Navigating *Change*

Federal Reserve Bank of Philadelphia Annual Report 2010

2010 Annual Report

Navigating *Change*

Message from the President 2

A Farewell to the Fed 6

Accepting the Challenge 10

The Scope and Responsibilities of Monetary Policy 12

Making History: Regulatory Reform Enacted 22

Keeping Credit Markets on the RADAR Screen 26

Reaching Out in the Third District — and Beyond 30

2010 Bank Highlights 35

Board of Directors 42

Economic Advisory Council 44

Management & Policy Committee 45

Current Officers 46

Operating Statistics 47

Statement of Auditor Independence 48

Financial Reports 49

Notes to Financial Statements 57

Message from the President

As the theme of this annual report indicates, 2010 marked a year of "Navigating Change" for the Philadelphia Fed and the Federal Reserve System. The financial crisis and the recession led some people to question the role of the Federal Reserve and even the effectiveness of monetary policy in supporting the nation's economy.

In this year's opening essay, "The Scope and Responsibilities of Monetary Policy," I explain my concerns about assigning to monetary policy goals that it cannot hope to achieve. In particular, I stress that monetary policy is not capable of achieving employment levels inconsistent with underlying economic fundamentals; it is not a good instrument for selectively bursting perceived bubbles in asset prices; nor is it an appropriate tool for allocating credit to particular sectors or firms as a substitute for fiscal policy. In fact, expanding the reach and scope of monetary policy can undermine the Fed's credibility and its effectiveness in achieving the one goal for which it is uniquely and ideally suited – price stability. Securing price stability, however, is not just an end unto itself, but it is the most effective means by which monetary policy can promote maximum employment and sustainable growth over the longer term.

From a regulatory perspective, the most important change of 2010 was the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is the most substantial reform of the financial regulatory landscape since the 1930s. The Federal Reserve has already started intensive work on implementing many of the law's provisions, which involves, among other things, writing hundreds of new rules. The Fed has direct responsibility for writing more than 50 rules, and it will contribute to many others. Several key employees from the Philadelphia Fed have participated in this important work.

Effective regulation requires effective supervision. Accordingly, the act expands the Fed's supervisory responsibilities and encourages a more macroprudential approach, one where regulators seek to assess not only the risks to individual firms but risks to the entire financial system. The Fed continues to share responsibility for regulating institutions with the OCC, the FDIC, and state regulators. It also retains its responsibility for bank holding companies and is given expanded responsibilities for thrift holding companies. Here in the Third District, that will include adding responsibility for 34 thrift holding companies, in addition to the more than 100 bank holding companies and 20 state member banks. The first feature article in this report details the Philadelphia Fed's role in implementing regulatory reform.

Our second feature article describes Philadelphia's leadership role in developing and launching a centralized database for the Federal Reserve System of consumer credit and related securities. Known as RADAR, for Risk Assessment, Data Analysis, and Research, the database will primarily be used in the su-

pervision and regulation function and will improve the Fed's ability to monitor and supervise risk-taking. It will also help research economists and community development staffs understand economic and financial behavior. It has already proven to be an excellent resource in the Fed's efforts to identify emerging threats that may pose systemic risk in the broader economy.

The final feature article highlights ways the Philadelphia Fed has navigated the changes of 2010. It describes the many ways in which the Bank communicates with its constituents throughout the Third District. These include traditional approaches, such as the annual field meetings for the local banking communities, now in their 66th year, but also new activities, such as specialized foreclosure workshops. The story also details our efforts to reach out to legislative staffs, to inform them of the Fed's mission and its role in the nation's economy.

Changes Within the Bank

In addition to the many ways we are navigating changes in the financial and regulatory world, last year the Philadelphia Fed also experienced its own sea change. During 2010, we said farewell to several of our key executives. First Vice President William Stone, Executive Vice President Richard Lang, and Vice President and General Counsel Edward Mahon retired last year. All three of them were trusted colleagues. Their collective experience, insight, and institutional knowledge have been invaluable to me during my tenure as president. I offer Bill, Rick, and Ed my special thanks for a job well done and my warmest wishes for a long and healthy retirement. This report includes a farewell message from Bill Stone, recalling his long career with the Philadelphia Fed and the many changes he witnessed.

I am pleased to report that the leadership transition has progressed smoothly, with Blake Prichard taking on his new role as first vice president and chief operating officer of the Philadelphia Fed on January 1, 2011. Blake is a talented executive with a deep knowledge of the Federal Reserve System and a strong commit-

Charles I. Plosser

ment to its principles. The many leadership positions he has held over nearly 40 years with the Federal Reserve have prepared him well for his new responsibilities. During his nearly 20-year tenure at the Philadelphia Fed, he has helped manage some of the most complex projects undertaken by our Bank and the Federal Reserve System. Blake has contributed a brief message to this annual report, which follows Bill Stone's message. Our list of current officers also notes other officer transitions in 2010.

Board of Directors

During these times of change, we are especially grateful for the advice and counsel of the business leaders who serve on our board of directors. I sincerely thank all of them for their acumen and insights into the region's economy.

Chairman Charles P. Pizzi, president and CEO of the Tasty Baking Company, and Deputy Chairman Jeremy Nowak, president and CEO of The Reinvestment Fund, completed their first year in these leadership roles and both have been re-appointed to serve in 2011. Jeremy was also re-appointed to a new three-year term as director. Keith S. Campbell, chairman of Mannington Mills, Inc., has been re-elected to a three-year term.

In addition, I welcome our newest board member, R. Scott Smith, Jr., chairman and CEO of Fulton Financial Corporation, and look forward to his contributions. I also want to thank Ted Cecala, former chairman and CEO of Wilmington Trust Corporation, for his service, which ended in 2010.

Scott Smith has served for the past three years as the Third District's representative to the Federal Advisory Council. To that post, we have now appointed Bharat Masrani, president and CEO of TD Bank, N.A., for 2011. We are pleased that he will serve as the District's representative on the Federal Advisory Council, which meets quarterly with the Board of Governors in Washington, D.C.

Our Advisory Councils

Finally, I also want to acknowledge the business and community leaders who participate on the Bank's Economic Advisory Council. These representatives from diverse industries as well as nonprofits and organized labor in the Third District provide information on business conditions in their industries and communities. The council held its first meeting in September 2010 and will hold semi-annual meetings to add to the guidance we get from the Bank's board of directors.

Late in 2010, the Federal Reserve Board of Governors asked each Federal Reserve Bank to establish another advisory council, the Community Depository Institutions Advisory Council (CDIAC). These new councils will include representatives from commercial banks, thrift institutions, and credit unions from local markets around each District. The Bank's CDIAC had its inaugural meeting in March 2011, and we will bring you up to date on its activities in next year's annual report.

Conversations with the Bank's board of directors, its advisory councils, and local business people are invaluable in developing a rich and comprehensive picture of the region's economy. These conversations with people who live and work within the communities that underpin our economy bring Main Street perspectives to the national policy table. Such input is reflected in discussions at the Federal Open Market Committee (FOMC) as it sets policies that best meet the needs of this geographically and economically diverse nation.

Closing Thoughts

In closing, I want to extend my gratitude to the talented and dedicated employees at the Philadelphia Fed. I am proud of their many contributions to the Bank and the Federal Reserve System, especially as we continue to navigate the changes.

The one constant in this climate of change has been the steadfast mission of the Federal Reserve: to foster an environment of price stability that is supportive of maximum sustainable economic growth and employment. We remain dedicated to serving the financial institutions, businesses, and communities of the Third District, as we have for nearly a century. As always, I look forward to working with you in the year ahead.

Charles I. Plosser
President and Chief Executive Officer
May 2011

A Farewell to the Fed

By William H. Stone, Jr., First Vice President, Federal Reserve Bank of Philadelphia

In 2010, First Vice President and Chief Operating Officer Bill Stone announced his plans to retire from the Bank after nearly 40 years of service. In his final annual report message, he reflects upon his tenure at the Bank and shares his thoughts on the future of the Federal Reserve.

From our offices, I can look out on Independence Mall, the National Constitution Center, and William Penn atop City Hall. Also, just a few blocks from here stand the First and Second Bank of the United States, predecessors to today's Federal Reserve, which serve as a reminder of how central banking has evolved over the centuries. I am honored to have had the opportunity to contribute to an institution as prestigious as the Federal Reserve and to have worked with so many talented and dedicated people.

Since joining the Philadelphia Fed in 1971, I have observed tremendous changes in the financial industry, as well as in the Federal Reserve System. We've seen how rapid technological advancements have indelibly changed the way we do business, and we've witnessed an explosion in the number and sophistication of financial products. When I began my career here, many of the Bank's operations were still being performed manually. Today, we have more information on our mobile devices than we had on the massive mainframes of the 1970s.

Our region's financial landscape also looks very different than it did four decades ago. Our District, once dominated by a small number of regional banks, changed as larger financial institutions outside our District acquired local banks. Just as the banking industry has evolved, so too has the Philadelphia Fed. I stand in awe at the remarkable progress we have made as an institution. Yet, throughout our history, one constant has remained: our strong connection to the financial industry and the communities we serve.

The Evolution of a Central Bank

The Philadelphia Fed and the Federal Reserve System have been through extraordinary changes.

Perhaps the most widespread difference has been consumers' steady shift toward electronic payments. The Federal Reserve's recently released study of noncash payments indicates that more than three-quarters of all U.S. noncash payments were made electronically in 2009. Since our last study

three years ago, electronic payments have increased by 9.3 percent annually, while at the same time, the number of checks processed decreased by 7.2 percent annually. Moreover, we observed a rapid rise in the electronification of the clearing process, with roughly 96 percent of interbank checks now cleared electronically, compared with only 43 percent in our last study.[1]

This sweeping shift in how people make payments was the catalyst that led the Fed to consolidate its check processing operations to a single site for electronic check processing in Atlanta and a single site for paper check processing in Cleveland. It is worth mentioning, however, that before the consolidation, Philadelphia's check operation was, at one time, the largest in the System, processing over a billion checks per year at its peak in the 1980s and 1990s.[2] Another monumental change to our organization was the passage of the Monetary Control Act (MCA) in 1980. Before then, the Fed had provided services for free to member banks.[3] The law mandated that the Federal Reserve offer priced services not only to member banks but also to any depository institution that wanted to use them. The act also required all depository institutions to hold the same level of reserves and granted them equal access to discount window lending.

Since the MCA required the Fed to sell its services in competition with private providers of payment services, the Federal Reserve's business expanded to include sales. We were able to build a broad

[1] A summary report of the 2010 Federal Reserve Payments Study is available at www.frbservices.org. Detailed reports on the individual studies will be available in early 2011.

[2] Federal Reserve Bank of Philadelphia, 1989 Annual Report.

[3] A member bank is any national bank or a state-chartered bank that chooses to join the Federal Reserve System.

William H. Stone, Jr.

presence in the region based on our success in winning check business and our reputation for quality service, which encouraged banks to do business with us.

I spent my first decade at this Bank visiting the CEOs of local financial institutions to discuss business conditions and industry trends. These conversations enabled us to see the economy through the eyes of our financial institutions and to better serve them, usually through adding new services that catered to their unique needs.

Many of the close relationships the Bank developed with District financial institutions continue today. In fact, the Philadelphia Fed is one of only a few Reserve Banks to host annual field meetings, at which Bank officers travel throughout the Third District to meet with banking leaders and discuss the economy and the banking industry. In 2010, we marked the 65th year of this outreach program, making these the oldest continual series of field meetings in the Federal Reserve System.

One more point about the Monetary Control Act is that it paved the way for the ongoing shift from paper to electronic check processing, ultimately leading to the Check Clearing for the 21st Century Act in 2003. The Fed proposed and supported the passage of this act, which improved the efficiency of check processing by allowing for the substitution of check images in clearing and settlement. From a monetary policy perspective, the Fed has made considerable progress in communicating its actions. Our move from opacity to openness has helped us make strides toward clarifying our objectives to the public. Sharing knowledge allows the Fed to contribute to the economic vitality of the nation. In our cash operations, the Fed has worked with the U.S. Treasury, the U.S. Bureau of Engraving and Printing, and the U.S. Secret Service over the last two decades to improve our currency's security features. It has also greatly enhanced the automation of its currency and coin operations.

Within the Federal Reserve System, our Bank's leadership and expertise have been recognized in many areas. We developed the first book-entry system for marketable Treasury securities transactions for retail customers in the mid-1980s. We are the home of the Treasury Check Information System (TCIS), which is the Treasury's check processing and reconcilement system. Through this program, we are tasked with tracking all government checks issued and paid. We also run the Treasury's collateral management and monitoring business.

The Payment Cards Center, established just over 10 years ago, is another example of how the Philadelphia Fed has earned a reputation for knowledge and expertise. The center provides insights into consumer credit and payments through research, conferences, and publications.

Our Research Department is also well respected for its various data-collection efforts and for the rigorous economic research it produces. Philadelphia's intellectual output is widely published in top-tier academic and scholarly journals. In addition, the Philadelphia Fed's regional Business Outlook Survey is broadly recognized as an indicator of the national economy.

Our public outreach efforts are second to none. Throughout each year, various departments hold workshops, seminars, and conferences to educate our many constituencies on a range of topics, including the important work of the Federal Reserve. Our Community Development area has a long

history of focusing attention on community development issues and helping consumers improve their financial literacy. In 2003, the Bank opened "Money in Motion," our interactive financial and historical exhibit, to help educate the public about money, finance, and the history of central banking in the United States.

In recent years, new programs have given us even greater outreach in our communities. We developed PhillyFedCARES to coordinate and support our employees' volunteer efforts. This initiative strengthens our community ties and helps important causes in the communities we serve.

Throughout its evolution, the Fed has played a vital role in guiding the nation's economy not only through extraordinary changes but also through crises. From the savings and loan crisis in the 1980s, to the tragedy of 9/11, to the more recent Great Recession, the Federal Reserve has continued to support the country's economy through some very difficult times. Through our triumphs and challenges, we have continued to grow and evolve. Much of what we have learned from these events will help us shape better policy, more effective supervision and regulation, and a more efficient payments system.

Looking Toward the Future

Looking ahead, in the wake of the financial crisis and the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Fed and other regulatory agencies will undergo some significant changes. Right now, the Fed and its counterparts are working diligently to create the infrastructure that will implement this landmark legislation. In an era in which the Federal Reserve is centralizing operations and Reserve Banks are becoming more specialized in their activities, the Philadelphia Fed has carved out some important niches. We make strong contributions to the System, and we are particularly known for our expertise in retail and consumer credit, payment cards, and Treasury services.

Passing the Baton

I know that under the capable leadership of President Plosser and my successor, Blake Prichard, our Bank will continue its stellar work. I am confident that our Bank is well positioned to face whatever challenges lie ahead. The Philadelphia Fed – along with the entire Federal Reserve System – is doing its part to ensure that our customers and constituents remain confident in the integrity of our nation's central bank.

In Closing

I would be remiss if I did not close with an expression of how tremendously rewarding my work at the Philadelphia Fed has been. I have always been proud to work at the Bank because of our employees' shared commitment to public service. As I close this chapter of my career, I want to express my gratitude for having had the privilege of being part of this great institution. I hope I have helped to build something that will carry on a tradition of excellence for a long time to come.

The Philadelphia Fed makes strong contributions to the System, and we are particularly known for our expertise in retail and consumer credit, payment cards, and Treasury services.

Accepting the Challenge

By D. Blake Prichard, First Vice President and Chief Operating Officer

Blake Prichard was appointed first vice president and chief operating officer of the Philadelphia Fed, effective January 1, 2011. Prior to assuming his new role, Prichard was executive vice president responsible for Retail Payments, Treasury Services, Information Technology Services, and Customer Relations. He also provided oversight to the Federal Reserve System's Groupware Leadership Center, which provides national e-mail and related services.

The preceding letters from President Plosser and Bill Stone noted the many forces of change that the Philadelphia Fed experienced in 2010. Among them was Bill Stone's retirement after 39 years with the Bank, including 23 years as first vice president. I am honored indeed to follow Bill in the role of first vice president and chief operating officer.

Change is inevitable in every institution. Managing change is a fundamental management responsibility in every organization. We are indebted to Bill Stone for his exceptional leadership and his commitment to preparing others to fulfill their management responsibilities. Bill was the model of a mission-focused executive, with a firm understanding of the public service that Federal Reserve Bank employees provide. I have benefited from Bill's coaching and mentoring during my career. I know that many others within our management team and many of our employees have benefited as well.

We have an extraordinary depth of talent in our Bank, and I look forward to working with all of the Bank's employees as we continue to deliver the best possible service.

The nation's economy, financial institutions, businesses, and families are still recovering from a deep recession. We have much to do before the nation's economic performance and the financial conditions of its citizens and businesses are back to normal. Passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act last July has also meant new roles and additional responsibilities for the Fed. It will require an innovative and talented staff throughout the System, including those here in Philadelphia, to figure out how best to carry out these assignments.

The Dodd-Frank Act has resulted in other changes at the Reserve Banks as

well. Each Reserve Bank and the Board of Governors, as well as other regulatory agencies, were required to establish an Office of Minority and Women Inclusion (OMWI) and name a director by January 21, 2011. In response, the Philadelphia Fed has established an Office of Diversity and Inclusion (ODI) and appointed Mary Ann Hood as director, in addition to her ongoing roles as senior vice president of the Human Resources Department and the Bank's equal opportunity officer. The new ODI will fulfill the requirements of Dodd-Frank while also recognizing the ongoing commitment that our Bank has made to diversity initiatives in recent years, including a formal Diversity Council of Bank employees, an active diversity recruitment program, and ongoing efforts to increase women- and minority-owned businesses within the Bank's supplier ranks. All of these efforts to support diversity make the Philadelphia Fed a stronger institution and better able to support the diverse neighborhoods and communities that make up the Third District.

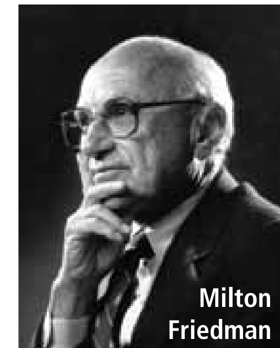
In conclusion, all of us at the Bank are following in the footsteps of some remarkable role models of public service. Yet, when I look around at the terrific team of employees, I am confident that we have the drive and determination to continue to deliver the best service possible to our Third District constituents.

D. Blake Prichard

The Scope and Responsibilities of Monetary Policy

By Charles I. Plosser

"...we are in danger of assigning to monetary policy a larger role than it can perform, in danger of asking it to accomplish tasks that it cannot achieve, and, as a result, in danger of preventing it from making the contribution that it is capable of making."


Milton Friedman

These words are taken from the presidential address of the distinguished economist and Nobel Laureate Milton Friedman to the American Economic Association in 1967.[1] Although the message was delivered over 40 years ago, I believe Friedman's caution is one well worth remembering, especially in this world where central banks have taken extraordinary actions in response to a financial crisis and severe recession. I believe policymakers and the public need to step back from our focus on short-term fluctuations in economic conditions and to think more broadly about what monetary policy can and should do and in the process adjust our expectations of what we believe to be the scope and responsibilities of our central bank.[2]

First, it may help to put Friedman's words into context. His remarks were directed at an economics profession that had gravitated toward believing that there was a stable and exploitable trade-off between inflation and unemployment, otherwise known as the Phillips curve. According to this view, policymakers should pick a point on the Phillips curve that balances the nation's desire for low unemployment and low inflation. Friedman argued that this was a false trade-off, and the experience in the U.S. in the decade that followed his remarks, often referred to as the Great Inflation, was a painful demonstration of Friedman's valuable insight. In particular, that episode illustrated quite dramatically and painfully that there was no stable relationship between inflation and unemployment. We witnessed the dangers inherent in monetary policies that take low inflation for granted in a world of high unemployment or perceived large output gaps.[3] Our experiences clearly showed that efforts to manage or stabilize the real economy in the short term were beyond the scope of monetary policy, and if policymakers made aggressive attempts to do so, it would undermine the one contribution monetary policy could and should make to economic stability – price stability.

Of course, monetary theory has advanced over the past four decades as economists have developed more sophisticated models and better empirical methods to test the validity of these models. However, the proper scope of monetary policy remains an important issue of our day. In response to the global financial crisis, central banks have been asked to use monetary policy and other central bank functions to deal with an increasing array of economic challenges. These challenges include high unemployment, asset booms and busts, and the allocation and availability of credit.

I believe we have come to expect too much from monetary policy. Indeed, broadening monetary policy's scope can actually diminish its effectiveness. When monetary policy overreaches and fails to deliver desired, but unattainable, outcomes, its credibility is undermined. That makes it more difficult to deliver on the one goal that monetary policy is actually capable of meeting. Moreover, when the central bank is asked to implement policies more appropriately assigned to fiscal authorities, the independence of monetary policy from the political process is put at risk, which also undercuts the effectiveness of monetary policy.

In this year's annual report essay, I discuss the appropriate scope of monetary policy in dealing with real economic fluctuations, asset-price swings, and the allocation of credit. My views are informed by Friedman's caution that we should be careful not to expect too much of monetary policy. If we recognize the limits to what monetary policy *can* do effectively, we will be better able to understand what monetary policy *should* do.

Monetary Policy and Real Economic Fluctuations

The U.S. Congress has established the broad objectives for monetary policy as promoting "effectively the goals of maximum employment, stable prices and moderate long-term interest rates." This has typically been characterized as the "dual mandate," since if prices are stable and the economy is operating at maximum employment, long-term nominal interest rates will generally be moderate.

Most economists now understand that *in the long run*, monetary policy determines only the level of prices and not the unemployment rate or other real variables.[4] In this sense, it is monetary policy that has ultimate responsibility for the purchasing power of a nation's fiat currency. In the long run, employ-

Most economists now understand that *in the long run*, monetary policy determines only the level of prices and not the unemployment rate or other real variables.

ment depends on factors such as demographics, productivity, tax policy, and labor laws. Nevertheless, many economists believe that monetary policy can sometimes temporarily stimulate real economic activity in the short run, albeit with considerable uncertainty as to the timing and magnitude, what economists call the "long and variable lag." This type of activist monetary policy is actually quite difficult to do successfully for several reasons. First, any boost to the real economy from stimulative monetary policy will eventually fade away as prices rise and the purchasing power of money erodes in response to the policy. Even the temporary benefit can be mitigated, or completely negated, if inflation expectations rise in reaction to the monetary accommodation. Moreover, a variety of shocks can simultaneously buffet the economy. Shocks can occur to specific sectors, such as a sharp drop in housing prices or a sharp rise in the price of oil, or to specific regions. Some may be large and some may be small. Some may be positive and boost economic growth, while others may be detrimental to growth. If monetary policy responds to one shock in an attempt to offset its possible effects, it may aggravate the effects of another shock. Thus, monetary policy's ability to neutralize the impact of shocks is actually quite limited.

In addition, successfully implementing such an economic stabilization policy requires predicting the state of the economy more than a year in advance and anticipating the nature, timing, and likely impact of *future* shocks. The truth is that economists simply do not possess the knowledge to make such forecasts with the degree of precision that would be needed to offset the economic shocks. Attempts to stabilize the economy will, more likely than not, end up providing stimulus when none is needed, or vice versa. It also risks distorting price signals and thus resource allocations, adding to instability. In most cases, the effects of shocks to the economy simply have to play out over time as markets adjust to a new equilibrium. Monetary policy is likely to have little ability to hasten that adjustment. For example, monetary policy cannot retrain a workforce or help reallocate jobs to lower unemployment. It cannot help keep gasoline prices at low levels when the price of crude oil rises to high levels. And monetary policy cannot reverse the sharp decline in house prices when the economy has significantly over-invested in housing. In all of these cases, monetary policy cannot eliminate the need for households or businesses to make the necessary real adjustments when such shocks occur. Asking monetary policy to do what it cannot do with aggressive attempts at stabilization can actually increase economic instability rather than reduce it.

Let me be clear that this does not mean that monetary policy should be unresponsive to changes in broad economic conditions. Monetary policymakers should set their policy instrument – the federal funds rate in the U.S. – consistent with controlling inflation over the intermediate term. So the target federal funds rate will vary with economic conditions. But the goal in changing the funds rate target is to maintain low and stable inflation. This will foster the conditions that enable households and businesses to make the necessary adjustments to return the economy to its sustainable growth path and to long-run maximum employment. Monetary policy itself does not determine this path, nor should it attempt to do so.

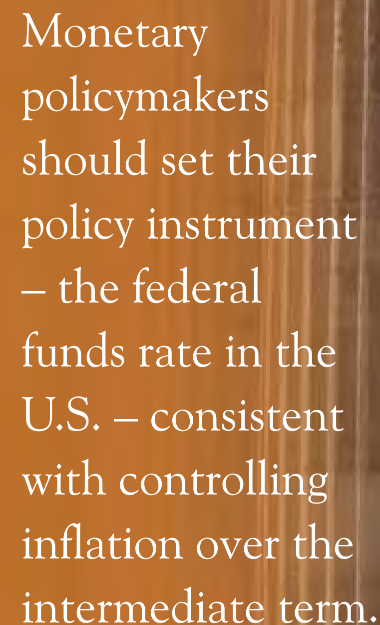
For example, if an adverse productivity shock results in a substantial reduction in the outlook for economic growth, then real interest rates tend to fall. As long as inflation is at an acceptable level, the appropriate monetary policy is to reduce the federal funds rate to facilitate the adjustment to lower real

interest rates. Failure to do so could result in a misallocation of resources, a steadily declining rate of inflation, and perhaps even deflation.

Conversely, when the outlook for economic growth is revised upward, real market interest rates will tend to rise. Provided that inflation is at an acceptable level, appropriate policy would be to raise the federal funds rate. Failure to do so would result in a misallocation of resources and, in this case, a rising inflation rate.

In both cases, changes in the federal funds target are responding to economic conditions in order to keep inflation low and stable and doing so in a systematic manner. Monetary policy is *not* trading off more inflation for less unemployment or vice versa. As I have already argued, the empirical and theoretical case for such a trade-off is tenuous at best. And the data to support the view that central banks can favorably exploit such a potential trade-off are even more dubious.

So what should monetary policy do? To strengthen the central bank's commitment to price stability, I have long advocated that the Federal Reserve adopt and clearly communicate an explicit numerical inflation objective and publicly commit to achieving that objective over some specified time period through a systematic approach to policy. It is one of the messages of economic research over the last 40 years that policy is best conducted in a rule-like manner. This systematic approach helps promote more effective communication so that the public and the markets will understand and better predict how policy will evolve as economic conditions change. This, in turn, helps reduce economic volatility and makes policy more effective in achieving its long-run goals.


Monetary policymakers should set their policy instrument – the federal funds rate in the U.S. – consistent with controlling inflation over the intermediate term.

Indeed, the Federal Reserve is one of the few central banks among the major industrialized countries that have not made such a public commitment to a numerical inflation objective. I believe it is time we did. Such a commitment will help the public form its expectations about monetary policy, which would enhance macroeconomic stability.

Monetary Policy and Asset Prices

Let me now turn to the role of monetary policy in the evolution of asset prices. Some argue that monetary policy can be a source of distorted asset prices. But a systematic approach to achieving price stability would help monetary policymakers avoid exacerbating the effects of asset-price swings on the economy. I think it is fair to say that no one takes issue with the view that asset prices are important in assessing the outlook for the economy and inflation. Movements in asset prices can provide useful information about the current and future state of the economy. Even when a central bank is operating under an inflation target, asset prices are informative. Put another way, judgments about the inflationary stance of monetary policy should be informed by a wide array of market signals, including asset-price movements.[5]

The broad view among many monetary policymakers is that asset prices should not be a direct focus of monetary policy. While asset prices may be relevant in the normal course of monetary policymaking, the presumption is that such prices are responding efficiently and correctly to the underlying state of the economy, including the stance of monetary or fiscal policy. The bottom line of this view was that monetary policy should not seek to actively burst perceived asset bubbles. Instead, various forms of prudential regulation or supervision of financial institutions are likely better suited to addressing asset-price swings, should such intervention be called for.

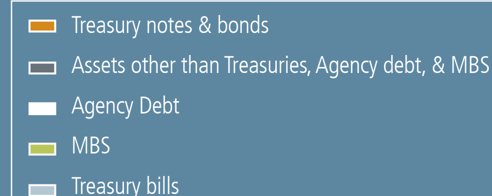
However, in light of the recent housing boom, its subsequent collapse, and the financial crisis that followed, some people have begun to rethink this position concerning the scope of monetary policy and advocate an active role for monetary policy to restrain asset-price booms. They tend to believe that asset prices are not always tied to market fundamentals. They worry that when asset values rise above their fundamental value for extended periods – that is, when a so-called bubble forms – the result will be an over-investment in the over-valued asset. When the market corrects such a misalignment – as it always does – the resulting reallocation of resources may depress economic activity in that sector and possibly the overall economy. Such boom-bust cycles are, by definition, inefficient and disruptive. So, the argument goes, policy should endeavor to prevent or temper such patterns.

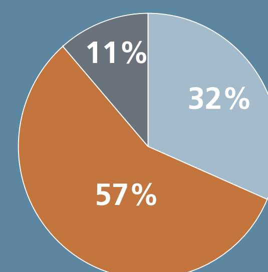
This argument for monetary policy to respond directly to a perceived mispricing of specific assets is controversial and in my view not persuasive. It requires that policymakers know when an asset is over-priced relative to market fundamentals, which is no easy task. For example, equity values might appear high relative to current profits, but if market participants expect profit growth to rise in the future, then high equity values may be justified.

Another challenge in addressing asset-price bubbles is that contrary to most of the models used to justify intervention, there are many assets, not just one. And these assets have different characteristics. For example, equities are very different from real estate. Misalignments or bubble-like behavior may appear in one asset class and not others and may vary even within a specific asset class. But monetary policy is a blunt instrument. How would policymakers have gone about pricking a bubble in technology stocks in 1998 and 1999 without wreaking havoc on investments in other asset classes? After all, while the NASDAQ grew at an annual rate of 81 percent in 1999, the NYSE composite index grew just 11 percent. What damage would have been done to other stocks and other asset classes had monetary policy aggressively raised rates to dampen the tech boom. During the housing boom, some parts of the U.S. housing market were experiencing rapid price appreciation while others were not. How do you use monetary policy to burst a bubble in Las Vegas real estate, where house prices were appreciating at an annual rate of 45 percent by the end of 2004, without damaging the Detroit market, where prices were increasing at an annual rate of less than 3 percent?

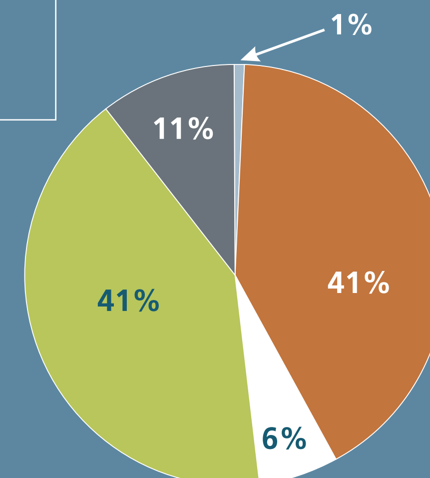
Ultimately, sound policymaking requires us to understand the limits of what we know. I doubt we could find enough agreement among policymakers or economists about the interpretation of asset-price movements to allow for stable, rule-based policymaking. In the absence of such a clearly stated rule, we risk uncertainty about central bank policy itself as well as its effect on the economy. That could become a source of volatility in asset markets and, ultimately, in real activity and inflation. Put more bluntly, asset prices are often volatile, and creating expectations that monetary policy will intervene directly to influence the price-setting mechanism seems more dangerous for the orderly functioning of markets than helpful even in the rare instances when a true and significant distortion may in fact exist. Moreover, the moral hazard created by the belief that the central bank would intervene if prices of a certain class of assets became "misaligned" might, in fact, cause more inefficient pricing and more instability, not less. Humility in policymaking requires that we respect the limits of our knowledge and not overreach, particularly when it involves overriding market signals with policy actions.

Federal Reserve System Assets





January 3, 2007
Total assets = $0.879 trillion



December 29, 2010
Total assets = $2.423 trillion

Source: Table H.4.1 data compiled by Research Department, Federal Reserve Bank of Philadelphia

Monetary Policy and Credit Allocation

Finally, let me address another issue that has loomed large during the financial crisis and where great caution is required going forward: the role of monetary policy in the allocation of credit. At various times during the crisis, the Federal Reserve and many other central banks around the world intervened in various markets to facilitate intermediation. In many cases, these efforts were targeted to specific sectors of the economy – e.g., the Fed's purchases of mortgage-backed securities issued by the federal housing agencies – to specific types of firms or financial markets – e.g., the primary dealer credit facility and the term asset-backed securities loan facility, or in some cases, to specific firms – e.g., the lending to Bear Stearns and to AIG.

Many of these efforts, especially earlier in the crisis, were justified on the grounds that central banks should act as "lender of last resort" in order to preserve financial stability. The specific criteria for undertaking these actions could not help but be somewhat arbitrary as policymakers had little experience with such a crisis, and little theory to guide them beyond Walter Bagehot's dictum from the 1873 classic *Lombard Street* to limit systemic risk by "lending freely at a penalty rate against good collateral."[6] In general, these actions, especially in the U.S., involved extensive use of the central bank's balance sheet and likely went far beyond what Bagehot would have imagined.

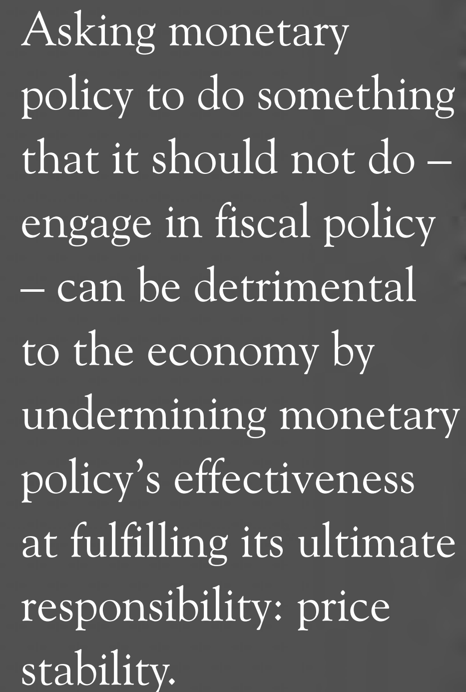
Even when it is appropriate for a central bank to function as a lender of last resort, in my view, such policy should follow a rule-like or systematic approach. This suggests announcing in advance the criteria that will be used to lend and who will be eligible to participate. Economic and financial stability would be best served by establishing such guidelines in advance and committing to following them in a crisis. That commitment is hard to deliver on, but institutional constraints can help tie the hands of policymakers in ways that limit their discretion. Most central banks, including the Fed, have not developed such systematic plans and thus, during the crisis, behaved in a highly discretionary manner that generated moral hazard and volatility.

My purpose here is not to critique the myriad programs that were put in place or the varying degrees of moral hazard they created but to make a more general point: that these actions, for the most part, are better thought of as forms of fiscal policy, not monetary policy, because they involved allocating credit to specific firms or industries and putting taxpayer dollars at risk. Moreover, asking monetary policy to do something that it should not do – engage in fiscal policy – can be detrimental to the economy by undermining monetary policy's effectiveness at fulfilling its ultimate responsibility: price stability.

A body of empirical research indicates that when central banks have a degree of independence in conducting monetary policy, more desirable economic outcomes usually result. But such independence can be threatened when a central bank ventures into conducting fiscal policy, which, in the U.S., rightly belongs with Congress and the executive branch of government. Having crossed the Rubicon into fiscal policy and engaged in actions to use its balance sheet to support specific markets and firms, the Fed, I believe, is likely to come under pressure in the future to use its powers as a substitute for other fiscal decisions. This is a dangerous precedent, and we should seek means to prevent such future actions.[7]

I have long argued for a clear, bright line to restore the boundaries between monetary and fiscal policy, leaving the latter to Congress and not the central bank. For example, I have advocated the elimination of Section 13(3) of the Federal Reserve Act, which allowed the Fed to lend directly to "corporations, partnerships and individuals" under "unusual and exigent circumstances." The Dodd-Frank Wall Street Reform and Consumer Protection Act sets limits on the Fed's use of Section 13(3), allowing the Board, in consultation with the Treasury, to provide liquidity to the financial system, but not to aid a failing financial firm or company.[8] But I think more is needed. I have suggested that the System Open Market Account (SOMA) portfolio, which is used to implement monetary policy in the U.S., be restricted to short-term U.S. government securities. Before the financial crisis, U.S. Treasury securities constituted about 90 percent of the Fed's balance-sheet assets. Given that as of the end of 2010, the Fed holds almost $1 trillion in agency mortgage-backed securities (MBS) and agency debt securities intended to support the housing sector, that number is 41 percent. The sheer magnitude of the mortgage-related securities demonstrates the degree to which monetary policy has engaged in supporting a particular sector of the economy through its allocation of credit. It also points to the potential challenges the Fed faces as we remove our direct support of the housing sector. Decisions to grant subsidies to specific industries or firms must rest with Congress, not the central bank.

Asking monetary policy to do something that it should not do – engage in fiscal policy – can be detrimental to the economy by undermining monetary policy's effectiveness at fulfilling its ultimate responsibility: price stability.



I have also advocated that the Fed and the Treasury reach an agreement whereby the Treasury takes the non-discount-window loans and other non-Treasury assets from the Fed's balance sheet in exchange for Treasury securities. I have further advocated that if, in the future, the fiscal authority wanted the central

bank to engage in lending outside its normal operations and, importantly, should the Fed determine "unusual and exigent circumstances" warranted such action, then any accumulation of nontraditional assets by the Fed would be exchanged for government securities. Such an accord would offer two major benefits.[9] First, it would transfer funding for the credit programs to the Treasury – which would issue Treasury securities to fund the programs – thus ensuring that credit policies that place taxpayer funds at risk are under the oversight of the fiscal authority. Second, it would preserve the Fed's independence to control its balance sheet and ensure that the full authority and responsibility for fiscal matters remained with the Treasury and Congress, where it rightfully belongs.

There is a historical precedent for such an accord. In 1951, the Treasury and the Fed struck an accord that freed the Fed from pegging the interest rate on long-term Treasury debt below 2.5 percent, which the Fed had done during and after World War II.[10] By pegging long rates below 2.5 percent, the Fed was committing to add reserves to the banking system when market interest rates began to rise without regard to its inflation goal. This inability to control its own balance sheet was a fundamental problem for the credibility of the Fed in achieving its dual mandate. After considerable negotiations, the Treasury and the Fed reached an accord that freed the Fed to set interest rates consistent with its long-term goals. This allowed the Fed to re-establish its independence and to conduct monetary policy in accordance with its dual mandate.

Today, an accord to substitute Treasuries for non-Treasury debt on our balance sheet would similarly help ensure that the Fed will be able to implement its policy decisions. After all, the time will soon come when the Fed will need to begin exiting from the extraordinarily accommodative monetary policy in order to achieve its goals. With Treasuries back on the balance sheet, the Fed will be able to drain reserves in a timely fashion with minimal concerns about disrupting particular credit allocations or the pressures from special interests.

Conclusion

Like Milton Friedman in an earlier time, I too am concerned that we are in the process of assigning to monetary policy goals that it cannot hope to achieve. Monetary policy is not going to be able to speed up the adjustments in labor markets or effectively burst perceived asset bubbles, and attempts to do so may create more instability, not less. Nor should monetary policy be asked to perform credit allocation in support of particular sectors or firms. Expecting too much of monetary policy will undermine its ability to achieve the one thing that it is well-designed to do: ensuring long-term price stability. It is by achieving this goal that monetary policy is best able to support full employment and sustainable growth over the longer term, which benefits all in society. Although Friedman's words were spoken more than four decades ago, policymakers would do well to heed his insights, which remain particularly relevant for our times.

Endnotes

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

[2] This essay is based on a speech by the author, "The Scope and Responsibilities of Monetary Policy," GIC 2011 Global Conference Series: Monetary Policy and Central Banking in the Post-Crisis Environment, The Central Bank of Chile, January 17, 2011. The views expressed here are the author's and not necessarily those of the Federal Reserve Board or the Federal Open Market Committee.

[3] Throughout the early 1960s, the inflation rate in the U.S. remained below 2 percent. By 1966, the rate had doubled. Despite evidence of increasing price pressures, the Federal Reserve was reluctant to tighten policy because many policymakers believed the economy was still not at full employment even though unemployment had fallen to 4.5 percent by mid-1965. This delay proved quite costly. Inflation continued to rise, reaching 6 percent in early 1970 and peaking at over 12 percent in 1974.

[4] There are some extreme cases. If the monetary authority engineers a hyperinflation, it is likely to have deleterious effects on output and employment.

[5] Research does offer some support for the predictive value of various asset-price movements for the future path of inflation; however, the evidence varies considerably across types of assets and, in my view, is not overwhelmingly supportive.

[6] Walter Bagehot, *Lombard Street: A Description of the Money Market* (New York: E.P. Dutton and Company, 1921). [Orig. pub. 1873]

[7] See Charles I. Plosser, "Credible Commitments and Monetary Policy After the Crisis," speech at the Swiss National Bank Monetary Policy Conference, Zurich, Switzerland, September 24, 2010.

[8] See Charles I. Plosser, "The Federal Reserve System: Balancing Independence and Accountability," speech at the World Affairs Council of Philadelphia, February 17, 2010.

[9] For a discussion of such an accord in a different context, see J. Alfred Broaddus, Jr. and Marvin Goodfriend's article, "What Assets Should the Federal Reserve Buy?" and Goodfriend's article, "Why We Need an 'Accord' for Federal Reserve Credit Policy: A Note," Federal Reserve Bank of Richmond *Economic Quarterly* (Winter 2001). Such an accord would also be consistent with the recommendations made by the Group of Thirty's Working Group on Financial Reform about the role of central banks in providing financial stability. See "Financial Reform: A Framework for Financial Stability," Group of Thirty, Washington, D.C. (2009).

[10] For several articles about the 1951 Accord, see the Federal Reserve Bank of Richmond's *Economic Quarterly* (Winter 2001).

Making History: Regulatory Reform Enacted

In 1933, "King Kong" was taking movie theaters by storm. The New York Giants won the World Series. A couple of dollars would fill up your gas tank. But money for the movies, a seat in the ballpark, or a Sunday drive was a luxury few could afford during the depths of the Great Depression. Jobs were scarce and the unemployment rate reached 25 percent. Bank runs and bank failures had disrupted the banking system and devastated the public's confidence. President Franklin Roosevelt responded by signing the Banking Act of 1933, which laid a solid foundation on which to rebuild the country's financial system.

In the years since, Congress has passed other legislation related to the financial services industry – the Banking Act of 1935, the Monetary Control Act of 1980, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and the Gramm-Leach Bliley Act of 1999, to name a few. But, arguably, since 1933, Congress has passed no other law as broad in scope in direct response to a financial crisis – until 2010.

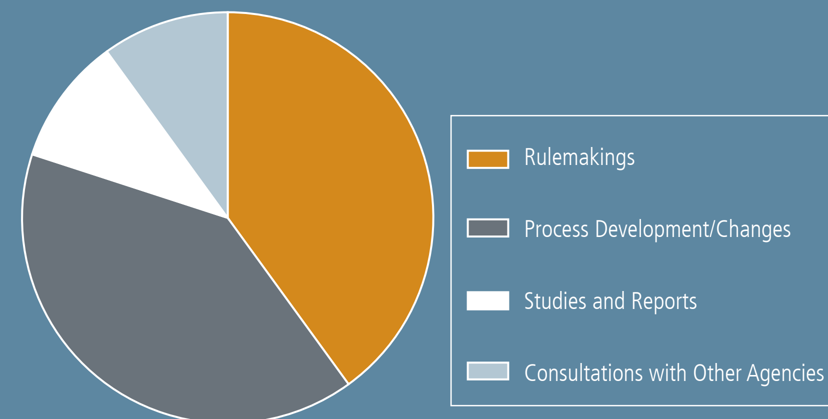
Enter the Dodd-Frank Wall Street Reform and Consumer Protection Act, a comprehensive piece of legislation signed into law on July 21, 2010. Congress passed the law to improve accountability and transparency in the financial system and to protect consumers and investors from abusive practices in response to the worst financial crisis since the Great Depression. At the Philadelphia Fed, President Charles Plosser led the Bank's efforts to address regulatory reform by sharing his ideas, through speeches and meetings with legislators, on how to achieve effective reform. As Congress debated various reform measures, President Plosser spoke out on the importance of preserving the Fed's independence and its regional structure, which has served the nation's economy and its banking system for almost 100 years.

Soon after the Dodd-Frank Act passed, the Federal Reserve set up System-wide working groups to determine how the Fed should marshal its resources to best meet its new responsibilities related to ensuring financial stability, conducting supervision and lending, managing systemic bank failures, and improving consumer protection. Several officers from the Philadelphia Reserve Bank participated in these groups.

Executive Vice President and Director of Research Loretta Mester served on

the five-member Steering Committee. Robert Hunt, vice president and director of the Payment Cards Center, contributed to the System's consumer protection working group by assessing the potential market effects of proposed rules. Vice President Mitchell Berlin, who oversees the Research Department's Banking and Financial Markets section, worked with the resolution authority group, which looked at issues related to too big to fail. Berlin was also a member of the work group evaluating alternative levels of disclosure for the stress tests.

Federal Reserve Initiatives Under Dodd-Frank*



Source: Federal Reserve Bank of Philadelphia, *SRC Insights*, First Quarter 2011

* Chart shows types of initiatives the Fed will implement under Dodd-Frank.

Significant Supervision Changes

Some of the most significant changes mandated for the Fed are in its supervision of banks and banking organizations. Dodd-Frank requires that the Fed work with other regulatory agencies to recognize risks to overall financial stability, not just individual firms.

The Fed has always worked closely with federal and state agencies to supervise and regulate banks to ensure the safety and soundness of about 8,000 insured depository institutions nationwide. The Fed supervises about 850 state-chartered member banks and under the authority of the Bank Holding Company Act of 1956, about 5,000 bank holding companies (BHCs). The Philadelphia Fed will continue to supervise more than 100 BHCs and 20 state member banks.

Dodd-Frank shifts some supervisory responsibilities away from the Fed and its fellow regulators, abolishes the Office of Thrift Supervision, and extends the Fed's responsibilities to include the supervision of thrift holding companies, also known as savings and loan holding companies.

For the Philadelphia Fed, this means responsibility for an additional 34 thrift holding companies, including oversight for the largest thrift holding company in the country. To help manage the additional workload, Philadelphia is hiring more bank examiners.

Under Dodd-Frank, the Fed is also required to examine nonbank subsidiaries of holding companies if the subsidiary offers traditional bank services. In fact, the law also requires commercial companies that own industrial loan companies or industrial banks, which are not supervised by the Fed, to have an "affirmative commitment" to serve as a source of strength for the bank.

The Government Accountability Office is taking a closer look at these commercial companies that own banks, yet aren't subject to regulatory oversight to determine improvements.

Financial Stability Oversight Council

To address the issue of systemic risks, Dodd-Frank calls for the creation of the Financial Stability Oversight Council. The council will consist of 10 voting members who are federal financial regulators, including the Federal Reserve, plus an independent member from the insurance industry and five nonvoting members.

The council's work will be supported by the new Office of Financial Research. Housed within the Treasury, this unit will be staffed with economists, lawyers, and other specialists who will collect financial data and conduct economic analyses.

In November 2010, Vice President Leonard Nakamura of Philadelphia's Research Department led a cross-department effort to create a financial stability report and briefing process for the Bank's senior management. The report, which focuses on developments in consumer credit markets, is being shared with the Board of Governors' Office of Financial Stability Policy and Research. The analysis presented in the report is contributing to the Board's monitoring of systemic risk.

Consumer Financial Protection Bureau

Dodd-Frank makes significant changes to the federal consumer protection regulatory role by creating the Consumer Financial Protection Bureau. The bureau will be housed within the Fed for purposes of funding its budget but will be independent of the Fed in terms of its decision-making authority. Congress created the bureau to consolidate consumer protection functions for financial services into one agency. Until Dodd-Frank, the Fed had authority to write regulations to implement most federal consumer protection laws, such as the Truth in Lending Act (TILA).

Under Dodd-Frank, the rulemaking authority for most of these laws will transfer to the bureau effective July 21, 2011. The bureau will have authority over a vast array of consumer protection laws, including TILA, the Real Estate Settlement Procedures Act (RESPA), the Equal Credit Opportunity Act, the Truth in Savings Act, and the Fair Credit Reporting Act. Dodd-Frank also directs the bureau to create a disclosure form that combines the existing mortgage disclosures under TILA and RESPA. This combined rule will reduce the paperwork consumers receive in mortgage transactions and help consumers better understand the costs of their mortgage and the cost of loan-closing services. Dodd-Frank also directs the bureau to conduct consumer testing of its disclosure forms to ensure that the information is understood and to examine whether mandatory arbitration clauses in consumer contracts should be banned.

While most consumer protection rulemaking powers will transfer to the bureau, authority for enforcing compliance with a few laws, including the Community Reinvestment Act (CRA) and the Fair Housing Act, will remain with the Fed and other existing federal agencies.

Bureau's Examination Authority

The bureau will examine and supervise all banks, savings and loan associations, and credit unions with assets of $10 billion or more (approximately 103 institutions) to verify their compliance with federal consumer protection laws and to investigate consumer complaints. The Philadelphia

Fed expects that consumer compliance examinations for only one of its 20 state-member banks will be transferred to the bureau. These institutions' existing regulators, which include the Fed, will continue to supervise them for safety and soundness and will continue to conduct CRA exams.

One of the most significant changes resulting from Dodd-Frank is that the law requires the bureau to examine and supervise certain nonbanking institutions, including mortgage brokers, providers of foreclosure relief service, payday lenders, providers of private education loans, and large providers of consumer financial services. Currently, the Federal Trade Commission can take action against these institutions for violating consumer protection laws but does not examine them or investigate individual consumer complaints.

Rule-Writing Responsibilities

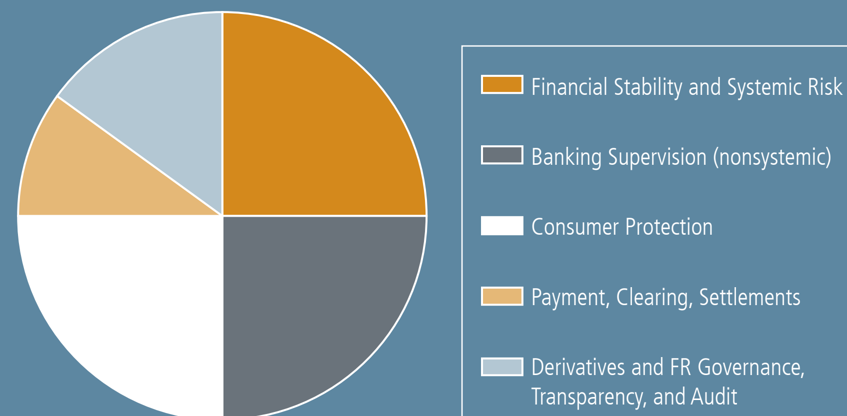
To meet their rule-writing responsibilities, the Fed and other regulatory agencies will solicit views from the financial industry, academics, and others to ensure that the key issues relevant to Dodd-Frank are implemented. The Fed is working with these agencies to write hundreds of new rules – both mandatory and discretionary. The Fed has direct responsibility for writing more than 50 rules.

The work is already under way. Julia Cheney, manager of research and programming for the Payment Cards Center, has been assisting the Board of Governors in Washington, D.C., in writing rules governing "reasonable and proportional interchange fees" charged for debit transactions. Her primary focus has been on the fraud adjustment portion of the rule. Her work ranges from assisting in the design of the surveys sent to market participants to evaluating the data received.

Conclusion

Throughout the Federal Reserve System, more than 300 staff members are working on Dodd-Frank-related projects. The new law's effectiveness will depend on the interpretation and implementation. The Philadelphia Fed will continue to contribute to this work, which will lead to a better understanding of financial firms and emerging risks, improved transparency and accountability, and increased protections for consumers. The ultimate goal is to improve the strength and effectiveness of the nation's regulatory system and enhance financial stability.

Federal Reserve Initiatives Under Dodd-Frank*



Source: Federal Reserve Bank of Philadelphia, *SRC Insights*, First Quarter 2011

* Chart shows areas of focus for initiatives the Fed will implement under Dodd-Frank.

Keeping Credit Markets on the RADAR Screen

What might have happened in the recent financial crisis and recession if regulators and researchers had had better and timelier information about mortgage and credit markets? Could the data have helped prevent the spread of contagion from the subprime mortgage market to the broader economy?

While there are no easy answers to those questions, they have prompted the Philadelphia Fed to initiate a System-wide project to create a large and comprehensive warehouse of data on consumer credit markets and provide the ability to analyze the underlying securities that support consumer credit. The objective is to provide tools that can help Federal Reserve analysts identify emerging threats to the financial system. Clearly, the recent recession revealed that researchers need more detailed, better quality, real-time information, particularly on consumer credit behavior and markets.

In 2008, the Federal Reserve Bank of Philadelphia collaborated with the Federal Reserve Bank of Kansas City to create an initial data warehouse with more than 37 million active mortgages going back to 1992. The data warehouse was instrumental in helping the Federal Reserve carry out several key responses to the crisis. For example, the Federal Reserve used the data in designing the Supervisory Capital Assessment Program, commonly known as the stress test, which determined how the nation's largest banking organizations would fare in a severe or protracted economic downturn. The data also helped analysts at the Federal Reserve estimate losses for the government-sponsored enterprises Fannie Mae and Freddie Mac.

The need for an even more comprehensive set of data was evident to Larry Cordell of the Philadelphia Fed's Supervision, Regulation and Credit Department (SRC) while he was working with the initial data warehouse. As Cordell studied the data, he had an idea: expand the information set to include a much broader array of consumer credit data and also gather information on pools of securities that are backed by these same credits.

So Cordell proposed that the Fed acquire additional consumer credit data and then centralize the data into a high-tech data warehouse that could be securely accessed throughout the Federal Reserve System. He also proposed that the Federal Reserve Bank of Philadelphia set up a separate securities evaluation capability to monitor securities markets and to assist examiners in evaluating complex securities at banks to help improve bank supervision. His innovative idea gained Bank-wide support and became a strategic initiative of the Philadelphia Fed. The Bank again partnered with the Kansas City Fed to set up the data warehouse part of the project. Together, these two initiatives were named RADAR, shorthand for Risk Assessment, Data Analysis, and Research, when it was formally launched at mid-year 2010.

"We have added to the original mortgage database, and we now have a set of databases with information on almost 180 million mortgage loans. We also added a database on consumer credit that includes over 40 million individuals, from which personal identifying information has been removed. And all of these data are available System-wide in a state-of-the-art computing environment," said Cordell. "In addition, we built a securities evaluation capability that allows us to conduct surveillance across entire classes of securities or perform evaluations of individual securities in bank portfolios."

The project involved others in the Bank, as well. Frank Doto, an assistant vice president in SRC, played a key role as project leader, developing a budget, formulating a communications strategy, and obtaining approvals from the Bank's board of directors as well as the Board of Governors in Washington.

Bob Hunt, vice president and director of the Payment Cards Center, set up a System-wide user group as well as a group of data managers whose job is to ensure that the Reserve Banks comply with the terms of the data contracts. He worked with staff from Philadelphia's Information Technology Services Department to make sure that Bank staff could start to work with the data while the larger warehouse was being designed.

Clockwise from left: Bob Hunt, Larry Cordell, Frank Doto, MaiHoa Le, and Vidya Shenoy

In addition, two of the Bank's senior officers contributed oversight to the project. Michael Collins, executive vice president and lending officer, was the project's sponsor, and he and Loretta Mester, executive vice president and director of research, served on the Executive Steering Committee, along with executives from the Board and the Kansas City Fed.

This centralized data resource allows the Fed to evaluate consumer behavior in credit markets, monitor risk-taking more effectively, and better understand consumer credit trends. Cordell noted, "RADAR offers data at a level of detail that was previously unavailable and is not available anywhere else." Moreover, Doto observed, "Centralizing these data provides huge savings on the costs of contracts and computing environments and allows for better quality control, data governance, and leveraging of technical expertise and knowledge."

Seated front to back: Jeremy Brizzi, Onesime Epouhe, and Meredith Williams. Standing left to right: Yilin Huang, Robert Dittmar, Michael Hopkins, Saba Tesfaye, and Nicholas Arcidiacono.

Macroprudential Supervision, Micro-Market Insight

RADAR enables the Fed to examine data both more deeply and more broadly. It assists in macroprudential supervision, which assesses the risk to the entire financial system rather than to any one individual firm or sector. At the same time, it also helps the Fed develop insights into markets at the micro level, allowing data to be broken down to individual securities or loans in a specific region.

Although still relatively new, RADAR has already had a positive impact on the Federal Reserve's activities. This new data warehouse has not only proven useful in helping users search for specific information, write reports, and analyze research findings, it also informs policy briefings and helps policymakers in addressing specific issues stemming from disruptions in financial markets. In short, it has enhanced the effectiveness and productivity of examiners, economists, and community development staff who use RADAR's two major components, the Data Warehouse and the Securities Evaluation Service (see the sidebar on the next page).

RADAR is also helping the Fed address the regulatory challenges it faces in light of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This legislation calls for an improvement in the quantity and quality of financial data. The Federal Reserve views RADAR as a prototype that will extend to collaborative analysis of data for other markets and sectors as well.

Major Components of RADAR

RADAR Data Warehouse

The RADAR data warehouse provides direct, immediate access to a broad array of U.S. consumer credit data, including credit cards, auto loans, student loans, mortgages, and more. Its sophisticated technology allows users to generate and view data by geography, demographics, time periods, or loan status. It has many options for customizing the views of data, including the ability to develop maps or charts for fast and meaningful analysis. Although researchers are able to see all relevant loan data, any personal identifying information is removed from individual loan files to protect consumers' privacy.

A business support team at the Philadelphia Fed helps ensure that the data are high quality and answers questions from analysts around the Federal Reserve System. These experts can also incorporate the best thinking from around the Fed on how to use data in the most meaningful ways. A second technical team helps support the data warehouse, which is housed at the Kansas City Fed, and helps provide technical assistance to users of the data.

While the data warehouse is mainly used for bank surveillance purposes, it has also proven useful in the Fed's community development initiatives. For example, researchers have been able to generate reports that provide a detailed and specific snapshot of conditions in a region's mortgage sector, including delinquencies and foreclosures. This ability to dig deeper into the data allows researchers to more easily spot patterns or trends, providing a better understanding of a community's or a region's credit health.

RADAR Securities Evaluation Service

Before RADAR, examiners evaluated an institution's assessment of any impairment or stresses on securities within its portfolio. Now, RADAR's securities evaluation service brings an independent analysis to the examination process. Through this service, bank examiners and market analysts throughout the System have access to a team of experts at the Philadelphia Fed whose analysis and evaluation of securities can assist them in assessing the securities positions of financial institutions. Complex securities, which are often illiquid and opaque, can prove challenging to accurately evaluate. But users of the service cite the team's understanding and in-depth knowledge as invaluable in assessing these complex types of securities.

Enhanced surveillance capabilities provide an overall view of markets, as well as analysis at the sector level or at the individual security level. Using the securities assessment process, examiners can more accurately evaluate a bank's risk management practices.

This service integrates the information contained in the data warehouse with risk models and securities evaluation software. In addition, the service allows examiners access to modeling tools to create benchmarks against which to compare banks' own valuations of the securities they hold in their portfolios. This way, examiners can help bank management refine their securities valuation process to better estimate credit risk and accurately reflect financials.

Reaching Out in the Third District—and Beyond

From members of a building trade association in Newark, Delaware, to banking executives in Trenton, New Jersey. From legislative staff in Williamsport, Pennsylvania, to business owners at the Philadelphia Navy Yard. In 2010, staff from the Philadelphia Fed crisscrossed the Third District, developing and strengthening relationships with key stakeholders. They also provided the information these stakeholders need in order to navigate through challenging economic times.

Bank staff also journeyed to Washington, D.C. to educate legislators involved in crafting new laws on financial regulatory reform. Although the financial crisis had waned in 2010, the Bank's outreach took on particular importance as Congress, and others, questioned the Fed's role and its mission, policies, and actions in the wake of the nation's worst financial crisis since the 1930s. Consequently, the Philadelphia Fed realized that it had to do its part to educate legislators about the Federal Reserve's roles and responsibilities.

In early 2010, Milissa Tadeo took on a new role as senior vice president for Corporate Affairs. The Bank created this new role to coordinate the outreach efforts of the Public Affairs, Community Development Studies and Education, and Financial Institutions Relations departments.

"The Federal Reserve Bank of Philadelphia has always had an active outreach function, but we felt we could strengthen it by bringing all of our outward-facing programs together under one umbrella," Tadeo said. "We want to increase awareness of the many ways the Philadelphia Fed serves the Third District and the resources that are available to our stakeholders. Using all the connections we've made throughout the District allows us to gather feedback, so that we can have an intelligent conversation about the issues affecting banks, small and large businesses, our communities, and our other key stakeholders."

Reaching Out to Business Leaders

Luke Tilley, regional economic advisor, Corporate Affairs, sees the Bank's outreach activities as an opportunity for two-way communication. Tilley is often called upon to give economic outlook speeches to business groups and trade associations. Last year, he spoke to more than 30 groups.

"The business professionals that I talk to are primarily interested in where the economy is going. As a result of our discussions, I often bring their

comments and questions back to our Research Department and to the Bank's leadership. I also try to interest the business people I meet in participating in the various Research surveys," Tilley said.

Sometimes, audience members who work for nonprofit organizations or community associations are interested in establishing relationships with the Bank's Community Development Studies and Education Department. Tilley facilitates these introductions as well.

In addition to Tilley's outreach efforts, staff members in the Research Department also give presentations to groups of bankers, bank regulators, business executives, and the media and use these forums to engage the business community in a dialogue about the national and regional economy. In 2010, Research staff made numerous presentations to these various groups.

Research staff also use these events as an opportunity to interest local business leaders in participating in the department's surveys. For example, whether speaking to a Bankers' Forum here at the Bank or an economic outlook breakfast sponsored by Lincoln University and the Chester County Chamber of Business and Industry, Tim Schiller, senior economic analyst, finds that these outreach activities prove useful in generating contacts for the Federal Reserve System's Beige Book, which reports anecdotal information on current economic conditions in the 12 Federal Reserve Districts, and the department's various surveys, including its well-known Business Outlook Survey of regional manufacturers.

Reaching Out to Legislators

Luke Tilley was also instrumental in the Bank's outreach activities that focused on reaching legislators and their staffs. In July 2010, President

Luke Tilley and Milissa Tadeo

Charles Plosser and other Bank staff traveled to the Board of Governors to meet with the Washington-based staffs of Third District legislators. "The meeting gave us an opportunity to talk about who we are and what we do, what's common among Federal Reserve Banks, and what's unique about the Philadelphia Fed," Tadeo said. "For example, the Philadelphia Fed has the Payment Cards Center. So when legislative staffs start thinking about consumer payment and credit issues, we can provide them with our research findings and tell them what resources are available to them."

Tilley, one of the presenters at that meeting, said that as the Dodd-Frank legislation was being developed, the Federal Reserve was getting questions about its mission and its role. "We wanted to make sure that federal legislators had accurate information, especially if they were going to be writing and voting on legislation that concerns the Fed. For their part, they wanted to be fully informed, as well," Tilley said.

At the local level, Amy Lempert, community development advisor and outreach coordinator, Community Development Studies and Education, met with the district office directors of the region's legislators to introduce them to what her department does and the resources and data available to them. "Overall, they were delighted that we met with them. Many of them did not know that we regularly convene meetings of community development leaders and lenders, nonprofits, and other stakeholders. From the Bank's point of view, we are making contact with people who have their finger on the pulse of issues in a particular community. It's a two-way street," Lempert said. "They often get questions from their constituents about programs of the Federal Housing Administration or the Department of Housing and Urban Development, and we can help direct them to those resources," she added.

Promoting Relationships with Financial Institutions

Anthony Scafide and Thomas Lombardo, assistant vice presidents in the Bank's Financial Institutions Relations Department, are responsible for establishing and maintaining relationships with approximately 250 financial institutions and banking associations in the Third District. At the start of each year, Scafide and Lombardo meet with the heads of the four banking associations in the Third District. They share the Bank's strategy with them and seek their input about what is important to their membership. Once those meetings are completed, they begin the process of meeting with the leaders of Third District banking institutions. Last year was no exception.

"Our purpose is to maintain the Bank's relationships with bankers. We rely on them for their insight on economic, banking, and general business conditions. We meet with them face to face because we want to know what's on their minds. We bring the information we glean about banking, the economy, regulatory issues, and other topics back to President Plosser and the Bank's senior management team.

"The bankers also use us as a portal into the Bank and the System. For example, if they have a problem with one of their financial services, we can help steer them to the information and resources they need," Scafide said.

In October 2010, the Federal Reserve Board of Governors announced that it was forming a Community Depository Institutions Advisory Council. The Board requested that each Reserve Bank form a similar council. Scafide and Lombardo helped the Philadelphia Fed identify 12 members to appoint to this new council, which held its first meeting in 2011.

Scafide and Lombardo were also instrumental in organizing the Bank's annual field meetings. For the 65th year, the Bank's senior management took to the road to meet with the senior management of Third District financial institutions and their boards of directors. "Directors, who are business people themselves, bring a local business perspective to discussions about the financial services industry and the economy," Lombardo said. The meetings also offer the Fed the opportunity to exchange views about national and regional economic conditions and the health of banks in the Third District, as well as to hear bankers' concerns about the issues affecting their businesses and their customers.

In addition to the activities of the Financial Institutions Relations staff, the Bank's Supervision, Regulation and Credit Department (SRC) also engages in outreach with financial institutions. SRC's activities take the form of Bankers' Forums, Directors' Workshops, online training for bank directors, CFO/CPA Roundtables, and the Partnership for Progress program, which provides guidance to minority-owned and start-up financial institutions on current and emerging issues. The primary purpose of these initiatives is to share information, knowledge, and experiences with the institutions the Bank supervises in a nonexamination setting. Another goal is to receive feedback on banking and regulatory matters that can help to inform public policy questions.

Community Development Studies and Education

Another key area under Tadeo's direction is the Community Development Studies and Education (CDS&E) Department, formerly known as Community Affairs. Its mission is to support economic growth by promoting community development and fair and impartial access to credit. The department accomplishes this through research, outreach, and meetings at which interested parties can discuss current and emerging issues.

Anthony Scafide (left) and Tom Lombardo

Amy Lempert (left) and Dede Myers

"The department's number one objective last year was to reach out to the counselors and other professionals who help people in foreclosure achieve some equilibrium in their lives," said Vice President Dede Myers, who heads the department. To this end, CDS&E held its fourth biennial conference on *Reinventing Older Communities* in May 2010. The conference focused on rebuilding older communities in the wake of the foreclosure crisis and the federal government's economic stimulus programs. Over 400 people attended, including Federal Reserve Chairman Ben Bernanke, who joined the conference on Thursday, May 13. He toured the Philadelphia Navy Yard to see how this former shipyard has been transformed into a 1,200-acre mixed-use industrial park. The Chairman then attended a conference luncheon that featured a discussion of economic and community development issues between him and Jeremy Nowak, president and CEO of The Reinvestment Fund and deputy chairman of the Philadelphia Fed's board of directors.

In other activities last year, the department's economic education staff continued to offer several training programs for teachers, including "Keys to Financial Success" and "Making Sense of Money and Banking." In addition, these staff members also presented and hosted an exhibit booth at the New Jersey Education Association's annual conference and presented on the Bank's economics and children's literature lessons at the National Council for the Social Studies' annual conference.

Late in the year, the department began developing its first Community Outlook Survey. CDS&E will conduct the survey quarterly and use the results to quantify what staff members hear in one-on-one meetings. Other CDS&E activities last year included a workshop on reverse mortgages and one on Pennsylvania's affordable rental market, co-sponsored with the Cleveland Fed.

Federal Reserve Bank of Philadelphia

2010 Bank Highlights

Audit

The Audit Department co-sponsored a fraud prevention session with the Enterprise Risk Management Department to provide Bank management with useful tips to identify potential fraud scenarios and specific actions that may help uncover such acts. The department also continued to provide support to other Federal Reserve organizations, the audit profession, and the international audit community. Three staff members assisted staff at the Board of Governors by participating in reviews of other Federal Reserve Districts, and one staff member assisted on an audit at the New York Fed. During 2010, the Bank's general auditor became a member of the Board of Governors of the Philadelphia Chapter of the Institute of Internal Auditors. In addition, a staff member shared best practices with auditors at the Bank of Lithuania by observing an audit of the bank's e-mail function and by presenting at an international auditing conference in Vilnius, the capital of Lithuania.

Cash Services

In 2010, the currency counting division installed the final software release for the upgrade of the high-speed currency processing machines. In addition, Cash completed the installation of the second-generation currency authentication sensor. This was the first milestone of a multi-year strategic plan to upgrade all the electronic sensors that authenticate currency to keep pace with advancements in technology and the new designs of U.S. currency. Cash management continued to provide leadership on several System work groups to make improvements in training, business continuity, and fraud detection.

Community Development Studies and Education

The Community Affairs Department is now the Community Development Studies and Education Department. The new name better reflects the department's mission and recognizes its two functions: community development and economic education. In May 2010, the department hosted the fourth biennial community development conference, *Rethink. Recover. Rebuild: Reinventing Older Communities*. Federal Reserve Chairman Ben Bernanke visited the conference and toured the Philadelphia Navy Yard as part of the program. The department continued its work on the longitudinal study of the effectiveness of homeownership counseling. Other department studies in 2010 covered such topics as the Federal Housing Administration's loan portfolio, Neighborhood Stabilization Program efforts across the country, evidence of student achievement in the Bank's personal finance curriculum, and the status of high school personal financial education in the United States. The department's researchers have responded to various requests to speak on these topics at System, professional, and industry events. The department's economic education staff reached 700 teachers with courses designed to help K-12 teachers understand economic concepts, the Federal Reserve System, monetary policy, and personal financial education through its various courses, lesson plans, and conference presentations. The department continued to expand its community outreach efforts by visiting legislative staff in the District. Staff also developed a Community Outlook Survey, which monitors economic factors affecting low- and moderate-income households, and released the first quarterly results in early 2011.

Enterprise Risk Management

Philadelphia's ERM officer co-chaired the International Operational Risk Working Group's conference and led a presentation on how central banks use heat maps and other tools used in reporting. ERM staff provided leadership for the Bank's Green Team, which promotes environmental conservation and sustainability. Also in 2010, the team sponsored an exposition on green products and services as well as an educational workshop on energy conservation for Bank employees. In addition, ERM continues to lead the Bank's innovation initiative, which is committed to encouraging and supporting employee ideas, ranging from process improvement to new business opportunities.

Facilities Management

The Facilities Management Department continued to support the Bank's green initiatives with the installation of a solar hot water heating system on the roof and the initiation of a four-year project to replace the building's lighting system with a highly efficient, intelligent system. The department also modernized the Bank's emergency power distribution infrastructure, a project that provided the Bank with a more robust emergency power grid. The department also completed a project to relocate three departments to the fifth floor of the Bank. The remaining area of the fifth floor is being prepared for possible use by an outside tenant.

Financial Institutions Relations

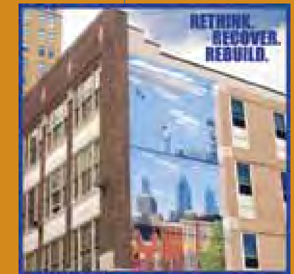
In 2010, the Financial Institutions Relations staff met with senior executives at more than 90 percent of Third District financial institutions. Discussions centered on current business trends, credit conditions, fees, general regulatory issues, and other relevant matters, as well as the national and regional economy. In addition, department staff actively participated in meetings of regional community banking associations to further strengthen relationships and gain knowledge. The department's staff also used the meetings with financial institution representatives to build a base for selecting future members of the recently formed Community Depository Institutions Advisory Council.

Financial Management Services

Staff in FMS chaired several System groups, including the COSO Coordinators Group, the Cost Accounting Group, the Enterprise Risk Management Group, the Government Entity Accounting Reporting System Management Steering Group, and the Integrated Accounting System Enhancement Evaluation Work Group. The Bank's chief financial officer also acted as trustee chair for the Accounting Professional Education Program and hosted its 13th annual program attended by some 75 FRS financial management and audit professionals. FMS worked on many departmental strategic and internal initiatives that supported both System and Bank goals and objectives. One of these objectives was to prepare the Private Sector Adjustment Factor module of the Capital Tracking and Information Network budgeting application for use by all Reserve Banks. In 2010, the module was used on a voluntary basis. In 2011, it will be used in tandem with the existing process and will be centralized in 2012.

Community Development Studies & Education's *Reinventing Older Communities Conference*

In May 2010, the Community Development Studies and Education Department hosted the fourth biennial community development conference, Rethink. Recover. Rebuild: Reinventing Older Communities. More than 400 people from 22 states participated in the three-day event. On Thursday, May 13, Federal Reserve Chairman Ben Bernanke visited the conference and toured the Philadelphia Navy Yard, which is now home to a mixed-use office complex, research laboratories, distribution facilities, and an industrial park (top left and bottom left). After the tour, Chairman Bernanke joined Jeremy Nowak, president and CEO of The Reinvestment Fund and deputy chair of the Bank's board of directors, for a conversation on economic and community development issues. Nowak also moderated a panel session that included Dudley Benoit, senior vice president, JPMorgan Chase Community Development Banking (top right). Sandra Braunstein, director of the Board of Governors' division of Consumer and Community Affairs, addressed the conference (middle left). Participants also had the opportunity to see Temple University's Neighborhood Revitalization Initiatives (bottom right).



Financial Statistics

In 2010, Financial Statistics staff continued to provide superior analysis to ensure the accuracy and quality of incoming financial information used by Federal Reserve policymakers responding to changing economic conditions. Members of the staff made important contributions to the Federal Reserve System's Statistics and Reserves Technology Modernization Project, to the management and enhancement of existing technology applications and business processes, to the Federal Reserve's Census of Finance Companies, and to System-level training initiatives in the Statistics area.

Human Resources

In 2010, the Bank established the Office of Diversity and Inclusion to fulfill one of the provisions of the Dodd-Frank Act. In addition to supporting ongoing diversity initiatives, the office is developing standards and procedures to ensure inclusion of minorities and women in all matters, including procurement activities to increase participation in our supplier ranks. Enhancements to Human Resources information systems included automation of the tuition reimbursement process and an improved performance review tool, ePerformance. The department also launched an upgraded recruiting software system to strengthen recruitment practices and enhance the overall effectiveness of talent management processes. The Talent Management and Organizational Development division held a three-day Education Fair highlighting the various learning and development opportunities available to all employees. Human Resources supported the local responsibilities related to implementing the System's Enterprise Information Technology Strategies initiative.

Information Technology Services

IT Services managed many Bank projects, supporting most business lines, and provided significant support to initiatives for the Federal Reserve System and the Treasury. The department implemented enhancements to the Treasury Check Information System (TCIS) and the Collateral Management System (CMS). IT staff also provided software quality assurance services for major projects throughout the Federal Reserve System and designed and implemented a system to host and enable a securities evaluation system related to the RADAR data warehouse (see the story on page 26). The department upgraded the Bank's local area network facilities. The Groupware Leadership Center, which provides System-wide e-mail and calendar services, delivered new and enhanced capabilities, and completed testing and certification of a new BlackBerry platform that provides enhanced resiliency. In addition, the GLC relocated core video conferencing infrastructure components from an externally hosted site.

Law Enforcement

The Law Enforcement Department has now fully integrated the off-site screening facility that was opened in the fourth quarter of 2009. In 2010, all security surveillance systems were completed and are now in use. In addition, the department completed a major modernization of the pedestrian-entry security portals. This effort has resulted in faster screening of Bank employees and visitors.

Legal

The Legal Department devoted significant time to analyzing the Dodd-Frank Wall Street Reform and Consumer Protection Act and assisting in its implementation at the Bank. Shortly after passage of the act, the Bank's general counsel participated in a Town Hall meeting to educate the Bank's officers and employees on the scope of this expansive legislation. Department officers continued to provide legal support to initiatives at the System level, including the System's Groupware Leadership Center, the Workers' Compensation Coalition, and a System-wide litigation project, among other collaborative legal efforts.

Payment Cards Center

The Payment Cards Center organized three important meetings in 2010. The first addressed payment card fraud and the technological options available to mitigate those risks. The second focused on economic and regulatory developments in the market for prepaid cards. The third event celebrated the center's 10-year anniversary. This conference brought together more than 100 representatives from industry, nonprofit organizations, regulatory agencies, and academia to discuss the future of consumer credit and payments in the United States. In addition to conferences, center staff produced influential papers on topics that included the triggers of mortgage default, the changing mix of payments used by consumers, and the use of consumer testing to inform the regulation of overdraft fees. Center staff also participated in the Board's ongoing rulemaking process for designing "reasonable and proportional" debit interchange fees and in the Federal Reserve System's planning process for implementing portions of the Dodd-Frank Act.

Public Affairs

The Public Affairs Department supported the Bank's outreach to communicate information about regulatory reform to key stakeholders. These activities included the Bank president's public speeches, meetings with legislative staffs as well as a briefing for the Joint Economic Committee of Congress, and communications to other key constituents. In October, the department held a workshop on regulatory reform for journalists. The department also published *The Second Bank of the United States: A Chapter in the History of Central Banking*, a booklet that will be used by teachers nationwide using the Bank's economic education programs. The department also helped promote the biennial *Reinventing Older Communities* conference for the Bank's Community Development Studies and Education Department, including a visit by Chairman Bernanke as part of the event. Public Affairs also welcomed more than 25,226 people to the "Money in Motion" exhibit in 2010.

Research

In 2010, the Research Department led a cross-functional group in developing a financial stability report and briefing process. This report is being shared with the Board of Governors' Office of Financial Stability Policy and Research. In September, the department participated in the System's conference on the Dodd-Frank Wall Street Reform and Consumer Protection Act. The research director served on the five-member Steering Committee, and another Research officer

served on a working group for the conference. Other System projects that Research supported last year include the quantitative surveillance project on macro-financial risks, a working group on financial firm disclosures, and the Foreclosure Mitigation Task Force. Staff in the department's Real-Time Data Research Center worked with the Board of Governors to make changes to the quarterly Survey of Professional Forecasters to support bank examinations. In addition, department staff continued to publish their research in top-tier academic journals in economics and finance and presented their work at high-profile conferences and workshops. Research library staff continued to coordinate the library management system shared by the Philadelphia, Dallas, Richmond, and St. Louis Reserve Banks.

Retail Payments

The final phases of the Retail Payments check consolidation were completed in 2010. Philadelphia printed and distributed substitute checks until the end of the third quarter and managed the workflows for Check 21 electronic files into the fourth quarter. The substitute check printing and distribution functions were successfully moved to the Federal Reserve Bank of Cleveland and responsibility for managing electronic files was successfully moved to the Federal Reserve Bank of Atlanta.

Supervision, Regulation and Credit

Supervision, Regulation and Credit (SRC) staff continued to improve supervision through enhanced analytics while maintaining core principles and applying a balanced approach to bank examinations. The Dodd-Frank Act ushered in a transitional phase for the Federal Reserve and SRC and expanded the Fed's overall responsibility. Three SRC officers took on high-profile assignments, assisting System efforts related to supervising large banks, assessing risk management practices, and enhancing supervision operations. Department staff led an initiative to acquire and centralize large databases and make them available to Federal Reserve staff. The result was RADAR (see the related story on page 26). SRC staff also made presentations at financial trade group conferences, in academic settings, and at individual outreach engagements. In addition, SRC hosted periodic outreach events such as the Bankers' Forum, Directors' Workshops, and the CFO/CPA Roundtable.

Treasury Services

In 2010, the Bank's Treasury Services Department implemented important enhancements to the Collateral Management System, which it operates for the entire Federal Reserve System. System improvements included the enhanced functionality of both the Automated Loan Deposit and the Term Deposit Facility. Additionally, the department successfully developed and tested enhancements to support the revised Board of Governors' Payment System Risk policy. The department also provided direction and expertise on collateral-related issues to the credit risk management community.

Payment Cards Center Marks Its 10th Anniversary

The idea of creating a center that focused on payment cards emerged in planning sessions at the Philadelphia Fed in 1999. At that time, the largest concentration of credit card receivables was held by banks located in the Third District. Managing these accounts involved numerous ACH and wire transactions between banks each day as well as millions of checks written by consumers each month. These circumstances made the Bank an appropriate place to establish a center to foster the analysis of developments in the markets for consumer credit and payments.

Anthony Santomero, the Bank's president from 2000 to 2006, formally established the Payment Cards Center in 2000. From the start, the center defined its audience to include consumers and consumer groups, industry participants, regulators and other policymakers, and academic researchers. This interdisciplinary focus underlines how the center's activities encourage interaction with each constituency and explains why the Bank created the center as an independent unit. Rather than duplicating efforts, the Bank designed the center to facilitate collaboration across departments while providing its own unique expertise.

The center's basic agenda includes producing a regularly updated bibliography on consumer credit and payments, analytical discussion papers accessible to a wide audience, an internal workshop series, and conferences focused on issues relevant to the credit and payment markets. The center's staff track emerging issues and assemble groups of experts to engage in candid conversations. The staff then shares the lessons from these conversations with the public through the center's publications.

Gradually, the center has expanded its horizons and introduced new lines of inquiry, including a focus on consumer credit and payment issues that have yet to receive significant attention in formal research and studies of mobile payments and the application of payment cards to transit fare systems. The center has also produced a series of papers documenting new applications of prepaid cards, including government benefits, disaster relief, and medical savings accounts.

Among its many other activities, the center and the Bank's Research Department have co-sponsored a series of biennial research conferences on topics in consumer credit and payments. Four conferences later, these meetings are regarded as some of the best in this area of study. The center has also established a visiting scholars program to benefit from the expertise of outstanding researchers and to assist them in their research.

Over the course of its first decade, the Payment Cards Center has organized or co-organized numerous conferences, and the center's staff and its visiting scholars have written well over 100 papers and published more than 20 articles in journals and books. In addition, staff members have participated in dozens of industry and policy events. Looking back, the Payment Cards Center has served its mission well: to promote a deeper understanding of the markets for consumer credit and payments. But as recent events demonstrate, this is an ongoing task and perhaps more important today than ever.

Federal Reserve Bank of Philadelphia
Board of Directors

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

Jeremy Nowak (a, b, d)
Deputy Chairman
President & CEO
The Reinvestment Fund

Michael F. Camardo (a, c)
Retired Executive Vice President
Lockheed Martin ITS

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

Ted T. Cecala (a)
Chairman & CEO
Wilmington Trust Corporation

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

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

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

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

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

Seated left to right: Aaron Groff, Jeremy Nowak, and Charles Pizzi. Standing left to right: Michael Camardo, Deborah Fretz, Frederick Peters, and Keith Campbell. Not pictured: Ted Cecala and James Nevels

Federal Reserve Bank of Philadelphia

Economic Advisory Council

Edward Coryell, Business Manager
Metropolitan Regional Council
of Philadelphia & Vicinity
Philadelphia, PA

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

Daniel Falasca, Jr., President
Falasca Mechanical
Vineland, NJ

Kevin Flemming, President
Integrity Personnel
Allentown, PA

Robert Laskowski, M.D., MBA
President and CEO
Christiana Care Health System
Wilmington, DE

Rose Lee, President
Saint-Gobain Crystals
Valley Forge, PA

Sharmain Matlock-Turner
President and CEO
Urban Affairs Coalition
Philadelphia, PA

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

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

Christopher Schell, President
Schell Brothers
Lewes, DE

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

Rodman Ward, President and CEO
Corporation Service Company Inc.
Wilmington, DE

Seated left to right: Kevin Flemming, RoseAnn Rosenthal, Robert McMahon, John Dawkins, Valerie Sill, and Rodman Ward. Standing, left to right: Robert Laskowski, Christopher Schell, Daniel Falasca, and Edward Coryell. Not pictured: Sharmain Matlock-Turner and Rose Lee.

Federal Reserve Bank of Philadelphia

Management & Policy Committee

The Bank's Management and Policy Committee is the senior group that advises the president and first vice president in managing the affairs of the Bank. Seated left to right: First Vice President William H. Stone, Jr., Senior Vice President Mary Ann Hood, President Charles Plosser and Executive Vice President Loretta Mester. Standing left to right: Senior Vice President Milissa Tadeo, Senior Vice President Arun Jain, Executive Vice President Blake Prichard, Executive Vice President Michael Collins, and Senior Vice President Donna Franco. Not pictured: Senior Vice President William Lang (on assignment at the Board of Governors)

Federal Reserve Bank of Philadelphia

Current Officers

Charles I. Plosser
President and CEO

D. Blake Prichard
First Vice President

Michael E. Collins
Executive Vice President and Lending Officer
Supervision, Regulation and Credit

Loretta J. Mester
Executive Vice President and Director of Research

Donna L. Franco
Senior Vice President and Chief Financial Officer

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

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

Arun K. Jain
Senior Vice President
Treasury and Financial Services

William W. Lang
Senior Vice President and Chief Examination Officer
Supervision, Regulation and Credit

Milissa M. Tadeo
Senior Vice President
Corporate Affairs

John D. Ackley
Vice President
Treasury Services

John G. Bell
Vice President
Financial Statistics

Mitchell S. Berlin
Vice President and Economist
Research

Robert J. Bucco
Vice President

Michael Dotsey
Vice President and Senior Economic Policy Advisor
Research

James S. Ely
Vice President
Public Affairs

Robert Hunt
Vice President and Director
Payment Cards Center

Alice Kelley Menzano
Vice President
Information Technology Services

Mary DeHaven Myers
Vice President and Community Affairs Officer
Community Development Studies and Education

Leonard Nakamura
Vice President and Economist
Research

James Nason
Vice President and Economist
Research

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

Patrick M. Regan
Vice President
Information Technology Services

Jeanne R. Rentezelas
Vice President and General Counsel
Legal

Michelle M. Scipione
Vice President
Cash Services

Richard A. Sheaffer
Vice President and General Auditor
Audit

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

Todd Vermilyea
Vice President
Supervision, Regulation and Credit

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

James K. Welch
Vice President
Law Enforcement and Facilities Management

Donna Brenner
Assistant Vice President
Enterprise Risk Management

Brian Calderwood
Assistant Vice President
Information Technology Services

Jennifer E. Cardy
Assistant Vice President
Financial Management Services

Maryann T. Connelly
Assistant Vice President and Counsel
Legal

Cynthia L. Course
Assistant Vice President and Assistant Secretary
Supervision, Regulation and Credit

Frank J. Doto
Assistant Vice President
Supervision, Regulation and Credit

Michael T. Doyle
Assistant Vice President
Treasury and Financial Services

Gregory Fanelli
Assistant Vice President
Information Technology Services

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

Stephen G. Hart
Assistant Vice President
Human Resources

John P. Kelly
Assistant Vice President
Treasury Services

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

Thomas J. Lombardo
Assistant Vice President and Assistant Secretary
Financial Institutions Relations

Robert F. Mucerino
Assistant Vice President
Treasury Services

Camille M. Ochman
Assistant Vice President
Cash Services

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

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

Stephen J. Smith
Assistant Vice President and Counsel
Legal

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

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

Patrick F. Turner
Assistant Vice President
Information Technology Services

Constance H. Wallgren
Assistant Vice President
Supervision, Regulation and Credit

Christopher C. Henderson
Retail Risk Officer
Supervision, Regulation and Credit

Christopher Ivanoski
Facilities Officer
Facilities Management

Keith Morales
Information Technology Services Officer
Information Technology Services

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

Gregory Ramick
Wholesale Product Office Officer
Wholesale Product Office

Stanley Sienkiewicz
Research Support Officer
Research

Gail L. Todd
Credit Officer
Supervision, Regulation and Credit

Includes promotions through March 2011

Federal Reserve Bank of Philadelphia

Operating Statistics

In 2010, Philadelphia continued to be a major processor of cash in the Federal Reserve System, although the volume of currency processed decreased 11 percent due to improvements in financial institutions' cash-handling practices. These improvements enabled the Cash Department to reduce the number of currency-counting processing shifts at the end of 2009. The actual dollar value of currency processed increased 5 percent due to a 10 percent increase in the volume of $20 notes processed. In 2010, the volume of coin bags processed on-site decreased 17 percent, and the value of processed coin decreased 11 percent because coin-handling activity was redirected to the off-site coin terminals.

In 2010, there was a significant decrease in discount window lending activity, both in the number of loans and the value of loans advanced by the Reserve Bank. The substantial year-over-year decrease in borrowing activity was influenced by stabilization in the financial markets. In addition, the Term Auction Facility special lending program established in 2007 ended in the first quarter of 2010, and the primary credit reverted to overnight lending.

In 2010, Philadelphia's Check 21 volumes remained flat in comparison to 2009. Philadelphia handled 1.2 billion Check 21 items for a dollar value of $1,877 billion. Check 21 dollar values handled decreased in 2010 by 15 percent in comparison to 2009. The final phases of the Retail Payments check consolidation were completed in 2010. Philadelphia printed and distributed substitute checks until the end of the third quarter and managed the workflows for Check 21 electronic files until midway through the fourth quarter. The substitute check printing and distribution functions were successfully transitioned from the Federal Reserve Bank of Philadelphia to the Federal Reserve Bank of Cleveland, and responsibility for managing the workflows of Check 21 electronic files was successfully transitioned to the Federal Reserve Bank of Atlanta. These events marked the completion of over 90 years of check processing by Philadelphia in the Federal Reserve System.

SERVICES TO DEPOSITORY INSTITUTIONS

	2010 Volume	2010 Dollar Value	2009 Volume	2009 Dollar Value
Cash operations:				
Currency processed	1,523.5 million notes	$24.8 billion	1,702.7 million notes	$23.7 billion
Coin paid and received On-site	379.0 thousand bags	$192.5 million	459.0 thousand bags	$215.1 million
Coin paid and received Off-site	1,205.7 thousand bags	$917.0 million	1,015.6 thousand bags	$867.8 million
Loans to depository institutions during the year	525 loans	$62.5 billion	1,295 loans	$7,369.0 billion
Commercial check services:				
Check 21 received	1.2 billion checks	$1,877 billion	1.2 billion checks	$2,198.0 billion
Paper processed	-	-	182.1 million checks	$300.0 billion

Statement of Auditor Independence

In 2010, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks and the consolidated financial statements of the limited liability companies (LLCs) that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the Federal Reserve Bank of New York. Fees for D&T's services are estimated to be $8.0 million, of which approximately $1.6 million were for the audits of the LLCs.* 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 2010, the Bank did not engage D&T for any non-audit services.

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* 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.

2010 Annual Report

Financial Reports *Contents*

Management's Report on Internal Control Over Financial Reporting 50

Independent Auditors' Report 51

Abbreviations 53

Financial Statements:

Statements of Condition as of December 31, 2010 and December 31, 2009 54

Statements of Income and Comprehensive Income for the years ended December 31, 2010 and December 31, 2009 55

Statements of Changes in Capital for the years ended December 31, 2010 and December 31, 2009 56

Notes to Financial Statements 57

Management's Report on Internal Control Over Financial Reporting

March 22, 2011

To the Board of Directors

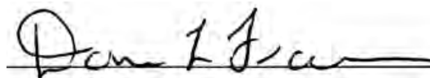
The management of the Federal Reserve Bank of Philadelphia (FRBP) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2010 and 2009, and the Statements of Income and Comprehensive Income and Statements of Changes in Capital for the years then ended (the Financial Statements). The Financial Statements have been prepared in conformity with the accounting principles, policies and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the FAM and include all disclosures necessary for such fair presentation.

The management of the FRBP 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 FAM. Internal control contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal control are reported to management and appropriate corrective measures are implemented.

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

The management of the FRBP 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 FRBP maintained effective internal control over financial reporting as it relates to the Financial Statements.

Charles I. Plosser, President and Chief Executive Officer



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

Deloitte & Touche LLP
1700 Market Street
Philadelphia, PA 19103-3984
USA

Tel: +1 215 246 2300
Fax: +1 215 569 2441

www.deloitte.com

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying Statements of Condition of the Federal Reserve Bank of Philadelphia ("FRBP") as of December 31, 2010 and 2009 and the related Statements of Income and Comprehensive Income, and of Changes in Capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of the FRBP as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The FRBP'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's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these Financial Statements and an opinion on the FRBP's internal control over financial reporting based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Financial Statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the Financial Statements included examining, on a test basis, evidence supporting the amounts and disclosures in the Financial Statements, assessing the accounting principles used and significant estimates made by management, 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.

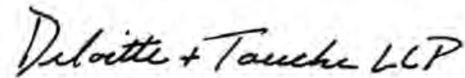
Member of
Deloitte Touche Tohmatsu

The FRBP's internal control over financial reporting is a process designed by, or under the supervision of, the FRBP's principal executive and principal financial officers, or persons performing similar functions, and effected by the FRBP's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. The FRBP's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the FRBP; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of Financial Statements in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System, and that receipts and expenditures of the FRBP are being made only in accordance with authorizations of management and directors of the FRBP; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the FRBP's assets that could have a material effect on the Financial Statements.

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

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

In our opinion, such Financial Statements present fairly, in all material respects, the financial position of the FRBP as of December 31, 2010 and 2009, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, the FRBP maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established *in Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.



March 22, 2011

Abbreviations

ACH	Automated clearinghouse
AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ASC	Accounting Standards Codification
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
Dodd-Frank Act	The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
FAM	*Financial Accounting Manual for Federal Reserve Banks*
Fannie Mae	Federal National Mortgage Association
FASB	Financial Accounting Standards Board
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
FRBNY	Federal Reserve Bank of New York
Freddie Mac	Federal Home Loan Mortgage Corporation
GAAP	Accounting principles generally accepted in the United States of America
Ginnie Mae	Government National Mortgage Association
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
MBS	Mortgage-backed securities
OEB	Office of Employee Benefits of the Federal Reserve System
OFR	Office of Financial Research
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
STRIP	Separate Trading of Registered Interest and Principal of Securities
TAF	Term Auction Facility
TBA	To be announced
TDF	Term Deposit Facility
TIPS	Treasury Inflation-Protected Securities
TOP	Term Securities Lending Facility Options Program
TSLF	Term Securities Lending Facility

Statements of Condition - As of December 31, 2010 and December 31, 2009 (in millions)

	2010	2009
ASSETS		
Gold certificates	$ 404	$ 450
Special drawing rights certificates	210	210
Coin	172	165
Items in process of collection	74	51
Loans: Depository institutions	-	1,735
System Open Market Account:		
Treasury securities, net	24,916	12,504
Government-sponsored enterprise debt securities, net	3,572	2,596
Federal agency and government-sponsored enterprise mortgage-backed securities, net	23,463	14,256
Foreign currency denominated assets, net	2,847	2,776
Central bank liquidity swaps	8	1,128
Accrued interest receivable	332	197
Bank premises and equipment, net	89	92
Deferred asset - interest on Federal Reserve notes	-	284
Interdistrict settlement account	12,748	35,084
Other assets	29	53
Total assets	**$ 68,864**	**$ 71,581**
LIABILITIES AND CAPITAL		
Federal Reserve notes outstanding, net	$ 40,533	$ 32,831
System Open Market Account:		
Securities sold under agreements to repurchase	1,394	1,206
Other liabilities	-	9
Deposits:		
Depository institutions	21,083	31,597
Other deposits	5	5
Interest payable to depository institutions	3	3
Accrued benefit costs	94	93
Deferred credit items	271	220
Accrued interest on Federal Reserve notes	334	-
Other liabilities	9	13
Total liabilities	**63,726**	**65,977**
Capital paid-in	2,569	2,802
Surplus (including accumulated other comprehensive loss of $24 million and $30 million at December 31, 2010 and 2009, respectively)	2,569	2,802
Total capital	**5,138**	**5,604**
Total liabilities and capital	**$ 68,864**	**$ 71,581**

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

Statements of Income and Comprehensive Income - For the years ended December 31, 2010 and December 31, 2009 (in millions)

	2010	2009
INTEREST INCOME		
Loans: Depository institutions	$ 1	$ 60
System Open Market Account:		
Securities purchased under agreements to resell	-	1
Treasury securities, net	557	488
Government-sponsored enterprise debt securities, net	74	39
Federal agency and government-sponsored enterprise mortgage-backed securities, net	945	356
Foreign currency denominated assets, net	24	32
Central bank liquidity swaps	1	231
Total interest income	1,602	1,207
INTEREST EXPENSE		
System Open Market Account: Securities sold under agreements to repurchase	2	3
Deposits: Depository institutions	82	46
Total interest expense	84	49
Net interest income	1,518	1,158
NON-INTEREST INCOME		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	15	5
Foreign currency gains, net	61	29
Compensation received for service costs provided	7	26
Reimbursable services to government agencies	34	32
Other income	4	7
Total non-interest income	121	99
OPERATING EXPENSES		
Salaries and benefits	103	104
Occupancy	14	13
Equipment	9	11
Assessments:		
Board of Governors operating expenses and currency costs	78	72
Bureau of Consumer Financial Protection and Office of Financial Research	5	-
Other	31	28
Total operating expenses	240	228
Net income prior to distribution	1,399	1,029
Change in funded status of benefit plans	6	(6)
Comprehensive income prior to distribution	**$ 1,405**	**$ 1,023**
Distribution of comprehensive income:		
Dividends paid to member banks	$ 171	$ 151
Transferred to (from) surplus and change in accumulated other comprehensive loss	(233)	487
Payments to Treasury as interest on Federal Reserve notes	1,467	385
Total distribution	**$ 1,405**	**$ 1,023**

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

Statements of Changes in Capital - For the years ended December 31, 2010 and December 31, 2009 (in millions, except share data)

		Surplus			
	Capital paid-in	Net income retained	Accumulated other comprehensive loss	Total surplus	Total capital
Balance at January 1, 2009 (46,301,161 shares)	$ 2,315	$ 2,339	$ (24)	$ 2,315	$ 4,630
Net change in capital stock issued (9,737,906 shares)	487	-	-	-	487
Transferred to surplus and change in accumulated other comprehensive loss	-	493	(6)	487	487
Balance at December 31, 2009 (56,039,067 shares)	$ 2,802	$ 2,832	$ (30)	$ 2,802	$ 5,604
Net change in capital stock redeemed (4,654,911 shares)	(233)	-	-	-	(233)
Transferred from surplus and change in accumulated other comprehensive loss	-	(239)	6	(233)	(233)
Balance at December 31, 2010 (51,384,156 shares)	$ 2,569	$ 2,593	$ (24)	$ 2,569	$ 5,138

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

1. STRUCTURE

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

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

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

2. OPERATIONS AND SERVICES

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

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

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

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

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. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks. Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by the other Reserve Banks include Collateral Management System, Electronic Cash Letter System, Groupware Leadership Center, Treasury Check Information Services Central Business Administration Function, Treasury Direct Central Business Administration Function and Video Conferencing Network.

3. FINANCIAL STABILITY ACTIVITIES

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

Large-Scale Asset Purchase Programs

The FOMC authorized and directed the FRBNY to purchase $300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The FRBNY began the purchases of these Treasury securities in March 2009 and completed them in October 2009. On August 10, 2010, the FOMC announced that the Federal Reserve will maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and Federal agency and GSE MBS in longer-term Treasury securities. On November 3, 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional $600 billion by June 2011. The FOMC will regularly review the pace of these securities purchases and the overall size of the asset purchase program and will adjust the program as needed to best foster maximum employment and price stability.

The FOMC authorized and directed the FRBNY to purchase GSE debt securities and Federal agency and GSE MBS, with a goal to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally. The FRBNY was authorized to purchase up to $175 billion in fixed-rate, non-callable GSE debt securities and $1.25 trillion in fixed-rate Federal agency and GSE MBS. Purchases of GSE debt securities began in November 2008, and purchases of Federal agency and GSE MBS began in January 2009. The FRBNY completed the purchases of GSE debt securities and Federal agency and GSE MBS in March 2010. The settlement of all Federal agency and GSE MBS transactions was completed by August 2010.

Central Bank Liquidity Swaps

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which could be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements. U.S. dollar liquidity swap arrangements were authorized with 14 foreign central banks to provide liquidity in U.S. dollars to overseas markets. The authorization for these swap arrangements expired on February 1, 2010. In May 2010, U.S. dollar liquidity swap arrangements were reestablished with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank; these arrangements will expire on August 1, 2011.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. The authorization for these swap arrangements expired on February 1, 2010.

Lending to Depository Institutions

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

Lending to Primary Dealers

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

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

Other Lending Facilities

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

4. SIGNIFICANT ACCOUNTING POLICIES

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

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost and the recording of such securi-

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

In addition, the Bank does not present a Statement of Cash Flows as required by GAAP because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities. 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. Unique accounts and significant accounting policies are explained below.

a. Consolidation

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

b. Gold and Special Drawing Rights Certificates

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

SDR certificates are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. SDRs are recorded by the Bank at original cost. In 2009, the Treasury issued $3 billion in SDR certificates to the Reserve Banks, of which $127 million was allocated to the Bank. There were no SDR transactions in 2010.

c. Coin

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

d. Loans

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

Loans are impaired when current information and events indicate that it is probable that the Bank will not receive the principal and interest that is due in accordance with the contractual terms of the loan agreement. Impaired loans are evaluated to determine whether an allowance for loan loss is required. The Bank has developed procedures for assessing the adequacy of any allowance for loan losses using all available information to identify incurred losses. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers and, as appropriate, evaluating collateral values. Generally, the Bank would discontinue recognizing interest income on impaired loans until the

borrower's repayment performance demonstrates principal and interest would be received in accordance with the terms of the loan agreement. If the Bank discontinues recording interest on an impaired loan, cash payments are first applied to principal until the loan balance is reduced to zero; subsequent payments are applied as recoveries of amounts previously deemed uncollectible, if any, and then as interest income.

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a tri-party arrangement. In a tri-party arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the Bank and counterparty. The collateral pledged must exceed the principal amount of the transaction by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including TIPS and STRIP Treasury securities); direct obligations of several Federal agency and GSE-related agencies, including Fannie Mae and Freddie Mac; and pass-through MBS of Fannie Mae, Freddie Mac, and Ginnie Mae. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. Repurchase transactions are reported at their contractual amount as "System Open Market Account: Securities purchased under agreements to resell," and the related accrued interest receivable is reported as a component of "Accrued interest receivable" in the Statements of Condition.

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

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income" in the Statements of Income and Comprehensive Income.

Activity related to securities purchased under agreements to resell, securities sold under agreements to repurchase, and securities lending is allocated to

each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April each year.

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

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

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the FRBNY entered into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell "to be announced" (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. The FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. The FRBNY's participation in the dollar roll and coupon swap markets furthers the MBS purchase program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets more generally. The FRBNY accounts for outstanding commitments under dollar roll and coupon swaps on a settlement-date basis. Based on the terms of the FRBNY dollar roll and coupon swap transactions, transfers of MBS upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Transfers and Servicing*, and the related outstanding commitments are accounted for as sales or purchases upon settlement. Net gains resulting from dollar roll and coupon swap transactions are reported as "Non-interest income: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

Foreign currency denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on foreign currency denominated assets are reported as "Foreign currency gains, net" in the Statements of Income and Comprehensive Income.

Activity related to Treasury securities, GSE debt securities, and Federal agency and GSE MBS, including the premiums, discounts, and realized gains and

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

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

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as "Interest income: Central bank liquidity swaps" in the Statements of Income and Comprehensive Income.

Foreign currency liquidity swaps

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

h. 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.

i. Bank Premises, Equipment, and Software

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

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

j. Federal Reserve Notes

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

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

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of $4,826 million and $5,591 million at December 31, 2010 and 2009, respectively.

At December 31, 2010 and 2009, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2010, all gold certificates, all special drawing right certificates, and $925 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2010, no investments denominated in foreign currencies were pledged as collateral.

k. Deposits

Depository institutions

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

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

Other

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

l. Items in Process of Collection and Deferred Credit Items

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

m. Capital Paid-in

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

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

n. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. Accumulated other comprehensive income is reported as a component of "Surplus" in the Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

o. Interest on Federal Reserve Notes

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

If earnings during the year are not sufficient to provide for the costs of operations, payment of dividends, and equating surplus and capital paid-in, payments to the Treasury are suspended. A deferred asset is recorded that represents the amount of net earnings a Reserve Bank will need to realize before remittances to Treasury resume. This deferred asset is periodically reviewed for impairment. The deferred asset is reported as "Deferred asset – interest on Federal Reserve notes" on the Statements of Condition. As of December 31, 2010, no impairment existed.

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 Treasury in the following year.

p. Income and Costs Related to Treasury Services

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depositary of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2010 and 2009, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

The Treasury and other government agencies reimbursement process for all Reserve Banks is centralized at the Bank. Each Reserve Bank transfers its Treasury reimbursement receivable to the Bank. The reimbursement receivable is reported in "Other assets" and totaled $2 million and $30 million at December 31, 2010 and 2009, respectively. The cost of unreimbursed Treasury services is reported as "Operating expenses: Other" and was none for years ended December 31, 2010 and 2009.

q. Compensation Received for Service Costs Provided

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

r. Assessments

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

During the period prior to the Bureau transfer date of July 21, 2011, there is no fixed limit on the funding that can be provided to the Bureau and that is assessed to the Reserve Banks; the Board of Governors must provide the amount estimated by the Secretary of the Treasury needed to carry out the authorities granted to the Bureau under the Dodd-Frank Act and other federal law. After the transfer date, the Dodd-Frank Act requires the Board of Governors to fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the Federal Reserve System as reported in the Board of Governors' 2009 annual report. The fixed percentage of total operating expenses of the System is 10% for 2011, 11% for 2012, and 12% for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act.

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

s. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were $2 million for each of the years ended December 31, 2010 and 2009 and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

t. Restructuring Charges

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

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

The Bank had no significant restructuring activities in 2010 and 2009.

u. Recently Issued Accounting Standards

In June 2009, FASB issued Statement of Financial Accounting Standards 166, *Accounting for Transfers of Financial Assets – an amendment to FASB Statement No. 140,* (codified in ASC 860). The new standard revises the criteria for recognizing transfers of financial assets as sales and clarifies that the transferor must consider all arrangements when determining if the transferor has surrendered control. The adoption of this accounting guidance was effective for the Bank for the year beginning on January 1, 2010, and did not have a material effect on the Bank's financial statements.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Receivables* (Topic 310), which requires additional disclosures about the allowance for credit losses and the credit quality of loan portfolios. The additional disclosures include a rollforward of the allowance for credit losses on a disaggregated basis and more information, by type of receivable, on credit quality indicators, including the amount of certain past due receivables and troubled debt

restructurings and significant purchases and sales. The adoption of this accounting guidance is effective for the Bank on December 31, 2011, and is not expected to have a material effect on the Bank's financial statements.

5. LOANS

The Bank had no loans outstanding at December 31, 2010. Total loans outstanding at December 31, 2009, were as follows (in millions):

	2009 Total
Primary, secondary, and seasonal credit	$ 122
TAF	1,613
Loans to depository institutions	$ 1,735

Loans to Depository Institutions

The Bank offers primary, secondary, and seasonal credit to eligible borrowers and each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every 14 days by the Bank's board of directors, subject to review and determination by the Board of Governors. Primary and secondary credit are extended on a short-term basis, typically overnight, whereas seasonal credit may be extended for a period of 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; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; asset-backed securities; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Bank, which is typically fair value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program were eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conducted auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans were extended on a short-term basis, with terms ranging from 28 to 84 days. All advances under the TAF program were collateralized to the satisfaction of the Bank. All TAF loan principal and accrued interest was fully repaid.

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

At December 31, 2010 and 2009, the Bank did not have any impaired loans and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2010 and 2009.

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

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 2.335 percent and 1.551 percent at December 31, 2010 and 2009, respectively.

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

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

	2009				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 286	$ -	$ -	$ 286	$ 286
Notes	8,817	101	(15)	8,903	9,045
Bonds	2,945	380	(10)	3,315	3,579
Total Treasury securities	$ 12,048	$ 481	$ (25)	$ 12,504	$ 12,910
GSE debt securities	$ 2,480	$ 116	$ -	$ 2,596	$ 2,598
Federal agency and GSE MBS	$ 14,092	$ 188	$ (24)	$ 14,256	$ 14,184

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

	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Bills	$ 18,422	$ 18,422	$ 18,423	$ 18,423
Notes	786,575	804,703	573,877	583,040
Bonds	261,955	289,757	213,672	230,717
Total Treasury securities	$ 1,066,952	$ 1,112,882	$ 805,972	$ 832,180
GSE debt securities	$ 152,972	$ 156,780	$ 167,362	$ 167,444
Federal agency and GSE MBS	$ 1,004,695	$ 1,026,003	$ 918,927	$ 914,290

The fair value amounts in the above tables are presented solely for informational purposes. Although the fair value of security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value of Federal agency and GSE MBS was determined using a model-based

approach that considers observable inputs for similar securities; fair value for all other SOMA security holdings was determined by reference to quoted prices for identical securities.

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

The following table provides additional information on the amortized cost and fair values of the Federal agency and GSE MBS portfolio at December 31, 2010 and 2009 (in millions):

	2010		2009	
Distribution of MBS holdings by coupon rate	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
3.5%	$ 8	$ 8	$ 6	$ 6
4.0%	3,916	3,933	2,639	2,571
4.5%	11,622	11,882	6,738	6,697
5.0%	5,404	5,547	3,032	3,047
5.5%	2,175	2,239	1,604	1,622
6.0%	302	312	197	200
6.5%	36	39	40	41
Total	$ 23,463	$ 23,960	$ 14,256	$ 14,184
SOMA:				
3.5%	$ 341	$ 352	$ 363	$ 365
4.0%	167,675	168,403	170,119	165,740
4.5%	497,672	508,798	434,352	431,646
5.0%	231,420	237,545	195,418	196,411
5.5%	93,119	95,873	103,379	104,583
6.0%	12,910	13,376	12,710	12,901
6.5%	1,558	1,656	2,586	2,644
Total	$ 1,004,695	$ 1,026,003	$ 918,927	$ 914,290

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

	Securities purchased under agreements to resell		Securities sold under agreements to repurchase	
	2010	2009	2010	2009
Allocated to the Bank:				
Contract amount outstanding, end of year	$ -	$ -	$ 1,394	$ 1,206
Average daily amount outstanding, during the year	-	158	1,235	1,644
Maximum balance outstanding, during the year	-	3,493	1,573	3,909
Securities pledged (par value), end of year			1,019	1,208
SOMA:				
Contract amount outstanding, end of year	$ -	$ -	$ 59,703	$ 77,732
Average daily amount outstanding, during the year	-	3,616	58,476	67,837
Maximum balance outstanding, during the year	-	80,000	77,732	89,525
Securities pledged (par value), end of year			43,642	77,860

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value. The FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed primarily to temporarily drain reserve balances from the banking system.

The remaining maturity distribution of Treasury securities, GSE debt securities, Federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2010 was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	$ 229	$ 579	$ 1,267	$ 10,265	$ 7,799	$ 3,715	$ 23,854
GSE debt securities (par value)	26	323	666	1,659	715	55	3,444
Federal agency and GSE MBS (par value)	-	-	-	1	-	23,168	23,169
Securities sold under agreements to repurchase (contract amount)	1,394	-	-	-	-	-	1,394

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2010, which differs from the stated maturity because the weighted average life factors in prepayment assumptions, is approximately 4.2 years.

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

	Allocated to the Bank		SOMA	
	2010	2009	2010	2009
Treasury securities	$ 516	$ 318	$ 22,081	$ 20,502
GSE debt securities	38	17	1,610	1,108

Other liabilities, which are related to purchases of Federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the Bank has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Bank's obligation to pay for the securities when delivered. The amount of other liabilities allocated to the Bank and held in the SOMA at December 31, was as follows (in millions):

	Allocated to the Bank		SOMA	
	2010	2009	2010	2009
Other liabilities	$ -	$ 9	$ -	$ 601

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. There were no commitments to buy Treasury and GSE debt securities as of December 31, 2010.

The FRBNY enters into commitments to buy Federal agency and GSE MBS and records the related MBS on a settlement-date basis. There were no commitments to buy or sell Federal agency or GSE MBS as of December 31, 2010.

During the years ended December 31, 2010 and 2009, the Reserve Banks recorded net gains from dollar roll and coupon swap related transactions of $782 million and $879 million, respectively, of which $15 million and $5 million, respectively, was allocated to the Bank. These net gains are reported as "Non-interest income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

7. FOREIGN CURRENCY DENOMINATED ASSETS

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

The Bank's allocated share of foreign currency denominated assets was approximately 10.928 percent and 10.984 percent at December 31, 2010 and 2009, respectively.

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

	2010	2009
Euro:		
Foreign currency deposits	$ 771	$ 812
Securities purchased under agreements to resell	270	285
Government debt instruments	503	542
Japanese yen:		
Foreign currency deposits	424	374
Government debt instruments	879	763
Total allocated to the Bank	$ 2,847	$ 2,776

At December 31, 2010 and 2009, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was $2,865 million and $2,799 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 Treasury securities, GSE debt securities, and Federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

Total Reserve Bank foreign currency denominated assets were $26,049 million and $25,272 million at December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the fair value of the total Reserve Bank foreign currency denominated assets, including accrued interest, was $26,213 million and $25,480 million, respectively.

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2010, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total allocated to the Bank
Euro	$ 593	$ 328	$ 221	$ 402	$ 1,544
Japanese yen	448	61	267	527	1,303
Total allocated to the Bank	$ 1,041	$ 389	$ 488	$ 929	$ 2,847

At December 31, 2010 and 2009, the authorized warehousing facility was $5 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2010 and 2009.

There were no foreign exchange contracts outstanding as of December 31, 2010.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2010, there were $209 million of outstanding commitments to purchase Euro-denominated government debt instruments, of which $23 million was allocated to the Bank. These securities settled on January 4, 2011, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date.

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

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 10.928 percent and 10.984 percent at December 31, 2010 and 2009, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2010 and 2009, was $75 million and $10,272 million, respectively, of which $8 million and $1,128 million, respectively, was allocated to the Bank. All of the U.S. dollar liquidity swaps outstanding at December 31, 2010 were transacted with the European Central Bank and had remaining maturity distributions of less than 15 days.

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2010 and 2009.

9. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2010	2009
Bank premises and equipment:		
Land and land improvements	$ 8	$ 8
Buildings	102	102
Building machinery and equipment	17	16
Construction in progress	1	1
Furniture and equipment	62	70
Subtotal	190	197
Accumulated depreciation	(101)	(105)
Bank premises and equipment, net	$ 89	$ 92
Depreciation expense, for the years ended December 31	$ 10	$ 11

The Bank leases space to an outside tenant with a remaining lease term of one year. Rental income from such lease was $2 million and $1 million for the years ended December 31, 2010 and 2009, respectively, and is reported as a component of "Other income" in the Statements of Income and Comprehen-

sive Income. Future minimum lease payments that the Bank will receive under the noncancelable lease agreement in existence at December 31, 2010 are $3 million for the year 2011.

The Bank had capitalized software assets, net of amortization, of $6 million at December 31, 2010 and 2009. Amortization expense was $2 million for each of the years ended December 31, 2010 and 2009. Capitalized software assets are reported as a component of "Other assets" in the Statements of Condition and the related amortization is reported as a component of "Operating expenses: Other" in the Statements of Income and Comprehensive Income.

10. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2010, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 2 to approximately 9 years. One lease provides for increased rental payments based upon increases in operating quantity.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was $1 million for each of the years ended December 31, 2010 and 2009. Certain of the Bank's leases have options to renew. The Bank has no capital leases.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2010, are as follows (in thousands):

	Operating leases
2011	$ 607
2012	613
2013	434
2014	445
2015	457
Thereafter	1,481
Future minimum rental payments	$ 4,037

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2010 or 2009.

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 employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP) and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Bank (SERP). In addition, under the Dodd-Frank Act, employees of the Bureau can elect to participate in the System Plan. There were no Bureau participants in the System Plan as of December 31, 2010.

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, Board of Governors, and OEB and in the future will provide retirement benefits to certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2010 and 2009, costs associated with the System Plan were not reimbursed by other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2010 and 2009, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches em-

ployee contributions based on a specified formula. Effective April 1, 2009, the Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. For the first three months of the year ended December 31, 2009, the Bank matched 80 percent of the first 6 percent of employee contributions for employees with less than five years of service and 100 percent of 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 each of the years ended December 31, 2010 and 2009 and are reported as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income.

12. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

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

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

	2010	2009
Accumulated postretirement benefit obligation at January 1	$ 83.7	$ 72.5
Service cost benefits earned during the period	2.2	1.8
Interest cost on accumulated benefit obligation	4.6	4.4
Net actuarial loss (gain)	(2.4)	3.4
Contributions by plan participants	1.6	1.3
Benefits paid	(5.9)	(4.6)
Medicare Part D subsidies	0.5	0.4
Plan amendments	(1.3)	4.5
Accumulated postretirement benefit obligation at December 31	$ 83.0	$ 83.7

At December 31, 2010 and 2009, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.25 percent and 5.75 percent, respectively.

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

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

	2010	2009
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	3.8	2.9
Contributions by plan participants	1.6	1.3
Benefits paid	(5.9)	(4.6)
Medicare Part D subsidies	0.5	0.4
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$ 83.0	$ 83.7
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (2.2)	$ (3.4)
Net actuarial loss	(21.8)	(26.6)
Total accumulated other comprehensive loss	$ (24.0)	$ (30.0)

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:

	2010	2009
Health care cost trend rate assumed for next year	8.00%	7.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2015

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2010 (in millions):

	1 percentage point increase	1 percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ -	$ (0.2)
Effect on accumulated postretirement benefit obligation	0.6	(1.9)

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

	2010	2009
Service cost-benefits earned during the period	$ 2.2	$ 1.8
Interest cost on accumulated benefit obligation	4.6	4.4
Amortization of prior service cost	-	(1.2)
Amortization of net actuarial loss	2.4	3.0
Total periodic expense	9.2	8.0
Curtailment gain	-	(0.4)
Net periodic postretirement benefit expense	$ 9.2	$ 7.6

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2011 are shown below:

Prior service cost	$	0.3
Net actuarial loss		1.9
Total	$	2.2

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2010 and 2009, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 6.00 percent, respectively.

Net periodic postretirement benefit expense is reported as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income. A curtailment gain associated with restructuring programs that are described in Note 14 was recognized in net income in the year ended December 31, 2009, related to employees who terminated employment during 2009.

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 $0.3 million and $0.6 million in the years ended December 31, 2010 and 2009, respectively. Expected receipts in 2011, related to benefits paid in the years ended December 31, 2010 and 2009, are $0.2 million.

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

	Without subsidy		With subsidy	
2011	$	4.6	$	4.2
2012		4.9		4.5
2013		5.3		4.8
2014		5.7		5.1
2015		6.0		5.4
2016 - 2020		34.7		30.7
Total	$	61.2	$	54.7

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 was $7.1 million at December 31, 2010 and 2009. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2010 and 2009 operating expenses were $1.7 million and $3.3 million, respectively, and are recorded as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount related to postretirement benefits other than retirement plans
Balance at January 1, 2009	$ (23.6)
Change in funded status of benefit plans:	
Prior service costs arising during the year	(4.5)
Net actuarial loss arising during the year	(3.3)
Amortization of prior service cost	(1.2)
Amortization of net actuarial loss	3.0
Amortization of deferred curtailment gain	(0.4)
Change in funded status of benefit plans - other comprehensive loss	(6.4)
Balance at December 31, 2009	$ (30.0)
Change in funded status of benefit plans:	
Prior service costs arising during the year	1.3
Net actuarial gain arising during the year	2.4
Amortization of prior service cost	(0.1)
Amortization of net actuarial loss	2.4
Change in funded status of benefit plans - other comprehensive loss	6.0
Balance at December 31, 2010	$ (24.0)

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

14. BUSINESS RESTRUCTURING CHARGES

The Bank had no business restructuring charges in 2010 or 2009.

Before 2009, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites; one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing.

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

	2008 and prior restructuring plans
Information related to restructuring plans as of December 31, 2010:	
Total expected costs related to restructuring activity	$ 3.4
Expected completion date	2009
Reconciliation of liability balances:	
Balance at January 1, 2009	$ 2.9
Other costs	0.2
Adjustments	0.6
Payments	(1.4)
Balance at December 31, 2009	$ 2.3
Adjustments	(0.3)
Payments	(1.9)
Balance at December 31, 2010	$ 0.1

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

Other costs include retention benefits and outplacement services and are shown as a component of "Salaries and other benefits" and "Other expenses" in the Statements of Income and Comprehensive Income.

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

15. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2010. Subsequent events were evaluated through March 22, 2011, which is the date that the Bank issued the financial statements.

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The Federal Reserve Bank of Philadelphia is one of 12 regional Reserve Banks in the United States that, together with the Board of Governors in Washington, D.C., make up the Federal Reserve System — the nation's central bank. The System's primary role is to ensure a sound financial system and a healthy economy. The Philadelphia Fed serves the Third District, which is composed of eastern Pennsylvania, southern New Jersey, and Delaware.

Federal Reserve Bank
of Philadelphia

Ten Independence Mall
Philadelphia, PA 19106
www.philadelphiafed.org