

FEDERAL RESERVE BANK *of* NEW YORK



2009 ANNUAL REPORT

Cover photography: MaryRose Devine

Federal Reserve Bank of New York

Annual Report

*For the year ended
December 31, 2009*



SECOND FEDERAL RESERVE DISTRICT

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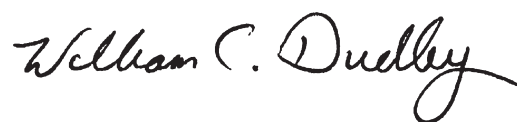
June 2010

To the Depository Institutions in
the Second Federal Reserve District:

It is my pleasure to send you the ninety-fifth annual report of the Federal Reserve Bank of New York, covering the year 2009.

Following the “Letter from the President,” the *2009 Annual Report* presents detailed tables, with extensive notes, on the Bank’s financial condition.

I hope you will find the information we present interesting and useful.

A handwritten signature in black ink, reading "William C. Dudley". The signature is written in a cursive, flowing style with a large, prominent 'W' and 'D'.

William C. Dudley
President

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Letter from the President

LETTER FROM THE PRESIDENT

The year 2009 was a difficult one for the Federal Reserve Bank of New York, the Federal Reserve System of which the Bank is a part, and the nation.¹ In the United States and around the world, extraordinary measures were taken to stabilize the financial system and prevent a deep global recession from becoming a full-blown depression.

The Federal Reserve acted to support financial institutions and markets, with the ultimate goal of safeguarding the flow of credit to American families and businesses. At the same time, the Federal Reserve also responded to the recession with aggressive monetary policy.² The New York Fed played an integral role in helping to design these initiatives and implemented them in challenging market conditions.

Over the course of 2009, the economy and financial markets did stabilize and the worst economic outcomes were avoided. But even after the economy began to recover, the initial rebound was weak. Unemployment continued

to rise through late 2009 both in the Second Federal Reserve District³ and elsewhere. In addition, ongoing declines in housing prices left many people with negative equity in their homes, and foreclosure rates increased in many areas. While the economic outlook had improved substantially by year-end, some risks remained.

The impact of the financial crisis is a sharp reminder that financial stability is an essential precondition for prosperity. The New York Fed embraces its responsibility as part of the Federal Reserve to translate the lessons of the crisis into concrete actions that will help to create a more resilient financial system for the future.

Last year was my first as president of the New York Fed. In this role, I have been privileged to lead a remarkably dedicated and professional group of public servants and have benefited greatly from the work accomplished under the leadership of my predecessor, Timothy F. Geithner.

[In 2009,] the Federal Reserve acted to support financial institutions and markets, with the ultimate goal of safeguarding the flow of credit to American families and businesses.

¹ The Federal Reserve Bank of New York, identified informally in this letter as “the New York Fed” or “the Bank,” is one of twelve regional Federal Reserve Banks, each of which represents a different part of the nation. The Federal Reserve System is made up in part of these twelve regional Banks and the Board of Governors of the Federal Reserve System, an independent agency of the U.S. government. The Federal Reserve System, typically abbreviated to “Federal Reserve,” is the nation’s central bank.

² Federal Reserve Chairman Ben S. Bernanke described this monetary policy response in his April 2010 speech “Economic Challenges: Past, Present, and Future,” available at <http://www.federalreserve.gov/newsevents/speech/20100407a.htm>.

³ The New York Fed serves the Second District, which comprises New York State, the twelve northern counties of New Jersey, Fairfield County in Connecticut, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands.

Staff from the New York Fed were key participants in the Federal Reserve-led Supervisory Capital Assessment Program—sometimes referred to as the “bank stress tests”—which aimed to restore confidence in the U.S. financial system.

REVIEW OF 2009

At the start of 2009, the U.S. economy was contracting sharply. Questions about the duration and depth of the recession created extreme uncertainty about asset values and the balance sheet strength of financial firms. The economy and the financial system were caught in a downward spiral of increased risk aversion, declining asset values, constrained credit, and contracting employment and output that threatened to result in a very protracted period of economic and financial distress.

Acting at the direction of the Board of Governors of the Federal Reserve System (the Board)⁴ and the Federal Open Market Committee (FOMC),⁵ the New York Fed implemented policies that aimed to break this downward spiral. These initiatives included measures to improve the supply of credit from the financial sector by strengthening financial institutions and markets, as well as monetary stimulus to support economic activity and employment.

The New York Fed acted to implement these measures in a timely and effective manner, carefully managing risks by building out its compliance and risk management capabilities. The policy actions fell into four categories:

■ Strengthening financial institutions

Staff from the New York Fed were key participants in the Federal Reserve-led Super-

visory Capital Assessment Program (SCAP)—sometimes referred to as the “bank stress tests”—which aimed to restore confidence in the U.S. financial system.⁶ Regulators examined the nineteen largest bank holding companies to determine the losses they would incur in a more adverse economic scenario than was generally expected at the time. These firms were then required to establish a large enough capital buffer to ensure that they would remain well capitalized in such a scenario. The SCAP, along with intensive ongoing supervision, helped to improve the condition of the largest banks so that they were better able to provide credit to the economy.

■ Implementing asset purchases to reduce the cost of credit

The New York Fed implemented the FOMC’s decision to buy \$1.7 trillion of agency mortgage-backed securities, agency debt, and Treasury securities—actions that were ultimately completed in March 2010. These purchases provided additional stimulus to the economy at a time when short-term interest rates were already close to zero. While the precise impact of this program continues to be debated, our judgment is that these asset purchases supported activity in the housing market by reducing the cost and increasing the availability of mortgage credit, and lowered long-term interest rates more generally.

⁴In addition to its many other duties, the Board is responsible for authorizing actions, under section 13(3) of the Federal Reserve Act, that permit lending by the Reserve Banks to non-deposit-taking institutions in “unusual and exigent circumstances.”

⁵The Federal Open Market Committee, which is made up of the Governors, the president of the New York Fed, and four of the remaining Reserve Bank presidents (who vote on a rotating basis), determines monetary policy and directs the New York Fed to implement this policy on its behalf.

⁶Participants from the regulatory community included staff from the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation as well as Federal Reserve staff.

■ Providing liquidity to support the flow of credit

The New York Fed worked with the Board and the U.S. Treasury to implement the Term Asset-Backed Securities Loan Facility (TALF). This program helped revive the securitization markets for consumer and business loans by ensuring that financing was available for investors willing to participate in these markets. The Bank also executed a wide range of other programs that provided large amounts of short-term credit to financial institutions and markets domestically and, through currency swaps, internationally. The Bank continuously strengthened the control, compliance, and risk management systems supporting these programs over the course of 2009.

■ Stabilizing systemically important institutions at risk

During the year, the New York Fed, along with the U.S. Treasury, restructured the government assistance for AIG (American International Group) in a way that further stabilized AIG, allowed it to begin the process of selling assets and repaying its government aid, and reduced the overall risk to the Federal Reserve. The New York Fed also implemented additional measures to manage the risks relating to the loans secured against the “Maiden Lane” portfolios. The Maiden Lane loans resulted from the AIG and Bear Stearns interventions in 2008, which were undertaken to prevent disorderly financial failures that would have harmed many households and businesses.

In addition, the New York Fed worked to mitigate the foreclosure crisis in the Second District and beyond. The Bank’s efforts included the development of a credit conditions website that is now widely used by local governments and community groups to evaluate local conditions and to determine where best to direct scarce resources.⁷

FINANCIAL AND ECONOMIC OUTCOMES

The SCAP process was an important turning point in instilling confidence in the U.S. financial system. The nineteen banks subject to the SCAP process were able to raise \$107 billion in common equity from private sources in 2009.

Aided by ongoing liquidity provision, the financial system began to heal around the second quarter of 2009 and this process accelerated as the year progressed. The high interest rate spreads at which banks borrowed from each other—a hallmark of the financial crisis—fell back toward more normal levels. Asset-backed securities were issued in greater volumes, and private demand for commercial paper increased. There was a broad-based rally in overall financial market assets by year-end.

Supported by exceptional monetary and fiscal stimulus, the economy stopped contracting around the middle of 2009 and began to expand at a moderate pace in the second half of the year. However, improvements in wholesale credit markets did not translate into a rapid easing in credit availability, and unemployment continued to climb as firms aggressively shed workers.

The Bank . . . executed a wide range of . . . programs that provided large amounts of short-term credit to financial institutions and markets domestically and, through currency swaps, internationally. The Bank continuously strengthened the control, compliance, and risk management systems supporting these programs over the course of 2009.

⁷ Visit <http://data.newyorkfed.org/creditconditions/>.

As 2009 progressed, the FOMC tasked the New York Fed with preparing tools that would ensure that the Federal Reserve could raise interest rates and tighten financial conditions when the economic outlook merited such action.

Demand for the Bank's short-term liquidity programs, which were priced to be expensive under more typical market conditions, declined as market conditions normalized; many of the programs were subsequently closed in early 2010.⁸

DEVELOPING TOOLS TO SUPPORT MONETARY POLICY

As 2009 progressed, the FOMC tasked the New York Fed with preparing tools that would ensure that the Federal Reserve could raise interest rates and tighten financial conditions when the economic outlook merited such action, in spite of the elevated size of its balance sheet and bank reserve balances.

The New York Fed developed plans for large-scale reverse repurchase agreements with its primary dealer counterparties as well as with new counterparties, including money market mutual funds. Along with staff from the Board and other Federal Reserve Banks, the New York Fed contributed to the development of plans for a term deposit facility for banks. These tools can be used to withdraw reserves and reinforce the basic tool of paying interest on reserves.⁹

By preparing these tools, the New York Fed reinforced market confidence that the Federal

Reserve could effectively tighten monetary policy when the time came to do so, and this helped to contain inflation expectations.

TRANSPARENCY AND ACCOUNTABILITY

The nontraditional actions taken by the Federal Reserve during the crisis gave rise to understandable demands for greater transparency and disclosure. The Federal Reserve took important steps to provide better information about its facilities, including the release of monthly reports to Congress and the creation of new websites.¹⁰ The New York Fed continues to look for additional ways to increase transparency, while at the same time ensuring that the disclosure regime does not undermine the ability of the Federal Reserve to fulfill its mandate, including acting as an effective lender of last resort in times of stress.

The independently audited financial statements in this report are an important and long-standing means of achieving transparency. These statements show that the New York Fed's overall balance sheet declined slightly over the year and the asset mix changed substantially as a fall in short-term loans was largely offset by an increase in long-term securities.¹¹

⁸ Currency swaps were revived in May 2010 in response to the re-emergence of strains in short-term funding markets in Europe. The Federal Reserve took this step in cooperation with other central banks to improve liquidity conditions in global money markets and to minimize the risks that strains abroad could spread to U.S. markets.

⁹ Interest on reserves should establish a rough floor for private overnight borrowing rates by providing a risk-free overnight rate below which private rates should not fall far, if at all, and thereby allow the Bank to better manage the policy rate set by the FOMC.

¹⁰ Visit <http://www.federalreserve.gov/monetarypolicy/bst.htm> and <http://www.newyorkfed.org/markets/maidenlane.html>.

¹¹ The Bank's securities holdings are reported on a weekly basis throughout the year at http://www.newyorkfed.org/markets/soma/sysopen_accholdings.html. The Federal Reserve System's balance sheet is published weekly in the Federal Reserve's H.4.1 release, at <http://www.federalreserve.gov/releases/h41/>.

As explained above, the programs executed by the New York Fed were intended to restore market functioning and to advance the dual-mandate goals of full employment and price stability given to the Federal Reserve by Congress. The interest income and fees that accrued to the New York Fed from these programs exceeded its operating costs and generated profit that was remitted to the U.S. Treasury. This profit is a by-product of these operations and should not be viewed as the primary measure of the Bank's success.

In 2009, interest receipts from loans exceeded \$5 billion, with no credit losses. The Commercial Paper Funding Facility earned more than \$4 billion in net income, also with no credit losses, while the three Maiden Lane facilities all generated significant income.

The long-term securities held by the New York Fed for the Federal Reserve System also produced substantial net income, although in future years the amount of net income from these assets may vary, depending on a number of factors, including the prevailing level of interest rates and policy decisions by the FOMC with respect to the asset holdings. Overall, the Bank remitted almost \$24 billion to the Treasury. The Maiden Lane collateral portfolios (only 5 percent of the New York Fed's assets) meanwhile continued to improve.

THE ROAD AHEAD

As I write this letter, the U.S. economy, financial markets, and financial institutions are all in considerably better shape than they were in early 2009. However, the recovery is expected to be slower than those that followed earlier deep downturns, with unemployment likely to

diminish only gradually. The New York Fed will continue to support the FOMC's efforts to reduce unemployment and maintain price stability.

Meanwhile, the latest bout of market stress in Europe demonstrates that financial stability can never be taken for granted. As the past three years showed, financial stability is indispensable for economic growth and the maintenance of an environment in which people can confidently plan for the future—whether they wish to go to school, expand their business, or retire with comfort and security. In the period ahead, it is important that policymakers put financial stability policy on a par with monetary policy, because the two are ultimately interconnected: monetary policy cannot achieve the objectives of maximum sustainable employment and price stability without financial stability.

The New York Fed has always had important responsibilities in the financial stability area through its implementation of monetary policy, supervision of banks, and operation and oversight of payment and settlement systems. It is deeply committed to this mission.

APPLYING THE LESSONS OF THE CRISIS

With the benefit of hindsight, it is clear that in the years preceding the crisis, regulators and private sector leaders alike were slow to recognize the vulnerabilities and market excesses spawned by rapid financial innovation and a long period of economic stability.

In the future, regulators collectively need to do a better job of understanding the rapid evolution of the financial system and of challenging benign explanations for the status

It is important that policymakers put financial stability policy on a par with monetary policy, because the two are ultimately interconnected: monetary policy cannot achieve the objectives of maximum sustainable employment and price stability without financial stability.

The New York Fed is contributing to broader efforts to make financial institutions internalize more of the costs of their risk taking in advance and to make the financial system one that dampens rather than propagates shocks.

quo. Because the financial system is constantly evolving, supervisory and regulatory policy must constantly adapt to be effective.

Policymakers are unlikely to be able to put an end to financial crises. However, there are steps that can be taken to reduce both the likelihood and the severity of financial shocks.

The New York Fed is only one actor in this process, and its role even within the Federal Reserve's own policy arena is strictly a supporting one. However, we take seriously our obligation to help advance this work. The challenge is to reduce systemic risk in the financial sector while supporting financial vibrancy along with deep and liquid financial markets.

WHAT WE ARE DOING TO MINIMIZE FUTURE CRISES

The New York Fed is contributing to broader efforts to make financial institutions internalize more of the costs of their risk taking in advance and to make the financial system one that dampens rather than propagates shocks. These efforts include initiatives to:

- strengthen derivatives market infrastructure through exchange trading and central clearing of standardized products and the use of trade repositories;
- reform the triparty repo market, a key source of short-term finance;
- develop new capital and liquidity rules that will better capture the risks run by financial institutions and require these institutions to hold more capital and highly liquid assets against their exposures; and

- enhance bank supervision by applying a macroeconomic perspective to the assessment of risk at the firm level and by developing horizontal (sector-wide) reviews.

The New York Fed is researching how new strategies might be used to preempt asset price bubbles more aggressively. It is also studying how "contingent capital" instruments might be used to strengthen the financial position of a weakened firm in a timely fashion.

In all this, we hope to help promote financial stability and impose effective discipline on firms that might otherwise be deemed "too big to fail" to the detriment of smaller competitors and the public.

WORKING TOGETHER IN THE PUBLIC INTEREST

The future, though brighter than it looked a year ago, remains uncertain. In addition to contending with near-term challenges, the global economy will eventually need to adjust in a way that brings national consumption, saving, and investment into better balance. The United States will have to develop a credible plan to put its long-term public finances on a sustainable path, in a way that does not threaten the nascent recovery.

At the time that I write, Congress is considering legislation that would reshape the regulatory and supervisory regime in the United States. Whichever agency or group of agencies is ultimately charged with responsibility for financial stability, it is critical that the different dimensions of financial stability policy be appropriately coordinated.

Regulatory reform may result in changes to our governance as well as to our mandate. Regardless of the form these changes take, the Federal Reserve Bank of New York will strive to achieve the mandate given to us by Congress and the Federal Reserve Board, and honor the trust placed in us by the American people.

I have every confidence that the staff of the New York Fed will do their utmost to live up to these responsibilities in the future, as they have in the past. In that regard, it is important to recognize that the New York Fed's performance in 2009 cannot be attributed to a few individuals or even a few groups. It took the entire institution to manage all of the challenges faced during the year—and to do so while continuing to execute all of the Bank's regular responsibilities.

Research economists worked alongside markets and bank supervision experts to develop and implement new programs. Risk managers evaluated and priced risks. Auditors and accountants created new compliance and reporting regimes. Legal and communications staff faced intense demands. Financial services staff and technology and support services kept our operations running smoothly. Human resources professionals oversaw the hiring and integration of new staff urgently recruited to meet the challenges of the crisis.

Staff at every level showed deep commitment to public service, working long and intense hours. They brought all of the New York Fed's resources to bear in responding to the crisis.

I am very proud of their efforts.

William C. Dudley
June 10, 2010

Management's Report on Internal Control over Financial Reporting

Management's Report on Internal Control over Financial Reporting

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

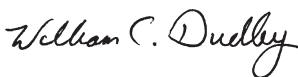
April 21, 2010

The management of the Federal Reserve Bank of New York ("FRBNY") is responsible for the preparation and fair presentation of the Consolidated Statements of Condition, Consolidated Statements of Income and Comprehensive Income, and Consolidated Statements of Changes in Capital as of December 31, 2009 (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* ("Manual"), 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 *Manual* and include all disclosures necessary for such fair presentation.

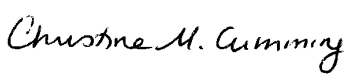
The management of the FRBNY is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation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

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

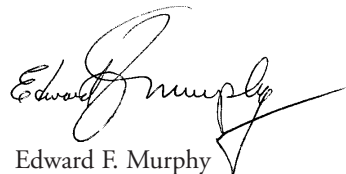
The management of the FRBNY assessed its internal control over financial reporting reflected in the Financial Statements, based upon the criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment,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



William C. Dudley
President



Christine M. Cumming
First Vice President



Edward F. Murphy
Principal Financial Officer

External Auditor Independence

EXTERNAL AUDITOR INDEPENDENCE

In 2009, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks and the consolidated financial statements of the limited liability companies (LLCs) that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the Federal Reserve Bank of New York. Fees for D&T's services are estimated to be \$9.6 million, of which approximately \$2.0 million was for the audits of the LLCs. Each LLC will reimburse the Board of

Governors for the fees related to the audit of its financial statements from the entity's available net assets. To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of Reserve Banks, or in any other way impairing its audit independence. In 2009, the Bank engaged D&T for non-audit services, the fees for which were immaterial.

Consolidated Financial Statements[†]

[†]Separate financial statements for the Commercial Paper Funding Facility LLC, Maiden Lane LLC, Maiden Lane II LLC, Maiden Lane III LLC, and TALF LLC are available at <http://www.newyorkfed.org/aboutthefed/annualreports.html>.

Independent Auditors' Report

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

We have audited the accompanying consolidated statements of condition of the Federal Reserve Bank of New York and its subsidiaries (collectively "FRBNY") as of December 31, 2009 and 2008 and the related consolidated statements of income and comprehensive income and changes in capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRBNY as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRBNY's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on FRBNY's internal control over financial reporting based on our audits.

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

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

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

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

In our opinion, such consolidated financial statements referred to above present fairly, in all material respects, the financial position of FRBNY as of December 31, 2009 and 2008, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, FRBNY maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

DELOITTE + TOUCHE LLP

April 21, 2010 (June 10, 2010, as to the effects of the subsequent events described in Note 17)
New York, New York

CONSOLIDATED STATEMENTS OF CONDITION

as of December 31, 2009, and December 31, 2008

(in millions)

ASSETS	2009	2008
Gold certificates	\$ 3,895	\$ 3,935
Special drawing rights certificates	1,818	874
Coin	77	76
Prepaid interest on Federal Reserve notes	—	2,860
Loans to depository institutions	77,757	300,665
Other loans, net (of which \$48,183 is measured at fair value as of December 31, 2009)	69,433	76,318
System Open Market Account:		
Securities purchased under agreements to resell	—	28,464
Treasury securities, net	315,035	171,297
Government-sponsored enterprise debt securities, net	65,418	7,379
Federal agency and government-sponsored enterprise mortgage-backed securities, net	359,186	—
Investments denominated in foreign currencies	6,724	6,210
Central bank liquidity swaps	2,733	138,622
Other investments	2	—
Investments held by consolidated variable interest entities (of which \$71,648 and \$74,570 are measured at fair value as of December 31, 2009 and 2008, respectively)	81,380	411,996
Preferred securities	25,106	—
Accrued interest receivable	4,948	2,511
Interdistrict settlement account	120,324	110,091
Bank premises and equipment, net	322	254
Other assets	203	168
Total assets	<u>\$1,134,361</u>	<u>\$1,261,720</u>

CONSOLIDATED STATEMENTS OF CONDITION

as of December 31, 2009, and December 31, 2008

(in millions)

LIABILITIES AND CAPITAL	2009	2008
Federal Reserve notes outstanding, net	\$ 326,127	\$ 311,129
System Open Market Account:		
Securities sold under agreements to repurchase	30,383	31,435
Other liabilities	235	—
Consolidated variable interest entities:		
Beneficial interest in consolidated variable interest entities, at fair value	5,095	2,824
Other liabilities (of which \$143 is measured at fair value as of December 31, 2009)	1,316	5,813
Deposits:		
Depository institutions	525,907	509,858
Treasury, general account	186,632	106,123
Treasury, supplementary financing account	5,001	259,325
Other deposits	36,094	21,527
Deferred credit items	14	—
Accrued interest on Federal Reserve notes	1,075	—
Interest due to depository institutions	60	88
Accrued benefit costs	1,423	2,278
Other liabilities	115	106
Total liabilities	1,119,477	1,250,506
Capital paid-in	7,442	5,607
Surplus (including accumulated other comprehensive loss of \$3,440 and \$4,471 at December 31, 2009 and 2008, respectively)	7,442	5,607
Total capital	14,884	11,214
Total liabilities and capital	\$1,134,361	\$1,261,720

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

for the years ended December 31, 2009, and December 31, 2008
(in millions)

	<u>2009</u>	<u>2008</u>
Interest income		
Loans to depository institutions	\$ 644	\$ 2,442
Other loans, net	4,447	2,877
System Open Market Account:		
Securities purchased under agreements to resell	4	676
Treasury securities	8,775	9,144
Government-sponsored enterprise debt securities	792	35
Federal agency and government-sponsored enterprise mortgage-backed securities	7,927	—
Investments denominated in foreign currencies	78	155
Central bank liquidity swaps	568	903
Other investments	—	—
Investments held by consolidated variable interest entities	9,820	4,087
Total interest income	<u>33,055</u>	<u>20,319</u>
Interest expense		
Securities sold under agreements to repurchase	37	264
Depository institution deposits	1,117	457
Beneficial interest in consolidated variable interest entities	267	463
Total interest expense	<u>1,421</u>	<u>1,184</u>
Provision for loan restructuring	<u>(2,621)</u>	<u>—</u>
Net interest income, after provision for loan restructuring	<u>29,013</u>	<u>19,135</u>

**CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME**
for the years ended December 31, 2009, and December 31, 2008
(in millions)

	<u>2009</u>	<u>2008</u>
Non-interest income (loss)		
Other loans unrealized gains	557	—
System Open Market Account:		
Treasury securities gains	—	1,357
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	355	—
Foreign currency gains, net	59	313
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities (losses), net	(1,937)	(9,626)
Beneficial interest in consolidated variable interest entities (losses) gains, net	(1,903)	4,389
Dividends on preferred securities	106	—
Income from services	67	61
Compensation received for services provided	4	11
Reimbursable services to government agencies	113	114
Other income	260	346
Total non-interest income (loss)	<u>(2,319)</u>	<u>(3,035)</u>
Operating expenses		
Salaries and other benefits	480	426
Occupancy expense	55	52
Equipment expense	22	23
Compensation paid for service costs incurred	33	30
Assessments by the Board of Governors	216	198
Net periodic pension expense	658	148
Professional fees related to consolidated variable interest entities	125	80
Other expenses	278	150
Total operating expenses	<u>1,867</u>	<u>1,107</u>
Net income prior to distribution	<u>24,827</u>	<u>14,993</u>
Change in funded status of benefit plans	<u>1,031</u>	<u>(3,133)</u>
Comprehensive income prior to distribution	<u><u>\$25,858</u></u>	<u><u>\$11,860</u></u>
Distribution of comprehensive income		
Dividends paid to member banks	413	301
Transferred to surplus and change in accumulated other comprehensive income	1,835	988
Payments to U.S. Treasury as interest on Federal Reserve notes	23,610	10,571
Total distribution	<u><u>\$25,858</u></u>	<u><u>\$11,860</u></u>

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

CONSOLIDATED STATEMENTS OF CHANGES IN CAPITAL

for the years ended December 31, 2009, and December 31, 2008
(in millions, except share data)

	Capital Paid-In	Net Income Retained	Surplus		Total Capital
			Accumulated Other Comprehensive Income (Loss)	Total Surplus	
Balance at January 1, 2008 (92,374,124 shares)	\$4,619	\$ 5,957	\$(1,338)	\$4,619	\$ 9,238
Net change in capital stock issued (19,774,408 shares)	988	—	—	—	988
Transferred to surplus and change in accumulated other comprehensive income (loss)	—	4,121	(3,133)	988	988
Balance at December 31, 2008 (112,148,532 shares)	\$5,607	\$10,078	\$(4,471)	\$5,607	\$11,214
Net change in capital stock issued (36,685,306 shares)	1,835	—	—	—	1,835
Transferred to surplus and change in accumulated other comprehensive income	—	804	1,031	1,835	1,835
Balance at December 31, 2009 (148,833,838 shares)	<u>\$7,442</u>	<u>\$10,882</u>	<u>\$(3,440)</u>	<u>\$7,442</u>	<u>\$14,884</u>

FEDERAL RESERVE BANK OF NEW YORK

Notes to Consolidated Financial Statements

1. STRUCTURE

The Federal Reserve Bank of New York (“Bank”) is part of the Federal Reserve System (“System”) and is one of the twelve 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 Second Federal Reserve District, which includes the state of New York; the twelve northern counties of New Jersey; Fairfield County, Connecticut; the Commonwealth of Puerto Rico; and the U.S. Virgin Islands.

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

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

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

is also authorized and directed by the FOMC to maintain U.S. dollar currency liquidity swap arrangements with fourteen central banks. The FOMC has also authorized the Bank to maintain foreign currency liquidity swap arrangements with four foreign central banks.

Although the Reserve Banks are separate legal entities, they collaborate in the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks. Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by the other Reserve Banks include the management of SOMA, the Wholesale Product Office, the System Credit Risk Technology Support function, the Valuation Support team, centralized business administration functions for wholesale payments services, and three national information technology operations dealing with incident response, remote access, and enterprise search.

3. FINANCIAL STABILITY ACTIVITIES

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

Expanded Open Market Operations and Support for Mortgage-Related Securities

The Single-Tranche Open Market Operation Program allows primary dealers to initiate a series of twenty-eight-day term repurchase transactions while pledging Treasury securities, Federal agency and GSE debt securities, and Federal agency and GSE MBS as collateral.

The Federal Agency and GSE Debt Securities and MBS Purchase Program provides support to the mortgage and housing markets and fosters improved conditions in financial markets. Under this program, the Bank purchases housing-related GSE debt securities and Federal agency and GSE MBS. Purchases of housing-related GSE debt securities began in November 2008 and purchases of Federal agency and GSE MBS began in January 2009. The Bank is authorized to purchase up to \$200 billion in fixed-rate, non-callable GSE debt securities and up to \$1.25 trillion in fixed-rate Federal agency and GSE MBS. The activities of both of these programs are allocated to the other Reserve Banks.

Central Bank Liquidity Swaps

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

U.S. dollar liquidity swap arrangements were authorized with fourteen foreign central banks to provide liquidity in U.S. dollars to overseas markets. Such arrangements were authorized with the following central banks: the Reserve Bank of Australia, Banco Central do Brasil, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Korea, Banco de México, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, Sveriges Riksbank, and the Swiss National Bank. The maximum amount that could be drawn under these swap arrangements varied by central bank. The authorization for these swap arrangements expired on February 1, 2010.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. Such arrangements were authorized with the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. The maximum amount that could be drawn under the swap arrangements varied by central bank. The authorization for these swap arrangements expired on February 1, 2010.

Lending to Depository Institutions

The Term Auction Facility (“TAF”) promotes the efficient dissemination of liquidity by providing term funds to depository institutions. Under the TAF, Reserve Banks auction term funds to depository institutions against any collateral eligible to secure primary, secondary, and seasonal credit less a margin, which is a reduction in the assigned collateral value that is intended to provide the Banks additional credit protection. All depository institutions that are considered to be in generally sound financial condition by their Reserve Bank and that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All loans must be collateralized to the satisfaction of the Reserve Banks.

Lending to Primary Dealers

The Term Securities Lending Facility (“TSLF”) promoted liquidity in the financing markets for Treasury securities. Under the TSLF, the Bank could lend up to an aggregate amount of \$200 billion of Treasury securities held in the SOMA to primary dealers secured for a term of twenty-eight days. Securities were lent to primary dealers through a competitive single-price auction and were collateralized, less a margin,

by a pledge of other securities, including Treasury securities, municipal securities, Federal agency and GSE MBS, non-agency AAA/Aaa-rated private-label residential MBS, and asset-backed securities (“ABS”). The authorization for the TSLF expired on February 1, 2010.

The Term Securities Lending Facility Options Program (“TOP”) offered primary dealers, through a competitive single-price auction, to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program enhanced the effectiveness of the TSLF by ensuring additional liquidity during periods of heightened collateral market pressures, such as around quarter-end dates. The program was suspended effective with the maturity of the June 2009 TOP options and the program authorization expired on February 1, 2010.

The Primary Dealer Credit Facility (“PDCF”) was designed to improve the ability of primary dealers to provide financing to participants in the securitization markets. Primary dealers could obtain secured overnight financing under the PDCF in the form of repurchase transactions. Eligible collateral was that which could be pledged in tri-party arrangements, which primarily includes Treasury securities, Federal agency and GSE MBS, other MBS, municipal securities, ABS, and money market equities. The interest rate charged on the secured financing was the Bank’s primary credit rate. Participants paid a frequency-based fee if they accessed the program on more than forty-five business days during the term of the program. Secured financing made under the PDCF was made with recourse to the primary dealer. The authorization for the PDCF expired on February 1, 2010.

The Transitional Credit Extension (“TCE”) program provided liquidity support to broker-dealers that were in the process of transitioning to the bank holding company structure. Loans were collateralized similar to loans made under either the Bank’s primary credit programs or the PDCF. The authorization for the TCE program expired on February 1, 2010.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (“AMLF”) provided funding to depository institutions and bank holding companies to finance the purchase of eligible high-quality asset-backed commercial paper (“ABCP”) from money market mutual funds. The program assisted money market mutual funds that hold such paper to meet the demands for investor redemptions and to foster liquidity in the ABCP market and money markets more generally. The Federal Reserve Bank of Boston (“FRBB”) administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other

Reserve Banks. All loans extended under the AMLF were non-recourse and were recorded as assets by the FRBB, and if the borrowing institution settles to a depository account in the Second Federal Reserve District, the funds were credited to the depository institution account and settled between the Reserve Banks through the interdistrict settlement account. The credit risk related to the AMLF was assumed by the FRBB. The authorization for the AMLF expired on February 1, 2010.

The Commercial Paper Funding Facility (“CPFF program”) enhanced the liquidity of the commercial paper market in the United States by increasing the availability of term commercial paper funding to issuers and by providing greater assurance to both issuers and investors that issuers would be able to roll over their maturing commercial paper. The authorization to purchase high-quality commercial paper through the CPFF program expired on February 1, 2010. The Commercial Paper Funding Facility LLC (“CPFF”) is a Delaware limited liability company formed on October 14, 2008, in connection with the implementation of the CPFF program, to purchase eligible three-month unsecured commercial paper and ABCP directly from eligible issuers using the proceeds of loans made to CPFF by the Bank. CPFF is a single-member limited liability company, with the Bank as the sole and managing member. The Bank is the controlling party of CPFF and will remain as the controlling party as long as it retains an economic interest.

All lending to CPFF was made with recourse to the assets of CPFF. The interest rate on each loan to CPFF was the target federal funds rate and was fixed through the term of the loan. If the target federal funds rate was a range, the interest rate was set at the maximum rate within the range. Principal and accrued interest are payable to the Bank, in full, at the maturity date of the commercial paper. The Bank’s loans to CPFF were eliminated in consolidation.

To be eligible for purchase by CPFF, commercial paper was required to be (1) issued by a United States issuer (which includes United States issuers with a foreign parent company and United States branches of foreign banks) and (2) rated at least A-1/P-1/F1 by a nationally recognized statistical rating organization (“NRSRO”) or, if rated by multiple NRSROs, was rated at least A-1/P-1/F1 by two or more. The commercial paper was also required to be U.S.-dollar-denominated and have a three-month maturity. Commercial paper purchased by CPFF was discounted when purchased and carried at amortized cost. The maximum amount of a single issuer’s commercial paper that CPFF could own at any time (“maximum face value limit”) was the greatest amount of U.S.-dollar-denominated commercial paper the issuer had outstanding on any day between January 1 and August 31, 2008. The CPFF did not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including CPFF) equaled or exceeded the issuer’s maximum face value limit.

Each issuer was required to pay a non-refundable facility fee upon registration with CPFF equal to 10 basis points of the issuer's maximum face value limit ("registration fee"). The CPFF program participants that issued unsecured commercial paper to CPFF were required to pay a surcharge of 100 basis points per annum of the face value ("credit enhancement fee"). The CPFF was authorized to reinvest cash in short-term and highly liquid assets, which included Treasury securities, Federal agency debt securities (excluding MBS), money market funds, repurchase agreements collateralized by Treasury securities and Federal agency securities, and U.S.-dollar-denominated overnight deposits. ABCP issuers that were inactive prior to the creation of the CPFF program were ineligible for participation. An issuer was considered inactive if it did not issue ABCP to institutions other than the sponsoring institution for any consecutive period of three months or longer between January 1 and August 31, 2008.

The Money Market Investor Funding Facility ("MMIFF") supported a private-sector initiative designed to provide liquidity to U.S. money market investors. Under the MMIFF, the Bank could provide senior secured funding to a series of special purpose vehicles ("SPVs") to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors. No activity was recorded for the MMIFF in 2008 or 2009. The authorization for the MMIFF expired on October 30, 2009.

The Term Asset-Backed Securities Loan Facility ("TALF") assists financial markets in accommodating the credit needs of consumers and businesses of all sizes by facilitating the issuance of ABS collateralized by a variety of consumer and business loans; it is also intended to improve the market conditions for ABS. The Board of Governors has authorized the offering of TALF loans collateralized by newly issued ABS and legacy commercial mortgage-backed securities ("CMBS") until March 31, 2010, and TALF loans collateralized by newly issued CMBS until June 30, 2010.

Under the TALF, the Bank is authorized to lend up to \$200 billion to eligible borrowers. Up to \$100 billion of the total authorized TALF loans can have maturities of five years to finance purchases of commercial mortgage-backed securities ("CMBS"), ABS backed by student loans, and ABS backed by loans guaranteed by the Small Business Administration ("SBA"). Interest proceeds paid on collateral supporting a TALF five-year loan or a three-year loan collateralized by CMBS may be used toward an accelerated repayment of the principal amount of the loan.

Each TALF loan is secured by eligible collateral, with the Bank lending an amount equal to the value of the collateral, as determined by the Bank, less a haircut. Loan proceeds are disbursed to the borrower contingent on receipt by the Bank's custodian of the eligible collateral, an administrative fee, and, if applicable, a haircut.

Eligible collateral includes U.S.-dollar-denominated ABS that are (1) backed by student loans, auto loans, credit card loans, loans guaranteed by the SBA, loans or leases related to business equipment, leases of vehicle fleets, floor plan loans, mortgage servicing advances, and insurance premium finance loans that have a credit rating in the highest investment-grade rating category from two or more approved rating agencies and do not have a credit rating below the highest investment-grade rating category from a major rating agency, or (2) are newly issued CMBS or certain high-quality CMBS issued before January 1, 2009 (“legacy CMBS”). High-quality newly issued and legacy CMBS must have at least two AAA ratings from the approved rating agencies and must not have a rating below AAA from any of these rating agencies. As of December 31, 2009, approved credit rating agencies for ABS included Fitch, Moody’s Investors Service, and Standard & Poor’s. The credit rating agencies for ABS were expanded in February 2010 to include DBRS and Realpoint. As of December 31, 2009, approved credit rating agencies for CMBS included Fitch, Moody’s Investors Service, Standard & Poor’s, DBRS, and Realpoint. Prior to its acceptance by the Bank, pledged collateral must also have met other risk assessment criteria as stipulated in the TALF program’s terms and conditions.

The TALF loans are extended on a non-recourse basis. If the borrower does not repay the loan, the Bank will enforce its rights in the collateral and may sell the collateral to TALF LLC, a Delaware limited liability company, established for the purpose of purchasing such assets. As of December 31, 2009, the Bank had not enforced its rights to any of the collateral and, as a result, TALF LLC did not purchase such assets.

Pursuant to a put agreement with the Bank, TALF LLC has committed to purchase assets that secured a TALF loan at a price equal to the principal amount outstanding plus accrued but unpaid interest, regardless of fair value of the collateral. TALF LLC’s purchases of these securities are funded first through the fees received by TALF LLC from the Bank for this commitment and any interest earned on its investments. The fee represents the spread on the TALF loans, which is the TALF loan interest rate paid by the TALF borrower less the overnight indexed swap (“OIS”) rate plus 25 basis points. In the event that such funding proves insufficient for the asset purchases that TALF LLC has committed to make under the put agreement, the Treasury, as a subordinated lender, has committed to lend up to \$20 billion to TALF LLC at a rate of the one-month London Interbank Offered Rate (“LIBOR”) plus 300 basis points. The Bank has agreed to lend up to \$180 billion to TALF LLC in the form of senior debt at a rate of the one-month LIBOR plus 100 basis points. Both the senior, when funded, and subordinated loans to TALF LLC

are secured by all of the assets of TALF LLC through a pledge to Bank of New York Mellon as the collateral agent. The Bank is the managing member and the controlling party of TALF LLC and will remain as the controlling party as long as it retains an interest. After TALF LLC has paid all operating expenses and principal due to the Bank, the remaining proceeds of the portfolio holdings will be distributed in the following order: principal due to Treasury, interest due to the Bank, and interest due to Treasury. Any residual cash flows will be shared between the Bank, which will receive 10 percent, and the Treasury, which will receive 90 percent, as contingent interest.

Support for Specific Institutions

Bear Stearns Companies, Inc.

In connection with and to facilitate the merger of The Bear Stearns Companies, Inc. (“Bear Stearns”) and JPMorgan Chase & Co. (“JPMC”), the Bank extended credit to Maiden Lane LLC (“ML”) in June 2008. ML is a Delaware limited liability company formed by the Bank to acquire certain assets of Bear Stearns and to manage those assets over time, in order to maximize the potential for the repayment of the credit extended to ML and to minimize disruption to the financial markets. The assets acquired by ML were valued at \$29.9 billion as of March 14, 2008, the date that the Bank committed to the transaction, and largely consisted of Federal agency and GSE MBS, non-agency residential mortgage-backed securities (“non-agency RMBS”), commercial and residential mortgage loans, and derivatives. The Bank extended a senior loan of approximately \$28.8 billion and JPMC extended a subordinated loan of \$1.15 billion to finance the acquisition of the assets. The loans are collateralized by all of the assets of ML through a pledge to State Street as the collateral agent. The interest rate on the senior loan is the primary credit rate in effect from time to time. JPMC bears the first \$1.15 billion of any losses associated with the portfolio through its subordinated loan. Residual gains, if any, will be allocated to the Bank. The interest rate on the JPMC subordinated loan is the primary credit rate plus 450 basis points. The Bank is the sole and managing member and the controlling party of ML and will remain as such as long as the Bank retains an economic interest in ML.

American International Group, Inc.

In September 2008, the Board of Governors authorized the Bank to lend to American International Group, Inc. (“AIG”). Initially, the Bank provided AIG with a line of credit collateralized by the pledge of a substantial portion of the assets of

AIG. Under the provisions of the original agreement, the Bank was authorized to lend up to \$85 billion to AIG for two years at the three-month LIBOR, with a floor of 350 basis points, plus 850 basis points. In addition, the Bank assessed AIG a one-time commitment fee of 200 basis points on the full amount of the commitment and a fee of 850 basis points per annum on the undrawn credit line. A condition of the credit agreement was that AIG would issue to a trust, for the sole benefit of the fiscal treasury, preferred shares convertible to approximately 78 percent of the issued and outstanding shares of the common stock of AIG. The AIG Credit Facility Trust ("Trust") was formed January 16, 2009, and the preferred shares were issued to the Trust on March 4, 2009. The Trust has three independent trustees who control the Trust's voting and consent rights. The Bank cannot exercise voting or consent rights. On October 8, 2008, the Bank began providing cash collateral to certain AIG insurance subsidiaries in connection with AIG's domestic securities lending program.

The Bank and the Treasury announced a restructuring of the government's financial support to AIG in November 2008. As part of the restructuring, the Treasury purchased \$40 billion of newly issued AIG preferred shares under the Troubled Asset Relief Program ("TARP"). The TARP funds were used to pay down AIG's debt to the Bank. In addition, the terms of the original agreement were modified to reduce the line of credit to \$60 billion; reduce the interest rate to the three-month LIBOR with a floor of 350 basis points, plus 300 basis points; reduce the fee on undrawn funds to 75 basis points; and extend the term of the agreement to five years. The other material terms of the funding were unchanged. These revised terms were more consistent with terms granted to other entities with similar credit risk.

Concurrent with the November 2008 restructuring of its financial support to AIG, the Bank established two limited liability companies ("LLCs"). The Bank extended credit to Maiden Lane II LLC ("ML II"), a Delaware limited liability company formed to purchase non-agency RMBS from the reinvestment pool of the securities lending portfolio of several regulated U.S. insurance subsidiaries of AIG. ML II borrowed \$19.5 billion from the Bank and used the proceeds to purchase non-agency RMBS that had an approximate fair value of \$20.8 billion as of October 31, 2008, from AIG's domestic insurance subsidiaries. The Bank is the sole and managing member and the controlling party of ML II and will remain as the controlling party as long as the Bank retains an economic interest in ML II. Net proceeds received by ML II will be applied to pay the Bank's senior loan plus interest at one-month LIBOR plus 100 basis points. As part of the agreement, the AIG subsidiaries also received from ML II a fixed deferred purchase price of up to \$1.0 billion, plus interest on any such fixed deferred purchase price outstanding at one-month LIBOR

plus 300 basis points, payable from the net proceeds received by ML II and only to the extent that the Bank's senior loan, including accrued and unpaid interest, has been paid in full. After ML II has paid the Bank's senior loan, including accrued and unpaid interest, and the fixed deferred purchase price in full, including accrued and unpaid interest, the Bank will be entitled to receive five-sixths of any additional net proceeds received by ML II as contingent interest on the senior loan and the AIG subsidiaries will be entitled to receive one-sixth of any net proceeds received by ML II as variable deferred purchase price. The Bank's loan and the fixed deferred purchase price of the AIG subsidiaries are collateralized by all of the assets of ML II through a pledge to Bank of New York Mellon as the collateral agent. As a result of the formation and commencement of operations of ML II, the Bank's lending in connection with AIG's securities lending program was terminated.

The Bank also extended credit to Maiden Lane III LLC ("ML III"), a Delaware limited liability company formed to purchase ABS collateralized debt obligations ("ABS CDOs") from certain third-party counterparties of AIG Financial Products Corp. ("AIGFP"). In connection with the acquisitions, the third-party counterparties agreed to terminate their related credit default swap ("CDS") contracts with AIGFP. ML III borrowed approximately \$24.3 billion from the Bank and AIG provided an equity contribution of \$5 billion to ML III. The proceeds were used to purchase ABS CDOs with a fair value of \$29.6 billion. The counterparties received \$26.8 billion net of principal, interest received, and finance charges paid. ML III also made a payment to AIGFP of \$2.5 billion, representing the return of excess collateral previously posted by AIGFP with the counterparties. The Bank is the managing member and the controlling party of ML III and will remain as the controlling party as long as the Bank retains an economic interest in ML III. Net proceeds received by ML III will be applied to repay the Bank's senior loan plus interest at one-month LIBOR plus 100 basis points. The Bank's senior loan is collateralized by all of the assets of ML III through a pledge to Bank of New York Mellon as the collateral agent. After payment of principal and accrued and unpaid interest on the Bank's senior loan in full, AIG, or its assignee, is entitled to receive from ML III repayment of its equity contribution, including accrued and unpaid interest at one-month LIBOR plus 300 basis points, payable from net proceeds received by ML III as additional interest. After ML III has paid the Bank's senior loan and AIG's equity contribution in full, the Bank will be entitled to receive two-thirds of any additional net proceeds received by ML III on the senior loan and AIG, or its assignee, will be entitled to receive one-third of any net proceeds received by ML III as contingent distributions on its equity interest.

On April 17, 2009, the Bank, as part of the U.S. government's commitment to the orderly restructuring of AIG over time, in the face of continuing market dislocations, additionally restructured the AIG loan by lowering the interest rate. Effective April 17, 2009, the 350-basis-point floor on LIBOR used to calculate the interest rate on the loan was eliminated. The interest rate on the modified loan is the three-month LIBOR plus 300 basis points.

On December 1, 2009, the Bank's commitment to lend to AIG was reduced to \$35 billion and the outstanding balance of the Bank's loan to AIG was reduced by \$25 billion in exchange for a liquidation preference of non-voting perpetual preferred interests in two limited liability companies. AIG created these limited liability companies to hold, directly or indirectly, all of the outstanding common stock of American Life Insurance Company ("ALICO") and American International Assurance Company Ltd. ("AIA"), two life insurance holding company subsidiaries of AIG. The Bank will be paid a 5 percent cumulative dividend on its non-voting preferred interests through September 22, 2013, and a 9 percent cumulative dividend thereafter. Although the Bank has certain governance rights to protect its interests, AIG retains control of the limited liability companies and the underlying operating companies. The initial value of the Bank's preferred interests, which represented a percentage of the fair market value of ALICO and AIA at December 1, 2009, was \$16 billion for the AIA Aurora LLC ("AIA LLC") and \$9 billion for the ALICO Holdings LLC ("ALICO LLC").

In addition, the Bank was authorized to make loans of up to \$8.5 billion to other SPVs established by AIG or its subsidiaries. Loans extended by the Bank to these SPVs would have been repaid from net cash flows of designated blocks of existing life insurance policies issued by certain domestic insurance subsidiaries of AIG. No loans were made under this authorization during the year ended December 31, 2009. On February 26, 2010, AIG stated in its 2009 annual report filed with the Securities and Exchange Commission that it was no longer pursuing this transaction.

Citigroup, Inc.

The Board of Governors, the Treasury, and the FDIC ("parties") jointly announced on November 23, 2008, that they would provide financial support to Citigroup, Inc. ("Citigroup"). The agreement provided funding support for possible future principal losses on up to \$301 billion of Citigroup's assets. The funding support was for a period of ten years for residential assets and five years for non-residential assets. Under the agreement, a loss on a portfolio asset would have included a charge-off or realized loss upon collection, through a permitted disposition or exchange, or upon

a foreclosure or short-sale loss, but not through a change in Citigroup's mark-to-market accounting for the asset or the creation or increase of a related loss reserve. The Bank's commitment to lend under the agreement would have been triggered at the time that qualifying losses of \$56.2 billion were recognized in the covered assets pool. At that point, if Citigroup made a proper election, the Bank would have made a single non-recourse loan to Citigroup in an amount equal to the aggregate adjusted baseline value of the remaining covered assets, as defined in the relevant agreements. Under this agreement no loans were made during the years ended December 31, 2009, and December 31, 2008. On December 23, 2009, the parties terminated the arrangement and, as consideration for terminating the agreement, Citigroup paid the Bank a \$50 million termination fee and agreed to reimburse the Bank for its out-of-pocket expenses.

4. SIGNIFICANT ACCOUNTING POLICIES

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

Limited differences exist between the accounting principles and practices in the FAM and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all SOMA securities holdings at amortized cost rather than the fair value presentation required by GAAP. Treasury securities, GSE debt securities, Federal agency and GSE MBS, and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis rather than the trade-date basis required by GAAP. The cost basis of Treasury securities, GSE debt securities, and foreign government debt instruments is adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Accounting for these securities on a settlement-date basis more appropriately reflects the timing of the transaction's effect on the quantity of reserves in

the banking system. Although the application of fair value measurements to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

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

Preparing the consolidated financial statements in conformity with the FAM requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. The classification of certain variable interest entities ("VIEs") assets has been reclassified as follows: RMBS and non-agency CMOs have been reclassified as non-agency RMBS, agency CMOs and TBA commitments have been reclassified as Federal agency and GSE MBS, and commercial and residential mortgage loans have been shown separately. The classification of certain retirement plan assets has been reclassified and revised for the retirement plan asset allocation disclosure. International equities assets have been shown separately from fixed-income assets. The account "Investments held by consolidated variable interest entities gains/(losses), net" has been separated into the two accounts: "Beneficial interest in consolidated variable interest entities (losses) gains, net" and "Investments held by consolidated variable interest entities (losses), net." Unique accounts and significant accounting policies are explained below.

a. Consolidation

The consolidated financial statements include the accounts and results of operations of the Bank as well as several VIEs, which include ML, ML II, ML III, CPFF, and TALF LLC. The consolidation of the VIEs was assessed in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (ASC) Topic 810 (ASC 810), *Consolidation* (previously FIN 46R), which requires a variable interest entity to be consolidated by its controlling financial interest holder. Intercompany balances and transactions have been eliminated in consolidation.

The Bank consolidates a VIE if it has a controlling financial interest because it will absorb a majority of the entity’s expected losses, receive a majority of the entity’s expected residual returns, or is most closely associated with the VIE. To determine whether it is the controlling financial interest holder of a VIE, the Bank evaluates the VIE’s design, capital structure, and relationships with the variable interest holders. The Bank reconsiders whether it is the controlling financial interest holder of a VIE, as required by ASC 810, when certain events occur.

b. Gold and Special Drawing Rights Certificates

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

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

SDR certificates are issued by the International Monetary Fund (the “Fund”) to its members in proportion to each member’s quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks’ SDR

certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2008, and in 2009 the Treasury issued \$3 billion in SDR certificates to the Reserve Banks, of which \$944 million was allocated to the Bank.

c. Loans to Depository Institutions and Other Loans

Loans, except for loans extended under TALE, are reported at their outstanding principal balances net of unamortized administrative or commitment fees, and interest income is recognized on an accrual basis. Loan administrative and commitment fees are generally deferred and amortized on a straight-line basis over the term of the loan or commitment period. This method results in an interest amount that is substantially similar to the interest method.

Loans are impaired when, based on current information and events, it is probable that the Bank will not receive the principal or interest that is due in accordance with the contractual terms of the loan agreement. 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 reflect the assessment of credit risk. 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 for each program. Generally, the Bank discontinues recognizing interest income on impaired loans until the borrower's repayment performance demonstrates principal and interest will be received in accordance with the term 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.

Impaired loans include loans that have been modified in debt restructurings involving borrowers experiencing financial difficulties. The allowance for loan restructuring is determined by discounting the restructured cash flows using the original effective rate for the loan. Similar to other impaired loans, the Bank discontinues recognizing interest income until the borrower demonstrates that it can meet the restructured terms. Performance prior to the restructuring, or significant

events that coincide with the restructuring, are considered in assessing whether the borrower can meet the new terms and, if so, the Bank may resume recording interest income.

The Bank has elected to record the TALF loans at fair value in accordance with FASB ASC Topic 825 (ASC 825), *Financial Instruments* (previously Statement of Financial Accounting Standards (“SFAS”) 159). Unrealized gains (losses) on TALF loans that are recorded at fair value are reported as “Non-interest income (loss): Other loans unrealized gains” in the Consolidated Statements of Income and Comprehensive Income. The interest income on TALF loans is recognized based on the contracted rate and is reported as a component of “Interest income: Other loans” in the Consolidated Statements of Income and Comprehensive Income. Administrative fees paid by borrowers at the initiation of each loan, which are recognized as incurred and not deferred, are reported as a component of “Non-interest income: Other income” in the Consolidated Statements of Income and Comprehensive Income.

d. Securities Purchased under Agreements to Resell, Securities Sold under Agreements to Repurchase, and Securities Lending

The Bank may engage in purchases of securities with primary dealers under agreements to resell (“repurchase transactions”). These repurchase transactions are typically executed through a tri-party arrangement (“tri-party transactions”). Tri-party transactions are conducted with two commercial custodial banks that manage the clearing, settlement, and pledging of collateral. The collateral pledged must exceed the principal amount of the transaction. Acceptable collateral under tri-party repurchase transactions primarily includes Treasury securities; pass-through mortgage securities of Fannie Mae, Freddie Mac, and Ginnie Mae; STRIP Treasury securities; and “stripped” securities of federal agencies. The tri-party transactions are accounted for as financing transactions with the associated interest income accrued over the life of the transaction. Repurchase transactions are reported at their contractual amount as “System Open Market Account: Securities purchased under agreements to resell” in the Consolidated Statements of Condition and the related accrued interest receivable is reported as a component of “Accrued interest receivable.”

The Bank may engage in sales of securities with primary dealers under agreements to repurchase (“reverse repurchase transactions”). These reverse repurchase transactions may be executed through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international accounts. 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 in the Consolidated Statements of Condition and the related accrued interest payable is reported as a component of “Other liabilities.”

Treasury securities and GSE debt securities held in the SOMA are lent to primary dealers to facilitate the effective functioning of the domestic securities market. Overnight securities lending transactions are fully collateralized by other Treasury securities. TSLF transactions are fully collateralized with investment-grade debt securities, collateral eligible for tri-party repurchase agreements arranged by the Bank, or both. The collateral taken in both overnight and term securities lending transactions is in excess of the fair value of the securities lent. The Bank charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of “Other income.” In addition, TOP fees are reported as a component of “Other income.”

Activity related to securities purchased under agreements to resell, securities sold under agreements to repurchase, and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the inter-district settlement account that occurs in April each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District.

e. Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Investments Denominated in Foreign Currencies; and Warehousing Agreements

Interest income on Treasury securities, GSE debt securities, and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Interest income on Federal agency and GSE MBS is accrued using the interest method and includes amortization of premiums, accretion of discounts, and pay-down gains or losses. Paydown gains or losses result from scheduled payment and prepayment of principal and represent the difference between the principal amount and the carrying value of the related security. Gains and losses resulting from sales of securities are determined by specific issue based on average cost.

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the Bank enters into dollar roll transactions (“dollar rolls”), which primarily involve an initial transaction to purchase or sell “to be announced” (“TBA”) MBS combined with an agreement to sell or purchase TBA MBS on a specified future date. The Bank’s participation in the dollar roll market furthers the MBS Purchase program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets. The Bank accounts for outstanding commitments to sell or purchase TBA MBS on a settlement-date basis. Based on the terms of the Bank’s dollar roll transactions, transfers of MBS

upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (previously SFAS 140), and the related outstanding commitments are accounted for as sales or purchases upon settlement.

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

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

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

Warehousing agreements are designated as held-for-trading purposes and are valued daily at current market exchange rates. Activity related to these agreements is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

f. Central Bank Liquidity Swaps

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

Activity related to U.S. dollar and foreign currency swap transactions, including the related income and expense, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Similar to investments denominated in foreign currencies, the foreign currency amounts associated with these central bank liquidity swap arrangements are revalued at current foreign currency market exchange rates.

U.S. Dollar Liquidity Swaps

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

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

Foreign Currency Liquidity Swaps

At the initiation of each foreign currency liquidity swap transaction, the Bank will transfer, at the prevailing market exchange rate, 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. Concurrent with this transaction, the Bank and the foreign central bank agree to a second transaction that obligates the Bank to return the foreign currency and the foreign central bank to return the U.S. dollars on a specified future date. The Bank compensates the foreign central bank based on the foreign currency transferred to the Bank. For each foreign currency swap transaction with a foreign central bank, it is anticipated that the Bank will enter into a corresponding transaction with a U.S. depository institution in order to provide foreign currency liquidity to that institution. No foreign currency liquidity swap transactions occurred in 2008 or 2009.

g. Investments Held by Consolidated Variable Interest Entities

Investments of the consolidated VIEs include commercial paper, Federal agency and GSE MBS, commercial and residential real estate mortgage loans, non-agency RMBS, CDOs, other investment securities, other real estate owned, and derivatives. These investments are accounted for and classified as follows:

- Commercial paper held by the CPFF is designated as held-to-maturity under FASB ASC Topic 320 (ASC 320), Investments—Debt and Equity Securities (previously SFAS 115), according to the terms of the CPFF program. The

Bank has the positive intent and the ability to hold the securities to maturity, therefore, the commercial paper is recorded at amortized cost. The amortization of premiums and accretion of discounts is recorded on a straight-line basis that is not materially different from the interest method. Interest income on the commercial paper is reported as “Interest income: Investments held by consolidated variable interest entities” in the Consolidated Statements of Income and Comprehensive Income. All other investments, consisting of short-term highly liquid assets, held by the CPFF are classified as trading securities under ASC 320 and are recorded at fair value.

The Bank evaluates commercial paper for impairment on a quarterly basis. An investment is impaired if its fair value falls below its recorded value and the decline is considered other than temporary. An other-than-temporary impairment is triggered if (1) the Bank has the intent to sell the security, (2) it is more likely than not that the Bank will be required to sell the security before recovery of its recorded investment, or (3) the Bank does not expect to recover the entire amortized cost basis of the security even if it does not intend to sell the security.

- ML follows the guidance in ASC 320 when accounting for investments in debt securities. ML classifies its debt securities as available for sale and has elected the fair value option for all eligible assets and liabilities in accordance with ASC 825. Other financial instruments, including derivatives contracts in ML, are recorded at fair value in accordance with FASB ASC Topic 815 (ASC 815), *Derivatives and Hedging* (previously SFAS 133).
- ML II and ML III qualify as non-registered investment companies under ASC 946, *Financial Services—Investment Companies* (previously the American Institute of Certified Public Accountants’ *Audit and Accounting Guide for Investment Companies*), therefore, all investments are recorded at fair value in accordance with FASB ASC Topic 820 (ASC 820), *Fair Value Measurements and Disclosures* (previously SFAS 157).
- TALF LLC follows the guidance in ASC 320 when accounting for ABS investments once obtained. All other investments held by the TALF LLC are classified as available for sale securities under ASC 320 and TALF LLC has elected the fair value option for all eligible assets in accordance with ASC 825. These assets are recorded as “Investments held by consolidated variable interest entities” in the Consolidated Statements of Condition.
- Interest income, accretion of discounts, amortization of premiums on investments, and paydown gains and losses on Federal agency and GSE MBS, non-agency RMBS, and CMOs held by consolidated VIEs are reported in

“Interest income: Investments held by consolidated variable interest entities” in the Consolidated Statements of Income and Comprehensive Income. Realized and unrealized gains (losses) on investments in consolidated VIEs that are recorded at fair value are reported as “Non-interest income (loss): Investments held by consolidated variable interest entities (losses), net” in the Consolidated Statements of Income and Comprehensive Income.

h. Preferred Securities

As part of the restructuring of the AIG loan, the Bank was issued preferred securities in AIA LLC and ALICO LLC, which were created to hold all of the outstanding common stock of AIA and ALICO, respectively. The preferred securities are presented at cost consistent with ASC 320 and are reported on the Consolidated Statements of Condition as “Preferred securities.” The 5 percent cumulative dividend accrued by the Bank on the preferred securities is reported as “Dividends on preferred securities” on the Consolidated Statements of Income and Comprehensive Income. On a quarterly basis, the accrued dividends are capitalized and increase the recorded cost of the Bank’s preferred interest in the AIA LLC and ALICO LLC. A preferred security is impaired if its fair value falls below its recorded value and the decline is considered other than temporary. An other-than-temporary impairment is triggered if (1) the Bank has the intent to sell the security, (2) it is more likely than not that the Bank will be required to sell the security before recovery of its recorded investment, or (3) the Bank does not expect to recover the entire amortized cost basis of the security even if it does not intend to sell the security. Dividends are accrued unless the impairment analysis indicates that the dividends will not be collected.

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 Consolidated Statements of Condition.

j. Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from two to fifty years. Major alterations, renova-

tions, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

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

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

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

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the outstanding Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the U.S. government. At December 31, 2009, and December 31, 2008, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

"Federal Reserve notes outstanding, net" in the Consolidated Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of \$71,925 million and \$46,609 million at December 31, 2009, and December 31, 2008, respectively.

l. Beneficial Interest in Consolidated Variable Interest Entities

ML, ML II, ML III, and TALF LLC have outstanding senior and subordinated financial interests, inclusive of a fixed deferred purchase price in ML II and an equity contribution in ML III. Upon issuance of the senior and subordinated financial interests, ML, ML II, ML III, and TALF LLC each elected to measure these obligations at fair value in accordance with ASC 825. Principal, interest, and changes in fair value on the senior financial interest, which were extended by the Bank, are eliminated in consolidation. The subordinated financial interest is recorded at fair value as “Beneficial interest in consolidated variable interest entities” in the Consolidated Statements of Condition. Interest expense and changes in fair value of the subordinated financial interest are recorded in “Interest expense: Beneficial interest in consolidated variable interest entities” and “Non-interest income (loss): Investments held by consolidated variable interest entities gains (losses), net,” respectively, in the Consolidated Statements of Income and Comprehensive Income.

m. Treasury Supplemental Financing Account and Other Deposits

The Treasury’s temporary supplementary program consists of a series of Treasury bill auctions, in addition to Treasury’s standard borrowing program. The proceeds of this debt are held in an account at the Bank that is separate from the Treasury’s general account, and which is reported as “Treasury, supplementary financing account” in the Consolidated Statements of Condition. The purpose of placing funds in this account is to drain reserves from the banking system and partially offset the reserve impact of the Reserve Bank’s lending and liquidity initiatives.

Other deposits represent amounts held in accounts at the Bank by GSEs and foreign central banks and governments.

n. Items in Process of Collection and Deferred Credit Items

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

o. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and sur-

plus of the member bank. These shares are non-voting with a par value of \$100 and may not be transferred or hypothecated. As a member bank's capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

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

p. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. Accumulated other comprehensive income is reported as a component of surplus in the Consolidated Statements of Condition and the Consolidated Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to the System retirement plan and other postretirement benefit plans that, under GAAP, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 13, 14, and 15.

q. Interest on Federal Reserve Notes

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

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

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

r. Interest on Depository Institution Deposits

On October 9, 2008, the Reserve Banks began paying interest to depository institutions on qualifying balances held at the Banks. 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 effective federal funds rate.

s. Income and Costs Related to Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the U.S. Government. By statute, the Department of the Treasury has appropriations to pay for these services. During the years ended December 31, 2009, and December 31, 2008, the Bank was reimbursed for substantially all services provided to the Department of the Treasury as its fiscal agent.

t. Compensation Received for Services Provided and Compensation Paid for Service Costs Incurred

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

u. Assessments by the Board of Governors

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred

by the Treasury to produce and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

v. 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 \$5 million for the years ended December 31, 2009, and December 31, 2008, respectively, and are reported as a component of "Occupancy expense."

w. 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.

The Bank had no significant restructuring activities in 2009 and 2008.

x. Recently Issued Accounting Standards

In December 2008, FASB issued FASB Staff Position ("FSP") FAS 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* (codified within ASC Topic 715 [ASC 715] *Compensation—Retirement Benefits*). ASC 715 provides rules for the disclosure of information about assets held in a defined benefit plan in the financial statements of the employer sponsoring that plan, and additional disclosures about asset categories and concentrations of risk. It is effective for financial statements with fiscal years ending after December 15, 2009. The disclosures required by ASC 715 have been reflected, as appropriate, in the accompanying footnotes.

In March 2008, FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (codified in ASC 815), which requires expanded qualitative, quantitative, and credit-risk disclosures about derivatives and hedging activities and their effects on a company's financial position, financial performance, and cash flows. These provisions of ASC 815 are effective for the Bank's consolidated financial statements for the year beginning on January 1, 2009, and have not had a material effect on the Bank's consolidated financial statements. The disclosure requirements have been reflected, as appropriate, in Note 9.

In February 2008, FASB issued FSP FAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* (codified in ASC 860). ASC 860 requires that an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of, the initial transfer be evaluated together as a linked transaction unless certain criteria are met. These provisions of ASC 860 are effective for the Bank's consolidated financial statements for the year beginning on January 1, 2009, and have not had a material effect on the Bank's consolidated financial statements. The requirements of this standard have been reflected in the accompanying footnotes.

In June 2009, FASB issued SFAS 166, *Accounting for Transfers of Financial Assets—an amendment to FASB Statement No. 140* (codified in ASC 860). The new guidance modifies existing guidance to eliminate the scope exception for qualifying SPVs and clarifies that the transferor must consider all arrangements of the transfer of financial assets when determining if the transferor has surrendered control. These provisions of ASC 860 are effective for the Bank's consolidated financial statements for the year beginning on January 1, 2010, and earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Bank's consolidated financial statements.

In April 2009, FASB issued FSP FAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary-Impairments* (codified in ASC 320), which amends the other-than-temporary impairment guidance for debt securities and the financial statement presentation and disclosure requirements. These provisions of ASC 320, which are effective for the Bank's consolidated financial statements ended December 31, 2009, have not had a material effect on the Bank's consolidated financial statements.

In April 2009, FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (codified in ASC *Fair Value Measurements and Disclosures*), which provides additional guidance for estimating fair value when the value and level of market activity for an asset or liability have significantly decreased. The standard also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of the FSP, which are effective for the Bank's consolidated financial statements for the year ending December 31, 2009, were considered in determining the valuation of assets and liabilities that are measured at fair value. The adoption of this provision did not have a material effect on the Bank's consolidated financial statements.

In May 2009, FASB issued SFAS 165, *Subsequent Events* (codified in FASB ASC Topic 855 [ASC 855], *Subsequent Events*), which establishes general standards of accounting for and disclosing events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 sets forth (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date, including disclosure of the date through which an entity has evaluated subsequent events and whether that represents the date the financial statements were issued or were available to be issued. The Bank adopted ASC 855 for the period ended December 31, 2009, and the required disclosures are reflected in Note 17.

In June 2009, FASB issued SFAS 167, *Amendments to FASB Interpretation No. 46(R)* (codified in ASC 810), which expands the scope of Interpretation 46R, *Consolidation of Variable Interest Entities*, and changes the approach for determining whether an entity has a controlling interest in a VIE by making a qualitative assessment of its financial interests. Additional disclosures are required for a variable interest in a VIE. These provisions of ASC 810 are effective for the Bank's consolidated financial statements for the year beginning on January 1, 2010, and earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Bank's consolidated financial statements.

In June 2009, the FASB issued SFAS 168, *The Statement of Financial Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, a replacement of SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (codified in FASB Topic 105 [ASC 105], *Generally Accepted Accounting Principles*). ASC 105 establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP. The ASC does not change current GAAP, but it introduces a new structure that organizes the authoritative standards by topic. ASC 105 is effective for financial statements issued for periods ending after September 15, 2009. As a result, both the ASC and the legacy standard are referenced in the Bank's consolidated financial statements and footnotes.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements* (codified in ASC 820), which requires additional disclosures related to fair value measurements. This update is effective for the Bank's consolidated financial statements for the year beginning on January 1, 2010, and early adoption is prohibited. The adoption of this update is not expected to have a material effect on the Bank's consolidated financial statements.

5. LOANS

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

	2009	2008
Primary, secondary, and seasonal credit	\$ 19,503	\$ 80,230
TAF	58,254	220,435
Loans to depository institutions	<u>\$ 77,757</u>	<u>\$300,665</u>
PDCF	—	37,404
TALF loans, at fair value	48,183	—
AIG	22,738	38,914
Other loans	<u>70,921</u>	<u>76,318</u>
Allowance for loan restructuring	(1,488)	—
Other loans, net	<u>\$ 69,433</u>	<u>\$ 76,318</u>

The remaining maturity distributions of loans, net of allowance, outstanding at December 31 were as follows (in millions):

	2009				
	Primary, Secondary, and Seasonal Credit	TAF	PDCF	TALF Loans at Fair Value	AIG, Net
Within 15 days	\$15,459	\$58,254	\$ —	\$ —	\$ —
16 to 90 days	4,044	—	—	—	—
91 days to under 1 year	—	—	—	—	—
Over 1 year to 5 years	—	—	—	48,183	21,250
Over 5 years to 10 years	—	—	—	—	—
Over 10 years	—	—	—	—	—
Total loans	<u>\$19,503</u>	<u>\$58,254</u>	<u>\$ —</u>	<u>\$48,183</u>	<u>\$21,250</u>

	2008				
	Primary, Secondary, and Seasonal			TALF Loans at Fair	
	Credit	TAF	PDCF	Value	AIG, Net
Within 15 days	\$75,300	\$131,690	\$37,404	\$ —	\$ —
16 to 90 days	4,930	88,745	—	—	—
91 days to under 1 year	—	—	—	—	—
Over 1 year to 5 years	—	—	—	—	38,914
Over 5 years to 10 years	—	—	—	—	—
Over 10 years	—	—	—	—	—
Total loans	\$80,230	\$220,435	\$37,404	\$ —	\$38,914

Loans to Depository Institutions

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

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; ABS; 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 or face value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program are also eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans are extended on a short-term basis, with terms ranging from twenty-eight to eighty-four days. All advances under the TAF program must be collateralized to the satisfaction of the Bank. Assets eligible to collateralize TAF loans include the com-

plete list noted above for loans to depository institutions. Similar to the process used for primary, secondary, and seasonal credit, a lending value is assigned to each asset that is accepted as collateral for TAF loans reduced by a margin.

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

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

At December 31, 2009 and 2008, the Bank did not have any impaired loans to depository institutions and no allowance for loan losses was required.

Other Loans

PDCF

The PDCF provided secured overnight financing to primary dealers in exchange for a specified range of collateral, including Treasury securities; Federal agency and GSE MBS; other MBS; municipal securities; ABS; and money market equities, for which prices were available. Interest on PDCF-secured financing was accrued using the primary credit rate offered by the Bank to depository institutions. The secured financing is reported as a component of “Other loans” in the Consolidated Statements of Condition. The frequency-based fees are reported as “Other income” in the Consolidated Statements of Income and Comprehensive Income.

At December 31, 2009, the Bank did not have any PDCF loans outstanding.

TALF

Credit extensions under TALF are non-recourse loans secured by eligible collateral. Each TALF loan has a three-year maturity, except for loans secured by SBA Pool Certificates, loans secured by SBA Development Company Participation Certificates, or ABS backed by student loans or commercial mortgage loans, which have a five-year maturity if the borrower so elects.

The Bank has elected the fair value option for all TALF loans under ASC 825. Recording all TALF loans at fair value, rather than at the remaining principal amount outstanding, results in consistent accounting treatment among all TALF-

related transactions and provides the most appropriate presentation of the TALF program on the financial statements by matching the change in fair value of TALF loans, the related put agreement with the consolidated TALF LLC, and the valuation of the beneficial interests in TALF LLC. Additional information regarding the TALF LLC assets and liabilities is presented in Note 9.

In certain cases where there is limited activity around inputs to the valuation, loans are classified within level 3 of the valuation hierarchy. Because external price information was not available, market-based models were used to determine the fair value of these loans. The fair value of the TALF loans was determined by valuing the future cash flows from loan interest income and the estimated fair value losses associated with collateral that may be put to the Bank. The valuation model takes into account a range of outcomes on TALF loan repayments, market prices of the collateral, risk premiums estimated using market prices, and the volatilities of market risk factors. Other methodologies employed or assumptions made in determining fair value could result in an amount that differs significantly from the amount reported.

The following table presents the TALF loans at fair value as of December 31, 2009, by ASC 820 hierarchy (in millions):

	Fair Value Hierarchy			Total Fair Value
	Level 1	Level 2	Level 3	
TALF loans	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 48,183</u>	<u>\$48,183</u>

The table below presents a reconciliation of the TALF loans, which are measured at fair value using significant unobservable inputs (Level 3) during the period February 4, 2009 (inception), to December 31, 2009 (in millions):

	Fair Value at February 4, 2009 ¹	Loans Originated ²	Unrealized Gains	Transfers Out ³	Fair Value at December 31, 2009
TALF loans	<u>\$ —</u>	<u>\$61,626</u>	<u>\$557</u>	<u>\$(14,000)</u>	<u>\$48,183</u>

¹TALF LLC was formed on February 4, 2009.

²Loans originated include \$52 million in accrued interest receivable.

³Net transfers out represent principal prepayments.

The fair value of TALF loans reported in the Consolidated Statements of Condition at December 31, 2009, includes \$557 million in unrealized gains. The Bank attributes substantially all changes in fair value of non-recourse loans to changes in instrument-specific credit spreads.

The table below presents principal and accrued interest by concentration for the TALF loans as of December 31, 2009 (in millions):

Collateral Type and Credit Rating	Years to Maturity			Percent of Total
	Up to 3 Years	Over 3 Years to 5 Years	Total	
Auto (AAA)	\$ 5,851	\$ —	\$ 5,851	12%
CMBS (AA)	—	25	25	0%
CMBS (AAA)	3,572	4,941	8,513	18%
Credit card (AAA)	20,297	—	20,297	43%
Floorplan (AAA)	2,427	—	2,427	5%
SBAs (AAA)	915	357	1,272	3%
Student loan (AAA)	2,236	4,168	6,404	13%
Other (AAA) ¹	2,837	—	2,837	6%
Total	\$38,135	\$9,491	\$47,626	100%

¹Includes equipment, servicing advances, and premium finance ABS.

The aggregate remaining principal amount outstanding on TALF loans as of December 31, 2009, was \$47,574 million.

At December 31, 2009, no TALF loans were over ninety days past due or in non-accrual status.

Since the Bank recorded the TALF loans at fair value, an allowance for loan losses was not required.

AIG

The \$21,250 million extended to AIG under the revolving line of credit is net of unamortized deferred commitment fees and allowance for restructuring and includes unpaid commitments fees and capitalized interest. The AIG loan is reported as a component of “Other loans” in the Consolidated Statements of Condition.

The table below represents the components of the loan amounts outstanding to AIG at December 31.

AIG Loan Components	2009	2008
Line of credit drawn	\$17,900	\$36,800
Capitalized interest	3,835	1,932
Unpaid commitment fees	1,700	1,700
Unamortized deferred commitment fees	(697)	(1,518)
Allowance for loan restructuring, net	(1,488)	—
Loan to AIG, net	\$21,250	\$38,914

The fair value of the AIG line of credit provided by the Bank, based on estimated draws and repayments, was not materially different from the net amount reported as a component of “Other loans” in the Consolidated Statements of Condition at December 31, 2009.

The activity related to the allowance for loan restructuring for the year ended December 31, 2009, was as follows (in millions):

	January 1, 2009	Provisions for Loan Restructuring	Recoveries	December 31, 2009
AIG	\$ —	\$ (2,621)	\$ 1,133	\$ (1,488)

The allowance for loan restructuring represents the economic effect of the reduction of the interest rate on loans the Bank made to AIG prior to April 17, 2009, as part of the loan restructuring that occurred on that date. The restructuring charges will be recovered over the remaining term of the related loan. The allowance outstanding, net of amortized recoveries, is deducted from “Other loans” in the Consolidated Statements of Condition and recoveries are reported as a component of “Interest income: Other loans” on the Consolidated Statements of Income and Comprehensive Income. The average balance of the credit extensions to AIG under the revolving line of credit, net of the allowance for restructuring, during the year ended December 31, 2009, was \$39,099 million. Interest income recognized on credit extensions to AIG during the year ended December 31, 2009, was \$3,996 million. There was no interest income foregone after the recorded restructuring.

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

The Bank, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank’s allocated share of SOMA balances was approximately 39.088 percent and 35.579 percent at December 31, 2009 and 2008, respectively.

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):

	2009					
	Treasury Securities				GSE Debt Securities	Federal Agency and GSE MBS
	Bills	Notes	Bonds	Total Treasury Securities		
Par	\$ 7,201	\$ 222,143	\$ 74,205	\$ 303,549	\$ 62,493	\$ 355,060
Unamortized premiums	—	2,558	9,561	12,119	2,935	4,734
Unaccreted discounts	—	(387)	(246)	(633)	(10)	(608)
Total amortized cost	\$ 7,201	\$ 224,314	\$ 83,520	\$ 315,035	\$ 65,418	\$ 359,186
Fair value	\$ 7,201	\$ 227,896	\$ 90,182	\$ 325,279	\$ 65,450	\$ 357,374
	2008					
	Treasury Securities				GSE Debt Securities	Federal Agency and GSE MBS
	Bills	Notes	Bonds	Total Treasury Securities		
Par	\$ 6,555	\$ 119,112	\$ 43,663	\$ 169,330	\$ 7,012	\$ —
Unamortized premiums	—	98	2,387	2,485	379	—
Unaccreted discounts	—	(298)	(220)	(518)	(12)	—
Total amortized cost	\$ 6,555	\$ 118,912	\$ 45,830	\$ 171,297	\$ 7,379	\$ —
Fair value	\$ 6,555	\$ 127,270	\$ 60,283	\$ 194,108	\$ 7,423	\$ —

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

2009						
	Treasury Securities			Total Treasury Securities	GSE Debt Securities	Federal Agency and GSE MBS
	Bills	Notes	Bonds			
Amortized cost	\$18,423	\$573,877	\$213,672	\$805,972	\$167,362	\$918,927
Fair value	18,423	583,040	230,717	832,180	167,444	914,290
2008						
	Treasury Securities			Total Treasury Securities	GSE Debt Securities	Federal Agency and GSE MBS
	Bills	Notes	Bonds			
Amortized cost	\$18,422	\$334,217	\$128,810	\$481,449	\$20,740	\$ —
Fair value	18,422	357,709	169,433	545,564	20,863	—

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

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

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

Distribution of MBS Holdings by Coupon Rate	Amortized Cost	Fair Value
Allocated to the Bank:		
4.0%	\$ 66,495	\$ 64,784
4.5%	169,778	168,720
5.0%	76,384	76,772
5.5%	40,408	40,879
6.0%	4,968	5,043
Other ¹	1,153	1,176
Total	\$359,186	\$357,374
System total:		
4.0%	\$ 170,119	\$165,740
4.5%	434,352	431,646
5.0%	195,418	196,411
5.5%	103,379	104,583
6.0%	12,710	12,901
Other ¹	2,949	3,009
Total	\$918,927	\$914,290

¹Represents less than 1 percent of the total portfolio.

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

	Securities Purchased under Agreements to Resell		Securities Sold under Agreements to Repurchase	
	2009	2008	2009	2008
Allocated to the Bank:				
Contract amount outstanding, end of year	\$ —	\$ 28,464	\$30,383	\$ 31,435
Average daily amount outstanding, during the year	1,287	30,778	25,779	19,702
Maximum month-end balance outstanding, during the year	—	42,339	30,383	35,067
Securities pledged, end of year	—	—	30,434	28,071
System total:				
Contract amount outstanding, end of year	\$ —	\$ 80,000	\$77,732	\$ 88,352
Average daily amount outstanding, during the year	3,616	86,227	67,837	55,169
Maximum month-end balance outstanding, during the year	—	119,000	77,732	98,559
Securities pledged, end of year	—	—	77,860	78,896

The Bank has revised its disclosure of securities purchased under agreements to resell and securities sold under agreements to repurchase from a weighted average calculation, disclosed in 2008, to the simple daily average calculation, disclosed above. The previously reported System total 2008 weighted average amount outstanding for securities purchased under agreements to resell was \$97,037 million, of which \$34,525 million was allocated to the Bank. The previously reported System total 2008 weighted average amount outstanding for securities sold under agreements to repurchase was \$65,461 million, of which \$23,290 million was allocated to the Bank.

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

The remaining maturity distribution of Treasury securities, GSE debt securities, Federal agency and GSE MBS bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2009, was as follows (in millions):

	Treasury Securities (Par Value)	GSE Debt Securities (Par Value)	Federal Agency and GSE MBS (Par Value)	Securities Purchased under Agreements to Resell (Contract Amount)	Securities Sold under Agreements to Repurchase (Contract Amount)
Within 15 days	\$ 4,541	\$ 27	\$ —	\$ —	\$30,383
16 days to 90 days	11,278	1,190	—	—	—
91 days to 1 year	19,845	8,415	—	—	—
Over 1 year to 5 years	127,767	38,854	5	—	—
Over 5 years to 10 years	83,538	13,207	8	—	—
Over 10 years	56,580	800	355,047	—	—
Total allocated to the Bank	<u>\$303,549</u>	<u>\$62,493</u>	<u>\$355,060</u>	<u>\$ —</u>	<u>\$30,383</u>

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2009, which differs from the stated maturity primarily because it factors in prepayment assumptions, is approximately 6.4 years.

At December 31, 2009 and 2008, Treasury securities and GSE debt securities with par values of \$21,610 million and \$180,765 million, respectively, were loaned from the SOMA, of which \$8,447 million and \$64,315 million, respectively, were allocated to the Bank.

At December 31, 2009, the total of other investments was \$5 million, of which \$2 million was allocated to the Bank. Other investments consist of cash and short-term investments related to the Federal agency and GSE MBS portfolio.

At December 31, 2009, the total of other liabilities was \$601 million, of which \$235 million was allocated to the Bank. These other liabilities, which are related to purchases of Federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the Bank on the settlement date. Although the Bank has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered. The amount reported as other liabilities represents the Bank's obligation to pay for the securities when delivered.

The Bank enters into commitments to buy Federal agency and GSE MBS and records the related MBS on a settlement-date basis. As of December 31, 2009, the total purchase price of the Federal agency and GSE MBS under outstanding commitments was \$160,099 million, of which \$32,838 million was related to dollar roll transactions. The amount of outstanding commitments allocated to the Bank was \$62,579 million, of which \$12,836 million was related to dollar roll transactions. These commitments, which had contractual settlement dates extending through March 2010, are primarily for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitments are unknown at the time of the trades. These commitments are subject to market and counterparty risks that result from their future settlement. As of December 31, 2009, the fair value of Federal agency and GSE MBS under outstanding commitments was \$158,868 million, of which \$62,098 million was allocated to the Bank. During the year ended December 31, 2009, the Reserve Banks recorded net gains from dollar-roll-related sales of \$879 million, of which \$355 million was allocated to the Bank. These net gains are reported as "Non-Interest Income (Loss): Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Combined Statements of Income and Comprehensive Income.

7. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The Bank, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. These investments are guaranteed as to principal and interest by the issuing foreign governments. In addition, the Bank enters into transactions to purchase foreign-currency-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 investments denominated in foreign currencies was approximately 26.605 percent and 25.034 percent at December 31, 2009 and 2008, respectively.

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

	<u>2009</u>	<u>2008</u>
Euro:		
Foreign currency deposits	\$ 1,968	\$1,393
Securities purchased under agreements to resell	689	1,020
Government debt instruments	1,313	1,154
Yen:		
Foreign currency deposits	906	872
Government debt instruments	<u>1,848</u>	<u>1,771</u>
Total allocated to the Bank	<u>\$ 6,724</u>	<u>\$6,210</u>

At December 31, 2009 and 2008, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was \$6,779 million and \$6,264 million, respectively. The fair value of government-debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the Treasury securities, GSE debt securities, and Federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

Total Reserve Bank investments denominated in foreign currencies were \$25,272 million and \$24,804 million at December 31, 2009 and 2008, respectively. At December 31, 2009 and 2008, the fair value of the total Reserve Bank investments denominated in foreign currencies, including accrued interest, was \$25,481 million and \$25,021 million, respectively.

The remaining maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2009, was as follows (in millions):

	<u>Euro</u>	<u>Yen</u>	<u>Total</u>
Within 15 days	\$ 1,614	\$ 964	\$2,578
16 days to 90 days	667	123	790
91 days to 1 year	641	630	1,271
Over 1 year to 5 years	1,049	1,036	2,085
Total allocated to the Bank	<u>\$3,971</u>	<u>\$2,753</u>	<u>\$6,724</u>

At December 31, 2009 and 2008, the authorized warehousing facility was \$5 billion, with no balance outstanding.

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

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 26.605 percent and 25.034 percent at December 31, 2009 and 2008, respectively.

At December 31, 2009 and 2008, the total Reserve Bank amount of foreign currency held under U.S. dollar liquidity swaps was \$10,272 million and \$553,728 million, respectively, of which \$2,733 million and \$138,622 million, respectively, were allocated to the Bank.

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

	2009			2008		
	Within 15 Days	16 Days to 90 Days	Total	Within 15 Days	16 Days to 90 Days	Total
Australian dollar	\$ —	\$ —	\$ —	\$ 2,503	\$ 3,212	\$ 5,715
Danish krone	—	—	—	—	3,755	3,755
Euro	1,731	—	1,731	37,794	35,144	72,938
Japanese yen	145	—	145	11,990	18,731	30,721
Korean won	—	—	—	—	2,592	2,592
Mexican peso	857	—	857	—	—	—
Norwegian krone	—	—	—	551	1,508	2,059
Swedish krona	—	—	—	2,503	3,755	6,258
Swiss franc	—	—	—	4,812	1,491	6,303
U.K. pound	—	—	—	30	8,251	8,281
Total	\$2,733	\$ —	\$2,733	\$60,183	\$ 78,439	\$138,622

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2008 and 2009.

9. INVESTMENTS HELD BY CONSOLIDATED VARIABLE INTEREST ENTITIES

a. Summary Information for Consolidated Variable Interest Entities

The total assets of consolidated VIEs, including cash, cash equivalents, and accrued interest, at December 31 were as follows (in millions):

	2009	2008
CPFF	\$14,233	\$334,910
ML	28,140	30,635
ML II	15,912	19,195
ML III	22,797	27,256
TALF LLC	298	—
Total	\$81,380	\$411,996

The Bank's maximum exposure to loss at December 31, 2009 and 2008, was \$73,879 million and \$405,377 million, respectively. These estimates incorporate potential losses associated with assets recorded on the Bank's balance sheet, net of the fair value of subordinated interests (beneficial interest in consolidated VIEs).

The classification of significant assets and liabilities of the consolidated VIEs at December 31 was as follows (in millions):

	2009	2008
Assets:		
Commercial paper	\$ 9,421	\$333,631
CDOs	22,650	26,957
Non-agency RMBS	17,552	20,675
Federal agency and GSE MBS	18,149	15,654
Commercial mortgage loans	4,025	5,553
Residential mortgage loans	583	937
Swap contracts	1,127	2,454
Other investments	5,467	2,340
Subtotal	\$ 78,974	\$408,201
Cash, cash equivalents, and accrued interest receivable	2,406	3,795
Total investments held by consolidated VIEs	\$ 81,380	\$411,996
Liabilities:		
Beneficial interest in consolidated VIEs	\$ (5,095)	\$ (2,824)
Other liabilities ¹	\$ (1,316)	\$ (5,813)

¹ The amounts reported as "Consolidated variable interest entities: Other liabilities" in the Consolidated Statements of Condition at December 31, 2009, included \$980 million related to cash collateral received on swap contracts and at December 31, 2008, included \$2,572 million related to cash collateral received on swap contracts and \$2,369 million payable for investments purchased by VIEs. The amounts for 2009 and 2008 also included accrued interest, unearned registration fees, and accrued other expenses.

Total realized gains (losses) and unrealized gains (losses) for the twelve months ended December 31, 2009, were as follows (in millions):

	Total Portfolio Holdings Realized Gains (Losses)	Fair Value Changes Unrealized Gains (Losses)	Total Portfolio Holdings Realized/Unrealized Gains (Losses)
CDOs	\$ (3)	\$(1,211)	\$ (1,214)
Non-agency RMBS	217	(991)	(774)
Federal agency and GSE MBS	322	521	843
Commercial mortgage loans	(47)	(1,177)	(1,224)
Residential mortgage loans	(48)	(219)	(267)
Swap contracts	(119)	212	93
Other investments	12	712	724
Other assets	(182)	64	(118)
Total	\$ 152	\$(2,089)	\$ (1,937)

Total realized gains (losses) and unrealized gains (losses) for the twelve months ended December 31, 2008, were as follows (in millions):

	Total Portfolio Holdings Realized Gains (Losses)	Fair Value Changes Unrealized Gains (Losses)	Total Portfolio Holdings Realized/Unrealized Gains (Losses)
CDOs	\$ —	\$(3,281)	\$ (3,281)
Non-agency RMBS	(4)	(3,001)	(3,005)
Federal agency and GSE MBS	(166)	50	(116)
Commercial mortgage loans	42	(2,130)	(2,088)
Residential mortgage loans	(3)	(563)	(566)
Swap contracts	(70)	155	85
Other investments	237	(892)	(655)
Total	\$ 36	\$(9,662)	\$ (9,626)

The net income (loss) attributable to ML, ML II, ML III, and CPFF for the twelve months ended December 31, 2009, and for TALF LLC for the period from inception to December 31, 2009, was as follows (in millions):

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	\$ 1,476	\$ 1,088	\$ 3,032	\$ 4,224	\$ —	\$ 9,820
Less: Interest expense	61	33	171	—	2	267
Net interest income	1,415	1,055	2,861	4,224	(2)	9,553
Non-interest income:						
Portfolio holdings						
gains (losses)	(102)	(604)	(1,239)	8	—	(1,937)
Less: Unrealized gains						
(losses) on beneficial						
interest in						
consolidated VIEs	61	34	(1,299)	—	(699) ¹	(1,903)
Net non-interest	(41)	(570)	(2,538)	8	(699)	(3,840)
Total net interest						
income and						
non-interest income	1,374	485	323	4,232	(701)	5,713
Less: Professional fees	55	12	27	30	1	125
Net income (loss)						
attributable to						
consolidated						
VIEs	\$ 1,319	\$ 473	\$ 296	\$ 4,202	\$ (702)²	\$ 5,588

¹ The TALF LLC reported net operating income of \$776 million for the period from inception to December 31, 2009, included gains of \$557 million on the put option between the Bank and TALF LLC that are eliminated in consolidation. The unrealized loss on beneficial interest in consolidated VIEs represents Treasury's 90 percent financial interest in the TALF LLC's net operating income.

² The net loss of the TALF LLC does not include income and gains on the TALF loans extended by the Bank. The amounts of interest income, administrative fee income, and unrealized gains recorded by the Bank related to the TALF loans from inception to December 31, 2009, were \$414 million, \$54 million, and \$557 million, respectively. In the Consolidated Statements of Income and Comprehensive Income, these are reported as follows: interest income is reported as "Other loans, net," administrative fee income is reported as "Other income," and unrealized gains is reported as "Other loans unrealized gains." Additional information regarding TALF loans is presented in Note 5.

The net income (loss) attributable to consolidated VIEs from inception through December 31, 2008, was as follows (in millions):

	ML	ML II	ML III	CPFF	Total
Interest income:					
Portfolio interest income	\$ 1,561	\$ 302	\$ 517	\$1,707	\$ 4,087
Less: Interest expense	332	103	28	—	463
Net interest income	1,229	199	489	1,707	3,624
Non-interest income:					
Portfolio holdings gains (losses)	(5,497)	(1,499)	(2,633)	3	(9,626)
Less: Unrealized gains on beneficial interest in consolidated VIEs	1,188	1,003	2,198	—	4,389
Non-interest income (loss)	(4,309)	(496)	(435)	3	(5,237)
Total net interest income and non-interest income	(3,080)	(297)	54	1,710	(1,613)
Less: Professional fees	54	5	9	12	80
Net income (loss) attributable to consolidated VIEs	<u>\$(3,134)</u>	<u>\$ (302)</u>	<u>\$ 45</u>	<u>\$1,698</u>	<u>\$(1,693)</u>

The subordinated financial interest of the consolidated VIEs from inception through December 31, 2009, was as follows (in millions):

	ML I Subordinated Loan	ML II Deferred Purchase Price	ML III Equity Contribution	TALF Treasury Contribution	Total
Beginning principal in 2008	\$1,150	\$ 1,000	\$ 5,000	\$ —	\$7,150
Interest accrued and capitalized	38	3	22	—	63
Ending principal balance	1,188	1,003	5,022	—	7,213
Unrealized (gain)	(1,188)	(1,003)	(2,198)	—	(4,389)
Balance at December 31, 2008	\$ —	\$ —	\$ 2,824	\$ —	\$2,824
Treasury loan	\$ —	\$ —	\$ —	\$100	\$ 100
Interest accrued and capitalized	61	34	171	2	268
Ending principal balance	61	34	2,995	102	3,192
Unrealized (gain)/loss	(61)	(34)	1,299	699	1,903
Balance at December 31, 2009	\$ —	\$ —	\$ 4,294	\$801	\$5,095

b. Commercial Paper Funding Facility LLC

The CPFF Program charged a lending rate for unsecured commercial paper equal to a three-month OIS rate plus 100 basis points per annum, with an additional surcharge of 100 basis points per annum for an unsecured credit enhancement fee. The interest rate for ABCP is the three-month OIS rate plus 300 basis points.

Unsecured commercial paper issuers covered by the FDIC Temporary Liquidity Guarantee Program are viewed as having a satisfactory guarantee and the credit enhancement fee for those participants is waived. The credit enhancement fee is amortized on a straight-line basis over the term of the commercial paper, which is not materially different from the interest method. The registration fees are amortized on a straight-line basis over the life of the program, which is not materially different from the interest method.

The Bank conducts a periodic review of the CPFF's commercial paper to determine if impairment is other than temporary such that a loss should be recognized. At December 31, 2009, there were no commercial paper securities for which management considered impairments to be other than temporary.

The remaining maturity distribution of the commercial paper and trading securities held by the CPFF at December 31, 2009, was as follows (in millions):

	Commercial Paper		Trading Securities	Total
	Asset-Backed	Non-Asset-Backed		
Within 15 days	\$ —	\$ —	\$ 1	\$ 1
16 days to 60 days	7,422	1,999	30	9,451
61 days to 92 days	—	—	2,364	2,364
93 days to 124 days	—	—	2,392	2,392
Total	<u>\$ 7,422</u>	<u>\$1,999</u>	<u>\$4,787</u>	<u>\$14,208</u>

Top-tier commercial paper has received the highest ratings (A-1, P-1, F1) from all rating agencies that provide a rating for the paper. Split-rated commercial paper has received a top-tier rating from two rating agencies and second tier rating (A-2, P-2, F2) from a third rating agency. All of the commercial paper held by the CPFF at December 31, 2009, was top tier.

The credit ratings profile of the commercial paper held by the CPFF by asset type, issuer type, and industry sector, at December 31, 2009, was as follows (in millions):

	<u>Total</u>
Asset-backed:	
Multi-seller	\$3,583
Securities arbitrage	2,741
Structured investment vehicle	1,088
Registered investment company	10
Subtotal	7,422
Non-asset-backed:	
Insurance	1,999
Total	<u>\$9,421</u>

The largest issuer, an asset-backed commercial paper conduit of a diversified financial company, represents 29 percent of the total commercial paper portfolio holdings at December 31, 2009. This entity and affiliates of this entity, together, represent 62 percent of the total commercial paper portfolio held at December 31, 2009.

c. Maiden Lane LLC

ML's investment portfolio consists primarily of Federal agency and GSE MBS, non-agency RMBS, commercial and residential mortgage loans, and derivatives. A description of the significant holdings at December 31, 2009, and the associated credit risk for each holding follows.

i. Debt Securities

ML has investments in Federal agency and GSE MBS, which represent fractional ownership interests in RMBS issued by Federal agencies and GSEs. The yield characteristics of these securities may differ from traditional debt securities. One such major difference is that all or a principal part of the obligations may be prepaid at any time because the underlying mortgages may be prepaid at any time. A portion of the ML's investments include interest only ("IO") or principal only ("PO") security classes. The IO class receives the interest cash flows from the underlying mortgages, while the PO class receives the principal cash flows. The yield to maturity on these securities is sensitive to the rate of principal repayments (including prepayments) on the related underlying mortgage assets. The principal prepayments may have a material effect on yield to maturity. If the underlying mortgage assets experience greater-than-anticipated prepayments of principal, ML may not fully recoup its initial investment in IO classes.

The yield to maturity on the PO classes may be impacted by delinquencies or defaults on the underlying mortgage assets. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located, the level of the borrower's equity in the mortgaged property and the individual financial circumstances of the borrower. Changes in economic conditions, including delinquencies and defaults on the underlying mortgages, can affect the value, income, and liquidity of ML's positions.

ML's non-agency RMBS investments expose ML to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS are issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area

where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying mortgage loans, often referred to as an "available funds cap." As a result of this available funds cap, the return to ML on such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher interest rate.

As of December 31, 2009, approximately 51 percent of the properties collateralizing the non-agency RMBS held by ML were located in California and Florida, based on the geographic location data available for the underlying loans by aggregate unpaid principal balance.

Other investments are primarily comprised of CMBS and CDOs.

At December 31, 2009, the ratings breakdown of the \$20,965 million of debt securities, which are recorded at fair value in the ML portfolio as a percentage of aggregate fair value of all securities in the portfolio, was as follows:

Security type: ²	Ratings ¹						Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and Lower	Government/ Agency	
Federal agency and GSE							
MBS	0.0%	0.0%	0.0%	0.0%	0.0%	86.6%	86.6%
Non-agency							
RMBS	0.5%	0.5%	0.8%	0.3%	7.0%	0.0%	9.1%
Other ³	1.2%	0.6%	0.5%	0.7%	1.2%	0.1%	4.3%
Total	1.7%	1.1%	1.3%	1.0%	8.2%	86.7%	100.0%

¹Lowest of all ratings is used for the purposes of this table for securities rated by two or more nationally recognized statistical rating organizations.

²This table does not include ML's commercial and residential mortgage loans, swaps, and other derivative contracts.

³Includes all asset sectors that, individually, represent less than 5 percent of aggregate fair value of debt securities.

ii. Commercial and Residential Mortgage Loans

Commercial and residential mortgage loans are subject to a high degree of credit risk because of exposure to loss from loan defaults. Default rates are subject to a wide variety of factors, including, but not limited to, property performance, property management, supply and demand, construction trends, consumer behavior, regional economic conditions, interest rates, and others.

The performance profile for the commercial and residential mortgage loans at December 31, 2009, was as follows (in millions):

	Remaining Principal Amount Outstanding	Fair Value	Fair Value as a Percentage of Remaining Principal
Performing loans			
Commercial	\$ 7,037	\$ 3,879	55.1%
Residential	747	378	50.6%
Subtotal	7,784	4,257	54.7%
Non-performing loans (past due more than 90 days) ¹			
Commercial	1,081	146	13.5%
Residential	739	205	27.8%
Subtotal	1,820	351	19.3%
Total			
Commercial	8,118	4,025	49.6%
Residential	1,486	583	39.3%
Total loans	\$9,604	\$4,608	48.0%

¹ In 2009, ML changed its classification of non-performing/non-accrual loans to include loans with payments past due more than ninety days or when ML has doubts about the future performance of the loan assets. The prior-year classification included all loans more than sixty days past due. This change in presentation was made to conform to industry standards and did not have a material effect on ML's consolidated financial statements.

The following table summarizes the state in which residential mortgage loans are collateralized and the property types of the commercial mortgage loans held in the ML portfolio at December 31, 2009:

	Concentration of Unpaid Principal Balances	
	Residential	Commercial ²
By state:		
California	36.4%	
Florida	9.1%	
Other ¹	54.5%	
Total	100.0%	
By property:		
Hospitality		82.8%
Office		9.1%
Other ¹		8.1%
Total		100.0%

¹ No other individual state or property type comprises more than 5 percent of the total.

² One borrower represents approximately 50 percent of total unpaid principal balance of the commercial mortgage loan portfolio.

iii. Derivative Instruments

Derivative contracts are instruments, such as futures or swap contracts that derive their value from underlying assets, indexes, reference rates or a combination of these factors. The ML portfolio includes various derivative financial instruments, primarily consisting of a total return swap agreement ("TRS") with JPMC. ML and JPMC entered into the TRS with reference obligations representing single-named CDS primarily on ABS and interest rate swaps ("IRS") with various market participants, including JPMC. ML, through its investment manager, currently manages the CDS contracts within the TRS as a runoff portfolio and may unwind, amend, or novate reference obligations on an ongoing basis.

On an ongoing basis, per the terms of the TRS, ML pledges collateral for credit- or liquidity-related shortfalls based on 20 percent of the notional amount of sold CDS protection and 10 percent of the present value of future premiums on purchased CDS protection. Separately, ML and JPMC engage in bilateral posting of collateral to cover the net mark-to-market ("MTM") variations in the swap portfolio. ML only nets the collateral received from JPMC from the bilateral MTM posting for the reference obligations where JPMC is the counterparty. The values of ML's cash equivalents and investments, purchased by the re-hypothecation of cash collateral associated with the TRS, were \$0.8 billion and \$0.5 billion, respectively, as of December 31, 2009,

and \$2.1 billion and \$0.5 billion, respectively, as of December 31, 2008. In addition, ML has pledged \$1.5 billion and \$3.0 billion of Federal agency and GSE MBS to JPMC as of December 31, 2009 and 2008, respectively.

ML enters into additional derivative contracts consisting of futures and interest rate swaps to economically hedge its exposure to interest rates. All derivatives are recorded at fair value in accordance with ASC 815. None of the derivatives held in ML are designated as hedging instruments for accounting purposes.

The following risks are associated with the derivative instruments within ML as part of the TRS agreement with JPMC, as well as any derivatives outside of the TRS:

Market Risk

IRS obligate two parties to exchange one or more payments typically calculated with reference to fixed or periodically reset rates of interest applied to a specified notional principal amount. Notional principal is the amount to which interest rates are applied to determine the payment streams under IRS. Such notional principal amounts often are used to express the volume of these transactions but are not actually exchanged between the counterparties.

Futures contracts are agreements to buy and sell financial instruments for a set price on a future date. Initial margin deposits are made upon entering into futures contracts in the form of cash or securities. During the period that a futures contract is open, changes in the value of the contract are recorded as unrealized gains or losses by revaluing the contracts on a daily basis to reflect the market value of the contract at the end of each day's trading. Variation margin payments are paid or received, depending upon whether unrealized gains or losses result. When the contract is closed, ML will record a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and ML's cost basis in the contract. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates, and the underlying hedged assets. ML is also at risk of not being able to enter into a closing transaction for the futures contract because of an illiquid secondary market. ML had pledged collateral related to future contracts of \$40 million and \$69 million as of December 31, 2009 and 2008, respectively.

CDS are agreements that provide protection for the buyer against the loss of principal on a bond or loan in case of a default by the issuer. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency, or failure to meet payment

obligations when due. The buyer of the CDS pays a premium in return for payment protection upon the occurrence, if any, of a credit event. Upon the occurrence of a triggering credit event, the maximum potential amount of future payments the seller could be required to make under a CDS is equal to the notional amount of the contract. Such future payments could be reduced or offset by amounts recovered under recourse or by collateral provisions outlined in the contract, including seizure and liquidation of collateral pledged by the buyer. ML's derivatives portfolio consists of purchased credit protection with underlying referenced names not correlated to offset its exposure to sold credit protection.

Credit Risk

Credit risk is the risk of financial loss resulting from failure by a counterparty to meet its contractual obligations to ML. This can be caused by factors directly related to the counterparty, such as business or management. Taking collateral is the most common way to mitigate credit risk. ML takes financial collateral in the form of cash and marketable securities as part of the TRS agreement with JPMC, as well as the over-the-counter derivatives activities outside of the TRS.

The following table summarizes the notional amounts of derivative instruments by contract type outstanding as of December 31, 2009 and 2008 (in millions):

	Notional Amounts ^{1,2}	
	2009	2008
Interest rate contracts:		
IRS	\$ 3,185	\$11,188
Futures and options on futures ³	70	45
Credit derivatives:		
CDS	7,323	11,791
Total	\$10,578	\$23,024

¹ Represents the sum of gross long and gross short notional derivative contracts.

² There were 1,764 and 3,606 CDS and IRS contracts outstanding as of December 31, 2009 and 2008, respectively.

³ Futures and options on futures relate to contract obligations and not gross notional amounts.

The following table summarizes the fair value of derivative instruments by contract type on a gross basis as of December 31, 2009 (in millions):

	Derivatives Used in Trading Activities	
	Gross Derivative Assets	Gross Derivative Liabilities
Interest rate contracts:		
IRS	\$ 5	\$ 195
Futures and options on futures	20	—
Credit derivatives:		
CDS	3,271	1,816
Counterparty netting	(1,868)	(1,868)
Cash collateral netting	(281)	—
Total	\$ 1,147	\$ 143

The table below summarizes certain information regarding protection sold through CDS as of December 31, 2009 (in millions):

Credit Ratings of the Reference Obligation	Maximum Potential Payout/Notional					Fair Value
	Years to Maturity					
	Up to 1 Year	Over 1 Year to 3 Years	Over 3 Years to 5 Years	Over 5 Years	Total	
CDS:						
Investment-grade (AAA to BBB-)	\$40	\$140	\$ 5	\$ 165	\$ 350	\$ (154)
Non-investment- grade (BB+ and lower)	5	20	120	1,954	2,099	(1,640)
Total CDS	\$45	\$160	\$125	\$2,119	\$2,449	\$(1,794)

d. Maiden Lane II LLC

ML II's investments in non-agency RMBS expose ML II to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS are issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying mortgage loans, often referred to as an "available funds cap." As a result of this cap, the return to the holder of such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher rate of interest.

At December 31, 2009, the type/sector and rating composition of ML II's \$15,643 million non-agency RMBS portfolio, recorded at fair value, as a percentage of aggregate fair value, was as follows:

	Ratings ^{1,3}					Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and Lower	
Asset type:						
Alt-A (adjustable rate)	0.9%	3.1%	2.2%	1.9%	23.3%	31.3%
Subprime	7.7%	2.8%	3.0%	1.9%	39.4%	54.8%
Option ARM	0.0%	0.0%	0.0%	0.1%	6.0%	6.1%
Other ²	0.1%	0.6%	0.0%	0.0%	7.2%	7.8%
Total	8.7%	6.4%	5.2%	3.8%	75.9%	100.0%

¹ Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

² Includes all asset sectors that, individually, represent less than 5 percent of aggregate outstanding fair value of the debt securities.

³ Rows and columns may not total due to rounding.

At December 31, 2009, approximately 44 percent of the properties collateralizing the non-agency RMBS held by ML II were located in California and Florida, based on the geographic location data available for the underlying loans by aggregate unpaid principal balance.

e. Maiden Lane III LLC

The primary holdings within ML III are ABS CDOs. An ABS CDO is a security issued by a bankruptcy remote entity that is backed by a diversified pool of debt securities, which in the case of ML III are primarily RMBS and CMBS. The cash flows of ABS CDOs can be split into multiple segments, called “tranches,” which vary in risk profile and yield. The junior tranches bear the initial risk of loss, followed by the more senior tranches. The ABS CDOs in the ML III portfolio largely represent senior tranches. Because they are shielded from defaults by the subordinated tranches, senior tranches typically have higher credit ratings and lower yields than the underlying securities, and will often receive investment-grade ratings from one or more of the nationally recognized rating agencies. Despite the protection afforded by the subordinated tranches, senior tranches can experience substantial losses from actual defaults on the underlying non-agency RMBS or CMBS.

ABS CDO securities are limited recourse obligations of the issuer thereof payable solely from the underlying securities owned by the issuer or proceeds thereof. Consequently, holders of ABS CDO securities must rely solely on distributions on the collateral underlying such ABS CDO securities or the proceeds thereof for payment. Such collateral may consist of investment grade debt securities, high-yield debt securities, loans, structured finance securities, synthetic securities, and other debt instruments. Investments in assets through the purchase of synthetic securities present risks in addition to those resulting from direct purchases of those assets because the buyer of such synthetic security usually will have a contractual relationship only with the synthetic security counterparty and not the obligor on the reference obligation of such synthetic security. The buyer of a synthetic security will not benefit from any collateral supporting the reference obligation of such synthetic security, will not have any remedies that would normally be available to the holder of such reference obligation and will be subject to the credit risk of the synthetic security counterparty as well as the obligor on such reference obligation. Over the last several years, there has been a significant increase in the default rates of, delinquencies on, and rating downgrades reported on RMBS and CMBS. As a result of increases in the default rates and delinquencies, there has been a decrease in the amount of credit support available for the ABS CDO securities backed by such RMBS and CMBS since the issue date thereof. Diminished credit support as a result of increases in the default rates of, delinquencies on, and rating downgrades reported on RMBS and CMBS could increase the likelihood that payments may not be made to holders of ABS CDO securities.

Certain ABS CDO issuers can issue short-term eligible investments under Rule 2a-7 of the Investment Company Act of 1940 if the ABS CDO contains arrangements to remarket the securities at defined periods. The investments must contain put options (“2a-7 Puts”), which allow the purchasers to sell the ABS CDO at par to a third-party (“Put Provider”), if a scheduled remarketing is unsuccessful due to reasons other than a credit or bankruptcy event. As of December 31, 2009, the total notional value of ABS CDOs held by ML III with embedded 2a-7 Puts, for which AIGFP was, directly or indirectly, the Put Provider, was \$1.6 billion. ML III has entered into an agreement not to exercise the 2a-7 Puts, or to only exercise the 2a-7 Puts if it simultaneously repurchases the ABS CDOs at par. In return, ML III will receive the put premiums and AIGFP will take the necessary steps to attempt conversion of the ABS CDOs to long-term notes. The termination dates of this agreement range from December 31, 2010, to April 30, 2011, depending on the respective ABS CDOs.

CMBS and RMBS expose ML III to varying levels of credit, interest rate, liquidity, and concentration risk. Credit-related risk arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the securities are issued. The rate of delinquencies and defaults on residential and commercial mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower’s equity in the mortgaged property; and the individual financial circumstances of the borrower.

At December 31, 2009, the investment type/vintage and rating composition of ML III's \$22,339 million portfolio, recorded at fair value, as a percentage of aggregate fair value of all securities in the portfolio was as follows:

	Rating ^{1,2,3}						Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and Lower	Not Rated	
ABS CDOs:							
High-grade ABS CDOs	0.0%	0.0%	0.0%	0.0%	68.9%	0.0%	68.9%
Pre-2005	0.0%	0.0%	0.0%	0.0%	24.3%	0.0%	24.3%
2005	0.0%	0.0%	0.0%	0.0%	30.6%	0.0%	30.6%
2006	0.0%	0.0%	0.0%	0.0%	7.3%	0.0%	7.3%
2007	0.0%	0.0%	0.0%	0.0%	6.7%	0.0%	6.7%
Mezzanine ABS CDOs	0.0%	0.2%	0.0%	0.5%	8.0%	0.3%	8.9%
Pre-2005	0.0%	0.2%	0.0%	0.5%	4.4%	0.3%	5.4%
2005	0.0%	0.0%	0.0%	0.0%	2.8%	0.0%	2.8%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	0.0%	0.0%	0.7%	0.0%	0.7%
Commercial real- estate CDOs	1.5%	0.5%	18.9%	0.0%	0.0%	0.0%	21.0%
Pre-2005	1.5%	0.5%	3.1%	0.0%	0.0%	0.0%	5.2%
2005	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	15.8%	0.0%	0.0%	0.0%	15.8%
RMBS, CMBS, and Other:	0.2%	0.2%	0.1%	0.1%	0.6%	0.0%	1.2%
Pre-2005	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.2%
2005	0.1%	0.1%	0.1%	0.1%	0.4%	0.0%	0.9%
2006	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.1%
2007	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total investments	1.7%	0.8%	19.1%	0.6%	77.5%	0.3%	100.0%

¹ Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

² The year of issuance with the highest concentration of underlying assets as measured by outstanding principal balance determines the vintage of the CDO.

³ Rows and columns may not total due to rounding.

f. TALF LLC

TALF loans are extended on a non-recourse basis by the Bank. If the borrower does not repay the loan, the Bank will enforce its rights in the collateral and may sell the collateral, pursuant to a put agreement, to TALF LLC, established for the purpose of purchasing such assets. As of December 31, 2009, the Bank did not enforce its rights to the TALF loan collateral or exercise the put option; as a result, TALF LLC did not purchase any assets from the Bank.

Cash receipts resulting from the put option fees paid to the TALF LLC and proceeds from the Treasury's subordinated loan are invested in the following types of U.S. dollar-denominated short-term investments and cash equivalents eligible for purchase by the TALF LLC: (1) Treasury securities, (2) Federal agency securities that are senior, negotiable debt obligations of the Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal Home Loan Banks (FHLB) and Federal Farm Credit Banks (FFCB), which have a fixed rate of interest, (3) repurchase agreements that are collateralized by Treasury and Federal agency securities and fixed-rate agency MBS, and (4) money market mutual funds registered with the Securities and Exchange Commission and regulated under Rule 2a-7 of the Investment Company Act that invest exclusively in Treasury and Federal agency securities.

g. Fair Value Measurement

The consolidated VIEs have adopted ASC 820 and ASC 825 and have elected the fair value option for all securities and commercial and residential mortgages held by ML and TALF LLC. ML II and ML III qualify as non-registered investment companies under the provisions of ASC 946; therefore, all investments are recorded at fair value in accordance with ASC 820. In addition, the Bank has elected to record the beneficial interests in ML, ML II, ML III, and the TALF LLC at fair value.

The accounting and classification of these investments appropriately reflects the VIEs' and the Bank's intent with respect to the purpose of the investments and most closely reflects the amount of the assets available to liquidate the entities' obligations.

i. Fair Value Hierarchy

ASC 820 establishes a three-level fair value hierarchy that distinguishes between market participant assumptions developed using market data obtained from independent sources (observable inputs) and the consolidated VIEs' assumptions about market participant assumptions developed using the best information available in the circumstances (unobservable inputs).

The three levels established by ASC 820 are described below:

- 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 inputs from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the consolidated VIEs' estimates of assumptions that market participants would use in pricing the asset and liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

ii. Determination of Fair Value

The consolidated VIEs value their investments on the basis of the last available bid prices or current market quotations provided by dealers, or pricing services selected by their designated investment managers. To determine the value of a particular investment, pricing services may use information on transactions in such investments; quotations from dealers; pricing metrics; market transactions in comparable investments; relationships observed in the market between investments; and calculated yield measures based on valuation methodologies commonly employed in the market for such investments.

Market quotations may not represent fair value in circumstances in which the investment manager believes that facts and circumstances applicable to an issuer, a seller, a purchaser, or the market for a particular security result in the current market quotations reflecting an inaccurate fair value of the security. To determine fair value, the investment manager applies proprietary valuation models that use collateral performance scenarios and pricing metrics derived from the reported performance of the universe of bonds with similar characteristics, as well as the observable market.

Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available fair value, the fair value of these investments may differ significantly from the values that would have been reported if a readily available fair value had existed for these investments and may differ materially from the values that may ultimately be realized.

The fair value of the liability for the beneficial interests of consolidated VIEs was estimated based upon the fair value of the underlying assets held by the VIEs. The holders of these beneficial interests do not have recourse to the general credit of the Bank.

iii. Valuation Methodologies for Level 3 Assets and Liabilities

In certain cases where there is limited activity around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. For example, in valuing CDOs, certain collateralized mortgage obligations, and commercial and residential mortgage loans, the determination of fair value is based on collateral performance scenarios. These valuations also incorporate pricing metrics derived from the reported performance of the universe of bonds, as well as observations and estimates of market data. Because external price information is not available, market-based models are used to value these securities. Key inputs to the model are market spreads, data for each credit rating, collateral type, and other relevant contractual features. Because there is lack of observable pricing, securities and investment loans that are carried at fair value are classified within level 3.

The following table presents the financial instruments recorded in VIEs at fair value as of December 31, 2009, by ASC 820 hierarchy (in millions):

	2009				
	Level 1	Level 2	Level 3	Netting ¹	Total Fair Value
Assets:					
Cash equivalents	\$1,933	\$ 142	\$ —	\$ —	\$ 2,075
CDOs	—	241	22,409	—	22,650
Non-agency RMBS	—	9,461	8,091	—	17,552
Federal agency and GSE MBS	—	18,125	24	—	18,149
Commercial mortgage loans	—	—	4,025	—	4,025
Residential mortgage loans	—	—	583	—	583
Swap contracts	—	5	3,272	(2,150)	1,127
Other investments	31	5,413	23	—	5,467
Other assets	20	—	—	—	20
Total assets	\$1,984	\$33,387	\$38,427	\$(2,150)	\$71,648
Liabilities:					
Beneficial interest in consolidated VIEs	\$ —	\$ —	\$(5,095)	\$ —	\$(5,095)
Swap contracts	—	(195)	(1,816)	1,868	(143)
Total liabilities	\$ —	\$ (195)	\$(6,911)	\$ 1,868	\$(5,238)

¹ Derivative receivables and payables and the related cash collateral received and paid are shown netted when a master netting agreement exists.

The following table presents the financial instruments recorded in VIEs at fair value as of December 31, 2008, by ASC 820 hierarchy (in millions):

	2008			Total Fair Value
	Level 1	Level 2	Level 3	
Assets:				
CDOs	\$ —	\$ 155	\$26,802	\$26,957
Non-agency RMBS	—	8,165	12,510	20,675
Federal agency and GSE MBS	—	14,759	895	15,654
Commercial mortgage loans	—	—	5,553	5,553
Residential mortgage loans	—	—	937	937
Swap contracts	—	—	2,454	2,454
Other investments	—	1,992	348	2,340
Total assets	\$ —	\$25,071	\$49,499	\$74,570
Liabilities:				
Beneficial interest in consolidated VIEs	\$ —	\$ —	\$ (2,824)	\$(2,824)

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (level 3) at December 31, 2009. Unrealized gains and losses related to those assets still held at December 31, 2009 and 2008 are reported as a component of “Consolidated variable interest entities: Investments held by consolidated variable interest entities, net” in the Consolidated Statements of Condition.

	2009				Fair Value December 31	Change in Unrealized Gains/(Losses) Related to Financial Instruments Held at December 31, 2009
	Fair Value January 1	Net Purchases, Sales, and Settlements	Total Realized/ Unrealized Gains (Losses)	Net Transfers In or Out		
Assets:						
CDOs	\$26,802	\$(3,123)	\$(1,267)	\$ (3)	\$ 22,409	\$(1,265)
Non-agency RMBS	12,510	(1,481)	(499)	(2,439)	8,091	(533)
Federal agency and GSE MBS	895	(248)	—	(623)	24	—
Commercial mortgage loans	5,553	(305)	(1,223)	—	4,025	(1,177)
Residential mortgage loans	937	(86)	(268)	—	583	(219)
Other investments	348	(263)	30	(92)	23	29
Total assets	\$47,045	\$(5,506)	\$(3,227)	\$(3,157)	\$35,155	\$(3,165)
Net swap contracts ²	\$ 2,454	\$ (906)	\$ 94	\$ (186)	\$ 1,456	\$ 212
Liabilities:						
Beneficial interest in consolidated VIEs	\$(2,824)	\$ (368) ¹	\$(1,903)	\$ —	\$(5,095)	\$(1,902)

¹Includes \$268 million in capitalized interest.

²Level 3 derivative assets and liabilities are presented net for the purposes of this table.

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (level 3) at December 31, 2008.

	2008				Fair Value December 31	Change in Unrealized Gains/(Losses) Related to Financial Instruments Held at December 31, 2008
	Fair Value January 1	Net Purchases, Sales, and Settlements	Total Realized/ Unrealized Gains (Losses)	Net Transfers In or Out		
Assets:						
CDOs	\$ —	\$29,740	\$(2,938)	\$ —	\$ 26,802	\$(2,938)
Non-agency RMBS	—	14,668	(2,158)	—	12,510	(2,159)
Federal agency and GSE MBS	—	891	4	—	895	4
Commercial mortgage loans	—	7,683	(2,130)	—	5,553	(2,130)
Residential mortgage loans	—	1,500	(563)	—	937	(563)
Swap contracts	—	2,369	85	—	2,454	155
Other investments	—	625	(277)	—	348	(278)
Total assets	\$ —	\$57,476	\$(7,977)	\$ —	\$49,499	\$(7,909)
Liabilities:						
Beneficial interest in consolidated VIEs	\$ —	\$(7,213) ¹	\$ 4,389	\$ —	\$(2,824)	\$ 4,389

¹Includes \$63 million in capitalized interest.

h. Professional Fees

The consolidated VIEs have recorded costs for professional services provided by several nationally recognized institutions to serve as investment managers, administrators, and custodians for the VIEs' assets. The fees charged by the investment managers, custodians, administrators, as well as the auditors, attorneys, and other service providers, are recorded in "Professional fees related to consolidated variable interest entities" in the Consolidated Statements of Income and Comprehensive Income.

10. NON-CONSOLIDATED VARIABLE INTEREST ENTITIES

In December 2009, the Bank obtained preferred securities in two VIEs. The Bank does not consolidate these VIEs because it does not have a controlling financial interest. The Bank's maximum exposure to any potential losses of the VIEs, should they occur, is limited to the recorded value of the Bank's investment in the preferred securities and dividends receivable from the VIE. The following table shows the financial information related to non-consolidated VIEs for the year ended December 31, 2009 (in millions):

	AIA LLC	ALICO LLC	Total Non-Consolidated VIEs
Total assets	\$89,100	\$114,800	\$203,900
Total liabilities	73,600	100,800	174,400
Maximum exposure to loss	16,068	9,038	25,106

The recorded value of the Bank's investment in the preferred securities, including capitalized dividends, was \$16,068 million for AIA LLC and \$9,038 million for ALICO LLC at December 31, 2009. The Bank's investment in preferred securities and capitalized dividends is reported as "Preferred securities," and dividends receivable are reported as a component of "Other assets" in the Bank's Consolidated Statements of Condition.

The fair value of the Bank's preferred interests in AIA LLC and ALICO LLC was not materially different from the amount reported as "Preferred securities" in the Consolidated Statements of Condition as of December 31, 2009.

11. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	<u>2009</u>	<u>2008</u>
Bank premises and equipment:		
Land	\$ 20	\$ 20
Buildings	322	257
Building machinery and equipment	71	70
Construction in progress	13	15
Furniture and equipment	127	100
Subtotal	<u>553</u>	<u>462</u>
Accumulated depreciation	(231)	(208)
Bank premises and equipment, net	<u><u>\$ 322</u></u>	<u><u>\$ 254</u></u>
Depreciation expense, for the year ended December 31	<u><u>\$ 26</u></u>	<u><u>\$ 25</u></u>

The Bank had capitalized software assets, net of amortization, of \$57 million and \$43 million at December 31, 2009 and 2008, respectively. Amortization expense was \$15 million and \$14 million for the years ended December 31, 2009 and 2008, respectively. Capitalized software assets are reported as a component of “Other assets” in the Consolidated Statements of Condition and the related amortization is reported as a component of “Other expenses” in the Consolidated Statements of Income and Comprehensive Income.

12. COMMITMENTS AND CONTINGENCIES

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

Operating Leases

At December 31, 2009, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from one to approximately fourteen years. These leases provide for increased rental 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 \$17 million and \$14 million for the years ended December 31, 2009 and 2008, respectively.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2009, are as follows (in millions):

	Operating Leases
2010	\$ 8
2011	10
2012	10
2013	10
2014	10
Thereafter	93
Future minimum rental payments	\$ 141

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 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, 2009 or 2008.

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

Other Commitments

In support of financial market stability activities, the Bank entered into commitments to provide financial assistance and backstop support to financial institutions. The contractual amount represents the Bank's maximum exposure to loss in the event that the commitments are fully funded and there is a default by the borrower or total loss in value of pledged collateral. Total commitments at December 31, 2009 and 2008 were as follows (in millions):

	2009		2008	
	Contractual Amount	Unfunded Amount	Contractual Amount	Unfunded Amount
Loan commitment (Citigroup)	\$ —	\$ —	\$ 244,800	\$ 244,800
Secured line of credit (AIG)	35,000	17,100	60,000	23,200
Commercial loan commitments (ML)	157	157	266	266
Total	\$35,157	\$17,257	\$305,066	\$268,266

The agreement with Citigroup, while legally a loan commitment, is accounted for in accordance with FASB ASC Topic 460 (ASC 460), *Guarantees* (previously FIN 45). This agreement was terminated effective December 23, 2009, and, as a result, the Bank had no contractual obligation at December 31, 2009. The termination fee of \$50 million is reported as a component of “Other income” in the Consolidated Statements of Income.

The secured line of credit relates to the undrawn portion of the Bank’s commitment to lend to AIG. The amount of the Bank’s commitment to lend to AIG was reduced during the year ended December 31, 2009, as a result of the debt restructuring described in Note 3, Note 4, and Note 5. Collateral to secure the Bank’s loan to AIG includes the equity in AIG’s subsidiaries. The Bank does not expect to incur any losses related to the unfunded commitment as of December 31, 2009.

The undrawn portion of the Bank’s commercial loan commitment relates to commercial mortgage loans acquired by ML.

13. RETIREMENT AND THRIFT PLANS

Retirement Plans

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

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

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

	2009	2008
Actuarial present value of projected benefit obligation at January 1	\$7,031	\$5,325
Service cost-benefits earned during the period	204	150
Interest cost on projected benefit obligation	427	357
Actuarial (gain) loss	(28)	599
Contributions by plan participants	3	3
Special termination benefits	9	9
Benefits paid	(291)	(280)
Plan amendments	9	868
Actuarial present value of projected benefit obligation at December 31	<u>\$7,364</u>	<u>\$7,031</u>

Following is a reconciliation showing the beginning and ending balance of the System Plan assets, the funded status, and the accrued pension benefit costs (in millions):

	2009	2008
Plan assets at January 1 (of which \$5,037 and \$6,566 are measured at fair value as of January 1, 2009 and 2008, respectively)	\$ 5,053	\$ 6,604
Actual return on plan assets	1,016	(1,274)
Contributions by the employer	500	—
Contributions by plan participants	3	3
Benefits paid	(291)	(280)
Plan assets at December 31 (of which \$6,252 and \$5,037 are measured at fair value as of December 31, 2009 and 2008, respectively)	<u>\$ 6,281</u>	<u>\$ 5,053</u>
Funded status and accrued pension benefit costs	<u>\$(1,083)</u>	<u>\$(1,978)</u>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ (883)	\$ (989)
Net actuarial loss	(2,488)	(3,429)
Total accumulated other comprehensive loss	<u>\$(3,371)</u>	<u>\$(4,418)</u>

Accrued pension benefit costs are reported as “Accrued benefit costs” in the Consolidated Statements of Condition.

The accumulated benefit obligation for the System Plan, which differs from the estimated actuarial present value of the projected benefit obligation because it is based on current rather than future compensation levels, was \$6,430 million and \$6,143 million at December 31, 2009 and 2008, respectively.

The weighted-average assumptions used in developing the accumulated and projected pension benefit obligations for the System Plan as of December 31 were as follows:

	<u>2009</u>	<u>2008</u>
Discount rate	6.00%	6.00%
Rate of compensation increase	5.00%	5.00%

Net periodic benefit expenses for the years ended December 31, 2009 and 2008 were actuarially determined using a January 1 measurement date. In 2008, several amendments were made to the plan. As a result, the actuarially determined net periodic benefit expenses for the year ended December 31, 2008, were remeasured as of November 1, 2008, using a 7.75 percent discount rate. The plan amendments, the most significant of which was to incorporate annual, rather than ad-hoc, cost-of-living adjustments to the participants’ plan benefit, resulted in a \$60 million increase in net periodic benefit expenses for the year ended December 31, 2008. There were no significant benefit changes approved in 2009.

The weighted average assumptions used in developing net periodic benefit expenses for the System Plan for the years were as follows:

	<u>2009</u>	<u>2008</u>
Discount rate	6.00%	6.50%
Expected asset return	7.75%	8.00%
Rate of compensation increase	5.00%	5.00%

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the System Plan's benefits when due. The expected long-term rate of return on assets was based on a combination of factors, including the System Plan's asset allocation strategy and historical returns; surveys of expected rates of return for other entities' plans; a projected return for equities and fixed-income investments based on real interest rates, inflation expectations, and equity risk premiums; and surveys of expected returns in equity and fixed-income markets.

The components of net periodic pension benefit expense for the System Plan for the years ended December 31 are shown below (in millions):

	2009	2008
Service cost-benefits earned during the period	\$ 204	\$ 150
Interest cost on accumulated benefit obligation	427	357
Amortization of prior service cost	116	41
Amortization of net loss	285	78
Expected return on plan assets	(389)	(497)
Net periodic pension benefit expense	643	129
Special termination benefits	9	9
Total periodic pension benefit expense	\$ 652	\$ 138
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2010 are shown below:		
Prior service cost	\$ 112	
Net actuarial loss	181	
Total	\$ 293	

Following is a summary of expected benefit payments, excluding enhanced retirement benefits (in millions):

	Expected Benefit Payments
2010	\$ 332
2011	343
2012	364
2013	388
2014	411
2015-2018	2,389
Total	\$ 4,227

The System's Committee on Investment Performance ("CIP") is responsible for establishing investment policies, selecting investment managers, and monitoring the investment managers' compliance with the policies. At December 31, 2009, the System Plan's assets were held in six investment vehicles: a constant-mix asset allocation account, a liability-linked account, an indexed U.S. investment-grade bond fund, an indexed U.S. equity fund, a non-U.S. developed markets fund, and a money market fund. The diversity in investment vehicles is to limit concentration of risk and the risk of loss related to any specific sector. The constant mix account tracks the Standard & Poor's 500 Stock Index and the Barclays Aggregate Bond Index, and is automatically rebalanced. The liability-linked account, funded in April 2008, seeks to defease a portion of the System Plan's liability related to retired lives using a Treasury securities portfolio. The policy governing this account calls for cash-matching the first two years of a portion of retiree benefits payments and immunizing the remaining obligation. The money market fund is the repository for cash balances and adheres to a constant dollar accounting methodology. Permitted and prohibited investments, as well as use of derivatives, in the indexed vehicles for which the System Plan's assets are invested, are defined as part of the trust agreement for the selected investment vehicle. The CIP reviews this agreement as part of the selection of each investment to ensure that the trust agreement is consistent with the CIP's investment objectives for the System Plan's assets. In the case of the constant-mix asset allocation account, investments must be within the defined indexes and the use of derivatives is permitted to the extent necessary to manage cash flows.

The System Plan's policy and actual asset allocations at December 31, by asset category, are as follows:

	Policy Weight	2009	2008
U.S. equities	50.7%	53.0%	55.4%
International equities	11.8%	12.9%	5.9%
Fixed income	37.5%	33.8%	36.9%
Cash	0.0%	0.3%	1.8%
Total	100.0%	100.0%	100.0%

Contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System Plan's actuarial funding method is expected to produce a recommended annual funding range between \$400 and \$450 million. In 2010, the System will make monthly contributions of \$35 million and will reevaluate upon completion of the 2010 actuarial valuation. The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2009 and 2008, and for the years then ended, were not material.

The System Plan's investments are reported at fair value as required by ASC 820. ASC 820 establishes a three-level fair value hierarchy that distinguishes between market participant assumptions developed using market data obtained from independent sources (observable inputs) and the Bank's assumptions about market participant assumptions developed using the best information available in the circumstances (unobservable inputs).

The three levels established by ASC 820 are described below:

- 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 inputs from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Bank's estimates of assumptions that market participants would use in pricing the asset and liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The following tables present the financial instruments recorded at fair value as of December 31 by ASC 820 hierarchy (in millions):

Description	2009			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ —	\$ 24	\$ —	\$ 24
Treasury and Federal agency securities	677	38	—	715
GSE debt securities	—	156	—	156
Other fixed-income securities	—	128	—	128
Common stocks	883	—	—	883
Commingled funds	—	4,346	—	4,346
Total	\$1,560	\$4,692	\$ —	\$6,252

Description	2008			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ 15	\$ 119	\$ —	\$ 134
Treasury and Federal agency securities	852	109	—	961
GSE debt securities	—	403	—	403
Other fixed-income securities	—	482	—	482
Common stocks	1,905	—	—	1,905
Commingled funds	—	1,152	—	1,152
Total	\$2,772	\$2,265	\$ —	\$5,037

The System Plan enters into futures contracts, traded on regulated exchanges, to manage certain risks and to maintain appropriate market exposure in meeting the investment objectives of the System Plan. The System Plan bears the market risk that arises from any unfavorable changes in the value of the securities or indexes underlying these futures contracts. The use of futures contracts involves, to varying degrees, elements of market risk in excess of the amount recorded in the Consolidated Statements of Condition. The guidelines established by the CIP further reduce risk by limiting the net futures positions, for most fund managers, to 15 percent of the market value of the advisor's portfolio. No limit has been established on the futures positions of the liability-driven investments, since the fund manager only executes Treasury futures.

At December 31, 2009 and 2008, cash available for futures trading was \$1 million and \$2 million, respectively. At December 31, 2009, there were \$1 million of Treasury securities pledged as collateral. At December 31, 2008, there were no securities pledged as collateral.

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 employee contributions based on a specified formula. For the year ended December 31, 2008, and for the first three months of the year ended December 31, 2009, the Bank matched 80 percent of the first 6 percent of employee contributions for employees with less than five years of service and 100 percent of the first 6 percent of employee contributions for employees with five or more years of service. Effective April 1, 2009, the Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. The Bank's Thrift Plan contributions totaled \$19 million and \$15 million for the years ended December 31, 2009 and 2008, respectively, and are reported as a component of "Salaries and other benefits" in the Consolidated Statements of Income and Comprehensive Income.

14. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

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

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

	2009	2008
Accumulated postretirement benefit obligation at January 1	\$ 247.1	\$226.7
Service cost-benefits earned during the period	6.2	5.5
Interest cost on accumulated benefit obligation	14.9	14.1
Net actuarial loss	17.1	14.4
Curtailment gain	—	(0.6)
Contributions by plan participants	1.9	1.7
Benefits paid	(16.7)	(15.5)
Medicare Part D subsidies	1.0	0.8
Accumulated postretirement benefit obligation at December 31	<u>\$ 271.5</u>	<u>\$247.1</u>

At December 31, 2009 and 2008, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.75 percent and 6.00 percent, respectively.

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

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

	2009	2008
Fair value of plan assets at January 1	\$ —	\$ —
Contributions by the employer	13.8	13.0
Contributions by plan participants	1.9	1.7
Benefits paid	(16.7)	(15.5)
Medicare Part D subsidies	1.0	0.8
Fair value of plan assets at December 31	\$ —	\$ —
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 271.5</u>	<u>\$247.1</u>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 5.2	\$ 10.7
Net actuarial loss	(75.6)	(64.0)
Total accumulated other comprehensive loss	\$ (70.4)	\$ (53.3)

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs” in the Consolidated Statements of Condition.

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

	2009	2008
Health care cost trend rate assumed for next year	7.50%	7.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2015	2014

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, 2009 (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	\$ 3.2	\$ (2.6)
Effect on accumulated postretirement benefit obligation	31.5	(26.5)

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

	<u>2009</u>	<u>2008</u>
Service cost for benefits earned during the period	\$ 6.2	\$ 5.5
Interest cost on accumulated benefit obligation	14.9	14.1
Amortization of prior service cost	(5.5)	(5.3)
Amortization of net actuarial loss	<u>6.4</u>	<u>4.9</u>
Total periodic expense	22.0	19.2
Curtailment loss	—	0.6
Net periodic postretirement benefit expense	<u>\$22.0</u>	<u>\$19.8</u>
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2010 are shown below:		
Prior service cost	\$(4.4)	
Net actuarial loss	<u>7.3</u>	
Total	<u>\$ 2.9</u>	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2009 and 2008, the weighted average discount rate assumptions used to determine net periodic postretirement benefit expense were 6.00 percent and 6.25 percent, respectively.

Net periodic postretirement benefit expense is reported as a component of “Salaries and other benefits” in the Consolidated 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 \$0.8 million and \$0.4 million in the years ended December 31, 2009 and 2008, respectively. Expected receipts in 2010, related to benefits paid in the year ended December 31, 2009, are \$0.2 million.

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

	Without Subsidy	With Subsidy
2010	\$ 16.6	\$ 15.5
2011	17.7	16.5
2012	18.6	17.2
2013	19.5	18.0
2014	20.2	18.6
2015-2019	110.8	100.8
Total	<u>\$203.4</u>	<u>\$186.6</u>

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2009 and 2008, were \$38 million and \$29 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Consolidated Statements of Condition. Net periodic postemployment benefit expenses included in 2009 and 2008 operating expenses were \$13 million and \$4 million, respectively, and are recorded as a component of "Salaries and other benefits" in the Consolidated Statements of Income and Comprehensive Income.

15. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount Related to Defined Benefit Retirement Plan	Amount Related to Postretirement Benefits Other Than Retirement Plans	Total Accumulated Other Comprehensive Income (Loss)
Balance at January 1, 2008	\$ (1,298)	\$ (40)	\$ (1,338)
Change in funded status of benefit plans:			
Prior service costs arising during the year	(868)	—	(868)
Net actuarial loss arising during the year	(2,371)	(14)	(2,385)
Deferred curtailment gain	—	1	1
Amortization of prior service cost	41	(5)	36
Amortization of net actuarial loss	78	5	83
Change in funded status of benefit plans - other comprehensive (loss)	(3,120)	(13)	(3,133)
Balance at December 31, 2008	\$ (4,418)	\$ (53)	\$ (4,471)
Change in funded status of benefit plans:			
Prior service costs arising during the year	(10)	—	(10)
Net actuarial gain (loss) arising during the year	656	(16)	640
Amortization of prior service cost	116	(6)	110
Amortization of net actuarial loss	285	6	291
Change in funded status of benefit plans - other comprehensive income (loss)	1,047	(16)	1,031
Balance at December 31, 2009	\$ (3,371)	\$ (69)	\$ (3,440)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Notes 13 and 14.

16. BUSINESS RESTRUCTURING CHARGES

The Bank had no significant restructuring activities in 2009 and 2008.

17. SUBSEQUENT EVENTS

Subsequent events were evaluated through June 10, 2010, which is the date that the Bank reissued the consolidated financial statements in the Bank's Annual Report.

On March 1, 2010, AIG announced a definitive agreement with Prudential plc for the sale of the AIA Group for approximately \$35.5 billion, including approximately \$25 billion in cash, \$8.5 billion in Prudential plc equity securities, and \$2 billion in Prudential plc preferred stock. The cash proceeds from the sale were expected to be used to redeem the Bank's preferred interests in AIA LLC of approximately \$16 billion and to repay approximately \$9 billion under the Bank's line of credit agreement with AIG. Proceeds from the orderly sale, over time, of AIG's holdings of Prudential plc equity securities, following the agreed-on holding periods, would have been used to repay amounts outstanding under the Bank's line of credit agreement with AIG. In early June, Prudential plc announced its intention not to proceed with the transaction.

On March 8, 2010, AIG announced a definitive agreement for the sale of ALICO to MetLife, Inc., for approximately \$15.5 billion, including approximately \$6.8 billion in cash and \$8.7 billion in MetLife, Inc., equity securities, including common stock and convertible preferred securities. The cash proceeds from the sale will be used to redeem the Bank's preferred interests in ALICO LLC of approximately \$9 billion. Proceeds from the orderly sale, over time, of AIG's holdings of MetLife, Inc., equity securities, following the agreed-on holding periods, will be used to redeem the remainder of the Bank's preferred interests in ALICO LLC, and any residual proceeds will be used to repay amounts outstanding under the Bank's line of credit agreement with AIG.

On April 8, 2010, an agreement was reached to modify approximately \$4.1 billion of commercial mortgage and mezzanine loans held in ML's investment portfolio. These loans, which represent ML's largest investment based on unpaid principal balance, are reported as hospitality loans in the table in Note 9 that discloses the concentration of unpaid principal balances in the ML investment portfolio. The key provisions of the modification include the discounted payoff of certain mezzanine loans, the conversion of most junior mezzanine loans to preferred equity, an extension of the final maturity date of the remaining loans from 2013 to 2015, and an increase in interest rates and fees. Bank management is evaluating the impact of the modification and does not believe it will result in an adverse effect to the Bank's consolidated financial statements.

Directors of the Federal Reserve Bank of New York

CHANGES IN DIRECTORS

2010

Member banks in this District have reelected JAMIE DIMON a class A director for a three-year term beginning January 2010. Mr. Dimon, Chairman and Chief Executive Officer, JPMorgan Chase & Co., New York, N.Y., has been serving as a class A director since January 2007.

Member banks in this District have also reelected JEFFREY B. KINDLER a class B director for a three-year term beginning January 2010. Mr. Kindler, who is Chairman and Chief Executive Officer of Pfizer, Inc., New York, N.Y., has been serving as a class B director since September 2009.

The Board of Governors has reappointed LEE C. BOLLINGER, President, Columbia

University, a class C director for a three-year term beginning January 2010 and redesignated him Deputy Chair for the year 2010. Mr. Bollinger has been serving as a class C director since January 2007 and Deputy Chair since August 2009.

The Board of Governors has also redesignated DENIS M. HUGHES, President, New York State AFL-CIO, New York, N.Y., as Chair of the Board and Federal Reserve Agent for the year 2010. Mr. Hughes has been serving as a class C director since January 2006 and Chair since August 2009; he served as Deputy Chair from January 2007 until his appointment as Chair. Prior to that, Mr. Hughes served as a class B director from January 2004 through December 2005.

DIRECTORS OF THE FEDERAL RESERVE BANK OF NEW YORK

DIRECTORS	TERM EXPIRES DEC. 31	CLASS
JAMIE DIMON <i>Chairman and Chief Executive Officer</i> JPMorgan Chase & Co., New York, N.Y.	2009	A
RICHARD L. CARRIÓN <i>Chairman, President, and Chief Executive Officer</i> Popular, Inc., San Juan, P.R.	2010	A
CHARLES V. WAIT <i>President, Chief Executive Officer, and Chairman</i> The Adirondack Trust Company, Saratoga Springs, N.Y.	2011	A
JEFFREY B. KINDLER <i>Chairman and Chief Executive Officer</i> Pfizer, Inc., New York, N.Y.	2009	B
JAMES S. TISCH <i>President and Chief Executive Officer</i> Loews Corporation, New York, N.Y.	2010	B
JEFFREY R. IMMELT <i>Chairman and Chief Executive Officer</i> General Electric Company, Fairfield, Conn.	2011	B
LEE C. BOLLINGER, Deputy Chair <i>President</i> Columbia University, New York, N.Y.	2009	C
KATHRYN S. WYLDE <i>President and Chief Executive Officer</i> Partnership for New York City, New York, N.Y.	2010	C
DENIS M. HUGHES, Chair and Federal Reserve Agent <i>President</i> New York State AFL-CIO, New York, N.Y.	2011	C

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[†] Will retire effective May 1, 2010.

^{††} Will retire effective April 1, 2010.

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*Vice President*JOHN G. RICKETTI
*Vice President*PAUL D. WHYNOTT
Vice President[†] Will retire effective February 1, 2010.^{††} Will retire effective August 1, 2010.^{†††} On leave of absence.^{††††} Will retire effective April 1, 2010.

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BELINDA WILLIAMS

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HAYLEY BOESKY^{††}
Vice President

[†] On assignment at the Federal Reserve Bank of Richmond.

^{††} Resigned effective March 12, 2010.

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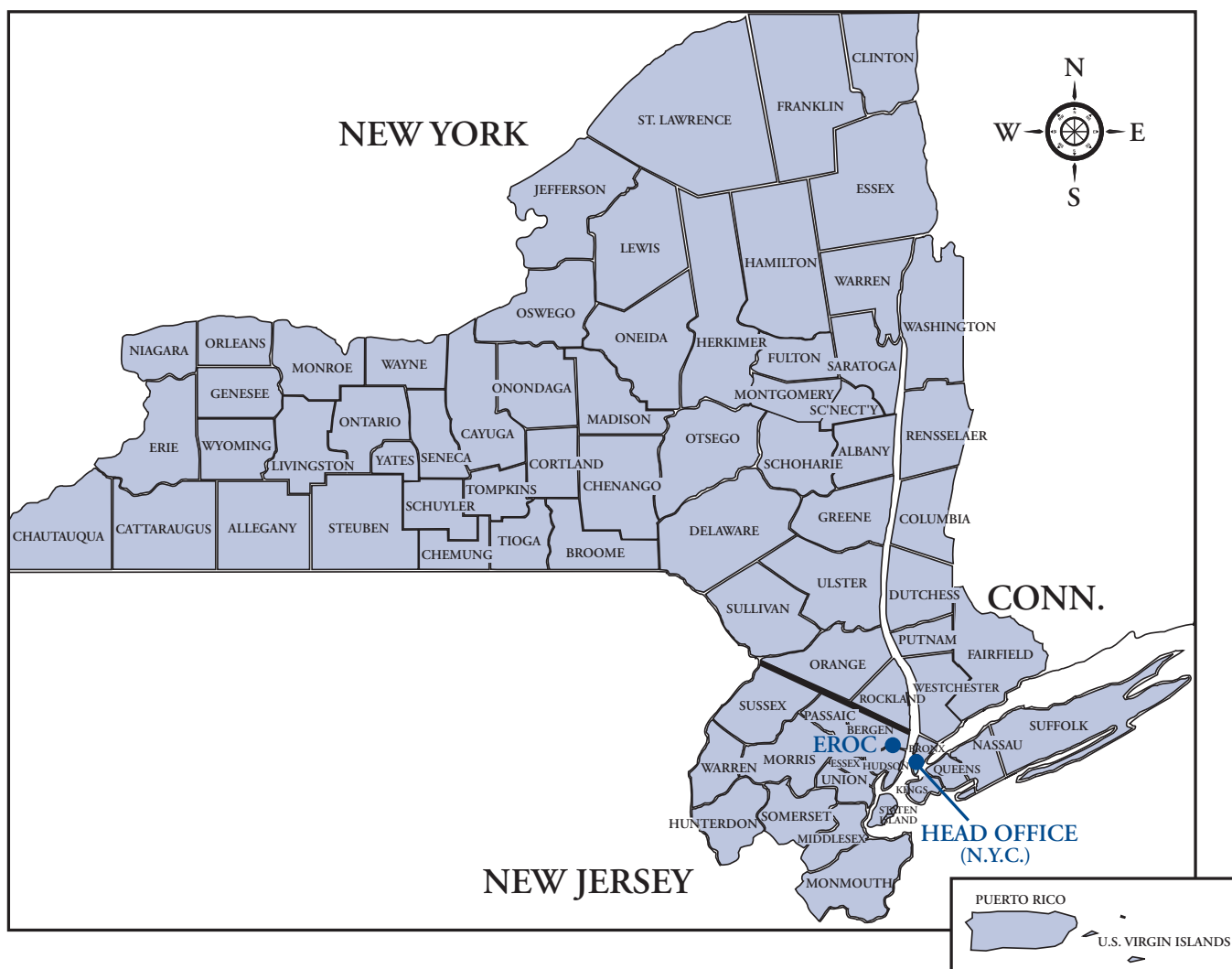
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P. BETH SCHWARTZBERG

Statistics Officer

Map of the Second Federal Reserve District

THE SECOND FEDERAL RESERVE DISTRICT



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