of accounting is an acceptable basis for the preparation of the FRB Philadelphia's financial statements in the circumstances. The FRB Philadelphia's management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The FRB Philadelphia's management is also responsible 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on the FRB Philadelphia's internal control over financial reporting based on our audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) (the "PCAOB") and we conducted our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of the financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the FRB Philadelphia's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of the financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting involves obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Definition of Internal Control Over Financial Reporting

The FRB Philadelphia's internal control over financial reporting is a process designed by, or under the supervision of, the FRB Philadelphia's principal executive and principal financial officers, or persons performing similar functions, and effected by the 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. The 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 the FRB Philadelphia; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the accounting principles established by the Board, and that receipts and expenditures of the FRB Philadelphia are being made only in accordance with authorizations of management and directors of the FRB Philadelphia; and (3) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the FRB Philadelphia's assets that could have a material effect on the financial statements.

Inherent Limitations of Internal Control Over Financial Reporting

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 and corrected 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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FRB Philadelphia as of December 31, 2014 and 2013, and the results of its operations for the years then ended in accordance with the basis of accounting described in Note 3 to the financial statements. Also, in our opinion, the FRB Philadelphia maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Basis of Accounting

We draw attention to Note 3 to the financial statements, which describes the basis of accounting. The FRB Philadelphia has prepared these financial statements in conformity with accounting principles established by the Board, as set forth in the *Financial Accounting Manual for Federal Reserve Banks,* which is a 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 and accounting principles generally accepted in the United States of America are also described in Note 3 to the financial statements. Our opinion is not modified with respect to this matter.

Deloitte & Touche LLP

March 11, 2015

ABBREVIATIONS

ACH	Automated clearinghouse
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
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
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
TBA	To be announced
TDF	Term Deposit Facility

STATEMENTS OF CONDITION

FEDERAL RESERVE BANK OF PHILADELPHIA

As of December 31, 2014 and December 31, 2013 (in millions)

	2014	2013
ASSETS		
Gold certificates	$ 338	$ 397
Special drawing rights certificates	210	210
Coin	122	123
Loans to depository institutions	7	-
System Open Market Account:		
Treasury securities, net (of which $267 and $497 is lent as of December 31, 2014 and 2013, respectively)	62,198	68,363
Government-sponsored enterprise debt securities, net (of which $15 and $32 is lent as of December 31, 2014 and 2013, respectively)	958	1,713
Federal agency and government-sponsored enterprise mortgage-backed securities, net	42,861	44,442
Foreign currency denominated investments, net	1,571	1,835
Central bank liquidity swaps	115	21
Accrued interest receivable	619	685
Other assets	1	-
Bank premises and equipment, net	90	87
Other assets	29	28
Total assets	**$ 109,119**	**$ 117,904**
LIABILITIES AND CAPITAL		
Federal Reserve notes outstanding, net	$ 41,512	$ 36,063
System Open Market Account:		
Securities sold under agreements to repurchase	12,214	9,154
Other liabilities	20	39
Deposits:		
Depository institutions	47,897	48,568
Other deposits	28	21
Interest payable to depository institutions	2	2
Accrued benefit costs	121	104
Accrued remittances to the Treasury	7	84
Interdistrict settlement account	4,108	19,721
Other liabilities	16	12
Total liabilities	**105,925**	**113,768**
Capital paid-in	1,597	2,068
Surplus (including accumulated other comprehensive loss of $25 and $14 at December 31, 2014 and 2013, respectively)	1,597	2,068
Total capital	**3,194**	**4,136**
Total liabilities and capital	**$ 109,119**	**$ 117,904**

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

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

FEDERAL RESERVE BANK OF PHILADELPHIA

For the years ended December 31, 2014 and December 31, 2013 (in millions)

	2014	2013
INTEREST INCOME		
System Open Market Account:		
Treasury securities, net	$ 1,589	$ 1,549
Government-sponsored enterprise debt securities, net	40	66
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,296	1,098
Foreign currency denominated investments, net	6	8
Central bank liquidity swaps	-	2
Total interest income	2,931	2,723
INTEREST EXPENSE		
System Open Market Account:		
Securities sold under agreements to repurchase	3	2
Deposits:		
Depository institutions	146	99
Term Deposit Facility	11	1
Total interest expense	160	102
Net interest income	2,771	2,621
NON-INTEREST LOSS		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	2	1
Foreign currency translation losses, net	(218)	(98)
Other	-	1
Compensation received for service costs provided	3	4
Reimbursable services to government agencies	44	39
Other	3	3
Total non-interest loss	(166)	(50)
OPERATING EXPENSES		
Salaries and benefits	133	124
Occupancy	15	16
Equipment	7	7
Other	47	51
Assessments:		
Board of Governors operating expenses and currency costs	78	81
Bureau of Consumer Financial Protection	42	43
Total operating expenses	322	322
Net income before providing for remittances to the Treasury	2,283	2,249
Earnings remittances to the Treasury	2,625	2,189
Net (loss) income	(342)	60
Change in prior service costs related to benefit plans	1	-
Change in actuarial (losses) gains related to benefit plans	(12)	19
Total other comprehensive (loss) income	(11)	19
Comprehensive (loss) income	**$ (353)**	**$ 79**

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

STATEMENTS OF CHANGES IN CAPITAL

FEDERAL RESERVE BANK OF PHILADELPHIA

For the years ended December 31, 2014 and December 31, 2013 (in millions, except share data)

		Surplus			
	Capital paid-in	Net income retained	Accumulated other comprehensive income (loss)	Total surplus	Total capital
Balance at December 31, 2012 (42,324,391 shares)	$ 2,116	$ 2,149	$ (33)	$ 2,116	$ 4,232
Net change in capital stock redeemed (958,630 shares)	(48)	-	-	-	(48)
Comprehensive income:					
Net income	-	60	-	60	60
Other comprehensive income	-	-	19	19	19
Dividends on capital stock	-	(127)	-	(127)	(127)
Net change in capital	(48)	(67)	19	(48)	(96)
Balance at December 31, 2013 (41,365,761 shares)	$ 2,068	$ 2,082	$ (14)	$ 2,068	$ 4,136
Net change in capital stock redeemed (9,433,205 shares)	(471)	-	-	-	(471)
Comprehensive income:					
Net loss	-	(342)	-	(342)	(342)
Other comprehensive loss	-	-	(11)	(11)	(11)
Dividends on capital stock	-	(118)	-	(118)	(118)
Net change in capital	(471)	(460)	(11)	(471)	(942)
Balance at December 31, 2014 (31,932,556 shares)	$ 1,597	$ 1,622	$ (25)	$ 1,597	$ 3,194

The accompanying notes are an integral part of these 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 nationally-chartered 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 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, U.S. offices of foreign banking organizations, and designated financial market utilities pursuant to authority delegated by the Board of Governors. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and 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, and 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 and directed to lend the Treasury securities and GSE debt securities that are held in the SOMA.

To be prepared to counter disorderly conditions in foreign exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities, the FOMC has authorized and directed the FRBNY to execute spot and forward foreign exchange transactions in 14 foreign currencies, to hold balances in those currencies, and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY holds these securities and obligations in the SOMA. The FOMC has also authorized the FRBNY 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 in the maximum amount of $5 billion.

Because of the global character of bank funding markets, the System has at times coordinated with other central banks to provide liquidity. The FOMC authorized and directed the FRBNY to establish U.S. dollar liquidity and reciprocal foreign currency liquidity swap lines with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. The FRBNY holds amounts outstanding under these swap lines in the SOMA. These swap lines, which were originally established as temporary arrangements, were converted to standing arrangements on October 31, 2013, and will remain in place until further notice.

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 for which the costs were not reimbursed by the other Reserve Banks include Collateral Management System, Groupware Leadership Center, and Video Conferencing Network.

3. SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank. 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. 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, adjusted for credit impairment, if any, the recording of all SOMA securities on a settlement-date basis, and the use of straight-line amortization for Treasury securities, GSE debt securities, and foreign currency denominated investments. Amortized cost, rather than the fair value presentation, more appropriately reflects the financial position associated with 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 ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. 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 Bank's 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. Other than those described above, there are no significant differences between the policies outlined in the FAM and GAAP.

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

In 2014, the description of certain line items presented in the Statements of Condition and the Statements of Income and Comprehensive Income have been revised to better reflect the nature of these items. Amounts related to these line items were not changed from the prior year, only the nomenclature for the line item was revised, as further noted below:

- The line item "System Open Market Account: Other investments" has been revised in the Statements of Condition to "System Open Market Account: Other assets."

- The line item "System Open Market Account: Foreign currency denominated assets, net" has been revised in the Statements of Income and Comprehensive Income to "System Open Market Account: Foreign currency denominated investments, net."

Certain amounts relating to the prior year have been reclassified in the Statements of Income and Comprehensive Income to conform to the current year presentation. $1 million previously reported for the year ended December 31, 2013 as "Non-interest loss: Other" has been reclassified into a new line titled "Non-interest loss: System Open Market Account: Other."

Significant accounts and accounting policies are explained below.

a. Consolidation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the 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 in connection with those institutions' compliance with consumer protection statutes. 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. The Board of Governors funds the Bureau 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 relationship to the Bureau and determined that it should not 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 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. Gold certificates are recorded by the Banks at original cost. The Board of Governors allocates the gold certificates among the Reserve Banks once a year based on each Reserve Bank's average Federal Reserve notes outstanding during the preceding twelve months.

Special drawing rights (SDR) 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. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for 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 certificate transactions occur, the Board of Governors allocates the SDR certificates among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding calendar year. SDR certificates are recorded by the Banks at original cost. There were no SDR certificate transactions during the years ended December 31, 2014 and 2013.

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 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 typically settled through a tri-party arrangement. In a tri-party 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 FRBNY 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 Treasury Inflation-Protected Securities, Separate Trading of Registered Interest and Principal of Securities Treasury securities, and Treasury Floating Rate Notes); direct obligations of several federal and GSE-related agencies, including Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal Home Loan Banks; and pass-through federal agency and GSE MBS. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. These transactions are reported at their contractual amounts as "System Open Market Account: Securities purchased under agreements to resell" and the related accrued interest receivable is reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.

The FRBNY may engage in sales of securities under agreements to repurchase with primary dealers and with a set of expanded counterparties which includes banks, savings associations, GSEs, and domestic money market funds (Overnight and term reverse repurchase agreements). These reverse repurchase transactions are settled through a tri-party arrangement, 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, or 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 "System Open Market Account: Other liabilities" in the Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers, typically overnight, to facilitate the effective functioning of the domestic securities markets. The amortized cost basis of securities lent continues to be reported as "System Open Market Account: Treasury securities, net" and "System Open Market Account: Government-sponsored enterprise debt securities, net," as appropriate, in the Statements of Condition. Securities lending transactions are fully collateralized by Treasury securities based on the fair values of the securities lent increased by a margin determined by the FRBNY. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Non-interest loss: System Open Market Account: 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 Investments, and Warehousing Agreements

Interest income on Treasury securities, GSE debt securities, and foreign currency denominated investments included in the SOMA is accrued using the straight-line method. 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 or accreted 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. During the years ended December 31, 2014 and 2013, the FRBNY executed dollar rolls to facilitate settlement of outstanding purchases of federal agency and GSE MBS. The FRBNY accounts for dollar rolls as purchases or sales on a settlement-date basis. In addition, TBA MBS transactions may be paired off or assigned prior to settlement. Net gains (losses) resulting from these MBS transactions are reported as "Non-interest loss: 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 investments, 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. Foreign currency translation gains and losses that result from the daily revaluation of foreign currency denominated investments are reported as "Non-interest loss: System Open Market Account: Foreign currency translation losses, net" in the Statements of Income and Comprehensive Income.

Because the FRBNY enters into commitments to buy Treasury securities, federal agency and GSE MBS, and foreign government debt instruments and records the related securities on a settlement-date basis in accordance with the FAM, the related outstanding commitments are not reflected in the Statements of Condition.

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 investments, 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 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.

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 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 amount outstanding and the rate under the swap agreement. 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 amounts that the FRBNY receives are recorded as a liability.

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 to acquire software are capitalized based on the purchase price. Costs incurred during the application development stage to develop internal-use software are capitalized based on 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 and minor replacements 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

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.

An annual settlement of the interdistrict settlement account occurs in the second quarter of each year. As a result of the annual settlement, the balance in each Bank’s interdistrict settlement account is adjusted by an amount equal to the average balance in the account during the previous twelve-month period ended March 31. An equal and offsetting adjustment is made to each Bank’s allocated portion of SOMA assets and liabilities.

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 $4,940 million and $5,920 million at December 31, 2014 and 2013, respectively.

At December 31, 2014 and 2013, all Federal Reserve notes outstanding, reduced by the Reserve Bank’s currency holdings, were fully collateralized. At December 31, 2014, all gold certificates, all special drawing rights certificates, and $1,282 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2014, no investments denominated in foreign currencies were pledged as collateral.

k. Deposits

Depository Institutions

Depository institutions’ deposits represent the reserve and service-related 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 a component of “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 a component of “Interest payable to depository institutions” in the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2014 and 2013.

Other

Other deposits include the Bank's allocated portion of foreign central bank and foreign government deposits held at the FRBNY. Other deposits also include cash collateral held by the Bank.

l. 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 six 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 six percent on the paid-in capital stock. This cumulative dividend is paid semiannually.

m. 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 9 and 10.

n. Remittances to the Treasury

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. Currently, remittances to the Treasury are made on a weekly basis. This amount is reported as "Earnings remittances to the Treasury" in the Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued remittances to the Treasury" in the Statements of Condition. See Note 12 for additional information on earnings remittances to the Treasury.

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, remittances 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.

o. 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, 2014 and 2013, the Bank was reimbursed for substantially all services provided to the Treasury as its fiscal agent.

The Bank seeks reimbursement from the Treasury and other government agencies on behalf of all Reserve Banks of costs of performing fiscal agency functions. Each Reserve Bank transfers its Treasury reimbursement receivable to the Bank. The reimbursement receivable is reported in "Other assets" and totaled $2 million for each of the years ended December 31, 2014 and 2013. There was no cost of unreimbursed Treasury services at December 31, 2014. The cost of unreimbursed Treasury services is reported in "Other expense" and was immaterial at December 31, 2013.

p. 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, the FRBNY has overall responsibility for managing the Reserve Banks' provision of Fedwire funds and securities services, and the Federal Reserve Bank of Chicago has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions. The Reserve Bank that has overall responsibility for managing these services recognizes the related total System revenue in its Statements of Income and Comprehensive Income. The Bank is compensated for costs incurred to provide these services by the Reserve Banks responsible for managing these services and reports this compensation as "Non-interest loss: Compensation received for service costs provided" in its Statements of Income and Comprehensive Income.

q. Assessments

The Board of Governors assesses the Reserve Banks to fund its operations and the operations of the Bureau. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances. The Board of Governors also assesses each Reserve Bank for expenses related to producing, issuing, and retiring 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.

The Dodd-Frank Act requires that, after the transfer of its responsibilities to the Bureau on July 21, 2011, 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. After 2013, the amount will be adjusted annually in accordance with the provisions of the Dodd-Frank Act. The percentage of total operating expenses of the System for the years ended December 31, 2014 and 2013 was 12.22 percent ($608.4 million) and 12 percent ($597.6 million), respectively. The Bank's assessment for Bureau funding is reported as "Assessments: Bureau of Consumer Financial Protection" in the Statements of Income and Comprehensive Income.

r. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were $1 million and $2 million for the years ended December 31, 2014 and 2013, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

s. Restructuring Charges

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

In 2014, the Treasury announced plans to consolidate the provision of substantially all fiscal agent services for the U.S. Treasury at the Federal Reserve Bank of Cleveland, the Federal Reserve Bank of Kansas City, the FRBNY, and the Federal Reserve Bank of St. Louis. The implementation plan associated with this consolidation is expected to be completed in 2018.

Note 11 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.

t. Recently Issued Accounting Standards

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, *Presentation of Financial Statements* (Topic 205) *and Property, Plant, and Equipment* (Topic 360): *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. This update changes the requirements for reporting discontinued operations, which may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. This update is effective for the Bank for the year ending December 31, 2015, and is not expected to have a material effect on the Bank's financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606). This update was issued to create common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The guidance is applicable to all contracts for the transfer of goods or services regardless of industry or type of transaction. This update requires recognition of revenue in a manner that reflects the consideration that the entity expects to receive in return for the transfer of goods or services to customers. This update is effective for the Bank for the year ending December 31, 2018, and is not expected to have a material effect on the Bank's financial statements.

In June 2014, the FASB issued ASU 2014-11, *Transfer and Servicing* (Topic 860): *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.* This update requires changes in the accounting for repurchase to maturity transactions and repurchase financing transactions. Additionally, this update provides guidance for the disclosures for certain transfers of financial assets accounted for as sales, where the transferor retains substantially all of the exposure to economic return on the transferred financial asset; and repurchase agreements, securities lending transactions, and repurchase to maturity transactions that are accounted for as secured borrowings. This update is effective for the Bank for the year ending December 31, 2015, and is not expected to have a material effect on the Bank's financial statements.

4. LOANS

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. 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.

The loans to depository institutions outstanding as of December 31, 2014 was $7 million with remaining maturity within 15 days. The Bank had no loans outstanding as of December 31, 2013.

At December 31, 2014 and 2013, the Bank did not have any loans that were impaired, restructured, past due, or on non-accrual status, and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2014 and 2013.

5. SYSTEM OPEN MARKET ACCOUNT

a. Domestic Securities Holdings

The FRBNY conducts domestic open market operations and, on behalf of the Reserve Banks, holds the resulting securities in the SOMA.

During the years ended December 31, 2014 and 2013, the FRBNY continued the purchase of Treasury securities and federal agency and GSE MBS under the large-scale asset purchase programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would reinvest principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In June 2012, the FOMC announced that it would continue this reinvestment policy. In September 2012, the FOMC announced that the Federal Reserve would purchase additional federal agency and GSE MBS at a pace of $40 billion per month. In December 2012, the FOMC announced that the Federal Reserve would also purchase longer-term Treasury securities initially at a pace of $45 billion per month after its program to extend the average maturity of its holdings of Treasury securities was completed in 2012. In December 2013, the FOMC announced that it would slow the pace of its additional asset purchases. In October 2014, the FOMC concluded its asset purchase program while maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction.

The Bank's allocated share of activity related to domestic open market operations was 2.396 percent and 2.897 percent at December 31, 2014 and 2013, respectively.

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):

	2014			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Notes	$ 39,168	$ 663	$ (185)	$ 39,646
Bonds	19,799	2,985	(232)	22,552
Total Treasury securities	$ 58,967	$ 3,648	$ (417)	$ 62,198
GSE debt securities	$ 927	$ 31	$ -	$ 958
Federal agency and GSE MBS	$ 41,609	$ 1,275	$ (23)	$ 42,861

	2013			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Notes	$ 42,518	$ 967	$ (165)	$ 43,320
Bonds	21,480	3,724	(161)	25,043
Total Treasury securities	$ 63,998	$ 4,691	$ (326)	$ 68,363
GSE debt securities	$ 1,658	$ 55	$ -	$ 1,713
Federal agency and GSE MBS	$ 43,176	$ 1,297	$ (31)	$ 44,442

The FRBNY enters into transactions for the purchase of securities under agreements to resell and transactions to sell securities under agreements to repurchase as part of its monetary policy activities. These operations are for the purpose of further assessing the appropriate structure of such operations in supporting the implementation of monetary policy during normalization. In addition, transactions to sell securities under agreements to repurchase are entered into as part of a service offering to foreign official and international account holders.

There were no material transactions related to securities purchased under agreements to resell during the years ended December 31, 2014 and 2013. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2014	2013	2014	2013
Overnight and term reverse repurchase agreements:				
Contract amount outstanding, end of year	$ 9,504	$ 5,730	$ 396,705	$ 197,755
Average daily amount outstanding, during the year	3,238	121	130,281	4,161
Maximum balance outstanding, during the year	9,504	5,730	396,705	197,755
Securities pledged (par value), end of year	8,750	5,448	365,235	188,028
Securities pledged (market value), end of year	9,548	5,700	398,540	196,726
Foreign official and international accounts:				
Contract amount outstanding, end of year	$ 2,710	$ 3,424	$ 113,132	$ 118,169
Average daily amount outstanding, during the year	2,602	2,876	102,968	95,520
Maximum balance outstanding, during the year	3,424	3,543	122,232	118,169
Securities pledged (par value), end of year	2,596	3,547	108,355	122,424
Securities pledged (market value), end of year	2,710	3,424	113,132	118,175
Total contract amount outstanding, end of year	$ 12,214	$ 9,154	$ 509,837	$ 315,924

Securities pledged as collateral, at December 31, 2014 and 2013, consisted solely of Treasury securities.

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, 2014 and 2013 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
December 31, 2014:							
Treasury securities (par value)	$ -	$ -	$ 84	$ 26,662	$ 16,449	$ 15,772	$ 58,967
GSE debt securities (par value)	26	17	94	733	-	57	927
Federal agency and GSE MBS (par value)[1]	-	-	-	-	155	41,454	41,609
Securities sold under agreements to repurchase (contract amount)	12,214	-	-	-	-	-	12,214
December 31, 2013:							
Treasury securities (par value)	$ -	$ 9	$ 5	$ 22,117	$ 25,054	$ 16,813	$ 63,998
GSE debt securities (par value)	67	219	251	1,051	2	68	1,658
Federal agency and GSE MBS (par value)[1]	-	-	-	-	74	43,102	43,176
Securities sold under agreements to repurchase (contract amount)	9,154	-	-	-	-	-	9,154

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

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, was approximately 5.7 and 6.5 years as of December 31, 2014 and 2013, respectively.

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

	Allocated to the Bank		Total SOMA	
	2014	2013	2014	2013
Treasury securities (amortized cost)	$ 267	$ 497	$ 11,144	$ 17,153
Treasury securities (par value)	242	448	10,105	15,447
GSE debt securities (amortized cost)	15	32	633	1,099
GSE debt securities (par value)	15	31	616	1,055

The FRBNY enters into commitments to buy and sell Treasury securities and records the related securities on a settlement-date basis. As of December 31, 2014, there were no outstanding commitments.

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, 2014, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was $28,692 million, none of which was related to dollar rolls. The total purchase price of outstanding purchase commitments allocated to the Bank was $687 million, none of which was related to dollar rolls. As of December 31, 2014, there were no outstanding sales commitments for federal agency and GSE MBS. These commitments, which had contractual settlement dates extending through January 2015, are principally for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to 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 MBS commitments as part of its risk management practices used to mitigate the counterparty credit risk.

Other assets consists primarily of cash and short-term investments related to the federal agency and GSE MBS portfolio. Other liabilities, which are primarily 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 include obligations that arise from the failure of a seller to deliver MBS 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 assets and 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	
	2014	2013	2014	2013
Other assets:				
MBS portfolio related cash and short term investments	$ 1	$ -	$ 28	$ 1
Other	-	-	1	1
Total other assets	$ 1	$ -	$ 29	$ 2
Other liabilities:				
Cash margin	$ 19	$ 38	$ 793	$ 1,320
Obligations from MBS transaction fails	1	1	30	11
Other	-	-	7	-
Total other liabilities	$ 20	$ 39	$ 830	$ 1,331

Accrued interest receivable on domestic securities holdings was $25,561 million and $23,405 million as of December 31, 2014 and 2013, respectively, of which $613 million and $678 million, respectively, was allocated to the Bank. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the years ended December 31, 2014 and 2013, is summarized as follows (in millions):

	Allocated to the Bank				
	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2012	$ 37,759	$ 22,049	$ 59,808	$ 2,627	$ 31,416
Purchases[1]	10,822	6,235	17,057	-	26,256
Sales[1]	-	-	-	-	-
Realized gains, net[2]	-	-	-	-	-
Principal payments and maturities	-	-	-	(586)	(8,303)
Amortization of premiums and accretion of discounts, net	(181)	(286)	(467)	(24)	(211)
Inflation adjustment on inflation-indexed securities	8	19	27	-	-
Annual reallocation adjustment[3]	(5,088)	(2,974)	(8,062)	(304)	(4,716)
Balance at December 31, 2013	$ 43,320	$ 25,043	$ 68,363	$ 1,713	$ 44,442
Purchases[1]	4,337	2,242	6,579	-	11,948
Sales[1]	-	-	-	-	(1)
Realized gains, net[2]	-	-	-	-	-
Principal payments and maturities	(13)	-	(13)	(494)	(5,070)
Amortization of premiums and accretion of discounts, net	(140)	(256)	(396)	(15)	(179)
Inflation adjustment on inflation-indexed securities	12	33	45	-	-
Annual reallocation adjustment[3]	(7,870)	(4,510)	(12,380)	(246)	(8,279)
Balance at December 31, 2014	$ 39,646	$ 22,552	$ 62,198	$ 958	$ 42,861
Year-ended December 31, 2013					
Supplemental information - par value of transactions:					
Purchases[4]	$ 10,744	$ 5,572	$ 16,316	$ -	$ 25,424
Sales	-	-	-	-	-
Year-ended December 31, 2014					
Supplemental information - par value of transactions:					
Purchases[4]	$ 4,400	$ 2,198	$ 6,598	$ -	$ 11,548
Sales	-	-	-	-	(1)

[1] Purchases and sales may include payments and receipts related to principal, premiums, discounts, and inflation compensation adjustments to the basis of inflation-indexed securities. The amount reported as sales includes the realized gains and losses on such transactions. Purchases and sales exclude MBS TBA transactions that are settled on a net basis.

[2] Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

[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 3i.

[4] Includes inflation compensation.

	Total SOMA				
	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2012	$1,142,219	$ 666,969	$ 1,809,188	$ 79,479	$ 950,321
Purchases[1]	358,656	206,208	564,864	-	864,537
Sales[1]	-	-	-	-	-
Realized gains, net[2]	-	-	-	-	-
Principal payments and maturities	(21)	-	(21)	(19,562)	(273,990)
Amortization of premiums and accretion of discounts, net	(6,024)	(9,503)	(15,527)	(795)	(7,008)
Inflation adjustment on inflation-indexed securities	285	645	930	-	-
Balance at December 31, 2013	$1,495,115	$ 864,319	$ 2,359,434	$ 59,122	$ 1,533,860
Purchases[1]	165,306	85,826	251,132	-	466,384
Sales[1]	-	-	-	-	(29)
Realized gains, net[2]	-	-	-	-	-
Principal payments and maturities	(475)	-	(475)	(18,544)	(203,933)
Amortization of premiums and accretion of discounts, net	(5,545)	(10,132)	(15,677)	(588)	(7,199)
Inflation adjustment on inflation-indexed securities	500	1,327	1,827	-	-
Balance at December 31, 2014	$1,654,901	$ 941,340	$ 2,596,241	$ 39,990	$ 1,789,083
Year-ended December 31, 2013					
Supplemental information - par value of transactions:					
Purchases[3]	$ 356,766	$ 184,956	$ 541,722	$ -	$ 837,490
Sales	-	-	-	-	-
Year-ended December 31, 2014					
Supplemental information - par value of transactions:					
Purchases[3]	$ 167,497	$ 83,739	$ 251,236	$ -	$ 450,633
Sales	-	-	-	-	(29)

[1] Purchases and sales may include payments and receipts related to principal, premiums, discounts, and inflation compensation adjustments to the basis of inflation-indexed securities. The amount reported as sales includes the realized gains and losses on such transactions. Purchases and sales exclude MBS TBA transactions that are settled on a net basis.

[2] Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

[3] Includes inflation compensation.

b. Foreign Currency Denominated Investments

The FRBNY conducts foreign currency operations and, on behalf of the Reserve Banks, holds the resulting foreign currency denominated investments in the SOMA.

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 backed by the full faith and credit of 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, which are backed by the full faith and credit of those issuing governments.

The Bank's allocated share of activity related to foreign currency operations was 7.519 percent and 7.735 percent at December 31, 2014 and 2013, respectively.

Information about foreign currency denominated investments valued at amortized cost and foreign currency market exchange rates at December 31 was as follows (in millions):

	Allocated to Bank		Total SOMA	
	2014	2013	2014	2013
Euro:				
Foreign currency deposits	$ 521	$ 582	$ 6,936	$ 7,530
Securities purchased under agreements to resell	-	197	-	2,549
German government debt instruments	187	185	2,494	2,396
French government debt instruments	277	186	3,687	2,397
Japanese yen:				
Foreign currency deposits	194	227	2,576	2,927
Japanese government debt instruments	392	458	5,207	5,925
Total	$ 1,571	$ 1,835	$ 20,900	$ 23,724

Accrued interest receivable on foreign currency denominated investments was $83 million and $88 million as of December 31, 2014 and 2013, respectively, of which $6 million and $7 million, respectively, was allocated to the Bank. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.

The remaining maturity distribution of foreign currency denominated investments that were allocated to the Bank at December 31, 2014 and 2013, 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
December 31, 2014:					
Euro	$ 273	$ 211	$ 124	$ 377	$ 985
Japanese yen	207	30	116	233	586
Total	$ 480	$ 241	$ 240	$ 610	$ 1,571
December 31, 2013:					
Euro	$ 544	$ 140	$ 167	$ 299	$ 1,150
Japanese yen	241	29	145	270	685
Total	$ 785	$ 169	$ 312	$ 569	$ 1,835

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2014.

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, 2014, there were $137 million of outstanding commitments to purchase foreign government debt instruments, of which $10 million was allocated to the Bank. These securities settled on January 5, 2015, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date. During 2014, there were purchases and maturities of foreign government debt instruments of $5,494 million and $3,337 million, respectively, of which $414 million and $252 million, respectively, were allocated to the Bank. There were no sales of foreign government debt instruments in 2014.

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 monitoring procedures.

At December 31, 2014 and 2013, there was no balance outstanding under the authorized warehousing facility.

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, 2014 and 2013.

Foreign currency working balances held and foreign exchange contracts executed by the Bank to facilitate its international payments and currency transactions it made on behalf of foreign central banks and U.S. official institution customers were not material as of December 31, 2014 and 2013.

c. Central Bank Liquidity Swaps

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 7.519 percent and 7.735 percent at December 31, 2014 and 2013, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2014 and 2013, was $1,528 million and $272 million, respectively, of which $115 million and $21 million, respectively, was allocated to the Bank**.**

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

	2014	2013		
	Within 15 days	Within 15 days days	16 days to 90 days	Total
Euro	$ -	$ 9	$ 12	$ 21
Japanese yen	115	-	-	-
Total	$ 115	$ 9	$ 12	$ 21

Foreign Currency Liquidity Swaps

At December 31, 2014 and 2013, there was no balance outstanding related to foreign currency liquidity swaps.

d. Fair Value of SOMA Assets and Liabilities

The fair value amounts below are presented solely for informational purposes. Although the fair value of SOMA 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. Because SOMA securities are recorded at amortized cost, cumulative unrealized gains (losses) are not recognized in the Statements of Condition and the changes in cumulative unrealized gains (losses) are not recognized in the Statements of Income and Comprehensive Income.

The fair value of the Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments in the SOMA's holdings is subject to market risk, arising from movements in market variables such as interest rates and credit risk. 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 fair value of foreign government debt instruments is also affected by currency risk. Based on evaluations performed as of December 31, 2014, there are no credit impairments of SOMA securities holdings.

The following table presents the amortized cost, fair value, and cumulative unrealized gains (losses) on the Treasury securities, GSE debt securities, and federal agency and GSE MBS held in the SOMA at December 31 (in millions):

Allocated to the Bank

	2014			2013		
	Amortized cost	Fair value	Cumulative unrealized gains	Amortized cost	Fair value	Cumulative unrealized gains (losses)
Treasury securities:						
Notes	$ 39,646	$ 40,328	$ 682	$ 43,320	$ 43,432	$ 112
Bonds	22,552	25,225	2,673	25,043	24,406	(637)
Total Treasury securities	$ 62,198	$ 65,553	$ 3,355	$ 68,363	$ 67,838	$ (525)
GSE debt securities	958	1,018	60	1,713	1,803	90
Federal agency and GSE MBS	42,861	43,615	754	44,442	43,333	(1,109)
Total domestic SOMA portfolio securities holdings	$ 106,017	$ 110,186	$ 4,169	$ 114,518	$ 112,974	$ (1,544)
Memorandum - Commitments for:						
Purchases of Treasury securities	$ -	$ -	$ -	$ -	$ -	$ -
Purchases of Federal agency and GSE MBS	687	690	3	1,720	1,713	(7)
Sales of Federal agency and GSE MBS	-	-	-	-	-	-

Total SOMA

	2014			2013		
	Amortized cost	Fair value	Cumulative unrealized gains	Amortized cost	Fair value	Cumulative unrealized gains (losses)
Treasury securities:						
Notes	$ 1,654,901	$ 1,683,377	$ 28,476	$ 1,495,115	$ 1,499,000	$ 3,885
Bonds	941,340	1,052,916	111,576	864,319	842,336	(21,983)
Total Treasury securities	$ 2,596,241	$ 2,736,293	$ 140,052	$ 2,359,434	$ 2,341,336	$ (18,098)
GSE debt securities	39,990	42,499	2,509	59,122	62,236	3,114
Federal agency and GSE MBS	1,789,083	1,820,544	31,461	1,533,860	1,495,572	(38,288)
Total domestic SOMA portfolio securities holdings	$ 4,425,314	$ 4,599,336	$ 174,022	$ 3,952,416	$ 3,899,144	$ (53,272)
Memorandum - Commitments for:						
Purchases of Treasury securities	$ -	$ -	$ -	$ -	$ -	$ -
Purchases of Federal agency and GSE MBS	28,692	28,803	111	59,350	59,129	(221)
Sales of Federal agency and GSE MBS	-	-	-	-	-	-

The fair value of Treasury securities and GSE debt securities was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of federal agency and GSE MBS was determined using a pricing service that utilizes a model-based approach that considers observable inputs for similar securities.

The cost basis of securities purchased under agreements to resell, securities sold under agreements to repurchase, and other investments held in the SOMA domestic portfolio approximate fair value.

At December 31, 2014 and 2013, the fair value of foreign currency denominated investments was $20,996 million and $23,802 million, respectively, of which $1,579 million and $1,841 million, respectively, was allocated to the Bank. The fair value of foreign government debt instruments was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of foreign currency deposits and securities purchased under agreements to resell was determined by reference to market interest rates.

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):

	2014		2013	
Distribution of MBS holdings by coupon rate	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
2.0%	$ 306	$ 302	$ 411	$ 392
2.5%	2,746	2,718	3,588	3,432
3.0%	12,297	12,129	15,119	14,032
3.5%	11,531	11,724	10,132	9,804
4.0%	10,255	10,570	6,672	6,696
4.5%	3,734	4,021	5,384	5,664
5.0%	1,570	1,694	2,413	2,549
5.5%	365	393	623	658
6.0%	51	55	88	93
6.5%	6	9	12	13
Total	$ 42,861	$ 43,615	$ 44,442	$ 43,333
Total SOMA:				
2.0%	$ 12,788	$ 12,618	$ 14,191	$ 13,529
2.5%	114,609	113,468	123,832	118,458
3.0%	513,289	506,280	521,809	484,275
3.5%	481,305	489,390	349,689	338,357
4.0%	428,047	441,204	230,256	231,113
4.5%	155,867	167,844	185,825	195,481
5.0%	65,544	70,719	83,290	87,968
5.5%	15,232	16,414	21,496	22,718
6.0%	2,110	2,287	3,052	3,225
6.5%	292	320	420	448
Total	$ 1,789,083	$ 1,820,544	$ 1,533,860	$ 1,495,572

The following tables present the realized gains (losses) and the change in the cumulative unrealized gains (losses) related to SOMA domestic securities holdings during the years ended December 31, 2014 and 2013 (in millions):

Allocated to Bank

	2014		2013	
	Realized gains[1]	Change in cumulative unrealized gains (losses)[2]	Realized gains[1]	Change in cumulative unrealized losses[2]
Treasury securities	$ -	$ 4,056	$ -	$ (5,286)
GSE debt securities	-	(15)	-	(71)
Federal agency and GSE MBS	2	1,796	1	(2,396)
Total	$ 2	$ 5,837	$ 1	$ (7,753)

Total SOMA

	2014		2013	
	Realized gains[1]	Change in cumulative unrealized gains (losses)[2]	Realized gains[1]	Change in cumulative unrealized losses[2]
Treasury securities	$ -	$ 158,150	$ -	$ (183,225)
GSE debt securities	-	(605)	-	(2,411)
Federal agency and GSE MBS	81	69,749	51	(81,957)
Total	$ 81	$ 227,294	$ 51	$ (267,593)

[1] Realized gains are reported in "Non-interest loss: System Open Market Account" in the Statements of Income and Comprehensive Income.

[2] Because SOMA securities are recorded at amoritized cost, the change in the cumulative unrealized gains (losses) is not reported in the Statements of Income and Comprehensive Income.

The amount of change in cumulative unrealized gains (losses) position, net, related to foreign currency denominated investments was a gain of $18 million and a loss of $90 million for the years ended December 31, 2014 and 2013, respectively, of which $1 million and $7 million, respectively, were allocated to the Bank.

Accounting Standards Codification (ASC) Topic 820 (ASC 820) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level fair value hierarchy that distinguishes between assumptions developed using market data obtained from independent sources (observable inputs) and the Bank's assumptions developed using the best information available in the circumstances (unobservable inputs). The three levels established by ASC 820 are described as follows:

- Level 1 – Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is based on model-based techniques that use significant inputs and assumptions not observable in the market. These unobservable inputs and assumptions reflect the Bank's estimates of inputs and assumptions that market participants would use in pricing the assets and liabilities. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments are classified as Level 2 within the ASC 820 hierarchy because the fair values are based on indicative quotes and other observable inputs obtained from independent pricing services. The fair value hierarchy level of SOMA financial assets is not necessarily an indication of the risk associated with those assets.

6. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2014	2013
Bank premises and equipment:		
Land and land improvements	$ 8	$ 8
Buildings	119	113
Building machinery and equipment	28	25
Construction in progress	1	1
Furniture and equipment	50	53
Subtotal	206	200
Accumulated depreciation	(116)	(113)
Bank premises and equipment, net	$ 90	$ 87
Depreciation expense, for the years ended December 31	$ 9	$ 10

The Bank leases space to outside tenants with remaining lease terms ranging from 3 to 10 years. Rental income from such leases was $2 million for each of the years ended December 31, 2014 and 2013, and is reported as a component of "Non-interest loss: Other" in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2014, are as follows (in millions):

2015	$	2
2016		2
2017		2
2018		2
2019		3
Thereafter		4
Total	$	15

The Bank had capitalized software assets, net of amortization, of $7 million and $6 million at December 31, 2014 and 2013, respectively. Amortization expense was $2 million for each of the years ended December 31, 2014 and 2013. 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.

7. COMMITMENTS AND CONTINGENCIES

In 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, 2014, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 5 years. These leases provide for increased lease payments based upon increases in real estate taxes, operating costs, or selected price indexes.

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, 2014 and 2013. Certain of the Bank's leases have options to renew. The Bank has no capital leases.

Future minimum lease payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2014, are as follows (in thousands):

	Operating leases	
2015	$	457
2016		468
2017		480
2018		492
2019		41
Future minimum lease payments	$	1,938

At December 31, 2014, 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 one percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2014 and 2013.

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.

8. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System 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. 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 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 years ended December 31, 2014 and 2013, certain costs associated with the System Plan were reimbursed by the Bureau.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2014 and 2013, 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 six percent of employee contributions from the date of hire and provides an automatic employer contribution of one percent of eligible pay. The Bank's Thrift Plan contributions totaled $5 million for each of the years ended December 31, 2014 and 2013 and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

9. 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 and life insurance benefits 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):

	2014	2013
Accumulated postretirement benefit obligation at January 1	$ 91.3	$ 103.6
Service cost benefits earned during the period	3.0	3.3
Interest cost on accumulated benefit obligation	4.5	3.9
Net actuarial loss (gain)	13.0	(16.3)
Curtailment loss	(0.9)	-
Contributions by plan participants	1.9	1.9
Benefits paid	(6.6)	(5.9)
Medicare Part D subsidies	0.4	0.4
Plan amendments	-	0.4
Accumulated postretirement benefit obligation at December 31	$ 106.6	$ 91.3

At December 31, 2014 and 2013, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 3.96 percent and 4.79 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. The System Plan discount rate assumption setting convention uses an unrounded rate.

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

	2014	2013
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	4.3	3.6
Contributions by plan participants	1.9	1.9
Benefits paid	(6.6)	(5.9)
Medicare Part D subsidies	0.4	0.4
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$ 106.6	$ 91.3
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (0.5)	$ (1.2)
Net actuarial loss	(24.7)	(13.2)
Total accumulated other comprehensive loss	$ (25.2)	$ (14.4)

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

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

	2014	2013
Health-care cost trend rate assumed for next year	6.60 %	7.00 %
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.75 %	5.00 %
Year that the rate reaches the ultimate trend rate	2019	2019

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A one percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2014 (in millions):

	One percentage point increase	One percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 0.2	$ (0.8)
Effect on accumulated postretirement benefit obligation	2.1	(9.6)

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

	2014	2013
Service cost-benefits earned during the period	$ 3.0	$ 3.3
Interest cost on accumulated benefit obligation	4.5	3.9
Amortization of prior service cost	0.6	0.4
Amortization of net actuarial loss	0.7	2.9
Total periodic expense	8.8	10.5
Curtailment	0.1	-
Net periodic postretirement benefit expense	$ 8.9	$ 10.5

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2015 are shown below:

Prior service cost	$ 0.1
Net actuarial loss	2.0
Total	$ 2.1

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2014 and 2013, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 4.79 percent and 3.75 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. A curtailment loss associated with restructuring programs that are described in Note 11 was recognized in net income in the year ended December 31, 2014.

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 $408 thousand and $331 thousand in the years ended December 31, 2014 and 2013, respectively. Expected receipts in 2015, related to benefits paid in the years ended December 31, 2014 and 2013, are $195 thousand.

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

	Without subsidy	With subsidy
2015	$ 5.1	$ 4.8
2016	5.4	5.0
2017	5.7	5.2
2018	5.9	5.4
2019	6.2	5.6
2020 - 2024	33.3	30.1
Total	$ 61.6	$ 56.1

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 providing disability; medical, dental, and vision insurance; and survivor income benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2014 and 2013, were $6.7 million and $7.2 million, respectively. This cost is included as a component of “Accrued benefit costs” in the Statements of Condition. Net periodic postemployment benefit expense (credit) included in 2014 and 2013 operating expenses were $0.3 million and $1.6 million, respectively, and are recorded as a component of “Operating expenses: Salaries and benefits” in the Statements of Income and Comprehensive Income.

10. Accumulated Other Comprehensive Income And Other Comprehensive Income

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive income (loss) as of December 31 (in millions):

	2014	2013
	Amount related to postretirement benefits other than retirement plans	Amount related to postretirement benefits other than retirement plans
Balance at January 1	$ (14.4)	$ (33.5)
Change in funded status of benefit plans:		
Prior service costs arising during the year	0.1 [1]	(0.4)
Amortization of prior service cost	0.6 [2]	0.4 [2]
Change in prior service costs related to benefit plans	0.7	-
Net actuarial (loss) gain arising during the year	(12.2) [3]	16.2
Amortization of net actuarial loss	0.7 [2]	2.9 [2]
Change in actuarial (losses) gains related to benefit plans	(11.5)	19.1
Change in funded status of benefit plans - other comprehensive (loss) income	(10.8)	19.1
Balance at December 31	$ (25.2)	$ (14.4)

[1] Net curtailment loss due to acceleration of prior service cost related to business restructuring. See Note 11 for further information.

[2] Reclassification is reported as a component of "Operating Expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

[3] Includes an actuarial gain on curtailment of $0.8 million related to business restructuring. See Note 11 for further information.

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

11. Business Restructuring Charges

In 2014, the Treasury announced a plan to consolidate the number of Reserve Banks providing fiscal agent services to the Treasury from ten to four. As a result of this initiative, the Government Entity Accounting and Reporting System and Treasury Collateral Management and Monitoring operations performed by the Bank will be transitioned to the Federal Reserve Bank of St. Louis in 2015. Additionally, the Post Payment System and Treasury Software Quality Assurance operations performed by the Bank will transition in phases to the Federal Reserve Bank of Kansas City over the next several years. The Bank had no material business restructuring charges in 2013.

In years prior to 2013, 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 paper and electronic check processing at the FRBA.

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

	2014 restructuring plans
Information related to restructuring plans as of December 31, 2014:	
Total expected costs related to restructuring activity	$ 2.9
Expected completion date	June 2014
Reconciliation of liability balances:	
Balance at December 31, 2013	$ -
Employee separation costs	2.1
Adjustments	0.8
Balance at December 31, 2014	$ 2.9

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.

Costs associated with enhanced postretirement benefits are disclosed in Note 9.

12. DISTRIBUTION OF COMPREHENSIVE INCOME

In accordance with Board policy, Reserve Banks remit excess earnings, after providing for dividends and the amount necessary to equate surplus with capital paid-in, to the U.S. Treasury as earnings remittances to the Treasury. The following table presents the distribution of the Bank's comprehensive income in accordance with the Board's policy for the years ended December 31 (in millions):

	2014	2013
Dividends on capital stock	$ 118	$ 127
Transfer from surplus - amount required to equate surplus with capital paid-in	(471)	(48)
Earnings remittances to the Treasury	2,625	2,189
Total distribution	$ 2,272	$ 2,268

During the year ended December 31, 2014, the Bank recorded a reduction in the amount of capital paid-in and a corresponding reduction of surplus, which is presented in the above table as "Transfer from surplus – amount required to equate surplus with capital paid-in." The reduction of surplus resulted in an equivalent increase in "Earnings remittances to the Treasury" and a reduction in "Comprehensive income" for the year ended December 31, 2014.

13. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2014. Subsequent events were evaluated through March 11, 2015, which is the date that the financial statements were available to be issued.

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