

THE FEDERAL RESERVE BANK OF RICHMOND
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Unsustainable Fiscal Policy
Implications for Monetary Policy



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MESSAGE FROM THE PRESIDENT



Jeffrey M. Lacker
President

The past five years have presented the Federal Reserve with a series of difficult challenges. The financial market strains that emerged in the summer of 2007 were at first difficult to diagnose, and even harder to know how to treat as the crisis unfolded.

The recession that began at the end of 2007 required stimulative interest rate cuts, which the Federal Open Market Committee (FOMC) initiated in January 2008, but the subsequent surge in inflation made it difficult to calibrate that stimulus. Beginning in March of that year, distress at a series of financial institutions elicited unanticipated emergency lending, which exacerbated future moral hazard problems. After interest rates were effectively reduced to zero in late 2008, the FOMC provided further monetary stimulus through large expansions of the money supply.

Meanwhile, the federal government's budget outlook has deteriorated markedly over the past five years. The deficit has grown dramatically in the wake of a recession-induced decline in federal revenues and increased expenditures to help combat that downturn. The result has been a significant increase in federal debt. These recent developments have only made more acute what is projected to be a severe long-term problem. The nonpartisan Congressional Budget Office (CBO) issues two long-term federal budget projections. A "baseline" scenario assumes that current laws will remain constant, tax cuts that are set to expire will not be extended, and spending will be held in check as promised. In that scenario, federal debt held by the public would rise slowly over time, increasing from nearly 68 percent as a share of gross domestic product to 84 percent of GDP by 2035 and then remaining relatively constant. That debt level is large, by historical standards, but probably manageable. In the CBO's "alternative" scenario—which it deems more likely to occur—tax revenues relative to GDP would remain close to their historical levels, and spending would increase sharply in both entitlement and discretionary programs. In this scenario, federal debt held by the public would exceed its historical peak of 109 percent of GDP by 2023 and surpass 200 percent of GDP by the late 2030s.

Those projections are alarming, and if they come to pass, they could pose significant challenges for monetary policy, as Renee Haltom and John Weinberg explain in the following essay. If the federal debt were to rise to such levels, it is conceivable that our country could hit what economists call the "fiscal limit," where it would no longer be possible to raise enough money to resolve the fiscal imbalance. The result would be a very unsatisfying choice: federal debt could be reduced through default, or the real level of the debt could be reduced through inflationary actions by the central bank.

Over many years, the Federal Reserve has worked hard to establish and maintain the credibility of our commitment to low and stable inflation. The FOMC recently clarified that commitment by stating that it views an inflation rate of 2 percent as most consistent with price stability over the longer run. Although containing inflation has widespread public support, one must acknowledge that the federal government might be tempted to seek the assistance of the central bank in addressing fiscal problems, especially if those problems become acute. Indeed, there have been calls in some quarters for the Fed to deliberately engineer higher inflation to reduce the real debt burden on private borrowers. It's only a short step from that position to advocating inflation to reduce the real burden of the federal debt or to minimize the interest expense on federal obligations. During World War II, the Fed cooperated with the U.S. Treasury Department to cap interest rates on government debt to limit financing costs, but a massive and intrusive program of federal price controls was required to contain the resulting inflationary pressures. Our country's experience with price controls in the 1970s also was disastrous, so they are not a realistic option.

The current independence that the Federal Reserve enjoys to conduct monetary policy—while remaining accountable to Congress and the public—has helped it stay focused on maintaining price stability. But pressures could emerge that would threaten that independence if the federal government were on the brink of default.

Even more disturbing, inflation still could break loose before the fiscal limit is reached. Research suggests that simply approaching the fiscal limit could be enough to convince markets that the central bank eventually will act to alleviate fiscal pressures. Such expectations could raise inflation without any change in central bank policy.

Apparently, market participants believe that the CBO's "baseline" scenario is, in fact, fairly realistic—that is, the legislative and executive branches will agree on the difficult measures necessary to prevent federal debt from reaching

unsustainable levels. After all, the public remains willing to purchase government debt in the form of U.S. Treasury securities at very low interest rates, and inflation expectations remain subdued.

That is a bright sign in what could be a very dreary fiscal picture. But policymakers must not be complacent. Those in charge of fiscal policy must not exploit the public's continued trust to delay difficult compromises. And monetary policymakers must be mindful that a central bank's credibility, once lost, can be recovered only at a steep price.



Jeffrey M. Lacker
President



Unsustainable Fiscal Policy

Implications for Monetary Policy

Renee Haltom and John A. Weinberg

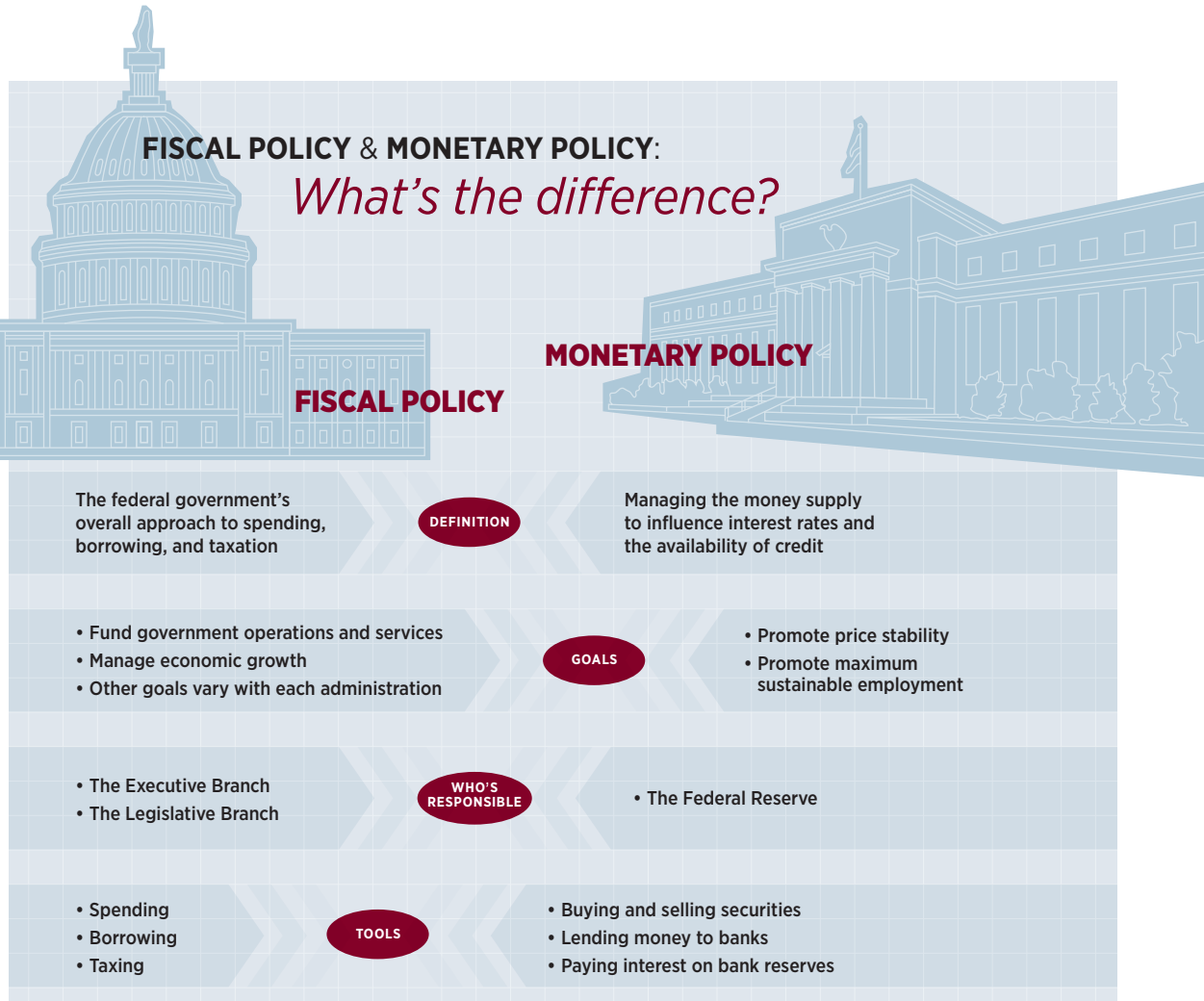
The debt of the United States government that is held by the public reached its highest point since World War II in 2011, at 67.7 percent of gross domestic product (GDP).¹ Annual deficits surpassed 10 percent of GDP in 2009, the highest level since 1945, dipping to 8.7 percent of GDP in 2011. The early-to-mid 1980s was the only other point in the postwar period in which deficits exceeded 5 percent of GDP.

Recent numbers are high by historical comparison, but more important than the current size of the deficit and debt is the path they are likely to follow in the future. Federal debt held by the public was actually higher after World War II than it is today—109 percent of GDP in 1946, the highest level on record—but a key difference was that large deficits then were almost entirely associated with the temporary war effort. The same cannot be said today; several factors point to large demands on fiscal resources for most of the foreseeable future. Most prevalent is the aging population. The first baby boomers reached retirement age in 2011, and the fraction of the population aged 65 or older will surpass 20 percent by 2035, compared to 13 percent today. For the past 30 years, there have been roughly five working people in the United States for every person of retirement age; that number will drop to 2.8 after 2035. This “dependency ratio” is a rough approximation of the number of working individuals in the economy that support, through taxes and Social Security contributions, the people drawing age-related benefits from the government. The aging

population will impose significant demands on federal resources through Social Security, Medicare, and Medicaid. These programs are written into law, which means their spending is not determined annually by the federal budgets created by the U.S. president and Congress, but instead can only be reduced through major overhauls to law.²

The nonpartisan Congressional Budget Office (CBO) projects the federal government’s long-term budget outlook under two scenarios: a “baseline” scenario that holds current laws constant and an “alternative” scenario that incorporates the effects of laws the CBO deems likely to pass. (The budget outlooks under both scenarios are displayed in Figure 1.) The baseline scenario reflecting current laws presents the more optimistic view of the future path of fiscal policy. Tax revenues are projected to reach much higher levels than in recent history, while each category of spending except that on Social Security, health care entitlements, and interest payments on debt is projected to fall to its lowest level since World War II. Still, the

FISCAL POLICY & MONETARY POLICY: *What's the difference?*



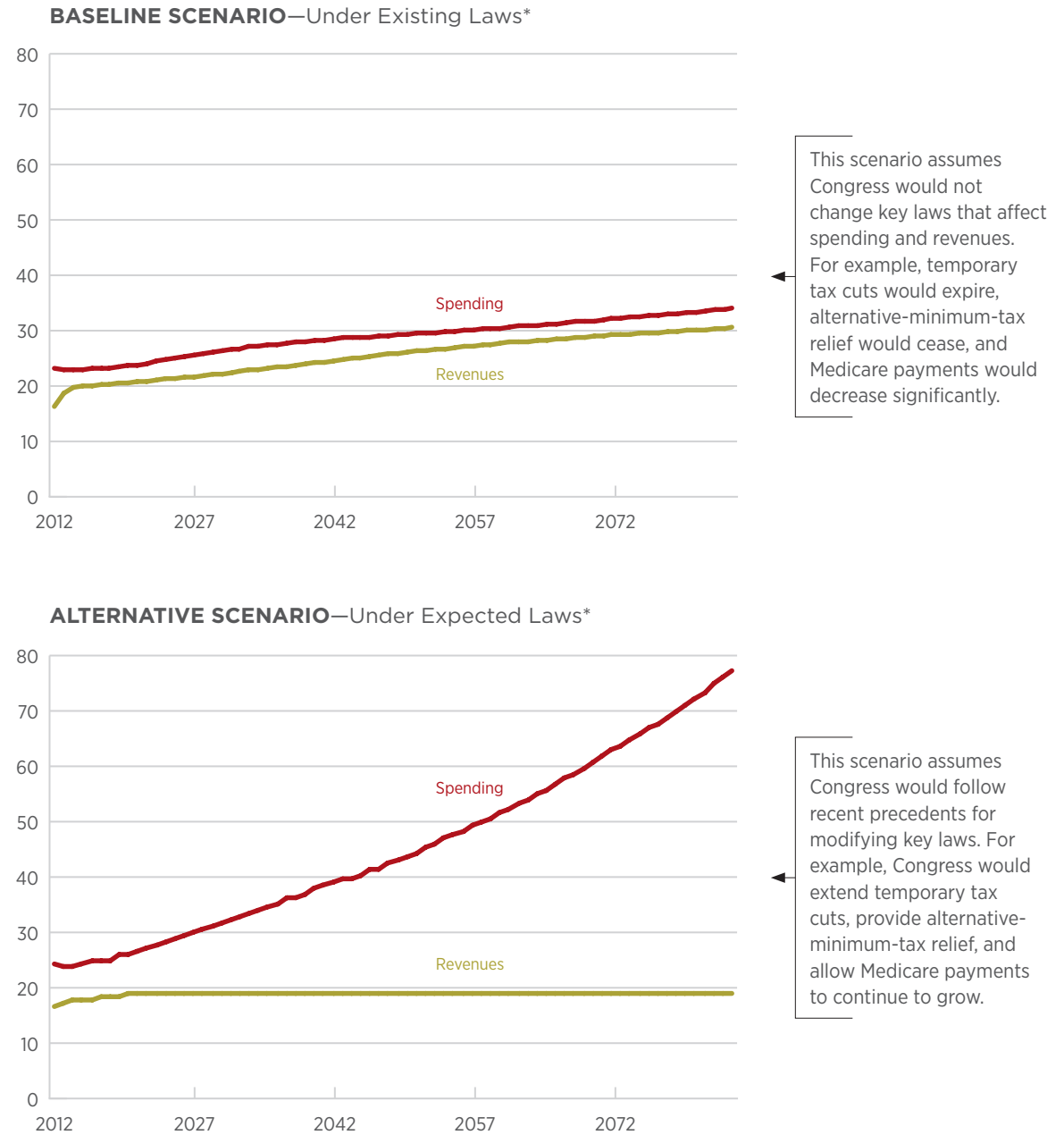
increase in revenues and decline in other spending would be slightly more than offset by increased spending on Social Security, Medicaid, and Medicare as the population ages. Therefore, deficits would remain positive, causing debt levels to grow slowly over time. Under the baseline scenario, debt held by the public would rise to 84 percent of GDP by 2035, staying in that ballpark for the remaining decades of the forecast. (See Figure 2.)

The alternative scenario—the one the CBO considers more likely—presents a more alarming picture of the growth in federal debt. In that scenario, revenues do not rise much from where they are today, yet spending grows rapidly. This is because of law changes the

CBO deems likely to take place, including an extension of the tax cuts that were enacted since 2001 and extended in 2010. The CBO also assumes that tax laws will be changed to keep tax revenues close to their long-run average of 18.4 percent of GDP, rather than rising to historically large levels as they do in the baseline scenario. In addition, Medicare payments are not assumed to decrease as current law dictates, health care spending under the major reform bill passed in 2010 is not assumed to decrease after 2021 as current law prescribes, and spending on non-entitlement programs is not assumed to fall as rapidly as in the baseline scenario. Under these conditions, federal debt held by the public would rise sharply after 2011, exceeding its historical record of 109 percent of GDP as early as 2023. It would

Figure 1: Projected Budget Gaps (As a Percent of GDP)

The Congressional Budget Office produces two long-term budget projections: the “baseline” scenario, based on current laws, and the “alternative” scenario, based on laws expected to pass.

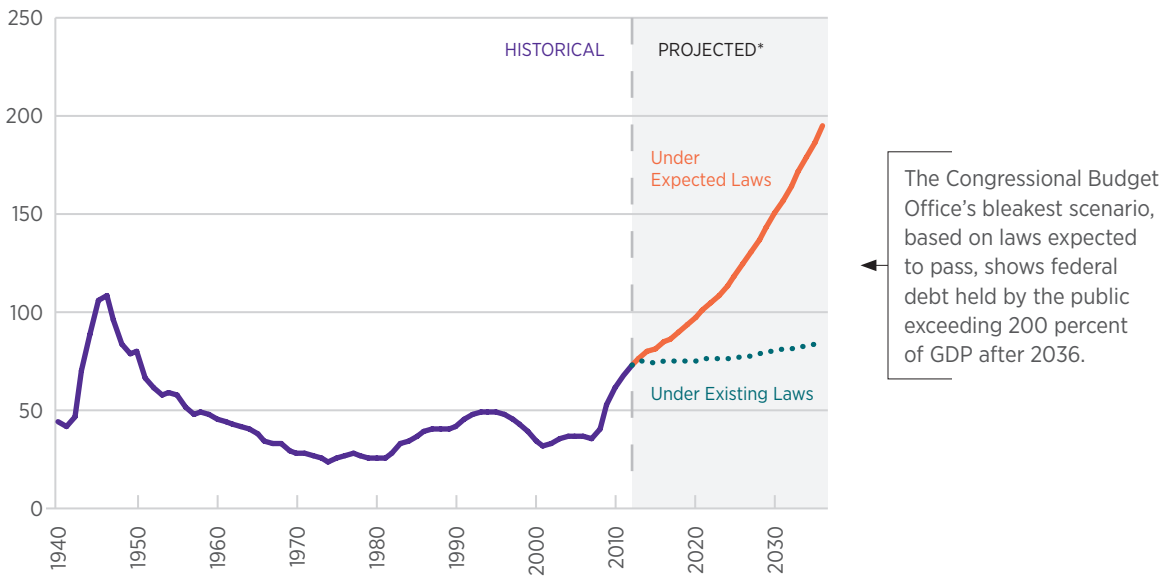


Source: Congressional Budget Office's 2011 Long-Term Budget Outlook

* Projections begin with the 2012 budget.

Figure 2: Federal Debt Held by the Public (As a Percent of GDP)

Federal debt held by the public consists primarily of U.S. Treasury securities, including those held by the Federal Reserve. It does not include debt held in federal government accounts or securities issued by Fannie Mae or Freddie Mac.



Source: Congressional Budget Office's 2011 Long-Term Budget Outlook

*Projections begin with the 2012 debt level.

surpass 200 percent of GDP—far more than double today's share of GDP—by the late 2030s.

The two scenarios represent optimistic and pessimistic alternatives from a range of possible outcomes. The exercise shows that the evolution of the federal government's fiscal position depends largely on policy decisions that have yet to be made. Given the demands on fiscal resources coming from the aging population under existing laws, achieving a path toward fiscal balance will involve very difficult tradeoffs for fiscal policymakers.

Unsustainable Fiscal Policy

Economists use the word “unsustainable” to describe debt levels projected by the CBO's alternative scenario, a characterization reflecting the likelihood that

financial markets would force a painful adjustment in fiscal policy before such debt levels could be reached. That notion is based on a simple framework called the government's intertemporal budget constraint. “Intertemporal” simply means “over time,” while a budget constraint is a basic accounting identity that says an entity must pay for everything that it purchases. The government's intertemporal budget constraint says that the value of the government's outstanding debt must equal the present value of its expected future surpluses—that is, what financial markets believe surpluses will be, calculated in today's dollars.

The intertemporal budget constraint suggests that any time the real debt increases by even a small amount—a budget deficit is run in a single year—the expectation of future taxes or spending must adjust to put the



The cost of Medicare, Social Security, and other entitlement programs will rise dramatically as increasing numbers of baby boomers reach retirement age.

equation in balance. However, the equation says only that surpluses must eventually rise; it provides no guidance on when that must occur. Historical experience doesn't provide a great deal more insight. For example, the U.S. government ran moderate deficits, averaging roughly 3 percent of GDP every year, from 1970 to 1997, with no obvious concern from financial market participants about the sources of future surpluses. That experience would imply that governments can sustain moderate deficits seemingly indefinitely.

That is less likely to be true when the imbalance between outstanding debt and future surpluses is very large. The larger the debt grows, the larger future

surpluses—revenues in excess of spending—must be to satisfy the equation. However, there are limits to future surpluses. Spending cannot drop to zero; to the contrary, spending is expected to rise to historically high levels as a percent of GDP even under the CBO's most optimistic scenario, and tax revenues have an upper limit. As tax rates grow higher, they distort incentives to work and produce, and at very high rates would shrink the revenue collected by the government. There are likely to be political limits to tax revenues even before that point is reached, a reality reflected in the CBO's alternative scenario assumption that tax revenues will revert to their historical average of 18.4 percent of GDP within a decade. With debt

levels predicted to grow much larger than GDP within two decades, it is clear that many years of higher taxes would be required to produce enough surpluses to resolve the resulting imbalance. There is some level of debt that is high enough—although how high is difficult to predict—that generating the amount of future surpluses required would simply be infeasible.

That point is what economists have called the “fiscal limit.” At the fiscal limit, the government cannot borrow further, and the government’s existing spending promises therefore cannot be funded. At least one of two events must occur at the fiscal limit: the government would reduce its debt levels by defaulting, or real debt levels would be reduced through actions taken by the central bank.

There are two main ways in which central banks can improve governments’ fiscal positions. The first is through “seigniorage,” the revenue that governments effectively receive when central banks create money. In the United States, it comes from the interest the Fed earns on the Treasury securities it purchases to expand the money supply. The Fed retains only the interest revenue that it requires to fund operations, and turns the rest over to the Treasury each fiscal year.³ The level of seigniorage remitted annually does not significantly affect debt: it amounts to slightly more than 1 percent of revenues in most years.⁴ The governments of most developed nations do not regularly rely on seigniorage as a funding strategy because overreliance on seigniorage—that is, on money creation—will inevitably lead to rising inflation. Perhaps the most famous example of printing money to fund government operations is Germany in the early 1920s, when the price level doubled every two days. This action is sometimes called “monetizing” government debt: if the market grows unwilling to purchase government debt at low rates, the central bank can step in to purchase that debt directly from the government. Stanley Fischer, Ratna Sahay, and Carlos Vegh (2002) estimate how much government revenue can be created through seigniorage from a sample of 24 countries in the post-World War II period. Those nations created enough money to push annual inflation above 100 percent. During

those episodes, seigniorage amounted to just 4 percent of GDP on average—not enough to cover their average deficits of just below 5 percent of GDP. By comparison, deficits under the CBO’s alternative scenario are projected to grow from a low of 5.6 percent of GDP in 2014 to more than 57 percent of GDP by 2085.

Aside from seigniorage, a central bank can reduce the government’s debt burden by creating inflation that was not anticipated by financial markets. Inflation allows all borrowers, the government included, to repay loans issued in nominal terms with cheaper dollars than the ones they borrowed. In the United States, inflation tends to be low and predictable from year to year. Inflation that is higher than expected, and therefore not priced into the contract interest rate, tends to produce only a small transfer of wealth from lenders to borrowers. (Indeed, this is one strong rationale behind the Fed’s price stability objective for monetary policy.) However, roughly 90 percent of the federal government’s debt is issued in nominal terms at prices that reflect the market’s expectations for inflation over the life of the loan. A significant deviation from those expectations would produce a larger transfer of wealth from lenders to borrowers. Historically, some central banks—though never the Federal Reserve—have even produced inflation for the sole purpose of eroding the value of the government’s debt.

Today, the central banks of most developed nations operate independently of fiscal policy considerations, and none that the authors are aware of produce inflation for the explicit purpose of reducing government debt levels. Between low, stable inflation and minimal seigniorage revenue, the Federal Reserve’s policies generally have little direct impact on the government’s debt burden. (See Box 1 for an overview of other ways in which fiscal and monetary policies interact.) This could change, however, if financial markets began to view hitting the fiscal limit as a possibility. That situation would inevitably invite monetary policymakers to intervene since inflation presents one possible source of revenue. (See sidebar on page 12 for a discussion of ways in which this pressure could arise in a crisis.)

BOX 1

The Interaction Between Fiscal Policy and Monetary Policy

Several of the everyday interactions between fiscal policy and monetary policy do not have a large effect on their respective goals to support a strong economy.

The most direct interaction in the United States is that monetary policy is conducted in the secondary market for U.S. Treasury securities. The Fed buys treasuries to put money into the banking system when it wants to accommodate economic growth, and sells them to remove money and suppress inflation. The Fed does not exchange securities directly with the U.S. Treasury, but instead conducts transactions with private financial market participants, which avoids conflicts of interest that could otherwise arise from this relationship. The Fed also affects the government's borrowing costs when it raises interest rates in times of strong economic growth. Today the Fed's independence avoids pressure to make borrowing cheaper for the government, but this was not always the case. (See sidebar on page 12.)

More fundamentally, both fiscal policy and monetary policy affect the broader economy through the spending

and investment decisions of households and businesses—though neither has a perfect ability to manage the economy in this way—and as a result their policies can affect each other's goals. (This, too, has led to political pressures throughout the Fed's history, as discussed in the sidebar.) So the Fed must consider the effects of current fiscal policy when it sets monetary policy to pursue its goals of price stability and healthy employment. For example, the Fed must consider how fiscal actions are likely to affect private demand based on how and when people expect those actions to be paid for by increased taxes or future expenditure reductions. Another possible effect of debt-financed fiscal stimulus—and another way in which fiscal and monetary policy interact—is that it could put upward pressure on interest rates in the economy as government borrowing rises.

Finally, as the main essay discusses, fiscal policy can have costly implications for monetary policy in times of fiscal crisis.

In fact, economic research suggests that high debt levels ultimately could overwhelm a central bank's efforts to keep prices stable. The remainder of this essay will argue that these outcomes should be avoided in the United States by putting fiscal policy on a sustainable path.

Sources of Fiscal Inflation

Even without direct political pressures on the central bank to create inflation, unsustainable fiscal policy may be able to force that outcome. Inflation is commonly argued to be “always and everywhere a monetary phenomenon,” a statement reflecting the monetarist notion that in the long run, inflation can be created only by the central bank's actions to increase the money supply. However, economists Thomas Sargent and

Neil Wallace (1981) show that the central bank may not have control over inflation in times of fiscal crisis. This stems from the idea that the public has a limited demand, based on its private portfolio preferences, to hold government debt as a percent of GDP. Sargent and Wallace model a scenario in which the government has reached that limit on debt, yet continues to run budget deficits. If the government is to avoid default, the central bank has no choice but to produce inflation to reduce debt levels and satisfy the intertemporal budget constraint. In this scenario, monetary policymakers uncharacteristically focus on stabilizing debt, while inflation is determined by deficit policy.⁵

Does this scenario resemble the way monetary and fiscal policies are conducted in the United States? In the Sargent and Wallace framework, fiscal authorities

“move first” by choosing levels of debt and surpluses, leaving monetary policymakers to make up for any imbalance. However, the central bank may be able to constrain the actions of fiscal authorities by making the first move; that is, by firmly establishing the expectation among both fiscal authorities and market participants that it will not step in to reduce debt levels with inflation.⁶ One could argue that this is the way monetary policy is conducted in the United States, such that the inflationary outcome that Sargent and Wallace describe need not be a concern. Since the early 1980s, American monetary policy has tended to adjust interest rates fairly predictably in response to the performance of inflation and unemployment.

As a result of this consistent stance in opposition to inflation, financial markets view the Fed’s inflation objectives as highly credible, as evidenced by anchored inflation expectations. The same is true for the central banks of many other developed nations. Some central banks even face legally binding price stability mandates, such as the Bank of England, which must explain its failures to the Chancellor of the Exchequer, as well as the actions that are being taken to correct them. The credibility that these central banks have earned is bolstered by the operational independence most of them have been granted by their governments, which insulates monetary policy from pressure to set aside price stability to temporarily boost the economy.

Could the Fed’s Monetary Policy Independence Withstand a Fiscal Crisis?

SIDEBAR

On March 4, 1951, the Federal Reserve and the Treasury Department publicly agreed that the Fed would end its nine-year program in support of fiscal policy. Soon after the United States entered World War II, the Fed had committed to regularly purchasing enough Treasury debt to keep the government’s financing costs low. The agreement to end that program became known as the Fed-Treasury accord, and it marked the end of an era of strong Treasury influence over monetary policy decisions, helping to usher in a new era of Fed independence. The accord asserted the Fed’s authority to independently determine the size of the money supply to reach its congressionally established goals, which today include stable prices and healthy employment. This separation of authority has been essential to keeping the Fed accountable while shielding monetary policy from short-term political influence.

The 1951 accord has not completely insulated the Fed from political intervention, however. Pressures on the Fed often have been motivated by a short-term interest in economic stimulus, but the Fed also has experienced pressures to place greater weight on price stability, including recently. Since the 1980s, despite occasional pressures, appreciation has grown both inside and outside of central banks for monetary policy independence as the best way to achieve both objectives.

The main essay points to research suggesting that fiscal imbalances can lead to inflation. This could occur most directly through explicit pressure from elected leaders to create inflation, but it also could stem from the central bank’s desire to soothe an economy suffering from fiscal crisis.

It is useful to consider the conditions that likely would arise in fiscal crisis. The federal government would face two extreme choices: defaulting on its debt or enacting some combination of painful spending cuts and tax increases. The prospect of the first option would wreak havoc in financial markets as investors become concerned about the growing risk associated with U.S. Treasury securities. This effect has been demonstrated by the unfolding sovereign debt crisis in Europe. In early 2010, markets began to demand higher yields to hold debt issued by European governments that sustained large projected debt levels. The debt of some nations was downgraded by credit rating agencies, damaging the financial position of the many European banks that hold large amounts of sovereign debt because the banks were then forced to raise more capital. A similar effect would arise in a U.S. fiscal crisis since Treasury securities are widely held by financial institutions and play an important role in many private market transactions as well. The European Central Bank responded by purchasing sovereign debt and also accepting that debt as collateral

In practice, however, a central bank's credibility cannot constrain fiscal policy in any meaningful sense: it cannot stop fiscal policymakers from running budget deficits that continually expand the debt. As a result, whether high debt levels would lead to inflation depends critically on whether the public believes fiscal authorities will balance the intertemporal budget constraint, or instead leave fiscal imbalances to be addressed by inflation. Unfortunately, neither theory nor experience provides a good rule of thumb for when those expectations might begin to change, potentially unleashing a fiscal crisis, though it is reasonable to expect that such a shift becomes more likely as projected debt levels grow ever larger. For example, Eric Leeper (2010) imagines

a scenario in which the federal government is almost at its fiscal limit, but fiscal authorities still have some ability to adjust fiscal policy to stabilize debt levels. Being near the fiscal limit is enough to enable an equilibrium in which markets expect the central bank to accommodate the debt with inflation in the future. The public's expectation of higher inflation can push actual inflation higher before the central bank decides to create a single dollar.⁷

To emphasize the power of expectations in creating inflation, it is worth noting that a change in expectations also could bring an inflationary episode to a quick end. Sargent (1981) looked at the hyperinfla-

in loan agreements to banks. (The ECB's purchases were "sterilized," meaning that an equal amount in liquidity was removed from the financial system so that the purchases would not add to the overall money supply.)

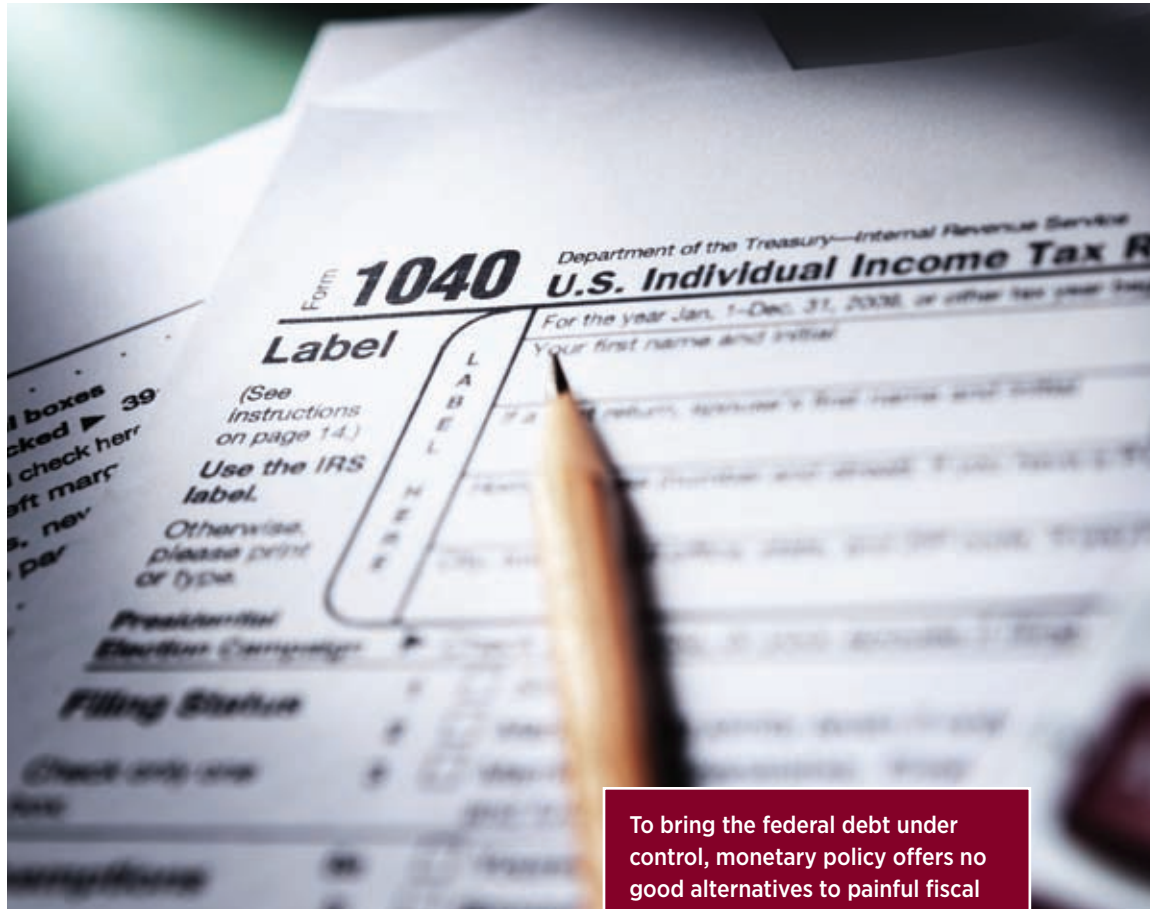
The second option facing governments, a combination of sudden tax increases and broad cuts to services, could cause economic weakness in the short run. Independent of the possible short-run effects of fiscal "austerity," rational households and businesses are likely to hold back spending in anticipation of fiscal retrenchments even before such decisions are announced, particularly if there is uncertainty over the specific forms those adjustments would take. Without knowing whether payroll taxes will be higher in five years, a planned government investment project will come to fruition, or employer health care costs will change abruptly, firms may delay a broad spectrum of spending, hiring, and investment decisions until those various sources of uncertainty have been resolved. In Europe, too, the uncertain resolution of fiscal imbalances has dampened spending and economic activity. Though monetary policy cannot resolve this type of uncertainty, it is clear that both default and extreme fiscal retrenchment may threaten the central bank's economic objectives.

That is why the dynamics of fiscal crisis can create difficult short-term tradeoffs for the central bank: the economic pain

associated with fiscal crisis versus the longer-term costs of central bank intervention to reduce debt levels—including the risk of inflation, damaged central bank credibility, and a precedent for rescuing the government from its debt. At the same time, even the most conservative central banker might feel compelled to intervene in hopes of limiting a panic before it could grow more severe, despite the known costs of doing so. (A related discussion is presented by Jeffrey Lacker, 2011.)

Averting fiscal crisis entails making people believe that difficult fiscal policy choices will be made before they are forced by financial markets. Thus, creating that expectation may require fiscal constraint before it seems strictly necessary. Yet because of the difficult and unpopular tradeoffs required to achieve fiscal balance, it may be tempting for elected officials to delay action in hopes that monetary policy will relieve imbalances.

Experience since the 1951 accord and the prospects for how a fiscal crisis could unfold make clear the conditional nature of monetary policy independence. Extreme conditions could stress both the consensus in support of independence and the central bank's ability to act independently. While formal agreements like the accord can make overt political intervention in monetary policy more difficult, such "rules" cannot ensure that the central bank would escape difficult choices in times of crisis.



To bring the federal debt under control, monetary policy offers no good alternatives to painful fiscal policy decisions regarding taxation and spending.

tions experienced by Austria, Hungary, Germany, and Poland after World War I. Each country financed massive government deficits and war reparations through sales of government debt to the central bank, resulting in hyperinflation. In each case, hyperinflation was brought to a sudden end through drastic regime changes in both fiscal and monetary policies: each nation established an independent central bank that was legally prohibited from extending credit to the government and established rules that limited fiscal policy to financing debt through private markets. In each case, the regime change credibly convinced market participants that the central bank would no longer finance fiscal policy.

The lesson from this literature is that when the public expects fiscal authorities to take action to satisfy the budget constraint while they still can, inflation need not rise. This is perhaps the situation in the United States today: debt projections under the CBO's more likely scenario exceed historical records for most developed countries, yet markets appear perfectly willing to purchase government debt at low interest rates, indicating that inflation expectations remain low. Apparently markets believe fiscal imbalances will be resolved through fiscal policy rather than through inflation. However, as long as there is uncertainty over the feasibility of generating sufficient future surpluses, policymakers cannot be sure that market

expectations will not shift unexpectedly and produce inflation. Leeper (2010) argues that a way to reduce that uncertainty would be to establish clear rules that govern fiscal policy in times of fiscal strain to avoid long-term imbalances, a topic discussed at the end of this essay. In the meantime, since uncertainty remains over how current fiscal imbalances would be resolved, it is useful to consider the options facing the central bank in an environment of fiscal crisis.

Encouraging Sustainable Policy

Credible monetary policy may help postpone the spike in inflation expectations that the above literature describes by convincing the public that the central bank will not quickly or easily agree to erode the debt through inflation. In many developing countries, central banks have a history of creating large amounts of inflation to help governments finance spending. For countries with that history, fiscal imbalances may more easily lead to a spike in inflation. Fortunately, the United States has no such history. The Fed can preserve its credibility by continuing to meet its price stability objectives, a task made more complicated in times of economic turbulence. In the past few years, weak economic conditions have greatly influenced the policies of the Fed and many other central banks, while inflation has perhaps been less of an immediate concern. It is useful to remember that the Fed's credibility helps make policies aimed at supporting real economic growth more effective. For example, markets remained confident in 2008 that the Fed would act to constrain any inflation pressures that emerged, even as the Fed added extraordinary liquidity to the banking system.

There are additional steps that can be taken to bolster the Fed's credibility. Elected leaders could reaffirm the central bank's independence to reassure markets that the Fed will not face political pressure to erode the debt through inflation, similar in spirit to the formal accord struck between the Fed and the Treasury Department in 1951. (See sidebar on page 12.) A formal target for inflation, like the one adopted by the Fed in early 2012, may strengthen the central bank's perceived commitment to avoiding inflation.

However, these steps may not be sufficient. As research by Sargent and Wallace and others describes, fiscal policy that does not contain the debt may lead to inflation even if monetary policymakers have the best intentions. This is due to the incontrovertible nature of the government's intertemporal budget constraint. When the expected path for fiscal policy does not by itself achieve balance in the constraint over time, the price level is the only other factor that can adjust to provide it.

It is useful to consider how much inflation would be required to adequately reduce current debt levels. The opening paragraphs of this essay noted that the historical peak of the U.S. debt-to-GDP ratio was reached after World War II. Counting only the portion of that debt that could easily be bought and sold in public markets, George Hall and Sargent (2011) estimate that it took 30 years for debt to fall from 97.2 to 16.9 as a percent of GDP. They estimate that about 20 percent of that debt reduction came from inflation. (Annual inflation, measured by the Personal Consumption Expenditures Price Index, averaged 3.2 percent over that time period.) To consider how much inflation would be required today to address current debt imbalances, Michael Krause and Stéphane Moyon (2011) estimate that a moderate rise in inflation to 4 percent annually sustained for at least 10 years—in effect a permanent doubling of the Fed's inflation objective—would reduce the value of the additional debt that accrued during the 2008–09 financial crisis, not the total debt, by just 25 percent. If the rise in inflation lasted only two or three years, a 16 percentage point increase—from roughly 2 percent inflation today to 18 percent—would be required to reduce that additional debt by just 3 percent to 8 percent. Such inflation rates were not reached even in the worst days of the inflationary 1970s. The reason inflation has such a minimal impact on debt in Krause and Moyon's estimates is that while inflation erodes the value of existing nominal debt, it increases the financing costs for newly issued debt because investors must be compensated to be willing to hold bonds that will be subject to higher inflation. This effect would be greater for governments such as the United States

that have a short average maturity of government debt and therefore need to reissue it often.

With these estimates in mind, it is worth recalling the CBO's projection that debt held by the public may triple as a percent of GDP within 25 years. The estimates cited above suggest that inflation is simply not a viable strategy for reducing such debt levels. In addition, it is important to remember that inflation is costly on many levels. Inflation high enough to significantly erode the debt would inflict considerable damage on the economy and would require costly policies for the Fed to regain its credibility after the fact. Inflation that was engineered specifically to erode debt would provide a significant source of fiscal revenue without approval via the democratic process, and so would raise questions about the role of the central bank as opposed to the roles of Congress and the executive branch in raising fiscal revenues.

Ultimately, the solution to high debt levels must come from fiscal authorities. Decades of monetary policy research suggests that rules and institutions can help ensure that central bankers take a long-run view of their policy objectives, even when doing so entails difficult or unpopular policy choices in the short term. Monetary policymakers have increasingly adopted transparent and consistent practices that make their policy rules credible and reduce uncertainty over their priorities.

The same rules-based institutions do not currently exist for fiscal policy. To a degree, this is a matter of necessity: the distributional nature of fiscal policy ought to be subject to the approval of the general public via the political process. However, it may be possible to create better rules for the more objective aspects of fiscal policy, a point argued by Leeper (2010). Just as Congress has agreed to set long-run objectives for the Fed while leaving day-to-day policy choices to independent monetary policymakers, fiscal policymakers could adopt objective long-run goals for fiscal policy—such as appropriate long-run targets for the ratio of debt to economic growth, guidelines for when unusual circumstances justify a large increase

in debt, and how quickly fiscal imbalances should be resolved in that situation—while leaving the distributional details to the democratic process.

With that said, guaranteeing that policymakers will remain committed to those rules is difficult in practice. The recent fiscal crisis in Europe provides telling proof. As a pre-condition to joining the European monetary union, 17 nations agreed to the Stability and Growth Pact, an agreement obligating each nation to maintain annual deficits of less than 3 percent of GDP and overall debt levels of less than 60 percent of GDP. Even the threat of sanctions for breaching this agreement was not enough to bind the fiscal policies of many European nations, including ones that have been the focus of the recent debt crisis and ones currently in relative fiscal health. If everyone knows that there are circumstances under which the rules will be violated—such as a demographic shift or an unprecedented financial crisis that calls upon national resources—then those rules will fail to anchor expectations. Though rules may be helpful, they may not be enough without some mechanism for enforcing them.

Despite the difficulties of establishing fiscal rules to reduce uncertainty over how fiscal imbalances would be resolved, there are encouraging examples from within the United States of fiscal policymakers adopting a longer-term perspective. Before the Constitution was created, the federal government had no power to levy taxes without unanimous approval from the states. After a period in which both federal and state debt became significantly devalued, the fiscal regime was changed in 1790 by creating new powers for federal taxation and, as a quid pro quo, nationalizing state debt. This policy established an unfortunate precedent for relieving local governments of their debt burdens. Nearly 50 years later, the states again had incurred heavy debts and defaulted after the recession of the late 1830s. Creditors again looked to the federal government, but Congress rejected proposals to take on state debt, arguing that states had entered into debt of their own accord to finance local projects. The decision was costly to the federal government. Its reputation suffered because international creditors did



For the past 30 years, there have been roughly five working people in the United States for every person of retirement age; that number will drop to 2.8 after 2035.

not distinguish between state and federal debt, yet the decision forced states to rewrite their treatment of debt in their constitutions. Many adopted the balanced-budget amendments they retain today. Sargent (2011) describes this episode as an example of how fiscal crises can lead to positive institutional changes.

Ultimately, the solution to current fiscal imbalances will require our elected authorities to make difficult decisions. The Fed's best contribution to this process is to maintain its commitment to monetary policy objectives, including low and stable inflation. For the time being, markets appear to believe that fiscal policymakers will put future debt, spending, and tax

levels on a more sustainable path. If they are correct, our nation will not have to experience the significant economic challenges of a world in which those expectations have changed. ■

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The views expressed are those of the authors and not necessarily those of the Federal Reserve Bank of Richmond or the Federal Reserve System.

ENDNOTES

1. There are two common ways to measure the government's debt burden. Debt held by the public, used in this essay, reflects government borrowing from private financial markets. Total federal debt, the second common measure, comprises debt held by the public (private investors, including the Federal Reserve) and debt held by government accounts. The two measures have different implications. Debt held by the public can affect the current economy by crowding out private borrowing. In contrast, debt held by government accounts reflects internal transactions that are not traded in capital markets. However, that debt is nonetheless a legal liability of the federal government and a burden on taxpayers, which is why total debt is also used as a measure of the government's overall debt burden. We focus on debt held by the public because that is the measure for which long-term projections are readily available.
2. The aging population may not be the only source of coming strains on government budgets. Additional, though less certain, liabilities stem from the government's implicit support of other sectors of the economy. This is the support that market participants may assume the federal government will provide to certain markets in the event of trouble, including contingent support to the housing agencies Fannie Mae and Freddie Mac, as well as private pension funds. Whether the government ever will provide this implicit support is highly uncertain, but John Walter and Nadezhda Malysheva (2010) estimated that more than half the private financial sector—potentially \$25 trillion in liabilities, far greater than the size of the economy—was likely to enjoy some explicit or implicit federal backing at the end of 2009. Not included in their analysis were public sector pensions, which are underfunded by more than \$3 trillion, more than triple states' outstanding debts, according to the most pessimistic estimates.
3. This revenue for the Treasury effectively is a tax on the public's holdings of non-interest-bearing money—the currency and bank reserves issued by the Fed—since the public would have otherwise earned interest from holding those treasuries.
4. Since 2009, the Fed has produced a larger than average amount of seigniorage because the Fed has earned greater interest revenue due to the large expansion of the Fed's balance sheet to treat the financial crisis. From 2001 through 2008, the Fed turned an average of \$26 billion over to the Treasury each fiscal year, averaging 1.1 percent of gross fiscal receipts. From 2009 through 2011, the Fed turned an average of \$67.9 billion over to the Treasury each year, or roughly 2.7 percent of gross fiscal receipts. Data for the Fed's annual remissions to the Treasury can be found in the annual reports of the Federal Reserve Board of Governors, available on its website. Though the seigniorage revenue remitted to the Treasury has been larger in recent years due to the Fed's increased interest income, partially offsetting that increased income is the fact that the Fed, as of 2008, pays banks interest for the reserves they hold. The Federal Reserve System paid \$3.8 billion to banks in 2011 in interest on reserves and term deposits.
5. Sargent and Wallace label this outcome the “unpleasant monetarist arithmetic” of chronic fiscal deficits. Variations of this model are presented by Eric Leeper (1991), Christopher Sims (1994), John Cochrane (1999), and Michael Woodford (2001), among others.
6. Eric Leeper (1991) describes this as an “active monetary policy / passive fiscal policy” framework. An active policy is one that chooses its objectives—surplus or deficit levels for fiscal policy, or money supply growth for monetary policy—as it sees fit, leaving the “passive” entity to stabilize debt. If monetary policy is “active,” it generally follows a policy that adjusts interest rates in response to inflation. When fiscal policy is active, it pursues the spending and tax policies it desires without necessarily stabilizing debt. If it chooses large debt levels, it will ultimately determine inflation as a result of Sargent and Wallace's “unpleasant arithmetic.”
7. This effect presents an outcome similar to the “unpleasant monetarist arithmetic”—that chronic fiscal deficits can lead to inflation—except that here inflation can arise even without monetary accommodation provided by the central bank. Accordingly, this branch of literature is called “the fiscal theory of the price level.” Several of the references provided in footnote five follow this line of thinking.

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MESSAGE FROM MANAGEMENT



Sarah G. Green
 First Vice President and
 Chief Operating Officer

The Federal Reserve System has been the subject of much controversy. We hear that the central bank did too much, or too little, during the financial crisis and that we should be doing more, or less, to promote economic growth and low inflation.

The Fed is no stranger to controversy. Since our founding almost 100 years ago, we have tried our best to serve the public. We have not always gotten it right, and we have learned many lessons, although scholars continue to debate both the causes of economic events and the efficacy of actions taken by the Fed and others. Let's look at some examples of lessons learned since our founding and at our key roles today.

Prior to our founding, the country did not have a centrally managed currency, and it experienced periods of financial panic. In 1913, the Federal Reserve Act established the Fed as a national clearinghouse to help resolve these issues. The debate about the central bank had hinged largely on the extent to which authority would be vested in the powerful money centers or dispersed throughout the nation. The Federal Reserve System—which includes 12 independent regional Reserve Banks and a federal agency, the Board of Governors—represents a compromise between those alternative views. From its start, the Fed has balanced the sometimes competing interests of different parts of the country and different parts of the banking system. The importance of staying close to Main Street, even as we address national economic issues, is an enduring lesson.

Since our founding, the economy has been through good times and bad. The Roaring Twenties was a time of great prosperity. Then, during the early years of the Great Depression, gross domestic product declined 30 percent, and unemployment rose to 25 percent. One-third of all banks failed. During this period, the Fed's interest rate policy fluctuated, but the Fed's actions were insufficient to prevent a collapse of the money supply and prices. Along with other factors, this policy error contributed to the depth and duration of the depression. This was a lesson learned—provide accommodative monetary policy in times of severe economic stress and falling prices.

During World War II, the U.S. Treasury pressed the Fed to cap interest rates to help finance government debt. This created inflationary pressure. Through this experience, we learned the importance of keeping monetary policy independent from fiscal policy. In 1951, the Fed and the Treasury reached an accord, which gave the Fed independence to set interest rates in pursuit of economic stability.

In the mid-1960s and 1970s, inflation began to rise, and policymakers did not respond effectively. During this period, called the Great Inflation, inflation spiked

into double digits. Beginning in 1979, the Federal Open Market Committee (FOMC) increased interest rates to bring inflation back under control, causing a sharp recession in the early 1980s. This lesson was clear—do not let inflation creep out of control.

From 1985 to 2007, we enjoyed a long period of generally favorable economic performance called the Great Moderation. Improved monetary policy contributed to this prosperous period, which came to an abrupt end with the latest financial crisis. The causes of the crisis and the severe recession that followed remain a matter of debate. Certainly imprudent risk taking by many financial institutions and imperfect oversight by the Fed and other regulators played a role. So too did the incentives created by a large and ambiguously defined federal financial safety net.

Let's turn now from history to look briefly at the Federal Reserve today and to think about the implications of the lessons learned. The mission of the Federal Reserve System is to ensure the stability, integrity, and efficiency of the nation's monetary, financial, and payments systems. We accomplish this through our monetary policy, supervision and regulation, and payments roles.

In our monetary policy role, during the most recent recession, the FOMC established and continues to pursue a highly accommodative monetary policy while remaining vigilant about inflation. Our decentralized structure provides us with a deep and broad understanding of the economy and with the political independence needed to make decisions in the long-run interest of the public.

The Federal Reserve's focus on supervision and regulation ensures that financial institutions follow safe and sound practices and that they identify and mitigate risk. Many community and regional banks remain weak, so Reserve Banks have increased the frequency and depth of examinations. The Board of Governors and the Reserve Banks also have strengthened their oversight of the largest financial institutions. We are performing stress tests that assess

how prepared they are for adverse financial and economic scenarios. We also are implementing enhanced capital standards and resolution plans.

The Federal Reserve System began as a system of clearinghouses for payments between banks, and continues in that role today. In 2011, we transferred more than \$4 trillion per day on average in electronic payments, checks, and currency and coin. We also acted as the fiscal agent of the U.S. Treasury. These services underpin the day-to-day economic activities of consumers and businesses.

The community outreach activities of the Reserve Banks and the Board of Governors are integral to all three of our roles. Recently, our local outreach has focused on issues such as housing foreclosures, small business lending, workforce development, and nonprofit capacity building. The economy works best with a well-informed public, so we focus also on economic education and financial literacy.

Central banking depends both on science and judgment. There is no simple, single formula for optimal economic policy. So perhaps we should not be surprised by the level of controversy about the Federal Reserve, or even proposals to "end the Fed." Our roles and policies have evolved as we have learned from our history, but our founders created a structure that has withstood the test of time and that brings a mix of independent regional and national views to the policy table. In 2013, the Federal Reserve System will commemorate its centennial, and our dedicated people are ready to carry our public service mission into the next century. Ultimately, the public will judge how effectively we fulfill our responsibilities as a central bank.



Sarah G. Green

First Vice President and
Chief Operating Officer

Providing Resources that Strengthen the Fifth District

The Federal Reserve Bank of Richmond is one of 12 regional Reserve Banks that, along with the Board of Governors, constitute the Federal Reserve System. This regional structure enhances the Fed's ability to facilitate payments, regulate financial institutions (most of them local or regional), and closely monitor economic conditions that inform monetary policy decisions. The regional structure also puts the Richmond Fed in a unique position to provide additional resources that strengthen communities throughout the Fifth District.

The Bank is based in Richmond with branch offices in Baltimore and Charlotte, but it gathers economic information from all parts of the Federal Reserve's Fifth District, which includes Virginia, Maryland, North Carolina, South Carolina, Washington, D.C., and most of West Virginia. The Bank conducts surveys, telephone interviews, and face-to-face meetings with people throughout the District. It then synthesizes and analyzes this information and makes it available to the public in a variety of formats, including publications, presentations, websites, and databases. The Richmond Fed often convenes conferences and seminars that bring people together from different perspectives to discuss issues that are important to the economic vitality of their communities. The Bank also partners with educators to promote economic education and financial literacy, and it works with its own employees to create a culture of community service.

Gathering Information

The Bank's ability to collect vital economic information from throughout the Fifth District begins with its oversight boards. Nine directors oversee management of the Federal Reserve Bank of Richmond. Member banks elect six of them, and the Board of Governors

appoints the other three. The Bank's branch offices in Baltimore and Charlotte each have seven-member boards, with four directors elected by the Richmond Board and three appointed by the Board of Governors. Board members provide anecdotal information and unique perspectives from a wide variety of fields including banking, finance, housing, health care, construction, insurance, petroleum, power generation, information technology, organized labor, and higher education.

The Richmond Fed also gathers information from three advisory councils. The Community Investment Council keeps the Bank abreast of emerging economic issues in Fifth District communities, including low- and moderate-income neighborhoods in both urban and rural areas; the Community Depository Institutions Advisory Council provides information and advice about lending conditions and other concerns; and the Payments Advisory Council helps the Bank respond to the evolving needs of its banking constituency.

Boards and advisory councils bring valuable information to the Bank, but Bank officials also go out into the community to obtain first-hand knowledge of economic issues and trends. The Bank's top man-

PHOTO: JIM STRADER



Shane Griffin, assistant manager of the Perdue hatchery on Maryland's Eastern Shore, shows visitors from the Bank how to distinguish between male and female baby chicks.

agers routinely travel throughout the District, as do many other employees of the Richmond Fed. Twice a year, the Bank's president, Jeff Lacker, and first vice president, Sally Green, lead delegations on extended trips to gain more in-depth knowledge about local economies. In the past five years, these delegations have visited Central Maryland, Virginia's Southwest and Southside regions, West Virginia's Metro Valley and Mountaineer regions, South Carolina's Upstate and Charleston regions, and North Carolina's Eastern and Research Triangle regions.

In May 2011, Bank officials spent three days learning about economic activity in Northern Virginia and Washington, D.C. Among their many stops, they toured Marine Corps Base Quantico and discussed with local leaders how military base closings and realignments might affect the region's economy. They also consulted with groups of business executives and information technology professionals.

In October 2011, Bank leaders visited the Eastern Shore of Maryland and Virginia, where agriculture and aquaculture are staples of the economy. They toured a chicken hatchery and an oyster hatchery and participated in discussions about the poultry and

seafood industries. They also toured NASA's Wallops Flight Facility, where the space agency launches rockets on orbital and suborbital missions.

The Bank frequently reaches out to the community by organizing business roundtables that represent cross-sections of Fifth District economies. In 2011, the Bank's regional economics group hosted 11 roundtables, including three in Richmond, three in Charlotte, three in Baltimore, one in Charleston, S.C., and one in Charleston, W.Va. The group also conducts monthly and quarterly business surveys that track economic activity throughout the District. Survey participants share their first-hand knowledge of recent economic conditions and their expectations for the next six months.

Sharing Resources

Although the Richmond Fed does not share proprietary information obtained in confidence from individual business leaders, the Bank often synthesizes and analyzes this information and releases it to the public in aggregate formats.

Results of the Bank's surveys, for example, are available at richmondfed.org/research/regional_economy. This regional economics website also provides data, analysis, and presentations from the Bank's regional economists, including the Bank's contribution to the Federal Reserve's *Beige Book*, which summarizes current economic conditions in each Federal Reserve district eight times per year.

Another portion of the Bank's website, richmondfed.org/community_development, provides a wealth of resources, including several publications from the Community Development Department. In 2011, *Community Scope* devoted two issues to exploring the strategies and results of the federal Neighborhood Stabilization Program. The department also publishes *Fifth District Footprint*, an online publication that debuted in 2011. Each issue of the *Footprint* focuses on mapping key economic trends across the District's cities and counties. The publication has highlighted

several data sets, including information on poverty rates, broadband access, vacant housing, and home-mortgage modifications.

The Community Development Department also maintains the Map Resource Center, online collections of data maps that cover the Fifth District as a whole, each state within the region, and the District of Columbia. The maps also display data by zip code and census tract. The Bank's other data resource centers provide extensive information about community development and foreclosure prevention.

The Richmond Fed encourages local governments and nonprofit organizations to use these and other Bank resources to make data-driven decisions that improve their operations. In October 2011, for instance, the Community Development Department held an interactive conference in Richmond called "Unleashing the Power of Local Data." The conference, which explored ways to use data to enhance neighborhood stabilization efforts, attracted 110 participants from 11 states and the District of Columbia. The Richmond Fed partnered with the Board of Governors to hold a similar conference at the Bank's Baltimore branch in December 2011. The conference attracted more than 200 leaders of community development initiatives from across the United States.

The Bank frequently convenes meetings that bring together people who share mutual interests in strengthening their communities. In June 2011, for example, the Community Development Department collaborated with Virginia Commonwealth University's Nonprofit Learning Point to introduce nonprofit managers in the Richmond area to business leaders who might be interested in serving on their boards. The event was the fourth in a series of workshops designed to help nonprofit organizations leverage their resources. In December 2011, a fifth workshop focused on how nonprofits can harness innovation.

Teaching Money Matters

The Richmond Fed devotes considerable resources to promoting economic education and financial literacy. The Bank's economic education team helped establish a high school course on economics and personal finance that is required for graduation from Virginia's public schools, and in 2011, the team helped develop a website, TeachingMoneyVa.org, that provides resources to instructors who teach the course. The Bank partners with the Virginia Council on Economic Education and several other organizations to maintain the website and enhance its content.

The economic education team also produces *5E Educator*, an instructional resource with about 700 subscribers, including many high school and middle school teachers. *5E Educator* provides lesson plans and classroom activities based on articles from the Bank's research publications.

Another popular resource for economic education is The Fed Experience, an interactive exhibit that occupies the first floor of the Bank's Richmond headquarters. Since opening in 2010, The Fed Experience has welcomed more than 15,000 visitors with games, videos, and displays that highlight economic concepts, market dynamics, economic history, and the role of the Federal Reserve. The exhibit, which is free and open to the public, presents information on several levels, engaging visitors from kindergarteners to retirees.

The Richmond Fed partnered with the Board of Governors to host a national conference in Baltimore that focused on strategic uses of data to promote neighborhood stabilization.

PHOTO: JEN GIOVANNITTI



College students developed some of the financial literacy videos in The Fed Experience by competing in an annual contest called “Share the Wealth.” One video, produced by University of Richmond students, features a young man who falls for an easy-credit scheme and buys a big-screen TV that he cannot afford. The video’s punch line says: “Spend money you don’t have. Live in your mom’s basement. Read the fine print.”

A more scholarly competition, the College Fed Challenge, attracted teams from 30 colleges and universities throughout the Fifth District in 2011. They analyzed economic scenarios and made monetary policy decisions as though they were members of the Federal Open Market Committee. A team from the University of North Carolina at Chapel Hill won the most recent contest, which was judged by several of the Bank’s economists. Then the UNC team earned an honorable mention in the national College Fed Challenge at the Board of Governors in Washington, D.C.

Other collegiate programs are more collaborative than competitive. Afternoon @ the Fed, for example, supplements classroom experience by bringing together students, professors, and Bank economists for deeper discussions about monetary policy and the economy. In 2011, this three-part program attracted several hundred participants—in person and online—to sessions in Richmond, Baltimore, and Charlotte.

Strengthening the Community

Serving Fifth District communities is an important part of the Richmond Fed’s daily operations, but that commitment does not end at 5 p.m. Many of the Bank’s 1,450 employees in Richmond, Baltimore, and Charlotte donate significant time, talent, and financial resources to a wide variety of nonprofit efforts.

Fedcorps, a volunteer organization run by employees and retirees, helps create a culture of community service within the Bank. In 2011, employees and retirees supported several dozen Fedcorps initiatives with thousands of community service hours. Fedcorps volunteers partnered with national organizations, such

PHOTO: LARRY CAIN



Fedcorps mentor Shonda Stewart (right) works with Ahmarri Simmons (left) and Lamar Bowman during the Bank’s lunch buddies program at Bellevue Elementary School in Richmond.

as Junior Achievement and Habitat for Humanity, and they worked with local groups, such as hospitals and food banks. They mentored students, collected clothing, served meals, donated blood, and walked or ran countless miles to raise money for worthy causes.

To encourage more employees to get involved, the Bank provides two days of paid leave each year that employees may use to work on community service projects. But the official tally of those community service days measures only a small portion of their contributions to the community. Some employees deliver Meals on Wheels during their lunch breaks. Many employees coach youth sports in the evenings and on weekends, while others pull night shifts at volunteer fire departments and rescue squads.

The Federal Reserve Bank of Richmond exemplifies 24/7 commitment. The Bank’s primary functions—conducting monetary policy, regulating financial institutions, and facilitating payments—are round-the-clock responsibilities. And that same level of dedication spills over into the Bank’s efforts to provide additional resources to the community. These initiatives are supported and encouraged by the Bank, but they are powered by the collective desire of the Bank’s employees to make a difference in the communities they serve. ■

Fifth District Economy Continued to Stabilize in 2011

The Fifth District economy—like the national economy—remained weaker in 2011 than most economists and policymakers had anticipated at the outset. Slow growth in gross domestic product and consumer spending in the United States was reflected in Fifth District economic activity as the region faced weak retail spending, sluggish labor markets, and continued uncertainty among area businesses. Exacerbating the economic uncertainty was the wrangling over the debt ceiling and potential budget cuts, which would have a sizeable impact on the District, where the federal government's presence is particularly strong.

Meanwhile, area banks continued to operate in a challenging environment, and real estate activity remained subdued as expected. Despite the prolonged weakness, however, a gradual recovery in the District seemed to take hold across several sectors of the economy in the second half of 2011.

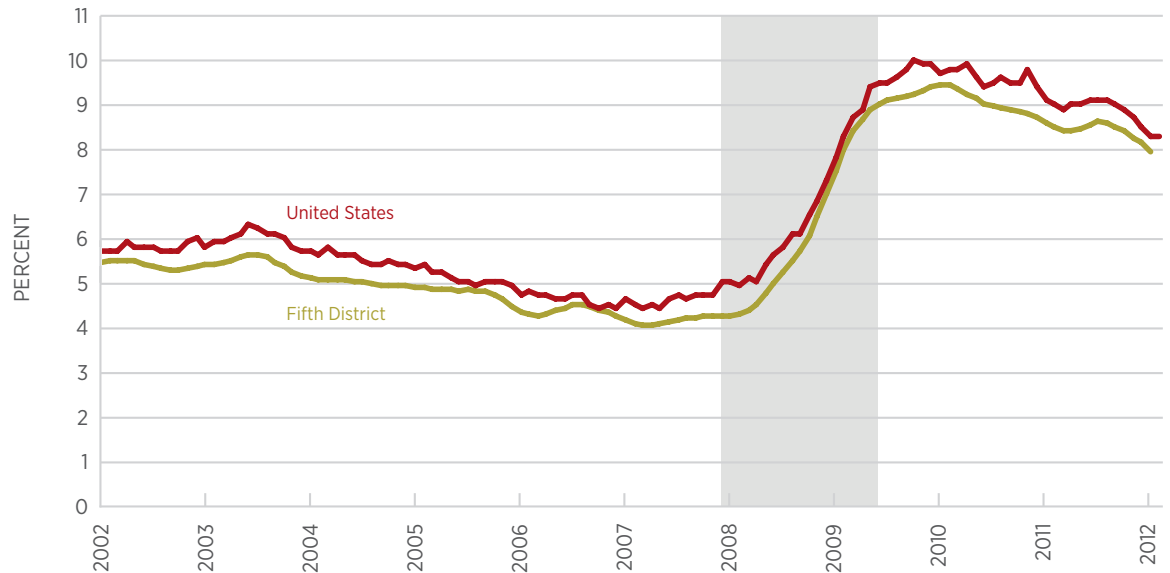
Labor Market Conditions

Although labor markets in the Fifth District did not rebound as strongly as might be expected after such a deep recession, District hiring activity did pick up in 2011 after two years of employment decline (2008 and 2009) and a third year of slow growth in 2010. (See Figure 1.) The District's net job increase of 168,600 workers in 2011 exceeded the increase in 2007. Employment growth was uneven during the year, however. Much of the momentum in the first quarter of 2011 was lost to payroll declines or inconsistent growth in the late spring and summer months before hiring activity picked up again in the fall. National employment growth also slowed in the middle of the year, but U.S. employment slightly outperformed District employment over the year, growing 1.4 percent compared to the District's 1.3 percent.

The District's overall employment trend in 2011 was driven primarily by increases in the professional and business services sector and the education and health services sector, although the leisure and hospitality sector and the trade, transportation, and utilities sector also expanded notably. Annual gains were distributed somewhat evenly across District states, with most states posting job growth of between 1 percent and 2 percent in 2011. The sharpest deviation was the District of Columbia, where employment expanded 2.8 percent.

Private sector hiring drove overall job expansion in the Fifth District; government employment in the District grew only 0.3 percent (6,800 net jobs) in 2011. Those gains were concentrated entirely in federal government employment, which expanded 1.4 percent (8,800 jobs). Only the District of Columbia and West Virginia reported contractions in federal government employment. Meanwhile, state and local governments in the Fifth District reduced their payrolls by 2,000 workers. North Carolina and South Carolina combined trimmed 14,600 state and local government jobs, while Virginia added more than 9,000 state and local government jobs.

FIGURE 1
Unemployment Rates in the Fifth District and the United States



Sources: Bureau of Labor Statistics, Haver Analytics

Federal Government Presence

Challenges facing state and local governments during the past few years reflected national trends. The federal government, on the other hand, plays a unique role in the Fifth District. In March 2011, approximately one-quarter of all federal government workers were employed in the District—clustered in and around Washington, D.C., and in numerous civilian and military facilities across the Fifth District. In fact, the federal government is the Fifth District’s largest employer. Even excluding the U.S. Postal Service and the military, the federal government employed 4 percent of District workers in March 2011; in the United States as a whole, the federal government employed only 1.6 percent of workers.

Of course, non-defense employment statistics understate the role of the federal government in the District because of the large military presence. From the Pentagon in Washington, D.C., to the Navy installations in Hampton Roads, Va., to Fort Bragg in

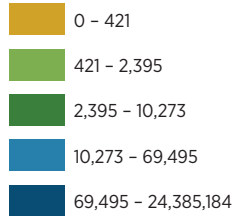
Fayetteville, N.C., the military is an important engine of local employment. According to 2009 data, more than 250,000 military personnel—23.5 percent of the nation’s total—are stationed in the District.

Even including military personnel, the role of the federal government in District labor markets is understated. In addition to grants, loans, guarantees, direct payments, insurance, and other expenditures, the federal government purchases goods and services through contracts with private sector businesses—a sizeable number of them in the Washington, D.C., metropolitan area. Federal contract spending grew 10.3 percent per year on average from 2000 through 2010, representing approximately 0.8 percent of the District’s economy during that time. (See Figure 2.)

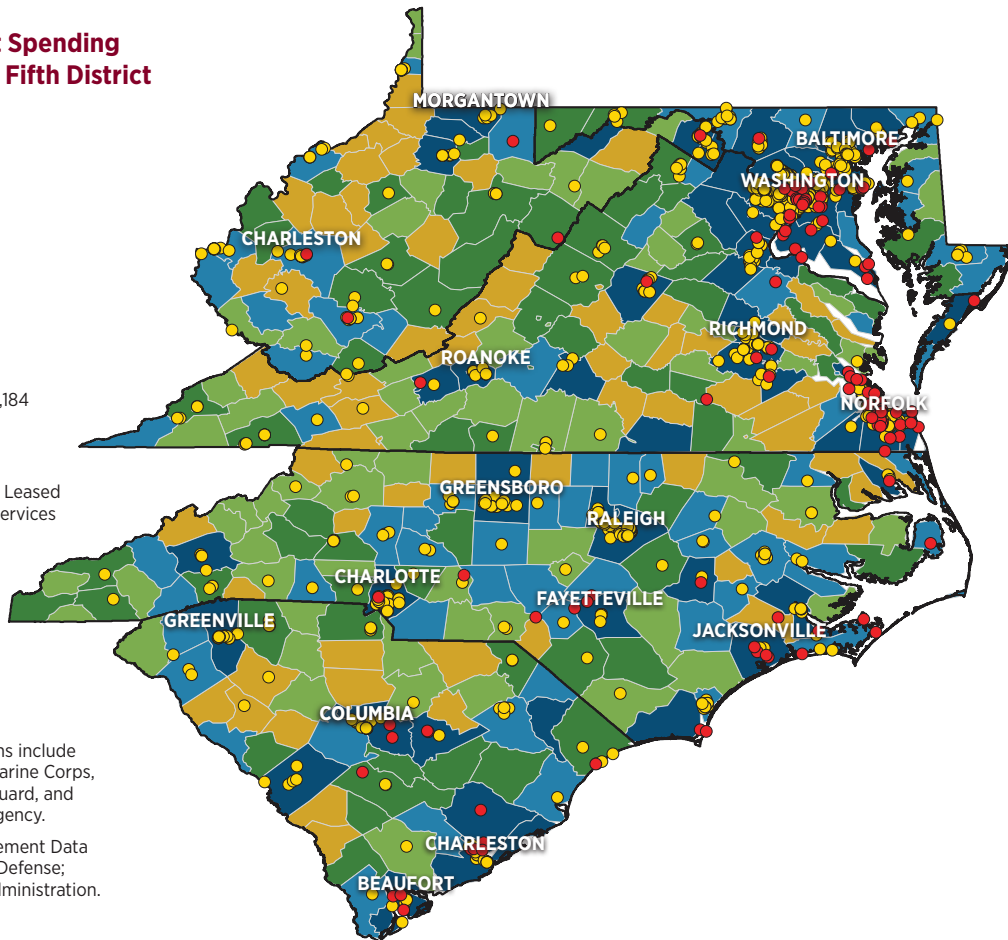
Federal jobs and spending sheltered the District from some of the labor market contractions that affected

FIGURE 2
Federal Contract Spending
By County in the Fifth District
 (Fiscal Year 2010)

\$ In Thousands



- Military Installations
- Properties Owned or Leased by the U.S. General Services Administration



Note: Military Installations include installations for Army, Marine Corps, Navy, Air Force, Coast Guard, and the Defense Logistics Agency.

Sources: Federal Procurement Data System; Department of Defense; U.S. General Services Administration.

the rest of the country in the latest recession. The District's unemployment rate has remained consistently below the national average, largely due to low unemployment in the Washington, D.C., metropolitan area (which includes parts of Maryland, Virginia, and West Virginia). However, if federal budget problems lead to a significant reduction in federal spending in 2012, this would affect District labor markets markedly more than labor markets in other parts of the country. Already, there are reports that the uncertainty surrounding the federal budget impeded business spending and investment in 2011. Also, military and civilian employees are likely to be affected by federal budget cuts in 2012. Even if those spending cuts do

not lead to outright elimination of jobs, they could produce further pay freezes or reductions that would affect residents of the District disproportionately.

Real Estate Conditions

As in the nation, real estate markets in the Fifth District remained weak throughout 2011. Housing markets stabilized and improved modestly—both in number and value of sales—toward the middle of the year, but activity remained sluggish at best. In general, sales of low- to mid-price homes continued to fare better than sales of more expensive homes, and short sales—which occur when a home is sold for less than

the outstanding mortgage balance and the mortgage lender agrees to a lower payout—represented a sizeable share of total activity in most markets.

Continued delinquency and foreclosure activity only exacerbated the excess inventory problem in the District. Although the share of mortgages with payments more than 90 days past due stabilized in 2011, the foreclosure inventory continued to rise. By the end of the year, the District had more than 145,000 mortgages in foreclosure, representing 3.1 percent of all mortgages in the region. Of the Fifth District jurisdictions, only Virginia and West Virginia did not suffer a rise in the number of homes facing foreclosure in 2011. In more positive news, the share of mortgages with payments more than 90 days past due decreased in all Fifth District states. Only D.C. saw an increase in that category.

With slow home sales and high inventories, it is not surprising that house prices continued to fall, albeit at a much slower pace. According to data from the Federal Housing Finance Agency, house prices in the District fell notably in the first two quarters of the year, and although prices stabilized toward the end of the year, home values still depreciated 2.4 percent over the course of 2011. This trend was evident across all Fifth District states. Only the District of Columbia reported higher home values for the whole year.

Most sources indicated that commercial real estate activity was stable over the course of 2011, but reports were inconsistent throughout the year. Generally, vacancy rates neither rose nor fell notably in most District markets, and the reports of improved sales of office, industrial, or retail space were roughly matched by those stating that demand was stagnant across all commercial markets. In general, the ratio of leasing to buying increased over the year, and challenges in obtaining financing continued to hold up many deals.

Banking Conditions

Over the course of 2011, banks faced numerous challenges, including regulatory changes, a U.S. sovereign

debt downgrade, distressed international markets, continued slow economic recovery, and a subdued housing market. Despite these challenges, banks in the Fifth District and nationwide hinted at slight signs of recovery through stabilizing credit quality and modest improvement in earnings.

The share of unprofitable institutions in the District decreased from 31 percent to 25 percent during the year. Moreover, the median return on average assets for banks in the District improved 10 basis points to 0.45 percent, but remained well below the national median of 0.77 percent. Large institutions (banks with total assets greater than \$1 billion) faced heightened earnings pressures due to the current low-rate environment. Margins at these institutions constricted as pressures on loan yields more than offset lower interest expense. For smaller banks, lingering credit quality issues continued to hamper earnings. Loan losses remained most noticeable in commercial and residential real estate portfolios. Because small District banks (those with total assets less than \$1 billion) held higher concentrations of these loans before the recession, their credit quality improvement continued to lag the nation. At 1.27 percent, aggregate losses as a percentage of loans at small institutions remained higher than at their nationwide peers (0.89 percent). For the first time since the recession began, however, losses trended downward, ending the fourth quarter 19 basis points below year-end 2010. Banks were able to reduce their reserves for future loan losses, aiding a slight upward trend in earnings.

Capital positions also improved, primarily driven by deleveraging and continued marginal balance sheet contraction due to negative annual loan growth. Though District levels have trailed the national median since the previous recession, capital ratios began a long road to recovery in 2010 and improved steadily over the course of 2011. The increasing rate of capitalization was driven by large institutions, while smaller banks that had built relatively substantial reserve balances before the recession saw levels stabilize in 2011 after drastic reductions in capital over the past four years.

Business Conditions

The first part of 2011 saw challenging but improving conditions for businesses in the Fifth District. Manufacturing activity remained quite strong, although high energy and commodity prices squeezed margins for many District manufacturers in the first part of the year—a phenomenon that was exacerbated by turmoil in the Middle East. Many businesses also expressed an unwillingness to invest significantly given uncertainty about the direction of government policy and the federal budget. Nonetheless, businesses—particularly manufacturing firms—remained upbeat about rises in domestic and international demand for goods in early 2011.

As the year progressed, some manufacturers reported strong demand and potential expansion, but many others cited uncertain global conditions and sluggish consumer spending domestically as drags on their business. The Federal Reserve Bank of Richmond maintains a composite manufacturing index based on the Bank's Fifth District Survey of Manufacturing Activity. The index started the year firmly in positive territory, but spent most of the summer and autumn months below zero. (The Bank's manufacturing and service sector indexes are diffusion indexes. A positive reading indicates that the number of firms reporting expansion exceeded the number of firms reporting contraction.) The March tsunami in Japan negatively affected some District manufacturers, mostly auto parts suppliers. Export activity remained generally steady throughout the year, although imports were soft, perhaps due to sluggish demand in domestic retail. On the whole, 2011 brought tighter margins for District manufacturers, but a more positive outlook than any of the three previous years.

The service sector also contracted somewhat toward the middle of 2011. The Bank's service sector indexes for revenues and employment were below zero for most of the summer and early autumn months. Retail activity was weak, as well, as increased consumer uncertainty manifested itself in a particularly volatile index for retail revenues throughout 2011.

Summary

Neither the national nor the Fifth District economy did as well in 2011 as was hoped or anticipated. Generally weak economic conditions were compounded by uncertainty engendered by national policy debates and concerns about global markets. As consumer spending and retail activity remained weak, businesses held back and labor markets continued to struggle. Furthermore, as expected, residential and commercial real estate activity was weak, and banks struggled in a challenging lending environment. Despite all of this, the economy continued to stabilize throughout 2011 and began to recover and improve toward the end of the year. ■

Note: Regional economic data are current as of March 13, 2012. Banking conditions data are current as of December 31, 2011.

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BOARDS OF DIRECTORS, ADVISORY COUNCILS, AND OFFICERS**Federal Reserve Bank of Richmond
Board of Directors**

The Bank's board of directors oversees the management of the Bank and its Fifth District offices, provides timely business and economic information, participates in the formulation of national monetary and credit policies, and serves as a link between the Federal Reserve System and the private sector. The board also appoints the Bank's president and first vice president, with approval from the Federal Reserve Board of Governors. Six directors are elected by banks in the Fifth District that are members of the Federal Reserve System, and three are appointed by the Board of Governors.

The Bank's board of directors annually appoints the Fifth District's representative to the Federal Advisory Council, which consists of one member from each of the 12 Federal Reserve Districts. The council meets four times a year with the Board of Governors to consult on business conditions and issues related to the banking industry.

**Baltimore and Charlotte Branches
Boards of Directors**

The Bank's Baltimore and Charlotte branches have separate boards that oversee operations at their respective locations and, like our Richmond Board, contribute to policymaking and provide timely business and economic information about the District. Four directors on each of these boards are appointed by the Richmond directors, and three are appointed by the Board of Governors.

**Community Depository Institutions
Advisory Council**

Created in 2011, the Bank's Community Depository Institutions Advisory Council advises the Bank's management and the Board of Governors on the economy, lending conditions, and other issues from the perspective of banks, thrifts, and credit unions with total assets under \$10 billion. The council's members are appointed by the Bank's president.

Community Investment Council

Established in 2011, the Community Investment Council advises the Bank's management about emerging issues and trends in communities across the Fifth District, including low- and moderate-income neighborhoods in urban and rural areas. The council's members are appointed by the Bank's president.

Payments Advisory Council

Created in 1978, the Payments Advisory Council serves as a forum for communication with financial institutions about financial services provided by the Federal Reserve. The council helps the Bank respond to the evolving needs of its banking constituency. Council members are appointed by the Bank's first vice president.

Listings include members who served during 2011.

THANK YOU

We are grateful to our boards of directors for their guidance, leadership, expertise, and integrity. Their insight into regional and national economic conditions is essential to our work as a policy leader, and their vision will help us continue to support the economic recovery in the Fifth District and across the nation.

Thank you to those directors who have completed their service on our boards: Dana S. Boole and Kelly S. King of the Richmond Board; Biana J. Arentz of the Baltimore Board; Ronald Blackwell, who served as chairman of the Baltimore Board; and Linda L. Dolny and James H. Speed, Jr., of the Charlotte Board.

We also welcome our new directors: Marshall O. Larsen and Edward L. Willingham, IV, of the Richmond Board; Stephen R. Sleigh and Jana Wheatley of the Baltimore Board; and Claude Z. Demby and Christopher J. Estes of the Charlotte Board.

BOARD OF DIRECTORS | FEDERAL RESERVE BANK OF RICHMOND



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35



Left to right: James H. Speed, Jr., Lucia Z. Griffith, Claude C. Lilly, Robert R. Hill, Jr., John S. Kreighbaum, Linda L. Dolny, David J. Zimmerman

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Behavioral Science
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*In 2011, Charles H. Majors served as the Fifth District's representative on the Community Depository Institutions Advisory Council at the Federal Reserve Board of Governors.

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Assistant Vice President

Richard F. Westerkamp, Jr.
Assistant Vice President

Listings include officers who retired
or left the Bank during 2011.
We thank them for their service.

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STATEMENT OF AUDITOR INDEPENDENCE

In 2011, the Board of Governors engaged Deloitte & Touche LLP (D&T) to audit the combined and individual financial statements of the Reserve Banks and those of the consolidated LLC entities. Each LLC will reimburse the Board of Governors for the fees related to the audit of its financial statements from the entity's available net assets. In 2011, D&T also conducted audits of internal control over financial reporting for each of the Reserve Banks and the consolidated LLC entities. Fees for D&T's services totaled \$8 million, of which \$2 million was for the audits of the consolidated LLC entities. To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audits. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2011, the Bank did not engage D&T for any non-audit services.

Management's Report on Internal Control Over Financial Reporting
March 20, 2012

To the Board of Directors:

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

The management of the Federal Reserve Bank of Richmond is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. The Federal Reserve Bank of Richmond'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 Federal Reserve Bank of Richmond assessed its internal control over financial reporting based upon the criteria established in the *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that the Federal Reserve Bank of Richmond maintained effective internal control over financial reporting.

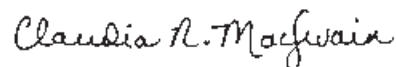
Federal Reserve Bank of Richmond



Jeffrey M. Lacker
President



Sarah G. Green
First Vice President and
Chief Operating Officer



Claudia N. MacSwain
Senior Vice President and
Chief Financial Officer

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

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

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

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

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

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

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



Deloitte & Touche LLP

March 20, 2012
Richmond, Virginia

STATEMENTS OF CONDITION (in millions)

As of December 31,	2011	2010
Assets		
Gold certificates	\$ 872	\$ 846
Special drawing rights certificates	412	412
Coin	409	354
Loans to depository institutions	5	61
System Open Market Account:		
Treasury securities, net	202,139	121,514
Government-sponsored enterprise debt securities, net	12,453	17,422
Federal agency and government-sponsored enterprise mortgage-backed securities, net	97,965	114,424
Foreign currency denominated assets, net	5,321	7,253
Central bank liquidity swaps	20,469	21
Accrued interest receivable	2,279	1,621
Bank premises and equipment, net	333	333
Items in process of collection	5	8
Other assets	91	92
Total assets	\$ 342,753	\$ 264,361
Liabilities and Capital		
Federal Reserve notes outstanding, net	\$ 83,711	\$ 76,694
System Open Market Account:		
Securities sold under agreements to repurchase	11,537	6,800
Other liabilities	158	—
Deposits:		
Depository institutions	111,914	105,026
Other deposits	89	74
Interest payable to depository institutions	13	15
Accrued benefit costs	249	217
Deferred credit items	20	74
Accrued interest on Federal Reserve notes	240	2,041
Interdistrict settlement account	123,650	62,497
Other liabilities	44	45
Total liabilities	331,625	253,483
Capital paid-in	5,564	5,439
Surplus (including accumulated other comprehensive loss of \$49 million and \$31 million at December 31, 2011 and 2010, respectively)	5,564	5,439
Total capital	11,128	10,878
Total liabilities and capital	\$ 342,753	\$ 264,361

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

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (in millions)

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For the years ended December 31,	2011	2010
Interest income		
System Open Market Account:		
Treasury securities, net	\$ 4,864	\$ 2,420
Government-sponsored enterprise debt securities, net	351	318
Federal agency and government-sponsored enterprise mortgage-backed securities, net	4,403	4,096
Foreign currency denominated assets, net	52	62
Central bank liquidity swaps	7	3
Total interest income	9,677	6,899
Interest expense		
System Open Market Account:		
Securities sold under agreements to repurchase	5	10
Deposits:		
Depository institutions	268	446
Term Deposit Facility	1	—
Total interest expense	274	456
Net interest income	9,403	6,443
Non-interest income		
System Open Market Account:		
Treasury securities gains, net	261	—
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	1	61
Foreign currency gains, net	34	154
Compensation received for service costs provided	19	20
Reimbursable services to government agencies	46	40
Other	5	4
Total non-interest income	366	279
Operating expenses		
Salaries and benefits	335	312
Occupancy	48	43
Equipment	63	56
Assessments:		
Board of Governors operating expenses and currency costs	152	170
Bureau of Consumer Financial Protection	51	8
Office of Financial Research	8	2
Other	(110)	(110)
Total operating expenses	547	481
Net income prior to distribution	9,222	6,241
Change in prior service costs related to benefit plans	(4)	8
Change in actuarial losses related to benefit plans	(14)	3
Comprehensive income prior to distribution	\$ 9,204	\$ 6,252
Distribution of comprehensive income:		
Dividends paid to member banks	\$ 330	\$ 349
Transferred to (from) surplus and change in accumulated other comprehensive loss	125	(1,701)
Payments to Treasury as interest on Federal Reserve notes	8,749	7,604
Total distribution	\$ 9,204	\$ 6,252

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

STATEMENTS OF CHANGES IN CAPITAL

(in millions, except share data)

For the years ended December 31, 2011 and December 31, 2010	Capital paid-in	Surplus			Total capital
		Net income retained	Accumulated other comprehensive loss	Total surplus	
Balance at January 1, 2010 (142,793,445 shares)	\$ 7,140	\$ 7,182	\$ (42)	\$ 7,140	\$ 14,280
Net change in capital stock redeemed (34,016,332 shares)	(1,701)	—	—	—	(1,701)
Transferred from surplus and change in accumulated other comprehensive loss	—	(1,712)	11	(1,701)	(1,701)
Balance at December 31, 2010 (108,777,113 shares)	\$ 5,439	\$ 5,470	\$ (31)	\$ 5,439	\$ 10,878
Net change in capital stock issued (2,507,360 shares)	125	—	—	—	125
Transferred to surplus and change in accumulated other comprehensive loss	—	143	(18)	125	125
Balance at December 31, 2011 (111,284,473 shares)	\$ 5,564	\$ 5,613	\$ (49)	\$ 5,564	\$ 11,128

1 Structure

The Federal Reserve Bank of Richmond (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 Fifth Federal Reserve District, which includes Maryland, North Carolina, South Carolina, Virginia, District of Columbia, and portions of West Virginia.

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

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

2 Operations and Services

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

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

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

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

Although the Reserve Banks are separate legal entities, they collaborate on the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks. Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by the other Reserve Banks include Standard Cash Automation, Currency Technology Office, IT Transformation Initiatives, Enterprise-wide Security Projects, Enterprise Security Operations Coordination, the Payroll Central Business Administration Function, Daylight Overdraft Reporting and Pricing, and the National Procurement Office. Costs are, however, redistributed to the other Reserve Banks for computing and support services the Bank provides for the System. The Bank's total reimbursement for these services was \$258 million and \$255 million for the years ended December 31, 2011 and 2010, respectively, and is included in "Operating expenses: Other" on the Statements of Income and Comprehensive Income.

3 Financial Stability Activities

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

Large-Scale Asset Purchase Programs and Reinvestment of Principal Payments

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

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

Central Bank Liquidity Swaps

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

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

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

Lending to Depository Institutions

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

Lending to Primary Dealers

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

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

Other Lending Facilities

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

4 Significant Accounting Policies

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

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States of America (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost and the recording of SOMA securities on a settlement-date basis. Amortized cost, rather than the fair value presentation, more appropriately reflects the Bank's securities holdings

given the System's unique responsibility to conduct monetary policy. Although the application of fair value measurements to the securities holdings may result in values substantially greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, better reflects the timing of the transaction's effect on the quantity of reserves in the banking system. The cost bases of Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP.

In addition, the Bank does not present a Statement of Cash Flows, as required by GAAP, because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities as a central bank. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital, and the accompanying notes to the financial statements. There are no other significant differences, other than those described above, between the policies outlined in the FAM and GAAP.

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

a. Consolidation

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

b. Gold and Special Drawing Rights Certificates

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

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

c. Coin

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

d. Loans

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

Loans are impaired when current information and events indicate that it is probable that the Bank will not receive the principal and interest that are due in accordance with the contractual terms of the loan agreement. Impaired loans are evaluated to determine whether an allowance for loan loss is required. The Bank has developed procedures for assessing the adequacy of any allowance for loan losses using all available information to identify incurred losses. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers and, as appropriate, evaluating collateral values. Generally, the Bank would discontinue recognizing interest income on impaired loans until the borrower's repayment performance demonstrates principal and interest would be received in accordance with the terms of the loan agreement. If the Bank discontinues recording interest on an impaired loan, cash payments are first applied to principal until the loan balance is reduced to zero; subsequent payments are applied as recoveries of amounts previously deemed uncollectible, if any, and then as interest income.

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

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

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

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

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

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

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

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

Foreign currency denominated assets, which can include foreign currency deposits, securities purchased under agreements to resell, and government debt instruments, are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on foreign currency denominated assets are reported as “Non-interest income: System Open Market Account: Foreign currency gains, net” in the Statements of Income and Comprehensive Income.

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

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

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

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

Foreign currency liquidity swaps

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

h. Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 2 to 50 years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

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

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

i. Interdistrict Settlement Account

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

j. Federal Reserve Notes

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

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

Banks. Finally, Federal Reserve notes are obligations of the United States government.

“Federal Reserve notes outstanding, net” in the Statements of Condition represents the Bank’s Federal Reserve notes outstanding, reduced by the Bank’s currency holdings of \$10,670 million and \$12,999 million at December 31, 2011 and 2010, respectively.

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

k. Deposits

Depository institutions

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

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

Other

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

l. Items in Process of Collection and Deferred Credit Items

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

m. Capital Paid-in

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

By law, each Reserve Bank is required to pay each member bank an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. To meet the Federal Reserve Act requirement that annual dividends be deducted from net earnings, dividends are presented as a distribution of comprehensive income in the Statements of Income and Comprehensive Income.

n. Surplus

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

o. Interest on Federal Reserve Notes

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

Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as “Accrued interest on Federal Reserve notes” in the Statements of Condition.

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

p. Income and Costs Related to Treasury Services

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

q. Compensation Received for Service Costs Provided

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

r. Assessments

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

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

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

s. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank’s real property taxes were \$3 million and \$2 million for the years ended December 31, 2011 and 2010, respectively, and are reported as a component of “Operating expenses: Occupancy” in the Statements of Income and Comprehensive Income.

t. Restructuring Charges

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

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

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

u. Recently Issued Accounting Standards

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

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

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

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

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

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

5 Loans

The remaining maturity distribution of loans outstanding at December 31, 2011, and total loans outstanding at December 31, 2010, was as follows (in millions):

	2011		2010
	Within 15 days	Total	Total
Loans to depository institutions	\$ 5	\$ 5	\$ 61

Loans to Depository Institutions

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

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

Allowance for Loan Loss

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

6 Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Securities Purchased Under Agreements to Resell; Securities Sold Under Agreements to Repurchase; and Securities Lending

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA.

The Bank's allocated share of SOMA balances was approximately 11.549 percent and 11.389 percent at December 31, 2011 and 2010, respectively.

NOTES TO FINANCIAL STATEMENTS

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

	2011				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	\$ 2,128	\$ —	\$ —	\$ 2,128	\$ 2,128
Notes	148,560	3,095	(142)	151,513	160,465
Bonds	41,424	7,085	(11)	48,498	58,749
Total Treasury securities	\$ 192,112	\$ 10,180	\$ (153)	\$ 202,139	\$ 221,342
GSE debt securities	\$ 12,010	\$ 445	\$ (2)	\$ 12,453	\$ 13,193
Federal agency and GSE MBS	\$ 96,744	\$ 1,341	\$ (120)	\$ 97,965	\$ 103,421

	2010				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	\$ 2,098	\$ —	\$ —	\$ 2,098	\$ 2,098
Notes	88,069	1,601	(87)	89,583	91,647
Bonds	26,170	3,728	(65)	29,833	33,000
Total Treasury securities	\$ 116,337	\$ 5,329	\$ (152)	\$ 121,514	\$ 126,745
GSE debt securities	\$ 16,794	\$ 630	\$ (2)	\$ 17,422	\$ 17,856
Federal agency and GSE MBS	\$ 112,994	\$ 1,607	\$ (177)	\$ 114,424	\$ 116,851

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

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

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

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

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

Distribution of MBS holdings by coupon rate	2011		2010	
	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
3.0%	\$ 152	\$ 154	\$ —	\$ —
3.5%	2,242	2,271	39	40
4.0%	18,649	19,606	19,097	19,179
4.5%	46,943	49,796	56,680	57,947
5.0%	21,076	22,251	26,356	27,054
5.5%	7,714	8,092	10,605	10,919
6.0%	1,057	1,110	1,470	1,523
6.5%	132	141	177	189
Total	\$ 97,965	\$ 103,421	\$ 114,424	\$ 116,851
Total SOMA:				
3.0%	\$ 1,313	\$ 1,336	\$ —	\$ —
3.5%	19,415	19,660	341	352
4.0%	161,481	169,763	167,675	168,403
4.5%	406,465	431,171	497,672	508,798
5.0%	182,497	192,664	231,420	237,545
5.5%	66,795	70,064	93,119	95,873
6.0%	9,152	9,616	12,910	13,376
6.5%	1,140	1,221	1,558	1,656
Total	\$ 848,258	\$ 895,495	\$ 1,004,695	\$ 1,026,003

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

	2011	2010
Allocated to the Bank:		
Contract amount outstanding, end of year	\$ 11,537	\$ 6,800
Average daily amount outstanding, during the year	8,315	5,364
Maximum balance outstanding, during the year	14,380	7,673
Securities pledged (par value), end of year	9,942	4,970
Securities pledged (market value), end of year	11,537	6,800
Total SOMA:		
Contract amount outstanding, end of year	\$ 99,900	\$ 59,703
Average daily amount outstanding, during the year	72,227	58,476
Maximum balance outstanding, during the year	124,512	77,732
Securities pledged (par value), end of year	86,089	43,642
Securities pledged (market value), end of year	99,900	59,703

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

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

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	\$ 1,876	\$ 3,131	\$ 10,383	\$ 75,034	\$ 75,058	\$ 26,630	\$ 192,112
GSE debt securities (par value)	288	580	2,275	6,999	1,597	271	12,010
Federal agency and GSE MBS (par value)*	—	—	—	2	4	96,738	96,744
Securities sold under agreements to repurchase (contract amount)	11,537	—	—	—	—	—	11,537

* The par amount shown for Federal agency and GSE MBS is the remaining principal balance of the underlying mortgages.

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

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

Allocated to the Bank				
	Amortized cost		Par value	
	2011	2010	2011	2010
Treasury securities	\$ 1,746	\$ 2,577	\$ 1,614	\$ 2,515
GSE debt securities	147	192	140	183

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

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the Treasury securities under outstanding commitments was \$3,200 million. The total purchase price of outstanding commitments allocated to the Bank was \$370 million. These commitments had contractual settlement dates extending through January 3, 2012. As of December 31, 2011, the fair value of Treasury securities under outstanding purchase commitments was \$3,208 million, of which \$370 million was allocated to the Bank.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was \$41,503 million, of which \$513 million was related to dollar roll transactions. The total purchase price of outstanding purchase commitments allocated to the Bank was \$4,793 million, of which \$59 million was related to dollar roll transactions. As of December 31, 2011, the total sales price of the federal agency and GSE MBS under outstanding sales commitments was \$4,430 million, all of which was related to dollar roll transactions. The total sales price of outstanding sales commitments allocated to the Bank was \$512 million, all of which was related to dollar roll transactions. These commitments, which had contractual settlement dates extending through February 2012, are for the purchase and sale of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. As of December 31, 2011, the fair value of federal agency and GSE MBS purchases and sales, net under outstanding commitments was \$41,873 million and \$4,473 million, respectively, of which \$4,836 million and \$517 million, respectively, was allocated to the Bank. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

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

	Allocated to the Bank		Total SOMA	
	2011	2010	2011	2010
Cash margin	\$ 147	\$ —	\$ 1,271	\$ —
Obligations from MBS transaction fails	11	—	97	—
Total	\$ 158	\$ —	\$ 1,368	\$ —

During the years ended December 31, 2011 and 2010, the Reserve Banks recorded net gains from federal agency and GSE MBS transactions of \$10 million and \$782 million, respectively, of which \$1 million and \$61 million, respectively, were allocated to the Bank. These net gains are reported as "Non-interest income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

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

	Allocated to the Bank						
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS	
Balance December 31, 2010	\$ 2,098	\$ 89,583	\$ 29,833	\$ 121,514	\$ 17,422	\$ 114,424	
Purchases ¹	27,550	83,913	18,616	130,079	—	4,867	
Sales ¹	—	(15,907)	—	(15,907)	—	—	
Realized gains, net ²	—	261	—	261	—	—	
Principal payments and maturities	(27,551)	(7,744)	—	(35,295)	(4,993)	(22,480)	
Amortization of premiums and discounts	1	(512)	(574)	(1,085)	(193)	(364)	
Inflation adjustment on inflation-indexed securities	—	148	126	274	—	—	
Annual reallocation adjustment ³	30	1,771	497	2,298	217	1,518	
Balance December 31, 2011	\$ 2,128	\$ 151,513	\$ 48,498	\$ 202,139	\$ 12,453	\$ 97,965	
Supplemental information—par value of transactions:							
Purchases	\$ 27,551	\$ 81,912	\$ 14,695	\$ 124,158	\$ —	\$ 4,730	
Proceeds from sales	—	(15,571)	—	(15,571)	—	—	

	Total SOMA						
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS	
Balance December 31, 2010	\$ 18,422	\$ 786,575	\$ 261,955	\$ 1,066,952	\$ 152,972	\$ 1,004,695	
Purchases ¹	239,487	731,252	161,876	1,132,615	—	42,145	
Sales ¹	—	(137,734)	—	(137,734)	—	—	
Realized gains, net ²	—	2,258	—	2,258	—	—	
Principal payments and maturities	(239,494)	(67,273)	—	(306,767)	(43,466)	(195,413)	
Amortization of premiums and discounts	8	(4,445)	(4,985)	(9,422)	(1,678)	(3,169)	
Inflation adjustment on inflation-indexed securities	—	1,284	1,091	2,375	—	—	
Balance December 31, 2011	\$ 18,423	\$ 1,311,917	\$ 419,937	\$ 1,750,277	\$ 107,828	\$ 848,258	
Supplemental information—par value of transactions:							
Purchases	\$ 239,494	\$ 713,878	\$ 127,802	\$ 1,081,174	\$ —	\$ 40,955	
Proceeds from sales	—	(134,829)	—	(134,829)	—	—	

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

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

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

7 Foreign Currency Denominated Assets

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

The Bank's allocated share of foreign currency denominated assets was approximately 20.505 percent and 27.845 percent at December 31, 2011 and 2010, respectively.

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

	2011	2010
Euro:		
Foreign currency deposits	\$ 1,921	\$ 1,965
Securities purchased under agreements to resell	—	687
German government debt instruments	386	514
French government debt instruments	540	767
Japanese yen:		
Foreign currency deposits	817	1,081
Japanese government debt instruments	1,657	2,239
Total allocated to the Bank	\$ 5,321	\$ 7,253

At December 31, 2011 and 2010, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was \$5,355 million and \$7,299 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to Treasury securities, GSE debt securities, and federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

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

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

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
Euro	\$ 1,097	\$ 601	\$ 434	\$ 715	\$ 2,847
Japanese yen	857	136	645	836	2,474
Total	\$ 1,954	\$ 737	\$ 1,079	\$ 1,551	\$ 5,321

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

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

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

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2011, there were \$216 million of outstanding commitments to purchase Euro-denominated government debt instruments, of which \$44 million was allocated to the Bank. These securities settled on January 4, 2012, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date. As of December 31, 2011, the fair value of Euro-denominated government debt instruments under outstanding commitments was \$216 million of which \$44 million was allocated to the Bank.

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

8 Central Bank Liquidity Swaps

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 20.505 percent and 27.845 percent at December 31, 2011 and 2010, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2011 and 2010, was \$99,823 million and \$75 million, respectively, of which \$20,469 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):

	2011			2010	
	Within 15 days	16 days to 90 days	Total	Within 15 days	Total
Euro	\$ 7,045	\$ 10,474	\$ 17,519	\$ 21	\$ 21
Japanese yen	1,853	1,016	2,869	—	—
Swiss franc	65	16	81	—	—
Total	\$ 8,963	\$ 11,506	\$ 20,469	\$ 21	\$ 21

Foreign Currency Liquidity Swaps

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

9 Bank Premises, Equipment, and Software

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

	2011	2010
Bank premises and equipment:		
Land and land improvements	\$ 48	\$ 48
Buildings	234	231
Building machinery and equipment	76	76
Construction in progress	2	3
Furniture and equipment	296	276
Subtotal	656	634
Accumulated depreciation	(323)	(301)
Bank premises and equipment, net	\$ 333	\$ 333
Depreciation expense, for the years ended December 31	\$ 50	\$ 46

Bank premises and equipment at December 31 included the following amounts for capitalized leases (in millions):

	2011	2010
Leased premises and equipment under capital leases	\$ 24	\$ 18
Accumulated depreciation	(13)	(8)
Leased premises and equipment under capital leases, net	\$ 11	\$ 10
Depreciation expense related to leased premises and equipment under capital leases	\$ 5	\$ 3

The Bank leases space to outside tenants with remaining lease terms ranging from 1 to 7 years. Rental income from such leases was \$1 million for each of the years ended December 31, 2011 and 2010 and is reported as a component of “Non-interest income: Other” in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under non-cancelable lease agreements in existence at December 31, 2011, are as follows (in thousands):

2012	\$ 1,222
2013	1,279
2014	1,319
2015	1,244
2016	1,213
Thereafter	699
Total	\$ 6,976

The Bank had capitalized software assets, net of amortization, of \$35 million and \$29 million at December 31, 2011 and 2010, respectively. Amortization expense was \$13 million and \$12 million for the years ended December 31, 2011 and 2010, respectively. Capitalized software assets are reported as a component of “Other assets” in the Statements of Condition and the related amortization is reported as a component of “Operating expenses: Other” in the Statements of Income and Comprehensive Income.

10 Commitments and Contingencies

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

At December 31, 2011, the Bank was obligated under non-cancelable leases for premises and equipment with remaining terms ranging from three to approximately four years.

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 \$360 thousand and \$256 thousand for the years ended December 31, 2011 and 2010, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under non-cancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 2011, were not material.

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

At December 31, 2011, the Bank had commitments of approximately \$8 million for the construction and acquisition of an air-handling unit at its Richmond facility. Expected fixed payments for the next two years under these commitments are as follows (in millions):

2012	\$	4
2013		4

Under the Insurance Agreement of the Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2011 and 2010.

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

11 Retirement and Thrift Plans

Retirement Plans

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

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

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

Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. The Bank's Thrift Plan contributions totaled \$14 million and \$13 million for the years ended December 31, 2011 and 2010, respectively, and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

12 Postretirement Benefits Other Than Retirement Plans and Postemployment Benefits**Postretirement Benefits Other Than Retirement Plans**

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

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

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

	2011	2010
Accumulated postretirement benefit obligation at January 1	\$ 193.0	\$ 191.8
Service cost benefits earned during the period	8.6	8.3
Interest cost on accumulated benefit obligation	10.4	11.3
Net actuarial loss	17.9	1.5
Contributions by plan participants	2.7	2.2
Benefits paid	(10.5)	(12.2)
Medicare Part D subsidies	0.7	0.6
Plan amendments	(0.9)	(10.5)
Accumulated postretirement benefit obligation at December 31	\$ 221.9	\$ 193.0

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

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

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

	2011	2010
Fair value of plan assets at January 1	\$ —	\$ —
Contributions by the employer	7.1	9.4
Contributions by plan participants	2.7	2.2
Benefits paid	(10.5)	(12.2)
Medicare Part D subsidies	0.7	0.6
Fair value of plan assets at December 31	\$ —	\$ —
Unfunded obligation and accrued postretirement benefit cost	\$ 221.9	\$ 193.0
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 17.2	\$ 20.6
Net actuarial loss	(66.2)	(52.4)
Total accumulated other comprehensive loss	\$ (49.0)	\$ (31.8)

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:

	2011	2010
Health-care cost trend rate assumed for next year	7.50%	8.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2017

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

	1 percentage point increase	1 percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 3.5	\$ (2.8)
Effect on accumulated postretirement benefit obligation	33.7	(27.4)

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

	2011	2010
Service cost-benefits earned during the period	\$ 8.6	\$ 8.3
Interest cost on accumulated benefit obligation	10.4	11.3
Amortization of prior service cost	(4.3)	(3.4)
Amortization of net actuarial loss	4.1	5.2
Net periodic postretirement benefit expense	\$ 18.8	\$ 21.4
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2012 are shown below:		
Prior service cost	\$ (4.2)	
Net actuarial loss	5.6	
Total	\$ 1.4	

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

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

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

Federal Medicare Part D subsidy receipts were \$512 thousand and \$534 thousand in the years ended December 31, 2011 and 2010, respectively. Expected receipts in 2012, related to benefits paid in the years ended December 31, 2011 and 2010, are \$371 thousand.

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

	Without subsidy	With subsidy
2012	\$ 9.8	\$ 9.1
2013	10.4	9.6
2014	10.9	10.0
2015	11.6	10.6
2016	12.2	11.1
2017-2021	74.2	66.6
Total	\$ 129.1	\$ 117.0

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2011 and 2010, were \$20 million and \$19 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2011 and 2010 operating expenses were \$4 million and \$2 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

13 Accumulated Other Comprehensive Income and Other Comprehensive Income

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

	Amount related to postretirement benefits other than retirement plans
Balance at January 1, 2010	\$ (42)
Change in funded status of benefit plans:	
Prior service costs arising during the year	11
Amortization of prior service cost	(3)
Change in prior service costs related to benefit plans	8
Net actuarial loss arising during the year	(2)
Amortization of net actuarial loss	5
Change in actuarial losses related to benefit plans	3
Change in funded status of benefit plans—other comprehensive loss	11
Balance at December 31, 2010	\$ (31)
Change in funded status of benefit plans:	
Amortization of prior service cost	(4)
Change in prior service costs related to benefit plans	(4)
Net actuarial loss arising during the year	(18)
Amortization of net actuarial loss	4
Change in actuarial losses related to benefit plans	(14)
Change in funded status of benefit plans—other comprehensive loss	(18)
Balance at December 31, 2011	\$ (49)

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

14 Business Restructuring Charges

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

Before 2010, the Reserve Banks announced their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites; one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing. Additional announcements prior to 2010 included restructuring plans associated with the U.S. Treasury's Collections and Cash Management Modernization (CCMM) initiative.

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

	2009 and prior restructuring plans
<i>Information related to restructuring plans as of December 31, 2011:</i>	
Total expected costs related to restructuring activity	\$ 8.3
Estimated future costs related to restructuring activity	—
Expected completion date	2011
<i>Reconciliation of liability balances:</i>	
Balance at January 1, 2010	\$ 1.0
Adjustments	0.1
Payments	(0.9)
Balance at December 31, 2010	\$ 0.2
Adjustments	0.1
Payments	(0.1)
Balance at December 31, 2011	\$ 0.2

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period of 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 pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 11.

15 Subsequent Events

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

ACH	Automated Clearinghouse
AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ASU	Accounting Standards Update
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
FAM	<i>Financial Accounting Manual for Federal Reserve Banks</i>
FASB	Financial Accounting Standards Board
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
FRBNY	Federal Reserve Bank of New York
GAAP	Accounting Principles Generally Accepted in the United States of America
GSE	Government-Sponsored Enterprise
IMF	International Monetary Fund
MBS	Mortgage-Backed Securities
OEB	Office of Employee Benefits of the Federal Reserve System
OFR	Office of Financial Research
SDR	Special Drawing Rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
STRIP	Separate Trading of Registered Interest and Principal of Securities
TAF	Term Auction Facility
TBA	To Be Announced
TDF	Term Deposit Facility
TIPS	Treasury Inflation-Protected Securities
TOP	Term Securities Lending Facility Options Program
TSLF	Term Securities Lending Facility

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