# Financial Statements

## Report of Independent Accountants
Coopers & Lybrand L.L.P.

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 statement of condition of the Federal Reserve Bank of New York (the "Bank") as of December 31, 1997 and 1996, and the related statements of income and changes in capital for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurances about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 3, the financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the Financial Accounting Manual for Federal Reserve Banks and constitute a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 1997 and 1996, and results of its operations for the years then ended, on the basis of accounting described in note 3.

Coopers & Lybrand L.L.P.

New York, New York
March 20, 1998

## STATEMENT OF CONDITION

(in millions)

| ASSETS | December 31, 1997 | December 31, 1996 |
|---|---|---|
| Gold certificates | $ 3,934 | $ 4,049 |
| Special drawing rights certificates | 3,202 | 3,385 |
| Coin | 20 | 21 |
| Items in process of collection | 1,026 | 1,796 |
| Loans to depository institutions | 1,465 | — |
| U.S. government and federal agency securities, net | 164,932 | 169,238 |
| Investments denominated in foreign currencies | 3,885 | 5,128 |
| Accrued interest receivable | 1,609 | 1,657 |
| Interdistrict settlement account | 16,310 | — |
| Bank premises and equipment, net | 241 | 233 |
| Other assets | 1,246 | 976 |
| **Total assets** | **$197,870** | **$186,483** |

| LIABILITIES AND CAPITAL | | |
|---|---|---|
| Liabilities: | | |
| Federal Reserve notes outstanding, net | $179,316 | $139,364 |
| Deposits: | | |
| Depository institutions | 9,257 | 8,167 |
| U.S. Treasury, general account | 5,444 | 7,742 |
| Other deposits | 452 | 177 |
| Deferred credit items | 794 | 883 |
| Statutory surplus transfer due U.S. Treasury | 254 | 296 |
| Interdistrict settlement account | — | 27,599 |
| Accrued benefit cost | 144 | 136 |
| Other liabilities | 45 | 43 |
| **Total liabilities** | **195,706** | **184,407** |
| Capital: | | |
| Capital paid-in | 1,108 | 1,052 |
| Surplus | 1,056 | 1,024 |
| **Total capital** | **2,164** | **2,076** |
| **Total liabilities and capital** | **$197,870** | **$186,483** |

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

## STATEMENT OF INCOME

for the years ended December 31, 1997, and December 31, 1996
(in millions)

| | December 31, 1997 | December 31, 1996 |
|---|---|---|
| Interest income: | | |
| Interest on U.S. government securities | $9,014 | $9,207 |
| Interest on foreign currencies | 86 | 118 |
| Interest on loans to depository institutions | 2 | 1 |
| **Total interest income** | **9,102** | **9,326** |
| Other operating income (loss): | | |
| Income from services | 98 | 105 |
| Reimbursable services to government agencies | 47 | 45 |
| Foreign currency (losses), net | (591) | (444) |
| Government securities gains, net | 4 | 12 |
| Other income | 30 | 32 |
| **Total other operating income (loss)** | **(412)** | **(250)** |
| Operating expenses: | | |
| Salaries and other benefits | 285 | 284 |
| Occupancy expense | 43 | 43 |
| Equipment expense | 39 | 37 |
| Cost of unreimbursed Treasury services | 2 | 4 |
| Assessments by Board of Governors | 158 | 183 |
| Other expenses | 134 | 116 |
| **Total operating expenses** | **661** | **667** |
| Net income before net periodic pension expense | 8,029 | 8,409 |
| Net periodic pension credit | (201) | (141) |
| **Net income prior to distribution** | **$8,230** | **$8,550** |
| Distribution of net income: | | |
| Dividends paid to member banks | 65 | 65 |
| Transferred to (from) surplus | 56 | (5) |
| Payments to U.S. Treasury as interest on Federal Reserve notes | — | 6,119 |
| Payments to U.S. Treasury as required by statute | 8,109 | 2,371 |
| **Total distribution** | **$8,230** | **$8,550** |

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

## STATEMENT OF CHANGES IN CAPITAL

for the years ended December 31, 1997, and December 31, 1996
(in millions)

| | Capital Paid-in | Surplus | Total Capital |
|---|---|---|---|
| **Balance at January 1, 1996 (21.1 million shares)** | **$1,057** | **$1,057** | **$2,114** |
| Net income transferred to (from) surplus | — | (5) | (5) |
| Statutory surplus transfer to the U.S. Treasury | — | (28) | (28) |
| Net change in capital stock issued (redeemed) (0.1 million shares) | $ (5) | — | $ (5) |
| **Balance at December 31, 1996 (21.0 million shares)** | **$1,052** | **$1,024** | **$2,076** |
| Net income transferred to (from) surplus | — | 56 | 56 |
| Statutory surplus transfer to the U.S. Treasury | — | (24) | (24) |
| Net change in capital stock issued (redeemed) (1.2 million shares) | $ 56 | — | $ 56 |
| **Balance at December 31, 1997 (22.2 million shares)** | **$1,108** | **$1,056** | **$2,164** |

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 FOMC is composed of members of the Board of Governors, this Bank's president, and, on a rotating basis, four other Reserve Bank presidents.

#### Structure

The Bank and its branch in Buffalo serve the Second Federal Reserve District, which includes the state of New York, the 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 are exercised by a board of directors. 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 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, 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 clearinghouse 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.

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 purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, and the lending of U.S. government securities. Additionally, the Bank is authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange and securities contracts in, fourteen foreign currencies; maintain reciprocal currency arrangements ("FX swaps") with various central banks; and "warehouse" foreign currencies for the U.S. Treasury Exchange Stabilization Fund ("ESF") through the Reserve Banks.

## 3. SIGNIFICANT ACCOUNTING POLICIES

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by 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 documented in the "Financial Accounting Manual for Federal Reserve Banks" ("Financial Accounting Manual"), which is issued 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 accounting principles and practices of the System and generally accepted accounting principles ("GAAP").

The primary differences are 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. 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 certain 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 Reserve Banks 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 accounts are 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 at the end of the preceding year.

### b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("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 accounts are 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. The Board of Governors allocates each SDR transaction among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year.

### 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 basis and is charged at the applicable discount rate established at least every fourteen days by the boards of directors of the Reserve Banks, subject to review by the Board of Governors. However, Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

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

The Bank has been designated by the FOMC 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"). 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 in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities.

Purchases of securities under agreements to resell and matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Purchases under agreements to resell are transactions in which the Bank purchases a security and sells it back at the rate specified at the commencement of the transaction. Matched sale-purchase transactions are transactions in which the Bank sells a security and buys it back at the rate specified at the commencement of the transaction.

Reserve Banks are authorized by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements, in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires the lending Reserve Bank to take possession of 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 lending Reserve Bank on a daily basis, with additional collateral obtained as necessary. The securities loaned continue to be accounted for in the SOMA.

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 extends 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.

The Bank, on behalf of the Reserve Banks, maintains renewable, short-term FX swap arrangements with authorized foreign central banks. The parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time (up to twelve months) at an agreed-upon interest rate. These arrangements give the FOMC temporary access to foreign currencies that it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the FX swap arrangements can be initiated by either the Bank or the partner foreign central bank, and must be agreed to by the drawee. The FX 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 FX swap in interest-bearing instruments.

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.

In connection with its foreign currency activities, the Bank, on behalf of the Reserve Banks, may enter into contracts that contain varying degrees of off-balance-sheet market risk, because they represent contractual commitments involving future settlement, and counterparty credit risk. The Bank controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. However, decisions regarding the securities and foreign currency transactions, 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.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as "Interest on U.S. government securities" or "Interest on foreign currencies," as appropriate. Income earned on securities-lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as "Government securities gains, net." Foreign-currency-denominated assets are revalued monthly at current 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 (losses), net." Foreign currencies held through FX swaps, when initiated by the counterparty, and warehousing arrangements are revalued monthly, with the unrealized gain or loss reported by the Bank as a component of "Other assets" or "Other liabilities," as appropriate.

Balances of U.S. government and federal agency securities bought outright, investments denominated in foreign currency, interest income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an FX swap arrangement, are allocated to each Reserve Bank. Securities purchased under agreements to resell and the related premiums, discounts, and income, and unrealized gains and losses on the revaluation of foreign currency holdings under FX swaps and warehousing arrangements are designated to the Bank and not participated to other Reserve Banks. Income from securities-lending transactions is recognized only by the lending Reserve Bank.

### 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 clearing and automated clearinghouse ("ACH") operations, and allocations of shared expenses. The cumulative net amount due to or from 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. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and agency securities, loans allowed under Section 13, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose 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 their obligation to provide sufficient collateral for their 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 Federal Reserve 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 United States government.

The "Federal Reserve notes outstanding, net" account represents Federal Reserve notes reduced by cash held in the vaults of the Bank of $30,527 million and $44,004 million at December 31, 1997, and December 31, 1996, 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 1998 and 1997 (which began on October 1, 1997, and October 1, 1996, respectively). In addition, the legislation directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of $107 million and $106 million during fiscal years 1998 and 1997, respectively. Reserve Banks are not permitted to replenish surplus for these amounts during this time. The Reserve Banks made these transfers on October 1, 1997, and October 1, 1996, respectively. The Bank's share of these transfers is reported on the Statement of Changes in Capital as "Statutory surplus transfer to the U.S. Treasury."

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. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

## 4. U.S. GOVERNMENT AND FEDERAL AGENCY SECURITIES

Securities bought outright and held under agreements to resell are held in the SOMA at the Bank. An undivided interest in SOMA activity, with the exception of securities held under agreements to resell and the related premiums, discounts, and income, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 32.345 percent and 37.190 percent at December 31, 1997, and December 31, 1996, respectively.

The Bank's allocated shares of securities held in the SOMA at December 31, 1997, and December 31, 1996, that were bought outright were as follows:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Par value: | | |
| Federal agency | $ 221 | $ 827 |
| U.S. government: | | |
| Bills | 63,760 | 70,901 |
| Notes | 56,347 | 56,127 |
| Bonds | 19,215 | 18,349 |
| Total par value | 139,543 | 146,204 |
| Unamortized premiums | 2,005 | 1,739 |
| Unaccreted discounts | (1,170) | (1,319) |
| **Total allocated to Bank** | **$140,378** | **$146,624** |

Total SOMA securities bought outright were $434,001 million and $394,261 million at December 31, 1997, and December 31, 1996, respectively.

The maturities of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 1997, were as follows:

| | Par Value (in Millions) | | |
|---|---|---|---|
| Maturities of Securities Held | U.S. Government Securities | Federal Agency Obligations | Total |
| Within 15 days | $ 4,192 | $ — | $ 4,192 |
| 16 days to 90 days | 30,937 | 19 | 30,956 |
| 91 days to 1 year | 44,599 | 62 | 44,661 |
| Over 1 year to 5 years | 30,737 | 50 | 30,787 |
| Over 5 years to 10 years | 13,231 | 82 | 13,313 |
| Over 10 years | 15,626 | 8 | 15,634 |
| **Total** | **$139,322** | **$221** | **$139,543** |

Securities held under agreements to resell at December 31, 1997, and December 31, 1996, were as follows:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Par value: | | |
| Federal agency | $ 2,652 | $ 1,612 |
| U.S. government | 21,188 | 19,971 |
| Total par value | 23,840 | 21,583 |
| Unamortized premiums | 996 | 1,327 |
| Unaccreted discounts | (282) | (296) |
| **Total** | **$24,554** | **$22,614** |

These balances have been allocated solely to the Bank. The resell date for securities under agreements to resell does not exceed fifteen days after the purchase date.

At December 31, 1997, and December 31, 1996, matched sale-purchase transactions involving U.S. government securities with par values of $17 billion and $15 billion, respectively, were outstanding, of which $6 billion and $5 billion were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

At December 31, 1997, and December 31, 1996, U.S. government securities with par values of $887 million and $489 million, respectively, were loaned by the Bank.

## 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, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on FX swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's 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 22.804 percent and 26.639 percent at December 31, 1997, and December 31, 1996, respectively.

The Bank's allocated shares of investments denominated in foreign currencies, valued at current exchange rates at December 31, 1997, and December 31, 1996, were as follows:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| German marks: | | |
| Foreign currency deposits | $1,886 | $2,731 |
| Government debt instruments including agreements to resell | 733 | 740 |
| Japanese yen: | | |
| Foreign currency deposits | 131 | 170 |
| Government debt instruments including agreements to resell | 1,118 | 1,469 |
| Accrued interest | 17 | 18 |
| **Total** | **$3,885** | **$5,128** |

Total investments denominated in foreign currencies were $17,046 million and $19,264 million at December 31, 1997, and December 31, 1996, respectively. The December 31, 1997, and December 31, 1996, balances include $3 million and $5 million, respectively, of unearned interest collected on certain foreign currency holdings that are allocated solely to the Bank and are included in accrued interest above.

The maturities of investments denominated in foreign currencies that were allocated to the Bank at December 31, 1997, and December 31, 1996, were as follows:

| Maturities of Investments Denominated in Foreign Currencies | Amount (in Millions) 1997 | 1996 |
|---|---|---|
| Within 1 year | $3,821 | $5,128 |
| Over 1 year to 5 years | 16 | — |
| Over 5 years to 10 years | 48 | — |
| Over 10 years | — | — |
| **Total** | **$3,885** | **$5,128** |

At December 31, 1997, and December 31, 1996, the Bank had no open foreign exchange contracts. At December 31, 1997, and December 31, 1996, there were no FX swaps outstanding. At December 31, 1997, and December 31, 1996, the warehousing facility was $20 billion, with zero outstanding.

## 6. BANK PREMISES AND EQUIPMENT

A summary of bank premises and equipment at December 31, 1997, and December 31, 1996, is as follows:

| | Amount (in Millions) 1997 | 1996 |
|---|---|---|
| Bank premises and equipment: | | |
| Land | $ 21 | $ 21 |
| Buildings | 135 | 119 |
| Building machinery and equipment | 48 | 51 |
| Construction in progress | 2 | 7 |
| Furniture and equipment | 221 | 212 |
| Subtotal | 427 | 410 |
| Accumulated depreciation | (186) | (177) |
| **Bank premises and equipment, net** | **$241** | **$233** |

Note: Depreciation expenses were $32 million and $30 million for the years ended December 31, 1997, and December 31, 1996, respectively.

Bank premises and equipment at December 31, 1997, and December 31, 1996, include the following amounts for leases that have been capitalized:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Bank premises and equipment | $15 | $15 |
| Accumulated depreciation | (14) | (10) |
| **Capitalized leases, net** | **$ 1** | **$ 5** |

## 7. COMMITMENTS AND CONTINGENCIES

At December 31, 1997, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately twenty-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 for each of the years ended December 31, 1997, and December 31, 1996. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals and concessions, with terms of one year or more, at December 31, 1997, were:

| | Amount (in Millions) |
|---|---|
| 1998 | $ 4.0 |
| 1999 | 5.0 |
| 2000 | 5.2 |
| 2001 | 4.6 |
| 2002 | 4.4 |
| Thereafter | 122.9 |
| | **$146.1** |

At December 31, 1997, there were no other commitments and long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks dated 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 the total capital and surplus of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital bears to the total capital of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 1997, or December 31, 1996.

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 ("System Plan") and the Benefit Equalization Retirement Plan ("BEP").

The System Plan is a multi-employer plan. The Bank acts as the sponsor of this plan, including the prepaid pension cost 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. It is the System's policy to fund the pension liability as accrued. No contributions to the System Plan were required under this policy during 1997 or 1996.

The BEP is an unfunded 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, 1997, and December 31, 1996, and for the years then ended, are not material and are reflected as components of "Accrued benefit cost" and "Salaries and other benefits," respectively.

Following is a reconciliation between the funded status of the System Plan and amounts recognized at December 31, 1997, and December 31, 1996:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Accumulated benefit obligation: | | |
| Vested | $1,931 | $1,758 |
| Nonvested | 90 | 85 |
| **Total** | **$2,021** | **$1,843** |
| Plan assets at fair value, primarily listed stocks and bonds | 5,031 | 4,153 |
| Less: Actuarial present value of projected benefit obligation | 2,476 | 2,270 |
| **Plan assets in excess of projected benefit obligation** | **2,555** | **1,883** |
| Less: Unrecognized net transition obligation | 181 | 226 |
| Unrecognized net gain | 1,307 | 884 |
| Unrecognized prior service cost | (135) | (144) |
| **Prepaid pension cost** | **$1,202** | **$ 917** |

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

| | 1997 | 1996 |
|---|---|---|
| Discount rate | 7.00% | 7.25% |
| 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, 1997, and December 31, 1996, are shown below:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Service cost—benefits earned during the year | $ 71 | $ 71 |
| Interest cost on projected benefit obligation | 160 | 152 |
| Actual return on plan assets | (904) | (634) |
| Net amortization and deferral | 468 | 269 |
| Cost of special termination benefits | 4 | 1 |
| **Net pension (credit)** | **$(201)** | **$(141)** |

Note: The net pension credit is reported as "Net periodic pension credit."

### Thrift Plan

Employees of the Bank may also participate in the Thrift Plan for Employees of the Federal Reserve System ("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 20 percent limit. 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 for each of the years ended December 31, 1997, and December 31, 1996, and are reported 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 as of December 31, 1997, and December 31, 1996:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Accumulated postretirement benefit obligation: | | |
| Retirees and covered spouses | $ 75 | $ 62 |
| Actives eligible to retire | 8 | 12 |
| Other actives and disableds | 38 | 44 |
| **Total accumulated postretirement benefit obligation** | **121** | **118** |
| Unrecognized net gain (loss) | 5 | 4 |
| Unrecognized prior service cost | 1 | 1 |
| **Accrued postretirement benefit cost** | **$127** | **$123** |

Note: Accrued postretirement benefit cost is reported as a component of "Accrued benefit cost."

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

| | 1997 | 1996 |
|---|---|---|
| Discount rate | 7.00% | 7.25% |
| Rate of increase in health care costs—initial | 9.00% | 9.50% |
| Rate of increase in health care costs—ultimate | 5.00% | 5.50% |

Note: The ultimate health care cost rate is expected to be achieved in 2005.

The following is a summary of the components of net periodic postretirement cost for the years ended December 31, 1997, and December 31, 1996:

| | Amount (in Millions) | |
|---|---|---|
| | 1997 | 1996 |
| Service cost | $ 3 | $ 3 |
| Interest cost of accumulated benefit obligation | 8 | 8 |
| Net amortization and deferral | 0 | 0 |
| **Net periodic postretirement cost** | **$11** | **$11** |

Note: Net periodic postretirement cost is reported 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, 1997, and December 31, 1996, by approximately $18 million and $21 million, respectively, and would change the aggregate service and interest cost components of net periodic postretirement benefit cost for the years ended December 31, 1997, and December 31, 1996, by approximately $3 million in each year.

### Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 1997, and December 31, 1996, were $16 million and $14 million, respectively. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 1997 and 1996 operating expenses were $4 million in each year.