Letter from the President

LETTER FROM THE PRESIDENT

I have had the privilege of leading the Federal Reserve Bank of New York since November 17, 2003. This is my first annual report, but it largely reflects the accomplishments of my immediate predecessors, William McDonough and Jamie Stewart. I am fortunate in that these two men left in place a strong institution, with a talented and committed team of managers and a remarkable record of contributions to the U.S. financial system.

Although the environment in which we operate continues to change, the core responsibilities of the Federal Reserve Bank of New York stand unaltered:

- to contribute to the development of monetary policy and to execute that policy on behalf of the Federal Open Market Committee;
- to support financial stability in the United States through our responsibilities for financial supervision, market oversight, and the lender-of-last-resort functions of the central bank of the United States;
- to foster a robust and efficient payments system through the operation of the wholesale payments system and the provision of services to financial institutions, the Treasury, and foreign central banks; and
- to play an active role internationally in promoting a better functioning global financial system.

Our challenge is to continue a tradition of leadership on these issues, not only through excellence in execution of the core functions of a central bank, but also through the quality of ideas we contribute to the policy discussion in this country and abroad. This places a very high premium on the quality of our research and analysis, our understanding of markets, and our dealings with our counterparties.

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As a central bank, our principal focus must be to get monetary policy decisions right and to help ensure that monetary policy is appropriately calibrated to achieve sustained growth and price stability. The U.S. economy has experienced a steady rise in productivity growth, which offers the prospect of an extended period of higher income growth. Against this improvement in U.S. fundamentals, the deterioration in the U.S. fiscal position and the steep decline in the net national saving rate present risks to the financial system and the overall economy. Together, these imbalances increase the burden on the credibility of monetary policy in maintaining growth and price stability.

These changes in the economic landscape have been accompanied by a major transformation of the U.S. and global financial systems.

It is a mark of respect for the achievements of the Federal Reserve that we are viewed institutionally as a guardian of overall financial stability and not just of the banks and bank holding companies that we supervise directly.

Capital markets have increased their role in the financial intermediation process relative to banks. We are also witnessing the development of truly globalized markets, with an increasing amount of cross-border financial intermediation and growth in the size and breadth of financial institutions with worldwide operations. Along with this expansion of financial activity, the range of opportunities for financial institutions to separate and distribute, as well as to manage and hedge, different types of risk continues to grow as innovation in financial technology and risk management processes evolve.

These developments in financial intermediation have improved the overall resilience and performance of the financial system, but they do not eliminate the potential for systemic events that could affect its stability. It is a mark of respect for the achievements of the Federal Reserve that we are viewed institutionally as a guardian of overall financial stability and not just of the banks and bank holding companies that we supervise directly. With this responsibility comes the obligation to be at the frontier of understanding the risks and vulnerabilities in the financial system as a whole.

The Federal Reserve Bank of New York traditionally has played a very active role in the international arena. As the world economy and financial markets become even more integrated, we have an increasingly greater stake in promoting a stronger international financial system. The wealth of experience we have in central banking operations and in markets puts us in a position to help ensure that global economic and financial integration is accompanied by improvements in the quality of institutions that are central to the functioning of financial markets and systems.

This is especially important at the national level for the emerging market countries that currently are working hard to put in place better functioning financial systems, capital markets, supervisory structures, and mechanisms for respecting property rights. The degree of success of these institution-building efforts will have much to do with the ability of governments around the world to achieve greater financial stability and improve growth performance.

Another policy focus for us concerns payments and settlement systems, part of the critical infrastructure that banks and the financial markets rely upon. In recent years, the Bank has been an active participant in the public-private effort to bring about further improvements in backup facilities and overall resilience. Both in our oversight role and as a system participant, we will continue to play a leadership role in strengthening payments and settlement systems.

Technology has already begun to open new possibilities in the design and operation of payments and settlement infrastructure. In the securities world, advances in computers and telecommunications now make it feasible to streamline the processing of transaction information, which can raise efficiency but alter the risk profile in the transfer of securities and the corresponding payment of money. Going forward, we must continue to broaden our dialogue with private sector participants to ensure that significant changes to wholesale and retail payments and to securities clearing and settlement systems achieve both gains in efficiency and reductions in systemic risk.

Finally, we will continue active outreach programs in the communities throughout our District. These include programs for financial education and housing development, as well as support for the stronger public policies that are critical to the health of this economy and to New York's position at the center of the international financial system.

Management's Letter on Responsibility for Financial Reporting

To the Board of Directors of the
Federal Reserve Bank of New York:

March 3, 2004

The management of the Federal Reserve Bank of New York ("FRBNY") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2003 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the "Financial Accounting Manual for the Federal Reserve Banks" ("Manual"), and as such, include amounts, some of which are based on judgments and estimates of management. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies, and practices documented in the Manual and include all disclosures necessary for such fair presentation.

The management of the FRBNY is responsible for maintaining an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, 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.

The management of the FRBNY assessed its process of internal controls over financial reporting, including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, we believe that the FRBNY maintained an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements.

Timothy F. Geithner	Christine M. Cumming	Suzanne Cutler
President	First Vice President	Principal Financial Officer

Report of Independent Accountants
PricewaterhouseCoopers LLP

To the Board of Directors of the
Federal Reserve Bank of New York:

We have examined management's assertion, included in the accompanying letter, that the Federal Reserve Bank of New York ("FRBNY") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the financial statements as of December 31, 2003, based on criteria established in the "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRBNY's management is responsible for maintaining effective internal control over financial reporting and safeguarding of assets as they relate to the financial statements. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances.We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that FRBNY maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the financial statements as of December 31, 2003, is fairly stated, in all material respects, based on criteria established in the "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

This report is intended solely for the use of management and the Board of Directors and Audit Committee of FRBNY, and any organization with legally defined oversight responsibilities, and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

March 3, 2004
New York, New York