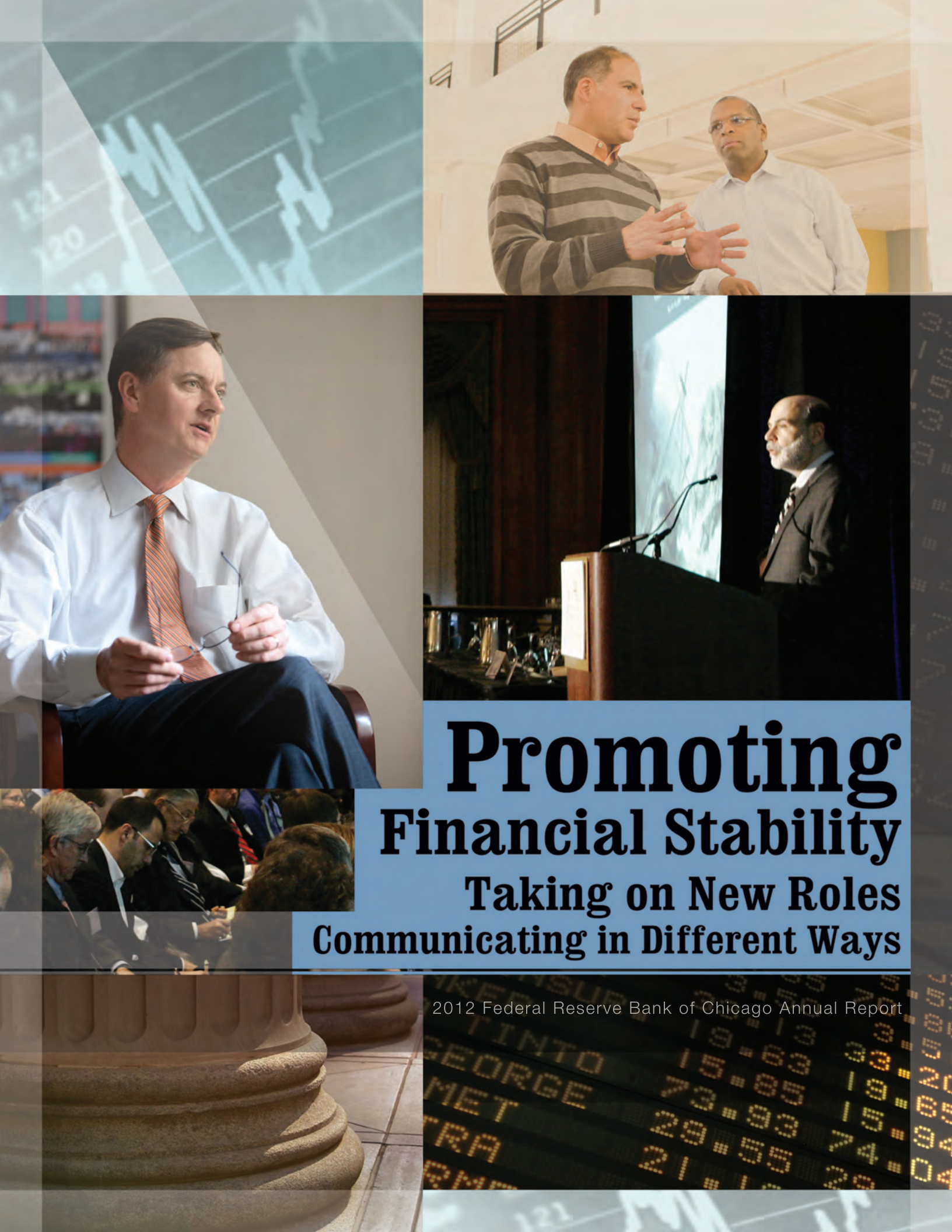


Promoting Financial Stability

Taking on New Roles
Communicating in Different Ways

2012 Federal Reserve Bank of Chicago Annual Report

Table of Contents

Letter from the President	1
The Economy and Monetary Policy in 2012	2
Fed Communications: A Look Back at a Landmark 2012	4
Promoting Corporate Social Responsibility	6
Chicago Fed Highlights of 2012	7
Promoting Financial Stability: Taking on New Roles in Today's Markets	8
Fed's Strategic Direction on Payments Unveiled at Symposium	16
Directors	18
Management Committee	22
Executive Officers	24
Advisory Councils	25
Executive Changes	27
Operations Volumes	28
Financial Reports	29

Letter from the President

Charles L. Evans

As I think about our progress promoting the Federal Reserve's dual goals of maximum employment and stable prices, I believe that last year we arrived at the appropriate stance for monetary policy. Communication is an important component of monetary policy, and the Fed's communications evolved significantly in 2012. Most importantly, we clarified how our policy decisions are conditional on making adequate progress toward maximum employment and stable prices by making future policy decisions depend on economic conditions, not calendar time. I strongly supported this decision, as I have advocated since 2011 that the most appropriate federal funds rate forward guidance would feature this type of economic conditionality. I am confident that this course of action will instill confidence in the public that monetary policy will continue to be accommodative until economic conditions improve substantially. This report offers a short chronology, starting on page 4, of our policy communications as the year progressed and explains why I feel that the actions we took in 2012 were important ones.

In addition, this report features an extensive essay on another important issue: how our regulatory responsibilities continue to evolve, all with the ultimate goal of promoting financial stability. A detailed essay on this topic begins on page 8.

Managing any type of change requires the commitment of a very dedicated, talented and flexible group of staff members, and I am happy to say we have that at the Chicago Fed. As always, we also appreciate the contributions of our directors, whose guidance and counsel is invaluable to the success of our operations, as is their first-hand knowledge of regional business conditions.

Of note are the following members of the Chicago board who completed their service in 2012: Ann Murtlow, president and chief executive officer of AM Consulting LLC in Indianapolis, Indiana; Bill Foote, retired chairman of Chicago-based USG Corporation, who was chairman of the Chicago board for three years; and Steve Goodenow, chairman and chief executive officer of Bank Midwest in Spirit Lake, Iowa. I would also like to thank Detroit branch director Brian Walker, president and chief executive officer of Herman Miller, Inc. in Zeeland, Michigan, who also completed his service in 2012.

In conclusion, I hope you find this annual report useful and informative as we continue our efforts to return the U.S. economy to a level of performance that is solid and sustainable. We appreciate the opportunity to serve you.

Charles L. Evans
President and Chief Executive Officer
April 1, 2013

The Economy & Monetary Policy in 2012*

The U.S. economy continued to recover slowly in 2012. Real gross domestic product (GDP) grew a disappointing 1.7 percent over the course of the year, slightly below the pace in 2011. While the recovery continues to face headwinds emanating from both here and abroad, most professional forecasters expect growth to pick up this year. The median of the Federal Open Market Committee's (FOMC) projections from its March 2013 meeting is for growth to reach about 2.5 percent in 2013.

Over the course of last year and into early 2013, the unemployment rate fell by slightly less than 1 percentage point. While it remains well above the FOMC's view of its long-run range, the Committee in March projected that growth in the economy will be sufficient to bring the unemployment rate a bit below 7 percent by the end of next year. However, it is still expected to be some time further before the unemployment rate declines to a level consistent with the employment side of our dual mandate.

Looking at the price stability side of our mandate, the FOMC continues to expect inflation to remain near or a bit below its target of 2 percent through 2015. The Personal Consumption Expenditures (PCE) price index ended the fourth quarter of 2012 1.6 percent higher than in the fourth quarter of 2011. Excluding volatile food and energy prices, core PCE inflation was up 1.5 percent over the same period.

The Economy

Growth in household spending was again modest in 2012. Households continued to be challenged by a debt overhang and large losses of wealth that were incurred during the financial crisis. Spending on nondurables and services was soft throughout the year. In contrast, purchases of durable goods, spurred by increases in light vehicle sales, were more robust and the housing market strengthened.

The labor market, though still tepid, showed signs of improvement. Additions to nonfarm payrolls averaged 183,000 new jobs per month in 2012, slightly higher than the pace in 2011, for a total of 2.2 million new jobs. Likewise, initial claims for unemployment insurance reached their lowest levels since early 2008, and the unemployment rate declined to 7.7 percent by February 2013.

Growth in business investment slowed in 2012. Business spending on new equipment and software decelerated, perhaps as firms grew cautious given the uncertainty surrounding the future course of fiscal policy. Although the immediate threats from the end-of-the-year fiscal cliff were avoided, there still are many issues to resolve regarding the course of government spending and tax policy.

Demand from abroad also weakened last year, as our trading partners confronted their own economic and financial difficulties. The Eurozone entered into a recession, and the most recent forecasts look for only modest growth during 2013 as a whole. In Asia, growth in China appears to be gaining momentum after slowing down somewhat last year, but analysts are not forecasting a return to the heady double-digit growth rates China experienced a few years ago.

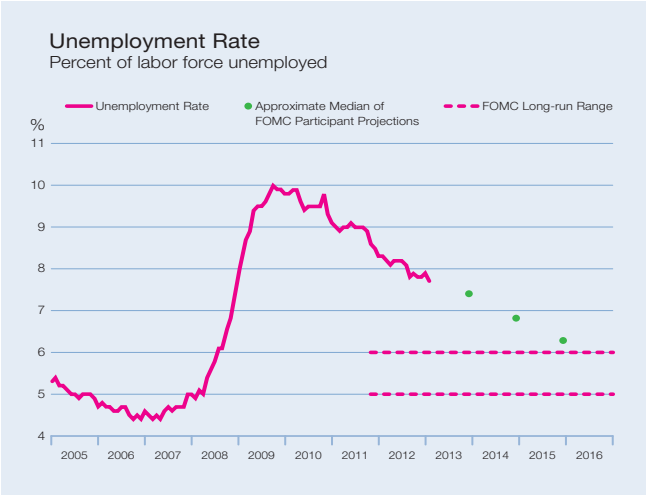
Cost pressures were again moderate and wage growth modest in 2012. Unit labor costs in the nonfarm business

sector ended the fourth quarter of 2012 at a level 2.1 percent higher than in the fourth quarter of 2011, a modest increase from the 1.3 percent increase over the same period during the prior year.

Financial conditions continued to improve. Low interest rates have helped many households and businesses pare debt burdens and restructure their balance sheets. This has particularly been true for businesses with access to the bond market; and so today many firms have plenty of cash on hand and are well-positioned to ramp up activity when more and more customers begin to show up at their door.

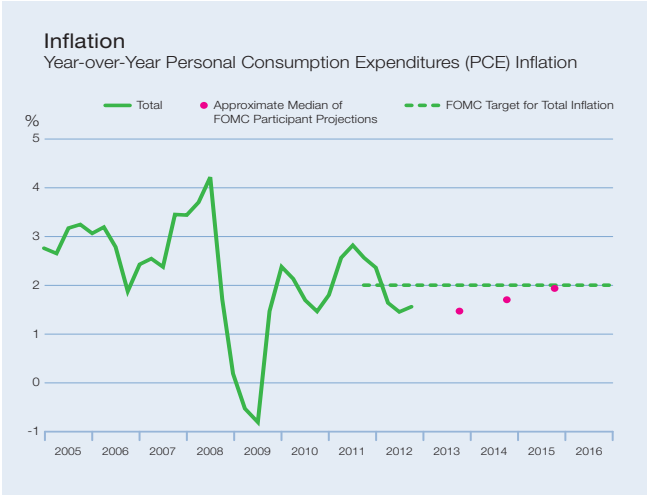
that is, our commitment to leave the rate at essentially zero until adequate progress is made toward economic recovery.

After its December 2012 meeting, the FOMC gave a clear statement of the economic conditions under which it expects that it would begin to remove its policy accommodation. Specifically, the Committee stated that the federal funds rate will remain within its current range at least as long as the unemployment rate remains above 6.5 percent, medium term inflation is projected to be no more than 2.5 percent, and longer-term inflation expectations continue to be well anchored. Moreover, when it does become time to begin to remove



As of the March 19-20, 2013 meeting, the FOMC expected that the unemployment rate will likely first fall below 6.5 percent in 2015.

Source: *Haver Analytics and the Minutes of the Federal Open Market Committee.*



As of the March 19-20, 2013 meeting, the FOMC expected inflation to remain near or a bit below its target of 2 percent through 2015.

Source: *Haver Analytics and the Minutes of the Federal Open Market Committee.*

Monetary Policy

Though much progress has been made, our country's continued recovery hinges critically on maintaining the current highly accommodative stance for monetary policy. One aspect of that accommodation is the Federal Reserve's open-ended large-scale asset purchase program. Each month, the Federal Reserve is buying $85 billion of mortgage-backed securities and long-term Treasury securities. Another tool is the exceptionally low level of the federal funds rate and the Federal Reserve's forward guidance about the federal funds rate —

policy accommodation, the Committee intends to take a balanced approach consistent with its dual mandate.

When making their projections in March 2013, fourteen out of nineteen FOMC participants did not expect policy firming to commence before 2015. By the end of 2015, a majority of participants expected the funds rate to remain at or below 1 percent, and only one expected the rate to be in the 4.0 to 4.5 percent range judged to be appropriate by the Committee in the longer run.

*Data current as of March 28, 2013.

FED Communications
A Look Back at a Landmark 2012

Effective Communication Matters

The goal of monetary policy is to foster financial conditions that support both full employment and price stability. Effective communication is an important element of the process. Clear articulation of our goals and actions helps reduce financial and economic uncertainty and facilitates better informed decision-making by households and businesses. In the current economic environment, effective communication plays an additional role. We have already brought our primary policy tool, the federal funds (fed funds) rate, down to its lower bound of zero. We simply cannot reduce the funds rate any further to provide additional support to the economic recovery. However, as explained below, clear guidance about our commitment to keep rates low in the future can provide such added policy accommodation and, hopefully, quicken our return to full employment within the context of price stability.

January – Statement of Principles and Projections for the Appropriate Path for Policy

The year began with the Federal Open Market Committee (FOMC) providing the public with a statement of the principles guiding its conduct of monetary policy. This is the first such statement the FOMC has made. It clarified the Committee's thinking in three key areas:

- First, the FOMC explicitly set a longer-run goal for inflation of 2 percent, measured by the annual change in the price index for Personal Consumption Expenditures. In providing this yardstick, the Federal Reserve is better able to anchor longer-term inflation expectations, which are an important determinant of actual future inflation.
- Second, the statement notes that the maximum level of employment is determined by a number of factors that can fluctuate over time and are outside the direct control of monetary policy. Therefore, the FOMC does not set a specific employment target. Rather, the Committee's assessments about maximum employment are informed by a wide range of labor market indicators and are necessarily subject to uncertainty. A long-run benchmark can be gleaned from participants' long-run unemployment projections in the FOMC's quarterly Summary of Economic Projections (SEP). The central tendency of these most recent unemployment forecasts was 5.2 percent to 6.0 percent.
- Third, the statement clarifies that if the FOMC judges that the policy prescriptions necessary to meet its two goals are not complementary, then it will take a balanced approach when setting policy. In doing so, the Committee will consider both the magnitude of deviations from each goal and the anticipated time horizons over which employment and inflation are expected to return to levels consistent with Fed objectives.

In another January communications development, FOMC participants' assessments of the appropriate future path for the target federal funds rate were added to the SEP. These additions complement the projections of inflation, output, and unemployment already included in the SEP. Given current conditions, the projected policy paths provide important information about the likely timing and magnitude of future changes in the fed funds rate.

September – Open-Ended Large-Scale Asset Purchase Program (LSAP) and Highly Accommodative Policy Even after the Recovery Strengthens

At its September meeting, the FOMC added a new directive to purchase agency mortgage-backed securities (MBS) at a pace of $40 billion per month. Rather than stipulating a total dollar

amount to be spent over a specific period, as had been the case with earlier programs, this time the FOMC made a significant policy change and tied the duration of the purchases and possible changes to the program to the achievement of a substantial improvement in labor market conditions within the context of price stability.[1] This economic conditionality was an important addition, as it signaled our commitment to provide further monetary accommodation if we did not see adequate progress toward our policy goals.

In addition, in its discussion of the fed funds rate, the September FOMC statement noted that the Committee "expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens." Many modern macroeconomic models suggest that such a long-term commitment to accommodation — beyond what would be typical during an economic recovery — is warranted following a period with rates stuck at the zero lower bound. The delay in raising rates makes up for the time when they were constrained from going negative. In other words, the average path for rates will be closer to being right over time.

December – Economic Conditionality and the Fed Funds Rate

In December 2012, the FOMC enhanced its forward guidance about future monetary policy actions by moving from using a calendar date to using more specific economic conditions to describe when it would consider beginning to remove policy accommodation.[2] Namely, the Committee's statement after the December meeting indicated that the fed funds rate will stay within its current range at least as long as the unemployment rate remains above 6-1/2 percent, medium-term inflation is projected to be no more than 2-1/2 percent, and long-term inflation expectations continue to be well anchored. Moreover, the Committee stated that when it does begin to remove policy accommodation, it will take a balanced approach that is consistent with its longer-run goals of maximum employment and 2 percent inflation.

By tying the timing of the fed funds rate lift-off to specific economic conditions, the FOMC clarified that its policy decisions are conditional on whether we are making adequate progress toward our dual mandate goals. Such progress is measured by economic conditions, not calendar time. Indeed, because it is impossible to anticipate all potential developments affecting the outlook, the Committee cannot commit firmly to a date when those economic conditions will be achieved. Furthermore, the particular thresholds that were chosen more accurately convey the Committee's intent to keep rates near zero even after the recovery is firmly entrenched. And the inflation threshold does not mean we are abandoning our commitment to a 2 percent inflation target. Rather, the slightly higher threshold simply captures how the committee's symmetrical view of our long-run goal allows for inflation at times to run modestly above 2 percent.

Conclusion

With a clearer understanding of the Fed's thinking surrounding policy actions, the public can be more confident that the Federal Reserve will provide the monetary accommodation necessary to close the large resource gaps that currently exist in our economy. Additionally, the public can be certain that we will not wait too long to tighten monetary policy if inflation becomes a substantial concern. The steps taken over the past year represent important improvements in communicating both this resolve and the actions the committee would take in order to achieve its dual mandate goals.

[1] These MBS purchases were in addition to the existing Maturity Extension Program (MEP), in which the Federal Reserve was selling $45 billion per month of short-term Treasury securities and in their place buying $45 billion of long-term Treasury securities. In December 2012 the Committee decided that when the MEP was completed at the end of the year, it would be replaced with $45 billion per month of outright purchases of longer-term Treasury securities, which would continue under the same conditions as the new MBS program.

[2] In December 2008, when it first lowered the federal funds rate to zero, the FOMC's policy statement indicated that "the Committee anticipates that weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time." In March 2009, "for an extended period" replaced "for some time" in the policy statement. In August 2011, the statement began indicating a calendar date through which the Committee expected an exceptionally low level of the fed funds rate likely would be warranted. Subsequently, as the economic outlook and policy positions evolved, so did the calendar date in the statement.

Promoting Corporate Social Responsibility

The Federal Reserve Bank of Chicago is committed to operating in a socially responsible manner. Staff members carried out a wide variety of activities in 2012 that promoted environmentalism, volunteerism, economic and financial education, community and economic development, regional economic outreach, employee diversity and inclusion, and supplier diversity.

Minority and female entrepreneurs take part in a minority business enterprise forum hosted by the Chicago Fed.

Chicago Fed volunteers help out with a 5K run for a local non-profit group called "Girls on the Run," which inspires girls to be healthy and confident.

Students from majority-Latino high schools participate in a speed-mentoring exercise with Chicago Fed staff during the "Yo Lo Hice, You Can Too" event co-sponsored by the Chicago Fed and Junior Achievement of Chicago.

Chicago Fed Highlights of 2012

Formulating Monetary Policy

- Participated in meetings of the Federal Open Market Committee, the group headed by Chairman Ben Bernanke that makes national policy decisions.

Conducting Economic Research

- Provided high-caliber research on many vital topics and provided outstanding analysis concerning national and regional economic policy, labor markets, the insurance and payments industries, and the impact of contagion risk on sovereign bond yields.
- Studied state and local government policies, including research on the sector's behavior during cyclical swings.
- Published a series of working papers on the risks of high-speed trading and its impact on the financial markets.

Supervising and Regulating Banks

- Banking conditions continued to improve throughout the District; however, experienced a 6% increase in supervisory events as problem banks continued to work through their existing issues.
- Responded to heightened supervisory requirements and implemented additional supervision programs as required by the Dodd-Frank Act while exceeding all mandates and timeliness expectations for conducting exams and delivering accurate supervisory reports.
- Gained oversight responsibility for three of the eight designated systemically important Financial Market Utilities (FMUs), partnering with Central Bank Services and the Financial Markets Group to identify policy, procedural, and legal issues for providing access to accounts, services, and emergency credit to these FMUs.
- Provided leadership of System efforts around Large Bank supervision, wholesale credit, stress testing, incentive compensation and IT examinations.

Providing Central Bank Services

- Provided leadership on a high-priority System project to develop a methodology for calculating the additional haircut on discount-window collateral pledged by troubled depository institutions.

Fostering Good Customer Relations and Support

- Met critical objectives, exceeded FedLine revenue targets, and led the communication efforts to inform stakeholders of the new Federal Reserve Financial Services strategic direction.
- Hosted the 2012 Chicago Payments Symposium, which introduced the new strategic direction to the payments industry.

Fostering Community Development and Studying Policy

- Studied community and economic development issues including trends impacting low- to moderate-income communities.
- Analyzed the availability of financial services in Detroit and how changes in the location of financial service providers affect the availability of credit and banking services for Detroit's small businesses.
- Convened small business owners, lenders, and service providers to discuss potential solutions to financing problems.

Carrying Out Currency Responsibilities

- Met all performance targets while maintaining a strong control environment.
- Provided uninterrupted currency services during the NATO Summit held in Chicago.

Promoting Diversity and Inclusion

- Sustained emphasis on diversity and inclusion initiatives, continuing to provide key leadership to national diversity recruitment and national diversity supplier programs.
- Conducted diversity and inclusion training for all people leaders in the organization.
- Continued to attract a strong pool of diverse and highly skilled candidates, support professional growth and development for staff, and expand the District's succession management strategies with a focus on diversity-related issues.

Fostering Partnerships

- Sustained a successful track-record of partnering with others throughout the System, leading and participating on numerous System-level committees, projects, and workgroups.

Creating a Healthy Work Environment

- Received certification for Leadership in Energy and Environmental Design for Existing Buildings (LEED-EB) Silver.
- Opened a new Wellness Center for employees.

Other

- Completed construction of new Business Continuity Office emergency relocation site, which became fully functional in November.
- Continued to coordinate and grow Money Smart Week, with more than 3,000 free financial education classes offered in more than 35 states. Classes are hosted by partner organizations including financial institutions, universities, government agencies, community groups and libraries.

Daniel Zaglama (left to right), Olga Gurevich, Michael McGillen and Craig Volk help the Federal Reserve Bank of Chicago supervise savings and loan holding companies in the Seventh District. Effective supervision of this highly diverse industry requires staff with expertise in financial reporting, business analysis, bank examination and communications.

Promoting Financial Stability

Taking on New Roles in Today's Markets

The work of the Federal Reserve Bank of Chicago's Supervision and Regulation Department (S&R) has expanded sharply in the wake of the financial crisis. S&R is supervising new companies, participating in new activities to focus on financial stability, and collaborating with others in new ways in order to take on these roles in today's financial services market.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA) to a large extent shapes modern-day supervision and many of these new functions within S&R. In addition to expanding the role of the Federal Reserve System in supervision, this expansive piece of legislation also reinforced many of the System's existing responsibilities. S&R oversees one of the System's largest and most diverse collections of financial institutions. More than 1,000 banking organizations — ranging from hundreds of rural, community banks to large financial institutions with consolidated total assets exceeding $350 billion — are headquartered in the Seventh District. Together, these organizations represent a vibrant cross-section of the nation's economy and banking system that continues to provide valuable insights and perspectives.

"It is impossible to know with certainty which risks will challenge the financial system in the future," says Cathy Lemieux, executive vice president and the head of S&R. "However, if firms have ways to measure and monitor the risks they take, as well as sufficient capital to withstand stressful conditions, then we will have a banking system able to provide businesses and consumers with the credit necessary for a vibrant economy."

The Federal Reserve Bank of Chicago has strategically trained and hired employees in S&R to take on new roles in supervision. The following articles highlight not only the new activities within S&R, but also the skills of staff involved directly in these efforts. Our people are an important element of this work as we strive for fair and equal access to credit within a financial system that meets the needs of the communities where its participants do business.

Supervising New Companies

Savings and Loan Holding Companies

The Chicago Fed's new role in supervising holding companies that own savings and loan associations (S&Ls) is an example of the way our work has meaningfully evolved in the span of just a few years. Since 2011, DFA has required the System to supervise Savings and Loan Holding Companies (SLHCs) whose holdings include S&Ls, also known as thrifts. At first blush, this new responsibility may not seem radically different than some of our existing roles in supervising banks. However, supervising modern-day SLHCs is a more complex job than it might initially appear.

Today's SLHC industry is highly relevant to the 7th District's economy. Big companies in industries that include manufacturers and insurers – two key sectors in the Chicago Fed's geographic footprint – have come to own and use S&Ls in highly specialized ways. An S&L owned by an equipment manufacturer, for example, may finance customer purchases; an insurance company, by contrast, may use its S&L to offer more products to customers. As a supervisor, the Chicago Fed has to understand how each institution's business activities, including those performed at both the holding company and throughout non-bank subsidiaries, impact the overall financial health of the parent company.

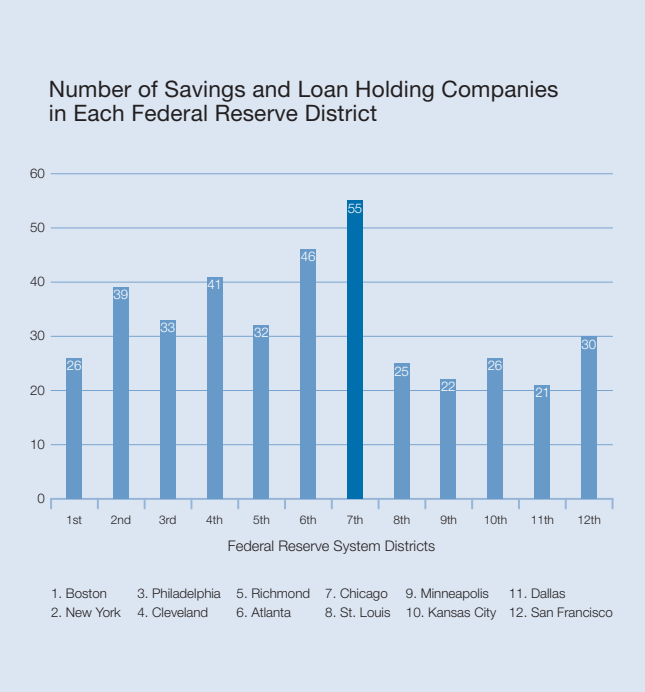
The Chicago Fed's own supervisory assignments reflect the SLHC industry's diversity. The 7th District's portfolio encompasses 55 unique SLHCs that range in size from $65 million to $130 billion in total assets, as of December 31, 2012. This portfolio is the Federal Reserve System's largest and includes household corporate names like farm equipment maker Deere & Company, grocer Hy-Vee Inc., and State Farm Mutual Automobile Insurance Co.

The team overseeing SLHCs has individuals with diverse backgrounds, including working in the thrift industry, insurance industry, and data management. The staff also emphasizes strong communication skills to help these companies understand the policies that apply to them, some of which are new.

"One of the most important aspects of our responsibilities is working with holding companies that own savings and loans

to understand the new rules and how they apply," says Gustavo Lira, a manager in the Chicago Fed's Regional Thrift Group. "To do that, it's imperative we understand the unique characteristics and risk profile of each company."

As new jobs require new skill sets, these roles also provide opportunities for efficiencies in execution. SLHC examination team members are among the many at the Chicago Fed that are finding creative ways to lower costs and increase efficiencies, including performing more examination work without traveling to the supervised company. Meeting in person with management and conducting onsite examinations remain important elements of S&R's work. But thanks to advancements in technology, efforts to do more work remotely have delivered a number of benefits within the last year. Fewer hours on the road mean lower costs, less regulatory burden on examined institutions, and more time for examiners to work on assignments.



Source: Federal Reserve System, 2012.

Financial Market Utilities

On July 18, 2012, the Financial Stability Oversight Council (FSOC) designated eight financial market utilities (FMUs) as systemically important under Title VIII of DFA. FMUs are multilateral systems for transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions. Three designated FMUs are headquartered in the 7th District – The Chicago Mercantile Exchange Inc. (CME), ICE Clear Credit LLC, and The Options Clearing Corporation (OCC). The primary supervisory agencies for these three designated FMUs are the U.S. Commodity Futures Trading Commission (CME and ICE Clear Credit) and the Securities and Exchange Commission (SEC). S&R works with the primary supervisor for each firm through a team of individuals with experience in FMUs, including central clearing, counterparty credit, liquidity, and risk management in operations and information technology.

Gustavo Lira (left) and Andre Reynolds together bring more than 30 years of experience in financial supervision to their roles as managers on the Chicago Fed's Savings and Loan Holding Company Team.

Focusing on Financial Stability

Given the interconnected nature of financial markets, the Chicago Fed is also taking on new activities related to carrying out DFA provisions intended to minimize the systemic imprint of financial failure.

"A focus on systemic risk has been central to reform efforts, and fittingly so," said Federal Reserve Gov. Daniel Tarullo in a 2011 speech.[1] "It was, after all, a systemic financial crisis that we experienced and that led to the Great Recession."

Staff involvement in capital stress testing efforts, the System's Wholesale Credit Risk Center and resolution and incentive compensation planning reflect a significant shift in the way the Chicago Fed helps meet the mission of promoting financial stability.[2]

A key component of the financial condition of any banking organization is capital resiliency. Capital has been a cornerstone of banking supervision for decades, and international coordination efforts in measuring capital standards have occurred since the 1980s. Perhaps one of the most defining capital moments in recent history was the launch of the Supervisory Capital Assessment Program (SCAP)[3] in early 2009 to assess the strength of the 19 largest U.S. bank holding companies at the time. This first round of capital "stress tests" helped calm roiling markets by providing additional transparency and assurance as to the financial condition of the largest banking entities. Congress later made these stress tests a fixture of supervision of large financial institutions. The DFA includes a requirement for all financial institutions above $10 billion in total assets to conduct at least one such test per year.

In the stress tests of large firms, financial institutions with total assets exceeding $50 billion submit to the Federal Reserve System data tied to their balance sheets and income statements. The Fed then processes it using models that measure capital adequacy under extreme economic stress. Staff members then analyze results alongside capital plans and firm-specific internal capital stress testing efforts. In the latter part of the cycle, supervisors use the results to determine whether each institution has sufficient capital to withstand financial and economic stress, as well as adequate forward-looking capital planning processes.

More than 100 staff members at the Chicago Fed participated in stress test efforts in 2012. Supervisors assessed whether stress testing assumptions and approaches are appropriate, including estimated loss exposures and sources of revenue. The Chicago Fed also houses a team of individuals that specializes in wholesale lending, which includes commercial real estate and corporate loan activities. This team carries out its job as part of the Wholesale Credit Risk Center, which has delegated responsibility to monitor large financial institutions' wholesale lending activities nationwide. Wholesale Credit Risk Center personnel have experience ranging from commercial banking, statistics and data analysis to programming and modeling.

[1] *http://www.federalreserve.gov/newsevents/speech/tarullo20110603a.htm*

[2] *Federal Reserve's Mission Statement: http://www.federalreserve.gov/aboutthefed/mission.htm*

[3] *Press release from Fed, Treasury, FDIC, OCC, OTS: http://www.federalreserve.gov/newsevents/press/bcreg/20090223a.htm*

"We've been hiring staff from a variety of backgrounds, but they all have one characteristic in common: intellectual curiosity," notes Nancy Beebe, an assistant vice president of the Wholesale Credit Risk Center. "We're working in a world that's constantly changing, so we need professionals who can keep learning and adapting." Beebe joined the Chicago Fed after working in global banking for more than a decade.

The work of the Wholesale Credit Risk Center extends beyond assumptions surrounding capital stress testing efforts. Detailed loan information is reported to, and used by, this team to identify emerging and macro risks in wholesale lending.

"We can see things and ask questions like we never could before," said Paul Huck, Ph.D. and assistant vice president overseeing the Chicago Fed's Wholesale Credit Risk Center and capital analysis team.

While capital stress tests are a critical tool in identifying capital resiliency at large financial institutions, they are but one aspect of overall efforts to foster financial stability. Title I, Section 165(d) of DFA requires covered companies with assets totaling greater than $50 billion to develop plans for emergency funding and, if necessary, an orderly wind-down of operations in the event of material financial distress or failure. These plans are an effort to reduce systemic risk by rapidly resolving large firms during a crisis. A number of large firms have submitted their plans to supervisors, and some sections are available to the public. Chicago Fed staff members have participated in the review of the initial plans, while also staying in close connection with companies slated to submit initial plans in 2013.

The Bank is also working to address the incentives that contribute to firms taking on imprudent risks. A multi-disciplinary Federal Reserve effort is focused on identifying and remedying inappropriate incentive compensation arrangements that fail to deter the taking of long-term risks to achieve short-term profits. Chicago Fed staff has been actively engaged in this effort by working with local institutions, leading several important initiatives and providing leadership to the national implementation project.

Said Lemieux, "Not only do we need to identify risks taken by supervised institutions; we also need to better understand the behaviors that incent such risk-taking activities."

Junling Zhang (left to right), David Ortiz, Nancy Beebe and Paul Huck bring a wide range of experience to the Federal Reserve System's stress test efforts, including backgrounds in global banking, mathematical modeling, securities and investment analysis, and data management.

Collaborating in New and Expanded Ways

The growing roles and activities within S&R provide new opportunities for employees to communicate and collaborate with others, both within and outside of the Chicago Fed. S&R's partnerships extend across the Federal Reserve System and also include other supervisory agencies. This ongoing collaboration also involves outreach to the banking industry. Members of S&R actively lead and participate in System committees that strive for consistent supervision across various market sectors, including community, regional and large financial institutions. Lemieux is currently chair of the System's Large Banking Organization Management Group, which meets regularly to discuss and establish processes to ensure consistent supervisory assessment of risks across holding companies ranging in size from $50 billion to $400 billion in total assets.

Collaborating with New Partners

The financial crisis demonstrated that financial stability relies in part on close cooperation and coordination among relevant supervisory agencies. As such S&R has developed close collaborative relationships with the Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission in monitoring designated FMUs in the Seventh District. Also, Chicago Fed staff works with others in the System on the FMU Supervision Committee, an inter-disciplinary committee that includes lawyers, economists, supervisors and policy analysts who discuss risk and share perspectives.

During the financial crisis, anecdotal and statistical information indicated consumers were vulnerable to unfair lending practices, including some that led to the housing market crisis. In response, DFA renewed supervisors' focus on maintaining a banking system that provides fair and equal access to credit and generally meets the needs of communities. The System is responsible for examining the consumer practices of banks under $10 billion, while assisting the newly created Consumer Financial Protection Bureau (CFPB) in monitoring compliance of larger institutions. In these roles, the Chicago Fed has responsibility for the second-largest portfolio of state member banks among the System's 12 Districts.

The consumer compliance team at the Chicago Fed has expanded its skills and expertise in order to capably carry out its newly shaped role.

"The world won't stop while we adjust to our new responsibilities," says Gretchen Cappiello, manager in the consumer compliance area of S&R. "We have a number of examiners who are new to the Chicago Fed. Getting them up to speed quickly has included extensive education, field training, coaching and mentoring."

The full examiner commissioning training process typically takes employees about three years to complete. During the

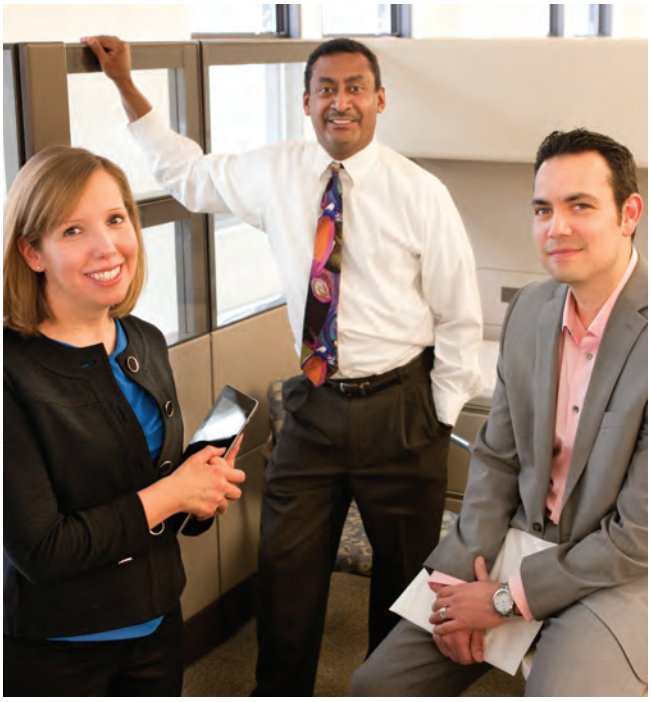
training period, examiner trainees collect valuable on-the-job experience by assisting commissioned staff in exams and other supervisory work.

The advent of the CFPB through DFA is a clear example of the critical need for supervisors to work together closely. The CFPB is charged with protecting consumers through regulation of financial services and products. Although the CFPB is an independent bureau, Congress requires the Federal Reserve to support its work in a number of ways. As one example, S&R staff have helped the Federal Reserve System meet requirements to offer perspective to the CFPB as the bureau proposes and issues new consumer protection rules. The perspectives of S&R continue to be shaped by the 7th District's large presence of community banks, whose business models typically vary substantially from those of larger banking institutions.

New Outreach Efforts

Community banks play a critical role in extending credit across the 7th District. The System continues to make distinct efforts to tailor supervisory guidance and in some cases regulations to account for the differences between community banks and large financial institutions. Community banks, for example, are specifically excluded from enhanced prudential standards outlined in DFA, such as capital stress testing, which applies to larger organizations.

The Chicago Fed is keenly interested in understanding how its actions, as well as new rules from the Board of Governors and other supervisors, affect institutions and their various business activities. Staff members routinely gather input through a range of local forums that also help build awareness of industry issues and regulatory changes, as well as foster the sharing of best practices. For example, the Annual Community Bankers Symposium, which is attended by senior banking industry representatives, is held in the fourth quarter every year at the Chicago Fed's headquarters. The System recently launched a website entitled *Community Banking Connections*, which is designed specifically for smaller banks and offers access to the most up-to-date regulatory information and education. S&R also participates periodically in *Ask the Fed* sessions, a series of teleconference calls to facilitate discussion among supervisors and bankers about top banking issues.



Gretchen Cappiello (left to right), Stanley Coriolan and Alexander Contreras help the Chicago Fed's Consumer Compliance team protect consumers, foster fair lending, and assist the newly formed Consumer Financial Protection Bureau. Cappiello and Coriolan have more than 30 years of experience in consumer protection supervision, while Contreras' experience includes retail financial services.

Embracing the Future

The Chicago Fed and its S&R staff continue to execute both new and existing functions in order to help promote financial stability and the fair and equal treatment of consumers. Now and in the future, staff members will look for ways to efficiently implement additional provisions of DFA, while strategically developing the skills and abilities of staff.

Lemieux notes, "It takes a well-trained and flexible staff to stay abreast of risk issues across an increasing array of financial institutions."

Gordon Werkema

FED's Strategic Direction on Payments Unveiled at Symposium

By **Gordon Werkema**
First Vice President and Chief Operating Officer

The Reserve Banks continue to operate in a dynamic payment environment. New technology advances are triggering innovations in the payments system. Driving these advances are end-users' and payment providers' need to find faster and more efficient payment solutions.

To ensure that Reserve Banks keep pace with industry changes and to support the evolution of the payment system, the Financial Services Policy Committee (FSPC) — which is the oversight and governing body of Federal Reserve Financial Services (FRFS) — recently refreshed the FRFS strategic direction to address the current and future environment. Traditionally, the Reserve Banks have fostered the integrity, efficiency and accessibility of the U.S. payments system by focusing on the needs of depository institutions that serve various end-users. The refreshed direction calls for expanded efforts to better understand and support the industry's goal of delivering improvements to end-users and financial institutions. The Reserve Banks will collaborate with financial institutions to pursue opportunities to enhance the speed, safety, cost effectiveness, and ease of use of payments — from initiation to completion.

To raise awareness of the renewed strategic direction, the Chicago Fed hosted a Payments Symposium in 2012 bringing industry leaders together to discuss ways collaboration could be most productive in making payments faster, safer and more efficient.

Sandra Pianalto, chair of the FSPC and president and CEO of the Federal Reserve Bank of Cleveland, announced that the Federal Reserve has been actively engaged in adjusting its planning, product development and resources to address innovation in the marketplace, within the context of its unchanging financial services mission of integrity, efficiency, and accessibility. She emphasized the need for industry collaboration and noted that, "…a payment system built around competition and collaboration will best serve the needs of different users, including banks, consumers, businesses, and government. Our strategy calls for more engagement with both traditional providers such as the banking industry — and with new market participants and innovators."

The payments symposium attracted more than 150 senior leaders representing all sectors of the payments industry — including financial institutions, industry associations, consulting firms, processors, vendors, networks, merchants and regulators. More than 30 of these experts participated as speakers. This served as an opportunity for payments professionals to educate one another on a variety of issues that affect the payments marketplace today. Of particular interest at the symposium, participants and panelists proposed a number of ideas that, collectively, could help foster the creation of a roadmap to unify the fragmented payments industry and ultimately improve the payment system. In the near term, this could include:

- Fostering safe, easily accessible and efficient directories of transaction account information that can be used in an interoperable fashion and that leverage current payments infrastructure to benefit end-users.
- Fostering faster payments that improve the availability of funds and improving error resolution and providing additional transaction-level information to payers and payees.

In the longer term, participants suggested:

- Forming a national payments strategy or framework, with broad industry involvement and support.
- Developing incentives for different parties involved in payment transactions (e.g., consumers, merchants, and payment service providers) to continue to improve security practices and ensure the integrity of the overall system.
- Investing in generating and implementing new standards (e.g., authentication, etc.) that account for the industry's fast pace of change.

The annual Payments Symposium is an excellent example of how our Reserve Bank is taking on a leadership role within the Federal Reserve System and the banking industry to advance, in a substantive way, the discussion about the future of payments. This forum helped industry participants gain insight into new payment services and changes within the payments infrastructure. This level of engagement is the first step to bring forward improvements to the payments system. As the U.S. payments landscape continues to evolve, the Reserve Banks are committed to working with the industry, and the Chicago Fed will play a key role in fostering diverse and inclusive industry relationships in support of the renewed direction.

Contributing to the development of this essay were Kirstin Wells, assistant vice president, Financial Market Group; Mike Hoppe, vice president, Customer Relations and Support Office (CRSO); Brian Mantel, vice president, CRSO; and Johanna Perez, strategic analyst, CRSO.

Board of Directors

CHAIRMAN
William C. Foote
Retired Chairman
USG Corporation
Chicago, Illinois

DEPUTY CHAIRMAN
Jeffrey A. Joerres
Chairman and Chief Executive Officer
ManpowerGroup
Milwaukee, Wisconsin

Nelda J. Connors
Chairwoman and Chief Executive Officer
Pine Grove Holdings, LLC
Chicago, Illinois

Stephen J. Goodenow
Chairman and Chief Executive Officer
Bank Midwest
Spirit Lake, Iowa

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

Terry Mazany
President and Chief Executive Officer
The Chicago Community Trust
Chicago, Illinois

Federal Reserve Bank of Chicago

Ann D. Murtlow
President and CEO
AM Consulting LLC
Indianapolis, Indiana

Frederick H. Waddell
Chairman and Chief Executive Officer
Northern Trust Corporation and
The Northern Trust Company
Chicago, Illinois

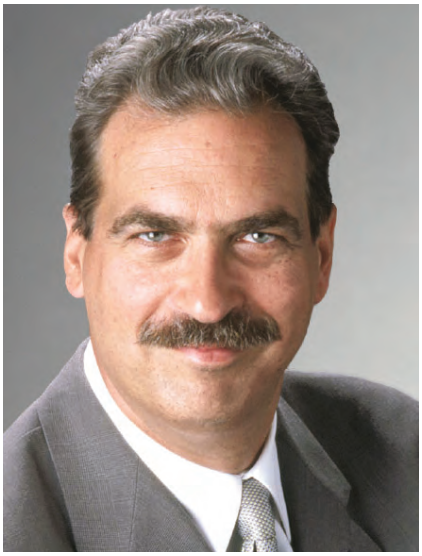
Three new directors joined the Chicago Board in 2013:

Greg Brown (left), Chairman and Chief Executive Officer of Motorola Solutions, Inc., in Schaumburg, Illinois, replaced **William C. Foote**.

William M. Farrow III, President and Chief Executive Officer of Urban Partnership Bank in Chicago, Illinois, replaced **Stephen J. Goodenow**.

Jorge Ramirez (right), President of the Chicago Federation of Labor in Chicago, Illinois, replaced **Ann D. Murtlow**.

Board of Directors



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

Michael E. Bannister
Chairman and Chief Executive Officer
Ford Motor Credit Company
Dearborn, Michigan

Sheilah P. Clay
President and Chief Executive Officer
Neighborhood Service Organization
Detroit, Michigan

Fernando Ruiz
Corporate Vice President and Treasurer
The Dow Chemical Company
Midland, Michigan

Nancy M. Schlichting
Chief Executive Officer
Henry Ford Health System
Detroit, Michigan

Lou Anna K. Simon
President
Michigan State University
East Lansing, Michigan

Federal Reserve Bank of Chicago – Detroit Branch

Brian C. Walker
President and Chief Executive Officer
Herman Miller, Inc.
Zeeland, Michigan

One new director joined the Detroit Branch Board in 2013:

Susan M. Collins, Joan and Sanford Weill Dean of Public Policy, Gerald R. Ford School of Public Policy at the University of Michigan in Ann Arbor, Michigan, replaced **Brian C. Walker**.

Management Committee

Charles L. Evans
President and
Chief Executive Officer

Gordon Werkema
First Vice President and
Chief Operating Officer

Ellen Bromagen
Executive Vice President
Customer Relations and Support Office (CRSO)

Elizabeth A. Knospe
Senior Vice President and General Counsel
Legal, Board of Directors, Enterprise Strategy and Risk Management, Business Continuity, Human Resources and Internal Communications

Margaret K. Koenigs
Senior Vice President and
Chief Financial Officer
Finance

Catharine M. Lemieux
Executive Vice President
Supervision and Regulation

Federal Reserve Bank of Chicago

Jeffrey B. Marcus
Vice President and General Auditor
Internal Audit

David A. Marshall
Senior Vice President and
Associate Director of Research and
Director of Financial Markets Group

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

Valerie J. Van Meter
Senior Vice President,
EEO Officer and Director of OMWI
Central Bank Services, System Leadership
Initiatives, and Office of Diversity and Inclusion

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

Executive Officers

Charles L. Evans
President and
Chief Executive Officer

Gordon Werkema
First Vice President and
Chief Operating Officer

ECONOMIC RESEARCH AND PROGRAMS

Daniel G. Sullivan
Executive Vice President and
Director of Research

Spencer D. Krane
Senior Vice President and
Senior Research Advisor

David A. Marshall
Senior Vice President,
Associate Director of Research
and Director of Financial Markets
Group

Regional Economics

William A. Testa
Vice President and
Director of Regional Research

Macroeconomic Policy Research

Jonas D.M. Fisher
Vice President and Director
of Macroeconomic Research

Microeconomic Policy Research

Daniel R. Aaronson
Vice President and Director
of Microeconomic Research

Financial Markets Group

Douglas D. Evanoff
Vice President and
Senior Research Advisor

Edward J. Nosal
Vice President and
Senior Research Advisor

Anna L. Paulson
Vice President and
Director of Financial Research

Richard D. Porter
Vice President and
Senior Research Advisor

Richard A. Heckinger
Vice President and Senior
Policy Advisor

Community Development and Policy Studies

Alicia Williams
Vice President

Public Affairs

G. Douglas Tillett
Vice President

SUPERVISION AND REGULATION

Catharine M. Lemieux
Executive Vice President

Community Bank and Consumer Compliance

Julie Williams
Senior Vice President

Joe Davidson
Vice President
Consumer Compliance

Risk Specialists

Steven M. Durfey
Senior Vice President

Large Specialized Institutions

James Nelson
Senior Vice President

Regional Banking and Holding Companies

Mark Kawa
Vice President

Technology Group

Doug Kasl
Vice President

Department Oversight

Pamela S. Rieger
Vice President

CUSTOMER RELATIONS AND SUPPORT OFFICE (CRSO)

Gordon Werkema
Product Director

Ellen J. Bromagen
Executive Vice President
and Product Manager

Electronic Access

Todd Aadland
Vice President and
Chief Information Officer
Architecture, Application Development
and Information Security

National Sales and Marketing

Sean Rodriguez
Senior Vice President

Shonda Clay
Vice President and
National Marketing and
Regional Sales Director

Michael J. Hoppe
Vice President and
National Account Manager

Laura J. Hughes
Vice President

Steven E. Jung
Vice President

Ted Kurdes
Vice President

Brian Mantel
Vice President

Tracy Harrington
Vice President

Cynthia Pijarowski
Vice President

DISTRICT OPERATIONS, ADMINISTRATIVE SERVICES, LAW ENFORCEMENT AND DETROIT BRANCH

Robert G. Wiley
Senior Vice President and
Branch Manager

Matt LaRocco
Vice President
Administrative Services

District Cash

Donna M. Dziak
Vice President

Mary H. Sherburne
Vice President
Chicago Cash

CENTRAL BANK SERVICES, SYSTEM LEADERSHIP INITIATIVE, AND OFFICE OF DIVERSITY AND INCLUSION

Valerie J. Van Meter
Senior Vice President, EEO Officer,
and Director of OMWI

Jerome E. Julian
Vice President

Craig Marchbanks
Vice President

INFORMATION TECHNOLOGY

Robert G. Wiley
Senior Vice President

Daniel F. Reimann
Vice President

LEGAL, BOARD OF DIRECTORS, ENTERPRISE STRATEGY AND RISK MANAGEMENT, BUSINESS CONTINUITY, HUMAN RESOURCES AND INTERNAL COMMUNICATIONS

Elizabeth A. Knospe
Senior Vice President and
General Counsel

Guenever Scheuermann
Vice President
Enterprise Strategy and
Risk Management
and Business Continuity

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

Nokihomis Willis
Vice President
Human Resources and
Internal Communications

Yurii Skorin
Vice President and
Associate General Counsel

Anna M. Voytovich
Vice President and
Associate General Counsel

INTERNAL AUDIT

Jeffrey B. Marcus
Vice President and General Auditor

FINANCE

Margaret K. Koenigs
Senior Vice President and
Chief Financial Officer

Jeffery S. Anderson
Vice President

Kelly Emery
Vice President

Advisory Councils

/ SEVENTH DISTRICT ADVISORY COUNCIL ON AGRICULTURE, SMALL BUSINESS AND LABOR

ILLINOIS

John A. Challenger
Chief Executive Officer
Challenger, Gray & Christmas, Inc.
Chicago

Diane Cullinan Oberhelman
Chairman & Founding Partner
Cullinan Properties, Ltd.
Peoria

Joel Hertz
Chairman
Hertz Farm Management
Monticello

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

Jorge Ramirez
President
Chicago Federation of Labor
Chicago

Robert Seegers, Jr.
Owner
Seegers Grain, Inc.
Crystal Lake

Whitney Smith
Program Manager
The Joyce Foundation
Chicago

ILLINOIS

Siva Yam
President
United States of America –China Chamber of Commerce (USCCC)
Chicago

INDIANA

Harold Force
President & CEO
Force Construction Company, Inc.
Columbus

Nancy Guyott
President
Indiana State AFL-CIO
Indianapolis

David Howell
Owner
Howell Farms
Middletown

IOWA

Scott Peterson
President,
Harbor Group
CFO, Interstates Companies
Sioux Center

Ken D. Sagar
President
Iowa Federation of Labor AFL-CIO
Des Moines

MICHIGAN

Dave Armstrong
Chief Executive Officer
GreenStone Farm Credit Services
East Lansing

MICHIGAN

Scott Z. Goldstein
President
National Default Exchange (NDeX)
Farmington Hills

John A. James
Chairman & CEO
James Group International, Inc.
Detroit

Birgit Klohs
President & CEO
The Right Place, Inc.
Grand Rapids

Cathy McClelland
President & CEO
McClelland & Associates
Southfield

Donald Snider
Senior Vice President
Urban Economic Development
Michigan Economic Development Corp.
Detroit

WISCONSIN

David J. Lubar
President
Lubar & Co.
Milwaukee

Carol Maria
President
Wisconsin Business Development Service Company
Waukesha

Advisory Councils

Community Depository Institutions Advisory Council (CDIAC)

Standing from left to right: William M. Farrow III, Steven M. Eldred, Timothy G. Marshall, Jeff Plagge, David M. Findlay, Micah R. Bartlett, David W. Heeter, Michael L. Scudder. Sitting from left to right: Jean M. Trainor, Catherine J. Tierney, Sandra Jelinksi, Barrie G. Christman.

ILLINOIS

Micah R. Bartlett
President and
Chief Executive Officer
Town and Country Bank
Springfield

William M. Farrow III
President and
Chief Executive Officer
Urban Partnership Bank
Chicago

Michael L. Scudder
President and
Chief Executive Officer
First Midwest Bancorp, Inc.
Chairman of the Board and Chief
Executive Officer
First Midwest Bank
Itasca

IOWA

Barrie G. Christman
Chairman of the Bank
Principal Bank
Des Moines

Jeff Plagge
President and
Chief Executive Officer
Northwest Financial Corp.
Arnolds Park

Jean Trainor
President and CEO
Veridian Credit Union
Waterloo

WISCONSIN

Steven M. Eldred
President and
Chief Executive Officer
First National Bank and Trust
Beloit

Catherine J. Tierney
President and
Chief Executive Officer
Community First Credit Union
Appleton

INDIANA

David M. Findlay
President and
Chief Financial Officer
Lake City Bank
Warsaw

David W. Heeter
Chief Executive Officer
MutualBank
Muncie

MICHIGAN

Sandra Jelinski
President and
Chief Executive Officer
Lake Michigan Credit Union
Grand Rapids

Timothy G. Marshall
President and
Chief Executive Officer
Bank of Ann Arbor
Ann Arbor

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. Seventh District member banks elect three bankers and three non-bankers. The Board of Governors appoints three additional non-bankers and designates the Reserve Bank chairman and deputy chairman 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 Chicago board designates one of the Board of Governors appointees as chairman of the Detroit Board. Reserve Bank and Branch directors may serve three-year terms, with a maximum of two full terms.

Director appointments and elections at the Chicago Reserve Bank and its Detroit Branch effective in 2012 were:

Michael E. Bannister was appointed to a three-year term as a Detroit Branch director.

Carl T. Camden was re-appointed to a one-year term as Detroit Branch board chairman.

Nelda J. Connors was re-elected to a three-year term as a Chicago director.

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

Jeffrey A. Joerres was re-appointed to a three-year term as a Chicago director and appointed to a one-year term as Chicago board deputy chairman.

Fernando Ruiz was appointed in February to serve an unexpired term as a Detroit Branch director.

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

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

The following appointments and elections for 2013 were announced:

Greg Brown was appointed to a three-year term as a Chicago director and appointed to a one-year term as Chicago board deputy chairman.

Carl T. Camden was re-appointed to a one-year term as Detroit Branch board chairman.

Susan M. Collins was appointed to serve an unexpired term as a Detroit Branch director.

William M. Farrow was elected to serve a three-year term as a Chicago director.

Jeffrey A. Joerres was appointed to a one-year term as Chicago board chairman.

Terry Mazany was re-elected to a three-year term as a Chicago director.

Jorge Ramirez was elected to serve an unexpired term as a Chicago director.

Lou Anna K. Simon was re-appointed to a three-year term as a Detroit Branch director.

FEDERAL ADVISORY COUNCIL REPRESENTATIVE

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.

David W. Nelms, Chairman and Chief Executive Officer of Discover Financial Services in Riverwoods, Illinois, served one-year terms in 2010, 2011, and 2012 as the Federal Advisory Council representative for the Seventh Federal Reserve District. He was selected to serve a fourth one-year term in 2013.

EXECUTIVE CHANGES

Todd Aadland to CRSO Chief Information Officer, retains title of Vice President

Shonda S. Clay, CRSO Vice President, Regional Sales and Analytics, assumed responsibility for the National Marketing function

Matt La Rocco to Vice President, Administrative Services

Michael J. Hoppe, CRSO Vice President, National Account Sales, assumed additional responsibilities for FedLine revenue management and CRSO office strategic planning

The Bank's Board of Directors acted on the following promotions during 2012:

Ellen Bromagen to Executive Vice President and Product Manager of the Customer Relations and Support Office (CRSO)

Joseph C. Davidson to Vice President in the Supervision and Regulation Department

Kelly Emery to Vice President in the Finance Division

Tracy Harrington to Vice President of CRSO FedLine Product Line

Margaret Koenigs to Chief Financial Officer, retains title of Senior Vice President

Brian J. Mantel to Vice President, CRSO Market Research and Product Development

Craig F. Marchbanks to Vice President in charge of Corporate Social Responsibility and Deputy Director of the Office of Minority and Women Inclusion

Jeffrey B. Marcus to General Auditor, retains title of Vice President

Cynthia J. Pijarowski to Vice President, CRSO Finance, Reporting and Compliance

Guenever Scheurmann to Vice President, Enterprise Strategy and Risk Management and Business Continuity

Julie A. Williams to Senior Vice President, Community Bank and Consumer Compliance

Nokihomis T. Willis to Vice President, Human Resources and Internal Communications

Operations Volumes

	Dollar Amount		Number of Items	
	2012	2011	2012	2011
Cash Operations				
Currency Counted	44.0 Billion	43.7 Billion	2.9 Billion	2.9 Billion
Unfit Currency Destroyed	3.8 Billion	4.0 Billion	294.2 Million	335.1 Million
Coin Bags Paid and Received	1.5 Billion	1.7 Billion	3.2 Million	3.4 Million
Number of Notes Paid and Received	107.6 Billion	109.5 Billion	6.7 Billion	6.9 Billion
Loans to Depository Institutions				
Total Loans Made During Year	502.5 Million	1.1 Billion	548 Loans	651 Loans

Financial Reports Contents

Auditor Independence	30
Management's Report on Internal Control Over Financial Reporting	31
Independent Auditors' Report	32
Abbreviations	34
Statements of Condition	35
Statements of Income and Comprehensive Income	36
Statements of Changes in Capital	37
Notes to Financial Statements	38

Auditor Independence

The Board of Governors engaged Deloitte & Touche LLP (D&T) to audit the 2012 combined and individual financial statements of the Reserve Banks and those of the consolidated LLC entities.[1] In 2012, D&T also conducted audits of internal controls over financial reporting for each of the Reserve Banks, Maiden Lane LLC, Maiden Lane III LLC, and TALF LLC. Fees for D&T's services totaled $7 million, of which $1 million was for the audits of the consolidated LLC entities. To ensure auditor independence, the Board requires that D&T be independent in all matters relating to the audits. 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 the Reserve Banks, or in any other way impairing its audit independence. In 2012, the Bank did not engage D&T for any non-audit services.

[1] In addition, D&T audited the Office of Employee Benefits of the Federal Reserve System (OEB), the Retirement Plan for Employees of the Federal Reserve System (System Plan), and the Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The System Plan and the Thrift Plan provide retirement benefits to employees of the Board, the Federal Reserve Banks, and the OEB.

Management's Report on Internal Control Over Financial Reporting

March 14, 2013

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 Statements of Condition as of December 31, 2012 and 2011, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (the financial statements). The financial statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the financial statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the FAM and include all disclosures necessary for such fair presentation.

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

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

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

Federal Reserve Bank of Chicago

by Charles L. Evans	by Gordon Werkema	by Margaret Koenigs
President	First Vice President	Senior Vice President and CFO

Independent Auditors' Report

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 financial statements of the Federal Reserve Bank of Chicago ("FRB Chicago"), which are comprised of the statements of condition as of December 31, 2012 and 2011, and the related statements of income and comprehensive income, and of changes in capital for the years then ended, and the related notes to the financial statements. We also have audited the FRB Chicago's internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management's Responsibility

The FRB Chicago's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles established by the Board of Governors of the Federal Reserve System (the "Board") as described in Note 3 to the financial statements. The Board has determined that this basis of accounting is an acceptable basis for the preparation of the FRB Chicago's financial statements in the circumstances. The FRB Chicago's management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The FRB Chicago's management is also responsible for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on the FRB Chicago's internal control over financial reporting based on our audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) ("PCAOB") and we conducted our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of the financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the FRB Chicago's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of the financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting involves obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Member of
Deloitte Touche Tohmatsu Limited

Definition of Internal Control Over Financial Reporting

The FRB Chicago's internal control over financial reporting is a process designed by, or under the supervision of, the FRB Chicago's principal executive and principal financial officers, or persons performing similar functions, and effected by the 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. The 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 the 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, and that receipts and expenditures of the FRB Chicago are being made only in accordance with authorizations of management and directors of the FRB Chicago; and (3) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the FRB Chicago's assets that could have a material effect on the financial statements.

Inherent Limitations of Internal Control Over Financial Reporting

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 and corrected 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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FRB Chicago as of December 31, 2012 and 2011, and the results of its operations for the years then ended in accordance with the basis of accounting described in Note 3 to the financial statements. Also, in our opinion, the FRB Chicago maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the criteria established in *Internal Control —Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Basis of Accounting

We draw attention to Note 3 to the financial statements, which describes the basis of accounting. The FRB Chicago has prepared these financial statements in conformity with accounting principles established by the Board, as set forth in the *Financial Accounting Manual for Federal Reserve Banks*, which is a 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 and accounting principles generally accepted in the United States of America are also described in Note 3 to the financial statements. Our opinion is not modified with respect to this matter.

Deloitte & Touche LLP

March 14, 2013

Financial Statements

Abbreviations:

ACH	Automated clearinghouse
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
FAM	*Financial Accounting Manual for Federal Reserve Banks*
FASB	Financial Accounting Standards Board
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
FOMC	Federal Open Market Committee
FRBNY	Federal Reserve Bank of New York
GAAP	Accounting principles generally accepted in the United States of America
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
MBS	Mortgage-backed securities
OEB	Office of Employee Benefits of the Federal Reserve System
OFR	Office of Financial Research
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
TBA	To be announced
TDF	Term Deposit Facility

Financial Statements

Federal Reserve Bank of Chicago Statements of Condition As of December 31, 2012 and December 31, 2011 (in millions)	2012	2011
Assets		
Gold certificates	$ 839	$ 854
Special drawing rights certificates	424	424
Coin	311	332
Loans to depository institutions	9	17
System Open Market Account:		
Treasury securities, net (of which $507 and $898 is lent as of December 31, 2012 and 2011, respectively)	100,366	103,941
Government-sponsored enterprise debt securities, net (of which $39 and $76 is lent as of December 31, 2012 and 2011, respectively)	4,409	6,403
Federal agency and government-sponsored enterprise mortgage-backed securities, net	52,720	50,374
Foreign currency denominated assets, net	666	657
Central bank liquidity swaps	237	2,529
Other investments	1	-
Accrued interest receivable	1,050	1,169
Bank premises and equipment, net	231	236
Items in process of collection	-	20
Other assets	30	24
Total assets	**$ 161,293**	**$ 166,980**
Liabilities and Capital		
Federal Reserve notes outstanding, net	$ 82,679	$ 76,931
System Open Market Account:		
Securities sold under agreements to repurchase	5,946	5,933
Other liabilities	176	81
Deposits:		
Depository institutions	69,746	76,731
Other deposits	27	36
Interest payable to depository institutions	9	7
Accrued benefit costs	185	166
Deferred credit items	-	56
Accrued interest on Federal Reserve notes	89	170
Interdistrict settlement account	856	5,416
Other liabilities	20	17
Total liabilities	**159,733**	**165,544**
Capital paid-in	780	718
Surplus (including accumulated other comprehensive loss of $60 and $47 at December 31, 2012 and 2011, respectively)	780	718
Total capital	**1,560**	**1,436**
Total liabilities and capital	**$ 161,293**	**$ 166,980**

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

Financial Statements

Federal Reserve Bank of Chicago Statements of Income and Comprehensive Income For the years ended December 31, 2012 and December 31, 2011 (in millions)	2012	2011
Interest Income		
System Open Market Account:		
Treasury securities, net	$ 2,626	$ 2,673
Government-sponsored enterprise debt securities, net	149	197
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,782	2,460
Foreign currency denominated assets, net	4	6
Central bank liquidity swaps	6	1
Other investments	1	-
Total interest income	**4,568**	**5,337**
Interest Expense		
System Open Market Account:		
Securities sold under agreements to repurchase	8	3
Deposits:		
Depository institutions	173	174
Term Deposit Facility	-	1
Total interest expense	**181**	**178**
Net interest income	**4,387**	**5,159**
Non-Interest Income		
System Open Market Account:		
Treasury securities gains, net	747	134
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	14	1
Foreign currency translation gains (losses), net	(30)	4
Income from services	77	76
Compensation received for service costs provided	20	21
Reimbursable services to government agencies	6	5
Other	7	8
Total non-interest income	**841**	**249**
Operating Expenses		
Salaries and benefits	191	175
Occupancy	28	29
Equipment	12	12
Compensation paid for service costs incurred	12	8
Assessments:		
Board of Governors operating expenses and currency costs	80	73
Bureau of Consumer Financial Protection	11	7
Office of Financial Research	-	1
Other	82	77
Total operating expenses	**416**	**382**
Net income before interest on Federal Reserve notes expense remitted to Treasury	4,812	5,026
Interest on Federal Reserve notes expense remitted to Treasury	4,690	4,932
Net income	122	94
Change in prior service costs related to benefit plans	(1)	(1)
Change in actuarial losses related to benefit plans	(12)	(5)
Total other comprehensive loss	**(13)**	**(6)**
Comprehensive income	**$ 109**	**$ 88**

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

Financial Statements

Federal Reserve Bank of Chicago Statements of Changes in Capital
For the years ended December 31, 2012 and December 31, 2011 (in millions, except share data)

		Surplus			
	Capital paid-in	Net income retained	Accumulated other comprehensive loss	Total surplus	Total capital
Balance at December 31, 2010 (13,439,824 shares)	**$ 672**	**$ 713**	**$ (41)**	**$ 672**	**$ 1,344**
Net change in capital stock issued (913,335 shares)	46	-	-	-	46
Comprehensive income:					
Net income	-	94	-	94	94
Other comprehensive loss	-	-	(6)	(6)	(6)
Dividends on capital stock	-	(42)	-	(42)	(42)
Net change in capital	46	52	(6)	46	92
Balance at December 31, 2011 (14,353,159 shares)	**$ 718**	**$ 765**	**$ (47)**	**$ 718**	**$ 1,436**
Net change in capital stock issued (1,251,396 shares)	62	-	-	-	62
Comprehensive income:					
Net income	-	122	-	122	122
Other comprehensive loss	-	-	(13)	(13)	(13)
Dividends on capital stock	-	(47)	-	(47)	(47)
Net change in capital	62	75	(13)	62	124
Balance at December 31, 2012 (15,604,555 shares)	**$ 780**	**$ 840**	**$ (60)**	**$ 780**	**$ 1,560**

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

Notes to Financial Statements

1. Structure

The Federal Reserve Bank of Chicago (Bank) is part of the Federal Reserve System (System) and is one of the 12 Federal Reserve Banks (Reserve Banks) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank serves the 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. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

In addition to the 12 Reserve Banks, the System also consists, in part, of the Board of Governors and the Federal Open Market Committee (FOMC). The Board of Governors, an independent federal agency, is charged by the Federal Reserve Act with a number of specific duties, including general supervision over the Reserve Banks. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York (FRBNY), and, on a rotating basis, four other Reserve Bank presidents.

2. Operations and Services

The Reserve Banks perform a variety of services and operations. These functions include participating in formulating and conducting monetary policy; participating in the payment system, including large-dollar transfers of funds, automated clearinghouse (ACH) operations, and check collection; distributing coin and currency; performing fiscal agency functions for the U.S. Department of the Treasury (Treasury), certain federal agencies, and other entities; serving as the federal government's bank; providing short-term loans to depository institutions; providing loans to participants in programs or facilities with broad-based eligibility in unusual and exigent circumstances; serving consumers and communities by providing educational materials and information regarding financial consumer protection rights and laws and information on community development programs and activities; and supervising bank holding companies, state member banks, savings and loan holding companies, U.S. offices of foreign banking organizations, and designated financial market utilities pursuant to authority delegated by the Board of Governors. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, government-sponsored enterprise (GSE) debt securities, federal agency and GSE mortgage-backed securities (MBS), the purchase of these securities under agreements to resell, and the sale of these securities under agreements to repurchase. The FRBNY holds the resulting securities and agreements in a portfolio known as the System Open Market Account (SOMA). The FRBNY is authorized and directed to lend the Treasury securities and federal agency and GSE debt securities that are held in the SOMA.

To counter disorderly conditions in foreign exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities, the FOMC has authorized and directed the FRBNY to execute spot and forward foreign exchange transactions in 14 foreign currencies, to hold balances in those currencies, and to invest such foreign currency holdings, while maintaining adequate liquidity. The FOMC has also authorized the FRBNY to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of $2 billion and $3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund.

Because of the global character of funding markets, the System has at times coordinated with other central banks to provide temporary liquidity. In May 2010, the FOMC authorized and directed the FRBNY to establish temporary U.S. dollar liquidity swap arrangements with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank through January 2011. Subsequently, the FOMC authorized and directed the FRBNY to extend these arrangements through February 1, 2013. In December, 2012, the FOMC authorized and directed the FRBNY to extend these arrangements through February 1, 2014. In addition, in November 2011, as a contingency measure, the FOMC authorized the FRBNY to establish temporary bilateral foreign currency liquidity swap arrangements, with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank so that liquidity can be provided to U.S. institutions in any of their currencies if necessary. In December 2012, the FOMC authorized the FRBNY to extend these temporary bilateral foreign currency liquidity swap arrangement through February 1, 2014.

Although the Reserve Banks are separate legal entities, they collaborate on the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks. Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by the other Reserve Banks include national business development and customer support.

3. Significant Accounting Policies

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

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States of America (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost and the recording of all SOMA securities on a settlement-date basis. Amortized cost, rather than the fair value presentation, more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Although the application of fair value measurements to the securities holdings may result in values substantially greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, better reflects the timing of the transaction's effect on the quantity of reserves in the banking system. The cost bases of Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP. SOMA securities holdings are evaluated for credit impairment periodically.

In addition, the Bank does not present a Statement of Cash Flows as required by GAAP because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities as a central bank. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital, and the accompanying notes to the financial statements. Other than those described above, there are no 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.

The presentation of "Dividends on capital stock" and "Interest on Federal Reserve notes expense remitted to Treasury" in the Statements of Income and Comprehensive Income for the year ended December 31, 2011 has been revised to conform to the current year presentation format. In addition, the presentation of "Comprehensive income" and "Dividends on capital stock" in the Statements of Changes in Capital for the year ended December 31, 2011 have been revised to conform to the current year presentation format. The revised presentation of "Dividends on capital stock" and "Interest on Federal Reserve notes expense remitted to Treasury" better reflects the nature of these items and results in a more consistent treatment of the amounts presented in the Statements of Income and Comprehensive Income and the related balances presented in the Statements of Condition. As a result of the change to report "Interest on Federal Reserve notes expense remitted to Treasury" as an expense, the amount reported as "Comprehensive income" for the year ended December 31, 2011 has been revised. Significant accounts and accounting policies are explained below.

a. Consolidation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that has supervisory authority over some institutions previously supervised by the Reserve Banks in connection with those institutions' compliance with consumer protection statutes. Section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the System. Section 152 of the Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury. The Board of Governors funds the Bureau and OFR through assessments on the Reserve Banks as required by the Dodd-Frank Act. The Reserve Banks reviewed the law and evaluated the design of and their relationships to the Bureau and the OFR and determined that neither should be consolidated in the Bank's financial statements.

b. Gold and Special Drawing Rights Certificates

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

SDRs are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for

the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR certificate transactions occur, the Board of Governors allocates the SDR certificates among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding calendar year. SDR certificates are recorded by the Banks at original cost. There were no SDR certificate transactions during the years ended December 31, 2012 and 2011.

c. Coin

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

d. Loans

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

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

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a triparty arrangement. In a triparty arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the FRBNY and counterparty. The collateral pledged must exceed the principal amount of the transaction by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including Treasury Inflation-Protected Securities and Separate Trading of Registered Interest and Principal of Securities Treasury securities); direct obligations of several federal and GSE-related agencies, including Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac); and pass-through MBS of Fannie Mae, Freddie Mac, and Government National Mortgage Association. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. These transactions are reported at their contractual amounts as "System Open Market Account: Securities purchased under agreements to resell" and the related accrued interest receivable is reported as a component of "Other assets" in the Statements of Condition.

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and selected money market funds. The list of eligible counterparties was expanded to include GSEs, effective in July 2011, and bank and savings institutions, effective in December 2011. These reverse repurchase transactions may be executed through a triparty arrangement as an open market operation, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, and federal agency and GSE MBS that are held in the SOMA. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts as "System Open Market Account: Securities sold under agreements to repurchase" and the related accrued interest payable is reported as a component of "Other liabilities" in the Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. The amortized cost basis of securities lent continues to be reported as "Treasury securities, net" and "Government-sponsored enterprise debt securities, net," as appropriate, in the Statements of Condition. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Non-interest income: Other" in the Statements of Income and Comprehensive Income.

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

f. Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Foreign Currency Denominated Assets; and Warehousing Agreements

Interest income on Treasury securities, GSE debt securities, and foreign currency denominated assets comprising the SOMA is accrued on a straight-line basis. Interest income on federal agency and GSE MBS is accrued using the interest method and includes amortization of premiums, accretion of discounts, and gains or losses associated with principal paydowns. Premiums and discounts related to federal agency and GSE MBS are amortized or accreted over the term of the security to stated maturity, and the amortization of premiums and accretion of discounts are accelerated when principal payments are received. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Treasury securities, GSE debt securities, and federal agency and GSE MBS are reported net of premiums and discounts in the Statements

of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts in the Statements of Income and Comprehensive Income.

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell "to be announced" (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. During the years ended December 31, 2012 and 2011, the FRBNY executed dollar rolls primarily to facilitate settlement of outstanding purchases of federal agency and GSE MBS. The FRBNY accounts for dollar roll transactions as purchases or sales on a settlement-date basis. In addition, TBA MBS transactions may be paired off or assigned prior to settlement. Net gains (losses) resulting from dollar roll transactions are reported as "Non-interest income: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

Foreign currency denominated assets, which can include foreign currency deposits, securities purchased under agreements to resell, and government debt instruments, are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Foreign currency translation gains and losses that result from the daily revaluation of foreign currency denominated assets are reported as "Non-interest income: System Open Market Account: Foreign currency translation gains (losses), net" in the Statements of Income and Comprehensive Income.

Activity related to Treasury securities, GSE debt securities, and federal agency and GSE MBS, including the premiums, discounts, and realized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in the second quarter of each year. Activity related to foreign currency denominated assets, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31.

Warehousing is an arrangement under which the FOMC has approved the exchange, at the request of the Treasury, of U.S. dollars for foreign currencies held by the Treasury over a limited period. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury for financing purchases of foreign currencies and related international operations. Warehousing agreements are designated as held-for-trading purposes and are valued daily at current market exchange rates. Activity related to these agreements is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31.

g. Central Bank Liquidity Swaps

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

Central bank liquidity swaps activity, including the related income and expense, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31. The foreign currency amounts associated with these central bank liquidity swap arrangements are revalued daily at current foreign currency market exchange rates.

U.S. dollar liquidity swaps

At the initiation of each U.S. dollar liquidity swap transaction, the foreign central bank transfers a specified amount of its currency to a restricted account for the FRBNY in exchange for U.S. dollars at the prevailing market exchange rate. Concurrent with this transaction, the FRBNY and the foreign central bank agree to a second transaction that obligates the foreign central bank to return the U.S. dollars and the FRBNY to return the foreign currency on a specified future date at the same exchange rate as the initial transaction. The Bank's allocated portion of the foreign currency amounts that the FRBNY acquires are reported as "System Open Market Account: Central bank liquidity swaps" in the Statements of Condition. Because the swap transaction will be unwound at the same U.S. dollar amount and exchange rate that were used in the initial transaction, the recorded value of the foreign currency amounts is not affected by changes in the market exchange rate.

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The Bank's allocated portion of the amount of compensation received during the term of the swap transaction is reported as "Interest income: System Open Market Account: Central bank liquidity swaps" in the Statements of Income and Comprehensive Income.

Foreign currency liquidity swaps

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

h. Bank Premises, Equipment, and Software

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

Costs incurred for software during the application development stage, whether developed internally or acquired for internal use, are capitalized based on the purchase cost and the cost of direct services and materials associated with designing, coding, installing, and testing the software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which generally range from two to five years. Maintenance costs related to software are charged to operating expense in the year incurred.

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

i. Interdistrict Settlement Account

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

An annual settlement of the interdistrict settlement account occurs in the second quarter of each year. As a result of the annual settlement, the balance in each Bank's interdistrict settlement account is adjusted by an amount equal to the average balance in the account during the previous twelve month period ended March 31. An equal and offsetting adjustment is made to each Bank's allocated portion of SOMA assets and liabilities.

j. Federal Reserve Notes

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

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

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of $12,410 million and $11,962 million at December 31, 2012 and 2011, respectively.

At December 31, 2012 and 2011, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2012, all gold certificates, all special drawing right certificates, and $1,110 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2012, no investments denominated in foreign currencies were pledged as collateral.

k. Deposits

Depository Institutions

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as a component of "Interest payable to depository institutions" in the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2012 and 2011.

Other

Other deposits include the Bank's allocated portion of foreign central bank and foreign government deposits held at the FRBNY.

l. Items in Process of Collection and Deferred Credit Items

"Items in process of collection" primarily represents amounts attributable to checks that have been deposited for collection and that, as of the balance sheet date, have not yet been presented to the paying bank. "Deferred credit items" is the counterpart liability to items in process of collection. The amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can vary significantly.

m. Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to six 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 six percent on the paid-in capital stock. This cumulative dividend is paid semiannually.

n. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in. On a daily basis, surplus is adjusted to equate the balance to capital paid-in. Accumulated other comprehensive income is reported as a component of "Surplus" in the Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 9 and 10.

o. Interest on Federal Reserve Notes

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This

amount is reported as "Interest on Federal Reserve notes expense remitted to Treasury" in the Statements of Income and Comprehensive Income. See Note 12 for additional information on interest on Federal Reserve notes.

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

p. Income and Costs Related to Treasury Services

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depositary of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2012 and 2011, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

q. Income from Services, Compensation Received for Service Costs Provided and Compensation Paid for Service Costs Incurred

The Bank has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions and, as a result, reports total System revenue for these services as "Income from services" in its Statements of Income and Comprehensive Income. The Bank compensates the applicable Reserve Banks for the costs incurred to provide these services and reports the resulting compensation paid as "Operating expenses: Compensation paid for service costs incurred" in its Statements of Income and Comprehensive Income.

The Federal Reserve Bank of Atlanta has overall responsibility for managing the Reserve Banks' provision of check and ACH services to depository institutions and the FRBNY has overall responsibility for managing the Reserve Banks' provision of Fedwire funds and securities services. The Reserve Bank that has overall responsibility for managing these services recognizes the related total System revenue in its Statements of Income and Comprehensive Income. The Bank is compensated for costs incurred to provide these services and reports this compensation as "Non-interest income: Compensation received for service costs provided" in its Statements of Income and Comprehensive Income.

r. Assessments

The Board of Governors assesses the Reserve Banks to fund its operations, the operations of the Bureau and, for a two-year period following the July 21, 2010 effective date of the Dodd-Frank Act, the OFR. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances. The Board of Governors also assesses each Reserve Bank for expenses related to producing, issuing, and retiring Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

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

The Board of Governors assessed the Reserve Banks to fund the operations of the OFR for the two-year period ended July 21, 2012, following enactment of the Dodd-Frank Act; thereafter, the OFR is funded by fees assessed on bank holding companies and nonbank financial companies that meet the criteria specified in the Dodd-Frank Act.

s. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were $3 million for each of the years ended December 31, 2012 and 2011, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

t. Restructuring Charges

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Bank commits to a formalized restructuring plan or executes the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 11 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY.

The Bank had no significant restructuring activities in 2012 and 2011.

u. Recently Issued Accounting Standards

In April 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-02, *Receivables* (Topic 310): *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which clarifies accounting for troubled debt restructurings, specifically clarifying creditor concessions and financial difficulties experienced by borrowers. This update is effective for the Bank for the year ended December 31, 2012, and did not have a material effect on the Bank's financial statements.

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

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

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income* (Topic 220): *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This update indefinitely deferred the requirements of ASU 2011-05 which required an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective net income line items. Subsequently, in February 2013, the FASB issued ASU 2013-02, *Comprehensive Income* (Topic 220): *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which established an effective date for the requirements of ASU 2011-05 related to reporting of significant reclassification adjustments from accumulated other comprehensive income. These presentation requirements of ASU 2011-05 are effective for the Bank for the year ending December 31, 2013, and will be reflected in the Bank's 2013 financial statements.

In January 2013, the FASB issued ASU 2013-01, *Balance Sheet* (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. This update clarifies that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815. This update is effective for the Bank for the year ending December 31, 2013, and is not expected to have a material effect on the Bank's financial statements.

4. Loans

Loans to Depository Institutions

The Bank offers primary, secondary, and seasonal loans to eligible borrowers, and each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every 14 days by the Bank's board of directors, subject to review and determination by the Board of Governors. Primary and secondary loans are extended on a short-term basis, typically overnight, whereas seasonal loans may be extended for a period of up to nine months.

Primary, secondary, and seasonal loans are collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; asset-backed securities; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Bank, which is typically fair value reduced by a margin. Loans to depository institutions are monitored daily to ensure that borrowers continue to meet eligibility requirements for these programs. The financial condition of borrowers is monitored by the Bank and, if a borrower no longer qualifies for these programs, the Bank will generally request full repayment of the outstanding loan or, for primary or seasonal loans, may convert the loan to a secondary credit loan. Collateral levels are reviewed daily against outstanding 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.

Loans to depository institutions were $9 million and $17 million as of December 31, 2012 and 2011, respectively with a remaining maturity within 15 days.

At December 31, 2012 and 2011, the Bank did not have any loans that were impaired, past due, or on non-accrual status, and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2012 and 2011.

5. System Open Market Account

a. Domestic Securities Holdings

The FRBNY conducts domestic open market operations and, on behalf of the Reserve Banks, holds the resulting securities in the SOMA.

During the years ended December 31, 2012 and 2011, the FRBNY continued the purchase of Treasury securities and federal agency and GSE MBS under the large-scale asset purchase programs authorized by the FOMC. In August 2010, the FOMC announced that the Federal Reserve would maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in longer-term Treasury securities. In November 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional $600 billion and completed these purchases in June 2011. In September 2011, the FOMC announced that the Federal Reserve would reinvest principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In June 2012, the FOMC announced that it would continue the existing policy of reinvesting principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS, and suspended the policy of rolling over maturing Treasury securities into new issues at auction. In September 2012, the FOMC announced that the Federal Reserve would purchase additional federal agency and GSE MBS at a pace of $40 billion per month and maintain its existing policy of reinvesting principal payments from its holdings of agency debt and federal agency and GSE MBS in federal agency and GSE MBS. In December 2012, the FOMC announced that the Federal Reserve would purchase longer-term Treasury securities at a pace of $45 billion per month after its program to extend the average maturity of its holdings of Treasury securities is completed at the end of 2012.

During the years ended December 31, 2012 and 2011, the FRBNY also continued the purchase and sale of SOMA portfolio holdings under the maturity extension programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would extend the average maturity of the SOMA portfolio holdings of securities by purchasing $400 billion par value of Treasury securities with maturities of six to thirty years and selling or redeeming an equal par amount of Treasury securities with remaining maturities of three years or less by the end of June 2012. In June 2012, the FOMC announced that the Federal Reserve would continue through the end of 2012 its program to extend the average maturity of securities by purchasing $267 billion par value of Treasury securities with maturities of six to thirty years and selling or redeeming an equal par amount of Treasury securities with maturities of three and a quarter years or less by the end of 2012. In September 2012, the FOMC announced it would continue its program to extend the average maturity of its holdings of securities as announced in June 2012.

The Bank's allocated share of activity related to domestic open market operations was 5.548 percent and 5.939 percent at December 31, 2012 and 2011, respectively.

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

	2012			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Bills	$ -	$ -	$ -	$ -
Notes	61,600	1,804	(39)	63,365
Bonds	30,830	6,179	(8)	37,001
Total Treasury securities	$ 92,430	$ 7,983	$ (47)	$ 100,366
GSE debt securities	$ 4,260	$ 150	$ (1)	$ 4,409
Federal agency and GSE MBS	$ 51,407	$ 1,352	$ (39)	$ 52,720

	2011			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Bills	$ 1,094	$ -	$ -	$ 1,094
Notes	76,390	1,592	(73)	77,909
Bonds	21,300	3,643	(5)	24,938
Total Treasury securities	$ 98,784	$ 5,235	$ (78)	$ 103,941
GSE debt securities	$ 6,176	$ 228	$ (1)	$ 6,403
Federal agency and GSE MBS	$ 49,746	$ 690	$ (62)	$ 50,374

The FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed to temporarily drain reserve balances from the banking system and as part of a service offering to foreign official and international account holders.

There were no material transactions related to securities purchased under agreements to resell during the years ended December 31, 2012 and 2011. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2012	2011	2012	2011
Contract amount outstanding, end of year	$ 5,946	$ 5,933	$ 107,188	$ 99,900
Average daily amount outstanding, during the year	5,199	4,554	91,898	72,227
Maximum balance outstanding, during the year	6,798	7,394	122,541	124,512
Securities pledged (par value), end of year	5,190	5,112	93,547	86,089
Securities pledged (market value), end of year	5,946	5,933	107,188	99,900

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2012, and 2011 was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
December 31, 2012:							
Treasury securities (par value)	$ -	$ -	$ 1	$ 20,996	$ 47,843	$ 23,590	$ 92,430
GSE debt securities (par value)	87	155	844	2,931	113	130	4,260
Federal agency and GSE MBS (par value)[1]	-	-	-	-	131	51,276	51,407
Securities sold under agreements to repurchase (contract amount)	5,946	-	-	-	-	-	5,946
December 31, 2011:							
Treasury securities (par value)	$ 965	$ 1,610	$ 5,339	$ 38,582	$ 38,595	$ 13,693	$ 98,784
GSE debt securities (par value)	148	298	1,170	3,599	822	139	6,176
Federal agency and GSE MBS (par value)[1]	-	-	-	1	2	49,743	49,746
Securities sold under agreements to repurchase (contract amount)	5,933	-	-	-	-	-	5,933

[1] The par amount shown for federal agency and GSE MBS is the remaining principal balance of the securities.

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, was approximately 3.3 and 2.4 years as of December 31, 2012, and 2011, respectively.

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

	Allocated to the Bank		Total SOMA	
	2012	2011	2012	2011
Treasury securities (amortized cost)	$ 507	$ 898	$ 9,139	$ 15,121
Treasury securities (par value)	469	830	8,460	13,978
GSE debt securities (amortized cost)	39	76	697	1,276
GSE debt securities (par value)	38	72	676	1,216

The FRBNY enters into commitments to buy and sell Treasury securities and records the related securities on a settlement-date basis. As of December 31, 2012, there were no outstanding commitments.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2012, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was $118,215 million, of which $10,164 million was related to dollar roll transactions. The total purchase price of outstanding purchase commitments allocated to the Bank was $6,558 million, of which $564 million was related to dollar roll transactions. As of December 31, 2012, there were no outstanding sales commitments for federal agency and GSE MBS. These commitments, which had contractual settlement dates extending through February 2013, are for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

Other investments consist of cash and short-term investments related to the federal agency and GSE MBS portfolio. Other liabilities, which are related to federal agency and GSE MBS purchases and sales, includes the FRBNY's obligation to return cash margin posted by counterparties as collateral under commitments to purchase and sell federal agency and GSE MBS. In addition, other liabilities includes obligations that arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the FRBNY has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount included in other liabilities represents the FRBNY's obligation to pay for the securities when delivered. The amount of other investments and other liabilities allocated to the Bank and held in the SOMA at December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2012	2011	2012	2011
Other investments	$ 1	$ -	$ 23	$ -
Other liabilities:				
Cash margin	$ 171	$ 75	$ 3,092	$ 1,271
Obligations from MBS transaction fails	5	6	85	97
Total other liabilites	$ 176	$ 81	$ 3,177	$ 1,368

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the years ended December 31, 2012 and 2011, is summarized as follows (in millions):

	Allocated to the Bank					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2010	$ 1,389	$ 59,297	$ 19,748	$ 80,434	$ 11,532	$ 75,740
Purchases[1]	15,300	48,815	10,401	74,516	-	2,503
Sales[1]	-	(8,179)	-	(8,179)	-	-
Realized gains, net[2]	-	134	-	134	-	-
Principal payments and maturities	(15,301)	(4,254)	-	(19,555)	(2,847)	(12,485)
Amortization of premiums and accretion of discounts, net	1	(280)	(315)	(594)	(109)	(204)
Inflation adjustment on inflation-indexed securities	-	81	69	150	-	-
Annual reallocation adjustment[4]	(295)	(17,705)	(4,965)	(22,965)	(2,173)	(15,180)
Balance December 31, 2011	$ 1,094	$ 77,909	$ 24,938	$ 103,941	$ 6,403	$ 50,374
Purchases[1]	6,859	22,597	14,942	44,398	-	24,339
Sales[1]	-	(28,721)	(661)	(29,382)	-	-
Realized gains, net[2]	-	676	71	747	-	-
Principal payments and maturities	(7,881)	(3,849)	-	(11,730)	(1,544)	(18,268)
Amortization of premiums and accretion of discounts, net	-	(309)	(425)	(734)	(64)	(295)
Inflation adjustment on inflation-indexed securities	-	36	59	95	-	-
Annual reallocation adjustment[4]	(72)	(4,974)	(1,923)	(6,969)	(386)	(3,430)
Balance December 31, 2012	$ -	$ 63,365	$ 37,001	$ 100,366	$ 4,409	$ 52,720
Year ended December 31, 2011						
Supplemental information - par value of transactions:						
Purchases[3]	$ 15,301	$ 47,728	$ 8,237	$ 71,266	$ -	$ 2,432
Sales[3]	-	(8,007)	-	(8,007)	-	-
Year ended December 31, 2012						
Supplemental information - par value of transactions:						
Purchases[3]	$ 6,859	$ 21,744	$ 11,613	$ 40,216	$ -	$ 23,309
Sales[3]	-	(27,865)	(512)	(28,377)	-	-

[1] Purchases and sales are reported on a settlement-date basis and may include payments and receipts related to principal, premiums, discounts, and inflation compensation adjustments to the basis of inflation-indexed securities. The amount reported as sales includes the realized gains and losses on such transactions. Purchases and sales exclude MBS TBA transactions that are settled on a net basis.

[2] Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

[3] Includes inflation compensation

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

	Total SOMA					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2010	$ 18,422	$ 786,575	$ 261,955	$ 1,066,952	$ 152,972	$ 1,004,695
Purchases[1]	239,487	731,252	161,876	1,132,615	-	42,145
Sales[1]	-	(137,734)	-	(137,734)	-	-
Realized gains, net[2]	-	2,258	-	2,258	-	-
Principal payments and maturities	(239,494)	(67,273)	-	(306,767)	(43,466)	(195,413)
Amortization of premiums and accretion of discounts, net	8	(4,445)	(4,985)	(9,422)	(1,678)	(3,169)
Inflation adjustment on inflation-indexed securities	-	1,284	1,091	2,375	-	-
Balance December 31, 2011	$ 18,423	$ 1,311,917	$ 419,937	$ 1,750,277	$ 107,828	$ 848,258
Purchases[1]	118,886	397,999	263,991	780,876	-	431,487
Sales[1]	-	(507,420)	(11,727)	(519,147)	-	-
Realized gains, net[2]	-	12,003	1,252	13,255	-	-
Principal payments and maturities	(137,314)	(67,462)	-	(204,776)	(27,211)	(324,181)
Amortization of premiums and accretion of discounts, net	5	(5,461)	(7,531)	(12,987)	(1,138)	(5,243)
Inflation adjustment on inflation-indexed securities	-	643	1,047	1,690	-	-
Balance December 31, 2012	$ -	$ 1,142,219	$ 666,969	$ 1,809,188	$ 79,479	$ 950,321
Year ended December 31, 2011						
Supplemental information - par value of transactions:						
Purchases[3]	$ 239,494	$ 713,878	$ 127,802	$ 1,081,174	$ -	$ 40,955
Sales[3]	-	(134,829)	-	(134,829)	-	-
Year ended December 31, 2012						
Supplemental information - par value of transactions:						
Purchases[3]	$ 118,892	$ 383,106	$ 205,115	$ 707,113	$ -	$ 413,160
Sales[3]	-	(492,234)	(9,094)	(501,328)	-	-

[1] Purchases and sales are reported on a settlement-date basis and may include payments and receipts related to principal, premiums, discounts, and inflation.
[2] Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.
[3] Includes inflation compensation

b. Foreign Currency Denominated Assets

The FRBNY conducts foreign currency operations and, on behalf of the Reserve Banks, holds the resulting foreign currency denominated assets in the SOMA.

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

The Bank's allocated share of activity related to foreign currency operations was 2.668 percent and 2.534 percent at December 31, 2012 and 2011, respectively.

Information about foreign currency denominated assets, including accrued interest, valued at amortized cost and foreign currency market exchange rates at December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2012	2011	2012	2011
Euro:				
Foreign currency deposits	$ 238	$ 237	$ 8,925	$ 9,367
Securities purchased under agreements to resell	18	-	659	-
German government debt instruments	58	48	2,178	1,884
French government debt instruments	66	67	2,470	2,635
Japanese yen:				
Foreign currency deposits	95	101	3,553	3,986
Japanese government debt instruments	191	204	7,187	8,078
Total allocated to the Bank	$ 666	$ 657	$ 24,972	$ 25,950

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2012, and 2011, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
December 31, 2012:					
Euro	$ 176	$ 46	$ 58	$ 100	$ 380
Japanese yen	101	13	57	115	286
Total	$ 277	$ 59	$ 115	$ 215	$ 666
December 31, 2011:					
Euro	$ 136	$ 74	$ 54	$ 88	$ 352
Japanese yen	106	17	79	103	305
Total	$ 242	$ 91	$ 133	$ 191	$ 657

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2012.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2012, there were no outstanding commitments to purchase foreign government debt instruments. During 2012, there were purchases, sales, and maturities of foreign government debt instruments of $4,959 million, $0, and $4,840 million, respectively, of which $132 million, $0, and $128 million, respectively, were allocated to the Bank.

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

At December 31, 2012 and 2011, the authorized warehousing facility was $5 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2012 and 2011.

c. Central Bank Liquidity Swaps

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 2.668 percent and 2.534 percent at December 31, 2012 and 2011, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2012 and 2011, was $8,889 million and $99,823 million, respectively, of which $237 million and $2,529 million, respectively, was allocated to the Bank.

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

	2012			2011		
	Within 15 days	16 days to 90 days	Total	Within 15 days	16 days to 90 days	Total
Euro	$ 46	$ 191	$ 237	$ 870	$ 1,294	$ 2,164
Japanese yen	-	-	-	229	126	355
Swiss franc	-	-	-	8	2	10
Total	$ 46	$ 191	$ 237	$ 1,107	$ 1,422	$ 2,529

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2012 and 2011.

d. Fair Value of SOMA Assets

The fair value amounts presented below are solely for informational purposes. Although the fair value of SOMA security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities.

The fair value of the fixed-rate Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments in the SOMA's holdings is subject to market risk, arising from movements in market variables such as interest rates and credit risk. The fair value of federal agency and GSE MBS is also affected by the expected rate of prepayments of mortgage loans underlying the securities. The fair value of foreign government debt instruments is affected by currency risk. Based on evaluations performed as of December 31, 2012, there are no credit impairments of SOMA securities holdings as of that date.

The following table presents the amortized cost and fair value of the Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign currency denominated assets, net, held in the SOMA at December 31 (in millions):

	Allocated to the Bank					
	2012			2011		
	Amortized cost	Fair value	Fair value greater than amortized cost	Amortized cost	Fair value	Fair value greater than amortized cost
Treasury securities:						
Bills	$ -	$ -	$ -	$ 1,094	$ 1,094	$ -
Notes	63,365	67,302	3,937	77,909	82,512	4,603
Bonds	37,001	42,224	5,223	24,938	30,209	5,271
GSE debt securities	4,409	4,716	307	6,403	6,784	381
Federal agency and GSE MBS	52,720	55,142	2,422	50,374	53,179	2,805
Foreign currency denominated assets	666	671	5	657	662	5
Total SOMA portfolio securities holdings	$ 158,161	$ 170,055	$ 11,894	$ 161,375	$ 174,440	$ 13,065
Memorandum - Commitments for:						
Purchases of Treasury securities	$ -	$ -	$ -	$ 190	$ 190	$ -
Purchases of Federal agency and GSE MBS	6,558	6,568	10	2,465	2,487	22
Sales of Federal agency and GSE MBS	-	-	-	263	266	3
Purchases of foreign government debt instruments	-	-	-	5	5	-

	Total SOMA					
	2012			2011		
	Amortized cost	Fair value	Fair value greater than amortized cost	Amortized cost	Fair value	Fair value greater than amortized cost
Treasury securities:						
Bills	$ -	$ -	$ -	$ 18,423	$ 18,423	$ -
Notes	1,142,219	1,213,177	70,958	1,311,917	1,389,429	77,512
Bonds	666,969	761,138	94,169	419,937	508,694	88,757
GSE debt securities	79,479	85,004	5,525	107,828	114,238	6,410
Federal agency and GSE MBS	950,321	993,990	43,669	848,258	895,495	47,237
Foreign currency denominated assets	24,972	25,141	169	25,950	26,116	166
Total SOMA portfolio securities holdings	$ 2,863,960	$ 3,078,450	$ 214,490	$ 2,732,313	$ 2,952,395	$ 220,082
Memorandum - Commitments for:						
Purchases of Treasury securities	$ -	$ -	$ -	$ 3,200	$ 3,208	$ 8
Purchases of Federal agency and GSE MBS	118,215	118,397	182	41,503	41,873	370
Sales of Federal agency and GSE MBS	-	-	-	4,430	4,473	43
Purchases of foreign government debt instruments	-	-	-	216	216	-

The fair value of Treasury securities, GSE debt securities, and foreign government debt instruments was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of federal agency and GSE MBS was determined using a pricing service that utilizes a model-based approach that considers observable inputs for similar securities. The cost basis of foreign currency deposits adjusted for accrued interest approximates fair value. The contract amount for euro-denominated securities sold under agreements to repurchase approximates fair value.

The cost basis of securities purchased under agreements to resell, securities sold under agreements to repurchase, and other investments held in the SOMA approximate fair value.

Because the FRBNY enters into commitments to buy Treasury securities, federal agency and GSE MBS, and foreign government debt instruments and records the related securities on a settlement-date basis in accordance with the FAM, the related outstanding commitments are not reflected in the Statements of Condition.

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

	2012		2011	
Distribution of MBS holdings by coupon rate	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
2.0%	$ 47	$ 47	$ -	$ -
2.5%	2,084	2,095	-	-
3.0%	8,910	8,973	78	79
3.5%	9,963	10,249	1,153	1,168
4.0%	7,642	8,097	9,589	10,081
4.5%	14,562	15,654	24,138	25,605
5.0%	6,940	7,335	10,838	11,441
5.5%	2,217	2,320	3,967	4,161
6.0%	313	327	543	571
6.5%	42	45	68	73
Total	$ 52,720	$ 55,142	$ 50,374	$ 53,179
Total SOMA:				
2.0%	$ 845	$ 846	$ -	$ -
2.5%	37,562	37,766	-	-
3.0%	160,613	161,757	1,313	1,336
3.5%	179,587	184,752	19,415	19,660
4.0%	137,758	145,955	161,481	169,763
4.5%	262,484	282,181	406,465	431,171
5.0%	125,107	132,214	182,497	192,664
5.5%	39,970	41,819	66,795	70,064
6.0%	5,642	5,888	9,152	9,616
6.5%	753	812	1,140	1,221
Total	$ 950,321	$ 993,990	$ 848,258	$ 895,495

The following tables present the realized gains and the change in the unrealized gain position of the domestic securities holdings during the years ended December 31, 2012 (in millions):

	Allocated to the Bank		Total SOMA	
	Total portfolio holdings realized gains[1]	Fair value changes in unrealized gains[2]	Total portfolio holdings realized gains[1]	Fair value changes in unrealized gains[2]
Treasury securities	$ 747	$ (114)	$ 13,255	$ (1,142)
GSE debt securities	-	(50)	-	(885)
Federal agency and GSE MBS	14	(192)	241	(3,568)
Total	$ 761	$ (356)	$ 13,496	$ (5,595)

[1] Total portfolio holdings realized gains are reported in "Non-interest income: System Open Market Account" in the Statements of Income and Comprehensive Income

[2] Because SOMA securities are recorded at amortized cost, unrealized gains (losses) are not reported in the Statements of Income and Comprehensive Income

The amount of change in unrealized gains, net, related to foreign currency denominated assets was an increase of $3 million for the year ended December 31, 2012. The amount allocated to the Bank was immaterial.

Accounting Standards Codification (ASC) Topic 820 (ASC 820) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level fair value hierarchy that distinguishes between assumptions developed using market data obtained from independent sources (observable inputs) and the Bank's assumptions developed using the best information available in the circumstances (unobservable inputs). The three levels established by ASC 820 are described as follows:

- Level 1 – Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is based on model-based techniques that use significant inputs and assumptions not observable in the market. These unobservable inputs and assumptions reflect the Bank's estimates of inputs and assumptions that market participants would use in pricing the assets and liabilities. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

The following tables present the classification of SOMA financial assets at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2012	2011
	Level 2	Level 2
Assets:		
Treasury securities	$ 1,974,315	$ 1,916,546
GSE debt securities	85,004	114,238
Federal agency and GSE MBS	993,990	895,495
Foreign government debt instruments	12,003	12,762
Total assets	$ 3,065,312	$ 2,939,041

The SOMA financial assets are classified as Level 2 in the table above because the fair values are based on indicative quotes and other observable inputs obtained from independent pricing services that, in accordance with ASC 820, are consistent with the criteria for Level 2 inputs. Although information consistent with the criteria for Level 1 classification may exist for some portion of the SOMA assets, all securities in each asset class were valued using the inputs that are most applicable to the securities in the asset class. The inputs used for valuing the SOMA financial assets are not necessarily an indication of the risk associated with those assets.

6. Bank Premises, Equipment, and Software

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

	2012	2011
Bank premises and equipment:		
Land and land improvements	$ 17	$ 17
Buildings	276	268
Building machinery and equipment	39	36
Construction in progress	8	9
Furniture and equipment	64	68
Subtotal	404	398
Accumulated depreciation	(173)	(162)
Bank premises and equipment, net	$ 231	$ 236
Depreciation expense, for the years ended December 31	$ 18	$ 20

The Bank leases space to outside tenants with remaining lease terms ranging from three to eight years. Rental income from such leases was $5 million and $6 million for the years ended December 31, 2012 and 2011, respectively, and is reported as a component of "Non-interest income: Other" in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2012, are as follows (in millions):

2013	$ 4
2014	7
2015	5
2016	5
2017	4
Thereafter	6
Total	$ 31

The Bank had capitalized software assets, net of amortization, of $8 million and $2 million at December 31, 2012 and 2011, respectively. Amortization expense was $1 million for each of the years ended December 31, 2012 and 2011, respectively. Capitalized software assets are reported as a component of "Other assets" in the Statements of Condition and the related amortization is reported as a component of "Operating expenses: Other" in the Statements of Income and Comprehensive Income.

7. Commitments and Contingencies

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

At December 31, 2012, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from two to approximately eight years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was $2 million and $1 million for the years ended December 31, 2012 and 2011, respectively.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2012, are as follows (in thousands):

	Operating leases
2013	$ 259
2014	376
2015	375
2016	382
2017	235
Thereafter	1,007
Future minimum rental payments	$ 2,634

At December 31, 2012, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain losses in excess of 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, 2012 and 2011.

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

8. Retirement and Thrift Plans

Retirement Plans

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). Under the Dodd-Frank Act, newly hired Bureau employees are eligible to participate in the System Plan and transferees from other governmental organizations can elect to participate in the System Plan. In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP) and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP).

The System Plan provides retirement benefits to employees of the Reserve Banks, Board of Governors, OEB, and certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2012 and 2011, certain costs associated with the System Plan were reimbursed by the Bureau.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2012 and 2011, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches 100 percent of the first six percent of employee contributions from the date of hire and provides an automatic employer contribution of one percent of eligible pay. The Bank's Thrift Plan contributions totaled $8 million and $7 million for the years ended December 31, 2012 and 2011, respectively, and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

9. Postretirement Benefits Other Than Retirement Plans and Postemployment Benefits

Postretirement Benefits Other Than Retirement Plans

In addition to the Bank's retirement plans, employees who have met certain age and length-of-service requirements are eligible for both medical and life insurance benefits 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):

	2012	2011
Accumulated postretirement benefit obligation at January 1	$ 146.2	$ 133.9
Service cost benefits earned during the period	4.4	3.4
Interest cost on accumulated benefit obligation	6.6	6.8
Net actuarial loss	16.1	8.3
Contributions by plan participants	2.3	2.3
Benefits paid	(10.2)	(9.2)
Medicare Part D subsidies	0.7	0.7
Accumulated postretirement benefit obligation at December 31	$ 166.1	$ 146.2

At December 31, 2012 and 2011, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 3.75 percent and 4.50 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):

	2012	2011
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	7.2	6.2
Contributions by plan participants	2.3	2.3
Benefits paid	(10.2)	(9.2)
Medicare Part D subsidies	0.7	0.7
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$ 166.1	146.2
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 1.1	$ 1.8
Net actuarial loss	(60.6)	$ (48.4)
Total accumulated other comprehensive loss	$ (59.5)	$ (46.6)

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:

	2012	2011
Health-care cost trend rate assumed for next year	7.00%	7.50%
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	2018	2017

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, 2012 (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	$ 2.0	$ (1.6)
Effect on accumulated postretirement benefit obligation	26.5	(21.5)

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

	2012	2011
Service cost-benefits earned during the period	$ 4.4	$ 3.4
Interest cost on accumulated benefit obligation	6.6	6.8
Amortization of prior service cost	(0.7)	(0.8)
Amortization of net actuarial loss	3.9	3.4
Total periodic expense	$ 14.2	$ 12.8

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2013 are shown below:

Prior service cost	$ (0.5)
Net actuarial loss	5.4
Total	$ 4.9

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2012 and 2011, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 4.50 percent and 5.25 percent, respectively.

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

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 $522 thousand and $524 thousand in the years ended December 31, 2012 and 2011, respectively. Expected receipts in 2013, related to benefits paid in the years ended December 31, 2012 and 2011, are $420 thousand.

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

	Without subsidy	With subsidy
2013	$ 8.3	$ 7.7
2014	8.5	7.8
2015	8.6	7.9
2016	8.9	8.1
2017	9.0	8.1
2018-2022	48.5	43.2
Total	$ 91.8	$ 82.8

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2012 and 2011, were $11 million and $13 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. A net periodic postemployment benefit credit of $28 thousand and a net periodic postemployment benefit expense of $1 million were included in 2012 and 2011 operating expenses, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

10. Accumulated Other Comprehensive Income And Other Comprehensive Income

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive loss as of December 31 (in millions):

	2012	2011
	Amount related to postretirement benefits other than retirement plans	Amount related to postretirement benefits other than retirement plans
Balance at January 1	$ (46.6)	$ (40.9)
Change in funded status of benefit plans:		
Amortization of prior service cost	(0.7)	(0.8)
Change in prior service costs related to benefit plans	(0.7)	(0.8)
Net actuarial loss arising during the year	(16.2)	(8.3)
Amortization of net actuarial loss	4.0	3.4
Change in actuarial losses related to benefit plans	(12.2)	(4.9)
Change in funded status of benefit plans - other comprehensive loss	(12.9)	(5.7)
Balance at December 31	$ (59.5)	$ (46.6)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 9.

11. Business Restructuring Charges

The Bank had no business restructuring charges in 2012 or 2011.

In years prior to 2011, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated paper and electronic check processing at the Federal Reserve Bank of Atlanta. During the years ended December 31, 2012 and 2011, payments related to this restructuring program were immaterial, and the Bank had no remaining liability as of December 31, 2012.

12. Distribution of Comprehensive Income

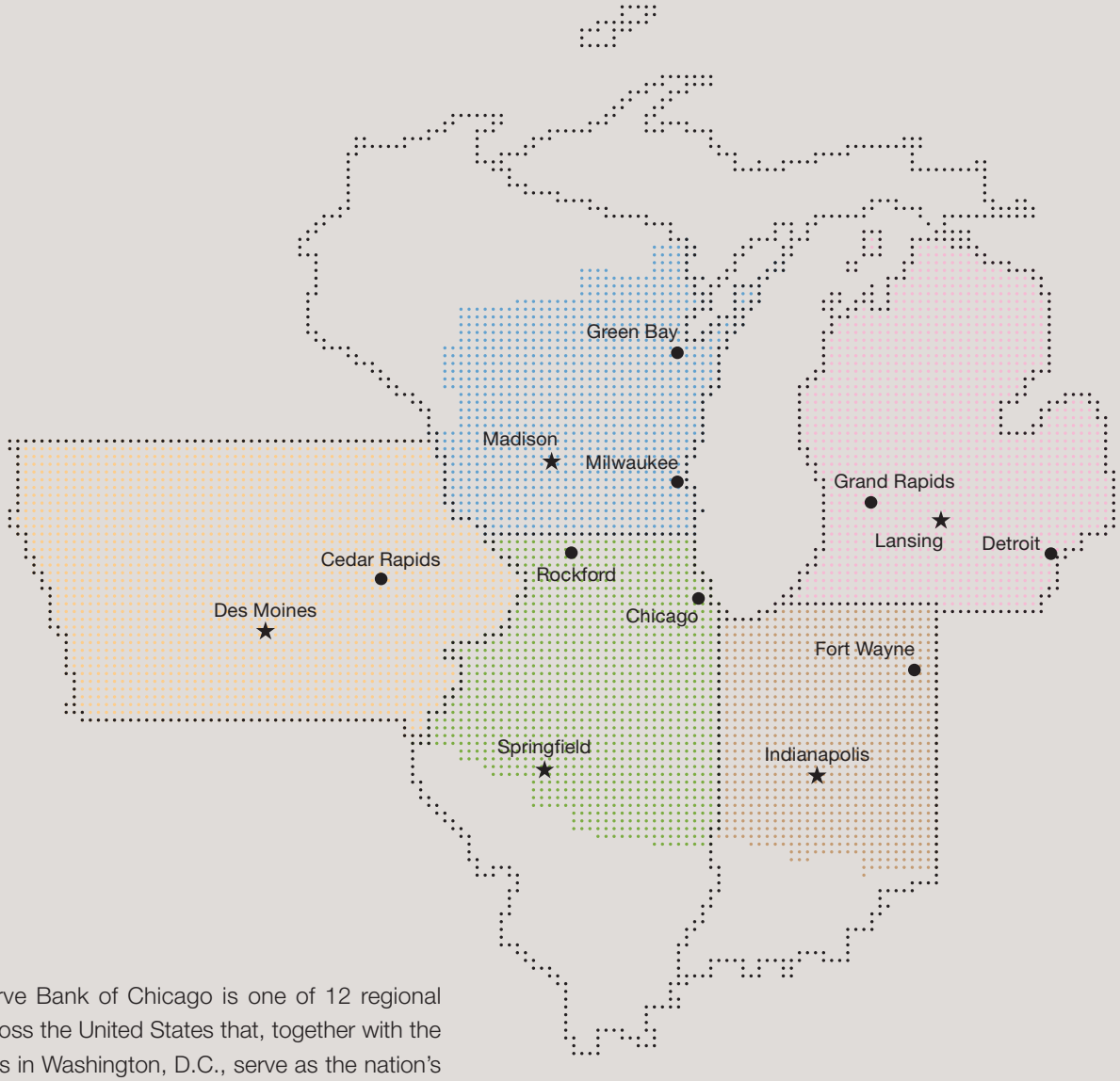
In accordance with Board policy, Reserve Banks remit excess earnings, after providing for dividends and the amount necessary to equate surplus with capital paid-in, to the U.S. Treasury as interest on Federal Reserve notes. The following table presents the distribution of the Bank's comprehensive income in accordance with the Board's policy for the years ended December 31 (in millions):

	2012	2011
Dividends on capital stock	$ 47	$ 42
Transfer to surplus - amount required to equate surplus with capital paid-in	62	46
Interest on Federal Reserve notes expense remitted to Treasury	4,690	4,932
Total Distribution	$ 4,799	$ 5,020

13. Subsequent Events

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2012. Subsequent events were evaluated through March 14, 2013, which is the date that the Bank issued the financial statements.

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 and branch in Detroit, 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.

FEDERAL RESERVE BANK
OF CHICAGO

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

FSC
www.fsc.org
MIX
Paper from
responsible sources
FSC® C003546