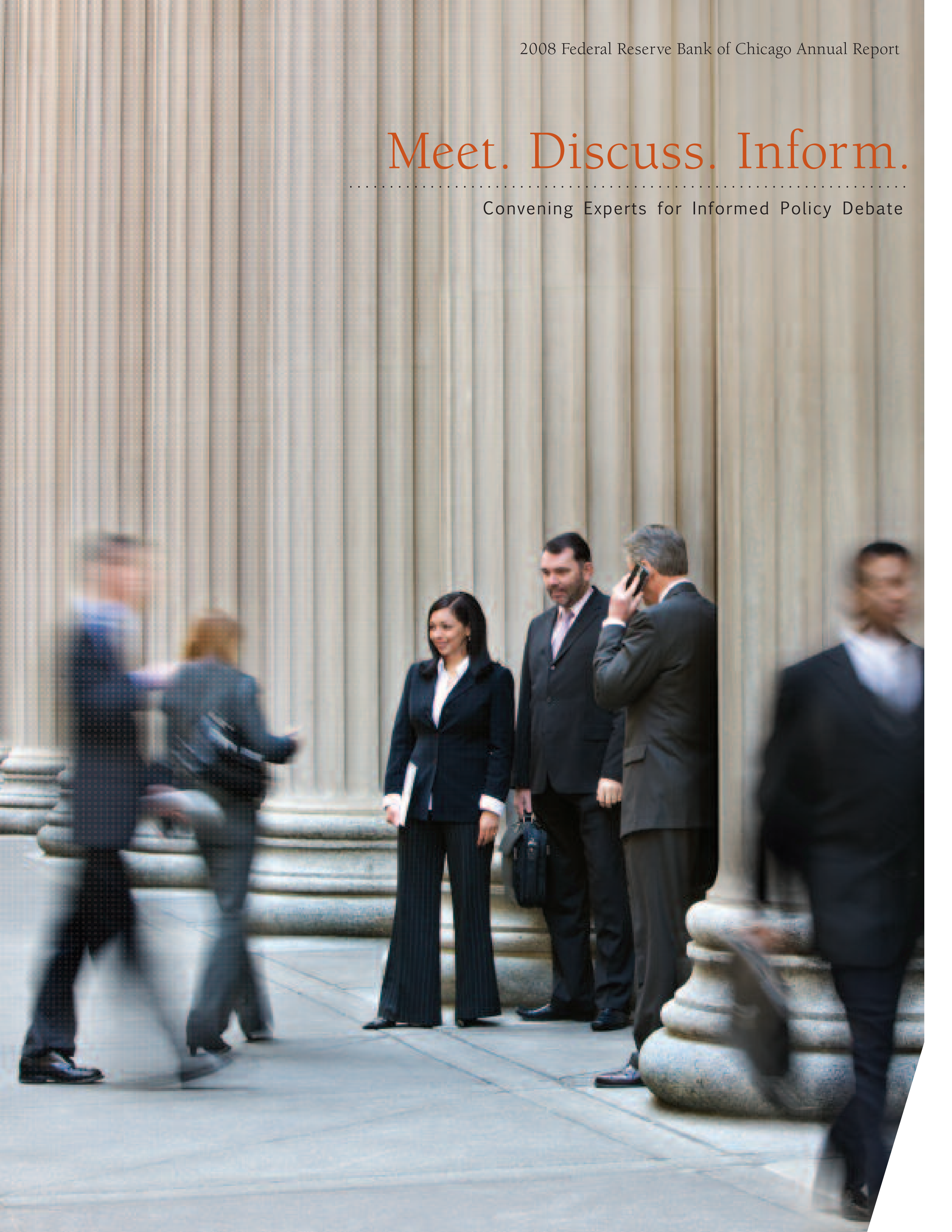


2008 Federal Reserve Bank of Chicago Annual Report

Meet. Discuss. Inform.

Convening Experts for Informed Policy Debate

TABLE OF

Contents

Letter from the President	1
The Economy and Monetary Policy	2
Chicago Fed Highlights of 2008	4
Meet. Discuss. Inform. Convening Experts for Informed Policy Debate	7
Directors	14
Management Committee	18
Executive Officers	19
Advisory Councils	20
Executive Changes	21
Operations Volumes	22

LETTER FROM

The President

Unprecedented economic turmoil challenged the Federal Reserve System and the Federal Reserve Bank of Chicago in 2008. Housing markets deteriorated. Employment and consumer confidence plummeted, and credit markets experienced large-scale disruptions. The Fed responded aggressively to stem the tide. We looked at problems in new ways and responded quickly to a rapidly changing financial services industry.

The Bank's new vision statement helped guide our efforts. It emphasizes the importance of talented staff members collaborating with one another as well as with customers and stakeholders. It reinforces our commitment to work in the public interest to foster a strong economy and stable financial system. Approaching our jobs with this vision in mind helped us deal with not just the financial crisis but also with restructuring our check-processing operations, offering high-quality currency services, and helping banks access our electronic payment products more effectively.

As we navigated through these challenges, our boards of directors in Chicago and at the Detroit Branch made important contributions. Their counsel on our operations and insight into regional business conditions proved to be especially valuable as the year progressed. They asked tough questions, provided thoughtful feedback, and shared useful information on economic conditions.

This year's annual report looks at other ways we gather and share information on economic and financial conditions: our conference program. The report outlines some of the findings of important conferences we sponsored in 2008. As always, we leveraged our unique ability to convene top experts in diverse fields. As the financial crisis unfolded, these experts discussed timely topics such as credit market turmoil, the state of the automotive industry, risk management, the economic forecast, preventing home foreclosures and promoting financial education.

These conferences foster an informed debate on important public policy issues facing the economy and banking system. They provide new perspectives and contribute to the development and dissemination of high-quality research. The summary that follows offers a glimpse into the concerns and policy solutions that surfaced as the year progressed. I hope you find it informative.

Charles L. Evans

Charles L. Evans
President and Chief Executive Officer

THE ECONOMY AND

Monetary Policy*

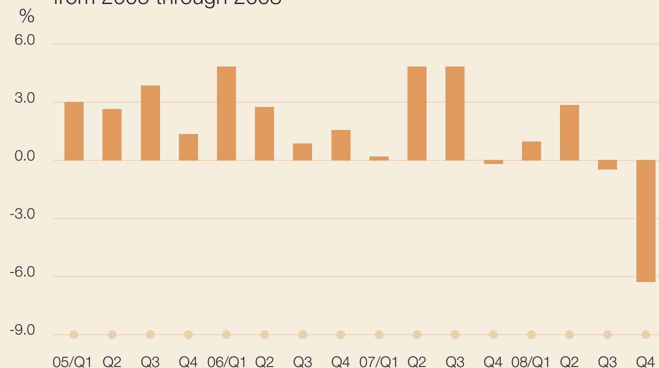
As 2009 began, the U.S. economy was in the midst of a serious recession. Real gross domestic product (GDP) fell sharply late in 2008 and apparently again in early 2009. These declines occurred despite aggressive moves by the Federal Reserve that lowered the federal funds rate to near zero and approximately tripled the size of its balance sheet. Since the beginning of the recession, 4.3 million jobs have been lost, with the unemployment rate reaching 8.1% in February 2009.

Weak labor markets and the early-year increases in energy prices held back growth in real incomes in 2008. This, along with strains in financial markets and substantial declines in household wealth, led to a large drop in consumer spending over the second half of the year. Residential investment continued to deteriorate throughout 2008, with construction, new home sales and home prices all declining further. Business spending also contracted sharply in the second half of 2008, and weakening foreign activity and the higher U.S. dollar reduced the strong contribution to growth from net exports that had occurred in the first half of the year.

Measures of consumer price inflation decreased in 2008 from the prior year. Inflationary pressures eased substantially over the course of the year, reflecting falling prices for energy and other commodities later in the year, declining import prices, and increases in resource slack due to diminished economic activity.

Economic Growth

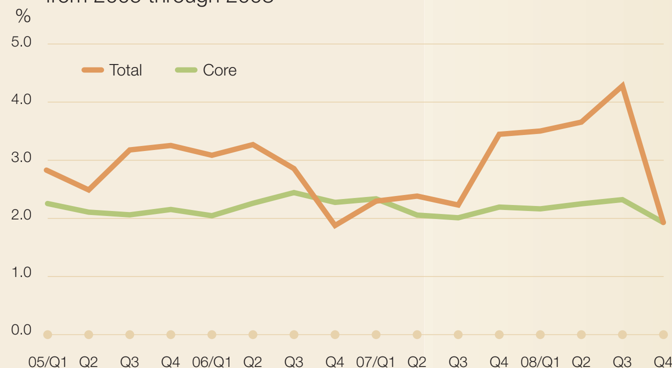
Annualized quarterly Real Gross Domestic Product growth from 2005 through 2008



Real gross domestic product rose over the first half of 2008 but declined in the second half of the year. From the fourth quarter of 2007 to the fourth quarter of 2008, real GDP declined by 0.8%.

Inflation

Year-over-year Personal Consumption Expenditures (PCE) Inflation from 2005 through 2008



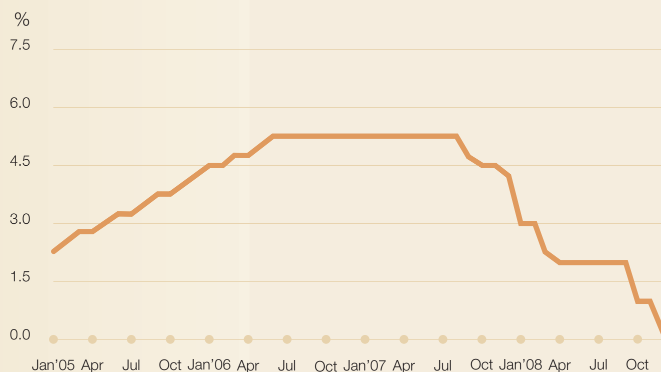
Inflation rose over the first half of 2008 before declining substantially by year-end. The total and core Personal Consumption Expenditures (PCE) price indexes both finished 2008 1.9% higher than in the fourth quarter of 2007.

RESPONDING TO THE CREDIT CRISIS

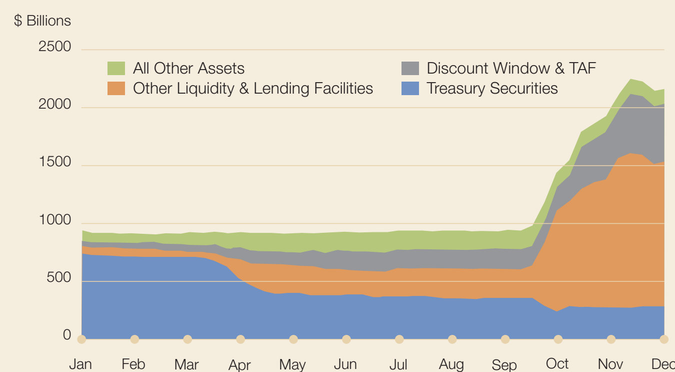
In 2008, the tightening of credit conditions began to weigh on economic activity. Problems with several major financial institutions intensified market participants' concerns about potential losses on a range of assets as well as the ability of counterparties to meet contractual obligations. This further increased risk aversion and sparked a "flight to quality" toward traditionally safe assets such as U.S. Treasuries. Toward the end of 2008, a further pullback in risk-taking occurred, spurred by further disruptions in short-term funding markets as well as a more pessimistic outlook for the economy. This led to even lower equity prices, higher risk spreads, and tighter credit markets, all of which fed back into further declines in real and financial activity.

In response to these extraordinary events, the Fed made large adjustments to its traditional monetary policy instrument — the federal funds rate. At the Federal Open Market Committee (FOMC) meeting in December 2008, the federal funds rate was essentially cut to zero — 300 basis points lower than where it was at the start of the year. Although the corresponding injections of liquidity helped credit conditions, it became clear that further extensions of central bank liquidity would be necessary to facilitate market functioning. These included increasing the maturity of discount window loans from overnight to 90 days and the expansion of the Term Auction Facility (TAF) to provide loans through auctions in order to overcome stigma associated with discount window borrowing.

Furthermore, the sudden demise of several non-depository institutions led to the creation of a number of new lending facilities under emergency powers granted by the Federal Reserve Act. These measures were first aimed at broker-dealers, who have a large-scale presence in short-term funding markets. Subsequently, lending facilities were introduced to help work through disruptions in the money market mutual fund and commercial paper markets. The Fed also began to purchase debt and mortgage-backed securities issued by government-sponsored enterprises (GSEs) to support the flow of credit in mortgage markets.



The Federal Open Market Committee in 2008 reduced its target for the Federal Funds Rate from 3% to essentially zero by year-end.



The Federal Reserve, using traditional tools such as the Discount Window and non-traditional liquidity and lending facilities, expanded its assets by roughly $1.3 trillion in 2008.

MOVING FORWARD

The Fed has not been alone in dealing with this crisis, as both the FDIC and the U.S. Treasury have taken numerous actions aimed at addressing difficulties in financial markets. These actions, along with market forces, will help move the U.S. economy back toward financial stability. Still, it could take some time before financial markets function in a manner that noticeably facilitates economic activity. Consequently, real GDP is likely to decline in the first half of 2009, before stabilizing later in the year, with important support coming from monetary and fiscal policy. However, the unemployment rate is likely to rise into 2010 as it could take some time for the rebound in activity to be strong enough to close resource gaps.

Although futures markets expect some rise in the prices for energy and other commodities, resource slack should result in another reduction in inflation in 2009 and a further edging down in 2010. Over the longer run, overall inflation is expected to average somewhere in the range of 2%, which is a rate consistent with price stability. However, there is notable risk that inflation will run a good deal below this range in the medium term.

In the coming year, several new policy tools will be employed, including the Term Asset-Backed Security Loans Facility (TALF), a joint program with the Treasury. The first TALF lending is aimed at reducing funding pressures in the student, consumer, and small business asset-backed securities (ABS) markets. Subsequent extensions are likely to address pressures in other ABS markets such as commercial mortgage-backed securities. The Fed has also begun buying longer-term Treasury securities to reduce borrowing costs for a range of longer-term instruments and expanded its purchases of GSE securities. However, as economic activity recovers and financial conditions normalize, the use of such tools will have to be scaled back, the size of our balance sheet will have to be reduced, and the FOMC will return to its traditional focus on the federal funds rate.

Source for all charts: Haver Analytics

**This essay reflects information available as of March 27, 2009.*

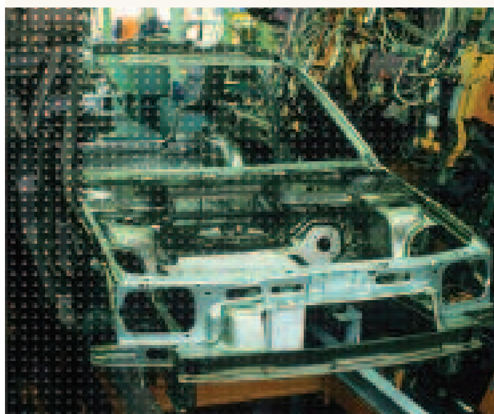
CHICAGO FED

Highlights of 2008

The Federal Reserve Bank of Chicago continued to play an important role in a variety of Federal Reserve System efforts to address a weak economy, volatile financial markets, and the rapidly changing payments landscape.

POLICY ANALYSIS AND RESEARCH

Economic Research and the Financial Markets Group provided high-quality research on topics including:



- Housing, mortgage and foreclosure issues.
- The automotive industry.
- The Emergency Economic Stabilization Act of 2008.
- Monetary policy.
- World inflation index-forecasting.
- International responses to economic and financial challenges.
- Access to central bank services for financial market institutions in different countries.
- Inflation and asset pricing.
- Liquidity risk management and stability issues associated with financial market clearing and settlement arrangements.
- Financial markets and clearing and settlement operations.

Twenty-one new working papers were completed, and 19 previously written papers were accepted for publication in scholarly journals.

Eight papers were added to the financial markets policy discussion paper series.

Research analyzing a range of economic and policy developments appeared in *Ag Letter*, *Chicago Fed Letter*, and *Economic Perspectives*.

SUPERVISION AND REGULATION

Supervision and Regulation responded to depressed commercial and residential real estate values, struggling automotive and manufacturing industries, and stresses in the credit and liquidity markets by:

- Increasing bank supervisory activities and realigning resources to meet emerging needs.
- Supporting the government's response to the liquidity and credit crisis.
- Helping administer the U.S. Treasury's Troubled Asset Relief Program (TARP) by updating banks and processing 352 TARP applications.

RELATIONSHIP BUILDING

Bank staff worked with the financial community by meeting with senior executives and experts from financial exchanges, clearinghouses, financial institutions, regulatory agencies and foreign central banks.

Conferences and forums fostered high-quality public policy research and provided an opportunity for dialogue and discussion. These included:

- A two-week workshop on money, banking, and payments that brought

together leading international experts from academia and policy institutions.

- The 2008 Payments Conference, which examined payments fraud.
- Two leadership conferences that were held in Chicago for Federal Reserve System executives.

Additional information on conferences sponsored by the Chicago Fed appears in the main article of this annual report.

COMMUNITY OUTREACH

Efforts to work with community groups, government agencies and businesses, as well as educate the public and inform policy decisions, included:

- Continuing to assist borrowers confronting foreclosure via the Home Ownership Preservation Initiative (HOPI), a partnership of Neighborhood Housing Services of Chicago and the City of Chicago.
- Launching regional HOPI efforts to help mitigate foreclosure problems across the wider Chicago metropolitan area, with discussions focusing on how best to allocate new federal funds targeted for foreclosure issues.
- Sponsoring teacher workshops to help educators teach students about the economy and the Federal Reserve.
- Introducing an economic education blog and distributing an educational video to more than 850 high school teachers.
- Offering 30 high school teams and 23 college teams the opportunity to participate in the Fed Challenge competition.
- Hosting almost 40,000 visitors at the Bank's Money Museum.

For information about Money Smart Week, a related outreach program, see page 11.

FEDERAL RESERVE OPERATIONS

The Bank's internal operation areas maintained high levels of performance. Key performance and control measures were successfully met while staff adjusted to changing volumes.

DISCOUNT WINDOW

Bank staff implemented and administered new Discount Window programs, such as the Term Auction Facility (TAF) introduced in December 2007. Staff members successfully managed the increased Discount Window volume and related collateral arrangement activity. They also supported other Reserve Banks in the administration of special lending programs.

CUSTOMER RELATIONS & SUPPORT OFFICE

The Customer Relations and Support Office (CRSO) achieved its 2008 high-priority objectives, customer-focused service agreement goals, National Account Program and System revenue targets, and the Electronic Access cost-recovery target.

The CRSO successfully achieved all interim goals in 2008 for converting customers to an Internet-based FedLine connection environment by early 2009.

The Electronic Access Customer Contact Center focused efforts on reducing costs and gaining efficiencies through a number of strategic tools and technologies, including self-service tools and virtual call center technology.

FINANCIAL SERVICES

Cash operations met all key performance goals.

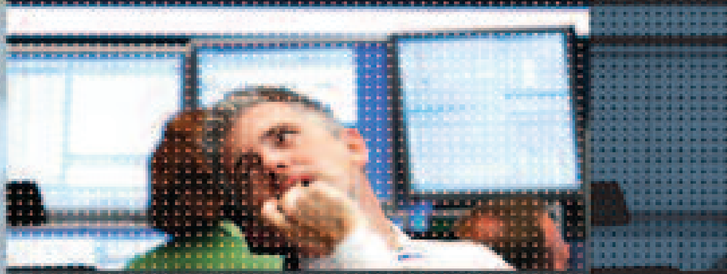
Check and Check Adjustments maintained strong performance levels in 2008, meeting all productivity, cost, quality and float targets.

Sales staff played a vital role in selling, implementing and supporting electronic check products, completing 849 FedReceipt/FedReceipt Plus implementations.

Implementation of the National Check Restructuring Program continued, as did preparation for planned office consolidations.

DOWJONES
AG LEHMAN

Countrywide
BANKING



Meet. Discuss. Inform.

Convening Experts for Informed Policy Debate

Throughout 2008, the economy and financial system experienced extraordinary turbulence. The slumping U.S. housing market and rising delinquencies on subprime mortgages triggered a financial crisis that quickly spread to a wide range of asset classes, markets, and global financial institutions. In September, the crisis hit its boiling point. Lehman Brothers filed for bankruptcy, Merrill Lynch and Washington Mutual were acquired by other financial institutions, Goldman Sachs and Morgan Stanley reorganized as bank holding companies, and the Federal Reserve provided loans to AIG.

In the days following these events, financial regulators from around the world gathered at the Federal Reserve Bank of Chicago to discuss how banking rules would need to change. The timing of this conference brought an exceptional relevance to the proceedings. A group of financial reporters closely covered the conference's discussions and speeches. Participants filled the halls discussing recent events with counterparts from other countries. They frequently phoned colleagues at home to discuss the latest developments. The conference participants were at the forefront of discussions of how to find the right balance between bank-based and market-based financial intermediation.

The meeting was the Chicago Fed's annual International Banking Conference, co-sponsored by the European Central Bank. It is one of many examples of how the Chicago Fed fosters an informed public policy debate on important economic and financial issues. We frequently leverage our ability to convene experts in diverse fields to address major public policy questions. These conferences inform our own efforts to promote sustainable economic growth and price stability and help us develop and disseminate high-quality research. They also create and advance the intellectual framework needed for future policy discussions and support our bank supervision efforts.

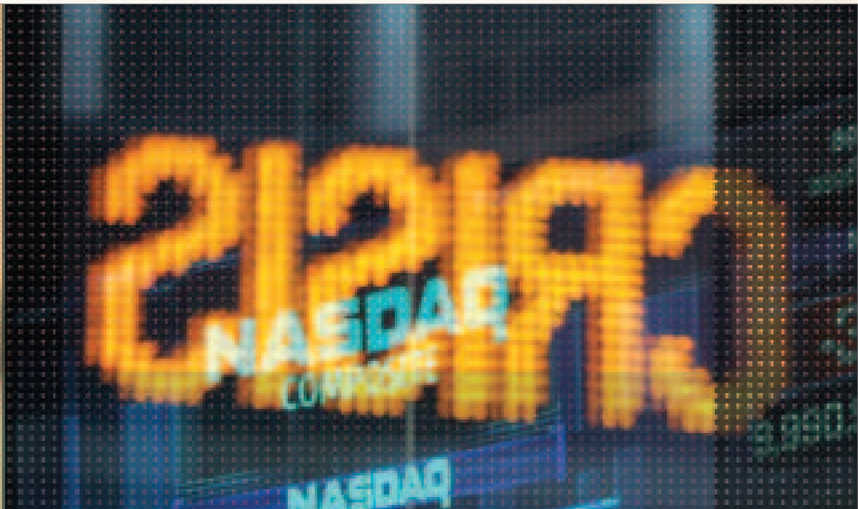
In this essay, we highlight some of our conference discussions with experts from the public and private sectors during 2008. The questions addressed at these meetings related to a broad range of issues, including the global regulatory environment and how to make regulation more effective, the impact of the recession on community banks, improving banks' risk management practices, preventing home foreclosures and educating the public about available resources, improving household budget management, how private equity is adapting to the credit crunch, and the outlook for the auto industry.

WHAT REGULATORY CHANGES ARE NEEDED?

Participants at the International Banking Conference in September identified several factors contributing to the asset-price bubble and ensuing credit market turmoil and proposed a range of regulatory changes that might prevent future crises. Conference participants debated the factors contributing to the asset-price bubble, with many blaming a combination of accommodative monetary policy, financial engineering, asset complexity, lack of adequate transparency, and questionable information provided by rating agencies. Looking forward, the conference participants proposed adjustments to regulatory policy ranging from minor tweaks to a major overhaul of existing capital requirements and regulatory structures. There was also significant debate about the future role of market discipline in influencing the behavior of both consumers and private companies.

Ideas for possible regulatory changes also surfaced frequently at a November conference titled, "The Capital Markets: After the Bubble." This event featured banking and securities regulators and risk management experts from the U.S. and abroad, including representatives of international and U.S. banking regulatory agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. The presenters agreed significant changes are needed in various parts of international capital markets, deal structures, incentives, and governance. This conference also addressed new proposals on covered bonds and re-consolidation issues for structured investment vehicles and asset-backed commercial paper. Participants generally agreed that while these markets and products played a critical role in causing the global financial crisis, they are also critical to economic stability and recovery.

Many of those in attendance at the capital markets conference focused on securitizations and the ratings, governance, and transparency associated with those transactions. Since the breakdown of this market is a major cause of the financial crisis, its future structure is a key to recovery. And some of the smaller markets that have collapsed during this crisis, such as the one for auction rate securities, are unlikely to return in their previous form.



HOW HAVE COMMUNITY BANKS BEEN AFFECTED BY THE TUMULTUOUS ECONOMIC ENVIRONMENT?

The Chicago Fed hosted the Community Bankers Symposium in November, an event that attracted officers and directors from community banks and bank holding companies throughout the Midwest, as well as state and federal bank regulators. Panelists agreed that the current environment offers both challenges and opportunities. Bankers and regulators face the challenges of how best to assess risk management processes and how to value certain underlying assets, which serve as collateral for community bank loans. As for opportunities, some community banks are seeing increased loan demand as larger banks de-lever and shrink their balance sheets. From a deposit perspective, banks are seeing opportunities to raise funds through the Internet and because of a general flight to safety, with banks large and small benefiting from changes to the deposit insurance program.

Conference participants said that many community banks are going back to the basics, by creating underwriting standards with a focus on repayment capacity, establishing strong controls to ensure adherence to established policies, and ensuring that incentives are aligned with risk.

Finally, this conference emphasized the importance of community banking in providing fair and equal access to credit for consumers and small business proprietors.

WHAT HAS THE CREDIT CRISIS REVEALED ABOUT RISK MANAGEMENT?

With risk management in banking becoming more complex and sophisticated, the Chicago Fed's Supervision and Regulation Department partnered with DePaul University's Center for Financial Services in April of 2008 to sponsor a conference on the issue.

It brought together bankers, supervisors and academics to focus on comprehensive risk management, also known as enterprise risk management (ERM).

One panel discussed how the blurring of credit and capital markets has complicated risk management. In recent years, more banks have adopted the "originate-to-distribute" model, under which they originate loans for the sole purpose of selling them to others. Now loans that were traditionally credit assets are common in trading books, and the difference between credit risk and market risk has become increasingly less distinct. Jeff Phillips of BMO Capital Markets Group discussed how this had contributed to recent financial turmoil. Kathryn Dick from the Office of the Comptroller of the Currency and Coryann Stefannson from the Federal Reserve Board examined how the market blurring has affected bank supervision. The panel discussion following these presentations centered on the use of credit ratings by investors and regulators and how these ratings might be improved.

Finally, the conference included keynote addresses from Eric S. Rosengren, president of the Federal Reserve Bank of Boston, and Craig S. Donohue, chief executive officer of the CME Group. In light of recent difficulties in pricing complex financial instruments, Rosengren questioned whether some instruments should be more standardized or possibly moved from dealer markets to exchange-traded instruments. Similarly, Donohue advocated a more centralized and transparent execution system for these products.

Federal Reserve Chairman Ben Bernanke also spoke about risk management at the Chicago Fed's annual Bank Structure Conference in May of 2008. This gathering is the Chicago Fed's longest-running conference and traditionally draws top leaders in the nation's financial industry. Past speakers include FDIC Chairman Sheila Bair, SEC Chairman Christopher Cox, and Treasury Secretary John Snow. Joining Chairman Bernanke last year was James Lockhart, director of the Office of Federal Housing Enterprise Oversight, and James Rohr, chairman and CEO of the PNC Financial Services Group.

Chairman Bernanke focused his remarks on risk management lessons from the credit market turmoil, explaining that, "The turmoil in credit markets underscores some important principles for bank risk management, including the value of proper risk identification and measurement, the need for robust and objective valuation methods, the importance of preparing for liquidity disruptions, and the critical role of strong oversight by senior managers. "He also noted that the role of the Fed and other supervisors is no less critical. "[It] is clear that supervisors must redouble their efforts to help organizations improve their risk-management practices," Bernanke said. "Accordingly, we have increased supervisory attention to this issue. … We are also considering the need for additional or revised supervisory guidance regarding various aspects of risk management, including further emphasis on the need for an enterprise-wide perspective when assessing risk. … We are also seeking to promote better disclosures by banking institutions with the goal of increasing transparency, thereby strengthening market discipline."

WHAT CAN BANKS, REGULATORS, AND COMMUNITY ORGANIZATIONS DO TO PREVENT HOME FORECLOSURES?

The Bank convened the Regional Home Ownership Preservation Initiative (RHOPI) with the Chicago Community Trust and NHS of Chicago. Individuals representing almost 100 organizations worked to reach recommendations and action steps late in 2008 to address the high rates of foreclosure and resulting vacant property in the metropolitan area. Other key topics included homeowner counseling, legal assistance, refinancing, and loss mitigation issues. Many of these organizations are now implementing recommendations from this forum. Participants agreed that preventing further foreclosures was an important goal, because a large proportion of loans already modified to prevent or remedy

NASDAQ
-4.4%
1,860.01
-86.01

FORECLOSURE
HOME
FOR

default have also defaulted. An even more difficult issue is the many vacant properties resulting from foreclosures in our region. A group of RHOPI participants is working to channel federal and other relief to the hardest hit areas of the Chicago metro area.

During the past year, the Chicago Fed also sponsored numerous other discussions about the foreclosure crisis and the resources available to local communities to deal with housing issues. Among these forums were a symposium co-sponsored by the Iowa and Davenport Civil Rights Commissions on "Fair Lending/ Fair Housing in the Foreclosure Crisis," conferences co-sponsored by the University of Wisconsin Extension and the Wisconsin Housing and Economic Development Authority to address the problems wrought by foreclosures in that state, and a conference at the Chicago Fed's Detroit Branch on "Saving the American Dream: Preventing Foreclosure & Preserving Homeownership." At the meeting in Detroit, discussion focused on both mortgage foreclosures and tax foreclosures. With many Michigan residents facing tax foreclosures, participants agreed more communication is needed with the public about the problem. Toward that end, they formed a task force to inform consumers about resources available to those facing a tax foreclosure.

In addition, at the Bank Structure Conference in May, financial regulators discussed their efforts to provide delinquent homeowners with information to work with mortgage holders and evaluate their options. A representative from the Hope Now Alliance also described its work with counselors, mortgage companies, investors, and financially constrained homeowners, all designed to enable residents to stay in their homes.

WHAT TYPES OF PROGRAMS HELP PEOPLE TO UNDERSTAND AND MANAGE THEIR FINANCES?

The Chicago Fed helps consumers learn how to manage their personal finances. In challenging economic times, knowledge of subjects like budgeting, saving, and using credit wisely is especially important. Toward that end, we have increased the number of participants in our Money Smart programs in central Illinois, Chicago, Indiana, Michigan, Iowa, and Wisconsin. Approximately 1,200 partners took part in these Money Smart Weeks in 2008, including local community groups, financial institutions, not-for-profit organizations, businesses, schools, libraries, local and national government agencies, and media personalities. They worked together to bring roughly 2,100 seminars, classes, and special events on personal finance topics to thousands of consumers. Among the Money Smart Week Chicago events:

- Nearly 400 people attended an event sponsored by the Illinois Financial Planners Association. The audience heard from author and financial expert Terry Savage and had the opportunity to meet one-on-one with certified financial planners.
- Harold Washington College hosted 500 students and community members for its second-annual financial literacy fair, featuring more than a dozen Money Smart partners and topics.
- The Bank and Visa, Inc. co-sponsored a "webinar" on ways to bring financial education to consumers.

WHAT IS THE OUTLOOK FOR THE AUTO INDUSTRY?

With about one-third of the nation's new motor vehicles produced in the Chicago Fed's five-state region, we have a deep interest in the health of the auto industry. In June of 2008, the Automotive Outlook Symposium at our Detroit Branch brought together more than 90 economists and analysts from the industry, academia, and government. The group discussed the near-term outlook from the perspectives of U.S. auto manufacturers, heavy truck producers, auto dealers, and parts suppliers.

David Andrea, vice president of the Original Equipment Suppliers Association, predicted that bankruptcies among the auto parts suppliers will continue in the near term. Yet, looking past 2009, he cited diversification into non-automotive work and increasing globalization as reasons for optimism. In 2007, 68.6 million automobiles were sold across the world, and Andrea predicted the volume to increase to 87.3 million by 2014.

The auto industry was also the topic of discussions at the Chicago Fed's annual Economic Outlook Symposium in December 2008. This meeting was held two weeks after U.S. auto executives appeared at Congressional hearings on the future of the industry and amid growing uncertainty about the industry. Conference participants debated whether the industry's short- and long-term struggles would be best addressed through normal bankruptcy or a government-assisted restructuring outside the court system. Speaking about the short-term market dynamics, William Shearin, formerly with Chrysler LLC, said that composite measures of consumers' "ability to buy" and "willingness to buy" had deteriorated significantly in the previous 12 months. In a forecast survey associated with the conference, economists forecasted light vehicle sales to fall further in 2009. But Shearin did give one reason to be optimistic about sales once credit markets normalize: The average age of used vehicles has increased to a historically high 6.5 years, suggesting that many vehicle owners will want to replace their aging vehicles as soon as economic conditions allow them to do so.

Finally, the ownership structure of the auto industry was the focus of a presentation in 2008 at a conference sponsored by the Federal Reserve System's Private Equity Merchant Banking Knowledge Center, which is based at the Chicago Fed. The July event brought together private equity professionals, banking supervisors, academics and bankers to discuss how the financial crisis has dramatically altered the landscape for private equity, particularly in the buyout sector. In the first luncheon keynote address,

Jacques Nasser, managing director of One Equity Partners and formerly president and CEO of the Ford Motor Company, explored private equity investment strategies that target the auto industry. Each of the three segments of the auto industry (manufacturers, suppliers, and dealers) has significant structural and operational weaknesses that could present opportunities for private equity firms, he said. Nasser also proposed a broader and longer-term strategy — with investments in a range of new technologies that would benefit energy security and environmental protection while generating profits for both the automotive sector and the private equity industry at large.

HOW ARE EQUITY INVESTMENT MARKETS ADAPTING TO THE GLOBAL CREDIT CRUNCH?

At the conference mentioned directly above, Meredith Coffey from the Loan Syndication and Trading Association described how supply and terms in the so-called "leveraged lending" market have

become much less favorable for private equity firms. As a result, merger and acquisition lending has fallen sharply, with leveraged buyouts hit hardest. Private equity firms had become accustomed to a stream of increasingly large buyout deals, with their buying power supported by the availability of inexpensive leverage. Now that this access to credit has largely dried up, some private equity firms have altered their investment strategies.

According to Avy Stein, Willis Stein Partners, such new strategies include the middle market, minority (non-controlling) investments, emerging markets, non-equity instruments, and distressed assets. Private equity investors see opportunities in the U.S. banking sector, as well as the auto industry, in the current weak environment.

Finally, the prospect of lower returns on private equity investments going forward will affect a wide range of investors. These include institutional investors such as pension funds and university endowments, which in recent years have been increasing their use of private equity, among other nontraditional investments. In view of recent experience, it is also very likely that institutional investors will change their investment strategies to favor a more traditional, lower-risk investment mix once more.

CONCLUSION

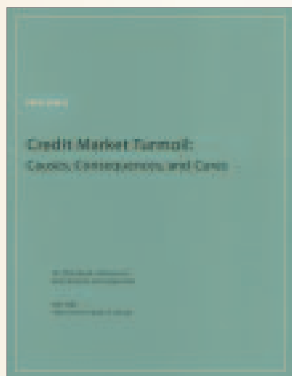
In this essay, we have shared some examples of the issues addressed at conferences hosted by the Chicago Fed in 2008. With the credit crisis still to be resolved and with new public policy issues regularly emerging, the Chicago Fed will continue to leverage its ability to convene the best minds from the Seventh District, the nation, and abroad to discuss appropriate ways forward in the face of uncertainty.

This essay was a collaborative effort, with contributions from many Chicago Fed staff members including: Mike Berry, Cathie Bourke, Adrian D'Silva, Emily Engel, Doug Evanoff, Harry Ford, Brian Gordon, William Mark, Michael Munley, Mark Kawa, Helen Koshy, Cathy Lemieux, Michael Plaskett, William Strauss, Doug Tillett, Steven VanBever, Dan Wassmann, and Alicia Williams.

CONFERENCE SUMMARIES AVAILABLE

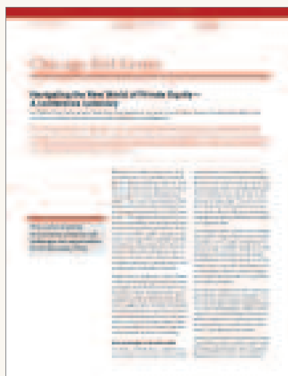
More information is available from the Federal Reserve Bank of Chicago on the discussions that took place at many of the conferences mentioned in this essay:

Credit Market Turmoil: Causes, Consequences, and Cures



For information on the conference proceedings book, call Jerry Nelson at 312-322-5187.

Navigating the New World of Private Equity



www.chicagofed.org/publications/fedletter/cflnovember2008_256a.pdf

The Credit Market Turmoil of 2007-08: Implications for Public Policy

A conference proceedings book will be available in the summer of 2009 at www.worldscibooks.com

Risk: Keeping Ahead of the Curve

www.chicagofed.org/publications/fedletter/cfljuly2008_252a.pdf

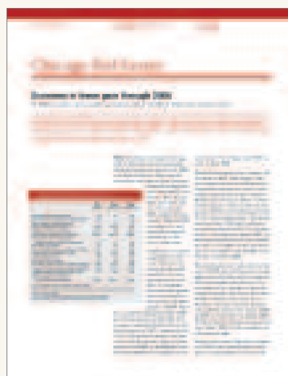
Resources on Preventing Foreclosures

Profitwise
News and Views

www.chicagofed.org/community_development/files/pnv_remar08_web_all.pdf

www.chicagofed.org/community_development/foreclosure.cfm

Automotive Outlook Symposium



www.chicagofed.org/publications/fedletter/cflaugust2008_253a.pdf

Money Smart Week

Reports outlining the activities of various Money Smart Weeks are available by calling Jerry Nelson at 312-322-5187.

Board of Directors

FEDERAL RESERVE BANK OF CHICAGO

CHAIRMAN
John A. Canning, Jr.
Chairman
Madison Dearborn
Partners, LLC
Chicago, Illinois

DEPUTY CHAIRMAN
William C. Foote
Chairman and
Chief Executive Officer
USG Corporation
Chicago, Illinois

Michael L. Kubacki.
Chairman, President and
Chief Executive Officer
Lake City Bank and
Lakeland Financial Corporation
Warsaw, Indiana

Dennis J. Kuester
Chairman
Marshall & Ilsley Corporation
Milwaukee, Wisconsin

Ann D. Murtlow
President and
Chief Executive Officer
Indianapolis Power
and Light Company
Indianapolis, Indiana
Vice President
AES Corporation

Anthony K. Anderson
Vice Chair and
Midwest Managing Partner
Ernst & Young
Chicago, Illinois

Mark T. Gaffney
President
Michigan AFL-CIO
Lansing, Michigan

Mark C. Hewitt
President and
Chief Executive Officer
Clear Lake Bank & Trust Company
Clear Lake, Iowa

Thomas J. Wilson
Chairman, President and
Chief Executive Officer
The Allstate Corporation
Northbrook, Illinois

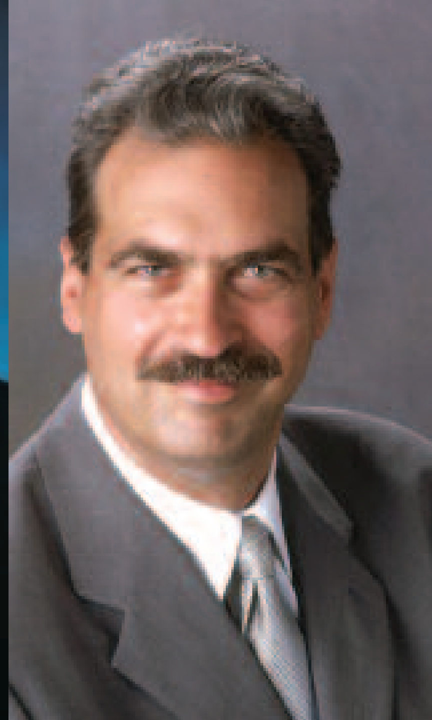
One new director joined the Chicago Board in 2009:

Frederick H. Waddell (above), President and Chief Executive Officer of Northern Trust Corporation and The Northern Trust Company, Chicago, Illinois, replaced **Dennis J. Kuester**, who completed his service on the board at the end of 2008.

Board of Directors

DETROIT BRANCH

CHAIRMAN
Timothy M. Manganello
Chairman and
Chief Executive Officer
BorgWarner, Inc.
Auburn Hills, Michigan



Carl T. Camden
President and
Chief Executive Officer
Kelly Services, Inc.
Troy, Michigan

Linda S. Likely
Director of Housing and
Community Development
Kent County Community Development
Department and Housing Commission
Grand Rapids, Michigan

Michael M. Magee, Jr.
President and
Chief Executive Officer
Independent Bank Corporation
Ionia, Michigan

Tommi A. White
Chief Executive Officer
ER-One, Inc.
Livonia, Michigan

Roger A. Cregg
Executive Vice President and
Chief Financial Officer
Pulte Homes, Inc.
Bloomfield Hills, Michigan

William R. Hartman
Chairman, President and
Chief Executive Officer
Citizens Republic Bancorp
Flint, Michigan

One new director joined the Detroit Branch Board in 2009:

Brian C. Walker, President and Chief Executive Officer of Herman Miller, Inc., Zeeland, Michigan, replaced **Tommi A. White**, who completed her service on the board at the end of 2008.

From left to right: *William A. Barouski, Valerie J. Van Meter, Robert G. Wiley, Elizabeth A. Knospe, Gordon Werkema, Catharine Lemieux, Margaret K. Koenigs, Charles L. Evans, Daniel G. Sullivan, Barbara D. Benson and David A. Marshall.*

Management Committee

FEDERAL RESERVE BANK OF CHICAGO

Charles L. Evans
President and
Chief Executive Officer

Gordon Werkema
First Vice President and
Chief Operating Officer

William A. Barouski
Executive Vice President
Customer Relations and
Support Office (CRSO) and
Technology Group

Barbara D. Benson
Senior Vice President
People, Strategy, and Finance

Elizabeth A. Knospe
Senior Vice President and
General Counsel
Legal Relations, Board of Directors,
Enterprise Risk Management,
Business Continuity, and
Law Enforcement

Margaret K. Koenigs
Senior Vice President and
General Auditor
Internal Audit

Catharine Lemieux
Senior Vice President
Supervision and Regulation

David A. Marshall
Senior Vice President
Financial Markets Group

Daniel G. Sullivan
Senior Vice President and
Director of Research
Economic Research
and Programs

Valerie J. Van Meter
Senior Vice President and
EEO Officer
Central Bank Services, Corporate
Accounting, and Procurement

Robert G. Wiley
Senior Vice President and
Branch Manager
District Operations, Administrative
Services, and Detroit Branch

EXECUTIVE OFFICERS

Charles L. Evans
President and
Chief Executive Officer

Gordon Werkema
First Vice President and
Chief Operating Officer

CENTRAL BANK SERVICES

Valerie J. Van Meter
Senior Vice President and
EEO Officer

Jerome E. Julian
Vice President

ECONOMIC RESEARCH AND PROGRAMS

Daniel G. Sullivan
Senior Vice President and
Director of Research

Spencer D. Krane
Economic Advisor and
Senior Vice President

Regional Economics
William A. Testa
Economic Advisor and
Vice President

Banking and Financial Studies
Douglas D. Evanoff
Economic Advisor and
Vice President

Macroeconomic Policy Research
Jonas D. Fisher
Economic Advisor and
Vice President

Microeconomic Policy Research
Daniel R. Aaronson
Economic Advisor and
Vice President

Consumer and Community Affairs
Alicia Williams
Vice President

Public Affairs
G. Douglas Tillett
Vice President

FINANCIAL MARKETS GROUP

David A. Marshall
Senior Vice President

Adrian B. D'Silva
Vice President

Ed Nosal
Vice President

Richard D. Porter
Vice President

SUPERVISION AND REGULATION

Catharine Lemieux
Senior Vice President

Community Bank
Mark H. Kawa
Vice President

Large Bank
Steven M. Durfey
Vice President

Large Financial Institutions/HSBC
A. Raymond Bacon
Vice President

Risk Specialists
Carl R. Tannenbaum
Vice President

Operations
Douglas J. Kasl
Vice President

Strategy and Workforce Practices
Pamela S. Rieger
Vice President

CUSTOMER RELATIONS AND SUPPORT OFFICE (CRSO)

Gordon Werkema
Product Director

William A. Barouski
Executive Vice President and
Product Manager

Electronic Access
Ellen J. Bromagen
Senior Vice President

National Marketing
Laura J. Hughes
Vice President and
Program Director

National Sales
Sean Rodriguez
Senior Vice President and
National Accounts Director

William J. Devine
Vice President

Shonda Clay
Vice President and
Regional Sales Director

Steven E. Jung
Vice President

Michael J. Hoppe
Vice President and
National Account Manager

DISTRICT OPERATIONS AND DETROIT BRANCH

Robert G. Wiley
Senior Vice President and
Branch Manager

District Cash
Donna M. Dziak
Vice President

Mary H. Sherburne
Vice President, Chicago Cash

District Check
Kimberly A. Clark
Vice President

CORPORATE ACCOUNTING, PROCUREMENT, AND DISTRICT ADMINISTRATIVE SERVICES

Valerie J. Van Meter
Senior Vice President and
EEO Officer

Jeffrey Marcus
Vice President and
Corporate Controller

PEOPLE, STRATEGY, AND FINANCE

Barbara D. Benson
Senior Vice President

Jeffrey S. Anderson
Vice President

TECHNOLOGY GROUP

William A. Barouski
Executive Vice President

Daniel F. Reimann
Vice President

LEGAL RELATIONS, BOARD OF DIRECTORS, ENTERPRISE RISK MANAGEMENT, BUSINESS CONTINUITY, AND LAW ENFORCEMENT

Elizabeth A. Knospe
Senior Vice President and
General Counsel

Katherine Hilton Schrepfer
Vice President,
Associate General Counsel,
Ethics Officer and
District Board Secretary

Yurii Skorin
Vice President and
Associate General Counsel

Anna M. Voytovich
Vice President and
Associate General Counsel

OFFICE OF THE GENERAL AUDITOR

Margaret K. Koenigs
Senior Vice President and
General Auditor

From left to right: Donald Snider, G. Curtis Lansbery, John L. Howard, William P. Beckett, Siva Yam, John D. Hardin, Jr., Jeffrey D. Armstrong, Joseph R. Massa, Jack B. Evans, David Newby, Cathy McClelland, Gary Sipiorski and David Terrell. Not pictured are Michael T. Carrigan, Joe Crookham, Clarence Nixon, Jr., and Ken Zeller.

Advisory Council

SEVENTH DISTRICT ADVISORY COUNCIL ON AGRICULTURE, SMALL BUSINESS AND LABOR

Illinois

Michael T. Carrigan
President
AFL-CIO of Illinois
Springfield

John L. Howard
Senior VP & General Counsel
W.W. Grainger, Inc.
Lake Forest

G. Curtis Lansbery
President
North American Tool Corp.
South Beloit

Siva Yam
President
United States of America-China
Chamber of Commerce
Chicago

Indiana

John D. Hardin, Jr.
Owner
Hardin Farms
Danville

David Terrell
Executive Director
Indiana Office of Community and
Rural Affairs
Indianapolis

Ken Zeller
President
Indiana State AFL-CIO
Indianapolis

Iowa

Joe Crookham
President & Principal Owner
Musco Corporation and Mahaska
Communication Group
Oskaloosa

Jack B. Evans
President
The Hall-Perrine Foundation
Cedar Rapids

Joseph R. Massa
General Manager
Riverside Casino and Golf Resort
Riverside

Michigan

Jeffrey D. Armstrong
Dean and Professor of College of
Agriculture and Natural Resources
Michigan State University
East Lansing

Cathy McClelland
President & CEO
Detroit Entrepreneurship
Institute, Inc.
Detroit

Clarence Nixon, Jr.
President & CEO
CNC Group, LLC
Detroit

Donald Snider
CEO and Owner
Paper – Plas Corporation
Detroit

Wisconsin

William P. Beckett
President & CEO
Chrysalis Packaging & Assembly
Corporation
Milwaukee

David Newby
President
Wisconsin State AFL-CIO
Milwaukee

Gary Sipiorski
Dairy Development Manager
Vita Plus Corporation
Madison

EXECUTIVE CHANGES

DIRECTORS

Members of the Federal Reserve Bank of Chicago's boards of directors are selected to represent a cross section of the Seventh District economy, including consumers, industry, agriculture, the service sector, labor and banks of various sizes.

The Chicago board consists of nine members. Member banks elect three bankers and three non-bankers. The Board of Governors appoints three additional non-bankers and designates the Reserve Bank chair and deputy chair from among its three appointees.

The Detroit Branch has a seven-member board of directors. The Board of Governors appoints three non-bankers, and the Chicago Reserve Bank board appoints four additional directors. The Branch board selects its own chair each year, with the approval of the Chicago board. Reserve Bank and Branch directors may serve three-year terms, with a two-term maximum. Director appointments and elections at the Chicago Reserve Bank and its Detroit Branch effective in 2008 were:

John A. Canning, Jr. was appointed to a one-year term as Chicago board chairman.

William C. Foote was appointed to a one-year term as Chicago board deputy chairman.

Thomas J. Wilson was appointed to a three-year term as a Chicago director.

Mark C. Hewitt was elected to a three-year term as a Chicago director.

Anthony K. Anderson was elected to a one-year term as a Chicago director.

Ann D. Murtlow was re-elected to a three-year term as a Chicago director.

Carl T. Camden was appointed to a three-year term as a Detroit Branch director.

William R. Hartman was appointed to a two-year term as a Detroit Branch director.

Michael M. Magee, Jr. was re-appointed to a three-year term as a Detroit Branch director.

Timothy M. Manganello was re-appointed to a one-year term as Detroit Branch board chairman.

At the end of 2008, the following appointments and elections for 2009 were announced:

John A. Canning, Jr. was re-appointed to a one-year term as a Chicago director and as Chicago board chairman.

William C. Foote was re-appointed to a one-year term as Chicago board deputy chairman.

Frederick H. Waddell was elected to a three-year term as a Chicago director.

Anthony K. Anderson was re-elected to a three-year term as a Chicago director.

Brian C. Walker was appointed to a three-year term as a Detroit Branch director.

Roger Cregg was re-appointed to a one-year term as a Detroit Branch director.

Timothy M. Manganello was re-appointed to a three-year term as a Detroit Branch director and re-appointed to a one-year term as Detroit Branch board chairman.

FEDERAL ADVISORY COUNCIL

The Federal Advisory Council, which meets quarterly to discuss business and financial conditions with the Board of Governors in Washington, D.C., is composed of one person from each of the 12 Federal Reserve Districts.

Each year the Chicago Reserve Bank's board of directors selects a representative to this group. William A. Downe, President and Chief Executive Officer of BMO Financial Group, Chicago, Illinois, was selected to be the 2009 representative. He also served in 2007 and 2008.

EXECUTIVE CHANGES

The Bank's Board of Directors acted on the following promotions during 2008:

Daniel R. Aaronson to Vice President, Economic Research and Programs.

Ellen J. Bromagen to Senior Vice President, Customer Relations and Support Office (CRSO).

Shonda Clay to Vice President, Customer Relations and Support Office (CRSO).

Jerome E. Julian to Vice President, Central Bank Services.

Margaret K. Koenigs to Senior Vice President, Internal Audit.

Spencer D. Krane to Senior Vice President, Economic Research and Programs.

Daniel F. Reimann to Vice President, Technology Group.

Sean Rodriguez to Senior Vice President, Customer Relations and Support Office (CRSO).

Valerie J. Van Meter to Senior Vice President, Central Bank Services, Corporate Accounting, and Procurement.

The Bank's Board of Directors acted on the following transfers:

Steven E. Jung transferred from FRB San Francisco as Vice President, Customer Relations and Support Office (CRSO).

William J. Devine transferred from FRB Atlanta as Vice President, Customer Relations and Support Office (CRSO).

The following officers retired from the Bank:

Angela Robinson, Senior Vice President, Central Bank Services, Corporate Accounting, and Procurement, 33 years.

Kristi Zimmermann, Vice President, Administrative Services, 27 years.

In addition, **Ira Zilist** transferred to Federal Reserve Information Technology (FRIT).

OPERATIONS VOLUMES

	DOLLAR AMOUNT		NUMBER OF ITEMS	
	2008	2007	2008	2007
CHECK AND ELECTRONIC PAYMENTS				
Checks, NOWs, & Share Drafts Processed	749.6 Billion	1.1 Trillion	490.5 Million	921.6 Million
Legacy Images Captured	—	—	38.4 Million	72.2 Million
Check 21 Images Presented	—	—	429.1 Million	213.0 Million
Check 21 IRD* Printed	—	—	412.9 Million	319.7 Million
Check 21 Items Received	1.7 Trillion	1.4 Trillion	1.1 Billion	722.6 Million
CASH OPERATIONS				
Currency Counted	45.7 Billion	51.9 Billion	3.1 Billion	3.6 Billion
Unfit Currency Destroyed	5.4 Billion	5.2 Billion	512.6 Million	561.2 Million
Coin Bags Paid and Received	1.9 Billion	1.8 Billion	3.8 Million	4.1 Million
Number of Notes Paid and Received	121.4 Billion	126.4 Billion	8.2 Billion	8.9 Billion
LOANS TO DEPOSITORY INSTITUTIONS				
Total Loans Made During Year	48.4 Billion	3.5 Billion	1.4 Thousand	1.0 Thousand

Image Replacement Documents

FINANCIAL REPORTS

Contents

Auditor Independence	24
Management's Report on Internal Control Over Financial Reporting	25
Report of Independent Auditors	26
Statements of Condition	28
Statements of Income and Comprehensive Income	29
Statements of Changes in Capital	30
Notes to Financial Statements	31

AUDITOR INDEPENDENCE

In 2008, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks. Fees for D&T's services are estimated to be $10.2 million. Approximately $2.7 million of the estimated total fees were for the audits of the limited liability companies (LLCs) that are associated with recent Federal Reserve actions to address the financial crisis, and are consolidated in the financial statements of the Federal Reserve Bank of New York.[1] To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of Reserve Banks, or in any other way impairing its audit independence. In 2008, the Bank did not engage D&T for any non-audit services.

[1]*Each LLC will reimburse the Board of Governors for the fees related to the audit of its financial statements from the entity's available net assets.*

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

April 2, 2009

To the Board of Directors

The management of the Federal Reserve Bank of Chicago ("FRBC") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statements of Income and Comprehensive Income, and Statement of Changes in Capital as of December 31, 2008 (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 and as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and as such, include amounts, some of which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the Manual and include all disclosures necessary for such fair presentation.

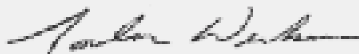
The management of the FRBC is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation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

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

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

Federal Reserve Bank of Chicago

by Charles L. Evans
President



by Gordon Werkema
First Vice President

by Jeffrey Marcus
Vice President and Controller

Deloitte & Touche LLP
111 S. Wacker Drive
Chicago, IL 60606-4301
USA
Tel: +1 312 486 1000
Fax: +1 312 486 1486
www.deloitte.com

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

We have audited the accompanying statements of condition of the Federal Reserve Bank of Chicago ("FRB Chicago") as of December 31, 2008 and 2007 and the related statements of income and comprehensive income and changes in capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRB Chicago as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRB Chicago's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on FRB Chicago's internal control over financial reporting based on our audits.

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

FRB Chicago's internal control over financial reporting is a process designed by, or under the supervision of, FRB Chicago's principal executive and principal financial officers, or persons performing similar functions, and effected by FRB Chicago'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. FRB Chicago'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 FRB Chicago; (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 FRB Chicago are

being made only in accordance with authorizations of management and directors of FRB Chicago; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of FRB Chicago'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, FRB Chicago 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, the financial statements referred to above present fairly, in all material respects, the financial position of FRB Chicago as of December 31, 2008 and 2007, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, FRB Chicago maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Deloitte & Touche LLP

April 2, 2009

Federal Reserve Bank of Chicago
Statements of Condition

As of December 31, 2008 and December 31, 2007 (in millions)	2008	2007
Assets		
Gold certificates	$ 913	$ 903
Special drawing rights certificates	212	212
Coin	194	137
Items in process of collection	111	155
Loans to depository institutions	6,922	2,339
System Open Market Account:		
Securities purchased under agreements to resell	7,060	3,900
U.S. government, Federal agency, and government-sponsored enterprise securities, net	44,323	62,541
Investments denominated in foreign currencies	1,100	1,283
Central bank liquidity swaps	24,559	1,364
Interdistrict settlement account	34,760	6,133
Bank premises and equipment, net	235	233
Accrued interest receivable	552	535
Other assets	22	25
Total assets	**$ 120,963**	**$ 79,760**
Liabilities and Capital		
Federal Reserve notes outstanding, net	$ 70,135	$ 72,705
System Open Market Account:		
Securities sold under agreements to repurchase	7,798	3,689
Deposits:		
Depository institutions	41,013	910
Other deposits	2	3
Deferred credit items	323	517
Interest on Federal Reserve notes due to U.S. Treasury	127	160
Accrued benefit costs	127	119
Other liabilities	32	29
Total liabilities	**119,557**	**78,132**
Capital paid-in	**703**	**814**
Surplus (including accumulated other comprehensive loss of $31 and $27 at December 31, 2008 and 2007, respectively)	703	814
Total capital	**1,406**	**1,628**
Total liabilities and capital	**$ 120,963**	**$ 79,760**

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

Federal Reserve Bank of Chicago
Statements of Income and Comprehensive Income
For the years ended December 31, 2008 and December 31, 2007 (in millions)

	2008	2007
Interest income:		
Loans to depository institutions	$ 78	$ 2
System Open Market Account:		
Securities purchased under agreements to resell	165	121
U.S. government, Federal agency, and government-sponsored enterprise securities	2,221	3,336
Investments denominated in foreign currencies	28	31
Central bank liquidity swaps	161	2
Total interest income	**2,653**	**3,492**
Interest expense:		
System Open Market Account:		
Securities sold under agreements to repurchase	64	145
Depository institutions deposits	29	-
Total interest expense	**93**	**145**
Net interest income	**2,560**	**3,347**
Non-interest income:		
System Open Market Account:		
U.S. government, Federal agency, and government-sponsored enterprise securities gains, net	322	–
Foreign currency gains, net	62	102
Income from services	63	59
Compensation received for services provided	57	82
Reimbursable services to government agencies	5	5
Other income	75	12
Total non-interest income	**584**	**260**
Operating expenses:		
Salaries and other benefits	150	161
Occupancy expense	25	24
Equipment expense	11	13
Compensation paid for services costs incurred	11	9
Assessments by the Board of Governors	61	73
Other expenses	94	119
Total operating expenses	**352**	**399**
Net income prior to distribution	**2,792**	**3,208**
Change in funded status of benefit plans	**(4)**	**14**
Comprehensive income prior to distribution	**$ 2,788**	**$ 3,222**
Distribution of Comprehensive Income:		
Dividends paid to member banks	$ 66	$ 53
Transferred from surplus and change in accumulated other comprehensive loss	(111)	(44)
Payments to U.S. Treasury as interest on Federal Reserve notes	2,833	3,213
Total distribution	**$ 2,788**	**$ 3,222**

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

Federal Reserve Bank of Chicago
Statements of Changes in Capital
For the years ended December 31, 2008 and December 31, 2007 (in millions, except share data)

		Surplus			
	Capital Paid-In	Net Income Retained	Accumulated Other Comprehensive Loss	Total Surplus	Total Capital
Balance at January 1, 2007 (17 million shares)	**$ 858**	**$ 899**	**$ (41)**	**$ 858**	**$ 1,716**
Net change in capital stock redeemed (1 million shares)	(44)	–	–	–	(44)
Transferred from surplus and change in accumulated other comprehensive loss	–	(58)	14	(44)	(44)
Balance at December 31, 2007 (16 million shares)	**$ 814**	**$ 841**	**$ (27)**	**$ 814**	**$ 1,628**
Net change in capital stock redeemed (2 million shares)	(111)	–	–	–	(111)
Transferred from surplus and change in accumulated other comprehensive loss	–	(107)	(4)	(111)	(111)
Balance at December 31, 2008 (14 million shares)	**$ 703**	**$ 734**	**$ (31)**	**$ 703**	**$ 1,406**

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

1. Structure

The Federal Reserve Bank of Chicago ("Bank") is part of the Federal Reserve System ("System") and is one of the twelve 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 Seventh Federal Reserve District, which includes Iowa, and portions of Michigan, Illinois, Wisconsin and Indiana.

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 in the System. 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.

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. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government's bank; provision of short-term loans to depository institutions; provision of loans to individuals, partnerships, and corporations in unusual and exigent circumstances; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY to execute transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of securities of the U.S. government, Federal agencies, and government-sponsored enterprises ("GSEs"), the purchase of these securities under agreements to resell, the sale of these securities under agreements to repurchase, and the lending of these securities. The FRBNY executes these transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account ("SOMA").

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. The FRBNY is authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, fourteen foreign currencies and to invest such foreign currency holdings, ensuring adequate liquidity is maintained. The FRBNY is also authorized and directed by the FOMC to maintain reciprocal currency arrangements with fourteen central banks and to "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks.

Although the Reserve Banks are separate legal entities, they collaborate in the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks providing the service and the other 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 reimburse the other Reserve Banks for services provided to them.

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 national business development and customer support.

3. Recent Financial Stability Activities

The Federal Reserve has implemented a number of programs designed to support the liquidity of financial institutions and to foster improved conditions in financial markets. These new programs, which are set forth below, have resulted in significant changes to the Bank's financial statements.

Expanded Open Market Operations and Support for Mortgage Related Securities

The Single-Tranche Open Market Operation Program, created on March 7, 2008, allows primary dealers to initiate a series of term repurchase transactions that are expected to accumulate up to $100 billion in total. Under the provisions of the program, these transactions are conducted as 28-day term repurchase agreements for which primary dealers pledge U.S. Treasury and agency securities and agency Mortgage-Backed Securities ("MBS") as collateral. The FRBNY can elect to increase the size of the term repurchase program if conditions warrant. The repurchase transactions are reported as "System Open Market Account: Securities purchased under agreements to resell" in the Statements of Condition.

The GSE and Agency Securities and MBS Purchase Program was announced on November 25, 2008. The primary goal of the program is to provide support to the mortgage and housing markets and to foster improved conditions in financial markets. Under this program, the FRBNY will purchase the direct obligations of housing-related GSEs and MBS backed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), and the Government National Mortgage Association ("Ginnie Mae"). Purchases of the direct obligations of housing-related GSEs began in November 2008 and purchases of GSE and agency MBS began in January 2009. There were no purchases of GSE and agency MBS during the period ended December 31, 2008. The program was initially authorized to purchase up to $100 billion in GSE direct obligations and up to $500 billion in GSE and agency MBS. In March 2009, the FOMC authorized FRBNY to purchase up to an additional $750 billion of GSE and agency MBS and up to an additional $100 billion of GSE direct obligations.

The FRBNY holds the resulting securities and agreements in the SOMA portfolio and the activities of both programs are allocated to the other Reserve Banks.

Central Bank Liquidity Swaps

The FOMC authorized the FRBNY to establish temporary reciprocal currency swap arrangements (central bank liquidity swaps) with the European Central Bank and the Swiss National Bank on December 12, 2007 to help provide liquidity in U.S. dollars to overseas markets. Subsequently, the FOMC authorized reciprocal currency swap arrangements with additional foreign central banks. Such arrangements are now authorized with the following central banks: the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, Sveriges Riksbank, and the Swiss National Bank. The activity related to the program is allocated to the other Reserve Banks. The maximum amount of borrowing permissible under the swap arrangements varies by central bank. The central bank liquidity swap arrangements are authorized through October 30, 2009.

Lending to Depository Institutions

The temporary Term Auction Facility ("TAF") program was created on December 12, 2007. The goal of the TAF is to help promote the efficient dissemination of liquidity, which is achieved by the Reserve Banks injecting term funds through a broader range of counterparties and against a broader range of collateral than open market operations. Under the TAF program, Reserve Banks auction term funds to depository institutions against a wide variety of collateral. All depository institutions that are judged to be in generally sound financial

condition by their Reserve Bank and that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All advances must be fully collateralized. The loans are reported as "Loans to depository institutions" in the Statements of Condition.

Lending to Primary Dealers

The Term Securities Lending Facility ("TSLF") was created on March 11, 2008, to promote the liquidity in the financing markets for U.S. Treasuries and other collateral. Under the TSLF, the FRBNY will lend up to an aggregate amount of $200 billion of U.S. Treasury securities to primary dealers secured for a term of 28 days. Securities loans are collateralized by a pledge of other securities, including federal agency debt, federal agency residential mortgage-backed securities, and non-agency AAA/Aaa-rated private-label residential mortgage-backed securities, and are awarded to primary dealers through a competitive single-price auction. The TSLF is authorized through October 30, 2009. The fees related to these securities lending transactions are reported as a component of "Non-interest income: Other income" in the Statements of Income and Comprehensive Income.

The Term Securities Lending Facility Options Program ("TOP"), created on July 30, 2008, offers primary dealers the option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The options are awarded through a competitive auction. The program is intended to enhance the effectiveness of the TSLF by ensuring additional securities liquidity during periods of heightened collateral market pressures, such as around quarter-end dates. TOP auction dates are determined by the FRBNY, and the program authorization ends concurrently with the TSLF.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF"), created on September 19, 2008, is a lending facility that provides funding to U.S. depository institutions and bank holding companies to finance the purchase of high-quality asset-backed commercial paper ("ABCP") from money market mutual funds under certain conditions. The program is intended to assist money market mutual funds that hold such paper to meet the demands for investor redemptions and to foster liquidity in the ABCP market and money markets more generally. The Federal Reserve Bank of Boston ("FRBB") administers the AMLF and is authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. All loans extended under the AMLF are recorded as assets by the FRBB and, if the borrowing institution settles to a depository account in the Seventh Reserve District, the funds are credited to the institution's depository account and settled between the Banks through the interdistrict settlement account. The credit risk related to the AMLF is assumed by the FRBB. The FRBB is authorized to finance the purchase of commercial paper through October 30, 2009.

4. Significant Accounting Policies

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

Differences exist between the accounting principles and practices in the FAM and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all SOMA securities holdings at amortized cost rather than using the fair value presentation required by GAAP. U.S. government, Federal agency, and GSE securities, and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and are adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Although the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities

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

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

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

a. Gold and Special Drawing Rights Certificates

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

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

SDR certificates are issued by the International Monetary Fund (the "Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2008 or 2007.

b. Loans to Depository Institutions

Loans are reported at their outstanding principal balances net of commitment fees. Interest income is recognized on an accrual basis. Loan commitment fees are generally deferred and amortized on a straight-line basis over the commitment period, which is not materially different from the interest method.

Outstanding loans are evaluated to determine whether an allowance for loan losses is required. The Bank has developed procedures for assessing the adequacy of the allowance for loan losses that reflect the assessment of credit risk considering all available information. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers.

Loans are considered to be impaired when it is probable that the Bank will not receive principal and interest due in accordance with the contractual terms of the loan agreement. The amount of the impairment is the difference between the recorded amount of the loan and the amount expected to be collected, after consideration of the fair value of the collateral. Recognition of interest income is discontinued for any loans that are considered to be impaired. Cash payments made by borrowers on impaired loans are applied to principal until the balance is reduced to zero; subsequent payments are recorded as recoveries of amounts previously charged off and then to interest income.

c. Securities Purchased Under Agreements to Resell, Securities Sold Under Agreements to Repurchase, and Securities Lending

The FRBNY may engage in tri-party purchases of securities under agreements to resell ("tri-party agreements"). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities; pass-through mortgage securities of Fannie Mae, Freddie Mac, and Ginnie Mae; STRIP securities of the U.S. government; and "stripped" securities of other government agencies. The tri-party agreements are accounted for as financing transactions and the associated interest income is accrued over the life of the agreement.

Securities sold under agreements to repurchase are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts in the Statements of Condition and the related accrued interest payable is reported as a component of "Other liabilities."

U.S. government securities held in the SOMA are lent to U.S. government securities dealers to facilitate the effective functioning of the domestic securities market. Overnight securities lending transactions are fully collateralized by other U.S. government securities. Term securities lending transactions are fully collateralized with investment-grade debt securities, collateral eligible for tri-party repurchase agreements arranged by the Open Market Trading Desk, or both. The collateral taken in both overnight and term securities lending transactions is in excess of the fair value of the securities loaned. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income."

Activity related to securities purchased under agreements to resell, securities sold under agreements to repurchase, and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account.

d. U.S. Government, Federal Agency, and Government-Sponsored Enterprise Securities; Investments Denominated in Foreign Currencies; and Warehousing Agreements

Interest income on U.S. government, Federal agency, and GSE securities and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains, net" in the Statements of Income and Comprehensive Income.

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

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

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

e. Central Bank Liquidity Swaps

At the initiation of each central bank liquidity swap transaction, the foreign central bank transfers a specified amount of its currency to 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. The foreign currency amounts that the FRBNY acquires are reported as "Central bank liquidity swaps" on the Statements of Condition. Because the swap transaction will be

unwound at the same exchange rate that was used in the initial transaction, the recorded value of the foreign currency amounts is not affected by changes in the market exchange rate.

The foreign central bank pays interest to the FRBNY based on the foreign currency amounts held by the FRBNY. The FRBNY recognizes interest income during the term of the swap agreement and reports the interest income as a component of "Interest income: Central bank liquidity swaps" in the Statements of Income and Comprehensive Income.

Activity related to these swap transactions, including the related interest income, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Similar to other investments denominated in foreign currencies, the foreign currency holdings associated with these central bank liquidity swaps are revalued at current foreign currency market exchange rates and allocated to the other Reserve Banks. Because the swap arrangement will be unwound at the same exchange rate that was used in the initial transaction, the obligation to return the foreign currency is also revalued at current foreign currency market exchange rates and is recorded in a currency exchange valuation account by the FRBNY. This revaluation method eliminates the effects of the changes in the market exchange rate. As of December 31, 2008, the FRBNY began allocating this currency exchange valuation account to the Bank and, as a result, the reported amount of central bank liquidity swaps reflects the Bank's allocated portion at the contract exchange rate.

f. 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.

g. Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from two to fifty years. Major alterations, 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 cost of direct services and materials associated with designing, coding, installing, and testing the software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from two to five years. Maintenance costs related to software are charged to expense in the year incurred.

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

h. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the chairman of the board of directors of each Reserve Bank and their designees) to the Reserve Banks upon deposit with such agents of specified classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be at least equal to the sum of the notes applied for by such Reserve Bank.

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

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the outstanding Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government. At December 31, 2008 and 2007, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

"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 $12,938 million and $13,560 million at December 31, 2008 and 2007, respectively.

i. Items in Process of Collection and Deferred Credit Items

"Items in process of collection" in the Statements of Condition primarily represents amounts attributable to checks that have been deposited for collection and that, as of the balance sheet date, have not yet been presented to the paying bank. "Deferred credit items" are the counterpart liability to items in process of collection, and 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.

j. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. These shares are nonvoting with a par value of $100 and may not be transferred or hypothecated. As a member bank's capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

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

k. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks will be required to call on member banks for additional capital.

Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to other postretirement benefit plans that, under accounting standards, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

l. Interest on Federal Reserve Notes

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to U.S. Treasury as interest on Federal Reserve notes" in the Statements of Income and Comprehensive Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

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

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

m. Interest on Depository Institutions Deposits

Beginning October 9, 2008, the Reserve Banks began paying interest to depository institutions on qualifying balances held at the Banks. Authorization for payment of interest on these balances was granted by Title II of the Financial Services Regulatory Relief Act of 2006, which had an effective date of 2011. Section 128 of the Emergency Economic Stabilization Act of 2008, enacted on October 3, 2008, made that authority immediately effective. The interest rates paid on required reserve balances and excess balances are based on an FOMC-established target range for the effective federal funds rate.

n. Income and Costs Related to U.S. Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury has appropriations to pay for these services. During the years ended December 31, 2008 and 2007, the Bank was reimbursed for all services provided to the Department of the Treasury as its fiscal agent.

o. Compensation Received for Services Provided and Compensation Paid for Services Costs Incurred

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

p. Assessments by the Board of Governors

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

q. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property and, in some states, sales taxes on construction-related materials. The Bank's real property taxes were $3 million and $2 million for the years ended December 31, 2008 and 2007, respectively, and are reported as a component of "Occupancy expense."

r. 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 of the Bank's 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.

s. Recently Issued Accounting Standards

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which established a single authoritative definition of fair value and a framework for measuring fair value, and expands the required disclosures for assets and liabilities measured at fair value. SFAS 157 was effective for fiscal years beginning after November 15, 2007, with early adoption permitted. The Bank adopted SFAS 157 effective January 1, 2008. The provisions of this standard have no material effect on the Bank's financial statements.

In February 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" ("SFAS 159"), which provides companies with an irrevocable option to elect fair value as the measurement for selected financial assets, financial liabilities, unrecognized firm commitments and written loan commitments that are not subject to fair value under other accounting standards. There is a one-time election available to apply this standard to existing financial instruments as of January 1, 2008; otherwise, the fair value option will be available for financial instruments on their initial transaction date. SFAS 159 reduces the accounting complexity for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently, and it eliminates the operational complexities of applying hedge accounting. The Bank adopted SFAS 159 effective January 1, 2008. The provisions of this standard have no material effect on the Bank's financial statements.

In February 2008, FASB issued FASB Staff Position ("FSP") FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions." FSP FAS 140-3 requires that an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of, the initial transfer be evaluated together as a linked transaction under SFAS 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," unless certain criteria are met. FSP FAS 140-3 is effective for the Bank's financial statements for the year beginning on January 1, 2009 and earlier adoption is not permitted. The provisions of this standard will not have a material effect on the Bank's financial statements.

5. Loans

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

	2008	2007
Primary, secondary, and seasonal credit	$ 1,828	$ 1,259
TAF	5,094	1,080
Total loans to depository institutions	**$ 6,922**	**$ 2,339**

Loans to Depository Institutions

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

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans, U.S. Treasury securities, Federal agency securities, GSE obligations, foreign sovereign debt obligations, municipal or corporate obligations, 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 deemed appropriate by the Bank, which is typically fair value or face value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program are also eligible to participate in the temporary TAF program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans are extended on a short-term basis, with terms of either 28 or 84 days. All advances under the TAF must be fully collateralized. Assets eligible to collateralize TAF loans include the complete list

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

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

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

The maturity distribution of loans outstanding at December 31, 2008, was as follows (in millions):

	Primary, secondary, and seasonal credit	TAF
Within 15 days	$ 970	$ 3,950
16 days to 90 days	858	1,144
Total loans	**$ 1,828**	**$ 5,094**

Allowance for Loan Losses

At December 31, 2008 and 2007, no loans were considered to be impaired and the Bank determined that no allowance for loan losses was required.

6. U.S. Government, Federal Agency, and Government-sponsored Enterprise 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 8.826 percent and 8.388 percent at December 31, 2008 and 2007, respectively.

The Bank's allocated share of U.S. government, Federal agency, and GSE securities, net held in the SOMA at December 31 was as follows (in millions):

	2008	2007
U.S. government securities:		
Bills	$ 1,626	$ 19,110
Notes	29,548	33,700
Bonds	10,831	9,310
Federal agency and GSE securities	1,739	–
Total par value	**43,744**	**62,120**
Unamortized premiums	710	670
Unaccreted discounts	(131)	(249)
Total allocated to the Bank	**$ 44,323**	**$ 62,541**

At December 31, 2008 and 2007, the fair value of the U.S. government, Federal agency, and GSE securities allocated to the Bank, excluding accrued interest, was $49,993 million and $65,184 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government, Federal agency, and GSE securities, net, held in the SOMA was $502,189 million and $745,629 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the fair value of the U.S. government, Federal agency, and GSE securities held in the SOMA, excluding accrued interest, was $566,427 million and $777,141 million, respectively, as determined by reference to quoted prices for identical securities.

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 central bank, to meet their financial obligations and responsibilities and do not represent a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31, 2008 and 2007, were as follows (in millions):

	Securities purchased under agreements to resell		Securities sold under agreements to repurchase	
	2008	2007	2008	2007
Allocated to the Bank:				
Contract amount outstanding, end of year	$ 7,060	$ 3,900	$ 7,798	$ 3,689
Weighted average amount outstanding, during the year	8,564	2,942	5,778	2,923
Maximum month-end balance outstanding, during the year	10,503	4,320	8,699	3,689
Securities pledged, end of year	–	–	6,963	3,695
System total:				
Contract amount outstanding, end of year	$ 80,000	$ 46,500	$ 88,352	$ 43,985
Weighted average amount outstanding, during the year	97,037	35,073	65,461	34,846
Maximum month-end balance outstanding, during the year	119,000	51,500	98,559	43,985
Securities pledged, end of year	–	–	78,896	44,048

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

The maturity distribution of U.S. government, Federal agency, and GSE securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2008, was as follows (in millions):

	U.S. government securities (Par value)	Federal agency and GSE securities (Par value)	Subtotal: U.S. government Federal agency, and GSE securities (Par value)	Securities purchased under agreements to resell (Contract amount)	Securities sold under agreements to repurchase (Contract amount)
Within 15 days	$ 1,689	$ 40	$ 1,729	$ 3,530	$ 7,798
16 days to 90 days	1,850	289	2,139	3,530	–
91 days to 1 year	5,590	86	5,676	–	–
Over 1 year to 5 years	15,298	1,003	16,301	–	–
Over 5 years to 10 years	8,590	321	8,911	–	–
Over 10 years	8,988	–	8,988	–	–
Total allocated to the Bank	**$ 42,005**	**$ 1,739**	**$ 43,744**	**$ 7,060**	**$ 7,798**

At December 31, 2008 and 2007, U.S. government securities with par values of $180,765 million and $16,649 million, respectively, were loaned from the SOMA, of which $15,954 million and $1,396 million, respectively, were allocated to the Bank.

7. Investments Denominated in Foreign Currencies

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. These investments are guaranteed as to principal and interest by the issuing foreign governments.

The Bank's allocated share of investments denominated in foreign currencies was approximately 4.435 percent and 5.599 percent at December 31, 2008 and 2007, respectively.

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

	2008	2007
Euro:		
Foreign currency deposits	247	402
Securities purchased under agreements to resell	181	143
Government debt instruments	204	261
Japanese yen:		
Foreign currency deposits	154	157
Government debt instruments	314	320
Total allocated to the Bank	**$ 1,100**	**$ 1,283**

At December 31, 2008 and 2007, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was $1,110 million and $1,282 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the U.S. government, Federal agency, and GSE securities discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were $24,804 million and $22,914 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was $25,021 million and $22,892 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2008, was as follows (in millions):

	Euro	Japanese Yen	Total
Within 15 days	$ 337	$ 154	$ 491
16 days to 90 days	52	28	80
91 days to 1 year	77	88	165
Over 1 year to 5 years	166	198	364
Total allocated to the Bank	**$ 632**	**$ 468**	**$ 1,100**

At December 31, 2008 and 2007, the authorized warehousing facility was $5.0 billion, with no balance outstanding.

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

8. Central Bank Liquidity Swaps

Central bank liquidity swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, whereby the parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time. At the end of that period of time, the currencies are returned at the original contractual exchange rate and the foreign central bank pays interest to the Federal Reserve at an agreed-upon rate. These arrangements give the authorized foreign central bank temporary access to U.S. dollars. Drawings under the swap arrangements are initiated by the foreign central bank and must be agreed to by the Federal Reserve.

The Bank's allocated share of central bank liquidity swaps was approximately 4.435 percent and 5.599 percent at December 31, 2008 and 2007, respectively.

At December 31, 2008 and 2007, the total System amount of foreign currency held under central bank liquidity swaps was $553,728 million and $24,353 million, respectively, of which $24,559 million and $1,364 million, respectively, was allocated to the Bank.

The maturity distribution of central bank liquidity swaps that were allocated to the Bank at December 31 was as follows (in millions):

	2008			2007
	Within 15 days	16 days to 90 days	Total	16 days to 90 days
Australian dollar	$ 444	$ 569	$ 1,013	$ –
Danish krone	–	665	665	–
Euro	6,696	6,227	12,923	1,136
Japanese yen	2,124	3,319	5,443	–
Korean won	–	459	459	–
Norwegian krone	98	267	365	–
Swedish krona	443	665	1,108	–
Swiss franc	852	264	1,116	228
U.K. pound	5	1,462	1,467	–
Total	**$ 10,662**	**$ 13,897**	**$ 24,559**	**$ 1,364**

9. Bank Premises, Equipment, and Software

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

	2008	2007
Bank premises and equipment:		
Land	$ 15	$ 14
Buildings	242	238
Building machinery and equipment	33	31
Construction in progress	11	4
Furniture and equipment	60	62
Subtotal	**361**	**349**
Accumulated depreciation	(126)	(116)
Bank premises and equipment, net	$ 235	$ 233
Depreciation expense, for the years ended December 31	$ 16	$ 16

Bank premises and equipment at December 31 included the following amounts for capitalized leases (in thousands):

	2008	2007
Leased premises and equipment under capital leases	$ –	$ 622
Accumulated depreciation	–	(596)
Leased premises and equipment under capital leases, net	$ –	$ 26
Depreciation expense related to leased premises and equipment under capital leases	$ 26	$ 104

The Bank leases space to outside tenants with remaining lease terms ranging from 3 to 12 years. Rental income from such leases was $5 million for each of the years ended December 31, 2008 and 2007, and is reported as a component of “Other income.” Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2008, are as follows (in millions):

2009	$ 5
2010	5
2011	5
2012	4
2013	4
Thereafter	**18**
Total	**$ 41**

The Bank has capitalized software assets, net of amortization, of $1 million and $2 million at December 31, 2008 and 2007, respectively. Amortization expense was $1 million and $2 million for the years ended December 31, 2008 and 2007, respectively. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses."

Assets impaired as a result of the Bank's restructuring plan, as discussed in Note 14, include check equipment, leasehold improvements, furniture and software. Asset impairment losses of $9.7 million for the period ended December 31, 2007 were determined using fair values based on quoted fair values or other valuation techniques and are reported as a component of "Other expenses." The Bank had no impairment losses in 2008.

10. Commitments and Contingencies

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

At December 31, 2008, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 3 to approximately 4 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was $2 million for each of the years ended December 31, 2008 and 2007.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2008, are as follows (in thousands):

	Operating leases
2009	$ 433
2010	433
2011	336
2012	21
Future minimum rental payments	$ 1,223

At December 31, 2008, there were no material unrecorded unconditional purchase commitments or long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of one 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, 2008 or 2007.

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

11. Retirement and Thrift Plans

Retirement Plans

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

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are 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, 2008 and 2007, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2008 and 2007, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service. The Bank's Thrift Plan contributions totaled $5 million for each of the years ended December 31, 2008 and 2007 and are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income. Beginning in 2009, the Bank will match 100 percent of the first 6 percent of employee contributions from the date of hire and provide an automatic employer contribution of 1 percent of eligible pay.

12. Postretirement Benefits Other Than Pensions and Postemployment Benefits

Postretirement Benefits Other Than Pensions

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):

	2008	2007
Accumulated postretirement benefit obligation at January 1	$ 105.6	$ 110.9
Service cost-benefits earned during the period	2.7	2.5
Interest cost on accumulated benefit obligation	6.6	6.6
Net actuarial loss (gain)	5.8	(7.2)
Curtailment loss (gain)	0.1	(3.9)
Special termination benefits loss	–	3.2
Contributions by plan participants	1.7	1.6
Benefits paid	(8.4)	(8.6)
Medicare Part D subsidies	0.5	0.5
Accumulated postretirement benefit obligation at December 31	$ 114.6	$ 105.6

At December 31, 2008 and 2007, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 6.00 percent and 6.25 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.

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):

	2008	2007
Fair value of plan assets at January 1	$ –	$ –
Contributions by the employer	6.2	6.5
Contributions by plan participants	1.7	1.6
Benefits paid	(8.4)	(8.6)
Medicare Part D subsidies	0.5	0.5
Fair value of plan assets at December 31	$ –	$ –
Unfunded obligation and accrued postretirement benefit cost	$ 114.6	$ 105.6
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 4.3	$ 5.6
Net actuarial loss	(36.1)	(33.3)
Deferred curtailment gain	1.2	1.6
Total accumulated other comprehensive loss	**$ (30.6)**	**$ (26.1)**

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:

	2008	2007
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	2014	2013

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2008 (in millions):

	One percentage point increase	One percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 1.3	$ (1.1)
Effect on accumulated postretirement benefit obligation	12.9	(10.8)

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

	2008	2007
Service cost-benefits earned during the period	$ 2.7	$ 2.5
Interest cost on accumulated benefit obligation	6.6	6.6
Amortization of prior service cost	(1.9)	(2.3)
Amortization of net actuarial loss	3.4	5.9
Total periodic expense	10.8	12.7
Curtailment gain	(0.1)	–
Special termination benefits loss	–	3.2
Net periodic postretirement benefit expense	$ 10.7	$ 15.9

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2009 are shown below:

Prior service cost	$ (2.0)
Net actuarial loss	2.3
Total	**$ 0.3**

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2008 and 2007, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 6.25 percent and 5.75 percent, respectively.

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

The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 14. A net curtailment gain was recognized in net income in the year ended December 31, 2008 related to employees who terminated employment during 2008. A deferred curtailment gain was recorded in 2007 as a component of accumulated other comprehensive loss; the gain will be recognized in net income in future years when the related employees terminate employment.

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

Federal Medicare Part D subsidy receipts were $0.4 million and $0.8 million in the years ended December 31, 2008 and 2007, respectively. Expected receipts in 2009, related to benefits paid in the years ended December 31, 2008 and 2007 are $0.3 million.

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

	Without subsidy	With subsidy
2009	$ 7.9	$ 7.3
2010	8.4	7.7
2011	8.8	8.0
2012	9.1	8.3
2013	9.4	8.5
2014 – 2018	48.1	42.7
Total	**$ 91.7**	**$ 82.5**

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued post-employment benefit costs recognized by the Bank at December 31, 2008 and 2007, were $9 million and $11 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense (credit) included in 2008 and 2007 operating expenses were $(1) million and $3 million, respectively, and are recorded as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

13. Accumulated Other Comprehensive Income and Other Comprehensive Income

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

	Amount related to postretirement benefits other than pensions	
Balance at January 1, 2007	$	(41)
Change in funded status of benefit plans:		
Prior service costs arising during the year		(2)
Net actuarial gain arising during the year		11
Deferred curtailment gain		2
Amortization of prior service cost		(2)
Amortization of net actuarial loss		5
Change in funded status of benefit plans — other comprehensive loss		14
Balance at December 31, 2007	**$**	**(27)**
Change in funded status of benefit plans:		
Prior service costs arising during the year		1
Net actuarial loss arising during the year		(6)
Amortization of prior service cost		(2)
Amortization of net actuarial gain		3
Change in funded status of benefit plans — other comprehensive loss		(4)
Balance at December 31, 2008	**$**	**(31)**

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

14. Business Restructuring Charges

2007 Restructuring Plans

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes.

2006 and Prior Restructuring Costs

The Bank incurred various restructuring charges prior to 2007 related to the restructuring of check adjustment and operations. Following is a summary of financial information related to the restructuring plans (in thousands):

	2006 and prior restructuring plans	2007 restructuring plans	Total
Information related to restructuring plans as of December 31, 2008:			
Total expected costs related to restructuring activity	$ 7,364	$ 5,312	$ 12,676
Estimated future costs related to restructuring activity	–	–	–
Expected completion date	2008	2008	
Reconciliation of liability balances:			
Balance at January 1, 2007	$ 982	$ –	$ 982
Employee separation costs	–	6,011	6,011
Adjustments	(538)	–	(538)
Payments	(396)	–	(396)
Balance at December 31, 2007	**$ 48**	**$ 6,011**	**$ 6,059**
Employee separation costs	–	25	25
Contract termination costs	–	113	113
Adjustments	(18)	(837)	(855)
Payments	(30)	(819)	(849)
Balance at December 31, 2008	**$ –**	**$ 4,493**	**$ 4,493**

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 "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

Contract termination costs include the charges resulting from terminating an existing lease and are shown as a component of "Other expenses" in the Statements of Income and Comprehensive Income.

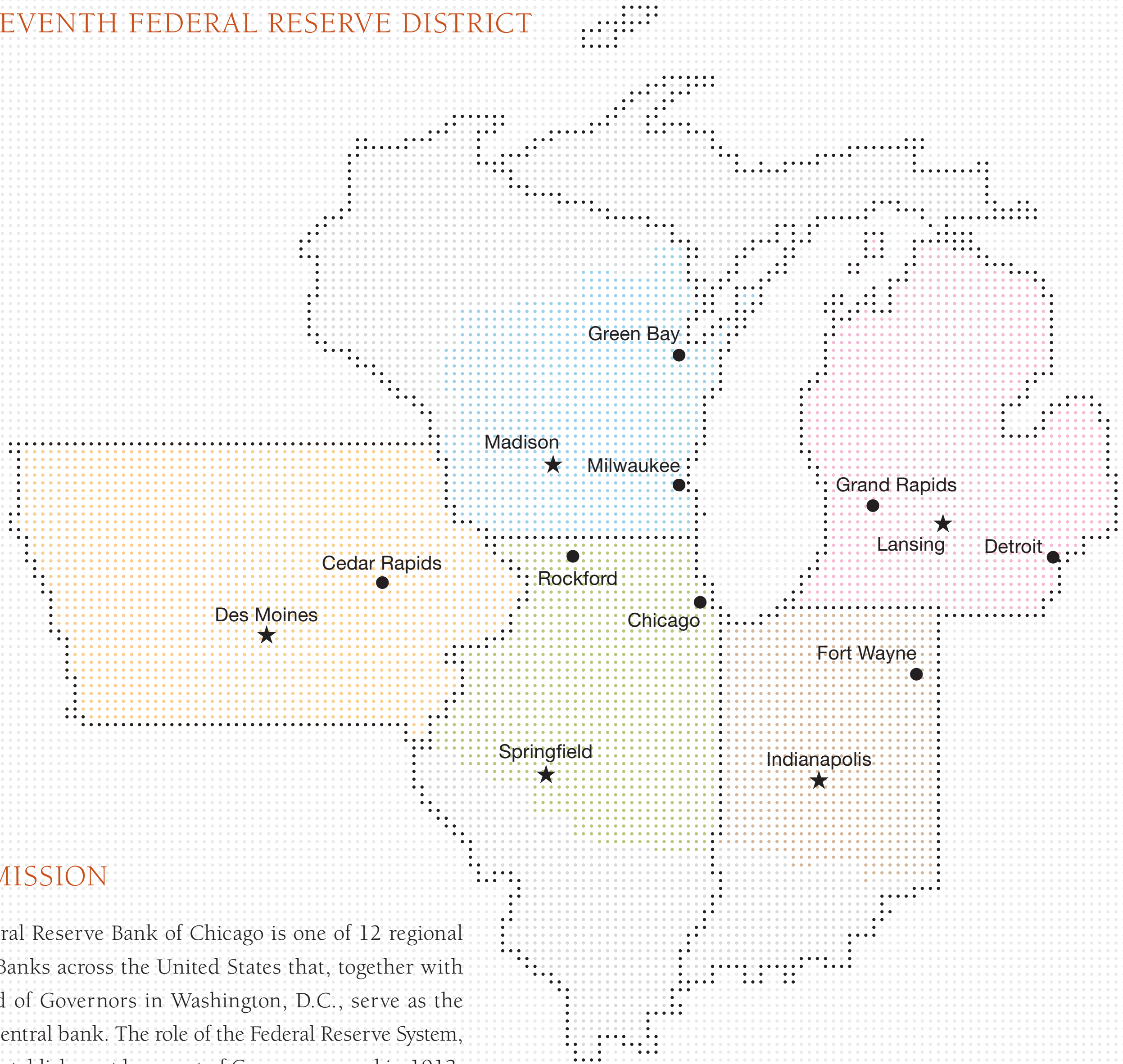
Adjustments to the accrued liability are primarily due to changes in the estimated restructuring costs and are shown as a component of the appropriate expense category in the Statements of Income and Comprehensive Income.

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

In February 2009, the System announced the extension through October 30, 2009, of liquidity programs that were previously scheduled to expire on April 30, 2009. The extension pertains to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and the Term Securities Lending Facility. In addition, the temporary reciprocal currency arrangements (swap lines) between the Federal Reserve and other central banks were extended to October 30, 2009.

THE SEVENTH FEDERAL RESERVE DISTRICT



OUR MISSION

The Federal Reserve Bank of Chicago is one of 12 regional Reserve Banks across the United States that, together with the Board of Governors in Washington, D.C., serve as the nation's central bank. The role of the Federal Reserve System, since its establishment by an act of Congress passed in 1913, has been to foster a strong economy, supported by a stable financial system.

To this end, the Federal Reserve Bank of Chicago participates in the formulation and implementation of national monetary policy; supervises and regulates state-member banks, bank holding companies and foreign bank branches; and provides financial services to depository institutions and the U.S. government. Through its head office in Chicago, branch in Detroit and check-processing facility in Bedford Park, Ill., the Federal Reserve Bank of Chicago serves the Seventh Federal Reserve District, which includes most of Illinois, Indiana, Michigan and Wisconsin, plus all of Iowa.

OUR VISION

We serve the public interest by fostering a strong economy and promoting financial stability. We accomplish this with talented and innovative people working within a collaborative and inclusive culture.

Head Office
230 South LaSalle Street
P.O. Box 834
Chicago, Illinois 60690-0834
312-322-5322

Detroit Branch
1600 East Warren Avenue
Detroit, Michigan 48207-1063
313-961-6880

Midway Facility
4944 West 73rd Street
Bedford Park, Illinois 60638
708-924-8900

FEDERAL RESERVE BANK
OF CHICAGO