*The Current Financial Crisis:*

# WHAT SHOULD WE LEARN FROM THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

The Region

THE FEDERAL RESERVE BANK OF MINNEAPOLIS 2008 ANNUAL REPORT

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# Message from the President

*I want readers to understand*

*the background to this year's* Annual Report *essay.*

*We are not trying to weigh in on a political debate;*

*rather, we are trying to inform the discussion about*

*economic policy by applying work that was begun*

*here years ago.*

Nine years ago a research conference was held at this Bank, during which economists from around the world presented papers on one of the most vexing questions in economic history: What caused the great depressions of the 20th century? No reporters were in attendance. There were no heated debates in the blogosphere. There were no real-time policy implications drawn from the papers' conclusions. There was simply the lively and energizing discussion that is always present when economists get together to discuss their work. That's because the idea of another Great Depression occurring in the United States was more a theoretical exercise than a practical concern.

Those were the days. If such a conference were held today, it would not only be a news story but would likely become immediately politicized, with economists' work categorized as representing one political view over another, and thus being categorically dismissed by the opposing camp. Academics are accustomed to having their work dismissed, but it's usually by colleagues who have qualms about such things as models or methodology. However, given the recent financial crisis and the concomitant recession, economic analysis of the Great Depression has become fodder for columnists, cartoonists, pundits, bloggers and, oh yes, economists too.

I mention this context because I want readers to understand the background to this year's *Annual Report* essay. We are not trying to weigh in on a political debate; rather, we are trying to inform the discussion about economic policy by applying work that was begun here years ago. In that regard, the year before we held our conference, we published papers on this subject in a 1999 issue of our *Quarterly Review*. We also published an article about the conference in the December 2000 *Region,* and this Bank published a book in 2007 that gathered the conference papers and other contributions. Finally, I would add that I penned a 1987 *Annual Report* essay on the Great Depression following the stock market crash in October of that year. So we have established our *bona fides* on this subject.

And yes, for those of you who don't remember, many people said we were entering another depression 22 years ago following the stock market's plunge. Needless to say, it didn't happen. Indeed, quite the opposite happened—we experienced two decades of strong growth, interrupted by two relatively mild recessions. The current recession is anything but mild, but it too will end, and if history is any guide, we will once again return to normal rates of growth—and likely sometime in 2010, following a turnaround this year.

The question at hand is to what degree history is a guide for current policy. Do the lessons of the Great Depression have anything to teach us about our current situation? They almost cer-

*The question at hand is*

*to what degree history is a guide for current policy. Do the lessons of the Great Depression have anything to teach us about our current situation? They almost certainly do. Do we claim that the authors of this essay have all the answers? Of course not. Do we think they have something useful to contribute? Yes.*

tainly do. Do we claim that the authors of this essay have all the answers? Of course not. Do we think they have something useful to contribute? Yes. In that regard, this year's essay sounds a cautionary note about government's response to economic downturns. Views like those expressed in this essay challenge conventional wisdom about the government's role in an economy or the likely impact of government intervention. That doesn't mean the conventional wisdom is necessarily wrong, but if the views expressed in this essay have merit, then it means that conventional wisdom should at least confront these challenges.

Absolute certainty is a rare commodity even in tranquil times, and we shouldn't kid ourselves into thinking that it's more easily mined in times of crisis. One thing that current events have reinforced is the need for open-mindedness when it comes to policy response. The Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corp., the Congress and many private-sector players have engaged in activity that none would have considered even remotely possible two years ago. It's become a cliché to suggest that these extraordinary times call for extraordinary measures, but it's no less true. However, they also call for extraordinary analysis, and now is the time for due consideration of challenging ideas, however iconoclastic. It is in that spirit that we offer this year's essay. As always, we welcome your comments, and doubtless you will have some.

Before I sign off, I want to note that this will be the final President's Message I will write for this Bank's *Annual Report,* as I plan to retire later this year. I have had the distinct honor to serve as president of the Federal Reserve Bank of Minneapolis for 24 years. For an economist with an interest in public policy, few jobs offer such challenges and rewards. Also, as someone who grew up in Wisconsin, it has been especially gratifying to serve the states of the Ninth District. I have traveled from western Montana to the Upper Peninsula of Michigan a number of times and met many people throughout the district, all with a keen interest in their central bank. A real strength of the Federal Reserve System is its decentralized nature that encourages the participation of bankers, business owners, farmers and laborers from every state. It has been my privilege to work with these people over the years, especially including those who have served on our Board of Directors and on our Advisory Councils, and to them is owed a special debt of gratitude. Thanks to all of you for your interest in this Bank and in the Federal Reserve.

*Gary H. Stern*

The New York Times

TUESDAY, OCTOBER 7, 2008

$1.50

Printed in Minnesota

# FED WEIGHS BID TO SPUR ECONOMY AS MARKETS PLUMMET WORLDWIDE

Asia

Europe

Americas

**Credit Markets Stayed Tight . . .**

- Yields on one-month T-bills fell to almost zero as investors rushed for safety.
- Rates on overnight commercial paper, or i.o.u.'s sold by companies, jumped to 3.7 percent.
- High-grade corporate bonds fell, driving yields, which move in the opposite direction of prices, to 8.15 percent.

**. . . Dow Ends Below 10,000 . . .**

Monday's close: 9,955.50, -369.88, -3.58%

1-minute intervals

Source: Bloomberg

**. . . and World Markets Fall Amid Fears of Banking Instability and Global Recession**

AUSTRALIA, JAPAN, HONG KONG, INDONESIA

Major Asian markets fell about 3 to 5 percent after European leaders failed to stanch fears of banking instability. But Indonesia fell 10 percent on worries about its huge trade deficit.

GERMANY, FRANCE, IRELAND

European markets ended down 5 to 10 percent, after leaders failed to reach a unified policy. German officials insist on control of any money contributed by taxpayers to a bailout fund.

CANADA, BRAZIL

A Day (Gasp) Like Any Other

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*The Current Financial Crisis:*

# WHAT SHOULD WE LEARN FROM THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

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*Universidad de Salamanca*

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*University of Minnesota*
*Federal Reserve Bank of Minneapolis*
*National Bureau of Economic Research*

This paper was published as Research Department Staff Report 421 by the Federal Reserve Bank of Minneapolis. It is a translation of "La Crisis Financiera Actual: ¿Qué Debemos Aprender de las Grandes Depresiones del Siglo XX?" by the same authors. The authors thank Juan Carlos Conesa, Ed Prescott, and Art Rolnick for helpful comments and suggestions. They are grateful to the Proyecto de Excelencia P07-SEJ-02479 of the Junta de Andalucía, and Kehoe is grateful to the National Science Foundation for financial support under grant SES-0536970. The views expressed herein are those of the authors and not necessarily those of the Federal Reserve Bank of Minneapolis or the Federal Reserve System.

*Could the world economy enter a great depression?*

A retired member of the United Auto Workers attends a monthly benefits meeting in Detroit.

*If so,*
*what can*
*government do*
*to avoid it?*

G. Richard Wagoner Jr., then chairman of General Motors, wipes his eyes as he awaits the start of a Senate hearing on the auto industry.

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *Bad government policies*

*are responsible for causing great depressions.*

*While different sorts of shocks can lead*

*to ordinary business cycle downturns,*

*overreaction by the government*

*can prolong and deepen the downturn,*

*turning it into a depression.*

# THE CURRENT FINANCIAL CRISIS HAS PROMPTED THESE QUESTIONS:

Could the world economy enter a great depression like that of the 1930s? If so, what can governments do to avoid it?

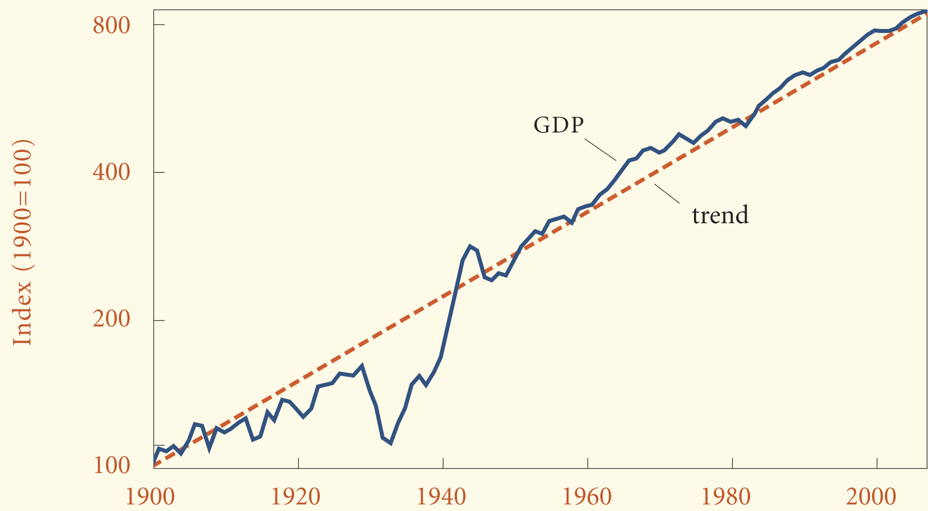
Looking at historical experience can help us answer these questions. Since 2000, Timothy Kehoe and Edward Prescott have been running a project at the Federal Reserve Bank of Minneapolis to study the great depressions that occurred during the 20th century. Kehoe and Prescott define a great depression to be a very large and sustained drop in output per working-age person below trend growth.

To get an idea of how different a great depression is from an ordinary business cycle downturn, we can look at a graph (on page 15) of real gross domestic product (GDP) per person aged 15–64 in the United States over the period 1900–2007. On a logarithmic scale, we see that the business cycle fluctuations around a trend growth line of 2 percent per year are very small. In contrast, the Great Depression of 1929–39 and the subsequent World War II buildup are huge deviations from trend growth.

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

OBSERVATION:

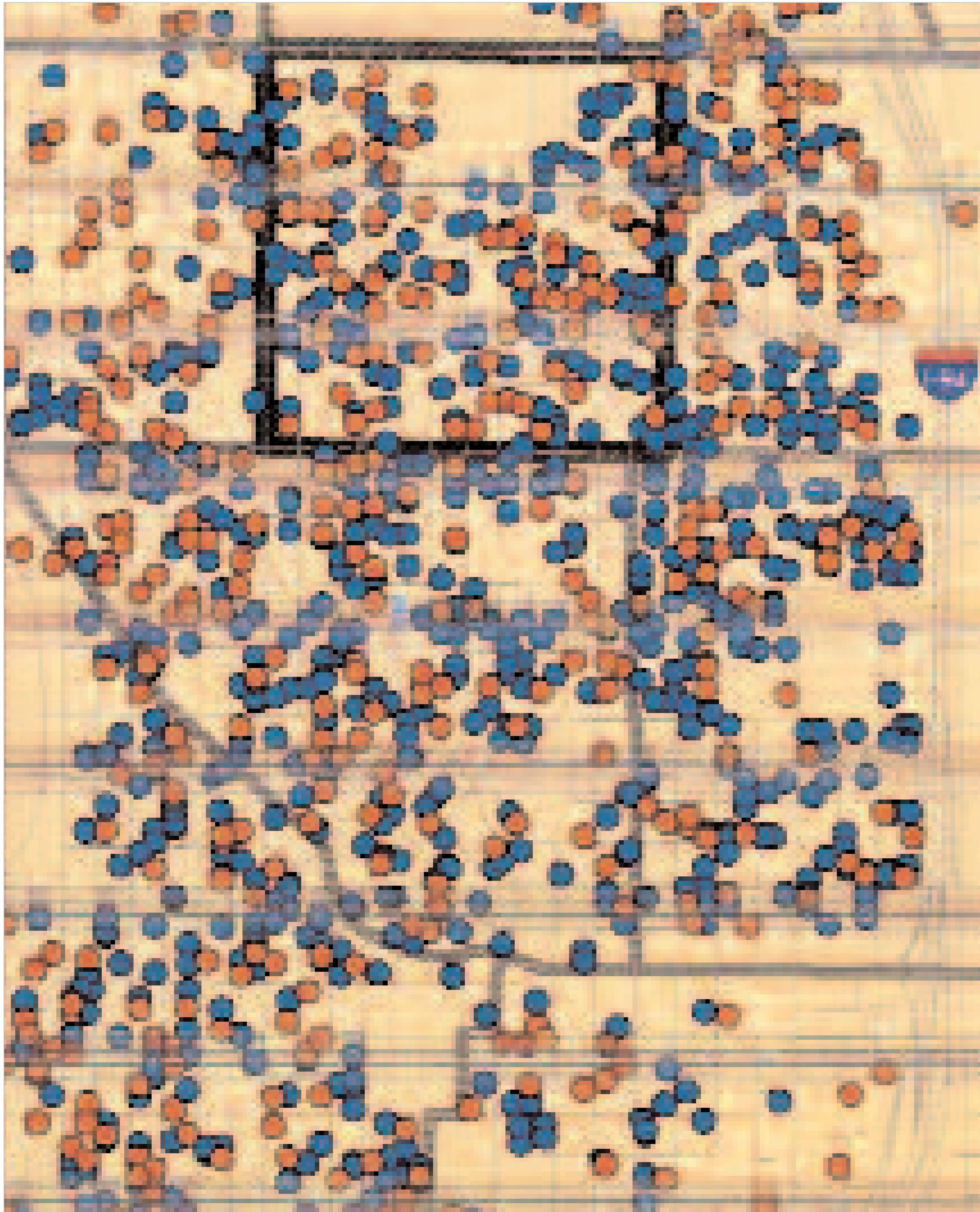
*The Chilean government liquidated the insolvent banks and reprivatized the solvent banks, and set up a new regulatory scheme to avoid mismanagement. These new regulations allowed the market to determine interest rates and the allocation of credit to firms.*




In *Great Depressions of the Twentieth Century,* Kehoe and Prescott (2007), together with a team of 24 economists from all over the world, study the great depressions that occurred in North America and Western Europe in the 1930s, those that occurred in Latin America in the 1980s, and isolated experiences in other places and times. What lessons can be learned from comparing and contrasting these historical experiences? The authors of each of the studies in the book start by decomposing the decline in output during the depression into declines in inputs of labor and capital and a decline in the efficiency with which these factors are employed, measured as productivity. They find that a large drop in productivity always plays a large role in accounting for the depression. In some depressions, such as the U.S. depression of the 1930s, large drops in labor inputs also play important roles. In others, such as the Mexican depression of the 1980s, the drop in productivity accounts for almost the entire drop in output.

Photograph by Paula Woessner

A foreclosed home in North Minneapolis.



Map by Charlie Edelman, Macalester College geography student, April 2009. Based on 2007 data from MetroGIS and the Hennepin County Sheriff's Office.

A map showing the density of foreclosed properties in 2007 in a 27 × 18 block area (approximate) of North Minneapolis. Red represents owner-occupied properties; blue represents renter-occupied properties.

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *Finland also suffered*

*a financial crisis in the early 1990s and followed similar sorts of policies as Chile, paying the costs of reform and letting the market dictate the allocation of credit to the private sector. The Finnish economy has grown spectacularly since then.*

Looking at the historical evidence, Kehoe and Prescott conclude that bad government policies are responsible for causing great depressions. In particular, they hypothesize that, while different sorts of shocks can lead to ordinary business cycle downturns, overreaction by the government can prolong and deepen the downturn, turning it into a depression.

An instructive exercise is to compare the experiences of Chile and Mexico in the 1980s studied in *Great Depressions of the Twentieth Century* by Raphael Bergoeing et al. (2007). In 1981–82, both countries were hit by the shocks of rising world interest rates and falling international prices of the commodities they exported—copper for Chile and petroleum for Mexico. These shocks exposed weakness in the banking systems in both countries and produced financial crises.

In 1982 in Chile, banks that held half of the deposits were suffering severe liquidity crises. The government took control of these banks. Within three years, the Chilean government had liquidated the insolvent banks and reprivatized the solvent banks. The government set up a new regulatory scheme to avoid mismanagement. These new regulations allowed the market to determine interest rates and the allocation of credit to firms. The short-term costs of the crisis and the reform in Chile were severe, and real GDP fell sharply in 1982 and 1983. By 1984, however, the Chilean economy started to grow, and Chile has been the fastest-growing economy in Latin America since then.

In 1982 in Mexico, the government nationalized the entire banking system, and banks were only reprivatized in the early 1990s. Throughout the 1980s, in an effort to maintain employment and investment, the government-controlled banks provided credit at below-market interest rates to some large firms and no credit to others. Even the privatization of banks in the early 1990s and the reforms following the 1995 crisis have not been effective in producing a banking system that

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

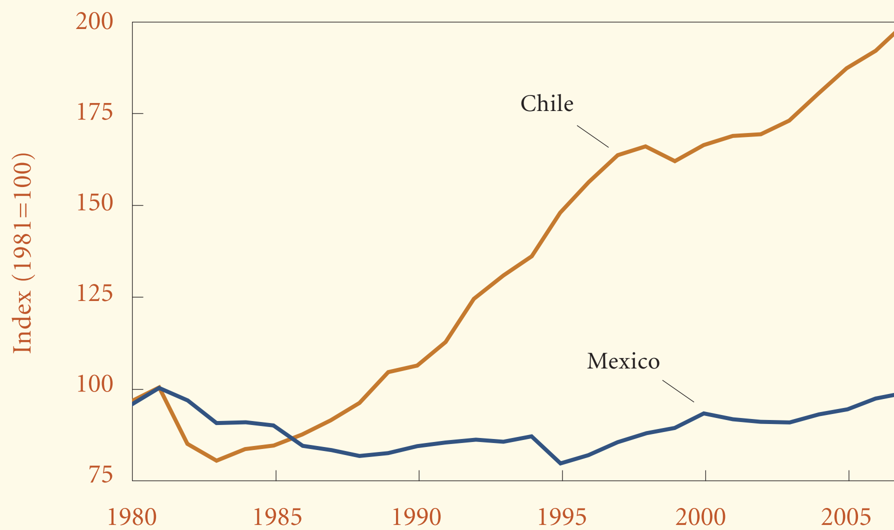
## OBSERVATION:

# *Unproductive firms*

*need to die. ... Bailouts and other financial efforts to keep unproductive firms in operation depress productivity. These firms absorb labor and capital that are better used by productive firms. The market makes better decisions than the government.*

provides substantial credit at market interest rates to firms in Mexico. The result has been an economic disaster for Mexico: Between 1982 and 1995, Mexico experienced no economic growth and has grown only modestly since then.

Real GDP per working-age person in Chile and Mexico




The differences in economic performance in Chile and Mexico since the early 1980s have not been in employment and investment, but in productivity. In Chile, unproductive firms have died and new firms have been born and grown. Workers and capital have been channeled from unproductive to productive firms. In Mexico, a poorly functioning financial system has impeded this process.

Some features of the situations in Chile and Mexico in the 1980s should make us cautious in generalizing the lessons learned from studying their crises to the current crisis in North America and Western Europe: Chile and Mexico were poorer and were in a financial crisis that

Last day at Lehman Brothers offices in New York City.

Bear Stearns corporate headquarters in New York City.

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *Different sorts of shocks*

*can start financial crises. However,*

*the analysis of great depressions shows that*

*the type of shock that starts the depression*

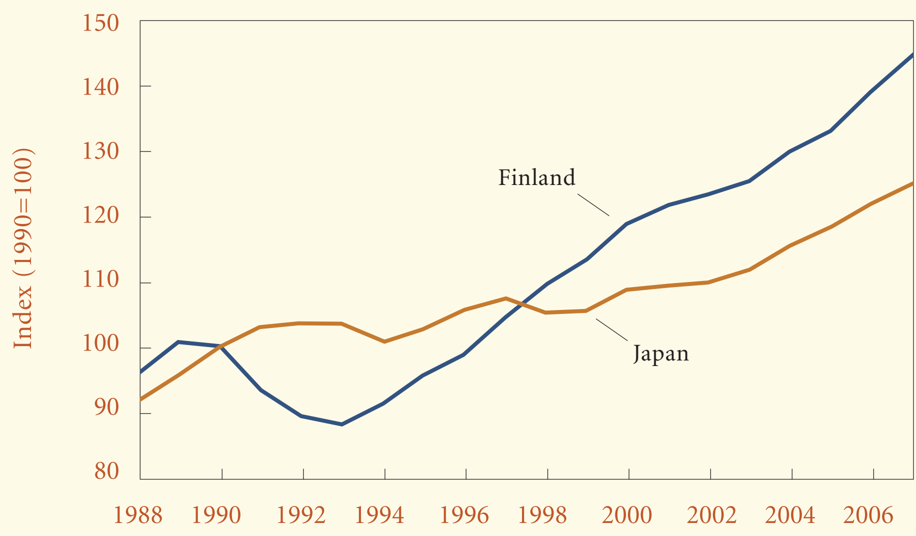
*is less important than reaction to the shock*

*by the economy and, in particular,*

*the government.*

was largely restricted to Latin America. Furthermore, Chile undertook its massive and costly reforms when its government was a military dictatorship, which eliminated the need to obtain difficult political consensus.

Real GDP per working-age person in Finland and Japan




Nevertheless, the central lessons from studying Chile and Mexico can be generalized. Consider the crises in Finland and Japan, also studied in *Great Depressions of the Twentieth Century*—Finland by Juan Carlos Conesa et al. (2007) and Japan by Fumio Hayashi and Edward Prescott (2007). Japan suffered a financial crisis in the early 1990s and followed similar sorts of policies as Mexico, keeping otherwise insolvent banks running, providing credit to some firms and not others, and using massive fiscal stimulus programs to maintain employment and investment. Japan has stagnated since then. Finland also suffered a financial crisis in

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *The lack of understanding*

*of systemic risk on the part of banks, regulators, and bond ratings agencies calls for reform and, perhaps, new regulations.*

the early 1990s and followed similar sorts of policies as Chile, paying the costs of reform and letting the market dictate the allocation of credit to the private sector. The Finnish economy has grown spectacularly since then.

Now the countries of North America and Western Europe find themselves in a financial crisis. To emerge from the crisis as did Chile and Finland, and not become trapped in stagnation as did Mexico and Japan, these countries need to avoid implementing policies that stifle productivity by providing bad incentives to the private sector. With banks and other financial institutions in crisis, these governments need to focus on providing liquidity so that banks can provide credit at market interest rates and, using the market mechanism, to productive firms. Unproductive firms need to die. This is as true for the automobile industry as it is for the banking system. Bailouts and other financial efforts to keep unproductive firms in operation depress productivity. These firms absorb labor and capital that are better used by productive firms. The market makes better decisions than does the government about which firms should survive and which should die.

Different sorts of shocks can start financial crises. Some shocks are external to the economy. In the cases of Chile and Mexico, the shock was the increase in world interest rates and the decrease in international commodity prices, and in the case of Finland, it was collapse in trade with the former Soviet Union. Some shocks are internal. In the case of Japan, the shock was the fall in the prices of commercial real estate, and, currently in North America and Western Europe, it is the fall in the prices of residential real estate. The analysis of great depressions shows that the type of shock that starts the depression is less important than reaction to the shock by the economy and, in particular, the government.

Over the past decade, lending by China and other countries in East Asia, fueled by massive

Circuit City, the nation's second-largest electronics retailer, shut its doors for good, liquidating the last of its merchandise.

Unsold automobiles sit in the Marine Terminal at the Port of Baltimore.

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *Indiscriminate bailouts*

*in the financial sector will reward*

*many of those who made bad decisions*

*and make it even more difficult*

*to assess risks in the future.*

trade surpluses, has kept world interest rates low. Consumers in North America and Western Europe have benefited from these low interest rates and have consumed and invested more. Much of the increased investment has been in residential real estate. In the United States, much of this investment has been concentrated in certain cities and regions. In Europe, much of it has been concentrated in Spain. In a more integrated Europe, Spain has the same natural role as Florida and Arizona have in the United States. There is nothing wrong with investment in real estate or with the investment being concentrated as long as investors understand the risks.

The specific problem with the real estate boom of the early 2000s was that it generated an aggregate risk when most investors were betting that housing prices could go in no other direction than up. The systemic risk created by the possibility of housing prices falling was a problem precisely because banks, regulators, and bond ratings agencies either did not understand that this risk existed or did not understand its implications. When housing prices fell, many mortgage-backed bonds that were rated AAA by ratings agencies turned out to be riskier than Argentinean government bonds in the late 1990s. If the risk of a fall in housing prices had been understood and priced correctly, higher interest rates on lending for construction projects and mortgages would have corrected the problem. The lack of understanding of systemic risk on the part of banks, regulators, and bond ratings agencies calls for reform and, perhaps, new regulations.

The fall in housing prices has exposed an even more fundamental problem in the financial system. Some investors and policymakers have come to regard some financial institutions, and even some manufacturing firms, as being too big to fail. In the banking system, a tension exists between the government insuring depositors in banks and regulating the banks. The fundamental principle involved in efficiently allocating risk is that any insurance should be accompanied by

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *Central banks*

*in the countries that are in crisis*

*should lend to banks to maintain liquidity.*

*Any bailouts of nonbank financial institutions*

*should be accompanied, at least temporarily,*

*by strict regulations.*

regulation. Any institution that is too big to fail needs to be regulated.

Governments are now spending huge sums of public money to bail out financial institutions that had not been previously regulated. Even aside from the costs of generating the need for more taxes, these bailouts will create difficulties for the future. Risky investments will pay returns in spite of bad outcomes. Labor and capital will stay employed in unproductive uses. Incentives for future investment will be distorted by moral hazard problems. The North American and Western European countries in crises now got there because of poor assessments of risk. Indiscriminate bailouts in the financial sector will reward many of those who made bad decisions and make it even more difficult to assess risks in the future. Understanding the moral hazard problems created by bailouts, many citizens and politicians will call for massive regulation of all financial institutions. Directly and indirectly, massive and indiscriminate bailouts of the financial system will create inefficiency and low productivity.

What do they need to do now? The central banks in the countries that are in crisis should lend to banks to maintain liquidity. Any bailouts of nonbank financial institutions should be accompanied, at least temporarily, by strict regulations. The bailout should not be used to maintain high returns either to the equity holders or to the bond holders in these institutions. Investors who made risky investments should not be rewarded when these investments have gone bad. Any public spending on investment in infrastructure should be justified on its own merits, especially in terms of its potential for increasing productivity. Otherwise, governments should let the market work in letting unproductive firms go bankrupt and reallocating what remains of their resources to more productive firms. Reforming bankruptcy laws in some countries could make this process more efficient.

A trader watches news of the latest Fed plan to boost liquidity in the credit markets.

Photograph by Paula Woessner

An all-too-common sign in North Minneapolis, and across the nation.

WHAT SHOULD WE LEARN FROM
THE GREAT DEPRESSIONS OF THE 20TH CENTURY?

## OBSERVATION:

# *There are costs*

*to be paid for past mistakes, but, if this opportunity is used to make reforms and reallocate resources to more productive uses, the economies of North America and Western Europe can emerge quickly from the current crisis as Chile and Finland did from theirs, and stronger than ever.*

The people and the governments of some countries may decide that there should be some sort of social insurance for workers who lose their jobs, for households who lose their homes, and even for firms in some sectors or regions. If so, this insurance should be provided directly and not indirectly through massive and indiscriminate bailouts of firms.

There are costs to be paid for past mistakes, but, if this opportunity is used to make reforms and reallocate resources to more productive uses, the economies of North America and Western Europe can emerge quickly from the current crisis as Chile and Finland did from theirs, and stronger than ever. Bear in mind, however, that as bad as the current situation is, it could get worse. If the financial crisis has the effect of stopping the flow of savings from China and other countries in East Asia to the rest of the world, interest rates will rise, making the adjustment more difficult.

Studying the experience of countries that have experienced great depressions during the 20th century teaches us that massive public interventions in the economy to maintain employment and investment during a financial crisis can, if they distort incentives enough, lead to a great depression. Those who try to justify the sorts of Keynesian policies implemented by the Mexican government in the 1980s and the Japanese government in the 1990s often quote Keynes' (1924) dictum from *A Tract on Monetary Reform:* "The long run is a misleading guide to current affairs. In the long run we are all dead." Studying past great depressions turns this dictum on its head: "If we do not consider the consequences of policy for productivity, in the long run we could all be in a great depression."

A large, vacant, newly constructed home in a northern Twin Cities exurb.

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Federal Reserve Bank of Minneapolis

# 2008 Operations Report

# Message from the First Vice President

The Federal Reserve System faces significant challenges and uncertainties as it seeks to fulfill its mission to foster the stability, integrity, and efficiency of the nation's monetary, financial, and payments systems. Over the past 18 months, the Federal Reserve System has taken unprecedented actions to respond to the financial and economic crisis through easing of monetary policy and the introduction of several new lending facilities.

During these times of uncertainty, the Federal Reserve Bank of Minneapolis remains focused on effectively executing its strategic plan, which is directed at ensuring all System objectives are met while also maximizing the Bank's operational efficiency and quality of service delivery. In addition, the Bank continues to seek opportunities to make important System contributions and pursue new business opportunities. For 2008, the Bank's many achievements demonstrate our effectiveness in executing our strategic plan and building on our strengths.

- Overall, Bank performance was strong in 2008. Bank expenses were below budgeted levels, all efficiency measures in the check and cash operations were better than plan, and the Bank met nearly all quality measures. Our check operations met the Retail Payments Office's cost target. However, the sales revenue target was not fully achieved due to a more rapid transition to electronic check processing by our customers than assumed in our plans.

- The Bank effectively led the Financial Services Policy Committee (the Federal Reserve System's payments policymaking arm) and the Financial Services Council, as evidenced by the achievement of all of their high priority objectives, except full cost recovery in Check.

- The Bank pursued several initiatives as part of its continuing commitment to advance economic research and financial literacy, as well as to increase awareness of community development issues. In particular, the Bank's analysis and recommendations to better manage the too-big-to-fail problem have received increased attention given financial market developments. A number of scholarly articles published by the Bank's economists and advisers helped promote understanding of other policy issues.

- One of our key challenges in 2008 was the need to accelerate the planned consolidation of our check operations as paper check processing volumes declined at a faster rate than expected. The check operations in Minneapolis transitioned from a full service paper and electronic check processing operation to a more limited capture/print operation during the fourth quarter of 2008.

# 2008 by the Numbers

In 2008, the Federal Reserve Bank of Minneapolis processed:

- 11.4 billion ACH (Automated Clearing House) payments worth approximately $19.8 trillion. FedACH is a nationwide system, developed and operated by Minneapolis staff on behalf of the entire Federal Reserve System, which provides the electronic exchange of debits and credits.

- 850 million check items worth $810 million; 80 percent of the items were received electronically.

- $10.5 billion of currency deposits from financial institutions, destroyed $963 million of worn and torn currency, and shipped $12.4 billion of currency to financial institutions.

- Tenders, account maintenance, forms, and other customer transactions for 319,000 active Legacy Treasury Direct accounts for individuals holding Treasury securities totaling $62 billion, and 3.6 million savings bond purchase requests worth $1.8 billion, as one of two Treasury Retail Securities sites in the Federal Reserve System.

- 209,700 transaction items valued at $505 billion through FR-ETA (Federal Reserve-Electronic Tax Application), a same-day payment mechanism, hosted by the Minneapolis Fed, for businesses paying federal taxes via their financial institutions.

■ The Supervision, Regulation, and Credit Division focused its efforts on the oversight of the District's only large complex banking organization and prompt identification and redress of the areas of greatest risk in the financial institutions under supervision.

■ The Bank manages several key System operational responsibilities including FedACH Support Services, Treasury Services, Electronic Access Customer Contact Center, FedMail/FedPhone Leadership Center, Learning Management Support Office, and Technology Project Standards Office. The Bank met expectations for these responsibilities as defined by System performance metrics and corroborated by feedback from other Federal Reserve Banks and Product Offices.

The Bank's success in 2008 is a result of the strong commitment by our employees to excellence and the Bank's core values. Looking to the future, we will strive to sustain this commitment, successfully meet the challenges that lie ahead, and thereby continue to support the Federal Reserve System's mission to foster stability, integrity, and efficiency in the nation's monetary, financial, and payments systems.

James M. Lyon
First Vice President

## Helena Branch Board of Directors

Seated (from left): Joseph McDonald, Dean Folkvord; standing (from left): John Franklin, Timothy Bartz, Kay Clevidence

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Joseph F. McDonald
*Vice Chair*

Timothy J. Bartz
*Chief Executive Officer*
Anderson ZurMuehlen & Co. PC
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Kay Clevidence
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Farmers State Bank
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Jake Marvin, *Deputy Chair*

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(elected by member banks
to represent member banks)

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*Chief Executive Officer*
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*Chief Executive Officer*
Reuben Johnson & Son Inc.
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Randy Peterson
*Facility Director*
Lake Superior State University
Sault Ste. Marie, Michigan

William J. Shorma
*President and*
*Chief Executive Officer*
Shur-Co
Yankton, South Dakota

Class C Directors
(elected by the Board of Directors
to represent the public)

Mary K. Brainerd
*President and*
*Chief Executive Officer*
HealthPartners
Minneapolis, Minnesota

James J. Hynes
*Executive Officer*
Twin City Pipe Trades
Service Association
St. Paul, Minnesota

Jake Marvin
*Chairman and*
*Chief Executive Officer*
Marvin Windows and Doors
Warroad, Minnesota



PHOTOGRAPHY BY STEVE NIEDORF (THIS PAGE)

## Advisory Council on Small Business and Labor

William Shorma (Chairman)
*President*
Shur-Co
Yankton, South Dakota

David Brown
*Senior Vice President*
Business Banking
Home Federal Bank
Sioux Falls, South Dakota

Rolin Erickson
*President*
Montana Resources LLP
Butte, Montana

Kim Hamilton
*Owner*
White Winter Winery
Iron River, Wisconsin

Marty Lasley
*President*
Alan Sturm & Associates
Edina, Minnesota

Harry Lerner
*Chief Executive Officer*
Lerner Publishing Group
Minneapolis, Minnesota

Keith Moyle
*Vice President and*
*General Manager*
Upper Peninsula Power Co.
Ishpeming, Michigan

Prakash Puram
*President and*
*Chief Executive Officer*
iXmatch Inc.
Minneapolis, Minnesota

Jon Reissner
*President and*
*Chief Executive Officer*
MagStar Technologies Inc.
Hopkins, Minnesota

G. Bradley Schlossman
*Chief Executive Officer*
West Acres Development
Fargo, North Dakota

Pamela Schmidt
*Vice President*
SIA Marketing
Bismarck, North Dakota

Randy Schneider
*Certified Public Accountant*
Bismarck, North Dakota

Seated (from left): Keith Moyle, G. Bradley Schlossman, Pamela Schmidt, Randy Schneider; standing (from left): David Brown, Harry Lerner, William Shorma, Prakash Puram, Marty Lasley, Jon Reissner

## Advisory Council on Agriculture

Seated (from left): Richard Dale, Dean Folkvord, Duane Kroll, Joel Dick; standing (from left): G. C. "Tucker" Hughes, Katie Dilse, Dean Dreessen, William Kaul, Lisa Heggedahl, Rodney Schmidt

Dean Folkvord (Chairman)
*General Manager and Chief Executive Officer*
Wheat Montana Farms and Bakery
Three Forks, Montana

Richard Dale
*Owner*
Highland Valley Farm
Bayfield, Wisconsin

Joel Dick
*Vice President and Chief Operating Officer*
Roman Meal Milling Co.
Fargo, North Dakota

Katie Dilse
*Owner*
Dilse Farm
Scranton, North Dakota

Dean Dreessen
*Executive Vice President*
Merchants State Bank
Freeman, South Dakota

Stephen Hansen
*President*
F.H.C. Inc.
Oakes, North Dakota

Lisa Heggedahl
*Owner*
Adah Oaks Angus
Hayfield, Minnesota

G. C. "Tucker" Hughes
*President*
Hughes & Sons Cattle Co.
Stanford, Montana

William Kaul
*Vice President*
Great River Energy
Elk River, Minnesota

Duane Kroll
*Owner*
Kroll Farm
Royalton, Minnesota

Rodney Schmidt
*District Manager*
Bayer Crop Science
Lakeville, Minnesota



PHOTOGRAPHY BY STEVE NIEDORF

# Federal Reserve Bank of Minneapolis

## Senior Management

Seated (from left): James Lyon, Claudia Swendseid, Ron Feldman, Niel Willardson; standing (from left): Creighton Fricek, Duane Carter, Arthur Rolnick, Gary Stern, Cheryl Venable

Gary H. Stern
*President*

James M. Lyon
*First Vice President*

Duane A. Carter
*Senior Vice President and Equal Employment Opportunity Officer*

Ron J. Feldman
*Senior Vice President*

Creighton R. Fricek
*Senior Vice President and Corporate Secretary*

Arthur J. Rolnick
*Senior Vice President and Director of Research*

Claudia S. Swendseid
*Senior Vice President*

Cheryl L. Venable
*Senior Vice President*

Niel D. Willardson
*Senior Vice President and General Counsel*



PHOTOGRAPHY BY STEVE NIEDORF

# Federal Reserve Bank of Minneapolis

## Officers

Barbara G. Coyle
*Vice President*

R. Paul Drake
*Vice President and Branch Manager*

David G. Fettig
*Vice President*

Michael Garrett
*Vice President*

Linda M. Gilligan
*Vice President and General Auditor*

Matthew D. Larson
*Vice President*

Frederick L. Miller
*Vice President*

Marie R. Munson
*Vice President*

Paul D. Rimmereid
*Vice President and Chief Financial Officer*

Susan K. Rossbach
*Vice President and Deputy General Counsel*

Richard M. Todd
*Vice President*

Mary E. Vignalo
*Vice President*

Warren E. Weber
*Senior Research Officer*

Peter Baatrup
*Assistant Vice President and Assistant General Counsel*

Nicole E. Bennett
*Assistant Vice President*

Kelly A. Bernard
*Assistant Vice President*

Sheryl L. Britsch
*Assistant Vice President*

Jacquelyn K. Brunmeier
*Assistant Vice President*

Michelle R. Brunn
*Assistant Vice President*

James A. Colwell
*Assistant Vice President*

Walter A. Cox
*Assistant Vice President*

James T. Deusterhoff
*Assistant Vice President and Discount Officer*

Timothy L. Devaney
*Assistant Vice President*

Scott F. Forss
*Assistant Vice President*

Jean C. Garrick
*Assistant Vice President*

Peter J. Gavin
*Assistant Vice President*

Jacqueline G. King
*Assistant Vice President and Community Affairs Officer*

Elizabeth W. Kittelson
*Assistant Vice President*

Deborah A. Koller
*Assistant Vice President*

Todd A. Maki
*Assistant Vice President*

Kinney G. Misterek
*Assistant Vice President*

Forrest W. Peiper
*Assistant Vice President*

Barbara J. Pfeffer
*Assistant Vice President*

Mark A. Rauzi
*Assistant Vice President*

Randy L. St. Aubin
*Assistant Vice President and Assistant General Auditor*

Darian A. Vietzke
*Assistant Vice President*

Mark R. Vukelich
*Assistant Vice President*

Tamra J. Wheeler
*Assistant Vice President*

John E. Yanish
*Assistant Vice President*

December 31, 2008

## Auditor Independence

In 2008, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks. Fees for D&T's services are estimated to be $10.2 million. Approximately $2.7 million of the estimated total fees were for the audits of the limited liability companies (LLCs) that are associated with recent Federal Reserve actions to address the financial crisis, and are consolidated in the financial statements of the Federal Reserve Bank of New York.[1] To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of Reserve Banks, or in any other way impairing its audit independence. In 2008, the Bank did not engage D&T for any non-audit services.

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

Federal Reserve Bank of Minneapolis

# 2008 Financial Statements

December 31, 2008 and 2007


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Federal Reserve Bank of Minneapolis

90 Hennepin Avenue, P.O. Box 291
Minneapolis, Minnesota 55480-0291

Phone (612) 204-5000

April 2, 2009

To the Board of Directors
Federal Reserve Bank of Minneapolis
90 Hennepin Avenue, P.O. Box 291
Minneapolis, MN 55480

The management of the Federal Reserve Bank of Minneapolis ("FRBM") is responsible for the preparation and fair presentation of the Statement of Condition, Statements of Income and Comprehensive Income, and Statement of Changes in Capital as of December 31, 2008 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and as such, include amounts, some of which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the Manual and include all disclosures necessary for such fair presentation.

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

Even effective internal control, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Federal Reserve Bank of Minneapolis

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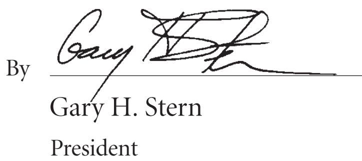
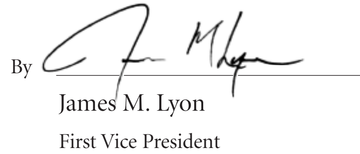
Minneapolis, Minnesota 55480-0291

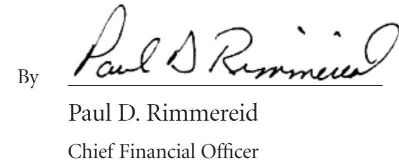
Phone (612) 204-5000

The management of the FRBM assessed its internal control over financial reporting reflected in the Financial Statements, based upon the criteria established in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that the FRBM maintained effective internal control over financial reporting as it relates to the Financial Statements.

Federal Reserve Bank of Minneapolis

By 
Gary H. Stern
President

By 
James M. Lyon
First Vice President

By 
Paul D. Rimmereid
Chief Financial Officer

Deloitte.

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## REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying statements of condition of the Federal Reserve Bank of Minneapolis ("FRB Minneapolis") as of December 31, 2008 and 2007 and the related statements of income and comprehensive income and changes in capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRB Minneapolis as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRB Minneapolis's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management Assertion*. Our responsibility is to express an opinion on these financial statements and an opinion on FRB Minneapolis's internal control over financial reporting based on our audits.

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

FRB Minneapolis's internal control over financial reporting is a process designed by, or under the supervision of, FRB Minneapolis's principal executive and principal financial officers, or persons performing similar functions, and effected by FRB Minneapolis's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. FRB Minneapolis's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of FRB Minneapolis; (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

**Member of**
**Deloitte Touche Tomatsu**

Governors of the Federal Reserve System, and that receipts and expenditures of FRB Minneapolis are being made only in accordance with authorizations of management and directors of FRB Minneapolis; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of FRB Minneapolis'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, FRB Minneapolis 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, the financial statements referred to above present fairly, in all material respects, the financial position of FRB Minneapolis as of December 31, 2008 and 2007, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, FRB Minneapolis maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

April 2, 2009

Federal Reserve Bank of Minneapolis

Federal Reserve Bank of Minneapolis

# STATEMENTS OF CONDITION

As of December 31, 2008 and December 31, 2007
(in millions)

| | 2008 | 2007 |
|---|---|---|
| ASSETS | | |
| Gold certificates | $ 199 | $ 203 |
| Special drawing rights certificates | 30 | 30 |
| Coin | 54 | 45 |
| Items in process of collection | 76 | 98 |
| Loans to depository institutions | 5,860 | 3 |
| System Open Market Account: | | |
| Securities purchased under agreements to resell | 1,510 | 928 |
| U.S. government, Federal agency, and government-sponsored enterprise securities, net | 9,481 | 14,877 |
| Investments denominated in foreign currencies | 477 | 413 |
| Central bank liquidity swaps | 10,641 | 438 |
| Interdistrict settlement account | – | 2,140 |
| Bank premises and equipment, net | 121 | 122 |
| Accrued interest receivable | 142 | 127 |
| Other assets | 18 | 20 |
| **Total assets** | $ 28,609 | $ 19,444 |
| | | |
| LIABILITIES AND CAPITAL | | |
| Federal Reserve notes outstanding, net | $ 14,684 | $ 16,429 |
| System Open Market Account: | | |
| Securities sold under agreements to repurchase | 1,668 | 877 |
| Deposits: | | |
| Depository institutions | 1,614 | 1,104 |
| Other deposits | 1 | 1 |
| Deferred credit items | 235 | 222 |
| Interest on Federal Reserve notes due to U.S. Treasury | 32 | 38 |
| Interdistrict settlement account | 9,656 | – |
| Accrued benefit costs | 61 | 55 |
| Other liabilities | 8 | 8 |
| **Total liabilities** | 27,959 | 18,734 |
| | | |
| Capital paid-in | 325 | 355 |
| Surplus (including accumulated other comprehensive loss of $5 million and $1 million at December 31, 2008 and 2007, respectively) | 325 | 355 |
| **Total capital** | 650 | 710 |
| **Total liabilities and capital** | $ 28,609 | $ 19,444 |

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

Federal Reserve Bank of Minneapolis

## STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

For the years ended December 31, 2008 and December 31, 2007
(in millions)

| | 2008 | 2007 |
|---|---|---|
| Interest income: | | |
| Loans to depository institutions | $ 47 | $ 2 |
| System Open Market Account: | | |
| Securities purchased under agreements to resell | 36 | 28 |
| U.S. government, Federal agency, and government-sponsored enterprise securities | 494 | 777 |
| Investments denominated in foreign currencies | 12 | 10 |
| Central bank liquidity swaps | 69 | – |
| Total interest income | 658 | 817 |
| Interest expense: | | |
| System Open Market Account: | | |
| Securities sold under agreements to repurchase | 14 | 34 |
| Depository institutions deposits | 2 | – |
| Total interest expense | 16 | 34 |
| Net interest income | 642 | 783 |
| Non-interest income: | | |
| System Open Market Account: | | |
| U.S. government, Federal agency, and government-sponsored enterprise securities gains, net | 74 | – |
| Foreign currency gains, net | 24 | 34 |
| Compensation received for services provided | 76 | 79 |
| Reimbursable services to government agencies | 27 | 29 |
| Other income | 15 | 1 |
| Total non-interest income | 216 | 143 |
| Operating expenses: | | |
| Salaries and other benefits | 104 | 105 |
| Occupancy expense | 12 | 12 |
| Equipment expense | 6 | 7 |
| Assessments by the Board of Governors | 20 | 20 |
| Other expenses | 41 | 43 |
| Total operating expenses | 183 | 187 |
| Net income prior to distribution | 675 | 739 |
| Change in funded status of benefit plans | (4) | 11 |
| **Comprehensive income prior to distribution** | $ 671 | $ 750 |
| Distribution of comprehensive income: | | |
| Dividends paid to member banks | $ 20 | $ 19 |
| Transferred (from)/to surplus and change in accumulated other comprehensive loss | (30) | 79 |
| Payments to U.S. Treasury as interest on Federal Reserve notes | 681 | 652 |
| **Total distribution** | $ 671 | $ 750 |

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

# STATEMENTS OF CHANGES IN CAPITAL

For the years ended December 31, 2008 and December 31, 2007
(in millions, except share data)

| | | Surplus | | | |
|---|---|---|---|---|---|
| | Capital paid-in | Net income retained | Accumulated other comprehensive loss | Total surplus | Total capital |
| **Balance at January 1, 2007** (5.5 million shares) | $ 276 | $ 288 | $ (12) | $ 276 | $ 552 |
| Net change in capital stock issued (1.6 million shares) | 79 | – | – | – | 79 |
| Transferred to surplus and change in accumulated other comprehensive loss | – | 68 | 11 | 79 | 79 |
| **Balance at December 31, 2007** (7.1 million shares) | $ 355 | $ 356 | $ (1) | $ 355 | $ 710 |
| Net change in capital stock redeemed (0.6 million shares) | (30) | – | – | – | (30) |
| Transferred from surplus and change in accumulated other comprehensive loss | – | (26) | (4) | (30) | (30) |
| **Balance at December 31, 2008** (6.5 million shares) | $ 325 | $ 330 | $ (5) | $ 325 | $ 650 |

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

# Notes to Financial Statements

## 1. Structure

The Federal Reserve Bank of Minneapolis ("Bank") is part of the Federal Reserve System ("System") and is one of the twelve Reserve Banks ("Reserve Banks") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act"), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank serves the Ninth Federal Reserve District, which includes Minnesota, Montana, North Dakota, South Dakota, and portions of Michigan and Wisconsin.

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

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

## 2. Operations and Services

The Reserve Banks perform a variety of services and operations. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government's bank; provision of short-term loans to depository institutions; provision of loans to individuals, partnerships, and corporations in unusual and exigent circumstances; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY to execute transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of securities of the U.S. government, Federal agencies, and government-sponsored enterprises ("GSEs"), the purchase of these securities under agreements to resell, the sale of these securities under agreements to repurchase, and the lending of these securities. The FRBNY executes these transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account ("SOMA").

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

Although the Reserve Banks are separate legal entities, they collaborate in the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks providing the service and the other 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 reimburse the other Reserve Banks for services provided to them.

## 3. Recent Financial Stability Activities

The Federal Reserve has implemented a number of programs designed to support the liquidity of financial institutions and to foster improved conditions in financial markets. These new programs, which are set forth below, have resulted in significant changes to the Bank's financial statements.

***Expanded Open Market Operations and Support for Mortgage Related Securities***

The Single-Tranche Open Market Operation Program, created on March 7, 2008, allows primary dealers to initiate a series of term repurchase transactions that are expected to accumulate up to $100 billion in total. Under the provisions of the program, these transactions are conducted as 28-day term repurchase agreements for which primary dealers pledge U.S. Treasury and agency securities and agency Mortgage-Backed Securities ("MBS") as collateral. The FRBNY can elect to increase the size of the term repurchase program if conditions warrant. The repurchase transactions are reported as "System Open Market Account: Securities purchased under agreements to resell" in the Statements of Condition.

The GSE and Agency Securities and MBS Purchase Program was announced on November 25, 2008. The primary goal of the program is to provide support to the mortgage and housing markets and to foster improved conditions in financial markets. Under this program, the FRBNY will purchase the direct obligations of housing-related GSEs and MBS backed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"). Purchases of the direct obligations of housing-related GSEs began in November 2008 and purchases of GSE and agency MBS began in January 2009. There were no purchases of GSE and agency MBS during the period ended December 31, 2008. The program was initially authorized to purchase up to $100 billion in GSE direct obligations and up to $500 billion in GSE and agency MBS. In March 2009, the FOMC authorized FRBNY to purchase up to an additional $750 billion of GSE and agency MBS and up to an additional $100 billion of GSE direct obligations.

The FRBNY holds the resulting securities and agreements in the SOMA portfolio and the activities of both programs are allocated to the other Reserve Banks.

***Central Bank Liquidity Swaps***

The FOMC authorized the FRBNY to establish temporary reciprocal currency swap arrangements (central bank liquidity swaps) with the European Central Bank and the Swiss National Bank on December 12, 2007 to help provide liquidity in U.S. dollars to overseas markets. Subsequently, the FOMC authorized reciprocal currency swap arrangements with additional foreign central banks. Such arrangements are now authorized with the following central banks: the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, Sveriges Riksbank, and the Swiss National Bank. The activity related to the program is allocated to the other Reserve Banks. The maximum amount of borrowing permissible under the swap arrangements varies by central bank. The central bank liquidity swap arrangements are authorized through October 30, 2009.

***Lending to Depository Institutions***

The temporary Term Auction Facility ("TAF") program was created on December 12, 2007. The goal of the TAF is to help promote the efficient dissemination of liquidity, which is achieved by the Reserve Banks injecting term funds through a broader range of counterparties and against a broader range of collateral than open market operations. Under the TAF program, Reserve Banks auction term funds to depository institutions against a wide variety of collateral. All depository institutions that are judged to be in generally sound financial condition by their Reserve Bank and that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All advances must be fully collateralized. The loans are reported as "Loans to depository institutions" in the Statements of Condition.

***Lending to Primary Dealers***

The Term Securities Lending Facility ("TSLF") was created on March 11, 2008 to promote the

liquidity in the financing markets for U.S. Treasury securities and other collateral. Under the TSLF, the FRBNY will lend up to an aggregate amount of $200 billion of U.S. Treasury securities to primary dealers secured for a term of 28 days. Securities loans are collateralized by a pledge of other securities, including federal agency debt, federal agency residential mortgage-backed securities, and non-agency AAA/Aaa-rated private-label residential mortgage-backed securities, and are awarded to primary dealers through a competitive single-price auction. The TSLF is authorized through October 30, 2009. The fees related to these securities lending transactions are reported as a component of "Non-interest income: Other income" in the Statements of Income and Comprehensive Income.

The Term Securities Lending Facility Options Program ("TOP"), created on July 30, 2008, offers primary dealers the option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The options are awarded through a competitive auction. The program is intended to enhance the effectiveness of the TSLF by ensuring additional securities liquidity during periods of heightened collateral market pressures, such as around quarter-end dates. TOP auction dates are determined by the FRBNY, and the program authorization ends concurrently with the TSLF.

***Other Lending Facilities***

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF"), created on September 19, 2008, is a lending facility that provides funding to U.S. depository institutions and bank holding companies to finance the purchase of high-quality asset-backed commercial paper ("ABCP") from money market mutual funds under certain conditions. The program is intended to assist money market mutual funds that hold such paper to meet the demands for investor redemptions and to foster liquidity in the ABCP market and money markets more generally. The Federal Reserve Bank of Boston ("FRBB") administers the AMLF and is authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. All loans extended under the AMLF are recorded as assets by the FRBB and, if the borrowing institution settles to a depository account in the Ninth Reserve District, the funds are credited to the institution's depository account and settled between the Banks through the interdistrict settlement account. The credit risk related to the AMLF is assumed by the FRBB. The FRBB is authorized to finance the purchase of commercial paper through October 30, 2009.

## 4. Significant Accounting Policies

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

Differences exist between the accounting principles and practices in the FAM and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all SOMA securities holdings at amortized cost rather than using the fair value presentation required by GAAP. U.S. government, Federal agency, and GSE securities, and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and are adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Although the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Bank has elected not to present a Statement of Cash Flows because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the FAM and GAAP.

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

**a. *Gold and Special Drawing Rights Certificates***

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

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

among the Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund (the "Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2008 or 2007.

**b. *Loans to Depository Institutions***

Loans are reported at their outstanding principal balances net of commitment fees. Interest income is recognized on an accrual basis. Loan commitment fees are generally deferred and amortized on a straight-line basis over the commitment period, which is not materially different from the interest method.

Outstanding loans are evaluated to determine whether an allowance for loan losses is required. The Bank has developed procedures for assessing the adequacy of the allowance for loan losses that reflect the assessment of credit risk considering all available information. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers.

Loans are considered to be impaired when it is probable that the Bank will not receive principal and interest due in accordance with the contractual terms of the loan agreement. The amount of the impairment is the difference between the recorded amount of the loan and the amount expected to be collected, after consideration of the fair value of the collateral. Recognition of interest income is discontinued for any loans that are considered to be impaired. Cash payments made by borrowers on impaired loans are applied to principal until the balance is reduced to zero; subsequent payments are recorded as recoveries of amounts previously charged off and then to interest income.

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

The FRBNY may engage in tri-party purchases of securities under agreements to resell ("tri-party agreements"). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities; pass-through mortgage securities of Fannie Mae, Freddie Mac, and Ginnie Mae; STRIP securities of the U.S. government; and "stripped" securities of other government

agencies. The tri-party agreements are accounted for as financing transactions and the associated interest income is accrued over the life of the agreement.

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

U.S. government securities held in the SOMA are lent to U.S. government securities dealers to facilitate the effective functioning of the domestic securities market. Overnight securities lending transactions are fully collateralized by other U.S. government securities. Term securities lending transactions are fully collateralized with investment-grade debt securities, collateral eligible for tri-party repurchase agreements arranged by the Open Market Trading Desk, or both. The collateral taken in both overnight and term securities lending transactions is in excess of the fair value of the securities loaned. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income."

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

**d. *U.S. Government, Federal Agency, and Government-Sponsored Enterprise Securities; Investments Denominated in Foreign Currencies; and Warehousing Agreements***

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

Activity related to U.S. government, Federal agency, and GSE securities, including the premiums, discounts, and realized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

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

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

Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

**e. *Central Bank Liquidity Swaps***

At the initiation of each central bank liquidity swap transaction, the foreign central bank transfers a specified amount of its currency to 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. The foreign currency amounts that the FRBNY acquires are reported as "Central bank liquidity swaps" on the Statements of Condition. Because the swap transaction will be unwound at the same exchange rate that was 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 pays interest to the FRBNY based on the foreign currency amounts held by the FRBNY. The FRBNY recognizes interest income during the term of the swap agreement and reports the interest income as a component of "Interest income: Central bank liquidity swaps" in the Statements of Income and Comprehensive Income.

Activity related to these swap transactions, including the related interest income, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Similar to other investments denominated in foreign currencies, the foreign currency holdings associated with these central bank liquidity swaps are revalued at current foreign currency market exchange rates. Because the swap arrangement will be unwound at the same exchange rate that was used in the initial transaction, the obligation to return the foreign currency is also revalued at current foreign currency market exchange rates and is recorded in a currency exchange valuation account by the FRBNY. This revaluation method eliminates the effects of the changes in the market exchange rate. As of December 31, 2008, the FRBNY began allocating this currency exchange valuation account to the Bank and, as a result, the reported amount of central bank liquidity swaps reflects the Bank's allocated portion at the contract exchange rate.

**f. *Interdistrict Settlement Account***

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

**g. *Bank Premises, Equipment, and Software***

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from two to fifty years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the

asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

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

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

**h. *Federal Reserve Notes***

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

Assets eligible to be pledged as collateral security include all of the Bank's assets. The collateral value is equal to the book value of the collateral tendered with the exception of securities, for which the collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the outstanding Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government. At December 31, 2008 and 2007, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of $2,839 million and $2,790 million at December 31, 2008 and 2007, respectively.

**i. *Items in Process of Collection and Deferred Credit Items***

"Items in process of collection" in the Statements of Condition primarily represents amounts attributable to checks that have been deposited for collection and that, as of the balance sheet

date, have not yet been presented to the paying bank. "Deferred credit items" are the counterpart liability to items in process of collection, and the amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can vary significantly.

**j. *Capital Paid-in***

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

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

**k. *Surplus***

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks will be required to call on member banks for additional capital.

Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to other postretirement benefit plans that, under accounting standards, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

**l. *Interest on Federal Reserve Notes***

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to U.S. Treasury as interest on Federal Reserve notes" in the Statements of Income and Comprehensive Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

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

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

**m. *Interest on Depository Institution Deposits***

Beginning October 9, 2008, the Reserve Banks began paying interest to depository institutions on qualifying balances held at the Banks. Authorization for payment of interest on these balances was granted by Title II of the Financial Services Regulatory Relief Act of 2006, which had an effective date of 2011. Section 128 of the Emergency Economic Stabilization Act of 2008, enacted on October 3, 2008, made that authority immediately effective. The interest rates paid on required reserve balances and excess balances are based on an FOMC-established target range for the effective federal funds rate.

**n. *Income and Costs Related to U.S. Treasury Services***

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury has appropriations to pay for these services. During the years ended December 31, 2008 and 2007, the Bank was reimbursed for all services provided to the Department of the Treasury as its fiscal agent.

**o. *Compensation Received for Services Provided***

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

**p. *Assessments by the Board of Governors***

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred for the U.S. Treasury to prepare and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

**q. *Taxes***

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property and, in some states, sales taxes on construction-related materials. The Bank's real property taxes were $3 million for each of the years ended December 31, 2008 and 2007, and are reported as a component of "Occupancy expense."

**r. *Restructuring Charges***

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

Note 14 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain of the Bank's assets are discussed in Note 9. 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.

**s. *Recently Issued Accounting Standards***

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"), which established a single authoritative definition of fair value and a framework for measuring fair value, and expands the required disclosures for assets and liabilities measured at fair value. SFAS 157 was effective for fiscal years beginning after November 15, 2007, with early adoption permitted. The Bank adopted SFAS 157 effective January 1, 2008. The provisions of this standard have no material effect on the Bank's financial statements.

In February 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" ("SFAS 159"), which provides companies with an irrevocable option to elect fair value as the measurement for selected financial assets, financial liabilities, unrecognized firm commitments and written loan commitments that are not subject to fair value under other accounting standards. There is a one-time election available to apply this standard to existing financial instruments as of January 1, 2008; otherwise, the fair value option will be available for financial instruments on their initial transaction date. SFAS 159 reduces the accounting complexity for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently, and it eliminates the operational complexities of applying hedge accounting. The Bank adopted SFAS 159 effective January 1, 2008. The provisions of this standard have no material effect on the Bank's financial statements.

In February 2008, FASB issued FASB Staff Position ("FSP") FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions." FSP FAS 140-3 requires that an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of, the initial transfer be evaluated together as a linked transaction under SFAS 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," unless certain criteria are met. FSP FAS 140-3 is effective for the Bank's financial statements for the year beginning on January 1, 2009 and earlier adoption is not permitted. The provisions of this standard will not have a material effect on the Bank's financial statements.

## 5. LOANS

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

| | 2008 | 2007 |
|---|---|---|
| Primary, secondary, and seasonal credit | $ 124 | $ 3 |
| TAF | 5,736 | – |
| Total loans to depository institutions | $ 5,860 | $ 3 |

***Loans to Depository Institutions***

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

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans, U.S. Treasury securities, Federal agency securities, GSE obligations, foreign sovereign debt obligations, municipal or corporate obligations, 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 deemed appropriate by the Bank, which is typically fair value or face value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program are also eligible to participate in the temporary TAF program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans are extended on a short-term basis, with terms of either 28 or 84 days. All advances under the TAF must be fully collateralized. Assets eligible to collateralize TAF loans include the complete list noted above for loans to depository institutions. Similar to the process used for primary, secondary, and seasonal credit, a lending value is assigned to each asset accepted as collateral for TAF loans.

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

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

The maturity distribution of loans outstanding at December 31, 2008, was as follows (in millions):

| | Primary, secondary, and seasonal credit | TAF |
|---|---|---|
| Within 15 days | $ 74 | $ 5,714 |
| 16 days to 90 days | 50 | 22 |
| Total loans | $ 124 | $ 5,736 |

***Allowance for Loan Losses***

At December 31, 2008 and 2007, no loans were considered to be impaired and the Bank determined that no allowance for loan losses was required.

## 6. U.S. Government, Federal Agency, and Government-Sponsored Enterprise 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 1.888 percent and 1.995 percent at December 31, 2008 and 2007, respectively.

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

| | 2008 | 2007 |
|---|---|---|
| U.S. government securities: | | |
| Bills | $ 348 | $ 4,546 |
| Notes | 6,320 | 8,016 |
| Bonds | 2,317 | 2,215 |
| Federal agency and GSE securities | 372 | – |
| Total par value | 9,357 | 14,777 |
| Unamortized premiums | 152 | 159 |
| Unaccreted discounts | (28) | (59) |
| Total allocated to the Bank | $ 9,481 | $ 14,877 |

At December 31, 2008 and 2007, the fair value of the U.S. government, Federal agency, and GSE securities allocated to the Bank, excluding accrued interest, was $10,694 million and $15,506 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government, Federal agency, and GSE securities, net, held in the SOMA was $502,189 million and $745,629 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the fair value of the U.S. government, Federal agency, and GSE securities held in the SOMA, excluding accrued interest, was $566,427 million and $777,141 million, respectively, as determined by reference to quoted prices for identical securities.

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 central bank, to meet their financial obligations and responsibilities and do not represent a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31, 2008 and 2007, were as follows (in millions):

| | Securities purchased under agreements to resell | | Securities sold under agreements to repurchase | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Allocated to the Bank: | | | | |
| Contract amount outstanding, end of year | $ 1,510 | $ 928 | $ 1,668 | $ 877 |
| Weighted average amount outstanding, during the year | 1,832 | 700 | 1,236 | 695 |
| Maximum month-end balance outstanding, during the year | 2,247 | 1,028 | 1,861 | 877 |
| Securities pledged, end of year | | | 1,489 | 879 |
| System total: | | | | |
| Contract amount outstanding, end of year | $ 80,000 | $ 46,500 | $ 88,352 | $ 43,985 |
| Weighted average amount outstanding, during the year | 97,037 | 35,073 | 65,461 | 34,846 |
| Maximum month-end balance outstanding, during the year | 119,000 | 51,500 | 98,559 | 43,985 |
| Securities pledged, end of year | | | 78,896 | 44,048 |

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

The maturity distribution of U.S. government, Federal agency, and GSE securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2008, was as follows (in millions):

| | U.S. government securities (Par value) | Federal agency and GSE securities (Par value) | Subtotal: U.S. government, Federal agency, and GSE securities (Par value) | Securities purchased under agreements to resell (Contract amount) | Securities sold under agreements to repurchase (Contract amount) |
|---|---|---|---|---|---|
| Within 15 days | $ 361 | $ 9 | $ 370 | $ 755 | $ 1,668 |
| 16 days to 90 days | 396 | 62 | 458 | 755 | – |
| 91 days to 1 year | 1,196 | 18 | 1,214 | – | – |
| Over 1 year to 5 years | 3,272 | 214 | 3,486 | – | – |
| Over 5 years to 10 years | 1,837 | 69 | 1,906 | – | – |
| Over 10 years | 1,923 | – | 1,923 | – | – |
| Total allocated to the Bank | $ 8,985 | $ 372 | $ 9,357 | $ 1,510 | $ 1,668 |

At December 31, 2008 and 2007, U.S. government securities with par values of $180,765 million and $16,649 million, respectively, were loaned from the SOMA, of which $3,413 million and $332 million, respectively, were allocated to the Bank.

## 7. Investments Denominated in Foreign Currencies

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. These investments are guaranteed as to principal and interest by the issuing foreign governments.

The Bank's allocated share of investments denominated in foreign currencies was approximately 1.922 percent and 1.799 percent at December 31, 2008 and 2007, respectively.

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

| | 2008 | 2007 |
|---|---|---|
| Euro: | | |
| Foreign currency deposits | $ 107 | $ 130 |
| Securities purchased under agreements to resell | 78 | 46 |
| Government debt instruments | 89 | 84 |
| Japanese yen: | | |
| Foreign currency deposits | 67 | 50 |
| Government debt instruments | 136 | 103 |
| Total allocated to the Bank | $ 477 | $ 413 |

At December 31, 2008 and 2007, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was $481 million and $412 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the U.S. government, Federal agency, and GSE securities discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were $24,804 million and $22,914 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was $25,021 million and $22,892 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2008, was as follows (in millions):

| | Euro | Japanese Yen | Total |
|---|---|---|---|
| Within 15 days | $ 146 | $ 67 | $ 213 |
| 16 days to 90 days | 22 | 12 | 34 |
| 91 days to 1 year | 34 | 38 | 72 |
| Over 1 year to 5 years | 72 | 86 | 158 |
| Total allocated to the Bank | $ 274 | $ 203 | $ 477 |

At December 31, 2008 and 2007, the authorized warehousing facility was $5 billion, with no balance outstanding.

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

### 8. Central Bank Liquidity Swaps

Central bank liquidity swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, whereby the parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time. At the end of that period of time, the currencies are returned at the original contractual exchange rate and the foreign central bank pays interest to the Federal Reserve at an agreed-upon rate. These arrangements give the authorized foreign central bank temporary access to U.S. dollars. Drawings under the swap arrangements are initiated by the foreign central bank and must be agreed to by the Federal Reserve.

The Bank's allocated share of central bank liquidity swaps was approximately 1.922 percent and 1.799 percent at December 31, 2008 and 2007, respectively.

At December 31, 2008 and 2007, the total System amount of foreign currency held under central bank liquidity swaps was $553,728 million and $24,353 million, respectively, of which $10,641 million and $438 million, respectively, was allocated to the Bank.

The maturity distribution of central bank liquidity swaps that were allocated to the Bank at December 31 was as follows (in millions):

| | 2008 | | | 2007 |
|---|---|---|---|---|
| | Within 15 days | 16 days to 90 days | Total | 16 days to 90 days |
| Australian dollar | $ 192 | $ 247 | $ 439 | $ – |
| Danish krone | – | 288 | 288 | – |
| Euro | 2,901 | 2,698 | 5,599 | 365 |
| Japanese yen | 920 | 1,438 | 2,358 | – |
| Korean won | – | 199 | 199 | – |
| Norwegian krone | 42 | 116 | 158 | – |
| Swedish krona | 192 | 288 | 480 | – |
| Swiss franc | 370 | 114 | 484 | 73 |
| U.K. pound | 3 | 633 | 636 | – |
| Total | $ 4,620 | $ 6,021 | $ 10,641 | $ 438 |

## 9. Bank Premises, Equipment, and Software

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

| | 2008 | 2007 |
|---|---|---|
| Bank premises and equipment: | | |
| Land | $ 19 | $ 18 |
| Buildings | 115 | 115 |
| Building machinery and equipment | 15 | 15 |
| Construction in progress | 1 | – |
| Furniture and equipment | 27 | 37 |
| Subtotal | 177 | 185 |
| Accumulated depreciation | (56) | (63) |
| Bank premises and equipment, net | $ 121 | $ 122 |
| Depreciation expense, for the years ended December 31 | $ 6 | $ 7 |

The Bank leases space to outside tenants with remaining lease terms ranging from five to seven years. Rental income from such leases was not material for the years ended December 31, 2008 and 2007, and is reported as a component of "Other income." Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2008, are as follows (in millions):

| | |
|---|---|
| 2009 | $ 0.3 |
| 2010 | 0.3 |
| 2011 | 0.3 |
| 2012 | 0.3 |
| 2013 | 0.2 |
| Thereafter | 0.2 |
| Total | $ 1.6 |

The Bank has capitalized software assets, net of amortization, of $6 million and $5 million at December 31, 2008 and 2007, respectively. Amortization expense was $2 million for the years ended December 31, 2008 and 2007. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses."

Assets impaired as a result of the Bank's restructuring plan, as discussed in Note 14, include check equipment. Asset impairment losses of $2 million for the year ended December 31, 2007, were determined using fair values based on quoted fair values or other valuation techniques and are reported as a component of "Other expenses." The Bank had no impairment losses in 2008.

## 10. Commitments and Contingencies

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

At December 31, 2008, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from four to five years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $292 thousand and $271 thousand for the years ended December 31, 2008 and 2007, respectively.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2008, were not material.

At December 31, 2008, there were no material unrecorded unconditional purchase commitments or long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of one percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2008 or 2007.

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

## 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 Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). Employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP") and certain Reserve Bank officers participate in the Supplemental Employee Retirement Plan ("SERP").

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

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2008 and 2007, and for the years then ended, were not material.

### *Thrift Plan*

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2008 and 2007, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service. The Bank's Thrift Plan contributions totaled $4 million for the years ended December 31, 2008 and 2007, and are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income. Beginning in 2009, the Bank will match 100 percent of the first 6 percent of employee contributions from the date of hire and provide an automatic employer contribution of 1 percent of eligible pay.

## 12. Postretirement Benefits Other Than Pensions and Postemployment Benefits

### *Postretirement Benefits Other Than Pensions*

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

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

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

| | 2008 | 2007 |
|---|---|---|
| Accumulated postretirement benefit obligation at January 1 | $ 48.3 | $ 54.4 |
| Service cost-benefits earned during the period | 2.1 | 2.5 |
| Interest cost on accumulated benefit obligation | 3.2 | 3.1 |
| Net actuarial loss (gain) | 3.3 | (8.7) |
| Curtailment gain | (0.6) | (1.4) |
| Contributions by plan participants | 0.4 | 0.4 |
| Benefits paid | (2.6) | (2.2) |
| Medicare Part D subsidies | 0.2 | 0.2 |
| Accumulated postretirement benefit obligation at December 31 | $ 54.3 | $ 48.3 |

At December 31, 2008 and 2007, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 6.00 percent and 6.25 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):

| | 2008 | 2007 |
|---|---|---|
| Fair value of plan assets at January 1 | $ – | $ – |
| Contributions by the employer | 2.0 | 1.6 |
| Contributions by plan participants | 0.4 | 0.4 |
| Benefits paid | (2.6) | (2.2) |
| Medicare Part D subsidies | 0.2 | 0.2 |
| Fair value of plan assets at December 31 | $ – | $ – |
| Unfunded obligation and accrued postretirement benefit cost | $ 54.3 | $ 48.3 |
| Amounts included in accumulated other comprehensive loss are shown below: | | |
| Prior service cost | $ 2.8 | $ 3.4 |
| Net actuarial loss | (8.2) | (5.4) |
| Deferred curtailment gain | 0.2 | 0.6 |
| Total accumulated other comprehensive loss | $ (5.2) | $ (1.4) |

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

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

| | 2008 | 2007 |
|---|---|---|
| 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 | 2014 | 2013 |

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2008 (in millions):

| | One percentage point increase | One percentage point decrease |
|---|---|---|
| Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs | $ 0.8 | $ (0.7) |
| Effect on accumulated postretirement benefit obligation | 6.6 | (5.5) |

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

| | 2008 | 2007 |
|---|---|---|
| Service cost-benefits earned during the period | $ 2.1 | $ 2.5 |
| Interest cost on accumulated benefit obligation | 3.2 | 3.1 |
| Amortization of prior service cost | (0.9) | (1.1) |
| Amortization of net actuarial loss | 0.2 | 1.6 |
| Total periodic expense | 4.6 | 6.1 |
| Curtailment gain | (0.4) | – |
| Net periodic postretirement benefit expense | $ 4.2 | $ 6.1 |

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense (credit) in 2009 are shown below:

| | |
|---|---|
| Prior service cost | $ (0.9) |
| Net actuarial loss | 0.1 |
| Total | $ (0.8) |

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2008 and 2007, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 6.25 percent and 5.75 percent, respectively.

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

A net curtailment gain was recognized in net income in the year ended December 31, 2008 related to employees who terminated employment during 2008. A deferred curtailment gain was recorded in 2007 as a component of accumulated other comprehensive loss; a portion of the gain was recognized in 2008 and the remaining amount will be recognized in net income in future years when the related employees terminate employment.

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

Federal Medicare Part D subsidy receipts were $0.2 million and $0.3 million in the years ended December 31, 2008 and 2007, respectively. Expected receipts in 2009, related to benefits paid in the years ended December 31, 2008 and 2007 are $91 thousand.

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

| | Without subsidy | With subsidy |
|---|---|---|
| 2009 | $ 3.1 | $ 2.9 |
| 2010 | 3.4 | 3.2 |
| 2011 | 3.7 | 3.4 |
| 2012 | 3.9 | 3.6 |
| 2013 | 4.2 | 3.8 |
| 2014–2018 | 23.5 | 21.0 |
| Total | $ 41.8 | $ 37.9 |

***Postemployment Benefits***

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2008 and 2007, were $4 million and $5 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2008 and 2007 operating expenses was $1 million, and is recorded as a component of "Salaries and other 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 pensions |
|---|---|
| Balance at January 1, 2007 | $ (12) |
| Change in funded status of benefit plans: | |
| Prior service costs arising during the year | (1) |
| Net actuarial gain arising during the year | 10 |
| Deferred curtailment gain | 1 |
| Amortization of prior service cost | (1) |
| Amortization of net actuarial loss | 2 |
| Change in funded status of benefit plans - other comprehensive income | 11 |
| Balance at December 31, 2007 | $ (1) |
| Change in funded status of benefit plans: | |
| Net actuarial loss arising during the year | $ (3) |
| Amortization of prior service cost | (1) |
| Change in funded status of benefit plans - other comprehensive loss | (4) |
| Balance at December 31, 2008 | $ (5) |

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

## 14. Business Restructuring Charges

***2007 Restructuring Plans***

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes. Additional announcements in 2007 included restructuring plans associated with U.S. Treasury operations.

In 2008, the Reserve Banks accelerated the restructuring initiative announced in 2007 to align the check processing infrastructure and operations with declining check processing volumes. As a result, the Minneapolis operations were consolidated to the Cleveland processing site in 2008.

***2006 and Prior Restructuring Costs***

The Bank incurred various restructuring charges prior to 2007 related to the restructuring to align the check processing infrastructure and operations with declining check processing volumes. As a result, the Helena branch operations were consolidated to the Denver processing site in 2007.

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

| | 2006 and prior restructuring plans | 2007 restructuring plans | Total |
|---|---|---|---|
| Information related to restructuring plans as of December 31, 2008: | | | |
| Total expected costs related to restructuring activity | $ 1.1 | $ 5.0 | $ 6.1 |
| Expected completion date | 2007 | 2009 | |
| Reconciliation of liability balances: | | | |
| Balance at January 1, 2007 | $ 1.0 | $ – | $ 1.0 |
| Employee separation costs | 0.4 | 4.0 | 4.4 |
| Adjustments | (0.3) | – | (0.3) |
| Payments | (0.8) | – | (0.8) |
| Balance at December 31, 2007 | $ 0.3 | $ 4.0 | $ 4.3 |
| Employee separation costs | – | 0.9 | 0.9 |
| Payments | (0.1) | (0.7) | (0.8) |
| Balance at December 31, 2008 | $ 0.2 | $ 4.2 | $ 4.4 |

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

Restructuring costs associated with the impairment of certain check equipment are discussed in Note 9. 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

In February 2009, the System announced the extension through October 30, 2009, of liquidity programs that were previously scheduled to expire on April 30, 2009. The extension pertains to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and the Term Securities Lending Facility. In addition, the temporary reciprocal currency arrangements (swap lines) between the Federal Reserve and other central banks were extended to October 30, 2009.

For more information on the Minneapolis Fed
and the Federal Reserve System, go to minneapolisfed.org.

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## Useful telephone numbers

(612 area code unless otherwise indicated):

### *For the Public*

- Consumer Affairs Help Line: 204-6500
- Media Inquiries: 204-5261
- Research Library: 204-5509
- Treasury Auction Results, Current Offerings, Bills, Notes, Bonds: 1-800-722-2678

### *For Financial Institutions*

- Cash Services Help Line: 204-5227 or 1-800-553-9656 ext. 5227
- Electronic Access Customer Contact Center
  FedLine Support: 1-888-333-7010
  Computer Interface Support: 1-800-769-3265
- FedACH Central Operations Support: 204-5555 or 1-888-883-2180
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*The question at hand is*

*to what degree history is a guide for current policy. Do the lessons of the Great Depression have anything to teach us about our current situation? They almost certainly do. Do we claim that the authors of this essay have all the answers? Of course not. Do we think they have something useful to contribute? Yes.*

*—Gary H. Stern*