

***The Federal Reserve
Bank of Cleveland***

*Financial Statements as of and for the Years Ended
December 31, 2011 and 2010 and
Independent Auditors' Report*

THE FEDERAL RESERVE BANK OF CLEVELAND

Table of Contents

	Page
Management's Report on Internal Control over Financial Reporting	1
Independent Auditors' Report	2-3
Abbreviations	4
Financial Statements:	
Statements of Condition as of December 31, 2011 and December 31, 2010	5
Statements of Income and Comprehensive Income for the years ended December 31, 2011 and December 31, 2010	6
Statements of Changes in Capital for the years ended December 31, 2011 and December 31, 2010	7
Notes to Financial Statements	8-35

FEDERAL RESERVE BANK *of* CLEVELAND

CLEVELAND, OHIO 44101
AREA CODE 216-579-2000

Management's Report on Internal Control Over Financial Reporting

March 20, 2012

To the Board of Directors of the Federal Reserve Bank of Cleveland:

The management of the Federal Reserve Bank of Cleveland (Bank) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2011 and 2010, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (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 Bank is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the financial statements. The Bank's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with the FAM. The Bank's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the Bank's assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with FAM, and that the Bank's receipts and expenditures are being made only in accordance with authorizations of its management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on its financial statements.

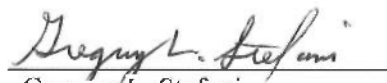
Even effective internal control, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements. Also, projections of any evaluation of effectiveness 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 Bank assessed its internal control over financial reporting 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 Bank maintained effective internal control over financial reporting.

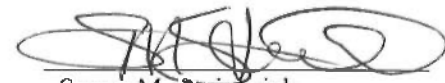
Federal Reserve Bank of Cleveland



Sandra Pianalto
President &
Chief Executive Officer



Gregory L. Stefani
First Vice President &
Chief Operating Officer



Susan M. Steinbrick
Senior Vice President &
Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying Statements of Condition of the Federal Reserve Bank of Cleveland ("FRB Cleveland") as of December 31, 2011 and 2010, 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 Cleveland as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The FRB Cleveland's management is responsible for these Financial Statements, for maintaining effective internal control over financial reporting, and for its assertion 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 Cleveland's internal control over financial reporting based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, as well as 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.

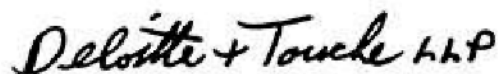
The FRB Cleveland's internal control over financial reporting is a process designed by, or under the supervision of, the FRB Cleveland's principal executive and principal financial officers, or persons performing similar functions, and effected by the FRB Cleveland's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. The FRB Cleveland's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the FRB Cleveland; (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 Cleveland are being made only in accordance with authorizations of management and directors of the FRB Cleveland; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the FRB Cleveland's 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 Cleveland 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 Cleveland as of December 31, 2011 and 2010, 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 Cleveland maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The image shows a handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

March 20, 2012

FEDERAL RESERVE BANK OF CLEVELAND

Abbreviations:

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

FEDERAL RESERVE BANK OF CLEVELAND
STATEMENTS OF CONDITION
As of December 31, 2011 and December 31, 2010
(in millions)

	2011	2010
<u>ASSETS</u>		
Gold certificates	\$ 450	\$ 463
Special drawing rights certificates	237	237
Coin	173	164
System Open Market Account:		
Treasury securities, net	47,279	36,250
Government-sponsored enterprise debt securities, net	2,913	5,197
Federal agency and government-sponsored enterprise mortgage-backed securities, net	22,913	34,135
Foreign currency denominated assets, net	1,925	1,941
Central bank liquidity swaps	7,405	6
Accrued interest receivable	534	484
Bank premises and equipment, net	137	157
Items in process of collection	59	89
Other assets	28	27
Total assets	\$ 84,053	\$ 79,150
<u>LIABILITIES AND CAPITAL</u>		
Federal Reserve notes outstanding, net	\$ 45,046	\$ 38,601
System Open Market Account:		
Securities sold under agreements to repurchase	2,698	2,028
Other liabilities	37	-
Deposits:		
Depository institutions	26,962	18,152
Other deposits	3	4
Interest payable to depository institutions	3	1
Accrued benefit costs	121	133
Deferred credit items	142	410
Accrued interest on Federal Reserve notes	82	26
Interdistrict settlement account	4,966	15,854
Other liabilities	15	7
Total liabilities	80,075	75,216
Capital paid-in	1,989	1,967
Surplus (including accumulated other comprehensive loss of \$11 million and \$37 million at December 31, 2011 and 2010, respectively)	1,989	1,967
Total capital	3,978	3,934
Total liabilities and capital	\$ 84,053	\$ 79,150

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

FEDERAL RESERVE BANK OF CLEVELAND
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
For the years ended December 31, 2011 and December 31, 2010
(in millions)

	2011	2010
<u>INTEREST INCOME</u>		
System Open Market Account:		
Treasury securities, net	1,213	937
Government-sponsored enterprise debt securities, net	89	125
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,115	1,595
Foreign currency denominated assets, net	18	17
Central bank liquidity swaps	3	1
Total interest income	2,438	2,675
<u>INTEREST EXPENSE</u>		
System Open Market Account:		
Securities sold under agreements to repurchase	1	3
Deposits:		
Depository institutions	55	41
Total interest expense	56	44
Net interest income	2,382	2,631
<u>NON-INTEREST INCOME</u>		
System Open Market Account:		
Treasury securities gains, net	61	-
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	-	29
Foreign currency gains, net	11	41
Compensation received for service costs provided	25	27
Reimbursable services to government agencies	52	46
Other	4	4
Total non-interest income	153	147
<u>OPERATING EXPENSES</u>		
Salaries and benefits	142	128
Occupancy	16	16
Equipment	7	8
Assessments:		
Board of Governors operating expenses and currency costs	70	64
Bureau of Consumer Financial Protection	18	2
Office of Financial Research	3	1
Other	33	19
Total operating expenses	289	238
Net income prior to distribution	2,246	2,540
Change in prior service costs related to benefit plans	19	(2)
Change in actuarial gains (losses) related to benefit plans	7	(16)
Comprehensive income prior to distribution	\$ 2,272	\$ 2,522
Distribution of comprehensive income:		
Dividends paid to member banks	\$ 118	\$ 115
Transferred to surplus and change in accumulated other comprehensive loss	22	57
Payments to Treasury as interest on Federal Reserve notes	2,132	2,350
Total distribution	\$ 2,272	\$ 2,522

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

FEDERAL RESERVE BANK OF CLEVELAND
STATEMENTS OF CHANGES IN CAPITAL
For the years ended December 31, 2011 and December 31, 2010
(in millions, except share data)

	<u>Surplus</u>				
	<u>Capital paid-in</u>	<u>Net income retained</u>	<u>Accumulated other comprehensive loss</u>	<u>Total surplus</u>	<u>Total capital</u>
Balance at January 1, 2010 (38,208,062 shares)	\$ 1,910	\$ 1,929	\$ (19)	\$ 1,910	\$ 3,820
Net change in capital stock issued (1,142,322 shares)	57	-	-	-	57
Transferred to surplus and change in accumulated other comprehensive loss	<u>-</u>	<u>75</u>	<u>(18)</u>	<u>57</u>	<u>57</u>
Balance at December 31, 2010 (39,350,384 shares)	\$ 1,967	\$ 2,004	\$ (37)	\$ 1,967	\$ 3,934
Net change in capital stock issued (422,697 shares)	22	-	-	-	22
Transferred from surplus and change in accumulated other comprehensive loss	<u>-</u>	<u>(4)</u>	<u>26</u>	<u>22</u>	<u>22</u>
Balance at December 31, 2011 (39,773,081 shares)	<u>\$ 1,989</u>	<u>\$ 2,000</u>	<u>\$ (11)</u>	<u>\$ 1,989</u>	<u>\$ 3,978</u>

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

FEDERAL RESERVE BANK OF CLEVELAND NOTES TO FINANCIAL STATEMENTS

1. STRUCTURE

The Federal Reserve Bank of Cleveland (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 Fourth Federal Reserve District, which includes Ohio and portions of Kentucky, Pennsylvania, and West Virginia.

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 clearinghouse (ACH) operations, and check collection; distributing coin and currency; performing fiscal agency functions for the U.S. Department of the Treasury (Treasury), certain federal agencies, and other entities; serving as the federal government's bank; providing short-term loans to depository institutions; providing loans to participants in programs or facilities with broad-based eligibility 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, savings and loan holding companies, and U.S. offices of foreign banking organizations pursuant to authority delegated by the Board of Governors. 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 established a Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that has 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; limited the Reserve Banks' authority to provide loans in unusual and exigent circumstances to lending programs or facilities with broad-based eligibility or to designated financial market utilities; and vested 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

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, 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 in the maximum amounts of \$2 billion and \$3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund.

Although the Reserve Banks are separate legal entities, they collaborate on 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 Treasury Retail Services Technology, Cash Technology, Financial Services Policy Committee, and National Server Management Transition.

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 and Reinvestment of Principal Payments

On March 18, 2009, 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 would 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 and completed these purchases in June 2011. On June 22, 2011, the FOMC announced that the Federal Reserve would maintain its existing policy of reinvesting principal payments from all domestic securities in Treasury securities. On September 21, 2011, the FOMC announced that the Federal Reserve intends to purchase, by the end of June 2012, \$400 billion par value of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less, of which \$133 billion has been purchased and \$134 billion sold as of December 31, 2011. In addition, the FOMC announced that it will maintain its existing policy of rolling over maturing Treasury securities at auction and, rather than reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in Treasury securities, such payments will be reinvested in federal agency and GSE MBS.

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,

FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS

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. As discussed above, on September 21, 2011, the FOMC announced that the Federal Reserve will begin to reinvest principal payments from its holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS.

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.

In May 2010, U.S. dollar liquidity swap arrangements were re-authorized with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank through January 2011. Subsequently, these arrangements were extended through February 1, 2013. There is no specified limit to the amount that may be drawn by the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank under these swap arrangements; the Bank of Canada may draw up to \$30 billion under the swap arrangement with the FRBNY. In addition to the central bank liquidity swap arrangements, the FOMC has authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico, as discussed in Note 2.

Foreign currency liquidity swap arrangements were authorized with 4 foreign central banks and 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. In November 2011, as a contingency measure, the FOMC agreed to establish temporary bilateral liquidity swap arrangements with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank so that liquidity can be provided in any of their currencies, if necessary. The swap lines are authorized until February 1, 2013.

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, 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 (ABCP) 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.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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 of America (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 SOMA securities on a settlement-date basis. 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. 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. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, better reflects the timing of the transaction's effect on the quantity of reserves in the banking system. The cost bases of Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP.

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 as a central bank. 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, and the accompanying notes to the financial statements. There are no other significant differences, other than those described above, 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 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 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 Bank's financial statements.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO 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 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. There were no SDR transactions during the years ended December 31, 2011 and 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 are 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 triparty arrangement. In a

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

triparty 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 TIPS and STRIP Treasury securities); direct obligations of several federal and GSE-related agencies, including Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac); and pass-through MBS of Fannie Mae, Freddie Mac, and Government National Mortgage Association. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction.

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. The list of eligible counterparties was subsequently expanded to include GSEs, effective in May 2011, and bank and savings institutions, effective in July 2011. These reverse repurchase transactions may be executed through a triparty arrangement as an open market operation, 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. The amortized cost basis of securities lent continues to be reported as “Treasury securities, net” or “Government-sponsored enterprise debt securities, net,” as appropriate, in the Statements of Condition. 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 “Non-interest income: Other” 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 interdistrict settlement account that occurs in the second quarter of 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. 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 in the Statements of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts in the Statements of Income and Comprehensive Income.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar 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. In 2010, 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. During the year-ended December 31, 2010, the FRBNY’s participation in the dollar roll and coupon swap markets furthered the MBS purchase program goals of providing support to the mortgage and housing markets and of fostering improved conditions in financial markets more generally. During the year-ended December 31, 2011, the FRBNY executed dollar rolls primarily to facilitate settlement. The FRBNY accounts for outstanding commitments under dollar roll and coupon swaps as purchases or sales on a settlement-date basis. 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, which can include foreign currency deposits, securities purchased under agreements to resell, and government debt instruments, 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 the second quarter 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 the Reserve Banks’ 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. 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 the Reserve Banks’ 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 the Reserve Banks’ aggregate capital and surplus at the preceding December 31. The foreign currency amounts associated with these central bank liquidity swap arrangements are revalued daily 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

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

transaction. The Bank's allocated portion of the foreign currency amounts that the FRBNY acquires are reported as "System Open Market Account: Central bank liquidity swaps" in 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 Bank's allocated portion of the amount of compensation received during the term of the swap transaction is reported 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. 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 operating 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.

i. Interdistrict Settlement Account

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

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.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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 \$9,085 million and \$7,304 million at December 31, 2011 and 2010, respectively.

At December 31, 2011 and 2010, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2011, all gold certificates, all special drawing right certificates, and \$1,018 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2011, no investments denominated in foreign currencies were pledged as collateral.

k. Deposits

Depository Institutions

Depository institutions’ deposits represent the reserve and service-related balances, such as required clearing 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” in 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” in the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2011 and 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” is 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.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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. On a daily basis, surplus is adjusted to equate the balance to capital paid-in. 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 the Treasury resume. This deferred asset is periodically reviewed for impairment.

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 years ended December 31, 2011 and 2010, 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 in 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 in 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 “Non-interest income: 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, the operations of the Bureau and, for a two-year period following the July 21, 2010, effective date of the Dodd-Frank Act, 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 Governors’ 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.

FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS

During the period prior to the Bureau transfer date of July 21, 2011, there was no limit on the funding provided to the Bureau and assessed to the Reserve Banks; the Board of Governors was required to 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. The Dodd-Frank Act requires that, after the transfer date, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governors' 2009 annual report, which totaled \$4.98 billion. The fixed percentage of total 2009 operating expenses of the System is 10 percent (\$498.0 million) for 2011, 11 percent (\$547.8 million) for 2012, and 12 percent (\$597.6 million) for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act. The Bank's assessment for Bureau funding is reported as "Assessments: Bureau of Consumer Financial Protection" in the Statements of Income and Comprehensive Income.

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 bank holding companies and nonbank financial companies that meet the criteria specified in the Dodd-Frank Act.

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 \$2 million for each of the years ended December 31, 2011 and 2010, 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. The costs associated with the impairment of certain Bank assets are discussed in Note 9. 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. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 12.

u. Recently Issued Accounting Standards

In July 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, 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 update is effective for the Bank for the year ended December 31, 2011, and did not have a material effect on the Bank's financial statements.

In April 2011, the FASB issued ASU 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which clarifies accounting for troubled debt restructurings, specifically clarifying creditor concessions and financial difficulties experienced by

FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS

borrowers. This update is effective for the Bank for the year ended December 31, 2012, and is not expected to have a material effect on the Bank's financial statements.

In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements*, which reconsidered the effective control for repurchase agreements. This update prescribes when the Bank may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. This determination is based, in part, on whether the Bank has maintained effective control over the transferred financial assets. This update is effective for the Bank for the year ended December 31, 2012, and is not expected to have a material effect on the Bank's financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which requires a reporting entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. The update is intended to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items by presenting the components reported in other comprehensive income. The Bank has adopted the update in this ASU effective for the year ended December 31, 2011, and the required presentation is reflected in the Bank's financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. This update will require a reporting entity to present enhanced disclosures for financial instruments and derivative instruments that are offset or subject to master netting agreements or similar such agreements. This update is effective for the Bank for the year ended December 31, 2013, and is not expected to have a material effect on the Bank's financial statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This update indefinitely defers the requirements of ASU 2011-05 related to presentation of reclassification adjustments.

5. LOANS

The Bank had no loans outstanding at December 31, 2011 and 2010.

Loans to Depository Institutions

The Bank offers primary, secondary, and seasonal loans 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 loans are extended on a short-term basis, typically overnight, whereas seasonal loans may be extended for a period of up to nine months.

Primary, secondary, and seasonal loans are 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. 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 loans, may convert the loan to a secondary credit loan. Collateral levels are reviewed daily against outstanding

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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.

Allowance for Loan Loss

At December 31, 2011 and 2010, 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, 2011 and 2010.

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 2.701 percent and 3.398 percent at December 31, 2011 and 2010, respectively.

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

	2011				
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost	Fair value
Bills	\$ 498	\$ -	\$ -	\$ 498	\$ 498
Notes	34,747	724	(33)	35,438	37,531
Bonds	9,688	1,657	(2)	11,343	13,741
Total Treasury securities	<u>\$ 44,933</u>	<u>\$ 2,381</u>	<u>\$ (35)</u>	<u>\$ 47,279</u>	<u>\$ 51,770</u>
GSE debt securities	<u>\$ 2,809</u>	<u>\$ 104</u>	<u>\$ -</u>	<u>\$ 2,913</u>	<u>\$ 3,086</u>
Federal agency and GSE MBS	<u>\$ 22,627</u>	<u>\$ 314</u>	<u>\$ (28)</u>	<u>\$ 22,913</u>	<u>\$ 24,189</u>
	2010				
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost	Fair value
Bills	\$ 626	\$ -	\$ -	\$ 626	\$ 626
Notes	26,273	477	(26)	26,724	27,340
Bonds	7,807	1,112	(19)	8,900	9,845
Total Treasury securities	<u>\$ 34,706</u>	<u>\$ 1,589</u>	<u>\$ (45)</u>	<u>\$ 36,250</u>	<u>\$ 37,811</u>
GSE debt securities	<u>\$ 5,010</u>	<u>\$ 188</u>	<u>\$ (1)</u>	<u>\$ 5,197</u>	<u>\$ 5,327</u>
Federal agency and GSE MBS	<u>\$ 33,709</u>	<u>\$ 479</u>	<u>\$ (53)</u>	<u>\$ 34,135</u>	<u>\$ 34,859</u>

**FEDERAL RESERVE BANK OF CLEVELAND
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):

	2011		2010	
	Amortized cost	Fair value	Amortized cost	Fair value
Bills	\$ 18,423	\$ 18,423	\$ 18,422	\$ 18,422
Notes	1,311,917	1,389,429	786,575	804,703
Bonds	419,937	508,694	261,955	289,757
Total Treasury securities	<u>\$ 1,750,277</u>	<u>\$ 1,916,546</u>	<u>\$ 1,066,952</u>	<u>\$ 1,112,882</u>
GSE debt securities	<u>\$ 107,828</u>	<u>\$ 114,238</u>	<u>\$ 152,972</u>	<u>\$ 156,780</u>
Federal agency and GSE MBS	<u>\$ 848,258</u>	<u>\$ 895,495</u>	<u>\$ 1,004,695</u>	<u>\$ 1,026,003</u>

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 expected rate of prepayments of mortgage loans underlying the securities.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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

Distribution of MBS holdings by coupon rate	2011		2010	
	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
3.0%	\$ 36	\$ 36	\$ -	\$ -
3.5%	524	531	11	12
4.0%	4,362	4,586	5,697	5,722
4.5%	10,979	11,647	16,909	17,287
5.0%	4,930	5,204	7,863	8,071
5.5%	1,804	1,892	3,164	3,257
6.0%	247	260	438	454
6.5%	31	33	53	56
Total	<u>\$ 22,913</u>	<u>\$ 24,189</u>	<u>\$ 34,135</u>	<u>\$ 34,859</u>
Total SOMA:				
3.0%	\$ 1,313	\$ 1,336	\$ -	\$ -
3.5%	19,415	19,660	341	352
4.0%	161,481	169,763	167,675	168,403
4.5%	406,465	431,171	497,672	508,798
5.0%	182,497	192,664	231,420	237,545
5.5%	66,795	70,064	93,119	95,873
6.0%	9,152	9,616	12,910	13,376
6.5%	1,140	1,221	1,558	1,656
Total	<u>\$ 848,258</u>	<u>\$ 895,495</u>	<u>\$ 1,004,695</u>	<u>\$ 1,026,003</u>

There were no transactions related to securities purchased under agreements to resell during the years ended December 31, 2011 and 2010. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	2011	2010
Allocated to the Bank:		
Contract amount outstanding, end of year	\$ 2,698	\$ 2,028
Average daily amount outstanding, during the year	2,066	2,079
Maximum balance outstanding, during the year	3,363	3,071
Securities pledged (par value), end of year	2,325	1,483
Securities pledged (market value), end of year	2,698	2,028
Total SOMA:		
Contract amount outstanding, end of year	\$ 99,900	\$ 59,703
Average daily amount outstanding, during the year	72,227	58,476
Maximum balance outstanding, during the year	124,512	77,732
Securities pledged (par value), end of year	86,089	43,642
Securities pledged (market value), end of year	99,900	59,703

The contract amounts for securities sold under agreements to repurchase approximate fair value. 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 to temporarily drain reserve balances from the banking system and as part of a service offering to foreign official and international account holders.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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, 2011, 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)	\$ 439	\$ 732	\$ 2,428	\$ 17,550	\$ 17,555	\$ 6,229	\$ 44,933
GSE debt securities (par value)	67	136	532	1,637	374	63	2,809
Federal agency and GSE MBS (par value) ¹	-	-	-	-	1	22,626	22,627
Securities sold under agreements to repurchase (contract amount)	2,698	-	-	-	-	-	2,698

¹ The par amount shown for Federal agency and GSE MBS is the remaining principal balance of the underlying mortgages.

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, 2011, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, is approximately 2.4 years.

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

	Allocated to the Bank			
	Amortized cost		Par value	
	2011	2010	2011	2010
Treasury securities	\$ 408	\$ 769	\$ 378	\$ 750
GSE debt securities	34	57	33	55

	Total SOMA			
	Amortized cost		Par value	
	2011	2010	2011	2010
Treasury securities	\$ 15,121	\$ 22,627	\$ 13,978	\$ 22,081
GSE debt securities	1,276	1,686	1,216	1,610

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the Treasury securities under outstanding commitments was \$3,200 million. The total purchase price of outstanding commitments allocated to the Bank was \$86 million. These commitments had contractual settlement dates extending through January 3, 2012. As of December 31, 2011, the fair value of Treasury securities under outstanding purchase commitments was \$3,208 million, of which \$87 million was allocated to the Bank.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was \$41,503 million, of which \$513 million was related to dollar roll transactions. The total purchase price of outstanding purchase commitments allocated to the Bank was \$1,121 million, of which \$14 million was related to dollar roll transactions. As of December 31, 2011, the total sales price of the federal agency and GSE MBS under outstanding sales commitments was \$4,430 million, all of which was related to dollar roll transactions. The total sales price of outstanding sales

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

commitments allocated to the Bank was \$120 million, all of which was related to dollar roll transactions. These commitments, which had contractual settlement dates extending through February 2012, are for the purchase and sale of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. As of December 31, 2011, the fair value of federal agency and GSE MBS purchases and sales, net under outstanding commitments was \$41,873 million and \$4,473 million, respectively, of which \$1,131 million and \$121 million, respectively, was allocated to the Bank. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

Other liabilities, which are related to federal agency and GSE MBS purchases and sales, includes the FRBNY's obligation to return cash margin posted by counterparties as collateral under commitments to purchase and sell federal agency and GSE MBS. In addition, other liabilities includes obligations that arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although FRBNY 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 included in other liabilities represents the FRBNY'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
	2011	2011
Cash margin	\$ 34	\$ 1,271
Obligations from MBS transaction fails	3	97
Total	\$ 37	\$ 1,368

During the years ended December 31, 2011 and 2010, the Reserve Banks recorded net gains from federal agency and GSE MBS transactions of \$10 million and \$782 million, respectively, of which \$262 thousand and \$29 million, respectively, were allocated to the Bank. These net gains are reported as "Non-interest income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the year ended December 31, 2011, is summarized as follows (in millions):

	Allocated to the Bank					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2010	\$ 626	\$ 26,724	\$ 8,900	\$ 36,250	\$ 5,197	\$ 34,135
Purchases ¹	6,938	22,098	4,716	33,752	-	1,138
Sales ¹	-	(3,720)	-	(3,720)	-	-
Realized gains, net ²	-	61	-	61	-	-
Principal payments and maturities	(6,938)	(1,930)	-	(8,868)	(1,289)	(5,661)
Amortization of premiums and discounts	-	(127)	(143)	(270)	(49)	(93)
Inflation adjustment on inflation-indexed securities	-	37	31	68	-	-
Annual reallocation adjustment ³	(128)	(7,705)	(2,161)	(9,994)	(946)	(6,606)
Balance December 31, 2011	<u>\$ 498</u>	<u>\$ 35,438</u>	<u>\$ 11,343</u>	<u>\$ 47,279</u>	<u>\$ 2,913</u>	<u>\$ 22,913</u>
Supplemental information - par value of transactions:						
Purchases	\$ 6,938	\$ 21,605	\$ 3,734	32,277	\$ -	\$ 1,106
Proceeds from sales	-	(3,642)	-	(3,642)	-	-
	Total SOMA					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2010	\$ 18,422	\$ 786,575	\$ 261,955	\$ 1,066,952	\$ 152,972	\$ 1,004,695
Purchases ¹	239,487	731,252	161,876	1,132,615	-	42,145
Sales ¹	-	(137,734)	-	(137,734)	-	-
Realized gains, net ²	-	2,258	-	2,258	-	-
Principal payments and maturities	(239,494)	(67,273)	-	(306,767)	(43,466)	(195,413)
Amortization of premiums and discounts	8	(4,445)	(4,985)	(9,422)	(1,678)	(3,169)
Inflation adjustment on inflation-indexed securities	-	1,284	1,091	2,375	-	-
Balance December 31, 2011	<u>\$ 18,423</u>	<u>\$ 1,311,917</u>	<u>\$ 419,937</u>	<u>\$ 1,750,277</u>	<u>\$ 107,828</u>	<u>\$ 848,258</u>
Supplemental information - par value of transactions:						
Purchases	\$ 239,494	\$ 713,878	\$ 127,802	\$ 1,081,174	\$ -	\$ 40,955
Proceeds from sales	-	(134,829)	-	(134,829)	-	-

¹Purchases and sales are reported on a settlement-date basis and include payments and receipts related to principal, premiums, discounts, and inflation compensation included in the basis of inflation-indexed securities. The amount reported as sales also includes realized gains, net.

² Adjustments for realized gains, net is required because these amounts do not affect the reported amount of the related securities. Excludes gains and losses that result from net settled MBS TBA transactions.

³ Reflects the annual adjustment to the Bank's allocated portion of the related SOMA securities that results from the annual settlement of the interdistrict settlement account, as discussed in Note 4f.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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 of Germany, France, and Japan. 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 7.418 percent and 7.451 percent at December 31, 2011 and 2010, 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):

	2011	2010
Euro:		
Foreign currency deposits	\$ 695	\$ 526
Securities purchased under agreements to resell	-	184
German government debt instruments	140	138
French government debt instruments	195	205
Japanese yen:		
Foreign currency deposits	296	289
Japanese government debt instruments	599	599
Total allocated to the Bank	\$ 1,925	\$ 1,941

At December 31, 2011 and 2010, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was \$1,937 million and \$1,953 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 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 \$25,950 million and \$26,049 million at December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, the fair value of the total Reserve Bank foreign currency denominated assets, including accrued interest, was \$26,116 million and \$26,213 million, respectively.

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2011, 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
Euro	\$ 397	\$ 218	\$ 157	\$ 258	\$ 1,030
Japanese yen	310	49	233	303	895
Total	\$ 707	\$ 267	\$ 390	\$ 561	\$ 1,925

At December 31, 2011 and 2010, the authorized warehousing facility was \$5 billion, with no balance outstanding.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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, 2011 and 2010.

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2011.

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, 2011, there were \$216 million of outstanding commitments to purchase Euro-denominated government debt instruments, of which \$16 million was allocated to the Bank. These securities settled on January 4, 2012, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date. As of December 31, 2011, the fair value of Euro-denominated government debt instruments under outstanding commitments was \$216 million, of which \$16 million was allocated to the Bank.

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 7.418 percent and 7.451 percent at December 31, 2011 and 2010, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2011 and 2010, was \$99,823 million and \$75 million, respectively, of which \$7,405 million and \$6 million, respectively, was allocated to the Bank.

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

	2011			2010
	Within 15 days	16 days to 90 days	Total	Within 15 days
Euro	\$ 2,549	\$ 3,789	\$ 6,338	\$ 6
Japanese yen	670	368	1,038	-
Swiss franc	24	5	29	-
Total	\$ 3,243	\$ 4,162	\$ 7,405	\$ 6

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2011 and 2010.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

9. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2011	2010
Bank premises and equipment:		
Land and land improvements	\$ 10	\$ 10
Buildings	175	172
Building machinery and equipment	59	62
Furniture and equipment	48	54
Subtotal	292	298
Accumulated depreciation	(155)	(141)
Bank premises and equipment, net	\$ 137	\$ 157
Depreciation expense, for the years ended December 31	\$ 11	\$ 11

The Bank leases space to outside tenants with remaining lease terms ranging from one to thirteen years. Rental income from such leases was \$2 million for each of the years ended December 31, 2011 and 2010, and is reported as a component of “Non-interest income: Other” in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2011, are as follows (in millions):

2012	\$ 2
2013	1
2014	1
2015	2
2016	1
Thereafter	8
Total	\$ 15

The Bank had capitalized software assets, net of amortization, of \$12 million and \$9 million at December 31, 2011 and 2010, respectively. Amortization expense was \$2 million for each of the years ended December 31, 2011 and 2010. 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.

As a result of the Bank’s restructuring plan discussed in Note 14, the Bank has determined that it will vacate the Pittsburgh branch facility. The Bank recorded an impairment loss of \$12 million during the year ended December 31, 2011, to adjust the recorded amount of related building and land, building machinery and equipment, and land improvements to fair value. Fair values were based on appraisals and other valuation techniques. A portion of the impairment loss in the amount of \$10 million is reported as a component of “Operating Expenses: Other” and the remaining amount of \$2 million is reported as a component of “Operating Expense: Occupancy” in the Statements of Income and Comprehensive Income. The Bank had no impairment losses in 2010.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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, 2011, the Bank was obligated under a noncancelable lease for premises and equipment with a remaining term of one year. The lease provides for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$358 thousand and \$355 thousand for the years ended December 31, 2011 and 2010, respectively.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 2011, were not material.

At December 31, 2011, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the 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 which the loss is shared. No claims were outstanding under the agreement at December 31, 2011 and 2010.

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 legal actions 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). Under the Dodd-Frank Act, newly hired Bureau employees are eligible to participate in the System Plan and transferees from other governmental organizations can elect to participate in the 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 Banks (SERP).

The System Plan provides retirement benefits to employees of the Reserve Banks, Board of Governors, OEB, and 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 year ended December 31, 2011, certain costs associated with the System Plan were reimbursed by the Bureau. During the year ended December 31, 2010, 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, 2011 and 2010, and for the years then ended, were not material.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. The Bank's Thrift Plan contributions totaled \$5 million for each of the years ended December 31, 2011 and 2010, 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):

	<u>2011</u>	<u>2010</u>
Accumulated postretirement benefit obligation at January 1	\$ 117.7	\$ 93.7
Service cost benefits earned during the period	5.8	4.2
Interest cost on accumulated benefit obligation	6.5	5.5
Net actuarial loss	4.5	18.0
Curtailement gain	(6.9)	-
Contributions by plan participants	0.9	0.7
Benefits paid	(5.0)	(4.7)
Medicare Part D subsidies	0.3	0.3
Plan amendments	(19.4)	-
Accumulated postretirement benefit obligation at December 31	<u>\$ 104.4</u>	<u>\$ 117.7</u>

At December 31, 2011 and 2010, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 4.50 percent and 5.25 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.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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):

	<u>2011</u>	<u>2010</u>
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	3.8	3.7
Contributions by plan participants	0.9	0.7
Benefits paid	(5.0)	(4.7)
Medicare Part D subsidies	0.3	0.3
Fair value of plan assets at December 31	<u>\$ -</u>	<u>\$ -</u>
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 104.4</u>	<u>\$ 117.7</u>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 19.4	\$ 0.1
Net actuarial loss	(31.0)	(37.1)
Total accumulated other comprehensive loss	<u>\$ (11.6)</u>	<u>\$ (37.0)</u>

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:

	<u>2011</u>	<u>2010</u>
Health-care cost trend rate assumed for next year	7.50%	8.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2017

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, 2011 (in millions):

	<u>1 percentage point increase</u>	<u>1 percentage point decrease</u>
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 2.3	\$ (1.9)
Effect on accumulated postretirement benefit obligation	15.0	(12.2)

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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

	<u>2011</u>	<u>2010</u>
Service cost-benefits earned during the period	\$ 5.8	\$ 4.2
Interest cost on accumulated benefit obligation	6.5	5.5
Amortization of prior service cost	-	(1.4)
Amortization of net actuarial loss	<u>3.6</u>	<u>1.7</u>
Net periodic postretirement benefit expense	<u>\$ 15.9</u>	<u>\$ 10.0</u>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2012 are shown below:

Prior service cost	\$ (3.6)
Net actuarial loss	<u>2.1</u>
Total	<u>\$ (1.5)</u>

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2011 and 2010, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.25 percent and 5.75 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 curtailment gain associated with restructuring programs that are described in Note 14 was recognized in net income in the year ended December 31, 2011, related to employees who terminated employment during 2011.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a prescription drug benefit under Medicare (Medicare Part D) and a federal subsidy to sponsors of retiree health-care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. The benefits provided under the Bank’s plan to certain participants are at least actuarially equivalent to the Medicare Part D prescription drug benefit. The estimated effects of the subsidy are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were \$343 thousand and \$259 thousand for the years ended December 31, 2011 and 2010, respectively. Expected receipts in 2012, related to benefits paid in the years ended December 31, 2011 and 2010, are \$79 thousand.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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

	<u>Without subsidy</u>	<u>With subsidy</u>
2012	\$ 5.6	\$ 5.2
2013	5.7	5.3
2014	5.9	5.5
2015	6.0	5.5
2016	6.4	5.9
2017 - 2021	<u>35.6</u>	<u>31.6</u>
Total	<u>\$ 65.2</u>	<u>\$ 59.0</u>

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2011 and 2010, were \$13.9 million and \$12.1 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2011 and 2010 operating expenses were \$3.6 million and \$0.9 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

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):

	<u>Amount related to postretirement benefits other than retirement plans</u>
Balance at January 1, 2010	\$ (19)
Change in funded status of benefit plans:	
Amortization of prior service cost	<u>(2)</u>
Change in prior service costs related to benefit plans	(2)
Net actuarial loss arising during the year	(18)
Amortization of net actuarial loss	<u>2</u>
Change in actuarial loss related to benefit plans	<u>(16)</u>
Change in funded status of benefit plans - other comprehensive loss	<u>(18)</u>
Balance at December 31, 2010	<u>\$ (37)</u>
Change in funded status of benefit plans:	
Prior service costs arising during the year	<u>19</u>
Change in prior service costs related to benefit plans	19
Net actuarial gain arising during the year	3
Amortization of net actuarial loss	<u>4</u>
Change in actuarial gain related to benefit plans	<u>7</u>
Change in funded status of benefit plans - other comprehensive loss	<u>26</u>
Balance at December 31, 2011	<u>\$ (11)</u>

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

14. BUSINESS RESTRUCTURING CHARGES

In 2011, the U.S. Treasury announced a restructuring initiative to consolidate the Treasury Retail Securities (TRS) operations located in the Bank's Pittsburgh branch into the Federal Reserve Bank of Minneapolis. In coordination with the TRS restructuring in Pittsburgh, the Bank announced the restructuring of support and overhead functions at the branch and the sale of the Pittsburgh branch facility. Additional announcements in 2011 included the consolidation of paper check processing into the Federal Reserve Bank of Atlanta.

The Bank had no business restructuring charges in 2010.

**FEDERAL RESERVE BANK OF CLEVELAND
NOTES TO FINANCIAL STATEMENTS**

Additional announcements prior to 2010 included restructuring plans associated with Check Operations and Electronic Treasury Financial Services.

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

	2011 restructuring plans	2009 and prior restructuring plans	Total
<i>Information related to restructuring plans as of December 31, 2011:</i>			
Total expected costs related to restructuring activity	\$ 10.0	\$ 2.1	\$ 12.1
Expected completion date	2011	2010	
<i>Reconciliation of liability balances:</i>			
Balance at January 1, 2010	\$ -	\$ 0.1	\$ 0.1
Adjustments	-	(0.1)	(0.1)
Balance at December 31, 2010	\$ -	\$ -	\$ -
Employee separation costs	10.9	-	10.9
Adjustments	(0.8)	-	(0.8)
Payments	(4.0)	-	(4.0)
Balance at December 31, 2011	<u>\$ 6.1</u>	<u>\$ -</u>	<u>\$ 6.1</u>

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.

Restructuring costs associated with the impairment of certain Bank assets, including software, buildings, leasehold improvements, furniture, and equipment, are discussed in Note 9. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 11. Costs associated with enhanced postretirement benefits are disclosed in Note 12.

15. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2011. Subsequent events were evaluated through March 20, 2012, which is the date that the Bank issued the financial statements.