



CENTRAL TO AMERICA'S ECONOMY<sup>®</sup>  
STLOUISFED.ORG

# Many Moving Parts

A LOOK INSIDE THE **U.S. LABOR MARKET**



ANNUAL REPORT 2010

## Eighth District **Highlights for 2010**

At the Federal Reserve Bank of St. Louis, we're all about numbers—millions and millions of them every day. But the ones below are of a different sort. They represent a sample of our efforts to share all those other numbers—and what they mean—with anyone and everyone who is interested in economics, personal finance, banking and, more generally, the economy.

**8,000**

Students enrolled in online economic and financial education programs

**360,000**

Downloads of online economic education material

**11,000**

Participants at St. Louis Fed public presentations

**210**

Countries and territories represented in visits to our Bank's web sites

**24,000**

Facebook post views

**38,979**

Informational materials about community development that were distributed to the public

**694**

Citations to St. Louis Fed research publications in outside research publications

**104**

Banks supervised

**17,000**

Page views to Dodd-Frank regulatory reform rules web site

**7**

Informational conferences held in the District on regulatory reform

**201**

Economic research referee reports

**25,264**

Total data series available in FRED® (Federal Reserve Economic Data)

**84**

Working papers and peer-reviewed publications written

**1,200**

Doorknob hangers explaining loan-modification scams distributed to neighborhoods

**8,000**

Subscribers to *Bridges*, our community development newsletter

### **Awards/Recognition**

Green Business Challenge Circle of Excellence—St. Louis Regional Chamber & Growth Association  
Green Restaurant Certificate

**FOLLOW THE FED**  
stlouisfed.org/followthefed



FEDERAL RESERVE BANK OF ST. LOUIS

# Annual Report

FOR THE YEAR 2010



CENTRAL TO AMERICA'S ECONOMY™

---

[STLOUISFED.ORG](http://STLOUISFED.ORG)

PUBLISHED APRIL 2011

# Table of Contents

President’s Message.....	3
Many Moving Parts: A Look Inside the U.S. Labor Market.....	4
Boards of Directors, Advisory Councils, Bank Officers.....	16
Chairman’s Message.....	17
Financial Statements.....	27

# The Fed's Dual Mandate: Lessons of the 1970s

When the U.S. Congress amended the Federal Reserve Act in 1977, it essentially gave the Fed a dual mandate: to promote maximum sustainable employment and price stability. Price stability is usually interpreted as low and stable inflation, and the impetus for this explicit objective was the highly volatile inflation of the 1970s.

The Fed's dual mandate stands in contrast to the European Central Bank's (ECB's) single mandate. In 1992, the Maastricht Treaty, which laid the groundwork for the establishment of the ECB later in the decade, designated price stability as the primary objective of monetary policy. In the 1990s, European governments and policymakers operated with more knowledge than when the U.S. Congress gave the Fed its dual mandate in 1977. The ECB's single mandate, therefore, was partly the result of the global experience and lessons learned in previous decades.

What were those lessons? The 1970s are often cited as a time when U.S. monetary policy became misaligned with its objectives. From the late 1960s through the early 1980s, inflation rates were high and variable; for example, over roughly four years, Consumer Price Index (CPI) inflation rose from about 3 percent to 12 percent and then fell to 5 percent. Many were surprised that, along with the swings in inflation, real output was quite volatile and the unemployment rate generally was high, peaking at 10.8 percent in 1982. The U.S. suffered through four recessions in the 13 years from 1970 to 1982. The economy fluctuated from boom to bust. Each cycle ushered in both higher inflation and higher unemployment. In retrospect, the Federal Open Market Committee



(FOMC) placed too much emphasis on real output and unemployment during this decade and ended up with the worst of both worlds, a volatile real economy with high and variable inflation.

The Volcker disinflation—named after then-Chairman Paul Volcker—lowered the CPI inflation rate from more than 14 percent in early 1980 to less than 3 percent by mid-1983. At this point, the FOMC tried a new policy—keep inflation low and stable. The result was a long expansion during the 1980s and another long expansion during the 1990s. During these expansions, inflation remained low and, in fact, declined, while the unemployment rate declined to as low as 3.8 percent in 2000. The boom-bust cycle was eliminated.

The FOMC learned a valuable lesson on how to pursue the dual mandate from the 1970s experience—namely, the Committee should aim for policies that keep inflation low and stable for the sake of both price stability and the real economy. This lesson was not lost on other central banks around the globe, which helps explain why, in the 1990s, the Maastricht Treaty gave the ECB the single objective of price stability.

Still, one would not have to go all the way to a single mandate in order to obtain the good experience of the 1980s and 1990s. Another way to achieve the same outcome is to simply internalize the message from the 1970s, thus understanding that the optimal way to deliver on the dual mandate is to pursue low and stable inflation, which in turn helps the real economy. In other words, monetary policy can achieve the same desired outcomes with a single mandate as it can with an appropriately interpreted dual mandate.

Today, it may be tempting to lose sight of the lessons of the 1970s, but I believe they remain as relevant as ever. As both the U.S. and Europe continue to recover from the severe financial crisis and subsequent recession of 2007-2009, many policy changes are in the air. But the fundamental importance of low and stable inflation for the performance of the real economy remains a bedrock principle of central banking.

James Bullard

# Many Moving Parts

A LOOK INSIDE THE **U.S. LABOR MARKET**



By **David Andolfatto** and **Marcela M. Williams**

The U.S. economy lost almost 8 million jobs in the latest recession, and the unemployment rate rose to over 9 percent. Roughly 1 million jobs have been added to the economy since early 2010, but the unemployment rate remains persistently high. Some policymakers are concerned about the prospect of a prolonged “jobless recovery,” a period of rising average income (GDP) with little or no employment growth. There is considerable debate over what, if anything, monetary and fiscal policy can or should do to help the labor market adjust in the wake of one of the worst recessions since the Great Depression.



**David Andolfatto** is an economist at the Federal Reserve Bank of St. Louis. His areas of expertise are money, banking and labor markets.



**Marcela M. Williams** is an officer at the Federal Reserve Bank of St. Louis. She oversees the external communications function in Public Affairs.

Since the end of the latest recession, for example, job openings in the U.S. appear to have increased—yet unemployment remains persistently high. Some economists interpret this as evidence that the latest recession has led to “structural” change, which will take some time to work through.

Disagreements over what should be done to stimulate the labor market stem, in part, from its complicated nature. The labor market has many moving parts, and policies frequently have unintended consequences. The purpose of this essay is to describe a few of these moving parts and to explain why it is sometimes difficult to interpret the ups and downs we experience in the labor market. One theme that emerges is that the big picture, as seen in the aggregated data, is not always representative of what is happening up close, as seen in the data that have been dissected.

We begin by looking at the timeline of U.S. employment since World War II. Employment, measured as a ratio of population size, remains relatively stable over time. This overall behavior, however, masks several underlying trends. For example, employment rates have generally been rising for women and falling for men. We look next at the share of employment across different sectors of the economy. Again, we see sharp differences in the evolution of employment over even relatively short periods of time. These different behaviors suggest, among other things, a degree of caution in the use of a “one size fits all” policy affecting the labor market.

We will then turn to the issue of unemployment. Contrary to common belief, unemployment is not technically a measure of joblessness. It is, instead, a measure of job search activity among the jobless. Millions of unemployed people find jobs every month, even in a deep recession. Millions of workers either lose or leave their jobs every month, too, even in a robust expansion. The large and simultaneous

flow of workers into and out of employment suggests that the labor market plays an important role in reallocating human resources to their most productive uses through good times and bad.

The job search activity of unemployed workers is mirrored on the other side of the labor market with the recruiting efforts of firms that have unfilled job openings. It is a property of the labor market that job vacancies coexist with unemployed workers, a fact that suggests the presence of “frictions” in the process of matching workers to jobs.

Vacancy and unemployment rates tend to move in opposite directions over the business cycle. Normally, good times induce firms to create job openings, and those additional openings then make it easier for unemployed workers to find jobs. However, the usual relationship between unemployment and vacancies sometimes breaks down. Since the end of the latest recession, for example, job openings in the U.S. appear to have increased—yet unemployment remains persistently high. Some economists interpret this as evidence that the latest recession has led to “structural” change, which will take some time to work through.

Indeed, history shows that the unemployment rate frequently does take a long time to decline following a recession. Given the severity of the most recent recession and given recent experience, it is likely to take years before the unemployment rate falls back to its pre-recession levels.

In the postwar era, the U.S. employment rate has averaged about 60 percent and has remained, for the most part, within three percentage points of this average.

## Employment

Everyone has a common-sense notion of what it means to be employed. But to measure employment, the concept has to be defined precisely. Doing this is not as straightforward as one might imagine.

We are all given a gift of time: 24 hours a day, 7 days a week, 52 weeks a year and so on. We generally have many competing uses for our time. Deciding how to spend a fixed amount of time across competing uses is a problem familiar to most of us. Some time is devoted to the office, some to the gym, some to household chores and so on. The time “employed” in many of these different activities could rightfully be described as “work.” A stay-at-home parent may legitimately be said to have a “job” (and an important one, at that). Going down this path, however, soon leads to the conclusion that almost everyone could be classified as “employed” in the sense of engaging in some productive activity. There may very well be some merit to this point of view.

In everyday language, however, a “job” or “employment” is commonly associated with an activity that generates a monetary reward. This is essentially the way statistical agencies measure employment. Standard labor force surveys record a person as employed in a given month if he or she reports having performed any paid work in the previous four weeks. The term “paid” should be understood here as direct monetary compensation by another party (an employer or, in the case of the self-employed, a customer).

Understanding how employment is defined and measured is important for how its level is interpreted. An increase in employment is usually thought to be a good thing, and, indeed, it frequently is. But employment may also increase when, for example, a student cannot

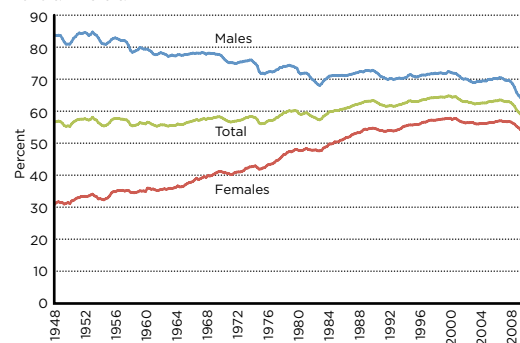
afford to remain in school or when a stay-at-home parent is forced to find a paying job. Clearly, it is not in the interest of society to have everyone employed. But if this is the case, then how is “full employment” to be defined and measured?

The idea that the economy is at full employment when everyone who wants a job has a job is not very helpful. Almost anybody can get some sort of job in relatively short order. The problem for most people is in finding a high-paying job that they enjoy doing. Everybody wants this type of job even if he or she is currently engaged in other productive activities, such as going to school or minding the household. Conceptual difficulties such as these have led some economists to look to the data for guidance. In particular, might it be possible to identify full employment by appealing to some long-run historical average level of employment?

FIGURE 1

### U.S. Employment–Population Ratio

1948:Q1 - 2010:Q4



SOURCE: Bureau of Labor Statistics/Haver Analytics.

Figure 1 plots the evolution of employment in the United States from 1948 to the present. Because employment will grow naturally along with the population, it is sometimes more illuminating to examine the behavior of employment relative to population size. The employment–population ratio recorded in Figure 1 represents employment divided by the relevant population.<sup>1</sup>

In the postwar era, the U.S. employment rate has averaged about 60 percent and has remained, for the most part, within three percentage points of this average over the sample period. Because the population base is large, a small change in the employment rate can translate into millions of jobs. For example, in the most recent recession, the employment rate declined by more than three percentage points,

<sup>1</sup> Population is civilian noninstitutional ages 16+.

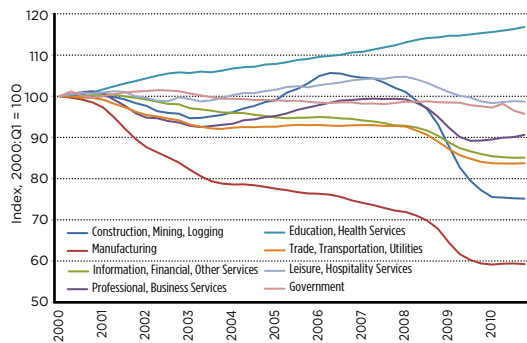


Manufacturing sector employment is in long-run decline, while employment in the education and health services sector is steadily on the rise—even through the most recent recession.

FIGURE 2

### Evolution of Sectoral Employment

2000:Q1 - 2010:Q4



SOURCE: Bureau of Labor Statistics/Haver Analytics.

which corresponds to a decline of almost 8 million jobs.

Figure 1 also reveals an interesting difference in how male and female employment rates have evolved over time. First, while employment rates are lower for females relative to males, this gap has closed significantly over the past 60 years. Male employment rates show a persistent decline in the first half of the sample, while female employment rates are generally on the rise. While these long-run adjustments appear to have stabilized over the past 20 years or so, it remains unclear whether some notion of “full employment” can be identified in this data. If it can, then it would appear to differ across the sexes and fluctuate over time.

Employment rates in different sectors of the economy are also evolving. Figure 2 shows the employment-population ratios for eight sectors; these ratios have been normalized at 100 in the first quarter of 2000. The subsequent points on each curve can then be interpreted as the percentage change in that sector’s employment-population ratio since the beginning of 2000.

If an economy were to grow along what economists call a “balanced growth path,” then

all of the lines in Figure 2 could be expected to fluctuate around the normalized value of 100. But there appear to be clear trends in at least two sectors: Manufacturing sector employment is in long-run decline, while employment in the education and health services sector is steadily on the rise—even through the most recent recession. In terms of cyclicity, there is no surprise. To take two extremes, construction sector employment is highly cyclical, while government sector employment is not.

## Unemployment

According to Figure 1, about 40 percent of the U.S. adult population is “jobless” at any point in time. Joblessness (nonemployment), however, is not the same thing as unemployment, at least according to standard labor force survey definitions. To be classified as unemployed, a nonemployed person must report being available for paid work and having engaged in some job search activity in the previous four weeks.<sup>2</sup> Nonemployed persons who are not actively looking for jobs are classified as nonparticipants.

Conceptually, the distinction between unemployment and nonparticipation is clear enough; it involves some notion of active job search. The standard labor force survey asks nonemployed people what they have done to find work (in the previous four weeks). If the respondents answer “nothing,” then they are classified as nonparticipants. Almost any evidence of active job seeking warrants classification as unemployed.<sup>3</sup> It is important to understand that these classifications are

<sup>2</sup> The only exception to this rule is for those on temporary layoff. Only a small fraction of the unemployed fall into this category.

<sup>3</sup> If respondents say they have only “looked at want ads,” they are also classified as nonparticipants.

The incidence of unemployment falls more heavily on the less-educated. A high school dropout, for example, is roughly three times more likely to be unemployed than a college graduate.

determined by the surveyor. The people being surveyed are never asked directly whether they are unemployed or not.

From an economic perspective, then, a nonemployed person who had one job interview in four weeks may not look that much different from a nonparticipant. Indeed, our clean conceptual distinctions are clouded further by the fact that in any given month, the number of nonparticipants who find jobs is as large as the number of unemployed who do.

On the other hand, the data show that an unemployed person is more likely to find a job than a nonparticipant. This difference in the probability of finding a job suggests that the unemployed are in some sense “more attached” to the labor market than nonparticipants are. It is for this reason that the labor force is defined to be the sum of employment and unemployment. The implication is that nonparticipants are “not in the labor force.”

When a recession hits, the unemployment rate typically spikes very quickly and sharply. Over the course of the subsequent recovery, however, the unemployment rate typically declines much more gradually. Figure 3 shows this pattern quite clearly for the United States. It evidently takes a lot of time to rebuild the job-worker relationships that are destroyed in a severe recession. If history is any guide, then, one should not expect the U.S. unemployment rate to fall back to pre-recession levels for many years to come.

One should keep in mind that unemployment rates, like most measures of labor market activity, often vary significantly across economic

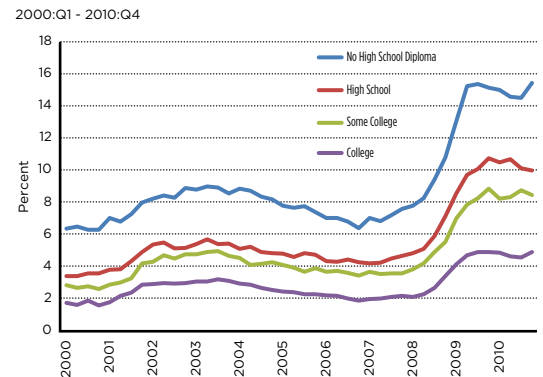
**FIGURE 3**  
**U.S. Unemployment Rate**  
1976:Q1 - 2010:Q4



SOURCE: Bureau of Labor Statistics/Haver Analytics.

and demographic characteristics, such as income, age, sex and education.

**FIGURE 4**  
**U.S. Unemployment Rates across Education Groups (Ages 25+)**  
2000:Q1 - 2010:Q4



SOURCE: Bureau of Labor Statistics/Haver Analytics.

Figure 4 depicts the unemployment rates for four educational attainment categories in the U.S. since the year 2000. As one might expect, the incidence of unemployment falls more heavily on the less-educated. A high school dropout, for example, is roughly three times more likely to be unemployed than a college graduate. It is interesting to note, however, that the unemployment rates across all education categories increased at roughly the same proportion during the past recession.

## Labor Market Transitions

The categories of employment, unemployment and nonparticipation represent snapshots of labor market activity at a point in time. But workers belonging to a given category will not necessarily remain in that category for long. Over a given interval of time, a number of workers will make transitions from one labor market category to another. These transitions are called “worker flows.”

An analogy may be of some use here. Imagine a bathtub of water, with its drain unstopped, and the faucet turned on. The level of water at a point in time corresponds to the level of employment. The water draining from the tub corresponds to the flow of workers losing or leaving their jobs. The water pouring in from the faucet corresponds to the flow of workers finding jobs.

Several other interesting facts are evident from Figure 5. Although about 4.4 million workers left employment every month, fewer than half of these workers became unemployed—most left the labor force. Similarly, about 3.2 million workers left unemployment every month. But only 1.8 million of these workers found jobs; the rest left the labor force.

Whether the water level rises or falls depends on the relative size of the inflow and outflow. And so it is with the level of employment, unemployment and nonparticipation.

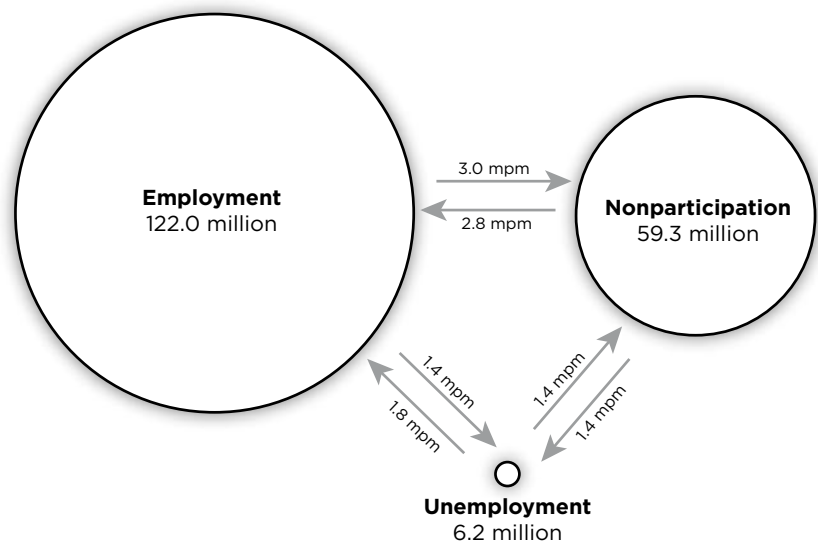
It is of some interest to measure worker flows because their magnitude reveals something about the fluidity of the labor market. Do labor market categories such as unemployment, for example, represent stagnant pools of workers who exhibit little mobility? Or is there a flurry of economic activity hidden below the surface? As it turns out, data from the Current Population Survey (CPS) can be used to answer this question.

Figure 5 examines CPS data over the period 1996-2003.<sup>4</sup> The figure divides the adult U.S. population into three familiar categories. The average level of employment was 122 million workers, and the average level of unemployment was 6.2 million workers. The average number of adults out of the labor force was 59.3 million.

The numbers associated with the arrows in Figure 5 represent average worker flows per month. These monthly flows are huge in relation to population size. For example, 9 million workers moved into and out of employment every month on average from 1996-2003. That's over 100 million transitions into and out of employment over the course of a year, a number that is almost as large as the average number of people employed at any given time.

Several other interesting facts are evident from Figure 5. Although about 4.4 million workers left employment every month, fewer than half of these workers became unemployed—most left the labor force. Similarly, about 3.2 million workers left unemployment every month. But only 1.8 million of these workers found jobs; the rest left the labor force.

**FIGURE 5**  
**Average Worker Flows 1996-2003**  
mpm = millions per month



SOURCE: Adapted from Davis, Faberman and Haltiwanger (2006) Figure 1.

Economists Steven Davis, R. Jason Faberman and John Haltiwanger suggested in a 2006 paper that the economic forces behind these worker flows can be grouped into “supply” side and “demand” side. On the demand side, employers continuously create new jobs and destroy old ones, a process that evidently accounts for much of the observed job mobility and many of the jobless spells experienced by workers. On the supply side, workers frequently switch jobs and change their labor market status for any number of reasons, including retirement, family relocation, schooling and so on. Also on the supply side, new workers are entering the labor force.

As one might expect, there is considerable cyclical (as well as seasonal) variation in these flows. Figure 6 plots the average monthly flow

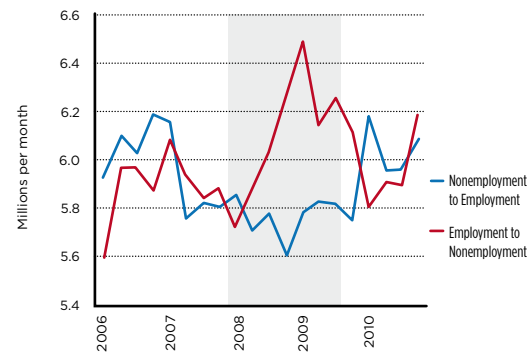
<sup>4</sup> Fallick and Fleischman (2004), cited in Davis, Faberman and Haltiwanger (2006).

FIGURE 6

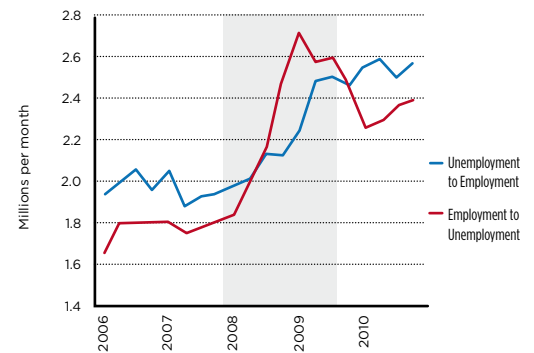
## U.S. Labor Market Flows

2006:Q1 - 2010:Q4

### Employment–Nonemployment Flows



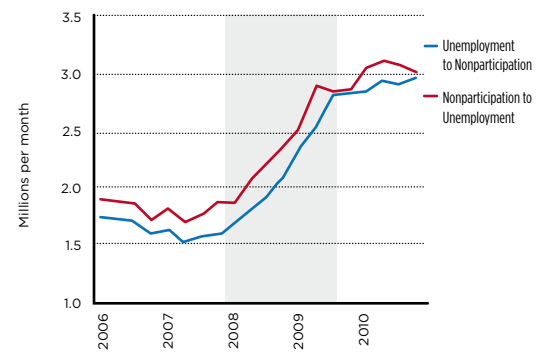
### Employment–Unemployment Flows



### Employment–Nonparticipation Flows



### Unemployment–Nonparticipation Flows



SOURCE: Current Population Survey, Bureau of Labor Statistics/Haver Analytics.

NOTE: Shaded areas represent recessions as determined by the National Bureau of Economic Research.

If unemployment durations are short, at least the pain of unemployment is short-lived. But long-duration unemployment is more of a concern.

of workers for the United States from 2006:Q1 to 2010:Q4. The shaded region represents the most recent recession (officially dated by the National Bureau of Economic Research).

The top-left panel plots the flow of workers into and out of employment (nonemployment is the sum of unemployment and nonparticipation). Not surprisingly, there is a sharp spike in the flow of workers leaving employment during the recession. There is also a moderate decline in the flow of workers into employment. It is interesting to note that an average of 5.6 million workers per month found jobs even in the depths of the recession. The flow of workers losing or leaving their jobs, however, was much higher. The difference in these two flows accounts for the sharp recent decline in employment recorded in Figure 1.

The top-right panel shows a large increase in the flow of workers moving from employment to unemployment during the recession. This is what one would expect when the economy sours. But there is also a significant, though less pronounced, increase in the number of unemployed workers

finding jobs. This latter increase is due, in part, to the fact that there are now more unemployed workers. But as unemployed workers have the option of leaving the labor force, the fact that more unemployed workers are finding jobs must to some extent also reflect a growing availability of job opportunities.

The bottom-left panel depicts the flow of workers between employment and nonparticipation. Both of these flows are declining throughout the recent recession. It is evidently not as easy to find a job while out of the labor force. And likewise, workers appear less inclined to leave the labor force as the economy worsens.

The bottom-right panel depicts the flow of workers between unemployment and nonparticipation. The unemployment to nonparticipation flow is rising throughout the recession; this might, in large part, be due to a “discouraged worker” effect, whereby unemployed workers facing bleak prospects stop looking for jobs. There also appears to be an “encouraged worker” effect; at least, this is one interpretation

One interpretation of this recent pattern is that matching jobs with workers has become more difficult in the wake of an exceptionally severe recession. If this is the case, then it is not immediately clear how monetary or fiscal policies might alleviate the problem.

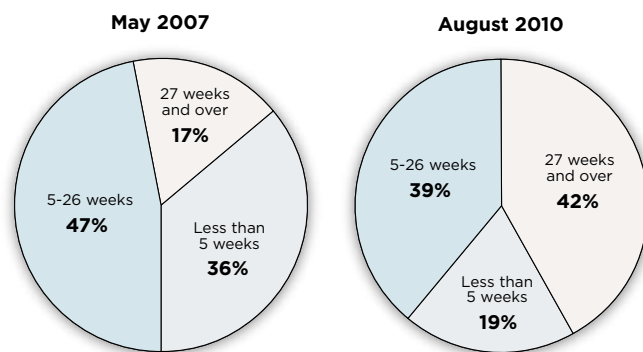
for the corresponding rise in the flow of non-participants choosing to enter the workforce.

Taken together, the data exhibited in Figure 6 reveal that the pattern of labor market activity over the course of booms and recessions is considerably more complicated than is generally recognized. As more and better data have become available, economists have been led to reassess existing labor market theories. In conventional theory, for example, unemployment is frequently portrayed as a stagnant pool of idle workers, waiting on the sidelines until market conditions improve.

In fact, the microdata show that for most workers, the length of their unemployment spells is relatively short; see the left-hand panel in Figure 7. This panel shows a fairly typical pattern: 83 percent of all unemployed workers in May 2007 had been unemployed for 26 weeks or less. However, while most unemployment spells are short, most of the time spent in unemployment is accounted for by a relatively small fraction of workers—the “long-term unemployed.”

The right-hand panel in Figure 7 depicts the distribution of unemployment spells in August 2010. It still remains true that the majority of unemployment spells are of short duration, but the fraction is now much lower than it was prior to the recession. The fraction of unemployed workers who have been out of work longer than 26 weeks has risen to 42 percent. For policy-makers, this post-recessionary increase in the fraction of long-term unemployment is disconcerting. If unemployment durations are short, at least the pain of unemployment is short-lived. But long-duration unemployment is more of a concern. This will certainly be the case if, as some fear, long unemployment spells lead to a

**FIGURE 7**  
**Unemployment Duration**



SOURCE: Bureau of Labor Statistics/Haver Analytics.

deterioration of skills, rendering workers unemployable when the job market recovers.

## Vacancies and Unemployment

A job vacancy corresponds to an “unemployed job” from the perspective of a firm. Unemployed workers are looking for unemployed jobs, and many unemployed jobs are looking for unemployed workers.<sup>5</sup> On the surface, it seems puzzling that job vacancies should coexist with unemployment. Why do firms with job openings simply not hire available workers until the unemployment rate drops to zero or until the available supply of vacant jobs is exhausted?

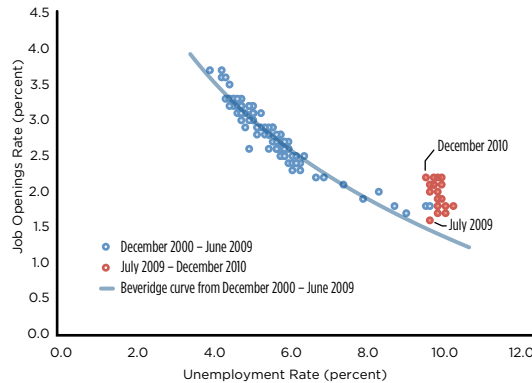
One answer to this question is that resource allocation in the labor market is complicated by “search frictions.” The basic idea is as follows: First, jobs and workers each possess idiosyncratic characteristics that make some job-worker pair-

<sup>5</sup> Of course, many job openings are also targeted at employed workers; likewise, many employed workers are also looking for better jobs. The flow of employment to employment transitions is also very large.

Some people argue that higher productivity is responsible for the lack of hiring. But productivity has been rising for centuries, and with no obvious detriment to employment opportunities.

**FIGURE 8**  
**U.S. Beveridge Curve**

December 2000 - December 2010



SOURCE: Job Opening and Labor Turnover Survey, Bureau of Labor Statistics/Haver Analytics.

ings more productive than others. Second, jobs and workers do not necessarily know beforehand where the best pairing is located. If this is true, then it follows that jobs and workers should expend time and resources to search out the best matches. A firm will generally not want to hire the first worker who comes through the door. Likewise, an unemployed worker may not want to accept the first available job offer. The same principles are at work in most matching markets, including, for example, the marriage market.

Like unemployment, vacancies vary over the business cycle. In fact, unemployment and job vacancy rates tend to vary in a systematic way: The unemployment rate tends to be high when the vacancy rate is low, and vice versa. The relationship between these two variables is referred to as the Beveridge curve. Figure 8 uses data from the Job Openings and Labor Turnover Survey to depict the Beveridge curve for the United States from December 2000 to December 2010.

From Figure 8, it seems that the Beveridge curve maintains its classic negative slope through most of the decade and, indeed, throughout the recent recession. The common interpretation

of this pattern is that depressed business conditions lead firms to demand less labor and post fewer job openings, making it more difficult for unemployed workers to find jobs (that is, jobs well-matched with their personal characteristics). Because jobs are harder to find, the unemployment rate rises.

The red dots in Figure 8 depict the Beveridge curve since the U.S. recession was formally declared ended in June 2009. One would normally expect the unemployment rate to decline as economic growth resumes. But here, we see evidence of increased recruiting activity on the part of the business sector together with no apparent decline in the unemployment rate. One interpretation of this recent pattern is that matching jobs with workers has become more difficult in the wake of an exceptionally severe recession. If this is the case, then it is not immediately clear how monetary or fiscal policies might alleviate the problem.

## Implications for Policy

With the U.S. unemployment rate still very high, many are asking what might be done about it. It is not immediately clear what can be done in the short term. The Federal Reserve has lowered its policy rate as far as it can go. The economy is flush with liquidity. Many firms, however, remain reluctant to spend on investment and additional labor. For better or worse, political and fiscal constraints are holding back large expenditures on public works projects.

A key question, as far as policy is concerned, relates to why many firms appear reluctant to go “full speed ahead” in their investment and employment plans as the economy improves.

This is where much of the disagreement lies. Some argue that private sector spending remains restrained by psychological factors—a simple lack of confidence. Others think that there are legitimate reasons for the apparent lack of confidence—including the policy uncertainty generated by the political machinations of the public sector. Where one falls between these two perspectives naturally influences one’s view on what constitutes desirable policy.

On a brighter note, the U.S. economy is clearly in recovery mode, even if the recovery is not very robust. Real per capita GDP is growing, even if employment per capita is not. A growing GDP combined with zero employment growth necessarily means higher labor productivity (more output is being produced with the same amount of labor). Some people argue that higher productivity is responsible for the lack of hiring. But productivity has been rising for centuries, and with no obvious detriment to employment opportunities.

The recovery in GDP, however, has done little to diminish the belief among some that “more should be done” to help the labor market. It is easy to understand what motivates this sentiment. GDP is a measure of average income—it sheds no light on how this income is distributed across the population. Moreover, the incidence of unemployment is concentrated among the poor and less-educated. In short, there is a concern that the prosperity associated with the recovery will not be shared by all. Determining the best way to ensure shared prosperity without crippling the machine that creates it is always a challenge for policymakers—and it is likely to remain so in the foreseeable future.

#### REFERENCES

Davis, Steven J.; Faberman, R. Jason; and Haltiwanger, John. “The Flow Approach to Labor Markets: New Data Sources and Micro-Macro Links,” *Journal of Economic Perspectives*, Summer 2006, Vol. 20, No. 3, pp. 3-26.

Fallick, Bruce; and Fleischman, Charles A. “Employer-to-Employer Flows in the U.S. Labor Market: The Complete Picture of Gross Worker Flows,” Finance and Economics Discussion Series No. 2004-34, Board of Governors of the Federal Reserve System, May 2004.

# A Closer Look at G-7 Labor Patterns during the 2007-2009 Recession

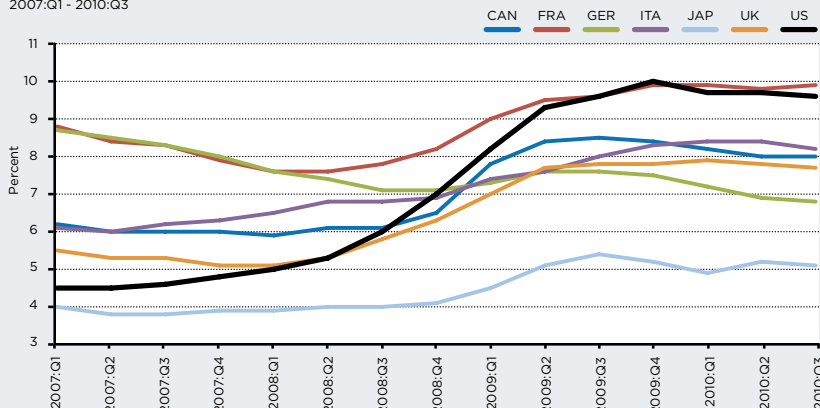
In the two decades prior to the 2007-09 recession, the U.S. had one of the lowest unemployment rates among the world’s major industrialized countries. As of the first quarter of 2007, for example, the U.S. unemployment rate stood at 4.5 percent, roughly half that of France and Germany. Only Japan’s unemployment rate was lower among the Group of 7 (G-7) countries.<sup>1</sup> See Figure 1.

During the Great Recession, the U.S. went from having one of the lowest unemployment rates to one of the highest. By the end of the recession, the U.S. unemployment rate stood close to 10 percent, roughly on par with France—a country whose unemployment rate stood at 9 percent *prior* to the recession! Even more shocking to seasoned observers of world labor markets, the unemployment rate in Germany actually *declined* through most of the recession.

FIGURE 1

## Unemployment Rate in G-7 Countries

2007:Q1 - 2010:Q3



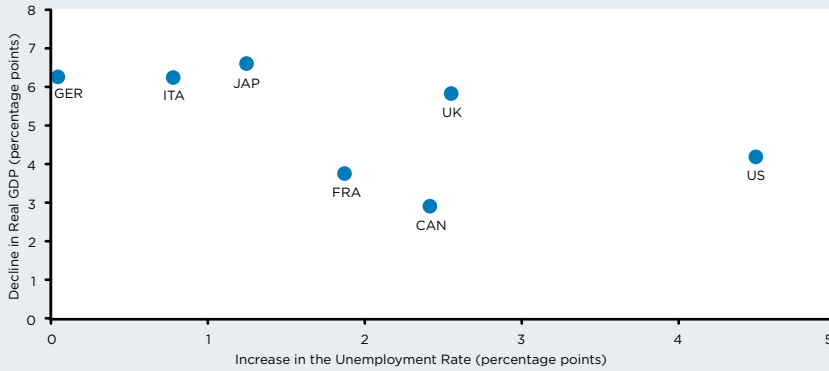
SOURCES: Statistics Canada, OECD, Bureau of Labor Statistics/Haver Analytics.

Why has the unemployment response to the recession been so different among G-7 countries? One explanation may simply be that the strength of recessionary forces varied across each country. If true, then one might expect a strong relationship between the change in the unemployment rate and the change in GDP across countries. If a country experienced only a small decline in GDP, then one would expect the change in unemployment to be correspondingly small in that country, and vice versa. In fact, this appears not to be the case at all.

<sup>1</sup> The G-7 countries are Canada, France, Germany, Italy, Japan, the United Kingdom and the United States.

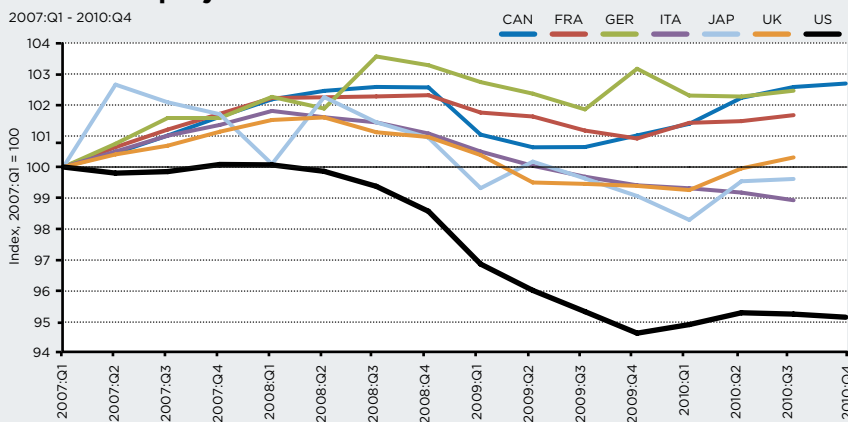
The U.S. appears to be the outlier here, shedding a significantly larger percentage of employees than the rest of the G-7 countries.

**FIGURE 2**  
**The 2007-09 Recession: Impact on Real GDP and Unemployment in G-7 Countries**



SOURCES: Data come from OECD/Haver Analytics. Peak and trough dates for each country are from the National Bureau of Economic Research (for the U.S.) or from the Organisation for Economic Co-operation and Development (for the remaining G-7 countries).

**FIGURE 3**  
**Civilian Employment in G-7 Countries**



SOURCES: Statistics Canada, OECD, Bureau of Labor Statistics/Haver Analytics.

Consider Figure 2, which plots the decline in GDP from peak to trough against the increase in the unemployment rate for each G-7 country. There appears to be little, if any, correlation between changes in GDP and unemployment. Compared with other G-7 countries, the U.S. experienced a relatively small decline in GDP during this recession—the third smallest decline in GDP after France and Canada. Of all G-7 countries, however, the U.S. experienced the largest increase in its unemployment rate.

The level of employment in six of the seven G-7 countries over the course of the recession

followed a broadly similar pattern. Figure 3 shows quarterly civilian employment for G-7 countries, with the series normalized to 100 in the first quarter of 2007. As the picture shows, the U.S. appears to be the outlier here, shedding a significantly larger percentage of employees than the rest of the G-7 countries. Canada, Germany and France actually saw their employment levels rise during the recession compared with the first quarter of 2007.

Employment normally contracts during a recession. Moreover, real GDP usually declines proportionately more than employment. The implication is that labor productivity—measured as output per worker—tends to decline during a recession. This commonly observed behavior was evident among all the G-7 economies during the past recession, with the notable exception of the U.S.; see Figure 4.

Figure 4 plots labor productivity (GDP per employed worker), normalized to 100 in the first quarter of 2007. As the figure illustrates, U.S. labor productivity rose throughout the recession and continues to rise rapidly. Countries for which the impact of the recession on the unemployment rate was relatively small, such as Germany and Japan, saw output per worker decline significantly. As of the third quarter of 2010, only Canada, France and Japan had essentially returned to pre-recession productivity levels.

As usual, there are several ways to interpret the data. First, it may be possible that the productivity of labor rose in the U.S. and that this event allowed U.S. firms to economize on labor. It is hard, however, to imagine a recession being the consequence of some random force that increased economy-wide labor productivity.

An alternative explanation is that low-skilled workers are affected disproportionately during a typical recession: They are the first ones to be let go. If this is the case, then the average quality of employed workers tends to rise during a recession. Perhaps this accounts



## Employment protection varies quite a bit among G-7 countries, with the U.S. having the least-strict employment protection.

for the increase in measured average labor productivity in the U.S. If this hypothesis is correct, then to explain the data, one must be willing to entertain the idea that business managers are somehow more willing or able to lay off lower-skilled workers (or workers in general) in the U.S. relative to other G-7 economies.

In fact, there is some evidence to suggest that cross-country differences in regulatory environments permit varying degrees of labor market flexibility. Figure 5, for example, compares the strictness of employment protection for G-7 countries according to a measure constructed by the Organisation for Economic Co-operation and Development (OECD).<sup>2</sup> The index is a weighted sum of a set of employment protection indicators that measure the rules and costs regarding the firing of workers (individuals and groups) and the use of temporary contracts. As can be seen in the figure, employment protection varies quite a bit among G-7 countries, with the U.S. having the least-strict employment protection.

For most of the past 30 years, the U.S. labor market has outperformed most others, especially in terms of low unemployment rates. This relative success has been attributed, at least in part, to the alleged flexibility in the U.S. labor market. In particular, high unemployment in European countries is frequently linked to laws that make it difficult to shed workers and/or hire temporary workers. Less flexibility means less profitability for firms and, hence, less incentive to hire workers.

It is perfectly natural, then, to expect employment and unemployment to react more violently to cyclical forces in a flexible labor market. And, indeed, this appears to have been the case during the recent recession.

<sup>2</sup> For more details on the OECD indicators of employment protection, see OECD (2011) and Venn.

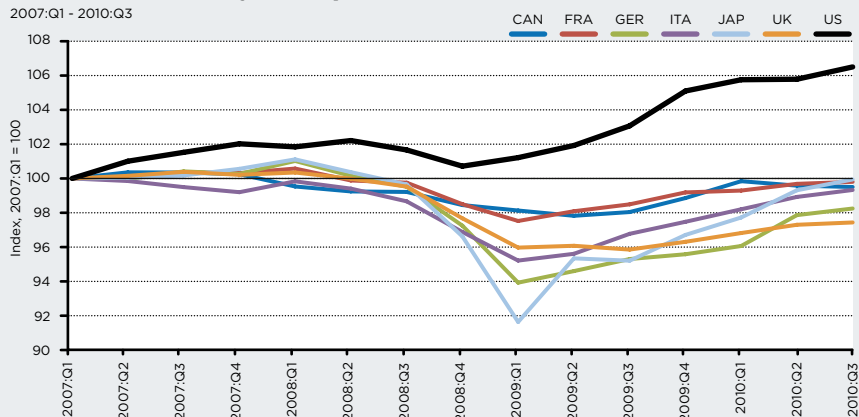
### REFERENCES

DiCecio, Riccardo. "Cross-Country Productivity Growth." Federal Reserve Bank of St. Louis *International Economic Trends*, November 2005. See <http://research.stlouisfed.org/publications/iet/20051101/cover.pdf>

FIGURE 4

### Labor Productivity (GDP per Worker) for G-7 Countries

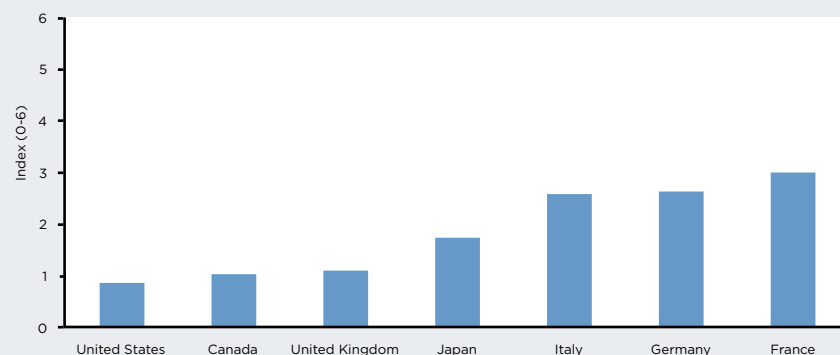
2007:Q1 - 2010:Q3



SOURCE: G10+ Database/Haver Select.

FIGURE 5

### Overall Strictness of Employment Protection OECD Index, 2008



SOURCE: OECD Indicators of Employment Protection.

NOTE: The index ranges from 0 to 6, with 0 representing the least-strict and 6 representing the most-strict employment protection.

Organisation for Economic Co-operation and Development. "OECD Indicators of Employment Protection." Accessed on March 9, 2011. See [www.oecd.org/employment/protection](http://www.oecd.org/employment/protection)

Organisation for Economic Co-operation and Development. *OECD Employment Outlook 2010: Moving Beyond the Jobs Crisis*. Paris: OECD Publishing, 2010.

Organisation for Economic Co-operation and Development. *OECD Employment Outlook 2009: Tackling the Jobs Crisis*. Paris: OECD Publishing, 2009.

Organisation for Economic Co-operation and Development. "Employment Protection: The Costs and Benefits of Greater Job Security." OECD Policy Brief, September 2004. See [www.oecd.org/dataoecd/6/32/33736760.pdf](http://www.oecd.org/dataoecd/6/32/33736760.pdf)

Venn, Danielle. "Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators." Working Paper No. 89, OECD Social, Employment and Migration, 2009. See [www.oecd.org/dataoecd/36/9/43116624.pdf](http://www.oecd.org/dataoecd/36/9/43116624.pdf)

# Boards of Directors Advisory Councils Bank Officers

We bid farewell and express our gratitude to those members of the boards of directors and of our advisory councils who retired recently.

---

## FROM THE BOARDS OF DIRECTORS

St. Louis

**Paul T. Combs**

Little Rock

**Sharon Priest**

Louisville

**John A. Hillerich IV**  
and **Steven E. Trager**

Memphis

**Nick Clark**  
and **Thomas G. Miller**

## FROM THE INDUSTRY COUNCILS

Agriculture

**Ray C. Dillon**

Health Care

**Gary D. Henley**

Real Estate

**H. Collins Haynes**

Transportation

**Robert L. Lekites**  
**Donald H. Sanders**  
**Kirk Thompson**  
**Philip H. Trenary**

## FROM THE COMMUNITY DEVELOPMENT ADVISORY COUNCIL

**Tim Bolding**  
**David Jackson**  
**Leslie Lane**  
**W. Thomas Reeves**  
**Ben Steinberg**  
**Stephanie Streett**  
**Marita W. Willis**  
**John J. Wuest**

## FROM THE FEDERAL ADVISORY COUNCIL

**Lewis F. Mallory Jr.**

All those listed on the following pages are current officeholders.

## Chairman's Message



It's an honor to serve on the board of directors for the Federal Reserve Bank of St. Louis. Our role is similar to a corporate board, but with some additional responsibilities that make it a particularly interesting and challenging opportunity.

Our charge is unique—to help keep our nation's banking system running smoothly and our economy moving ahead. As you might expect, we review the Bank's strategic direction, performance metrics and budget. As business leaders, we also share our knowledge of economic trends in our own industries and communities.

Our board members come from industries throughout the Eighth District, which includes Arkansas and parts of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee. The current board is comprised of leaders in the fields of legal services, health care, energy, retail and manufacturing—as well as banking. Each of the St. Louis Fed's three regional branches—in Little Rock, Louisville and Memphis—also has an advisory board, broadening our industry representation to also include education, natural resources, real estate, plastics, maintenance and shipping.

Together, we bring to the table our knowledge of local credit needs, plans to expand or contract businesses, status of the workforce, condition of public works, upcoming capital investment and other factors that influence the economy. We advise James Bullard, president of the Federal Reserve Bank of St. Louis, so that he can accurately represent our region in Washington, D.C. It's an honor to be part of the Federal Reserve System that ensures all of America is considered as part of national monetary policy decisions.

We are the representatives who have the responsibility to share our communities' concerns with policymakers and who have the opportunity to bring economic information back to our neighbors. I hope that you'll take some time to get to know us in the following pages and that you'll reach out to us to help us better represent you and the rest of the Eighth District.

Steven H. Lipstein

*On the following pages, representatives of each board share a few words about their service to the Fed. Snapshots that they submitted of their businesses and employees reflect the variety of industries and interests of board members.*

# St. Louis Board



Chairman

**Steven H. Lipstein**  
President and CEO  
BJC HealthCare  
St. Louis



Deputy Chairman

**Ward M. Klein**  
CEO  
Energizer Holdings Inc.  
St. Louis



**William E. Chappel**  
President and CEO  
The First National Bank  
Vandalia, Ill.



**Gregory M. Duckett**  
Senior Vice President  
and Corporate Counsel  
Baptist Memorial Health  
Care Corp.  
Memphis, Tenn.



**Sharon D. Fiehler**  
Executive Vice President  
and Chief Administrative  
Officer  
Peabody Energy  
St. Louis

**Sharon D. Fiehler, Executive Vice President and Chief Administrative Officer of Peabody Energy**

*“Our global operations create enormous economic value, with whole communities rising around our mines. Peabody also is a regional economic engine. The payroll in our downtown St. Louis headquarters alone exceeds \$70 million annually. Within the district, our Midwest operations contribute more than \$3 billion in direct and implied economic benefits every year.*”

*“Economies are converging, and individuals are connecting around the world. What happens on one continent now more dramatically affects what happens in our backyard and vice versa.”*



*“Ten percent of U.S. electricity and 2 percent of global power come from Peabody Energy coal. ... One fact that always amazes me is that the state of Illinois has more energy in the form of coal than Saudi Arabia has oil.”*

**Robert G. Jones, President and CEO of Old National Bancorp**

*“Without a doubt, being a director has broadened my perspective and increased my understanding of the many facets of our regional economy, especially the drivers of economic growth in the Eighth District. I’ve also had the privilege to meet and learn from my fellow board members, who are some of the most innovative and intelligent people I’ve come across in my 30-plus years in the financial industry.”*



Donut Bank has been a staple in Evansville, Ind., since 1967. Co-owners of the family-owned franchise (from left) Chris, Ben and Joe Kempf meet with their Old National financial partner, Matt Merkel.



**Sonja Yates Hubbard**  
CEO  
E-Z Mart Stores Inc.  
Texarkana, Texas



**Robert G. Jones**  
President and CEO  
Old National Bancorp  
Evansville, Ind.



**J. Thomas May**  
Chairman and CEO  
Simmons First  
National Corp.  
Pine Bluff, Ark.



**Cal McCastlain**  
Partner  
Dover Dixon Horne PLLC  
Little Rock, Ark.

**Sonja Yates Hubbard, CEO of E-Z Mart Stores Inc.**

On why it's important for the St. Louis Fed to remain visible in the community during these tough economic times: *"The information received from the markets as to emerging trends and the results of performance from businesses allow the Fed to more accurately predict changes and swings that should be acted upon. Additionally, without continued contact and reliable relationships with the financial institutions, we could not make proper decisions to ensure their soundness."*



Within the St. Louis Fed's District, E-Z Mart operates 103 stores, all in Arkansas, making it one of the largest chains of convenience retailers in that state. Those stores generate \$275 million in revenue a year. The family-owned company operates an additional 201 stores in adjacent states, which generate an additional \$516 million in annual revenue.



**Ward M. Klein, CEO of Energizer Holdings**

*"In terms of truly understanding what is impacting the economy, what is impacting St. Louis, what is impacting my business, there is no better seat than at the board table of the Federal Reserve."*

*"Energizer Holdings serves globally. But I have really gotten to appreciate the interconnectedness of the world economy more from my Fed position than from working in just my company. For example, the impacts of the U.S. crisis on Europe and on the emerging markets have been fascinating to watch, to deal with, to figure out. Again, the Federal Reserve is in the middle of understanding this interconnectedness."*

*"I have been proud to be part of this organization, particularly of late. When there have been disputes and politics and partisan bickering over the causes and effects of the Great Recession, the Fed has been the adult in the room. It has stepped in with a mature, professional and thoughtful reflection and response to what has been a trying time for this country."*

Energizer Holdings has more than 16,000 employees worldwide. About 400 work at its headquarters in a St. Louis suburb. While best known for its batteries and other consumer products (and its bunny hot-air balloon), it is also known in the St. Louis area for employee involvement in charities and such organizations as Civic Progress, for which Mr. Klein is the president-elect.

# Little Rock Board



Chairman

**Kaleybra Mitchell Morehead**

Vice President for College Affairs/Advancement  
Southeast Arkansas College  
College  
Pine Bluff, Ark.



**Phillip N. Baldwin**

President and CEO  
Southern Bancorp  
Arkadelphia, Ark.



**Michael A. Cook**

Vice President and  
Assistant Treasurer  
Wal-Mart Stores Inc.  
Bentonville, Ark.



**Ray C. Dillon**

President and CEO  
Deltic Timber Corp.  
El Dorado, Ark.



**William C. Scholl**

President  
First Security Bancorp  
Searcy, Ark.



**C. Sam Walls**

CEO  
Arkansas Capital Corp.  
Little Rock, Ark.



**Robert A. Young III**

Chairman  
Arkansas Best Corp.  
Fort Smith, Ark.

**Kaleybra Mitchell Morehead, Vice President for College Affairs/Advancement of Southeast Arkansas College**

*"My primary focus was that of understanding financial issues as they relate to the college and not that of trying to tie the college into the economy as a whole. However, since being appointed to the St. Louis Fed's Little Rock board, I have gathered a profound understanding of how the numerous facets of our economy are linked. In other words, I was looking more at the 'little' picture, where now I see, with clarity, the 'big' picture."*

*"Southeast Arkansas College and other institutions of higher education in Arkansas have a significant impact on Arkansas' economy. The institutions prepare students for the work world, thereby injecting money into the economy. It is noteworthy that, compared with high school graduates, graduates of institutions of higher learning are going to be higher wage earners and contribute larger sums of money to the economy."*

With an average student age of 29, Southeast Arkansas College (SEARK) provides comprehensive community college education and services to traditional and nontraditional students, with an emphasis on academic transfer, technical education and workforce development. Last fall, enrollment was 2,192. The college's Technology Center (right) was completed in the 2009 spring semester.



# Louisville Board



Chairman  
**Gary A. Ransdell**  
President  
Western Kentucky University  
Bowling Green, Ky.



**David P. Heintzman**  
Chairman and CEO  
Stock Yards Bank & Trust Co.  
Louisville, Ky.



**Jon A. Lawson**  
President, CEO  
and Chairman  
Bank of Ohio County  
Beaver Dam, Ky.



**Gerald R. Martin**  
Managing Member  
River Hill Capital LLC  
Louisville, Ky.



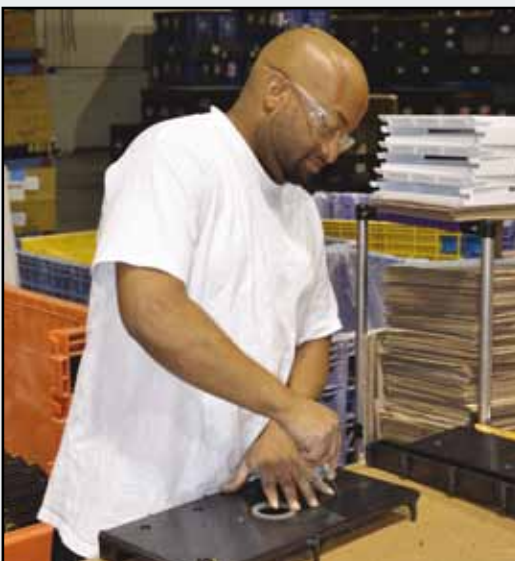
**Barbara Ann Popp**  
CEO  
Schuler Bauer  
Real Estate Services  
New Albany, Ind.



**John C. Schroeder**  
President  
Wabash Plastics Inc.  
Evansville, Ind.



**Kevin Shurn**  
President and Owner  
Superior Maintenance Co.  
Elizabethtown, Ky.



Wabash Plastics employee Kris Saunders clears flash after welding two injection-molded plastic parts. Wabash and its two sister companies operate three plants in the Evansville, Ind., area and six elsewhere.

## John C. Schroeder, President of Wabash Plastics

*"In our local community of over 150,000 people, one could say that the 400 people we employ are not a significant number. However, when you consider that we have been an Evansville employer for over 60 years, the families benefiting from our companies become more important in the community."*

*"Our company's economic role in the community reaches beyond the number of paychecks, though. Our philosophy has been to give back to the community. Our employees have served as presidents or chairmen of most civic boards in the area."*

*"Prior to serving on the Federal Reserve board, my main concerns were with the economy and how it was affecting my business. Regulatory reform, increased federal debt, the independence of the Federal Reserve, banking regulations and other responsibilities of the Federal Reserve were not my concerns. I know now that these areas are vital to the entire system. I also realize how a breakdown in any one area will eventually affect my business."*

*"I also realize how vital it is for the Federal Reserve to know what is happening on Main Street in small communities. What we know and see each day is important to the entire economic system. I am continually impressed by the fact that top Federal Reserve officials are open to my comments and value my input."*

# Memphis Board



Chairman  
**Lawrence C. Long**  
 Partner  
 St. Rest Planting Co.  
 Indianola, Miss.



**Charles S. Blatteis**  
 Managing Member  
 Blatteis Law Firm PLLC  
 Memphis, Tenn.



**Allegra C. Brigham**  
 Interim President  
 Mississippi University  
 for Women  
 Columbus, Miss.



**Mark P. Fowler**  
 Vice Chairman  
 Liberty Bank of Arkansas  
 Jonesboro, Ark.



**Clyde Warren Nunn**  
 Chairman and President  
 Security Bancorp of  
 Tennessee Inc.  
 Halls, Tenn.



**Susan S. Stephenson**  
 Co-Chairman  
 and President  
 Independent Bank  
 Memphis, Tenn.



**Charlie E. Thomas III**  
 Regional Director of  
 External and Legislative  
 Affairs  
 AT&T Tennessee  
 Memphis, Tenn.

## Susan S. Stephenson, Co-Chairman and President of Independent Bank

*"The St. Louis Fed has done a wonderful job of being active and visible throughout the entire District. This visibility is particularly important in the current environment, since factual information and feedback have a calming influence and provide an important counterpoint to misinformation and market confusion.*

*"My view that the U.S. economy is strong, creative and resilient has been reinforced by seeing strong, capable and creative leadership at work in the Federal Reserve System.*

*"The opportunity to interact with Fed officials strengthens ties to business and political leaders in various communities, enhances the ability to collect market data, and supports economic development efforts in the region. On a national level, President Bullard's visibility provides a positive lift to the Eighth District, reminding national companies and industries that the mid-America region is a great place to live, work and do business."*



Independent Bank serves the financial needs of middle market companies, small businesses and individuals. One customer, Memphis-based retailer Oak Hall, has opened two additional stores in the past three years with financing from Independent Bank. Shown at a recent trunk show are Bob Levy (left) and Paul Kauerz of the store, along with the bank's Susan S. Stephenson.



# Industry Councils

Council members represent a wide range of Eighth District industries and businesses. The members' periodic reports on economic conditions are considered in monetary policy deliberations.

---

## AGRI BUSINESS

Based in Little Rock, Ark.

**Sam J. Fiorello**  
Chief Operating Officer  
and Senior Vice President  
Donald Danforth Plant  
Science Center  
St. Louis

**Timothy J. Gallagher**  
Executive Vice President  
Bunge North America Inc.  
St. Louis

**Keith Glover**  
President and CEO  
Producers Rice Mill Inc.  
Stuttgart, Ark.

**Bert Greenwalt**  
Professor of Agricultural  
Economics  
Arkansas State University  
State University, Ark.

**Leonard J. Guarraia**  
Chairman and CEO  
World Agricultural Forum  
St. Louis

**Ted C. Huber**  
Owner  
Huber's Orchard & Winery  
Starlight, Ind.

**Richard M. Jameson**  
Owner  
Jameson Family  
Farms Partnership  
Brownsville, Tenn.

**John C. King III**  
Owner  
King Farms  
Helena, Ark.

**Steven M. Turner**  
CEO  
Turner Dairies LLC  
Memphis, Tenn.

**Lyle B. Waller II**  
Owner  
L.B. Waller and Co.  
Morganfield, Ky.

**David Williams**  
Founder and Co-owner  
Burkman Feeds  
Danville, Ky.

---

## HEALTH CARE

Based in Louisville, Ky.

**Calvin Anderson**  
Vice President of Corporate  
and Government Affairs  
Blue Cross Blue Shield  
of Tennessee  
Memphis, Tenn.

**Steven J. Bares**  
President and Executive Director  
Memphis Bioworks Foundation  
Memphis, Tenn.

**Kevin Bramer**  
President and CEO  
MedVenture Technology Corp.  
Jeffersonville, Ind.

**Jeffrey B. Bringardner**  
President of Kentucky Market  
Humana-Kentucky Inc.  
Louisville, Ky.

**Robert S. Gordon**  
Executive Vice President and  
Chief Administration Officer  
Baptist Memorial Health Care  
Memphis, Tenn.

**Paul Halverson, M.D.**  
Director, State Health Officer  
Arkansas Department of Health  
Little Rock, Ark.

**Russell D. Harrington Jr.**  
President and CEO  
Baptist Health  
Little Rock, Ark.

**Dick Pierson**  
Vice Chancellor  
for Clinical Programs  
University of Arkansas  
for Medical Sciences  
Little Rock, Ark.

**Sister Mary Jean Ryan**  
Chair and CEO  
SSM Health Care  
St. Louis

**Jan C. Vest**  
CEO  
Signature Health Services Inc.  
St. Louis

**Stephen A. Williams**  
President and CEO  
Norton Healthcare  
Louisville, Ky.

---

## REAL ESTATE

Based in St. Louis

**Joseph D. Hegger**  
Director  
Jeffrey E. Smith Institute  
of Real Estate,  
University of Missouri-Columbia  
Columbia, Mo.

**J. Scott Jagoe**  
Owner  
Jagoe Homes Inc.  
Owensboro, Ky.

**Larry K. Jensen**  
President and CEO  
Commercial Advisors LLC  
Memphis, Tenn.

**Gregory J. Kozicz**  
President and CEO  
Alberici Corp.  
St. Louis

**Steven P. Lane**  
Principal  
Colliers International  
Bentonville, Ark.

**Jack McCray**  
Executive Vice President  
of Real Estate Acquisition  
and Development  
Bank of the Ozarks  
Little Rock, Ark.

**John J. Miranda**  
Partner  
Pinnacle Properties  
of Louisville LLC  
Louisville, Ky.

**William M. Mitchell**  
Vice President  
and Principal Broker  
Crye-Leike Realtors  
Memphis, Tenn.

**David W. Price**  
Vice President and  
General Manager  
Whittaker Builders Inc.  
St. Louis

**E. Phillip Scherer III**  
President  
Commercial Kentucky Inc.  
Louisville, Ky.

**Mary R. Singer**  
President  
CresaPartners Commercial  
Realty Group  
Memphis, Tenn.

---

## TRANSPORTATION

Based In Memphis, Tenn.

**Bob Blocker**  
Director of Planning  
and Business Development  
AEP River Operations LLC  
Chesterfield, Mo.

**Charles L. Ewing Sr.**  
President  
Ewing Moving Service  
and Storage Inc.  
Memphis, Tenn.

**Gene Huang**  
Chief Economist  
FedEx Corp.  
Memphis, Tenn.

**Richard McClure**  
President  
Uni Group Inc.  
St. Louis

**Dennis B. Oakley**  
President  
Bruce Oakley Inc.  
North Little Rock, Ark.

**John F. Pickering**  
Chief Operations Officer  
Cass Information Systems Inc.  
Bridgeton, Mo.

**Roger Reynolds**  
President  
Reynolds Group LLC  
Louisville, Ky.

**Michael P. Ryan**  
President and CEO  
American Commercial  
Lines Inc.  
Jeffersonville, Ind.

**David L. Summitt**  
President  
Summitt Trucking LLC  
Clarksville, Ind.

**Paul Wellhausen**  
President  
Lewis and Clark Marine  
Granite City, Ill.

# Community Development Advisory Council

The council keeps the Bank's president and staff informed about community development issues in the District and suggests ways for the Bank to support local development efforts.

---

**Joe W. Barker**

Executive Director  
Southwest Tennessee  
Development District  
Jackson, Tenn.

**The Rev. Adrian Brooks**

Pastor  
Memorial Baptist Church  
Founder, Memorial Community  
Development Corp.  
Evansville, Ind.

**Brian Dabson**

President and CEO  
Rural Policy Research Institute  
University of Missouri  
Columbia, Mo.

**George Hartsfield**

Community Volunteer  
Jefferson City, Mo.

**Trinita Logue**

President  
IFF  
Chicago, Ill.

**Edgardo Mansilla**

Executive Director  
Americana Community Center  
Louisville, Ky.

**Paulette Meikle**

Assistant Professor  
Sociology and Community  
Development  
Delta State University  
Cleveland, Miss.

**Sara Oliver**

Vice President of Housing  
Arkansas Development  
Finance Authority  
Little Rock, Ark.

**Ines Polonius**

Executive Director  
alt.Consulting Inc.  
Pine Bluff, Ark.

**Kevin Smith**

President and CEO  
Community Ventures Corp.  
Lexington, Ky.

**Royce A. Sutton**

Vice President and Community  
Development Manager  
Fifth Third Bank  
St. Louis, Mo.

**Emily Trenholm**

Executive Director  
Community Development  
Council of Greater Memphis  
Memphis, Tenn.

**Sherece Y. West**

President and CEO  
The Winthrop Rockefeller  
Foundation  
Little Rock, Ark.

# Community Depository Institutions Advisory Council

The members of this council, formed in 2011, meet twice a year to advise the Bank's president on the credit, banking and economic conditions facing their institutions and communities. The council's chairman also meets twice a year in Washington, D.C., with his counterparts from the 11 other Fed districts and with the Federal Reserve chairman.

---

CDIAC Chairman

**Dennis M. Terry**

President and CEO  
First Clover Leaf Bank FSB  
Edwardsville, Ill.

**Kirk P. Bailey**

Chairman, President and CEO  
Magna Bank  
Memphis, Tenn.

**Glenn D. Barks**

President and CEO  
First Community Credit Union  
Chesterfield, Mo.

**H. David Hale**

Chairman, President and CEO  
First Capital Bank of Kentucky  
Louisville, Ky.

**D. Keith Hefner**

President and CEO  
Citizens Bank & Trust Co.  
Van Buren, Ark.

**Gary E. Metzger**

Chairman, President and CEO  
Liberty Bank  
Springfield, Mo.

**William J. Rissel**

President and CEO  
Fort Knox Federal Credit Union  
Radcliff, Ky.

**Mark A. Schroeder**

Chairman and CEO  
German American Bancorp  
Jasper, Ind.

**Gordon Waller**

President and CEO  
First State Bank & Trust  
Caruthersville, Mo.

**Larry T. Wilson**

Chairman, President and CEO  
First Arkansas Bank & Trust  
Jacksonville, Ark.

**Vance Witt**

Chairman and CEO  
BNA Bank  
New Albany, Miss.

**Larry Ziglar**

President and CEO  
First National Bank in Staunton  
Staunton, Ill.

# Federal Advisory Council Member

The council is comprised of one representative from each of the 12 Federal Reserve districts. Members confer with the Fed's Board of Governors at least four times a year on economic and banking developments and make recommendations on Fed System activities.

---

**Bryan Jordan**

President and CEO  
First Horizon National Corp.  
Memphis, Tenn.

# Management Committee



**James Bullard**  
President and CEO



**David A. Sapenaro**  
First Vice President  
and COO



**Robert H. Rasche**  
Executive Vice President  
and Senior Policy Adviser



**Karl W. Ashman**  
Senior Vice President



**Karen L. Branding**  
Senior Vice President



**Mary H. Karr**  
Senior Vice President,  
General Counsel  
and Secretary



**Kathleen O'Neill Paese**  
Senior Vice President



**Julie L. Stackhouse**  
Senior Vice President



**Christopher J. Waller**  
Senior Vice President  
and Director of Research

# Bank Officers

---

## ST. LOUIS

**James Bullard**

President and CEO

**David A. Sapenaro**

First Vice President and COO

**Robert H. Rasche**

Executive Vice President  
and Senior Policy Adviser

**Karl W. Ashman**

Senior Vice President

**Karen L. Branding**

Senior Vice President

**Mary H. Karr**

Senior Vice President,  
General Counsel and Secretary

**Kathleen O'Neill Paese**

Senior Vice President

**Michael D. Renfro**

Senior Vice President  
and General Auditor

**Julie L. Stackhouse**

Senior Vice President

**Christopher J. Waller**

Senior Vice President  
and Director of Research

**David Andolfatto**

Vice President

**Richard G. Anderson**

Vice President

**John P. Baumgartner**

Vice President

**Timothy A. Bosch**

Vice President

**Timothy C. Brown**

Vice President

**Fontaine LaMare Chapman**

Vice President

**Marilyn K. Corona**

Vice President

**Cletus C. Coughlin**

Vice President

**Susan K. Curry**

Vice President

**William T. Gavin**

Vice President

**Susan F. Gerker**

Vice President

**Anna M. Helmering Hart**

Vice President

**Roy A. Hendin**

Vice President

**James L. Huang**

Vice President

**Vicki L. Kosydor**

Vice President

**Jean M. Lovati**

Vice President

**Michael J. Mueller**

Vice President

**Kim D. Nelson**

Vice President

**Arthur A. North II**

Vice President

**James A. Price**

Vice President

**Daniel L. Thornton**

Vice President

**Matthew W. Torbett**

Vice President

**David C. Wheelock**

Vice President

**Jonathan C. Basden**

Assistant Vice President

**Jane Anne Batjer**

Assistant Vice President

**Dennis W. Blase**

Assistant Vice President

**Winchell S. Carroll**

Assistant Vice President

**Hillary B. Debenport**

Assistant Vice President

**William R. Emmons**

Assistant Vice President

**William M. Francis**

Assistant Vice President

**Kathy A. Freeman**

Assistant Vice President

**Thomas A. Garrett**

Assistant Vice President

**Paul M. Helmich**

Assistant Vice President

**Cathryn L. Hohl**

Assistant Vice President

**Joel H. James**

Assistant Vice President

**Debra E. Johnson**

Assistant Vice President

**Visweswara R. Kaza**

Assistant Vice President

**Catherine A. Kusmer**

Assistant Vice President

**Raymond McIntyre**

Assistant Vice President

**John W. Mitchell**

Assistant Vice President

**Christopher J. Neely**

Assistant Vice President

**Glen M. Owens**

Assistant Vice President

**Kathy A. Schildknecht**

Assistant Vice President

**Philip G. Schlueter**

Assistant Vice President

**Harriet Siering**

Assistant Vice President

**Scott B. Smith**

Assistant Vice President

**Katrina L. Stierholz**

Assistant Vice President

**Kristina L.C. Stierholz**

Assistant Vice President

**Scott M. Trilling**

Assistant Vice President

**Yi Wen**

Assistant Vice President

**Carl D. White II**

Assistant Vice President

**Glenda Joyce Wilson**

Assistant Vice President

**Subhayu Bandyopadhyay**

Research Officer

**Diane E. Berry**

Assistant Counsel

**Heidi Lynne Beyer-Powe**

Research Officer

**Mary C. Francone**

Learning Technology Officer

**Carlos Garriga**

Research Officer

**Michael W. McCracken**

Research Officer

**Michael Thomas Owyang**

Research Officer

**Marcela M. Williams**

Public Affairs Officer

---

## LITTLE ROCK

**Robert A. Hopkins**

Senior Branch Executive

---

## LOUISVILLE

**Maria G. Hampton**

Senior Branch Executive

**Ronald L. Byrne**

Vice President

---

## MEMPHIS

**Martha L. Perine Beard**

Senior Branch Executive

**Ranada Y. Williams**

Assistant Vice President

# Financial Statements

For the years ended December 31, 2010 and 2009

In 2010, 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 \$8.0 million, of which approximately \$1.6 million were 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 2010, the Bank did not engage D&T for any non-audit services.

March 22, 2011

To the Board of Directors:

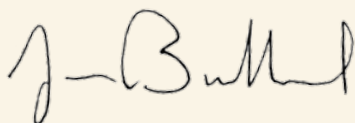
The management of the Federal Reserve Bank of St. Louis (FRB St. Louis) is responsible for the preparation and fair presentation of the Statements of Condition, Statements of Income and Comprehensive Income, and Statements of Changes in Capital as of December 31, 2010 (the Financial Statements). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the FAM and include all disclosures necessary for such fair presentation.

The management of the FRB St. Louis 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 FAM. 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 FRB St. Louis 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 FRB St. Louis maintained effective internal control over financial reporting as it relates to the Financial Statements.


Federal Reserve Bank of St. Louis



**James Bullard**, President and Chief Executive Officer



**David A. Saperano**, First Vice President and Chief Operating Officer



**Marilyn K. Corona**, Vice President, Chief Financial Officer

TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
AND THE BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF ST. LOUIS:

We have audited the accompanying Statements of Condition of the Federal Reserve Bank of St. Louis ("FRB St. Louis") as of December 31, 2010 and 2009 and the related Statements of Income and Comprehensive Income, and of 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 the FRB St. Louis as of December 31, 2010, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The FRB St. Louis' management is responsible for these 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 Financial Statements and an opinion on the FRB St. Louis' 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 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 Financial Statements included examining, on a test basis, evidence supporting the amounts and disclosures in the 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.

The FRB St. Louis' internal control over financial reporting is a process designed by, or under the supervision of, the FRB St. Louis' principal executive and principal financial officers, or persons performing similar functions, and effected by the FRB St. Louis' 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. The FRB St. Louis' internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the FRB St. Louis; (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 the FRB St. Louis are being made only in accordance with authorizations of management and directors of the FRB St. Louis; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the FRB St. Louis' assets that could have a material effect on the 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 Financial Statements, the FRB St. Louis has prepared these 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 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 Financial Statements present fairly, in all material respects, the financial position of the FRB St. Louis as of December 31, 2010 and 2009, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, the FRB St. Louis maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.



St. Louis, Missouri  
March 22, 2011



**ABBREVIATIONS**

<b>ACH</b>	Automated clearinghouse
<b>AMLF</b>	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
<b>ASC</b>	Accounting Standards Codification
<b>BEP</b>	Benefit Equalization Retirement Plan
<b>Bureau</b>	Bureau of Consumer Financial Protection
<b>Dodd-Frank Act</b>	The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
<b>FAM</b>	<i>Financial Accounting Manual for Federal Reserve Banks</i>
<b>FASB</b>	Financial Accounting Standards Board
<b>Fannie Mae</b>	Federal National Mortgage Association
<b>Freddie Mac</b>	Federal Home Loan Mortgage Corporation
<b>FOMC</b>	Federal Open Market Committee
<b>FRBA</b>	Federal Reserve Bank of Atlanta
<b>FRBNY</b>	Federal Reserve Bank of New York
<b>GAAP</b>	Accounting principles generally accepted in the United States of America
<b>GSE</b>	Government-sponsored enterprise
<b>IMF</b>	International Monetary Fund
<b>MBS</b>	Mortgage-backed securities
<b>OEB</b>	Office of Employee Benefits of the Federal Reserve System
<b>OFR</b>	Office of Financial Research
<b>SDR</b>	Special drawing rights
<b>SERP</b>	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
<b>SOMA</b>	System Open Market Account
<b>TAF</b>	Term Auction Facility
<b>TBA</b>	To be announced
<b>TDF</b>	Term Deposit Facility
<b>TSLF</b>	Term Securities Lending Facility
<b>TOP</b>	Term Securities Lending Facility Options Program

## STATEMENTS OF CONDITION

(in millions)

	As of December 31,	
	2010	2009
<b>ASSETS</b>		
Gold certificates	\$ 324	\$ 329
Special drawing rights certificates	150	150
Coin	35	32
Items in process of collection	12	19
Loans:		
Depository institutions	2	619
System Open Market Account:		
Treasury securities, net	27,483	31,575
Government-sponsored enterprise debt securities, net	3,940	6,557
Federal agency and government-sponsored enterprise mortgage-backed securities, net	25,879	36,000
Foreign currency denominated assets, net	244	251
Central bank liquidity swaps	1	102
Accrued interest receivable	367	495
Bank premises and equipment, net	153	151
Other assets	31	30
<b>Total assets</b>	<b>\$ 58,621</b>	<b>\$ 76,310</b>
<b>LIABILITIES AND CAPITAL</b>		
Federal Reserve notes outstanding, net	\$ 27,858	\$ 26,948
System Open Market Account:		
Securities sold under agreements to repurchase	1,538	3,045
Other liabilities	-	24
Deposits:		
Depository institutions	10,492	10,315
Other deposits	56	3
Interest payable to depository institutions	1	1
Accrued benefit costs	88	85
Deferred credit items	67	67
Accrued interest on Federal Reserve notes	69	59
Interdistrict settlement account	18,011	35,273
Other liabilities	9	10
<b>Total liabilities</b>	<b>58,189</b>	<b>75,830</b>
Capital paid-in	216	240
Surplus (including accumulated other comprehensive loss of \$10 million and \$11 million at December 31, 2010 and 2009, respectively)	216	240
<b>Total capital</b>	<b>432</b>	<b>480</b>
<b>Total liabilities and capital</b>	<b>\$ 58,621</b>	<b>\$ 76,310</b>

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

## STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(in millions)

	<b>For the year ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>INTEREST INCOME</b>		
Loans:		
Depository institutions	\$     –	\$     8
System Open Market Account:		
Treasury securities, net	780	874
Government-sponsored enterprise debt securities, net	105	79
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,329	793
Foreign currency denominated assets, net	2	3
Central bank liquidity swaps	-	22
<b>Total interest income</b>	<b>2,216</b>	<b>1,779</b>
<b>INTEREST EXPENSE</b>		
System Open Market Account:		
Securities sold under agreements to repurchase	2	4
Deposits:		
Depository institutions	28	17
<b>Total interest expense</b>	<b>30</b>	<b>21</b>
<b>Net interest income</b>	<b>2,186</b>	<b>1,758</b>
<b>NON-INTEREST INCOME</b>		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	25	36
Foreign currency gains, net	5	2
Compensation received for service costs provided	4	7
Reimbursable services to government agencies	105	105
Other income	1	5
<b>Total non-interest income</b>	<b>140</b>	<b>155</b>
<b>OPERATING EXPENSES</b>		
Salaries and benefits	111	107
Occupancy	13	13
Equipment	6	5
Assessments:		
Board of Governors operating expenses and currency costs	25	21
Other	87	87
<b>Total operating expenses</b>	<b>242</b>	<b>233</b>
Net income prior to distribution	2,084	1,680
Change in funded status of benefit plans	1	9
<b>Comprehensive income prior to distribution</b>	<b>\$ 2,085</b>	<b>\$ 1,689</b>
Distribution of comprehensive income:		
Dividends paid to member banks	\$ 14	\$ 14
Transferred (from) to surplus and change in accumulated other comprehensive loss	(24)	30
Payments to Treasury as interest on Federal Reserve notes	2,095	1,645
<b>Total distribution</b>	<b>\$ 2,085</b>	<b>\$ 1,689</b>

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

**STATEMENTS OF CHANGES IN CAPITAL**

for the years ended December 31, 2010, and December 31, 2009  
(in millions except share data)

	Capital Paid-In	Net Income Retained	Surplus		Total Capital
			Accumulated Other Comprehensive Loss	Total Surplus	
Balance at January 1, 2009 (4,193,727 shares)	\$ 210	\$ 230	\$ (20)	\$ 210	\$ 420
Net change in capital stock issued (611,886 shares)	30	-	-	-	30
Transferred to surplus and change in accumulated other comprehensive loss	-	21	9	30	30
Balance at December 31, 2009 (4,805,613 shares)	\$ 240	\$ 251	\$ (11)	\$ 240	\$ 480
Net change in capital stock redeemed (482,293 shares)	(24)	-	-	-	(24)
Transferred from surplus and change in accumulated other comprehensive loss	-	(25)	1	(24)	(24)
<b>Balance at December 31, 2010 (4,323,320 shares)</b>	<b>\$ 216</b>	<b>\$ 226</b>	<b>\$ (10)</b>	<b>\$ 216</b>	<b>\$ 432</b>

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

**NOTES TO FINANCIAL STATEMENTS****1. STRUCTURE**

The Federal Reserve Bank of St. Louis (Bank) is part of the Federal Reserve System (System) and is one of the 12 Federal Reserve Banks (Reserve Banks) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank serves the Eighth Federal Reserve District, which includes Arkansas, and portions of Illinois, Indiana, Kentucky, Mississippi, Missouri and Tennessee.

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

In addition to the 12 Reserve Banks, the System also consists,

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

**2. OPERATIONS AND SERVICES**

The Reserve Banks perform a variety of services and operations. These functions include participating in formulating and conducting monetary policy; participating in the payment system, including large-dollar transfers of funds, automated clearing-house (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 FRBNY.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which was signed into law and became effective on July 21, 2010, changed the scope of some services performed by the Reserve Banks. Among other things, the Dodd-Frank Act establishes a Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the Federal Reserve System that will have supervisory authority over some institutions previously supervised by the Reserve Banks under delegated authority from the Board of Governors in connection with those institutions' compliance with consumer protection statutes; limits the Reserve Banks' authority to provide loans in unusual and exigent circumstances to lending programs or facilities with broad-based eligibility; and vests the Board of Governors with all supervisory and rule-writing authority for savings and loan holding companies.

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, 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 FRBNY holds the resulting securities and agreements in a portfolio known as the System Open Market Account (SOMA). The FRBNY 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 FRBNY to conduct 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 FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, 14 foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico and to "warehouse" foreign currencies for the Treasury and the Exchange Stabilization Fund.

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 operation of the Treasury Relations and Support Office and the Treasury Relations and Systems Support Department, which provide services to the Treasury. These services include: relationship management, strategic consulting, and oversight for fiscal payments related projects for the Federal Reserve System and operational support for the Treasury's tax collection, cash management, accounting and collateral monitoring functions.

### **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.

#### **LARGE-SCALE ASSET PURCHASE PROGRAMS**

The FOMC authorized and directed the FRBNY to purchase \$300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The FRBNY began the purchases of these Treasury securities in March 2009 and completed them in October 2009. On August 10, 2010, the FOMC announced that the Federal Reserve will maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and Federal agency and GSE MBS in longer-term Treasury securities. On November 3, 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional \$600 billion by June 2011. The FOMC will regularly review the pace of these securities purchases and the overall size of the asset purchase program and will adjust the program as needed to best foster maximum employment and price stability.

The FOMC authorized and directed the FRBNY to purchase GSE debt securities and Federal agency and GSE MBS, with a goal to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally. The FRBNY was authorized to purchase up to \$175 billion in fixed-rate, non-callable GSE debt securities and \$1.25 trillion in fixed-rate Federal agency and GSE MBS. Purchases of GSE debt securities began in November 2008, and purchases of Federal agency and GSE MBS began in January 2009. The FRBNY completed the purchases of GSE debt securities and Federal agency and GSE MBS in March 2010. The settlement of all Federal agency and GSE MBS transactions was completed by August 2010.

#### **CENTRAL BANK LIQUIDITY SWAPS**

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which could be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements. U.S. dollar liquidity swap arrangements were authorized with 14 foreign central banks to provide liquidity in U.S. dollars to overseas markets. The authorization for these swap arrangements expired on February 1, 2010. In May 2010, U.S. dollar liquidity swap arrangements were reestablished with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank; these arrangements will expire on August 1, 2011.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. The authorization for these swap arrangements expired on February 1, 2010.

#### **LENDING TO DEPOSITORY INSTITUTIONS**

The Term Auction Facility (TAF) promoted the efficient dissemination of liquidity by providing term funds to depository institutions. The last TAF auction was conducted on March 8, 2010, and the related loans matured on April 8, 2010.

#### **LENDING TO PRIMARY DEALERS**

The Term Securities Lending Facility (TSLF) promoted liquidity in the financing markets for Treasury securities. Under the TSLF,

**NOTES TO FINANCIAL STATEMENTS**

the FRBNY could lend up to an aggregate amount of \$200 billion of Treasury securities held in the SOMA to primary dealers on a secured basis for a term of 28 days. The authorization for the TSLF expired on February 1, 2010.

The Term Securities Lending Facility Options Program (TOP) offered primary dealers the opportunity to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program was suspended effective with the maturity of the June 2009 TOP options, and authorization for the 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 from money market mutual funds. The Federal Reserve Bank of Boston administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. The authorization for the AMLF expired on February 1, 2010.

**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* (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 financial statements have been prepared in accordance with the FAM.

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost and the recording of such securities on a settlement-date basis. 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, rather than using the interest method required by GAAP. Amortized cost, rather than the fair value presentation, more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, 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 greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the 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 before maturity. Decisions regarding securities and foreign currency transactions, including their

purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities.

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

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

**A. CONSOLIDATION**

The Dodd-Frank Act established the Bureau as an independent bureau within the Federal Reserve System, and section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the Federal Reserve System. Section 152 of the Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury. The Board of Governors funds the Bureau and OFR through assessments on the Reserve Banks as required by the Dodd-Frank Act. The Reserve Banks reviewed the law and evaluated the design of and their relationships to the Bureau and the OFR and determined that neither should be consolidated in the Reserve Banks' combined financial statements.

**B. GOLD AND SPECIAL DRAWING RIGHTS CERTIFICATES**

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

SDR certificates are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. 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 U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve

**NOTES TO FINANCIAL STATEMENTS**

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. SDRs are recorded by the Bank at original cost. In 2009, the Treasury issued \$3 billion in SDR certificates to the Reserve Banks, of which \$79 million was allocated to the Bank. There were no SDR transactions in 2010.

**C. COIN**

The amount reported as coin in the Statements of Condition represents the face value of all United States coin held by the Bank. The Bank buys coin at face value from the U.S. Mint in order to fill depository institution orders.

**D. LOANS**

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

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

**E. SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL, SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE, AND SECURITIES LENDING**

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

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and, beginning August 2010, with selected money market funds, as an open market operation. 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 account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, and Federal agency and GSE MBS that are held in the SOMA. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts as "System Open Market Account: Securities sold under agreements to repurchase" and the related accrued interest payable is reported as a component of "Other liabilities" in the Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income" in the Statements of Income and Comprehensive Income.

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

**F. TREASURY SECURITIES; GOVERNMENT-SPONSORED ENTERPRISE DEBT SECURITIES; FEDERAL AGENCY AND GOVERNMENT-SPONSORED ENTERPRISE MORTGAGE-BACKED SECURITIES; FOREIGN CURRENCY DENOMINATED ASSETS; AND WAREHOUSING AGREEMENTS**

Interest income on Treasury securities, GSE debt securities, and foreign currency denominated assets 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 gains or losses associated with principal paydowns. Premiums and discounts related to Federal agency and GSE MBS are amortized over the term of the security to stated maturity, and the amortization of premiums and accretion of discounts are accelerated when principal payments are received. Paydown gains and losses represent the difference between the principal amount paid and the amortized cost basis of the related security. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Treasury securities, GSE debt securities, and Federal agency and GSE MBS are reported net of premiums and discounts on the Statements of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts on the Statements of Income and Comprehensive Income.

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the FRBNY entered into dollar

**NOTES TO FINANCIAL STATEMENTS**

roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell “to be announced” (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. The FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. The FRBNY’s participation in the dollar roll and coupon swap markets furthers the MBS purchase program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets more generally. The FRBNY accounts for outstanding commitments under dollar roll and coupon swaps on a settlement-date basis. Based on the terms of the FRBNY dollar roll and coupon swap 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), *Transfers and Servicing*, and the related outstanding commitments are accounted for as sales or purchases upon settlement. Net gains resulting from dollar roll and coupon swap transactions are reported as “Non-interest income: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net” in the Statements of Income and Comprehensive Income.

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 foreign currency denominated assets are reported as “Non-interest income: System Open Market Account: Foreign currency gains, net” in the Statements of Income and Comprehensive Income.

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. Activity related to foreign currency denominated assets, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank based on the ratio of each Reserve Bank’s capital and surplus to aggregate capital and surplus at the preceding December 31.

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

**G. CENTRAL BANK LIQUIDITY SWAPS**

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

Central bank liquidity swaps activity, including the related income and expense, is allocated to each Reserve Bank based on the ratio of each Reserve Bank’s capital and surplus to aggregate capital and surplus at the preceding December 31. 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 FRBNY in exchange for U.S. dollars at the prevailing market exchange rate. Concurrent with this transaction, the FRBNY and the foreign central bank agree to a second transaction that obligates the foreign central bank to return the U.S. dollars and the FRBNY to return the foreign currency on a specified future date at the same exchange rate as the initial transaction. The Bank’s allocated portion of the foreign currency amounts that the FRBNY acquires is reported as “System Open Market Account: Central bank liquidity swaps” on the Statements of Condition. Because the swap transaction will be unwound at the same U.S. dollar amount and exchange rate that were used in the initial transaction, the recorded value of the foreign currency amounts is not affected by changes in the market exchange rate.

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as “Interest income: System Open Market Account: Central bank liquidity swaps” in the Statements of Income and Comprehensive Income.

**FOREIGN CURRENCY LIQUIDITY SWAPS**

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

**H. INTERDISTRICT SETTLEMENT ACCOUNT**

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

**I. BANK PREMISES, EQUIPMENT, AND SOFTWARE**

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

Costs incurred 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 generally 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.

#### J. FEDERAL RESERVE NOTES

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

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

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of \$4,381 million and \$4,106 million at December 31, 2010 and 2009, respectively.

At December 31, 2010 and 2009, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2010, all gold certificates, all special drawing right certificates, and \$925 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2010, no investments denominated in foreign currencies were pledged as collateral.

#### K. DEPOSITS

##### DEPOSITORY INSTITUTIONS

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as "Interest payable to depository institutions" on the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2010.

##### OTHER

Other deposits include foreign central bank and foreign government deposits held at the FRBNY that are allocated to the Bank.

#### L. ITEMS IN PROCESS OF COLLECTION AND DEFERRED CREDIT ITEMS

"Items in process of collection" 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.

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

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

#### N. 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 Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

#### O. 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 Treasury as interest on Federal Reserve notes" in the Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued interest on Federal Reserve notes" in the Statements of Condition.

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

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.

#### P. INCOME AND COSTS RELATED TO TREASURY SERVICES

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the

**NOTES TO FINANCIAL STATEMENTS**

years ended December 31, 2010 and 2009, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

**Q. COMPENSATION RECEIVED FOR SERVICE COSTS PROVIDED**

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. Similarly, the FRBNY 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. The FRBA and the FRBNY compensate the applicable Reserve Banks for the costs incurred to provide these services. The Bank reports this compensation as “Compensation received for service costs provided” in the Statements of Income and Comprehensive Income.

**R. ASSESSMENTS**

The Board of Governors assesses the Reserve Banks to fund its operations and the operations of the Bureau and, for a two-year period, the OFR. These assessments are allocated to each Reserve Bank based on each Reserve Bank’s capital and surplus balances as of December 31 of the prior year for the Board of Governor’s operations and as of the most recent quarter for the Bureau and OFR operations. 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.

During the period prior to the Bureau transfer date of July 21, 2011, there is no fixed limit on the funding that can be provided to the Bureau and that is assessed to the Reserve Banks; the Board of Governors must provide the amount estimated by the Secretary of the Treasury needed to carry out the authorities granted to the Bureau under the Dodd-Frank Act and other federal law. After the transfer date, the Dodd-Frank Act requires the Board of Governors to fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the Federal Reserve System as reported in the Board of Governors’ 2009 annual report. The fixed percentage of total operating expenses of the System is 10% for 2011, 11% for 2012, and 12% for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act.

The Board of Governors assesses the Reserve Banks to fund the operations of the OFR for the two-year period following enactment of the Dodd-Frank Act; thereafter, the OFR will be funded by fees assessed on certain bank holding companies.

**S. 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 \$1 million for each of the years ended December 31, 2010 and 2009, respectively, and are reported as a component of “Operating expenses: Occupancy” in the Statements of Income and Comprehensive Income.

**T. RESTRUCTURING CHARGES**

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities

from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Bank commits to a formalized restructuring plan or executes the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 14 describes the Bank’s restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY.

The Bank had no significant restructuring activities in 2010 and 2009.

**U. RECENTLY ISSUED ACCOUNTING STANDARDS**

In June 2009, FASB issued Statement of Financial Accounting Standards 166, *Accounting for Transfers of Financial Assets – an amendment to FASB Statement No. 140*, (codified in ASC 860). The new standard revises the criteria for recognizing transfers of financial assets as sales and clarifies that the transferor must consider all arrangements when determining if the transferor has surrendered control. The adoption of this accounting guidance was effective for the Bank for the year beginning on January 1, 2010, and did not have a material effect on the Bank’s financial statements.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Receivables* (Topic 310), which requires additional disclosures about the allowance for credit losses and the credit quality of loan portfolios. The additional disclosures include a rollforward of the allowance for credit losses on a disaggregated basis and more information, by type of receivable, on credit quality indicators, including the amount of certain past due receivables and troubled debt restructurings and significant purchases and sales. The adoption of this accounting guidance is effective for the Bank on December 31, 2011, and is not expected to have a material effect on the Bank’s financial statements.

**5. LOANS**

The remaining maturity distribution of loans outstanding at December 31, 2010, and total loans outstanding at December 31, 2009, were as follows (in millions):

	2010		2009
	Within 15 days	Total	Total
Primary, secondary, and seasonal credit	\$ 2	\$ 2	\$ 26
TAF	-	-	593
<b>Loans to depository institutions</b>	<b>\$ 2</b>	<b>\$ 2</b>	<b>\$ 619</b>

**LOANS TO DEPOSITORY INSTITUTIONS**

The Bank offers primary, secondary, and seasonal credit to eligible borrowers, and each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every 14 days by the Bank’s board of directors, subject to review and determination by the Board of Governors. Primary

and secondary credit is 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; asset-backed securities; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Bank, which is typically fair value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program were eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conducted auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans were extended on a short-term basis, with terms ranging from 28 to 84 days. All advances under the TAF program were collateralized to the satisfaction of the Bank. All TAF loan principal and accrued interest was fully repaid.

Loans to depository institutions are monitored daily 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 or 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, 2010 and 2009, the Bank did not have any impaired loans and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2010 and 2009.

**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 FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 2.576 percent and 3.918 percent at December 31, 2010 and 2009, respectively.

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

	2010				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	\$ 474	\$ -	\$ -	\$ 474	\$ 474
Notes	19,919	362	(20)	20,261	20,728
Bonds	5,919	843	(14)	6,748	7,464
<b>Total Treasury securities</b>	<b>\$ 26,312</b>	<b>\$ 1,205</b>	<b>\$ (34)</b>	<b>\$ 27,483</b>	<b>\$ 28,666</b>
<b>GSE debt securities</b>	<b>\$ 3,798</b>	<b>\$ 143</b>	<b>\$ (1)</b>	<b>\$ 3,940</b>	<b>\$ 4,038</b>
<b>Federal agency and GSE MBS</b>	<b>\$ 25,556</b>	<b>\$ 363</b>	<b>\$ (40)</b>	<b>\$ 25,879</b>	<b>\$ 26,428</b>

	2009				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	\$ 722	\$ -	\$ -	\$ 722	\$ 722
Notes	22,265	256	(39)	22,482	22,841
Bonds	7,437	958	(24)	8,371	9,039
<b>Total Treasury securities</b>	<b>\$ 30,424</b>	<b>\$ 1,214</b>	<b>\$ (63)</b>	<b>\$ 31,575</b>	<b>\$ 32,602</b>
<b>GSE debt securities</b>	<b>\$ 6,264</b>	<b>\$ 294</b>	<b>\$ (1)</b>	<b>\$ 6,557</b>	<b>\$ 6,560</b>
<b>Federal agency and GSE MBS</b>	<b>\$ 35,587</b>	<b>\$ 474</b>	<b>\$ (61)</b>	<b>\$ 36,000</b>	<b>\$ 35,818</b>

## NOTES TO FINANCIAL STATEMENTS

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):

	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Bills	\$ 18,422	\$ 18,422	\$ 18,423	\$ 18,423
Notes	786,575	804,703	573,877	583,040
Bonds	261,955	289,757	213,672	230,717
<b>Total Treasury securities</b>	<b>\$ 1,066,952</b>	<b>\$1,112,882</b>	<b>\$ 805,972</b>	<b>\$ 832,180</b>
<b>GSE debt securities</b>	<b>\$ 152,972</b>	<b>\$ 156,780</b>	<b>\$ 167,362</b>	<b>\$ 167,444</b>
<b>Federal agency and GSE MBS</b>	<b>\$ 1,004,695</b>	<b>\$1,026,003</b>	<b>\$ 918,927</b>	<b>\$ 914,290</b>

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. The fair value of Federal agency and GSE MBS was determined using a model-based approach that considers observable inputs for similar securities; fair value for all other SOMA security holdings was determined by reference to quoted prices for identical 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, 2010 and 2009 (in millions):

Distribution of MBS holdings by coupon rate	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
<b>ALLOCATED TO THE BANK:</b>				
3.5%	\$ 9	\$ 9	\$ 14	\$ 14
4.0%	4,319	4,338	6,665	6,493
4.5%	12,819	13,106	17,016	16,910
5.0%	5,961	6,119	7,656	7,695
5.5%	2,398	2,469	4,050	4,097
6.0%	333	344	498	505
6.5%	40	43	101	104
<b>Total</b>	<b>\$ 25,879</b>	<b>\$ 26,428</b>	<b>\$ 36,000</b>	<b>\$ 35,818</b>
<b>SOMA:</b>				
3.5%	\$ 341	\$ 352	\$ 363	\$ 365
4.0%	167,675	168,403	170,119	165,740
4.5%	497,672	508,798	434,352	431,646
5.0%	231,420	237,545	195,418	196,411
5.5%	93,119	95,873	103,379	104,583
6.0%	12,910	13,376	12,710	12,901
6.5%	1,558	1,656	2,586	2,644
<b>Total</b>	<b>\$ 1,004,695</b>	<b>\$ 1,026,003</b>	<b>\$ 918,927</b>	<b>\$ 914,290</b>

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	
	2010	2009	2010	2009
<b>ALLOCATED TO THE BANK:</b>				
Contract amount outstanding, end of year	\$ -	\$ -	\$ 1,538	\$ 3,045
Average daily amount outstanding, during the year	-	125	1,730	2,561
Maximum balance outstanding, during the year	-	2,765	3,045	3,094
Securities pledged (par value), end of year	-	-	1,124	3,050
<b>SOMA:</b>				
Contract amount outstanding, end of year	\$ -	\$ -	\$ 59,703	\$ 77,732
Average daily amount outstanding, during the year	-	3,616	58,476	67,837
Maximum balance outstanding, during the year	-	80,000	77,732	89,525
Securities pledged (par value), end of year	-	-	43,642	77,860

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value. The FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed primarily to temporarily drain reserve balances from the banking system.

The remaining maturity distribution of Treasury securities, GSE debt securities, Federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2010 was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	\$ 252	\$ 640	\$ 1,398	\$ 11,323	\$ 8,602	\$ 4,097	\$ 26,312
GSE debt securities (par value)	29	356	734	1,830	788	61	3,798
Federal agency and GSE MBS (par value)	-	-	-	1	1	25,554	25,556
Securities sold under agreements to repurchase (contract amount)	1,538	-	-	-	-	-	1,538

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, 2010, which differs from the stated maturity primarily because the weighted average life factors in prepayment assumptions, is approximately 4.2 years.

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

	2010	2009	2010	2009
Treasury securities	\$ 569	\$ 803	\$ 22,081	\$ 20,502
GSE debt securities	41	44	1,610	1,108

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 FRBNY 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, and the amount reported as other liabilities represents the Bank's obligation to pay for the securities when delivered. The amount of other liabilities allocated to the Bank and held in the SOMA at December 31, was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2010	2009	2010	2009
Other liabilities	\$ -	\$ 24	\$ -	\$ 601

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. There were no commitments to buy Treasury and GSE debt securities as of December 31, 2010.

## NOTES TO FINANCIAL STATEMENTS

The FRBNY enters into commitments to buy Federal agency and GSE MBS and records the related MBS on a settlement-date basis. There were no commitments to buy or sell Federal agency or GSE MBS as of December 31, 2010. During the years ended December 31, 2010 and 2009, the Reserve Banks recorded net gains from dollar roll and coupon swap related transactions of \$782 million and \$879 million, respectively, of which \$25 million and \$36 million, respectively, were allocated to the Bank. These net gains are reported as "Non-interest income: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

## 7. FOREIGN CURRENCY DENOMINATED ASSETS

The FRBNY holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments. These foreign government debt instruments are guaranteed as to principal and interest by the issuing foreign governments. In addition, the FRBNY enters into transactions to purchase Euro-denominated government debt securities under agreements to resell for which the accepted collateral is the debt instruments issued by the governments of Belgium, France, Germany, Italy, the Netherlands, and Spain.

The Bank's allocated share of foreign currency denominated assets was approximately .937 percent and .995 percent at December 31, 2010 and 2009, respectively.

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

	2010	2009
<b>EURO:</b>		
Foreign currency deposits	\$ 66	\$ 73
Securities purchased under agreements to resell	23	26
Government debt instruments	43	49
<b>JAPANESE YEN:</b>		
Foreign currency deposits	37	34
Government debt instruments	75	69
<b>Total allocated to the Bank</b>	<b>\$ 244</b>	<b>\$ 251</b>

At December 31, 2010 and 2009, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was \$246 million and \$254 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 foreign currency denominated assets were \$26,049 million and \$25,272 million at December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the fair value of the total Reserve Bank foreign currency denominated assets, including accrued interest, was \$26,213 million and \$25,480 million, respectively.

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2010, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total allocated to the Bank
Euro	\$ 50	\$ 28	\$ 19	\$ 35	\$ 132
Japanese yen	39	5	23	45	112
<b>Total allocated to the Bank</b>	<b>\$ 89</b>	<b>\$ 33</b>	<b>\$ 42</b>	<b>\$ 80</b>	<b>\$ 244</b>

At December 31, 2010 and 2009, the authorized warehousing facility was \$5 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2010 and 2009.

There were no foreign exchange contracts outstanding as of December 31, 2010.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2010, there were \$209 million of outstanding commitments to purchase Euro-denominated government debt instruments, of which \$2 million was allocated to the Bank. These securities settled on January 4, 2011, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date.

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

## 8. CENTRAL BANK LIQUIDITY SWAPS

### U.S. DOLLAR LIQUIDITY SWAPS

The Bank's allocated share of U.S. dollar liquidity swaps was approximately .937 percent and .995 percent at December 31, 2010 and 2009, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2010 and 2009, was \$75 million and \$10,272 million, respectively, of which \$1 million and \$102 million, respectively, was allocated to the Bank. All of the U.S. dollar liquidity swaps outstanding at December 31, 2010 were transacted with the European Central Bank and had remaining maturity distributions of less than 15 days.

### FOREIGN CURRENCY LIQUIDITY SWAPS

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2010 and 2009.

## 9. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2010	2009
<b>BANK PREMISES AND EQUIPMENT:</b>		
Land and land improvements	\$ 12	\$ 12
Buildings	149	146
Building machinery and equipment	21	20
Construction in progress	2	3
Furniture and equipment	37	37
Subtotal	221	218
Accumulated depreciation	(68)	(67)
<b>Bank premises and equipment, net</b>	<b>\$ 153</b>	<b>\$ 151</b>
<b>Depreciation expense, for the years ended December 31</b>	<b>\$ 10</b>	<b>\$ 9</b>

The Bank leases space to outside tenants with remaining lease terms of less than one year. Rental income from such leases was not material for the years ended December 31, 2010 and 2009. Future minimum lease payments that the Bank will receive under agreements in existence at December 31, 2010, were not material.

The Bank had capitalized software assets, net of amortization, of \$2 million for each of the years ended December 31, 2010 and 2009. Amortization expense was \$1 million and \$2 million for the years ended December 31, 2010 and 2009, respectively. Capitalized software assets are reported as a component of "Other assets" in the Statements of Condition and the related amortization is reported as a component of "Operating expenses: Other" in the Statements of Income and Comprehensive Income.

## 10. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2010, the Bank was obligated under non-cancelable leases for premises and equipment with remaining terms ranging from one to approximately five years. These leases provide for increased rental payments 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 \$1 million and \$2 million for the years ended December 31, 2010 and 2009, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2010, are as follows (in thousands):

	<b>Operating leases</b>
2011	\$ 381
2012	390
2013	402
2014	414
2015	56
<b>Future minimum rental payments</b>	<b>\$ 1,643</b>

At December 31, 2010, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in

## NOTES TO FINANCIAL STATEMENTS

which the loss is shared. No claims were outstanding under the agreement at December 31, 2010 or 2009.

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.

## 11. 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). In addition, under the Dodd-Frank Act, employees of the Bureau can elect to participate in the System Plan. There were no Bureau participants in the System Plan as of December 31, 2010.

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, Board of Governors, and OEB and in the future will provide retirement benefits to certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2010 and 2009, costs associated with the System Plan were not reimbursed by other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2010 and 2009, and for the years then ended, were not material.

### THRIFT PLAN

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches employee contributions based on a specified formula. 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. 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. The Bank's Thrift Plan contributions totaled \$5 million and \$4 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

## 12. 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):

	2010	2009
Accumulated postretirement benefit obligation at January 1	\$ 75.5	\$ 80.6
Service cost benefits earned during the period	2.6	2.5
Interest cost on accumulated benefit obligation	4.3	4.7
Net actuarial gain	(3.2)	(9.7)
Contributions by plan participants	1.2	1.1
Benefits paid	(4.4)	(4.0)
Medicare Part D subsidies	0.4	0.3
<b>Accumulated postretirement benefit obligation at December 31</b>	<b>\$ 76.4</b>	<b>\$ 75.5</b>

At December 31, 2010 and 2009, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.25 percent and 5.75 percent, respectively.

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

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):

	2010	2009
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	2.8	2.6
Contributions by plan participants	1.2	1.1
Benefits paid	(4.4)	(4.0)
Medicare Part D subsidies	0.4	0.3
<b>Fair value of plan assets at December 31</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Unfunded obligation and accrued postretirement benefit cost</b>	<b>\$ 76.4</b>	<b>\$ 75.5</b>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 1.4	\$ 4.5
Net actuarial loss	(11.7)	(16.1)
Deferred curtailment gain	-	0.2
<b>Total accumulated other comprehensive loss</b>	<b>\$ (10.3)</b>	<b>\$ (11.4)</b>

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs" in the Statements of Condition.



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

	2010	2009
Health care cost trend rate assumed for next year	8.0%	7.5%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2017	2015

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2010 (in millions):

	1 percentage point increase	1 percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 1.2	\$ (0.9)
Effect on accumulated postretirement benefit obligation	6.6	(6.5)

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

	2010	2009
Service cost-benefits earned during the period	\$ 2.6	\$ 2.5
Interest cost on accumulated benefit obligation	4.3	4.7
Amortization of prior service cost	(3.1)	(3.1)
Amortization of net actuarial loss	1.2	2.5
Total periodic expense	5.0	6.6
Curtailed gain	(0.2)	(0.2)
<b>Net periodic postretirement benefit expense</b>	<b>\$ 4.8</b>	<b>\$ 6.4</b>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2011 are shown below:

Prior service cost	\$ (1.0)
Net actuarial loss	\$ 0.5
<b>Total</b>	<b>\$ (0.5)</b>

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2010 and 2009, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 6.00 percent, respectively.

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

A deferred curtailment gain was recorded in 2007 as a component of accumulated other comprehensive loss; the gain is recognized in net income in 2009 and 2010 when the related employees terminated employment.

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 (gain)/loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were \$.3 million and \$.4 million in the years ended December 31, 2010 and 2009, respectively. Expected receipts in 2011, related to benefits paid in the years ended December 31, 2010 and 2009, are \$.2 million.

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

	Without subsidy	With subsidy
2011	\$ 4.0	\$ 3.7
2012	4.3	3.9
2013	4.6	4.1
2014	4.9	4.3
2015	5.1	4.6
2016 - 2020	29.1	25.2
<b>Total</b>	<b>\$ 52.0</b>	<b>\$ 45.8</b>

#### 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, 2010 and 2009, were \$7 million for each year. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2010 and 2009 operating expenses were \$1 million and \$2 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

**13. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME**

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

	<b>Amount related to postretirement benefits other than retirement plans</b>
Balance at January 1, 2009	\$ (20.3)
Change in funded status of benefit plans:	
Net actuarial gain arising during the year	9.7
Amortization of prior service cost	(3.1)
Amortization of net actuarial loss	2.5
Amortization of deferred curtailment gain	(0.2)
Change in funded status of benefit plans - other comprehensive income	8.9
<b>Balance at December 31, 2009</b>	<b>\$ (11.4)</b>
Change in funded status of benefit plans:	
Net actuarial gain arising during the year	3.2
Amortization of prior service cost	(3.1)
Amortization of net actuarial loss	1.2
Amortization of deferred curtailment gain	(0.2)
Change in funded status of benefit plans - other comprehensive income	1.1
<b>Balance at December 31, 2010</b>	<b>\$ (10.3)</b>

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 12.

**14. BUSINESS RESTRUCTURING CHARGES**

The Bank had no business restructuring charges in 2010 and 2009.

Before 2009, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites; one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing.

Additional announcements prior to 2009 included restructuring plans associated with the U.S. Treasury's Collections and Cash Management Modernization initiative.

Following is a summary of financial information related to the restructuring plans (in millions):

	<b>2008 and prior restructuring plans</b>
<i>Information related to restructuring plans as of December 31, 2010:</i>	
Total expected costs related to restructuring activity	\$ 3.9
Estimated future costs related to restructuring activity	0.1
Expected completion date	2012
<i>Reconciliation of liability balances:</i>	
Balance at January 1, 2009	\$ 1.2
Adjustments	0.9
Payments	(0.9)
Balance at December 31, 2009	\$ 1.2
Adjustments	0.1
Payments	(0.1)
<b>Balance at December 31, 2010</b>	<b>\$ 1.2</b>

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period to termination. Restructuring costs related to employee separations are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

Adjustments to the accrued liability are primarily due to changes in the estimated restructuring costs and are shown as a component of the appropriate expense category in the Statements of Income and Comprehensive Income.

Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 11.

**15. SUBSEQUENT EVENTS**

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2010. Subsequent events were evaluated through March 22, 2011, which is the date that the Bank issued the financial statements.

**CREDITS**

**Al Stamborski**

Editor and Project Manager

**Brian Ebert**

Designer

**Barb Passiglia**

Production Manager

**Kristie M. Engemann**

**Charles S. Gascon**

**Constanza S. Liborio**

Research Assistance

**Steve Smith**

Photographer

**James Steinberg**

Illustrator

For additional copies, contact:

Public Affairs

Federal Reserve Bank of St. Louis

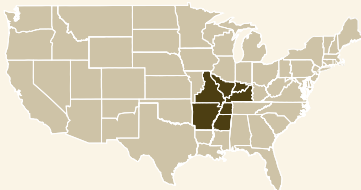
Post Office Box 442

St. Louis, MO 63166

Or e-mail [pubtracking@stls.frb.org](mailto:pubtracking@stls.frb.org).

This report is also available online at:

[www.stlouisfed.org/publications/ar](http://www.stlouisfed.org/publications/ar)



The Federal Reserve Bank of St. Louis is one of 12 regional Reserve banks that, together with the Board of Governors, make up the nation's central bank. The St. Louis Fed serves the Eighth Federal Reserve District, which includes all of Arkansas, eastern Missouri, southern Illinois and Indiana, western Kentucky and Tennessee, and northern Mississippi. The Eighth District offices are in Little Rock, Louisville, Memphis and St. Louis.

**Federal Reserve Bank  
of St. Louis**

One Federal Reserve Bank Plaza  
Broadway and Locust Street  
St. Louis, MO 63102  
314-444-8444

**Little Rock Branch**

Stephens Building  
111 Center St., Suite 1000  
Little Rock, AR 72201  
501-324-8205

**Louisville Branch**

National City Tower  
101 S. Fifth St., Suite 1920  
Louisville, KY 40202  
502-568-9200

**Memphis Branch**

200 N. Main St.  
Memphis, TN 38103  
901-579-2404

**FOLLOW THE FED**  
[stlouisfed.org/followthefed](http://stlouisfed.org/followthefed)



printed on recycled paper using 10% post-consumer waste

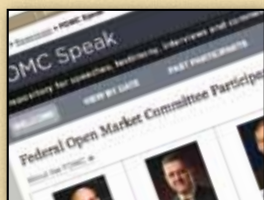


CENTRAL TO AMERICA'S ECONOMY™

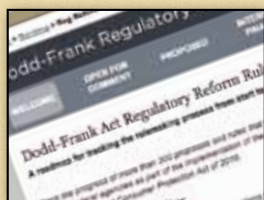
STLOUISFED.ORG

## Economic Information for All

The Federal Reserve Bank of St. Louis provides a multitude of ways to learn about the economy and economics. There is something for every audience—researchers, teachers, business executives, students, bankers, community developers and the general public. We offer periodicals, online courses, videos, podcasts, workshops, web sites and, of course, data ... lots and lots of data. Our signature database—FRED, or Federal Reserve Economic Data—contains more than 25,000 economic time series. Below is a sample of what we offer. For more information, see [www.stlouisfed.org](http://www.stlouisfed.org)



On the **FOMC Speak** web site, you can find in one spot public speeches, testimony, interviews and commentary by all participants of the Federal Open Market Committee. See [www.stlouisfed.org/fomcspeak](http://www.stlouisfed.org/fomcspeak)



Our **Dodd-Frank Act** web site helps users keep track of the rules being written as part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. See [www.stlouisfed.org/regreformrules](http://www.stlouisfed.org/regreformrules)



The tens of thousands of charts in **FRED** can be accessed not only from your computer but also from your phone, iPad or other mobile device. To get started, go to <http://m.research.stlouisfed.org/fred>



Tune into the **Economic Lowdown** for a series of short podcasts on topics related to economics, personal finance, banking and monetary policy. Our Economic Education department also offers online courses for students and the general public on basic economics and personal finance. Start at [www.stlouisfed.org/education\\_resources](http://www.stlouisfed.org/education_resources)



Our **publications** range from short newsletters to detailed research reports. All can be read online, and some are still available on paper through the mail. To see a complete list, go to [www.stlouisfed.org/publications/show\\_all.cfm](http://www.stlouisfed.org/publications/show_all.cfm)