Financial Statements

STATEMENT OF CONDITION

(in millions)

ASSETS	December 31, 1996	December 31, 1995
Gold certificates	$ 4,049	$ 4,273
Special drawing rights certificates	3,385	3,903
Coin	21	19
Items in process of collection	1,796	764
U.S. government and federal agency securities, net	169,238	166,401
Investments denominated in foreign currencies	5,128	5,654
Accrued interest receivable	1,657	1,761
Bank premises and equipment, net	233	227
Other assets	976	891
Total assets	$186,483	$183,893

LIABILITIES AND CAPITAL		
Liabilities:		
Federal Reserve notes outstanding, net	$139,364	$139,004
Deposits:		
Depository institutions	8,167	8,658
U.S. Treasury, general account	7,742	5,979
Other deposits	177	426
Deferred credit items	883	734
Statutory surplus transfer due U.S. Treasury	296	—
Interest on Federal Reserve notes due U.S. Treasury	—	289
Interdistrict settlement account	27,599	26,517
Accrued benefit cost	136	129
Other liabilities	43	43
Total liabilities	184,407	181,779
Capital:		
Capital paid-in	1,052	1,057
Surplus	1,024	1,057
Total capital	2,076	2,114
Total liabilities and capital	$186,483	$183,893

These statements are prepared by Bank management. Copies of the external auditor's opinion on the 1996 financial statements will be made available upon request to the Bank's Public Information Department. The accompanying notes are an integral part of these financial statements.

STATEMENT OF INCOME

for the years ended December 31, 1996, and December 31, 1995
(in millions)

	December 31, 1996	December 31, 1995
Interest income:		
Interest on U.S. government securities	$9,207	$9,387
Interest on foreign currencies	118	211
Interest on loans to depository institutions	1	2
Total interest income	9,326	9,600
Other operating income:		
Income from services	105	96
Reimbursable services to government agencies	45	48
Foreign currency gains (losses), net	(444)	269
Government securities gains, net	12	3
Other income	32	28
Total other operating income (loss)	(250)	444
Operating expenses:		
Salaries and other benefits	284	262
Occupancy expense	43	38
Equipment expense	37	37
Cost of unreimbursed Treasury services	4	3
Assessments by Board of Governors	183	190
Other expenses	116	98
Total operating expenses	667	628
Income before cumulative effect of accounting change	8,409	9,416
Cumulative effect of change in accounting principle	—	(16)
Net income before net periodic pension expense	8,409	9,400
Net periodic pension credit	(141)	(119)
Net income prior to distribution	$8,550	$9,519
Distribution of net income:		
Dividends paid to member banks	65	61
Transferred to surplus	(5)	69
Payments to U.S. Treasury as interest on Federal Reserve notes	6,119	9,389
Payments to U.S. Treasury as required by statute	2,371	—
Total distribution	$8,550	$9,519

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STATEMENT OF CHANGES IN CAPITAL

for the years ended December 31, 1996, and December 31, 1995
(in millions)

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 1995 (19,752,655 shares)	$ 988	$ 988	$1,976
Net income transferred to surplus	—	69	69
Net change in capital stock issued (1,379,658 shares)	$ 69	—	$ 69
Balance at December 31, 1995 (21,132,313 shares)	1,057	1,057	2,114
Net income transferred to surplus	—	(5)	(5)
Statutory surplus transfer to the U.S. Treasury	—	(28)	(28)
Net change in capital stock (redeemed)((104,392) shares)	$ (5)	—	$ (5)
Balance at December 31, 1996 (21,027,921 shares)	$1,052	$1,024	$2,076

These statements are prepared by Bank management. Copies of the external auditor's opinion on the 1996 financial statements will be made available upon request to the Bank's Public Information Department. The accompanying notes are an integral part of these financial statements.

FEDERAL RESERVE BANK OF NEW YORK
Notes to Financial Statements

1. ORGANIZATION

The Federal Reserve Bank of New York ("Bank") is part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act"), which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. Other major elements of the System are the Federal Open Market Committee ("FOMC") and the Federal Advisory Council. The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property.

Structure

The Bank and its branch in Buffalo serve the Second Federal Reserve District, which includes the state of New York, twelve northern counties of New Jersey, and Fairfield County, Connecticut, as well as 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 chosen partly by nomination and election by member banks and partly by the Board of Governors. Banks that are members of the System include all national banks and any state-chartered bank that applies and is approved for membership in the System.

Board of Directors

The Federal Reserve Act specifies the composition of Reserve Bank boards of directors. 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 and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. 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.

2. OPERATIONS AND SERVICES

The System performs a variety of services and operations. Functions include: formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearing house operations, and check processing; distribution of coin and currency; fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies, state member banks, and U.S. offices of foreign banking organizations; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

3. SIGNIFICANT ACCOUNTING POLICIES

Specialized accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are generally documented in the "Financial Accounting Manual for Federal Reserve Banks" (the "Financial Accounting Manual"), which is published by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual. The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the policies of the Reserve Banks and generally accepted accounting principles ("GAAP"). The primary difference is the presentation of all security holdings at amortized cost rather than at the fair value presentation requirements of GAAP, and the accounting for matched sale-purchase transactions as separate sales and purchases, rather than secured borrowings with pledged collateral, as is required by GAAP. Accounting policies and practices for U.S. government and federal agency securities and investments denominated in foreign currencies are further described in note 3(d). In addition, the Bank has elected not to include a Statement of Cash Flows, as the liquidity and cash position of the Bank are not of primary concern to users of these financial statements. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. Therefore, a Statement of Cash Flows would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

The preparation of the financial statements in conformity with the Financial Accounting Manual requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Unique accounts and significant accounting policies are explained below.

a. Gold Certificates

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. These gold certificates held by the System are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged and the Reserve Banks' gold certificate account is lowered. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon Federal Reserve notes outstanding in each District.

b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") 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. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate account is increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations.

c. Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is recorded on the accrual method and is charged at the discount rate established at least every fourteen days by the Board of Directors of the Bank, subject to review by the Board of Governors. However, Reserve Banks retain the option to impose a surcharge above that rate in certain circumstances.

d. U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

The FOMC is composed of members of the Board of Governors, the Bank president and, on a rotating basis, four other Reserve Bank presidents. The FOMC has designated the Bank to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the Bank for its execution of transactions. Authorized transaction types include direct purchases and sales of securities, matched sale-purchase transactions, and the purchase of securities under agreements to resell. These transactions are conducted in U.S. government and federal agency securities. All balances and related income arising from these transactions, other than securities purchased under agreements to resell, are participated, or designated, to each Reserve Bank. All securities purchased under agreements to resell are designated to the Bank.

Specifically, the Bank provides or absorbs reserve deposits of depository institutions by purchasing or selling government securities, respectively, in the open market. While the application of current market prices to the securities currently held by the Reserve Banks may result in values substantially above or below their carrying values, these unrealized changes in value would have no necessary effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital.

Matched sale-purchase transactions are generally overnight transactions in which the Bank sells a security and buys it back the next day at the rate specified at the commencement of the transaction. These transactions are accounted for as separate sale and purchase transactions. At December 31, 1996, and December 31, 1995, matched sale-purchase transactions involving U.S. government securities with par values of $13 billion and $12 billion, respectively, were outstanding.

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the Bank to execute operations in foreign markets for major currencies and, to the extent possible, invest the resulting balances. The portfolio for each foreign currency shall generally have an average duration of no more than eighteen months. Balances and changes in balances of investments denominated in foreign currencies arise from transactions to counter disorderly conditions in exchange markets and other needs specified by the FOMC in carrying out the System's central bank responsibilities.

Although the portfolios of U.S. government and federal agency securities and investments denominated in foreign currencies generate interest income and transactions can result in gains or losses when holdings are sold prior to maturity, decisions regarding these investments, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, earnings and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

In order to ensure the effective conduct of the domestic securities market, the FOMC authorizes the Reserve Banks to lend U.S. government securities held in the SOMA to securities dealers and to banks participating in U.S. government securities clearing arrangements conducted through a Reserve Bank, under such instructions as the FOMC may specify from time to time. At December 31, 1996, and December 31, 1995, U.S. government securities with par values of $489 million and $ 1 billion, respectively, were loaned by the Bank. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires the Bank to take possession of the collateral in amounts in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by the Bank on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be held in SOMA. Income earned by the Bank on securities-lending transactions is reported as a component of "Other income."

In accordance with the Federal Reserve Act, and as further explained in note 3(g), all domestic securities and investments denominated in foreign currencies held by the Bank are pledged as collateral for net Federal Reserve notes outstanding.

e. Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from two to fifty years. New assets, major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs, and minor replacements are charged to operations in the year incurred.

f. Interdistrict Settlement Account

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check and automated clearinghouse ("ACH") clearing operations, and allocations of shared expenses. The cumulative net amount owed from or due to other Reserve Banks is reported as the "Interdistrict settlement account."

g. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents to the Reserve Banks upon deposit with such agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be equal to the sum of the notes applied for by such Reserve Bank. The collateral value is equal to the par value of the securities tendered. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. To satisfy its obligation to provide sufficient collateral for its outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides that certain assets of the Reserve Banks are jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks. In the event that this collateral is insufficient, the Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the U.S. government. The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by cash held in the vaults of the Reserve Banks of $44,004 million and $28,541 million at December 31, 1996, and December 31, 1995, respectively.

h. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. As a member bank's capital and surplus change, its holdings of the Reserve Bank's stock must be adjusted. Member banks are those state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of $100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

i. Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of the prior year. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. Prior to October 1, 1996, this payment represented payment of interest on Federal Reserve notes outstanding.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66, Section 3002) codified the existing Board surplus policies as statutory surplus transfers, rather than as payments of interest on Federal Reserve notes, for federal government fiscal years 1997 (which began on October 1, 1996) and 1998. In addition, the legislation directs the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $106 million and $107 million during fiscal years 1997 and 1998, respectively. Reserve Banks are not permitted to replenish surplus for these amounts during this time. The Reserve Banks transferred $106 million to the U.S. Treasury on October 1, 1996. The Bank transferred $28 million from surplus on October 1, 1996, as its share of this payment.

In the event of losses, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury vary significantly.

j. Cost of Unreimbursed Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but will not be paid are reported as the "Cost of unreimbursed Treasury services."

k. Accounting Change

Effective January 1, 1995, the Financial Accounting Manual was changed to require the Bank to use the accrual method of accounting to recognize the obligation to provide benefits to former or inactive employees, consistent with the requirements of Statement of Financial Accounting Standards ("SFAS") No. 112, "Employers' Accounting for Postemployment Benefits." Prior to 1995, the Bank recognized costs for postemployment benefits when paid. The cumulative effect of this change in accounting for benefits was recognized by the Bank as a one-time charge to expense of $12 million. Additionally, the Bank recognized an increase in 1995 operating expenses of approximately $1 million as a result of the change in accounting for these costs.

Effective January 1, 1995, the Bank also began accruing a liability for employees' rights to receive compensation for future absences consistent with SFAS No. 43, "Accounting for Compensated

Absences." Prior to 1995, the Bank recognized these costs when paid. The cumulative effect of this change in accounting for compensated absences was recognized by the Bank as a one-time charge to expense of $4 million. Ongoing operating expenses for the year ended December 31, 1995, were not materially affected by the change in accounting for these costs.

4. U.S. GOVERNMENT AND FEDERAL AGENCY SECURITIES

U.S. government and federal agency securities include securities held under agreements to resell and the Bank's designated interest in securities bought outright, which are held in the SOMA at the Bank. The Bank's designated percentage interest is derived from an annual settlement, performed in April of each year, of interdistrict clearings and equalization among the Reserve Banks of gold certificate holdings to Federal Reserve notes outstanding. The Bank's designated interest in securities bought outright was approximately 37.190 percent and 39.745 percent at December 31, 1996, and December 31, 1995, respectively.

U.S. government and federal agency securities are recorded at cost on a settlement-date basis, adjusted for the amortization of premiums and accretion of discounts. Gains and losses resulting from sales of securities are determined for each specific issue based on average cost. Interest income is recorded on the accrual method. Interest income and gains and losses on the sale of these securities are allocated to the Bank based on its designated interest in the total portfolio and are reported as "Interest on U.S. government securities" and "Government securities gains, net," respectively.

Total U.S. government and federal agency securities bought outright, which are held in the SOMA, and the Bank's designated interest at December 31, 1996, and December 31, 1995, were as follows (in millions):

	December 31, 1996		December 31, 1995	
	Total Bought Outright	Designated to Bank	Total Bought Outright	Designated to Bank
Par value:				
Federal agency	$ 2,225	$ 827	$ 2,634	$ 1,047
U.S. Treasury:				
Bills	190,646	70,901	183,116	72,780
Notes	150,922	56,127	151,013	60,021
Bonds	49,339	18,349	44,069	17,515
Total par value	393,132	146,204	380,832	151,363
Unamortized premiums	4,677	1,739	4,508	1,792
Unaccreted discounts	(3,548)	(1,319)	(3,477)	(1,382)
	$394,261	$146,624	$381,863	$151,773

U.S. government and federal agency securities held in the SOMA under agreements to resell at December 31, 1996, and December 31, 1995, were as follows (in millions):

	December 31, 1996	December 31, 1995
Par value:		
Federal agency	$ 1,612	$ 1,100
U.S. Treasury	19,971	12,762
Total par value	21,583	13,862
Unamortized premiums	1,327	903
Unaccreted discounts	(296)	(137)
	$22,614	$14,628

These balances have been designated solely to the Bank.

The maturities of U.S. government and federal agency securities bought outright, which are held in the SOMA, at December 31, 1996, were as follows (in millions):

	Par Value, December 31, 1996		
Maturities of Securities Held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 7,875	$ 450	$ 8,325
16 days to 90 days	89,036	541	89,577
91 days to 1 year	122,780	232	123,012
Over 1 year to 5 years	95,608	520	96,128
Over 5 years to 10 years	33,782	457	34,239
Over 10 years	41,826	25	41,851
Total	$390,907	$2,225	$393,132

The maturities of U.S. government and federal agency securities bought outright, which are designated to the Bank, at December 31, 1996, were as follows (in millions):

	Par Value, December 31, 1996		
Maturities of Securities Held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 2,929	$167	$ 3,096
16 days to 90 days	33,112	201	33,313
91 days to 1 year	45,662	86	45,748
Over 1 year to 5 years	35,556	194	35,750
Over 5 years to 10 years	12,563	170	12,733
Over 10 years	15,555	9	15,564
Total	$145,377	$827	$146,204

The resell date for securities purchased under agreements to resell does not exceed fifteen days after the purchase date.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The Bank, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments. Each Reserve Bank is allocated a share of foreign-currency-denominated assets based on the ratio of its capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 26.639 percent and 26.814 percent at December 31, 1996, and December 31, 1995, respectively.

Investments denominated in foreign currencies are recorded at cost on a settlement date basis, adjusted for amortization of premiums and accretion of discounts. Foreign-currency-denominated assets of the Reserve Banks are revalued monthly at current market exchange rates in order to report these assets in U.S. dollars. Gains and losses resulting from sales of securities are determined using the average cost method. Interest income is recorded on the accrual basis. Realized and unrealized foreign currency gains and losses and interest income are allocated to the Bank based on its designated interest in the total portfolio and are reported as "Foreign currency gains (losses), net" and "Interest on foreign currencies," respectively.

Total investments denominated in foreign currencies, valued at current exchange rates at December 31, 1996, and December 31, 1995, and the Bank's designated share, were as follows (in millions):

	December 31, 1996		December 31, 1995	
	Total Foreign Currencies	Designated to Bank	Total Foreign Currencies	Designated to Bank
German marks:				
Foreign currency deposits	$10,253	$2,731	$12,329	$3,306
Government debt instruments including agreements to resell	2,777	740	1,186	318
Japanese yen:				
Foreign currency deposits	637	170	739	198
Government debt instruments including agreements to resell	5,515	1,469	6,130	1,644
Mexican pesos:				
Foreign currency swap	—	—	602	161
Accrued interest	87	23	118	32
Total foreign currencies	$19,269	$5,133	$21,104	$5,659

In addition to the balances reflected above, $5 million in unearned interest collected on certain foreign currency holdings was also reflected as "Investments denominated in foreign currencies" at December 31, 1996, and December 31, 1995. This balance has been designated solely to the Bank.

The Bank is authorized by the FOMC to hold balances of and to execute spot and forward foreign exchange contracts to receive or to deliver the currencies of fourteen foreign countries. Foreign exchange contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties, but will extend beyond two days from the trade date. The Bank generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction. As of December 31, 1996, and December 31, 1995, the Bank had no open foreign exchange contracts except as noted below.

At the direction of the FOMC, the Bank is authorized to maintain reciprocal currency arrangements ("F/X swaps") for periods up to a maximum of twelve months with various foreign central banks. An F/X swap is a renewable, short-term reciprocal currency arrangement, generally for up to one year, between two parties—the Bank, on behalf of the Reserve Banks, and an authorized foreign central bank—who agree to exchange their currencies up to a prearranged maximum amount and for an agreed upon period of time, at an agreed upon interest rate. These arrangements give the Federal Reserve temporary access to the foreign currencies that it needs for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it needs to support its own currencies. Drawings under the F/X swap arrangements can be initiated by either the Bank or the partner foreign central bank.

The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The Bank will generally invest the foreign currency received under an F/X swap in interest-bearing instruments. Interest income on the resulting foreign currency holdings is accrued and reported as "Interest on foreign currencies." Unrealized gains and losses on revaluation of the resulting currency holdings are not participated among Reserve Banks, but rather are reported by the Bank as a component of "Other assets" or "Other liabilities," since there is no exchange rate risk to the Reserve Banks at the maturity of the F/X swap. As of December 31, 1996, there were no open F/X swaps. As of December 31, 1995, there was an open F/X swap of $650 million, which was drawn at the direction of the Bank of Mexico.

The FOMC has an agreement to "warehouse" foreign currencies for the U.S. Treasury and the Exchange Stabilization Fund ("ESF"). This 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. This facility was $20 billion, with nothing outstanding, as of December 31, 1996, and December 31, 1995.

Certain of the contracts entered into by the Bank in connection with its foreign currency activities, on behalf of the Reserve Banks, may involve off-balance-sheet market risk and credit risk because they may represent contractual commitments involving future settlement. The credit risk is controlled through credit approvals, limits, and daily monitoring procedures.

6. BANK PREMISES AND EQUIPMENT

A summary of Bank premises and equipment at December 31, 1996, and December 31, 1995, is as follows (in millions):

	December 31, 1996	December 31, 1995
Bank premises and equipment:		
Land	$ 21	$ 21
Buildings	119	102
Building machinery and equipment	51	50
Construction in progress	7	13
Furniture and equipment	212	212
	410	398
Less: Accumulated depreciation	(177)	(171)
Bank premises and equipment, net	$233	$227

Depreciation expense was $30 million and $29 million for the years ended December 31, 1996, and December 31, 1995, respectively.

Bank premises and equipment at December 31, 1996, and December 31, 1995, include the following amounts for leases that have been capitalized (in millions):

	December 31, 1996	December 31, 1995
Bank premises and equipment	$15	$15
Accumulated depreciation	(10)	(5)
Capitalized leases, net	$ 5	$10

7. COMMITMENTS AND CONTINGENCIES

At December 31, 1996, the Bank was obligated under noncancelable leases for premises and equipment with terms, including renewal options, ranging from one to approximately six years. These leases provide for increased rentals based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was $18 million and $17 million for the years ended December 31, 1996, and December 31, 1995, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases and capital leases, net of sublease rentals, with terms of one year or more, at December 31, 1996, were (in millions):

	Operating	Capital
1997	$ 0.7*	$3.2
1998	10.5	.9
1999	10.5	0
2000	10.5	0
2001	10.7	0
Thereafter	9.9	0
	$52.8	$4.1
Amount representing interest		(.2)
Present value of net minimum lease payments		$3.9

* Payment of $9.6 million fixed minimum rent for 59 Maiden Lane space occupied by the Bank was made at the time of lease renewal in 1988.

Other commitments and long-term obligations in excess of one year were $8 million at December 31, 1996.

Under the Insurance Agreement of the Federal Reserve Banks dated as of June 7, 1994, 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 of the claiming Reserve Bank, up to 50 percent of total capital and surplus of all Reserve Banks. No claims were outstanding under such agreement at December 31, 1996, or December 31, 1995.

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.

8. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System (the "System Plan") and the Benefit Equalization Retirement Plan (the "BEP").

The System Plan is a multi-employer plan. The Bank acts as the sponsor of this plan, including the prepaid pension cost on its Statement of Condition as a component of "Other assets." The prepaid pension cost includes amounts related to the participation of employees of the twelve Reserve Banks, the Board of Governors, and the Plan Administrative Office in the plan.

Contributions to the System Plan are actuarially determined and fully funded by participating employers at amounts prescribed by the plan administrator (with the exception of a mandatory contribution of 7 percent of salary by certain employees of the Board of Governors that participate in the plan). No separate accounting is maintained of assets contributed by the participating employers, and net pension cost for the period is the required contribution for the period. No employer contributions were required to the System Plan during 1996 or 1995.

The BEP is an unfunded, single employer plan that was established January 1, 1996. Net pension cost for the period is actuarially determined and is based on the same economic and mortality assumptions used for the System Plan. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 1996, and for the year then ended are not material and are reflected as components of "Accrued benefit cost" and "Salaries and other benefits," respectively.

The following is a reconciliation between the funded status of the System Plan and amounts included in the Bank's Statement of Condition at December 31, 1996, and December 31, 1995 (in millions):

	December 31, 1996	December 31, 1995
Accumulated benefit obligation:		
Vested	$1,758	$1,679
Nonvested	85	91
Total	$1,843	$1,770
Plan assets at fair value, primarily listed stocks and bonds	$4,153	$3,628
Less: Actuarial present value of projected benefit obligation	(2,270)	(2,130)
Plan assets in excess of projected benefit obligation	1,883	1,498
Less: Unrecognized net transition obligation	227	272
Unrecognized net gain	884	606
Unrecognized prior service cost	(144)	(156)
Prepaid pension cost	$ 916	$ 776

The assumptions used in developing the pension benefit obligation for the System Plan and BEP are as follows:

	1996	1995
Discount rate	7.25%	7.00%
Rate of compensation increase	5.00%	5.00%
Long-term rate of return on plan assets	9.00%	9.00%

The components of the net pension credit for the System Plan for the years ended December 31, 1996, and December 31, 1995, are shown below (in millions):

	December 31, 1996	December 31, 1995
Service cost - benefits earned during the year	$ 71	$ 49
Interest cost on projected benefit obligation	152	133
Actual return on plan assets	(634)	(842)
Net amortization and deferral	269	537
Cost of special termination benefits	1	4
Net pension (credit)	$(141)	$(119)

Thrift Plan

Employees of the Bank may also participate in the Thrift Plan for Employees of the Federal Reserve System (the "Thrift Plan"). The Thrift Plan is a defined contribution plan. Under the Thrift Plan, employees may contribute a percentage of their salaries up to a maximum 19 percent limit as prescribed by the Internal Revenue Service. Matching contributions by the Bank are based on a fixed percentage of each employee's basic contribution. Currently, the Bank matches 80 percent of the first 6 percent of salary contributed by the employee. The Bank's Thrift Plan contributions totaled $9 million and $8 million for the years ended December 31, 1996, and December 31, 1995, respectively, and are reflected on the Statement of Income as a component of "Salaries and other benefits."

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Pensions

In addition to the Bank's defined benefit 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 retiree medical plan is contributory and provides benefits to retirees, their covered dependents, and beneficiaries. The life insurance plan is noncontributory and covers retirees only.

The Bank funds benefits payable under the medical and life insurance plans as due. Net postretirement benefit cost is actuarially determined, using a January 1 measurement date. The following is a reconciliation between the plan's funded status and the amounts recognized in the Bank's balance sheet as of December 31, 1996, and December 31, 1995 (in millions):

	December 31, 1996	December 31, 1995
Accumulated postretirement benefit obligation:		
Retirees and covered spouses	$ 62	$ 67
Actives eligible to retire	12	13
Other actives and disableds	44	48
Total accumulated postretirement benefit obligation	118	128
Unrecognized net transition obligation	0	0
Unrecognized net gain (loss)	4	(14)
Unrecognized prior service cost	1	1
Accrued postretirement benefit cost	$123	$115

The assumptions used in developing the postretirement benefit obligation are as follows:

	1996	1995
Discount rate	7.25%	7.00%
Rate of increase in health care costs - initial	9.50%	10.00%
Rate of increase in health care costs - ultimate	5.50%	5.50%

The ultimate health care cost rate is expected to be achieved in 2004.

The following is a summary of the components of net periodic postretirement cost for the years ended December 31, 1996, and December 31, 1995 (in millions):

	1996	1995
Service cost	$ 3	$ 3
Interest cost of accumulated benefit obligation	8	9
Net amortization and deferral	(0)	(0)
Net periodic postretirement cost	$11	$12

These costs are reflected on the Statement of Income as a component of "Salaries and other benefits."

Changing the assumed health care cost trend rates by one percentage point in each year would change the accumulated postretirement benefit obligation at December 31, 1996, and December 31, 1995, by approximately $21 million and $22 million, respectively, and would change the aggregate service and interest cost components of net periodic postretirement benefit cost for the years ended December 31, 1996, and December 31, 1995, by approximately $3 million and $2 million, respectively.

Postemployment Benefits

The Bank began using the accrual method of accounting to recognize the obligation to provide benefits to former or inactive employees, consistent with SFAS No. 112, "Employers' Accounting for Postemployment Benefits," effective January 1, 1995. Benefits include medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and the same health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 1996, and December 31, 1995, were $14 million and $13 million, respectively. These costs are included as a component of "Accrued benefit cost" on the Statement of Condition. Net periodic postemployment benefit costs included in 1996 and 1995 operating expenses were $4 million and $3 million, respectively.