

1913



1923



1933

1943



1953



1963

1973

1983



1993

2003



2013

2013 ANNUAL REPORT

FEDERAL RESERVE BANK OF PHILADELPHIA

100 YEARS OF TRADITION AND TRANSITION

*John B. Smith*  
Director of the Federal Reserve

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*John Burke*  
Chairman of the Board of Directors

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## MESSAGE FROM THE PRESIDENT

### 100 Years of Tradition and Transition



**Charles I. Plosser**  
President and Chief Executive Officer

On December 23, 2013, the Federal Reserve System marked 100 years from the signing of the Federal Reserve Act by President Woodrow Wilson. This began a centennial period that will run through the 100th anniversary of when the 12 Federal Reserve Banks opened for business on November 16, 1914.

That is why “100 Years of Tradition and Transition” is the subject of this year’s annual report. I have often described the Federal Reserve as a uniquely American form of a central bank — a decentralized central bank. To understand how it came to be, there is no better place to start than in Philadelphia, where just a few blocks from our Bank building you can find the vestiges of two earlier attempts at central banking from the time this city was the nation’s financial and political center.

The cover article provides an overview of the 100-year history of the Federal Reserve System, including a comparison of our present structure with the two prior attempts. In this year’s essay, “A Limited Central Bank,” I take a step back and consider the Federal Reserve’s essential role more broadly and how the Fed might be improved to better fulfill that role.

The annual report includes a message from First Vice President Blake Prichard on “A Century of Service” and “Bank Highlights” of our accomplishments during 2013. One of the past year’s highlights was the Policy Forum in December, which focused on

the “History of Central Banking in the United States.” We were extraordinarily pleased to have former Chairman Alan Greenspan and former Vice Chair Don Kohn, among others, participate in the daylong event.

Our institution has been fortunate to have extraordinary citizens who have served on the Bank’s board of directors and advisory councils. As I look back at 2013, I especially thank Jeremy Nowak, president of J Nowak and Associates, LLC, who completed his second year as chairman and his sixth year as a director. I also thank Keith S. Campbell, chairman of Mannington Mills of Salem, NJ, and R. Scott Smith, retired chairman and CEO of Fulton Financial Corporation of Lancaster, PA, who also completed their terms as directors.

James E. Nevels, founder and chairman of The Swarthmore Group, completed his second year as deputy chair and advanced to chairman in January 2014. Michael J. Angelakis, vice chairman and CFO of Comcast Corp., was appointed deputy chairman. Three other citizens joined the board in terms that began January 2014: William S. Aichele, chairman and CEO of Univest Corporation of Pennsylvania; Edward J. Graham, president and CEO of South Jersey Industries; and Brian M. McNeill, president and CEO of Southco Inc.

The Economic Advisory Council includes representatives from diverse industries, manufacturers, and nonprofits in the Third District. In 2013, we welcomed Ernest Dianastasis, managing director and principal, Computer Aid, Inc.; Chris Gheysens, president and CEO, Wawa, Inc.; Patrick Magri, senior vice president of managed markets and policy, Merck & Co., Inc.; and Michael Pearson, president, Union Packaging, LLC, to serve three-year terms.

The Community Depository Institutions Advisory Council (CDIAC) includes representatives from commercial banks, thrift institutions, and credit unions in the Third District. In 2013, members who joined were David E. Gillan, chairman and CEO of County Bank, Rehoboth

Beach, DE; Thomas M. Petro, president and CEO of Fox Chase Bancorp, Inc., Hatboro, PA; and Gregory A. Smith, president and CEO of the Pennsylvania State Employees Credit Union (PSECU), Harrisburg, PA. In addition, Dennis D. Cirucci, president, CEO, and director of Alliance Bancorp, Inc. and Alliance Bank, continued to represent our District on the Federal Reserve Board’s CDIAC.

I also thank Bharat Masrani, president and CEO of TD Bank, N.A., for his service as the Third District’s representative to the Federal Advisory Council, which meets quarterly with the Board of Governors in Washington, D.C. His term ended in 2013, and we welcomed Scott V. Fainor, president and CEO of National Penn Bancshares, Inc. and National Penn Bank, as our representative to the council for 2014.

Finally, I offer my sincere thanks to the talented and dedicated employees at the Philadelphia Fed. The 100-year history of our Bank is a story of the people who have contributed to its success through their public service to our many stakeholders. I especially would like to recognize Jeanne Rentezelas, who was promoted to senior vice president and general counsel during 2013.

I would also be remiss if I did not acknowledge that this is the last annual report that will feature Loretta Mester as our Bank’s executive vice president and director of research. She has been the Bank’s director of research since 2000, and I have been extraordinarily fortunate to have Loretta as my chief policy advisor since 2006. While we will miss her here in Philadelphia, we are fortunate that she will remain a colleague and a friend in her new role as the 11th president and chief executive officer of the Federal Reserve Bank of Cleveland, effective June 1, 2014.



Charles I. Plosser  
President and Chief Executive Officer  
May 2014



## MESSAGE FROM THE FIRST VICE PRESIDENT

### A Century of Service

The Federal Reserve Act enacted 100 years ago established a central bank for the United States and assured a framework that would promote economic stability, safe and sound practices at financial institutions, and efficient payment systems that support economic activity. For those of us at the Fed, this is less of a celebration and more of a reflection on how our actions have forged a new understanding during the past

century of why an effective central bank is essential to the long-term health of our economy.

On December 23, 1913, the Federal Reserve Act became law, and nearly a year later on November 16, 1914, all 12 Reserve Banks simultaneously opened for business. The Reserve Banks, under the supervision of the Board of Governors in Washington, D.C., began to provide their Districts with a variety of services that have evolved over time. There were coins and currency to be provided to banks, checks to be cleared, and regional economies and communities to be understood. Everything we do today grew from the seed of these service obligations, adapting to a changing and growing economy, and building a legacy of service.

Much has changed in the past century. Checks peaked and ebbed, and new payments emerged that were unimaginable, even 50 years ago. The number of banks has waxed and waned. Our economy was complex 100 years ago. Today, it is staggering in its complexity, with moving parts modeled by powerful computers and translated into discussions that form monetary policy.

Today, as in the past 100 years, the Federal Reserve is an institution focused solely on the public interest, always promoting equal access to its services, striving to be efficient and effective in performing our mandate, and demanding the highest integrity in all that we do. I hope the learning over our first century translates into a deeper understanding of lessons learned to help us be even more effective in our second century of service to America. The “2013 Bank Highlights” on the pages that follow provide clear examples of how we continued to build on a century of service.



**D. Blake Prichard**  
First Vice President and Chief Operating Officer

## 2013 BANK HIGHLIGHTS

### Philadelphia Fed Policy Forum

Economists and staff in the Philadelphia Fed’s Research Department hosted a number of conferences and workshops during 2013, including the 10th Philadelphia Fed Policy Forum, which focused on “The History of Central Banking in the United States.”

President Charles Plosser reflected on the history of central banking in the U.S. and noted that the Federal Reserve’s decentralized structure was influenced by the history of the First and Second Banks of the United States, two earlier attempts at central banking that were founded blocks away from today’s Bank.

The biennial Policy Forum brought together more than 150 academics, policymakers, and market economists from several countries. Among the many key players who participated in the event were former Federal Reserve Chairman Alan Greenspan, former Vice Chairman Don Kohn, and noted author Allan H. Meltzer.



The Philadelphia Fed  
**POLICY FORUM**

December 6, 2013

### Vidya Shenoy Wins System’s Top Bank Supervision Award

Vidya Shenoy, manager in the Risk Assessment, Data Analysis, and Research (RADAR) unit, was honored in June as one of five winners of the William Taylor Award, which is presented annually to System employees who display excellence in the field of bank supervision. Shenoy was honored for her leadership in delivering the new loan-level FR Y-14M consumer credit data that enabled successful completion of the consumer credit loss estimates for the Dodd-Frank Act stress testing. This loan-level data collection initiative involves gathering

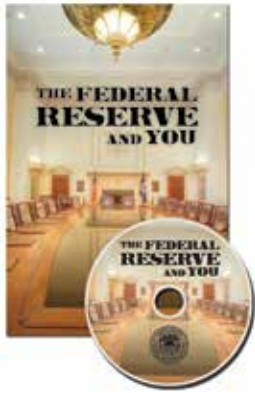
loan-level data each month on first-lien mortgages, home equity, credit cards, and address matches from large bank holding companies. Considered one of the most ambitious data collection efforts ever undertaken by the Fed, this initiative was launched and completed under tight, aggressive timelines.



Vidya Shenoy with former Chairman Ben Bernanke

## The Bank Rolls Out *The Federal Reserve and You* Video to the Public

After four years in the making, *The Federal Reserve and You* video was rolled out to the public in April 2013 by the Bank's Community Development Studies and Education Department. The video offers a look inside the Federal Reserve System and highlights the Fed's role in the U.S. economy. More than 70 video segments cover topics including the history of central banking in the U.S., the mechanics of money and banking, supervision and reg-



ulation, and the payments system. The video, available on DVD and streaming on the Bank's public website, was designed as an informative and entertaining way to help anyone interested in learning more about the Federal Reserve System. But its biggest impact is expected to be felt in high school classrooms nationwide as a new educational resource for high school teachers. Andrew Hill, economic education advisor in CDS&E, noted that more than 15,000 DVDs were distributed and nearly 10,000 viewers have seen the videos online in the first year. Keeping the video as a digital project will make it easier to update segments as needed, he said.

## The Secret Life of Money

In March 2013, "The Secret Life of Money" made its debut on the Discovery Channel. The documentary, hosted by Jacob Goldstein and David Kestenbaum from NPR's "Planet Money," explained how money is made, what gives it value, and how it ends up in your wallet. Highlights included interviews and footage recorded in the Bank's actual vaults.

Employees in the Cash Services Department specialize in handling huge amounts of cash each business day. They follow rigorous procedures as they process, distribute, and store currency in the Bank's vault. All their work is done behind the scenes, so it has rarely been seen by the public, until now.

The Bank's staff worked closely with the film's producer and crew to ensure the script and footage were accurate, without compromising Bank security. Filming was completed in 2011, and production extended into 2012, before the documentary aired in early 2013. Officials from the Bureau of Engraving and Printing, the U.S. Mint in Philadelphia, the U.S. Secret Service, and Dunbar armored carrier service also were featured in the documentary.

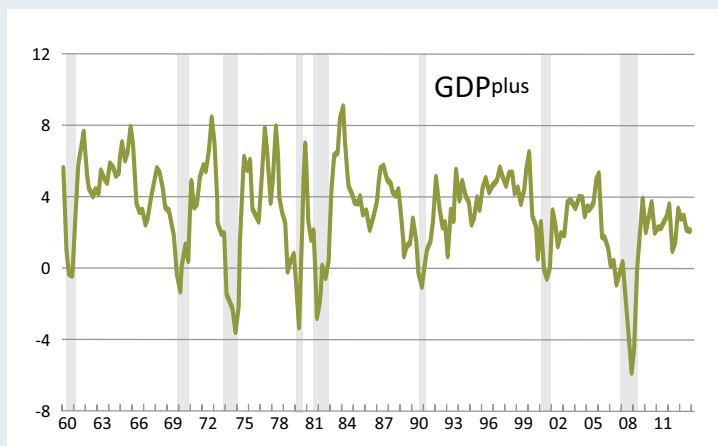


## 2013 BANK HIGHLIGHTS

### GDPplus Spices Up an Old Standard

Who can think of a more highly regarded measure of economic activity than gross domestic product (GDP)? The quarterly indicator, which seeks to distill all goods and services produced in the United States into a single number, is known by everyone, from economists to news-hungry Americans. In November, the Bank's Real-Time Data Research Center launched a new measurement using data from the U.S. Bureau of Economic Analysis (BEA) for estimates of GDP and gross domestic income (GDI). By using both GDP and GDI data, GDPplus is designed to better estimate underlying but unobserved economic activity.

Tom Stark, assistant director and manager of the Real-Time Data Research Center, was instrumental in overseeing this initiative. "We think analysts and policymakers will use GDPplus as well as the BEA's estimates of GDP and GDI to improve their understanding of the dynamics of the U.S. economy," Stark said.



The new measure was proposed by economic researchers Borağan Aruoba, Francis Diebold, Jeremy Nalewaik, Frank Schorfheide, and Dongho Song in their work "Improving GDP Measurement: A Measurement-Error Perspective." Aruoba, one of the paper's authors, explained, "Economic theory suggests that these two measures ought to be identical, but in practice, they almost never are. What we do in this project is to acknowledge that these two measures are measures of the same underlying latent variable (true GDP) and use some statistical methods to obtain a measure of this latent variable using these two measures."

### Facilities Management Department Wins TOBY Award

The Bank won The Outstanding Building of the Year (TOBY) award from the Building Owners and Managers Association International (BOMA) in 2013. This competition selected the Bank as the top contender among the many facilities that were nominated in the "Government Building" category and that rivaled other government buildings in the region. The evaluation process for the award included a detailed look at all aspects of building operations and management, from green initiatives to tenant relations to community service.



## The Bank Presents a Master Class on Diversity Metrics

As part of the Bank's Office of Diversity and Inclusion (D&I) initiatives, 41 D&I practitioners gathered in Philadelphia for a special program: "A Master Class on Diversity and Inclusion Metrics: Measuring What Matters." Master teachers Dr. Rohini Anand, senior vice president and global chief diversity officer for Sodexo, and her colleague, Chad Johnson, director of diversity/EEO systems and analytics, led the forum. Sodexo, a leading provider of quality of life services with 420,000 employees in 80 countries, was ranked No. 1 in Diversity-Inc.'s 2013 business index of Top Companies for Diversity and Inclusion.

## The Bank Partners with Cristo Rey Philadelphia High School

The Bank entered into a new partnership to host four high school interns from the Cristo Rey Philadelphia High School to further outreach efforts to majority-minority and inner-city high schools. The four students worked part-time through the school year in Human Resources and Financial Management Services. These experiences not only helped them develop valuable skills but also exposed them to future career opportunities within the Bank.



## Bank Hosts the Conference of Presidents and the Conference of First Vice Presidents

In September, the Bank welcomed the Conference of Presidents, the Conference of First Vice Presidents, and the Financial Services Policy Committee, three Federal Reserve System leadership conferences. President Charles Plosser and First Vice President Blake Prichard, both cochairs of their respective conferences, hosted the gathering. The more than 30 Fed presidents, first vice presidents, and other officers had the opportunity to see Philadelphia's historical roots of U.S. central banking as well as our nation's Independence Hall and Congress Hall.

## 2013 BANK HIGHLIGHTS

### Giving Back Year-Round

Throughout the year, many Bank staff members roll up their sleeves to participate in one of the many volunteer initiatives sponsored by the Bank. Outreach to the community comes in all shapes and sizes, from a single day of service to ongoing weekly programs. In addition, many employees serve on the boards of area nonprofits.

Bank employees volunteered time and talent through PhillyFedCARES in a variety of community service days. Events ranged from organizing the book inventory at a local elementary school library to reading stories to K–3 students as part of the National Education Association’s Read Across America Day. Another spring day was spent sprucing up a playground at a local city park. Bank employees, families, and friends also turned out for the 9-11 Heroes Run and fun walk in the fall. Some ran the 5K course while others walked it, and some cheered on the sidelines as part of the Bank’s continuing support to the local community.



### The Fed Completes the System-wide Transition from Lotus Notes to Outlook

The Bank hosts the System’s Groupware Leadership Center (GLC), which provides e-mail services and other collaboration tools System-wide. In 2013, the GLC completed its work to migrate all employees in the Federal Reserve System to new e-mail and collaboration services. Patrick Turner, assistant vice president of GLC, was the program manager who directed the changeover, known as the Connect & Share project.



## Cash Services Introduces New \$100 Note

The Bank's Cash Services Department and the Public Affairs Department hosted a special event at the Franklin Institute that marked the release of the new \$100 note in early October. The city of Philadelphia, Ben Franklin's adopted hometown, was one of five locations nationwide selected by the Board of Governors and the U.S. Treasury to roll out the new "Benjamins." Michelle Scipione and Jake Lofton appeared on morning television programs and then helped describe the new note and its security features to media members and the public at the museum.



## Windows into Our Past

The project started more than a year ago as a simple idea: The Bank wanted a visual history of the past 100 years as a tribute to the contributions of Bank employees. The result was the Windows into Our Past display, a photo collage in the Bank's Eastburn Court. The project was the brainchild of two Bank employees: Dianne Hallowell, Graphic Services, and Pat Lenar-Burns, Public Affairs, who worked with Bank volunteers in selecting the photographs. A similar "Centennial Wall" exhibit was installed in the third-floor lobby with photos and artifacts from our Bank's 100 years. Also in the third-floor lobby, a series of original photos and architectural drawings pays tribute to 925 Chestnut Street, the Bank's home from 1918 to 1976.





Image courtesy of the Woodrow Wilson Presidential Library and Museum, Staunton, VA

*The Signing of the Federal Reserve Act by Wilbur G. Kurtz Sr.*



## A LIMITED CENTRAL BANK

BY CHARLES I. PLOSSER

**A**s the Fed begins its 100th anniversary year, I believe it is entirely appropriate to reflect on its history and its future. At the same time, we need to reflect on what I believe is the Federal Reserve's essential role and how it might be improved as an institution to better fulfill that role.<sup>1</sup>

Douglass C. North was cowinner of the 1993 Nobel Prize in Economics for his work on the role that institutions play in economic growth.<sup>2</sup> North argued that institutions were deliberately devised to constrain interactions among parties both public and private. In the spirit of North's work, one theme of this essay will focus on the fact that the institutional structure of the central bank matters. The central bank's goals and objectives, its framework for implementing policy, and its governance structure all affect its performance.

Central banks have been around for a long time, but they have clearly evolved as economies and governments have changed. Most countries today operate under a fiat money regime, in which a nation's currency has value because the government says it does. Central banks are usually given the responsibility to protect and preserve the value or purchasing power of the currency.<sup>3</sup> In the U.S., the Fed does so by buying or selling assets in order to manage the growth of money and credit. The ability to buy and sell assets gives the Fed considerable power to intervene in financial markets not only through the quantity of its transactions but also through the types of assets it can buy and sell. Thus, it is entirely appropriate

that governments establish their central banks with limits that constrain the actions of the central bank to one degree or another.

Yet, in recent years, we have seen many of the explicit and implicit limits stretched. The Fed and many other central banks have taken extraordinary steps to address a global financial crisis and the ensuing recession. These steps have challenged the accepted boundaries of central banking and have been both applauded and denounced. For example, the Fed has adopted unconventional large-scale asset purchases to increase accommodation after it reduced its conventional policy tool — the federal funds rate — to near zero. These asset purchases have led to the creation of trillions of dollars of reserves in the banking system and have greatly expanded the Fed's balance sheet. But the Fed has done more than just purchase lots of assets; it has altered the composition of its balance sheet through the types of assets it has purchased. I have spoken on a number of occasions about my concerns that these actions to purchase specific (non-Treasury) assets amounted to a form of credit allocation, which targets specific industries, sectors, or firms. These credit policies cross the boundary from monetary policy and venture

into the realm of fiscal policy.<sup>4</sup> I include in this category the purchases of mortgage-backed securities (MBS) as well as emergency lending under Section 13(3) of the Federal Reserve Act, in support of the bailouts, most notably of Bear Stearns and AIG. Regardless of the rationale for these actions, one needs to consider the long-term repercussions that such actions may have on the central bank as an institution.

As we contemplate what the Fed of the future should look like, I will discuss whether constraints on its goals might help limit the range of objectives it could use to justify its actions. I will also consider restrictions on the types of assets it can purchase to limit its interference with market allocations of scarce capital and generally to avoid engaging in actions that are best left to the fiscal authorities or the markets. I will also touch on governance and accountability of our institution and ways to implement policies that limit discretion and improve outcomes and accountability.

### Goals and Objectives

The Federal Reserve's goals and objectives have evolved over time. When the Fed was first established in 1913,

the U.S. and the world were operating under a classical gold standard. Therefore, price stability was not among the stated goals in the original Federal Reserve Act. Indeed, the primary objective in the preamble was to provide an "elastic currency."

The gold standard had some desirable features. Domestic and international legal commitments regarding convertibility were important disciplining devices that were essential to the regime's ability to deliver general price stability. The gold standard was a de facto rule that most people understood, and it allowed markets to function more efficiently because the price level was mostly stable.

But the international gold standard began to unravel and was abandoned during World War I.<sup>5</sup> After the war, efforts to reestablish parity proved disruptive and costly in both economic and political terms. Attempts to reestablish a gold standard ultimately fell apart in the 1930s. As a result, most of the world now operates under a fiat money regime, which has made price stability an important priority for those central banks charged with ensuring the purchasing power of the currency.

Congress established the current set of monetary policy goals in 1978. The amended Federal Reserve Act specifies the Fed "shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Since moderate long-term interest rates generally result when prices are stable and the economy is operating at full employment, many have interpreted these goals as a dual mandate with price stability and maximum employment as the focus.

'WHEN THE FED WAS FIRST ESTABLISHED IN 1913, THE U.S. AND THE WORLD WERE OPERATING UNDER A CLASSICAL GOLD STANDARD. THEREFORE, PRICE STABILITY WAS NOT AMONG THE STATED GOALS IN THE ORIGINAL FEDERAL RESERVE ACT.'



Let me point out that the instructions from Congress call for the Federal Open Market Committee (FOMC) to stress the “long run growth” of money and credit commensurate with the economy’s “long run potential.” There are many other things that Congress could have specified, but it chose not to do so. The act doesn’t talk about managing short-term credit allocation across sectors; it doesn’t mention inflating housing prices or other asset prices. It also doesn’t mention reducing short-term fluctuations in employment.

Many discussions about the Fed’s mandate seem to forget the emphasis on the long run. The public, and perhaps even some within the Fed, have come to accept as an axiom that monetary policy can and should attempt to manage fluctuations in employment. Rather than simply set a monetary environment “commensurate” with the “long run potential to increase production,” these individuals seek policies that attempt to manage fluctuations in employment over the short run.

The active pursuit of employment objectives has been and continues to be problematic for the Fed. Most economists are dubious of the ability of monetary policy to predictably and precisely control employment in the short run, and there is a strong consensus that, in the long run, monetary policy cannot determine employment. As the FOMC noted in its statement on longer-run goals adopted in 2012, “the maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market.” In my view, focusing on short-run control of employment weakens the credibility and effectiveness of the Fed in achieving its price stability objective. We learned this lesson most dramatically during the 1970s when, despite the extensive efforts to reduce unemployment, the Fed essentially failed, and the nation experienced a prolonged period of high unemploy-

ment and high inflation. The economy paid the price in the form of a deep recession, as the Fed sought to restore the credibility of its commitment to price stability.

When establishing the longer-term goals and objectives for any organization, and particularly one that serves the public, it is important that the goals be achievable.

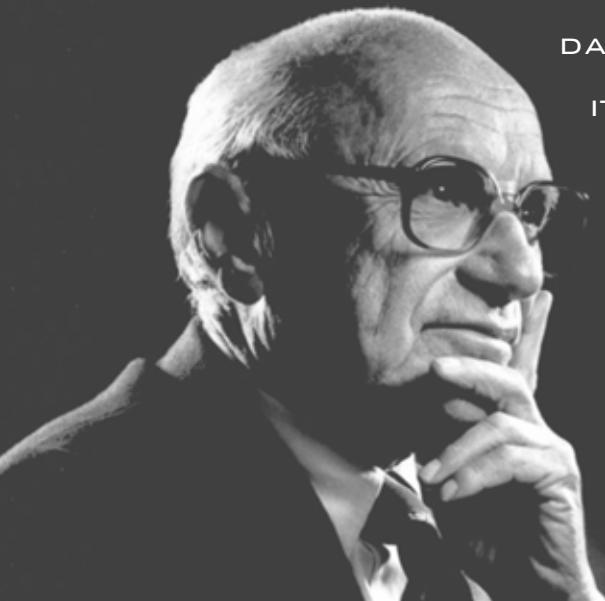
‘WE NEED TO BETTER ALIGN THE EXPECTATIONS OF MONETARY POLICY WITH WHAT IT IS ACTUALLY CAPABLE OF ACHIEVING.’

Assigning unachievable goals to organizations is a recipe for failure. For the Fed, it could mean a loss of public confidence. I fear that the public has come to expect too much from its central bank and too much from monetary policy, in particular. We need to heed the words of another Nobel Prize winner, Milton Friedman. In his 1967 presidential address to the American Economic Association, he said, “...we are in danger of assigning to monetary policy a larger role than it can perform, in danger of asking it to accomplish tasks that it cannot achieve, and as a result, in danger of preventing it from making the contribution that it is capable of making.”<sup>6</sup> In the 1970s, we saw the truth in Friedman’s earlier admonitions. I think that over the past 40 years, with the exception of the Paul Volcker era, we failed to heed this warning. We have assigned an ever-expanding role for monetary policy, and we expect our central bank to solve all manner of economic woes for which it is ill-suited to address. We need to better align the expectations of monetary policy with what it is actually capable of achieving.

The so-called dual mandate has contributed to this expansionary view of the powers of monetary policy. Even

‘...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  
1967



though the 2012 statement of objectives acknowledged that it is inappropriate to set a fixed goal for employment and that maximum employment is influenced by many factors, the FOMC’s recent policy statements have increasingly given the impression that it wants to achieve an employment goal as quickly as possible.<sup>7</sup>

I believe that the aggressive pursuit of broad and expansive objectives is quite risky and could have very undesirable repercussions down the road, including undermining the public’s confidence in the institution, its legitimacy, and its independence. To put this in different terms, assigning multiple objectives for the central bank opens the door to highly discretionary policies, which

can be justified by shifting the focus or rationale for action from goal to goal.

I have concluded that it would be appropriate to redefine the Fed’s monetary policy goals to focus solely, or at least primarily, on price stability. I base this on two facts: Monetary policy has very limited ability to influence real variables, such as employment. And, in a regime with fiat currency, only the central bank can ensure price stability. Indeed, it is the one goal that the central bank can achieve over the longer run.

### **Governance and Central Bank Independence**

Even with a narrow mandate to focus on price stability, the institution must be well designed if it is to be successful. To meet

even this narrow mandate, the central bank must have a fair amount of independence from the political process so that it can set policy for the long run without the pressure to print money as a substitute for tough fiscal choices. Good governance requires a healthy degree of separation between those responsible for taxes and expenditures and those responsible for printing money.

The original design of the Fed’s governance recognized the importance of this independence. Consider its decentralized, public-private structure, with Governors appointed by the U.S. President and confirmed by the Senate, and Fed presidents chosen by their boards of directors. This design helps ensure a diversity of views and a more decentralized governance structure that reduces the potential



for abuses and capture by special interests or political agendas. It also reinforces the independence of monetary policymaking, which leads to better economic outcomes.

### Implementing Policy and Limiting Discretion

Such independence in a democracy also necessitates that the central bank remain accountable. Its activities also need to be constrained in a manner that limits its discretionary authority. As I have already argued, a narrow mandate is an important limiting factor on an expansionist view of the role and scope for monetary policy.

What other sorts of constraints are appropriate on the activities of central banks? I believe that monetary policy and fiscal policy should have clear boundaries.<sup>8</sup> Independence is what Congress can and should grant the Fed, but, in exchange for such independence, the central bank should be constrained from conducting fiscal policy. As I have already mentioned, the Fed has ventured into the realm of fiscal policy by its purchase programs of assets that target specific industries and individual firms. One way to circumscribe the range of activities a central bank can undertake is to limit the assets it can buy and hold.

In its System Open Market Account, the Fed is allowed to hold only U.S. government securities and securities that are direct obligations of or fully guaranteed by agencies of the United States. But these restrictions still allowed the Fed to purchase large amounts of agency mortgage-backed securities in its effort to boost the housing sector. My preference would be to limit Fed purchases to Treasury securities and return the Fed's balance sheet to an all-Treasury portfolio. This would limit the ability of the Fed to engage in credit policies that target specific industries. As I've already noted, such programs to allocate credit rightfully belong in the realm of the fiscal authorities — not the central bank.

A third way to constrain central bank actions is to direct the monetary authority to conduct policy in a systematic, rule-like manner.<sup>9</sup> It is often difficult for policymakers to choose a systematic, rule-like approach that would tie their hands and thus limit their discretionary authority. Yet, research has discussed the benefits of rule-like behavior for some time. Rules are transparent and therefore allow for simpler and more effective communication of policy decisions. Moreover, a large body of research emphasizes the important role expectations play in determining economic outcomes. When policy is set systematically, the public and financial market participants can form better expectations about policy. Policy is no longer a source of instability or uncertainty. While choosing an appropriate rule is important, research shows that in a wide variety of models simple, robust monetary policy rules can produce outcomes close to those delivered by each model's optimal policy rule.

‘A NARROW MANDATE IS AN IMPORTANT LIMITING FACTOR ON AN EXPANSIONIST VIEW OF THE ROLE AND SCOPE FOR MONETARY POLICY.’

Systematic policy can also help preserve a central bank's independence. When the public has a better understanding of policymakers' intentions, it is able to hold the central bank more accountable for its actions. And the rule-like behavior helps to keep policy focused on the central bank's objectives, limiting discretionary actions that may wander toward other agendas and goals.

Congress is not the appropriate body to determine the form of such a rule. However, Congress could direct the

monetary authority to communicate the broad guidelines the authority will use to conduct policy. One way this might work is to require the Fed to publicly describe how it will systematically conduct policy in normal times — this might be incorporated into the semiannual Monetary Policy Report submitted to Congress. This would hold the Fed accountable. If the FOMC chooses to deviate from the guidelines, it must then explain why and how it intends to return to its prescribed guidelines.

My sense is that the recent difficulty the Fed has faced in trying to offer clear and transparent guidance on its current and future policy path stems from the fact that policymakers still desire to maintain discretion in setting monetary policy. Effective forward guidance, however, requires commitment to behave in a particular way in the future. But discretion is the antithesis of commitment and undermines the effectiveness of forward guidance. Given this tension, few should be surprised that the Fed has struggled with its communications.

What is the answer? I see three: Simplify the goals. Constrain the tools. Make decisions more systematically. All three steps can lead to clearer communications and a better understanding on the part of the public. Creating a stronger policymaking framework will ultimately produce better economic outcomes.

### **Financial Stability and Monetary Policy**

Before concluding, I would like to say a few words about the role that the central bank plays in promoting financial stability. Since the financial crisis, there has been an expansion of the Fed's responsibilities for controlling macroprudential and systemic risk. Some have even called for an expansion of the monetary policy mandate to include an explicit goal for financial stability. I think this would be a mistake.

The Fed plays an important role as the lender of last resort, offering liquidity to solvent firms in times of extreme financial stress to forestall contagion and mitigate systemic risk. This liquidity is intended to help ensure that solvent institutions facing temporary liquidity problems remain solvent and that there is sufficient liquidity in the banking system to meet the demand for currency. In this sense, liquidity lending is simply providing an "elastic currency."

Thus, the role of lender of last resort is not to prop up insolvent institutions. However, in some cases during the crisis, the Fed played a role in the resolution of particular insolvent firms that were deemed systemically important financial firms. Subsequently, the Dodd-Frank Wall Street Reform and Consumer Protection Act has limited some of the lending actions the Fed can take with individual firms under Section 13(3). Nonetheless, by taking these actions, the Fed has created expectations — perhaps unrealistic ones — about what the Fed can and should do to combat financial instability.

Just as it is true for monetary policy, it is important to be clear about the Fed's responsibilities for promoting financial stability. It is unrealistic to expect the central bank to alleviate all systemic risk in financial markets. Expanding the Fed's regulatory responsibilities too broadly increases the chances that there will be short-run conflicts between its monetary policy goals and its supervisory and regulatory goals. This should be avoided, as it could undermine the credibility of the Fed's commitment to price stability.

Similarly, the central bank should set boundaries and guidelines for its lending policy that it can credibly commit to follow. If the set of institutions having regular access to the Fed's credit facilities is expanded too far, it will create moral hazard and distort the market mechanism for allocating credit. This can end up undermining the very financial stability that it is supposed to promote.

Emergencies can and do arise. If the Fed is asked by the fiscal authorities to intervene by allocating credit to particular firms or sectors of the economy, then the Treasury should take these assets off of the Fed's balance sheet in exchange for Treasury securities. In 2009, I advocated that we establish a new accord between the Treasury and the Federal Reserve that protects the Fed in just such a way.<sup>10</sup> Such an arrangement would be similar to the Treasury-Fed Accord of 1951 that freed the Fed from keeping the interest rate on long-term Treasury debt below 2.5 percent. It would help ensure that when credit policies put taxpayer funds at risk, they are the responsibility of the fiscal authority — not the Fed. A new accord would also return control of the Fed's balance sheet to the Fed so that it can conduct independent monetary policy.

Many observers think financial instability is endemic to the financial industry, and therefore, it must be controlled through regulation and oversight. However, financial instability can also be a consequence of governments and their policies, even those intended to reduce instability. I can think of three ways in which central bank policies can increase the risks of financial instability. First, by rescuing firms or creating the expectation that creditors will be rescued, policymakers either implicitly or explicitly create moral hazard and excessive risk-taking by financial firms. For this moral hazard to exist, it doesn't matter if the taxpayer or the private sector provides the funds. What matters is that creditors are protected, in part, if not entirely.

Second, by running credit policies, such as buying huge volumes of mortgage-backed securities that distort market signals or the allocation of capital, policymakers can sow the seeds of financial instability because of the distortions that they create, which in time must be corrected.

## 'WHAT IS THE ANSWER?'

### I SEE THREE:

- SIMPLIFY THE GOALS.
- CONSTRAIN THE TOOLS.
- MAKE DECISIONS MORE SYSTEMATICALLY.'

And third, by taking a highly discretionary approach to monetary policy, policymakers increase the risks of financial instability by making monetary policy uncertain. Such uncertainty can lead markets to make unwise investment decisions — witness the complaints of those who took positions expecting the Fed to follow through with the taper decision in September 2013.

The Fed and other policymakers need to think more about the way their policies might contribute to financial instability. I believe that it is important that the Fed take steps to conduct its own policies and to help other regulators reduce the contributions of such policies to financial instability. The more limited role for the central bank I have described here can contribute to such efforts.

## Conclusion

The financial crisis and its aftermath have been challenging times for global economies and their institutions. The extraordinary actions taken by the Fed to combat the crisis and the ensuing recession and to support recovery have expanded the roles assigned to monetary policy.

The public has come to expect too much from its central bank. To remedy this situation, I believe it would be appropriate to set four limits on the central bank:

- First, limit the Fed's monetary policy goals to a narrow mandate in which price stability is the sole, or at least the primary, objective.
- Second, limit the types of assets that the Fed can hold on its balance sheet to Treasury securities.
- Third, limit the Fed's discretion in monetary policymaking by requiring a systematic, rule-like approach.

- And fourth, limit the boundaries of its lender-of-last-resort credit extension and ensure that it is conducted in a systematic fashion.

These steps would yield a more limited central bank. In doing so, they would help preserve the central bank's independence, thereby improving the effectiveness of monetary policy, and, at the same time, they would make it easier for the public to hold the Fed accountable for its policy decisions. These changes to the institution would strengthen the Fed for its next 100 years.

## ENDNOTES

<sup>1</sup> This essay is based on a speech by the author, "A Limited Central Bank," presented at the Cato Institute's 31st Annual Monetary Conference, November 14, 2013, in Washington, D.C. The views expressed here are the author's and not necessarily those of the Federal Reserve System or the Federal Open Market Committee.

<sup>2</sup> For more about Douglass C. North and his cowinner Robert W. Fogel and the 1993 Nobel Memorial Prize in Economic Sciences, see Nobel Media, "The Prize in Economics 1993 - Press Release," (1993), [www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/1993/press.html](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1993/press.html) (accessed November 11, 2013). See also Douglass C. North, "Institutions," *Journal of Economic Perspectives*, 5:1 (1991), pp. 97–112.

<sup>3</sup> Countries can and do pursue different means of setting the value of their currency, including pegging their monetary policy to that of another country, but I will not concern myself with such issues in these comments.

<sup>4</sup> See Charles Plosser, "Ensuring Sound Monetary Policy in the Aftermath of Crisis," speech to the U.S. Monetary Policy Forum, The Initiative on Global Markets, sponsored by the University of Chicago Booth School of Business, New York, NY, February 27, 2009, and Charles Plosser, "Fiscal Policy and Monetary Policy: Restoring the Boundaries," a speech to the same group, February 24, 2012.

<sup>5</sup> See Ben S. Bernanke, "A Century of U.S. Central Banking: Goals, Frameworks, Accountability," speech to the National Bureau of Economic Research, Cambridge, MA, July 10, 2013; and Jeffrey M. Lacker, "Global Interdependence and Central Banking," speech to the Global Interdependence Center, Philadelphia, November 1, 2013.

<sup>6</sup> See Milton Friedman, "The Role of Monetary Policy," *American Economic Review*, 58:1 (March 1968), pp. 1–17.

<sup>7</sup> See Daniel L. Thornton, "The Dual Mandate: Has the Fed Changed Its Objective?" *Federal Reserve Bank of St. Louis Review*, 94 (March/April 2012), pp. 117–33.

<sup>8</sup> See Plosser (2009) and Plosser (2012).

<sup>9</sup> See Charles Plosser, "The Benefits of Systematic Monetary Policy," speech given to the National Association for Business Economics, Washington Economic Policy Conference, Washington, D.C., March 3, 2008. Also see Finn E. Kydland and Edward C. Prescott, "Rules Rather Than Discretion: The Inconsistency of Optimal Plans," *Journal of Political Economy*, 85 (June 1977), pp. 473–91.

<sup>10</sup> See Plosser (2009).



# FEDERAL RESERVE SYSTEM

*100 Years of Tradition and Transition*



In 1913, Albert Einstein was working on his theory of gravity, Richard Nixon was born, and Franklin D. Roosevelt was sworn in as Assistant Secretary of the Navy. It was also the year Woodrow Wilson took the oath of office as the 28th President of the United States, intent on advocating progressive reform and change. One of his biggest reforms came on December 23, 1913, when he signed the Federal Reserve Act into law. This landmark legislation created the Federal Reserve System, the nation's central bank.

## A Need for Stability

Why was a central bank needed? After the charter of the Second Bank of the United States expired in 1836, the United States endured a series of financial crises throughout the 19th century and into the first decade of

the 20th century. When the Knickerbocker Trust Company in New York City failed in 1907, it triggered runs on other trust companies, as well as hundreds of bank failures, a decrease in the money supply, and a deep recession. In response, Congress set up the National Monetary Commission in 1908. The commission submitted a report to Congress four years later that proposed a plan to create a National Reserve Association of the United States. The actual plan was never implemented; however, it sparked a debate advocating a new central bank for the United States: the Federal Reserve System. Incoming President Wilson favored adding a central governmental board to oversee the reserve banks.

Among the many proposals introduced to Congress in 1913, Representative Carter Glass sponsored the key bill passed by the House and finally by the Senate on December 19, 1913. Four days later, President Woodrow Wilson signed the bill into law, creating the Federal Reserve System.

In part, the Federal Reserve Act established the Reserve Bank Organization Committee, in which the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency would divide the nation into no fewer than eight and no more than 12 Federal Reserve Districts. The committee was also charged with deciding which cities would host a Federal Reserve Bank, how the geographic boundaries of each Federal Reserve District would be defined, and how the Reserve Banks would be organized and supervised.

Between January and mid-February 1914, the committee held meetings in 18 cities across the nation. Local businessmen, bankers, farmers, and others made a case explaining why their city or state should be chosen as a Reserve Bank location. In April 1914, the committee submitted a report

to Congress listing the cities it had selected for the Reserve Banks, the same cities that host Reserve Banks today.

The Federal Reserve Act also provided an operating structure for the Reserve System: It created a Federal Reserve Board in Washington, D.C., designed to oversee the operations of the Reserve Banks. The Board consisted of seven

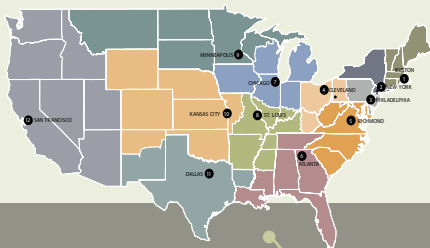
members, including the Secretary of the Treasury and the Comptroller of the Currency as ex officio members, as well as five members appointed by the President of the United States and confirmed by the Senate.

On November 16, 1914, all 12 regional Reserve Banks opened for business. Like the First Bank and the Second

## Panics and Crises

The Knickerbocker Trust Company, the second largest of its kind in New York, failed in October 1907, which led to runs on other trust companies. Knickerbocker did not have enough cash on hand to meet depositors' demand. Since there was no deposit insurance in 1907 and no lender of last resort to turn to, the run triggered a panic that launched hundreds of bank failures, a significant decrease in the money supply, and a deep recession. Financier J.P. Morgan formed a syndicate with his fellow bankers to put sufficient liquidity into the economy to quell the panic. Congress then set up a federal commission to study the economy, which eventually led to the creation of the Federal Reserve System in 1913.

But before the Federal Reserve System was established, the United States faced another crisis in July 1914. European investors, who owned more than 20 percent of American railroad stocks, started to sell these assets to secure a flow of gold to Europe to help pay for World War I. This sell-off put a serious drain on the U.S. gold supply, weakening the gold-backed dollar and making it hard for the U.S. to maintain the gold standard. Although Treasury Secretary William McAdoo tried to push for the Federal Reserve Banks to open early, his attempt was thwarted. So he moved to close Wall Street "to hamper British sales of American securities." The stock market closed on July 31, 1914, and reopened on December 12.



The Federal Reserve Act is passed by Congress and signed by President Woodrow Wilson.

1913

The 12 Federal Reserve Banks open for business.

1914

The Philadelphia Fed opens in its first headquarters at 406-408 Chestnut Street.

1914

Charles J. Rhoads is named the first governor of the Federal Reserve Bank of Philadelphia.

1914

World War I creates difficult economic conditions, but the Federal Reserve System takes an active role in marketing war debt to the banks and general public to raise funds for the war effort.

1914-18

Bank of the United States, the Fed was initially given a 20-year charter. However, the McFadden Act of 1927 removed the 20-year limit. This helped the Federal Reserve avoid the political battle over rechartering, which had ended both previous attempts at a central bank.

## Off to a Rough Start

With the nation's economy still unsettled, the Roaring Twenties were largely remembered as a period of economic prosperity and a rising stock market, despite three recessions. Middle class and wealthier households benefited from the boom, but not everyone shared in the prosperity. During the decade, crop prices collapsed, and as a result, many farmers defaulted on their mortgages. However, the Fed continued an accommodative monetary policy throughout 1927. Then in 1928, the Fed finally raised interest rates, but this proved to be too little too late. It further aggravated the economic situation by slowing down an already faltering economy. By 1929, the stock market crash deepened the crisis and triggered the Great Depression.

President Herbert Hoover attempted to stimulate the economy by urging Congress to pass the Reconstruction Finance Corporation (RFC) Act of 1932. The RFC was established to make loans to banks and other financial

## Works of Glass (1858-1946)

Carter Glass, the son of a newspaperman, was born in Lynchburg, VA. After attending school and working as a printer's apprentice, reporter, editor, and owner of a newspaper, he was elected to the state senate in 1899 and served as a delegate to Virginia's constitutional convention. After he was elected to the U.S. House of Representatives in 1902, he was appointed to the Committee on Banking and Currency. During the Panic of 1907, Glass saw the need to reduce, if not eliminate, the number of bank panics and financial crises as well as develop the need for a more elastic currency. Glass was Secretary of the Treasury from 1918 to 1920 and served in the Senate. One of his biggest accomplishments was his work on the bill that would become the Federal Reserve Act of 1913.



Carter Glass



Ellis P. Passmore is named governor of the Philadelphia Fed.

1918



The Philadelphia Fed moves to a larger building at 925 Chestnut Street.

1918



George W. Norris is named governor of the Philadelphia Fed. During his tenure, he oversees the System's first open market operations in 1923 and issues discounts and advances to avert monetary panic during the stock market crash in 1929.

1920



The McFadden Act is passed and creates significant changes for the Fed.

1927

The Black Tuesday Wall Street Crash sends the world into an economic panic.

1929

institutions and to lend funds to railroads, many of which could not meet their bond payments.

However, many people criticized Hoover, saying his actions weren't fast enough and didn't go far enough to stem the rise of bank failures and growing unemployment. Voters decided it was time for a change. Hoover lost the presidential election in November 1932, and voters sent Franklin D. Roosevelt to the White House. Although other factors, including the collapse of international trade, contributed to the severe economic distress in the United States, the breakdown of the banking system was credited with being the major cause of the Depression. Between 1930 and 1933, 9,000 banks failed in the United States. These bank failures limited money supply, which, in turn, led to a decline in spending on goods and services. Firms lowered their prices and laid

off workers. As incomes dwindled, many households defaulted on loans, and bankruptcies escalated.

Trust in banks evaporated. People withdrew their savings from banks and began hoarding cash. Bank reserves plunged, which resulted in tighter credit. In March 1933, Roosevelt declared a bank holiday, in which all U.S. banks were closed for four business days. After Congress passed the Emergency Banking Act on March 9, the Federal Reserve agreed to supply an unlimited amount of emergency money to the banks that reopened. This commitment by the Fed essentially created an early form of deposit insurance. These measures went a long way toward restoring the public's confidence in banks. By the end of March 1933, two-thirds of the money that had been withdrawn in earlier bank runs and panics had been redeposited in the nation's banks.

However, the Fed did not respond aggressively; it continued its tight monetary policy for too long, and prices started to fall, leading to widespread deflation. When banks did close their doors, people lost their savings and credit became scarce.

Congress passed many important pieces of legislation in response to the Great Depression. The Banking Act of 1933 created the Federal Deposit Insurance Corpora-

In March 1933, Roosevelt declared a bank holiday, in which all U.S. banks were closed for four business days.



The Great Depression: U.S. unemployment reaches 25%, international trade drops more than 50%, thousands of banks and other businesses fail, and tax revenue to the federal government drops dramatically.

Congress passes the Glass-Steagall Act to stem deflation, expand the Fed's ability to offer rediscounts, and separate the activities of commercial banks and securities firms.

The Gold Reserve Act passes, requiring all gold and gold certificates held by the Federal Reserve to be surrendered to and vested in the U.S. Department of the Treasury.

The Banking Act of 1935 calls for changes in the Federal Reserve's structure, including the Federal Open Market Committee.

1929-39

1933

1934

1935



tion (FDIC) as a temporary government agency with the authority to provide deposit insurance to banks, initially insuring bank deposits up to \$2,500. This act, known as the Glass-Steagall Act, separated investment banking from commercial banking and established the Federal Open Market Committee (FOMC). Although the Federal Reserve Banks had set up an Open Market Investment Committee in 1923, the Reserve Banks were not obligated to carry out the committee's recommendations. The 1933 law also gave the Federal Reserve Board the responsibility for supervising bank holding companies.

The Banking Act of 1935 made the FDIC a permanent government agency and increased the maximum amount of insured deposits to \$5,000. This law also further defined the FOMC, giving the Committee its current structure: the seven Governors on the Board of Governors and five of the 12 Reserve Bank presidents. One of the voting members is always the president of the New York Fed; the other four presidents serve one-year terms on a rotating basis. The Reserve Banks are required to carry out the directions of the FOMC, whose open market operations are centralized at the Open Market Trading Desk at the New York Fed. The 1935 law also changed the title of Reserve Bank heads from governor to president and removed the Comptroller of the Currency and the Secretary of the Treasury from their positions on the Federal Reserve Board.

## Going to War

World War II carried the American economy out of the Great Depression. Producing armaments and other goods for the war kept the economy buzzing in the early to mid-1940s. During this period, the Federal Reserve acted at the Treasury's request to keep rates low to help finance the war. After 1945, when the war was over, the Treasury wanted the Fed to continue to keep interest rates low.

But the Federal Reserve Act did not specifically set goals for monetary policy, stating instead that the Fed was required to furnish an "elastic currency." In 1946, Congress passed the Employment Act, which defines the goals of monetary policy to include promoting "maximum employment, production, and purchasing power."

In 1950, the Treasury pressed the Fed to maintain low rates at the start of the Korean War. However, the central bank was reluctant to do so. Finally, in 1951, the two parties signed the Treasury-Fed Accord, which acknowledged the Fed's independence in setting monetary policy.

The economy entered another recession in the mid-1950s. Once recovery was underway, the Fed raised interest rates above 3 percent to restrain inflation. But its actions were not fast enough to keep inflation from



John S. Sinclair is named president (he is the first to assume this title) of the Philadelphia Fed.

1936



World War II rages throughout Europe, North Africa, and the South Pacific.

1939-45



Alfred H. Williams is named president of the Philadelphia Fed.

1941

The Treasury-Federal Reserve Accord declares the Fed's independence in conducting monetary policy.

1951

reaching nearly 4 percent. When a second recession began in mid-1957 and unemployment rose dramatically, the Fed responded with a sharp drop in interest rates to spur spending and employment.

## Looking Out for the Consumer

In the 1960s and 1970s, Congress passed several important consumer protection laws, including the Truth in Lending Act in 1968, which requires lenders to disclose the cost of borrowing to consumers; the Equal Credit Opportunity Act in 1974, which combats discrimination in consumer and business lending; and the Electronic Fund Transfer Act in 1978, which provides protection for consumers in their electronic financial transactions. In 1977, Congress passed the Community Reinvestment Act, which encourages banks to meet the credit needs of all segments in their communities. This act also established a community affairs function at the Board of Governors and at each Reserve Bank.

Congress also passed the Full Employment and Balanced Growth Act of 1978, otherwise known as the Humphrey-Hawkins Act. This law expanded the goals of the Employment Act of 1946 and required the Federal Reserve's chairman to testify to Congress twice each year about the Fed's objectives and plans for monetary policy.

High inflation and high unemployment plagued the country during the 1970s; inflation climbed to about 6 percent at the start of the decade. With inflation still above 4 percent by mid-1971, President Richard Nixon imposed wage and price controls, which suppressed inflation for a time. The Fed tightened monetary policy when inflation rebounded following the end of the wage and price controls and a jump in oil prices during 1973–74.

Inflation rose to 12 percent in 1974, ushering in another recession. The Fed eased monetary policy in 1974, and the federal funds rate fell below 5 percent in early 1976. Since the Fed was slow to raise short-term interest rates during the rest of the decade, the Fed's monetary policy remained expansionary, and the Fed's stated anti-inflation policy lost credibility.

Although the economy expanded during the 1970s, oil prices jumped several times when oil-producing states tightened supplies. Inflation climbed to 14 percent in 1979 when the revolution in Iran reduced oil supplies to the U.S.

President Jimmy Carter appointed Paul Volcker as chairman of the Federal Reserve Board of Governors in 1979, and Volcker took decisive actions to curb inflation. Rather than targeting a short-term interest rate, the Federal



Karl R. Bopp is named president of the Philadelphia Fed, becoming one of the first professional economists to lead a Reserve Bank.

1958



David P. Eastburn is named president of the Philadelphia Fed.

1970



The Community Reinvestment Act (CRA) is passed.

1977



The Full Employment and Balanced Growth Act (commonly known as the Humphrey-Hawkins Act) passes, requiring the Federal Reserve to provide Congress with a semiannual report on the Fed's objectives and plans for monetary policy.

1978

Reserve under Volcker focused on controlling the growth of the money supply. This led to higher interest rates, but it succeeded in reducing inflation and lowering interest rates over time.

## The Changing Fed

The Depository Institutions Deregulation and Monetary Control Act of 1980 (MCA) changed the way the Fed provides services. The law mandated that the Federal Reserve offer payment services not only to member banks but also to any depository institution that wanted to use them and to charge all institutions (both member and nonmember banks) an amount sufficient to cover the cost of providing the service; the law also granted depository institutions equal access to discount window lending. In return, the MCA requires all banks to maintain reserves with the Fed.

In the 1980s and 1990s, more deregulation came to the banking industry. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 allowed banks to set up branches in other states. The Financial Services Modernization Act of 1999, also called the Gramm-Leach-Bliley Act, repealed the requirement that investment and commercial banking be separate, a provision that was originally set forth in the Glass-Steagall Act of 1933.

After the world ushered in a new millennium, the terrorist attacks of September 11, 2001, forever changed life in America. In the days and weeks that followed, the Fed maintained financial stability and kept the economy moving by pumping liquidity into U.S. financial markets. The Fed kept the payments system and banking operations as close to normal as possible. The attacks also generated new payment systems since all air transportation was grounded for several days after 9/11. The Fed couldn't move checks from one part of the country to another by air, so it stepped in to keep the financial system operational. The Fed credited the accounts of the banks receiving check payments and waited to debit the accounts of the paying banks until planes began flying again.

The Fed asked Congress to enact a law that would allow a substitute check to be legally acceptable for collection and payment. And in 2003, Congress passed the Check Clearing for the 21st Century Act, commonly called Check 21. This legislation, which went into effect in October 2004, reduced the time it took banks to clear checks: An electronic image was sent instead of the actual paper check.

In 2007, the Fed had to face yet another financial crisis and ensuing deep recession. This time, the Fed didn't waste time in taking extraordinary steps: It lowered



Edward G. Boehne is named president of the Philadelphia Fed. During his tenure, many Third District banks are taken over by larger rivals and the Federal Deposit Insurance Corporation Improvement Act is passed in 1991.

1981



Anthony Santomero is named president of the Philadelphia Fed. During his tenure, he oversees the launch of both the Payment Cards Center and the Money in Motion exhibit.

2000



Charles I. Plosser is named president of the Philadelphia Fed. During his tenure, he leads the Bank through the global financial crisis of 2008 and the ensuing Great Recession.

2006



The Federal Reserve System reaches a milestone: a century of service.

2013

## Comparing U.S. Central Banks

	1791-1811	1816-1836	1913-Present
	First Bank of the United States	Second Bank of the United States	Federal Reserve System
			
<b>Supervisory Duties</b>	No	No	Yes
<b>Monetary Policy</b>	No, but it was large enough to affect credit conditions nationwide.	No, but it was large enough to affect credit conditions nationwide.	Yes, but in the early years, the Fed did not conduct monetary policy as we know it today.
<b>Branches</b>	Yes	Yes	Yes
<b>20-Year Charter</b>	Yes, charter not renewed	Yes, charter not renewed	Yes, the Fed originally had a 20-year charter, but the McFadden Act of 1927 gave the central bank permanency.
<b>Issues Currency</b>	Yes	Yes	Yes
<b>Stockholders</b>	Yes, 20% was held by government; 80% by the public.	Yes, 20% was held by government; 80% by the public.	Yes, but only member banks hold stock, not the public.
<b>Stock</b>	Publicly traded, held by foreign and domestic investors	Publicly traded, held by foreign and domestic investors	Federal Reserve System members of national banks and state-chartered banks receive nontradable stock in their District Reserve Bank; stock pays a fixed dividend of 6%.
<b>Commercial Bank Operations</b>	Yes, it accepted deposits from and made loans to the public.	Yes, it accepted deposits from and made loans to the public.	No, the Fed is a “bankers’ bank”; it makes loans only to banks and holds their deposits called reserves.
<b>Competition with State Banks</b>	None	Yes	None
<b>Services to Federal Government</b>	Served as the federal government’s fiscal agent, received its revenues, held its deposits, and made its payments	Served as the federal government’s fiscal agent, received its revenues, held its deposits, and made its payments	Serves as the federal government’s fiscal agent, receives its revenues, holds its deposits, and makes its payments



short-term interest rates to near zero, established special lending programs, expanded traditional overnight loans through the discount window to 90 days, and supported the functioning of credit markets through open market purchases of long-term securities for the Fed's portfolio. In July 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which resulted in three significant changes for the Federal Reserve.

First, Congress expanded the Fed's regulatory role by adding savings and loan holding companies to the Fed's supervisory activities. The Fed was also given supervisory authority over systemically important nonbank financial companies. Congress also created the Financial Stability Oversight Council to conduct surveillance and monitor risks to the financial system.

Second, Congress limited the Fed's role under Section 13(3) of the Federal Reserve Act as lender of last resort in unusual and exigent circumstances. During the financial crisis, the Fed used this authority to make \$182 billion in loans to the American International Group (AIG) to prevent it from filing for bankruptcy, which would have destabilized the global financial system because of AIG's size.

Finally, Congress transferred the Fed's authority to write regulations for most federal consumer protection laws to the newly created Consumer Financial Protection Bureau (CFPB). Although Dodd-Frank funded the CFPB through the Fed, the new bureau is independent of the Fed in terms of its decision-making authority.

While rule-making authority for most consumer protection laws was transferred to the CFPB, the Fed and federal agencies still had the authority to write regulations for certain federal laws, including the Community Reinvestment Act (CRA), the National Flood Insurance Act, and the Expedited Funds Availability Act. And the Fed continues to be the consumer compliance regulator for state member banks with assets of less than \$10



## Living History

On December 16, 2013, more than 80 Federal Reserve Board officials gathered in Washington, D.C., to commemorate the signing of the Federal Reserve Act. Four Federal Reserve System Chairs whose service has spanned 35 years were on hand; from left to right, Janet Yellen (2014–ongoing), the first woman to be appointed Chair; Alan Greenspan (1987–2006), Ben Bernanke (2006–14), and Paul Volcker (1979–87).

billion. It also conducts limited consumer examinations of state member banks with assets of more than \$10 billion to ensure compliance with laws that the bureau doesn't cover in its examinations.

These changes were only the latest the Fed has undergone in the past 100 years. Yet, the economy and the banking industry have also been shaped by changing times. The financial services industry as a whole would be all but unrecognizable to our forebears a hundred years ago. Unlike its predecessors, the Fed has weathered the political storms of its day. It insulated itself from partisan politics, but it is clearly accountable to Congress and the American people. Its decentralized structure has kept it close to the economy on Main Streets throughout America. And that has made it ready to tackle the challenges to come as the Fed enters its second century of service as the nation's central bank.

*For more information on the history of central banking, see the ongoing series published by the Federal Reserve Bank of Philadelphia ([www.philadelphiafed.org/publications/economic-education/](http://www.philadelphiafed.org/publications/economic-education/)). For more on the Federal Reserve System's centennial, see [www.philadelphiafed.org/about-the-fed/centennial/](http://www.philadelphiafed.org/about-the-fed/centennial/).*

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**Michael Pearson**

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100 YEARS  
FEDERAL RESERVE SYSTEM  
Windows into Our Past



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Corporate Affairs

**Linda Van Valkenburg**  
Officer  
Information Technology Services

*Includes promotions through January 2014*





## STATEMENT OF AUDITOR INDEPENDENCE

The Board of Governors engaged Deloitte & Touche LLP (D&T) to audit the 2013 combined and individual financial statements of the Reserve Banks and those of the consolidated LLC entities.<sup>1</sup> In 2013, D&T also conducted audits of internal controls over financial reporting for each of the Reserve Banks. Fees for D&T's services totaled \$7 million, of which \$1 million was for the audits of the consolidated LLC entities. To ensure auditor independence, the Board requires that D&T be independent in all matters relating to the audits. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2013, the Bank did not engage D&T for any non-audit services.

<sup>1</sup> In addition, D&T audited the Office of Employee Benefits of the Federal Reserve System (OEB), the Retirement Plan for Employees of the Federal Reserve System (System Plan), and the Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The System Plan and the Thrift Plan provide retirement benefits to employees of the Board, the Federal Reserve Banks, and the OEB.



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## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING



FEDERAL RESERVE BANK  
OF PHILADELPHIA

March 14, 2014

To the Board of Directors

The management of the Federal Reserve Bank of Philadelphia (Bank) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2013 and 2012, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (the financial statements). The financial statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the financial statements are, in all material respects, fairly presented in conformity with the accounting principles, policies, and practices documented in the FAM and include all disclosures necessary for such fair presentation.

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

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

The management of the Bank assessed its internal control over financial reporting based upon the criteria established in the *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that the Bank maintained effective internal control over financial reporting.

Charles I. Plosser, President and Chief Executive Officer

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

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



## INDEPENDENT AUDITORS' REPORT



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**INDEPENDENT AUDITORS' REPORT**

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

We have audited the accompanying financial statements of the Federal Reserve Bank of Philadelphia ("FRB Philadelphia"), which are comprised of the statements of condition as of December 31, 2013 and 2012, and the related statements of income and comprehensive income, and of changes in capital for the years then ended, and the related notes to the financial statements. We also have audited the FRB Philadelphia's internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control — Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**Management's Responsibility**

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

**Auditors' Responsibility**

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

An audit of the financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers

## INDEPENDENT AUDITORS' REPORT — PAGE 2

internal control relevant to the FRB Philadelphia's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of the financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting involves obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

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

**Definition of Internal Control Over Financial Reporting**

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

**Inherent Limitations of Internal Control Over Financial Reporting**

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

**Opinions**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FRB Philadelphia as of December 31, 2013 and 2012, and the results of its operations for the years then ended in accordance with the basis of accounting described in Note 3 to the financial statements. Also, in our opinion, the FRB Philadelphia maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control — Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

## INDEPENDENT AUDITORS' REPORT — PAGE 3

**Basis of Accounting**

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



March 14, 2014

## ABBREVIATIONS

ACH	Automated clearinghouse
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
FAM	<i>Financial Accounting Manual for Federal Reserve Banks</i>
FASB	Financial Accounting Standards Board
FOMC	Federal Open Market Committee
FRBNY	Federal Reserve Bank of New York
GAAP	Accounting principles generally accepted in the United States of America
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
MBS	Mortgage-backed securities
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
TBA	To be announced
TDF	Term Deposit Facility



## STATEMENTS OF CONDITION

As of December 31, 2013 and December 31, 2012 (in millions)

	2013	2012
<b>ASSETS</b>		
Gold certificates	\$ 397	\$ 437
Special drawing rights certificates	210	210
Coin	123	141
Loans to depository institutions	-	2
System Open Market Account:		
Treasury securities, net (of which \$497 and \$302 is lent as of December 31, 2013 and 2012, respectively)	68,363	59,808
Government-sponsored enterprise debt securities, net (of which \$32 and \$23 is lent as of December 31, 2013 and 2012, respectively)	1,713	2,627
Federal agency and government-sponsored enterprise mortgage-backed securities, net	44,442	31,416
Foreign currency denominated investments, net	1,835	2,157
Central bank liquidity swaps	21	771
Accrued interest receivable	685	635
Other investments	-	1
Bank premises and equipment, net	87	87
Other assets	28	27
<b>Total assets</b>	<b>\$ 117,904</b>	<b>\$ 98,319</b>
<b>LIABILITIES AND CAPITAL</b>		
Federal Reserve notes outstanding, net	\$ 36,063	\$ 43,262
System Open Market Account:		
Securities sold under agreements to repurchase	9,154	3,543
Other liabilities	39	105
Deposits:		
Depository institutions	48,568	30,547
Other deposits	21	17
Interest payable to depository institutions	2	4
Accrued benefit costs	104	115
Accrued remittances to Treasury	84	29
Interdistrict settlement account	19,721	16,451
Other liabilities	12	14
<b>Total liabilities</b>	<b>113,768</b>	<b>94,087</b>
Capital paid-in	2,068	2,116
Surplus (including accumulated other comprehensive loss of \$14 and \$33 at December 31, 2013 and 2012, respectively)	2,068	2,116
<b>Total capital</b>	<b>4,136</b>	<b>4,232</b>
<b>Total liabilities and capital</b>	<b>\$ 117,904</b>	<b>\$ 98,319</b>

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

## STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

For the years ended December 31, 2013 and December 31, 2012 (in millions)

	2013	2012
<b>INTEREST INCOME</b>		
System Open Market Account:		
Treasury securities, net	\$ 1,549	\$ 1,550
Government-sponsored enterprise debt securities, net	66	88
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,098	1,051
Foreign currency denominated assets, net	8	12
Central bank liquidity swaps	2	21
Other investments	-	1
<b>Total interest income</b>	<b>2,723</b>	<b>2,723</b>
<b>INTEREST EXPENSE</b>		
System Open Market Account:		
Securities sold under agreements to repurchase	2	5
Deposits:		
Depository institutions	99	91
Term Deposit Facility	1	1
<b>Total interest expense</b>	<b>102</b>	<b>97</b>
<b>Net interest income</b>	<b>2,621</b>	<b>2,626</b>
<b>NON-INTEREST INCOME (LOSS)</b>		
System Open Market Account:		
Treasury securities gains, net	-	442
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	1	8
Foreign currency translation losses, net	(98)	(96)
Compensation received for service costs provided	4	2
Reimbursable services to government agencies	39	39
Other	4	2
<b>Total non-interest (loss) income</b>	<b>(50)</b>	<b>397</b>
<b>OPERATING EXPENSES</b>		
Salaries and benefits	124	112
Occupancy	16	14
Equipment	7	9
Other	51	46
Assessments:		
Board of Governors operating expenses and currency costs	81	76
Bureau of Consumer Financial Protection	43	31
<b>Total operating expenses</b>	<b>322</b>	<b>288</b>
Net income before providing for remittances to Treasury	2,249	2,735
Earnings remittances to Treasury	2,189	2,812
<b>Net income (loss)</b>	<b>60</b>	<b>(77)</b>
Change in prior service costs related to benefit plans	-	1
Change in actuarial gains (losses) related to benefit plans	19	(9)
<b>Total other comprehensive income (loss)</b>	<b>19</b>	<b>(8)</b>
<b>Comprehensive income (loss)</b>	<b>\$ 79</b>	<b>\$ (85)</b>

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

## STATEMENTS OF CHANGES IN CAPITAL

For the years ended December 31, 2013 and December 31, 2012 (in millions, except share data)

	Surplus				
	Capital paid-in	Net income retained	Accumulated other comprehensive income (loss)	Total surplus	Total capital
Balance at December 31, 2011 (46,662,518 shares)	\$ 2,333	\$ 2,358	\$ (25)	\$ 2,333	\$ 4,666
Net change in capital stock redeemed (4,338,127 shares)	(217)	-	-	-	(217)
Comprehensive income:					
Net loss	-	(77)	-	(77)	(77)
Other comprehensive loss	-	-	(8)	(8)	(8)
Dividends on capital stock	-	(132)	-	(132)	(132)
Net change in capital	(217)	(209)	(8)	(217)	(434)
Balance at December 31, 2012 (42,324,391 shares)	\$ 2,116	\$ 2,149	\$ (33)	\$ 2,116	\$ 4,232
Net change in capital stock redeemed (958,630 shares)	(48)	-	-	-	(48)
Comprehensive income:					
Net income	-	60	-	60	60
Other comprehensive income	-	-	19	19	19
Dividends on capital stock	-	(127)	-	(127)	(127)
Net change in capital	(48)	(67)	19	(48)	(96)
Balance at December 31, 2013 (41,365,761 shares)	\$ 2,068	\$ 2,082	\$ (14)	\$ 2,068	\$ 4,136

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

## NOTES TO FINANCIAL STATEMENTS

### 1. STRUCTURE

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

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

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

### 2. OPERATIONS AND SERVICES

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

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, government-sponsored enterprise (GSE) debt securities, and federal agency and GSE mortgage-backed securities (MBS); the purchase of these securities under agreements to resell; and the sale of these securities under agreements to



## NOTES TO FINANCIAL STATEMENTS

repurchase. The FRBNY holds the resulting securities and agreements in a portfolio known as the System Open Market Account (SOMA). The FRBNY is authorized and directed to lend the Treasury securities and GSE debt securities that are held in the SOMA.

To counter disorderly conditions in foreign exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities, the FOMC has authorized and directed the FRBNY to execute spot and forward foreign exchange transactions in 14 foreign currencies, to hold balances in those currencies, and to invest such foreign currency holdings, while maintaining adequate liquidity. The FOMC has also authorized the FRBNY to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of \$2 billion and \$3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund in the maximum amount of \$5 billion.

Because of the global character of bank funding markets, the System has at times coordinated with other central banks to provide liquidity. The FOMC authorized and directed the FRBNY to establish temporary U.S. dollar liquidity swap lines with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. In addition, as a contingency measure, the FOMC authorized and directed the FRBNY to establish temporary foreign currency liquidity swap arrangements with these five central banks to allow for the System to access liquidity, if necessary, in any of the foreign central banks' currencies. On October 31, 2013, the Federal Reserve and five other central banks agreed to convert their existing temporary liquidity swap arrangements to standing agreements which will remain in effect until further notice.

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

### 3. SIGNIFICANT ACCOUNTING POLICIES

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

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States of America (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary

## NOTES TO FINANCIAL STATEMENTS

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

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

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

In 2013, the description of certain line items presented in the Statements of Income and Comprehensive Income and the Statements of Condition have been revised to better reflect the nature of these items. Amounts related to these line items were not changed from the prior year, only the nomenclature for the line item was revised, as further noted below:

- The line item, "Accrued interest on Federal Reserve notes" has been revised in the Statements of Condition to "Accrued remittances to Treasury."
- The line item, "Net income before interest on Federal Reserve notes expense remitted to Treasury" has been revised in the Statements of Income and Comprehensive Income to "Net income before providing for remittances to Treasury."
- The line item, "Interest on Federal Reserve notes expense remitted to Treasury" has been revised in the Statements of Income and Comprehensive Income to "Earnings remittances to Treasury."

Certain amounts relating to the prior year have been reclassified in the Statements of Condition to conform to the cur-

## NOTES TO FINANCIAL STATEMENTS

rent year presentation. The amount reported as “System Open Market Account: Accrued interest receivable” for the year ended December 31, 2012 (\$635 million) was previously reported as a component of “System Open Market Account: Foreign currency denominated assets, net” (\$9 million) and “Accrued interest receivable” (\$626 million). Significant accounts and accounting policies are explained below.

### a. Consolidation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that has supervisory authority over some institutions previously supervised by the Reserve Banks in connection with those institutions’ compliance with consumer protection statutes. Section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the System. The Board of Governors funds the Bureau through assessments on the Reserve Banks as required by the Dodd-Frank Act. Section 152 of the Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury and required the Board of Governors to fund the OFR for the two-year period ended July 21, 2012. The Reserve Banks reviewed the law and evaluated the design of and their relationships to the Bureau and the OFR and determined that neither should be consolidated in the Bank’s financial statements.

### b. Gold and Special Drawing Rights Certificates

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

Special drawing rights (SDR) are issued by the International Monetary Fund (IMF) to its members in proportion to each member’s quota in the IMF at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks’ SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange-stabilization operations. At the time SDR certificate transactions occur, the Board of Governors allocates the SDR certificates among the Reserve Banks based upon each Reserve Bank’s Federal Reserve notes outstanding at the end of the preceding calendar year. SDR certificates are recorded by the Banks at original cost. There were no SDR certificate transactions during the years ended December 31, 2013 and 2012.

### 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.

## NOTES TO FINANCIAL STATEMENTS

### **d. Loans**

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

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

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

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

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and with the set of expanded counterparties which includes banks, savings associations, GSEs, and domestic money market funds. These reverse repurchase transactions, when arranged as open market operations, are settled through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, 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.

## NOTES TO FINANCIAL STATEMENTS

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

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

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

Interest income on Treasury securities, GSE debt securities, and foreign currency denominated assets included in 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 pay-downs. Premiums and discounts related to federal agency and GSE MBS are amortized or accreted over the term of the security to stated maturity, and the amortization of premiums and accretion of discounts are accelerated when principal payments are received. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Treasury securities, GSE debt securities, and federal agency and GSE MBS are reported net of premiums and discounts in the Statements of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts in the Statements of Income and Comprehensive Income.

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell “to be announced” (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. During the years ended December 31, 2013 and 2012, the FRBNY executed dollar rolls primarily to facilitate settlement of outstanding purchases of federal agency and GSE MBS. The FRBNY accounts for dollar rolls as purchases or sales on a settlement-date basis. In addition, TBA MBS transactions may be paired off or assigned prior to settlement. Net gains (losses) resulting from these MBS transactions are reported as “Non-interest income (loss): System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains (losses), net” in the Statements of Income and Comprehensive Income.

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

Because the FRBNY enters into commitments to buy Treasury securities, federal agency and GSE MBS, and foreign gov-



## NOTES TO FINANCIAL STATEMENTS

ernment debt instruments and records the related securities on a settlement-date basis in accordance with the FAM, the related outstanding commitments are not reflected in the Statements of Condition.

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

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

### **g. Central Bank Liquidity Swaps**

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

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

#### *U.S. dollar liquidity swaps*

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

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

## NOTES TO FINANCIAL STATEMENTS

### *Foreign currency liquidity swaps*

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

### **h. Bank Premises, Equipment, and Software**

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

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

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

### **i. Interdistrict Settlement Account**

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

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

### **j. Federal Reserve Notes**

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

## NOTES TO FINANCIAL STATEMENTS

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 \$5,920 million and \$4,304 million at December 31, 2013 and 2012, respectively.

At December 31, 2013 and 2012, all Federal Reserve notes outstanding, reduced by the Reserve Bank’s currency holdings, were fully collateralized. At December 31, 2013, all gold certificates, all special drawing rights certificates, and \$1,182 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2013, no investments denominated in foreign currencies were pledged as collateral.

### **k. Deposits**

#### *Depository Institutions*

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as a component of “Interest payable to depository institutions” in the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2013 and 2012.

#### *Other*

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

### **l. Capital Paid-in**

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

By law, each Reserve Bank is required to pay each member bank an annual dividend of six percent on the paid-in capital stock. This cumulative dividend is paid semiannually.

## NOTES TO FINANCIAL STATEMENTS

### **m. Surplus**

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in. On a daily basis, surplus is adjusted to equate the balance to capital paid-in. Accumulated other comprehensive income is reported as a component of “Surplus” in the Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 9 and 10.

### **n. Remittances to Treasury**

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. Currently, remittances to Treasury are made on a weekly basis. This amount is reported as “Earnings remittances to Treasury” in the Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as “Accrued remittances to Treasury” in the Statements of Condition. See Note 12 for additional information on interest on Federal Reserve notes.

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

### **o. Income and Costs Related to Treasury Services**

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2013 and 2012, the Bank was reimbursed for substantially all services provided to the Treasury as its fiscal agent.

The Bank seeks reimbursement from the Treasury and other government agencies on behalf of all Reserve Banks of costs of performing fiscal agency functions. Each Reserve Bank transfers its Treasury reimbursement receivable to the Bank. The reimbursement receivable is reported in “Other assets” and totaled \$2 million and \$1 million at December 31, 2013 and 2012, respectively. The cost of unreimbursed Treasury services is reported in “Other expense” and was immaterial at December 31, 2013 and 2012.

### **p. Compensation Received for Service Costs Provided**

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

## NOTES TO FINANCIAL STATEMENTS

### q. Assessments

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

The Dodd-Frank Act requires that, after the transfer date of July 21, 2011, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governors' 2009 annual report, which totaled \$4.98 billion. The fixed percentage of total operating expenses of the System for the years ended December 31, 2013 and 2012 was 12 percent (\$597.6 million) and 11 percent (\$547.8 million), respectively. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act. The Bank's assessment for Bureau funding is reported as "Assessments: Bureau of Consumer Financial Protection" in the Statements of Income and Comprehensive Income.

The Board of Governors assessed the Reserve Banks to fund the operations of the OFR for the two-year period ended July 21, 2012, following enactment of the Dodd-Frank Act; thereafter, the OFR is funded by fees assessed on bank holding companies and nonbank financial companies that meet the criteria specified in the Dodd-Frank Act.

### r. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were \$2 million for each of the years ended December 31, 2013 and 2012 and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

### s. Restructuring Charges

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Bank commits to a formalized restructuring plan or executes the specific actions contemplated in the plan and all criteria for financial statement recognition have been met. Note 11 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations.

### t. Recently Issued Accounting Standards

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This update indefinitely deferred the requirements of ASU 2011-05, which required an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective net income line items. Subsequently, in February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out*



## NOTES TO FINANCIAL STATEMENTS

of *Accumulated Other Comprehensive Income*, which established an effective date for the requirements of ASU 2011-05 related to reporting of significant reclassification adjustments from accumulated other comprehensive income. This update improves the transparency of changes in other comprehensive income and items reclassified out of accumulated other comprehensive income in the financial statements. These presentation requirements of ASU 2011-05 and the required disclosures in ASU 2013-02 are effective for the Bank for the year ending December 31, 2013, and are reflected in the Bank's 2013 financial statements and Note 10.

### 4. LOANS

#### Loans to Depository Institutions

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

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

The Bank had no loans outstanding as of December 31, 2013. Loans to depository institutions were \$2 million as of December 31, 2012 with a remaining maturity within 15 days.

At December 31, 2013 and 2012, the Bank did not have any loans that were impaired, restructured, past due, or on non-accrual status, and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2013 and 2012.

### 5. SYSTEM OPEN MARKET ACCOUNT

#### a. Domestic Securities Holdings

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

During the years ended December 31, 2013 and 2012, the FRBNY continued the purchase of Treasury securities and federal agency and GSE MBS under the large-scale asset purchase programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would reinvest principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In June 2012, the FOMC announced

## NOTES TO FINANCIAL STATEMENTS

that it would continue the existing policy of reinvesting principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In September 2012, the FOMC announced that the Federal Reserve would purchase additional federal agency and GSE MBS at a pace of \$40 billion per month. In December 2012, the FOMC announced that the Federal Reserve would purchase longer-term Treasury securities initially at a pace of \$45 billion per month after its program to extend the average maturity of its holdings of Treasury securities was completed at the end of 2012. In December 2012, the FOMC announced that the Federal Reserve would continue the policy of rolling over maturing Treasury securities into new issues at auction.

During the year ended December 31, 2012, the FRBNY also continued the purchase and sale of SOMA portfolio holdings under the maturity extension programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would extend the average maturity of the SOMA portfolio holdings of securities by purchasing \$400 billion par value of Treasury securities with maturities of six to thirty years and selling or redeeming an equal par amount of Treasury securities with remaining maturities of three years or less by the end of June 2012. In June 2012, the FOMC announced that the Federal Reserve would continue through the end of 2012 its program to extend the average maturity of securities by purchasing \$267 billion par value of Treasury securities with maturities of six to thirty years and selling or redeeming an equal par amount of Treasury securities with maturities of three and a quarter years or less by the end of 2012.

The Bank's allocated share of activity related to domestic open market operations was 2.897 percent and 3.306 percent at December 31, 2013 and 2012, respectively.

## NOTES TO FINANCIAL STATEMENTS

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

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

	2012			
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost
Notes	\$ 36,707	\$ 1,075	\$ (23)	\$ 37,759
Bonds	18,372	3,681	(4)	22,049
<b>Total Treasury securities</b>	<b>\$ 55,079</b>	<b>\$ 4,756</b>	<b>\$ (27)</b>	<b>\$ 59,808</b>
GSE debt securities	\$ 2,538	\$ 89	\$ -	\$ 2,627
Federal agency and GSE MBS	\$ 30,633	\$ 806	\$ (23)	\$ 31,416

The FRBNY enters into transactions for the purchase of securities under agreements to resell and transactions to sell securities under agreements to repurchase as part of its monetary policy activities. In addition, transactions to sell securities under agreements to repurchase are entered into as part of a service offering to foreign official and international account holders.

There were no material transactions related to securities purchased under agreements to resell during the years ended December 31, 2013 and 2012. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2013	2012	2013	2012
Contract amount outstanding, end of year	\$ 9,154	\$ 3,543	\$ 315,924	\$ 107,188
Average daily amount outstanding, during the year	2,997	3,069	99,681	91,898
Maximum balance outstanding, during the year	9,154	4,051	315,924	122,541
Securities pledged (par value), end of year	8,995	3,092	310,452	93,547
Securities pledged (market value), end of year	9,124	3,543	314,901	107,188

## NOTES TO FINANCIAL STATEMENTS

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, 2013 and 2012 was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
December 31, 2013:							
Treasury securities (par value)	\$ -	\$ 9	\$ 5	\$ 22,117	\$ 25,054	\$ 16,813	\$ 63,998
GSE debt securities (par value)	67	219	251	1,051	2	68	1,658
Federal agency and GSE MBS (par value) <sup>1</sup>	-	-	-	-	74	43,102	43,176
Securities sold under agreements to repurchase (contract amount)	9,154	-	-	-	-	-	9,154
December 31, 2012:							
Treasury securities (par value)	\$ -	\$ -	\$ 1	\$ 12,512	\$ 28,509	\$ 14,057	\$ 55,079
GSE debt securities (par value)	52	92	502	1,746	68	78	2,538
Federal agency and GSE MBS (par value) <sup>1</sup>	-	-	-	-	78	30,555	30,633
Securities sold under agreements to repurchase (contract amount)	3,543	-	-	-	-	-	3,543

<sup>1</sup> The par amount shown for federal agency and GSE MBS is the remaining principal balance of the securities.

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, was approximately 6.5 and 3.3 years as of December 31, 2013 and 2012, respectively.

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

	Allocated to the Bank		Total SOMA	
	2013	2012	2013	2012
Treasury securities (amortized cost)	\$ 497	\$ 302	\$ 17,153	\$ 9,139
Treasury securities (par value)	448	280	15,447	8,460
GSE debt securities (amortized cost)	32	23	1,099	697
GSE debt securities (par value)	31	22	1,055	676

## NOTES TO FINANCIAL STATEMENTS

The FRBNY enters into commitments to buy and sell Treasury securities and records the related securities on a settlement-date basis. As of December 31, 2013, there were no outstanding commitments.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2013, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was \$59,350 million, of which \$479 million was related to dollar rolls. The total purchase price of outstanding purchase commitments allocated to the Bank was \$1,720 million, of which \$14 million was related to dollar rolls. As of December 31, 2013, there were no outstanding sales commitments for federal agency and GSE MBS. These commitments, which had contractual settlement dates extending through February 2014, are for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

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

	Allocated to the Bank		Total SOMA	
	2013	2012	2013	2012
Other investments	\$ -	\$ 1	\$ 2	\$ 23
Other liabilities:				
Cash margin	\$ 38	\$ 102	\$ 1,320	\$ 3,092
Obligations from MBS transaction fails	1	3	11	85
Total other liabilities	\$ 39	\$ 105	\$ 1,331	\$ 3,177

Accrued interest receivable on domestic securities holdings was \$23,405 million and \$18,924 million as of December 31, 2013 and 2012, respectively, of which \$678 million and \$626 million, respectively, was allocated to the Bank. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.



## NOTES TO FINANCIAL STATEMENTS

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the years ended December 31, 2013 and 2012, is summarized as follows (in millions):

	Allocated to the Bank					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2011	\$ 631	\$ 44,942	\$ 14,385	\$ 59,958	\$ 3,694	\$ 29,058
Purchases <sup>1</sup>	4,011	13,316	8,818	26,145	-	14,387
Sales <sup>1</sup>	-	(16,949)	(391)	(17,340)	-	-
Realized gains, net <sup>2</sup>	-	400	42	442	-	-
Principal payments and maturities	(4,620)	(2,263)	-	(6,883)	(910)	(10,804)
Amortization of premiums and accretion of discounts, net	-	(183)	(251)	(434)	(38)	(174)
Inflation adjustment on inflation-indexed securities	-	21	35	56	-	-
Annual reallocation adjustment <sup>4</sup>	(22)	(1,525)	(589)	(2,136)	(119)	(1,051)
Balance at December 31, 2012	\$ -	\$ 37,759	\$ 22,049	\$ 59,808	\$ 2,627	\$ 31,416
Purchases <sup>1</sup>	-	10,822	6,235	17,057	-	26,256
Sales <sup>1</sup>	-	-	-	-	-	-
Realized gains, net <sup>2</sup>	-	-	-	-	-	-
Principal payments and maturities	-	-	-	-	(586)	(8,303)
Amortization of premiums and accretion of discounts, net	-	(181)	(286)	(467)	(24)	(211)
Inflation adjustment on inflation-indexed securities	-	8	19	27	-	-
Annual reallocation adjustment <sup>4</sup>	-	(5,088)	(2,974)	(8,062)	(304)	(4,716)
Balance at December 31, 2013	\$ -	\$ 43,320	\$ 25,043	\$ 68,363	\$ 1,713	\$ 44,442
Year-ended December 31, 2012	Supplemental information - par value of transactions:					
Purchases <sup>3</sup>	\$ 4,011	\$ 12,815	\$ 6,852	\$ 23,678	\$ -	\$ 13,777
Sales <sup>3</sup>	-	(16,443)	(303)	(16,746)	-	-
Year-ended December 31, 2013	Supplemental information - par value of transactions:					
Purchases <sup>3</sup>	\$ -	\$ 10,744	\$ 5,572	\$ 16,316	\$ -	\$ 25,424
Sales <sup>3</sup>	-	-	-	-	-	-

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

<sup>2</sup> Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

<sup>3</sup> Includes inflation compensation.

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

## NOTES TO FINANCIAL STATEMENTS

	Total SOMA					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2011	\$ 18,423	\$ 1,311,917	\$ 419,937	\$ 1,750,277	\$ 107,828	\$ 848,258
Purchases <sup>1</sup>	118,886	397,999	263,991	780,876	-	431,487
Sales <sup>1</sup>	-	(507,420)	(11,727)	(519,147)	-	-
Realized gains, net <sup>2</sup>	-	12,003	1,252	13,255	-	-
Principal payments and maturities	(137,314)	(67,463)	-	(204,777)	(27,211)	(324,181)
Amortization of premiums and accretion of discounts, net	5	(5,460)	(7,531)	(12,986)	(1,138)	(5,243)
Inflation adjustment on inflation-indexed securities	-	643	1,047	1,690	-	-
Balance at December 31, 2012	\$ -	\$ 1,142,219	\$ 666,969	\$ 1,809,188	\$ 79,479	\$ 950,321
Purchases <sup>1</sup>	-	358,656	206,208	564,864	-	864,537
Sales <sup>1</sup>	-	-	-	-	-	-
Realized gains, net <sup>2</sup>	-	-	-	-	-	-
Principal payments and maturities	-	(21)	-	(21)	(19,562)	(273,990)
Amortization of premiums and accretion of discounts, net	-	(6,024)	(9,503)	(15,527)	(795)	(7,008)
Inflation adjustment on inflation-indexed securities	-	285	645	930	-	-
Balance at December 31, 2013	\$ -	\$ 1,495,115	\$ 864,319	\$ 2,359,434	\$ 59,122	\$ 1,533,860
Year-ended December 31, 2012	Supplemental information - par value of transactions:					
Purchases <sup>3</sup>	\$ 118,892	\$ 383,106	\$ 205,115	\$ 707,113	\$ -	\$ 413,160
Sales <sup>3</sup>	-	(492,234)	(9,094)	(501,328)	-	-
Year-ended December 31, 2013	Supplemental information - par value of transactions:					
Purchases <sup>3</sup>	\$ -	\$ 356,766	\$ 184,956	\$ 541,722	\$ -	\$ 837,490
Sales <sup>3</sup>	-	-	-	-	-	-

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

<sup>2</sup> Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

<sup>3</sup> Includes inflation compensation.

## NOTES TO FINANCIAL STATEMENTS

### b. Foreign Currency Denominated Investments

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

The FRBNY holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments of Germany, France, and Japan. These foreign government debt instruments are 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 activity related to foreign currency operations was 7.735 percent and 8.674 percent at December 31, 2013 and 2012, respectively.

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

	Allocated to Bank		Total SOMA	
	2013	2012	2013	2012
<b>Euro:</b>				
Foreign currency deposits	\$ 582	\$ 774	\$ 7,530	\$ 8,925
Securities purchased under agreements to resell	197	57	2,549	659
German government debt instruments	185	185	2,396	2,133
French government debt instruments	186	210	2,397	2,421
<b>Japanese yen:</b>				
Foreign currency deposits	227	308	2,927	3,553
Japanese government debt instruments	458	623	5,925	7,182
<b>Total</b>	<b>\$ 1,835</b>	<b>\$ 2,157</b>	<b>\$ 23,724</b>	<b>\$ 24,873</b>

Accrued interest receivable on foreign currency denominated assets was \$88 million and \$99 million as of December 31, 2013 and 2012, respectively, of which \$7 million and \$9 million, respectively, was allocated to the Bank. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.

## NOTES TO FINANCIAL STATEMENTS

The remaining maturity distribution of foreign currency denominated investments that were allocated to the Bank at December 31, 2013 and 2012, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
December 31, 2013:					
Euro	\$ 544	\$ 140	\$ 167	\$ 299	\$ 1,150
Japanese yen	241	29	145	270	685
Total	\$ 785	\$ 169	\$ 312	\$ 569	\$ 1,835
December 31, 2012:					
Euro	\$ 572	\$ 149	\$ 187	\$ 318	\$ 1,226
Japanese yen	330	43	185	373	931
Total	\$ 902	\$ 192	\$ 372	\$ 691	\$ 2,157

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2013.

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, 2013, there were no outstanding commitments to purchase foreign government debt instruments. During 2013, there were purchases, sales, and maturities of foreign government debt instruments of \$3,539 million, \$0, and \$3,431 million, respectively, of which \$279 million, \$0, and \$270 million, respectively, were allocated to the Bank.

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

At December 31, 2013 and 2012, there was no balance outstanding under the authorized warehousing facility.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2013 and 2012.

### c. Central Bank Liquidity Swaps

#### *U.S. Dollar Liquidity Swaps*

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 7.735 percent and 8.674 percent at December 31, 2013 and 2012, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2013 and 2012, was \$272 million and \$8,889 million, respectively, of which \$21 million and \$771 million, respectively, was allocated to the Bank.

## NOTES TO FINANCIAL STATEMENTS

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

	2013			2012		
	Within 15 days	16 days to 90 days	Total	Within 15 days	16 days to 90 days	Total
Euro	\$ 9	\$ 12	\$ 21	\$ 151	\$ 620	\$ 771
Total	\$ 9	\$ 12	\$ 21	\$ 151	\$ 620	\$ 771

### *Foreign Currency Liquidity Swaps*

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2013 and 2012.

### **d. Fair Value of SOMA Assets**

The fair value amounts below are presented solely for informational purposes. Although the fair value of SOMA security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities.

The fair value of the Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments in the SOMA's holdings is subject to market risk, arising from movements in market variables such as interest rates and credit risk. The fair value of federal agency and GSE MBS is also affected by the expected rate of prepayments of mortgage loans underlying the securities. The fair value of foreign government debt instruments is also affected by currency risk. Based on evaluations performed as of December 31, 2013, there are no credit impairments of SOMA securities holdings.



## NOTES TO FINANCIAL STATEMENTS

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

	Allocated to the Bank					
	2013			2012		
	Amortized cost	Fair value	Cumulative unrealized gains (losses)	Amortized cost	Fair value	Cumulative unrealized gains
Treasury securities:						
Notes	\$ 43,320	\$ 43,432	\$ 112	\$ 37,759	\$ 40,105	\$ 2,346
Bonds	25,043	24,406	(637)	22,049	25,162	3,113
Total Treasury securities	\$ 68,363	\$ 67,838	\$ (525)	\$ 59,808	\$ 65,267	\$ 5,459
GSE debt securities	1,713	1,803	90	2,627	2,810	183
Federal agency and GSE MBS	44,442	43,333	(1,109)	31,416	32,859	1,443
Total domestic SOMA portfolio securities holdings	\$ 114,518	\$ 112,974	\$ (1,544)	\$ 93,851	\$ 100,936	\$ 7,085
Memorandum - Commitments for:						
Purchases of Treasury securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Purchases of Federal agency and GSE MBS	1,720	1,713	(7)	3,908	3,914	6
Sales of Federal agency and GSE MBS	-	-	-	-	-	-
	Total SOMA					
	2013			2012		
	Amortized cost	Fair value	Cumulative unrealized gains (losses)	Amortized cost	Fair value	Cumulative unrealized gains
Treasury securities:						
Notes	\$ 1,495,115	\$1,499,000	\$ 3,885	\$ 1,142,219	\$ 1,213,177	\$ 70,958
Bonds	864,319	842,336	(21,983)	666,969	761,138	94,169
Total Treasury securities	\$ 2,359,434	\$2,341,336	\$ (18,098)	\$ 1,809,188	\$ 1,974,315	\$ 165,127
GSE debt securities	59,122	62,236	3,114	79,479	85,004	5,525
Federal agency and GSE MBS	1,533,860	1,495,572	(38,288)	950,321	993,990	43,669
Total domestic SOMA portfolio securities holdings	\$ 3,952,416	\$3,899,144	\$ (53,272)	\$ 2,838,988	\$ 3,053,309	\$ 214,321
Memorandum - Commitments for:						
Purchases of Treasury securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Purchases of Federal agency and GSE MBS	59,350	59,129	(221)	118,215	118,397	182
Sales of Federal agency and GSE MBS	-	-	-	-	-	-

## NOTES TO FINANCIAL STATEMENTS

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

At December 31, 2013 and 2012, the fair value of foreign currency denominated investments was \$23,802 million and \$25,042 million, respectively, of which \$1,841 million and \$2,172 million, respectively, was allocated to the Bank. The fair value of government debt instruments was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of foreign currency deposits and securities purchased under agreements to resell was determined by reference to market interest rates.

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

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

Distribution of MBS holdings by coupon rate	2013		2012	
	Amortized cost	Fair value	Amortized cost	Fair value
<b>Allocated to the Bank:</b>				
2.0%	\$ 411	\$ 392	\$ 28	\$ 28
2.5%	3,588	3,432	1,242	1,248
3.0%	15,119	14,032	5,310	5,347
3.5%	10,132	9,804	5,937	6,108
4.0%	6,672	6,696	4,554	4,825
4.5%	5,384	5,664	8,677	9,328
5.0%	2,413	2,549	4,136	4,371
5.5%	623	658	1,321	1,382
6.0%	88	93	186	195
6.5%	12	13	25	27
<b>Total</b>	<b>\$ 44,442</b>	<b>\$ 43,333</b>	<b>\$ 31,416</b>	<b>\$ 32,859</b>
<b>Total SOMA:</b>				
2.0%	\$ 14,191	\$ 13,529	\$ 845	\$ 846
2.5%	123,832	118,458	37,562	37,766
3.0%	521,809	484,275	160,613	161,757
3.5%	349,689	338,357	179,587	184,752
4.0%	230,256	231,113	137,758	145,955
4.5%	185,825	195,481	262,484	282,181
5.0%	83,290	87,968	125,107	132,214
5.5%	21,496	22,718	39,970	41,819
6.0%	3,052	3,225	5,642	5,888
6.5%	420	448	753	812
<b>Total</b>	<b>\$ 1,533,860</b>	<b>\$ 1,495,572</b>	<b>\$ 950,321</b>	<b>\$ 993,990</b>

## NOTES TO FINANCIAL STATEMENTS

Because SOMA securities are recorded at amortized cost, the change in the cumulative unrealized gains (losses) is not reported in the Statements of Income and Comprehensive Income. The following tables present the realized gains (losses) and the change in the cumulative unrealized gains (losses), presented as “Fair Value changes unrealized gains (losses),” of the domestic securities holdings during the years ended December 31, 2013 and 2012 (in millions):

	Allocated to Bank			
	2013		2012	
	Total portfolio holdings realized gains <sup>1</sup>	Fair value changes unrealized losses	Total portfolio holdings realized gains <sup>1</sup>	Fair value changes unrealized losses
Treasury securities	\$ -	\$ (5,286)	\$ 442	\$ (53)
GSE debt securities	-	(71)	-	(30)
Federal agency and GSE MBS	1	(2,396)	8	(116)
<b>Total</b>	<b>\$ 1</b>	<b>\$ (7,753)</b>	<b>\$ 450</b>	<b>\$ (199)</b>

	Total SOMA			
	2013		2012	
	Total portfolio holdings realized gains <sup>1</sup>	Fair value changes unrealized losses	Total portfolio holdings realized gains <sup>1</sup>	Fair value changes unrealized losses
Treasury securities	\$ -	\$ (183,225)	\$ 13,255	\$ (1,142)
GSE debt securities	-	(2,411)	-	(885)
Federal agency and GSE MBS	51	(81,957)	241	(3,568)
<b>Total</b>	<b>\$ 51</b>	<b>\$ (267,593)</b>	<b>\$ 13,496</b>	<b>\$ (5,595)</b>

<sup>1</sup> Total portfolio holdings realized gains (losses) are reported in “Non-interest income (loss): System Open Market Account” in the Statements of Income and Comprehensive Income.

The amount of change in unrealized gains position, net, related to foreign currency denominated assets was a decrease of \$90 million and an increase of \$3 million for the years ended December 31, 2013 and 2012, respectively, of which \$7 million and \$206 thousand, respectively, were allocated to the Bank.

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

## NOTES TO FINANCIAL STATEMENTS

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

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

### 6. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2013	2012
Bank premises and equipment:		
Land and land improvements	\$ 8	\$ 8
Buildings	113	107
Building machinery and equipment	25	23
Construction in progress	1	2
Furniture and equipment	53	55
Subtotal	200	195
Accumulated depreciation	(113)	(108)
Bank premises and equipment, net	\$ 87	\$ 87
Depreciation expense, for the years ended December 31	\$ 10	\$ 9

## NOTES TO FINANCIAL STATEMENTS

The Bank leases space to outside tenants with remaining lease terms ranging from 4 to 11 years. Rental income from such leases was \$2 million for each of the years ended December 31, 2013 and 2012 and is reported as a component of “Non-interest income: Other” in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2013, are as follows (in millions):

2014	\$ 2
2015	2
2016	2
2017	2
2018	2
Thereafter	7
	<hr/>
Total	\$ 17
	<hr/> <hr/>

The Bank had capitalized software assets, net of amortization, of \$6 million and \$7 million at December 31, 2013 and 2012, respectively. Amortization expense was \$2 million for each of the years ended December 31, 2013 and 2012. Capitalized software assets are reported as a component of “Other assets” in the Statements of Condition and the related amortization is reported as a component of “Operating expenses: Other” in the Statements of Income and Comprehensive Income.

### 7. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2013, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 2 to approximately 6 years. These leases provide for increased lease payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$1 million for each of the years ended December 31, 2013 and 2012. Certain of the Bank’s leases have options to renew. The Bank has no capital leases.

Future minimum lease payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2013, are as follows (in thousands):

	Operating leases
	<hr/>
2014	\$ 554
2015	484
2016	469
2017	480
2018	492
Thereafter	41
	<hr/>
Future minimum lease payments	\$ 2,520
	<hr/> <hr/>



## NOTES TO FINANCIAL STATEMENTS

At December 31, 2013, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Reserve Banks, each of the Reserve Banks has agreed to bear, on a per-incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2013 and 2012.

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

### 8. RETIREMENT AND THRIFT PLANS

#### Retirement Plans

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

The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2013 and 2012, certain costs associated with the System Plan were reimbursed by the Bureau.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2013 and 2012, and for the years then ended, were not material.

#### Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches 100 percent of the first six percent of employee contributions from the date of hire and provides an automatic employer contribution of one percent of eligible pay. The Bank's Thrift Plan contributions totaled \$5 million for each of the years ended December 31, 2013 and 2012 and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

## NOTES TO FINANCIAL STATEMENTS

**9. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS****Postretirement Benefits Other Than Retirement Plans**

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

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Following is a reconciliation of the beginning and ending balances of the benefit obligation (in millions):

	2013	2012
Accumulated postretirement benefit obligation at January 1	\$ 103.6	\$ 89.5
Service cost benefits earned during the period	3.3	2.8
Interest cost on accumulated benefit obligation	3.9	4.1
Net actuarial (gain) loss	(16.3)	10.9
Contributions by plan participants	1.9	1.9
Benefits paid	(5.9)	(6.0)
Medicare Part D subsidies	0.4	0.4
Plan amendments	0.4	-
Accumulated postretirement benefit obligation at December 31	<u>\$ 91.3</u>	<u>\$ 103.6</u>

At December 31, 2013 and 2012, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 4.79 percent and 3.75 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. Beginning in 2013, the System Plan discount rate assumption setting convention changed from rounding the rate to the nearest 25 basis points to using an unrounded rate.

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):

	2013	2012
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	3.6	3.7
Contributions by plan participants	1.9	1.9
Benefits paid	(5.9)	(6.0)
Medicare Part D subsidies	0.4	0.4
Fair value of plan assets at December 31	<u>\$ -</u>	<u>\$ -</u>
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 91.3</u>	<u>\$ 103.6</u>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ (1.2)	\$ (1.2)
Net actuarial loss	(13.2)	(32.3)
Total accumulated other comprehensive loss	<u>\$ (14.4)</u>	<u>\$ (33.5)</u>

## NOTES TO FINANCIAL STATEMENTS

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:

	2013	2012
Health-care cost trend rate assumed for next year	7.00 %	7.00 %
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00 %	5.00 %
Year that the rate reaches the ultimate trend rate	2019	2018

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A one percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2013 (in millions):

	One percentage point increase	One percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 0.1	\$ (0.4)
Effect on accumulated postretirement benefit obligation	0.7	(4.9)

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

	2013	2012
Service cost-benefits earned during the period	\$ 3.3	\$ 2.7
Interest cost on accumulated benefit obligation	3.9	4.1
Amortization of prior service cost	0.4	0.6
Amortization of net actuarial loss	2.9	2.2
Net periodic postretirement benefit expense	\$ 10.5	\$ 9.6

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2014 are shown below:

Prior service cost	\$ 0.6
Net actuarial loss	0.6
Total	\$ 1.2

## NOTES TO FINANCIAL STATEMENTS

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2013 and 2012, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 3.75 percent and 4.50 percent, respectively.

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

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

Federal Medicare Part D subsidy receipts were \$331 thousand and \$350 thousand in the years ended December 31, 2013 and 2012, respectively. Expected receipts in 2014, related to benefits paid in the years ended December 31, 2013 and 2012, are \$292 thousand.

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

	Without subsidy	With subsidy
2014	\$ 4.7	\$ 4.3
2015	5.1	4.6
2016	5.4	5.0
2017	5.8	5.3
2018	6.1	5.5
2019 - 2023	34.5	31.2
Total	\$ 61.6	\$ 55.9

### Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical, dental, and vision insurance; survivor income; disability benefits; and self-insured workers’ compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2013 and 2012, were \$7.2 million and \$6.4 million, respectively. This cost is included as a component of “Accrued benefit costs” in the Statements of Condition. Net periodic postemployment benefit expense (credit) included in 2013 and 2012 operating expenses were \$1.6 million and \$(98) thousand, respectively, and are recorded as a component of “Operating expenses: Salaries and benefits” in the Statements of Income and Comprehensive Income.

## NOTES TO FINANCIAL STATEMENTS

**10. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME**

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

	2013	2012
	Amount related to postretirement benefits other than retirement plans	Amount related to postretirement benefits other than retirement plans
Balance at January 1	\$ (33.5)	\$ (25.4)
Change in funded status of benefit plans:		
Prior service costs arising during the year	(0.4)	-
Amortization of prior service cost	0.4 <sup>1</sup>	0.6 <sup>1</sup>
Change in prior service costs related to benefit plans	-	0.6
Net actuarial gain (loss) arising during the year	16.2	(10.9)
Amortization of net actuarial loss	2.9 <sup>1</sup>	2.2 <sup>1</sup>
Change in actuarial gain (losses) related to benefit plans	19.1	(8.7)
Change in funded status of benefit plans - other comprehensive income (loss)	19.1	(8.1)
Balance at December 31	\$ (14.4)	\$ (33.5)

<sup>1</sup>Reclassification is reported as a component of "Operating Expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

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

**11. BUSINESS RESTRUCTURING CHARGES**

The Bank had no material business restructuring charges in 2013. The Bank had no business restructuring charges in 2012.

In years prior to 2012, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated paper and electronic check processing at the Federal Reserve Bank of Atlanta. The Bank's liability balance for the check restructuring as of December 31, 2013 and 2012, and the related activity during the years then ended, were not material.



## NOTES TO FINANCIAL STATEMENTS

### 12. DISTRIBUTION OF COMPREHENSIVE INCOME

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

	2013	2012
Dividends on capital stock	\$ 127	\$ 132
Transfer from surplus - amount required to equate surplus with capital paid-in	(48)	(217)
Earnings remittances to Treasury	2,189	2,812
<b>Total distribution</b>	<b>\$ 2,268</b>	<b>\$ 2,727</b>

During each of the years ended December 31, 2013 and 2012, the Bank recorded a reduction in the amount of capital paid-in and a corresponding reduction of surplus, which is presented in the above table as "Transfer from surplus – amount required to equate surplus with capital paid-in. The reduction of surplus resulted in an equivalent increase in "Earnings remittances to Treasury" and a reduction in "Comprehensive loss" for each of the years ended December 31, 2013 and 2012.

### 13. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2013. Subsequent events were evaluated through March 14, 2014, which is the date that the financial statements were available to be issued.







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