97th Annual Report

2010

Board of Governors of the Federal Reserve System

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Letter of Transmittal

Board of Governors of the Federal Reserve System
Washington, D.C.

June 2011

The Speaker of the House of Representatives:

Pursuant to the requirements of section 10 of the Federal Reserve Act, I am pleased to submit the ninety-seventh annual report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 2010.

Sincerely,

Ben Bernanke
Chairman

Contents

Overview

The Federal Reserve, the central bank of the United States, is a federal system composed of a central governmental agency—the Board of Governors—and 12 regional Federal Reserve Banks.

The Board of Governors, located in Washington, D.C., consists of seven members appointed by the President of the United States and supported by a 2,200-person staff. Besides conducting research, analysis, and policymaking related to domestic and international financial and economic matters, the Board plays a major role in the supervision and regulation of the U.S. banking system and administers most of the nation's laws regarding consumer credit protection. It also has broad oversight responsibility for the nation's payments system and the operations and activities of the Federal Reserve Banks.

For More Background on Board Operations

For more information about the Federal Reserve Board and the Federal Reserve System, visit the Board's website at www.federalreserve.gov/aboutthefed/default.htm. An online version of this *Annual Report* is available at www.federalreserve.gov/boarddocs/rptcongress.

About this Report

This report covers Board and System operations and activities during calendar-year 2010. The report includes 11 sections:

- **Monetary Policy and Economic Developments.** Section 1 (beginning on page 5) provides adapted versions of the February 2011 and July 2010 *Monetary Policy Report to the Congress*.
- **Federal Reserve Operations.** Sections 2 through 5 (beginning on page 121) provide summaries of Board and System activities in the areas of banking supervision and regulation, consumer and community affairs, and Reserve Bank operations. It also summarizes Board compliance with the Government Performance and Results Act of 1993 and its activities regarding legislative developments that affected Board operations in 2010.
- **Record of Policy Actions.** Sections 6 through 8 (beginning on page 153) provide an account of actions taken by the Board on questions of policy in 2009, and it also includes the policy actions of the Federal Open Market Committee (FOMC).[1]
- **Statistical Tables.** Section 9 (beginning on page 293) includes 14 statistical tables that provide updated historical data concerning Board and System operations and activities.
- **Federal Reserve System Audits.** Section 10 (beginning on page 321) provides detailed information on the several levels of audit and review conducted that concern System operations and activities, including those provided by outside auditors and the Board's Office of Inspector General.
- **Federal Reserve System Organization.** Section 11 (beginning on page 409) provides listings of key officials at the Board and in the Federal Reserve System, including the Board of Governors, its officers, FOMC members, several System councils, and Federal Reserve Bank and Branch officers and directors.

About the Federal Reserve System

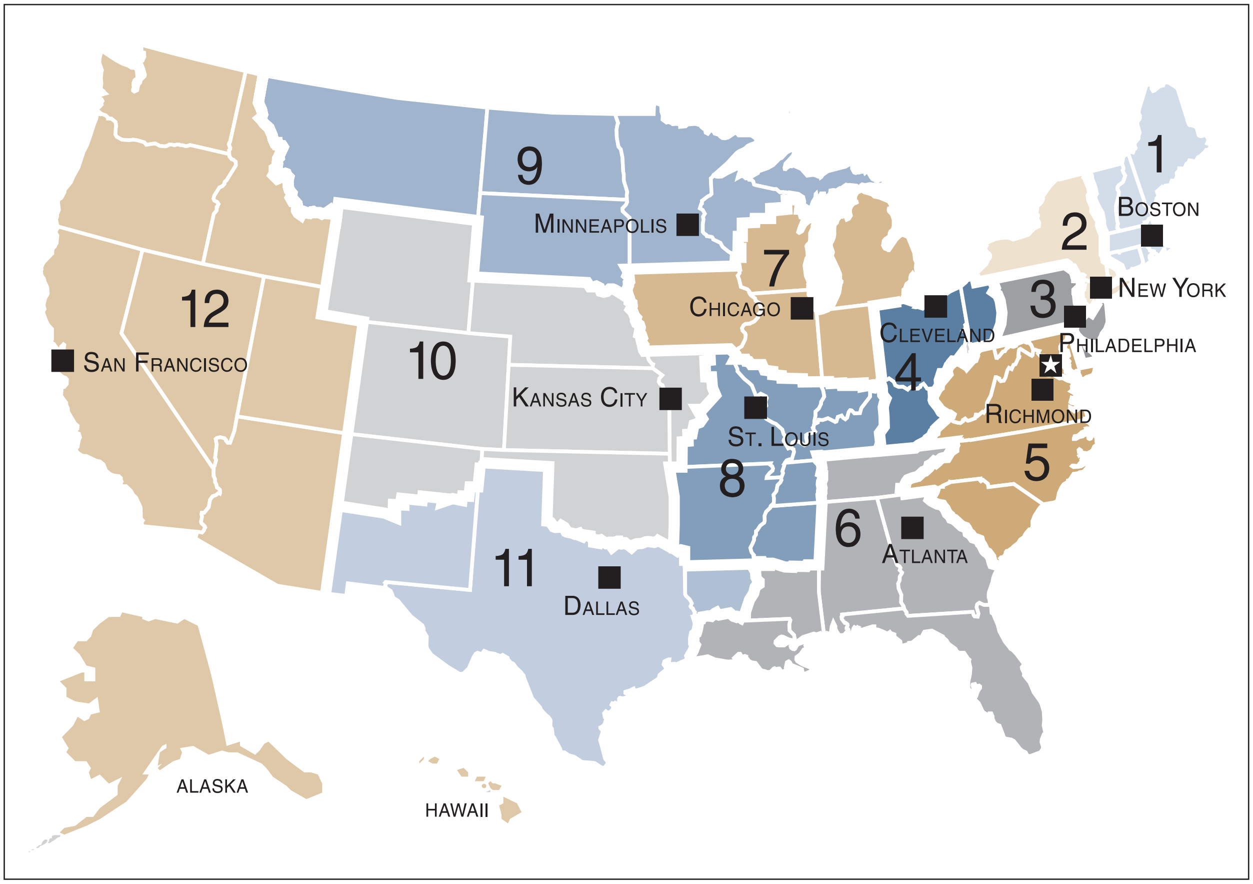
The Federal Reserve System, which serves as the nation's central bank, was created by an act of Congress on December 23, 1913. The System consists of a seven-member Board of Governors with headquar-

[1] For more information on the FOMC, see the Board's website at www.federalreserve.gov/monetarypolicy/fomc.htm.

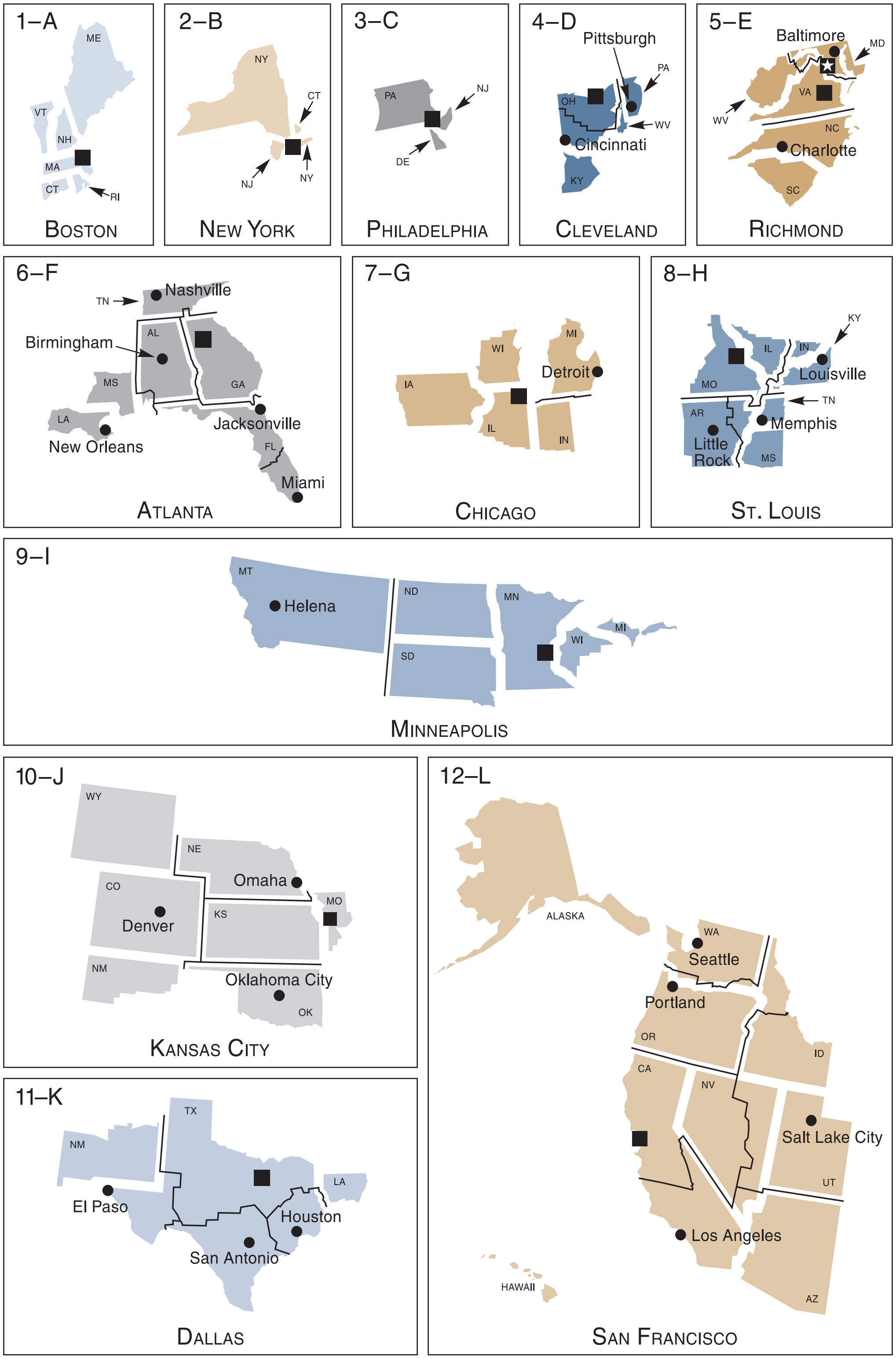
ters in Washington, D.C., and the 12 Reserve Banks located in major cities throughout the United States.

The Federal Reserve Banks are the operating arms of the central banking system, carrying out a variety of System functions, including operating a nationwide payment system; distributing the nation's currency and coin; under authority delegated by the Board of Governors, supervising and regulating bank holding companies and state-chartered banks that are members of the System; serving as fiscal agents of the U.S. Treasury; and providing a variety of financial services for the Treasury, other government agencies, and other fiscal principals.

The maps below and opposite identify Federal Reserve Districts by their official number, city, and letter designation.



■ Federal Reserve Bank city
☆ Board of Governors of the Federal Reserve System, Washington, D.C.



■ Federal Reserve Bank city
● Federal Reserve Branch city
✪ Board of Governors of the Federal Reserve System, Washington, D.C.
—Branch boundary

Monetary Policy and Economic Developments

As required by section 2B of the Federal Reserve Act, the Federal Reserve Board submits written reports to the Congress that contain discussions of "the conduct of monetary policy and economic developments and prospects for the future." The *Monetary Policy Report to the Congress,* submitted semiannually to the Senate Committee on Banking, Housing, and Urban Affairs and to the House Committee on Banking and Financial Services, is delivered concurrently with testimony given by the Chairman of the Federal Reserve Board.

The following discussion is an annual review of U.S. monetary policy and economic developments in 2010. It includes the text, tables, and selected figures from the March 1, 2011, report; the figures have been renumbered, and therefore the figure numbers differ from those in the report. Also included are the text and table from Parts 1–3 of the July 21, 2010, report; Part 4 of that report is identical to the addendum to the minutes of the June 22−23, 2010, meeting of the Federal Open Market Committee (FOMC) and is presented with those minutes in the "Minutes" section of this annual report.

The complete *Monetary Policy Report*s are available on the Board's website at www.federalreserve.gov/boarddocs/hh. Other materials in this annual report related to the conduct of monetary policy include the minutes of the 2010 meetings of the FOMC (see the "Minutes" section on page 163) and statistical tables 1–4 (see the "Statistical Tables" section on page 293).

Monetary Policy Report of March 2011

Part 1
Overview: Monetary Policy and the Economic Outlook

Economic activity in the United States expanded at a moderate pace, on average, in the second half of 2010 and early 2011. In the spring and early summer, a number of key indicators of economic activity softened relative to the readings posted in late 2009 and the first part of 2010, raising concerns about the durability of the recovery. In light of these developments—and in order to put the economic recovery on a firmer footing—the Federal Open Market Committee (FOMC) provided additional monetary policy stimulus during the second half of 2010 by reinvesting principal repayments from its holdings of agency debt and agency mortgage-backed securities in longer-term Treasury securities and by announcing its intention to purchase an additional $600 billion of Treasury securities by the end of the second quarter of 2011.

Financial market conditions improved notably in the fall of 2010, partly in response to actual and expected increases in monetary policy accommodation. In addition, later in the year, the tenor of incoming economic news strengthened somewhat, and the downside risks to economic growth appeared to recede. Nonetheless, the job market has improved only slowly. Employment gains have been modest, and although the unemployment rate fell noticeably in December and January, the margin of slack in the labor market remains wide. Meanwhile, despite rapid increases in commodity prices, longer-term inflation expectations remained stable, and measures of underlying consumer price inflation continued to trend downward on net.

Real gross domestic product (GDP) rose at a moderate rate in the third quarter. Inventories provided the principal impetus to growth while final sales showed little vigor—the same pattern that prevailed in the first half of the year. Less favorable readings that began to emerge during the second quarter for a range of indicators—new claims for unemployment insurance, industrial production, and numerous surveys of business activity, among others—pointed to a slowing in the pace of the recovery and suggested that the transition from a recovery boosted importantly by the inventory cycle to one propelled mainly by private final demand was proceeding only very gradually. Later in the year, however, this process appeared to gain traction. Indeed, real GDP is estimated to have risen a little faster in the fourth quarter than in the third quarter despite a substantial slowdown in the pace of inventory investment in the fourth quarter; final sales increased much more rapidly in the fourth quarter than earlier.

Over the second half of 2010, consumer spending posted a solid gain, boosted in part by continued, albeit modest, increases in real wage and salary income; some waning of the drag on outlays from earlier declines in household net worth; and a modest improvement in the availability of consumer credit. Businesses continued to step up their spending on equipment and software in response to a brighter outlook for sales as well as more favorable conditions in credit markets. In the external sector, the continued rebound in exports was supported by firming foreign demand. Meanwhile, the construction sector remained exceptionally weak.

The continued recovery in economic activity has been accompanied by only a slow improvement in labor market conditions. Private payroll employment has moved up at a relatively tepid rate—about 115,000 per month, on average, since the February 2010 trough in employment—recouping only a small portion of the 8¾ million jobs lost during 2008 and 2009. Over most of this period, the pace of hiring was insufficient to substantially reduce the unemployment rate. In December and January, however, the jobless rate was reported to have declined noticeably. In addition to the recent drop in the unemployment rate, some other indicators of labor market conditions—for example, measures of firms' hiring plans—have brightened a bit, raising the prospect that a pickup in the pace of hiring may be in the offing. That said, the level of the unemployment rate remains very elevated, and the long-term unemployed continue to account for a historically large fraction of overall joblessness.

Consumer price inflation trended down during 2010 as slack in resource utilization restrained cost pressures while longer-term inflation expectations remained stable. Although the prices of crude oil and many industrial and agricultural commodities rose rapidly in the latter half of 2010 and the early part of 2011, overall personal consumption expenditures (PCE) prices increased at an annual rate of just 1¼ percent over the 12 months ending in January, which compares with a 2½ percent rise during the preceding 12 months. Core PCE prices—which exclude prices for food and energy—rose ¾ percent in the 12 months ending in January.

Financial market conditions continued to be supportive of economic growth in the second half of 2010 and into 2011. Equity prices rose solidly, reflecting the more accommodative stance of monetary and fiscal policy, an improved economic outlook, and better-than-expected corporate earnings reports. Yields on longer-term Treasury securities declined in the summer and early autumn, reflecting in part anticipation of additional monetary policy stimulus, but subsequently rose as economic prospects improved and as market expectations of the ultimate size of FOMC Treasury purchases were revised down. Despite some volatility, yields on Treasury securities remained relatively low on balance. Medium- and longer-term inflation compensation derived from inflation-indexed Treasury securities increased since the summer as concerns about deflation eased, though these measures remained within historical ranges. Interest rates on fixed-rate residential mortgages moved broadly in line with yields on Treasury securities while the spreads between yields on corporate bonds and those on Treasury securities declined; overall, both mortgage rates and corporate yields continued to be at low levels. Although bank lending policies generally stayed tight, banks reported some easing in those conditions on net. After posting substantial declines since the third quarter of 2008, total loans held on the books of banks showed signs of stabilizing in recent months.

Larger nonfinancial corporations with access to capital markets took advantage of favorable financial conditions to issue debt at a robust pace. Bond and syndicated loan issuance was strong, particularly among lower-rated corporate borrowers. Commercial and industrial loans on banks' books started to expand around the end of 2010. Nevertheless, small, bank-dependent businesses remained constrained in their access to credit, although some indicators suggested that credit availability for these firms was beginning to improve.

Household debt appears to have contracted in the second half of 2010, but at a somewhat slower pace than earlier in the year. Household mortgage debt likely continued to decline, as housing demand remained weak and lending standards were reportedly still stringent. Revolving consumer credit also contracted. By contrast, nonrevolving consumer credit—primarily auto and student loans—increased solidly in the final quarter of 2010.

After first emerging during the spring, concerns about fiscal and banking developments in Europe resurfaced later in the year. Although some European sovereigns and financial institutions faced renewed funding pressures in the fourth quarter, the repercussions in broader global financial markets were muted. To help minimize the risk that strains abroad could spread to the United States, as well as to continue to support liquidity conditions in global money markets, the FOMC in December approved an extension of the temporary U.S. dollar liquidity swap arrangements with a number of foreign central banks.

Apparently seeking to boost returns in an environment of low interest rates, investors displayed an increased appetite for higher-yielding fixed-income instruments in the second half of 2010 and into 2011, which likely supported strong issuance of these products and contributed to a narrowing of risk spreads, such as those on corporate debt instruments. Information from a variety of sources, including the Federal Reserve Board's Senior Credit Officer Opinion Survey on Dealer Financing Terms, suggests that use of dealer-intermediated leverage by financial market participants rose a bit in recent quarters but remained well below its pre-crisis levels.[1] The condition of financial institutions generally appeared to improve further, and the regulatory capital ratios of commercial banks, particularly the largest banks, moved higher.

With the pace of recovery in output and employment seen as disappointingly slow and measures of inflation viewed as somewhat low relative to levels judged consistent with the Committee's mandate, the FOMC took several actions to provide additional support to the economic recovery during the second half of last year. In August, the FOMC decided to reinvest principal payments from agency debt and agency mortgage-backed securities held in the System Open Market Account (SOMA) in longer-term Treasury securities to keep constant the size of the SOMA portfolio and so avoid an implicit tightening of monetary policy. In November, to provide further policy accommodation to help support the economic recovery, the FOMC announced its intention to purchase an additional $600 billion in longer-term Treasury securities by the end of the second quarter of 2011. Throughout the second half of 2010 and early 2011, the FOMC maintained a target range for the federal funds rate of between 0 and ¼ percent and reiterated its expectation that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Federal Reserve continued to develop and test tools to drain or immobilize large volumes of banking system reserves in order to ensure that it will be able to smoothly and effectively exit from the current extraordinarily accommodative policy stance at the appropriate time. The Committee continues to monitor the economic outlook and financial developments, and it will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, returns to levels consistent with its mandate.

The economic projections prepared in conjunction with the January FOMC meeting are presented in Part 4 of this report. In broad terms, FOMC participants anticipated a sustained but modest recovery in real economic activity this year that would pick up somewhat in 2012 and 2013. The expansion was expected to be led by gains in consumer and business spending that are supported by improvements in household and business confidence. Nevertheless, economic growth was expected to be damped by a number of headwinds, including the gradual pace of improvements in the labor market, still-stringent borrowing conditions for households and bank-dependent small businesses, lingering household and business uncertainty, and ongoing weakness in real estate markets. On balance, FOMC participants anticipated that real GDP would increase at above-trend rates over the next three years, but not as rapidly as in previous recoveries. Meanwhile, the unemployment rate was projected to fall gradually. Inflation was expected to drift up slowly toward the levels that Committee participants believe to be most consistent with the Committee's mandate. Reflecting their assessment that the recovery appeared to be on a firmer footing, the participants upgraded slightly their projections for near-term economic growth relative to the ones they prepared in conjunction with the November FOMC meeting; otherwise, their projections for economic growth and inflation were little changed.

Participants generally judged that the uncertainty attached to their projections for both economic activity and inflation was greater than historical norms. A substantial majority of participants viewed the risks

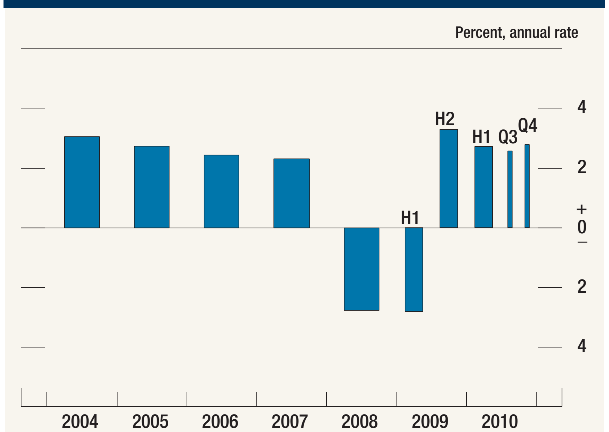
[1] The survey is conducted quarterly and is available at www.federalreserve.gov/econresdata/releases/scoos.htm.

to both economic growth and inflation as balanced; only a few saw them as tilted either to the upside or to the downside. In November, a noticeable share of participants had seen the risks—particularly those to economic growth—as tilted to the downside. Participants also reported their assessments of the rates to which key macroeconomic variables would be expected to converge over the longer term under appropriate monetary policy and in the absence of further shocks to the economy. The central tendencies of these longer-run projections were 2.5 to 2.8 percent for real GDP growth, 5.0 to 6.0 percent for the unemployment rate, and 1.6 to 2.0 percent for the inflation rate.

Part 2 Recent Economic and Financial Developments

Economic activity expanded at a moderate pace, on balance, in the second half of 2010. According to the currently available estimates from the Bureau of Economic Analysis, real gross domestic product (GDP) increased at an annual rate of about 2¾ percent, on average, over that period (**figure 1**). In the third quarter, as had been the case in the first half of the year, much of the increase was the result of inventory accumulation; in contrast, final sales continued to rise at a subdued rate. Meanwhile, several indicators of economic activity had softened from the readings observed earlier in the year, raising concerns about the durability of the recovery. Later in the year, however, the tone of the incoming data on economic activity brightened somewhat, final sales strengthened, and the recovery appeared to be on a firmer footing.

Figure 1. Change in real gross domestic product, 2004–10



Note: Here and in subsequent figures, except as noted, change for a given period is measured to its final quarter from the final quarter of the preceding period.

Source: Department of Commerce, Bureau of Economic Analysis.

Since the middle of 2010, consumer spending has risen solidly on average, businesses have continued to increase their outlays for equipment and software, and exports have moved up further. In contrast, construction of new homes and nonresidential buildings remains exceptionally weak. Conditions in the labor market have improved only slowly, with payrolls increasing at a modest pace. Throughout nearly all of 2010, that pace of employment expansion was insufficient to bring the unemployment rate down meaningfully from its recent peak. In December 2010 and January of this year, however, the unemployment rate is estimated to have dropped more noticeably, even though payroll employment gains remained lackluster. Meanwhile, long-duration joblessness persisted at near-record levels. With regard to inflation developments, despite rapid increases in commodity prices, longer-term inflation expectations have remained stable and consumer price inflation has continued to trend downward on net.

Conditions in financial markets generally improved over the course of the second half of 2010 and early 2011 and continued to be supportive of economic activity. This improvement reflected, in part, additional monetary policy stimulus provided by the Federal Reserve, as well as growing investor confidence in the sustainability of the economic recovery. Although yields on Treasury securities rose somewhat, on net, since mid-2010, yields on investment-grade corporate bonds were little changed at low levels, and yields on speculative-grade bonds declined. In equity markets, price indexes generally rose, buoyed by solid corporate earnings and a more positive economic outlook. Commercial banks reported that they had eased some of their lending standards and terms, though lending standards remained generally tight and some businesses and households continued to face difficulties obtaining credit. Changes in interest rates faced by households were mixed. The improvement in financial conditions was accompanied by some signs of a pickup in the demand for credit. Borrower credit quality generally improved, although problems persisted in some sectors of the economy. Concerns about European banking and fiscal strains increased again in late 2010 after having eased for a time; however, in contrast to what was observed in the spring, these concerns left little imprint on U.S. financial markets.

Domestic Developments

The Household Sector

Consumer Spending and Household Finance

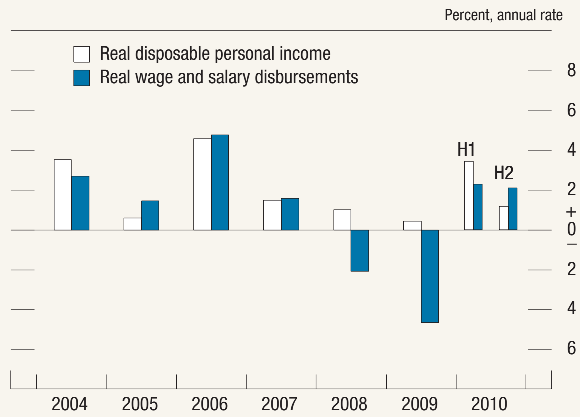
Real personal consumption expenditures (PCE) increased at an annual rate of about 3¼ percent in the second half of 2010, with a particularly brisk rise in the fourth quarter. The spending gains were supported by the continued, though modest, pickup in real household incomes, by some fading of the restraining effects of the earlier sharp declines in households' net worth, and by a modest improvement in the availability of consumer credit. Outlays for durable goods also may have been boosted to some extent by purchases that had been deferred during the recession. The increases in spending exceeded the rise in income, and the saving rate edged down during the second half of the year, though it remains well above levels that prevailed prior to the recession.

The increase in consumer outlays in the second half of 2010 partly reflected a step-up in sales of new light motor vehicles (cars, sport utility vehicles, and pickup trucks). Sales of light vehicles rose from an annual rate of 11¼ million units in the second quarter of 2010 to more than 12¼ million units in the fourth quarter and moved up further in the first part of 2011. Sales were supported, in part, by further improvements in credit conditions for auto buyers as well as by more-generous sales incentives from the automakers. Real spending in other goods categories also rose appreciably, while the increase in outlays for services was more subdued.

The determinants of consumer outlays showed further, albeit gradual, improvement during the second half of 2010. The level of real disposable personal income (DPI)—after-tax income adjusted for inflation—which rose rapidly in the first half of the year, continued to advance in the second half, as real wages and salaries moved up at an annual rate of 2 percent (**figure 2**). The increase in real wage and salary income reflected the continued, though tepid, recoveries in both employment and hours worked; in contrast, hourly pay was little changed in real terms.

The ratio of household net worth to DPI moved up a little in the third quarter of 2010 and appears to have risen further since then, as increases in equity values likely more than offset further declines in house prices. Although the wealth-to-income ratio has trended up since the beginning of 2009 and has returned to the levels that prevailed prior to the late 1990s, it remains well below its highs in 2006 and 2007. Consumer sentiment rose late in the year, boosted by gradual improvements in household assessments of financial and business conditions as well as job prospects; nevertheless, these gains only moved sentiment back to or a bit above the low levels that prevailed at the start of last year.

Figure 2. Change in real disposable personal income and in real wage and salary disbursements, 2004–10

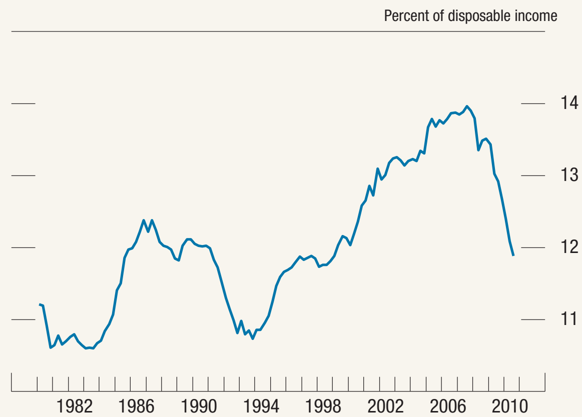


Source: Department of Commerce, Bureau of Economic Analysis.

Household debt likely fell at just under a 2 percent annual rate in the second half of 2010, a slightly slower pace than in the first half. The contraction for 2010 as a whole, which was due primarily to ongoing decreases in mortgage debt, marked the second consecutive annual decline. The reduction in overall household debt levels, combined with increases in personal income, resulted in a further decline in the ratio of household debt to income and in the debt service ratio—the required principal and interest payments on existing mortgage and consumer debt relative to income (**figure 3**).

The slowdown in the rate at which household debt contracted in the latter part of 2010 stemmed in large part from a modest recovery in consumer credit. Although revolving consumer credit—mostly credit card borrowing—continued to contract, the decline was at a slightly slower rate than in the first half of the year. Nonrevolving consumer credit, which consists largely of auto and student loans and accounts for about two-thirds of total consumer credit, rose 2 percent in the second half of 2010 after being about

Figure 3. Household debt service, 1980–2010



Note: The data are quarterly and extend through 2010:Q3. Debt service payments consist of estimated required payments on outstanding mortgage and consumer debt.

Source: Federal Reserve Board, "Household Debt Service and Financial Obligations Ratios," statistical release.

unchanged in the first half of the year. The pickup in nonrevolving consumer credit is consistent with responses to the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) indicating that banks have become increasingly willing to make consumer installment loans; however, lending standards for these loans likely remained fairly tight.[2] In addition, in the most recent survey, a small net fraction of respondents noted increased demand for consumer loans, the first time stronger demand was reported since mid-2005.

Some of the increased willingness to make consumer loans may reflect improvements in consumer credit quality. The delinquency rate on auto loans at captive finance companies moved down in the second half of 2010 to 2.6 percent, close to its longer-run historical average. Delinquency rates on credit cards at commercial banks and in securitized pools also moved down to around longer-run averages. However, charge-off rates on such loans remained well above historical norms despite having moved lower in the second half of the year.

Changes in interest rates on consumer loans were mixed. Interest rates on new auto loans were little changed, on net, in the second half of 2010 and into 2011. By contrast, interest rates on credit cards generally rose over the same period. A portion of the increase in credit card interest rates may be due to lingering adjustments by banks to the imposition of new rules under the Credit Card Accountability Responsibility and Disclosure Act (Credit Card Act).[3]

Issuance of consumer asset-backed securities (ABS) in the second half of 2010 occurred at about the same pace as in the first half of the year. Auto loan ABS issuance continued to be healthy, and the ability to securitize these loans likely held down interest rates on the underlying loans. Issuance of ABS backed by credit card loans, however, remained very weak, as the sharp contraction in credit card lending limited the need for new funding and accounting rule changes implemented at the beginning of 2010 made securitization of these loans less attractive.[4] Yields on ABS securities and the spreads of such yields over comparable-maturity interest rate swap rates were not much changed, on net, over the second half of 2010 and early 2011.

Residential Investment and Housing Finance

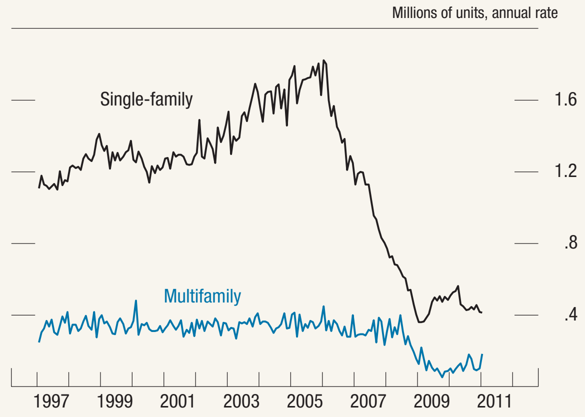
Housing activity remained depressed in the second half of 2010. Homebuilding continues to be restrained by sluggish demand, the large inventory of foreclosed or distressed properties on the market, and the tight credit conditions faced by homebuilders. In the single-family sector, new units were started at an average annual rate of about 430,000 units from July 2010 to January 2011, just 70,000 units above the quarterly low reached in the first quarter of 2009 (**figure 4**). In the multifamily market, demand for apartments appears to be increasing and occupancy rates have been edging up, as some potential homebuyers may be choosing to rent rather than to purchase a home. Nevertheless, the inventory of unoccupied multifamily units continues to be elevated, and construction financing remains tight. As a result, starts in the multifamily sector have averaged an annual rate of only 135,000 units since the middle of 2010, well below the 300,000-unit rate that had prevailed for much of the previous decade.

2 The SLOOS is available on the Federal Reserve Board's website at www.federalreserve.gov/boarddocs/SnLoanSurvey.

3 The Credit Card Act includes some provisions that place restrictions on issuers' ability to impose certain fees and to engage in risk-based pricing.

4 In June 2009, the Financial Accounting Standards Board (FASB) published Statements of Financial Accounting Standards Nos. 166 (*Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140*) and 167 (*Amendments to FASB Interpretation No. 46(R)*). The statements became effective at the start of a company's first fiscal year beginning after November 15, 2009, or, for companies reporting earnings on a calendar-year basis, after January 1, 2010.

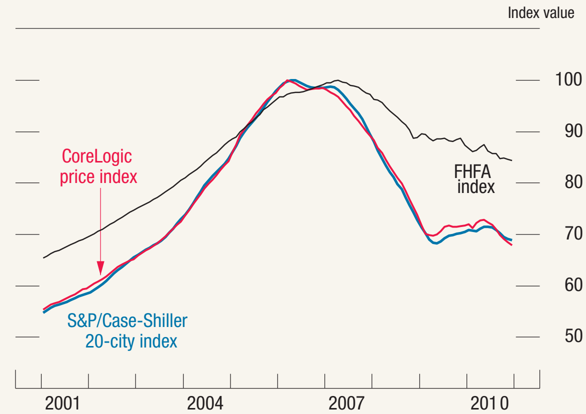
Figure 4. Private housing starts, 1997–2011



Note: The data are monthly and extend through January 2011.

Source: Department of Commerce, Bureau of the Census.

Figure 5. Prices of existing single-family houses, 2001–10



Note: The data are monthly and extend into 2010:Q4. Each index has been normalized so that its peak is 100. Both the CoreLogic price index and the FHFA index (formerly calculated by the Office of Federal Housing Enterprise Oversight) include purchase transactions only. The S&P/Case-Shiller index reflects all arm's-length sales transactions in selected metropolitan areas.

Source: For CoreLogic, CoreLogic; for FHFA, Federal Housing Finance Agency; for S&P/Case-Shiller, Standard & Poor's.

Home sales surged in the spring ahead of the expiration of the homebuyer tax credit, plunged for a few months during a payback period, and then recovered somewhat as the payback effect waned.[5] By late 2010 and early 2011, sales of existing single-family homes were a bit above levels that prevailed in mid-2009, before the enactment of the first homebuyer tax credit, while sales of new single-family homes remained below their mid-2009 levels. Housing demand has been held back by tight mortgage credit availability, uncertainty about future real estate values, and continued household concerns about the outlook for employment and income. Nonetheless, other determinants of housing demand are favorable and hold the potential to provide support to home sales as the economic recovery proceeds. In particular, the low level of mortgage rates and the earlier declines in house prices have made housing more affordable for those able to obtain mortgages.

House prices, as measured by several national indexes, decreased in the latter half of 2010 after having shown tentative signs of leveling off earlier in the year (**figure 5**). According to one measure with wide geographic coverage—the CoreLogic repeat-sales index—house prices fell 6 percent between June and December and moved below their mid-2009 trough. House prices continued to be weighed down by the large inventory of unsold homes—especially distressed properties—and by the sluggish demand for housing.

Indicators of credit quality in this sector pointed to continued difficulties amid depressed home values and elevated unemployment. Serious delinquency rates on prime and near-prime mortgages edged down to around 15 percent for adjustable-rate loans and to about 5 percent for fixed-rate loans—levels that remain high by historical standards. Delinquency rates for subprime mortgages moved up slightly toward the end of the year and remained extremely elevated. One sign of improvement, however, was that the rate at which mortgages transitioned from being current to being newly delinquent trended lower toward the end of 2010.

Reflecting the ongoing credit quality issues, the number of homes that entered foreclosure in the third quarter of 2010 jumped to more than 700,000, well above the pace seen earlier in the year. Late in the third quarter, concerns about the mishandling of documentation led some institutions to temporarily suspend some or all of their foreclosure proceedings.[6]

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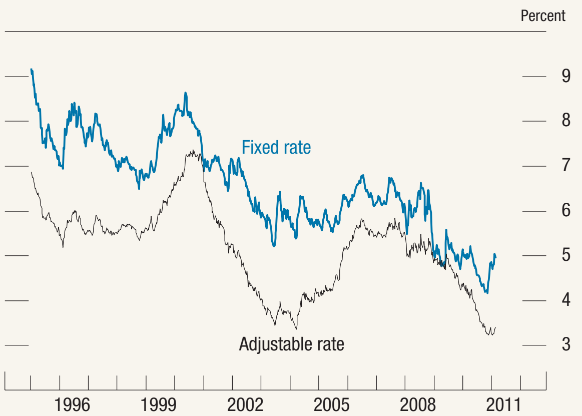
5 In order to receive the homebuyer tax credit, a purchaser had to sign a sales agreement by the end of April 2010 and close on the property by the end of September. The first-time homebuyer tax credit, which was enacted in February 2009 as part of the American Recovery and Reinvestment Act, was originally scheduled to expire on November 30, 2009. Shortly before it expired, the Congress extended the credit to sales occurring through April 30, 2010, and expanded it to include repeat homebuyers who had owned and occupied a house for at least five of the past eight years. Sales of existing homes are measured at closing, while sales of new homes are measured at the time the contract is signed.

6 The Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation are conducting an in-depth interagency

Figure 6. Mortgage interest rates, 1995–2011



Note: The data, which are weekly and extend through February 23, 2011, are contract rates on 30-year mortgages.

Source: Federal Home Loan Mortgage Corporation.

Despite these announced moratoriums, the pace of new foreclosures dipped only slightly in the fourth quarter. Moreover, these moratoriums will likely only extend, and not put an end to, the foreclosure process in most cases.

Interest rates on fixed-rate mortgages remained quite low, on net, by historical standards during the second half of 2010 and reached record lows in the fourth quarter (**figure 6**). The very low levels of mortgage rates prompted a sizable pickup in refinancing activity for a time, although some households were unable to refinance because of depressed home values, weak credit scores, and tight lending standards for mortgages. Mortgage applications for home purchases were generally subdued in the second half of the year. Overall, mortgage debt outstanding likely declined in the second half of 2010 at a pace only slightly slower than that of the first half.

Net issuance of mortgage-backed securities (MBS) guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae was fairly low in the second half of 2010, consistent with the subdued originations of mortgages used to finance home purchases. The securitization market for mortgage loans not guaranteed by a housing-related government-sponsored enterprise (GSE) or the Federal Housing Administration remained essentially closed.

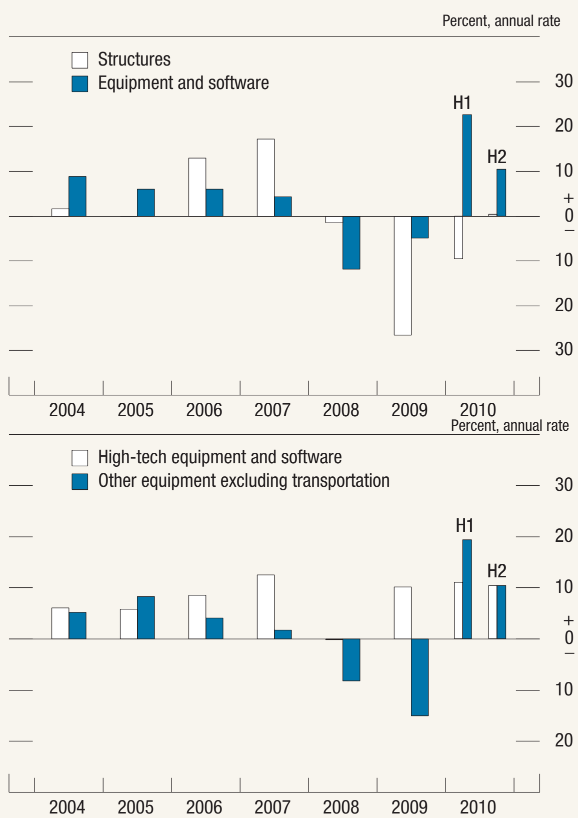
review of practices at the largest mortgage servicing operations to examine foreclosure practices generally, but with an emphasis on the breakdowns that led to inaccurate affidavits and other questionable legal documents being used in the foreclosure process. See Elizabeth A. Duke (2010), "Foreclosure Documentation Issues," statement before the Financial Services Subcommittee on Housing and Community Opportunity, U.S. House of Representatives, November 18, www.federalreserve.gov/newsevents/testimony/duke20101118a.htm.

The Business Sector

Fixed Investment

Real business spending on equipment and software, which surged in the first half of 2010, rose further in the second half (**figure 7**). Firms were likely motivated partly by a desire to replace aging equipment and to undertake capital spending that had been deferred during the recession. Improving business prospects also appear to have been a factor boosting capital expenditures. As a group, large firms continue to have ample internal funds, and those with access to capital markets generally have been able to obtain bond financing at favorable terms. Although credit availability for smaller firms and other bank-dependent businesses remains constricted, some tentative signs of easing lending standards have emerged.

Figure 7. Change in real business fixed investment, 2004–10



Note: High-tech equipment consists of computers and peripheral equipment and communications equipment.

Source: Department of Commerce, Bureau of Economic Analysis.

Overall spending on equipment and software rose at an annual rate of about 10 percent in the second half of 2010. Although business outlays in the volatile transportation equipment category plunged in the fourth quarter, that decline came in the wake of several quarters of sharp increases when vehicle rental firms were rebuilding their fleets of cars and light trucks. Meanwhile, spending on information technology (IT) capital—computers, software, and communications equipment—increased appreciably throughout the second half. Gains were apparently spurred by outlays to replace older, less-efficient IT capital as well as continued investments by wireless service providers to upgrade their networks. In addition, spending increases for equipment other than transportation and IT—nearly one-half of total equipment outlays—were well maintained and broad based. More recently, new orders for nondefense capital goods other than transportation and IT items were little changed, on net, in December and January; however, the level of orders remains above shipments, and business surveys suggest that respondents are upbeat about business conditions as well as their equipment spending plans.

Real spending on nonresidential structures other than those used for drilling and mining remained depressed, with the level of investment at the end of 2010 down almost 40 percent from its peak in early 2008. However, the rate of decline appears to be abating: Spending fell at an annual rate of nearly 10 percent in the second half of 2010 after plunging at a 25 percent rate in the first half. Although outlays for new power facilities jumped in the second half of the year, construction of office buildings, commercial structures, and manufacturing plants all moved down further. A large overhang of vacant space, depressed property prices, and an unwillingness of banks to add to their already high construction loan exposure still weighed heavily on the sector. In contrast, spending on drilling and mining structures continued to rise sharply in response to elevated energy prices.

Inventory Investment

Stockbuilding continued in the second half of 2010 at an average pace about in line with the growth of final sales. Inventory investment surged in the third quarter, but the pace of accumulation slowed sharply in the fourth quarter, with the swing magnified by developments in the motor vehicle sector. Vehicle stocks rose appreciably in the third quarter as dealers attempted to rebuild inventories that had become depleted earlier in the year, but inventories fell in the fourth quarter as auto sales moved up more rapidly than expected near the end of the year. As for other items aside from motor vehicles, inventory investment rose during the second half of the year, albeit more rapidly in the third quarter than in the fourth. The inventory-to-sales ratios for most industries covered by the Census Bureau's book-value data, which had risen significantly in 2009, have moved back to levels that prevailed before the recession, and surveys suggest that inventory positions for most businesses generally are in a comfortable range.

Corporate Profits and Business Finance

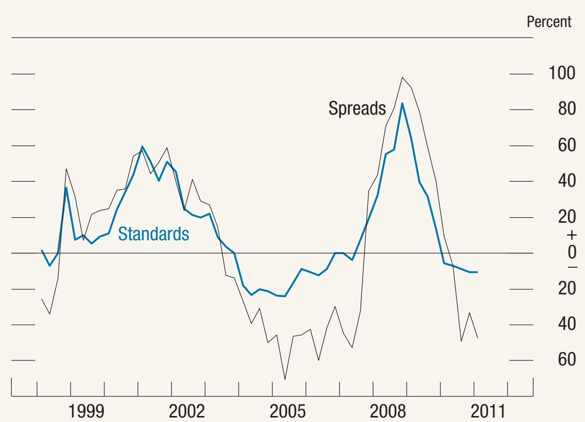
Operating earnings per share for S&P 500 firms continued to increase at a solid pace in the third and fourth quarters of 2010. Most industry groups reported gains. In aggregate, earnings per share climbed to near the levels posted in mid-2007, just prior to the financial crisis.

The already sturdy credit quality of nonfinancial corporations improved further in the second half of 2010. The aggregate debt-to-asset ratio, which provides an indication of corporate leverage, moved down in the third quarter, as nonfinancial corporations increased their assets by more than they increased their debt. Credit rating upgrades again outpaced downgrades and corporate bond defaults remained sparse. The delinquency rate on commercial and industrial (C&I) loans at commercial banks moved down in the second half of 2010 to 3 percent. By contrast, with fundamentals remaining weak, delinquency and charge-off rates on commercial real estate (CRE) loans at commercial banks decreased only modestly from quite elevated levels. Moreover, the delinquency rate on CRE loans in securitized pools continued to rise sharply.

Borrowing by nonfinancial corporations continued at a robust pace in the second half of 2010, driven by good corporate credit quality, attractive financing conditions, and an improving economic outlook. Issuance of corporate bonds was heavy for both investment-grade and high-yield issues. Borrowing in the syndicated loan market was also sizable, particularly by speculative-grade borrowers, with the dollar volume of such loans rebounding sharply from the low levels seen in 2008 and 2009. Demand for such loans from institutional investors was strong. Some of the strength in debt origination was reportedly due to corporations taking advantage of low interest rates to reduce debt service costs and extend maturities by refinancing; issuance to finance mergers and acquisitions also reportedly picked up in the second half of the year. Meanwhile, commercial paper outstanding remained about flat. C&I loans on banks' books decreased during the third quarter but started expanding toward the end of the year, consistent with responses to the January 2011 SLOOS that reported some easing of standards and terms and some firming of demand for C&I loans from large firms over the previous three months. Relatively large fractions of respondents to the most recent survey indicated that they narrowed the spread of C&I loan rates over their cost of funds somewhat further during the second half of 2010 (**figure 8**). Nevertheless, lending standards reportedly remained tight; about one-half of the respondents to special questions included in the October 2010 survey indicated that their lending standards on C&I loans were tighter than longer-run averages and were likely to remain so until at least 2012.

Borrowing conditions for small businesses continued to be tighter than for larger firms, although some signs of easing began to emerge. In particular, surveys conducted by the National Federation of Independent Business (NFIB) showed a gradual decline in the share of respondents reporting that credit was more difficult to obtain than three months previously. Similarly, in the past several surveys, moderate net fractions of SLOOS respondents have indicated that banks have eased some loan terms for smaller

Figure 8. Net percentage of domestic banks tightening standards and widening spreads over the banks' cost of funds for large and medium-sized business borrowers, 1998–2011



Note: The data are drawn from a survey generally conducted four times per year; the last observation is from the January 2011 survey, which covers 2010:Q4. Net percentage is the percentage of banks reporting a tightening of standards or a widening of spreads less the percentage reporting an easing or a narrowing. The definition for firm size suggested for, and generally used by, survey respondents is that large and medium-sized firms have annual sales of $50 million or more.

Source: Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices.

borrowers. Judging from responses to both the NFIB survey and the SLOOS, loan demand by small businesses remained subdued.

Banks' holdings of CRE loans continued to contract fairly sharply throughout the second half of 2010. Overall commercial mortgage debt declined at an annual rate of 6 percent in the third quarter, about the same pace as in the previous quarter. Responses to the January SLOOS suggest that banks have not yet started reversing their tight lending standards in this sector and that demand, while starting to pick up, likely remained weak. Despite the strains in CRE markets, the commercial mortgage-backed securities (CMBS) market showed tentative signs of improvement in the second half of 2010 and early 2011. Prices for some of the more highly rated tranches of existing CMBS rose. Although issuance of new securities remained tepid, the pace has been picking up. Responses to special questions on the September Senior Credit Officer Opinion Survey on Dealer Financing Terms (SCOOS) indicated that demand for warehousing of CRE loans for securitization had increased since the beginning of 2010, and that the willingness to fund CRE loans on an interim basis had increased somewhat.

A substantial number of initial and secondary equity offerings for nonfinancial firms were brought to market in the second half of 2010. Deals included an initial public offering by General Motors that was used to repay a portion of the government's capital infusion. Nevertheless, equity retirements in the third quarter through cash-financed mergers and acquisitions and share repurchases once again outpaced issuance; preliminary data for the fourth quarter (not shown) suggest a similar pattern.

The Government Sector

Federal Government

The deficit in the federal unified budget has remained very wide. The budget deficit for fiscal year 2010, although down somewhat from fiscal 2009, was $1.3 trillion. The fiscal 2010 figure was equal to 8¾ percent of nominal GDP, substantially above the average value of 2 percent recorded during the three-year period prior to the onset of the recession. The budget deficit continued to be boosted by spending commitments from the American Recovery and Reinvestment Act (ARRA) and other stimulus policy actions and by the weakness of the economy, which has reduced tax revenues and boosted payments for income support. By contrast, the budget effects of several financial transactions reduced the deficit in 2010: Outlays related to the Troubled Asset Relief Program (TARP), which added significantly to the deficit in 2009, helped to shrink the deficit in 2010 as estimated losses were revised down when many of the larger TARP recipients repaid their obligations to the Treasury; in addition, new assistance for the mortgage-related GSEs was extended at a slower pace, and depository institutions prepaid three years' worth of federal deposit insurance premiums. Moreover, the nascent recovery in the economy led to a small increase in revenues. The deficit is projected by the Congressional Budget Office to widen in fiscal 2011 to a level similar to the shortfall recorded in fiscal 2009.

Despite increasing 3 percent in fiscal 2010, tax receipts remained at very low levels; indeed, at less than 15 percent of GDP, the ratio of receipts to national income was at its lowest level in 60 years. Corporate income taxes surged nearly 40 percent in fiscal 2010 as profits increased briskly, and Federal Reserve remittances to the Treasury rose markedly owing to the expansion of its balance sheet. By contrast, despite rising household incomes, individual income and payroll taxes moved down in fiscal 2010, reflecting the tax cuts put in place by the ARRA. Total tax receipts increased nearly 10 percent over the first four months of fiscal 2011 relative to the comparable year-earlier period; individual income and payroll taxes turned up, a consequence of the further recovery in household incomes, and corporate income taxes continued to rise.

Outlays decreased 2 percent in fiscal 2010, a development attributable to financial transactions. Excluding financial transactions, spending rose 9 percent compared with fiscal 2009, mainly because of the effects of the weak labor market on outlays for income support programs (such as unemployment insurance and food stamps) as well as increases in Medicaid expenditures and spending associated with the ARRA and other stimulus-related policies. Net interest payments rose 5 percent in fiscal 2010, and Social Security spending increased 3½ percent—its smallest rise in 11 years—as the low rate of consumer price inflation in the previous year resulted in no cost of living adjustment. In the first four months of fiscal 2011, total federal outlays rose nearly 5 percent relative to the comparable year-earlier period. Excluding financial transactions, outlays were up about 1 percent. The relatively small increase so far this fiscal year for outlays excluding financial transactions reflects a flattening out of ARRA spending and income support payments; by contrast, other spending has been increasing at rates comparable to those recorded during fiscal 2010.

As measured in the national income and product accounts (NIPA), real federal expenditures on consumption and gross investment—the part of federal spending that is a direct component of GDP—rose at an annual rate of about 4 percent in the second half of 2010, a bit less than in the first half of the year. Nondefense outlays increased more slowly than in the first half of the year—when spending for the decennial census ramped up—while defense spending rose at roughly the same pace as in the first half.

Federal Borrowing

Federal debt expanded appreciably in the second half of last year, though at a slightly slower pace than in the first half. The ratio of federal debt held by the public to nominal GDP rose to more than 60 percent at the end of 2010 and is projected to reach nearly 70 percent by the end of 2011. Demand for Treasury securities has been well maintained. Bid-to-cover ratios at auctions, although somewhat mixed, were generally within historical ranges during the second half of 2010 and early 2011. Indicators of foreign participation at auctions as well as a rise in foreign custody holdings of Treasury securities by the Federal Reserve Bank of New York pointed to steady demand from abroad. Demand for these securities may have been supported by a heightened desire for relatively safe and liquid assets in light of fiscal troubles in some European countries.

State and Local Government

Despite the substantial federal aid provided by the ARRA, state and local governments remained under significant fiscal pressure in the second half of 2010. The strains reflect several factors, including a sharp drop in tax revenues in late 2008 and 2009 and increased commitments for Medicaid outlays—a cyclically sensitive transfer program—all in the context of balanced budget requirements. To address their budget shortfalls, these governments have been paring back operating expenditures. Indeed, real consumption expenditures of state and local governments, as measured in the NIPA, fell about 1 percent in 2010 after decreasing a similar amount in 2009. The weakness in spending was reflected in the continued reductions in payrolls. Total employment of state and local governments fell 250,000 during 2010, with nearly all of the cutbacks at the local level. Construction spending undertaken by these governments was volatile during 2010 but, on net, was down a bit for the year and remained below the level that prevailed before the recession despite the infrastructure grants provided by the federal government as part of the ARRA. While most capital expenditures are not subject to balanced budget requirements, some of these expenditures are funded out of operating budgets subject to these requirements. In addition, a substantial share of debt service payments on the bonds used to finance capital projects is made out of operating budgets—a factor that may be limiting the willingness of governments to undertake some new infrastructure projects.

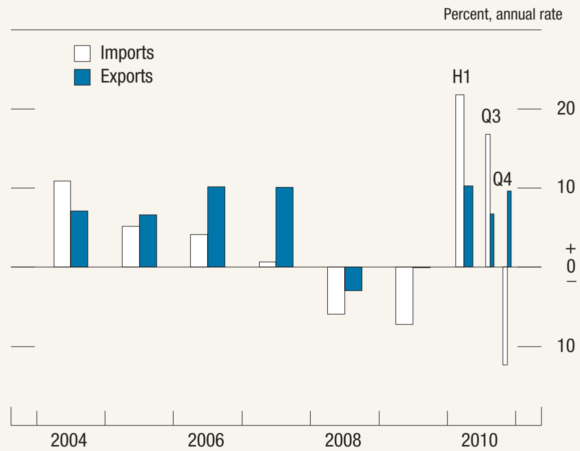
With overall economic activity recovering, state government revenues from income, business, and sales taxes rose in the second half of 2010. Nevertheless, state tax collections remain well below their prerecession levels, and available balances in reserve funds are low. Tax collections at the local level have fared relatively better. In particular, some localities appear to have adjusted statutory tax rates so that declining real estate assessments, which typically significantly lag market prices, are holding down property tax revenues by less than they otherwise would. However, many localities have seen sharp cutbacks in their grants-in-aid from state governments, and thus have experienced significant fiscal pressures. State and local governments will continue to face considerable budget strains, in part because federal stimulus grants will be winding down. Moreover, many state and local governments will need to set aside additional resources in coming years both to meet their pension obligations and to pay for health benefits provided to their retired employees.

State and Local Government Borrowing

Issuance of securities by state and local governments was robust during the latter half of 2010; it surged near the end of the year as state governments sought to take advantage of the Build America Bond program before the program expired.[7] Issuance of short-term municipal securities was also strong.

Yields on state and local government bonds rose noticeably more than those on comparable-maturity Treasury securities in the second half of 2010 and early 2011. The rise in yields on municipal securities may have reflected increased concerns about the fiscal position and financial health of state and local governments, although the heavy supply of these

Figure 9. Change in real imports and exports of goods and services, 2004–10



Source: Department of Commerce, Bureau of Economic Analysis.

securities coming to market likely also played a role. Spreads on credit default swaps for some states remained volatile but narrowed, on net, from their peak levels last summer. Downgrades of the credit ratings of state and local governments continued to outpace upgrades during the second half of 2010. Nonetheless, the pace of actual defaults on municipal issues continued to come down from its peak in 2008. In recent months, there were substantial outflows from long-term mutual funds that invest in municipal bonds.

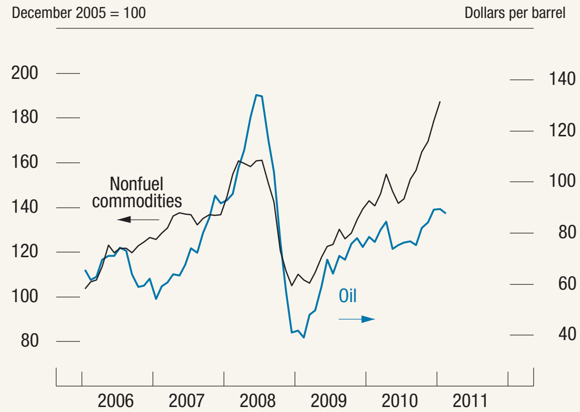
The External Sector

Supported by the expansion of foreign economic activity, real exports of goods and services continued to increase at a solid pace in the second half of 2010, rising at an annual rate of 8¼ percent (**figure 9**). Nearly all major categories of exports rose, with exports of machinery, agricultural goods, and services registering the largest gains. Moreover, the increase in export demand was broad based across trading partners.

Real imports of goods and services decelerated considerably in the second half of 2010, increasing at an annual rate of only 1¼ percent after surging more than 20 percent during the first half of last year. The sharp step-down partly reflected an unusually large decline in real oil imports, but more important, the growth in non-oil imports moderated to a pace more in line with the expansion in U.S. economic activity. During the second half of 2010, imports of consumer goods, machinery, and services posted the largest increases. As with exports, the increase in

7 The Build America Bond program allowed state and local governments to issue taxable bonds for capital projects and receive a subsidy payment from the Treasury for 35 percent of interest costs.

Figure 10. Prices of oil and nonfuel commodities, 2006–11



Note: The data are monthly. The oil price is the spot price of West Texas Intermediate crude oil, and the last observation is the average for February 1–22, 2011. The price of nonfuel commodities is an index of 45 primary-commodity prices and extends through January 2011.

Source: For oil, the Commodity Research Bureau; for nonfuel commodities, International Monetary Fund.

imports occurred across a wide range of trading partners.

All told, net exports shaved ½ percentage point off real GDP growth last year as the rebound in imports outpaced the recovery in exports for the year as a whole. The current account deficit widened from $378 billion in 2009 to an average of $479 billion at an annual rate, or about 3¼ percent of nominal GDP, in the first three quarters of 2010.

The spot price of West Texas Intermediate (WTI) crude oil moved higher over the second half of the year, rising to an average of $89 per barrel in December, about $11 above the average price that prevailed over the first six months of the year (figure 10). The upward movement in oil prices during the second half of the year largely reflected a widespread strengthening in global oil demand, particularly in emerging market economies (EMEs), against a backdrop of constrained supply. The depreciation of the dollar over this period also contributed somewhat to the rise in the price of oil. Spot WTI continued to fluctuate around its December average for much of the first two months of this year but moved up sharply in late February.[8] Unrest in several Middle Eastern and North African countries, and uncertainty about its potential implications for global oil supply, has put considerable upward pressure on oil prices in recent weeks.

The price of the long-term futures contract for crude oil (expiring in December 2019) has generally fluctuated in the neighborhood of $95 per barrel over the past six months, not much different from the average over the first half of 2010, although it has moved up some recently. Accordingly, the sharply upward sloping futures curve that characterized the oil market since the onset of the financial crisis has flattened considerably. Concurrent with this flattening of the futures curve, measured global inventories of crude oil have declined in recent months, although they remain high by historical standards.

Nonfuel commodity prices also rose markedly over the second half of the year and into early 2011, with increases broad based across a variety of commodities. As with oil, these prices have been supported by strengthening global economic activity, primarily in China as well as in other EMEs, and, to a lesser extent, by the lower dollar. In addition, adverse weather conditions have reduced harvests and curtailed supplies of important agricultural products in a number of key exporting countries, including Russia, Ukraine, and the United States.

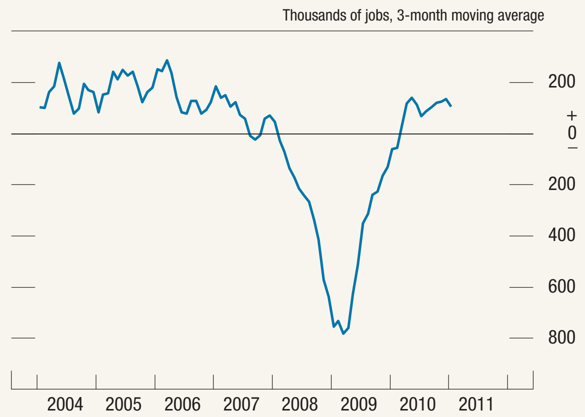
Prices of non-oil imported goods rose 1¼ percent at an annual rate over the second half of 2010 and have increased at an accelerated pace in January, boosted by higher commodity prices, the depreciation of the U.S. dollar, and foreign inflation. On net, non-oil import prices rose a bit more slowly over the second half of 2010 than in the first half and finished the year 2 percent higher than at the end of 2009.

National Saving

Total net national saving—that is, the saving of households, businesses, and governments excluding depreciation charges—remains low by historical standards. After having reached 3¾ percent of nominal GDP in 2006, net national saving dropped steadily over the subsequent three years, reaching roughly negative 3 percent in the third quarter of 2009. The widening of the federal budget deficit during the course of the recession more than accounted for the downswing in net saving. Since late 2009, net national saving has moved up, reflecting a sharp rise in private saving. Nonetheless, the total averaged about negative 1 percent in the third quarter of 2010 (the latest available data), and the large federal deficit will likely keep it at low levels in the near term. Currently, real interest rates are still low despite the depressed rate of

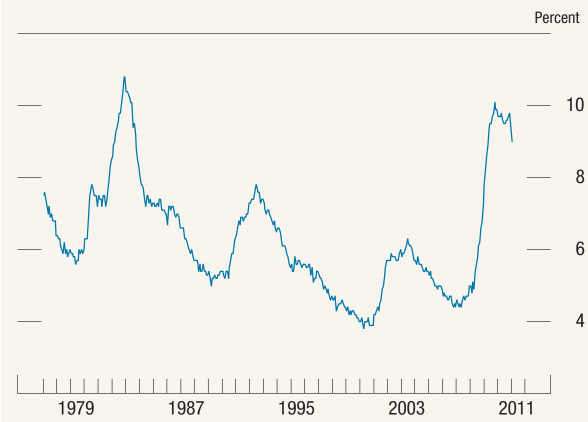
8 The prices of other grades of crude oil have risen by more over the first two months of this year as the high level of inventories accumulated at Cushing, Oklahoma, the delivery point for WTI, has depressed WTI prices.

Figure 11. Net change in private payroll employment, 2004–11



Note: The data are monthly and extend through January 2011.
Source: Department of Labor, Bureau of Labor Statistics.

Figure 12. Civilian unemployment rate, 1977–2011



Note: The data are monthly and extend through January 2011.
Source: Department of Labor, Bureau of Labor Statistics.

national saving. If national saving were to remain low as the economy recovers, interest rates would likely experience upward pressure, capital formation rates would likely be low, and borrowing from abroad would likely be heavy. In combination, such developments would limit the rise in the standard of living of U.S. residents and hamper the ability of the nation to meet the retirement needs of an aging population.

The Labor Market

Employment and Unemployment

Conditions in the labor market have continued to improve only slowly since the middle of 2010. Private payroll employment rose just 120,000 per month, on average, over the second half of last year, and payroll employment gains remained lackluster in January of 2011 (**figure 11**).[9] All told, only about one-seventh of the 8¾ million jobs lost from the beginning of 2008 to the trough in private payrolls in February 2010 have been recovered. Rather than adding jobs briskly, businesses have been achieving much of their desired increases in labor input over the past year by lengthening the hours worked by their employees; indeed, by January, the average workweek had recouped more than one-half of its decrease during the recession.

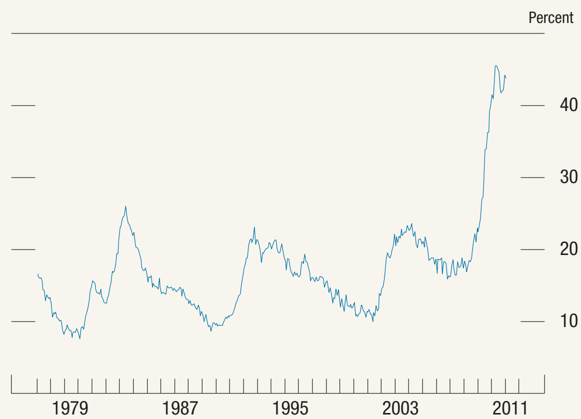
For most of last year, the overall net increase in hiring was barely sufficient to accommodate the increase in the size of the labor force, and the unemployment rate remained at or above 9½ percent through November (**figure 12**). However, the unemployment rate is estimated to have moved down noticeably in December and January, reaching 9.0 percent—about 1 percentage point below the highest reading during this episode. The recent decline in the jobless rate is encouraging, but the extent of the improvement in underlying labor-market conditions is, as yet, difficult to judge. The level of unemployment remains very elevated, and long-duration joblessness continues to account for an especially large share of the total. Indeed, in January, nearly 6¼ million persons among those counted as unemployed—about 44 percent of the total—had been out of work for more than six months, figures that were only a little below record levels observed in the middle of 2010 (**figure 13**).[10] Moreover, the number of individuals who are working part time for economic reasons—another indicator of the underutilization of labor—remained roughly twice its pre-recession value. Meanwhile, the labor force participation rate moved down further in the second half of the year. The decline in participation was mainly concentrated among men aged 25 and over without a college degree.

Several other indicators of labor market conditions, however, have brightened a bit recently. After showing little progress over the first half of the year, initial claims for unemployment insurance (an indicator of the pace of layoffs) generally have trended down in recent months. Moreover, survey measures of labor market expectations—such as business plans for

9 Total employment—private plus government—exhibited sharp swings from March 2010 to September 2010 as a result of the hiring of temporary workers for the decennial census.

10 The data on the duration of unemployment begin in 1948.

Figure 13. Long-term unemployed, 1977–2011



Note: The data are monthly and extend through January 2011. The series shown is the percentage of total unemployed persons who have been unemployed for more than 26 weeks.

Source: Department of Labor, Bureau of Labor Statistics.

future hiring and consumer attitudes about future labor market conditions—improved, on net, over the second half of 2010 and early this year after having softened around the middle of last year.

Productivity and Labor Compensation

Labor productivity rose further in the second half of 2010. According to the most recent published data, output per hour in the nonfarm business sector increased at an annual rate of about 2½ percent over that period. Productivity had surged in 2009 as firms aggressively eliminated many operational inefficiencies and reduced their labor input in an environment of severe economic stress. Although the recent gains in productivity have been less rapid, firms nonetheless continue to make efforts to improve the efficiency of their operations, and they appear to remain reluctant to increase staffing levels in a climate of lingering economic uncertainty.

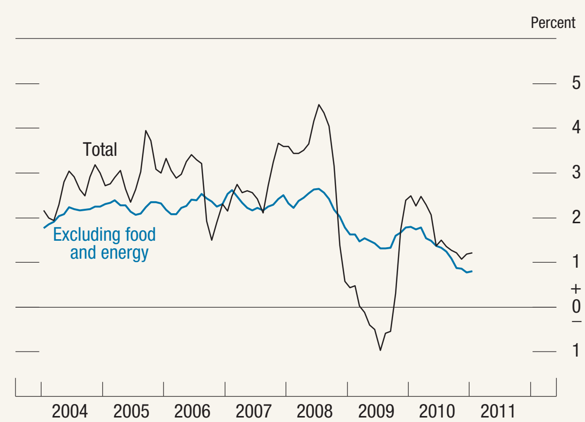
Increases in hourly compensation remained subdued in 2010, restrained by the wide margin of labor market slack. The employment cost index (ECI) for private industry workers, which measures both wages and the cost to employers of providing benefits, rose just 2 percent in nominal terms in 2010—up from an especially small increase in 2009 but still lower than the roughly 3 percent pace averaged in the several years preceding the recession. The rise in the ECI last year reflected a pickup in the growth of benefits, after a subdued increase in 2009, and a modest acceleration in wages and salaries. Nominal compensation per hour in the nonfarm business sector—derived from the labor compensation data in the NIPA—increased only 1½ percent in 2010, well below the average gain of about 4 percent in the years before the recession. After adjusting for the rise in consumer prices, hourly compensation was little changed in 2010. Because nominal hourly compensation and labor productivity in the nonfarm business sector rose at roughly the same pace in 2010, unit labor costs were about flat last year. During the preceding year, unit labor costs had plunged 3½ percent as a result of the moderate rise in nominal hourly compensation and the sizable advance in output per hour.

Prices

Consumer price inflation has been trending downward, on net, and survey measures of longer-term inflation expectations have remained stable, despite the rapid increases in a variety of commodity prices during the second half of 2010. Overall prices for personal consumption expenditures increased 1¼ percent over the 12 months ending in January 2011, compared with a rise of 2½ percent in the preceding 12-month period (**figure 14**). The core PCE price index—which excludes the prices of energy items as well as those of food and beverages—increased just ¾ percent over the 12 months ending in January, down from a 1¾ percent rise over the preceding 12 months.

The index of consumer energy prices, which declined in the first half of 2010, rose rapidly during the second half of the year and early 2011. The index was boosted by a surge in the prices of gasoline and

Figure 14. Change in the chain-type price index for personal consumption expenditures, 2004–11



Note: The data are monthly and extend through January 2011; changes are from one year earlier.

Source: Department of Commerce, Bureau of Economic Analysis.

home heating oil, which reflected the run-up in the price of crude oil that began in late summer. In contrast, consumer natural gas prices fell as increases in supply from new domestic wells helped boost inventories above typical levels. All told, the overall index of consumer energy prices rose nearly 7 percent during the 12 months ending in January 2011.

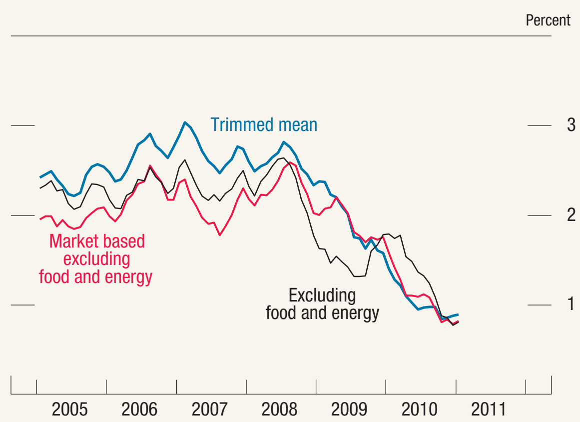
The index of consumer food prices rose 1¾ percent over the 12 months ending in January 2011 as the prices of beef and pork posted sizable increases. The price of fruits and vegetables ran up briskly early in 2010 following a couple of damaging freezes, but these prices turned down in the second half of the year, leaving them up only slightly for the year as a whole. However, spot prices in commodity markets for crops and for livestock moved up sharply toward the end of last year, pointing to some upward pressure on consumer food prices in the first part of 2011.

The slowdown in core PCE price inflation over the past year was particularly evident in the prices of goods other than food and energy, which fell 0.6 percent over the 12 months ending in January 2011. The decline in these core goods prices occurred despite sizable increases in the prices of some industrial commodities and materials; the modest degree of pass-through from commodity input costs to retail prices reflects the relatively small weight of materials inputs in total production costs. Prices for services other than energy rose about 1¼ percent over the 12 months ending in January, down from an increase of almost 2 percent in the preceding 12 months, as the continued weakness in the housing market put downward pressure on the rise in housing costs and as the wide margin of economic slack continued to restrain price increases for other services.

The widespread slowing in inflation over the past year is also apparent in a variety of alternative indicators of the underlying trend in inflation (**figure 15**). These indicators include trimmed-mean price indexes, which exclude the most extreme price increases and price declines in each period, and market-based measures of core prices, which exclude prices that must be imputed. These imputed prices (often referred to as "nonmarket" prices) tend to be highly erratic.

Survey-based measures of near-term inflation expectations have increased in recent months, likely reflecting the recent run-up in energy and food prices; in

Figure 15. Alternative measures of underlying price changes in personal consumption expenditures, 2005–11



Note: The data are monthly and extend through January 2011. The trimmed-mean personal consumption expenditures price index excludes the bottom 24 percent and the top 31 percent of the distribution of monthly price changes and is based on 178 components.

Source: For trimmed mean, Federal Reserve Bank of Dallas; for all else, Department of Commerce, Bureau of Economic Analysis.

contrast, survey-based measures of longer-term inflation expectations have remained relatively stable over the past year. In the Thomson Reuters/University of Michigan Surveys of Consumers, median year-ahead inflation remained between 2¾ percent and 3 percent for most of 2010 but then rose above 3 percent in early 2011. Longer-term expectations in the survey, at 2.9 percent in February, remained in the narrow range that has prevailed over the past few years. In the Survey of Professional Forecasters, conducted by the Federal Reserve Bank of Philadelphia, expectations for the increase in the consumer price index over the next 10 years edged down, on balance, during 2010 after having been essentially unchanged for many years.

Financial Developments

In light of the disappointing pace of the progress toward the Federal Reserve's dual objectives of maximum employment and price stability, the Federal Open Market Committee (FOMC) took steps in the second half of the year to reduce downside risk to the sustainability of the recovery and to provide further support to economic activity. At its August 2010 meeting, the FOMC decided to keep the Federal Reserve's holdings of longer-term securities constant at their then-current level by reinvesting principal payments from holdings of agency debt and agency MBS in longer-term Treasury securities. In November, the FOMC announced its intention to purchase

Box 1. The Effects of Federal Reserve Asset Purchases

Between late 2008 and early 2010, with short-term interest rates already near zero, the Federal Reserve provided additional monetary accommodation by purchasing $1.25 trillion in agency mortgage-backed securities (MBS), about $175 billion in agency debt, and $300 billion in longer-term Treasury securities. When incoming economic data in mid-2010 suggested that the recovery might be softening, the Federal Open Market Committee (FOMC) decided to take further action to fulfill its mandated objectives of promoting maximum employment and price stability. First, the Committee decided at its August 2010 meeting to reinvest the principal payments from its holdings of agency debt and agency MBS in longer-term Treasury securities. Second, it announced in November its intention to purchase an additional $600 billion of longer-term Treasury securities by the end of the second quarter of 2011.

The theory underlying these asset purchases, which dates back to the early 1950s, posits that asset prices are affected by the outstanding quantity of assets. In some models, for example, short- and long-term assets are imperfect substitutes for one another in investors' portfolios, and the term structure of interest rates can be influenced by changes to the supply of securities at different maturities. As a result, purchases of longer-term securities by the central bank can push up the prices and drive down the yields on those securities. Asset purchases can also affect longer-term interest rates by influencing investors' expectations of the future path of short-term rates. Similarly, the effect of central bank asset purchases depends on expectations regarding the timing and pace of the eventual unwinding of the purchases. Thus, central bank communication may play a key role in influencing the response of financial markets to such a program.

Recent empirical work suggests that the Federal Reserve's asset purchase programs have indeed provided significant monetary accommodation. Studies of the responses of asset prices to announcements by the Federal Reserve regarding its first round of asset purchases have found that the purchases of Treasury securities, agency debt, and agency MBS significantly reduced the yields on those securities.[1] Similarly, analyses of the responses of asset prices to the purchases themselves also documented an effect on the prices of the acquired securities.[2] Spillover effects of the purchase programs to other financial markets, in turn, appear to have resulted in lower interest rates on corporate debt and residential mortgages and to have contributed to higher equity valuations and a somewhat lower foreign exchange value of the dollar. These effects are qualitatively similar to those that typically result from conventional monetary policy easing.

Recent research by Federal Reserve staff has provided some estimates of the magnitude of the resulting effects on the economy using the FRB/US macroeconomic model—one of the models developed by the Federal Reserve Board staff and used for policy

(continued on next page)

[1] See, for example, Joseph Gagnon, Matthew Raskin, Julie Remache, and Brian Sack (2010), "Large-Scale Asset Purchases by the Federal Reserve: Did They Work?" Federal Reserve Bank of New York Staff Reports No. 441 (New York: Federal Reserve Bank of New York, March); and James Hamilton and Jing (Cynthia) Wu (2010), "The Effectiveness of Alternative Monetary Policy Tools in a Zero Lower Bound Environment," working paper (San Diego: University of California, San Diego, November). Evidence of similar effects in the United Kingdom from asset purchases by the Bank of England was found by Michael Joyce, Ana Lasaosa, Ibrahim Stevens, and Matthew Tong (2010), "The Financial Market Impact of Quantitative Easing," Working Paper 393 (London: Bank of England, August).

[2] See, for example, Stefania D'Amico and Thomas B. King (2010), "Flow and Stock Effects of Large-Scale Asset Treasury Purchases," Finance and Economics Discussion Series 2010-52 (Washington: Board of Governors of the Federal Reserve System, September).

a further $600 billion in longer-term Treasury securities by the end of the second quarter of 2011 (see **box 1**).

Financial market conditions, which had worsened early in the summer as a result of developments in Europe and concerns about the durability of the global recovery, subsequently improved as investors increasingly priced in further monetary policy accommodation. Accordingly, real Treasury yields declined, asset prices increased, and credit spreads narrowed. A brightening tone to the economic news starting in the fall bolstered investor sentiment and, together with a reassessment on the part of investors of the ultimate size of Federal Reserve Treasury purchases, contributed to a backup in interest rates and in measures of inflation compensation that continued through year-end. In contrast to the developments earlier in the year, the reemergence later in the year of concerns about the financial situation in Europe left little imprint on domestic financial markets.

Monetary Policy Expectations and Treasury Rates

In response to indications of a slowing pace of recovery in U.S. output and employment and a con-

Box 1. The Effects of Federal Reserve Asset Purchases—*continued*

analysis.[3] A simulation exercise suggests that the cumulative effect of the Federal Reserve's asset purchases since 2008—including the original purchases of Treasury securities, agency debt, and agency MBS; the reinvestment of principal payments; and the additional $600 billion in Treasury security purchases now intended—has been to provide significant and mounting support to economic activity over time. Although estimates of these effects are subject to considerable uncertainty, the model results suggest that the purchases have already boosted the level of real gross domestic product 1¾ percent relative to what it would have been if no such purchases had occurred, and that this effect will rise to 3 percent by 2012.[4] As a result of this stronger recovery in output, the model also suggests that by 2012 the asset purchase program will boost private employment about 3 million, and trim the unemployment rate 1½ percentage points relative to what they otherwise would be. Finally, the simulation results suggest that inflation is currently 1 percentage point higher than otherwise would have been the case if the FOMC had never initiated securities purchases, implying that, in the absence of such purchases, the economy would now be close to a state of deflation.

Although the asset purchase programs seem to have provided significant support to economic activity, some observers have noted that they are not without risk. One concern that has been voiced is that these purchase programs have increased the size of the Federal Reserve's balance sheet and could result in monetary accommodation being left in place for too long, leading to excessive inflation. However, in preparation for removing monetary accommodation, the Federal Reserve has continued to develop the tools it will need to raise short-term interest rates and drain large volumes of reserves when doing so becomes necessary to achieve the policy stance that best fosters the Federal Reserve's macroeconomic objectives.[5] Moreover, the current level of resource slack in the economy and the recent low readings on underlying inflation suggest that point is not yet near.

A second concern is that the asset purchase program could result in adverse financial imbalances if, for example, the lower level of longer-term interest rates encouraged potential borrowers to employ excessive leverage to take advantage of low financing costs or led investors to accept an imprudently small amount of compensation for bearing risk in an effort to enhance their rates of return. The Federal Reserve is carefully monitoring financial indicators, including credit flows and premiums for credit risk, for signs of potential threats to financial stability. For example, to monitor leverage provided by dealers to financial market participants, in June 2010 the Federal Reserve launched the Senior Credit Officer Opinion Survey on Dealer Financing Terms. This survey provides information on the terms on and availability of various forms of dealer-intermediated financing, including funding for securities positions. Moreover, to better monitor linkages among firms and markets that could undermine the stability of the financial system, the Federal Reserve has increased its emphasis on taking a multidisciplinary approach that integrates the contributions of economists, specialists in particular financial markets, bank supervisors, payment systems experts, and other professionals. An Office of Financial Stability Policy and Research was created within the Federal Reserve to coordinate staff efforts to identify and analyze potential risks to the financial system and broader economy.

3 Hess Chung, Jean-Phillipe Laforte, David Reifschneider, and John Williams (2011), "Have We Underestimated the Likelihood and Severity of Zero Lower Bound Events?" Federal Reserve Bank of San Francisco Working Paper Series 2011-01 (San Francisco: Federal Reserve Bank of San Francisco, January).

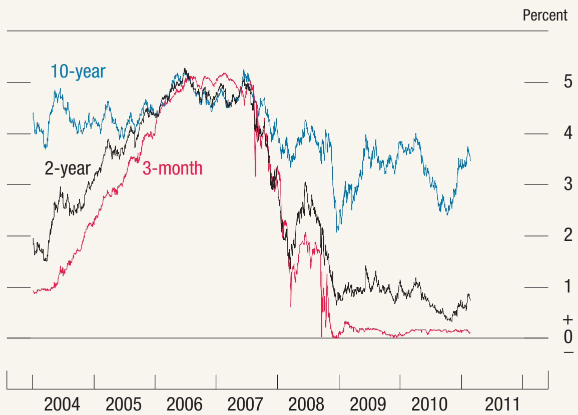
4 These effects are based on certain assumptions regarding the period assets are held and the unwinding of the purchases. These, and other, assumptions are described in more detail in Chung and others, "Zero Lower Bound Events," in box note 3.

5 The ongoing development of these tools is discussed in Part 3.

tinued downward trend in measures of underlying inflation, expectations regarding the path for the federal funds rate during 2011 and 2012 were revised down sharply in the third quarter and investors came to anticipate further Federal Reserve asset purchases. The FOMC's decision to begin additional purchases of longer-term Treasury securities occurred against the backdrop of this downward shift in expectations about monetary policy. Subsequently, expectations regarding the ultimate size of such purchases were scaled back as the recovery appeared to strengthen, downside risks to the outlook seemed to recede somewhat, and a tax-cut deal that was seen as supportive of economic activity was passed into law.

The current target range for the federal funds rate of 0 to ¼ percent is consistent with the level that investors expected at the end of June 2010. However, the date at which monetary policy tightening is expected to commence has moved back somewhat since the time of the July 2010 *Monetary Policy Report to the Congress*. Quotes on money market futures contracts indicate that, as of late February, investors anticipate that the federal funds rate will rise above its current

Figure 16. Interest rates on selected Treasury securities, 2004–11



Note: The data are daily and extend through February 22, 2011.

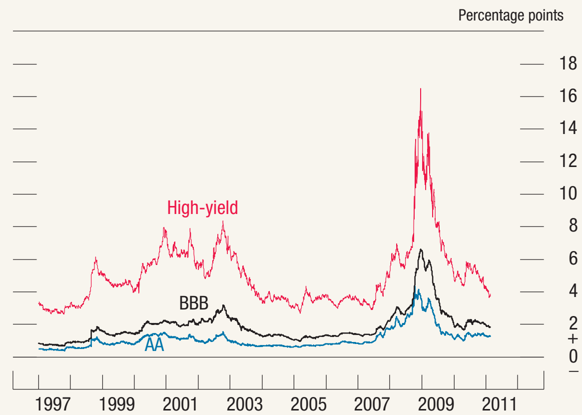
Source: Department of the Treasury.

range in the first quarter of 2012, about a year later than the date implied in July 2010. By the end of 2012, investors expect that the effective federal funds rate will be around 1.3 percent, fairly similar to the level anticipated in mid-2010.[11]

Yields on nominal Treasury securities fluctuated considerably in the second half of 2010 and in early 2011 due to shifts in investors' expectations regarding the prospects for economic growth and the size of any asset purchase program that would be conducted by the Federal Reserve (**figure 16**). Recently, Treasury yields declined as investors increased their demand for the relative safety and liquidity of Treasury securities following political turmoil in the Middle East and North Africa. On net, yields on 2-year Treasury notes were up a bit from their levels in mid-2010, while those on 10-year Treasury securities rose approximately 40 basis points. Nonetheless, yields on Treasury securities remained quite low by historical standards. Uncertainty about longer-term interest rates, as measured by the implied volatility on

[11] When interest rates are close to zero, determining the point at which financial market quotes indicate that the federal funds rate will move above its current range can be challenging. The path described in the text is the mean of a distribution calculated from derivatives contracts on federal funds and Eurodollars. The skewness induced in this distribution by the zero lower bound causes the mean to be influenced strongly by changes in uncertainty regarding the policy path, complicating its interpretation. Alternatively, one can use similar derivatives to calculate the most likely—or "modal"—path of the federal funds rate, which tends to be more stable. This path has also moved down, on net, since last summer, but it suggests a flatter overall trajectory for the target federal funds rate, according to which the effective rate does not rise above its current level until around the middle of 2012.

Figure 17. Spreads of corporate bond yields over comparable off-the-run Treasury yields, by securities rating, 1997–2011



Note: The data are daily and extend through February 22, 2011. The spreads shown are the yields on 10-year bonds less the 10-year Treasury yield.

Source: Derived from smoothed corporate yield curves using Merrill Lynch bond data.

10-year Treasury securities, rose significantly from November to mid-December, likely in part because of increased uncertainty about the ultimate size of the Federal Reserve's asset purchase program. Interest rate uncertainty declined subsequently and by early 2011 was only a bit higher, on net, than in mid-2010, apparently reflecting coalescing market expectations regarding Federal Reserve purchases.

Measures of medium- and long-term inflation compensation derived from inflation-indexed Treasury bonds rose, on balance, during the second half of 2010 but remained within their historical ranges. Both medium- and long-term measures of inflation compensation fell early in the third quarter as investors grew more concerned about the durability of the economic recovery, but they then moved back up as the FOMC was seen as taking additional steps to help move inflation back toward levels more consistent with its mandate and as economic prospects improved. Rising energy prices may also have contributed to the increases in medium-term inflation compensation.

Corporate Debt and Equity Markets

During the second half of 2010 and early 2011, the spreads between the yields on investment-grade corporate bonds and those on comparable-maturity Treasury securities narrowed modestly (**figure 17**). Similar risk spreads on corporate bonds with below-investment-grade ratings narrowed more substantially—as much as 200 basis points. This spread compression was consistent with continued improvements in corporate credit quality as well as increased investor confidence in the durability of the recovery. Nonetheless, bond spreads now stand near the lower end of their historical ranges. In the secondary market for syndicated leveraged loans, the average bid price moved up further, a development that reflected strong investor demand as well as improved fundamentals. A notable share of loans traded at or above par in early 2011.

Equity prices have risen sharply since mid-2010. The rally began amid expectations of further monetary policy accommodation and was further supported by robust corporate earnings and an improved economic outlook. The gains in equity prices were broad based. Implied volatility for the S&P 500, calculated from options prices, generally trended down in the second half of 2010 and early 2011 and reached fairly low levels, although it increased recently against a backdrop of rising political turmoil in the Middle East and North Africa.

With some investors apparently seeking to boost returns in an environment of low interest rates, net inflows into mutual funds that invest in higher-yielding fixed-income instruments, including speculative-grade bonds and leveraged loans, were robust in the second half of 2010 and early 2011. These inflows likely supported strong issuance and contributed to the narrowing of bond spreads during this period. Mutual funds focusing on international debt securities also attracted strong inflows. Inflows to other categories of bond funds were more modest so that overall inflows to bond funds in the second half of 2010 were similar to those in the first half of the year. Despite the strong gains in U.S. equity markets, mutual funds investing in domestic equities experienced sizable outflows for much of the second half of last year, but these funds attracted net inflows in early 2011. Investments in money market mutual funds changed little in the second half of 2010—following notable outflows earlier in the year—as the assets held by these funds continued to generate very low yields.

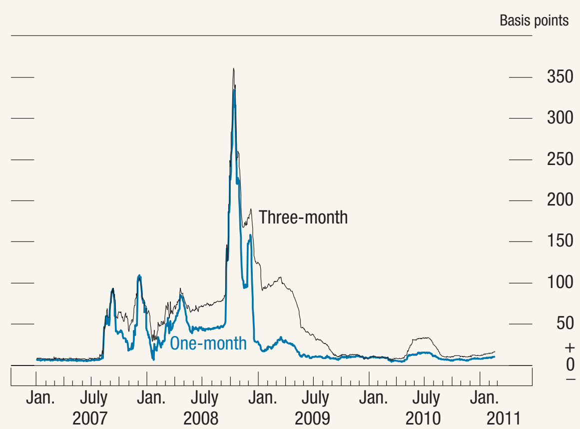
Market Functioning and Dealer-Intermediated Credit

Conditions in short-term funding markets, which had experienced notable strains in the spring when investors became concerned about European sovereign debt and banking issues, generally improved early in the second half of 2010. Spreads of London interbank offered rates, or Libor, over comparable-maturity overnight index swap rates—a measure of stress in short-term bank funding markets—reversed the widening observed in the spring and then remained fairly narrow despite the reemergence of concerns about the situation in Europe in the fall (**figure 18**). Nevertheless, amid the renewed concerns, tiering was reportedly evident in dollar funding markets abroad, as institutions located in peripheral European countries apparently faced reduced access to funding. Issuance of commercial paper in the United States by institutions headquartered in peripheral Europe declined as investors required notably higher rates to hold this paper.

Besides these strains and some modest, short-lived year-end pressures, conditions in short-term funding markets continued to be stable. The spreads between yields on lower-quality A2/P2-rated paper and AA-rated asset-backed commercial paper over those on higher-quality AA-rated nonfinancial paper remained narrow through the fall and into 2011. Since last summer, haircuts on securities used as collateral in repurchase agreements (repos), while exhibiting some volatility in the fourth quarter and early 2011, were generally little changed.

Information from the Federal Reserve's quarterly Senior Credit Officer Opinion Survey on Dealer Financing Terms suggested that the major dealers eased credit terms to most types of counterparties during the second half of 2010, primarily in response

Figure 18. Libor minus overnight index swap rate, 2007–11



Note: The data are daily and extend through February 22, 2011. An overnight index swap (OIS) is an interest rate swap with the floating rate tied to an index of daily overnight rates, such as the effective federal funds rate. At maturity, two parties exchange, on the basis of the agreed notional amount, the difference between interest accrued at the fixed rate and interest accrued by averaging the floating, or index, rate. Libor is the London interbank offered rate.

Source: For Libor, British Bankers' Association; for the OIS rate, Prebon.

to more-aggressive competition from other institutions and to an improvement in the current or expected financial strength of the counterparties. The easing of terms occurred primarily for securities-financing transactions, while nonprice terms for over-the-counter derivatives transactions were reportedly little changed on net. Survey respondents also noted a general increase in the demand for funding for all types of securities covered in the survey.

While remaining well below pre-crisis levels, the use of dealer-intermediated leverage appears to have gradually increased since the end of the summer, interrupted by a brief retrenchment in early December when concerns about developments in Europe intensified. This trend is reflected in the increased funding of equities by hedge funds and other levered investors and in an uptick in demand for the funding of some other types of securities. In addition, recent leveraged finance deals—involving the new issuance of high-yield corporate bonds and syndicated leveraged loans—on average reflected greater levering of the underlying corporate assets, but they nonetheless generated strong interest on the part of investors in a very low interest rate environment. However, there was little evidence that dealer-intermediated funding of less-liquid assets increased materially, and new issuance of structured products that embed leverage and were originated in large volumes prior to the crisis—including, for example, complex mortgage derivatives—has not resumed on any significant scale. In general, the appetite for additional leverage on the part of most market participants—as reflected in responses to special questions on the September SCOOS, triparty repo market volumes, and other indicators—appears to have remained generally muted, with most investors not fully utilizing their existing funding capacity.

Measures of liquidity and functioning in most financial markets pointed to generally stable conditions since mid-2010. In the Treasury market, various indicators, such as differences in prices of securities with similar remaining maturities and spreads between yields on on- and off-the-run issues, suggest that the market continued to operate normally, including during the period when the Federal Reserve was implementing its new asset purchase program. Bid-asked spreads were generally about in line with historical averages, and dealer transaction volumes have continued to reverse the declines observed during the financial crisis. In the syndicated loan market, bid-asked spreads trended down further in the second half of 2010 and in early 2011 as the market continued to

Figure 19. Spreads on credit default swaps for selected U.S. banks, 2007–11

Note: The data are daily and extend through February 22, 2011. Median spreads for six bank holding companies and nine other banks.

Source: Markit.

recover, although they remained above the levels observed prior to 2007. Estimates of bid-asked spreads in corporate bond markets were within historical ranges, as was the dispersion of dealer quotes in the credit default swap market.

Banking Institutions

Returns on equity and returns on assets for commercial banks in the second half of 2010 improved moderately from earlier in the year but remained well below the levels that prevailed before the financial crisis. Profits for the industry as a whole have benefitted considerably in recent quarters from reductions in loan loss provisioning. However, pre-provision net revenue decreased over the second half of the year as net interest margins slid and income from both deposit fees and trading activities declined.[12] About 70 of the more than 6,500 commercial banks in the United States failed between July and December 2010, down slightly from the 86 failures that occurred in the first half of the year.

Spreads on credit default swaps written on banking organizations generally held steady or moved down, on net, since mid-2010 (**figure 19**). Moreover, indicators of credit quality at commercial banks showed signs of improvement. Aggregate delinquency and charge-off rates moved down, although they remain high. Loss provisioning stayed elevated, but the recent reductions generally exceeded the declines in

[12] Pre-provision net revenue is the sum of net interest income and noninterest income less noninterest expense.

charge-offs, which suggests that banks expect credit quality to improve further in coming quarters. Indeed, for every major loan type, significant net fractions of banks reported on the January Senior Loan Officer Opinion Survey that they expect credit quality to improve during the current year if economic activity progresses in line with consensus forecasts.

Equity prices of commercial banks moved higher, on net, since mid-2010. During this period, large commercial banks generally reported earnings that beat analysts' expectations, and improved economic prospects were seen as boosting loan demand and supporting loan quality going forward, developments that would buoy banks' profitability. Nevertheless, investors were anxious about the degree to which future profitability might be negatively affected by a number of factors, including the quality of assets on banks' books, changes in the regulatory landscape, mortgage documentation and foreclosure issues, and the potential for some nonperforming mortgages in securitized pools to be put back to some of the large banks.

Total assets of commercial banks changed little, on net, during the second half of 2010, although there were notable compositional shifts. With demand weak and lending standards tight, total loans contracted. Nevertheless, the pace at which loans decreased was not as rapid as in the first half of the year, in part because banks' holdings of commercial and industrial loans picked up and their holdings of closed-end residential mortgages grew steadily. Partly offsetting the declines in total loans, banks expanded their holdings of Treasury securities and agency MBS, although the growth in their securities holdings slowed late in the year and into 2011.

Regulatory capital ratios at commercial banks moved higher, on balance, over the second half of 2010. The upward trend in capital ratios over the past several years has been most pronounced at the largest banks as they accumulated capital while risk-weighted assets decreased and tangible assets were about unchanged. Capital requirements for many of these banks will increase significantly under the new international capital standards, which will restrict the definition of regulatory capital and increase the risk weights assigned to some assets and off-balance-sheet exposures. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires that the Federal Reserve issue rules by January 31, 2012, that will subject bank holding companies with more than $50 billion in assets to additional capital and liquidity requirements.

Monetary Aggregates and the Federal Reserve's Balance Sheet

The M2 monetary aggregate has expanded at a moderate pace since mid-2010 after rising only slightly in the first half of last year; for the year as a whole, M2 grew 3.2 percent, the slowest annual increase since 1994.[13] As has been the case for some time, the strongest increase was in liquid deposits, the largest component of M2, while small time deposits and retail money market mutual fund assets continued to contract. Liquid deposits tended to pay slightly more-favorable interest rates than did their close substitutes. The currency component of the money stock expanded at a faster rate in the second half of 2010 than it had earlier in the year. The monetary base—essentially equal to the sum of currency in circulation and the reserve balances of depository institutions held at the Federal Reserve—contracted slightly during the second half of 2010, although the downward trend started to reverse late in the period in response to the Federal Reserve's new Treasury security purchase program.

The size of the Federal Reserve's balance sheet remained at a historically high level throughout the second half of 2010. In early 2011, the balance sheet stood at about $2.5 trillion, an increase of around $200 billion from its level in early July (table 1). The expansion of the balance sheet was more than accounted for by an increase in holdings of Treasury securities, which were up nearly $450 billion since the summer. The additional holdings of Treasury securities resulted from the FOMC's August decision to reinvest the proceeds from paydowns of agency debt and MBS in longer-term Treasury securities and the asset purchase program announced at the November FOMC meeting. To provide operational flexibility and to ensure that it is able to purchase the most

[13] M2 consists of (1) currency outside the U.S. Treasury, Federal Reserve Banks, and the vaults of depository institutions; (2) traveler's checks of nonbank issuers; (3) demand deposits at commercial banks (excluding those amounts held by depository institutions, the U.S. government, and foreign banks and official institutions) less cash items in the process of collection and Federal Reserve float; (4) other checkable deposits (negotiable order of withdrawal, or NOW, accounts and automatic transfer service accounts at depository institutions; credit union share draft accounts; and demand deposits at thrift institutions); (5) savings deposits (including money market deposit accounts); (6) small-denomination time deposits (time deposits issued in amounts of less than $100,000) less individual retirement account (IRA) and Keogh balances at depository institutions; and (7) balances in retail money market mutual funds less IRA and Keogh balances at money market mutual funds.

Table 1. Selected components of the Federal Reserve balance sheet, 2009–11
Millions of dollars

Balance sheet item	Dec. 30, 2009	July 7, 2010	Feb. 23, 2011
Total assets	**2,237,258**	**2,335,457**	**2,537,175**
Selected assets			
Credit extended to depository institutions and dealers			
Primary credit	19,111	17	24
Term auction credit	75,918	0	0
Primary Dealer Credit Facility and other broker-dealer credit	0	…	…
Central bank liquidity swaps	10,272	1,245	70
Credit extended to other market participants			
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	0	…	…
Net portfolio holdings of Commercial Paper Funding Facility LLC	14,072	1	…
Term Asset-Backed Securities Loan Facility	47,532	42,278	20,997
Support of critical institutions			
Net portfolio holdings of Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC[1]	65,024	66,996	64,902
Credit extended to American International Group, Inc.	22,033	24,560	…
Preferred interests in AIA Aurora LLC and ALICO Holdings LLC	25,000	25,733	…
Securities held outright			
U.S. Treasury securities	776,587	776,997	1,213,425
Agency debt securities	159,879	164,762	144,119
Agency mortgage-backed securities (MBS)[2]	908,257	1,118,290	958,201
Memo			
Term Securities Lending Facility[3]	0	…	…
Total liabilities	**2,185,139**	**2,278,523**	**2,484,141**
Selected liabilities			
Federal Reserve notes in circulation	889,678	907,698	956,012
Reverse repurchase agreements	70,450	62,904	59,484
Deposits held by depository institutions	1,025,271	1,061,239	1,297,905
Of which: Term deposits	…	2,122	5,070
U.S. Treasury, general account	149,819	16,475	23,123
U.S. Treasury, Supplementary Financing Account	5,001	199,963	124,976
Total capital	**52,119**	**56,934**	**53,035**

Note: LLC is a limited liability company.

1 The Federal Reserve has extended credit to several LLCs in conjunction with efforts to support critical institutions. Maiden Lane LLC was formed to acquire certain assets of the Bear Stearns Companies, Inc. Maiden Lane II LLC was formed to purchase residential mortgage-backed securities from the U.S. securities lending reinvestment portfolio of subsidiaries of American International Group, Inc. (AIG). Maiden Lane III LLC was formed to purchase multisector collateralized debt obligations on which the Financial Products group of AIG has written credit default swap contracts.

2 Includes only MBS purchases that have already settled.

3 The Federal Reserve retains ownership of securities lent through the Term Securities Lending Facility.

…Not applicable.

Source: Federal Reserve Board, Statistical Release H.4.1, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks."

attractive securities on a relative-value basis, the Federal Reserve temporarily relaxed its 35 percent per-issue limit on System Open Market Account (SOMA) holdings of individual Treasury securities and will allow SOMA holdings to rise above the previous threshold in modest increments up to a 70 percent per-issue limit; holdings of particular issues exceed the previous limit for only a small number of securities. In contrast, holdings of agency debt and agency MBS declined about $180 billion between early July and early 2011. The wave of mortgage refinancing that occurred in the autumn in the wake of the drop in mortgage rates contributed notably to the sharp decline in Federal Reserve holdings of MBS. In addition, holdings of agency debt declined as these securities matured.

Use of regular discount window lending facilities, such as the primary credit facility, has been minimal for some time. The Term Asset-Backed Securities Loan Facility (TALF) was closed on June 30, 2010. Loans outstanding under the TALF declined from $42 billion in mid-2010 to $21 billion in early 2011 as improved conditions in some securitization markets resulted in prepayments of loans made under the facility. The other broad-based credit facilities that the Federal Reserve had introduced to provide liquidity to financial institutions and markets during the financial crisis were closed early in 2010. All loans extended through these programs had been repaid by the summer.

The portfolio holdings of Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC, which were created to acquire certain assets from troubled systemically important institutions during the crisis, have generally changed little, on net, since mid-2010. Current estimates of the fair values of the portfolios of the three Maiden Lane LLCs exceed the corresponding loan balances outstanding to each limited liability company from the Federal Reserve Bank of New York. Consistent with the terms of the Maiden Lane LLC transaction, on July 15, 2010, this limited liability company began making distributions to repay the loan received from the Federal Reserve Bank of New York. On January 14, 2011, American International Group, Inc., or AIG, repaid the credit extended by the Federal Reserve under the revolving credit line, and the Federal Reserve was paid in full for its preferred interests in the special purpose vehicles AIA Aurora LLC and ALICO Holdings LLC, thereby reducing the balances in these accounts to zero.

Stresses in European dollar funding markets in May led to the reestablishment of liquidity swap lines between the Federal Reserve and foreign central banks. Only a small amount of credit has been issued under the reestablished facilities, which in December were extended through August 1, 2011.

On the liability side, Federal Reserve notes in circulation increased a bit, from $908 billion to $956 billion. Reverse repos edged down. Deposits held at the Federal Reserve by depository institutions rose to about $1.3 trillion. The Supplementary Financing Account declined early in 2011 following the announcement by the Treasury that it was suspending new issuance under the Supplementary Financing Program and that it would allow that account to fall to $5 billion as part of its efforts to maximize flexibility in debt management as federal debt approached the statutory debt limit.

International Developments

International Financial Markets

The foreign exchange value of the dollar declined over much of the third quarter of 2010 (**figure 20**). This decline was spurred in part by some reversal of flight-to-safety flows—as financial system strains in Europe temporarily diminished following the July release of the results of the European Union (EU) stress tests—and by fears that the recovery in the United States was slowing. Mounting expectations that the Federal Reserve might undertake further asset purchases in response to the weakening economic outlook also weighed on the dollar. Although the dollar initially dropped a bit more following the Federal Reserve's announcement in early November that it would purchase additional long-term Treasury securities, it subsequently reversed course as data on economic activity in the United States began to strengthen and as investors began to scale back their expectations of the ultimate size of the Federal Reserve's purchase program. In the first two months of this year, the dollar edged down again as the outlook for economic activity abroad appeared to strengthen and the financial situation in Europe stabilized. On net, the dollar declined 7 percent on a trade-weighted basis against a broad set of currencies over the second half of last year and into the first two months of this year.

Figure 20. U.S. dollar nominal exchange rate, broad index, 2006–11

Note: The data, which are in foreign currency units per dollar, are daily. The last observation for the series is February 22, 2011. The broad index is a weighted average of the foreign exchange values of the U.S. dollar against the currencies of a large group of the most important U.S. trading partners. The index weights, which change over time, are derived from U.S. export shares and from U.S. and foreign import shares.

Source: Federal Reserve Board, Statistical Release H.10, "Foreign Exchange Rates."

Foreign benchmark sovereign yields also declined over much of the third quarter as concerns about the U.S. recovery and worries that China's economy might decelerate more quickly than had been expected led investors to question the overall strength of global economic growth. However, foreign yields subsequently rose as confidence in the global recovery strengthened, leaving foreign benchmark yields 15 to 60 basis points higher on net.

Foreign equity markets rallied following the release of the EU stress tests in July, and, although those markets gave back part of these gains in August over heightened worries about the pace of global economic growth, they nonetheless ended the third quarter higher. Over the fourth quarter and into this year, foreign equity prices rose further as the global economic outlook improved, notwithstanding renewed stresses in peripheral Europe. On net, headline equity indexes in the euro area and Japan are up about 10 to 20 percent from their levels in mid-2010, while indexes in the major emerging market economies are about 20 percent higher; all those indexes increased, on balance, even after having declined a bit recently in the face of uncertainties about the Middle East and North Africa.

Although some banks in the euro-area periphery countries, particularly in Spain, seemed to have better access to capital markets immediately following the stress test, their costs of funding rose again late in the year as market concerns about the Irish and Spanish banking sectors resurfaced. Banks in the euro-area periphery relied heavily on the weekly and longer-term funding operations of the European Central Bank (ECB) over much of this period. The strains nevertheless spilled over into increased funding costs in dollars for some European banks, although the reaction was less severe than it had been in May. Reportedly, many European banks had already met their dollar funding needs through year-end before these strains occurred. Market participants welcomed the announcement that the swap lines between the Federal Reserve and the ECB, the Bank of England, the Swiss National Bank, the Bank of Japan, and the Bank of Canada would be extended through August 1.

With the yen at a 15-year high against the dollar in nominal terms, Japanese authorities intervened in currency markets on September 15. Japan's Ministry of Finance purchased dollars overnight to weaken the value of the yen, its first intervention operation since March 2004. The operation caused the yen to depreciate immediately about 3 percent against the dollar, but this movement was fairly short lived, as the yen rose past its pre-intervention level within a month.

During the third quarter, the EMEs saw an increase in capital inflows, which added to upward pressures on their currencies and reportedly triggered further intervention in foreign exchange markets by EME authorities. Authorities in several EMEs also announced new measures to discourage portfolio capital inflows in an attempt to ease upward pressures on their currencies and in their asset markets. Although capital flows to EMEs appeared to moderate late in the year as long-term interest rates in the advanced economies rose, intervention and the imposition of capital control measures continued.

The Financial Account

Financial flows in 2010 reflected changes in investor sentiment over the course of the year, driven in part by concerns over fiscal difficulties in Europe. Foreign private investors made large purchases of U.S. Treasury securities in the first half of the year, but these "flight to quality" demands eased somewhat in the third quarter with the improvement in conditions in European markets. Indicators for the fourth quarter are mixed but suggest that foreign private demand for U.S. Treasury securities picked up again late in the year as tensions in European markets reemerged. Foreign demand for other U.S. securities strengthened in the second half of the year. Net private purchases of both U.S. agency debt and U.S. equities were strong, and foreign investors made small net purchases of corporate debt securities, in contrast to net sales over the previous several quarters. U.S. residents continued to purchase sizable amounts of foreign bonds and equities, including both emerging market and European securities.

Banks located in the United States continued to lend abroad, on net, in the third quarter, but at a slower pace than in the first half of the year, as dollar funding pressures in European interbank markets eased and banks abroad relied less on U.S. counterparties for funding. As a result, inflows from increased foreign private purchases of U.S. securities more than offset the banking outflows in the third quarter, generating net private financial inflows for the first time since late 2008.

Inflows from foreign official institutions increased in the third quarter, with inflows primarily coming from countries seeking to counteract upward pressure on their currencies by purchasing U.S. dollars in foreign currency markets. These countries then used the proceeds to acquire U.S. assets, primarily Treasury securities. Available data for the fourth quarter indicate that foreign official purchases of U.S. Treasury securities slowed as the dollar stabilized.

Advanced Foreign Economies

Economic growth in the advanced foreign economies stepped down in the second half of 2010. To a large extent, this slowdown reflected standard business cycle dynamics, as support from fiscal stimulus and the rebound in global trade and inventories diminished over the course of the year. In Canada, signs of the maturing recovery were most evident in the domestic sector, whereas in Japan, exports decelerated as growth in emerging Asian economies moderated. In Europe, the recovery was further restrained by a reemergence of concerns over fiscal sustainability and banking sector vulnerabilities in some countries. (See **box 2**.) However, recent indicators of economic activity across the advanced foreign economies suggest that performance improved moderately toward the end of 2010. In the manufacturing sector, purchasing managers indexes have resumed rising and point to solid expansion. Moreover, the recovery appears to be gradually spilling over to the retail and service sectors, with household demand benefiting from improving labor market conditions and rising incomes.

Toward year-end, consumer prices in the advanced foreign economies were boosted by a run-up in food and energy prices. Japanese 12-month headline consumer price inflation turned slightly positive for the first time since early 2009, in part because of a hike in the tobacco tax, and headline inflation in Canada and the euro area recently moved above 2 percent. However, inflation in core consumer prices, which excludes food and energy prices, remained subdued amid considerable slack in these economies. One exception was the United Kingdom, where consumer price inflation—both headline and core—persisted

Box 2. An Update on the European Fiscal Crisis and Policy Responses

The European fiscal crisis has remained a source of concern in global financial markets despite official responses over the past year. The crisis began early in 2010 after large upward revisions to the statistics on Greek government deficits led to an erosion of market confidence in the ability of Greece to meet its fiscal obligations. This situation created spillovers to other euro-area countries with high debt or deficit levels. In early May, the European Union (EU) and the International Monetary Fund (IMF) announced a joint €110 billion financial support package for Greece; in addition, the EU established lending facilities of up to €500 billion, and the European Central Bank (ECB) began purchasing sovereign securities to ensure the depth and liquidity of euro-area debt markets. In response to signs of renewed pressures in dollar funding markets, the Federal Open Market Committee reopened dollar swap facilities with a number of foreign central banks.

Financial tensions moderated somewhat over the summer, in part because of favorable market reaction to the results of Europe-wide bank stress tests released in July. Nevertheless, the spreads of yields on the sovereign bonds of the most vulnerable euro-area countries over those of German bonds remained elevated. In the autumn, peripheral European sovereign bond spreads, particularly those of Ireland, widened further. Two developments contributed to the heightened tensions: (1) the discussion of a proposal for a more permanent financial stability mechanism for the euro area starting in 2013, which could eventually require the restructuring of private holdings of sovereign debt; and (2) increased concerns over the growing real estate loan losses of Irish banks and the associated funding difficulties. Afflicted in part by deposit flight and difficulties raising funds in the interbank market, Irish banks became increasingly dependent on funding from the ECB.

With access to market funding increasingly limited, Ireland agreed on November 28 to a €67.5 billion financial support package from the EU and the IMF, with an additional €17.5 billion of Ireland's own funds going to stabilize and recapitalize the country's banking sector. Ireland agreed to implement a four-year fiscal consolidation effort equal to 9 percent of gross domestic product, two-thirds of which will be spending cuts, on top of the austerity measures already adopted in the previous two years.

Following this announcement, markets appeared to shift their focus to the possibility that official assistance would also be required for other euro-area countries with high fiscal deficits or debts and vulnerable banking systems. This development led to a rise in the sovereign bond spreads of Portugal, Spain, and, to a lesser extent, Italy and Belgium. The fear that the Irish problems might spread was exacerbated by concerns that funds available under existing support mechanisms could be insufficient if Spain were to need external assistance. Partly in response to the increase in financial strains, the ECB temporarily stepped up its purchases of the debt of vulnerable euro-area countries and announced following its December policy meeting that it would delay exit from its nonstandard liquidity measures. In addition, European leaders have increasingly indicated their desire to expand or broaden the mandate of current support facilities, and European governments are organizing another round of bank stress tests.

above 3 percent throughout 2010, driven by prior exchange rate depreciation and increases in the value-added tax.

Major central banks in the advanced foreign economies have maintained an accommodative monetary policy stance, although some have taken steps to remove the degree of accommodation. The Bank of Canada raised its target for the overnight rate 50 basis points in the third quarter but since then has held its policy rate at 1 percent. The ECB discontinued refinancing operations at 6- and 12-month maturities but extended fixed-rate refinancing at shorter maturities and kept its main refinancing rate at 1 percent. The Bank of England maintained its policy rate at 0.5 percent and the size of its Asset Purchase Facility at £200 billion. The Bank of Japan took additional steps to ease policy by cutting its target interest rate from 10 basis points to a range of 0 to 10 basis points. In addition, it extended from three to six months the term for its fixed-rate funds-supplying operation, and it established an asset purchase program of ¥5 trillion to buy a broad range of financial assets, including government securities, commercial paper, corporate bonds, exchange-traded funds, and real estate investment trusts.

Emerging Market Economies

After a robust expansion in the first half of 2010, economic activity in the EMEs stepped down in the third quarter before bouncing back to solid growth in the fourth. On average over the two quarters, real GDP growth in the EMEs was well above that observed in the advanced economies. Economic activity in the EMEs was boosted by domestic demand, supported by accommodative monetary and fiscal policies. However, with output appearing to approach capacity for most countries, authorities in many EMEs have begun to unwind the stimulus measures, both monetary and fiscal, put in place during the crisis. The withdrawal of monetary stimulus has also been driven by a recent pickup in consumer price inflation, which has reflected, in part, a rise in commodity prices.

Monetary policy tightening in the EMEs has likely been tempered by uncertainties about the pace and durability of the economic recovery in advanced economies, which remain an important source of demand for the EMEs. In addition, the exit from accommodative stances has been complicated by the return of private capital flows to these economies. Capital inflows appear to have exerted some upward pressure on currencies and have raised concerns about the possibility of an overheating in asset prices. EME authorities have so far adopted a variety of strategies to cope with increased capital flows, including intervention in foreign exchange markets to slow the upward movement of domestic currencies, prudential measures targeted to specific markets (such as the property market), and, in several cases, capital controls.

Real GDP growth in China slowed a bit in the first half of last year, but it moved back up in the second half along with a pickup in inflation, prompting Chinese authorities to continue to tighten monetary policy. Since last June, bank reserve requirements increased a total of 250 basis points for the largest banks, and the benchmark one-year bank lending rate has risen 75 basis points. Chinese authorities have also raised the minimum down payment required for residential property investment in order to slow rising property prices. Since the announcement last June by Chinese authorities that they would allow more exchange rate flexibility, the renminbi has appreciated about 4 percent against the dollar. However, on a real multilateral, trade-weighted basis, which gauges the renminbi's value against China's major trading partners and adjusts for differences in inflation rates, the renminbi has depreciated slightly.

In emerging Asia excluding China, the pace of economic growth softened in the third quarter of last year. There was a steep decline in Singapore's real GDP, which often exhibits wide quarterly swings. Considerable weakness in third-quarter economic activity was also observed in Malaysia, the Philippines, and Thailand. However, available indicators suggest that fourth-quarter GDP growth in the region has picked up again.

In Latin America, real GDP in Mexico and Brazil also decelerated in the third quarter. Mexican output has yet to recover fully from the financial crisis; total manufacturing output slowed over the final two quarters of the year, largely reflecting lower U.S. manufacturing growth, which has depressed demand for exports from Mexico. Economic activity in Brazil, though having slowed from a very brisk pace in the first half of the year, has remained solid, supported by continued fiscal stimulus and high commodity prices. Brazil's central bank tightened reserve requirements in December, prompted by concerns about both the pace of credit creation and the quality of the credit being extended. In addition, the Brazilian central bank raised its policy rate 50 basis points in

January of this year. The new Brazilian government has announced some spending cuts to reduce aggregate demand and inflationary pressures.

Part 3 Monetary Policy: Recent Developments and Outlook

Monetary Policy over the Second Half of 2010 and Early 2011

The Federal Open Market Committee (FOMC) maintained a target range for the federal funds rate of 0 to ¼ percent throughout the second half of 2010 and into 2011. In the statement accompanying each regularly scheduled FOMC meeting, the Committee noted that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low levels of the federal funds rate for an extended period. With the unemployment rate elevated and measures of underlying inflation somewhat low relative to levels that the Committee judged to be consistent, over the long run, with its dual mandate of maximum employment and price stability, the FOMC took steps during the second half of 2010 to provide additional monetary accommodation in order to promote a stronger pace of economic recovery and to help ensure that inflation, over time, returns to levels consistent with its mandate. In August, the FOMC announced that it would keep constant the Federal Reserve's holdings of longer-term securities at their then-current level by reinvesting principal payments from agency debt and agency mortgage-backed securities (MBS) in longer-term Treasury securities. Then, in November, the FOMC announced that it intended to purchase an additional $600 billion of longer-term Treasury securities by the end of the second quarter of 2011. The Committee noted that it would regularly review the pace of its securities purchases and the overall size of the asset purchase program in light of incoming information.

The information reviewed at the August 10 FOMC meeting indicated that the pace of the economic recovery had slowed in recent months and that inflation remained subdued. Private employment had increased slowly in June and July, and industrial production was little changed in June after a large increase in May. Consumer spending continued to rise at a modest rate in June. However, housing activity dropped back, and nonresidential construction remained weak. In addition, the trade deficit widened sharply in May. Conditions in financial markets had become somewhat more supportive of economic growth since the June meeting, in part reflecting perceptions of diminished risk of financial dislocations in Europe. Moreover, participants saw some indications that credit conditions for households and smaller businesses were beginning to improve, albeit gradually. A further decline in energy prices and unchanged prices for core goods and services led to a fall in headline consumer prices in June.

Against this backdrop, the Committee agreed to make no change in its target range for the federal funds rate at the August meeting. The economic expansion was seen as continuing, and most members believed that inflation was likely to stabilize in coming quarters at rates near recent low readings and then gradually rise toward levels they considered more consistent with the Committee's dual mandate. Nonetheless, members generally judged that the economic outlook had softened somewhat more than they had anticipated, and some saw increased downside risks to the outlook for both economic growth and inflation. The Committee noted that the decline in mortgage rates since the spring was generating increased mortgage refinancing activity, which would accelerate repayments of principal on MBS held in the System Open Market Account (SOMA), and that private investors would have to hold more longer-term securities as the Federal Reserve's holdings ran off, making longer-term interest rates somewhat higher than they would have been otherwise. The Committee concluded that it would be appropriate to begin reinvesting principal payments received from agency debt and MBS held in the SOMA by purchasing longer-term Treasury securities; such an action would keep constant the face value of securities held in the SOMA and thus avoid the upward pressure on longer-term interest rates that might result if those holdings were allowed to decline.

As of the September 21 FOMC meeting, the data continued to suggest that the economic expansion was decelerating and that inflation remained low. Private businesses increased employment modestly in August, but the length of the workweek was unchanged and the unemployment rate remained elevated. The rise in business outlays for equipment and software seemed to have moderated following outsized gains in the first half of the year. Housing activity weakened further, and nonresidential construction remained depressed. Industrial production advanced at a solid pace in July and rose further in August. Consumer spending continued to increase at a moderate rate in July and appeared to be moving up again in August. After falling in the previous three months, headline consumer prices had risen in July and August as energy prices retraced some of their earlier declines, and prices for core goods and services edged up slightly. Credit was viewed by participants as remaining readily available for larger corporations with access to capital markets, and some reports suggested that credit conditions had begun to improve for smaller firms. Asset prices had been relatively sensitive to incoming economic data over the intermeeting period but generally ended the period little changed on net. Stresses in European financial markets were seen by participants as broadly contained but were thought to bear watching going forward. Although participants did not expect that the economy would reenter a recession, many expressed concern that output growth, and the associated progress in reducing the level of unemployment, could be slow for some time. Participants noted a number of factors that were restraining economic growth, including low levels of household and business confidence, heightened risk aversion, and the still-weak financial conditions of some households and small businesses.

The Committee agreed at the September meeting to maintain the target range for the federal funds rate of 0 to ¼ percent and to leave unchanged the level of its combined holdings of Treasury securities, agency debt, and agency MBS in the SOMA. In addition, members agreed that the statement to be released following the meeting should be adjusted to clarify their assessment that underlying inflation had been running below levels that the Committee judged to be consistent with its dual mandate for maximum employment and price stability. The clarification was intended, in part, to help anchor inflation expectations and to reinforce the indication that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. In light of the considerable uncertainty about the trajectory of the economy, members saw merit in accumulating further information before reaching a decision about providing additional monetary stimulus. In addition, members wanted to consider further the most effective framework for calibrating and communicating any additional steps to provide such stimulus. They noted that unless the pace of economic recovery strengthened or underlying inflation moved up toward levels consistent with the FOMC's mandate, the Committee would consider taking appropriate action soon.

On October 15, the Committee met by videoconference to discuss issues associated with its monetary policy framework, including alternative ways to express and communicate the Committee's objectives, possibilities for supplementing the Committee's communication about its policy decisions, the merits of making smaller and more-frequent adjustments in the Federal Reserve's intended securities holdings rather than larger and less-frequent adjustments, and the potential costs and benefits of targeting a term interest rate. The agenda did not encompass consideration of any policy actions, and none were taken.

The information reviewed at the November 2–3 FOMC meeting continued to indicate that the economic recovery was proceeding at a modest rate, with only a gradual improvement in labor market conditions. Moreover, measures of underlying inflation were somewhat low relative to levels that the Committee judged to be consistent, over the longer run, with its dual mandate. Consumer spending, business investment in equipment and software, and exports posted further gains in the third quarter, and nonfarm inventory investment stepped up. However, construction activity in both the residential and nonresidential sectors remained depressed, and a significant portion of the rise in domestic demand was again met by imports. U.S. industrial production slowed noticeably in August and September, hiring remained modest, and the unemployment rate stayed elevated. While participants considered it quite unlikely that the economy would slide back into recession, they noted that continued slow growth and high levels of resource slack could leave the economic expansion vulnerable to negative shocks. Participants saw financial conditions as having become more supportive of economic growth over the course of the intermeeting period; most, though not all, of the change appeared to reflect investors' increased anticipation of a further easing of monetary policy. Headline consumer price inflation had been subdued in recent months, despite a rise in energy prices, as core consumer price inflation trended lower.

Though the economic recovery was continuing, FOMC members considered progress toward meeting the Committee's dual mandate of maximum employment and price stability as having been disappointingly slow. Moreover, members generally thought that progress was likely to remain slow. Accordingly, most members judged it appropriate to provide additional policy accommodation. In their discussion of monetary policy for the period immediately ahead, Committee members agreed to maintain the target range for the federal funds rate at 0 to ¼ percent and to continue the Committee's existing policy of reinvesting principal payments from its securities holdings into longer-term Treasury securities. The Committee also announced its intention to purchase a further $600 billion of longer-term Treasury securities at a pace of about $75 billion per month through the second quarter of 2011. Purchases of additional Treasury securities were expected to put downward pressure on longer-term interest rates, boost asset prices, and lead to a modest reduction in the foreign exchange value of the dollar. These changes in financial conditions were expected to promote a somewhat stronger recovery in output and employment while also helping return inflation, over time, to levels consistent with the Committee's mandate.

The data presented at the December 14 FOMC meeting indicated that economic activity was increasing at a moderate rate but that the unemployment rate remained elevated. The pace of consumer spending picked up in October and November, exports rose rapidly in October, and the recovery in business spending on equipment and software appeared to be continuing. In contrast, residential and nonresidential construction activity was still depressed. Manufacturing production registered a solid gain in October. Nonfarm businesses continued to add workers in October and November, and the average workweek moved up. The fiscal package agreed to by the Administration and the Congress was generally expected by participants to support the pace of recovery in 2011. Participants noted that interest rates at intermediate and longer maturities had risen substantially over the intermeeting period, while credit spreads were roughly unchanged and equity prices had risen moderately. Financial pressures in peripheral Europe had increased, leading to a financial assistance package for Ireland. Longer-run inflation expectations were stable, but core inflation continued to trend lower. Overall, the information received during the intermeeting period pointed to some improvement in the near-term outlook, and participants expected economic growth to pick up somewhat going forward. A number of factors, however, were seen as likely to continue restraining the recovery, including the depressed housing market, employers' continued reluctance to add to payrolls, and ongoing efforts by some households and businesses to reduce leverage. Moreover, the recovery remained subject to some downside risks, such as the possibility of a more extended period of weak activity and lower prices in the housing sector as well as potential financial and economic spillovers if the banking and sovereign debt problems in Europe were to worsen further.

Members noted that, while incoming information over the intermeeting period had increased their confidence that the economic recovery would be sustained, progress toward the Committee's dual objectives of maximum employment and price stability continued to be modest, and unemployment and inflation appeared likely to deviate from the Committee's objectives for some time. Accordingly, in their discussion of monetary policy for the period immediately ahead, Committee members agreed to continue expanding the Federal Reserve's holdings of longer-term securities as announced in November. The Committee also decided to maintain the target range for the federal funds rate at 0 to ¼ percent and to reiterate its expectation that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. While the economic outlook was seen as improving, members generally felt that the change in the outlook was not sufficient to warrant any adjustments to the asset purchase program, and some noted that more time was needed to accumulate information on the economy before considering any adjustment. Members emphasized that the pace and overall size of the purchase program would be contingent on economic and financial developments; however, some indicated that they had a fairly high threshold for making changes to the program.

On December 21, the Federal Reserve announced an extension through August 1, 2011, of its 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. The authorization of the swap arrangements had previously been set to expire on January 31, 2011.

The data reviewed at the January 25–26 FOMC meeting indicated that the economic recovery was gaining a firmer footing, though the expansion had not yet been sufficient to bring about a significant improvement in labor market conditions. Consumer spending had risen strongly late in 2010, and the ongoing expansion in business outlays for equipment and software appeared to have been sustained in recent months. Industrial production had increased solidly in November and December. However, construction activity in both the residential and nonresidential sectors remained weak. Modest gains in employment had continued, but the unemployment rate remained elevated. Conditions in financial markets were viewed by participants as having improved somewhat further over the intermeeting period, as equity prices had risen and credit spreads on the debt of nonfinancial corporations had continued to narrow while yields on longer-term nominal Treasury securities were little changed. Credit conditions were still tight for smaller, bank-dependent firms, although bank loan growth had picked up in some sectors. Despite further increases in commodity prices, measures of underlying inflation remained subdued and longer-run inflation expectations were stable.

The information received over the intermeeting period had increased members' confidence that the economic recovery would be sustained, and the downside risks to both economic growth and inflation were viewed as having diminished. Nevertheless, members noted that the pace of the recovery was insufficient to bring about a significant improvement in labor market conditions, and that measures of underlying inflation were trending downward. Moreover, the economic projections submitted for this meeting indicated that unemployment was expected to remain above, and inflation to remain somewhat below, levels consistent with the Committee's objectives for some time. Accordingly, the Committee decided to maintain its existing policy of reinvesting principal payments from its securities holdings and reaffirmed its intention to purchase $600 billion of longer-term Treasury securities by the end of the second quarter of 2011. Members emphasized that the Committee would continue to regularly review the pace of its securities purchases and the overall size of the asset purchase program. In addition, the Committee maintained the target range of 0 to ¼ percent for the federal funds rate and reiterated its expectation that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period.

Tools for the Withdrawal of Monetary Policy Accommodation

Although the FOMC continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period, ultimately the Federal Reserve will need to begin to tighten monetary conditions to prevent the development of inflationary pressures as the economy recovers. The Federal Reserve has the tools it needs to remove policy accommodation at the appropriate time. One tool is the interest rate paid on reserve balances. By increasing the rate paid on reserves, the Federal Reserve will be able to put significant upward pressure on short-term market interest rates because banks will not supply short-term funds to the money markets at rates significantly below what they can earn by simply leaving funds on deposit at the Federal Reserve Banks. Two other tools, executing term reverse repurchase agreements (RRPs) with the primary dealers and other counterparties and issuing term deposits to depository institutions through the Term Deposit Facility (TDF), can be used to reduce the large quantity of reserves held by the banking system; such a reduction would improve the Federal Reserve's control of financial conditions by tightening the relationship between the interest rate paid on reserves and other short-term interest rates. The Federal Reserve could also reduce the quantity of reserves in the banking system by redeeming maturing and prepaid securities held by the Federal Reserve without reinvesting the proceeds or by selling some of its securities holdings.

During the second half of 2010, the Federal Reserve Bank of New York (FRBNY) conducted a series of small-scale triparty RRP transactions with primary dealers using all eligible collateral types, including, for the first time, agency debt and agency MBS from the SOMA portfolio.[14] The Federal Reserve also conducted a series of small-scale triparty RRP transactions with a set of counterparties that had been expanded to include approved money market mutual funds, using Treasury securities, agency debt, and agency MBS as collateral.

On September 8, the Federal Reserve Board authorized a program of regularly scheduled small-value offerings of term deposits under the TDF.[15] The auctions, which are to occur about every other month, are intended to ensure the operational readiness of the TDF and to increase the familiarity of eligible participants with the auction procedures. Since September, the Federal Reserve has conducted three auctions, each of which offered $5 billion in 28-day deposits. All of these auctions were well subscribed.

Recent Steps to Increase Transparency

Transparency is an essential principle of modern central banking because it appropriately contributes to

[14] In a triparty repurchase agreement, both parties to the agreement must have cash and collateral accounts at the same triparty agent, which is by definition also a clearing bank. The triparty agent will ensure that collateral pledged is sufficient and meets eligibility requirements, and all parties agree to use collateral prices supplied by the triparty agent.

[15] A few TDF auctions had occurred previously, but they were not part of a regular program.

the accountability of central banks to the government and the public and because it can enhance the effectiveness of central banks in achieving macroeconomic objectives. The Federal Reserve provides detailed information concerning the conduct of monetary policy.[16] During the financial crisis, the Federal Reserve developed a public website that contains extensive information on its credit and liquidity programs, and, in 2009, the Federal Reserve began issuing detailed monthly reports on these programs.[17]

Recently, the Federal Reserve has taken further steps to enhance its transparency and expand the amount of information it provides to the public. First, on December 1, the Federal Reserve posted detailed information on its public website about the individual credit and other transactions conducted to stabilize markets during the financial crisis, restore the flow of credit to American families and businesses, and support economic recovery and job creation in the aftermath of the crisis.[18] As mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), transaction-level details from December 1, 2007, to July 21, 2010, were provided about entities that participated in the agency MBS purchase program, used Federal Reserve liquidity swap lines, borrowed through the Term Auction Facility, or received loans or other financial assistance through a program authorized under section 13(3) of the Federal Reserve Act. Many of these transactions were conducted through a variety of broad-based lending facilities and provided liquidity to financial institutions and markets through fully secured, mostly short-term loans. Other transactions involved purchases of agency MBS and supported mortgage and housing markets; these transactions lowered longer-term interest rates and fostered economic growth. Dollar liquidity swap lines with foreign central banks posed no financial risk to the Federal Reserve because the Federal Reserve's counterparties were the foreign central banks themselves, not the institutions to which the foreign central banks then lent the funds; these swap facilities helped stabilize dollar funding markets abroad, thus contributing to the restoration of stability in U.S. markets. Other transactions provided liquidity to particular institutions whose disorderly failure could have severely stressed an already fragile financial system.

A second step toward enhanced transparency involves disclosures going forward. The Dodd-Frank Act established a framework for the disclosure of information on credit extended after July 21, 2010, through the discount window under section 10B of the Federal Reserve Act or from a section 13(3) facility, as well as information on all open market operation (OMO) transactions. Generally, this framework requires the Federal Reserve to publicly disclose certain information about discount window borrowers and OMO counterparties approximately two years after the relevant loan or transaction; information about borrowers under future section 13(3) facilities will be disclosed one year after the authorization for the facility is terminated. The information to be disclosed includes the name and identifying details of each borrower or counterparty, the amount borrowed, the interest rate paid, and information identifying the types and amounts of collateral pledged or assets transferred in connection with the borrowing or transaction.

Finally, the Federal Reserve has also increased transparency with respect to the implementation of monetary policy. In particular, the Federal Reserve took steps to provide additional information about its security purchase operations with the objective of encouraging wider participation in such operations. The FRBNY publishes, on an ongoing basis, schedules of purchase operations expected to take place over the next four weeks; details provided include lists of operation dates, settlement dates, security types to be purchased, the maturity date range of eligible issues, and an expected range for the size of each operation. Results of each purchase operation are published shortly after it has concluded. In addi-

[16] Immediately following each meeting, the FOMC releases a statement that lays out the rationale for the policy decision. Detailed minutes of each FOMC meeting are made public three weeks following the meeting. Lightly edited transcripts of FOMC meetings are released to the public with a five-year lag. FOMC statements, minutes, and transcripts, as well as other related information, are available on the Federal Reserve Board's website. See Board of Governors of the Federal Reserve System, "Federal Open Market Committee," webpage, www.federalreserve.gov/monetarypolicy/fomc.htm.

[17] See Board of Governors of the Federal Reserve System, "Credit and Liquidity Programs and the Balance Sheet," webpage, www.federalreserve.gov/monetarypolicy/bst.htm; and Board of Governors of the Federal Reserve System, "Monthly Report on Credit and Liquidity Programs and the Balance Sheet," webpage, www.federalreserve.gov/monetarypolicy/clbsreports.htm.

[18] These data are available at Board of Governors of the Federal Reserve System, "Regulatory Reform: Usage of Federal Reserve Credit and Liquidity Facilities," webpage, www.federalreserve.gov/newsevents/reform_transaction.htm.

tion, the FRBNY has commenced publication of information on the prices paid for individual securities in its purchase operations.[19]

Part 4
Summary of Economic Projections

The following material appeared as an addendum to the minutes of the January 25–26, 2011, meeting of the Federal Open Market Committee.

In conjunction with the January 25–26, 2011, Federal Open Market Committee (FOMC) meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in the deliberations of the FOMC, submitted projections for growth of real output, the unemployment rate, and inflation for the years 2011 to 2013 and over the longer run. The projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

As depicted in **figure 1**, FOMC participants' projections for the next three years indicated that they expect a sustained recovery in real economic activity, marked by a step-up in the rate of increase in real gross domestic product (GDP) in 2011 followed by further modest acceleration in 2012 and 2013. They anticipated that, over this period, the pace of the recovery would exceed their estimates of the longer-run sustainable rate of increase in real GDP by enough to gradually lower the unemployment rate. However, by the end of 2013, participants projected that the unemployment rate would still exceed their estimates of the longer-run unemployment rate. Most participants expected that inflation would likely move up somewhat over the forecast period but would remain at rates below those they see as consistent, over the longer run, with the Committee's dual mandate of maximum employment and price stability.

As indicated in **table 1**, relative to their previous projections in November 2010, participants anticipated somewhat more rapid growth in real GDP this year, but they did not significantly alter their expectations for the pace of the expansion in 2012 and 2013 or for the longer run. Participants made only minor changes to their forecasts for the path of the unemployment rate and for the rate of inflation over the next three years. Although most participants anticipated that the economy would likely converge to sustainable rates of increase in real GDP and prices over five or six years, a number of participants indicated that they expected that the convergence of the unemployment rate to its longer-run level would require additional time.

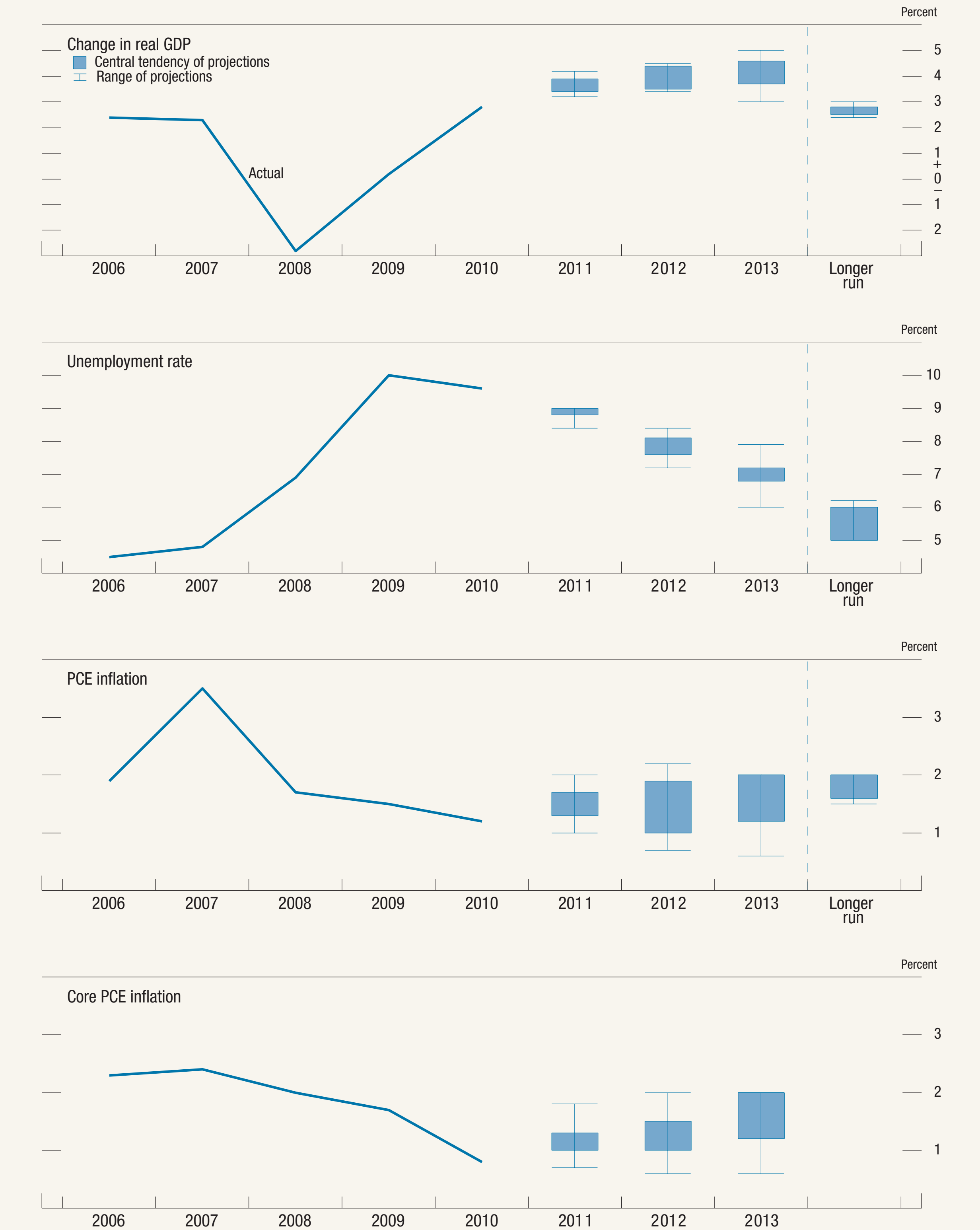
As they did in November, participants judged the level of uncertainty associated with their projections for real economic activity and inflation as unusually high relative to historical norms. Most continued to see the risks surrounding their forecasts of GDP growth, the unemployment rate, and inflation over the next three years to be generally balanced. However, fewer noted downside risks to the likely pace of the expansion and, accordingly, upside risks to the unemployment rate than in November; fewer also saw downside risks to inflation.

The Outlook

The central tendency of participants' forecasts for the change in real GDP in 2011 was 3.4 to 3.9 percent, somewhat higher than in the November projections. Participants stated that the economic information received since November indicated that consumer spending, business investment, and net exports increased more strongly at the end of 2010 than expected earlier; industrial production also expanded more rapidly than they previously anticipated. In addition, after the November projections were prepared, the Congress approved fiscal stimulus measures that were expected to provide further impetus to household and business spending in 2011. Moreover, participants noted that financial conditions had improved since November, including a rise in equity prices, a pickup in activity in capital markets, reports of easing of credit conditions in some markets, and an upturn in bank lending in some sectors. Many participants viewed the stronger tenor of the recent information, along with the additional fiscal stimulus, as suggesting that the recovery had gained some

[19] General information on OMOs, including links to the prices paid in recent purchases of Treasury securities, is available on the FRBNY's website at www.newyorkfed.org/markets/pomo/display/index.cfm.

Figure 1. Central tendencies and ranges of economic projections, 2011–13 and over the longer run



Note: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual. The data for the change in real GDP, PCE inflation, and core PCE inflation shown for 2010 incorporate the advance estimate of GDP for the fourth quarter of 2010, which the Bureau of Economic Analysis released on January 28, 2011. This information was not available to FOMC meeting participants at the time of their meeting.

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, January 2011
Percent

Variable	Central tendency[1]				Range[2]			
	2011	2012	2013	Longer run	2011	2012	2013	Longer run
Change in real GDP	3.4 to 3.9	3.5 to 4.4	3.7 to 4.6	2.5 to 2.8	3.2 to 4.2	3.4 to 4.5	3.0 to 5.0	2.4 to 3.0
November projection	3.0 to 3.6	3.6 to 4.5	3.5 to 4.6	2.5 to 2.8	2.5 to 4.0	2.6 to 4.7	3.0 to 5.0	2.4 to 3.0
Unemployment rate	8.8 to 9.0	7.6 to 8.1	6.8 to 7.2	5.0 to 6.0	8.4 to 9.0	7.2 to 8.4	6.0 to 7.9	5.0 to 6.2
November projection	8.9 to 9.1	7.7 to 8.2	6.9 to 7.4	5.0 to 6.0	8.2 to 9.3	7.0 to 8.7	5.9 to 7.9	5.0 to 6.3
PCE inflation	1.3 to 1.7	1.0 to 1.9	1.2 to 2.0	1.6 to 2.0	1.0 to 2.0	0.7 to 2.2	0.6 to 2.0	1.5 to 2.0
November projection	1.1 to 1.7	1.1 to 1.8	1.2 to 2.0	1.6 to 2.0	0.9 to 2.2	0.6 to 2.2	0.4 to 2.0	1.5 to 2.0
Core PCE inflation[3]	1.0 to 1.3	1.0 to 1.5	1.2 to 2.0		0.7 to 1.8	0.6 to 2.0	0.6 to 2.0	
November projection	0.9 to 1.6	1.0 to 1.6	1.1 to 2.0		0.7 to 2.0	0.6 to 2.0	0.5 to 2.0	

Note: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The November projections were made in conjunction with the meeting of the Federal Open Market Committee on November 2–3, 2010.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.

3 Longer-run projections for core PCE inflation are not collected.

strength—a development seen as likely to carry into 2011—and that the expansion was on firmer footing. Participants expected that the expansion in real economic activity this year would continue to be supported by accommodative monetary policy and by ongoing improvement in credit and financial market conditions. The strengthening in private demand was anticipated to be led by increases in consumer and business spending; over time, improvements in household and business confidence and in labor market conditions would likely reinforce the rise in domestic demand. Nonetheless, participants recognized that the information available since November also indicated that the expansion remained uneven across sectors of the economy, and they expected that the pace of economic activity would continue to be moderated by the weakness in residential and nonresidential construction, the still relatively tight credit conditions in some sectors, an ongoing desire by households to repair their balance sheets, business caution about hiring, and the budget difficulties faced by state and local governments.

Participants expected that the economic expansion would strengthen further in 2012 and 2013, with the central tendencies of their projections for the growth in real GDP moving up to 3.5 to 4.4 percent in 2012 and then to 3.7 to 4.6 percent in 2013. Participants cited, as among the likely contributors to a sustained pickup in the pace of the expansion, a continued improvement in financial market conditions, further expansion of credit availability to households and businesses, increasing household and business confidence, and a favorable outlook for U.S. exports. Several participants noted that, in such an environment, and with labor market conditions anticipated to improve gradually, the restraints on household spending from past declines in wealth and the desire to rebuild savings should abate. A number of participants saw such conditions fostering a broader and stronger recovery in business investment, with a few noting that the market for commercial real estate had recently shown signs of stabilizing. Nonetheless, participants saw a number of factors that would likely continue to moderate the pace of the expansion. Most participants expected that the recovery in the housing market would remain slow, restrained by the overhang of vacant properties, prospects for weak house prices, and the difficulties in resolving foreclosures. In addition, some participants expected that the fiscal strains on the budgets of state and local governments would damp their spending for a time and that the federal government sector would likely be a drag on economic activity after 2011.

Participants anticipated that a gradual but steady reduction in the unemployment rate would accompany the pickup in the pace of the economic expansion over the next three years. The central tendency of their forecasts for the unemployment rate at the end of 2011 was 8.8 to 9.0 percent—a decline of less than 1 percentage point from the actual rate in the fourth quarter of 2010. Although participants generally expected further declines in the unemployment rate over the subsequent two years—to a central tendency of 6.8 to 7.2 percent at the end of 2013—they anticipated that, at the end of that period, unemployment would remain noticeably higher than their estimates of the longer-run rate. Many participants thought that, with appropriate monetary policy and in the absence of further shocks, the unemployment rate would continue to converge gradually toward its longer-run rate within five to six years, but a number of participants indicated that the convergence process would likely be more extended.

While participants viewed the projected pace of the expansion in economic activity as the principal factor underlying their forecasts for the path of the unemployment rate, they also indicated that their projections were influenced by a number of other factors that were likely to contribute to a relatively gradual recovery in the labor market. In that regard, several participants noted that dislocations associated with the uneven recovery across sectors of the economy might retard the matching of workers and jobs. In addition, a number of participants viewed the modest pace of hiring in 2010 as, in part, the result of business caution about the durability of the recovery and of employers' efforts to achieve additional increases in productivity; several participants also cited the particularly slow recovery in demand experienced by small businesses as a factor restraining new job creation. With demand expected to strengthen across a range of businesses and with business confidence expected to improve, participants anticipated that hiring would pick up over the forecast period.

Participants continued to expect that inflation would be relatively subdued over the next three years and kept their longer-run projections of inflation unchanged. Many participants indicated that the persistence of large margins of slack in resource utilization should contribute to relatively low rates of inflation over the forecast horizon. In addition, participants noted that appropriate monetary policy, combined with stable longer-run inflation expectations, should help keep inflation in check. The central tendency of their projections for overall personal consumption expenditures (PCE) inflation in 2011 was 1.3 to 1.7 percent, while the central tendency of their forecasts for core PCE inflation was lower—1.0 to 1.3 percent. Increases in the prices of energy and other commodities, which were very rapid in 2010, were anticipated to continue to push headline PCE inflation above the core rate this year. The central tendency of participants' forecasts for inflation in 2012 and 2013 widened somewhat relative to 2011 and showed that inflation was expected to drift up modestly. In 2013, the central tendency of forecasts for both the total and core inflation rates was 1.2 to 2.0 percent. For most participants, inflation in 2013 was not expected to have converged to the longer-run rate of inflation that they individually considered most consistent with the Federal Reserve's dual mandate for maximum employment and stable prices. However, a number of participants anticipated that inflation would reach its longer-run rate within the next three years.

Table 2. Average historical projection error ranges
Percentage points

Variable	2011	2012	2013
Change in real GDP[1]	±1.3	±1.7	±1.8
Unemployment rate[1]	±0.7	±1.3	±1.5
Total consumer prices[2]	±1.0	±1.0	±1.1

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1990 through 2009 that were released in the winter by various private and government forecasters. As described in **box 3**, under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 For definitions, refer to general note in table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

Uncertainty and Risks

Most participants continued to share the view that their projections for economic activity and inflation were subject to a higher level of uncertainty than was the norm during the previous 20 years.[20] They identified a number of uncertainties that compounded the inherent difficulties in forecasting output growth, unemployment, and inflation. Among them were uncertainties about the nature of economic recoveries from recessions associated with financial crises, the effects of unconventional monetary policies, the persistence of structural dislocations in the labor market, the future course of federal fiscal policy, and the global economic outlook.

20 **Table 2** provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1990 to 2009. **Box 3** discusses the sources and interpretation of uncertainty in the economic forecasts and explains the approach used to assess the uncertainty and risks attending the participants' projections.

Box 3. Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Report*s and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 1.7 to 4.3 percent in the current year, 1.3 to 4.7 percent in the second year, and 1.2 to 4.8 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.0 to 3.0 percent in the current and second years, and 0.9 to 3.1 percent in the third year.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Almost all participants viewed the risks to their forecasts for the strength of the recovery in real GDP as broadly balanced. By contrast, in November, the distribution of views had been somewhat skewed to the downside. In weighing the risks to the projected growth rate of real economic activity, some participants noted the upside risk that the recent strengthening of aggregate spending might mark the beginning of a more normal cyclical rebound in economic activity in which consumer spending might be spurred by pent-up demand for household durables and in which business investment might be accelerated by the desire to rebuild stocks of fixed capital. A more-rapid-than-expected easing of credit availability was also seen as a factor that might boost the pickup in private demand. As to the downside risks, many participants pointed to the recent declines in house prices and the potential for a slower resolution of existing problems in mortgage and real estate markets as factors that could have more-adverse-than-expected consequences for household spending and bank balance sheets. In addition, several participants expressed concerns that, in an environment of only gradual improvement in labor market and credit conditions, households might be unusually focused on reducing debt and boosting saving. A number of participants also saw a downside risk in the possibility that the fiscal problems of some state and local governments might lead to a greater retrenchment in their spending than currently anticipated. Finally, several participants expressed concerns that the financial and fiscal strains in the euro area might spill over to U.S. financial markets.

The risks surrounding participants' forecasts of the unemployment rate were also broadly balanced and generally reflected the risks attending participants' views of the likely strength of the expansion in real activity. However, a number of participants noted that the unemployment rate might decline less than they projected if businesses were to remain hesitant to expand their workforces because of uncertainty about the durability of the expansion or about employment costs or if mismatches of workers and jobs were more persistent than anticipated.

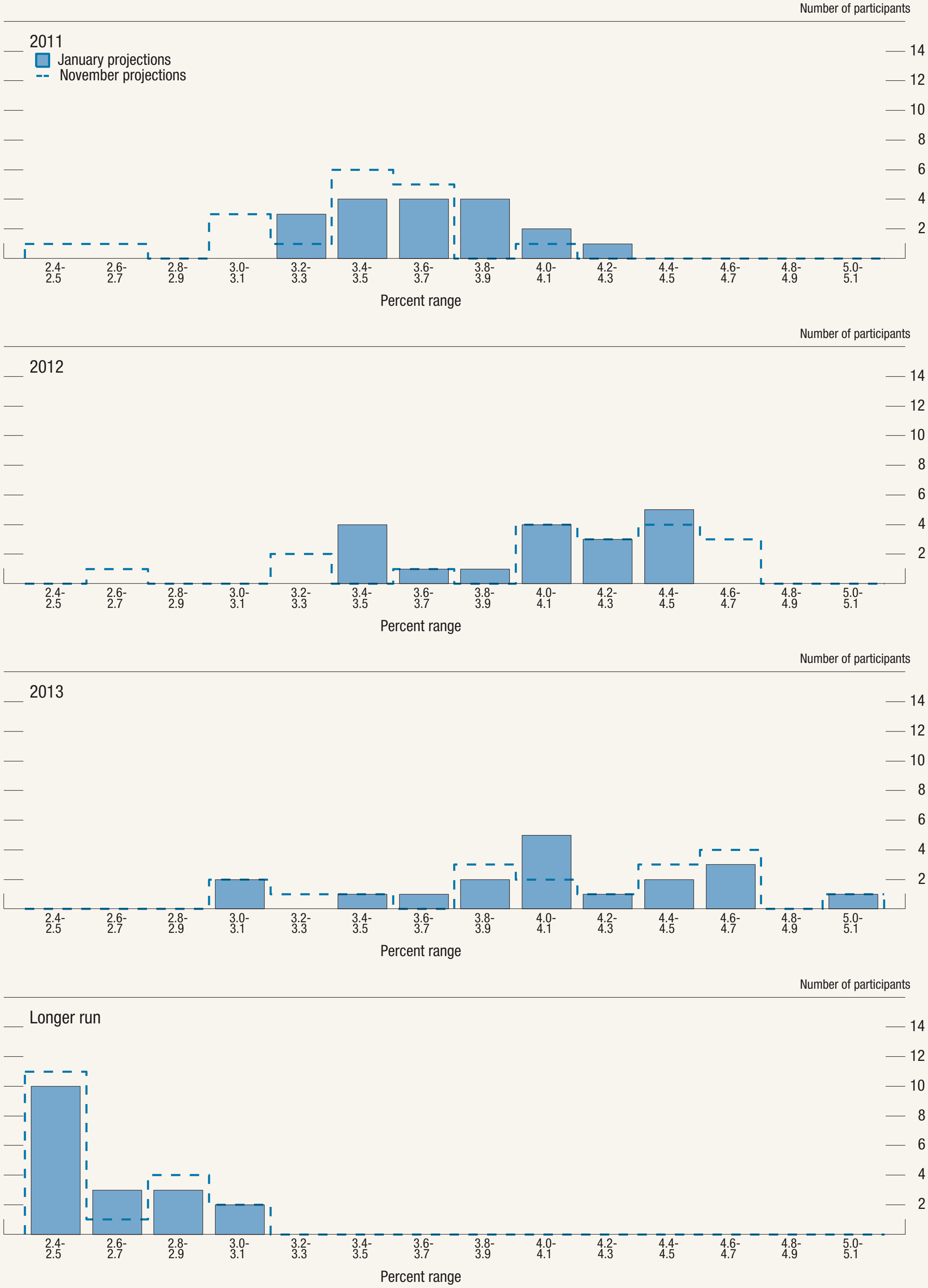
Most participants judged the risks to their inflation outlook over the period from 2011 to 2013 to be broadly balanced as well. Compared with their views in November, several participants no longer saw the risks as tilted to the downside, and an additional participant viewed the risks as weighted to the upside. In assessing the risks, a number of participants indicated that they saw the risks of deflation or further unwanted disinflation to have diminished. Many participants identified the persistent gap between their projected unemployment rate and its longer-run rate as a risk that inflation could be lower than they projected. A few of those who indicated that inflation risks were skewed to the upside expressed concerns that the expansion of the Federal Reserve's balance sheet, if left in place for too long, might erode the stability of longer-run inflation expectations. Alternatively, several participants noted that upside risks to inflation could arise from persistently rapid increases in the costs of energy and other commodities.

Diversity of Views

Figures 2.A and **2.B** detail the diversity of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate in 2011, 2012, 2013, and over the longer run. The dispersion in these projections reflected differences in participants' assessments of many factors, including the likely evolution of conditions in credit and financial markets, the timing and the degree to which various sectors of the economy and the labor market will recover from the dislocations associated with the deep recession, the outlook for economic and financial developments abroad, and appropriate future monetary policy and its effects on economic activity. For 2011 and 2012, the dispersions of participants' forecasts for the strength in the expansion of real GDP and for the unemployment rate were somewhat narrower than they were last November, while the ranges of views for 2013 and for the longer run were little changed.

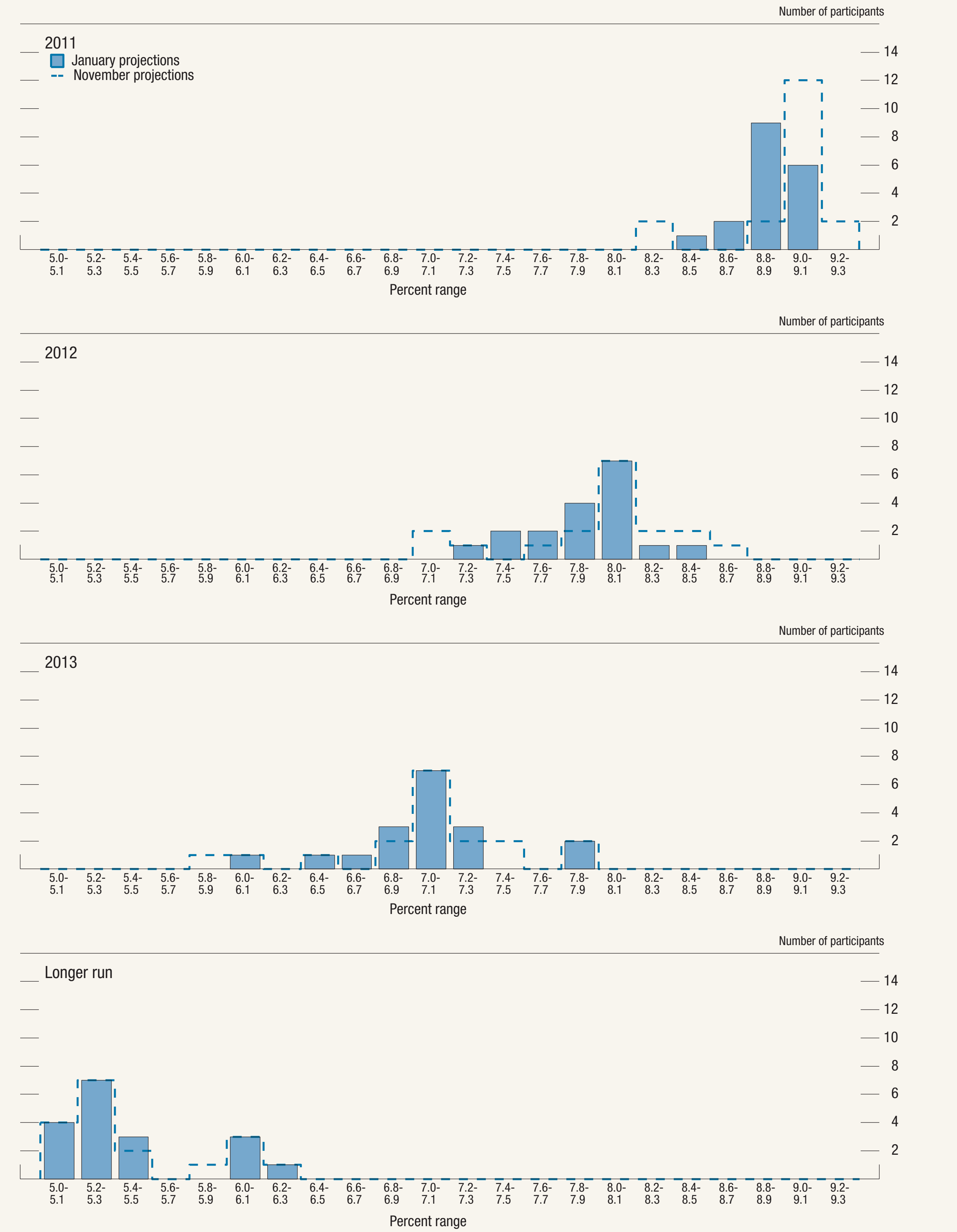
Figures 2.C and **2.D** provide the corresponding information about the diversity of participants' views regarding the outlook for total and core PCE inflation. These distributions were somewhat more tightly concentrated for 2011, but for 2012 and 2013, they were much the same as they were in November. In general, the dispersion in the participants' inflation forecasts for the next three years represented differences in judgments regarding the fundamental determinants of inflation, including estimates of the degree of resource slack and the extent to which such slack influences inflation outcomes and expectations as well as estimates of how the stance of monetary policy may influence inflation expectations. Although the distributions of participants' inflation forecasts for 2011 through 2013 continued to be relatively wide, the distribution of projections of the longer-run rate of overall inflation remained tightly concentrated. The narrow range illustrates the broad similarity in participants' assessments of the approximate level of inflation that is consistent with the Federal Reserve's dual objectives of maximum employment and price stability.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2011–13 and over the longer run



Note: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2011–13 and over the longer run

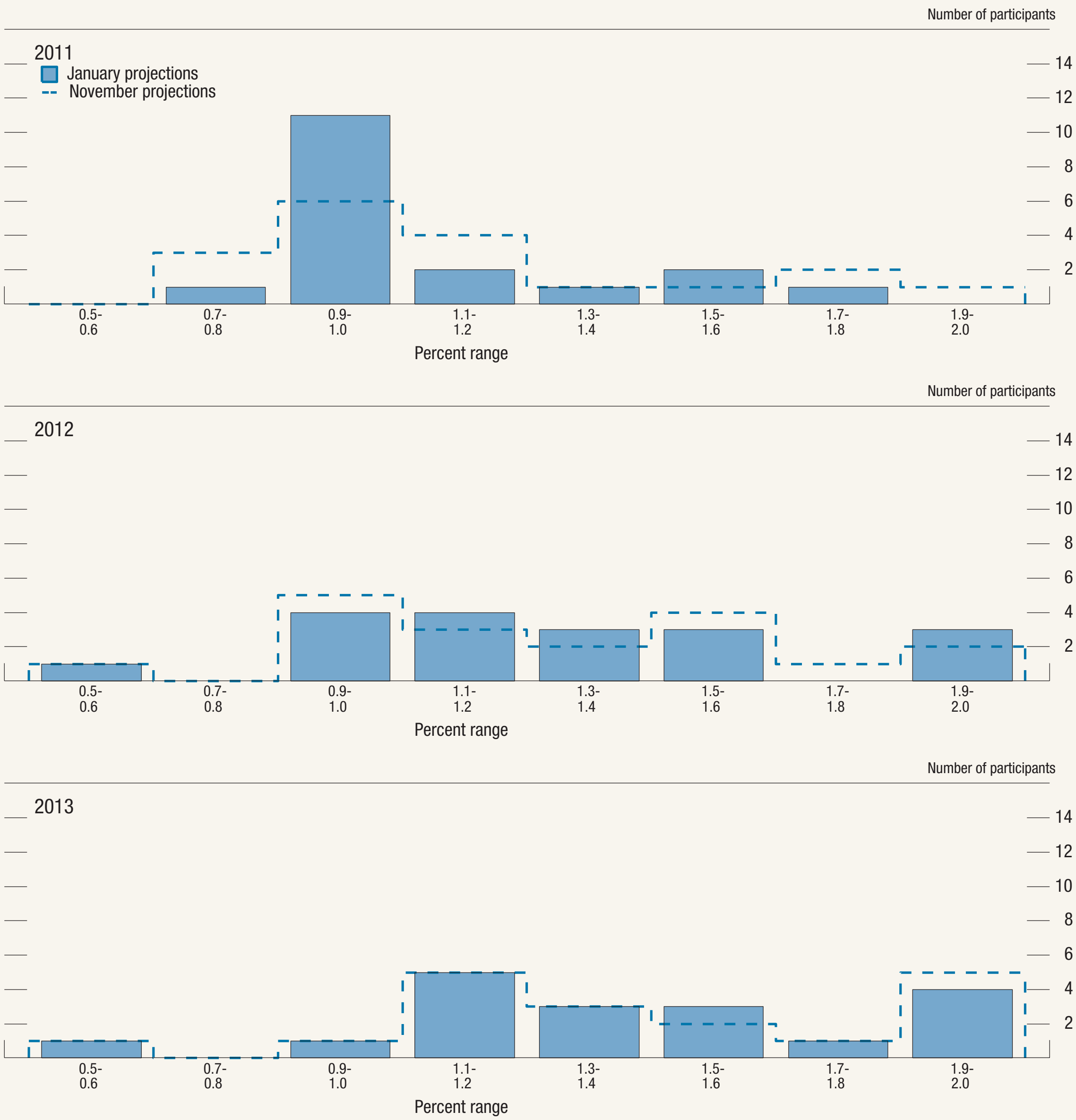


Note: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2011–13 and over the longer run

Note: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2011–13



Note: Definitions of variables are in the general note to table 1.

Abbreviations

ABS	asset-backed securities
AIG	American International Group, Inc.
ARRA	American Recovery and Reinvestment Act
C&I	commercial and industrial
CMBS	commercial mortgage-backed securities
CRE	commercial real estate
Credit Card Act	Credit Card Accountability Responsibility and Disclosure Act
DPI	disposable personal income
ECB	European Central Bank
ECI	employment cost index
EME	emerging market economy
EU	European Union
FASB	Financial Accounting Standards Board
FOMC	Federal Open Market Committee; also, the Committee
FRBNY	Federal Reserve Bank of New York
GDP	gross domestic product
GSE	government-sponsored enterprise
IMF	International Monetary Fund
IRA	individual retirement account
IT	information technology
Libor	London interbank offered rate
LLC	limited liability company
MBS	mortgage-backed securities
NFIB	National Federation of Independent Business
NIPA	national income and product accounts
NOW	negotiable order of withdrawal
OMO	open market operation
PCE	personal consumption expenditures
repo	repurchase agreement
RRP	reverse repurchase agreement
SCOOS	Senior Credit Officer Opinion Survey on Dealer Financing Terms
SLOOS	Senior Loan Officer Opinion Survey on Bank Lending Practices
SOMA	System Open Market Account
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TDF	Term Deposit Facility
WTI	West Texas Intermediate

Monetary Policy Report of July 2010

Part 1
Overview: Monetary Policy and the Economic Outlook

Economic activity expanded at a moderate pace in the first half of 2010 after picking up in the second half of 2009. Some of the increase in real gross domestic product (GDP) in the first half of the year came from a continued turn in the inventory cycle. But more broadly, activity was bolstered by ongoing stimulus from monetary and fiscal policies and generally supportive financial conditions. In the labor market, payrolls rose modestly and hours per worker increased; nevertheless, employment remained significantly below pre-recession levels and unemployment receded only slightly from its recent high. Meanwhile, consumer price inflation edged lower.

Financial markets, although volatile, generally supported economic growth in the first half of 2010. Bank credit, however, remained tight for many borrowers. Moreover, in the second quarter, uncertainty about the consequences of the fiscal pressures in a number of European countries and about the durability of the global recovery led to large declines in equity prices around the world and produced strains in some short-term funding markets. According to the projections prepared in conjunction with the June meeting of the Federal Open Market Committee (FOMC), meeting participants (members of the Board of Governors and presidents of the Federal Reserve Banks) continue to expect that economic activity will expand at a moderate rate over the second half of 2010 and in 2011. However, participants' current projections for economic growth are somewhat weaker than those prepared for the April FOMC meeting, and unemployment is expected to fall even more slowly than had been anticipated in April. Largely because of uncertainty about the implications of developments abroad, the participants also indicated somewhat greater concern about the downside risks to the economic outlook than they had at the time of the April meeting.

After rising at an annual rate of about 4 percent, on average, in the second half of 2009, U.S. real GDP increased at a rate of 2¾ percent in the first quarter of 2010, and available information points to another moderate gain in the second quarter. Some of the impetus to the continued recovery in economic activity during the first half of the year came from inventory investment as businesses started to rebuild stocks after the massive liquidation in the latter part of 2008 and in 2009. In addition, final sales continued to firm as personal consumption expenditures (PCE) rose and as business fixed investment was spurred by capital outlays that had been deferred during the downturn and by the need of many businesses to replace aging equipment. In the external sector, exports continued to rebound, providing impetus to domestic production, while imports were lifted by the recovery in domestic demand. On the less favorable side, outlays for nonresidential construction have declined further this year, and despite a transitory boost from the homebuyer tax credit, housing construction has continued to be weighed down by weak demand, a large inventory of distressed or vacant houses, and tight credit conditions for builders and some potential buyers. In addition, state and local governments are still cutting spending in response to ongoing fiscal pressures.

The upturn in economic activity has been accompanied by a modest improvement in labor market conditions. On average, private-sector employment rose 100,000 per month over the first half of 2010, with increases across a wide range of industries; businesses also raised their labor input by increasing hours per worker. Nonetheless, the pace of hiring to date has not been sufficient to bring about a significant reduction in the unemployment rate, which averaged 9¾ percent in the second quarter, only slightly below its recession high of 10 percent in the fourth quarter of 2009. Long-term unemployment has continued to worsen.

On the inflation front, prices of energy and other commodities have declined in recent months, and underlying inflation has trended lower. The overall PCE price index rose at an annual rate of about ¾ percent over the first five months of 2010 (compared with an increase of about 2 percent over the 12 months of 2009), while price increases for consumer expenditures other than food and energy items—so-called core PCE—slowed from 1½ percent over the 12 months of 2009 to an annual rate of 1 percent over the first five months of 2010. FOMC participants expect that, with substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.

Domestic financial conditions generally showed improvement through the first quarter of 2010, but the fiscal strains in Europe and the uncertainty they engendered subsequently weighed on financial markets. As a result, foreign and domestic equity price indexes fell appreciably in the second quarter, and pressures emerged in dollar funding markets; safe-haven flows lowered sovereign yields in most of the major advanced economies and boosted the foreign exchange value of the dollar and the Japanese yen.

Over the first half of the year, investors marked down expectations for the path of U.S. monetary policy in response to economic and financial developments and to the FOMC's continued indication that it expected economic conditions to warrant exceptionally low levels of the federal funds rate for an extended period. These same factors, as well as safe-haven flows, contributed to a decline in Treasury rates. Some private borrowing rates, including mortgage rates, also fell. Broad equity price indexes declined, on net, over the first half of 2010.

Consumer credit outstanding continued to fall, though at a less rapid pace than in the second half of last year. Larger corporations with access to capital markets were able to issue bonds to meet their financing needs, although some smaller businesses reportedly had considerable difficulties obtaining credit. Standards on many categories of bank loans remained tight, and loans on banks' books continued to contract, although somewhat less rapidly than around year-end. Commercial bank profitability stayed low by historical standards, as loan losses remained at very high levels.

To support the economic expansion, the FOMC maintained a target range for the federal funds rate of 0 to ¼ percent throughout the first half of 2010. To complete the purchases previously announced, over the first three months of the year, the Federal Reserve also conducted large-scale purchases of agency mortgage-backed securities and agency debt in order to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets. In light of improved functioning of financial markets, the Federal Reserve closed by the end of June all of the special liquidity facilities that it had created to support markets in late 2007 and in 2008. However, in response to renewed dollar funding pressures abroad, in May the Federal Reserve reestablished swap lines with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank. The Federal Reserve continued to develop its tools for draining reserves from the banking system to support the withdrawal of policy accommodation when such action becomes appropriate. The Committee is monitoring the economic outlook and financial developments, and it will employ its policy tools as necessary to promote economic recovery and price stability.

The economic projections prepared in conjunction with the June FOMC meeting are presented in Part 4 of this report. In general, FOMC participants anticipated that the economic recovery would proceed at a moderate pace. The expansion was expected to be restrained in part by household and business uncertainty, persistent weakness in real estate markets, only gradual improvement in labor market conditions, waning fiscal stimulus, and slow easing of credit conditions in the banking sector. The projected increase in real GDP was only a little faster than the economy's longer-run sustainable growth rate, and thus the unemployment rate was anticipated to fall only slowly over the next few years. Inflation was expected to remain subdued over this period. The participants' projections for economic activity and inflation were both somewhat lower than those prepared in conjunction with the April FOMC meeting, mainly because of the incoming economic data and the anticipated effects of developments abroad on the U.S. economy.

Participants generally judged that the degree of uncertainty surrounding the outlook for both economic activity and inflation was greater than historical norms. About one-half of the participants viewed the risks to the growth outlook as tilted to the downside, whereas in April, a large majority had seen the risks to growth as balanced; most continued to see balanced risks surrounding their inflation projections. Participants also reported their assessments of the rates to which macroeconomic variables would be expected to converge over the longer run under appropriate monetary policy and in the absence of further shocks to the economy. The central tendencies of these longer-run projections were 2.5 to 2.8 percent for real GDP growth, 5.0 to 5.3 percent for the unemployment rate, and 1.7 to 2.0 percent for the inflation rate.

Part 2 Recent Economic and Financial Developments

Real gross domestic product (GDP) increased at an annual rate of 2¾ percent in the first quarter of 2010 after rising about 4 percent on average in the second half of 2009, and it apparently posted another moderate gain in the second quarter.[1] Some of the impetus to the continued recovery in economic activity in the first half of the year came from inventory investment as businesses started to rebuild stocks after the massive liquidation in the latter part of 2008 and in 2009. In addition, final sales continued to firm as consumer spending moved up, businesses raised their outlays for equipment and software, and demand for U.S. exports strengthened. In contrast, the underlying pace of activity in the housing sector has improved only marginally since hitting bottom in 2009. In the labor market, employment rose gradually over the first half of 2010 and average weekly hours worked increased, but the unemployment rate fell just slightly. Headline consumer price inflation has been low this year, as energy prices have dropped and core inflation has slowed.

The gradual healing of the financial system that began in the spring of 2009 continued through the early spring of 2010. In the first quarter, financial market conditions generally became more supportive of economic activity, with yields and spreads on corporate bonds declining, broad equity price indexes rising, and measures of stress in many short-term funding markets falling to near their pre-crisis levels. In late April and early May, however, concerns about the effects of fiscal pressures in a number of European countries led to increases in credit spreads on many U.S. corporate bonds, declines in broad equity price indexes, and a renewal of strains in some short-term funding markets. Even so, over the first half of the year, mortgage rates and yields on U.S. corporate securities remained at low levels.

Domestic Developments

The Household Sector

Consumer Spending and Household Finance

Personal consumption expenditures (PCE) appear to have posted a moderate advance in the first half of 2010 after turning up in the second half of 2009. The improvement in employment and hours worked, and the associated pickup in real household incomes, provided important impetus to spending. The rise in household net worth in 2009 and the first quarter of 2010 also likely helped buoy spending, although the drop in stock prices during the spring unwound some of the earlier increase in wealth and—all else being equal—may restrain the rise in real PCE in the second half of the year. The personal saving rate has fluctuated in a fairly narrow range since the middle of 2009, and it stood at 4 percent in May.

The gains in consumer spending during the first half of 2010 were widespread. Sales of new light motor vehicles (cars, sport utility vehicles, and pickup trucks) rose from an annual rate of 10¾ million units in the fourth quarter of 2009 to 11¼ million units in the second quarter, supported in part by favorable financing conditions for auto buyers. Spending for other goods started the year on a strong note—perhaps boosted by pent-up demand for purchases that had been deferred during the recession—though it appears to have cooled somewhat during the spring. Real outlays for services increased modestly after having only edged up in 2009.

Aggregate real disposable personal income (DPI)—personal income less personal current taxes, adjusted to remove price changes—rose at an annual rate of more than 3½ percent over the first five months of the year after barely increasing in 2009. Real wage and salary income, which had fallen appreciably in 2009, has regained some lost ground this year, as employment and hours of work have turned up and as real hourly wages have been bolstered by the very low rate of PCE price inflation. One measure of real wages—average hourly earnings of all employees, adjusted for the rise in PCE prices—increased at an annual rate of roughly 1 percent over the first five months of 2010 after having been about flat over the 12 months of 2009.

With equity values up and house prices holding steady, the ratio of household net worth to DPI edged higher in the first quarter of 2010 after increasing appreciably over the last three quarters of 2009. Nonetheless, the wealth-to-income ratio at that time was well below the highs of 2006 and 2007. Moreover, equity prices have fallen substantially since the end of the first quarter, a development that has not only depressed net worth but has also adversely affected consumer sentiment in recent months.

Households continued to reduce their debt in the first half of 2010. Total household debt contracted at an annual rate of about 2½ percent in the first quarter of 2010, with both mortgage debt and consumer credit posting declines. The fall in consumer credit was less rapid than it had been in the second half of

[1] The oil spill in the Gulf of Mexico is having serious consequences for the environment and for many individuals and firms in the affected localities. However, the disaster does not appear to have registered sizable effects on the national economy to date.

2009, a development that is consistent with banks' increased willingness to extend consumer installment loans that has been reported in recent results of the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS).[2] However, SLOOS respondents also continued to report weak demand for such loans. Reflecting the contraction in household debt, debt service payments—the required principal and interest on existing mortgages and consumer debt—fell as a fraction of disposable income.

Changes in interest rates on consumer loans were mixed during the first half of 2010. Interest rates on new auto loans edged down on balance, and spreads on these loans relative to Treasury securities of comparable maturity remained near their average levels over the past decade. Interest rates on credit card loans rose through the first half of 2010; part of the increase early in the year may be attributable to adjustments made by banks prior to the imposition of new rules in February under the Credit Card Accountability Responsibility and Disclosure (Credit CARD) Act.[3]

Although delinquency rates on auto loans at captive finance companies and on credit card loans at commercial banks edged down in the first quarter of 2010, they remained at elevated levels. Charge-off rates for credit card loans at commercial banks were also high.

The Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) continued to support the issuance of consumer asset-backed securities (ABS) until its closure for such securities on March 31.[4] Subsequently, issuance of consumer ABS was solid during the second quarter. Yields on such securities fell on balance during the first quarter, and spreads on high-quality credit card and auto loan ABS relative to comparable-maturity Treasury securities declined to levels last seen in 2007.

Residential Investment and Housing Finance

Home sales and construction were boosted in the spring by the homebuyer tax credit. But looking through this temporary improvement, underlying housing activity appears to have remained weak this year despite a historically low level of mortgage interest rates. In an environment of soft demand, a large inventory of foreclosed or distressed properties on the market, and limits on the availability of financing for builders and some potential buyers, homebuilding has stayed at a slow pace. In the single-family sector, new units were started at an average annual rate of about 510,000 units between January and June—just 150,000 units above the quarterly low reached in the first quarter of 2009. Activity in the multifamily sector has continued to be held down by elevated vacancy rates and tight credit conditions; starts averaged just 100,000 units at an annual rate during the first half of 2010, essentially the same as in the second half of 2009 and well below the norm of 350,000 units per year that had prevailed over the decade prior to the financial crisis.

Home sales surged in the spring, but these increases likely were driven by purchases that were pulled forward to qualify for the homebuyer tax credit.[5] Sales of existing single-family houses jumped to an annual rate of 5 million units on average in April and May, ½ million units above their first-quarter pace. However, new home sales agreements—which also appear to have gotten a lift in April from the looming expiration of the tax credit—plummeted in May, and other indicators of housing demand generally remain lackluster.

Meanwhile, house prices, as measured by a number of national indexes, appear to be reaching bottom. For example, the LoanPerformance repeat-sales price index, which had dropped 30 percent from its peak in 2006 to its trough in 2009, has essentially moved sideways this year. This apparent end to the steep drop in house prices should begin to draw into the market potential buyers who had been reluctant to purchase homes when prices were perceived to be at risk of significant further declines.

Delinquency rates on most categories of mortgages showed tentative signs of leveling off over the first several months of 2010 but remain well above levels posted a year earlier. As of May, serious delinquency rates on prime and near-prime loans had edged down to about 15 percent for variable-rate loans and to

2 The SLOOS is available on the Federal Reserve Board's website at www.federalreserve.gov/boarddocs/SnLoanSurvey.

3 The Credit CARD Act includes some provisions that place restrictions on issuers' ability to impose certain fees and to engage in risk-based pricing.

4 The TALF extended loans to finance investment in ABS. The TALF remained open until June 30 for loans backed by newly issued commercial mortgage-backed securities.

5 In order to receive the homebuyer tax credit, a purchaser had to sign a sales agreement by the end of April. As the law was written, the purchaser had to close on the property by June 30, but the closing deadline was recently changed to September 30. Sales of existing homes are measured at closing, while sales of new homes are measured at the time the contract is signed.

about 5 percent for fixed-rate loans.[6] For subprime loans, as of April (the latest data available), delinquency rates moved down to about 40 percent for variable-rate loans and slightly less than 20 percent for fixed-rate loans. About 650,000 homes entered the foreclosure process in the first quarter of 2010, only slightly below the elevated pace seen in 2009.

On balance, interest rates on fixed-rate mortgages decreased over the first half of 2010, a move that partly reflected the decline in Treasury yields over that period. Some financial market participants had reportedly expressed concerns that rates would rise following the March 31 end of large-scale purchases of agency mortgage-backed securities (MBS) by the Federal Reserve. However, mortgage rates changed little around that date, and spreads have remained relatively narrow.

Despite the further fall in mortgage rates, the availability of mortgage financing continued to be constrained. The April 2010 SLOOS indicated that while banks had generally ceased tightening lending standards on all types of mortgages, they had not yet begun to ease those standards from the very stringent levels that had been imposed over the past few years. Perhaps reflecting the stringency of lending standards and low levels of home equity for many homeowners, over the first quarter of 2010 indicators of refinancing activity showed only a modest pickup from the subdued levels posted in the second half of 2009. Refinancing appeared to pick up late in the second quarter. Overall, residential mortgage debt contracted at a somewhat faster pace in the first half of 2010 than it had in the second half of the previous year.

Net issuance of MBS guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae fell during the first half of 2010 after having expanded briskly in the second half of 2009; the fall was largely attributable to weak demand for mortgages and to sizable prepayments on outstanding MBS stemming from repurchases by Fannie Mae and Freddie Mac of large numbers of delinquent mortgages out of the pools of mortgages backing agency MBS. The securitization market for mortgage loans not guaranteed by a housing-related government-sponsored enterprise (GSE) or the Federal Housing Administration remained essentially closed.

6 A mortgage is defined as seriously delinquent if the borrower is 90 days or more behind in payments or the property is in foreclosure.

The Business Sector

Fixed Investment

Real business fixed investment turned up in the fourth quarter of 2009 after more than a year of steep declines, and it appears to have risen further in the first half of 2010. The pickup occurred entirely in spending for equipment and software (E&S), which rebounded in response to the improvement in sales, production, and profits. Moreover, businesses have ample internal funds at their disposal. And although bank lending remains constrained—especially for small businesses—firms with access to capital markets have generally been able to finance E&S projects with the proceeds of bond issuance at favorable terms.

Real outlays for E&S rose at an annual rate of 11½ percent in the first quarter after an even larger increase in the fourth quarter. As it had in the fourth quarter, business spending on motor vehicles rose briskly, and outlays on information technology (IT) capital—computers, software, and communications equipment—continued to be spurred by the need to replace older, less-efficient equipment and by the expansion of the infrastructure for wireless communications networks. In addition, investment in equipment other than transportation and IT jumped in the first quarter after falling more than 15 percent in 2009. More recently, orders and shipments for a wide range of equipment rose appreciably this spring, pointing to another sizable increase in real E&S outlays in the second quarter.

Investment in nonresidential structures continued to decline in the first half of 2010 against a backdrop of high vacancy rates, low property prices, and difficult financing conditions. Real outlays on structures outside of the drilling and mining sector fell at an annual rate of 27½ percent in the first quarter after falling 18 percent in 2009, and the incoming data point to continued weakness in the second quarter. Construction of manufacturing facilities appears to have firmed somewhat in recent months and outlays in the power category—though volatile from quarter to quarter—have retained considerable vigor, but spending on office and commercial structures remained on a steep downtrend through May. Meanwhile, real spending on drilling and mining structures has posted solid increases in recent quarters in response to the rebound in oil and natural gas prices in the second half of last year; nonetheless, this pickup in activity follows a massive decline in the first half of

2009, and spending in this sector is still well below late-2008 levels.

Inventory Investment

The pace of inventory liquidation slowed dramatically in late 2009 as firms acted to bring production into closer alignment with sales, and businesses began restocking in the first quarter of 2010. That swing in inventory investment added nearly 2 percentage points to the rise in real GDP in the first quarter. Nonetheless, firms appear to be keeping a tight rein on stocks. For example, in the motor vehicle sector, manufacturers held second-quarter production of light vehicles to a pace that pushed days' supply below historical norms—even after adjusting for the reduction over the past couple of years in the number of models, trim lines, and dealerships. Outside of motor vehicles, real inventories rose modestly in the first quarter, and the limited available information suggests that stockbuilding remained at about this pace in the spring. The inventory-to-sales ratios for most industries covered by the Census Bureau's book-value data have moved back into a more comfortable range after rising sharply in 2009.

Corporate Profits and Business Finance

Operating earnings per share for S&P 500 firms continued to bounce back in the first quarter of 2010. In percentage terms, the recent advances were stronger among financial firms, as their profits rebounded from depressed levels, though profits at nonfinancial firms also posted solid increases. Analysts' forecasts point to an expected moderation in profit gains in the second quarter.

The credit quality of nonfinancial corporations has shown improvement this year. Credit rating upgrades outpaced downgrades through May, and very few corporate bond defaults have occurred this year. Although delinquency rates for commercial and industrial (C&I) loans edged down to about 4 percent in the first quarter of 2010, they remained near the higher end of their range over the past 20 years. Delinquency rates for commercial real estate (CRE) loans held steady as rates on construction and land development loans remained near 20 percent.

Reflecting an improved economic outlook and a somewhat more hospitable financing environment, particularly for larger firms, borrowing by nonfinancial businesses expanded over the first two quarters of 2010 after having fallen during the second half of 2009. Net issuance of corporate bonds increased through April as businesses took advantage of relatively low interest rates to issue longer-term debt, and net issuance of commercial paper turned positive. However, bond issuance fell in May as a result of the market volatility and pullback from risk that accompanied European financial developments. C&I loans declined through May before flattening out in June, while CRE lending contracted steeply throughout the first half of the year.

The decline in commercial bank lending to businesses is partly attributable to weak demand for such loans, as suggested by answers to the April 2010 SLOOS. In addition, respondents to the April survey reported that banks increased premiums charged on riskier C&I loans over the previous three months; and although a small net fraction of banks reported easing standards on those loans, the severe bout of tightening reported over the past several years has yet to be materially unwound. Moreover, a moderate net fraction of banks tightened standards on CRE loans over the first quarter of 2010.

Small businesses face relatively tight credit conditions given their lack of direct access to capital markets. Results from the May 2010 Survey of Terms of Business Lending indicated that the spread between the average interest rate on loans with commitment sizes of less than $1 million—loans that were likely made to smaller businesses—and swap rates of comparable maturity edged down in the second quarter but remained quite elevated. In surveys conducted by the National Federation of Independent Business, the net fraction of small businesses reporting that credit had become more difficult to obtain over the preceding three months remained at historically high levels during the first half of 2010. However, the fraction of businesses that cited credit availability as the most important problem that they faced remained small.

New issuance in the commercial mortgage-backed securities (CMBS) market, which had resumed in November 2009 with a securitization supported by the Federal Reserve's TALF program, continued at a very low level in the first half of 2010. The expiration of the legacy CMBS portion of the TALF program on March 31 had little apparent effect on issuance, and spreads on AAA-rated CMBS relative to comparable-maturity Treasury securities generally fell over the first half of the year, though they remained elevated in comparison with their pre-crisis levels.

In the equity market, combined issuance from seasoned and initial offerings by nonfinancial firms slowed a bit in the first quarter of 2010. Meanwhile, equity retirements due to cash-financed merger and acquisition deals and share repurchases increased somewhat, leaving net equity issuance modestly negative.

The Government Sector

Federal Government

The deficit in the federal unified budget appears to be stabilizing—albeit at a very high level—after its sharp run-up in fiscal year 2009. Indeed, over the first nine months of fiscal 2010, the deficit was a little smaller than that recorded a year earlier, and the ongoing recovery in economic activity should help shore up revenues over the remainder of the fiscal year. Nonetheless, the deficit is still on track to exceed 9 percent of nominal GDP for fiscal 2010 as a whole, only a shade below the 10 percent figure for 2009 and substantially above the average value of 2 percent of GDP for fiscal years 2005 to 2007, prior to the onset of the recession and financial crisis. The budget costs of financial stabilization programs, which added significantly to the deficit in fiscal 2009, have helped reduce the deficit this year as the sum of (1) repayments and downward revisions of expected losses in the Troubled Asset Relief Program (TARP) and (2) banks' required prepayments to the Federal Deposit Insurance Corporation of three years of deposit insurance premiums has exceeded the additional payments by the Treasury to the housing-related GSEs. However, the deficit has continued to be boosted by the American Recovery and Reinvestment Act (ARRA) and other policy actions and by the still-low level of economic activity, which is damping revenues and pushing up cyclically sensitive outlays.

After falling 16½ percent in fiscal 2009, federal receipts edged up ½ percent in the first nine months of fiscal 2010 compared with the same period in fiscal 2009; they currently stand around 14½ percent of GDP—the lowest percentage in 60 years. Taken together, individual income and payroll taxes were 4½ percent lower than a year earlier, in part because of the weakness in wage and salary income last fall and the low level of net final payments on 2009 tax liabilities this spring; in addition, the revenue provisions in ARRA had a larger negative effect on individual collections during the first nine months of fiscal 2010 than they did during the comparable period of fiscal 2009. In contrast, corporate receipts turned back up after a dramatic drop in 2008 and 2009. Outlays through June were nearly 3 percent lower than those during the first nine months of fiscal 2009, but the decrease was more than accounted for by a marked downswing in total net outlays for the TARP, the GSE conservatorship, and federal deposit insurance. Excluding these financial transactions, outlays rose 10 percent compared with a year earlier, mainly because of the effects of the weak labor market on income-support programs (such as unemployment insurance and food stamps) and because of the spending associated with ARRA and other stimulus-related policies. In addition, net interest payments have been pushed up by the higher levels of outstanding debt.

As measured in the national income and product accounts (NIPA), real federal expenditures on consumption and gross investment—the part of federal spending that is a direct component of GDP—rose at an annual rate of only 1 percent in the first quarter. Defense spending—which tends to be erratic from quarter to quarter—posted just a small rise, and nondefense purchases only inched up after a large stimulus-related increase in the second half of 2009. Real federal purchases likely increased somewhat faster in the second quarter, boosted by the surge in hiring for the decennial census.

Federal Borrowing

Federal debt held by the public is projected to reach more than 65 percent of nominal GDP by the end of this year, the highest ratio seen in more than 50 years. Despite the increase in financing needs, Treasury auctions have been mostly well received so far this year, and bid-to-cover ratios at those auctions were generally strong. Demand for Treasury securities was likely boosted by a desire for relatively safe and liquid assets in light of concerns about the consequences of fiscal strains in a number of European countries. Indicators of foreign demand for U.S. Treasury debt remained solid.

State and Local Government

State and local governments, facing difficult situations, have continued to reduce expenditures on consumption and gross investment. Over the first six months of 2010, these governments cut roughly 100,000 jobs after a similar reduction in the second half of 2009 and kept a tight rein on operating expenditures to satisfy balanced budget requirements. Real construction expenditures dropped in the fourth quarter of 2009 and remained low in the first half of

2010 despite the availability of federal stimulus funds and supportive conditions in municipal bond markets. Capital expenditures are not typically subject to balanced budget requirements; however, debt service payments on the bonds used to finance capital projects are generally made out of operating budgets (and thus must compete with Medicaid and other high-priority programs for scarce funding), which may be deterring governments from undertaking new infrastructure projects.

As is the case at the federal level, the hemorrhaging of revenues that took a heavy toll on state and local budgets in 2008 and 2009 seems to be easing, and governments will continue to receive significant amounts of federal stimulus aid through the end of the year. Still, total state tax collections are well below their pre-recession levels, and available balances in reserve funds are low. At the local level, property taxes held up well through the first quarter, likely in part because lower real estate assessments have been offset by hikes in statutory tax rates in some areas; however, further increases in tax rates may encounter resistance, and many local governments are facing steep cutbacks in state aid. Moreover, many state and local governments will need to set aside money in coming years to rebuild their employee pension funds after the financial losses experienced over the past couple of years and to fund their ongoing obligations to provide health care to their retired employees.

State and Local Government Borrowing

Despite concerns over the fiscal positions and the financial health of state and local governments, the municipal bond market remained receptive to issuers over the first half of the year. Issuance of long-term municipal bonds was solid and continued to be supported by the Build America Bond program, which was authorized under ARRA.[7] Short-term municipal bond issuance was moderate but generally consistent with typical seasonal patterns.

Interest rates on long-term municipal bonds on balance fell a bit less than those on comparable-maturity Treasury securities, leaving the ratio of their yields slightly elevated by historical standards. Downgrades of state and local government debt by credit agencies continued to exceed upgrades.

[7] The Build America Bond program allows state and local governments to issue taxable bonds for capital projects and receive a subsidy payment from the Treasury for 35 percent of interest costs.

The External Sector

Following a substantial rebound in the second half of 2009, both real exports and imports continued to increase at a robust pace in the first quarter of this year. While the cyclical recovery in real exports of goods and services remained strong, growth slowed from its 20 percent annual rate in the second half of last year to an 11 percent rate in the first quarter of 2010. Exports in almost all major categories expanded, with sales of industrial supplies, high-tech equipment, and services registering large increases. Exports of aircraft were the exception, as they slumped after a sizable increase in the fourth quarter of last year. Export demand from Mexico, Japan, Canada, and emerging Asia excluding China was especially vigorous, while exports to the European Union and China were flat. Data for April and May suggest that exports continued to rise at a solid pace in the second quarter.

Real imports of goods and services rose at an annual rate of 15 percent in the first quarter, about the same pace as in the fourth quarter of last year. All major categories of imports rose, especially industrial supplies (including petroleum), capital goods, and consumer goods. Data for April and May suggest that imports continued to climb robustly in the second quarter, with automotive products and computers registering notable increases.

In the first quarter of 2010, the U.S. current account deficit reached an annual rate of $436 billion, approximately 3 percent of GDP. The current account deficit has widened a little over the past few quarters, as imports have outpaced exports.

The spot price of a barrel of West Texas Intermediate crude oil started the year at about $80 and had risen to $86 by early May, continuing the rebound from last year's recession-induced lows as the global economic recovery progressed. The price has since moved back down to about $77 as a result of increased concerns about the sustainability of the global recovery. The prices of longer-term futures contracts for crude oil (that is, those expiring in December 2018) also fell, from $100 per barrel in early May to $92 per barrel in mid-July. The upward-sloping futures curve is consistent with the view that, despite mounting worries about the near-term growth outlook, oil prices will rise again as global demand strengthens over the medium term.

Nonfuel commodity prices have been mixed in 2010. Food prices have been roughly flat so far this year.

Prices for metals and agricultural raw materials have been volatile; prices for these commodities rose into early April, as the global recovery continued, but since then have fallen sharply, reflecting the stronger value of the dollar and growing uncertainty about the outlook for the global economy. Market commentary also suggests that prices for metals have fallen because of concerns that policy tightening in China may slow its demand for those commodities.

Prices of imported goods rose briskly in early 2010, boosted by the depreciation of the dollar in foreign exchange markets and the rise in commodity prices in late 2009. In the second quarter of this year, as commodity prices declined and the dollar appreciated, import price inflation slowed. Prices for imports of finished goods have, on average, been little changed in 2010.

National Saving

Total net national saving—that is, the saving of households, businesses, and governments excluding depreciation charges—remains very low by historical standards. After having reached 3¾ percent of nominal GDP in 2006, net national saving dropped steadily over the subsequent three years; since the start of 2009, it has averaged negative 2½ percent of nominal GDP. The widening of the federal budget deficit over the course of the recession has more than accounted for the downswing in net saving since 2006, and the large federal deficit will likely cause national saving to remain low in the near term. Because the demand for funds for capital investment is currently relatively meager, the low rate of national saving is not being translated into higher real interest rates or increased foreign borrowing. However, if not boosted over the longer term, persistent low levels of national saving will likely be associated with upward pressure on interest rates, low rates of capital formation, and heavy borrowing from abroad, which would limit the rise in the standard of living of U.S. residents over time and hamper the ability of the nation to meet the retirement needs of an aging population.

The Labor Market

Employment and Unemployment

The labor market bottomed out around the turn of the year and is now adding jobs across a range of industries, albeit at a modest pace. After falling steeply through most of 2009, nonfarm private payroll employment rose 100,000 per month, on average, over the first half of the year.[8] Firms have also raised their labor input by increasing hours per worker. Indeed, the average workweek of employees, which had dropped sharply over the course of the recession, ticked up toward the end of 2009 and rose considerably over the first half of 2010; by June, it had recouped nearly one-half of its earlier decrease. The job gains to date have only been sufficient to about match the rise in the number of jobseekers, and the unemployment rate in the second quarter, at 9¾ percent on average, was only slightly below the recession high of 10 percent reached in the fourth quarter of last year.

Other indicators are also consistent with a gradual improvement in labor market conditions this year. Measures of hiring and job openings have moved up from the low levels of 2009, as have readings from private surveys of hiring plans. In addition, layoffs have come down, although the relatively flat profile of initial claims for unemployment insurance in recent months suggests that the pace of improvement may have slowed lately.

The economy remains far from full employment. The job gains this year have reversed only a small portion of the nearly 8½ million jobs lost during 2008 and 2009, and the unemployment rate is still at its highest level since the early 1980s. Moreover, long-term unemployment has continued to worsen—in June, 6.8 million persons, 600,000 more than at the end of 2009 and nearly one-half of the total unemployed, had been out of work for six months or more. Also, the number of workers who are working part time for economic reasons—another indicator of the underutilization of labor—has fallen only slightly this year and stands at nearly twice its pre-recession level.

Productivity and Labor Compensation

Labor productivity has continued to rise briskly, although not as rapidly as in 2009. According to the latest published data, output per hour in the nonfarm business sector rose at an annual rate of 2¾ percent in the first quarter after a 5½ percent advance in 2009. The continuing strong productivity gains reflect ongoing efforts by firms to improve the effi-

[8] Total employment—private plus government—has exhibited unusually sharp swings of late, mainly because of the hiring of temporary workers for the decennial census. Census hiring started in earnest in March and peaked at about 400,000 in May. In June, the winding down of the census subtracted 225,000 workers from government payrolls. Apart from the census, government employment fell slightly on net over the first half of the year because of cutbacks at state and local governments.

ciency of their operations and their reluctance to increase their labor input in an uncertain economic environment.

Increases in hourly compensation continue to be restrained by the wide margin of slack in the labor market. The 12-month change in the employment cost index for private industry workers, which measures both wages and the cost to employers of providing benefits, has been 2 percent or less since the start of 2009 after several years of increases in the neighborhood of 3 percent. Compensation per hour in the nonfarm business sector—a measure derived from the labor compensation data in the NIPA—has also slowed noticeably over the past couple of years; though erratic from quarter to quarter, this measure rose just 1½ percent over the year ending in the first quarter of 2010. Similarly, average hourly earnings—the timeliest measure of wage developments—rose 1¾ percent in nominal terms over the 12 months ending in June; as suggested earlier, this measure appears to have posted a modest increase in real terms over this period as a consequence of the low rate of consumer price inflation of late.

Reflecting the small rise in hourly compensation and the sizable advance in labor productivity, unit labor costs in the nonfarm business sector declined 4¼ percent over the year ending in the first quarter of 2010. Over the preceding year, unit labor costs had been flat.

Prices

Inflation diminished further in the first half of 2010. After rising 2 percent over the 12 months of 2009, the overall PCE chain-type price index increased at an annual rate of just ¾ percent between December 2009 and May 2010 as energy prices fell. The core PCE price index—which excludes the prices of energy items as well as those of food and beverages—rose at an annual rate of 1 percent over the first 5 months of the year, compared with a rate of 1½ percent over the 12 months of 2009. This moderation was also evident in the appreciable slowing of inflation measures such as trimmed means and medians, which exclude the most extreme price movements in each period. Longer-run inflation expectations have been stable this year, with most survey-based measures remaining within the narrow ranges that have prevailed for the past few years.

Consumer energy prices continued to increase in January after a steep rise in the second half of 2009, but they turned down in February and fell further through midyear. Gasoline prices registered sizable decreases—especially in May and June—reflecting the ample inventories and drop in the price of crude oil in May. Although spot prices for natural gas were pushed up during the winter by unusually cold weather in some major consuming regions, they too fell on net over the spring and early summer as inventories remained high. Retail prices for electricity have fluctuated this year in response to movements in the cost of fossil fuel inputs, but on net they have changed little since the end of 2009.

Consumer food prices rose at an annual rate of 1¾ percent between December 2009 and May 2010, boosted by higher prices for meats and for fruits and vegetables. Farm prices drifted down through the end of June as reports on crop production pointed to an abundant harvest, though they have moved up a bit in recent weeks.

The slowdown in core PCE inflation has been centered in prices of core goods, which declined at an annual rate of 1½ percent, on net, over the first five months of 2010 after rising 1½ percent in 2009. The deceleration in core goods prices was widespread and occurred despite sizable increases in prices for some industrial commodities and materials. Meanwhile, prices of services other than energy posted only a small increase over this period, as the softness in the housing market continued to put downward pressure on housing costs and as prices of other services were restrained by the wide margin of economic slack.

Survey measures of inflation expectations have been relatively stable this year. In the preliminary Thomson Reuters/University of Michigan Surveys of Consumers for July, median year-ahead inflation expectations stood at 2.9 percent. Median 5- to 10-year inflation expectations were also at 2.9 percent in early July—a reading that is in line with the average value for 2009 and the first half of 2010. In the Survey of Professional Forecasters, conducted by the Federal Reserve Bank of Philadelphia, expectations for the increase in the consumer price index over the next 10 years remained around 2½ percent in the second quarter, a level that has been essentially unchanged for many years.

Financial Developments

The recovery of the financial system that began in the spring of 2009 generally continued through the early spring of 2010, but in recent months concerns about spillovers from the fiscal pressures in a number of European countries and the durability of the global recovery have led to the reemergence of strains in some markets.

Monetary Policy Expectations and Treasury Rates

On balance over the first half of 2010, market participants pushed back their expected timing of the first increase in the target federal funds rate from its current range of 0 to ¼ percent, and they scaled back their expectations of the pace with which monetary policy accommodation would be removed. Quotes on money market futures contracts imply that, as of mid-July 2010, investors' expected trajectory for the federal funds rate rises above the current target range in the first quarter of 2011, two quarters later than the quotes implied at the start of 2010. Investors also expect, on average, that the effective federal funds rate will be around 1 percent by the middle of 2012, about 1¼ percentage points lower than anticipated at the beginning of this year. The expected path for monetary policy appeared to move lower in response to the mounting fiscal strains in Europe and weaker-than-expected U.S. economic data releases. The drop probably also reflected Federal Reserve communications, including the repetition in the statement released after each meeting of the Federal Open Market Committee that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

Yields on longer-term nominal Treasury securities fell noticeably, on net, over the first half of the year, while two-year yields fell somewhat less. Yields were generally little changed during the first quarter but dropped in the second quarter along with the decline in the expected path for monetary policy. Increased demand for Treasury securities by investors looking for a haven from volatility in other markets has likely contributed to the decline in yields. On balance, over the first half of the year, yields on 2-year Treasury notes decreased about ½ percentage point to about ¾ percent, and yields on 10-year notes fell about ¾ percentage point to about 3 percent.

Yields on Treasury inflation-protected securities, or TIPS, declined substantially less than those on their nominal counterparts over the first half of the year, resulting in lower medium- and long-term inflation compensation. The decline in inflation compensation may have partly reflected a drop in inflation expectations given the subdued rates of growth in major price indexes over the period and indications that economic slack would remain substantial for some time. However, inferences about investors' inflation expectations based on TIPS have been complicated over recent years by special factors such as the safe-haven demands for nominal Treasury securities and changes over time in the relative liquidity of TIPS and nominal Treasury securities.

Other Interest Rates and Equity Markets

In the commercial paper market, over the first half of 2010, yields on lower-quality A2/P2-rated paper and on AA-rated asset-backed commercial paper rose a bit from low levels, pushing up spreads over higher-quality AA-rated nonfinancial commercial paper. Even so, spreads on both types of assets remain near the low end of the range observed since the fall of 2007.

Yields on corporate bonds rated AA and BBB fell by less than those on comparable-maturity Treasury securities over the first half of the year, resulting in a noticeable increase in risk spreads. Yields on speculative-grade corporate bonds fell during much of the first quarter but rose sharply during the second, leaving yields higher on net over the period and spreads somewhat more elevated. The widening of spreads appears to reflect a decrease in demand for risky assets stemming from concerns about developments in Europe and the outlook for the global economy.

Similarly, broad equity price indexes, which rose in the first quarter, owing both to relatively strong earnings reports and to some better-than-expected economic data releases, fell back in the second quarter. The second-quarter decline was broad based, encompassing most major equity market categories, and was consistent with movements in the prices of a wide variety of other asset classes. Implied volatility of the S&P 500, as calculated from option prices, spiked upward in May before receding somewhat, then ended the first half of the year at a still-elevated level.

Against a backdrop of declining equity prices and increases in equity market volatility, equity mutual funds experienced outflows in the second quarter; they had posted modest inflows in the first quarter after having been nearly flat for much of 2009. Most categories of bond funds and hybrid funds (which invest in a mix of bonds and equities) continued to show sizable inflows in the first half of 2010, although high-yield bond funds registered outflows as spreads widened in the second quarter. Money market mutual funds recorded large outflows, likely reflecting the very low yields on those assets relative to other short-term investments.

Financial Market Functioning

Financial market functioning continued to improve, on balance, during the first half of 2010. However, strains emerged in some markets. For example, the spread between the London interbank offered rate (Libor) and the rate on comparable-maturity overnight index swaps (OIS)—a measure of stress in short-term bank funding markets—widened over the first half of the year. The increases in Libor-OIS spreads were more pronounced at longer maturities. In securities financing markets, bid-asked spreads and haircuts applied to collateral fell slightly.

In order to expand the availability of information on developments with respect to credit and leverage outside the traditional banking sector, the Federal Reserve initiated a Senior Credit Officer Opinion Survey on Dealer Financing Terms (SCOOS). The SCOOS surveys senior credit officers at about 20 U.S. and foreign dealers that, in the aggregate, provide the vast majority of the financing of dollar-denominated securities to nondealers and are the most active intermediaries in over-the-counter (OTC) derivative instruments. The survey will be conducted on a quarterly basis. In the first survey, conducted in late May and early June, dealers generally reported that the terms at which they provided credit were tight relative to those at the end of 2006.[9] However, they noted some loosening of terms for both securities financing and OTC derivative transactions, on net, over the previous three months for certain classes of clients—including hedge funds, institutional investors, and nonfinancial corporations—and intensified pressures by those clients to negotiate more-favorable terms. At the same time, they reported a pickup in demand for financing across several collateral types over the past three months.

The SCOOS results are consistent with market commentary suggesting that financial system leverage had begun to pick up in early 2010. However, leverage reportedly fell back in May against the backdrop of heightened market volatility. Hedge funds, which had earned solid returns on average during the first few months of the year, posted a sharp decline in May.

Conditions in the leveraged loan market continued to improve on balance over the first half of 2010. Gross issuance of such loans picked up slightly during that period from very low levels in 2009, as loan pools issuing collateralized loan obligations (CLOs) moved to reinvest the cash received from companies that had paid down older loans with the proceeds of bond issues. New CLO issuance, which had nearly ceased in the second half of 2009, also began to pick up in the second quarter of 2010. The recovery in investor demand for syndicated loans was evident in the secondary market as well, where average bid-asked spreads declined, on net, over the first half of 2010, and bid prices moved closer to par.

Financial Institutions

Investor sentiment regarding the outlook for commercial banks, which had generally improved during the first quarter, became more pessimistic during the second quarter. Equity prices of commercial banks generally outperformed the broader market over the first quarter, before declining about in line with equity market indexes during the second. Bank equity prices were likely boosted slightly by modest improvements in returns on equity and assets in the first quarter, although both profitability measures remained near the bottom end of their ranges of the past 20 years. After adjusting for the effects of changes in the accounting treatment of securitized assets, net interest margins rose noticeably in the first quarter, while provisions for loan losses declined, consistent with responses to the January SLOOS that pointed to an improvement in banks' outlook on credit quality.[10] Smaller commercial banks collectively registered their first profitable quarter in more than a year in the first quarter.

Credit default swap (CDS) spreads for banking institutions—which primarily reflect investors' assessments of and willingness to bear the risk that those institutions will default on their debt obligations—in-

9 The SCOOS is available on the Federal Reserve Board's website at www.federalreserve.gov/econresdata/releases/scoos.htm.

10 The Financial Accounting Standards Board's Statements of Financial Accounting Standards Nos. 166 and 167 (FAS 166 and 167) modified the basis for determining whether a firm must consolidate securitized assets (as well as the associated liabilities and equity) onto its balance sheet. Most banking institutions were required to implement the standards in the first quarter of 2010. Banks are estimated to have brought $435 billion of loans back onto their books, of which about three-fourths were credit card loans, and increased their allowance for loan and lease losses by about $36 billion. For additional detail on the effects of FAS 166 and 167 on banks' balance sheets, see the "Notes on the Data" portion of Board of Governors of the Federal Reserve System, Statistical Release H.8, "Assets and Liabilities of Commercial Banks in the United States," www.federalreserve.gov/releases/h8/h8notes.htm.

creased on net over the first half of the year, particularly for larger banking organizations. The widening in CDS spreads reportedly reflected uncertainty about the outcome of legislation to reform the financial system as well as concerns about developments in Europe and their implications for the robustness of the U.S. and global economic recovery. The overall delinquency rate on loans held by commercial banks increased somewhat in the first quarter of 2010, as continued deterioration in the credit quality of residential mortgages offset decreases in delinquency rates on most other categories of loans.

With loan demand reportedly continuing to be weak and credit conditions remaining tight, total loans on banks' books contracted during the first half of the year, though less rapidly than they had during the second half of 2009. After adjusting for the effects of changes in the accounting treatment of securitizations, all major categories of loans posted sizable declines. Securities holdings rose, on balance, reflecting substantial accumulation of Treasury securities. Cash assets also posted noticeable increases. However, total and risk-weighted assets shrank even as banks continued to raise capital, resulting in increases in regulatory capital ratios to historical highs.

Monetary Aggregates and the Federal Reserve's Balance Sheet

The M2 monetary aggregate rose only modestly in the first half of 2010.[11] Liquid deposits expanded moderately, likely reflecting heightened household demand for safe and liquid assets. That increase was only partially offset by continued large outflows from small time deposits and retail money market mutual funds that likely reflected the very low rates of return offered on those products compared with other assets. The currency component of the money stock expanded moderately in the first half of the year. The monetary base—roughly equal to the sum of currency in circulation and the reserve balances of depository institutions held at the Federal Reserve—increased at a 3½ percent annual rate in the first half of 2010, well below the 30 percent rate posted in the second half of 2009. The slower growth rate was largely attributable to the more gradual expansion in reserve balances as the Federal Reserve's program of large-scale asset purchases came to an end.

The size of the Federal Reserve's balance sheet remained at a historically high level in mid-2010 (**table 1**). Total Federal Reserve assets on July 7, 2010, stood at about $2.3 trillion, about $100 billion more than at the end of 2009. The increase is largely attributable to the completion on March 31 of the Federal Reserve's program to purchase agency debt and agency mortgage-backed securities. Securities holdings, the vast majority of Federal Reserve assets, increased from about $1.8 trillion to about $2.1 trillion over the first half of the year.

On February 1, 2010, in light of improved functioning in financial markets, the Federal Reserve closed the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility. On March 8, the Federal Reserve conducted the final auction under the Term Auction Facility. With the closure of these facilities, the amount of credit extended by these programs fell to zero from roughly $100 billion at year-end. In addition, the terms on the primary credit facility were adjusted to increase the cost of funds to ¾ percent and to reduce the typical maturity of these loans to one day.[12] In response, primary credit declined from about $19 billion to about $17 million over the first half of the year. On June 30, the Federal Reserve closed the Term Asset-Backed Securities Loan Facility (TALF). About $42 billion in TALF loans, which have maturities of three or five years, remain on the Federal Reserve's balance sheet.

These broad-based programs, which were introduced during the crisis to provide liquidity to financial institutions and markets, contributed to the stabilization of financial markets and helped support the flow of credit to the economy—at no loss to the taxpayer. All of the loans extended through these programs that have come due have been repaid in full, with interest.

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[11] M2 consists of (1) currency outside the U.S. Treasury, Federal Reserve Banks, and the vaults of depository institutions; (2) traveler's checks of nonbank issuers; (3) demand deposits at commercial banks (excluding those amounts held by depository institutions, the U.S. government, and foreign banks and official institutions) less cash items in the process of collection and Federal Reserve float; (4) other checkable deposits (negotiable order of withdrawal, or NOW, accounts and automatic transfer service accounts at depository institutions; credit union share draft accounts; and demand deposits at thrift institutions); (5) savings deposits (including money market deposit accounts); (6) small-denomination time deposits (time deposits issued in amounts of less than $100,000) less individual retirement account (IRA) and Keogh balances at depository institutions; and (7) balances in retail money market mutual funds less IRA and Keogh balances at money market mutual funds.

[12] The primary credit rate had been ½ percent, and the maximum maturity of primary credit loans had been 90 days.

Table 1. Selected components of the Federal Reserve balance sheet, 2009–10
Millions of dollars

Balance sheet item	Dec. 30, 2009	July 7, 2010
Total assets	**2,237,258**	**2,335,457**
Selected assets		
Credit extended to depository institutions and dealers		
Primary credit	19,111	17
Term auction credit	75,918	…
Central bank liquidity swaps	10,272	1,245
Primary Dealer Credit Facility and other broker-dealer credit	0	…
Credit extended to other market participants		
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	0	…
Net portfolio holdings of Commercial Paper Funding Facility LLC	14,072	1
Term Asset-Backed Securities Loan Facility	47,532	42,278
Support of critical institutions		
Net portfolio holdings of Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC[1]	65,024	66,996
Credit extended to American International Group, Inc.	22,033	24,560
Preferred interests in AIA Aurora LLC and ALICO Holdings LLC	25,000	25,733
Securities held outright		
U.S. Treasury securities	776,587	776,997
Agency debt securities	159,879	164,762
Agency mortgage-backed securities (MBS)[2]	908,257	1,118,290
Memo		
Term Securities Lending Facility[3]	0	…
Total liabilities	**2,185,139**	**2,278,523**
Selected liabilities		
Federal Reserve notes in circulation	889,678	907,698
Reverse repurchase agreements	70,450	62,904
Deposits held by depository institutions	1,025,271	1,061,239
Of which: Term deposits	…	2,122
U.S. Treasury, general account	149,819	16,475
U.S. Treasury, supplemental financing account	5,001	199,963
Total capital	**52,119**	**56,934**

Note: LLC is a limited liability company.

1 The Federal Reserve has extended credit to several LLCs in conjunction with efforts to support critical institutions. Maiden Lane LLC was formed to acquire certain assets of the Bear Stearns Companies, Inc. Maiden Lane II LLC was formed to purchase residential mortgage-backed securities from the U.S. securities lending reinvestment portfolio of subsidiaries of American International Group, Inc. (AIG). Maiden Lane III LLC was formed to purchase multisector collateralized debt obligations on which the Financial Products group of AIG has written credit default swap contracts.

2 Includes only MBS purchases that have already settled.

3 The Federal Reserve retains ownership of securities lent through the Term Securities Lending Facility.

…Not applicable.

Source: Federal Reserve Board.

The credit provided to American International Group, Inc. (AIG), increased slightly, on net, over the first half of the year, in part because additional borrowing through this facility was used to pay down outstanding commercial paper that had been issued to the Commercial Paper Funding Facility LLC (limited liability company). The net portfolio holdings of Maiden Lane LLC—which was created in conjunction with efforts to avoid a disorderly failure of the Bear Stearns Companies, Inc.—increased as the recovery in financial markets boosted the fair value of the assets held in that LLC. Consistent with the terms of the transaction, the distribution of the proceeds realized on the asset portfolio held by Maiden Lane LLC will occur on a monthly basis going forward unless otherwise directed by the Federal Reserve. The monthly distributions will cover the expenses and repay the obligations of the LLC, including the principal and interest on the loan from the Federal Reserve Bank of New York, according to the priority established in the terms of the transaction. The portfolio holdings of Maiden Lane II LLC and Maiden Lane III LLC—which were created in conjunction with efforts to avoid the disorderly failure of AIG—decreased as prepayments and redemptions of some of the securities held in those portfolios were used to pay down the loans extended by the Federal Reserve Bank of New York. The Federal Reserve does not expect to incur a net loss on any of the secured loans provided during the crisis to help prevent the disorderly failure of systemically significant financial institutions.

On the liabilities side of the Federal Reserve's balance sheet, reserve balances averaged just over $1 trillion over the first six months of 2010. The Federal Reserve made preparations to conduct small-scale reverse repurchase operations to ensure its ability to use agency MBS collateral for such transactions, and the first small-value auctions in the Term Deposit Facility program were conducted in June and July. Reverse repurchase operations and the Term Deposit Facility are among the tools that the Federal Reserve will have at its disposal to drain reserves from the banking system at the appropriate time. The Treasury's supplementary financing account, which had fallen to about $5 billion when the statutory debt ceiling was approached last year, returned to its previous level of about $200 billion after the statutory debt ceiling was raised in early 2010.

On April 21, the Federal Reserve System released the 2009 annual comparative financial statements for the combined Federal Reserve Banks, the 12 individual Federal Reserve Banks, the LLCs that were created as part of the Federal Reserve's response to strains in financial markets, and the Board of Governors. The statements showed that the Reserve Banks' comprehensive income was just over $53 billion for the year ending December 31, 2009, an increase of nearly $18 billion from 2008. The increase in earnings was primarily attributable to the increase in the Federal Reserve's holdings of agency debt and agency MBS. The consolidated LLCs also contributed to the increase in the Reserve Banks' comprehensive income. The Reserve Banks transferred more than $47 billion of their $53 billion in comprehensive income to the U.S. Treasury in 2009, an increase of more than $15 billion—or about 50 percent—from the amount transferred in 2008.

International Developments

International Financial Markets

In recent months, global financial markets have been roiled by the Greek fiscal crisis and the resultant concerns about the European outlook more broadly (see **box 1**). Fears about the exposure of euro-area financial institutions to Greece and other vulnerable euro-area countries also resulted in pressure in dollar funding markets (see **box 2**). Risk-related flows into safe investments lifted the value of the dollar and lowered yields on the sovereign bonds of most major advanced economies, including the United States. On net for the first half of the year, the dollar has appreciated, and foreign stock markets and the yields on benchmark sovereign bonds have moved down.

In the first quarter of this year, a sense that the U.S. recovery was proceeding more rapidly than the recovery in Europe led the dollar to appreciate against the euro and sterling, while strong growth in emerging Asia led the dollar to depreciate against many emerging market currencies. These divergent movements left the Federal Reserve's broadest measure of the nominal trade-weighted foreign exchange value of

Box 1. European Fiscal Stress and Policy Responses

The fiscal crisis in Greece and its ramifications for Europe have been a source of anxiety in global financial markets in recent months. Concerns about Greece began mounting around the turn of the year after announcements revealed the government's deficit to be considerably larger than initially estimated. Despite the announcement by the Greek government of plans to implement significant fiscal consolidation, the spread of yields on Greek sovereign bonds over those of German bonds soared during the spring, as market confidence in the ability of Greece to meet its fiscal obligations diminished. At the same time, concerns also spread to other euro-area countries with high debt and deficit ratios, including Portugal, Spain, and Ireland. On May 2, with the Greek government and banking sectors having difficulty obtaining market finance, the European Union and International Monetary Fund (IMF) announced a joint €110 billion financial support package for Greece. Disbursement of the support, in the form of loans to be distributed over three years, is contingent on aggressive fiscal consolidation, which would bring the country's budget deficit from almost 14 percent of gross domestic product in 2009 to below 3 percent by 2014.

The announcement of the May 2 package assuaged investor concerns only briefly. Spreads on Greek sovereign debt and that of other vulnerable euro-area economies moved up sharply in the week after the announcement, and dollar funding strains for many euro-area institutions intensified.

In response, European leaders announced much broader stabilization measures on May 10. One set of initiatives addressed sovereign risk, providing up to €500 billion in funds—€60 billion through a European Financial Stabilization Mechanism and €440 billion from a special purpose vehicle, the European Financial Stabilization Facility, which is authorized to raise funds in capital markets backed by guarantees from euro-area member states. These funds may also be augmented with bilateral loans from the IMF. The European Central Bank (ECB) simultaneously announced that it was prepared to purchase government and private debt securities to ensure the depth and liquidity of euro-area debt markets that were considered dysfunctional. In addition, the ECB expanded its liquidity provision facilities. Finally, to forestall an emerging shortage of dollar liquidity, the Federal Reserve reopened temporary U.S. dollar liquidity swap lines with the ECB and four other major central banks.

The announcement of these measures and the subsequent purchases of sovereign debt by the ECB led to an improvement in market sentiment and a considerable drop in spreads, but spreads have since moved up. This renewed increase is due, at least in part, to market concerns about the growth implications of the significant and synchronized fiscal consolidation efforts being implemented across the euro area.

Considerable uncertainties also remain about the exposure of financial institutions to vulnerable countries and about the financial position of these institutions more generally. European governments are currently working to address these uncertainties through a coordinated set of bank stress tests.

Box 2. Dollar Funding Pressures and the Reinstitution of Central Bank Swap Lines

In March, dollar funding pressures began to reemerge in the euro area as uncertainties about the condition of some euro-area financial institutions were amplified by concerns about their possible exposures to Greece and other peripheral euro-area economies. The London interbank offered rate, or Libor, for U.S. dollars increased sharply in late April.

In response to the intensification of these dollar funding strains, the Federal Open Market Committee reestablished dollar liquidity swap lines on May 9 and 10 with the European Central Bank (ECB), the Bank of England, the Bank of Canada, the Bank of Japan, and the Swiss National Bank. So far, drawings on the lines have been limited, with only the ECB and the Bank of Japan attracting any bidders in their dollar tender operations.

Draws on these lines have been limited because the central banks are offering dollar liquidity in their markets at rates equal to the overnight index swap rate plus 100 basis points—rates that have exceeded the cost of dollar funding available to most institutions from alternative sources. However, these facilities were designed to provide a backstop, and as such, even with limited credit extensions, they are supporting the functioning of dollar funding markets and helping to curtail uncertainties in those markets.

the dollar little changed by the end of the first quarter. Foreign equity indexes generally rose modestly during the first quarter, as the effect of improving growth prospects in some regions was only partly offset by concerns about Greece. Those concerns led yields on the sovereign bonds of Germany and France to drift down, as investors shifted into those assets.

By late April, the problems in Greece were exacerbating concerns about fiscal sustainability in Europe and growth in the region more broadly. The increase in perceived risk caused the dollar to appreciate noticeably from mid-April to the end of May and led to sharp declines in foreign stock markets. The yields on the sovereign bonds of France and Germany fell further, and yields on the sovereign bonds of other advanced economies began falling as well, driven by flight-to-safety flows and expectations that policy tightening would occur later than had previously been expected.

Steps taken by European countries in early May to provide assistance to Greece and other countries with fiscal vulnerabilities supported some improvement in market sentiment; equity prices temporarily halted their decline by early June and the dollar depreciated somewhat, likely reflecting a modest reversal of flight-to-safety flows. Over the past month, however, worries about global growth prospects have intensified, and yields on advanced economy sovereign bonds have drifted down further.

The Financial Account

Financial flows in the first quarter of this year reflected a growing imprint of the strains in Europe. Data for the first quarter and indicators for the second quarter point to unusually large purchases of U.S. Treasury securities by private foreigners so far this year, likely indicating a flight to quality as fiscal problems in Europe mounted. Foreign demand for other U.S. securities remained mixed. Net purchases of U.S. agency debt stayed weak, while net purchases of U.S. equities, which were strong in the first quarter, appear to have weakened in the second quarter. Foreign private investors continued to sell U.S. corporate debt securities, on net, but at a slower pace in the second quarter. Conversely, U.S. residents continued to purchase sizable amounts of foreign bonds and equities, including both emerging market and European securities.

Banks located in the United States sharply increased net lending abroad, generating net private capital outflows. These outflows were spurred in part by the reemergence of dollar funding pressures in European interbank markets; such pressures had been acute at the height of the global financial crisis in late 2008 but had subsided by the middle of last year.

Inflows from foreign official institutions remained strong through the first quarter. Most of these inflows were from countries seeking to counteract upward pressure on their currencies by purchasing U.S. dollars on foreign currency markets. These countries then used the proceeds to acquire U.S. assets, primarily Treasury securities. Available data for the second quarter indicate that foreign official purchases of U.S. Treasury securities slowed in line with the strengthening of the dollar.

Advanced Foreign Economies

Notwithstanding the ongoing strains on the European economy, the data on economic activity abroad that we have received to date do not show significant effects of these strains and suggest that a moderate recovery is under way. In the first quarter, the recovery from last year's recession gathered momentum in the advanced foreign economies, driven by a rebound in world trade and continuing improvement in business sentiment. Growth was particularly robust in Japan, which benefited from rising exports to emerging Asia, and in Canada, where private domestic demand remained strong. Economic growth was less vigorous in the euro area, where consumption and investment spending declined again, and in the United Kingdom, where consumption was held back by the hike in the value-added tax in January.

Monthly indicators of economic activity across the advanced foreign economies suggest widespread growth in the second quarter. Industrial production has continued to rebound, business confidence has improved further, and purchasing managers indexes remain at levels consistent with solid expansion. However, indicators of household spending showed considerable variation across countries, with retail sales expanding rapidly in Canada but declining in the euro area. Such variation in part reflected differences in labor market developments. Canadian employment has rebounded this year, while euro-area employment has stagnated. As described earlier, increasing concerns about sovereign debt and banking systems in some euro-area countries have affected a wide array of financial markets. However, while these stresses are materially restraining economic activity in Greece and several other European countries, they have not yet had a broader effect on economic indicators in the other major advanced foreign economies.

Twelve-month consumer price inflation picked up a bit in the advanced foreign economies early this year, largely owing to increases in the prices of energy and other commodities, but inflation remained below target in the euro area and Canada and continued to be negative in Japan. Core consumer price inflation, excluding food and energy, remained subdued in these economies, as considerable economic slack persisted. In contrast, headline inflation in the United Kingdom rose above 3 percent this year, driven by exchange rate depreciation and the increase in the value-added tax.

After cutting policy rates to very low levels in 2009, most major foreign central banks have kept rates unchanged so far this year. The Bank of Canada, however, tightened monetary policy in June, raising its target for the overnight rate 25 basis points to ½ percent, amid signs of strong growth and diminishing excess capacity in the Canadian economy. The European Central Bank kept its main refinancing rate at 1 percent and, in the second quarter, took additional measures to provide liquidity: extending the period over which it promised to provide fixed-rate refinancing with full allotment, adjusting its collateral requirements on repurchase agreements to ensure that Greek government debt would remain eligible, and buying the debt of some euro-area countries in the secondary market. The Bank of Japan kept its targeted rate near zero and added a new lending facility aimed at encouraging private-bank lending to businesses.

Emerging Market Economies

The emerging market economies, which have led the recovery from the global financial crisis, have continued to grow strongly thus far this year.

In emerging Asia, aggregate real GDP growth picked up to an impressive double-digit pace in the first quarter. Indicators suggest that growth likely slowed to a more sustainable but still-rapid pace in the second quarter. In China, domestic demand has been strong, with retail sales registering significant gains. The accompanying rapid growth of imports has provided a boost to other economies in the region and to commodity exporters around the world. However, Chinese real GDP decelerated in the second quarter, reflecting a slowdown in fixed investment and tighter credit conditions. Rising property prices and concerns about the volume and quality of lending led authorities to clamp down on bank lending through a variety of prudential measures. Authorities also began to tighten monetary policy and have raised required reserve ratios for banks a cumulative 150 basis points since January. In late June, Chinese authorities announced that they would take steps to increase the flexibility of the renminbi. The renminbi has subsequently appreciated about 1 percent against the dollar.

In Latin America, real GDP growth dipped in the first quarter, with output declines in Mexico, Chile, and Venezuela offsetting rapid growth in Brazil. The fall in output in Mexico reflected both a sharp decline in Mexico's agricultural sector and deceleration in the manufacturing sector, but other indicators, including very strong exports, were more upbeat. Brazilian economic activity continued to show strength in the first quarter, with real GDP expanding at a double-digit rate, boosted by fiscal stimulus and strong demand for the country's commodity exports. Brazil's central bank has recently tightened monetary policy, raising the policy rate a cumulative 150 basis points since late April.

Inflation in emerging market economies rose at the end of 2009 and into 2010, reflecting increases in food and energy prices and, particularly in the case of Mexico, special factors such as tax increases. Consumer price readings from recent months suggest that these price pressures are waning.

Part 3 Monetary Policy: Recent Developments and Outlook

Monetary Policy over the First Half of 2010

The Federal Open Market Committee (FOMC) maintained a target range for the federal funds rate of 0 to ¼ percent throughout the first half of 2010 in order to continue to promote economic recovery and price stability. In the statement accompanying each regularly scheduled FOMC meeting, the Committee noted that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low levels of the federal funds rate for an extended period. At the end of March, the Federal Reserve concluded its purchases of agency mortgage-backed securities (MBS) and agency debt under its large-scale asset purchase programs, which were undertaken to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets. Also, in light of improved functioning of financial markets, by the end of June the Federal Reserve had closed all of the special liquidity facilities that it had created to support markets during the crisis. However, in response to the reemergence of strains in U.S. dollar short-term funding markets in Europe, the Federal Reserve and five foreign central banks announced in May the reestablishment of temporary U.S. dollar liquidity swap facilities.

At its January 26–27 meeting, the Committee agreed that the incoming information, though mixed, indicated that overall economic activity had strengthened in recent months, about in line with expectations. Consumer spending was well maintained in the fourth quarter, and business expenditures on equipment and software appeared to expand substantially. However, the improvement in the housing market had slowed, and spending on nonresidential structures continued to fall. Available data suggested that the pace of inventory liquidation had diminished considerably in the fourth quarter, providing a sizable boost to economic activity, and especially to industrial production. In the labor market, layoffs subsided noticeably in the final months of 2009, but the unemployment rate remained elevated and hiring stayed quite limited. The weakness in labor markets continued to be an important concern for the Committee; moreover, the prospects for job growth remained a significant source of uncertainty in the economic outlook, particularly for consumer spending. Financial market conditions were supportive of economic growth. Nonetheless, net debt financing by nonfinancial businesses was near zero in the fourth quarter after being negative in the third, consistent with sluggish demand for credit and tight lending standards and terms at banks. Increases in energy prices pushed up headline consumer price inflation, but core consumer price inflation remained subdued.

In their discussion of monetary policy for the period ahead, Committee members agreed that neither the economic outlook nor financial conditions had changed appreciably since the December meeting and that no changes to the Committee's large-scale asset purchase programs or to its target range for the federal funds rate of 0 to ¼ percent were called for. Further, policymakers reiterated their anticipation that economic conditions were likely to warrant exceptionally low rates for an extended period. The Committee affirmed its intention to purchase a total of $1.25 trillion of agency MBS and about $175 billion of agency debt by the end of the first quarter and to gradually slow the pace of these purchases to promote a smooth transition in markets. Committee members agreed that with substantial improvements in most financial markets, including interbank markets, the statement following the meeting would indicate that on February 1, 2010, the Federal Reserve would close several special liquidity facilities and that the temporary swap lines with foreign central banks would expire. In addition, the statement would say that the Federal Reserve was in the process of winding down the Term Auction Facility (TAF) and that the final auction would take place in March 2010.

As had been announced, on February 1, 2010, the Federal Reserve closed the Primary Dealer Credit Facility, the Term Securities Lending Facility, the Commercial Paper Funding Facility, and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility. The temporary swap lines with foreign central banks expired on the same day. On February 18, 2010, the Federal Reserve announced a further normalization of the terms of loans made under the primary credit facility. The rate charged on these loans was increased from ½ percent to ¾ percent, effective on February 19, and the typical maximum maturity for such loans was shortened to overnight, effective on March 18, 2010. The Federal Reserve also announced on February 18 that the minimum bid rate on the final TAF auction on March 8 had been raised to 50 basis points, ¼ percentage point higher than in previous auctions. The Federal Reserve noted that the modifications were not expected to lead to tighter financial conditions for households and businesses and did not signal any change in the outlook for the economy or for monetary policy.

The data reviewed at the March 16 FOMC meeting suggested that economic activity expanded at a moderate pace in early 2010. Business investment in equipment and software seemed to have picked up, and consumer spending increased further in January. Private employment would likely have turned up in February but for the snowstorms that affected the East Coast. Meeting participants agreed that available indicators suggested that the labor market appeared to be stabilizing. Output in the manufacturing sector continued to trend higher as firms increased production to meet strengthening final demand and to slow the pace of inventory liquidation. On the downside, housing activity remained flat and nonresidential construction weakened further. Meanwhile, a sizable increase in energy prices had pushed up headline consumer price inflation in recent months; in contrast, core consumer price inflation was quite low. Participants agreed that financial market conditions remained supportive of economic growth. Spreads in short-term funding markets were near pre-crisis levels, and risk spreads on corporate bonds and measures of implied volatility in equity markets were broadly consistent with historical norms given the outlook for the economy. Participants were also reassured by the absence of any signs of renewed strains in financial market functioning as a consequence of the Federal Reserve's winding down of its special liquidity facilities. However, bank lending was still contracting, and interest rates on many bank loans had risen further in recent months.

Against this backdrop, Committee members agreed that it would be appropriate to maintain the target range of 0 to ¼ percent for the federal funds rate and to complete the Committee's previously announced purchases of $1.25 trillion of agency MBS and about $175 billion of agency debt by the end of March. Nearly all members judged that it was appropriate to reiterate in the Committee's statement the expectation that economic conditions—including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period. In light of the improved functioning of financial markets, Committee members agreed that it would be appropriate for the statement to indicate that the previously announced schedule for closing the Term Asset-Backed Securities Loan Facility (TALF) was being maintained. On March 31, the TALF closed for loans backed by collateral other than newly issued commercial MBS.

The information reviewed at the April 27–28 FOMC meeting suggested that, on balance, the economic recovery was proceeding at a moderate pace and that the deterioration in the labor market was likely coming to an end. Consumer spending continued to post solid gains in the first three months of the year, and business investment in equipment and software appeared to have increased significantly further in the first quarter. In addition, growth of manufacturing output remained brisk, and gains became more broadly based across industries. However, residential construction, while having edged up, was still depressed, construction of nonresidential buildings remained on a steep downward trajectory, and state and local governments continued to retrench. Consumer price inflation remained low. Meeting participants expected that business investment would be supported by improved conditions in financial markets. Large firms with access to capital markets appeared to be having little difficulty in obtaining credit, and in many cases they also had ample retained earnings with which to fund their operations and investment. However, many participants noted that, while financial market conditions had generally improved, bank lending was still contracting and that smaller firms in particular continued to face substantial difficulty in obtaining bank loans. Members saw an escalation of financial strains in Europe as a risk to the outlook, although the attendant effects on global market conditions were only beginning to be felt.

Members agreed that no adjustments to the federal funds rate target range were warranted at the meeting. On balance, the economic outlook had changed little since the March meeting. Even though the recovery appeared to be continuing and was expected to strengthen gradually over time, most members projected that economic slack would continue to be elevated for some time, with inflation remaining below rates that would be consistent in the longer run with the Federal Reserve's dual objectives of maximum employment and price stability. In addition, nearly all members judged that it was appropriate to reiterate the expectation that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. In light of the improved functioning of financial markets, Committee members again agreed that it would be appropriate for the statement to indicate that the previously announced schedule for closing the TALF was being maintained.

On May 9, 2010, the Committee met by conference call to discuss developments in global financial markets and possible policy responses. Over the previous several months, financial market concerns about the ability of Greece and some other euro-area countries to contain their sizable budget deficits and finance their debt had increased. Conditions in short-term funding markets in Europe had deteriorated, and global financial markets more generally had been volatile and less supportive of economic growth.

In connection with the possible implementation by the European authorities of a number of measures to promote fiscal sustainability and support financial market functioning, some major central banks had requested that dollar liquidity swap lines with the Federal Reserve be reestablished. The Committee agreed that such arrangements could be helpful in limiting the strains in dollar funding markets and the adverse implications of recent developments for the U.S. economy. In order to promote the transparency of these arrangements, participants also agreed that it would be appropriate for the Federal Reserve to publish the swap contracts and to release on a weekly basis the amounts of draws under the swap lines by central bank counterparty. It was recognized that the Committee would need to consider the implications of swap lines for bank reserves and overall management of the Federal Reserve's balance sheet. Participants noted the importance of appropriate consultation with U.S. government officials and emphasized that a reestablishment of the lines should be contingent on strong and effective actions by authorities in Europe to address fiscal sustainability and support financial markets.

At the conclusion of its discussion, the Committee voted unanimously to authorize the Chairman to agree to reestablish swap lines with the European Central Bank (ECB), the Bank of England, the Swiss National Bank, the Bank of Japan, and the Bank of Canada. The arrangements with the Bank of England, the ECB, the Swiss National Bank, and the Bank of Japan would provide those central banks with the capacity to conduct tenders of U.S. dollars in their local markets at fixed rates for full allotment, similar to arrangements that had been in place previously. The arrangement with the Bank of Canada would support draws of up to $30 billion, as was the case previously. The swap arrangements were authorized through January 2011.

The information reviewed at the June 22–23 FOMC meeting suggested that the economic recovery was proceeding at a moderate pace in the second quarter. Businesses continued to increase employment and lengthen workweeks in April and May, but the unemployment rate remained elevated. Industrial production registered strong and widespread gains, and business investment in equipment and software rose rapidly. Consumer spending appeared to have moved up further in April and May. However, housing starts dropped in May, and nonresidential construction remained depressed. Falling energy prices held down headline consumer prices in April and May, while core consumer prices edged up.

Financial markets had become somewhat less supportive of economic growth since the April meeting, with developments in Europe a leading cause of greater global financial market tensions. Risk spreads for many corporate borrowers had widened noticeably, equity prices had fallen appreciably, and the dollar had risen in value against a broad basket of other currencies. Participants saw these changes as likely to weigh to some degree on household and business spending over coming quarters.

The Committee agreed to make no change in its target range for the federal funds rate at the meeting. Although the economic outlook had softened somewhat, and a number of meeting participants saw the risks to the outlook as having shifted to the downside, all saw the economic expansion as likely to be strong enough to continue raising resource utilization, albeit more slowly than they had previously anticipated. In addition, they saw inflation as likely to stabilize near recent low readings in coming quarters and then gradually rise toward more desirable levels. Nearly all members again judged that it was appropriate to indicate in the statement released following the meeting that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. Participants noted that in addition to continuing to develop and test instruments to exit from the period of unusually accommodative monetary policy, the Committee would need to consider whether further policy stimulus might become appropriate if the economic outlook were to worsen appreciably.

Tools for the Withdrawal of Monetary Policy Accommodation

Although the FOMC continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period, ultimately the Federal Reserve will need to begin to tighten monetary conditions to prevent the development of inflation pressures as the economy recovers. That tightening will be accomplished partly through changes that will affect the composition and size of the Federal Reserve's balance sheet.

The Federal Reserve has developed a number of tools that will facilitate the removal of policy accommodation and reduce the quantity of reserves held by the banking system at the appropriate time. These tools encompass (1) raising the interest rate paid on excess reserve balances (the IOER rate), (2) executing term reverse repurchase agreements (RRPs) with the primary dealers and other counterparties, (3) issuing term deposits to depository institutions through the Term Deposit Facility (TDF), (4) redeeming maturing and prepaid securities held by the Federal Reserve without reinvesting the proceeds, and (5) selling securities held by the Federal Reserve. All but the first of these tools would shrink the supply of reserve balances; the last two would also reduce the size of the Federal Reserve's balance sheet.

Interest on Excess Reserves Rate

In their discussion of the IOER rate at the January meeting, all participants agreed that raising that rate and the target for the federal funds rate would be a key element of a move to less-accommodative monetary policy. Most participants thought that it likely would be appropriate to reduce the supply of reserve balances, to some extent, before raising the IOER rate and the target for the federal funds rate, in part because reducing the supply of reserve balances would tighten the link between short-term market rates and the IOER rate. However, several participants noted that draining operations might be seen as a precursor to tightening and should be undertaken only when the Committee judged that an increase in its target for the federal funds rate would soon be appropriate. For the same reason, a few believed that it would be better to drain reserves concurrently with the eventual increase in the IOER and target rates.

With respect to longer-run approaches to implementing monetary policy, most policymakers saw benefits in continuing to use the federal funds rate as the operating target for implementing monetary policy, so long as other money market rates remained closely linked to the federal funds rate. Many thought that an approach in which the primary credit rate was set above the Committee's target for the federal funds rate and the IOER rate was set below that target—a corridor system—would be beneficial. Participants recognized, however, that the supply of reserve balances would need to be reduced considerably to lift the federal funds rate above the IOER rate. Participants noted that their judgments were tentative, that they would continue to discuss the ultimate operating regime, and that they might well gain useful information about longer-run approaches during the eventual withdrawal of policy accommodation.

Reverse Repurchase Agreements

At the January meeting, staff reported on successful tests of the Federal Reserve's ability to conduct term RRPs with primary dealers by arranging several small-scale transactions using Treasury securities and agency debt as collateral; staff anticipated that the Federal Reserve would be able to execute term RRPs against MBS later in the year and would have the capability to conduct RRPs with an expanded set of counterparties shortly thereafter. The staff updated the Committee on the status of work on RRPs at subsequent meetings.

Term Deposit Facility

In late December 2009, the *Federal Register* published a notice requesting the public's input on a proposal for a TDF. At the January FOMC meeting, Federal Reserve staff indicated that they would analyze comments from the public in the coming weeks and then prepare a final proposal for the Board's consideration. On April 30, the Federal Reserve Board announced that it had approved amendments to Regulation D (Reserve Requirements of Depository Institutions) authorizing the Reserve Banks to offer term deposits to institutions that are eligible to receive earnings on their balances at Reserve Banks. On May 10, the Federal Reserve Board authorized up to five small-value offerings of term deposits under the TDF, which were designed to ensure the effectiveness of TDF operations and to provide eligible institutions with an opportunity to gain familiarity with the procedures. The first of these offerings, for $1 billion in 14-day term deposits, was conducted on June 14. The auction had a stop-out rate of 27 basis points and a bid-to-cover ratio of slightly more than 6. The second offering, for $2 billion in 28-day deposits, was conducted on June 28. That auction had a stop-out rate of about 27 basis points and a bid-to-cover ratio of about 5½. The third, for $2 billion in 84-day term deposits, was conducted on July 12. That auction had a stop-out rate of 31 basis points and a bid-to-cover ratio of about 3¾.

Asset Redemptions and Sales

Over the course of the FOMC meetings conducted in the first half of 2010, participants discussed the eventual size and composition of the Federal Reserve's balance sheet and longer-run strategies for asset redemptions and sales. Participants agreed that any longer-run strategy for asset sales and redemptions should be consistent with the achievement of the Committee's objectives of maximum employment and price stability. Policymakers were also unanimous in the view that it will be appropriate to shrink the supply of reserve balances and the size of the Federal Reserve's balance sheet substantially over time. Moreover, they agreed that it will eventually be appropriate for the System Open Market Account to return its domestic holdings to only securities issued by the U.S. Treasury, as was the case before the financial crisis. Meeting participants also agreed that sales of agency debt and agency MBS should be implemented in accordance with a framework communicated well in advance and be conducted at a gradual pace that potentially could be adjusted in response to developments in economic and financial conditions.

Most participants favored deferring asset sales for some time, and a majority preferred beginning asset sales after the first increase in the FOMC's target for short-term interest rates. Such an approach would postpone any asset sales until the economic recovery was well established and would maintain short-term interest rates as the Committee's key monetary policy tool. Participants agreed that the current policy of redeeming and not replacing agency debt and agency MBS as those securities mature or are prepaid helped make progress toward the Committee's goals regarding the size and composition of the Federal Reserve's balance sheet. Many policymakers saw benefits to eventually adopting an approach of reinvesting maturing Treasury securities in bills and shorter-term coupon issues to shift the maturity composition of the Federal Reserve's portfolio toward the structure that had prevailed prior to the financial crisis. Several meeting participants thought the Federal Reserve should eventually hold a portfolio composed largely of shorter-term Treasury securities.

Participants expressed a range of views about the appropriate timing and pace of asset sales and redemptions, and Committee members did not reach final decisions about those issues over the course of the meetings in the first half of 2010. Participants agreed that it would be important to maintain flexibility regarding these issues given the uncertainties associated with the unprecedented size and composition of the Federal Reserve's balance sheet and its effects on financial conditions. For the time being, meeting participants agreed that the Federal Reserve should continue the interim approach of allowing all maturing agency debt and all prepayments of agency MBS to be redeemed without replacement while rolling over all maturing Treasury securities. At the June meeting, participants recognized that in light of the increased downside risks to an already gradual recovery from a deep recession, the Committee also needed to review its options for providing additional monetary stimulus should doing so become necessary. Participants will continue to consider the Committee's portfolio management strategy at future meetings.

Banking Supervision and Regulation

The Federal Reserve has supervisory and regulatory authority over a variety of financial institutions and activities with the goal of promoting a safe, sound, and stable banking and financial system that supports the growth and stability of the U.S. economy.

Overview

The Federal Reserve is the federal supervisor and regulator of all U.S. bank holding companies (BHCs), including financial holding companies and state-chartered commercial banks that are members of the Federal Reserve System. At the end of 2010, 2,193 banks were members of the Federal Reserve System and were operating 57,694 branches. These banks accounted for 34 percent of all commercial banks in the United States and for 71 percent of all commercial banking offices. In overseeing these organizations, the Federal Reserve seeks primarily to promote their safe and sound operation, including their compliance with laws and regulations.

The Federal Reserve also has responsibility for supervising the operations of all Edge Act and agreement corporations, the international operations of state member banks and U.S. BHCs, and the U.S. operations of foreign banking organizations. Furthermore, through the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the Federal Reserve has been assigned additional responsibilities for additional institutions, including systemically important nonbank financial firms and systemically important financial utilities. In addition, the act transfers authority for consolidated supervision of more than 400 savings and loan holding companies (SLHCs) and their non-depository subsidiaries from the Office of Thrift Supervision (OTS) to the Federal Reserve, effective July 21, 2011.

The Federal Reserve exercises important regulatory influence over entry into the U.S. banking system, and the structure of the system, through its administration of the Bank Holding Company Act, the Bank Merger Act (with regard to state member banks), the Change in Bank Control Act (with regard to BHCs and state member banks), and the International Banking Act. The Federal Reserve is also responsible for imposing margin requirements on securities transactions. In carrying out its responsibilities, the Federal Reserve coordinates supervisory activities with the other federal banking agencies, state agencies, functional regulators (that is, regulators for insurance, securities, and commodities firms), and foreign bank regulatory agencies.

This report highlights several topics relevant to the Federal Reserve's supervisory and regulatory activities in 2010:

- safety and soundness
- supervisory policy
- supervisory information technology
- staff development
- regulation of the U.S. banking structure
- enforcement of other laws and regulations

2010 Developments

During 2010, the U.S. banking system and financial markets improved further, continuing their recovery from the financial crisis that started in mid-2007.

Performance of bank holding companies. While a turnaround in BHC performance was evident during 2010, performance remains weak by historical standards, and the industry recovery could face challenges due to ongoing and elevated nonperforming asset levels. U.S. BHCs, in aggregate, reported earnings of $80.8 billion for the year ending December 31, 2010, compared to $12.9 billion for the full year 2009. Much of this improvement was due to lower loan loss provisioning and consequent reserve releases. The proportion of unprofitable BHCs, although down from 42 percent in 2009, remains high at 27 percent, which encompasses roughly 24 percent of industry assets. Nonperforming assets present a significant challenge to industry recovery, with the nonperforming asset ratio down only slightly to 4.1 percent of loans and foreclosed assets from 4.7 percent in 2009. Weaknesses were broad based, encompassing residential mortgages (first-lien), commercial real estate—especially non-owner nonfarm nonresidential and construction other than single-family—and commercial and industrial (C&I) loans. In 2010, an additional 73 BHCs that received funds from the U.S. Department of the Treasury's (Treasury) Troubled Asset Relief Program (TARP) repaid all funds received. As of year-end, 73 BHCs that received funds from Treasury's TARP repaid all funds received, and Treasury reports that approximately 82 percent of all distributed TARP's funds has been repaid.[1] (Also see "Bank Holding Companies" on page 76).

Performance of state member banks. Similar to BHCs, the turnaround at state member banks in 2010 was muted. As a group, state member banks reported a profit of $6.1 billion, up from aggregate losses totaling $4.6 billion in 2009, but low by historical norms. While earnings were up due largely to lower provisions ($17.7 billion versus $26.4 billion in 2009) and modest securities gains ($0.6 billion versus losses of $4.2 billion in 2009), almost a fifth of all state member banks continue to report losses. Mirroring trends at BHCs, the nonperforming assets ratio remained relatively unchanged at 4.3 percent of loans and foreclosed assets, reflecting both contracting loan balances and ongoing weaknesses in asset quality. Growth in problem loans slowed during 2010, but weakness encompassed nonfarm nonresidential lending, residential mortgages, and C&I loans. The number of foreclosed properties continued to increase, particularly those associated with construction and land development and one- to four-family residential lending. The risk-based capital ratios for state member banks improved during 2010 in the aggregate, and the percent of state member banks deemed well capitalized under prompt corrective action standards increased moderately to 97 percent from 95 percent at year-end 2009. In 2010, 18 state member banks with $8.5 billion in assets failed, with losses of $1.4 billion according to Federal Deposit Insurance Corporation (FDIC) estimates. (Also see "State Member Banks" on page 76.)

[1] The TARP statistics only include those BHCs that did not participate in the Supervisory Capital Assessment Program in 2009.

Impact of the Dodd-Frank Act. One of the most prominent events of 2010 was the passage of the Dodd-Frank Act. The Dodd-Frank Act closed a gap in the regulatory framework by subjecting designated systemically important nonbank financial institutions to prudential regulation and consolidated supervision and by providing a mechanism for orderly resolution in the event of the failure of such an institution. A key aspect the Dodd-Frank Act is a set of enhanced standards for all systemically important financial institutions. Other elements of the act included creation of a Financial Stability Oversight Council,[2] limits on certain types of proprietary trading, establishment of financial sector concentration limits, development of risk-retention requirements for securitizations, and improved oversight of over-the-counter (OTC) derivatives activity. In 2010, the Federal Reserve began the process of implementing elements of the Dodd-Frank Act through several proposed rulemakings (see "Capital Adequacy Standards" on page 83). For more detail on the impact of Dodd-Frank, see "Savings and Loan Holding Company Transfer" on page 77 and "Federal Legislative Developments" on page 144.

Capital adequacy. In addition, during 2010, the Federal Reserve was instrumental in augmenting standards related to capital adequacy of banking institutions. Federal Reserve staff worked proactively with the other federal banking agencies and with banking supervisors from other Basel Committee member countries to finalize a comprehensive and far-reaching reform package for internationally active banking organizations, issued in December 2010. This package aims to strengthen global capital and liquidity regulations, to be implemented in various stages in the coming years. In addition, the Federal Reserve worked with other U.S. banking agencies to issue for comment proposed rules to revise their market-risk capital rules, consistent with changes made at the Basel Committee level. Also, the Federal Reserve began implementing some of the provisions of the Dodd-Frank Act related to capital adequacy. (See "Supervisory Policy" on page 83.)

Other policy initiatives. Other key policy initiatives included guidelines for evaluating proposals by large BHCs to undertake capital actions in 2011. The guidelines outlined the criteria to be used by supervisors when evaluating any capital distribution proposal (see "Capital Adequacy Standards" on page 83). The Federal Reserve and other banking

[2] The Federal Reserve is a member of this newly formed council.

agencies also issued policy statements on underwriting standards for small business loans originated under the Treasury's Small Business Lending Fund (SBLF) Program. The agencies also issued guidelines for funding and liquidity risk management, appraisals, and incentive compensation. (See **box 1** and "Other Policy Issues" on page 90).

Bank examinations and inspections. In light of supervisory lessons learned, the Federal Reserve began augmenting its processes for conducting examinations and inspections as needed. A prominent example is the enhanced approach to supervision of the largest, most complex organizations that takes a macroprudential and multidisciplinary approach to

Box 1. Incentive Compensation

In June 2010, the Federal Reserve issued final supervisory guidance aimed at ensuring that incentive compensation arrangements at financial organizations take into account risk and are consistent with safe and sound practices (*Guidance on Sound Incentive Compensation Policies* at www.federalreserve.gov/newsevents/press/bcreg/20100621a.htm). Importantly, the other federal banking agencies—the Office of the Comptroller of the Currency, the OTS, and the FDIC—joined the Federal Reserve in adopting the guidance, ensuring that the principles embedded in the guidance will apply to all banking organizations regardless of their federal supervisor.

The interagency guidance is principles-based, recognizing that the methods used to achieve appropriately risk-sensitive compensation arrangements likely will differ significantly across and within organizations. Importantly, the interagency guidance is oriented to the risk-taking incentives created by incentive compensation arrangements and not the level or amount of incentive compensation. Because improperly structured compensation arrangements for both executive and non-executive employees may pose safety-and-soundness risks, the guidance applies not only to top-level managers, but also to other employees who have the ability to materially affect the risk profile of an organization, either individually or as part of a group.

The guidance adopted by the federal banking agencies is based on three key principles: (1) incentive compensation arrangements at a banking organization should provide employees incentives that appropriately balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risk; (2) these arrangements should be compatible with effective controls and risk management; and (3) these arrangements should be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. These principles, and the guidance more generally, are consistent with the Principles for Sound Compensation Practices issued in April 2009 by the Financial Stability Board and associated implementation standards.

The Board, in cooperation with other regulatory agencies, also conducted two supervisory initiatives designed to spur and monitor progress toward improved arrangements, identify emerging best practices, and advance the state of practice more generally in the industry. The first initiative, a horizontal review of incentive compensation practices at large complex banking organizations, will be completed in early 2011. This review has involved a multidisciplinary group of over 150 individuals, all of the banking agencies, and multiple project phases. Supervisory teams reviewed existing incentive compensation practices and related risk-management and corporate governance processes, evaluated plans and timetables for enhancements, and conducted more detailed reviews of a few specific business lines. Supervisors have observed and encouraged real, positive change in the incentive compensation practices of these banking organizations.

Additionally, the agencies incorporated oversight of incentive compensation arrangements into the regular examination process for smaller organizations. These reviews will be tailored to take account of the size, complexity, and other characteristics of these banking organizations.

Federal Reserve staff will prepare a report sometime after the conclusion of the 2010 bonus season, in consultation with the other federal banking agencies, on trends and developments in compensation practices at banking organizations. (For information on rulemaking/guidance required under the Dodd-Frank Act on incentive-based compensation, see "Changes to Banking Regulation and Supervision" in the "Federal Legislative Developments" chapter.)

supervision, making greater use of the broad range of skills of the Federal Reserve staff to promote financial stability. (Also see "Examinations and Inspections" below and **table 1**.)

Supervision

Safety and Soundness

To promote the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations and inspections, conducts off-site surveillance and monitoring, and takes enforcement and other supervisory actions as necessary. The Federal Reserve also provides training and technical assistance to foreign supervisors and minority-owned and de novo depository institutions.

Examinations and Inspections

The Federal Reserve conducts examinations of state member banks, the U.S. branches and agencies of foreign banks, and Edge Act and agreement corporations. In a process distinct from examinations, it conducts inspections of BHCs and their nonbank subsidiaries. Whether an examination or an inspection is being conducted, the review of operations entails

1. an evaluation of the adequacy of governance provided by the board and senior management, including an assessment of internal policies, procedures, controls, and operations;
2. an assessment of the quality of the risk-management and internal control processes in place to identify, measure, monitor, and control risks;
3. an assessment of the key financial factors of capital, asset quality, earnings, and liquidity; and
4. a review for compliance with applicable laws and regulations.

Table 1 provides information on examinations and inspections conducted by the Federal Reserve during the past five years.

The Federal Reserve uses a risk-focused approach to supervision, with activities directed toward identifying the areas of greatest risk to banking organizations and assessing the ability of the organizations'

Table 1. State Member Banks and Bank Holding Companies, 2006–2010

Entity/item	2010	2009	2008	2007	2006
State member banks					
Total number	829	845	862	878	901
Total assets (billions of dollars)	1,697	1,690	1,854	1,519	1,405
Number of examinations	912	850	717	694	761
By Federal Reserve System	722	655	486	479	500
By state banking agency	190	195	231	215	261
Top-tier bank holding companies					
Large (assets of more than $1 billion)					
Total number	482	488	485	459	448
Total assets (billions of dollars)	15,986	15,744	14,138	13,281	12,179
Number of inspections	677	658	519	492	566
By Federal Reserve System[1]	654	640	500	476	557
On site	491	501	445	438	500
Off site	163	139	55	38	57
By state banking agency	23	18	19	16	9
Small (assets of $1 billion or less)					
Total number	4,362	4,486	4,545	4,611	4,654
Total assets (billions of dollars)	991	1,018	1,008	974	947
Number of inspections	3,340	3,264	3,192	3,186	3,449
By Federal Reserve System	3,199	3,109	3,048	3,007	3,257
On site	167	169	107	120	112
Off site	3,032	2,940	2,941	2,887	3,145
By state banking agency	141	155	144	179	192
Financial holding companies					
Domestic	430	479	557	597	599
Foreign	43	46	45	43	44

[1] For large bank holding companies subject to continuous, risk-focused supervision, includes multiple targeted reviews.

management processes to identify, measure, monitor, and control those risks. Key aspects of the risk-focused approach to consolidated supervision of the largest institutions (see **box 2**) supervised by the Federal Reserve include

1. developing an understanding of each organization's legal and operating structure, and its primary strategies, business lines, and risk-management and internal control functions;
2. developing and executing a tailored supervisory plan that outlines the work required to maintain a comprehensive understanding and assessment of each institution, incorporating reliance to the fullest extent possible on assessments and information developed by other relevant domestic and foreign supervisors and functional regulators;
3. maintaining continual supervision of these organizations—including through meetings with banking organization management and analysis of internal and external information—so that the Federal Reserve's understanding and assessment of each organization's condition remains current;
4. assigning to each organization a supervisory team composed of Reserve Bank staff who have skills appropriate for the organization's risk profile; and

Box 2. Large Bank Supervision

The Dodd-Frank Act closed critical gaps in the regulatory framework by ensuring systemically important nonbank financial institutions would be subject to consolidated supervision and by providing a mechanism for orderly resolution in the event of the failure of such an institution. But, the crisis of 2008 also highlighted the critical importance of effective supervision of all systemically important institutions to reduce the potential for a destabilizing collapse of a troubled financial institution.

Well in advance of the passage of the Dodd-Frank Act, the Federal Reserve established an internal working group to enhance the effectiveness of the conduct of its supervisory activities. The working group, which comprised senior officials from the Board of Governors and the Reserve Banks, was charged with identifying key areas for improving supervision, as well as with laying out the actions necessary to effect those improvements. The working group identified needed improvements in each of three critical supervisory activities:

1. the identification of key risks and vulnerabilities;
2. the design and execution of the appropriate supervisory responses to these risks and concerns; and
3. effective communication from supervisors to institutions about the risks and vulnerabilities that have been identified and related remedial requirements.

In response, to improve risk identification of both safety-and-soundness issues at individual institutions and broader risks to the financial system, the Federal Reserve is incorporating a more macroprudential orientation. To enhance the design and execution of supervisory activities, such as horizontal examinations and stress tests, we are adopting a multidisciplinary approach supported by rigorous quantitative analysis. Further, to facilitate greater agility and effectiveness in our supervisory responses, our corporate governance for large bank supervision now involves more senior and centralized System expertise.

The structure and governance of large bank supervision has been reorganized to support these objectives. The Large Institution Supervision Coordinating Committee (LISCC) was established as a multidisciplinary group of senior Federal Reserve officials to provide strategic and policy direction for supervisory activities, to ensure that systemic risk concerns are fully integrated in supervisory planning, and to facilitate improved consistency and quality of supervision. Through the LISCC, an expansive breadth of expertise from within the Federal Reserve System—in the research divisions, markets group, and clearing and settlement functions— informs and complements the work of our supervisors. A multidisciplinary Operating Committee has been implemented to support the LISCC at the staff level. Like the LISCC, the Operating Committee incorporates participation from specialized skills from across the System in all phases of supervision for the most complex institutions.

Increased use of data-driven modeling and forecasting techniques, such as in the stress testing of low-probability, high-impact events, will allow supervisors to better anticipate and mitigate systemic risks. These tools are being used to assess potential risks and to support supervisors' assessment of an institution's internal capital assessment practices. Under this framework, the Federal Reserve will increase its use of horizontal examinations and scenario analysis, extend its focus to macroprudential issues, and increase cooperation with primary and functional supervisors.

5. promoting Systemwide and interagency information-sharing through automated systems and other mechanisms.

For other sized banking organizations, the risk-focused consolidated supervision program provides that examination and inspection procedures are tailored to each banking organization's size, complexity, risk profile, and condition. The supervisory program for an institution, regardless of its asset size, entails both off-site and on-site work, including development of supervisory plans, pre-examination visits, detailed documentation, and preparation of examination reports tailored to the scope and findings of the examination.

State Member Banks

At the end of 2010, 829 state-chartered banks (excluding nondepository trust companies and private banks) were members of the Federal Reserve System. These banks represented approximately 13 percent of all insured U.S. commercial banks and held approximately 14 percent of all insured commercial bank assets in the United States. The guidelines for Federal Reserve examinations of state member banks are fully consistent with section 10 of the Federal Deposit Insurance Act, as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994. A full-scope, on-site examination of these banks is required at least once a year, although certain well-capitalized, well-managed organizations having total assets of less than $500 million may be examined once every 18 months.[3] The Federal Reserve conducted 722 exams of state member banks in 2010.

Bank Holding Companies

At year-end 2010, a total of 5,464 U.S. BHCs were in operation, of which 4,844 were top-tier BHCs. These organizations controlled 5,443 insured commercial banks and held approximately 99 percent of all insured commercial bank assets in the United States. Federal Reserve guidelines call for annual inspections of large BHCs and complex smaller companies. In judging the financial condition of the subsidiary banks owned by holding companies, Federal Reserve examiners consult examination reports prepared by the federal and state banking authorities that have primary responsibility for the supervision of those banks, thereby minimizing duplication of effort and reducing the supervisory burden on banking organizations. Inspections of BHCs, including financial holding companies, are built around a rating system introduced in 2005. The system reflects the shift in supervisory practices away from a historical analysis of financial condition toward a more dynamic, forward-looking assessment of risk-management practices and financial factors. Under the system, known as RFI but more fully termed RFI/C(D), holding companies are assigned a composite rating (C) that is based on assessments of three components: Risk Management (R), Financial Condition (F), and the potential Impact (I) of the parent company and its nondepository subsidiaries on the subsidiary depository institution. The fourth component, Depository Institution (D), is intended to mirror the primary supervisor's rating of the subsidiary depository institution.[4] Noncomplex BHCs with consolidated assets of $1 billion or less are subject to a special supervisory program that permits a more flexible approach.[5] In 2010, the Federal Reserve conducted 654 inspections of large BHCs and 3,199 inspections of small, noncomplex BHCs.

Financial Holding Companies

Under the Gramm-Leach-Bliley Act, BHCs that meet certain capital, managerial, and other requirements may elect to become financial holding companies and thereby engage in a wider range of financial activities, including full-scope securities underwriting, merchant banking, and insurance underwriting and sales. As of year-end 2010, 430 domestic BHCs and 43 foreign banking organizations had financial holding company status. Of the domestic financial holding companies, 34 had consolidated assets of $15 billion or more; 101, between $1 billion and $15 billion; 68, between $500 million and $1 billion; and 227, less than $500 million.

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3 The Financial Services Regulatory Relief Act of 2006, which became effective in October 2006, authorized the federal banking agencies to raise the threshold from $250 million to $500 million, and final rules incorporating the change into existing regulations were issued on September 21, 2007.

4 Each of the first two components has four subcomponents: *Risk Management*— (1) Board and Senior Management Oversight; (2) Policies, Procedures, and Limits; (3) Risk Monitoring and Management Information Systems; and (4) Internal Controls. *Financial Condition*— (1) Capital, (2) Asset Quality, (3) Earnings, and (4) Liquidity.

5 The special supervisory program was implemented in 1997 and modified in 2002. See SR letter 02-01 for a discussion of the factors considered in determining whether a BHC is complex or noncomplex (www.federalreserve.gov/boarddocs/srletters/2002/sr0201.htm).

Box 3. Interagency Coordination of the Savings and Loan Holding Company Transfer

The Federal Reserve is engaged in a range of activities to implement the transfer of consolidated supervision of SLHCs from the OTS. Federal Reserve staff is working closely with the OTS, whose staff is providing valuable information, expertise, and consultation during this transition period. Additionally, the Federal Reserve is working with staff at the Office of the Comptroller of the Currency and the FDIC in light of the critical role that these primary federal regulators play in contributing to the Federal Reserve's knowledge of consolidated holding companies.

Savings and Loan Holding Company Transfer

The Dodd-Frank Act transfers authority for consolidated supervision of SLHCs and their nondepository subsidiaries from the OTS to the Federal Reserve, effective July 21, 2011. The overriding principles include securing an orderly transfer of information and knowledge (see **box 3**), ensuring that there are no gaps in holding company supervision, and providing the thrift industry with information on a flow basis so as to increase certainty and minimize unnecessary disruption during the transition period.

Any company that controls a depository institution should be held to appropriate prudential standards, including those for capital, liquidity, and risk management. As such, the Federal Reserve intends to create an oversight regime for thrift holding companies that is consistent with, and is as rigorous as, the supervisory regime applicable to BHCs. Consequently, the Federal Reserve intends, to the greatest extent possible, taking into account any unique characteristics of SLHCs and the requirements of the Home Owners' Loan Act (HOLA), to carry out supervisory oversight of SLHCs on a comprehensive consolidated basis, consistent with the established approach to BHC supervision.[6] To this end, Federal Reserve staff is reviewing all elements of its BHC supervision program to determine whether and how to incorporate SLHCs into the program, consistent with HOLA. The program includes

- understanding the structure of holding companies and material activities of these companies,
- evaluating risks posed by nonbanking activities in a holding company structure,
- imposing prudential standards on a consolidated basis, and
- assessing the consumer compliance risk profile for holding companies.

As the Federal Reserve develops plans for other aspects of the Dodd-Frank Act, it will extend these existing approaches to the supervisory programs for SLHCs, as appropriate.

The Dodd-Frank Act gives the Federal Reserve the authority to require grandfathered unitary SLHCs that conduct activities other than financial activities to establish an intermediate holding company over all, or a portion of, the financial activities. The Federal Reserve has established a working group to consider the issues associated with this authority and its potential advantages to effective supervision of such grandfathered companies. The Federal Reserve will implement this authority only after a proposed rule has been published for notice and public comment.

The Federal Reserve anticipates that all regulations, as appropriate, relating to (1) supervision of SLHCs and nondepository institution subsidiaries of SLHCs; (2) transactions with affiliates; (3) extensions of credit to executive officers, directors, and principal shareholders; and (4) tying arrangements will continue and will be enforceable by the appropriate agency. A working group is conducting an analysis of OTS and Federal Reserve regulations and guidance documents to determine policy or technical differences and to assess whether there are any gaps. The Federal Reserve will decide which OTS regulations should be amended after the transfer date, in conjunction with a broad assessment of the holding company standards to be applied to SLHCs and other policy considerations. The Federal Reserve will make changes, when necessary, to any transferred OTS regulations after public notice and opportunity for comment.

The Federal Reserve and the OTS are engaged in detailed discussions on the range of operational issues that they need to address during the transition period. In addition to detailed briefings on legal and regulatory issues, the OTS staff has provided information on its holding company program and on current supervisory issues. The agencies signed a memorandum of understanding (MOU) to facilitate the sharing of confidential supervisory information dur-

[6] See SR letter 08-9/CA 08-12, which sets forth the holding company supervision, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations" (www.federalreserve.gov/boarddocs/srletters/2008/SR0809.htm).

ing the transition. This will allow the Federal Reserve to become familiar with the condition of each SLHC coming under its jurisdiction and to identify resource requirements needed on the transfer date. The Federal Reserve will integrate SLHCs into its existing programs that align institutions with institutional portfolios based on their size and complexity. For instance, smaller, noncomplex SLHCs will be supervised in the Community Banking Organization portfolio while larger, more complex SLHCs will be supervised in the Regional or Large Banking Organization portfolios. The Federal Reserve Board has assigned each SLHC to a responsible Reserve Bank.[7] To facilitate the transition process, and pursuant to the MOU, examiners from the Federal Reserve are joining certain OTS examinations prior to the transfer date to gather information and learn about the OTS supervisory process. Discussions are well under way about the orderly transition of the caseload from the OTS to the Reserve Banks.

International Activities

The Federal Reserve supervises the foreign branches and overseas investments of member banks, Edge Act and agreement corporations, and BHCs (including the investments by BHCs in export trading companies). In addition, it supervises the activities that foreign banking organizations conduct through entities in the United States, including branches, agencies, representative offices, and subsidiaries.

Foreign Operations of U.S. Banking Organizations

In supervising the international operations of state member banks, Edge Act and agreement corporations, and BHCs, the Federal Reserve generally conducts its examinations or inspections at the U.S. head offices of these organizations, where the ultimate responsibility for the foreign offices lies. Examiners also visit the overseas offices of U.S. banks to obtain financial and operating information and, in some instances, to test their adherence to safe and sound banking practices and compliance with rules and regulations or to evaluate an organization's efforts to implement corrective measures. Examinations abroad are conducted with the cooperation of the supervisory authorities of the countries in which they take place; for national banks, the examinations are coordinated with the Office of the Comptroller of the Currency (OCC). At the end of 2010, 53 member banks were operating 567 branches in foreign countries and overseas areas of the United States; 31 national banks were operating 508 of these branches, and 22 state member banks were operating the remaining 59. In addition, 18 nonmember banks were operating 26 branches in foreign countries and overseas areas of the United States.

Edge Act and Agreement Corporations

Edge Act corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international business, especially exports. Agreement corporations are similar organizations, state chartered or federally chartered, that enter into agreements with the Board to refrain from exercising any power that is not permissible for an Edge Act corporation. Sections 25 and 25A of the Federal Reserve Act grant Edge Act and agreement corporations permission to engage in international banking and foreign financial transactions. These corporations, most of which are subsidiaries of member banks, may (1) conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions, and (2) make foreign investments that are broader than those permissible for member banks. At year-end 2010, 51 banking organizations, operating 10 branches, were chartered as Edge Act or agreement corporations. These corporations are examined annually.

U.S. Activities of Foreign Banks

The Federal Reserve has broad authority to supervise and regulate the U.S. activities of foreign banks that engage in banking and related activities in the United States through branches, agencies, representative offices, commercial lending companies, Edge Act corporations, commercial banks, BHCs, and certain nonbanking companies. Foreign banks continue to be significant participants in the U.S. banking system. As of year-end 2010, 173 foreign banks from 52 countries operated 205 state-licensed branches and agencies, of which six were insured by the FDIC, and 50 OCC-licensed branches and agencies, of which four were insured by the FDIC. These foreign banks also owned eight Edge Act and agreement corporations and two commercial lending companies. In addition, they held a controlling interest in 55 U.S. commercial banks. Altogether, the U.S. offices of these foreign banks at the end of 2010 controlled approximately 17 percent of U.S. commercial banking assets. These 173 foreign banks also operated 92 representative offices; an additional 54 foreign banks

7 See SR letter 05-27/CA letter 05-11, "Responsible Reserve Bank and Inter-District Coordination," (www.federalreserve.gov/boarddocs/srletters/2005/SR0527.htm).

operated in the United States through a representative office.

State-licensed and federally licensed branches and agencies of foreign banks are examined on-site at least once every 18 months, either by the Federal Reserve or by a state or other federal regulator. In most cases, on-site examinations are conducted at least once every 12 months, but the period may be extended to 18 months if the branch or agency meets certain criteria.

In cooperation with the other federal and state banking agencies, the Federal Reserve conducts a joint program for supervising the U.S. operations of foreign banking organizations. The program has two main parts. One part involves examination of those foreign banking organizations that have multiple U.S. operations and is intended to ensure coordination among the various U.S. supervisory agencies. The other part is a review of the financial and operational profile of each organization to assess its general ability to support its U.S. operations and to determine what risks, if any, the organization poses through its U.S. operations. Together, these two processes provide critical information to U.S. supervisors in a logical, uniform, and timely manner. The Federal Reserve conducted or participated with state and federal regulatory authorities in 465 examinations in 2010.

Compliance with Regulatory Requirements

The Federal Reserve examines institutions for compliance with a broad range of legal requirements, including anti-money-laundering (AML) and consumer protection laws and regulations, and other laws pertaining to certain banking and financial activities. Most compliance supervision is conducted under the oversight of the Board's Division of Banking Supervision and Regulation, but consumer compliance supervision is conducted under the oversight of the Division of Community and Consumer Affairs. The two divisions coordinate their efforts with each other and also with the Board's Legal Division to ensure consistent and comprehensive Federal Reserve supervision for compliance with legal requirements.

Anti-Money-Laundering Examinations

The Treasury regulations implementing the Bank Secrecy Act (BSA) generally require banks and other types of financial institutions to file certain reports and maintain certain records that are useful in criminal, tax, or regulatory proceedings. The BSA and separate Board regulations require banking organizations supervised by the Board to file reports on suspicious activity related to possible violations of federal law, including money laundering, terrorism financing, and other financial crimes. In addition, BSA and Board regulations require that banks develop written BSA compliance programs and that the programs be formally approved by bank boards of directors. The Federal Reserve is responsible for examining institutions for compliance with applicable AML laws and regulations and conducts such examinations in accordance with the Federal Financial Institutions Examination Council (FFIEC) *Bank Secrecy Act/Anti-Money Laundering Examination Manual*.[8]

Specialized Examinations

The Federal Reserve conducts specialized examinations of banking organizations in the areas of information technology, fiduciary activities, transfer agent activities, and government and municipal securities dealing and brokering. The Federal Reserve also conducts specialized examinations of certain nonbank entities that extend credit subject to the Board's margin regulations.

Information Technology Activities

In recognition of the importance of information technology to safe and sound operations in the financial industry, the Federal Reserve reviews the information technology activities of supervised banking organizations as well as certain independent data centers that provide information technology services to these organizations. All safety-and-soundness examinations include a risk-focused review of information technology risk-management activities. During 2010, the Federal Reserve continued as the lead agency in four interagency examinations of large, multiregional data processing servicers, and it assumed leadership in one additional examination late in the year.

Fiduciary Activities

The Federal Reserve has supervisory responsibility for state member banks and state member nondepository trust companies that reported $53.1 trillion and $36.5 trillion of assets, respectively, as of year-end 2010. These assets were held in various fiduciary

[8] The FFIEC is an interagency body of financial regulatory agencies established to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the OCC, the OTS, and the chair of the State Liaison Committee.

and custodial capacities. On-site examinations of fiduciary and custodial activities are risk-focused and entail the review of an organization's compliance with laws, regulations, and general fiduciary principles, including effective management of conflicts of interest; management of legal, operational, and reputational risk exposures; and audit and control procedures. In 2010, Federal Reserve examiners conducted 111 on-site fiduciary examinations, excluding transfer agent examinations, of state member banks.

Transfer Agents

As directed by the Securities Exchange Act of 1934, the Federal Reserve conducts specialized examinations of those state member banks and BHCs that are registered with the Board as transfer agents. Among other things, transfer agents countersign and monitor the issuance of securities, register the transfer of securities, and exchange or convert securities. On-site examinations focus on the effectiveness of an organization's operations and its compliance with relevant securities regulations. During 2010, the Federal Reserve conducted on-site transfer agent examinations at seven of the 38 state member banks and BHCs that were registered as transfer agents.

Government and Municipal Securities Dealers and Brokers

The Federal Reserve is responsible for examining state member banks and foreign banks for compliance with the Government Securities Act of 1986 and with the Treasury regulations governing dealing and brokering in government securities. Twelve state member banks and six state branches of foreign banks have notified the Board that they are government securities dealers or brokers not exempt from the Treasury's regulations. During 2010, the Federal Reserve conducted six examinations of broker–dealer activities in government securities at these organizations. These examinations are generally conducted concurrently with the Federal Reserve's examination of the state member bank or branch.

The Federal Reserve is also responsible for ensuring that state member banks and BHCs that act as municipal securities dealers comply with the Securities Act Amendments of 1975. Municipal securities dealers are examined, pursuant to the Municipal Securities Rulemaking Board's rule G-16, at least once every two calendar years. Of the 10 entities that dealt in municipal securities during 2010, seven were examined during the year.

Securities Credit Lenders

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchase or carrying of securities. As part of its general examination program, the Federal Reserve examines the banks under its jurisdiction for compliance with Board Regulation U (Credit by Banks and Persons other than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock). In addition, the Federal Reserve maintains a registry of persons other than banks, brokers, and dealers who extend credit subject to Regulation U. The Federal Reserve may conduct specialized examinations of these lenders if they are not already subject to supervision by the Farm Credit Administration (FCA) or the National Credit Union Administration (NCUA).

At the end of 2010, 531 lenders other than banks, brokers, or dealers were registered with the Federal Reserve. Other federal regulators supervised 178 of these lenders, and the remaining 353 were subject to limited Federal Reserve supervision. The Federal Reserve exempted 153 lenders from its on-site inspection program on the basis of their regulatory status and annual reports. Thirty-four inspections were conducted during the year.

Enforcement Actions

The Federal Reserve has enforcement authority over the banking organizations it supervises and their affiliated parties. Enforcement actions may be taken to address unsafe and unsound practices or violations of any law or regulation. Formal enforcement actions include cease-and-desist orders, written agreements, prompt corrective action directives, removal and prohibition orders, and civil money penalties. In 2010, the Federal Reserve completed 264 formal enforcement actions. Civil money penalties totaling $33,010 were assessed. As directed by statute, all civil money penalties are remitted to either the Treasury or the Federal Emergency Management Agency. Enforcement orders and prompt corrective action directives, which are issued by the Board, and written agreements, which are executed by the Reserve Banks, are made public and are posted on the Board's website (www.federalreserve.gov/apps/enforcementactions/).

In addition to taking these formal enforcement actions, the Reserve Banks completed 639 informal enforcement actions in 2010. Informal enforcement actions include MOU and board of directors resolutions. Information about these actions is not available to the public.

Surveillance and Off-Site Monitoring

The Federal Reserve uses automated screening systems to monitor the financial condition and performance of state member banks and BHCs in the period between on-site examinations. Such monitoring and analysis helps direct examination resources to institutions that have higher-risk profiles. Screening systems also assist in the planning of examinations by identifying companies that are engaging in new or complex activities.

The primary off-site monitoring tool used by the Federal Reserve is the Supervision and Regulation Statistical Assessment of Bank Risk model (SR-SABR). Drawing mainly on the financial data that banks report on their Reports of Condition and Income (Call Reports), SR-SABR uses econometric techniques to identify banks that report financial characteristics weaker than those of other banks assigned similar supervisory ratings. To supplement the SR-SABR screening, the Federal Reserve also monitors various market data, including equity prices, debt spreads, agency ratings, and measures of expected default frequency, to gauge market perceptions of the risk in banking organizations. In addition, the Federal Reserve prepares quarterly Bank Holding Company Performance Reports (BHCPRs) for use in monitoring and inspecting supervised banking organizations. The BHCPRs, which are compiled from data provided by large BHCs in quarterly regulatory reports (FR Y-9C and FR Y-9LP), contain, for individual companies, financial statistics and comparisons with peer companies. BHCPRs are made available to the public on the National Information Center (NIC) website, which can be accessed at www.ffiec.gov.

Federal Reserve analysts use Performance Report Information and Surveillance Monitoring (PRISM), a querying tool, to access and display financial, surveillance, and examination data. In the analytical module, users can customize the presentation of institutional financial information drawn from Call Reports, Uniform Bank Performance Reports, FR Y-9 statements, BHCPRs, and other regulatory reports. In the surveillance module, users can generate reports summarizing the results of surveillance screening for banks and BHCs. During 2010, four major upgrades to the web-based PRISM application were completed.

The Federal Reserve works through the FFIEC Task Force on Surveillance Systems to coordinate surveillance activities with the other federal banking agencies.

Training and Technical Assistance

The Federal Reserve provides training and technical assistance to foreign supervisors and minority-owned and de novo depository institutions.

International Training and Technical Assistance

In 2010, the Federal Reserve continued to provide technical assistance on bank supervisory matters to foreign central banks and supervisory authorities. Technical assistance involves visits by Federal Reserve staff members to foreign authorities as well as consultations with foreign supervisors who visit the Board or the Reserve Banks. The Federal Reserve, along with the OCC, the FDIC, and the Treasury, was an active participant in the Middle East and North Africa Financial Regulators' Training Initiative, which is part of the U.S. government's Middle East Partnership Initiative. The Federal Reserve also contributes to the regional training provision under the Asia Pacific Economic Cooperation Financial Regulators' Training Initiative.

In 2010, the Federal Reserve offered a number of training courses exclusively for foreign supervisory authorities, both in the United States and in a number of foreign jurisdictions. Federal Reserve staff also took part in technical assistance and training missions led by the International Monetary Fund (IMF), the World Bank, the Asian Development Bank, the Basel Committee on Banking Supervision (Basel Committee), and the Financial Stability Institute.

The Federal Reserve is also an associate member of the Association of Supervisors of Banks of the Americas (ASBA), an umbrella group of bank supervisors from countries in the Western Hemisphere. The group, headquartered in Mexico,

- promotes communication and cooperation among bank supervisors in the region;
- coordinates training programs throughout the region with the help of national banking supervisors and international agencies; and

- aims to help members develop banking laws, regulations, and supervisory practices that conform to international best practices.

The Federal Reserve contributes significantly to ASBA's organizational management and to its training and technical assistance activities.

Initiatives for Minority-Owned and De Novo Depository Institutions

The Partnership for Progress program is a Federal Reserve System program created to preserve and promote minority-owned, woman-owned, and de novo depository institutions (MBOs). Launched in 2008, the program seeks to help these institutions compete effectively in today's marketplace by offering them a combination of one-on-one guidance and targeted workshops on topics of particular relevance in terms of starting and growing a bank in a safe and sound manner. In addition, training and information on resources are provided through an extensive public website (www.fedpartnership.gov). Designated Partnership for Progress coordinators serve as local program contacts in each of the 12 Reserve Bank Districts and at the Board to answer questions and coordinate assistance for institutions requesting guidance.

The Board Oversight Committee is committed to further enhancing support for MBOs who are facing increasing marketplace challenges, as many operate in some of the hardest hit regions and are adversely impacted by the recent recession and sluggish economic recovery. The Board also appointed a new national coordinator to lead the program. The program district coordinators and the Board Oversight Committee will conduct two program conferences annually to discuss the program activities, meet with MBO bankers and industry experts, and report/coordinate the program Systemwide initiatives.

During 2010, the Federal Reserve hosted a variety of workshops and seminars including

- an information session for Federal Reserve examination staff on the condition of minority banks and the application of the Partnership for Progress program;
- a series of seven seminars on Community Development Financial Institutions (CDFI) programs and Small Business Lending programs;
- a workshop on Financial Intelligence for Developing Executives to increase expertise in analyzing financial data and performance metrics;
- presentations on the New Markets Tax Credits Program (NMTC) at the National Interagency Community Reinvestment Conference in New Orleans, in partnership with the CDFI Fund;
- a presentation on NMTCs at the National Bankers Association Legislative Regulatory Conference; and
- a series of advanced NMTC webinars as part of a collaborative interagency effort.

The seminars on the NMTC and CDFI programs helped minority bankers to better understand how these programs can be used as a source of funding. Along with the FDIC, OCC, and OTS, the Federal Reserve sponsored the NMTC guidance program.

The Federal Reserve participated in the FDIC Investor Series to share information with minority bankers and investors interested in purchasing bank assets or starting banks.[9] The Federal Reserve also participated in the National Bankers Association (NBA) Annual Convention to discuss priorities for the NBA and minority banks during 2011 and possible program initiatives to improve support for minority banks.

Additionally, the Federal Reserve coordinates its efforts with those of the other agencies through participation in an annual interagency conference for minority depository institutions. For the federal bank regulatory agencies, the conference provides an opportunity to meet with senior managers from minority-owned institutions and gain a better understanding of the institutions' unique challenges and opportunities. Finally, the agencies offer training classes and sessions on emerging banking issues.

Business Continuity/Pandemic Preparedness

In 2010, the Federal Reserve continued its efforts to strengthen the resilience of the U.S. financial system in the event of unexpected disruptions, including focused supervisory efforts to evaluate the resiliency of the banking institutions under its jurisdiction. The Federal Reserve revised, jointly with other regulatory agencies, its analysis of firms subject to the *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System* (Sound Practices paper).[10] Subsequently, the Federal Reserve notified firms with business lines falling within the

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[9] The FDIC Investor Series was held at events in Atlanta, Harlem, Houston, Los Angeles, Miami, and San Francisco.

[10] The population under review included core clearing and settlement organizations and firms that play a critical role in financial

parameters of the Sound Practices paper of the resiliency requirements and began meeting with those firms to assess their implementation plans and timeframes for implementation.

The Federal Reserve, together with other federal and state financial regulators, is a member of the Financial Banking Information Infrastructure Committee (FBIIC), which was formed to improve coordination and communication among financial regulators, enhance the resiliency of the financial services sector of U.S. critical infrastructures and key resources, and promote the public/private partnership. The FBIIC has established emergency communication protocols to maintain effective communication among members in the event of an emergency. The members of the FBIIC will convene by conference call no later than 90 minutes following the first public report of an event to share situational and operational status reports. As a member of FBIIC, the Federal Reserve is then responsible for establishing and maintaining communication with the institutions for which they have primary supervisory authority and for ensuring coordination between public affairs and media relations staff.

Supervisory Policy

The Federal Reserve's supervisory policy function, carried out by the Board, is responsible for developing guidance for examiners and banking organizations as well as regulations for banking organizations under the Federal Reserve's supervision. The Board, often in conjunction with the other federal banking agencies, issues rulemakings, public SR letters, and other policy statements and guidance in order to carry out its supervisory policy function. Federal Reserve staff also participate in supervisory and regulatory forums, provide support for the work of the FFIEC, and participate in international forums such as the Basel Committee, the Financial Stability Board, the Joint Forum, and the International Accounting Standards Board.

Capital Adequacy Standards

In 2010, the Board issued several rulemakings and guidance documents related to capital adequacy standards, including several joint proposed rulemakings with the other federal banking agencies to address provisions of the Dodd-Frank Act.

- In response to the Dodd-Frank Act's requirement to remove references to, or requirements of reliance on, the use of credit ratings in federal regulations, the federal banking agencies issued an advanced notice of proposed rulemaking (ANPR) seeking comment on alternatives to the use of credit ratings in the risk-based capital rules. The ANPR (1) describes how the agencies' risk-based capital standards currently reference ratings; (2) sets forth the factors the agencies will consider in assessing potential alternatives to the use of credit ratings; and (3) describes briefly, and requests comment on, potential alternatives to the use of credit ratings. The ANPR is available at www.gpo.gov/fdsys/pkg/FR-2010-08-25/pdf/2010-21051.pdf.
- The federal banking agencies issued for comment a notice of proposed rulemaking (NPR) to amend the advanced approaches capital adequacy framework, consistent with certain provisions of the Dodd-Frank Act. The proposed rule would require a banking organization operating under the advanced approaches framework to meet, on an ongoing basis, the higher of the generally applicable and the advanced approaches minimum risk-based capital standards. The NPR is available at http://edocket.access.gpo.gov/2010/pdf/2010-32190.pdf.
- In order to implement certain market risk-related changes to the Basel Accord, the Board, the OCC, and the FDIC issued for comment an NPR to revise their market-risk capital rules. The proposed revisions would (1) better capture positions for which the market-risk capital rules are appropriate, (2) reduce procyclicality in market-risk capital requirements, (3) enhance the rules' sensitivity to risks that are not adequately captured by the current regulatory measurement methodologies, and (4) increase market discipline through enhanced disclosures. The NPR is available at http://edocket.access.gpo.gov/2011/pdf/2010-32189.pdf.
- The federal banking agencies issued a statement clarifying the risk weight for claims on, or guaranteed by, the FDIC. The statement is available at www.federalreserve.gov/boarddocs/srletters/2010/sr1004a1.pdf.
- The Federal Reserve issued guidelines for evaluating proposals by large BHCs to undertake capital actions in 2011 in a revised temporary addendum to SR letter 09-4, "Dividend Increases and Other Capital Distributions for the 19 Supervisory Capital Assessment Program Firms." The guidelines

markets and are subject to resiliency guidelines issued in April 2003 (www.federalreserve.gov/boarddocs/srletters/2003/sr0309.htm).

state that any capital distribution proposal will be evaluated on the basis of a number of criteria including, for example, the firm's ability to absorb losses over the next two years under several scenarios, the firm's plans to meet Basel III capital requirements, and the firm's plans to repay U.S. government investments, if applicable. The guidelines are available at www.federalreserve.gov/boarddocs/srletters/2009/SR0904_Addendum.pdf.

In 2010, Board and Reserve Bank staff conducted supervisory analyses of a number of complex capital issuances, private capital investments, and novel transactions to determine their qualification for inclusion in regulatory capital and consistency with safety and soundness. For certain transactions, staff required banking organizations to make changes necessary for instruments to satisfy these criteria.

Board staff participated in making determinations regarding tier 1 qualification of capital issuances arising from the review of applications for private capital investments in banking organizations, including banking organizations in severely impaired condition. The focus of these analyses is compliance with the Board's capital standards for inclusion in tier 1 capital, as well as consistency with safety and soundness to ensure that the terms of such private investments do not (1) impede prudent action by issuing banking organizations to address financial problems or (2) impair the Federal Reserve's ability to take appropriate supervisory action.

Board staff also continued in 2010 to work closely with the Treasury and the other federal banking agencies in making determinations related to the tier 1 capital eligibility of capital instruments issued to Treasury under the Community Development Financial Institutions Program and securities issued to the Small Business Lending Fund, initiated by Congress in 2010.

International Guidance on Supervisory Policies

As a member of the Basel Committee, the Federal Reserve participates in efforts to advance sound supervisory policies for internationally active banking organizations and improve the stability of the international banking system. (See **box 4** for a list of Basel Committee publications on risk-management practices.)

Basel III

During 2010, Federal Reserve staff worked proactively with the other federal banking agencies and with banking supervisors from Basel Committee member countries to finalize a comprehensive and far-reaching reform package for internationally active banking organizations. On December 16, 2010, the Basel Committee issued "Basel III: A global regulatory framework for more resilient banks and banking systems," with the overarching goal of increasing the resiliency of the banking system by strengthening global capital and liquidity regulations. International implementation of Basel III is scheduled to begin January 1, 2013, and certain aspects are subject to transitional arrangements.

Basel III increases the quantity and quality of the regulatory capital base in several ways. Importantly, it establishes a new minimum common equity tier 1 to risk-weighted assets ratio of 4.5 percent. This is the first time that the risk-based capital framework will include an explicit capital standard based on tangible common equity, which is the highest form of capital. To instill market confidence in the regulatory capital framework, common equity tier 1 is subject to strict eligibility criteria, and regulatory deductions from capital are taken from common equity tier 1. Regulatory deductions include deferred tax assets associated with net operating losses, all intangible assets (except mortgage servicing rights), and defined benefit pension fund assets to which the banking organization does not have unfettered and unrestricted access. Mortgage servicing rights, deferred tax assets associated with timing differences, and sig-

Box 4. Risk Management

The Federal Reserve contributed to supervisory policy papers, reports, and recommendations issued by the Basel Committee during 2010 and aimed at improving the supervision of banking organizations' risk-management practices. Publications during 2010 included

- *Sound practices for back testing counterparty credit risk models* (final document, issued in December at www.bis.org/publ/bcbs185.htm);
- *Report and recommendations of the Cross-border Bank Resolution Group* (final document, issued in March at www.bis.org/publ/bcbs169.htm);
- *Operational risk–supervisory guidelines for the Advanced Measurement Approaches* (consultative paper, issued in December at www.bis.org/publ/bcbs184.htm); and
- *Range of methodologies for risk and performance alignment of remuneration* (consultative paper, issued in October at www.bis.org/publ/bcbs178.htm).

nificant investments in unconsolidated financial firms are subject to a strict individual and aggregate limit of 10 percent and 15 percent of common equity tier 1, respectively; amounts above these limits must be deducted from common equity tier 1.

Basel III tightens the criteria for tier 1 eligibility to ensure that all tier 1 capital can absorb losses on a going concern basis—those instruments that no longer qualify as tier 1 capital will be phased-out over an agreed-upon timeframe and either included in tier 2 capital or fully excluded from regulatory capital. Instruments that no longer qualify as tier 2 capital will be phased-out from regulatory capital. Under Basel III, the minimum tier 1 to risk-weighted assets ratio is increased from 4 percent to 6 percent, while the total capital to risk-weighted assets ratio remains at 8 percent.

Basel III introduces a series of measures to promote the buildup of capital buffers in good times that can be drawn upon in periods of stress. It requires banking organizations to hold a capital conservation buffer composed of common equity tier 1 above the regulatory minimum levels. The capital conservation buffer is calibrated at 2.5 percent of risk-weighted assets to enable banking organizations to maintain capital levels above the minimum requirements throughout a significant sector-wide downturn. Under Basel III, banking organizations that fail to maintain this 2.5 percent capital conservation buffer will face mandatory regulatory restrictions on the percentage of earnings that they can pay out in the form of capital distributions or employee discretionary bonus payments. Together, the minimum capital requirements plus the capital conservation buffer translate into 7 percent common equity tier 1, 8.5 percent tier 1, and 10.5 percent total capital to risk-weighted assets ratio requirements.

Subject to national discretion, Basel III also introduces a countercyclical capital buffer that fluctuates between 0 and 2.5 percent of risk-weighted assets that could be triggered when a relevant measure indicative of steep credit expansion hits a specified threshold. The countercyclical buffer would effectively work as an extension of the capital conservation buffer and should contribute to a more stable banking system by helping to dampen economic and financial shocks.

Moreover, Basel III strengthens capital requirements for counterparty credit-risk exposures arising from banking organizations' derivatives and securities financing activities. The reforms also provide market participants with incentives to move OTC derivative contracts to central counterparties, helping reduce systemic risk across the financial system.

Basel III introduces an international leverage ratio designed to contain the buildup of excessive on- and off-balance-sheet leverage in the banking system and to safeguard against attempts to arbitrage the risk-based capital requirements. The leverage ratio will be subject to a parallel run period, during which the Basel Committee will test a minimum tier 1 to quarterly average on- and off-balance-sheet assets ratio of 3 percent. U.S. banking organizations have long been subject to a simple leverage ratio, but most banks outside the United States have not. Adoption of an international leverage ratio should help to put U.S. banking organizations on a more level playing field with their foreign bank peers.

Basel III adopts a global minimum liquidity standard for internationally active banking organizations that includes a 30-day liquidity coverage ratio requirement underpinned by a longer-term structural liquidity ratio (the net stable funding ratio). The liquidity coverage ratio promotes short-term resiliency by ensuring that banking organizations have sufficient high-quality liquid assets to survive an acute stress scenario lasting for one month, whereas the net stable funding ratio was designed to capture structural liquidity mismatches and to promote resiliency over a longer-term horizon. The framework also includes a common set of monitoring metrics to assist supervisors in identifying and analyzing liquidity risk trends at both the banking organization and systemwide levels.

The Board, along with the other federal banking agencies, expects to issue during 2011 an interagency NPR describing how the agencies intend to implement Basel III in the United States, followed by an interagency final rule in 2012.

Joint Forum

In 2010, the Federal Reserve continued to participate in the Joint Forum—an international group of supervisors of the banking, securities, and insurance industries established to address varied issues crossing the traditional borders of these sectors, including the regulation of financial conglomerates. The Joint Forum operates under the aegis of the Basel Committee, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. National supervisors of these three sectors, who are members of the Joint Forum's founding organizations, work together to carry out the responsibilities of the Joint Forum.

The Joint Forum, through its founding organizations, issued a report in 2010 that reviewed developments in modeling risk aggregation and suggested improvements to the current modeling techniques used by complex firms to aggregate risks. During the year, the Federal Reserve also contributed to Joint Forum projects that will result in the issuance of reports or papers in the near future.

Financial Sector Assessment Program

Beginning in 2009 and extending into 2010, the Federal Reserve and other banking agencies underwent a Financial Sector Assessment Program (FSAP) review. The FSAP is a joint IMF and World Bank program designed to promote national and international financial stability and growth and to help strengthen the financial systems of member countries. The IMF views the FSAP as an integral part of their national assessments.

The Division of Banking Supervision and Regulation led an interagency effort to prepare for, and respond to, the IMF's assessment of the effectiveness of U.S. banking supervision. As part of this review, the Federal Reserve and other federal banking agencies jointly prepared a self assessment against the Basel Core Principles for Effective Banking Supervision (BCPs). For each principle and associated criteria, the self assessment includes a summary of applicable legal and regulatory provisions and a description of how the principles are put into practice, with specific citations regarding procedures. The U.S. BCP self assessment was made public in August of 2009 on Treasury's website (www.treasury.gov).

Based on the self assessment and several weeks of on-site work, the IMF concluded that the U.S. banking agencies were compliant with 96 percent of the BCPs, which are effectively best practices for banking supervision. The IMF's recommendations for improvement incorporated a number of initiatives already in process, including conducting stress tests; joining international efforts to initiate supervisory colleges for large, globally active U.S. banks; and directing large banks to improve their ability to aggregate risks across legal entities and product lines to identify risk concentrations and correlations.

Accounting Policy

The Federal Reserve strongly endorses sound corporate governance and effective accounting and auditing practices for all regulated financial institutions. Accordingly, the Federal Reserve's supervisory policy function is responsible for monitoring major domestic and international proposals, standards, and other developments affecting the banking industry in the areas of accounting, auditing, internal controls over financial reporting, financial disclosure, and supervisory financial reporting.

Federal Reserve staff interact with key constituents in the accounting and auditing professions, including standard-setters, accounting firms, the financial services industry, accounting and financial sector trade groups, and other financial sector regulators. The Federal Reserve also participates in the Basel Committee's Accounting Task Force, which represents the Basel Committee at international meetings on accounting, auditing, and disclosure issues affecting global banking organizations. These efforts help inform our understanding of current domestic and international practices and proposed standards and our formulation of policy positions based on the potential impact of changes in standards or guidance (or other events) on the financial sector. As a consequence, Federal Reserve staff routinely provide informal input to standard-setters, as well as formal input through public comment letters on proposals, to ensure appropriate and transparent financial statement reporting.

During 2010, addressing challenges related to financial sector accounting and reporting remained a priority for Federal Reserve staff. Issues during the year included fair value accounting, accounting for impairment in securities and other financial instruments, and accounting for asset securitizations and other off-balance-sheet items. As discussed below, to address these and other issues, the Federal Reserve participated in activities arising from general market conditions and in support of efforts related to financial stability.

Federal Reserve staff participated in a number of discussions with accounting and auditing standard-setters. In response to requests for comment, staff

- provided comment letters to the Financial Accounting Standards Board (FASB) on proposals related to the accounting for financial instruments, derivative instruments, hedging activities, troubled debt restructurings, and leases; and

- provided a comment letter on the International Accounting Standards Board's (IASB's) financial instrument impairment proposal and contributed to the development of numerous other comment letters related to accounting and auditing matters that were submitted to the IASB and the International Auditing and Assurance Standards Board through the Basel Committee.

Federal Reserve staff participated in the development and issuance of a Risk Retention report to Congress on the potential impact of credit-risk retention requirements on securitization markets. The report was required by the Dodd-Frank Act and highlights the potential interaction between risk retention, accounting standards, and regulatory capital requirements. Federal Reserve staff also participated in other supervisory activities to assess additional interactions between accounting standards and regulatory reform efforts.

The Federal Reserve issued supervisory guidance to financial institutions and supervisory staff on accounting matters, as appropriate, and participated in a number of supervisory related activities. For example, Federal Reserve staff

- issued guidance to address supervisory considerations relating to business combinations and other acquisitions when the fair value of net assets acquired exceeded the acquisition price;
- participated in activities related to structured finance, derivatives, trust preferred securities, new capital instruments, and loan participations;
- developed and participated in a number of domestic and international training programs to educate supervisors about new and emerging accounting and reporting topics affecting financial institutions; and
- supported the efforts of the Reserve Banks in financial institution supervisory activities related to financial accounting, auditing, reporting, and disclosure.

The Federal Reserve supports the concept of achieving a single widely accepted set of high-quality global accounting standards. Federal Reserve staff provided input to the Securities and Exchange Commission (SEC) on issues related to the convergence of U.S. generally accepted accounting principles and International Financial Reporting Standards (IFRS), including challenges that would need to be addressed before establishing a date for U.S. companies to utilize IFRS. The Federal Reserve supported the efforts of the FASB and the IASB to continue toward the achievement of converged standards, which should help to improve comparability of financial reporting across national jurisdictions and promote more efficient capital allocation. Given the Federal Reserve's unique perspectives on the challenges facing financial institutions and our role in the financial markets, staff participated on the joint FASB and IASB Financial Crisis Advisory Group. Federal Reserve staff also participated on the FASB's Valuation Resource Group, which was created to assist the FASB in matters involving valuation for financial reporting purposes.

Credit-Risk Management

The Federal Reserve works with the other federal banking agencies to develop guidance on the management of credit risk; to coordinate the assessment of regulated institutions' credit risk; and to ensure that institutions properly identify, measure, and manage credit risk.

Lending to Creditworthy Small Businesses

In February 2010, the Federal Reserve, along with the other banking agencies, issued guidance to examiners that reinforced the message that institutions should strive to meet the credit needs of creditworthy small business borrowers and that the supervisory agencies will not hinder those efforts.[11] This guidance directs examiners and bankers alike to be mindful of the effects of excessive credit tightening on the broader economy. As a general matter, the Federal Reserve does not expect examiners to adversely classify loans based solely on a decline in collateral value where, for example, the borrower has stable revenue streams and demonstrates the ability to repay the loan. To this end, we implemented training for examiners and conducted outreach to the banking industry to underscore this expectation. The 2010 guidance is the latest in a series of actions taken by the Federal Reserve and the other banking agencies to support sound bank lending and the credit intermediation process.

In an effort to encourage prudent commercial real estate (CRE) loan workouts, the Federal Reserve led

[11] See *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers*, (February 2010), www.federalreserve.gov/newsevents/press/bcreg/20100205a.htm.

the development of interagency guidance issued in October 2009 regarding CRE loan restructurings and workouts.[12] In January 2010, the Federal Reserve launched a comprehensive Systemwide training initiative to further underscore our expectations regarding CRE. These initiatives themselves build off of guidance that the Federal Reserve and other federal banking agencies issued in November 2008 to encourage banks to meet the needs of creditworthy borrowers, in a manner consistent with safe and sound banking practices, and to take a balanced approach in assessing a borrower's ability to repay.[13] Achieving this balance will not always be easy. That is why we have emphasized to both bankers and our examiners the importance of careful analysis of the circumstances of individual borrowers.

In addition to our outreach to banks and bank examiners, the Federal Reserve has conducted a number of forums in 2010 to better understand the difficulties faced by small businesses. In mid-November, the Board and the Federal Reserve Bank of San Francisco, in conjunction with the Small Business Administration, held small business forums in San Francisco and Los Angeles. We then conducted a series of meetings on small business access to credit hosted by the Reserve Banks, followed by a capstone event at the Board of Governors.

Interagency Appraisal and Evaluation Guidelines

In December 2010, the Federal Reserve, FDIC, NCUA, OCC, and OTS jointly issued the revised *Interagency Appraisal and Evaluation Guidelines*[14] that replaces the *1994 Interagency Appraisal and Evaluation Guidelines* and reflects consideration of comments received on the November 2008 proposal to revise the guidelines. The new guidelines clarify the agencies' long-standing expectations for an institution's appraisal and evaluation program. The core principles of the 1994 guidelines are retained in the new guidelines. Further, the new guidelines clarify the agencies' expectations for an institution's collateral valuation function, considering changes in appraisal practices and technologies since 1994. The new material in the 2010 guidelines is based largely on guidance documents that the agencies have issued over the past several years regarding independence in the appraisal and evaluation functions, appraisals for residential tract development lending, and revisions to Uniform Standards of Professional Appraisal Practice. There is also an expanded discussion on the conditions under which an institution's real estate–related transactions might be exempted from the agencies' appraisal regulations.

Shared National Credit Program

In September 2010, the Federal Reserve and the other federal banking agencies released summary results of the 2010 annual review of the Shared National Credit (SNC) Program. The agencies established the program in 1977 to promote the efficient and consistent review and classification of shared national credits. A SNC is any loan or formal loan commitment—and any asset, such as other real estate, stocks, notes, bonds, and debentures taken as debts previously contracted—extended to borrowers by a supervised institution, its subsidiaries, and affiliates. A SNC must have an original loan amount that aggregates to $20 million or more and either (1) is shared by three or more unaffiliated supervised institutions under a formal lending agreement or (2) a portion of which is sold to two or more unaffiliated supervised institutions, with the purchasing institutions assuming their pro rata share of the credit risk.

The 2010 SNC review was based on analyses of credit data as of December 31, 2009, provided by federally supervised institutions. The SNC portfolio totaled $2.5 trillion, with 8,292 credit facilities to approximately 5,600 borrowers. From the previous period, the dollar volume of the portfolio declined by $362 billion or 12.6 percent, and the number of credits declined by 663, or 7.4 percent. Although the 2010 review found that credit quality improved from the previous period, the volume and percentage of criticized and classified assets remained high.[15] Criticized assets declined by $194 billion to $448 billion, a 30 percent decline from 2009 findings. Criticized assets represented 17.8 percent of the portfolio, compared with 22.3 percent in the 2009 review. Classified credits declined by $142 billion, a 31.8 percent decline. Classified credits represented 12.1 percent of the portfolio, compared with 15.5 percent in the 2009 review. Credits rated special mention (or potentially weak) declined by $52 billion to $143 billion, a

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12 See *Policy Statement on Prudent Commercial Real Estate (CRE) Loan Workouts*, (October 2009), www.federalreserve.gov/newsevents/press/bcreg/20091030a.htm.

13 See *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* (November 2008), www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm.

14 See SR letter 10-16, www.federalreserve.gov/boarddocs/srletters/2010/sr1016.htm.

15 Criticized assets are composed of special mention and classified assets. Special mention assets are loans and securities that exhibit potential weakness but are not classified. Classified assets are loans and securities that exhibit well-defined weaknesses or a distinct possibility of loss.

26.7 percent decline. Special mention credits represented 5.7 percent of the portfolio, compared with 6.8 percent in the 2009 review. The reduction in the level of criticized and classified assets is attributed to improved borrower operating performance, debt restructurings, bankruptcy resolutions, and greater borrower access to bond and equity markets. Industry groups demonstrating significant improvement in credit quality included automotive, materials and commodities, and finance and insurance.

Continuing the trend from 2008, the number of credits originated in 2009 declined compared with prior years, but observed underwriting standards were generally satisfactory and improved over prior years. Performance of the SNC portfolio remained influenced by its significant exposure to credits originated in 2006 and 2007 that are characterized by weak underwriting standards. Refinancing risk within the portfolio is also significant, with nearly 67 percent of criticized commitments maturing between 2012 and 2014.

Compliance Risk Management

The Federal Reserve works with international and domestic supervisors to develop guidance that promote compliance with BSA/AML and counter terrorism laws.

Bank Secrecy Act and Anti-Money-Laundering Compliance

In 2010, the Federal Reserve continued to actively promote the establishment and maintenance of effective BSA/AML compliance risk-management programs. For example, the Federal Reserve issued guidance in April 2010 providing BHCs and their nonbank subsidiaries more flexibility in filing Suspicious Activity Reports (SARs). This additional flexibility permits these entities to file the type of SAR form that is most applicable to their business activities. Also, Federal Reserve supervisory staff participated in several interagency projects designed to clarify regulatory expectations, including developing and issuing guidance on (1) beneficial ownership, (2) sharing SARs, and (3) examination procedures for monitoring compliance with the Unlawful Internet Gambling Enforcement Act.

The Federal Reserve currently chairs the FFIEC BSA/AML working group, which is a monthly forum for the discussion of pending BSA policy and regulatory matters, and participates in the Treasury-led BSA Advisory Group, which includes representatives of regulatory agencies, law enforcement, and the financial services industry and covers all aspects of the BSA. Since 2009, the FFIEC BSA/AML working group meetings have included, on a quarterly basis, the SEC, the Commodity Futures Trading Commission, the Internal Revenue Service, and the Office of Foreign Assets Control (OFAC) in order to share and discuss information on BSA/AML examination procedures and general trends more broadly.

The FFIEC BSA/AML working group also is responsible for updating the FFIEC BSA/AML Examination Manual (Manual). The FFIEC created and publicly released the Manual as part of its ongoing commitment to provide current and consistent guidance on risk-based policies, procedures, and processes for banking organizations to comply with the BSA and safeguard their operations from money laundering and terrorist financing.

In 2009 and 2010, the Federal Reserve chaired the drafting group that updated the Manual; a revised version was issued in April 2010. Among the significant modifications to the Manual are the following: streamlined and reorganized procedures for reviewing BSA/AML compliance programs; a new section on reviewing bulk currency shipments; a reorganized discussion of suspicious activity monitoring and reporting; updated requirements for Currency Transaction Report exemptions; clarification of expectations for determining the severity of regulatory violations; and updated discussions of recent developments in electronic banking, Automated Clearing House transactions, prepaid cards, cover payments, and third-party processor customers.

The Federal Reserve and other federal banking agencies continued during 2010 to regularly share examination findings and enforcement proceedings with the Financial Crimes Enforcement Network under the interagency MOU that was finalized in 2004, and with the Treasury's OFAC under the interagency MOU that was finalized in 2006.

International Coordination on Sanctions, Anti-Money Laundering, and Counter-Terrorism Financing

The Federal Reserve participates in a number of international coordination initiatives related to sanctions, money laundering, and terrorism financing. For example, the Federal Reserve has a long-standing role in the U.S. delegation to the intergovernmental Financial Action Task Force (FATF) and its working groups, contributing a banking supervisory perspective to formulation of international standards on these matters. In 2010, the Federal Reserve actively contributed to the development of a FATF typologies report that addressed the use of new payment methods to launder money. Also, the Federal Reserve continued to participate in a subcommittee of the Basel Committee that focuses on AML and counter-terrorism financing issues.

Banks' Securities Activities

In 2010, the Federal Reserve continued to provide examiner training on Regulation R, which implemented certain key exceptions for banks from the definition of the term "broker" under section 3(a) (4) of the Securities Exchange Act of 1934, as amended by the Gramm-Leach-Bliley Act. Regulation R was adopted jointly by the Board and the SEC, with a compliance date for most banks of January 1, 2009, for most aspects of the regulation, and January 1, 2011 for certain trust and fiduciary activity-related aspects of the regulation.

Other Policy Issues

In 2010, the Board approved guidance and policy statements on a number of issues.

- The agencies issued a statement on underwriting standards for small business loans originated under the Treasury's SBLF Program. Pursuant to the Small Business Jobs Act of 2010, the Secretary of the Treasury is authorized to purchase up to $30 billion in preferred stock and other financial instruments from eligible financial institutions to increase the availability of credit for small businesses that qualify for the program. The statement is available at www.federalreserve.gov/boarddocs/srletters/2010/sr1017a1.pdf.
- The federal banking agencies, in conjunction with the Conference of State Bank Supervisors (CSBS), released supervisory guidance in March 2010 on their expectations for sound funding and liquidity risk-management practices. This policy statement, adopted by each of the agencies, summarizes the principles of sound liquidity risk management issued previously and, when appropriate, supplements them with the "Principles for Sound Liquidity Risk Management and Supervision" (issued in September 2008 by the Basel Committee on Banking Supervision). The policy statement emphasizes the importance of cash-flow projections; diversified funding sources; stress testing; a cushion of liquid assets; and a formal, well-developed contingency funding plan as primary tools for measuring and managing liquidity risk. The guidance is available at www.federalreserve.gov/newsevents/press/bcreg/20100317a.htm.
- The federal banking agencies, along with the NCUA and the FFIEC State Liaison Committee, issued an advisory reminding depository institutions of supervisory expectations for sound practices in managing interest-rate risk. The advisory reiterated the importance of effective risk-management practices related to interest-risk exposures and described interest-rate-risk management techniques used by effective risk managers. The advisory is available at www.federalreserve.gov/newsevents/press/bcreg/20100107a.htm.
- The federal banking agencies issued guidance reminding institutions of supervisory expectations on sound practices for managing risks associated with funding and credit concentrations arising from correspondent relationships with other financial institutions. The guidance is available at www.federalreserve.gov/newsevents/press/bcreg/20100430a.htm.
- The federal banking agencies issued supervisory guidance related to bargain purchases and acquisitions assisted by the FDIC and the NCUA. The guidance was issued primarily to address supervisory considerations relating to bargain purchase gains and the impact such gains have on the application approval process. The guidance is available at www.federalreserve.gov/boarddocs/srletters/2010/SR1012a1.pdf.
- The federal banking agencies, the NCUA, and the CSBS issued an interagency statement to assist financial institutions and their customers affected by the explosion and oil spill related to the Deepwater Horizon Mobile Offshore Drilling Unit in the Gulf of Mexico. The statement encouraged financial institutions to consider measures to assist creditworthy borrowers affected by the Gulf oil spill and stated that examiners would consider the unusual circumstances of banks and credit unions in affected areas when determining the appropriate supervisory response to safety-and-soundness issues. The interagency statement is available at www.federalreserve.gov/newsevents/press/bcreg/20100714a.htm.
- The federal banking agencies, together with the FCA and the NCUA, issued jointly developed rules requiring mortgage loan originators who are employees of institutions regulated by these agencies to meet the registration requirements of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the S.A.F.E. Act). The S.A.F.E. Act requires these agencies to jointly develop and maintain a system for registering residential mort-

gage loan originators using the National Mortgage Licensing System and Registry. The Federal Reserve also issued guidance that discussed S.A.F.E. Act requirements and implementation considerations. The rules are available at www.federalreserve.gov/newsevents/press/bcreg/20100728a.htm.

Regulatory Reports

The Federal Reserve's supervisory policy function is also responsible for developing, coordinating, and implementing regulatory reporting requirements for various financial reporting forms filed by domestic and foreign financial institutions subject to Federal Reserve supervision. Federal Reserve staff members interact with other federal agencies and relevant state supervisors, including foreign bank supervisors as needed, to recommend and implement appropriate and timely revisions to the reporting forms and the attendant instructions.

Bank Holding Company Regulatory Reports

The Federal Reserve requires that U.S. BHCs periodically submit reports that provide information about their financial condition and structure. This information is essential to formulating and conducting bank regulation and supervision. It is also used in responding to requests by Congress and the public for information about BHCs and their nonbank subsidiaries. Foreign banking organizations also are required to periodically submit reports to the Federal Reserve.

- FR Y-9 series reports—the FR Y-9C, FR Y-9LP, and FR Y-9SP—provide standardized financial statements for BHCs on both a consolidated and a parent-only basis. The reports are used to detect emerging financial problems, to review performance and conduct pre-inspection analysis, to monitor and evaluate risk profiles and capital adequacy, to evaluate proposals for BHC mergers and acquisitions, and to analyze a holding company's overall financial condition.
- Nonbank subsidiary reports—the FR Y-11, FR 2314, FR Y-7N, and FR 2886b—help the Federal Reserve determine the condition of BHCs that are engaged in nonbank activities and also aid in monitoring the number, nature, and condition of the companies' nonbank subsidiaries.
- The FR Y-8 report provides information on transactions between an insured depository institution and its affiliates that are subject to section 23A of the Federal Reserve Act; it is used to monitor bank exposures to affiliates and to ensure banks' compliance with section 23A of the Federal Reserve Act.
- The FR Y-10 report provides data on changes in organization structure at domestic and foreign banking organizations.
- The FR Y-6 and FR Y-7 reports gather additional information on organization structure and shareholders from domestic banking organizations and foreign banking organizations, respectively; the information is used to monitor structure so as to determine compliance with provisions of the Bank Holding Company Act and Regulation Y and to assess the ability of a foreign banking organization to continue as a source of strength to its U.S. operations.

During 2010, a number of revisions to the FR Y-9C report were implemented. The revisions included items to identify other-than-temporary impairment losses on debt securities; additional items for unused credit card lines and other unused commitments and a related additional item for other loans; reformatting of the schedule that collects information on quarterly averages; additional items for assets covered by FDIC loss-sharing agreements; and clarification of the instructions for unused commitments.

Also effective December 2010, the FR Y-9C and FR Y-9SP were revised to collect new footnote items associated with the Treasury's Community Development Capital Initiative program.

In 2010, the Federal Reserve proposed the following revisions to the FR Y-9C for implementation in 2011: (1) break out by loan category of other loans and leases that are troubled debt restructurings for those that (a) are past due 30 days or more or in nonaccrual status or (b) are in compliance with their modified terms and clarify reporting of restructured troubled debt consumer loans; (2) break out other consumer loans into automobile loans and all other consumer loans in several schedules; (3) break out commercial mortgage-backed securities issued or guaranteed by U.S. government agencies and sponsored agencies; (4) create a new Schedule HC-V, Variable Interest Entities, for reporting major categories of assets and liabilities of consolidated variable interest entities (VIEs); (5) break out loans and other real estate owned (OREO) information covered by FDIC loss-sharing agreements by loan and OREO category; (6) break out life insurance assets into data items for general account and separate account life insurance assets; (7) add new data items for the total assets of captive insurance and reinsurance subsidiaries; (8) add new income statement items for credit valuation adjustments and debit valuation adjustments included in trading revenues (for BHCs with total assets of $100 billion or more); (9) revise reporting instructions in the areas of construction lending, one- to four-family residential mortgage banking activities, and maturity and repricing data; and (10) collect expanded information on the quarterly-averages schedule.

Commercial Bank Regulatory Financial Reports

As the federal supervisor of state member banks, the Federal Reserve, along with the other banking agencies (through the FFIEC), requires banks to submit quarterly Call Reports. Call Reports are the primary source of data for the supervision and regulation of banks and the ongoing assessment of the overall soundness of the nation's banking system. Call Report data provide the most current statistical data available for evaluating institutions' corporate applications, identifying areas of focus for both on-site and off-site examinations, and considering monetary and other public policy issues. Call Report data, which also serve as benchmarks for the financial information required by many other Federal Reserve regulatory financial reports, are widely used by state and local governments, state banking supervisors, the banking industry, securities analysts, and the academic community.

During 2010, the FFIEC implemented revisions to the Call Report. The revisions included (1) items to identify other-than-temporary impairment losses on debt securities; (2) additional items for unused credit card lines and other unused commitments and a related additional item for other loans; (3) new items pertaining to reverse mortgages; (4) an additional item on time deposits and revisions to reporting of brokered deposits; and (5) additional items for assets covered by FDIC loss-sharing agreements. In addition, revisions were made to change the reporting frequency of the number of certain deposit accounts from annually to quarterly; to eliminate an item for internal allocations of income and expense from foreign offices; to clarify the instructions for unused commitments; and to change the reporting frequency of loans to small businesses and small farms from annually to quarterly.

Also during 2010, the FFIEC proposed the following revisions to the Call Report for implementation in 2011: (1) break out by loan category of other loans and leases that are troubled debt restructurings for those that (a) are past due 30 days or more or in nonaccrual status or (b) are in compliance with their modified terms and clarify reporting of restructured troubled debt consumer loans; (2) break out other consumer loans into automobile loans and all other consumer loans in several schedules; (3) break out commercial mortgage-backed securities issued or guaranteed by U.S. government agencies and sponsored agencies; (4) add a new memorandum item for the estimated amount of nonbrokered deposits obtained through the use of deposit listing service companies; (5) break out existing items for deposits of individuals, partnerships, and corporations into deposits of individuals and deposits of partnerships and corporations; (6) create a new Schedule HC-V, Variable Interest Entities, for reporting major categories of assets and liabilities of consolidated VIEs; (7) break out loans and OREO information covered by FDIC loss-sharing agreements by loan and OREO category; (8) break out life insurance assets into data items for general account and separate account life insurance assets; (9) add new data items for the total assets of captive insurance and reinsurance subsidiaries; (10) add new income statement items for credit valuation adjustments and debit valuation adjustments included in trading revenues (for banks with total assets of $100 billion or more); (11) change reporting frequency from annually to quarterly for the data reported in Schedule RC-T, Fiduciary and Related Services, on collective investment funds and common trust funds; and (11) revise reporting instructions in the areas of construction lending, one- to four-family residential mortgage banking activities, and maturity and repricing data.

In addition, during 2010, the FFIEC proposed several revisions to the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) to (1) collect additional detail on trading assets, (2) revise the reporting instructions in Schedule E for reporting of time deposits of $100,000 or more, and (3) expand the data collected on Schedule Q, Financial Assets and Liabilities Measured at Fair Value.

Supervisory Information Technology

The Federal Reserve's supervisory information technology function, carried out by the Board's Division of Banking Supervision and Regulation and the Reserve Banks under the guidance of the Subcommittee on Supervisory Administration and Technology, works to identify requirements and set priorities for information technology initiatives in the supervision and regulation (S&R) business line.

In 2010, the supervisory information technology function (1) developed an Application Portfolio framework and established an application architecture repository for all of the supervisory applications; (2) deployed simplified and secure single sign-on for most S&R applications; (3) identified and implemented technology infrastructure improvements to shift information technology investments to more efficient computing platforms and technologies; (4) researched and provided infrastructure in support of workgroup team collaboration and workflow automation to efficiently share technology demand across infrastructure assets; (5) conducted System-wide architecture blueprint workshops to shift from building custom systems to adopting light technologies and shared solutions; and (6) established a technology community plan to exchange best practices, case studies, and allow for proactive sharing of knowledge and improve technical problem solving.

National Information Center

The National Information Center (NIC) is the Federal Reserve's comprehensive repository for supervisory, financial, and banking-structure data. It is also the main repository for many supervisory documents. NIC includes (1) data on banking structure throughout the United States as well as foreign banking concerns; (2) the National Examination Desktop, which enables supervisory personnel as well as federal and state banking authorities to access NIC data; (3) the Banking Organization National Desktop, an application that facilitates secure, real-time electronic information-sharing and collaboration among federal and state banking regulators for the supervision of banking organizations; and (4) the Central Document and Text Repository, which contains documents supporting the supervisory processes.

Within the NIC, the supporting systems have been modified over time to extend their useful lives and improve business workflow efficiency. During 2010, work continued on upgrading the entire NIC infrastructure to provide easier access to information, a consistent Federal Reserve enterprise information data repository, a comprehensive metadata repository, and uniform security across the Federal Reserve System. Comprehensive testing was performed and implementation began in May 2010. Application developers began to transition their applications to use the new infrastructure, and all applications are expected to be completed during 2011. Also during the year, numerous programming changes were made to NIC applications in support of business needs and to converge and streamline supervisory applications where possible. A system of record was created for exam/inspection dates, including the calculation of the start dates for institutions supervised by the Federal Reserve System and transmitting those requirements to a work scheduling system. Another system of record was created for tracking issues resulting from examinations.

The NIC also supports the Shared National Credit Modernization project (SNC Mod), a multiyear, interagency, information technology development effort to improve the efficiency and effectiveness of the systems that support the SNC Program. SNC Mod focuses on a complete rewrite of the current legacy systems to take advantage of modern technology to enhance and extend the system's capabilities. The primary focus during 2010 was the development of a set of examination support tools (SNCnet) to be used by the interagency teams of examiners during the annual SNC examination. The new SNCnet system will be used during the execution of the 2011 SNC exam.

Finally, the Federal Reserve participated in a number of technology-related initiatives supporting the supervision function as part of FFIEC task forces and interagency committees. These efforts support standardized data collections and cross agency information sharing. Work in this area will continue to be important as the agencies work through the implementation of the Dodd-Frank Act.

Staff Development

The Federal Reserve's staff development program is responsible for the ongoing development of nearly 2,605 professional supervisory staff to ensure that they have the skills necessary to meet their evolving supervisory responsibilities. The Federal Reserve also provides course offerings to staff at state banking agencies. Training activities in 2010 are summarized in **table 2**.

Examiner Commissioning Program

The Examiner Commissioning Program (ECP) involves approximately 22 weeks of instruction. Individuals move through a combination of classroom offerings, self-paced assignments, and on-the-job training over a period of two to five years. Achievement is measured by two professionally validated proficiency examinations: the first proficiency exam

Table 2. Training for Banking Supervision and Regulation, 2010

Course sponsor or type	Number of enrollments		Instructional time (approximate training days)[1]	Number of course offerings
	Federal Reserve personnel	State and federal banking agency personnel		
Federal Reserve System	1,464	279	395	79
FFIEC	208	254	268	67
The Options Institute[2]	9	6	3	1
Rapid Response™	11,855	1,471	10	75

1 Training days are approximate. System courses were calculated using five days as an average, with FFIEC courses calculated using four days as an average.

2 The Options Institute, an educational arm of the Chicago Board Options Exchange, provides a three-day seminar on the use of options in risk management.

is required of all ECP participants, and the second proficiency exam is offered in two specialty areas—(a) safety and soundness and (b) consumer compliance. A third specialty, in information technology, requires that individuals earn the Certified Information Systems Auditor certification offered by the Information Systems Audit Control Association. In 2010, 227 examiners passed the first proficiency exam and 87 passed the second proficiency exam (69 in safety and soundness and 18 in consumer compliance).

Continuing Professional Development

Other formal and informal learning opportunities are available to examiners, including other schools and programs offered within the System and FFIEC-sponsored schools. System programs are also available to state and federal banking agency personnel. The Rapid Response® program, introduced in 2008, offers System and state personnel 60–90 minute teleconference presentations on emerging issues or urgent training needs associated with implementation or issuance of new laws, regulations, or guidance.

Regulation

Regulation of the U.S. Banking Structure

The Federal Reserve administers five federal statutes that apply to BHCs, financial holding companies, member banks, and foreign banking organizations—the Bank Holding Company Act, the Bank Merger Act, the Change in Bank Control Act, the Federal Reserve Act, and the International Banking Act.

In administering these statutes, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of the U.S. banking system at the local, regional, and national levels; the international operations of domestic banking organizations; or the U.S. banking operations of foreign banks. The proposals concern BHC formations and acquisitions, bank mergers, and other transactions involving bank or nonbank firms. In 2010, the Federal Reserve acted on 699 proposals representing 1,366 individual applications filed under the five statutes. Many of these proposals involved banking organizations in less than satisfactory financial condition.

Bank Holding Company Act

Under the Bank Holding Company Act, a corporation or similar legal entity must obtain the Federal Reserve's approval before forming a BHC through the acquisition of one or more banks in the United States. Once formed, a BHC must receive Federal Reserve approval before acquiring or establishing additional banks. Also, BHCs generally may engage in only those nonbanking activities that the Board has previously determined to be closely related to banking under section 4(c)(8) of the Bank Holding Company Act. Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement.

When reviewing a BHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, the competitive effects of the proposal, and the applicant's ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law. In the case of a foreign banking organization seeking to acquire control of a U.S. bank, the Federal Reserve also considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. In 2010, the

Federal Reserve acted on 312 applications and notices filed by BHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities, including proposals involving private equity firms.

A BHC may repurchase its own shares from its shareholders. When the company borrows money to buy the shares, the transaction increases the company's debt and decreases its equity. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital adequacy guidelines. In 2010, the Federal Reserve acted on three stock repurchase proposals by a BHC.

The Federal Reserve also reviews elections submitted by BHCs seeking financial holding company status under the authority granted by the Gramm-Leach-Bliley Act. BHCs seeking financial holding company status must file a written declaration with the Federal Reserve. In 2010, 12 domestic financial holding company declarations and one foreign bank declaration were approved.

Bank Merger Act

The Bank Merger Act requires that all proposals involving the merger of insured depository institutions be acted on by the relevant federal banking agency. The Federal Reserve has primary jurisdiction if the institution surviving the merger is a state member bank. Before acting on a merger proposal, the Federal Reserve considers the financial and managerial resources of the applicant, the future prospects of the existing and combined organizations, the convenience and needs of the community(ies) to be served, and the competitive effects of the proposed merger. The Federal Reserve also must consider the views of the U.S. Department of Justice regarding the competitive aspects of any proposed bank merger involving unaffiliated insured depository institutions. In 2010, the Federal Reserve approved 96 merger applications under the act.

Change in Bank Control Act

The Change in Bank Control Act requires individuals and certain other parties that seek control of a U.S. bank or BHC to obtain approval from the relevant federal banking agency before completing the transaction. The Federal Reserve is responsible for reviewing changes in the control of state member banks and BHCs. In its review, the Federal Reserve considers the financial position, competence, experience, and integrity of the acquiring person; the effect of the proposed change on the financial condition of the bank or BHC being acquired; the future prospects of the institution to be acquired; the effect of the proposed change on competition in any relevant market; the completeness of the information submitted by the acquiring person; and whether the proposed change would have an adverse effect on the Deposit Insurance Fund. A proposed transaction should not jeopardize the stability of the institution or the interests of depositors. During its review of a proposed transaction, the Federal Reserve may contact other regulatory or law enforcement agencies for information about relevant individuals. In 2010, the Federal Reserve approved 133 change in control notices related to state member banks and BHCs, including proposals involving private equity firms.

Federal Reserve Act

Under the Federal Reserve Act, a member bank may be required to seek Federal Reserve approval before expanding its operations domestically or internationally. State member banks must obtain Federal Reserve approval to establish domestic branches, and all member banks (including national banks) must obtain Federal Reserve approval to establish foreign branches. When reviewing proposals to establish domestic branches, the Federal Reserve considers, among other things, the scope and nature of the banking activities to be conducted. When reviewing proposals for foreign branches, the Federal Reserve considers, among other things, the condition of the bank and the bank's experience in international banking. In 2010, the Federal Reserve acted on new and merger-related branch proposals for 584 domestic branches and granted prior approval for the establishment of seven new foreign branches.

State member banks must also obtain Federal Reserve approval to establish financial subsidiaries. These subsidiaries may engage in activities that are financial in nature or incidental to financial activities, including securities-related and insurance agency-related activities. In 2010, no financial subsidiary application was approved.

Overseas Investments by U.S. Banking Organizations

U.S. banking organizations may engage in a broad range of activities overseas. Many of the activities are conducted indirectly through Edge Act and agreement corporation subsidiaries. Although most foreign investments are made under general consent procedures that involve only after-the-fact notification to the Federal Reserve, large and other significant investments require prior approval. In 2010, the Federal Reserve approved 51 applications and notices for overseas investments by U.S. banking organizations, many of which represented investments through Edge Act or agreement corporations.

International Banking Act

The International Banking Act, as amended by the Foreign Bank Supervision Enhancement Act of 1991, requires foreign banks to obtain Federal Reserve approval before establishing branches, agencies, commercial lending company subsidiaries, or representative offices in the United States.

In reviewing proposals, the Federal Reserve generally considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. It also considers whether the home-country supervisor has consented to the establishment of the U.S. office; the financial condition and resources of the foreign bank and its existing U.S. operations; the managerial resources of the foreign bank; whether the home-country supervisor shares information regarding the operations of the foreign bank with other supervisory authorities; whether the foreign bank has provided adequate assurances that information concerning its operations and activities will be made available to the Federal Reserve (if deemed necessary to determine and enforce compliance with applicable law); whether the foreign bank has adopted and implemented procedures to combat money laundering; whether the home country of the foreign bank is developing a legal regime or is participating in multilateral efforts to address money laundering; and the foreign bank's record in complying with U.S. law. In 2010, the Federal Reserve approved nine applications by foreign banks to establish branches, agencies, or representative offices in the United States.

Public Notice of Federal Reserve Decisions

Certain decisions by the Federal Reserve that involve an acquisition by a BHC, a bank merger, a change in control, or the establishment of a new U.S. banking presence by a foreign bank are made known to the public by an order or an announcement. Orders state the decision, the essential facts of the application or notice, and the basis for the decision; announcements state only the decision. All orders and announcements are made public immediately; they are subsequently reported in the Board's weekly H.2 statistical release. The H.2 release also contains announcements of applications and notices received by the Federal Reserve upon which action has not yet been taken. For each pending application and notice, the related H.2A release gives the deadline for comments. The Board's website (www.federalreserve.gov) provides information on orders and announcements as well as a guide for U.S. and foreign banking organizations that wish to submit applications.

Enforcement of Other Laws and Regulations

The Federal Reserve's enforcement responsibilities also extend to the disclosure of financial information by state member banks and the use of credit to purchase and carry securities.

Financial Disclosures by State Member Banks

State member banks that are not members of BHCs and that issue securities registered under the Securities Exchange Act of 1934 must disclose certain information of interest to investors, including annual and quarterly financial reports and proxy statements. By statute, the Board's financial disclosure rules must be substantially similar to those of the SEC. At the end of 2010, 13 state member banks were registered with the Board under the Securities Exchange Act.

Securities Credit

Under the Securities Exchange Act, the Board is responsible for regulating credit in certain transactions involving the purchasing or carrying of securities. The Board's Regulation T limits the amount of credit that may be provided by securities brokers and dealers when the credit is used to purchase debt and equity securities. The Board's Regulation U limits the amount of credit that may be provided by lenders other than brokers and dealers when the credit is used to purchase or carry publicly held equity securities if the loan is secured by those or other publicly held equity securities. The Board's Regulation X applies these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Several regulatory agencies enforce the Board's securities credit regulations. The SEC, the Financial Industry Regulatory Authority, and the Chicago Board Options Exchange examine brokers and dealers for compliance with Regulation T. With respect to compliance with Regulation U, the federal banking agencies examine banks under their respective jurisdictions; the FCA and the NCUA examine lenders under their respective jurisdictions; and the Federal Reserve examines other Regulation U lenders.

Consumer and Community Affairs

The Division of Consumer and Community Affairs (DCCA) has primary responsibility for carrying out the Board's consumer protection program. DCCA augments its dedicated expertise in consumer protection law, regulation, and policy with resources from other functions of the Board and the Federal Reserve System to write and interpret regulations, educate and inform consumers, and enforce laws and regulations for consumer financial products and services. Key elements of the division's program include:

- rulemaking, utilizing a team of attorneys to write regulations that implement legislation, update regulations to respond to changes in the marketplace, design consumer-tested disclosures to provide consumers consistent and vital information on financial products, and prohibit unfair and deceptive acts and practices;
- supervision and enforcement of state member banks and bank holding companies and their nonbank affiliates to ensure that consumer protection rules are being followed;
- consumer complaint and inquiry processes to assist consumers in resolving grievances with their financial institutions and to answer their questions;
- consumer education to inform consumers about what they need to know when making decisions about their financial services options;
- research to understand the implications of policy on consumer financial markets;
- outreach to national and local government agencies, consumer and community groups, academia, and industry to gain a broad range of perspectives, and to inform policy decisions and effective practices; and
- support for national and local agencies and organizations that work to protect and promote community development and economic empowerment to historically underserved communities.

Rulemaking and Regulations

Credit Card Reform

Throughout 2010, the Federal Reserve worked to implement the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the Credit Card Act). Consistent with the effective dates set by Congress, the Federal Reserve's rulemakings to implement the Credit Card Act were divided into three stages. As discussed in the Federal Reserve's 2009 Annual Report, the first stage was completed in 2009 and the second stage in January 2010. In June 2010, the Board completed the third stage of rulemaking, which is discussed in greater detail below. Subsequently, the Board proposed clarifications to the rules implementing the Credit Card Act. In addition, the Board released reports on credit card use by small businesses and on college credit card agreements.

Implementing the Credit Card Act: Stage Three

In June, the Board approved a final rule to protect credit card users from unreasonable late payment and other penalty fees and to require credit card issuers to reconsider interest rate increases imposed since the beginning of 2009. This rule went into effect on August 22, 2010.[1] With the approval of this rule, the Board's rulemaking to implement the provisions of the Credit Card Act was complete.

Reasonable Penalty Fees

The final rule requires that penalty fees imposed by card issuers be reasonable and proportional to the violation of the account terms. Among other things, the rule prohibits credit card issuers from charging a penalty fee of more than $25 for paying late or otherwise violating the account's terms, unless the consumer has engaged in repeated violations or the issuer can show that a higher fee represents a reason-

1 See press release (June 15, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100615a.htm.

able proportion of the costs it incurs as a result of violations. The rule also prohibits credit card issuers from charging penalty fees that exceed the dollar amount associated with the consumer's violation. For example, card issuers will no longer be permitted to charge a $39 fee when a consumer is late making a $20 minimum payment. Instead, the fee cannot exceed $20. In addition, the rule bans "inactivity" fees, such as fees imposed when a consumer doesn't use the account to make new purchases. Lastly, the rule prevents issuers from charging multiple penalty fees based on a single late payment or other violation of the account terms.

Reevaluation of Interest Rate Increases

The rules also require issuers that have increased a consumer's interest rates to evaluate whether the reasons for the increase have changed and, if appropriate, to reduce the rate. Specifically, the rule requires credit card issuers to reevaluate at least every six months annual percentage rates increased on or after January 1, 2009. In addition, the rule requires that notices of rate increases for credit card accounts disclose the principal reasons for the increase.

Clarifications

In October, the Board proposed clarifications to its rules implementing the Credit Card Act.[2] The proposal is intended to enhance consumer protections and to resolve areas of uncertainty so that card issuers fully understand their compliance obligations. In particular, the proposal would clarify that:

- the same protections exist for promotional programs that waive interest charges for a specified period of time as exist for promotional programs that apply a reduced rate for a specified period;
- fees charged to consumers prior to the opening of a credit card account are covered by the same limitations as fees charged during the first year after the account is opened; together, these fees may not exceed 25 percent of the account's initial credit limit; and
- a card issuer must consider a consumer's individual income, not household income, when evaluating the consumer's ability to make the required payments for a new credit card or for a higher credit limit on an existing account.

Small Business Credit Card Use and Credit Card Market

In May, the Board released a *Report to Congress on the Use of Credit Cards by Small Businesses and the Credit Card Market for Small Businesses*.[3] The report was submitted to Congress in accordance with a provision of the Credit Card Act requiring the Board to conduct a review of the use of credit cards by businesses with no more than 50 employees and of the credit card market for these businesses. In performing its review and preparing the report, the Board gathered data and other information from a number of sources: major issuers of small business credit cards, trade associations representing small business owners, and two consumer credit reporting agencies. Board staff also worked with a small business trade association to help develop some credit card-related questions for inclusion in their survey of small business owners, added special questions to a quarterly Board survey of banks' senior loan officers, and obtained from a vendor data regarding credit card direct mail offers to small businesses. Board staff reviewed the results of consumer testing conducted from 2006 to 2008 pertaining to disclosures given in connection with consumer credit card accounts, and considered customer complaint information maintained within the Board's own databases and provided by small business credit card issuers. Finally, Board staff reviewed existing surveys, studies, reports, and research related to small businesses' use of credit cards.

Among other things, the report discusses how small businesses use credit cards and describes issuers' practices in marketing and pricing small business credit cards. The report also summarizes small businesses' access to new credit cards during 2009 and small business credit card terms and conditions. In addition, the report reviews disclosures provided to small business credit card customers and other issuer practices. Finally, the report considers the potential benefits and adverse effects of applying disclosure and substantive requirements similar to those in the Truth in Lending Act, as amended by the Credit Card Act, to small business credit cards.

College Credit Card Agreements

In October, the Board released a report that contains payment and account information about more than 1,000 agreements between credit card issuers and

2 See press release (October 19, 2010), www.federalreserve.gov/newsevents/press/bcreg/20101019a.htm.

3 See Other Reports to the Congress (May 2010), www.federalreserve.gov/boarddocs/rptcongress/smallbusinesscredit/smallbusinesscredit.pdf.

Box 1. Credit Where Credit Is Due: Supporting Small Business Access to Credit

Small businesses are often characterized as the lifeblood of America's economy, providing vital jobs and services, and the embodiment of the nation's entrepreneurial spirit. In 2010, in the aftermath of the financial crisis and lingering economic challenges, credit for small businesses was tight. The matter of access to credit for small businesses emerged as an important issue for the System's community affairs agenda. In response, the Board led an initiative on financing for small businesses. The initiative was designed to gather information and perspectives to help the Federal Reserve and other key stakeholders craft responses to the immediate and intermediate needs of creditworthy small businesses.

The first phase of the small business initiative was to collect information about the financing challenges facing small businesses given the economic climate at the time. The Federal Reserve's Community Affairs Offices (CAOs) leveraged their role as convener and catalyst to host a series of more than 40 meetings, workshops, and conferences with key players in the public sector, small business, and lending communities. The gatherings were used to collect and share information on factors affecting the supply of and demand for small business credit and capital. The community affairs staff aggregated the information and elicited key themes and findings from the regional meetings so that potential solutions and follow-up discussions could be addressed.

The information-gathering process culminated in July 2010 when the Board hosted the *Addressing the Financing Needs of Small Businesses* summit for a national audience of key decision-makers, including leaders from community development financial institutions, banks, small businesses and trade groups, and government agencies as panelists and participants. The forum provided an opportunity to discuss promising solutions and key policy recommendations identified in the regional gatherings. Keynote remarks were given by Federal Reserve Chairman Ben Bernanke, Governor Elizabeth Duke, and Administrator of the U.S. Small Business Administration Karen Mills. Additionally, a summary of key insights and themes from these meetings was included as an addendum to Chairman Bernanke's monetary policy testimony, provided on July 21, 2010 (see the Board's website at www.federalreserve.gov/newsevents/testimony/bernanke20100721a.htm).

Throughout 2010, the small business initiative assisted in identifying strategies for enhancing access to financing for small businesses, and for improving the quality and infrastructure of small business technical support. The initiative also underscored the need for greater coordination between key stakeholder groups, including federal, state, and local agencies, as well as representatives from the public, nonprofit, and private sectors. Going forward, the CAOs will continue to work with partners to foster promising solutions for small businesses across the country by coordinating a series of regional forums with Reserve Banks for financial institutions and Community Development Financial Institutions, and identifying key lessons and promising practices to ensure that small businesses get the credit they need.

institutions of higher education or affiliated organizations that provide for the issuance of credit cards to students.[4] The Credit Card Act requires issuers to submit to the Board annually their agreements with educational institutions or affiliated organizations, such as alumni associations. The Board's report covers 1,044 agreements that were in effect during 2009. Among other things, the report lists the largest agreements by the dollar amount of payments made to the institution or organization during 2009, by the total number of accounts opened under the agreement during 2009, and by the total number of accounts opened under the agreement that remained open at the end of 2009 (regardless of when the account was opened).

[4] See press release (October 25, 2010), www.federalreserve.gov/newsevents/press/bcreg/20101025b.htm.

In addition, the Board launched a new online database, www.federalreserve.gov/collegecreditcardagreements, which provides additional information about the agreements submitted to the Board. Users can access the complete agreement text to see the information submitted by card issuers regarding payments and accounts. Users may also search for agreements by card issuer, by educational institution or organization, or by the city or state in which the institution or organization is located.

Overdraft Services and Gift Card Rules

Restrictions on Overdraft Fees

In May, the Board announced final clarifications to aspects of its November 2009 final rule under Regulation E (Electronic Fund Transfers) and its December 2008 final rule under Regulation DD (Truth in

Savings) pertaining to overdraft services.[5] The final clarifications address questions that have arisen under both the Regulation E and DD final rules and provide further guidance regarding compliance with certain aspects of the final overdraft rules. In particular, the final clarifications explain that the prohibition in Regulation E on assessing overdraft fees without the consumer's affirmative consent applies to all institutions, including those with a policy and practice of declining automated teller machine (ATM) and one-time debit card transactions when an account has insufficient funds. The final clarifications also make certain technical corrections and conforming amendments.

Restrictions on Fees and Expiration Dates for Gift Cards

In March, the Board announced final rules to restrict the fees and expiration dates that may apply to gift cards.[6] The rules protect consumers from certain unexpected costs and require that gift card terms and conditions be clearly stated. The final rules prohibit dormancy, inactivity, and service fees on gift cards unless (1) the consumer has not used the certificate or card for at least one year, (2) no more than one such fee is charged per month, and (3) the consumer is given clear and conspicuous disclosures about the fees. In addition, expiration dates for funds underlying gift cards must be at least five years after the date of issuance, or five years after the date when funds were last loaded. The new rules generally cover retail gift cards, which can be used to buy goods or services at a single merchant or affiliated group of merchants, and network-branded gift cards, which are redeemable at any merchant that accepts the card brand. The final rules, which had an effective date of August 22, 2010, were issued under Regulation E to implement the gift card provisions in the Credit Card Act.

In August, the Board announced an interim final rule implementing recent legislation modifying the effective date of certain disclosure requirements applicable to gift cards under the Credit Card Act.[7] For gift certificates, store gift cards, and general-use prepaid cards produced prior to April 1, 2010, the legislation and interim final rule delay the August 22, 2010 effective date of these disclosures until January 31, 2011, provided that several conditions are met. In October, after a public comment period, the Board finalized the August interim final rule.[8]

Mortgage Reform

Throughout 2010, the Board proposed significant new rules designed to enhance consumer protections and disclosures for home mortgage transactions, including reverse mortgages. The Board also proposed a rule to revise the coverage of escrow account requirements for first-lien "jumbo" mortgages, in order to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). In addition, the Board adopted final rules to protect mortgage borrowers from unfair, abusive, or deceptive lending practices that can arise from loan originator compensation practices, as well as rules to implement provisions of the Mortgage Disclosure Improvement Act of 2008 (MDIA) and the Helping Families Save Their Homes Act of 2009.

Consumer Protections and Disclosures for Home Mortgage Transactions

In August, the Board proposed enhanced consumer protections and disclosures for home mortgage transactions.[9] The proposal includes significant changes to Regulation Z and represents the second phase of the Board's comprehensive review and update of the mortgage lending rules. The proposed changes reflect the results of consumer testing by the Board.

Reverse Mortgages

Reverse mortgages are complex products available to older consumers, some of whom may be more vulnerable to abusive practices. To help consumers understand these products, the Federal Reserve's proposal would require creditors to provide improved disclosures that explain particular features unique to reverse mortgages. In order to protect consumers from unfair practices related to reverse mortgages, the proposal also would:

- prohibit creditors from conditioning a reverse mortgage on the consumer's purchase of another financial or insurance product, so that consumers are not forced to buy financial products that can be costly or may not be beneficial, such as annuities or long-term care insurance;

5 See press release (May 28, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100528a.htm.

6 See press release (March 23, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100323a.htm.

7 See press release (August 11, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100811a.htm.

8 See press release (October 19, 2010), www.federalreserve.gov/newsevents/press/bcreg/20101019b.htm.

9 See press release (August 16, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100816e.htm.

- require that a consumer receive counseling about reverse mortgages before any nonrefundable fee can be imposed (except a fee for the counseling itself) or the loan can be closed, to help ensure that consumers understand these complex products before they become obligated on the loan; and
- prohibit creditors from steering consumers to specific reverse mortgage counselors or compensating counselors or counseling agencies, to ensure that the counseling is unbiased.

Right of Rescission

A consumer generally has three business days after the loan closing to rescind certain home-secured loans, but this right may be extended for up to three years if the creditor fails to provide the consumer with certain disclosures or the notice of the right to rescind. The proposed revisions would:

- simplify and improve the notice of the right to rescind provided to consumers at closing;
- revise the list of disclosures that, if not properly made, can trigger an extended right to rescind, to focus on disclosures that testing shows are most important to consumers; and
- clarify creditors' obligations when the extended right to rescind is asserted.

In addition, the Board's proposal includes other amendments related to home-secured credit. For example, the proposed rules would ensure that consumers receive new disclosures when the parties agree to modify the key terms of an existing mortgage loan and clarify loan servicers' duty to respond within a reasonable amount of time when a consumer requests information about the owner of the loan.

Protections against Mortgage Loan Originator Practices

In August, the Board issued final rules to protect mortgage borrowers from unfair or abusive practices related to loan originator compensation.[10] The new rules apply to mortgage brokers and the companies that employ them, as well as mortgage loan officers employed by depository institutions and other lenders.

Yield Spread Premiums

Previously, lenders commonly compensated loan originators more if a borrower accepts an interest rate higher than the rate required by the lender (commonly referred to as a "yield spread premium"). Under the new rule, however, a loan originator may not receive compensation that is based on the interest rate or other loan terms. This will prevent loan originators from providing consumers loans with higher interest rates or other less-favorable terms to increase their own compensation. Loan originators can continue to receive compensation that is based on a percentage of the loan amount, which is a common practice.

The rule also prohibits a loan originator that receives compensation directly from the consumer from also receiving compensation from the lender or another party. In consumer testing, the Board found that consumers generally are not aware of the payments lenders make to loan originators and how those payments can affect the consumer's total loan cost. The new rule seeks to ensure that consumers who agree to pay the originator directly do not also pay the originator indirectly through the interest rate, thereby paying more in total compensation than they realize.

Anti-Steering Protections

The final rule prohibits loan originators from directing, or "steering," a consumer to accept a mortgage loan that is not in the consumer's best interest in order to increase the originator's compensation. To facilitate compliance with the anti-steering rule, loan originators would be deemed to comply by ensuring that consumers can choose from loan options that include the loan with the lowest interest rate and the loan with the least amount of points and origination fees, rather than the loans that maximize the originator's compensation.

The final rules take effect on April 1, 2011.[11]

Disclosures for Mortgage Payment Changes

In August, the Board issued an interim final rule revising the disclosure requirements for closed-end mortgage loans under Regulation Z, in order to implement provisions of the MDIA that require lenders to disclose how borrowers' regular mortgage payments can change over time.[12] The MDIA, which amended TILA, seeks to ensure that mortgage borrowers are alerted to the risks of payment increases

[10] See press release (August 16, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100816d.htm.

[11] At the time the rules were issued, they were to take effect on April 1, 2011. However, a delay imposed under a temporary court order resulted in the rules becoming effective on April 6, 2011.

[12] See press release (August 16, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100816b.htm.

before they take out mortgage loans with variable rates or payments. Accordingly, under the interim rule, lenders' cost disclosures must include a payment summary in the form of a table, stating the following:

- the initial interest rate together with the corresponding monthly payment;
- for adjustable-rate or step-rate loans, the maximum interest rate and payment that can occur during the first five years and a "worst case" example showing the maximum rate and payment possible over the life of the loan; and
- the fact that consumers might not be able to avoid increased payments by refinancing their loans.

The interim rule also requires lenders to disclose certain features, such as balloon payments or options to make only minimum payments that will cause loan amounts to increase. All of the disclosures required in the interim rule were developed through several rounds of qualitative consumer testing, including one-on-one interviews with consumers around the country.

Lenders must comply with the interim rule for applications they receive on or after January 30, 2011, as specified in the MDIA.

In December, the Board approved an interim rule amending Regulation Z to clarify certain aspects of the August interim rule implementing provisions of the MDIA, in response to public comments.[13] Creditors have the option of complying with either the Board's August 2010 interim rule as originally published or as revised by the December interim rule until October 1, 2011, at which time compliance with the December interim rule will become mandatory.

Rules for Jumbo Mortgage Escrow Accounts

In August, the Board proposed a rule to revise the escrow requirements for higher-priced first-lien "jumbo" mortgages, in order to implement a provision of the Dodd-Frank Act.[14] Jumbo mortgages are loans that exceed the conforming loan-size limit for purchase by Freddie Mac, as specified in the Dodd-Frank Act. The proposed rule would increase the annual percentage rate (APR) threshold that determines whether a mortgage lender must establish an escrow account for property taxes and insurance for first-lien jumbo mortgages. In July 2008, the Board issued rules requiring creditors to establish escrow accounts for first-lien loans if a loan's APR is 1.5 percentage points above the applicable prime offer rate. Under the proposed revisions, the escrow requirements would apply for jumbo mortgages only if the loan's APR is 2.5 percentage points or more above the applicable prime offer rate. The APR threshold for non-jumbo mortgages remains unchanged.

Notifying Consumers When Mortgages Are Sold or Transferred

In August, the Board issued final rules amending Regulation Z to implement a provision of the Helping Families Save Their Homes Act of 2009 requiring that consumers receive notice when their mortgage loan is sold or transferred.[15] The new disclosure requirement became effective when the statute was enacted and aims to ensure that consumers know who owns their mortgage loan. Consistent with the statute, the final rule requires purchasers or assignees that acquire loans to provide written disclosures notifying consumers of the sale or transfer of their mortgage loans within 30 days.

To provide compliance guidance, the Board had issued interim rules in November 2009. Compliance with the August 2010 final rules is mandatory on January 1, 2011.

Real Estate Appraisals

In October, the Board issued an interim final rule to ensure that real estate appraisers are free to use their independent professional judgment in assigning home values without influence or pressure from those with interests in the transactions.[16] The rule also seeks to ensure that appraisers receive customary and reasonable payments for their services. The interim final rule includes several provisions that protect the integrity of the appraisal process when a consumer's home is securing the loan. The interim final rule

- prohibits coercion and other similar actions designed to cause appraisers to base the appraised value of properties on factors other than their independent judgment;
- prohibits appraisers and appraisal management companies hired by lenders from having financial

[13] See press release (December 22, 2010), www.federalreserve.gov/newsevents/press/bcreg/20101222a.htm.

[14] See press release (August 16, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100816a.htm.

[15] See press release (August 16, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100816a.htm.

[16] See press release (October 19, 2010), www.federalreserve.gov/newsevents/press/bcreg/20101018a.htm.

or other interests in the properties or the credit transactions;

- prohibits creditors from extending credit based on appraisals if they know beforehand of violations involving appraiser coercion or conflicts of interest, unless the creditors determine that the values of the properties are not materially misstated;
- requires that creditors or settlement service providers that have information about appraiser misconduct file reports with the appropriate state licensing authorities; and
- requires the payment of reasonable and customary compensation to appraisers who are not employees of the creditors or of the appraisal management companies hired by the creditors.

The interim final rule is required by the Dodd-Frank Act, and compliance is mandatory as of April 1, 2011.

Public Hearings on Regulation C

Between July and September 2010, the Board held a series of four public hearings on Regulation C, which implements the Home Mortgage Disclosure Act (HMDA), at the Federal Reserve Banks of Atlanta, San Francisco, and Chicago, and at the Board in Washington, D.C.[17] The purpose of these hearings was threefold: (1) to evaluate whether revisions to Regulation C in 2002 helped gather useful and accurate information on the mortgage market, (2) to assess the need for additional data and other improvements, and (3) to identify areas for future research on emerging mortgage market issues.

Oversight and Enforcement

The Board's Division of Consumer and Community Affairs develops and supports supervisory policy and examination procedures for consumer protection laws and regulations, as well as the Community Reinvestment Act (CRA), as part of its supervision of state-chartered, depository institutions, and foreign banking organizations that are members of the Federal Reserve System. The division also administers the Federal Reserve System's risk-focused program for assessing consumer compliance risk in the largest bank and financial holding companies in the System. Division staff ensure consumer compliance risk is effectively integrated into the consolidated supervision of the holding company. The division also oversees the efforts of the 12 Reserve Banks to ensure that consumer protection laws and regulations are fully and fairly enforced. Division staff provide guidance and expertise to the Reserve Banks on consumer protection regulations, bank and bank holding company application analysis and processing, examination and enforcement techniques and policy matters, examiner training, and emerging issues. Staff also review Reserve Bank supervisory reports, examination work products, and consumer complaint analyses and responses. Finally, staff members participate in interagency activities that promote uniformity in examination principles, standards, and processes.

In addition, throughout 2010, the System established and implemented a policy for conducting risk-focused consumer compliance supervision of, and the investigation of consumer complaints against, nonbank subsidiaries of bank holding companies (BHCs) and foreign banking organizations (FBOs) with activities covered by the consumer protection laws and regulations the Federal Reserve has the authority to enforce. This policy is designed to enhance understanding of the consumer compliance risk profile of nonbank subsidiaries and to guide supervisory activities for these entities. Initial supervisory activities first targeted those nonbank subsidiaries considered to be of highest risk to the Federal Reserve System.[18]

Examinations are the Federal Reserve's primary method of enforcing compliance with consumer protection laws and assessing the adequacy of consumer compliance risk-management systems within regulated entities. During the 2010 reporting period, the Reserve Banks conducted 300 consumer compliance examinations of the System's 858 state member banks and three examinations of foreign banking organizations.[19]

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17 See press release (April 23, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100423a.htm.

18 Federal Reserve Board of Governors, 2009 Consumer Affairs Letters, Consumer Compliance Supervision Policy for Nonbank Subsidiaries of Bank Holding Companies and Foreign Banking Organizations, CA-09-8, September 14, 2009, www.federalreserve.gov/boarddocs/caletters/2009/0908/caltr0908.htm.

19 The foreign banking organizations examined by the Federal Reserve are organizations that operate under section 25 or 25A of the Federal Reserve Act (Edge Act and agreement corporations) and state-chartered commercial lending companies owned or controlled by foreign banks. These institutions are not subject to the Community Reinvestment Act and typically engage in relatively few activities covered by consumer protection laws. There are 197 such institutions throughout the Federal Reserve System.

Community Reinvestment Act Compliance

The CRA requires that the Federal Reserve and other federal banking and thrift agencies encourage financial institutions to help meet the credit needs of the local communities in which they do business, including low and moderate income areas, consistent with safe and sound operations.

To carry out this mandate, the Federal Reserve

- examines state member banks to assess their compliance with the CRA,
- analyzes applications for mergers and acquisitions by state member banks and bank holding companies in relation to CRA performance, and
- disseminates information on community development techniques to bankers and the public through Community Development offices within the Reserve Banks.

The Federal Reserve assesses and rates the CRA performance of state member banks in the course of examinations conducted by staff at the Reserve Banks. During the reporting period, the Reserve Banks conducted CRA examinations of 267 banks. Of those banks, 24 were rated “Outstanding,” 237 were rated “Satisfactory,” five were rated “Needs to Improve,” and one was rated “Substantial Non-Compliance.”

In September 2010, the Federal Reserve and other federal banking and thrift regulatory agencies announced a final rule to implement a provision of the Higher Education Opportunity Act (HEOA), which requires the agencies to consider low-cost higher education loans to low-income borrowers as a positive factor when assessing a financial institution’s record of meeting community credit needs under the CRA. In addition, the rule also incorporated a CRA statutory provision that allows the agencies to consider a financial institution’s capital investment, loan participation, and other ventures with minority-owned financial institutions, women-owned institutions, and low-income credit unions as factors in assessing the institution’s CRA record.

In December 2010, the Federal Reserve and the other federal banking and thrift regulatory agencies revised the CRA regulations to support community stabilization activities in neighborhoods affected by high numbers of foreclosures. The final rule encourages depository institutions to support, enable, or facilitate projects or activities that meet the “eligible uses” criteria described in section 2301(c) of the Housing and Economic Recovery Act of 2008 (HERA), as amended, and that are conducted in designated target areas identified in plans approved by the U.S. Department of Housing and Urban Development (HUD) under the Neighborhood Stabilization Program (NSP).

In addition to this revision to the CRA regulations, the Federal Reserve and the other federal banking and thrift regulatory agencies held public hearings in four cities (Arlington, VA; Atlanta, GA; Chicago, IL; and Los Angeles, CA) and invited the public to comment on ways that the CRA regulations should be revised to better reflect current banking practices. The agencies are considering ways to update the regulations to reflect changes in the financial services industry, including how banking services are delivered to consumers, to ensure that CRA continues to encourage institutions to meet community credit needs effectively. In addition to public hearings, the agencies invited written comments through August 31, 2010. The Federal Reserve received nearly 1,200 comment letters.

Mergers and Acquisitions in Relation to the CRA

During 2010, the Board considered and approved six banking merger applications.

- An application by First Niagara Financial Group, Inc., Buffalo, NY, to acquire Harleysville National Corp., Harleysville, PA, was approved in March.
- An application by Premier Commerce Bancorp, Inc., Palos Hills, IL, to acquire G.R. Bancorp, Ltd., Grand Ridge, IL, was approved in July.
- An application by The Toronto-Dominion Bank, Toronto, Canada, to acquire The South Financial Group, Inc. Greenville, SC, was approved in July.
- An application by Metcalf Bank, Lees Summit, MO, to purchase certain assets and assume certain liabilities of The First National Bank of Olathe, Olathe, KS, was approved in September.
- An application by SKBHC Holdings, LLC, Corona Del Mar, CA, to acquire Starbuck Bancshares, Inc., Starbuck, MN, was approved in October.
- An application by Caja de Ahorros de Valencia, Catellon Y Alicante, Valencia, Spain to become a bank holding company by acquiring control of CM Florida Holdings, Inc., Coral Gables, FL, and City National Bancshares, Inc. and its subsidiary,

City National Bank of Florida, both of Miami, FL, was approved in December.

(Four other protested applications were withdrawn by the applicants.)

Members of the public had the opportunity to submit comments on the applications; their comments raised various issues. Several comments referenced a failure to make credit available to certain minority groups and to low- and moderate-income individuals and in low- and moderate-income geographies, including insufficient branch presence in low-income geographies. Other comments cited predatory and discriminatory lending practices with respect to residential mortgages, credit card loans, and small business loans. Another comment alleged enabling predatory servicing and loss mitigation practices, as well as unethical business practices, as evidenced by a recent U.S. Securities and Exchange Commission civil lawsuit. Several comments warned of inadequate plans to meet communities' credit needs and a reduction in access to credit for affected communities.

The Board also considered 75 applications with outstanding issues involving compliance with consumer protection statutes and regulations, including fair lending laws and the CRA. Some of those issues involved unfair and deceptive practices, as well as concerns about stored value cards. Sixty of those applications were approved and 15 were withdrawn.

Fair Lending Enforcement

The Federal Reserve is committed to ensuring that the institutions it supervises comply fully with the federal fair lending laws—the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. Fair lending reviews are conducted regularly within the supervisory cycle. Additionally, examiners may conduct fair lending reviews outside of the usual supervisory cycle, if warranted by fair lending risk. When examiners find evidence of potential discrimination, they work closely with the division's Fair Lending Enforcement Section, which brings additional legal and statistical expertise to the examination and ensures that fair lending laws are enforced consistently and rigorously throughout the Federal Reserve System.

The Federal Reserve enforces the ECOA and the provisions of the Fair Housing Act that apply to lending institutions. The ECOA prohibits creditors from discriminating against any applicant, in any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex or marital status, or age. In addition, creditors may not discriminate against an applicant because the applicant receives income from a public assistance program or has exercised, in good faith, any right under the Consumer Credit Protection Act. The Fair Housing Act prohibits discrimination in residential real estate related transactions, including the making and purchasing of mortgage loans, on the basis of race, color, religion, sex, handicap, familial status, or national origin.

Pursuant to the ECOA, if the Board has reason to believe that a creditor has engaged in a pattern or practice of discrimination in violation of the ECOA, the matter will be referred to the U.S. Department of Justice (DOJ). The DOJ reviews the referral and determines whether further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement. The DOJ may decide instead to return the matter to the Federal Reserve for administrative enforcement. When a matter is returned to the Federal Reserve, staff ensures that the institution takes all appropriate corrective action.

During 2010, the Board referred eight matters to the DOJ.

- Three referrals involved redlining, or discrimination against potential borrowers based upon the racial composition of their neighborhoods, in violation of the ECOA and the Fair Housing Act. Based on an analysis of each bank's lending practices, its marketing, the location of its branches, and its delineated assessment area under the CRA, the Board determined that the banks avoided lending in minority neighborhoods.
- One referral involved discrimination in mortgage pricing, in violation of the ECOA and the Fair Housing Act. The lender charged African-American borrowers higher APRs than non-Hispanic white borrowers for mortgage loans originated through its wholesale channel and guaranteed by the Federal Housing Administration or the Department of Veterans Affairs. Legitimate pricing factors failed to explain the pricing disparities.
- One referral involved discrimination in the pricing of unsecured and automobile loans on the basis of national origin, in violation of the ECOA. The lender charged Hispanic borrowers higher interest rates than non-Hispanic borrowers for unsecured

and automobile loans, and the disparities could not be explained by legitimate pricing factors.

- Three referrals involved discrimination on the basis of marital status, in violation of the ECOA. The banks improperly required spousal guarantees and signatures on commercial or agricultural loans, in violation of Regulation B.

If a fair lending violation does not constitute a pattern or practice that is referred to the DOJ, the Federal Reserve acts on its own to ensure that the violation is remedied by the bank. Most lenders readily agree to correct fair lending violations. In fact, lenders often take corrective steps as soon as they become aware of a problem. Thus, the Federal Reserve generally uses informal supervisory tools (such as memoranda of understanding between the bank's board of directors and the Reserve Bank) or board resolutions to ensure that violations are corrected. If necessary to protect consumers, however, the Board can and does bring public enforcement actions.

Monitoring Emerging Fair Lending Issues

The Federal Reserve continues to carefully monitor credit markets for emerging fair lending risks. Developments in the financial industry surrounding loan modification and credit-tightening practices continue to raise potential fair lending concerns. Mortgage servicers face challenges managing the fair lending risk of their activities in the midst of increasing modification activity. Additionally, some lenders have adopted policies that could potentially pose a disproportionate impact on minorities, such as branch closings and tighter credit standards in specific geographic markets. In response to these trends, the Federal Reserve continues to carefully monitor lenders' practices for potential fair lending violations. In accordance with the Interagency Fair Lending Examination Procedures, the Federal Reserve conducts examinations to evaluate whether lenders' policies may violate fair lending laws by having an illegal disparate impact on minorities, and to identify steering, redlining, reverse redlining, and other fair lending violations. These risk-focused examinations include loan modification reviews when appropriate. Loan modification fair lending reviews include an analysis of servicer data for any evidence of potential disparate treatment or impact.

Financial Fraud Enforcement Task Force

As an active member of the Financial Fraud Enforcement Task Force (FFETF), the Federal Reserve coordinates with other federal agencies to ensure consistent and collaborative enforcement of the fair lending laws. The director of the Federal Reserve's Division of Consumer and Community Affairs co-chairs the FFETF's Nondiscrimination Working Group with the assistant attorney general for DOJ's Civil Rights Division, deputy general counsel of HUD, and the attorney general for the State of Illinois. One of the Working Group's key initiatives, led by HUD, DOJ, and the Federal Reserve, is to ensure that discrimination does not occur when borrowers receive loans backed by the Federal Housing Administration (FHA). In addition, the Federal Reserve is taking a leading role in the Working Group's effort to analyze data on Treasury's Home Affordable Modification Program for any evidence of potential discrimination by participating servicers.

Flood Insurance

The National Flood Insurance Act imposes certain requirements on loans secured by buildings or mobile homes located in, or to be located in, areas determined to have special flood hazards. Under the Federal Reserve's Regulation H, which implements the act, state member banks are generally prohibited from making, extending, increasing, or renewing any such loan unless the building or mobile home, as well as any personal property securing the loan, are covered by flood insurance for the term of the loan. The law requires the Board and other federal financial institution regulatory agencies to impose civil money penalties when they find a pattern or practice of violations of the regulation. The civil money penalties are payable to the Federal Emergency Management Agency (FEMA) for deposit into the National Flood Mitigation Fund.

During 2010, the Board imposed civil money penalties (CMPs) against three state member banks. The dollar amount of the penalties, which were assessed via consent orders, totaled $33,010.

Coordination with Other Federal Banking Agencies

The member agencies of the Federal Financial Institutions Examination Council (FFIEC) develop uniform examination principles, standards, procedures, and report formats. In 2010, the FFIEC member organizations issued the examination procedures and guidance regarding a number of regulations.

- **Interagency Examination Procedures for the Regulation on Risk-Based Pricing Notices (Regulation V).**

The revised examination procedures address changes to the Fair Credit Reporting Act (FCRA), as amended by the Fair and Accurate Credit Transactions Act of 2003. The regulation requires a creditor to provide a consumer with a notice when, based on the consumer's credit report, the creditor provides credit to the consumer on materially less favorable terms than it provides to other consumers. The regulation provides creditors with several methods for determining which consumers must receive risk-based pricing notices. As an alternative to providing risk-based pricing notices, the regulation permits creditors to provide consumers who apply for credit with a free credit score and information about their score.[20]

- **Interagency Examination Procedures for Regulation E–Electronic Fund Transfers (revised).** The revised examination procedures incorporate the Board's revisions to the gift card provisions of Regulation E. For cards produced prior to April 1, 2010, the revisions modify the effective date of certain disclosure and card expiration requirements in the gift card provisions of the Credit Card Act.[21]
- **Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks.** The interagency guidance addresses the compliance and reputation risks associated with reverse mortgages and focuses on ways in which lenders can mitigate several areas of regulatory concern, including misleading communication with consumers through marketing and advertisements, and potential conflicts of interest and abusive practices in connection with reverse mortgage transactions.[22]
- **Interagency Examination Procedures for Regulation Z–Truth in Lending (revised).** The revised examination procedures incorporate the 2009 amendments to Regulation Z, as a result of the Credit Card Act. The Credit Card Act amended TILA and established a number of new requirements for open-end consumer credit plans. The Credit Card Act provisions were effective in three stages, and these procedures reflect the third and final stage of revisions, which incorporate rules to protect credit card users from unreasonable late payment fees and other penalty fees. They also require credit card issuers to evaluate interest rate increases imposed since January 1, 2009.[23] (These procedures were superseded by revised Regulation Z examination procedures issued on January 28, 2011, and ultimately by revised procedures issued on March 18, 2011.)
- **Interagency Examination Procedures for Regulation DD–Truth in Savings (revised).**The revised examination procedures incorporate the 2010 technical clarifications to Regulation DD. These clarifications require use of the term *Total Overdraft Fees* when disclosing such fees on periodic statements and provide guidance for disclosing consumer account balance information through automated systems for retail sweep accounts.[24]
- **Interagency Supervisory Guidance for Institutions Affected by the Deepwater Horizon Oil Spill.** This guidance reminds financial institutions that they retain the flexibility to work with borrowers that may need additional time to resolve financial uncertainties related to the effects of the oil spill.[25]
- **Interagency Examination Procedures for Regulation E–Electronic Fund Transfers (revised).** The revised examination procedures incorporated the Board's recent amendments to Regulation E regarding overdraft fees and gift cards, which went into effect on July 1, 2010, and August 22, 2010, respectively. Section 205.17 of amended Regulation E prohibits financial institutions from charging fees for overdrafts on ATM and one-time debit card transactions, unless a consumer opts in to the overdraft service for those types of transactions. Section 205.20 of amended Regulation E restricts the fees and expiration dates that may apply to gift cards. The rules protect consumers from certain unexpected costs and require that gift card terms and conditions be clearly stated. The rules generally cover retail gift cards, which can be used to buy goods or services at a single merchant or affiliated group of merchants, and network-branded gift cards, which are redeemable at any merchant that

[20] Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1014/caltr1014.htm.

[21] Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1012/caltr1012.htm.

[22] Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1011/caltr1011.htm.

[23] Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2011/1103/caltr1103.htm.

[24] Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1009/caltr1009.htm.

[25] Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/srletters/2010/SR1013.htm.

accepts the card brand.[26] (These procedures were superseded by revised Regulation E examination procedures issued, on October 22, 2010.)

- **Interagency Examination Procedures for Regulation Z–Truth in Lending (revised).** The revised examination procedures incorporated amendments to Regulation Z that became effective, on July 1, 2010, which revised the requirements for credit card disclosures provided with applications and solicitations, at account opening, and on periodic statements. The new disclosure requirements were also imposed for convenience checks and advertisements.[27] (These procedures were initially superseded by revised Regulation Z examination procedures issued on August 20, 2010, which were then replaced by revised examination procedures issued on January 28, 2011, and ultimately by revised procedures issued on March 18, 2011.)
- **Interagency Examination Procedures Regarding the Duties of Furnishers of Information.** These examination procedures incorporate the 2010 changes to Regulation V, which implements the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003. The changes require furnishers of consumer information to (1) implement written policies and procedures regarding the accuracy and integrity of consumer information that it furnishes to a consumer reporting agency, (2) consider the interagency guidelines concerning information accuracy and integrity when developing written policies and procedures, and (3) conduct a reasonable investigation of disputes submitted by consumers concerning the accuracy of any information contained in a consumer report that pertains to an account or other relationship that the furnisher has or had with the consumer.[28]
- **Revised Interagency Questions and Answers on Community Reinvestment.** The interagency questions and answers interpret the CRA regulations and provide guidance to financial institutions and the public. The revised questions and answers provide examples of ways an institution could determine that its community services are targeted to low- and moderate-income individuals. In addition, the agencies revised the question and answer on reporting requirements for community development loans and made a conforming change to the question and answer that provides examples of "other loan data."[29]
- **Interagency Examination Procedures for Regulation Z–Truth in Lending (revised).** The revised examination procedures incorporate the 2009 amendments to Regulation Z, as a result of the Credit Card Act. The Credit Card Act amended TILA and established a number of new requirements for open-end consumer credit plans. The Credit Card Act provisions were effective in three stages, and these procedures reflect the second stage of revisions, which protect consumers from unexpected increases in credit card interest rates on existing balances, require card issuers to consider a consumer's ability to make the required payments, establish special requirements for extensions of credit to consumers who are under the age of 21, and limit the assessment of fees for exceeding the credit limit on a credit card account. The examination procedures also implemented provisions of HEOA that became effective on February 14, 2010. Under the HEOA amendments, creditors that extend private education loans must provide disclosures about loan terms on or with the loan application, when the loan is approved, and when the loan is consummated.[30] (These procedures were initially superseded by revised Regulation Z examination procedures issued on June 25, 2010, then January 28, 2011, and ultimately replaced by revised examination procedures issued on March 18, 2011.)

Training for Bank Examiners

Ensuring that financial institutions comply with laws that protect consumers and encourage community reinvestment is an important part of the bank examination and supervision process. As the number and complexity of consumer financial transactions grow, training for examiners of the organizations under the Federal Reserve's supervisory responsibility becomes even more important. The staff development function is responsible for the ongoing development of the professional consumer compliance supervisory

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26 Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1012/caltr1012.htm.

27 Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2011/1103/caltr1103.htm.

28 Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1005/caltr1005.htm.

29 Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2010/1002/caltr1002.htm.

30 Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2011/1103/caltr1103.htm.

staff, and ensuring that these staff members have the skills necessary to meet their supervisory responsibilities now and in the future.

Consumer Compliance Examiner Training Curriculum

The consumer compliance examiner training curriculum consists of six courses focused on various consumer protection laws, regulations, and examining concepts. In 2010, these courses were offered in 10 sessions, and training was delivered to a total of 165 System consumer compliance examiners and staff members, and 12 state banking agency examiners.

When appropriate, courses are delivered via alternative methods, such as the Internet or other distance-learning technologies. For instance, several courses use a combination of instructional methods: (1) classroom instruction focused on case studies and (2) specially developed computer-based instruction that includes interactive self-check exercises.

Board and Reserve Bank staff regularly review the core curriculum for examiner training, updating subject matter and adding new elements as appropriate. During 2010, staff initiated one curriculum review. The Fair Lending Examination Techniques (FLET) course was reviewed in order to incorporate technical changes in policy and laws, along with changes in instructional delivery techniques. This course is designed to equip assistant level examiners with the skills and knowledge to plan and conduct a risk-focused fair lending examination, and incorporates the FFIEC fair lending examination procedures. The risk-focused examination approach and the procedures require considerable examiner judgment in the planning stages of an examination.

In addition, a real estate workshop was held to train consumer compliance examiners. The workshop provided an overview of new and revised mortgage regulations, including in-class exercises for participants to apply their knowledge. Subsequent to the workshop, staff produced and distributed compact discs of the workshop to the 12 Reserve Banks for use in "train-the-trainer" sessions.

Life-long Learning

In addition to providing core examiner training, the Staff Development function emphasizes the importance of continuing life-long learning. Opportunities for continuing learning include special projects and assignments, self-study programs, rotational assignments, the opportunity to instruct at System schools, mentoring programs, and an annual consumer compliance examiner forum, where senior consumer compliance examiners receive information on emerging compliance issues, and are able to share best practices from across the System.

In 2010, the System continued to offer "Rapid Response" sessions, which are a powerful delivery method for just-in-time training. Debuted in 2008, Rapid Response sessions offer examiners one-hour teleconference presentations on emerging issues or urgent training needs that result from the implementation of new laws, regulations, or supervisory guidance. A total of six consumer compliance Rapid Response sessions were designed, developed, and presented to System staff during 2010.

Agency Reports on Compliance with Consumer Protection Laws

The Board reports annually on compliance with consumer protection laws by entities supervised by federal agencies. This section summarizes data collected from the 12 Federal Reserve Banks, the FFIEC member agencies, and other federal enforcement agencies.[31]

Regulation B (Equal Credit Opportunity)

The FFIEC agencies reported that approximately 82 percent of the institutions examined during the 2010 reporting period were in compliance with Regulation B, compared with 81 percent for the 2009 reporting period. The most frequently cited violations involved

- failure to provide a timely and/or accurate notice of approval, counteroffer, or adverse action within 30 days after receiving a completed credit application;
- improperly requiring a borrower to obtain the signature of a spouse or other person in order to be considered for credit approval; and
- failure to collect information about applicants seeking credit primarily for the purchase or refinancing of a principal residence, including applicant race, ethnicity, sex, marital status, and age, for government monitoring purposes.

The Board and the Office of the Comptroller of the Currency (OCC) each initiated one formal Regula-

[31] Because the agencies use different methods to compile the data, the information presented here supports only general conclusions. The 2010 reporting period was July 1, 2009, through June 30, 2010.

tion B-related public enforcement action during the reporting period, while the Office of Thrift Supervision (OTS) initiated five and the Federal Deposit Insurance Corporation (FDIC) initiated 15.[32] There were no other enforcement actions by FFIEC agencies.

The other agencies that enforce the ECOA—the Federal Trade Commission (FTC), the Farm Credit Administration (FCA), the Department of Transportation (DOT), the Securities and Exchange Commission (SEC), the Small Business Administration, and the Grain Inspection, Packers and Stockyards Administration of the Department of Agriculture—reported substantial compliance among the entities they supervise. The FCA's examination activities revealed that most Regulation B violations involved either (1) creditors' failure to request or provide information for government monitoring purposes or (2) creditors providing inadequate and/or untimely statements of specific reasons for adverse actions. None of these agencies initiated formal enforcement actions relating to Regulation B during the reporting period.

Regulation E (Electronic Fund Transfers)

The FFIEC agencies reported that approximately 93 percent of the institutions examined during the 2010 reporting period were in compliance with Regulation E, compared with 94 percent for the 2009 reporting period. The most frequently cited violations involved failure to

- provide a written explanation to the consumer when an investigation determines that no account error or a different error has occurred;
- provisionally credit the consumer's account for the amount of an alleged error when an investigation into the alleged error cannot be completed within 10 business days; and
- provide initial disclosures that contain required information, including limitations on the types of transfers permitted and error-resolution procedures, at the time a consumer contracts with an institution for an electronic fund transfer service.

The FDIC initiated 12 formal Regulation E-related enforcement actions during the reporting period. There were no other enforcement actions by FFIEC agencies or the SEC. The FTC filed one action against a company for violating a 2008 court order related to, among other things, a Regulation E violation.

Regulation M (Consumer Leasing)

The FFIEC agencies reported that 100 percent of the institutions examined during the 2010 reporting period were in compliance with Regulation M, which is the same compliance rate as the 2009 reporting period. The FFIEC agencies did not issue any public enforcement actions specific to Regulation M during the period.

Regulation P (Privacy of Consumer Financial Information)

The FFIEC agencies reported that approximately 98 percent of the institutions examined during the 2010 reporting period were in compliance with Regulation P, which is the same rate of compliance as the 2009 reporting period. The most frequently cited violations involved failure to

- provide clear and conspicuous initial privacy notices to customers,
- provide customers with a clear and conspicuous annual notice reflecting the institution's privacy policies and practices, and
- disclose the institution's information sharing practices in initial, annual, and revised privacy notices.

The OCC initiated two formal Regulation P-related enforcement actions during the reporting period, while the FDIC initiated six.[33] There were no other enforcement actions by FFIEC agencies.

Regulation Z (Truth in Lending)

The FFIEC agencies reported that approximately 82 percent of the institutions examined during the 2010 reporting period were in compliance with Regulation Z, compared with 92 percent for the 2009 reporting period. The most frequently cited violations involved

- failure to accurately disclose the finance charges in closed-end credit transactions;
- for certain residential mortgage transactions, failure to provide a good faith estimate of the required disclosures before consummation, or not later than

[32] Consumer compliance public enforcement actions are categorized by regulation throughout the report. Because some enforcement actions include violations of more than one regulation, the overall sum of actions derived from each regulation will be greater than the actual total number of enforcement actions initiated, which was 54.

[33] The FDIC's reported information in this area relates to part 332—Privacy of Consumer Financial Information—of the agency's regulations and not Regulation P.

three business days after receipt of a written loan application; and

- failure to provide complete and accurate disclosures for open-end credit secured by a consumer's dwelling (home equity plans).

In addition, 170 banks supervised by the Federal Reserve, FDIC, OCC, and OTS were required, under the Interagency Enforcement Policy in Regulation Z, to reimburse a total of approximately $2.12 million to consumers for understating APRs and/or finance charges in their consumer loan disclosures.

The Board initiated one formal Regulation Z-related enforcement action during the reporting period, the OTS initiated one, the OCC initiated four, and the FDIC initiated 18. The DOT continued to prosecute one air carrier for its alleged improper handling of credit card refund requests and other Federal Aviation Act violations.

Regulation AA (Unfair or Deceptive Acts or Practices)

The FFIEC agencies reported that approximately 99 percent of the institutions examined during the 2010 reporting period were in compliance with Regulation AA, which is the same rate of compliance as for the 2009 reporting period. The OTS initiated three formal Regulation AA-related enforcement actions, the OCC initiated three, and the FDIC initiated seven during the reporting period. There were no other enforcement actions by FFIEC agencies.

Regulation CC (Availability of Funds and Collection of Checks)

The FFIEC agencies reported that approximately 90 percent of institutions examined during the 2010 reporting period were in compliance with Regulation CC, which is the same rate of compliance as for the 2009 reporting period. The most frequently cited violations involved failure to

- make available on the next business day the lesser of $100 or the aggregate amount of checks deposited that are not subject to the next-day availability requirement,
- make funds deposited from local and certain other checks available for withdrawal within the times prescribed by the regulation, and
- provide required information to the consumer when placing an exception hold on an account.

The OCC initiated two formal Regulation CC-related enforcement actions during the reporting period, while the FDIC initiated seven. There were no other enforcement actions by FFIEC agencies.

Regulation DD (Truth in Savings)

The FFIEC agencies reported that approximately 86 percent of institutions examined during the 2010 reporting period were in compliance with Regulation DD, compared with 87 percent for the 2009 reporting period. The most frequently cited violations involved

- failure to provide required initial account disclosures;
- inappropriate use of the phrase "annual percentage yield" in an advertisement without providing required additional terms and conditions; and
- failure to provide account disclosures clearly and conspicuously, in writing, and in a form that the consumer may keep.

The FDIC initiated 17 formal Regulation DD-related enforcement actions during the reporting period. There were no other enforcement actions by FFIEC agencies.

Responding to Consumer Complaints and Inquiries

The Federal Reserve investigates complaints against state member banks and selected nonbank subsidiaries of bank holding companies (Federal Reserve Regulated Entities), and forwards complaints against other creditors and businesses to the appropriate enforcement agency.[34] Each Reserve Bank investigates complaints against state member banks and selected nonbank subsidiaries in its District. The Federal Reserve also responds to consumer inquiries on a broad range of banking topics, including consumer protection questions.

In late 2007, the Federal Reserve established Federal Reserve Consumer Help (FRCH) to centralize the processing of consumer complaints and inquiries. In 2010, FRCH processed 49,525 cases. Of these cases, more than half (26,324) were inquiries and the remainder (23,201) were complaints, with most cases received directly from consumers. Approximately 3 percent of cases were referred to the Federal Reserve from other agencies.

While consumers can contact FRCH by telephone, fax, mail, e-mail, or online, most FRCH consumer contacts occurred by telephone (51 percent). Nevertheless, 44 percent (21,563) of complaint and inquiry submissions were made electronically (including e-mail, online submissions, and fax) and the online form page received over 406,000 visits during the year.

Consumer Complaints

Complaints against Federal Reserve Regulated Entities totaled 7,461 in 2010. Approximately 33 percent (2,468) of these complaints were closed without investigation pending the receipt of additional information from consumers. Nearly 2 percent (140) of the total complaints are still under investigation. Of the remaining complaints, 69 percent (3,343) involved unregulated practices and 31 percent (1,510) involved regulated practices.

Complaints about Regulated Practices

The majority of regulated practice complaints concerned checking accounts (32 percent), real estate (27 percent), and credit cards (11 percent). The most common checking account complaints related to insufficient funds or overdraft charges and procedures (52 percent), disputed withdrawal of funds (10 percent), funds availability not as expected (7 percent), and disputed crediting of funds (5 percent). The most common real estate complaints by problem code related to: credit denied—other (13 percent), payment errors and delays (10 percent), credit—rates, terms, and fees (10 percent), and escrow account problems (9 percent). Complaints by product code related to: home-purchase loans (60 percent), home refinance and closed-end loans (25 percent), and home equity credit lines (10 percent).[35] The most common credit card complaints related to interest rates, terms, and fees (17 percent), payment errors and delays (11 percent), billing error resolutions (11 percent), and bank debt collection tactics (10 percent).

Forty-six regulated complaints alleging discrimination were received. Of these, 22 complaints (less than 2 percent of total regulated complaints) alleged discrimination on the basis of prohibited borrower

Table 1. Complaints against state member banks and selected nonbank subsidiaries of bank holding companies about regulated practices, by Regulation/Act, 2010

Regulation/Act	Number
Regulation AA (Unfair or Deceptive Acts or Practices)	39
Regulation B (Equal Credit Opportunity)	82
Regulation BB (Community Reinvestment)	3
Regulation C (Home Mortgage Disclosure)	1
Regulation CC (Expedited Funds Availability)	103
Regulation D (Reserve Requirements)	5
Regulation DD (Truth in Savings)	370
Regulation E (Electronic Funds Transfers)	203
Regulation G (Disclosure / Reporting of CRA-Related Agreements)	0
Regulation H (National Flood Insurance Act / Insurance Sales)	30
Regulation M (Consumer Lending)	7
Regulation P (Privacy of Consumer Financial Information)	26
Regulation Q (Payment of Interest)	7
Regulation V (Fair and Accurate Credit Transactions)	3
Regulation Z (Truth in Lending)	403
Fair Credit Reporting Act	69
Fair Debt Collection Practices Act	62
Fair Housing Act	22
Home Ownership Counseling	0
HOPA (Homeowners Protection Act)	4
Real Estate Settlement Procedures Act	67
Right to Financial Privacy Act	4
Total	**1,510**

34 Effective September 14, 2009, CA Letter 09-08, www.federalreserve.gov/boarddocs/caletters/2009/0908/caltr0908.htm.

35 Real estate loans include adjustable-rate mortgages; residential construction loans; open-end home equity lines of credit; home improvement loans; home purchase loans; home refinance/closed-end loans; and reverse mortgages.

Table 2. Complaints against state member banks and selected nonbank subsidiaries of bank holding companies about regulated practices, by product type, 2010

Subject of complaint/product type	All complaints		Complaints involving violations	
	Number	Percent	Number	Percent
Total	**1,510**	**100**	**68**	**4.5**
Discrimination alleged				
Real estate loans	27	1.8	2	0.1
Credit Cards	6	0.4	0	0
Other loans	13	0.9	1	0.1
Nondiscrimination complaints				
Checking accounts	486	32.2	18	1.2
Real estate loans	384	25.4	23	1.5
Credit cards	165	10.9	4	0.3

traits or rights.[36] Twenty-eight percent of discrimination complaints were related to the race, color, national origin, or ethnicity of the applicant or borrower. Thirteen percent of discrimination complaints were related to either the age or handicap of the applicant or borrower. There were two violations where discrimination was alleged; one involved a real estate loan and the other involved a motor vehicle loan.

In 87 percent of investigated complaints against Federal Reserve Regulated Entities, evidence revealed that institutions correctly handled the situation. Of the remaining 13 percent of investigated complaints, 34 percent were deemed violations of law, 21 percent were identified errors which were corrected by the bank, 8 percent were referred to other agencies, and the remainder were matters involving litigation or factual disputes, withdrawn complaints, internally referred complaints, or information was provided to the consumer. The most common violations involved real estate loans and checking accounts.

Complaints about Unregulated Practices

As required by section 18(f) of the Federal Trade Commission Act, the Board continued to monitor complaints about banking practices not subject to existing regulations, with a focus on instances of potential unfair or deceptive practices. In 2010, the Board received 3,343 complaints against Federal Reserve Regulated Entities that involved these unregulated practices. Most complaints were related to real estate concerns (37 percent), checking account activity (33 percent), and credit cards (6 percent).

More specifically, consumers most frequently complained about issues involving insufficient funds or overdraft charges and procedures; debt collection/foreclosures; interest rates, terms, and fees; depository forgery, fraud, embezzlement, or theft; opening and closing deposit accounts; procedure and policy concerns; and disputed withdrawals of funds.

Complaints about Loan Modifications and Foreclosures

In 2010, the Federal Reserve received 1,050 complaints related to loan modifications and foreclosures. Of these, consumers complained primarily about home purchase loans (79 percent), home refinance/closed-end loans (9 percent), and adjustable rate mortgage loans (6 percent). The top three consumer protection issues documented with specific codes were: debt collection/foreclosure (47 percent); interest rates, terms, and fees (27 percent); and credit denied (4 percent).

Complaint Referrals

In 2010, the Federal Reserve forwarded 15,505 complaints against other banks and creditors to the appropriate regulatory agencies and government offices for investigation. To minimize the time required to re-route complaints to these agencies, referrals were transmitted electronically.

The Federal Reserve forwarded 21 complaints to HUD that alleged violations of the Fair Housing Act.[37] The Federal Reserve's investigation of these complaints revealed no evidence of illegal credit discrimination.

[36] Prohibited basis includes: race, color, religion, national origin, sex, marital status, age, applicant income derived from public assistance programs, or applicant reliance on provisions of the Consumer Credit Protection Act.

[37] A memorandum of understanding between HUD and the federal bank regulatory agencies requires that complaints alleging a violation of the Fair Housing Act be forwarded to HUD.

Consumer Inquiries

The Federal Reserve received 26,324 consumer inquiries in 2010, covering a wide range of topics. The top three consumer protection issues documented with specific codes were: adverse action notices received pursuant to the Equal Credit Opportunity Act (7 percent), exchange or issuance of coin or currency (2 percent), and credit denials for reasons other than prohibited basis (2 percent). Consumers were typically directed to other resources, including other federal agencies or written materials, to address their inquiries.

The System's FRCH also empowers consumers in recognizing and reporting scams. The site contains consumer information alerting consumers to characteristics of a scam and provides a link for reporting information on a product or service they suspect of being a scam. Fifty-four scams were tracked through FRCH in 2010, and sent to the appropriate federal authorities for investigation and prosecution.

Supporting Community Economic Development

The Federal Reserve System's Community Affairs Offices (CAOs) work to promote community economic development and fair access to credit for low- and moderate-income communities and populations. As a decentralized function, the CAOs at each of the 12 Reserve Banks design activities to respond to the specific needs of the communities they serve, with oversight from Board staff. They provide information and promote awareness of investment opportunities to financial institutions, government agencies, and organizations that serve low- and moderate-income communities and populations. Similarly, the Board's CAO promotes and coordinates Systemwide, high-priority efforts; in particular, Board community affairs staff focus on issues that have public policy implications.

Small Business Finance and Mobile Banking Issues

The financial crisis and the economic downturn resulted in constrained credit conditions during 2010, raising significant concerns regarding access to credit for small businesses. To gain a better understanding of the issues, needs, and programs and policies that would be helpful, the CAOs undertook a comprehensive initiative to convene small business owners, lenders, community leaders, and government officials to support small businesses' access to credit. (See "Box 1. Credit Where Credit Is Due: Supporting Small Business Access to Credit" on page 99, for more details.)

In addition, DCCA recognized the importance of understanding and gaining insight into the fast-evolving dynamics in mobile banking. In 2010, staff convened an emerging issues forum entitled *Cash, Check, or Cell Phone? Protecting Consumers in a Mobile Finance World*. The forum brought together banking and industry leaders, vendors of mobile financial services, researchers, consultants, payment services firms, consumer advocates, and regulators to discuss the new opportunities and challenges presented by emerging technologies in banking and payments. The forum proceedings, including podcasts and presentations, are available to the public through the Board's website.[38] The important innovations in mobile finance now underway will change the way consumers conduct financial transactions with their bank, merchants, and other consumers. As mobile finance technologies, standards, and business models continue to advance, DCCA will continue to monitor their evolution to ensure that consumers are adequately protected as they take advantage of promising new products and services.

Vacant Properties and Neighborhood Stabilization

In 2010, issues related to high rates of foreclosure continued to dominate the System's community affairs agenda. While each Reserve Bank addressed the impact of foreclosure on low- and moderate-income communities—through programming tailored to the particular needs of communities in their Districts—the CAOs of the 12 Reserve Banks (under the sponsorship of their presidents) worked closely with the Board to develop the Mortgage Outreach and Research Efforts (MORE) Initiative.[39] The goal of MORE is to leverage the Federal Reserve's substantial knowledge of and expertise in mortgage markets in ways that are useful to policymakers, community organizations, financial institutions, and the public.[40]

As a key element of the MORE initiative, the System produced a volume on real estate owned (REO) prop-

[38] More information about the forum is available at www.federalreserve.gov/communityaffairs/national/2010mobile.

[39] To read about the MORE initiative, see www.chicagofed.org.

[40] *Resources for Stabilizing Communities* is available at www.federalreserve.gov/communitydev/stablecommunities.htm.

Box 2. What You Need to Know: Consumer Ed from the Fed

The Federal Reserve's consumer protection regulations affect consumers every day, but, due to numerous recent regulatory and legislative changes, many consumers may not understand, or be aware of, their new rights and obligations as consumers. The new regulatory protections can impact consumers who are making a purchase with a credit or debit card, opening a checking account, taking out a mortgage loan, or using another financial product or service.

Recognizing this as an opportunity to educate consumers about the changes, the Board launched a new consumer education series, *What You Need to Know*, in 2010 to provide consumers with plain-language information about new consumer protections (see the Board's website at www.federalreserve.gov/consumerinfo/wyntk.htm).

The first publication in the series, *What You Need to Know: New Credit Card Rules*, was released in February 2010 to coincide with the launch of a new microsite that focuses on the changes to credit card rules. The site also includes basic facts about common credit card options, interest rates, and fees, as well as information about common credit card problems, such as lost or stolen cards. Interactive features help consumers learn more about credit card offers and new features of their monthly statements.

When the Board issued new rules regarding gift cards, another publication was added to the series. *What You Need to Know: New Rules for Gift Cards* describes the different types of gift cards (store vs. logo cards) and the new limitations and required fee disclosures. The educational piece also informs consumers that certain types of cards—reloadable prepaid cards and rewards cards—are not covered under the new rules.

In June, the Board added *What You Need to Know: New Overdraft Rules for Debit and ATM Cards* to the series to accompany the release of new debit card rules. This piece provides consumers with an easy-to-understand overview of the facts about banks' overdraft policies and consumers' rights under the new rules in order to help them make educated decisions about whether or not to "opt in" to overdraft protection and what to do if they change their mind.

It is crucial that consumers understand how credit decisions are made, and the Federal Reserve and the Federal Trade Commission issued new rules in 2010 to help consumers get more information about how their credit report or credit score can impact a lender's decision. In advance of the rules' 2011 effective date, *What You Need to Know: New Rules about Credit Decisions and Notices* was released to help consumers find and understand their credit standing and to exercise their rights in applying for credit. This publication also describes the various notices that may be issued to consumers in response to a credit application or credit account, and instructions about what to do if they receive a notice.

What You Need to Know: New Rules for Mortgage Transfers was created in conjunction with new regulations effective January 1, 2011, which require that consumers be notified when their mortgage loan has been sold or transferred. This publication helps consumers understand who owns their mortgage loan and who they can contact to handle certain issues, including payment disputes and loan modifications.

The *What You Need to Know* series demonstrates the Federal Reserve's commitment to helping consumers understand how consumer protection regulations impact them and to providing them with the information they need to make good financial decisions.

erties and neighborhood stabilization issues. More specifically, with the goal of helping communities to address the effects of concentrated foreclosures, the Board worked with the Federal Reserve Banks of Boston and Cleveland to produce a special volume of research that examines important questions about lender-owned real estate.

The publication, *REO and Vacant Properties: Strategies for Neighborhood Stabilization*, consists of a series of papers that explore regional differences and present perspectives from the various participants involved in REO disposition—sellers, buyers, nonprofits, and municipalities.[41] The authors were drawn from national nonprofits, large holders of servicers of REOs, community affairs researchers, and academics. Chapters in the publication addressed a wide range of questions: What factors can bring about stability in a high-foreclosure neighborhood? and What are the incentives of the various parties to REO transactions? The publication was made public at the *REO and Vacant Property Strategies for Neighborhood Stabilization Summit*, a Board-hosted event that exam-

[41] The publication is available online at www.federalreserve.gov/events/conferences/2010/reovpsns/downloads/reo_20100901.pdf.

ined the community impacts of foreclosed and vacant properties, held in September 2010. At the summit, key findings from a Federal Reserve research project on local uses of NSP funds initiated in 2009 were also released.

In an effort to address the current foreclosure issues, the Board also continued its partnership with NeighborWorks America® (NWA), which was initiated in 2009 to continue to leverage the System's resources with those of the NWA.[42] As part of the partnership, the Board has coordinated the development and distribution of a new quarterly survey to the NWA organizations and the National Foreclosure Mitigation Counseling (NFMC) Program grantees and subgrantees. The survey is intended to gather information on loan modification efforts, rental housing, unemployment, and key emerging issues faced by low- and moderate-income communities. The survey was distributed to approximately 850 organizations.

Community Data Initiative

By complementing information-sharing and partnership roles with a rigorous analytical capacity, community affairs is able to provide reliable information that has helped to identify and close data gaps for low- and moderate-income communities. In 2010, the Board launched the Community Data Initiative (CDI), a CAO collaborative research project. The goal of the CDI project is to provide Board and Reserve Bank leadership with systematic and relevant community conditions and trend information on a consistent basis. The quarterly or biannual e-polling of selected district community stakeholders provides ongoing intelligence of current and emerging community development issues. To date, there are seven beta site Reserve Banks that are administering web-based polls and surveys. Two additional Reserve Banks are reviewing their capacity and resources for launching community stakeholder polls in 2011.

CRA Public Hearings

Throughout 2010, the Board partnered with the FDIC, OCC, and OTS to hold a series of joint public hearings in four cities to receive public comments as they consider updates to regulations governing procedures for assessing a financial institution's performance under the CRA.[43]

[42] More information about the NWA is available at www.stablecommunities.org.

[43] More information about the hearings is available at www.federalreserve.gov/communitydev/cra_hearings.htm.

Other Community Development Initiatives

In 2010, the Board began working with the Federal Reserve Bank of San Francisco to prepare for the 2011 biennial Community Affairs Research Conference.[44] A call for papers was released in May and submissions were due in September. Community Affairs expanded its paper submission review committee to include a number of key economists from the Board's Division of Research and Statistics, as well as the Board's DCCA staff, in order to tap the Board's pool of subject matter experts.

Consumer Advisory Council

The Consumer Advisory Council—whose members represent consumer and community organizations, the financial services industry, academic institutions, and state agencies—advises the Board on matters of Board-administered laws and regulations as well as other consumer-related financial services issues. Council meetings, open to the public, were held in March, June, and October of 2010. See a list of Council members on page 416; also, visit the Board's website for transcripts of Council meetings.[45]

Among the significant topics of discussion for the Council in 2010 were

- the Credit Card Act,
- proposed changes to Regulation Z to enhance consumer protection and improve disclosures for reverse mortgage transactions and other home mortgage loans,
- HMDA,
- CRA, and
- issues related to foreclosures and neighborhood stabilization.

The Credit Card Act

In its March meeting, the Council discussed proposed amendments to Regulation Z that would implement the provisions of the Credit Card Act requiring that credit card penalty fees be reasonable

[44] More information about the conference is available at www.frbsf.org/community/conferences/2011ResearchConference.

[45] The transcript from the March meeting is available at www.federalreserve.gov/aboutthefed/cac_20100325.pdf. The transcript from the June meeting is available at www.federalreserve.gov/aboutthefed/cac_20100617.pdf. The transcript from the October meeting will be available at www.federalreserve.gov/aboutthefed/cac.htm.

and proportional and that credit card issuers reevaluate annual percentage rate increases at least once every six months. Members generally commended the overall shift toward transparency and simplicity in credit card terms and pricing represented by the regulations implementing the Credit Card Act. They commented that additional and clearer up-front information would benefit consumers in their shopping and help credit card issuers to be more competitive.

The members also engaged in discussions regarding the requirement to reevaluate rate increases, as well as the issue of defining penalty fee provisions, with several consumer representatives and an industry representative urging the Board to set specific dollar amounts for penalty fees and expressing concern about giving discretion to issuers to set penalty fees.

On the other hand, several industry representatives expressed the view that the Board should not set specific penalty fees, but rather that issuers should be permitted to set the fees based on the Board's rules about what factors should be considered and how certain calculations should be made. They also noted that other Credit Card Act provisions require clear disclosures of penalty fees to consumers. Regarding the provisions about costs incurred as a result of violations of account terms, some industry representatives expressed concern about the restrictiveness of the proposed standards and urged the Board to allow consideration of a broader range of costs related to violations.

Proposed Rules Regarding Home Mortgage Transactions

In its October meeting, the Council discussed the Board's proposed rules to amend Regulation Z to enhance consumer protection and improve disclosures for reverse mortgage transactions and other home mortgage loans.

Reverse Mortgages

Members praised the Board's steps to improve the disclosures for reverse mortgages, pointing particularly to the proposed revision of the total annual loan cost disclosure so that it shows how the reverse mortgage balance grows over time in dollar amounts. A consumer representative urged the Board to go further and develop standard disclosures that all reverse mortgage creditors must use. Both consumer and industry representatives also supported the requirement that borrowers obtain counseling from a counselor or counseling agency that meets the counselor qualification standards established by HUD, with members emphasizing the importance of in-person, one-on-one counseling and the need for counseling in languages other than English.

Members also supported the provision to prohibit creditors from requiring a consumer to purchase another financial or insurance product as a condition of obtaining a reverse mortgage. Consumer representatives expressed concern about the proposed 10-day safe harbor in the anti-tying rule, urging the Board to designate a longer time period or not to establish a safe harbor at all.

Right of Rescission

Consumer representatives criticized proposed changes to the right to rescission under Regulation Z that would require the consumer to tender the principal balance less interest and fees, and any damages and costs, before the creditor is required to release its security interest. Consumer representatives noted that few borrowers would be able to tender the principal and expressed preference for the current form of the rescission process, which gives borrowers some leverage and temporarily halts the foreclosure process so that the lender and borrower can negotiate a workout.

Members had a mixed reaction to the Board's consumer-tested, proposed revised notice of the right to rescind, which would include a "tear-off" form for consumers to sign and send to the creditor and also would require creditors to provide only one copy of the rescission notice to the consumer. While some members supported the one-copy requirement and tear-off format as a way to simplify paperwork, others held the view that consumers should continue to receive two copies, and still others urged the Board to develop a standard form for the rescission notice that all lenders must use.

In the discussion about the proposed rules relating to material disclosures, some consumer representatives expressed their opposition to the provision allowing a $100 tolerance for erroneous disclosure of the monthly payment amount, stating that $100 is a significant amount for many borrowers and that an error of that magnitude should be considered material.

Home Mortgage Disclosure Act (HMDA)

Members discussed the advantages and disadvantages of suggested changes to Regulation C, which implements HMDA, including a proposal to collect additional information. Industry representatives urged the Board to take into account the time and resource burdens that would be imposed on institutions, particularly smaller institutions, in collecting and ensuring the integrity of an expanded set of data, as well as potentially reporting it more quickly. They also indicated that there should be a clear purpose and benefit for requiring any additional data collection and recommended waiting until other financial regulatory reforms have been implemented before making significant changes to HMDA.

Consumer representatives supported the collection of more data so that regulators and policymakers can better identify and track problematic products and practices, such as fair lending issues, and more effectively direct resources to particular populations or communities. They expressed the view that the value of additional data outweighs the costs of collecting and reporting it. Consumer representatives recommended several additions to the data, including applicants' credit score, age, and primary language, as well as additional loan information, such as loan-to-value ratio, originator channel, and underwriting characteristics (interest rate, prepayment penalty, fees). The inclusion of expanded underwriting data was supported by an industry representative, who noted that such information could be helpful in clarifying whether disparate pricing is justified.

Both consumer and industry representatives pointed to privacy issues that could arise with the collection of more data. Some members recommended the adoption of a model like that of the U.S. Census, using a credentialing and monitoring system to give limited data access to trusted researchers. Members also commented on the need to standardize and streamline data-collection efforts across government agencies and to coordinate with other data requirements of the Dodd-Frank Act.

Community Reinvestment Act (CRA)

In the context of the interagency hearings, Council members discussed possible ways to modernize the regulations that implement the CRA to reflect changes in the financial services industry, changes in how banking services are delivered to consumers today, and current housing and community development needs. Members praised the Federal Reserve and other federal regulators for the proposed rule to expand existing CRA consideration for neighborhood stabilization activities. Two consumer representatives expressed the view that institutions' performance related to REO properties, such as maintaining properties and paying taxes, should be carefully scrutinized under the CRA and recommended deductions for institutions engaging in practices that negatively impact communities.

Both consumer and industry representatives supported extending CRA coverage beyond depository institutions to include all institutions that offer certain financial products and services, such as nonbank affiliates of depository institutions, credit unions, and other non-bank financial services providers.

Consumer and industry members also agreed that regulators should differentiate among strong, mediocre, and inadequate CRA performance more consistently and effectively. In particular, they recommended the implementation of incentives to encourage institutions to strive for an "Outstanding" rating, such as a longer time between examinations or other operational or financial benefits that would decrease institutions' costs and whose savings could be reinvested in communities.

Consumer and industry members stated that community development services get relatively little credit currently in CRA examinations and supported giving more weight to such activities by allocating a larger percentage of the service test to them or by creating a new community development test. The activities for which they recommended more credit included community development loans, particularly those other than single-family lending; products and services to reach unbanked or formerly banked consumers; loan modifications; financial education and asset-building efforts; and indirect services and lending through partners.

Members presented a variety of views related to geographic coverage under the CRA, but both industry and consumer members urged regulators to loosen the constraints that the assessment-area analysis puts on banks' investments in national funds, which often direct resources to rural areas and other underserved markets. Members stated that, under the current approach, banks are limited to investing in proprietary funds directed toward their geographic assessment areas. However, some industry representatives also recommended that the geographic scope continue to incorporate a connection to the local deposit base and to the physical distribution of products and services through local branches.

Foreclosures and Neighborhood Stabilization

Throughout 2010, the Council discussed loss-mitigation efforts, including the Administration's Home Affordable Modification Program (HAMP), neighborhood stabilization initiatives and challenges, and other issues related to foreclosures.

In the discussions about HAMP and other loss-mitigation efforts, some consumer representatives noted that they had seen slight improvement in mortgage servicers' capacity, but generally held the view that servicing problems continued to be numerous and systemic. They pointed to issues such as lost or misplaced documentation, delays in making a decision about whether to grant a loan modification, delays in moving borrowers from trial modifications to permanent modifications, steering of borrowers to in-house modification programs with less favorable terms, a lack of response to borrower communications, and the use of "foreclosure mill" law firms that charge high fees to borrowers to make the modification effective. They also stated that foreclosures continue to be filed while borrowers are in the trial modification period. In addition, consumer representatives expressed concern about the lack of information provided to borrowers who are denied a HAMP modification and the absence of a process to appeal the denial.

Later in 2010, members discussed reports of improper "robo-signing" activities by servicers, with several consumer representatives noting that housing counselors had long warned about such problematic practices and questioning why regulators had not scrutinized them sooner. Though members generally expressed hesitation about the advisability of a national moratorium, consumer representatives urged servicers and lenders to halt foreclosures until they had reviewed their processes and corrected any deficiencies. They also urged regulators to investigate carefully servicers' practices, particularly payments by volume for affidavits and other documentation work performed by outside vendors.

Industry representatives expressed support for the corrective action to address problematic practices but stated that many financial institutions had targeted significant resources to address the increasing volume of foreclosures with the goal of keeping borrowers in their homes. They also noted that institutions must balance the sometimes competing interests of borrowers, investors, and safety and soundness considerations.

Members provided a variety of perspectives about HAMP itself and possible areas of improvement for the program. Both consumer and industry members expressed support for the change in HAMP requiring up-front income verification and for the HAMP effort targeting unemployed borrowers. Noting the qualification limits for the HAMP unemployment initiative, members pointed to the need for other approaches to help unemployed and underemployed borrowers, such as the successful programs used in Pennsylvania and other states. Both industry and consumer representatives expressed concerns about HAMP's net-present-value (NPV) model, such as the way redefault rates are assigned and the results produced for borrowers with second liens or with substantial equity in their home

Several consumer and industry representatives endorsed a focus on principal write-downs as a key way to achieve sustainable modifications. Some consumer representatives also expressed support for judicial mortgage modifications in the bankruptcy context as an additional tool to deal with foreclosures.

Throughout 2010, the Council also discussed the effects of foreclosures that extend beyond households to the surrounding community and efforts such as the federal NSP to address the challenges of stabilizing communities. Members expressed concern about banks not maintaining their REO properties or not completing foreclosure sales, leading to "toxic titles," and urged federal regulators to increase oversight of regulated institutions regarding these issues. A consumer representative emphasized the need for post-foreclosure solutions to prevent prolonged negative impacts particularly on lower-income communities and communities of color, where properties are likely to remain REO status for much longer than in other areas. In addition, an industry representative expressed concern about increasing investor purchases of REOs and urged consideration of ways to give potential owner-occupants a better chance to acquire properties. Several members pointed to the importance of collaborative efforts among public, private, and nonprofit entities and initiatives that strategically target particular neighborhoods.

Other Discussion Topics

At the March meeting, Council members discussed short-term, small-dollar loan products offered by depository institutions, including tax refund anticipation loans (RALs), and consumer protection issues related to such products. Both consumer and industry representatives agreed that RALs should be strictly regulated and recommended more education about the timing of tax refunds and more outreach to unbanked consumers, particularly at tax time, about saving and building wealth.

Members also encouraged regulated financial institutions to offer affordable, sustainable small-dollar loans and expressed concern about unregulated entities offering such loans with problematic features, including high APRs that result from the short term and fees of these loans. Some members expressed the view that the APR is not a useful shopping tool for consumers. An industry representative noted the challenges in the business model for this product, stating that institutions face reputational risk. A consumer representative urged the Board and other regulators to help improve the development of this product by clarifying capital requirements and assisting to define what constitutes a responsible, profitable small-dollar loan product.

At the June meeting, the Council addressed issues relating to the flow of credit to small businesses, including specific credit gaps, the role of small business support service providers, promising practices related to technical assistance, and alternative lending sources. Several members noted the need to give particular attention to small businesses in rural areas, which are often undercapitalized. Some members also recommended measures to make the Treasury Department's New Markets Tax Credit program more amenable to investments in small businesses. A consumer representative praised the Board for its ongoing dialogue with the Small Business Administration (SBA) and expressed support for efforts to highlight SBA programs and ensure their continued effectiveness, such as by bolstering the secondary market for certain SBA loans.

A consumer representative commented that small business credit is often closely connected with personal credit and encouraged lenders to consider alternative credit data related to personal credit history when underwriting small business borrowers. One member expressed support for additional consumer protections for small business credit cards, much like the protections provided by the Credit Card Act of 2009 for consumer credit cards.

At the October meeting, Council members discussed the Board's interim final rule to ensure that real estate appraisers are free to use their independent professional judgment in assigning home values without influence or pressure from those with interests in the transactions. Members generally agreed that the appraisal independence requirements should apply not only to consumer credit transactions secured by a consumer's principal dwelling but also to consumer loans secured by other dwellings, such as a second home. Members disagreed, however, about whether appraisers should be permitted to consider the sales contract in connection with rendering an opinion of value.

Regarding other appraisal issues, one member urged the Board to impose bonding, insurance, or capitalization requirements on appraisers so that judgments against them can be effective. An industry representative expressed concern about the quality of appraisals generally, particularly for those from appraisal management companies with high volume, and commented that the proposed rules would help to improve appraisal quality. Some consumer representatives commented on the importance of being able to communicate with appraisers, especially those who are not familiar with a certain community or neighborhood, to help inform them about the area.

Federal Reserve Banks

The Federal Reserve Banks provide "payment services" to depository and certain other institutions, distribute the nation's currency and coin to depository institutions, and serve as fiscal agents and depositories for the U.S. government and other entities. The Reserve Banks also contribute to setting national monetary policy and supervision and regulation of banks and other financial entities operating in the United States (discussed in the preceding sections of this report).

Developments in Federal Reserve Priced Services

Federal Reserve Banks provide a range of payment and related services to depository institutions, including collecting checks, operating an automated clearinghouse (ACH) service, transferring funds and securities, and providing a multilateral settlement service. The Reserve Banks charge fees for providing these "priced services."

The Monetary Control Act of 1980 requires that the Federal Reserve establish fees for priced services provided to depository institutions so as to recover, over the long run, all direct and indirect costs actually incurred as well as the imputed costs that would have been incurred—including financing costs, taxes, and certain other expenses—and the return on equity (profit) that would have been earned if a private business firm had provided the services.[1] The imputed costs and imputed profit are collectively referred to

1 Financial data reported throughout this chapter—including revenue, other income, costs, income before taxes, and net income—can be linked to the pro forma financial statements found at the close of this section.

Table 1. Priced Services Cost Recovery

Millions of dollars, except as noted

Year	Revenue from services[1]	Operating expenses and imputed costs[2]	Targeted return on equity[3]	Total costs	Cost recovery (percent)[4,5]
2001	960.4	901.9	109.2	1,011.1	95.0
2002	918.3	891.7	92.5	984.3	93.3
2003	881.7	931.3	104.7	1,036.0	85.1
2004	914.6	842.6	112.4	955.0	95.8
2005	**993.8**	**834.4**	103.0	**937.4**	**106.0**
2006	**1,029.7**	**874.8**	72.0	**946.8**	108.8
2007	1,012.3	**912.9**	80.4	**993.3**	101.9
2008	873.8	820.4	66.5	886.9	98.5
2009	675.4	707.5	19.9	727.5	92.8
2010	574.7	532.8	13.1	545.9	105.3
2001–2010	8,834.6	8,250.4	773.7	9,024.1	97.9

Note: Here and elsewhere in this chapter, components may not sum to totals or yield percentages shown because of rounding. Amounts in bold are restated due to changes in previously reported data.

1 For the 10-year period, includes revenue from services of $8,286.2 million and other income and expense (net) of $548.4 million.

2 For the 10-year period, includes operating expenses of $7,900.5 million, imputed costs of $95.5 million, and imputed income taxes of $254.4 million.

3 Beginning in 2009, given the uncertain long-term effect that the payment of interest on reserve balances held by depository institutions at the Reserve Banks would have on the level of clearing balances, the PSAF has been adjusted to reflect the actual clearing balance levels maintained; previously, the PSAF was calculated based on a projection of clearing balance levels.

4 Revenue from services divided by total costs.

5 For the 10-year period, cost recovery is 95.1 percent, including the reduction in equity related to ASC 715 reported by the priced services.

as the *private-sector adjustment factor* (PSAF).[2] Over the past 10 years, Reserve Banks have recovered 97.9 percent of their priced services costs, including the PSAF (see **table 1**).[3]

In 2010, Reserve Banks recovered 105.3 percent of total priced services costs, including the PSAF.[4] The Banks' operating costs and imputed expenses totaled $532.8 million. Revenue from operations totaled $566.7 million and other income was $7.9 million, resulting in net income from priced services of $41.8 million.[5]

The Reserve Banks are engaged in a number of technology initiatives that will modernize their priced services processing platforms over the next several years. The Banks are in the process of implementing a new end-to-end electronic check-processing system to improve the efficiency and reliability of their current check-processing operations. They also continued efforts to migrate the FedACH and Fedwire Funds services off a mainframe system and to a distributed computing environment.

Commercial Check-Collection Service

In 2010, Reserve Banks recovered 107.1 percent of the total costs of their commercial check-collection service, including the related PSAF. The Banks' operating expenses and imputed costs totaled $326.5 million. Revenue from operations totaled $353.6 million and other income totaled $4.9 million, resulting in net income of $31.9 million. In 2010, check-service revenue from operations decreased $128.1 million from 2009.[6] Reserve Banks handled 7.7 billion checks in 2010, a decrease of 10.2 percent from 2009 (see **table 2**). The decline in Reserve Bank check volume continues to be influenced by nationwide trends away from the use of checks and toward greater use of electronic payment methods.[7] By year-end 2010, 99.7 percent of Reserve Bank check deposits and 98.4 percent of Reserve Bank check presentments were being made electronically through Check 21 products.[8]

Because of the rapid adoption of electronic check processing, the Reserve Banks were able to complete the consolidation of their paper check-processing offices ahead of schedule, in 2010 instead of 2011. Under this multiyear initiative, which began in 2003, the Reserve Banks have reduced the number of offices at which they process paper checks from 45 to one. Beginning in February 2010, the Cleveland Reserve Bank operated the only paper check-processing site for the System. Further, the System's electronic check processing was consolidated at one Federal Reserve site.

Commercial Automated Clearinghouse Services

In 2010, the Reserve Banks recovered 103.4 percent of the total costs of their commercial ACH services, including the related PSAF. Reserve Bank operating expenses and imputed costs totaled $105.2 million.

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2 In addition to income taxes and the return on equity, the PSAF includes three other imputed costs: interest on debt, sales taxes, and an assessment for deposit insurance by the Federal Deposit Insurance Corporation (FDIC). Board of Governors assets and costs that are related to priced services are also allocated to priced services; in the pro forma financial statements at the end of this chapter, Board assets are part of long-term assets, and Board expenses are included in operating expenses.

3 Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* [Accounting Standards Codification (ASC) Topic 715 (ASC 715), *Compensation–Retirement Benefits*], which has resulted in the recognition of a $267.6 million reduction in equity related to the priced services' benefit plans through 2010. Including this reduction in equity, which represents a decline in economic value, results in cost recovery of 95.1 percent for the 10-year period. For details on how implementing ASC 715 affected the pro forma financial statements, refer to notes 3 and 5 to the "Pro Forma Financial Statements for Federal Reserve Priced Services" at the end of this chapter.

4 *Total cost* is the sum of operating expenses, imputed costs (interest on debt, interest on float, sales taxes, and the FDIC assessment), imputed income taxes, and the targeted return on equity.

5 *Other income* is investment income earned on clearing balances net of the cost of earnings credits, an amount termed net income on clearing balances.

6 In 2008, the Reserve Banks discontinued the transportation of commercial checks between their check-processing offices. As a result, in 2010, there were no costs or imputed revenues associated with the transportation of commercial checks between Reserve Bank check-processing offices.

7 The Federal Reserve System's retail payments research suggests that the number of checks written in the United States has been declining since the mid-1990s. For details, see Federal Reserve System, "The 2010 Federal Reserve Payments Study: Noncash Payment Trends in the United States, 2006–2009" (December 2010), www.frbservices.org/files/communications/pdf/press/2010_payments_study.pdf.

8 The Check Clearing for the 21st Century Act (Check 21), which became effective in 2004, was designed to foster innovation in payment systems and to enhance efficiency by reducing some of the legal impediments to check truncation. The law facilitates check truncation by creating a new negotiable instrument called a substitute check, which permits banks to truncate original checks, to process check information electronically, and to deliver substitute checks to banks that want to continue receiving paper checks.
The Reserve Banks also offer non-Check 21 electronic-presentment products. In 2010, 0.3 percent of Reserve Banks' deposit volume was presented to paying banks using these products.

Table 2. Activity in Federal Reserve priced services, 2008–2010
Thousands of items

Service	2010	2009	2008	Percent change	
				2009 to 2010	2008 to 2009
Commercial check	7,711,833	8,584,929	9,545,424	-10.2	-10.1
Commercial ACH	10,232,757	9,966,260	10,040,388	2.7	-0.7
Fedwire funds transfer	127,762	127,357	134,220	0.3	-5.1
National settlement	522	464	469	12.5	-1.1
Fedwire securities transfer	7,913	10,519	11,717	-24.6	-10.2

Note: Activity in *commercial check* is the total number of commercial checks collected, including processed and fine-sort items; in *commercial ACH*, the total number of commercial items processed; in *Fedwire funds transfer* and *securities transfer*, the number of transactions originated online and offline; and in *national settlement*, the number of settlement entries processed.

Revenue from ACH operations totaled $109.9 million and other income totaled $1.6 million, resulting in net income of $6.3 million. The Reserve Banks processed 10.2 billion commercial ACH transactions, an increase of 2.7 percent from 2009, which was in line with industry ACH volume growth.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 required the Board to work with the Reserve Banks to expand the use of the ACH for making international payments and remittances. In 2010, the Reserve Banks expanded their cross-border ACH product offerings to additional countries in Latin America and Europe to facilitate the provision of low-cost payment and remittance services by depository institutions in the United States. By year-end 2010, depository institutions were able to send payments using the Reserve Banks' FedGlobal service to 22 countries in Europe, 12 countries in Latin America, and Canada. The Reserve Banks, however, found it challenging to increase the use of FedGlobal services by individuals and businesses for making outbound payments. In particular, while outbound government payments increased 1.8 percent in 2010, to about 103,000 payments per month, outbound payments by individuals and businesses declined 5.4 percent, to slightly less than 3,000 payments per month, which included payments sent through the long-established service offerings to Canada and Mexico.

Fedwire Funds and National Settlement Services

In 2010, Reserve Banks recovered 100.6 percent of the costs of their Fedwire Funds and National Settlement Services, including the related PSAF. Reserve Bank operating expenses and imputed costs for these operations totaled $77.9 million in 2010. Revenue from these services totaled $79.1 million, and other income amounted to $1.2 million, resulting in a net income of $2.4 million.

Fedwire Funds Service

The Fedwire Funds Service allows participants to use their balances at Reserve Banks to transfer funds to other participants. In 2010, the number of Fedwire funds transfers originated by depository institutions increased 0.3 percent from 2009, to approximately 127.8 million. The average daily value of Fedwire funds transfers in 2010 was $2.4 trillion, a decrease of 3.6 percent from the previous year.

National Settlement Service

The National Settlement Service is a multilateral settlement system that allows participants in private-sector clearing arrangements to settle transactions using Federal Reserve balances. In 2010, the service processed settlement files for 19 local and national private-sector arrangements, a decrease from the 41 arrangements active in 2009. The decrease in the number of arrangements was primarily the result of consolidation among check clearinghouses. The Reserve Banks processed slightly more than 6,900 files that contained around 522,000 settlement entries for these arrangements in 2010. Activity in 2010 represents both a decrease from the 10,500 files processed in 2009 and an increase from the 464,000 settlement entries processed in 2009.

Fedwire Securities Service

In 2010, the Reserve Banks recovered 102.8 percent of the total costs of the priced-service component of their Fedwire Securities Service, including the related PSAF. The Banks' operating expenses and imputed costs for providing this service totaled $23.2 million in 2010. Revenue from the service totaled $24.1 million, and other income totaled $0.4 million, resulting in a net income of $1.2 million.

The Fedwire Securities Service allows participants to transfer electronically to other participants in the service certain securities issued by the U.S. Treasury, federal government agencies, government-sponsored enterprises, and certain international organizations.[9] In 2010, the number of non-Treasury securities transfers processed via the service decreased 24.6 percent from 2009, to approximately 7.9 million.

Float

The Federal Reserve had daily average credit float of $1,795.7 million, compared with daily average credit float of $1,976.4 million in 2009.[10]

Developments in Currency and Coin

The Federal Reserve Board is the issuing authority for the nation's currency (in the form of Federal Reserve notes). In 2010, the Board paid the U.S. Treasury's Bureau of Engraving and Printing (BEP) $598.2 million for producing 5.6 billion Federal Reserve notes.

The Federal Reserve Banks distribute currency and coin through depository institutions to meet public demand. The Reserve Banks also receive currency and coin from circulation through these institutions. The Reserve Banks received 35.4 billion Federal Reserve notes from circulation in 2010, a 0.4 percent increase from 2009, and distributed 36.3 billion notes into circulation (payments) in 2010, a 1.4 percent increase from 2009. The value of Federal Reserve notes in circulation increased 6.0 percent in 2010, to $942.0 billion, largely because of demand for $100 notes. The Reserve Banks received 62.4 billion coins from circulation in 2010, a 4.5 percent decrease from 2009, and made payments of 69.1 billion coins into circulation, a 0.2 percent increase from 2009.

In 2010, the Reserve Banks finished implementing a program to extend the useful life of the System's BPS 3000 high-speed currency-processing machines. The program replaced the operating systems of the equipment, significantly improving the Reserve Banks' processing efficiency. Reserve Banks continue to develop a new cash automation platform that will enhance controls of the Banks' cash operations and improve their efficiency, provide a responsive management information reporting system with superior and flexible reporting tools, facilitate business continuity and contingency planning, and enhance the support provided to Reserve Bank customers and business partners. In 2010, the Banks terminated the development contract with the primary vendor and redefined the design for the new system.

The Board continues to work with the BEP and the U.S. Secret Service to produce and issue a more-secure, new-design $100 note. In late 2010, the Board announced that the new-design $100 note would be released later than the planned February 2011 issue date because the BEP observed that the paper was occasionally creasing during production. The Board will announce a new issue date once the problem has been resolved.

Developments in Fiscal Agency and Government Depository Services

As fiscal agents and depositories for the federal government, the Federal Reserve Banks auction Treasury securities, process electronic and check payments for Treasury, collect funds owed to the federal government, maintain Treasury's bank account, and develop, operate, and maintain a number of automated systems to support Treasury's mission. The Reserve Banks also provide certain fiscal agency and depository services to other entities; these services are primarily related to book-entry securities.

Treasury and other entities fully reimbursed the Reserve Banks for the costs of providing fiscal agency and depository services. In 2010, reimbursable expenses amounted to $456.4 million, compared with $450.3 million in 2009 (see **table 3**). Support for Treasury programs accounted for 93.9 percent of the cost, and support for other entities accounted for 6.1 percent. The Reserve Banks actively monitor program expenses, and they strive to contain these costs while providing the resources necessary to accomplish program objectives.

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9 The expenses, revenues, volumes, and fees reported here are for transfers of securities issued by federal government agencies, government-sponsored enterprises, and certain international organizations. Reserve Banks provide Treasury securities services in their role as the U.S. Treasury's fiscal agent. These services are not considered priced services. For details, see "Treasury Securities Service," on page 125.

10 Credit float occurs when the Reserve Banks present items for collection to the paying bank prior to providing credit to the depositing bank (debit float occurs when the Reserve Banks credit the depositing bank prior to presenting items for collection to the paying bank).

Table 3. Expenses of the Federal Reserve Banks for Fiscal Agency and Depository Services, 2008–2010
Thousands of dollars

Agency and service	2010	2009	2008
Department of the Treasury			
Bureau of the Public Debt			
Treasury retail securities	73,104	73,679	72,374
Treasury securities safekeeping and transfer	10,136	8,815	9,305
Treasury auction	30,750	30,216	37,072
Computer infrastructure development and support	1,980	2,333	4,464
Other services	1,646	1,375	910
Total	117,615	116,417	124,124
Financial Management Service			
Payment services	112,224	104,355	108,219
Collection services	37,611	37,967	49,180
Cash-management services	48,226	49,046	48,676
Computer infrastructure development and support	66,461	66,958	65,059
Other services	8,815	7,393	7,577
Total	273,337	265,719	278,711
Other Treasury			
Total	37,793	40,390	27,017
Total, Treasury	428,744	422,527	429,852
Other Federal Agencies			
Total, other agencies	27,700	27,758	31,292
Total reimbursable expenses	456,445	450,285	461,144

Treasury Securities Services

The Reserve Banks work closely with Treasury's Bureau of the Public Debt in support of the borrowing needs of the federal government. The Banks auction, issue, maintain, and redeem securities; provide customer service; and operate the automated systems supporting paper U.S. savings bonds and book-entry marketable Treasury securities (bills, notes, and bonds). Treasury securities services consist of retail securities programs (which primarily serve individual investors) and wholesale securities programs (which serve institutional customers).

Retail Securities Programs

The Reserve Banks continued to support Treasury's efforts to improve the quality and efficiency of securities services provided to retail customers. The Banks process paper U.S. savings bonds transactions and book-entry marketable Treasury securities transactions for securities held in Legacy Treasury Direct. Reserve Bank operating expenses for the retail securities programs were $73.1 million in 2010, compared with $73.7 million in 2009.

In early 2010, Treasury announced plans to eliminate the issuance of paper payroll savings bonds through traditional employer-sponsored savings plans. As of September 30, 2010, federal employees are no longer able to purchase paper savings bonds through payroll deduction. The Reserve Banks printed and mailed more than 16 million savings bonds in 2010, a 20 percent decrease from 2009. Treasury also announced a strategy to transition retail customers from legacy products (such as paper savings bonds) to the Bureau of the Public Debt's web-based Treasury Direct system, which supports investments in marketable Treasury securities and electronic savings bonds.

The Reserve Banks continued working with the Bureau of the Public Debt on the Treasury Retail E-Services initiative, which aims to lower costs, provide a high-quality customer service experience, provide more opportunities for customer self-service, and eliminate duplicative processes.

Wholesale Securities Programs

The Reserve Banks support wholesale securities programs through the sale, issuance, safekeeping, and transfer of marketable Treasury securities for institutional investors. Reserve Bank operating expenses in 2010 in support of Treasury securities auctions were $30.7 million, compared with $30.2 million in 2009. In 2010, the Banks conducted 301 Treasury securities auctions, compared with 283 in 2009. The increase in the number of auctions was attributable primarily to the increased number of cash-management bill auctions.

Operating expenses associated with securities safekeeping and transfer activities were $10.1 million in 2010, compared with $8.8 million in 2009. The cost increase is attributable to higher Treasury securities transfer volume. In 2010, the number of Fedwire Treasury securities transfers increased 13 percent from 2009, to approximately 11.5 million.

Payments Services

The Reserve Banks work closely with Treasury's Financial Management Service and other government agencies to process payments to individuals and companies. For example, the Banks process Social Security and veterans' benefits, income tax refunds, vendor payments, and other types of payments. Reserve Bank operating expenses for payments-related activity totaled $112.2 million in 2010, compared with $104.4 million in 2009. The increase in expenses is largely due to expanded requirements for several Treasury projects, notably the stored value card (SVC) and Go Direct programs.

The Reserve Banks manage the SVC program, which provides stored value cards for use by military personnel on military bases. In 2010, the SVC program's expenses increased 14 percent, to $17.1 million, because of program expansion. The Reserve Banks also support Treasury's Go Direct initiative, an ongoing effort focused on converting check benefit payments to direct deposit or debit card. In 2010, expenses for Go Direct increased 23 percent, to more than $2.8 million, in connection with the expansion of the Go Direct marketing campaign and a call-center buildout.

Collection Services

The Reserve Banks also work closely with Treasury's Financial Management Service to collect funds owed the federal government, including fees for goods and services. Reserve Bank operating expenses in 2010 related to collections services remained roughly the same as in 2009, totaling $37.6 million.

Throughout 2010, the Reserve Banks continued to support Treasury's Collections and Cash Management Modernization (CCMM) initiative, a multiyear effort to simplify, modernize, and improve the services, systems, and processes supporting Treasury's collections and cash-management programs. In connection with the CCMM initiative, the Reserve Banks discontinued processing paper federal tax deposit coupons and, in late 2010, transitioned responsibility for the Federal Reserve Electronic Tax Application function to a commercial bank designated by Treasury.

The Reserve Banks continue to operate Pay.gov, an application supporting Treasury's program that allows the public to use the Internet to authorize and initiate payments to federal agencies. During the year, the Pay.gov program was expanded to include several new agencies and, as a result, collection volumes increased.

The Reserve Banks also support the government's centralized delinquent debt-collection program. Specifically, the Banks develop and maintain software that facilitates the collection of delinquent debts owed to federal agencies and states by matching federal payments against delinquent debts, including past-due child support payments owed to custodial parents.

Treasury Cash-Management Services

Treasury maintains an operating cash account at the Reserve Banks to function the various transactions discussed in the preceding sections of this chapter, and it may instruct the Banks to invest funds from its account in interest-bearing accounts with qualified depository institutions.

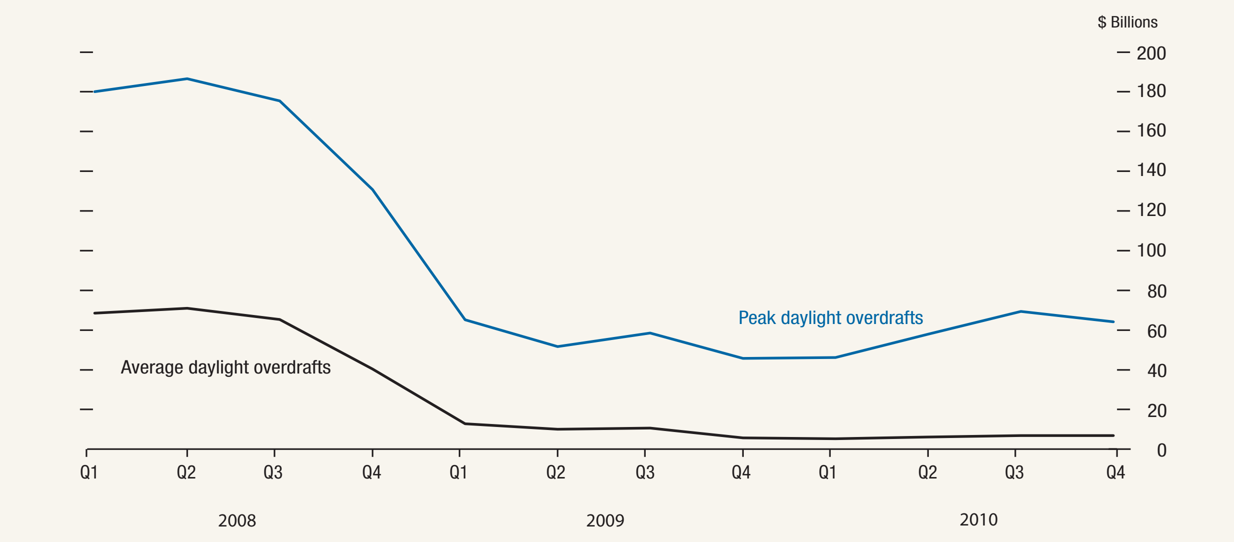
The Reserve Banks also provide collateral-management and collateral-monitoring services for Treasury programs that have collateral requirements. Reserve Bank operating expenses related to Treasury cash-management services totaled $48.2 million in 2010, compared with $49.0 million in 2009.

During 2010, the Reserve Banks continued to support Treasury's effort to modernize its financial management processes, with a focus on improving centralized government accounting and reporting functions. The Banks worked with Treasury to identify potential long-term efficiency improvements in the way the Banks account for government payments and collections processes. The Banks also collaborated with the Financial Management Service on several ongoing software development efforts, such as the Governmentwide Accounting and Reporting Modernization initiative.

Services Provided to Other Entities

When permitted by federal statute or when required by the Secretary of the Treasury, the Reserve Banks

Figure 1. Aggregate Daylight Overdrafts, 2008–2010



provide fiscal agency and depository services to other domestic and international entities. Reserve Bank operating expenses for services provided to other entities were $27.7 million in 2010, compared with $27.8 million in 2009. Book-entry securities issuance and maintenance activities account for a significant amount of the work performed for other entities, with the majority performed for the Federal Home Loan Mortgage Association, the Federal National Mortgage Association, and the Government National Mortgage Association. Cost increases associated with book-entry securities issuance and maintenance activities were offset primarily by reductions in the cost of postal money-order processing. Postal money orders are processed primarily in image form, resulting in operational improvements, lower staffing levels, and lower costs to the U.S. Postal Service.

Developments in the Use of Federal Reserve Intraday Credit

The Board's Payment System Risk (PSR) policy governs the use of Federal Reserve Bank intraday credit, also known as daylight overdrafts. A daylight overdraft occurs when an institution's account activity creates a negative balance in the institution's Federal Reserve account at any time in the operating day.[11] Daylight overdrafts enable institutions to send payments more freely throughout the day than if institutions were limited strictly by their available funds balance. In 2010, institutions held on average about $1.1 trillion in their Federal Reserve accounts overnight, while the daily value of funds transferred over just the Federal Reserve's funds transfer system was about $2.4 trillion. Institutions held historically high levels of overnight balances at the Reserve Banks in 2010 while demand for daylight overdrafts on average remained historically low.[12] In 2010, average daylight overdrafts across the System decreased to about $6 billion from nearly $10 billion in 2009, a decrease of about 35 percent (see **figure 1**).[13] The average level of peak daylight overdrafts, however, increased to almost $60 billion in 2010 from $55 billion in 2009, an increase of about 8 percent.[14] In 2010, institutions paid about $6 million in daylight overdraft fees.

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[11] When an institution ends a day with a negative balance, the institution incurs an overnight overdraft. The Federal Reserve strongly discourages overnight overdrafts by imposing penalties and taking administrative action against institutions that incur overnight overdrafts. Institutions that require overnight credit are encouraged to approach the Federal Reserve's discount window to borrow funds as necessary.

[12] The decision to pay interest on reserve balances, implemented October 2008, likely contributed significantly to the increase in overnight balances and the subsequent reduction in daylight overdrafts. For example, in 2007, average overnight balances held at the Reserve Banks were $15 billion and average daylight overdrafts were $60 billion.

[13] Average daylight overdrafts are calculated daily by summing all negative balances incurred by institutions across the Federal Reserve System for each minute of the Fedwire operating day (9 p.m. to 6:30 p.m. ET, or 21.5 hours). This sum is then divided by the number of minutes in the day (1,291 minutes) to arrive at the average overdraft.

[14] Peak overdrafts are calculated daily by summing the negative balances of all institutions on a minute-by-minute basis

In preparation for PSR policy changes effective as of March 24, 2011, throughout 2010 the Reserve Banks modified the systems they use to record collateral pledges and to track daylight overdrafts.[15] The revisions, in part, allow eligible institutions to collateralize daylight overdrafts and pay no fee for these overdrafts.

Electronic Access to Reserve Bank Services

The Reserve Banks provide depository institutions with a variety of alternatives for electronically accessing the Banks' financial services payment and information services. These electronic-access solutions are designed to meet the individual connectivity and contingency requirements of depository institution customers. FedLine Direct is a Reserve Bank service that permits unattended computer-to-computer access to the Banks' payment services through dedicated connections. Another service, FedLine Command, offers an unattended, computer-to-computer, batch-file solution for accessing Reserve Bank ACH services at a cost lower than that for FedLine Direct. Yet another service, FedLine Advantage, provides web-based access to the Banks' payment services, while FedLine Web permits access to information services and limited transaction services. In 2010, the Reserve Banks announced the restructuring of their electronic access offerings to better meet depository institutions' need for access options that include certain value-added services.

Information Technology

In 2010, the Federal Reserve Banks continued to improve the efficiency, effectiveness, and security of information technology (IT) services and operations.

To improve the efficiency and overall quality of operations, major multiyear initiatives were undertaken to consolidate the management and function of the Federal Reserve's help desk, server, and network operations. Significant progress was made, and the overall program met or exceeded its goals for the year.

In addition, Federal Reserve Information Technology (FRIT) continued to lead the Reserve Banks' transition to a more robust information security program, one that is based on guidance from the National Institute of Science and Technology and adapted to the Federal Reserve's environment.[16]

Examinations of the Federal Reserve Banks

The Reserve Banks and the consolidated limited liability company (LLC) entities are subject to several levels of audit and review.[17] The combined financial statements of the Reserve Banks (see "Federal Reserve Banks Combined Financial Statements" on page 342 in the "Federal Reserve System Audits" section of this report) as well as the annual financial statements of each of the 12 Banks and the consolidated LLC entities are audited annually by an independent auditing firm retained by the Board of Governors.[18] In addition, the Reserve Banks, including the consolidated LLC entities, are subject to oversight by the Board of Governors, which performs its own reviews.

The Reserve Banks use the framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to assess their internal controls over financial reporting, including the safeguarding of assets. Within this framework, the management of each Reserve Bank annually provides an assertion letter to its board of directors that confirms adherence to COSO standards. Similarly, each consolidated LLC entity annually provides an assertion letter to the board of directors of the Federal Reserve Bank of New York (the New York Reserve Bank).

In 2010, the Board engaged Deloitte & Touche LLP (D&T) to audit the combined and individual financial statements of the Reserve Banks and those of the

throughout the Fedwire operating day. The most negative of these minute-by-minute balances is the peak overdraft.

15 Details about the revisions to the PSR policy are available at www.federalreserve.gov/newsevents/press/other/20081219a.htm, and the policy that became effective on March 24, 2011, is available at www.federalreserve.gov/paymentsystems/psr_policy.htm.

16 FRIT supplies national infrastructure and business line technology services to the Federal Reserve Banks and provides thought leadership regarding the System information technology architecture and business use of technology. The National Institute of Science and Technology is a nonregulatory federal agency within the U.S. Department of Commerce.

17 The consolidated LLCs were funded by the New York Reserve Bank, and acquired financial assets and financial liabilities pursuant to the policy objectives. The consolidated LLCs were determined to be variable interest entities, and the New York Reserve Bank is considered to be the controlling financial interest holder of each.

18 Each LLC reimburses the Board of Governors—from the entity's available net assets—for the fees related to the audit of its financial statements.

consolidated LLC entities. In 2010, D&T also conducted audits of internal controls over financial reporting for each of the Reserve Banks and the four consolidated LLC entities that remained in operation at December 31, 2010.[19] Fees for D&T's services totaled $8 million, of which $2 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.

The Board's reviews of the Reserve Banks includes a wide range of off-site and on-site oversight activities, conducted primarily by the Division of Reserve Bank Operations and Payment Systems. Division personnel monitor the activities of each Bank and consolidated LLC entity on an ongoing basis and conduct a comprehensive on-site review of each Bank at least once every three years.

The reviews also include an assessment of the internal audit function's conformance to *International Standards for the Professional Practice of Internal Auditing*, conformance to applicable policies and procedures, and the audit department's efficiency.

To assess compliance with the policies established by the Federal Reserve's Federal Open Market Committee (FOMC), the division also reviews the accounts and holdings of the System Open Market Account (SOMA) at the New York Reserve Bank and the foreign currency operations conducted by that Reserve Bank. In addition, D&T audits the year-end schedule of participated asset and liability accounts and the related schedule of participated income accounts. The FOMC receives the external audit reports and a report on the division's examination.

Income and Expenses

Table 4 summarizes the income, expenses, and distributions of net earnings of the Reserve Banks for 2010 and 2009. Income in 2010 was $79,301 million, compared with $54,463 million in 2009.

[19] The financial statements of the Commercial Paper Funding Facility LLC (CPFF), which were released on August 17, 2010, did not include an audit of internal controls over financial reporting.

Expenses totaled $7,358 million: $3,489 million in operating expenses, $2,687 million in interest paid to depository institutions on reserve balances and earnings credits granted to depository institutions, $94 million in interest expense on securities sold under agreements to repurchase, $422 million in assessments for Board of Governors expenditures, $623 million for new currency costs, and $43 million for Consumer Financial Protection Bureau and Office of Financial Research costs. Net additions to and deductions from current net income showed a net profit of $9,746 million, which consists of $782 million in realized gains on federal agency and government-sponsored enterprise mortgage-backed securities (GSE MBS), $7,560 million in net income associated with consolidated LLCs, $850 million of other additions, and $554 million in unrealized gains on investments denominated in foreign currencies revalued to reflect current market exchange rates. Dividends paid to member banks, set at 6 percent of paid-in capital by section 7(1) of the Federal Reserve Act, totaled $1,583 million, $155 million more than in 2009; this reflects an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Reserve Banks.

Distributions to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $79,268 million in 2010, up from $47,431 million in 2009; the distributions equal net income after the deduction of dividends paid and the amount necessary to equate the Reserve Banks' surplus to paid-in capital.

The "Statistical Tables" section of this report provides more detailed information on the Reserve Banks and the LLCs. Table 9 is a statement of condition for each Reserve Bank; table 10 details the income and expenses of each Reserve Bank for 2010; table 11 shows a condensed statement for each Reserve Bank for the years 1914 through 2010; and table 13 gives the number and annual salaries of officers and employees for each Reserve Bank. A detailed account of the assessments and expenditures of the Board of Governors appears in the Board of Governors Financial Statements (see "Federal Reserve System Audits" on page 407).

SOMA Holdings and Loans

The Reserve Banks' average net daily holdings of securities and loans during 2010 amounted to

Table 4. Income, Expenses, and Distribution of Net Earnings of the Federal Reserve Banks, 2010 and 2009
Millions of dollars

Item	2010	2009
Current income	79,301	54,463
Current expenses	6,270	5,979
Operating expenses[1]	3,489	3,694
Interest paid to depository institutions and earnings credits granted	2,687	2,187
Interest expense on securities sold under agreements to repurchase	94	98
Current net income	73,031	48,484
Net additions to (deductions from) current net income	9,746	4,820
Profit on sales of federal agency and government-sponsored enterprise mortgage-backed securities	782	879
Profit on foreign exchange transactions	554	172
Net income (loss) from consolidated LLCs	7,560	5,588
Provisions for loan restructuring[2]	0	-2,621
Other additions[3]	850	802
Assessments by the Board of Governors	1,088	888
For Board expenditures	422	386
For currency costs	623	502
For Consumer Financial Protection Bureau and Office of Financial Research costs[4]	43	0
Change in funded status of benefit plans	46	1,007
Comprehensive income before distributions to Treasury	81,735	53,423
Dividends paid	1,583	1,428
Transferred to surplus and change in accumulated other comprehensive income	884	4,564
Distributions to U.S. Treasury[5]	79,268	47,431

1 Includes a net periodic pension expense of $529 million in 2010 and $663 million in 2009.

2 Represents the economic effect of the interest rate reduction made pursuant to the April 17, 2009, restructuring of the American International Group, Inc. loan.

3 Includes dividends on preferred securities, unrealized gain (loss) on Term Asset-Backed Securities Loan Facility loans, and compensation paid by Citigroup, Inc. and Bank of America Corporation for the New York Reserve Bank's and Richmond Reserve Bank's commitments to provide funding support, net of related expenses.

4 The Board of Governors assesses the Reserve Banks to fund the operations of the Consumer Financial Protection Bureau and, for a two-year period, the Office of Financial Research.

5 Interest on Federal Reserve notes.

$2,123,773 million, an increase of $344,327 million from 2009 (see **table 5**).[20]

SOMA Securities Holdings

The average daily holdings of Treasury securities increased by $177,595 million, to an average daily amount of $837,078 million. The average daily holdings of GSE debt securities increased by $68,717 million, to an average daily amount of $166,810 million. The average daily holdings of federal agency and GSE MBS increased by $605,375 million, to an average daily amount of $1,079,230 million.

20 Open market operations (OMOs)—the purchase and sale of securities in the open market by a central bank—are a key tool used by the Federal Reserve in the implementation of monetary policy. The System Open Market Account (SOMA) is the Federal Reserve's portfolio of securities held for the purpose of these purchases and sales.

These increases are due to the purchase of Treasury securities, GSE debt securities, and federal agency and GSE MBS through a large-scale asset purchase program. There were no holdings of securities purchased under agreements to resell in 2010, compared with average daily holdings of $3,616 million in similar purchases from 2009; the average daily balance of securities sold under agreements to repurchase was $58,476 million, a decrease of $9,361 million from 2009. Average daily holdings of foreign currency denominated assets in 2010 were $24,936 million, compared with $24,898 million in 2009. The average daily balance of central bank liquidity swap drawings was $989 million in 2010 and $177,688 million in 2009.

The average rates of interest earned on the Reserve Banks' holdings of Treasury securities decreased to 3.15 percent and the average rates on GSE debt secu-

Table 5. System Open Market Account (SOMA) Holdings and Loans of the Federal Reserve Banks, 2010 and 2009
Millions of dollars except as noted

Item	Average daily assets (+)/liabilities (–)		Current income (+)/expense (–)		Average interest rate (percent)	
	2010	2009	2010	2009	2010	2009
U.S. Treasury securities[1]	837,078	659,483	26,373	22,873	3.15	3.47
Government-sponsored enterprise debt securities[1]	166,810	98,093	3,510	2,048	2.10	2.09
Federal agency and government-sponsored enterprise mortgage-backed securities[2]	1,079,230	473,855	44,839	20,407	4.15	4.31
Foreign currency denominated assets[3]	24,936	24,898	223	296	0.89	1.19
Central bank liquidity swaps[4]	989	177,688	12	2,168	1.21	1.22
Securities purchased under agreements to resell	...	3,616	...	13	0.00	0.36
Other SOMA assets[5]	288	458	...	1	0.00	0.22
Securities sold under agreements to repurchase	-58,476	-67,837	-94	-98	0.16	0.14
Other SOMA liabilities[6]	-799	-182	...	...	0.00	0.00
Total SOMA holdings	**2,050,056**	**1,370,072**	**74,863**	**47,708**	**3.65**	**3.48**
Primary, secondary. and seasonal credit	4,709	40,405	32	204	0.68	0.50
Term auction credit	7,105	291,487	18	786	0.25	0.27
Total loans to depository institutions	**11,814**	**332,892**	**50**	**990**	**0.42**	**0.30**
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)	...	7,653	...	73	...	0.95
Primary Dealer Credit Facility (PDCF) and other broker-dealer credit	...	7,502	...	36	...	0.48
Credit extended to American International Group, Inc. (AIG), net[7]	22,874	39,099	2,728	3,996	11.93	10.22
Term Asset-Backed Securities Loan Facility (TALF)[8]	39,029	23,228	750	414	1.92	1.78
Total loans to others	61,903	77,482	3,478	4,519	5.62	5.83
Total loans	73,717	409,374	3,528	5,509	1.35	1.35
Total SOMA holding and loans	**2,123,773**	**1,779,446**	**78,391**	**53,217**	**3.69**	**2.99**

1 Face value, net of unamortized premiums and discounts.

2 Face value of the securities, which is the remaining principal balance of the underlying mortgages, net of unamortized premiums and discounts. Does not include unsettled transactions.

3 Includes accrued interest. Foreign currency denominated assets are revalued daily at market exchange rates.

4 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

5 Cash and short-term investments related to the federal agency and government-sponsored enterprise mortgage-backed securities portfolio.

6 Related to the purchases of federal agency and government-sponsored enterprise mortgage-backed securities that the seller fails to deliver on the settlement date.

7 Average daily balance includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring, and excludes undrawn amounts and credit extended to consolidated limited liability companies.

8 Represents the remaining principal balance. Excludes amount necessary to adjust TALF loans to fair value at December 31, which is reported in “Other assets” in the Statement of Condition of the Federal Reserve Banks in Table 9A in the “Statistical Tables” section of this report.

...Not applicable.

rities increased to 2.10 percent in 2010. The average rate of interest earned on federal agency and GSE MBS decreased to 4.15 percent in 2010. The average interest rates for securities sold under agreements to repurchase increased to 0.16 percent in 2010. The average rates of interest earned on foreign currency denominated assets and central bank liquidity swaps decreased to 0.89 percent and 1.21 percent, respectively, in 2010.

Lending

In 2010, average daily primary, secondary, and seasonal credit extended decreased by $35,696 million to $4,709 million, and average daily term auction credit extended under the Term Auction Facility decreased $284,382 million to $7,105 million. The average rate of interest earned on primary, secondary, and seasonal credit increased to 0.68 percent in 2010, from 0.50 percent in 2009, while the average interest rate on term auction credit decreased to 0.25 percent in 2010, from 0.27 percent in 2009.

The average daily balance of credit extended to the American International Group, Inc. (AIG) in 2010 was $22,874 million; this balance earned interest at an average rate of 11.93 percent. On January 14, 2011, all outstanding draws under the AIG revolving line of credit and the related accrued interest, capitalized interest, and capitalized commitment fees were paid in full as a result of the closing of the AIG recapitalization plan.[21]

The average daily balance of Term Asset-Backed Securities Loan Facility (TALF) loans in 2010 was $39,029 million, which earned interest at an average rate of 1.92 percent. The Board of Governors' authorization for the extension of new TALF loans expired in 2010. The authorization for TALF loans collateralized by newly-issued asset-backed securities (ABS) and legacy commercial mortgage-backed securities (CMBS) expired March 31 and TALF loans collateralized by newly issued CMBS expired June 30.

The authorization to lend under the Primary Dealer Credit Facility and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility expired on February 10, 2010. There were no balances outstanding under these facilities during 2010.

Investments of the Consolidated LLCs

Additional lending facilities established during 2008 and 2009, under authority of section 13(3) of the Federal Reserve Act, involved creating and lending to the consolidated LLC entities (see **table 6**). Consistent with generally accepted accounting principles, the assets and liabilities of these LLCs have been consolidated with the assets and liabilities of the New York Reserve Bank in the preparation of the statements of condition included in this report.[22] The proceeds at the maturity or the liquidation of the consolidated LLCs' assets will be used to repay the loans extended by the New York Reserve Bank.

Federal Reserve Bank Premises

Several Reserve Banks took action in 2010 to upgrade and refurbish their facilities. The multiyear renovation programs at the New York and St. Louis Reserve Banks' headquarters buildings continued. The New York Reserve Bank completed a program to enhance the business resiliency of its IT systems and to upgrade facility support for the Bank's open market operations, central bank services, and data center operations.

Security-enhancement programs continued at several facilities, including the construction of a remote vehicle-screening facility for the Dallas Reserve Bank, and the design of main entrance lobby security improvements for the Chicago and Dallas Reserve Banks' headquarters buildings.

Additionally, the San Francisco Reserve Bank continued its efforts to sell the former Seattle Branch building.

For more information on the acquisition costs and net book value of the Federal Reserve Banks and Branches, see table 14 on page 320 in the "Statistical Tables" section of this report.

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[21] On September 30, 2010, AIG announced an agreement with the U.S. Department of the Treasury, the Federal Reserve Bank of New York and the trustees of the AIG Credit Facility Trust on a recapitalization plan designed to accelerate repayment of its obligations to American taxpayers. The plan resulted in the full repayment and termination of the Reserve Bank's AIG credit facility.

[22] The consolidation of the variable interest entities (VIEs) was assessed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 810 (ASC 810) Consolidation, which requires a VIE to be consolidated by its controlling financial interest holder. A Reserve Bank consolidates a VIE if it has a controlling financial interest, which is defined as the power to direct the significant economic activities of the entity and the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the VIE. To determine whether it is the controlling financial interest holder of a VIE, the Reserve Bank evaluates the VIE's design, capital structure, and relationships with the variable interest holders. As a consequence of the consolidation, the extensions of credit from the New York Reserve Bank to the consolidated LLCs are eliminated, the net assets of the consolidated LLCs appear as assets in table 9 in the "Statistical Tables" section of this report, and the liabilities of the consolidated LLCs to entities other than the New York Reserve Bank, including those with recourse only to the portfolio holdings of the consolidated LLCs, are included in "Other liabilities" in statistical table 9A.

Table 6. Key financial data for Consolidated Limited Liability Companies, 2010 and 2009
Millions of dollars

Item	Commercial Paper Funding Facility LLC (CPFF)[1]		TALF LLC[1]		Maiden Lane LLC[1]		Maiden Lane II LLC[1]		Maiden Lane III LLC[1]		Total LLCs	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Net portfolio assets of the consolidated LLCs and the net position of the New York Reserve Bank (FRBNY) and subordinated interest holders												
Net portfolio assets[2]	...	14,233	665	298	27,961	28,140	16,457	15,912	23,583	22,797	68,666	81,380
Liabilities of consolidated LLCs	...	-173	0	0	-915	-1,137	-2	-2	-4	-3	-921	-1,315
Net portfolio assets available[3]	...	14,060	665	298	27,046	27,003	16,455	15,910	23,579	22,794	67,745	80,065
Loans extended to the consolidated LLCs by the FRBNY[4]	...	9,379	0	0	25,845	29,233	13,485	16,005	14,071	18,500	53,401	73,117
Other beneficial interests[4, 5]	...	...	106	102	1,315	1,248	1,071	1,037	5,366	5,193	7,858	7,580
Total loans and other beneficial interests	...	9,379	106	102	27,160	30,481	14,556	17,042	19,437	23,693	61,259	80,697
Cumulative change in net assets since the inception of the program[6]												
Allocated to FRBNY	...	4,681	-65	20	0	-2,230	1,582	-95	2,775	0	4,292	2,654
Allocated to other beneficial interests	...	...	624	176	-114	-1,248	317	-1,037	1,367	-899	2,194	-3,184
Cumulative change in net assets	...	4,681	559	196	-114	-3,478	1,899	-1,366	4,142	-899	6,486	-530
Summary of consolidated LLC net income, including a reconciliation of total consolidated LLC net income to the consolidated LLC net income recorded by FRBNY												
Portfolio interest income[7]	213	4,224	1	0	1,133	1,476	794	1,088	2,299	3,032	4,440	9,820
Interest expense on loans extended by FRBNY[8]	-4	-598	0	0	-205	-146	-186	-238	-204	-296	-599	-1,278
Interest expense–other	0	0	-4	-2	-66	-61	-34	-33	-173	-171	-277	-267
Portfolio holdings gains (losses)	1	8	0	0	2,571	-102	2,467	-604	3,141	-1,239	8,180	-1,937
Professional fees	-2	-30	-1	-1	-69	-55	-10	-12	-22	-27	-104	-125
Net income (loss) of consolidated LLCs	208	3,604	-4	-3	3,364	1,112	3,031	201	5,041	1,299	11,640	6,213
Less: Net income (loss) allocated to other beneficial interests	...	...	-75	699	1,135	-61	1,353	-34	2,266	1,299	4,679	1,903
Net income (loss) allocated to FRBNY	208	3,604	71	-702	2,229	1,173	1,678	235	2,775	0	6,961	4,310
Add: Interest expense on loans extended by FRBNY, eliminated in consolidation	4	598	0	0	205	146	186	238	204	296	599	1,278
Net income (loss) recorded by FRBNY	212	4,202	71[9]	(702)	2,434	1,319	1,864	473	2,979	296	7,560	5,588

1 CPFF LLC was formed to provide liquidity to the commercial paper market. The last commercial paper purchases by the CPFF matured on April 26, 2010, and the CPFF was dissolved on August 30, 2010. TALF LLC was formed in 2009 to purchase assets of the Term Asset-Backed Securities Loan Facility, which was formed to improve market conditions for asset-backed securities. Maiden Lane LLC was formed to acquire certain assets of Bear Stearns; Maiden Lane II LLC and Maiden Lane III LLC were formed to acquire certain assets of AIG and its subsidiaries.

2 TALF, Maiden Lane, Maiden Lane II, and Maiden Lane III holdings are recorded at fair value. Fair value reflects an estimate of the price that would be received upon selling an asset if the transaction were to be conducted in an orderly market on the measurement date. CPFF holdings are recorded at book value, which includes amortized cost and related fees.

3 Represents the net assets available for repayment of loans extended by FRBNY and "other beneficiaries" of the consolidated LLCs.

4 Book value. Includes accrued interest.

5 The other beneficial interest holders are the U.S. Treasury for TALF LLC, JPMorgan Chase for Maiden Lane LLC, and AIG for Maiden Lane II LLC and Maiden Lane III LLC.

6 Represents the allocation of the change in net assets and liabilities of the consolidated LLCs that are available for repayment of the loans extended by FRBNY and the other beneficiaries of the consolidated LLCs. The differences between the fair value of the net assets available and the face value of the loans (including accrued interest) are indicative of gains or losses that would be incurred by the beneficiaries if the assets had been fully liquidated at prices equal to the fair value.

7 Interest income is recorded when earned and includes amortization of premiums, accretion of discounts, and paydown gains and losses.

8 Interest expense recorded by each consolidated LLC on the loans extended by FRBNY is eliminated when the LLCs are consolidated in FRBNY's financial statements and, as a result, the consolidated LLCs' net income (loss) recorded by FRBNY is increased by this amount.

9 FRBNY earned $327 million on TALF loans during the year ended December 31, 2010, in addition to the net income attributable to TALF LLC. Earnings on TALF loans include interest income of $750 million, loss on the valuation of loans of $436 million, and administrative fees of $13 million.

Pro Forma Financial Statements for Federal Reserve Priced Services

Table 7: Pro Forma Balance Sheet for Federal Reserve Priced Services, December 31, 2010 and 2009
Millions of dollars

Item	2010		2009	
Short-term assets (Note 1)				
Imputed reserve requirements on clearing balances	248.8		317.4	
Imputed investments	3,463.4		4,112.9	
Receivables	45.6		49.8	
Materials and supplies	1.2		1.5	
Prepaid expenses	17.2		19.4	
Items in process of collection	374.5		449.7	
Total short-term assets		4,150.6		4,950.7
Long-term assets (Note 2)				
Premises	245.3		346.3	
Furniture and equipment	57.3		81.4	
Leases, leasehold improvements, and long-term prepayments	65.6		76.3	
Prepaid pension costs	354.7		77.1	
Prepaid FDIC asset	25.0		31.2	
Deferred tax asset	132.4		231.4	
Total long-term assets		880.2		843.7
Total assets		5,030.8		5,794.5
Short-term liabilities				
Clearing balances and balances	2,487.6		3,173.6	
Deferred-availability items	1,814.7		1,728.3	
Short-term debt	0.0		0.0	
Short-term payables	43.6		146.9	
Total short-term liabilities		4,345.9		5,048.8
Long-term liabilities				
Long-term debt	0.0		0.0	
Accrued benefit costs	392.3		436.8	
Total long-term liabilities		392.3		436.8
Total liabilities		4,738.2		5,485.5
Equity (including accumulated other comprehensive loss of $267.6 million and $478.3 million at December 31, 2010 and 2009, respectively)		292.6		309.0
Total liabilities and equity (Note 3)		5,030.8		5,794.5

Note: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

Table 8: Pro Forma Income Statement for Federal Reserve Priced Services, 2010 and 2009
Millions of dollars

Item	2010		2009	
Revenue from services provided to depository institutions (Note 4)		566.7		662.7
Operating expenses (Note 5)		503.9		713.8
Income from operations		62.9		-51.1
Imputed costs (Note 6)				
Interest on float	-3.2		-3.2	
Interest on debt	0.0		0.0	
Sales taxes	5.1		9.1	
FDIC Insurance	6.3	8.2	3.4	9.2
Income from operations after imputed costs		54.6		-60.3
Other income and expenses (Note 7)				
Investment income	10.7		16.6	
Earnings credits	-2.7	7.9	-3.9	12.7
Income before income taxes		62.5		-47.6
Imputed income taxes (Note 6)		20.7		-15.5
Net income		41.8		-32.1
Memo: Targeted return on equity (Note 6)		13.1		19.9

Note: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

Table 9: Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 2010
Millions of dollars

Item	Total	Commercial check collection	Commercial ACH	Fedwire funds	Fedwire securities
Revenue from services (Note 4)	566.7	353.6	109.9	79.1	24.1
Operating expenses (Note 5)	503.9	306.5	100.1	75.1	22.1
Income from operations	62.9	47.0	9.8	4.0	2.0
Imputed costs (Note 6)	8.2	4.2	2.0	1.6	0.5
Income from operations after imputed costs	54.6	42.9	7.9	2.4	1.5
Other income and expenses, net (Note 7)	7.9	4.9	1.6	1.2	0.4
Income before income taxes	62.5	47.7	9.4	3.5	1.8
Imputed income taxes (Note 6)	20.7	15.8	3.1	1.2	0.6
Net income	41.8	31.9	6.3	2.4	1.2
Memo: Targeted return on equity (Note 6)	13.1	8.1	2.6	1.9	0.6
Cost recovery (percent) (Note 8)	105.3	107.1	103.4	100.6	102.8

Note: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

Notes to Pro Forma Financial Statements for Priced Services

(1) Short-Term Assets

The imputed reserve requirement on clearing balances held at Reserve Banks by depository institutions reflects a treatment comparable to that of compensating balances held at correspondent banks by respondent institutions. The reserve requirement imposed on respondent balances must be held as vault cash or as balances maintained at a Reserve Bank; thus, a portion of priced services clearing balances held with the Federal Reserve is shown as required reserves on the asset side of the balance sheet. Another portion of the clearing balances is used to finance short-term and long-term assets. The remainder of clearing balances and deposit balances arising from float are assumed to be invested in a portfolio of investments, shown as imputed investments.

Receivables are composed of fees due the Reserve Banks for providing priced services and the share of suspense-account and difference-account balances related to priced services.

Materials and supplies are the inventory value of short-term assets.

Prepaid expenses include salary advances and travel advances for priced-service personnel.

Items in process of collection are gross Federal Reserve cash items in process of collection (CIPC), stated on a basis comparable to that of a commercial bank. They reflect adjustments for intra-System items that would otherwise be double-counted on a consolidated Federal Reserve balance sheet; adjustments for items associated with nonpriced items (such as those collected for government agencies); and adjustments for items associated with providing fixed availability or credit before items are received and processed. Among the costs to be recovered under the Monetary Control Act is the cost of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

(2) Long-Term Assets

Long-term assets consist of long-term assets used solely in priced services, the priced-service portion of long-term assets shared with nonpriced services, an estimate of the assets of the Board of Governors used in the development of priced services, an imputed prepaid FDIC asset (see note 6), and a deferred tax asset related to the priced services pension and postretirement benefits obligation (see note 3).

(3) Liabilities and Equity

Under the matched-book capital structure for assets, short-term assets are financed with short-term payables and clearing balances. Long-term assets are financed with long-term liabilities and core clearing balances. As a result, no short- or long-term debt is imputed. Other short-term liabilities include clearing balances maintained at Reserve Banks. Other long-term liabilities consist of accrued postemployment, postretirement, and qualified and nonqualified pension benefits costs and obligations on capital leases.

Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standard Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and*

Other Postretirement Plans (codified in FASB Accounting Standards Codification (ASC) Topic 715 (ASC 715), *Compensation–Retirement Benefits*), which requires an employer to record the funded status of its benefit plans on its balance sheet. In order to reflect the funded status of its benefit plans, the Reserve Banks recognized the deferred items related to these plans, which include prior service costs and actuarial gains or losses, on the balance sheet. This resulted in an adjustment to the pension and benefit plans related to priced services and the recognition of an associated deferred tax asset with an offsetting adjustment, net of tax, to accumulated other comprehensive income (AOCI), which is included in equity. The Reserve Bank priced services recognized a net pension asset in 2010 and 2009. The increase in the funded status resulted in a corresponding decrease in accumulated other comprehensive loss of ($210.7) million in 2010.

To satisfy the FDIC requirements for a well-capitalized institution, equity is imputed at 10 percent of total risk-weighted assets.

(4) Revenue

Revenue represents fees charged to depository institutions for priced services and is realized from each institution through one of two methods: direct charges to an institution's account or charges against its accumulated earnings credits (see note 7).

(5) Operating Expenses

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services plus the expenses of the Board of Governors related to the development of priced services. Board expenses were $7.2 million in 2010 and $7.8 million in 2009.

Effective January 1, 1987, the Reserve Banks implemented SFAS No. 87, *Employers' Accounting for Pensions* (codified in ASC 715). Accordingly, the Reserve Bank priced services recognized qualified pension-plan operating expenses of $53.8 million in 2010 and $121.2 million in 2009. Operating expenses also include the nonqualified pension expense of $4.4 million in 2010 and $2.3 million in 2009. The implementation of SFAS No. 158 (ASC 715) does not change the systematic approach required by generally accepted accounting principles to recognize the expenses associated with the Reserve Banks' benefit plans in the income statement. As a result, these expenses do not include amounts related to changes in the funded status of the Reserve Banks' benefit plans, which are reflected in AOCI (see note 3).

The income statement by service reflects revenue, operating expenses, imputed costs, other income and expenses, and cost recovery. Certain corporate overhead costs not closely related to any particular priced service are allocated to priced services based on an expense-ratio method. Corporate overhead was allocated among the priced services during 2010 and 2009 as follows (in millions):

	2010	2009
Check	14.6	22.0
ACH	5.5	5.0
Fedwire funds	3.9	3.3
Fedwire securities	1.9	1.8
Total	25.9	32.1

(6) Imputed Costs

Imputed costs consist of income taxes, return on equity, interest on debt, sales taxes, an FDIC assessment, and interest on float. Many imputed costs are derived from the private-sector adjustment factor (PSAF) model. The cost of debt and the effective tax rate are derived from bank holding company data, which serve as the proxy for the financial data of a representative private-sector firm, and are used to impute debt and income taxes in the PSAF model. The after-tax rate of return on equity is based on the returns of the equity market as a whole and is applied to the equity on the balance sheet to impute the profit that would have been earned had the services been provided by a private-sector firm. On October 9, 2008, the Federal Reserve began paying interest on required reserve and excess balances held by depository institutions at Reserve Banks as authorized by the Emergency Economic Stabilization Act of 2008. Beginning in 2009, given the uncertain long-term effect that payment of interest on reserve balances would have on the level of clearing balances, the equity used to determine the imputed profit has been adjusted to reflect the actual clearing balance levels maintained; previously, projections of clearing balance levels were used.

Interest is imputed on the debt assumed necessary to finance priced-service assets; however, no debt was imputed in 2010 or 2009.

Effective in 2007, the Reserve Bank priced services imputed a one-time FDIC assessment credit. In 2009, the credit offset $8.0 million of the imputed $11.4 million assessment, resulting in zero remaining credit. The imputed FDIC assessment also reflects the increased rates and new assessment calculation methodology approved in 2009, which resulted in a prepaid FDIC asset of $25.0 million in 2010 and $31.2 million in 2009 on the priced services balance sheet.

Interest on float is derived from the value of float to be recovered, either explicitly or through per-item fees, during the period. Float costs include costs for the Check, Fedwire Funds, ACH, and Fedwire Securities services.

Float cost or income is based on the actual float incurred for each priced service. Other imputed costs are allocated among priced services according to the ratio of operating expenses, less shipping expenses, for each service to the total expenses, less the total shipping expenses, for all services.

The following shows the daily average recovery of actual float by the Reserve Banks for 2010 in millions of dollars:

Total float	-1,795.1
Unrecovered float	1.4
Float subject to recovery	-1,796.5
Sources of recovery of float	
As-of adjustments	0.6
Direct charges	4.7
Per-item fees	-1,801.8

Unrecovered float includes float generated by services to government agencies and by other central bank services. As-of adjustments and direct charges refer to float that is created by the observance of nonstandard holidays by some depository institutions. Such float may be recovered from the depository institutions through adjustments to institution reserve or clearing balances or by billing institutions directly. Float recovered through direct charges and per-item fees is valued at the federal funds rate; credit float recovered through per-item fees has been subtracted from the cost base subject to recovery in 2010 and 2009.

(7) Other Income and Expenses

Other income and expenses consist of investment and interest income on clearing balances and the cost of earnings credits. Investment income on clearing balances for 2010 and 2009 represents the average coupon-equivalent yield on three-month Treasury bills plus a constant spread, based on the return on a portfolio of investments. The investment return is applied to the required portion of the clearing balance. Other income also includes imputed interest on the portion of clearing balances set aside as required reserves. Expenses for earnings credits granted to depository institutions on their clearing balances are based on a discounted average coupon-equivalent yield on three-month Treasury bills.

(8) Cost Recovery

Annual cost recovery is the ratio of revenue, including other income, to the sum of operating expenses, imputed costs, imputed income taxes, and targeted return on equity.

Other Federal Reserve Operations

The Board of Governors and the Government Performance and Results Act

Overview

The Government Performance and Results Act (GPRA) of 1993 requires that federal agencies, in consultation with Congress and outside stakeholders, prepare a strategic plan covering a multiyear period and submit an annual performance plan and performance report. Although the Federal Reserve is not covered by the GPRA, the Board of Governors voluntarily complies with the spirit of the act.

Strategic Plan, Performance Plan, and Performance Report

The Board's strategic plan articulates the Board's mission, sets forth major goals, outlines strategies for achieving those goals, and discusses the environment and other factors that could affect their achievement. It also addresses issues that cross agency jurisdictional lines, identifies key quantitative measures of performance, and discusses the evaluation of performance.

The performance plan includes specific targets for some of the performance measures identified in the strategic plan and describes the operational processes and resources needed to meet those targets. It also discusses validation of data and verification of results. The performance report discusses the Board's performance in relation to its goals.

The strategic plan, performance plan, and performance report are available on the Board's website, at www.federalreserve.gov/boarddocs/rptcongress. The Board's mission statement and a summary of the Federal Reserve's strategic and performance goals, as set forth in the most recently released strategic and performance plans, are listed below. Updated documents will be posted on the website as they are completed.

Mission

The mission of the Board is to foster the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems to promote optimal macroeconomic performance.

Goals and Objectives

The Federal Reserve has six primary strategic goals with interrelated and mutually reinforcing elements. To achieve these strategic goals, which cover four different functional areas, the Board has established a number of annual performance goals, which are described in this section.

Monetary Policy Function

Strategic Goal

Conducting monetary policy that promotes the achievement of the Federal Reserve's statutory objectives of maximum employment and stable prices

Annual Performance Goals

Informed monetary policy: Staying abreast of recent developments in and prospects for the U.S. and global economies and financial markets so that monetary policy decisions are well informed

Understanding of macroeconomics and markets: Enhancing our knowledge of the structural and behavioral relationships in the macroeconomic and financial markets, and improving the quality of the data used to gauge economic performance, through developmental research activities

Effective implementation of monetary policy: Implementing monetary policy effectively in highly unusual economic, financial, and monetary circumstances

Contribution to international efforts: Contributing to the development of U.S. international policies and procedures, in cooperation with the U.S. Department of the Treasury and other agencies, with respect to global financial markets, international organizations, and participation in international groups

Expanded public awareness of monetary policy: Promoting understanding of Federal Reserve policy among other government officials and the general public

Supervisory and Regulatory Function

Strategic Goals

Safety and soundness: Promoting a safe, sound, competitive, and accessible banking system and financial stability

Consumer protection: Developing regulations, policies, and programs designed to inform and protect consumers, to enforce federal consumer protection laws, to strengthen market competition, and to promote access to banking services in historically underserved markets

Annual Performance Goals

Financial stability and risk containment: Promoting overall financial stability by identifying emerging financial problems so that significant crises can be averted

Accessibility of the banking system: Providing a safe, sound, competitive, and accessible banking system through comprehensive and effective supervision of U.S. banks, bank and financial holding companies, foreign banking organizations, and related entities

Financial system efficiency: Enhancing efficiency and effectiveness by addressing the supervision function's procedures, technology, and resource allocation

Effective oversight of financial institutions: Promoting the compliance of domestic and foreign banking organizations (those under Federal Reserve supervision) with relevant laws, rules, regulations, policies, and guidelines through a comprehensive and effective supervision program

Consumer protection: Being a leader in, and a facilitator in helping shape the national dialogue on, consumer protection in the financial services arena

Relationship building: Promoting, developing, and strengthening effective communications and collaborations between the Board, the Federal Reserve Banks, and other agencies and organizations

Payment System Policy and Oversight Function

Strategic Goals

Policy: Fostering the integrity, efficiency, and accessibility of U.S. payment and settlement systems

Oversight: Providing oversight of Reserve Banks

Annual Performance Goals

Effective System strategies, projects, and operations: Producing high-quality assessments and oversight of Federal Reserve System strategies, projects, and operations, including adoption of technology to meet the business and operational needs of the Federal Reserve

Efficient, accessible payment systems: Developing sound, effective policies and regulations that foster the integrity, efficiency, and accessibility of payment, clearing, and settlement systems and overseeing U.S. dollar payment, clearing, and securities settlement systems by assessing their risks and risk-management approaches against relevant policy objectives and standards

Analysis of system dynamics and risks: Conducting research and analysis that contributes to policy development and increases the Board's and others' understanding of payment system dynamics and risk

Internal Board Support

Strategic Goal

Fostering the integrity, efficiency, and effectiveness of Board programs and operations

Annual Performance Goals

High-caliber staff: Developing appropriate policies, oversight mechanisms, and measurement criteria to ensure that the recruiting, training, and retention of staff meet Board needs

Fair, equal treatment of employees: Establishing, encouraging, and enforcing a climate of fair and equitable treatment for all employees regardless of race, creed, color, national origin, age, or sex

Effective planning and management: Providing strategic planning and financial management support needed for sound business decisions

Security of information: Providing cost-effective and secure information resource management services to Board divisions, supporting divisional distributed-processing requirements, and providing analysis on information technology issues to the Board, Reserve Banks, other financial regulatory institutions, and central banks

Safe, secure work environment: Providing safe, modern, secure facilities and necessary support for activities conducive to efficient and effective Board operations

Federal Legislative Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) (Pub. L. No. 111–203), enacted on July 21, is one of the most significant pieces of legislation affecting the U.S. financial regulatory framework in many years. The act includes many of the reforms championed by the Federal Reserve to help strengthen the financial system and reduce the likelihood of future financial crises. For example, the legislation creates an inter-agency council to monitor and coordinate responses to emerging threats to the financial system; requires that large bank holding companies and systemically designated financial firms be subject to enhanced prudential standards to reduce the risks they may present to the financial system; provides for the consolidated supervision of all systemically important financial institutions; gives the government an important additional tool to safely wind down financial firms whose failure could pose a threat to U.S. financial stability; and provides for the strengthened supervision of systemically important payment, settlement, and clearing utilities. In addition, the act enhances the transparency of the Federal Reserve while preserving the Federal Reserve's independence, which is crucial to the effective implementation of monetary policy.

The Small Business Jobs Act of 2010 (the Jobs Act) (Pub. L. No. 111–240), enacted on September 27, established a $30-billion Small Business Lending Fund (SBLF), which is designed to promote small business lending through Treasury investment in capital instruments issued by eligible banking organizations.

Following is a summary of the key provisions of the Dodd-Frank Act as they relate to the Federal Reserve, as well as a more detailed overview of the SBLF.

The Dodd-Frank Act

Financial Stability Oversight Council

The act establishes a new Financial Stability Oversight Council (FSOC) charged with a number of important duties, including monitoring and identifying emerging risks to financial stability across the entire financial system, identifying potential regulatory gaps, and coordinating the agencies' responses to potential systemic risks. The FSOC is composed of the Treasury Secretary (who is also chairperson of the FSOC); the Chairman of the Federal Reserve Board; the heads of the Consumer Financial Protection Bureau, Office of the Comptroller of the Currency (OCC), Securities and Exchange Commission (SEC), Federal Deposit Insurance Corporation (FDIC), Commodity Futures Trading Commission (CFTC), Federal Housing Finance Agency (FHFA), and National Credit Union Administration (NCUA); and an independent member with insurance expertise appointed by the President and confirmed by the Senate.

The act instructs the FSOC to designate as systemically important large, interconnected nonbank financial companies and financial market utilities (FMUs) that could pose a threat to U.S. financial stability. Further, the act identifies the Board as the consolidated supervisor of any nonbank financial firm designated by the FSOC as systemically important (referred to in the act as "nonbank financial companies supervised by the Board").

The act requires the FSOC to annually report to and testify before Congress on significant financial market and regulatory developments, potential emerging threats to U.S. financial stability, and recommendations for promoting market discipline and maintaining investor confidence. With the submission of the annual report to Congress, each voting member of the FSOC must either state that he or she believes the FSOC, the government, and the private sector are taking all reasonable steps to ensure financial stability and mitigate systemic risk, or identify what actions he or she believes need to be taken.

The act also establishes a new Office of Financial Research (OFR) within the Treasury Department to collect, standardize, and analyze data for the FSOC and member agencies in connection with the FSOC's duties. The OFR will be headed by a director appointed by the President with the advice and consent of the Senate.

Systemic Designations and Enhanced Prudential Standards for Financial Firms

The act requires the Board to establish heightened prudential standards for nonbank financial companies supervised by the Board and for bank holding companies (BHCs) with assets of $50 billion or more.[1] These heightened standards must be more stringent than the standards that apply to other non-

[1] Foreign banking organizations that are subject to the Bank Holding Company Act (BHC Act) and meet the asset threshold are also subject to the Board's heightened prudential standards.

bank financial companies and BHCs that do not pose similar risks to the financial system. In particular, these heightened standards must include risk-based capital and leverage requirements, liquidity requirements, overall risk-management requirements, concentration limits, and “living will” and credit exposure reporting requirements. In addition to the mandatory heightened standards, the Board may establish standards for designated nonbank financial companies and BHCs with assets of $50 billion or more relating to contingent capital, enhanced public disclosure, short-term debt limits, and such other prudential standards as deemed appropriate.

The act also requires the Board to conduct and publish summary results of annual stress tests of systemic nonbank financial firms and BHCs with $50 billion or more in assets. Such firms also are required to conduct their own stress tests on a semiannual basis. The act requires financial firms with more than $10 billion in assets to conduct annual stress tests in accordance with regulations established by the respective primary federal financial regulatory agency.

Changes to Banking Regulation and Supervision

The act makes a variety of changes to the laws designed to protect the safety and soundness of banking organizations and that are administered by the Federal Reserve. For example, section 171 of the act establishes floors for regulatory capital requirements applied to domestic BHCs, savings and loan holding companies (SLHCs), and designated nonbank financial companies supervised by the Board. Specifically, section 171 requires the minimum leverage and risk-based capital requirements for such institutions to be no lower than the requirements applied to insured depository institutions at any time in the future and not quantitatively lower than the requirements applied to insured depository institutions on July 21, 2010. The Board’s Basel II Advanced rules, proposed on December 15, 2010, incorporate the floors prescribed by the act. In addition, the act sets guidelines for whether certain instruments may be counted as regulatory capital.

Sections 608, 609, and 615 of the act enhance the limitations on transactions among a BHC, a subsidiary bank, and its affiliates. Specifically, the act clarifies that a “covered transaction” for the purposes of sections 23A and 23B of the Federal Reserve Act includes any credit exposure of a bank to an affiliate arising from derivative transactions or securities borrowing and lending transactions with such affiliate. In addition, the act eliminates certain exemptions from sections 23A and 23B for subsidiaries of BHCs and requires that any purchase of assets by a bank from an insider must be on market terms.

The act also requires the Board to incorporate a financial stability factor into certain regulatory determinations. Specifically, for certain transactions governed by the Bank Holding Company Act and Bank Merger Act, sections 163 and 604 require the Board to take into account risks to the stability of the U.S. banking or financial system. Moreover, section 173 adds financial stability to the list of factors that the Board may consider when acting on an application by a foreign bank to open an office in the United States. Specifically, the Board may consider whether the foreign bank’s home country has adopted or is making demonstrable progress toward adopting a financial regulatory system that mitigates risk to the stability of the U.S. financial system. Section 604 of the act authorizes the Board to incorporate financial stability into its supervision of BHCs.

Section 606(a) of the act provides that a BHC must be well capitalized and well managed at the holding company level in order to become and remain a financial holding company (FHC) eligible to engage in expanded activities. In addition, section 163(b) provides that in order to use authority under section 4(k) of the Federal Reserve Act to acquire a nonbank company with $10 billion or more in assets, a nonbank financial company that is supervised by the Board or a BHC with $50 billion or more in consolidated assets must obtain the Board’s prior approval. Further, section 164 applies restrictions on management interlocks to nonbank financial companies supervised by the Board.

Section 956 of the act requires the Board to issue a joint rulemaking or guidance with other federal regulators to prohibit incentive-based compensation arrangements at institutions with $1 billion or more in assets (covered financial institutions) that encourage inappropriate risks by providing excessive compensation, or potentially leading to material financial loss. In addition, the regulations or guidance must require covered financial institutions to disclose to their appropriate federal regulator sufficient information concerning the structure of incentive-based compensation arrangements to monitor compliance with these restrictions. These new regulations or guidelines will supplement the guidance the Board and other federal banking regulators issued on June 21, 2010, to ensure that incentive compensation arrangements at financial organizations take into account risk and are consistent with safe and sound practices.

Section 165(d) requires the Board and the FDIC to jointly issue a rule requiring that nonbank financial companies supervised by the Board and BHCs with $50 billion or more in total consolidated assets prepare and update plans for orderly resolution under the Bankruptcy Code and report (1) credit exposures to other significant financial firms and (2) credit exposures of significant financial firms to the reporting company.

Further, the act generally eliminates the limitations under the Gramm-Leach-Bliley Act that restricted the Board's ability to examine, obtain reports from, or take enforcement action against a functionally regulated subsidiary of a BHC, such as a broker-dealer or insurance company. The Board, however, must continue to rely on examinations conducted by the subsidiary's primary bank supervisors or functional regulators to the fullest extent possible and notify such supervisors before conducting an examination of the subsidiary.

Separately, section 605 of the act requires the Board to examine the activities of nonbank subsidiaries of BHCs—other than functionally regulated subsidiaries—that are permissible for the organization's subsidiary banks in the same manner, subject to the same standards, and with the same frequency as if such activities were conducted in the organization's lead subsidiary depository institution. Section 612 of the act prohibits a depository institution that is subject to a formal enforcement order or memorandum of understanding with respect to a significant supervisory matter from converting its charter unless the current and proposed supervisors establish a plan that addresses the problems at the depository institution and that will be implemented and monitored by the new supervisor.

Section 939A of the act requires all federal agencies to review their regulations, including capital rules, and remove any reference to credit ratings. Each agency must substitute an alternative standard of credit-worthiness that it deems appropriate. On August 10, 2010, the federal banking agencies issued an advance notice of proposed rulemaking regarding alternatives to the use of credit ratings in risk-based capital rules for banking organizations.

Finally, effective July 21, 2011, section 627 of the act repeals the prohibition on payment of interest on demand deposits currently implemented by the Board's Regulation Q.

Savings and Loan Holding Companies

The act transfers all supervisory and regulatory authority over SLHCs to the Board from the Office of Thrift Supervision (OTS). Effective on July 21, 2011, the act grants the Board the authority to examine, obtain reports from, and establish consolidated capital standards for SLHCs. The FDIC and OCC will exercise similar authority over thrift institutions. On January 25, 2011, the Board, in conjunction with the OTS, OCC, and FDIC, issued a report to Congress on the agencies' plans to implement the transfer of OTS authorities.

The act contains several provisions designed to preserve the traditional separation of banking and commercial activities and support the Board's supervision and regulation of SLHCs. First, the act provides that an SLHC will be allowed to conduct expanded activities permissible to an FHC, such as insurance underwriting, only if such SLHC satisfies the same capital, managerial, and Community Reinvestment Act criteria that govern whether a BHC qualifies as an FHC. In addition, the act instructs the Board to issue regulations establishing criteria for determining when a grandfathered unitary SLHC that engages in commercial activities must form an intermediate holding company (IHC) through which to conduct its financial activities. Such IHCs would be subject to Board supervision as an SLHC, and the Board may promulgate regulations to restrict or limit transactions between the IHC and any affiliate.

The "Volcker Rule": Prohibitions against Proprietary Trading and Other Activities

Section 619 of the act generally prohibits banking entities from engaging in proprietary trading or from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund. Proprietary trading does not include transactions entered into on behalf of customers or in connection with underwriting or market-making-related activities, risk-mitigating hedging activities, or investments in small business investment companies or other similar qualifying investments. The act also provides that nonbank financial companies supervised by the Board that engage in such activities or have such investments will be subject to additional capital requirements, quantitative limits, or other restrictions. These prohibitions and other provisions of section 619 are commonly known as the "Volcker Rule."

As required by the act, on January 18, 2011, the FSOC issued a study and made recommendations on the implementation of the Volcker Rule. The Board, OCC, FDIC, CFTC, and SEC are responsible for developing and adopting regulations to implement the prohibitions and restrictions of the Volcker Rule, and must adopt implementing rules not later than October 18, 2011.

The Board alone is responsible for adopting rules to implement the conformance provisions of the Volcker Rule, which provide a banking entity or a nonbank financial company supervised by the Board a period of time after the effective date of the Volcker Rule to bring its activities into compliance with the Volcker Rule and the agencies' implementing regulations. On February 9, 2011, the Board issued a final rule implementing the conformance period.

Financial Sector Concentration Limit

Section 622 of the act establishes a financial sector concentration limit that generally prohibits a financial company from merging or consolidating with, or acquiring, another company if the resulting company's consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies. As required by the act, on January 18, 2011, the FSOC completed a study of the concentration limit's effect on financial stability and other factors and made recommendations regarding modifications to the concentration limit that the FSOC believes would more effectively implement section 622.

The Board is required to adopt regulations to implement the financial sector concentration limit that reflect, and are in accordance with, the FSOC's recommendations. The Board must prescribe these rules no later than October 18, 2011.

Regulation of Derivatives Markets and Products

The act makes a number of significant changes to the regulation of derivatives, which it refers to as "swaps" and "security-based swaps," and participants in the derivatives markets. The act divides the regulation of the derivatives markets between the SEC, which will regulate security-based swaps, and the CFTC, which will regulate all other swaps. The act generally requires (1) all standardized derivatives to be centrally cleared and traded on an exchange or registered execution facility; (2) all derivatives to be reported to registered data repositories; (3) all derivatives dealers ("swap dealers") and major market participants ("major swap participants") to register with the SEC and/or the CFTC; and (4) the establishment of new, regulated organizations to support the derivatives market, including exchanges, clearing organizations, and data repositories. In general, the act mandates that the SEC and CFTC consult with the Board before issuing rules to implement the new regulatory regime applicable to derivatives.

In addition, the Board and the other federal banking agencies are required to adopt joint rules that establish capital and margin requirements for banks, BHCs, SLHCs, foreign banks, foreign bank branches, and Edge Act and agreement corporations that are swap dealers or major swap participants.

Derivatives "Push-Out"

Section 716 of the act, commonly referred to as the derivatives "push-out" provision, prohibits banks and other institutions receiving certain kinds of federal assistance from engaging in derivatives activities, except for derivatives used for hedging or other risk-mitigating purposes and derivatives involving interest or other rates; derivatives that reference assets that are eligible for bank investment (including foreign exchange, gold, and silver); and cleared credit default swaps. These institutions will be required to push out all other derivatives activities, including derivatives on agricultural commodities, energy, and other metals; equity derivatives; and uncleared credit default swaps to a separately capitalized affiliate. The Board and the other federal banking agencies must establish a transition period of up to 24 months after the effective date of the derivatives push-out provision for institutions to bring their activities into compliance with the derivatives push-out restrictions.

Credit-Risk Retention Study and Regulations

Section 941(b) of the act imposes certain credit-risk retention obligations on securitizers or originators of assets securitized through the issuance of asset-backed securities. Section 941 also requires the Board, in conjunction with other federal agencies, to jointly prescribe regulations implementing these credit-risk retention requirements. On October 19, 2010, the Board issued a report on the effect of the new risk-retention requirements to be developed and implemented by the federal agencies, and of Statements of Financial Accounting Standards Nos. 166 and 167.[2] The report highlights the significant differences in market practices and performance across securitizations backed by different types of assets.

Payment, Settlement, and Clearing Activities and Utilities

Sections 112(a)(2)(J) and 804(a) of the act give the FSOC the authority to identify and designate as systemically important an FMU if the FSOC determines that failure of or a disruption to the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. In addition, the FSOC may designate payment, clearing, or settlement activities it determines are systemically important. On November 23, 2010, the FSOC issued an advanced notice of proposed rulemaking on the criteria and analytical framework that it should apply in designating FMUs under the act.

In addition, section 805(a) of the act authorizes the Board to prescribe risk-management standards governing the operations of designated FMUs (except for designated FMUs that are registered with the CFTC as derivative clearing organizations or registered with the SEC as clearing agencies, which are subject to the applicable risk-management standards contained in regulations prescribed by the CFTC or SEC, respectively). Under section 807, the Board may examine and take enforcement action against designated FMUs for which it is the supervisory agency. In addition, the Board may consult on and participate in any examination of a designated FMU led by another supervisory agency and recommend the supervisory agency take enforcement action against the designated FMU. Section 809 of the act also authorizes the Board to require a designated FMU to submit reports and data in order to assess the safety and soundness of the utility and the systemic risk that the FMU's operations pose to the financial system.

Section 806(a) of the act also makes designated FMUs eligible for Federal Reserve services. Specifically, the Board may authorize a Reserve Bank to establish and maintain an account for and provide deposit and payment services to the designated FMU. In addition, section 806(b) of the act states that, in unusual and exigent circumstances and when a designated FMU demonstrates that it is unable to secure adequate credit accommodations from other banking institutions, the Board, after consultation with the Secretary of the Treasury, may authorize a Reserve Bank to provide discount and borrowing privileges to the designated FMU.

Debit Interchange

Section 1075 of the act restricts the interchange fees that issuers may receive for electronic debit card transactions. Specifically, the interchange fee an issuer receives for a particular transaction must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. The act requires the Board to set standards for determining whether an interchange fee is reasonable and proportional to the issuer's cost and permits the Board to adjust the interchange fee to account for an issuer's fraud-prevention costs. It also authorizes the Board to prescribe regulations in order to prevent circumvention or evasion of the interchange fee restrictions. The interchange fee restrictions do not apply to issuers that, together with affiliates, have less than $10 billion in assets, to debit cards issued pursuant to government-administered payment programs, or to certain general-use prepaid cards. In addition, the act requires the Board to prescribe rules prohibiting network exclusivity arrangements and routing restrictions in connection with electronic debit card transactions. On December 16, 2010, the Board requested comment on proposed rules implementing section 1075 of the act.

Resolution Framework

The act creates a special resolution process that allows the government to wind down a failing systemically important financial institution whose disorderly collapse would pose substantial risks to the financial system and the broader economy. Specifically, title II of the act permits the FDIC to be appointed as receiver for a failing nonbank financial company. This optional resolution framework is triggered only by a recommendation of two-thirds of the Federal Reserve Board and the FDIC's board of directors and a determination by the Secretary of the Treasury, in consultation with the President, that (1) the company is in default or in danger of default, (2) the failure of the company and its resolution under otherwise applicable federal or state law would have serious adverse effects on financial stability in the United States, and (3) resolution under the new regime would avoid or mitigate these adverse effects. The SEC would substitute for the FDIC in the rec-

[2] See Board of Governors of the Federal Reserve System (2010), "Report to the Congress on Risk Retention" (October), available at http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

ommendation process if the firm or its largest subsidiary is a broker-dealer.

The act vests in the FDIC, as receiver for the failed company, powers similar to those it has when acting as a receiver for a failed bank. Specifically, the FDIC may stabilize the company with loans or guarantees, sell assets or operations, and transfer assets and liabilities to a bridge company. The act requires the FDIC to ensure that creditors and shareholders of the failed company bear losses and that directors and management responsible for the company's failure are removed. The act also allows the FDIC to obtain temporary funding for a resolution by borrowing from the Treasury, subject to certain limits. Importantly, any borrowings from the Treasury must be repaid through proceeds from the sale of the failed company's operations. If such proceeds are insufficient to fully repay all borrowings from the Treasury, assessments would be made on certain creditors of the failed firm and, if necessary, on financial companies that have $50 billion or more in total assets.

Federal Reserve Lending, Transparency, and Governance

Lending

The act eliminates the Board's authority to authorize a Federal Reserve Bank to extend credit to a specific individual, partnership, or corporation under section 13(3) of the Federal Reserve Act. Importantly, however, the act provides that the Board may authorize a Federal Reserve Bank to extend credit under section 13(3) to an individual, partnership, or corporation as part of a program or facility with broad-based eligibility, with the approval of the Secretary of the Treasury. The Board must, in consultation with the Secretary of the Treasury, promulgate rules and procedures for section 13(3) lending. Such policies and procedures must ensure that collateral is of sufficient quality to protect taxpayers from losses, credit is extended to provide liquidity and not to assist a failing financial company, and the Federal Reserve Bank assigns a lendable value to all collateral for the purposes of determining that the loan is secured.

Transparency

As required by the act, on December 1, 2010, the Board publicly identified each entity, including foreign central banks, that had participated in or received assistance between December 1, 2007, and July 21, 2010, through the Term Auction Facility, the Agency Mortgage-Backed Securities Purchase Program, foreign currency liquidity swap lines, or facilities established under section 13(3). In the case of broad-based facilities, details provided by the Board included the name of the borrower, the amount borrowed, the date the credit was extended, the interest rate charged, information about collateral, and other relevant credit terms. Similar information was provided for the draws of foreign central banks on their dollar liquidity swap lines with the Federal Reserve. For agency mortgage-backed securities transactions, details included the name of the counterparty, the security purchased or sold, and the date, amount, and price of the transaction. Going forward, the act requires the Board to publicly disclose certain information regarding participants in all future credit facilities established under section 13(3), and borrowers or counterparties in discount window and open market transactions. All such disclosure is required within one year after the termination of any section 13(3) facility or two years after any discount window or open market transaction occurs.

Additionally, the act directs the Government Accountability Office (GAO) to conduct audits of certain Federal Reserve functions. Specifically, the act requires the GAO to conduct a one-time audit of any liquidity program or facility established between December 1, 2007, and July 21, 2010. GAO is instructed to analyze the operational integrity, accounting, financial reporting, and internal controls of each facility; the effectiveness of security and collateral policies in mitigating risk to the Federal Reserve and taxpayers; whether one or more specific participants were favored over other eligible institutions; the use of contractors for the facility or program; and the existence of any conflicts of interest. The act also allows the GAO to conduct similar operational audits of future credit facilities and discount window and open market transactions.

The act further requires the GAO to conduct an audit of Reserve Bank governance to examine whether the selection process for Class B and Class C directors fulfills the Federal Reserve Act's public interest requirement and whether the selection of Class A directors by member banks creates actual or potential conflicts of interest. Class A directors of each Reserve Bank represent the stockholding member banks of the Federal Reserve District. Class B and Class C directors represent the public and are chosen by member banks and by the Board of Governors, respectively, with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers. Class B and Class C directors may not be officers, directors, or employees of any bank. In addition, Class C directors may not be stockholders of any bank. The Board annually designates one Class C director at each District Bank as chair of the board of directors and another Class C director as deputy chair.

Governance

The act modifies the procedures for appointing Reserve Bank presidents by excluding Class A directors from the appointment process. Accordingly, Reserve Bank presidents will be chosen only by the Class B and Class C directors. The act also prevents the Board from delegating to the Reserve Banks certain Board responsibilities, including the establishment of policies relating to supervision and regulation.

Pursuant to section 342 of the act, the Board, and each Reserve Bank, has established an Office of Minority and Women Inclusion responsible for matters relating to diversity in management, employment, and business activities.

The act also establishes a new Vice Chairman for Supervision at the Board, to be appointed by the President with the advice and consent of the Senate. The Vice Chairman for Supervision will be responsible for developing policy recommendations for the Board regarding the supervision and regulation of financial firms, and for overseeing the supervision and regulation of such firms. The Vice Chairman for Supervision must also testify semiannually before Congress.

Consumer Financial Protection

Establishment of the Consumer Financial Protection Bureau

Title X of the act creates within the Federal Reserve an independent Consumer Financial Protection Bureau (CFPB) to ensure that consumers have access to financial markets and that such markets are fair, transparent, and competitive. The CFPB will be led by a director selected by the President and confirmed by the Senate. The CFPB will assume rulemaking authority for most federal consumer protection statutes. It also will have exclusive authority to conduct examinations, require reports, and take enforcement actions regarding the federal consumer protection laws with respect to nondepository institutions that are engaged in certain markets, such as the mortgage business, or that are otherwise larger participants in the consumer financial services industry. With respect to large depository institutions (with $10 billion or more in total assets), the CFPB will have exclusive authority to conduct examinations and require reports and primary authority to take enforcement actions with respect to the federal consumer protection laws. Employees of the Federal Reserve and other federal agencies who are necessary to the administration of federal consumer protection laws will be transferred from their current agency to the CFPB. The Secretary of the Treasury, in consultation with the affected regulatory agencies, has designated July 21, 2011, as the transfer date to the CFPB.

Additional Enhancements to Consumer Financial Protection

The act prohibits certain mortgage lending practices and places new restrictions on predatory lending. Many of these statutory reforms are similar to recent regulatory initiatives by the Board. For example, similar to final rules issued by the Board in August 2010, section 1403 of the act prohibits mortgage originators from receiving compensation based on loan terms other than principal amount and from steering consumers to unaffordable or predatory mortgages. Other mortgage provisions in the act bear resemblance to the Board's 2008 rules for higher-priced loans under the Home Ownership and Equity Protection Act and broaden some rules to apply to all mortgages. For instance, the act prohibits creditors from making residential mortgage loans unless the consumer has a reasonable ability to repay the loan.

Further, section 1461 of the act requires escrow accounts for taxes and insurance on higher-priced first-lien mortgages. This section also amends the Truth in Lending Act to provide a separate, higher threshold for mortgage loans that exceed the maximum principal balance eligible for sale to Freddie Mac in determining coverage of the escrow requirement. The Board requested comment on August 16, 2010, on a proposed rule to increase the annual percentage rate threshold used to determine whether a mortgage lender is required to establish an escrow account for property taxes and insurance for first-lien jumbo mortgage loans.

In addition, the act instructs the Board to prescribe interim final rules to ensure the independence of real estate appraisers, with final rules to be issued jointly by the federal banking agencies, the CFPB, and FHFA. The Board issued such interim final rules on October 18, 2010. The act also requires certain new disclosures for negative amortization, adjustable rate mortgages, and escrows.

The Small Business Jobs Act

The Jobs Act established the SBLF and authorized the Secretary of the Treasury to purchase up to $30 billion in tier 1-qualifying preferred stock or equivalents from eligible financial institutions with no more than $10 billion in consolidated assets. The SBLF promotes lending to small businesses by conditioning a participating institution's dividend rate on the amount by which it increases its small business lending.

The dividend rate on SBLF funding will begin at 5 percent and may be reduced to as low as 1 percent, depending on the amount by which the participating institution increases lending to small businesses. If the institution does not increase lending in the first two years, however, the rate will increase to 7 percent. After 4.5 years, the rate will increase to 9 percent unless the institution has not already repaid the SBLF funding.

To apply, eligible institutions must provide a small business lending plan to the institution's primary federal regulator. An institution may not participate in the program if it or any of its subsidiary depository institutions (as applicable) are on the FDIC's problem bank list or have been on the list in the past 90 days. A participating institution may exit the program by repaying the SBLF funding at any time with the approval of its primary federal regulator. Subject to certain conditions, participating institutions may refinance capital purchase program instruments they previously issued to Treasury through the SBLF.[3]

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3 For more information on the SBLF, visit the Treasury Department's website at www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx.

Record of Policy Actions of the Board of Governors

This report provides a summary account of policy actions taken by the Board in 2010, as implemented through (1) rules and regulations, (2) policy statements and other actions, (3) special liquidity facilities and other initiatives, and (4) discount rates for depository institutions. All actions were approved by a unanimous vote of the Board members, unless indicated otherwise.[1] More information on the actions with italicized dates is available via the online version of the Annual Report, from the "Reading Rooms" on the Board's FOIA web page, or on request from the Board's Freedom of Information Office.

Rules and Regulations

Regulation D
Reserve Requirements of Depository Institutions

[Docket No. R-1381]

On *April 21, 2010*, the Board approved a final rule to authorize Reserve Banks to offer interest-bearing deposits of a specified maturity, or "term deposits," to institutions that are eligible to receive earnings on balances held in their Federal Reserve accounts. Term deposits will be offered through a Term Deposit Facility and are intended to facilitate the conduct of monetary policy by providing a tool for managing the aggregate quantity of reserve balances. (See "Special Liquidity Facilities and Other Initiatives" on page 159.) Term deposits are separate and distinct from balances maintained in an institution's master account at a Reserve Bank as well as from those maintained in an excess balance account. The Board also approved minor amendments to its Policy on Payment System Risk to address transactions associated with term deposits. The final rule is effective June 4, 2010.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation E
Electronic Fund Transfers

[Docket No. R-1377]

On *March 19, 2010*, the Board approved a final rule to implement the gift card provisions of the Credit Card Accountability Responsibility and Disclosure Act (the Credit Card Act). The final rule prohibits dormancy, inactivity, and service fees on gift cards, unless (1) the consumer has not used the gift certificate or card for at least one year, (2) no more than one such fee is charged per month, and (3) the consumer is given clear and conspicuous disclosures about the fees. Expiration dates for funds underlying gift cards must be at least five years after the date of issuance, or five years after the date when funds were last loaded on the card. The rule generally covers retail gift cards, which can be used to buy goods or services from a single merchant or an affiliated group of merchants, and network-branded gift cards, which are redeemable at any merchant that accepts the card brand. The rule is effective August 22, 2010.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

On *August 10, 2010*, the Board approved an interim final rule with request for comment to implement legislation modifying the effective date of certain disclosure requirements applicable to gift cards under the Credit Card Act. For gift certificates, store gift cards, and general-use prepaid cards produced before April 1, 2010, the legislation and interim final rule delay the August 22, 2010, effective date of these disclosures until January 31, 2011, provided that several specified conditions are met.

[1] Vice Chairman Kohn's term as Vice Chairman expired on June 23, 2010, and he remained a member of the Board until September 1, 2010. Vice Chair Yellen and Governor Raskin joined the Board on October 4, 2010.

Voting for this action: Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

On *October 18, 2010*, the Board approved a final rule implementing the January 31, 2011, effective date for certain gift cards, as specified in the interim final rule.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Regulation E
Electronic Fund Transfers

Regulation DD
Truth in Savings

[Docket Nos. R-1343 and R-1315]

On *May 27, 2010*, the Board approved amendments to clarify certain provisions of the November 2009 final rule on Regulation E and the December 2008 final rule on Regulation DD. In particular, the amendments clarify that the Regulation E prohibition on assessing overdraft fees without a consumer's affirmative consent, or "opt in," applies to all institutions, including those that have a policy of declining ATM and one-time debit card transactions when an account has insufficient funds. For Regulation DD, the amendments address the application of the 2008 rule to retail sweep programs and clarify the terminology for overdraft fee disclosures. The amendments, which make other technical and conforming changes, are effective July 6, 2010 (except for the Regulation DD provision regarding the "Total Overdraft Fees" terminology, which is effective October 1, 2010).

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

[Docket No. R-1357]

On *April 12, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, and Farm Credit Administration, approved final rules to implement the registration requirements of the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act). Under the S.A.F.E. Act, mortgage loan originators who are employees of agency-regulated institutions must register with the Nationwide Mortgage Licensing System and Registry and are generally prohibited from originating residential mortgage loans unless they register. As part of the registration process, residential mortgage loan originators must furnish information and fingerprints for background checks, and originators will receive a unique identifier that will enable consumers to access employment and other information about them from the registry. The final rules further provide that agency-regulated institutions must (1) require their employees who act as residential mortgage loan originators to comply with the S.A.F.E. Act's registration and other requirements and (2) adopt and follow written policies and procedures designed to ensure compliance with these requirements. The agencies published their final rules on July 28, 2010. The Board also approved conforming amendments to Regulation K (International Banking Operations) to include an uninsured state-licensed branch or agency of a foreign bank or commercial lending company owned or controlled by a foreign bank and any residential mortgage loan originator that it employs. The rules are effective October 1, 2010, and the 180-day registration period for mortgage loan originators subject to the agencies' rules begins January 31, 2011.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

Regulation Y
Bank Holding Companies and Change in Bank Control

[Docket No. R-1368]

On *January 4, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, approved final rules amending the general and advanced risk-based capital adequacy frameworks to (1) eliminate the exclusion of certain consolidated asset-backed commercial paper programs from risk-weighted assets; (2) add a reservation of authority permitting the agencies to require banking organizations to treat off-balance-sheet entities as if they were consolidated for risk-based capital purposes; and (3) provide for an optional two-quarter delay, followed by an optional two-quarter partial implementation period, for most of the effects on risk-weighted assets and tier 2 capital resulting from a banking organization's implementation of Financial Accounting Standards Nos. 166 and 167. The final rule is effective March 29, 2010. Banking organizations may elect to comply with the rule as of the beginning of their first annual reporting period that begins after November 15, 2009.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation Z
Truth in Lending

[Docket No. R-1384]

On *June 14, 2010*, the Board approved a final rule to implement certain provisions of the Credit Card Act intended to ensure that penalty fees imposed by credit card issuers are reasonable and proportional to the violation. Among other changes, the rule (1) prohibits credit card issuers from charging a penalty fee of more than $25 if a consumer pays late or otherwise violates the account's terms, unless the consumer has engaged in repeated violations or the issuer can show that a higher fee represents a reasonable proportion of the costs it incurred as a result of the violations; (2) prohibits issuers from charging penalty fees that exceed the dollar amount associated with a consumer's violation; (3) prevents issuers from charging multiple penalty fees based on a single late payment or other violation of the account terms; and (4) bans "inactivity" fees, such as fees based on a consumer's failure to use the account to make new purchases. The rule also requires credit card issuers that have increased rates since January 1, 2009, to evaluate whether the reasons for the increase have changed and, if appropriate, to reduce the rate. The rule is effective August 22, 2010.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[Docket No. R-1378]

On *August 1, 2010*, the Board approved a final rule to implement a requirement in the Helping Families Save Their Homes Act that consumers receive written notice after their mortgage loan has been sold or transferred. Under the act, a purchaser or assignee that acquires a mortgage loan must provide the required disclosures in writing within 30 days. The final rule is effective January 1, 2011.

Voting for this action: Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

[Docket No. R-1366]

On *August 11, 2010*, the Board approved an interim rule with request for comment that revises the disclosure requirements for closed-end mortgage loans. Under the interim rule, which implements certain requirements of the Mortgage Disclosure Improvement Act, creditors extending consumer credit secured by real property or a dwelling must disclose certain summary information about interest rates and payment changes in a tabular format, including the initial interest rate together with the corresponding monthly payment. The disclosures must also include a statement that consumers might not be able to avoid increased payments by refinancing their loans. For adjustable-rate or step-rate loans, creditors must disclose the maximum interest rate and payment that can occur during the first five years and a "worst-case" example showing the possible maximum rate and payment due over the life of the loan. The rule also requires creditors to disclose certain features, such as balloon payments or options to make only minimum payments, that will cause loan amounts to increase. The interim final rule is effective October 25, 2010, and compliance is mandatory January 30, 2011.

Voting for this action: Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

On *December 21, 2010*, the Board approved an interim rule with request for comment to clarify certain aspects of the August 11, 2010, interim rule (published in September 2010), in response to public comments. This revised interim rule is effective January 30, 2011, and compliance is mandatory October 1, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

[Docket No. R-1366]

On *August 11, 2010*, the Board approved a final rule to protect mortgage borrowers from unfair or abusive lending practices that can arise from certain loan-originator compensation practices. The final rule prohibits payments to loan originators, including mortgage brokers and loan officers, that are based on the terms or conditions of a transaction, other than the amount of credit extended. The final rule also prohibits a loan originator receiving compensation directly from a consumer from also receiving compensation from the lender or another party. In addition, the final rule prohibits loan originators from directing, or "steering," consumers to a loan that is not in the consumer's interest in order to increase the originator's compensation. The final rule is effective April 1, 2011.

Voting for this action: Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

[Docket No. R-1394]

On *October 18, 2010*, the Board approved an interim final rule with request for comment to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) that establish new requirements for appraiser independence in consumer credit transactions secured by a consumer's principal dwelling. The rule ensures that real estate appraisers are free to use their independent professional judgment, without influence or pressure from parties who may have an interest in a transaction. The rule also seeks to ensure that appraisers receive customary and reasonable payments for their services. Among other provisions, the interim final rule (1) prohibits coercion and other similar actions designed to cause appraisers to base the appraised value of properties on factors other than their independent judgment, (2) prohibits appraisers and appraisal management companies hired by lenders from having financial or other interests in the properties or the credit transactions, and (3) requires creditors or settlement service providers that have information about appraiser misconduct to file reports with the appropriate state licensing authorities. The interim final rule is effective December 27, 2010, and compliance is mandatory April 1, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Regulation Z
Truth in Lending

Regulation AA
Unfair or Deceptive Acts or Practices

[Docket Nos. R-1370, R-1286, and R-1383]

On *January 7, 2010*, the Board approved a final rule amending Regulation Z to implement certain provisions of the Credit Card Act. The final rule protects consumers who use credit cards from a number of costly practices. In particular, the rule (1) protects consumers from unexpected increases in credit card interest rates by generally prohibiting increases in a rate during the first year after an account is opened and increases in a rate that applies to an existing credit card balance; (2) prohibits creditors from issuing a credit card to a consumer who is younger than the age of 21, unless certain requirements are met; (3) requires creditors to obtain a consumer's consent before charging fees for transactions that exceed the credit limit; (4) limits the high fees associated with subprime credit cards; and (5) prohibits creditors from allocating payments in ways that maximize interest charges. In addition, the rule bans creditors from imposing interest charges using the "two-cycle" billing method, in which charges are based on balances on days in the current billing cycle and in the previous billing cycle. The Board also withdrew certain amendments to Regulation Z and Regulation AA because those amendments were superseded. The final rule is effective February 22, 2010. Compliance with most aspects of the rule is mandatory July 1, 2010, although compliance with certain provisions is mandatory February 22, 2010.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation BB
Community Reinvestment

[Docket No. R-1360]

On *August 31, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift

Supervision, approved a joint final rule to implement a provision of the Higher Education Opportunity Act that requires the agencies to consider low-cost education loans provided to low-income borrowers when assessing an institution's record of meeting community credit needs under the Community Reinvestment Act (CRA). The joint final rule also incorporates a CRA provision that allows the agencies to consider a financial institution's capital investment, loan participation, and other ventures undertaken in cooperation with minority- or women-owned financial institutions and low-income credit unions as a factor when assessing the institution's CRA record. The joint final rule is effective November 3, 2010.

Voting for this action: Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

[Docket No. R-1387]

On *November 22, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, approved a joint final rule amending the agencies' CRA regulations to revise the term "community development" to include loans, investments, or services of the type eligible for funding under the Neighborhood Stabilization Program that benefit certain areas designated by the Department of Housing and Urban Development. The joint final rule is effective January 19, 2011.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Rules Regarding Access to Personal Information under the Privacy Act of 1974

[Docket No. R-1313]

On *October 4, 2010*, the Board approved a final rule amending its Privacy Act regulation to waive copying fees for Privacy Act requests by current or former Board employees or applicants for Board employment and to permit current and former Board employees to make Privacy Act requests in person or in writing to the Board office that maintains the record. The rule also permits certain consultations regarding the disclosure of medical records, changes the time limits for responding to requests for access to information, updates exemptions, and makes minor editorial and technical changes for clarity and consistency with the Board's published systems of records. The final rule is effective October 18, 2010.

Voting for this action: Chairman Bernanke and Governors Warsh, Duke, and Tarullo.

Policy Statements and Other Actions

Maximum Maturity of Primary Credit Loans

On *February 17, 2010*, the Board approved a reduction in the maximum maturity of primary credit loans at the discount window for most depository institutions from 28 days to overnight, effective March 18, 2010. Before August 2007, the maximum available term of primary credit was generally overnight but was subsequently lengthened in order to enhance banks' access to term funds and thus support their ability to lend to households and businesses. The maximum available term was lengthened to 30 days (on August 17, 2007) and to 90 days (on March 16, 2008) and then shortened to 28 days (on November 12, 2009).

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Interagency Questions and Answers Regarding Community Reinvestment

[Docket No. OP-1349]

On *March 1, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, approved final revised Interagency Questions and Answers Regarding Community Reinvestment. The revisions include examples of ways an institution could determine that its community services are targeted to low- and moderate-income individuals and a discussion of reporting requirements for community development loans. The revised questions and answers, which consolidate and supersede the agencies' previously published versions, are effective March 11, 2010.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Interagency Policy Statement on Funding and Liquidity Risk Management

[Docket No. OP-1362]

On *March 12, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, and the Conference of State Bank Supervisors, approved an interagency statement to provide depository institutions with consistent supervisory expectations regarding sound practices for managing funding and liquidity risk. The policy statement summarizes the agencies' past principles in this area, and when appropriate, supplements them with the "Principles for Sound Liquidity Risk Management and Supervision," issued by the Basel Committee on Banking Supervision in September 2008.

> **Voting for this action:** Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Correspondent Concentration Risks

[Docket No. OP-1369]

On *April 26, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, approved final interagency guidance on managing concentration risks arising from correspondent banking relationships. The guidance highlights the need for financial institutions to identify, monitor, and manage credit and funding concentrations to other institutions on a stand-alone and organization-wide basis. In addition, the guidance addresses the supervisory expectation that financial institutions should perform appropriate due diligence on all credit exposures to, and funding transactions with, other financial institutions as part of their risk-management policies and procedures. The policy is effective May 4, 2010.

> **Voting for this action:** Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Guidance on Sound Incentive Compensation Policies

[Docket No. OP-1374]

On *June 16, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, approved final interagency guidance on incentive compensation policies at banking organizations. The guidance is designed to ensure that incentive compensation arrangements do not encourage imprudent risk taking and do not undermine the safety and soundness of the organization or create undue risks to the financial system. The guidance applies not only to top-level managers but also to other employees who have the ability to materially affect the risk profile of an organization, either individually or as part of a group. The guidance is effective June 25, 2010.

> **Voting for this action:** Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Reverse Mortgage Products: Guidance for Managing Compliance and Reputation Risks

On *August 2, 2010*, the Board approved final interagency guidance, issued by the Federal Financial Institutions Examination Council on behalf of its members, addressing reverse mortgages, which are loan products typically offered to elderly consumers. The guidance emphasizes the consumer protection concerns raised by these products and stresses the importance of mitigating their compliance and reputational risks. The guidance is effective October 18, 2010.

> **Voting for this action:** Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

Community Depository Institutions Advisory Council

On *September 10, 2010*, the Board approved the establishment of an advisory council to represent insured community depository institutions. Members of the Community Depository Institutions Advisory Council (CDIAC) will be selected from the representatives of banks, thrift institutions, and credit unions who serve on newly created local advisory councils at the 12 Reserve Banks. CDIAC will replace the Thrift

Institutions Advisory Council. The Reserve Bank councils are expected to begin meeting in 2011, with meetings of CDIAC to follow later in the year.

Voting for this action: Chairman Bernanke and Governors Warsh, Duke, and Tarullo.

Office of Financial Stability Policy and Research

On *October 26, 2010*, the Board approved the establishment of the Office of Financial Stability Policy and Research to bring together economists, banking supervisors, markets experts, and other Federal Reserve staff to support the Board's financial stability responsibilities, including its expanded responsibilities in this area under the Dodd-Frank Act. The office will develop and coordinate staff efforts to identify and analyze potential risks to the financial system and the broader economy by, among other activities, monitoring asset prices, leverage, financial flows, and other market-risk indicators; following developments at key institutions; and analyzing policies to promote financial stability. It will also support the supervision of large financial institutions and the Board's participation on the Financial Stability Oversight Council.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Interagency Appraisal and Evaluation Guidelines

[Docket No. OP-1338]

On *December 1, 2010*, the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, and National Credit Union Administration, approved final supervisory guidance on sound practices by financial institutions for real estate appraisals and evaluations. The guidelines, which replace 1994 appraisal guidelines, (1) address the agencies' recent supervisory issuances on appraisal practices; (2) address advancements in information technology used in collateral valuation practices; and (3) clarify standards for the industry's appropriate use of analytical methods and technological tools in developing evaluations. Financial institutions should review their appraisal and evaluation programs to ensure they are consistent with the guidelines. The guidelines are effective December 10, 2010.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Office of Diversity and Inclusion

On *December 16, 2010*, the Board approved the establishment of the Office of Diversity and Inclusion in accordance with a provision of the Dodd-Frank Act that also applies to the Reserve Banks and other federal financial regulatory agencies. The office will incorporate the activities of the Board's current Equal Employment Opportunity Programs Office, as well as foster diversity in the Board's procurements and assist with developing standards to assess the diversity practices of the entities the Board regulates. The office will work with Board staff in areas that include procurement, staffing, banking supervision and regulation, and consumer and community affairs to carry out its statutory responsibilities.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Warsh, Duke, Tarullo, and Raskin.

Special Liquidity Facilities and Other Initiatives

Special Liquidity Facilities

On *January 27, 2010*, the Federal Reserve announced that the following special liquidity facilities would close as scheduled on February 1, 2010, in light of improved functioning of financial markets: Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Commercial Paper Funding Facility, Primary Dealer Credit Facility, and Term Securities Lending Facility. The Federal Reserve also announced the final Term Auction Facility (TAF) amounts and dates ($50 billion in 28-day credit on February 8 and $25 billion in 28-day credit on March 8, 2010) and affirmed that the expiration dates for the Term Asset-Backed Securities Loan Facility (TALF) remained set at June 30, 2010, for loans backed by newly issued commercial mortgage-backed securities and March 31, 2010, for loans backed by all other types of collateral. For more information on the establishment and purposes of these and the Federal Reserve's other special facilities and initiatives, see the *Annual Reports* for 2008 and 2009.

On *February 17, 2010*, the Board approved an increase in the minimum bid rate for the TAF from ¼ percentage point to ½ percent for the final auction on March 8, 2010. (See "Discount Rates for Depository Institutions in 2010" on page 161 for further discussion of the TAF.)

> **Voting for this action:** Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

On *July 9, 2010*, the Board approved a request by the Department of the Treasury (Treasury) to reduce from $20 billion to $4.3 billion the credit protection provided for the TALF under the Troubled Asset Relief Program (TARP). Any losses on the TALF program, which closed on June 30, 2010, with $43 billion in loans outstanding, would first be absorbed by the accumulated excess of the TALF loan interest payments over the Federal Reserve's cost of funds and then by the TARP funds.

> **Voting for this action:** Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.

On *December 1, 2010*, the Board posted detailed information on its public website about transactions conducted through the Federal Reserve's special liquidity facilities from December 1, 2007, to July 21, 2010, in accordance with the Dodd-Frank Act. Similar transaction-level detail was provided for the Federal Reserve's dollar liquidity swaps with foreign central banks and for purchases of agency mortgage-backed securities. The transaction-level details available include the name of the institution, the amount of the transaction, the interest rate charged, information about collateral, and other relevant terms of the programs.

Other Initiatives

American International Group, Inc.

On *September 29, 2010*, the Board authorized the Federal Reserve Bank of New York (Reserve Bank) to enter into a recapitalization plan for the American International Group, Inc. (AIG). The recapitalization plan is designed to restructure and facilitate repayment of the financial support provided to AIG by the Reserve Bank and Treasury. The plan consists of the following basic terms:

- Repayment of the outstanding balance (including all accrued interest and fees) on AIG's revolving credit facility with the Reserve Bank on an accelerated basis using the cash proceeds from the dispositions of certain AIG assets, notably the initial public offering of the AIA Group Limited (AIA) and the sale of American Life Insurance Company (ALICO), and termination of the facility.
- AIG's purchase of up to $22 billion of the Reserve Bank's preferred interests in two special-purpose vehicles that owned AIA and ALICO, respectively (the Reserve Bank had earlier taken the preferred interests in partial repayment of the revolving credit facility). To fund the purchase of the preferred interests, AIG would draw on Treasury's preferred stock commitment for AIG under the TARP and then transfer the preferred interests to Treasury in consideration for the TARP funding.
- Repayment of the Reserve Bank's remaining preferred interests with the proceeds of the dispositions of AIA and ALICO, and retention of any unpaid preferred interests by the Reserve Bank.
- Conversion of Treasury's outstanding preferred equity interests in AIG into common stock of AIG.
- Conversion of the preferred equity interest issued by AIG and held to the AIG Credit Facility Trust as a condition of the Reserve Bank's revolving credit facility into common stock of AIG and transfer of the common stock to Treasury.

> **Voting for this action:** Chairman Bernanke and Governors Warsh, Duke, and Tarullo.

Term Deposit Facility

On *May 7, 2010*, the Board approved up to five small-value offerings of term deposits under the Term Deposit Facility (TDF). (The Board had previously authorized Reserve Banks to offer term deposits to eligible institutions. See "Rules and Regulations" on page 153.) The small-value offerings are designed to ensure the effectiveness of TDF operations and provide eligible institutions with an opportunity to gain familiarity with term deposit procedures. The Board also approved a basic structure for the small-value TDF offerings. Similar to many money market instruments, the term deposits offered will be simple fixed-rate instruments with maturities of 84 days or less and will be issued primarily through competitive single-price auctions. TDF offerings will also include a noncompetitive bidding option to ensure access to term deposits for smaller institutions.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

On *September 7, 2010*, the Board approved a program of ongoing small-value TDF auctions. Although the terms and frequency of these auctions may evolve over time, the Board anticipates that they will be held about every other month.

Voting for this action: Chairman Bernanke and Governors Warsh, Duke, and Tarullo.

Discount Rates for Depository Institutions in 2010

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks must establish rates on discount window loans to depository institutions at least every 14 days, subject to review and determination by the Board of Governors.

Primary Credit

Primary credit, the Federal Reserve's main lending program for depository institutions, is extended at a rate above the federal funds rate target set by the Federal Open Market Committee (FOMC). It is typically made available, with minimal administration and for very short terms, as a backup source of liquidity to depository institutions that, in the judgment of the lending Federal Reserve Bank, are in generally sound financial condition.

Over the period from mid-August 2007 to early 2010, the Federal Reserve allowed depository institutions to borrow primary credit for longer periods to address liquidity pressures during the financial crisis. At the beginning of 2010, the maximum maturity of primary credit was 90 days, renewable by the borrower. Effective January 14, 2010, the maximum maturity of such financing was reduced to 28 days in light of improvement in financial market conditions. On February 18, 2010, the Board announced a further reduction in the typical maturity for primary credit loans to overnight effective March 18, 2010.

During 2010, the Board approved one change to the primary credit rate, an increase from ½ percent to ¾ percent effective February 19, 2010.[2]

Secondary and Seasonal Credit

Secondary credit is available in appropriate circumstances to depository institutions that do not qualify for primary credit. The secondary credit rate is set at a spread above the primary credit rate. Throughout 2010, the spread was set at 50 basis points.

Seasonal credit is available to smaller depository institutions to meet liquidity needs that arise from regular swings in their loans and deposits. The rate on seasonal credit is calculated every two weeks as an average of selected money-market yields, typically resulting in a rate close to the federal funds rate target.

At year-end, the secondary and seasonal credit rates were 1¼ percent and ¼ percent, respectively.[3]

Term Auction Facility Credit

In December 2007, the Federal Reserve established a temporary Term Auction Facility (TAF). Under the TAF, the Federal Reserve auctioned term funds to depository institutions that were in generally sound financial condition and were eligible to borrow under the primary credit program. The amount of each auction was determined in advance by the Federal Reserve, and the interest rate on TAF credit was determined as the rate at which all bids could be fulfilled, up to the maximum auction amount and subject to a minimum bid rate. Originally, the minimum bid rate for TAF auctions was determined based on a measure of the average expected overnight federal funds rate over the term of the credit being auctioned. For TAF auctions from January 2009 to February 2010, the minimum bid rate was set at a level equal to the rate of interest that banks earn on excess reserve balances, which was ¼ percent over this period. On February 18, 2010, the Board announced that it had raised the minimum bid rate to ½ percent.

On June 25, 2009, in light of the improvement in financial conditions and reduced usage of the TAF, the Federal Reserve trimmed the size of upcoming TAF auctions. The Federal Reserve anticipated that,

2 From the inception of the primary credit program in 2003 through mid-2007, the spread of the primary credit rate over the FOMC's target rate was ordinarily 100 basis points. In August 2007, the Board approved a narrowing of this spread to 50 basis points and in 2008, approved a further narrowing to 25 basis points. The 2010 increase in the primary credit rate widened the spread back to 50 basis points. Throughout 2010, the FOMC maintained a target range for the federal funds rate of 0 to ¼ percent.

3 For current and historical discount rates, see www.frbdiscountwindow.org/.

if market conditions continued to improve in coming months, TAF funding would be reduced gradually further. Throughout the second half of 2009, the Federal Reserve gradually reduced the amounts provided under the TAF. On January 27, 2010, the Federal Reserve announced that the final TAF auction would take place on March 8, 2010. There were a total of three TAF auctions held in 2010: $75 billion in 28-day credit was offered on January 11, $50 billion in 28-day credit was offered on February 8, and $25 billion in 28-day credit was offered at the final auction on March 8.[4]

Votes on Changes to Discount Rates for Depository Institutions

About every two weeks during 2010, the Board approved proposals by the 12 Reserve Banks to maintain the formulas for computing the secondary and seasonal credit rates. Until the final TAF auction was conducted, the Board also approved the auction procedure for determining the rate for the TAF about every two weeks. Details on the one action by the Board to approve changes to the primary credit rate are provided below.

February 17, 2010. Effective February 19, 2010, the Board approved establishment of the rate for discounts and advances under the primary credit program (primary credit rate) of ¾ percent (an increase from ½ percent) for the 12 Federal Reserve Banks.

> **Voting for this action:** Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[4] For more information on TAF auctions, including minimum bid rates and the auction-determined rates on TAF credit, see www.federalreserve.gov/monetarypolicy/taf.htm.

Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the Annual Report of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to Congress a full account of such actions.

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a summary of the information and discussions that led to the decisions. In addition, four times a year, starting with the October 2007 Committee meeting, a Summary of Economic Projections is published as an addendum to the minutes. The descriptions of economic and financial conditions in the minutes and the Summary of Economic Projections are based solely on the information that was available to the Committee at the time of the meetings.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the minutes. When members dissent from a decision, they are identified in the minutes and a summary of the reasons for their dissent is provided.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under instructions from the Federal Open Market Committee that take the form of an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Federal Reserve Bank of New York operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. Changes in the instruments during the year are reported in the minutes for the individual meetings.[1]

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1 As of January 1, 2010, the Federal Reserve Bank of New York was operating under the Domestic Policy Directive approved at the December 15–16, 2009, Committee meeting and the Authorization for Domestic Open Market Operations as amended June 23, 2009. The other policy instruments (the Authorization for Foreign Currency Operations, the Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations) in effect as of January 1, 2010, were approved at the January 27–28, 2009, meeting.

Meeting Held on January 26–27, 2010

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, January 26, 2010, at 2:00 p.m. and continued on Wednesday, January 27, 2010, at 8:30 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Donald L. Kohn

Sandra Pianalto

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Christine Cumming, Charles L. Evans, Richard Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Brian F. Madigan
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Alan D. Barkema, Thomas A. Connors, William B. English, Jeff Fuhrer, Steven B. Kamin, Simon Potter, Lawrence Slifman, Mark S. Sniderman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Jennifer J. Johnson
Secretary of the Board, Office of the Secretary, Board of Governors

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Robert deV. Frierson[1]
Deputy Secretary, Office of the Secretary, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

James A. Clouse
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson[2]
Assistant to the Board, Office of Board Members, Board of Governors

Sherry Edwards, Andrew T. Levin, and William R. Nelson
Senior Associate Directors, Division of Monetary Affairs, Board of Governors

David Reifschneider and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

Stephen A. Meyer
Senior Adviser, Division of Monetary Affairs, Board of Governors

Stephen D. Oliner
Senior Adviser, Division of Research and Statistics, Board of Governors

Michael Leahy
Associate Director, Division of International Finance, Board of Governors

Daniel E. Sichel
Associate Director, Division of Research and Statistics, Board of Governors

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1 Attended Tuesday's session only.

2 Attended Wednesday's session only.

Michael G. Palumbo
Deputy Associate Director, Division of Research and Statistics, Board of Governors

Egon Zakrajšek
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Carol C. Bertaut
Senior Economist, Division of International Finance, Board of Governors

Louise Sheiner
Senior Economist, Division of Research and Statistics, Board of Governors

Mark A. Carlson and Kurt F. Lewis
Economists, Division of Monetary Affairs, Board of Governors

Penelope A. Beattie
Assistant to the Secretary, Office of the Secretary, Board of Governors

Carol Low
Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Randall A. Williams
Records Management Analyst, Division of Monetary Affairs, Board of Governors

Harvey Rosenblum
Executive Vice President, Federal Reserve Bank of Dallas

David Altig, Spence Hilton, Loretta J. Mester, and Glenn D. Rudebusch
Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, Philadelphia, and San Francisco, respectively

Warren Weber
Senior Research Officer, Federal Reserve Bank of Minneapolis

David C. Wheelock
Vice President, Federal Reserve Bank of St. Louis

Julie Ann Remache
Assistant Vice President, Federal Reserve Bank of New York

Hesna Genay
Economic Advisor, Federal Reserve Bank of Chicago

Robert L. Hetzel
Senior Economist, Federal Reserve Bank of Richmond

Annual Organizational Matters

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for a term beginning January 26, 2010, had been received and that these individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William C. Dudley
President of the Federal Reserve Bank of New York, with
Christine Cumming
First Vice President of the Federal Reserve Bank of New York, as alternate.

Eric Rosengren
President of the Federal Reserve Bank of Boston, with
Charles I. Plosser
President of the Federal Reserve Bank of Philadelphia, as alternate.

Sandra Pianalto
President of the Federal Reserve Bank of Cleveland, with
Charles L. Evans
President of the Federal Reserve Bank of Chicago, as alternate.

James Bullard
President of the Federal Reserve Bank of St. Louis, with
Richard Fisher
President of the Federal Reserve Bank of Dallas, as alternate.

Thomas M. Hoenig
President of the Federal Reserve Bank of Kansas City, with
Narayana Kocherlakota, *President* of the Federal Reserve Bank of Minneapolis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were selected to serve until the selection of their successors at the first regularly scheduled meeting of the Committee in 2011, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

Brian F. Madigan
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas Baxter
Deputy General Counsel

Richard M. Ashton
Assistant General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Alan D. Barkema
Thomas A. Connors
William B. English
Jeff Fuhrer
Steven B. Kamin
Simon Potter
Lawrence Slifman
Mark S. Sniderman
Christopher J. Waller
David W. Wilcox
Associate Economists

By unanimous vote, the Committee amended its Program for Security of FOMC Information with the addition of a summary of the rule that governs non-citizen access to FOMC information.

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account.

By unanimous vote, Brian Sack was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, with the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

In his annual review of the Committee's authorizations for domestic open market operations and foreign currency transactions, the Manager noted that the Desk recommended continuing to use dollar roll transactions in the process of settling agency mortgage-backed securities (MBS) purchases, and that staff proposed adding a sentence to the directive to authorize using dollar roll transactions after March 31 for the purpose of settling MBS purchases executed by that date. He also noted that the Desk intended to conduct reverse repurchase agreements (RRPs) over the course of the coming year to ensure the readiness of the Federal Reserve's tools for absorbing bank reserves. Such transactions were authorized by the Committee's resolution of November 24, 2009. Finally, he indicated that the Desk was developing the capability to conduct agency MBS administration, trading, and settlement using internal resources, but it would continue to use agents to conduct these tasks until that capability was fully developed.

By unanimous vote, the Committee approved the Authorization for Domestic Open Market Operations (shown below) with amendments to paragraph 4 that allow the use of "securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States" in temporary short-term investment transactions with foreign and international accounts and fiscal agency accounts. The Guidelines for the Conduct of System Open Market Operations in Federal-Agency Issues remained suspended.

Authorization for Domestic Open Market Operations (Amended January 26, 2010)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

A. To buy or sell U.S. government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. government and federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; and

B. To buy or sell in the open market U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the System Open Market Account under agreements to resell or repurchase such securities or obligations (including such transactions as are commonly referred to as repo and reverse repo transactions) in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual counterparties.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to use agents in agency MBS-related transactions.

3. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. government securities and securities that are direct obligations of any agency of the United States, held in the System Open Market Account, to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids that could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

4. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to section 15 of the Federal Reserve Act, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York:

A. For the System Open Market Account, to sell U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, to such accounts on the bases set forth in paragraph 1.A under agreements providing for the resale by such accounts of those securities in 65 business days or less on terms comparable to those available on such transactions in the market; and

B. For the New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph l.B, repurchase agreements in U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and to arrange corresponding sale and repurchase agreements between its own account and such foreign, international, and fiscal agency accounts maintained at the Bank.

Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

5. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate and to take actions that result in material changes in the composition

and size of the assets in the System Open Market Account other than those anticipated by the Committee at its most recent meeting. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

By unanimous vote, the Authorization for Foreign Currency Operations, the Foreign Currency Directive, and the Procedural Instructions with Respect to Foreign Currency Operations were reaffirmed in the form shown below. The vote to reaffirm these documents included approval of the System's warehousing agreement with the U.S. Treasury.

Authorization for Foreign Currency Operations (Reaffirmed January 26, 2010)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for the System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

   A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

      Australian dollars
      Brazilian reais
      Canadian dollars
      Danish kroner
      euro
      Japanese yen
      Korean won
      Mexican pesos
      New Zealand dollars
      Norwegian kroner
      Pounds sterling
      Singapore dollars
      Swedish kronor
      Swiss francs

   B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

   C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

   D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies, excluding changes in dollar value due to foreign exchange rate movements and interest accruals. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Canada	2,000
Bank of Mexico	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1.A above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at nonmarket exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). Such investments may include buying or selling outright obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof; buying such securities under agreements for repurchase of such securities; selling such securities under agreements for the resale of such securities; and holding various time and other deposit accounts at foreign institutions. In addition, when appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, the Vice Chairman's alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to the Manager's responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

   A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

   B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

   C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign

currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive (Reaffirmed January 26, 2010)

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with IMF Article IV, Section 1.

2. To achieve this end the System shall:

   A. Undertake spot and forward purchases and sales of foreign exchange.

   B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

   C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

   A. To adjust System balances in light of probable future needs for currencies.

   B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

   C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

   A. In close and continuous consultation and cooperation with the United States Treasury;

   B. In cooperation, as appropriate, with foreign monetary authorities; and

   C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under IMF Article IV.

Procedural Instructions with Respect to Foreign Currency Operations (Reaffirmed January 26, 2010)

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee, unless otherwise directed by the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

   A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

   B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

   C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

   D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee

is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets during the period since the Committee met on December 15–16, 2009. Financial market conditions remained supportive of economic growth, though volatility in securities markets increased notably toward the end of the intermeeting period. Year-end funding pressures were minimal. No market strains had appeared as a result of the imminent closing, on February 1, of most of the Federal Reserve's special liquidity facilities. The Manager also reported on System open market operations in agency debt and agency MBS during the intermeeting period. The Desk continued to gradually slow the pace of its purchases of these securities as it moved toward completing the Committee's program of asset purchases by March 31. The Desk also continued to engage in dollar roll transactions in agency MBS securities to facilitate settlement of its outright purchases. The Federal Reserve's total assets remained a bit above $2.2 trillion, as the increase in the System's holdings of securities was almost entirely offset by a further decline in usage of the System's credit and liquidity facilities. By unanimous vote, the Committee ratified the Desk's transactions. Participants agreed that the Desk should continue the interim approach of not reinvesting the proceeds of maturing or prepaid agency securities and MBS held by the Federal Reserve. The Desk had continued to reinvest the proceeds of maturing Treasury securities by acquiring newly auctioned Treasury securities issued on the same day its existing holdings matured; participants agreed that the Desk should continue this practice for now, but the Committee would consider further its policy for redeeming or reinvesting maturing Treasury securities. There were no open market operations in foreign currencies for the System's account during the intermeeting period.

Staff briefed the Committee on current usage of the discount window and other liquidity facilities and suggested additional steps policymakers could take to normalize the Federal Reserve's liquidity provision. These steps included continuing to scale back amounts offered through the Term Auction Facility (TAF); returning to the pre-crisis standard of one-day maturity for primary credit loans to all but the smallest depository institutions; and increasing, initially to 50 basis points from 25 basis points, the spread between the primary credit rate and the upper end of the Committee's target range for the federal funds rate. Setting the spread reflects a balance between two objectives: encouraging depository institutions to use the discount window as a backup source of liquidity when they are faced with temporary liquidity shortfalls or when funding markets are disrupted, and discouraging depository institutions from relying on the discount window as a routine source of funds when other funding is generally available. The spread was 100 basis points before the financial crisis emerged; the Federal Reserve narrowed the spread to 50 basis points and then to 25 basis points as part of its response to the financial crisis. Participants judged that improvements in bank funding markets warranted reducing amounts offered at TAF auctions toward zero in three steps over the next few months, while noting that they would be prepared to modify that plan if necessary to support financial stability and economic growth. They agreed that it would soon be appropriate to return the maturity of primary credit loans to overnight and to widen the spread between the primary credit rate and the top of the Committee's target range for the federal funds rate. Several participants noted that the optimal spread could depend, in part, on the Committee's eventual decisions about the most suitable approach to implementing U.S. monetary policy over the longer term. Participants generally agreed that such steps to return the Federal Reserve's liquidity provision to a normal footing would be technical adjustments to reflect the notable diminution of the market strains that had made the creation of new liquidity facilities and expansion of existing facilities necessary and emphasized that such steps would not indicate a change in the Committee's assessment of the appropriate stance of monetary policy or the proper time to begin moving to a less accommodative policy stance.

> Secretary's note: After the FOMC meeting, the Chairman, acting under authority delegated by the Board of Governors, directed that TAF auction amounts be reduced to $50 billion for the February 8 auction and to $25 billion for the final TAF auction, to be held on March 8.

Staff also briefed policymakers about tools and strategies for an eventual withdrawal of policy accommodation and summarized linkages between these tools and strategies and alternative frameworks for implementing monetary policy in the longer run. The tools for moving to a less accommodative policy stance encompassed (1) raising the interest rate paid on excess reserve balances (the IOER rate); (2) executing term reverse repurchase agreements with the primary dealers; (3) executing term RRPs with a broader range of counterparties; (4) using a term deposit facility (TDF) to absorb excess reserves; (5) redeeming maturing and prepaid securities held by the Federal Reserve without reinvesting the proceeds; and (6) selling securities held by the Federal Reserve before they mature. All but the first of these tools would shrink the supply of reserve balances; the last two would also shrink the Federal Reserve's balance sheet. The Desk already had successfully tested its ability to conduct term RRPs with primary dealers by arranging several small-scale transactions using Treasury securities and agency debt as collateral; staff anticipated that the Federal Reserve would be able to execute term RRPs against MBS early this spring and would have the capability to conduct RRPs with an expanded set of counterparties soon after. In coming weeks, staff would analyze comments received in response to a *Federal Register* notice, published in late December, requesting the public's input on the TDF proposal. Staff would then prepare a final proposal for the Board's consideration. A TDF could be operational as soon as May.

Staff described several feasible strategies for using these six tools to support a gradual return toward a more normal stance of monetary policy: (1) using one or more of the tools to progressively reduce the supply of reserve balances—which rose to an exceptionally high level as a consequence of the expansion of the Federal Reserve's liquidity and lending facilities and subsequent large-scale asset purchases during the financial crisis—before raising the IOER rate and the target for the federal funds rate; (2) increasing the IOER rate in line with an increase in the federal funds rate target and concurrently using one or more tools to reduce the supply of reserve balances; and (3) raising the IOER rate and the target for the federal funds rate and using reserve draining tools only if the federal funds rate did not increase in line with the Committee's target.

Participants expressed a range of views about the tools and strategies for removing policy accommodation when that step becomes appropriate. All agreed that raising the IOER rate and the target for the federal funds rate would be a key element of a move to less accommodative monetary policy. Most thought that it likely would be appropriate to reduce the supply of reserve balances, to some extent, before the eventual increase in the IOER rate and in the target for the federal funds rate, in part because doing so would tighten the link between short-term market rates and the IOER rate; however, several noted that draining operations might be seen as a precursor to tightening and should only be undertaken when the Committee judged that an increase in its target for the federal funds rate would soon be appropriate. For the same reason, a few judged that it would be better to drain reserves concurrently with the eventual increase in the IOER and target rates.

With respect to longer-run approaches to implementing monetary policy, most policymakers saw benefits in continuing to use the federal funds rate as the operating target for implementing monetary policy, so long as other money market rates remained closely linked to the federal funds rate. Many thought that an approach in which the primary credit rate was set above the Committee's target for the federal funds rate and the IOER rate was set below that target—a corridor system—would be beneficial. Participants recognized, however, that the supply of reserve balances would need to be reduced considerably to lift the funds rate above the IOER rate. Several saw advantages to using the IOER rate, rather than a target for a market rate, to indicate the stance of policy. Participants noted that their judgments were tentative, that they would continue to discuss the ultimate operating regime, and that they might well gain useful information about longer-run approaches during the eventual withdrawal of policy accommodation.

Finally, staff noted that the Committee might want to address both the eventual size of the Federal Reserve's balance sheet and its composition. Policymakers were unanimous in the view that it will be appropriate to shrink the supply of reserve balances and the size of the Federal Reserve's balance sheet substantially over time. Moreover, they agreed that it will eventually be appropriate for the System Open Market Account to return to holding only securities issued by the U.S. Treasury, as it did before the financial crisis. Several thought the Federal Reserve should hold, eventually, a portfolio composed largely of shorter-term Treasury securities. Participants agreed that a policy of redeeming and not replacing agency debt and MBS as those securities mature or are prepaid would contribute to achieving both goals and thus would be appropriate. Many thought it would also be desirable to redeem some or all of the Treasury securities owned by the Federal Reserve as they mature, recognizing that at some point in the future the Federal Reserve would need to resume purchases of Treasury securities to offset reductions in other assets and to accommodate growth in the public's demand for U.S. currency. Participants expressed a range of views about asset sales. Most judged that a future program of gradual asset sales could be helpful in shrinking the size of the Federal Reserve's balance sheet, reducing reserve balances, and shifting the composition of securities holdings back toward Treasury securities; however, many were concerned that such transactions could cause market disruptions and have adverse implications for the economic recovery, particularly if they were to begin before the recovery had become self-sustaining and before the Committee had determined that a tightening of financial conditions was appropriate and had begun to raise short-term interest rates. Several thought it important to begin a program of asset sales in the near future to ensure that the Federal Reserve's balance sheet shrinks more quickly and in a more predictable manner than could be achieved solely by redeeming maturing securities and not reinvesting prepayments; they judged that a program of asset sales spread over a number of years would underscore the Committee's determination to exit from the period of exceptionally accommodative monetary policy in a manner and at a pace that would keep inflation contained without having large effects on asset prices or market interest rates. A few suggested that the pace of asset sales, and potentially of purchases, could be adjusted over time in response to developments in the economy and the evolution of the economic outlook. The Committee made no decisions about asset sales at this meeting.

Staff Review of the Economic Situation

The information reviewed at the January 26–27 meeting suggested that economic activity continued to strengthen in recent months. Consumer spending was well maintained in the fourth quarter, and business expenditures on equipment and software appeared to expand substantially. However, the improvement in the housing market slowed, and spending on nonresidential structures continued to fall. Recent data suggested that the pace of inventory liquidation diminished considerably last quarter, providing a sizable boost to economic activity. Indeed, industrial production advanced at a solid pace in the fourth quarter. In the labor market, layoffs subsided noticeably in the final months of last year, but the unemployment rate remained elevated and hiring stayed weak. Meanwhile, increases in energy prices pushed up headline consumer price inflation even as core consumer price inflation remained subdued.

Some indicators suggested that the deterioration in the labor market was abating. The pace of job losses continued to moderate: The three-month change in private nonfarm payrolls had become progressively less negative since early 2009; that pattern was widespread across industries. The unemployment rate was essentially unchanged from October through December. The labor force participation rate, however, had declined steeply since the spring, likely reflecting, at least in part, adverse labor market conditions. Moreover, hiring remained weak, the total number of individuals receiving unemployment insurance—including extended and emergency benefits—continued to climb, the average length of ongoing unemployment spells rose steeply, and joblessness became increasingly concentrated among the long-term unemployed.

Total industrial production (IP) rose in December, the sixth consecutive increase since its trough. The gain in December primarily resulted from a jump in output at electric and natural gas utilities caused by unseasonably cold weather. Manufacturing IP edged down after large and widespread gains in November. For the fourth quarter as a whole, the solid increase in manufacturing IP reflected a recovery in motor vehicle output, rising export demand, and a slower pace of business inventory liquidation. Output of consumer goods, business equipment, and materials all rose in the fourth quarter, though the average monthly gains in these categories were a little smaller than in the third quarter. The available near-term indicators of production suggested that IP would increase further in coming months.

Consumer spending continued to trend up late last year but remained well below its pre-recession level. After a strong increase in November, real personal consumption expenditures appeared to drop back some in December. Retail sales may have been held down by unusually bad weather, but purchases of new light motor vehicles continued to increase. The fundamental determinants of household spending—including real disposable income and wealth—strengthened modestly, on balance, near the end of the year but were still relatively weak. Despite the improvement from early last year, measures of consumer sentiment remained low relative to historical norms, and terms and standards on consumer loans, particularly credit card loans, stayed very tight.

The recovery in the housing market slowed in the second half of 2009, even though a number of factors supported housing demand. Interest rates for conforming 30-year fixed-rate mortgages remained historically low. In addition, the Reuters/University of Michigan Surveys of Consumers reported that the number of respondents who expected house prices to increase continued to exceed the number who expected prices to decrease. Sales of existing single-family homes rose strongly from July to November but fell in December, a pattern that suggested sales were pulled ahead in anticipation of the originally scheduled expiration of the first-time homebuyer credit on November 30. Still, existing home sales remained above their level in earlier quarters. Sales of new homes also turned down in November and December, retracing part of their recovery earlier in the year. Similarly, starts of single-family homes retreated a little from June to December after advancing briskly last spring. The pace of construction was slow enough that even the modest pace of new home sales was sufficient to further reduce the overhang of unsold new single-family houses.

Real spending on equipment and software apparently rose robustly in the fourth quarter following a slight increase in the previous quarter. Spending on high-tech equipment, in particular, appeared to increase at a considerably more rapid clip in the fourth quarter than in the third; both orders and shipments of high-tech equipment rose markedly, on net, in October and November. Business purchases of motor vehicles likely also climbed in the fourth quarter. Outside of the transportation and high-tech sectors, business outlays on equipment and software appeared to change little in the fourth quarter. Conditions in the nonresidential construction sector generally remained poor. Real spending on structures outside of the drilling and mining sector dropped in the third quarter; data on nominal expenditures through November pointed to an even faster rate of decline in the fourth quarter. The pace of real business inventory liquidation appeared to decrease considerably in the fourth quarter. After three quarters of sizable declines, real nonfarm inventories shrank at a more modest pace in October, and book-value data for this category suggested that inventories may have increased in real terms in November. Available data suggested that the change in inventory investment—including a sizable accumulation in wholesale stocks of farm products—made an appreciable contribution to the increase in real gross domestic product (GDP) in the fourth quarter.

Consumer price inflation was modest in December after being boosted in the preceding two months by increases in energy prices. Core consumer price inflation remained subdued. Price increases for non-energy services slowed early last year and remained modest throughout 2009, reflecting declining prices for housing services and perhaps the deceleration in labor costs. Price increases for core goods were quite modest during the second half of 2009. According to survey results, households' expectations of near-term inflation increased in January; in addition, median longer-term inflation expectations edged up, though they remained near the lower end of the narrow range that has prevailed over the past few years.

The U.S. international trade deficit widened in November, as a sharp rise in nominal imports outpaced an increase in exports. The rise in exports was driven primarily by a large gain in agricultural exports, which was partially offset by a decline in exports of consumer goods that followed robust growth in October. Imports of oil accounted for roughly one-third of the increase in total imports, though most other categories of imports also recorded gains.

Incoming data suggested that activity in advanced foreign economies continued to expand in the fourth quarter, though at a moderate pace. However, unemployment rates remained elevated and consumption indicators were mixed. Credit conditions improved further, as lending to the private sector expanded in some economies. Increases in export and import volumes pointed to a gradual recovery in international trade. Economic activity in emerging market economies continued to expand in the fourth quarter, although at a pace slower than that of the third quarter. Within emerging Asia, growth appeared to have remained robust in China and to have slowed elsewhere. In Latin America, indicators pointed to a continuation of growth in much of the region, although growth in Mexico appeared to slow significantly following the third quarter's outsized gain. Amid rising energy prices, 12-month headline inflation for December picked up in all advanced foreign economies except Japan, where deflation moderated only mildly. Headline inflation continued to rise in emerging Asia, driven by energy and food prices. In Latin America, headline inflation remained below its earlier elevated pace.

Staff Review of the Financial Situation

The decision by the FOMC to keep the target range for the federal funds rate unchanged at the December meeting and its retention of the "extended period" language in the statement were widely anticipated by market participants and elicited little price response. Later in the intermeeting period, the expected path of the federal funds rate implied by federal funds and Eurodollar futures quotes shifted down slightly as investors apparently interpreted Federal Reserve communications, including the discussion of large-scale asset purchases in the FOMC minutes, as pointing to a more protracted period of accommodative monetary policy than had been anticipated. By contrast, yields on 2- and 10-year nominal Treasury securities were about unchanged on net. Inflation compensation based on 5-year Treasury inflation-protected securities (TIPS) increased; the increase likely reflected higher inflation risk premiums and a further improvement in TIPS market liquidity, along with some rise in inflation expectations owing, in part, to increases in oil prices. Inflation compensation 5 to 10 years ahead declined slightly.

Financial market conditions remained supportive of economic growth over the intermeeting period, and short-term funding markets were generally stable. Spreads between London interbank offered rates (Libor) and overnight index swap (OIS) rates at one- and three-month maturities remained low, while spreads at the six-month maturity continued to edge down. Spreads on A2/P2-rated commercial paper (CP) and AA-rated asset-backed CP held steady at the low end of the range that has prevailed since mid-2007. Strong demand for Treasury bills in the cash and repurchase agreement (repo) market, together with a seasonal decline in bills outstanding, put downward pressure on both bill yields and short-term repo rates. Although year-end pressures in short-term funding markets were generally modest amid ample liquidity, the repo market experienced some year-end dislocations, with a few transactions reportedly occurring at negative interest rates. Use of Federal Reserve credit facilities edged lower over the intermeeting period, and market commentary suggested little concern about the impending expiration of a number of the facilities.

After trending higher for most of the intermeeting period, broad stock price indexes subsequently reversed course amid elevated volatility, ending the period little changed on balance. The gap between the staff's estimate of the expected real equity return over the next 10 years for S&P 500 firms and the real 10-year Treasury yield—a rough gauge of the equity risk premium—stayed about the same and remained well above its average level during the past decade. Over the intermeeting period, yields on both investment-grade and speculative-grade corporate bonds edged down, while those on comparable-maturity Treasury securities held steady. Estimates of bid-asked spreads for corporate bonds—a measure of liquidity in the corporate bond market—remained steady. In the leveraged loan market, average bid prices rose further and bid-asked spreads were little changed.

Overall, net debt financing by nonfinancial businesses was near zero in the fourth quarter after declining in the third, consistent with weak demand for credit and still tight credit standards and terms at banks. In December, gross public equity issuance by nonfinancial firms maintained its solid pace and issuance by financial firms increased noticeably, as several large banks issued shares and used the proceeds to repay capital injections they had received from the Troubled Asset Relief Program. Financing conditions for commercial real estate, however, remained strained. Moody's index of commercial property prices showed another drop in October, bringing the index back to its 2002 level. Delinquency rates on loans in commercial mortgage-backed securities pools increased further in December. The average interest rate on 30-year conforming fixed-rate residential mortgages increased slightly over the intermeeting period but remained within the narrow range of values over recent months. Consumer credit contracted for the 10th consecutive month in November, owing to a further steep decline in revolving credit. Credit card interest rate spreads continued to increase in November. In contrast, spreads on new auto loans extended their downtrend through early January. Delinquency rates on consumer loans remained high in recent months. Issuance of credit card asset-backed securities was minimal in October and November but picked up in December after the Federal Deposit Insurance Corporation announced a temporary extension of safe-harbor rules for its handling of securitized assets should a sponsoring bank be taken into receivership.

Commercial bank credit continued to contract in December, as an increase in banks' securities holdings was more than offset by a large drop in total loans. Commercial and industrial loans and commercial real estate loans again fell markedly. Although a substantial fraction of banks continued to tighten their credit policies on commercial real estate loans in the fourth quarter, lending standards for most other types of loans were little changed, according to the January Senior Loan Officer Opinion Survey on Bank Lending Practices. Nonetheless, standards and terms on all major loan types remained tight, and the demand for loans reportedly weakened further.

M2 continued to expand sluggishly in December. Growth of liquid deposits remained robust, but small time deposits and retail money market mutual funds again contracted at a rapid pace in response to the low yields on those assets. The monetary base and total bank reserves were roughly flat, as the contraction in credit outstanding from the Federal Reserve's liquidity and credit facilities was about offset by the Desk's purchases of agency debt and MBS.

Over the intermeeting period, benchmark sovereign yields in most advanced foreign economies displayed some volatility but ended little changed on net. Global sovereign bond offerings since the start of the year had been reasonably well received, although mounting fiscal concerns made investors more reluctant to hold debt issued by the Greek government; sovereign yields rose in Greece and, to a lesser extent, in several other countries where fiscal issues have raised concerns among investors. All major foreign central banks kept their policy rates unchanged. Foreign equity prices generally ended the intermeeting period down. European financial stocks declined substantially, as early profit reports for the fourth quarter from a few banks rekindled some concerns about the health of the banking system. The broad nominal index of the foreign exchange value of the dollar rose, reportedly reflecting a growing perception that U.S. growth prospects were better than those in Europe and Japan. Concerns that policy tightening by China might restrain the global recovery also may have contributed to the dollar's appreciation against many currencies late in the period.

Staff Economic Outlook

In the forecast prepared for the January FOMC meeting, the staff revised up its estimate of the increase in real GDP in the fourth quarter of 2009. The upward revision was in inventory investment; the staff's projection of the increase in final demand was unchanged. Nonfarm businesses apparently moved earlier to stem the pace of inventory liquidation than the staff had anticipated. As a result, the economy likely entered 2010 with production in closer alignment with sales than the staff had expected in mid-December. Apart from the fluctuations in inventories, economic developments largely were as the staff had anticipated. The incoming information on the labor market and industrial production was broadly consistent with staff expectations, and, though housing activity seemed to be on a lower-than-anticipated trajectory, recent data on business capital spending were slightly above expectations. The staff continued to project a moderate recovery in economic activity over the next two years, with economic growth supported by the accommodative stance of monetary policy and by a further waning of the factors that weighed on spending and production over the past two years. The staff also continued to expect that resource slack would be taken up only gradually over the forecast period.

The staff's forecasts for some slowing of core and headline inflation over the next two years were little changed. There were no significant surprises in the incoming price data, substantial slack in resource utilization was still expected to put downward pressure on costs, and longer-term inflation expectations remained relatively stable. Given staff projections for consumer energy prices, headline inflation was projected to run somewhat above core inflation in 2010 but to slow to the same subdued rate as core inflation in 2011.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants—the five members of the Board of Governors and the presidents of the 12 Federal Reserve Banks—provided projections for economic growth, the unemployment rate, and consumer price inflation for each year from 2010 through 2012 and over a longer horizon. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks. Participants' forecasts through 2012 and over the longer run are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, participants agreed that the incoming data and information received from business contacts, though mixed, indicated that economic growth had strengthened in the fourth quarter, that firms were reducing payrolls at a less rapid pace, and that downside risks to the outlook for economic growth had diminished a bit further. Participants saw the economic news as broadly in line with the expectations for moderate growth and subdued inflation in 2010 that they held when the Committee met in mid-December; moreover, financial conditions were much the same, on balance, as when the FOMC last met. Accordingly, participants' views about the economic outlook had not changed appreciably. Many noted the evidence that the pace of inventory decumulation slowed quite substantially in the fourth quarter of 2009 as firms increased output to bring production into closer alignment with sales. Participants saw the slower pace of inventory reductions as a welcome indication that, in general, firms no longer had large inventory overhangs. But they observed that business contacts continued to report great reluctance to build inventories, increase payrolls, and expand capacity. Participants expected the economic recovery to continue, but most anticipated that the pickup in output and employment growth would be rather slow relative to past recoveries from deep recessions. A moderate pace of expansion would imply slow improvement in the labor market this year, with unemployment declining only gradually. Most participants again projected that the economy would grow somewhat more rapidly in 2011 and 2012, generating a more pronounced decline in the unemployment rate, as financial conditions and the availability of credit continue to improve. In general, participants saw the upside and downside risks to the outlook for economic growth as roughly balanced. Participants agreed that underlying inflation currently was subdued and was likely to remain so for some time. Some noted the risk that, with output well below potential over the next couple of years, inflation could edge further below the rates they judged most consistent with the Federal Reserve's dual mandate for maximum employment and price stability; others, focusing on risks to inflation expectations and the challenge of removing monetary accommodation in a timely manner, saw inflation risks as tilted toward the upside, especially in the medium term.

The weakness in labor markets continued to be an important concern for the FOMC; moreover, the prospects for job growth remained an important source of uncertainty in the economic outlook, particularly in the outlook for consumer spending. While the average pace of layoffs diminished substantially in recent months, few firms were hiring. The unusually large fraction of individuals who were working part time for economic reasons, as well as the uncommonly low level of the average workweek, pointed to a gradual increase in payrolls for some time even if hours worked were to increase substantially as the economic recovery proceeded. Indeed, many business contacts again reported that they would be cautious in hiring, saying they expected to meet any near-term increase in demand by raising existing employees' hours and boosting productivity, thus delaying the need to add employees. If businesses were able to continue generating large productivity gains, as in recent quarters, then firms would need to hire fewer workers in the near term to meet rising demands for their products. But if the unusually rapid productivity growth seen in recent quarters was not sustained, then job growth could pick up significantly as productivity returned to sustainable levels. The rise in employment of temporary workers in recent months appeared to be continuing; historical experience suggested that increased use of temporary help could presage a broader increase in job growth.

Participants generally saw the data and anecdotal evidence as indicating moderate growth in demands for goods and services, although with substantial variation across sectors. Consumer spending appeared to be increasing modestly. Reports on holiday sales were mixed. Retailers indicated that consumers appeared more willing to buy but that they remained unusually sensitive to pricing. Business contacts continued to report that they were limiting investment outlays pending resolution of uncertainty about sales prospects and future tax and regulatory policies; moreover, they had substantial excess capacity and thus little need to expand production facilities. Even so, the data indicated solid growth in business spending on high-tech equipment in recent months. Anecdotal evidence suggested that such spending was being driven by opportunities to reduce costs and by replacement investment that firms had deferred during the downturn. By and large, participants judged that residential investment had stabilized but did not expect housing construction to make a sizable contribution to economic growth during the next year or two. Commercial construction continued to trend down, primarily reflecting weak fundamentals, though financing constraints probably were also playing a role. Stronger economic growth abroad was contributing to growth in U.S. exports, thus helping support the recovery in industrial production in the United States.

Policymakers judged that financial conditions were, on balance, about as supportive of growth as when the Committee met in December. Though volatility in equity prices increased late in the intermeeting period, broad equity price indexes were about unchanged overall, private credit spreads narrowed somewhat, and financial markets generally continued to function significantly better than early last year. All categories of bank loans, however, continued to contract sharply. Survey evidence suggested that banks had ceased tightening standards on most types of business and consumer loans, though commercial real estate loans were a notable exception. Anecdotal evidence suggested that some banks were starting to look for opportunities to expand lending.

Though headline inflation had been variable, largely reflecting swings in energy prices, core measures of inflation were subdued and were expected to remain so. One participant noted that core inflation had been held down in recent quarters by unusually slow increases in the price index for shelter, and that the recent behavior of core inflation might be a misleading signal of the underlying inflation trend. Reports from business contacts suggested less price discounting, but pricing power remained limited. Wage growth continued to be restrained, and unit labor costs were still falling. Energy prices had dropped back in recent weeks, but many participants saw upward pressures on commodity prices associated with expanding global economic activity as an inflation risk. However, some noted that the high degree of slack in resource utilization posed a downside risk to inflation. Survey measures of expected future inflation were fairly stable, but some market-based measures of inflation expectations and inflation risk suggested continuing concern among market participants about the risk of higher medium-term inflation, perhaps reflecting large fiscal deficits and the size of the Federal Reserve's balance sheet.

Though participants agreed there was considerable slack in resource utilization, their judgments about the degree of slack varied. The several extensions of emergency unemployment insurance benefits appeared to have raised the measured unemployment rate, relative to levels recorded in past downturns, by encouraging some who have lost their jobs to remain in the labor force. If that effect were large—some estimates suggested it could account for 1 percentage point or more of the increase in the unemployment rate during this recession—then the reported unemployment rate might be overstating the amount of slack in resource utilization relative to past periods of high unemployment. Several participants observed that the necessity of reallocating labor across sectors as the recovery proceeds, as well as the loss of skills caused by high levels of long-term unemployment and permanent separations, could reduce the economy's potential output, at least temporarily; historical experience following large adverse financial shocks suggests such an effect. On the other hand, if recent productivity gains were to be sustained, as some business contacts indicated they would be, potential output currently could be higher than standard measures suggested, and the high level of the unemployment rate could be a more accurate indication of slack in resource utilization than usual measures of the output gap.

Committee Policy Action

In their discussion of monetary policy for the period ahead, members agreed that no changes to the Committee's large-scale asset purchase programs or to its target range for the federal funds rate were warranted at this meeting, inasmuch as the asset purchase programs were nearing completion and neither the economic outlook nor financial conditions had changed appreciably since the December meeting. Accordingly, the Committee affirmed its intention to purchase a total of $1.25 trillion of agency MBS and about $175 billion of agency debt by the end of the current quarter and to gradually slow the pace of these purchases to promote a smooth transition in markets. The Committee emphasized that it would continue to evaluate its purchases of securities in light of the evolving economic outlook and conditions in financial markets. Members recognized that references to "purchases" of securities would need to be modified as the completion of the asset purchase programs draws near. One member recommended that the FOMC replace the portion of the statement that indicates the Committee will evaluate its "purchases" of securities with an indication that the Committee will evaluate its "holdings" of securities. The change in wording would encompass the possibility that the Committee might decide, at some point, either to sell securities or to purchase additional securities. Other members judged that it would be premature to make such a change in the statement before observing economic and financial conditions as the Committee's current asset purchase program comes to a close. Accordingly, the Committee decided to retain the reference to securities "purchases" for the time being. The Committee also affirmed its 0 to ¼ percent target range for the federal funds rate and, based on the outlook for a gradual economic recovery, decided to reiterate its anticipation that economic conditions, including low levels of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low rates for an extended period. Members agreed that the path of short-term rates going forward would depend on the evolution of the economic outlook.

Committee members and Board members agreed that, with few exceptions, the functioning of most financial markets, including interbank markets, no longer showed significant impairment. Accordingly they agreed that the statement to be released following the meeting would indicate that the Federal Reserve would be closing the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility on February 1, 2010. Committee members also agreed to announce that temporary liquidity swap arrangements between the Federal Reserve and other central banks would expire on February 1. In addition, the statement would say that amounts available through the Term Auction Facility would be scaled back further, with $50 billion of 28-day credit to be offered on February 8 and $25 billion of 28-day credit to be offered at the final auction of March 8. The statement also would note that the anticipated expiration dates for the Term Asset-Backed Securities Loan Facility remained June 30, 2010, for loans backed by new-issue commercial mortgage-backed securities, and March 31, 2010, for loans backed by all other types of collateral. Members emphasized that they were prepared to modify these plans if necessary to support financial stability and economic growth.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt and agency MBS during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Desk is expected to execute purchases of about $175 billion in housing-related agency debt and about $1.25 trillion of agency MBS by the end of the first quarter. The Desk is expected to gradually slow the pace of these purchases as they near completion. The Committee anticipates that outright purchases of securities will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The Committee directs the Desk to engage in dollar roll transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions to be conducted through the end of the first quarter, as directed above. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in December suggests that economic activity has continued to strengthen and that the deterioration in the labor market is abating. Household spending is expanding at a moderate rate but remains constrained by a weak labor market, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software appears to be picking up, but investment in structures is still contracting and employers remain reluctant to add to payrolls. Firms have brought inventory stocks into better alignment with sales. While bank lending continues to contract, financial market conditions remain supportive of economic growth. Although the pace of economic recovery is likely to be moderate for a time, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack continuing to restrain cost pressures and with longer-term inflation expectations stable, inflation is likely to be subdued for some time.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve is in the process of purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt. In order to promote a smooth transition in markets, the Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter. The Committee will continue to evaluate its purchases of securities in light of the evolving economic outlook and conditions in financial markets.

In light of improved functioning of financial markets, the Federal Reserve will be closing the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility on February 1, as previously announced. In addition, the temporary liquidity swap arrangements between the Federal Reserve and other central banks will expire on February 1. The Federal Reserve is in the process of winding down its Term Auction Facility: $50 billion in 28-day credit will be offered on February 8 and $25 billion in 28-day credit will be offered at the final auction on March 8. The anticipated expiration dates for the Term Asset-Backed Securities Loan Facility remain set at June 30 for loans backed by new-issue commercial mortgage-backed securities and March 31 for loans backed by all other types of collateral. The Federal Reserve is prepared to modify these plans if necessary to support financial stability and economic growth."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Donald L. Kohn, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he believed it was no longer advisable to indicate that economic and financial conditions were likely to "warrant exceptionally low levels of the federal funds rate for an extended period." In recent months, economic and financial conditions improved steadily, and Mr. Hoenig was concerned that, under these improving conditions, maintaining short-term interest rates near zero for an extended period of time would lay the groundwork for future financial imbalances and risk an increase in inflation expectations. Accordingly, Mr. Hoenig believed that it would be more appropriate for the Committee to express an expectation that the federal funds rate would be low for some time—rather than exceptionally low for an extended period. Such a change in communication would provide the Committee flexibility to begin raising rates modestly. He further believed that moving to a modestly higher federal funds rate soon would lower the risks of longer-run imbalances and an increase in long-run inflation expectations, while continuing to provide needed support to the economic recovery.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 16, 2010. The meeting adjourned at 1:20 p.m. on January 27, 2010.

Notation Vote

By notation vote completed on January 5, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on December 15–16, 2009.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the January 26–27, 2010, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation for the years 2010 to 2012 and over the longer run. The projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

FOMC participants' forecasts for economic activity and inflation were broadly similar to their previous projections, which were made in conjunction with the November 2009 FOMC meeting. As depicted in **figure 1**, the economic recovery from the recent recession was expected to be gradual, with real gross domestic product (GDP) expanding at a rate that was only moderately above participants' assessment of its longer-run sustainable growth rate and the unemployment rate declining slowly over the next few years. Most participants also anticipated that inflation would remain subdued over this period. As indicated in **table 1**, a few participants made modest upward revisions to their projections for real GDP growth in 2010. Beyond 2010, however, the contours of participants' projections for economic activity and inflation were little changed, with participants continuing to expect that the pace of the economic recovery will be restrained by household and business uncertainty, only gradual improvement in labor market conditions, and slow easing of credit conditions in the banking sector. Participants generally expected that it would take some time for the economy to converge fully to its longer-run path—characterized by a sustainable rate of output growth and by rates of employment and inflation consistent with their interpretation of the Federal Reserve's dual objectives—with a sizable minority of the view that the convergence process could take more than five to six years. As in November, nearly all participants judged the risks to their growth outlook as generally balanced, and most also saw roughly balanced risks surrounding their inflation projections. Participants continued to judge the uncertainty surrounding their projections for economic activity and inflation as unusually high relative to historical norms.

The Outlook

Participants' projections for real GDP growth in 2010 had a central tendency of 2.8 to 3.5 percent, a somewhat narrower interval than in November. Recent readings on consumer spending, industrial production, and business outlays on equipment and software were seen as broadly consistent with the view that economic recovery was under way, albeit at a moderate pace. Businesses had apparently made progress in bringing their inventory stocks into closer alignment with sales and hence would be likely to raise production as spending gained further momentum. Participants pointed to a number of factors that

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, January 2010
Percent

Variable	Central tendency[1]				Range[2]			
	2010	2011	2012	Longer run	2010	2011	2012	Longer run
Change in real GDP	2.8 to 3.5	3.4 to 4.5	3.5 to 4.5	2.5 to 2.8	2.3 to 4.0	2.7 to 4.7	3.0 to 5.0	2.4 to 3.0
November projection	2.5 to 3.5	3.4 to 4.5	3.5 to 4.8	2.5 to 2.8	2.0 to 4.0	2.5 to 4.6	2.8 to 5.0	2.4 to 3.0
Unemployment rate	9.5 to 9.7	8.2 to 8.5	6.6 to 7.5	5.0 to 5.2	8.6 to 10.0	7.2 to 8.8	6.1 to 7.6	4.9 to 6.3
November projection	9.3 to 9.7	8.2 to 8.6	6.8 to 7.5	5.0 to 5.2	8.6 to 10.2	7.2 to 8.7	6.1 to 7.6	4.8 to 6.3
PCE inflation	1.4 to 1.7	1.1 to 2.0	1.3 to 2.0	1.7 to 2.0	1.2 to 2.0	1.0 to 2.4	0.8 to 2.0	1.5 to 2.0
November projection	1.3 to 1.6	1.0 to 1.9	1.2 to 1.9	1.7 to 2.0	1.1 to 2.0	0.6 to 2.4	0.2 to 2.3	1.5 to 2.0
Core PCE inflation[3]	1.1 to 1.7	1.0 to 1.9	1.2 to 1.9		1.0 to 2.0	0.9 to 2.4	0.8 to 2.0	
November projection	1.0 to 1.5	1.0 to 1.6	1.0 to 1.7		0.9 to 2.0	0.5 to 2.4	0.2 to 2.3	

Note: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The November projections were made in conjunction with the meeting of the Federal Open Market Committee on November 3–4, 2009.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.

3 Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2010–12 and over the longer run

Note: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual. The data for the change in real GDP, PCE inflation, and core PCE inflation shown for 2009 incorporate the advance estimate of GDP for the fourth quarter of 2009, which the Bureau of Economic Analysis released on January 29, 2010; this information was not available to FOMC meeting participants at the time of their meeting.

would support the continued expansion of economic activity, including accommodative monetary policy, ongoing improvements in the conditions of financial markets and institutions, and a pickup in global economic growth, especially in emerging market economies. Several participants also noted that fiscal policy was currently providing substantial support to real activity, but said that they expected less impetus to GDP growth from this factor later in the year. Many participants indicated that the expansion was likely to be restrained not only by firms' caution in hiring and spending in light of the considerable uncertainty regarding the economic outlook and general business conditions, but also by limited access to credit by small businesses and consumers dependent on bank-intermediated finance.

Looking further ahead, participants' projections were for real GDP growth to pick up in 2011 and 2012; the projections for growth in both years had a central tendency of about 3½ to 4½ percent. As in November, participants generally expected that the continued repair of household balance sheets and gradual improvements in credit availability would bolster consumer spending. Responding to an improved sales outlook and readier access to bank credit, businesses were likely to increase production to rebuild their inventory stocks and increase their outlays on equipment and software. In addition, improved foreign economic conditions were viewed as supporting robust growth in U.S. exports. However, participants also indicated that elevated uncertainty on the part of households and businesses and the very slow recovery of labor markets would likely restrain the pace of expansion. Moreover, although conditions in the banking system appeared to have stabilized, distress in commercial real estate markets was expected to pose risks to the balance sheets of banking institutions for some time, thereby contributing to only gradual easing of credit conditions for many households and smaller firms. In the absence of further shocks, participants generally anticipated that real GDP growth would converge over time to an annual rate of 2.5 to 2.8 percent, the longer-run pace that appeared to be sustainable in view of expected demographic trends and improvements in labor productivity.

Participants anticipated that labor market conditions would improve only slowly over the next several years. Their projections for the average unemployment rate in the fourth quarter of 2010 had a central tendency of 9.5 to 9.7 percent, only a little below the levels of about 10 percent that prevailed late last year. Consistent with their outlook for moderate output growth, participants generally expected that the unemployment rate would decline only about 2½ percentage points by the end of 2012 and would still be well above its longer-run sustainable rate. Some participants also noted that considerable uncertainty surrounded their estimates of the productive potential of the economy and the sustainable rate of employment, owing partly to substantial ongoing structural adjustments in product and labor markets. Nonetheless, participants' longer-run unemployment projections had a central tendency of 5.0 to 5.2 percent, the same as in November.

Most participants anticipated that inflation would remain subdued over the next several years. The central tendency of their projections for personal consumption expenditures (PCE) inflation was 1.4 to 1.7 percent for 2010, 1.1 to 2.0 percent for 2011, and 1.3 to 2.0 percent for 2012. Many participants anticipated that global economic growth would spur increases in energy prices, and hence that headline PCE inflation would run slightly above core PCE inflation over the next year or two. Most expected that substantial resource slack would continue to restrain cost pressures, but that inflation would rise gradually toward their individual assessments of the measured rate of inflation judged to be most consistent with the Federal Reserve's dual mandate. As in November, the central tendency of projections of the longer-run inflation rate was 1.7 to 2.0 percent. A majority of participants anticipated that inflation in 2012 would still be below their assessments of the mandate-consistent inflation rate, while the remainder expected that inflation would be at or slightly above its longer-run value by that time.

Uncertainty and Risks

Nearly all participants shared the judgment that their projections of future economic activity and unemployment continued to be subject to greater-than-average uncertainty.[3] Participants generally saw the risks to these projections as roughly balanced, although a few indicated that the risks to the unemployment outlook remained tilted to the upside. As in November, many participants highlighted the difficulties inherent in predicting macroeconomic outcomes in the wake of a financial crisis and a severe

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[3] **Table 2** provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1989 to 2008. At the end of this summary, the **box "Forecast Uncertainty"** discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risk attending participants' projections.

Table 2. Average historical projection error ranges
Percentage points

Variable	2010	2011	2012
Change in real GDP[1]	±1.3	±1.5	±1.6
Unemployment rate[1]	±0.6	±0.8	±1.0
Total consumer prices[2]	±0.9	±1.0	±1.0

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1989 through 2008 that were released in the winter by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 For definitions, refer to general note in table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

recession. In addition, some pointed to uncertainties regarding the extent to which the recent run-up in labor productivity would prove to be persistent, while others noted the risk that the deteriorating performance of commercial real estate could adversely affect the still-fragile state of the banking system and restrain the growth of output and employment over coming quarters.

As in November, most participants continued to see the uncertainty surrounding their inflation projections as higher than historical norms. However, a few judged that uncertainty in the outlook for inflation was about in line with typical levels, and one viewed the uncertainty surrounding the inflation outlook as lower than average. Nearly all participants judged the risks to the inflation outlook as roughly balanced; however, two saw these risks as tilted to the upside, while one regarded the risks as weighted to the downside. Some participants noted that inflation expectations could drift downward in response to persistently low inflation and continued slack in resource utilization. Others pointed to the possibility of an upward shift in expected and actual inflation, especially if extraordinarily accommodative monetary policy measures were not unwound in a timely fashion. Participants also noted that an acceleration in global economic activity could induce a surge in the prices of energy and other commodities that would place upward pressure on overall inflation.

Diversity of Views

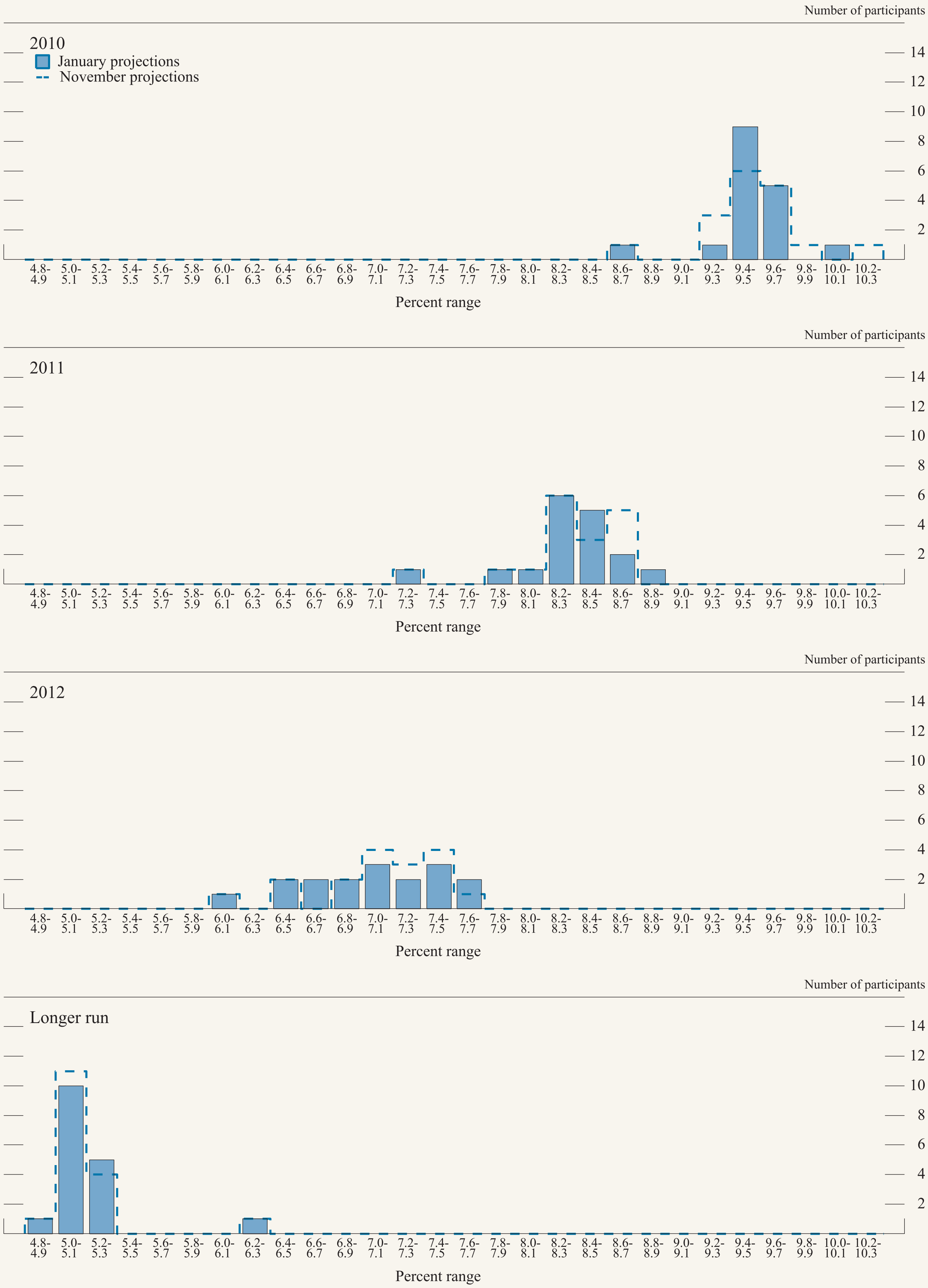
Figures 2.A and 2.B provide further details on the diversity of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate in 2010, 2011, 2012, and over the longer run. The distribution of participants' projections for real GDP growth this year was slightly narrower than the distribution of their projections last November, but the distributions of the projections for real GDP growth in 2011 and in 2012 were little changed. The dispersion in participants' output growth projections reflected, among other factors, the diversity of their assessments regarding the current degree of underlying momentum in economic activity, the evolution of consumer and business sentiment, and the likely pace of easing of bank lending standards and terms. Regarding participants' unemployment rate projections, the distribution for 2010 narrowed slightly, but the distributions of their unemployment rate projections for 2011 and 2012 did not change appreciably. The distributions of participants' estimates of the longer-run sustainable rates of output growth and unemployment were essentially the same as in November.

Figures 2.C and 2.D provide corresponding information about the diversity of participants' views regarding the inflation outlook. For overall and core PCE inflation, the distributions of participants' projections for 2010 were nearly the same as in November. The distributions of overall and core inflation for 2011 and 2012, however, were noticeably more tightly concentrated than in November, reflecting the absence of forecasts of especially low inflation. The dispersion in participants' projections over the next few years was mainly due to differences in their judgments regarding the determinants of inflation, including their estimates of prevailing resource slack and their assessments of the extent to which such slack affects actual and expected inflation. In contrast, the relatively tight distribution of participants' projections for longer-run inflation illustrates their substantial agreement about the measured rate of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2. A. Distribution of participants' projections for the change in real GDP, 2010–12 and over the longer run

Note: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2010–12 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2010–12 and over the longer run

Note: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2010–12

NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 1.7 to 4.3 percent in the current year, 1.5 to 4.5 percent in the second year, and 1.4 to 4.6 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 to 2.9 percent in the current year and 1.0 to 3.0 percent in the second and third years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Meeting Held on March 16, 2010

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, March 16, 2010, at 8:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Donald L. Kohn

Sandra Pianalto

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Christine Cumming, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Brian F. Madigan
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Thomas A. Connors, William B. English, Steven B. Kamin, Lawrence Slifman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Jennifer J. Johnson
Secretary of the Board, Office of the Secretary, Board of Governors

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Robert deV. Frierson
Deputy Secretary, Office of the Secretary, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

James A. Clouse
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Sherry Edwards and Andrew T. Levin
Senior Associate Directors, Division of Monetary Affairs, Board of Governors

David Reifschneider and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

Michael G. Palumbo
Deputy Associate Director, Division of Research and Statistics, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Min Wei
Senior Economist, Division of Monetary Affairs, Board of Governors

Penelope A. Beattie
Assistant to the Secretary, Office of the Secretary, Board of Governors

Valerie Hinojosa and Randall A. Williams
Records Management Analysts, Division of Monetary Affairs, Board of Governors

James M. Lyon
First Vice President, Federal Reserve Bank of Minneapolis

Jamie J. McAndrews and Harvey Rosenblum
Executive Vice Presidents, Federal Reserve Banks of New York and Dallas, respectively

David Altig, Craig S. Hakkio, Loretta J. Mester, Glenn D. Rudebusch, Mark E. Schweitzer, Daniel G. Sullivan, and John A. Weinberg
Senior Vice Presidents, Federal Reserve Banks of Atlanta, Kansas City, Philadelphia, San Francisco, Cleveland, Chicago, and Richmond, respectively

Giovanni Olivei
Vice President, Federal Reserve Bank of Boston

Joshua Frost
Assistant Vice President, Federal Reserve Bank of New York

Jonathan Heathcote
Senior Economist, Federal Reserve Bank of Minneapolis

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets during the period since the Committee met on January 26–27, 2010. The net effect of these developments was that financial conditions had become modestly more supportive of economic growth. No market strains emerged in conjunction with the Federal Reserve's closing of nearly all of its remaining special liquidity facilities over the intermeeting period. On February 1, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and the Term Securities Lending Facility were closed, and the Federal Reserve's temporary currency swap lines with foreign central banks expired. Financial markets also adjusted smoothly to the final offering of funds through the Term Auction Facility on March 8.

The Manager noted that securitized credit markets had not shown substantial strain from the anticipated end of new credit extensions under the Term Asset-Backed Securities Loan Facility (TALF), which was scheduled to close on June 30 for loans backed by new-issue commercial mortgage-backed securities (CMBS) and on March 31 for loans backed by all other types of collateral.[1] Spreads on asset-backed securities remained tight while issuance—the bulk of which was being financed outside of TALF—continued to be fairly strong. While the cumulative volume of borrowing from the TALF had expanded fairly steadily in recent months, the volume of repayments of TALF loans had also risen as borrowers were able to secure funding from other sources on more favorable terms. As a result, the net amount of outstanding TALF credit had leveled out and would likely decline going forward as a result of continuing repayments.

In his report on System open market operations, the Manager noted that over the period since the Committee had met in January, the Federal Reserve's total assets had risen to about $2.3 trillion, as an increase in the System's holdings of securities was partly offset by the declining usage of the System's credit and liquidity facilities. The Desk continued to gradually slow the pace of its purchases of agency mortgage-backed securities (MBS) and agency debt as it moved toward completing the Committee's previously announced asset purchases by the end of March. The Desk's purchases of agency MBS were on track to meet the targeted amount of $1.25 trillion, while its purchases of agency debt would likely cumulate to slightly less than $175 billion. The Desk continued to engage in dollar roll transactions in agency MBS securities to facilitate settlement of its outright purchases. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions. Participants also agreed that the Desk should continue the interim approach of allowing all maturing agency debt and all prepayments of agency MBS to be redeemed without replacement.

In addition, the Manager reported on recent progress in the development of reserve draining tools, including the initiation of a program for expanding the set of counterparties in conducting reverse repurchase agreements, and the staff gave a presentation on potential approaches for tightening the link between short-term market interest rates and the interest rate paid on reserve balances held at the Federal Reserve Banks.

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[1] The final non-CMBS subscription had already occurred in early March and the final subscription for legacy CMBS would take place soon after the FOMC meeting; subscriptions for new-issue CMBS would continue through June.

Secretary's note: A staff memorandum was provided to members of the Board of Governors and Federal Reserve Bank presidents summarizing public comments on last December's *Federal Register* notice regarding the establishment of a term deposit facility, but that topic was not discussed at this meeting.

The staff also briefed the Committee on potential approaches for managing the Treasury securities held by the Federal Reserve. To date, the Desk had been reinvesting all maturing Treasury securities by exchanging those holdings for newly issued Treasury securities, but an alternative strategy would be to allow some or all of those Treasury securities to mature without reinvestment. Redeeming all of its maturing Treasury holdings would significantly reduce the size of the Federal Reserve's balance sheet over coming years and hence could be helpful in limiting the need to use other reserve draining tools such as reverse repurchase agreements and term deposits. Redemptions would also lower the interest rate sensitivity of the Federal Reserve's portfolio over time. Nevertheless, the initiation of a redemption strategy might generate upward pressure on market rates, especially if that measure led investors to move up their expected timing of policy firming. Participants agreed that the Committee would give further consideration to these matters and that in the interim the Desk should continue its current practice of reinvesting all maturing Treasury securities.

Staff Review of the Economic Situation

The information reviewed at the March 16 meeting suggested that economic activity expanded at a moderate pace in early 2010. Business investment in equipment and software seemed to have picked up, consumer spending increased further in January, and private employment would likely have turned up in February in the absence of the snowstorms that affected the East Coast. Output in the manufacturing sector continued to trend higher as firms increased production to meet strengthening final demand and to slow the pace of inventory liquidation. On the downside, housing activity remained flat and the nonresidential construction sector weakened further. Meanwhile, a sizable increase in energy prices pushed up headline consumer price inflation in recent months; in contrast, core consumer price inflation was quite low.

Available indicators suggested that the labor market might be stabilizing. Declines in private payrolls slowed markedly in recent months, and, in the absence of the snowstorms, private employment probably would have risen in February. The average workweek for production and nonsupervisory workers fell back in February after ticking up in January; however, the drop was likely due to the storms. The unemployment rate was unchanged at 9.7 percent in February, and the labor force participation rate inched up over the past two months. However, the level of initial claims for unemployment insurance benefits remained high.

After increasing briskly in the second half of 2009, industrial production (IP) continued to expand, on net, in the early months of 2010, rising sharply in January and remaining little changed in February despite some adverse effects of the snowstorms. Recent production gains remained broadly based across industries, as firms continued to boost production to meet rising domestic and foreign demand and to slow the pace of inventory liquidation. Capacity utilization in manufacturing rose further, to a level noticeably above its trough in June, but remained well below its longer-run average. As a result, incentives for manufacturing firms to expand production capacity were weak. The available indicators of near-term manufacturing activity pointed to moderate gains in IP in coming months.

Consumer spending continued to move up. Although sales of new automobiles and light trucks softened slightly, on average, in January and February, real outlays for a wide variety of non-auto goods and food services increased appreciably, and real outlays for other services remained on a gradual uptrend. In contrast to the modest recovery in spending, measures of consumer sentiment remained relatively downbeat in February and had improved little, on balance, since a modest rebound last spring. Household income appeared less supportive of spending than at the January meeting, reflecting downward revisions to estimates by the Bureau of Economic Analysis of wages and salaries in the second half of 2009. The ratio of household net worth to income was little changed in the fourth quarter after two consecutive quarters of appreciable gains.

Activity in the housing sector appeared to have flattened out in recent months. Sales of both new and existing homes had turned down, while starts of single-family homes were about unchanged despite the substantial reduction in inventories of unsold new homes. Some of the recent weakness in sales might have been due to transactions that had been pulled forward in anticipation of the originally scheduled expiration of the tax credit for first-time homebuyers in November 2009; nonetheless, the underlying pace of housing demand likely remained weak. The slowdown in sales notwithstanding, housing demand was being supported by low interest rates for conforming fixed-rate 30-year mortgages and reportedly by a perception that real estate values were near their trough.

Real spending on equipment and software increased at a solid pace in the fourth quarter of 2009 and apparently rose further early in the first quarter of 2010. Business outlays for motor vehicles seemed to be holding up after a sharp increase in the fourth quarter, purchases of high-tech equipment appeared to be rising briskly, and incoming data pointed to some firming in outlays on other equipment. The recent gains in investment spending were consistent with improvements in many indicators of business demand. In contrast, conditions in the nonresidential construction sector generally remained poor. Real outlays on structures outside of the drilling and mining sector fell again in the fourth quarter, and nominal expenditures dropped further in January. The weakness was widespread across categories and likely reflected rising vacancy rates, falling property prices, and difficult financing conditions for new projects. However, real spending on drilling and mining structures increased strongly in response to the earlier rebound in oil and natural gas prices.

The pace of inventory liquidation slowed considerably in late 2009. As measured in the national income and product accounts, real nonfarm inventories excluding motor vehicles were drawn down at a much slower pace in the fourth quarter than in each of the preceding two quarters. Available data for January indicated a further small liquidation of real stocks early this year in the manufacturing and wholesale trade sectors. The ratio of book-value inventories to sales (excluding motor vehicles and parts) edged down again in January and stood well below the recent peak recorded near the end of 2008. Inventories remained elevated for equipment, materials, and, to a lesser degree, construction supplies, while inventories of consumer goods and business supplies appeared to be low relative to demand.

Although rising energy prices continued to boost overall consumer price inflation, consumer prices excluding food and energy were soft, as a wide variety of goods and services exhibited persistently low inflation or outright price declines. On a 12-month change basis, core personal consumption expenditures (PCE) price inflation slowed in January 2010 compared with a year earlier, as a marked and fairly widespread deceleration in market-based core PCE prices was partly offset by an acceleration in nonmarket prices. Survey expectations for near-term inflation were unchanged over the intermeeting period; median longer-term inflation expectations edged down to near the lower end of the narrow range that prevailed over the previous few years. With regard to labor costs, the revised data on wages and salaries showed that last year's deceleration in hourly compensation was even sharper than was evident at the January meeting.

The U.S. international trade deficit widened in December but narrowed slightly in January, ending the period a little larger. Both exports and imports rose sharply in December before pulling back somewhat the following month. For the period as a whole, the rise in exports was broadly based, with notable gains in aircraft and industrial supplies. Oil and other industrial supplies accounted for much of the increase in imports over the two months, while purchases of consumer products declined.

Economic performance in the advanced foreign economies was mixed in the fourth quarter, with real gross domestic product (GDP) advancing sharply in Canada and Japan but rising only slightly in the euro area and the United Kingdom. That divergence appeared to have persisted in the first quarter, as indicators pointed to continued rapid economic growth in Canada and moderate expansion in Japan but somewhat anemic growth in Europe. In the emerging market economies, rebounding global trade, inventory restocking, and increased domestic demand supported generally robust fourth-quarter growth. Continued rapid expansion in China and several other Asian economies offset slowdowns elsewhere in the region. In Latin America, Mexican activity was buoyed by rising manufacturing and exports to the United States, while Brazil's economy again grew briskly. Headline consumer price inflation picked up around the world over the past two months, principally reflecting increases in food and energy prices. Excluding food and energy, consumer prices were generally more subdued.

Staff Review of the Financial Situation

The decision by the Federal Open Market Committee (FOMC) at the January meeting to keep the target range for the federal funds rate unchanged and to retain the "extended period" language in the statement was widely anticipated by market participants. However, investors reportedly read the statement's characterization of the economic outlook as somewhat more upbeat than they had anticipated, and Eurodollar futures rates rose a bit in response. The changes to the terms for primary credit and the Term Auction Facility that were announced on February 18 resulted in a small increase in near-term futures rates, but this reaction proved short lived, as the statement and subsequent Federal Reserve communications—including the Chairman's semiannual congressional testimony—emphasized that the modifications were technical adjustments and did not signal any near-term shifts in the overall stance of monetary policy.

On balance, incoming economic data led investors to mark down the expected path of the federal funds rate over the intermeeting period. By contrast, yields on 2-year and 10-year nominal Treasury securities edged up, on net, over the period. Yields on Treasury inflation-protected securities (TIPS) rose at all maturities, reportedly buoyed by investor anticipation of heavier TIPS issuance and by reduced demand for TIPS by retail investors. Reflecting these developments, inflation compensation—the difference between nominal yields and TIPS yields for a given term to maturity—declined over the period, a move that was supported by the somewhat weaker-than-expected economic data and the publication of lower-than-expected readings on consumer prices.

Conditions in short-term funding markets remained generally stable over the intermeeting period. Spreads between London interbank offered rates (Libor) and overnight index swap (OIS) rates at one- and three-month maturities stayed low, while six-month spreads edged down somewhat further. Spreads of rates on A2/P2-rated commercial paper and on AA-rated asset-backed commercial paper over the AA nonfinancial rate were also little changed at low levels. The Federal Reserve continued to taper its large-scale asset purchases and wind down the emergency lending facilities with no apparent adverse effects on financial markets or institutions.

Broad stock price indexes rose, on net, over the intermeeting period, boosted in part by favorable earnings reports from the retail sector. Bank equity prices outperformed the broader equity markets. Option-implied volatility on the S&P 500 index dropped back to post-crisis lows after increasing earlier in the period on concerns about Chinese monetary policy tightening and fiscal strains in Europe. Nonetheless, the gap between the staff's estimate of the expected real equity return over the next 10 years for S&P 500 firms and the real 10-year Treasury yield—a rough measure of the equity risk premium—remained well above its average over the past decade. Yields on investment-grade corporate bonds, as well as their spreads over yields on comparable-maturity Treasury securities, were about unchanged over the intermeeting period; investment-grade risk spreads were near the levels that prevailed late in 2007. Yields and spreads on speculative-grade bonds edged down, and secondary-market prices of leveraged loans rose further.

Overall, net debt financing by nonfinancial firms was about zero over the first two months of 2010, consistent with firms' weak demand for credit and banks' tight credit policies. Gross public equity issuance by nonfinancial firms was robust in the fourth quarter of 2009. Since the turn of the year, gross public equity issuance by nonfinancial firms slowed somewhat, while announcements of both new share repurchase programs and cash-financed mergers and acquisitions picked up. Public equity issuance by financial firms declined in January and February following very strong issuance in December, when several large banks issued equity to facilitate the repayment of capital received under the Troubled Asset Relief Program. Gross bond issuance by financial firms remained solid. The contraction in commercial mortgage debt accelerated in the fourth quarter. The dollar value of commercial real estate sales remained very low in February, and the share of properties sold at a nominal loss inched higher. The delinquency rate on commercial mortgages in securitized pools increased in January, and the delinquency rate on commercial mortgages at commercial banks rose in the fourth quarter. The percentage of delinquent construction loans at banks also ticked higher in the fourth quarter. Nonetheless, indexes of commercial mortgage credit default swaps changed little, on balance, over the intermeeting period.

Since the January meeting, yields and spreads on agency MBS were little changed despite the continued tapering of the Federal Reserve's purchases of these securities, and residential mortgage interest rates and spreads were roughly flat. Net issuance of MBS by Fannie Mae and Freddie Mac remained subdued through the end of January. Consumer credit expanded in January, its first increase since January 2009. Despite low and stable spreads on consumer asset-backed securities (ABS), the amount of

ABS issued in the first two months of the year was somewhat below that in the fourth quarter, reflecting the very weak pace of consumer credit originations late last year. The spread of credit card interest rates over two-year Treasury yields ticked up in January, while spreads on new auto loans declined slightly, on net, over the intermeeting period. Delinquency rates on credit card loans in securitized pools and on auto loans at captive finance companies remained elevated in January but were down a bit from their recent peaks.

Total bank credit contracted substantially in January and February. Banks' securities holdings declined at a modest pace after several months of steady growth, and total loans on banks' books continued to drop. Commercial and industrial (C&I) loans continued falling, as spreads of interest rates on C&I loans over comparable-maturity market instruments climbed further in the first quarter and nonfinancial firms' need for external finance apparently remained subdued. Commercial real estate loans also posted significant declines. Household loans on banks' books contracted as well, in part because of a pickup in bank securitizations of first-lien residential mortgages with the government-sponsored enterprises in February. Consumer loans originated by banks declined, primarily reflecting a large drop in credit card loans. In contrast, other consumer loans—including auto, student, and tax advance loans—were roughly flat during January and February.

M2 decreased in January, owing partly to a contraction in liquid deposits. Many institutions opted out of the Federal Deposit Insurance Corporation's Transaction Account Guarantee Program because of the higher fees associated with participation after year-end, reportedly driving depositors to transfer funds out of transaction accounts and into alternative investments outside of M2. M2 expanded in February, however, as liquid deposits resumed their growth. Small time deposits and retail money market mutual funds contracted in January and, to a lesser extent, in February, while currency declined a bit in January but advanced notably in February. The monetary base rose in both months, as the increase in reserve balances resulting from the ongoing large-scale asset purchases by the Federal Reserve more than offset the contraction in balances associated with the decline in credit outstanding under the System's liquidity and credit facilities.

Movements in foreign financial markets since the January meeting were importantly influenced by concerns over fiscal problems in Greece. Spreads on Greek government debt relative to German bunds widened appreciably before falling back as press reports indicated that euro-area countries were discussing a possible aid package for Greece and the Greek government announced further deficit reduction measures. Spreads on debt issued by several other European countries followed a similar pattern over the intermeeting period. The Bank of England (BOE) and the European Central Bank (ECB) held rates steady during the period, and the BOE elected not to expand its Asset Purchase Facility, which reached its limit at the end of January. In early March, the ECB announced several steps to normalize its provision of liquidity. Equity prices in most foreign countries were up moderately since the January FOMC meeting. Likely reflecting the concerns about Greece as well as weak economic data in Europe, the dollar appreciated notably against sterling and the euro over the intermeeting period. However, the dollar declined against most emerging market currencies, which were buoyed by brightening growth prospects, leaving the broad trade-weighted value of the dollar down a bit since the January meeting.

Staff Economic Outlook

In the forecast prepared for the March FOMC meeting, the staff's outlook for real economic activity was broadly similar to that at the time of the January meeting. In particular, the staff continued to anticipate a moderate pace of economic recovery over the next two years, reflecting the accommodative stance of monetary policy and a further diminution of the factors that had weighed on spending and production since the onset of the financial crisis. The staff did make modest downward adjustments to its projections for real GDP growth in response to unfavorable news on housing activity, unexpectedly weak spending by state and local governments, and a substantial reduction in the estimated level of household income in the second half of 2009. The staff's forecast for the unemployment rate at the end of 2011 was about the same as in its previous projection.

Recent data on consumer prices and unit labor costs led the staff to revise down slightly its projection for core PCE price inflation for 2010 and 2011; as before, core inflation was projected to be quite subdued at rates below last year's pace. Although increased oil prices had boosted overall inflation over recent months, the staff anticipated that consumer prices for energy would increase more slowly going forward, consistent with quotes on oil futures contracts. Consequently, total PCE price inflation was projected to run a little above core inflation this year and then edge down to the same rate as core inflation in 2011.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, participants agreed that economic activity continued to strengthen and that the labor market appeared to be stabilizing. Incoming information on economic activity received over the intermeeting period was somewhat mixed but generally confirmed that the economic recovery was likely to proceed at a moderate pace. On the positive side, recent data pointed to significant gains in retail sales, a substantial pickup in business spending on equipment and software, and a further expansion of goods exports. Moreover, the latest labor market readings had been mildly encouraging, with a considerable increase in temporary employment, especially in the manufacturing and information technology sectors. However, housing starts had remained flat at a depressed level, investment in nonresidential structures was still declining, and state and local government expenditures were being depressed by lower revenues. Moreover, consumer sentiment continued to be damped by very weak labor market conditions, and firms remained reluctant to add to payrolls or to commit to new capital projects. Participants saw recent inflation readings as suggesting a slightly greater deceleration in consumer prices than had been expected. In light of stable longer-term inflation expectations and the likely continuation of substantial resource slack, they generally anticipated that inflation would be subdued for some time.

Participants agreed that financial market conditions remained supportive of economic growth. Spreads in short-term funding markets were near pre-crisis levels, and risk spreads on corporate bonds and measures of implied volatility in equity markets were broadly consistent with historical norms given the outlook for the economy. Participants were also reassured by the absence of any signs of renewed strains in financial market functioning as a consequence of the Federal Reserve's winding down of its special liquidity facilities. In contrast, bank lending was still contracting and interest rates on many bank loans had risen further in recent months. Participants anticipated that credit conditions would gradually improve over time, and they noted the possibility of a beneficial feedback loop in which the economic recovery would contribute to stronger bank balance sheets and so to an increased availability of credit to households and small businesses, which would in turn help boost the economy further.

While participants saw incoming information as broadly consistent with continued strengthening of economic activity, they also highlighted a variety of factors that would be likely to restrain the overall pace of recovery, especially in light of the waning effects of fiscal stimulus and inventory rebalancing over coming quarters. While recent data pointed to a noticeable pickup in the pace of consumer spending during the first quarter, participants agreed that household spending going forward was likely to remain constrained by weak labor market conditions, lower housing wealth, tight credit, and modest income growth. For example, real disposable personal income in January was virtually unchanged from a year earlier and would have been even lower in the absence of a substantial rise in federal transfer payments to households. Business spending on equipment and software picked up substantially over recent months, but anecdotal information suggested that this pickup was driven mainly by increased spending on maintaining existing capital and updating technology rather than expanding capacity. The continued gains in manufacturing production were bolstered by growing demand from foreign trading partners, especially emerging market economies. However, a few participants noted the possibility that fiscal retrenchment in some foreign countries could trigger a slowdown of those economies and hence weigh on the demand for U.S. exports.

Some labor market indicators displayed positive signals over the intermeeting period, including a pickup in temporary employment and increased job postings. Indeed, nonfarm payrolls might well have increased in February in the absence of weather disruptions. Nevertheless, participants were concerned about the scarcity of job openings, the elevated level of unemployment, and the extent of longer-term unemployment, which was seen as potentially leading to the loss of worker skills. Moreover, the downward trend in initial unemployment insurance claims appeared to have leveled off in recent weeks, while hiring remained at historically low rates. Information from business contacts and evidence from regional surveys generally underscored the degree to which firms' reluctance to add to payrolls or start large capital projects reflected their concerns about the economic outlook and uncertainty regarding future government policies. A number of participants pointed out that the economic recovery could not be sustained over time without a substantial pickup in job creation, which they still anticipated but had not yet become evident in the data.

Participants were also concerned that activity in the housing sector appeared to be leveling off in most regions despite various forms of government support, and they noted that commercial and industrial real estate markets continued to weaken. Indeed, housing sales and starts had flattened out at depressed levels, suggesting that previous improvements in those indicators may have largely reflected transitory effects from the first-time homebuyer tax credit rather than a fundamental strengthening of housing activity. Participants indicated that the pace of foreclosures was likely to remain quite high; indeed, recent data on the incidence of seriously delinquent mortgages pointed to the possibility that the foreclosure rate could move higher over coming quarters. Moreover, the prospect of further additions to the already very large inventory of vacant homes posed downside risks to home prices.

Participants referred to a wide array of evidence as indicating that underlying inflation trends remained subdued. The latest readings on core inflation—which exclude the relatively volatile prices of food and energy—were generally lower than they had anticipated, and with petroleum prices having leveled out, headline inflation was likely to come down to a rate close to that of core inflation over coming months. While the ongoing decline in the implicit rental cost for owner-occupied housing was weighing on core inflation, a number of participants observed that the moderation in price changes was widespread across many categories of spending. This moderation was evident in the appreciable slowing of inflation measures such as trimmed means and medians, which exclude the most extreme price movements in each period.

In discussing the inflation outlook, participants took note of signs that inflation expectations were reasonably well anchored, and most agreed that substantial resource slack was continuing to restrain cost pressures. Measures of gains in nominal compensation had slowed, and sharp increases in productivity had pushed down producers' unit labor costs. Anecdotal information indicated that planned wage increases were small or nonexistent and suggested that large margins of underutilized capital and labor and a highly competitive pricing environment were exerting considerable downward pressure on price adjustments. Survey readings and financial market data pointed to a modest decline in longer-term inflation expectations over recent months. While all participants anticipated that inflation would be subdued over the near term, a few noted that the risks to inflation expectations and the medium-term inflation outlook might be tilted to the upside in light of the large fiscal deficits and the extraordinarily accommodative stance of monetary policy.

Committee Policy Action

In their discussion of monetary policy for the period ahead, members agreed that it would be appropriate to maintain the target range of 0 to ¼ percent for the federal funds rate and to complete the Committee's previously announced purchases of $1.25 trillion of agency MBS and about $175 billion of agency debt by the end of March. Nearly all members judged that it was appropriate to reiterate the expectation that economic conditions—including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period, but one member believed that communicating such an expectation would create conditions that could lead to financial imbalances. A number of members noted that the Committee's expectation for policy was explicitly contingent on the evolution of the economy rather than on the passage of any fixed amount of calendar time. Consequently, such forward guidance would not limit the Committee's ability to commence monetary policy tightening promptly if evidence suggested that economic activity was accelerating markedly or underlying inflation was rising notably; conversely, the duration of the extended period prior to policy firming might last for quite some time and could even increase if the economic outlook worsened appreciably or if trend inflation appeared to be declining further. A few members also noted that at the current juncture the risks of an early start to policy tightening exceeded those associated with a later start, because the Committee could be flexible in adjusting the magnitude and pace of tightening in response to evolving economic circumstances; in contrast, its capacity for providing further stimulus through conventional monetary policy easing continued to be constrained by the effective lower bound on the federal funds rate.

Members noted the importance of continued close monitoring of financial markets and institutions—including asset prices, levels of leverage, and underwriting standards—to help identify significant financial imbalances at an early stage. At the time of the meeting the information collected in this process, including that by supervisory staff, had not revealed emerging misalignments in financial markets or widespread instances of excessive risk-taking. All members agreed that the Committee would continue to monitor the economic outlook and financial developments and would employ its policy tools as necessary to promote economic recovery and price stability.

In light of the improved functioning of financial markets, Committee members agreed that it would be appropriate for the statement to be released following the meeting to indicate that the previously announced schedule for closing the Term Asset-Backed Securities Loan Facility was being maintained. The Committee also discussed possible approaches for formulating and communicating key elements of its strategy for removing extraordinary monetary policy accommodation at the appropriate time. No decisions about the Committee's exit strategy were made at this meeting, but participants agreed to give further consideration to these issues at a later date.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to complete the execution of its purchases of about $1.25 trillion of agency MBS and of about $175 billion in housing-related agency debt by the end of March. The Committee directs the Desk to engage in dollar roll transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in January suggests that economic activity has continued to strengthen and that the labor market is stabilizing. Household spending is expanding at a moderate rate but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software has risen significantly. However, investment in nonresidential structures is declining, housing starts have been flat at a depressed level, and employers remain reluctant to add to payrolls. While bank lending continues to contract, financial market conditions remain supportive of economic growth. Although the pace of economic recovery is likely to be moderate for a time, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability.
>
> With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.
>
> The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve has been purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt; those purchases are nearing completion, and the remaining transactions will be executed by the end of this month. The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to promote economic recovery and price stability.
>
> In light of improved functioning of financial markets, the Federal Reserve has been closing the special liquidity facilities that it created to support markets during the crisis. The only remaining such program, the Term Asset-

Backed Securities Loan Facility, is scheduled to close on June 30 for loans backed by new-issue commercial mortgage-backed securities and on March 31 for loans backed by all other types of collateral."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Donald L. Kohn, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he believed it was no longer advisable to indicate that economic and financial conditions were likely to warrant "exceptionally low levels of the federal funds rate for an extended period." Mr. Hoenig was concerned that communicating such an expectation could lead to the buildup of future financial imbalances and increase the risks to longer-run macroeconomic and financial stability. Accordingly, Mr. Hoenig believed that it would be more appropriate for the Committee to express its anticipation that economic conditions were likely to warrant "a low level of the federal funds rate for some time." Such a change in communication would provide the Committee flexibility to begin raising rates modestly. He further believed that making such an adjustment to the Committee's target for the federal funds rate sooner rather than later would reduce longer-run risks to macroeconomic and financial stability while continuing to provide needed support to the economic recovery.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, April 27–28, 2010. The meeting adjourned at 1:00 p.m. on March 16, 2010.

Notation Vote

By notation vote completed on February 16, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on January 26–27, 2010.

Brian F. Madigan
Secretary

Meeting Held on April 27–28, 2010

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, April 27, 2010, at 2:00 p.m. and continued on Wednesday, April 28, 2010, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Donald L. Kohn

Sandra Pianalto

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Christine Cumming, Charles L. Evans, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Helen E. Holcomb
First Vice President, Federal Reserve Bank of Dallas

Brian F. Madigan
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Alan D. Barkema, Thomas A. Connors, William B. English, Jeff Fuhrer, Steven B. Kamin, Simon Potter, Lawrence Slifman, Mark S. Sniderman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Jennifer J. Johnson
Secretary of the Board, Office of the Secretary, Board of Governors

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Robert deV. Frierson[1]
Deputy Secretary, Office of the Secretary, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

James A. Clouse
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

William Nelson
Senior Associate Director, Division of Monetary Affairs, Board of Governors

Nellie Liang, David Reifschneider, and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

Seth B. Carpenter
Associate Director, Division of Monetary Affairs, Board of Governors

Christopher J. Erceg
Deputy Associate Director, Division of International Finance, Board of Governors

Egon Zakrajšek
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Brian J. Gross
Special Assistant to the Board, Office of Board Members, Board of Governors

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1 Attended Tuesday's session only.

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Jennifer E. Roush
Senior Economist, Division of Monetary Affairs, Board of Governors

Kurt F. Lewis
Economist, Division of Monetary Affairs, Board of Governors

Penelope A. Beattie
Assistant to the Secretary, Office of the Secretary, Board of Governors

Kimberley E. Braun
Records Project Manager, Division of Monetary Affairs, Board of Governors

Randall A. Williams
Records Management Analyst, Division of Monetary Affairs, Board of Governors

Esther L. George
First Vice President, Federal Reserve Bank of Kansas City

Loretta J. Mester, Harvey Rosenblum, and John C. Williams
Executive Vice Presidents, Federal Reserve Banks of Philadelphia, Dallas, and San Francisco, respectively

David Altig, Richard P. Dzina, Daniel G. Sullivan, and John A. Weinberg
Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, Chicago, and Richmond, respectively

Warren Weber
Senior Research Officer, Federal Reserve Bank of Minneapolis

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the Committee met on March 16, 2010. The Manager also reported on System open market operations in Treasury securities and in agency debt and agency mortgage-backed securities (MBS) during the intermeeting period. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account over the intermeeting period.

By unanimous vote, the Committee decided to extend the reciprocal currency ("swap") arrangements with the Bank of Canada and the Banco de Mexico for an additional year, beginning in mid-December 2010; these arrangements are associated with the Federal Reserve's participation in the North American Framework Agreement of 1994. The arrangement with the Bank of Canada is in the amount of $2 billion equivalent, and the arrangement with the Banco de Mexico is in the amount of $3 billion equivalent. The vote to renew the System's participation in these swap arrangements was taken at this meeting because of a provision in the arrangements that requires each party to provide six months' prior notice of an intention to terminate its participation.

The staff also briefed the Committee on recent progress in the development of reserve draining tools. The Desk was preparing to conduct small-scale reverse repurchase operations to ensure its ability to use agency MBS collateral. It also continued to work toward expansion of the set of counterparties for reverse repurchase operations. The staff noted that the Board had recently approved changes to Regulation D that would be necessary for the establishment of a term deposit facility.

The staff next gave a presentation on potential longer-run strategies for managing the SOMA. At previous meetings, Committee participants had expressed support for steps to reduce the size of the Federal Reserve's balance sheet over time and return the composition of the SOMA to only Treasury securities. The staff discussed the potential portfolio paths and macroeconomic consequences of a number of different strategies for accomplishing these objectives. To date, the Desk had been reinvesting the proceeds of all maturing Treasury securities in newly issued Treasury securities, but it had not been reinvesting principal and interest payments on maturing agency debt and agency MBS, nor had it been selling securities. One strategy considered in the staff presentation was a continuation of the current practice, which would normalize the balance sheet very gradually. In addition, the staff presented information on a number of other strategies that included sales of SOMA holdings of agency debt and MBS and under which the proceeds of maturing Treasury securities would not be reinvested; these strategies differed by the date and circumstances under which sales would be initiated, by the average pace of sales, and by the degree to which the timing and pace of such sales would be adjusted in response to financial and economic developments.

Meeting participants agreed broadly on key objectives of a longer-run strategy for asset sales and redemptions. The strategy should be consistent with the achievement of the Committee's objectives of maximum employment and price stability. In addition, the strategy should normalize the size and composition of the balance sheet over time. Reducing the size of the balance sheet would decrease the associated reserve balances to amounts consistent with more normal operations of money markets and monetary policy. Returning the portfolio to its historical composition of essentially all Treasury securities would minimize the extent to which the Federal Reserve portfolio might be affecting the allocation of credit among private borrowers and sectors of the economy.

Most participants expressed a preference for strategies that would eventually entail sales of agency debt and MBS in order to return the size and composition of the Federal Reserve's balance sheet to a more normal configuration more quickly than would be accomplished by simply letting MBS and agency securities run off. They agreed that sales of agency debt and MBS should be implemented in accordance with a framework communicated in advance and be conducted at a gradual pace that potentially could be adjusted in response to changes in economic and financial conditions.

Participants expressed a range of views on some of the details of a strategy for asset sales. Most participants favored deferring asset sales for some time. A majority preferred beginning asset sales some time after the first increase in the Federal Open Market Committee's (FOMC) target for short-term interest rates. Such an approach would postpone any asset sales until the economic recovery was well established and would maintain short-term interest rates as the Committee's key monetary policy tool. Other participants favored a strategy in which the Committee would soon announce a general schedule for future asset sales, with a date for the initiation of sales that would not necessarily be linked to the increase in the Committee's interest rate target. A few preferred to begin sales relatively soon. Earlier sales would normalize the size and composition of the balance sheet sooner and would unwind at least part of the unconventional policy stimulus put in place during the crisis before conventional policy firming got under way. Some participants saw advantages to varying the FOMC's holdings of longer-term assets systematically in response to economic and financial developments. However, others thought that a preannounced pace of sales that was unlikely to vary much would provide a high degree of certainty about sales, helping to limit disruptions in financial markets.

The views of participants also differed to some extent regarding the appropriate pace of asset sales. Most preferred that the agency debt and MBS held in the portfolio be sold at a gradual pace that would complete the sales about five years after they began. One possibility would be for the pace to be relatively slow initially but to increase over time, allowing markets to adjust gradually. A couple of participants thought faster sales, conducted over about three years, would be appropriate and felt that such a pace would not put undue strain on financial markets. In their view, a relatively brisk pace of sales would reduce the chance that the elevated size of the Federal Reserve's balance sheet and the associated high level of reserve balances could raise inflation expectations and inflation beyond levels consistent with price stability or could generate excessive growth of credit when the economy and banking system recover more fully.

Participants saw both advantages and disadvantages to not rolling over Treasury securities as they mature. On the one hand, redeeming Treasury securities would contribute to a more expeditious normalization of the size of the balance sheet and the quantity of reserves. On the other hand, such redemptions could put upward pressure on interest rates and would tend to work against the objective of returning the SOMA to an all-Treasuries composition.

No decisions about the Committee's longer-run strategy for asset sales and redemptions were made at this meeting. For the time being, participants agreed that the Desk should continue the interim approach of allowing all maturing agency debt and all prepayments of agency MBS to be redeemed without replacement while rolling over all maturing Treasury securities. Participants agreed to give further consideration to their longer-run strategy at a later date.

Staff Review of the Economic Situation

The information reviewed at the April 27–28 meeting suggested that, on balance, the economic recovery was proceeding at a moderate pace and that the deterioration in the labor market was likely coming to an end. Consumer spending continued to post solid gains in the first three months of the year, and business investment in equipment and software appeared to have increased significantly further in the first quarter. In addition, growth of manufacturing output remained brisk, and gains became more broadly based across industries. However, residential construction, while having edged up, was still depressed, construction of nonresidential buildings remained on a steep downward trajectory, and state and local governments continued to retrench. Consumer price inflation remained low.

The labor market showed signs of a nascent recovery in recent months. Private nonfarm payroll employment increased over the first quarter of 2010—the first quarterly increase since the onset of the recession. The average workweek also rose last quarter and data from the household survey pointed to a firming in labor market conditions. The unemployment rate held steady at 9.7 percent throughout the first quarter, and the labor force participation rate increased over the past few months following sharp declines over the second half of last year. The number of new job losers as a percentage of household employment continued to drop, and the fraction of workers on part-time schedules for economic reasons moved down since the end of last year. Nonetheless, finding a job remained very difficult, and the average duration of unemployment spells increased further.

Industrial production continued to expand at a brisk pace during the first quarter. Recent production gains remained broadly based across industries, as both foreign demand and a mild restocking of inventories contributed positively to output growth. Capacity utilization stood significantly above the trough recorded last June but was still well below its long-run average. Light motor vehicle production stepped up in March, and assemblies in the first quarter were above their fourth-quarter average as automakers cautiously began to rebuild dealers' inventories. Production in high-tech industries increased solidly, and available indicators pointed toward further expansion in this sector in the near term. On balance, indicators of near-term manufacturing activity remained quite positive.

Consumer spending continued to rise at a solid pace through March, with recent gains pronounced for most non-auto goods and food services. Despite signs of improvement recently, the determinants of spending remained subdued. While wages and salaries picked up early this year, real disposable income was flat in February after a slight decline in January; housing wealth was still well below its level prior to the crisis. Furthermore, although banks indicated a somewhat greater willingness to lend to consumers in recent months, terms and standards on consumer loans remained restrictive. Additionally, consumer sentiment dropped back in early April and was little changed, on net, since the beginning of the year.

Starts of new single-family homes edged up, on net, over February and March, but much of this increase likely reflected delayed projects getting under way as weather conditions returned to normal. Home sales strengthened noticeably, as sales of new single-family homes jumped and sales of existing single-family homes rose as well. However, both new home sales and existing home sales were likely boosted, at least in part, by the anticipated expiration of the homebuyer tax credit. Interest rates for conforming 30-year fixed-rate mortgages changed little in recent months and remained at levels that were very low by historical standards.

Real spending on equipment and software continued to rebound in the first quarter. Investment in high-tech equipment and transportation advanced further, and real spending for equipment other than high-tech and transportation appeared to turn up sharply after falling for more than a year, suggesting that the recovery in equipment and software investment became more broadly based. The recovery in equipment and software spending was consistent with the strengthening in many indicators of business activity. In contrast, the nonresidential construction sector continued to contract. Real outlays on structures outside drilling and mining fell steeply last year, and recent data on nominal expenditures through February suggested a further decline in the first quarter. The weakness was widespread across categories and likely reflected elevated vacancy rates, low levels of property prices, and difficulties in obtaining financing for new projects. Real spending on drilling and mining structures picked up strongly over the second half of last year in response to the rebound in oil and natural gas prices.

Available data suggested that the pace of inventory liquidation moderated further in the first quarter after slowing sharply in the fourth quarter of last year. Inventories appeared to approach comfortable levels relative to sales in the aggregate, although inventory positions across industries varied. Months' supply remained elevated for equipment, materials, and, to a lesser degree, construction supplies. By contrast, inventories of consumer goods, business supplies, and high-tech goods appeared low relative to demand.

Consumer price inflation was low in recent months; both headline and core personal consumption expenditures (PCE) prices were estimated to have risen slightly in March after remaining unchanged in February. On a 12-month change basis, core PCE prices slowed over the year ending in March, with deceleration widespread across categories of expenditures. In contrast, the corresponding change in the headline index moved up noticeably, as energy prices rebounded. Survey measures of long-term inflation expectations were fairly stable in recent months at levels slightly lower than those posted a year ago. Meanwhile, measures of inflation compensation based on Treasury inflation-protected securities (TIPS) edged up slightly. Cost pressures from rising commodity prices showed through to prices at early stages of processing, and the producer price index for core intermediate materials continued to rise rapidly through March. However, measures of labor costs decelerated sharply last year, as compensation per hour in the nonfarm business sector increased only slightly over the four quarters of 2009.

The U.S. international trade deficit widened in February, as a rise in nominal imports outpaced a small increase in exports. Increased exports of industrial supplies, capital goods, and automotive products were partly offset by declines in agricultural goods and consumer goods. The February rise in imports reversed a similarly sized decrease in January. Imports of oil accounted for more than one-third of the January decline, reflecting lower volumes, but they accounted for only about one-tenth of the February increase, as volumes rebounded but prices fell. Imports of capital goods rose as strong computer imports more than offset falling aircraft purchases, and imports of industrial supplies and consumer goods also moved up.

Recent indicators in the advanced foreign economies suggested a continued divergence in the pace of recovery, with a strong performance in Canada, a moderate expansion in Japan, and a more subdued rebound in Europe. Fiscal strains in Greece intensified during the intermeeting period, and in mid-April, euro-area member states announced a plan to provide financing aid to Greece in coordination with the International Monetary Fund. However, at the time of the April FOMC meeting, no official agreement had been reached concerning the scale, composition, and implementation of such an aid package. Economic activity in emerging markets continued to expand robustly in the first quarter. Despite the strength of exports, merchandise trade balances declined for some countries where strong domestic demand caused imports to outpace exports. In China, real gross domestic product (GDP) increased at a higher-than-expected annual rate in the first quarter as the economic recovery remained broad based, with industrial production, investment, and domestic demand continuing to grow briskly. In Latin America, indicators suggested that economic activity in Mexico and Brazil expanded further in the first quarter. Foreign inflation was boosted by increases in the prices of oil and other commodities, but core inflation generally remained subdued.

Staff Review of the Financial Situation

The decision by the FOMC at the March meeting to keep the target range for the federal funds rate unchanged and to retain the “extended period” language in the statement was largely anticipated by market participants. However, some market participants reportedly interpreted the retention of the “extended period” language as pointing to a longer period of low rates than previously expected, and Eurodollar futures rates temporarily declined a bit in response.

On balance over the intermeeting period, the expected path of policy edged down slightly. Yields on 2-year and 10-year nominal Treasury securities posted small mixed changes amid some volatility that reportedly reflected evolving views about the U.S. fiscal outlook, prospects for U.S. economic growth, and the fiscal situation in peripheral European countries. Inflation compensation—the difference between nominal Treasury yields and yields on TIPS—rose some over the period, but survey measures of longer-term inflation expectations were about unchanged.

Overall, conditions in short-term funding markets remained generally stable during the intermeeting period. Spreads between London interbank offered rates (Libor) and overnight index swap (OIS) rates were about unchanged at levels near those that prevailed in late 2007, although they began to edge up in the final days of the intermeeting period. Spreads in the commercial paper market were little changed. Equity indexes rose, on balance, over the intermeeting period, with bank shares outperforming the broader market. Stock prices were supported by somewhat better-than-expected macroeconomic data and a favorable response by investors to the initial batch of first-quarter earnings reports, especially those of banking institutions. Option-implied volatility on the S&P 500 index generally declined over the period but jumped at end of April on renewed concerns regarding the fiscal situation in Greece. The gap between the staff's estimate of the expected real equity return over the next 10 years for S&P 500 firms and the real 10-year Treasury yield—a rough measure of the equity risk premium—remained well above its average over the past decade. Yields on investment-grade corporate bonds edged down, leaving their spreads to comparable-maturity Treasury securities a bit lower, at levels around those that prevailed in late 2007. Consistent with more-favorable investor sentiment toward risky assets, yields and spreads on speculative-grade corporate bonds declined, and secondary market prices of syndicated leveraged loans rose further.

Overall, net debt financing by nonfinancial firms was positive in March. Issuance of nonfinancial bonds surged, and net issuance of commercial paper rebounded appreciably. Net equity issuance by nonfinancial firms was negative again in the first quarter as the solid pace of gross public issuance was more than offset by equity retirements from both cash-financed mergers and share repurchases. Financial firms issued a significant volume of debt securities in the first quarter and also raised a moderate amount of gross funds in the equity market, a pattern that appeared to continue in the first half of April. Credit quality in the commercial real estate sector continued to deteriorate as the delinquency rate for securitized commercial mortgages increased again in March. The decline in outstanding commercial mortgage debt in the fourth quarter of last year was the largest on record. Nonetheless, indexes of prices for credit default swaps on commercial mortgage-backed securities ticked up noticeably over the period, in line with the overall reduction in financial market risk premiums.

The conclusion of purchases under the Federal Reserve's agency MBS program had only a modest market effect. Over the intermeeting period, spreads on agency MBS retraced much of the increase seen around the time of the program's conclusion, ending the period roughly unchanged. The factors contributing to the recent narrowing of MBS and mortgage spreads included the low level of mortgage originations, which damped the supply of new MBS, and Fannie Mae's and Freddie Mac's increased purchases of mortgages through their buyouts of delinquent loans. Consumer credit continued to trend lower in recent months, pushed down by a steep decline in revolving credit. Spreads on high-quality credit card and auto loan asset-backed securities (ABS) edged down over the period, with little upward pressure evident from the end of the portion of the Term Asset-Backed Securities Loan Facility supporting ABS. Nonetheless, fewer ABS were issued in the first quarter than in the fourth quarter, reflecting continued weakness in loan originations. Delinquency rates on consumer loans edged down further in February but remained very elevated. Spreads of interest rates on credit cards over yields on two-year Treasury securities continued to drift upward, while interest rates on new auto loans at dealerships and their spreads over yields on five-year Treasury securities extended their previous decline.

After adjusting to remove the effects of banks' adoption of Financial Accounting Standards 166 and 167, bank credit contracted again in March, as both loans and securities holdings declined.[2] The contraction in commercial and industrial loans remained pronounced. The drop in commercial real estate loans persisted, reflecting weak fundamentals that limited originations as well as charge-offs of existing loans. Residential real estate loans also decreased further in March, as did credit card loans and other consumer loans.

M2 fell in March, reflecting a slowing in the expansion of liquid deposits along with a further contraction in small time deposits and a steep runoff in retail money market mutual funds. Currency grew at a moderate pace, likely as a result of continued demand for U.S. banknotes from abroad coupled with solid domestic demand. The monetary base contracted as the effect on reserves of purchases under the Federal Reserve's large-scale asset purchase programs was more than offset by a further contraction in credit outstanding under liquidity and credit facilities and an increase in the Treasury's balances at the Federal Reserve.

[2] The new accounting standards make it more difficult for U.S. banks to hold assets off balance sheet. Banks adopted the standards in the fourth quarter of 2009 and the first quarter of 2010. The cumulative effects of the resulting asset consolidation were incorporated in the bank credit data published on the Federal Reserve's H.8 Statistical Release "Assets and Liabilities of Commercial Banks in the United States" as of March 31, 2010. While all major loan categories were affected to some degree by banks' adoption of Financial Accounting Standards 166 and 167, the largest effect was on credit card loans on commercial bank balance sheets; banks also consolidated significant amounts of other consumer loans, commercial and industrial loans, and residential real estate loans.

Until the intensification of the Greek crisis near the end of the intermeeting period, equity indexes were higher in nearly all countries, and emerging-market risk spreads had generally declined. These moves appeared to reflect growing confidence that the global recovery was gaining momentum, particularly in emerging market economies. However, sovereign debt spreads in Greece, Portugal, and other peripheral European countries widened in the days leading up to the April FOMC meeting, as investor anxiety about the fiscal situation in those countries increased. Downgrades to the credit ratings of Greece and Portugal weighed on investor sentiment, and global markets retraced some of their earlier gains.

Over the intermeeting period, the Bank of Japan doubled the size of its three-month fixed-rate funds facility, the Bank of Canada dropped its conditional commitment to keeping rates steady through the first half of the year, and the Reserve Bank of Australia raised its policy rate. The trade-weighted value of the dollar changed little, on net; gains against the euro and yen were offset by declines against many emerging market currencies.

Staff Economic Outlook

The economic forecast prepared by the staff for the April FOMC meeting was similar to that developed for the March meeting. The staff continued to project that the accommodative stance of monetary policy, together with a further attenuation of financial stress, the waning of adverse effects of earlier declines in wealth, and improving household and business confidence, would support a moderate recovery in economic activity and a gradual decline in the unemployment rate over the next two years. The staff forecast for both real GDP growth and the unemployment rate through the end of 2011 was roughly in line with previous projections.

Recent data on core consumer prices led the staff to mark down slightly its forecast for core PCE inflation. The staff continued to anticipate that downward pressure on inflation from the substantial amount of projected resource slack would be tempered by stable inflation expectations. With energy price increases expected to slow next year, total PCE inflation was seen as likely to fall back in line with core inflation by the end of 2011, as in previous projections.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants—the five members of the Board of Governors and the presidents of the 12 Federal Reserve Banks—provided projections of economic growth, the unemployment rate, and consumer price inflation for each year from 2010 through 2012 and over a longer horizon. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks. Participants' forecasts through 2012 and over the longer run are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, meeting participants agreed that the incoming data and information received from business contacts indicated that economic activity continued to strengthen and the labor market was beginning to improve. Although some of the recent data on economic activity had been better than anticipated, most participants saw the incoming information as broadly in line with their earlier projections for moderate growth; accordingly, their views on the economic outlook had not changed appreciably. Participants expected the economic recovery to continue, but, consistent with experience following previous financial crises, most anticipated that the pickup in output would be rather slow relative to past recoveries from deep recessions. A moderate pace of expansion, in turn, would imply only a modest improvement in the labor market this year, with the unemployment rate declining gradually. Most participants again projected that the economy would grow somewhat faster in 2011 and 2012, generating a more pronounced decline in the unemployment rate. In light of stable longer-term inflation expectations and the likely continuation of substantial resource slack, policymakers anticipated that both overall and core inflation would remain subdued through 2012, with measured inflation somewhat below rates that policymakers considered to be consistent over the longer run with the Federal Reserve's dual mandate.

Participants expected that economic growth would continue: Recent data pointed to significant gains in retail sales, business spending on equipment and software had picked up substantially, and reports from business contacts and regional surveys indicated that production was increasing briskly in many sectors. Participants agreed that the growth in real GDP appeared to reflect a strengthening of private final demand and not just fiscal stimulus and a slower pace of inventory decumulation; this welcome development lessened policymakers' concerns about the economy's ability to maintain a self-sustaining recovery without government support. Businesses appeared to be gaining confidence in the economic recovery, and narrowing credit spreads in private debt markets were allowing low policy rates to be reflected more fully in the cost of capital. At the same time, rising stock prices and the apparent stabilization of house prices were helping to repair household balance sheets. As a result, consumers and firms were beginning to satisfy demands for durable goods and capital equipment that had been postponed during the economic downturn. Many participants noted that employment had increased in recent months, and that they expected a further firming of labor market conditions going forward. A stronger labor market could continue to boost consumer and business confidence and so contribute to further gains in spending.

Although these developments were positive, participants noted several factors that likely would continue to restrain expansion in economic activity and posed some downside risks. The recent increase in consumer spending appeared to be supported importantly by pent-up demands and possibly by other temporary factors, such as unusually large income tax refunds. With the personal saving rate having dropped back to a relatively low level, it seemed unlikely that consumer spending would be the major factor driving growth as the recovery progressed. Moreover, the recovery in the housing market appeared to have stalled in recent months despite various forms of government support. Although residential real estate values seemed to be stabilizing and in some areas had reportedly moved higher, housing sales and starts had leveled off in recent months at depressed levels. Some participants saw the possibility of elevated foreclosures adding to the already very large inventory of vacant homes as posing a downside risk to home prices, thereby limiting the extent of the pickup in residential investment for a while.

In the business sector, prospects for nonresidential construction outside the energy sector remained weak. Commercial real estate activity continued to fall in most parts of the country as a result of deteriorating fundamentals, including declining occupancy and rental rates and tight credit conditions. However, a number of participants noted that investment in equipment and software had been strengthening, and they relayed anecdotal information from their business contacts that suggested continued growth in orders for capital equipment.

Business investment was expected to be supported by improved conditions in financial markets. Large firms with access to capital markets appeared to be having little difficulty in obtaining credit, and in many cases they also had ample retained earnings with which to fund their operations and investment. However, many participants noted that while financial markets had improved, bank lending was still contracting and credit remained tight for many borrowers. Smaller firms in particular reportedly continued to face substantial difficulty in obtaining bank loans. Because such firms tend to be more dependent on commercial banks for financing, participants saw limited credit availability as a potential constraint on future investment and hiring by small businesses, which normally are a significant source of employment growth in recoveries. Some participants noted that many small and regional banks were vulnerable to deteriorating performance of commercial real estate loans.

Economic conditions abroad, especially in several emerging Asian economies, continued to strengthen in recent months, contributing to gains in U.S. exports. However, participants saw the escalation of fiscal strains in Greece and spreading concerns about other peripheral European countries as weighing on financial conditions and confidence in the euro area. If other European countries responded by intensifying their fiscal consolidation efforts, the result would likely be slower growth in Europe and potentially a weaker global economic recovery. Some participants expressed concern that a crisis in Greece or in some other peripheral European countries could have an adverse effect on U.S. financial markets, which could also slow the recovery in this country.

Developments in labor markets were positive over the intermeeting period. Nonfarm payrolls posted a modest gain in March, and the upturn in private employment was widespread across industries. Nevertheless, participants remained concerned about elevated unemployment, including high levels of long-term unemployment and permanent separations, which were seen as potentially leading to the loss of worker skills and greater needs for labor real-location that could slow employment growth going forward. Moreover, information from business contacts generally underscored the degree to which firms' reluctance to add to payrolls or start large capital projects reflected uncertainty about the economic outlook and future government policies. A number of participants pointed out that the economic recovery could eventually lose traction without a substantial pickup in job creation.

Participants cited a wide array of evidence as indications that underlying inflation remained subdued. The latest readings on core inflation—which exclude the relatively volatile prices of food and energy—were generally lower than they had anticipated. One participant noted that core inflation had been held down in recent quarters by unusually slow increases in the price index for shelter, and that the recent behavior of core inflation might be a misleading signal of the underlying inflation trend. However, a number of participants pointed out that the recent moderation in price changes was widespread across many categories of spending and was evident in measures that exclude the most extreme price movements in each period. In addition, survey measures of longer-term inflation expectations remained fairly stable, wage growth continued to be restrained, and unit labor costs were still falling; reports from business contacts also suggested that pricing power remained limited. Against this backdrop, most participants anticipated that substantial resource slack and stable longer-term inflation expectations would likely keep inflation subdued for some time.

Participants' assessments of the risks to the inflation outlook were mixed. Some participants saw the risks to inflation as tilted to the downside in the near term, reflecting the quite elevated level of economic slack and the possibility that inflation expectations could begin to decline in response to the low level of actual inflation. Others, however, saw the balance of risks as pointing to potentially higher inflation and cited pressures on commodity and energy prices associated with expanding global economic activity as an upside inflation risk; some also noted the possibility that inflation expectations could rise as a result of the public's concerns about the extraordinary size of the Federal Reserve's balance sheet in a period of very large federal budget deficits. While survey measures of longer-term inflation expectations had been fairly stable, some market-based measures of inflation expectations and inflation risk suggested increased concern among market participants about higher inflation. To keep inflation expectations well anchored, all participants agreed that it was important for policy to be responsive to changes in the economic outlook and for the Federal Reserve to continue to communicate clearly its ability and intent to begin withdrawing monetary policy accommodation at the appropriate time and pace.

Committee Policy Action

In the members' discussion of monetary policy for the period ahead, they agreed that no changes to the Committee's federal funds rate target range were warranted at this meeting. On balance, the economic outlook had changed little since the March meeting. Even though the recovery appeared to be continuing and was expected to strengthen gradually over time, most members projected that economic slack would continue to be quite elevated for some time, with inflation remaining below rates that would be consistent in the longer run with the Federal Reserve's dual objectives. Based on this outlook, members agreed that it would be appropriate to maintain the target range of 0 to $\frac{1}{4}$ percent for the federal funds rate. In addition, nearly all members judged that it was appropriate to reiterate the expectation that economic conditions—including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period. As at previous meetings, a few members noted that at the current juncture, the risks of an early start to policy tightening exceeded those associated with a later start, because the scope for more accommodative policy was limited by the effective lower bound on the federal funds rate, while the Committee could be flexible in adjusting the magnitude and pace of tightening in response to evolving economic circumstances. In light of the improved functioning of financial markets, Committee members agreed that it would be appropriate for the statement to be released following the meeting to indicate that the previously announced schedule for closing the Term Asset-Backed Securities Loan Facility was being maintained.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will fos-

ter price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to engage in dollar roll transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in March suggests that economic activity has continued to strengthen and that the labor market is beginning to improve. Growth in household spending has picked up recently but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software has risen significantly; however, investment in nonresidential structures is declining and employers remain reluctant to add to payrolls. Housing starts have edged up but remain at a depressed level. While bank lending continues to contract, financial market conditions remain supportive of economic growth. Although the pace of economic recovery is likely to be moderate for a time, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to promote economic recovery and price stability.

In light of improved functioning of financial markets, the Federal Reserve has closed all but one of the special liquidity facilities that it created to support markets during the crisis. The only remaining such program, the Term Asset-Backed Securities Loan Facility, is scheduled to close on June 30 for loans backed by new-issue commercial mortgage-backed securities; it closed on March 31 for loans backed by all other types of collateral."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Donald L. Kohn, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he believed it was no longer advisable to indicate that economic and financial conditions were likely to warrant "exceptionally low levels of the federal funds rate for an extended period." Mr. Hoenig was concerned that communicating such an expectation could lead to the buildup of future financial imbalances and increase the risks to longer-run macroeconomic and financial stability, while limiting the Committee's flexibility to begin raising rates modestly in the near term. Mr. Hoenig believed that the target for the federal funds rate should be increased toward 1 percent this summer, and that the Committee could then pause to further assess the economic outlook. He believed this approach would leave considerable policy accommodation in place to foster an expected gradual decline in unemployment in the quarters ahead and would reduce the risk of an increase in financial imbalances and inflation pressures in coming years. It would also mitigate the need to push the policy rate to higher levels later in the expansionary phase of the economic cycle.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, June 22–23, 2010. The meeting adjourned at 12:50 p.m. on April 28, 2010.

Notation Vote

By notation vote completed on April 5, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on March 16, 2010.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the April 27–28, 2010, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation for the years 2010 to 2012 and over the longer run. The projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

FOMC participants' forecasts for economic activity and inflation were broadly similar to their previous projections, which were made in conjunction with the January 2010 FOMC meeting. As depicted in **figure 1**, the economic recovery was expected to be gradual, with real gross domestic product (GDP) expanding at a rate only moderately above the participants' assessment of its longer-run sustainable growth rate and unemployment declining slowly over the next few years. Most participants also anticipated that inflation would remain subdued over this period. As indicated in **table 1**, participants generally made modest upward revisions to their projections for real GDP growth in 2010. Beyond 2010, however, the contours of participants' projections for economic activity and inflation were little changed. Participants continued to expect the pace of the economic recovery to be restrained by household and business uncertainty, only gradual improvement in labor market conditions, and slow easing of credit conditions in the banking sector. Participants generally expected that it would take some time for the economy to converge fully to its longer-run path—characterized by a sustainable rate of output growth and by rates of employment and inflation consistent with participants' interpretation of the Federal Reserve's dual objectives—but only a minority anticipated that the convergence process would take more than five to six

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, April 2010
Percent

Variable	Central tendency[1]				Range[2]			
	2010	2011	2012	Longer run	2010	2011	2012	Longer run
Change in real GDP	3.2 to 3.7	3.4 to 4.5	3.5 to 4.5	2.5 to 2.8	2.7 to 4.0	3.0 to 4.6	2.8 to 5.0	2.4 to 3.0
January projection	2.8 to 3.5	3.4 to 4.5	3.5 to 4.5	2.5 to 2.8	2.3 to 4.0	2.7 to 4.7	3.0 to 5.0	2.4 to 3.0
Unemployment rate	9.1 to 9.5	8.1 to 8.5	6.6 to 7.5	5.0 to 5.3	8.6 to 9.7	7.2 to 8.7	6.4 to 7.7	5.0 to 6.3
January projection	9.5 to 9.7	8.2 to 8.5	6.6 to 7.5	5.0 to 5.2	8.6 to 10.0	7.2 to 8.8	6.1 to 7.6	4.9 to 6.3
PCE inflation	1.2 to 1.5	1.1 to 1.9	1.2 to 2.0	1.7 to 2.0	1.1 to 2.0	0.9 to 2.4	0.7 to 2.2	1.5 to 2.0
January projection	1.4 to 1.7	1.1 to 2.0	1.3 to 2.0	1.7 to 2.0	1.2 to 2.0	1.0 to 2.4	0.8 to 2.0	1.5 to 2.0
Core PCE inflation[3]	0.9 to 1.2	1.0 to 1.5	1.2 to 1.6		0.7 to 1.6	0.6 to 2.4	0.6 to 2.2	
January projection	1.1 to 1.7	1.0 to 1.9	1.2 to 1.9		1.0 to 2.0	0.9 to 2.4	0.8 to 2.0	

Note: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The January projections were made in conjunction with the meeting of the Federal Open Market Committee on January 26–27, 2010.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.

3 Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2010–12 and over the longer run

Note: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

years. As in January, most participants judged the risks to their growth outlook as balanced, and most also saw balanced risks surrounding their inflation projections. Participants in general continued to judge the uncertainty surrounding their projections for economic activity and inflation as unusually high relative to historical norms.

The Outlook

Participants' projections for real GDP growth in 2010 had a central tendency of 3.2 to 3.7 percent, a little higher than in January. Readings on consumer spending and business outlays for equipment and software were seen as broadly consistent with a moderate pace of economic recovery. The labor market appeared to be starting to improve, but job growth was expected to be modest. Participants pointed to a number of factors that would support the continued expansion of economic activity, including accommodative monetary policy and the improved condition of financial markets and institutions. Several participants also noted that fiscal policy was currently providing substantial support to real activity. However, they expected less impetus to GDP growth from this factor later in the year and anticipated that budgetary pressures would probably continue to weigh on spending at the state and local levels. Many participants thought that the expansion was likely to be restrained by firms' caution in hiring and spending in light of the considerable uncertainty regarding the economic outlook, and by limited access to credit by small businesses and consumers.

Looking further ahead, participants' projections were for real GDP growth to pick up somewhat in 2011 and 2012; the projections for growth in both years had a central tendency of about 3½ to 4½ percent. As in January, participants generally expected the ongoing recovery in household wealth and gradual improvements in credit availability to bolster consumer spending. As the recovery became more firmly established, businesses were seen as likely to boost their outlays on equipment and software and to increase production in order to rebuild their inventories. Nevertheless, participants indicated several factors that would likely restrain the pace of expansion, including a higher household saving rate as households repair balance sheets, significant uncertainty on the part of households and businesses about the outlook for the economy, and a slow recovery in nonresidential construction. Moreover, although financial conditions had improved noticeably in recent months, ongoing strains in the commercial real estate sector were expected to pose risks to the balance sheets of banking institutions for some time. Terms and standards on bank loans remained restrictive, and participants anticipated only a gradual easing of credit conditions for many households and smaller firms. In the absence of further shocks, participants generally expected that real GDP growth would converge over time to an annual rate of 2.5 to 2.8 percent, the longer-run pace that appeared to be sustainable in view of expected trends in the labor force and improvements in labor productivity.

Participants anticipated that labor market conditions would improve slowly over the next several years. The central tendency of their projections for the average unemployment rate in the fourth quarter of 2010 was 9.1 to 9.5 percent, only modestly below the levels of late last year. In line with their outlook for moderate output growth, participants generally expected that the unemployment rate would decline only to about 6.6 to 7.5 percent by the end of 2012, remaining well above their assessments of its longer-run sustainable rate. Although some participants noted concerns that substantial ongoing structural adjustments in product and labor markets would reduce the sustainable level of employment, participants' longer-term unemployment projections had a central tendency of 5.0 to 5.3 percent, essentially the same as in January.

Most participants revised down slightly their near-term projections for inflation, and participants generally anticipated that inflation would remain subdued over the next several years. The central tendency of their projections for personal consumption expenditures (PCE) inflation was 1.2 to 1.5 percent for 2010, 1.1 to 1.9 percent for 2011, and 1.2 to 2.0 percent for 2012. Many participants anticipated that increases in food and energy prices would lead headline PCE inflation to run slightly above core PCE inflation over the next few years. Most expected that inflation would rise gradually toward their individual assessments of the measured rate of inflation judged to be most consistent with the Federal Reserve's dual mandate. As in January, the central tendency of projections of the longer-run inflation rate was 1.7 to 2.0 percent. A majority of participants anticipated that inflation in 2012 would still be below their

Table 2. Average historical projection error ranges
Percentage points

Variable	2010	2011	2012
Change in real GDP[1]	±1.1	±1.7	±1.8
Unemployment rate[1]	±0.5	±1.2	±1.5
Total consumer prices[2]	±0.9	±1.0	±1.1

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1990 through 2009 that were released in the spring by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 For definitions, refer to general note in table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

assessments of the mandate-consistent inflation rate, while the remainder expected that inflation would be at or slightly above its longer-run value by that time.

Uncertainty and Risks

Most participants continued to see their projections of future economic activity and unemployment as subject to greater-than-average uncertainty.[3] Participants generally perceived the risks to their projections as roughly balanced, although a few indicated that they now viewed the risks to economic growth as tilted to the upside. Many participants pointed to stronger incoming data as suggesting that the economic recovery was more firmly established than had been the case in January, but they emphasized that predicting macroeconomic outcomes in the wake of a financial crisis and a severe recession was particularly difficult. In addition, participants cited uncertainties regarding the likely persistence of both the recent pickup in the growth of consumer spending and rapid labor productivity growth and noted the risk that severe strains in the commercial real estate sector could continue to impair bank balance sheets, thus limiting credit availability and restraining growth of output and employment.

Most participants continued to see the uncertainty surrounding their inflation projections as elevated. However, a few judged that uncertainty in the outlook for inflation was about in line with typical levels, and one viewed the uncertainty surrounding the inflation outlook as lower than average. Nearly all participants judged the risks to the inflation outlook as roughly balanced; however, two saw these risks as tilted to the upside, while two regarded the risks as weighted to the downside. Several participants noted that inflation expectations were well anchored, likely mitigating the tendency for inflation to decline in response to continued slack in resource utilization. Others cited the risk that expected and actual inflation could increase, especially if extraordinarily accommodative monetary policy measures were not unwound in a timely fashion.

Diversity of Views

Figures 2.A and 2.B provide further details on the diversity of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate. The distributions of participants' projections for real GDP growth this year and next year were slightly narrower than the distributions of their projections in January, but the distribution of projections for real GDP growth in 2012 was little changed. As in earlier projections, the dispersion in participants' forecasts for output growth appeared to reflect the diversity of their assessments regarding the current degree of underlying momentum in economic activity, the evolution of consumer and business sentiment, the likely pace of easing of bank lending standards and terms, and other factors. Regarding participants' unemployment rate projections, the distribution for 2010 shifted down somewhat, but the distributions of their unemployment rate projections for 2011 and 2012 did not change appreciably. The distributions of participants' estimates of the longer-run sustainable rates of output growth and unemployment were essentially the same as in January.

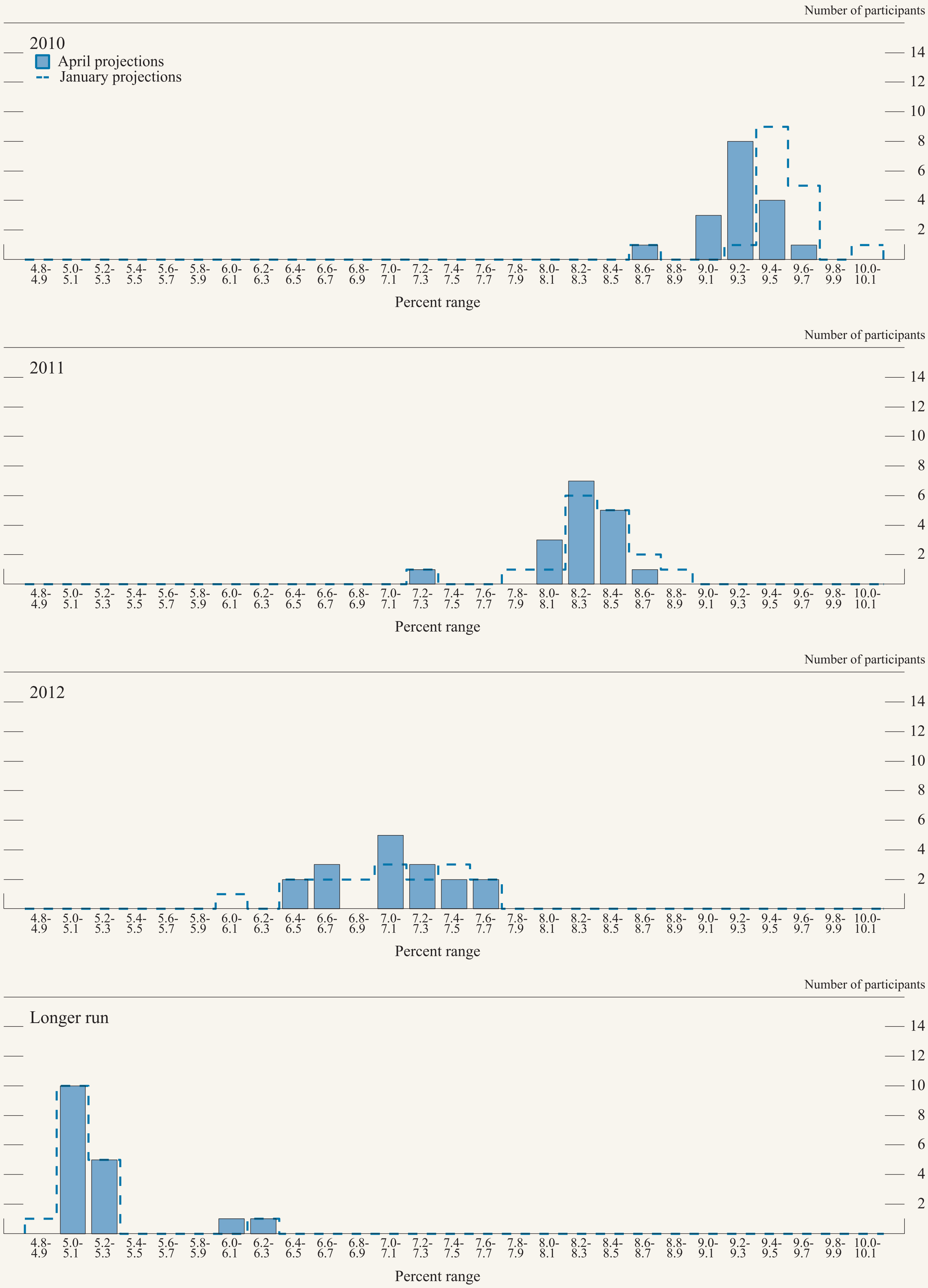
Corresponding information about the diversity of participants' views regarding the inflation outlook is provided in figures 2.C and 2.D . For overall and core PCE inflation, the distributions of participants' projections for 2010 shifted a bit lower relative to the distributions in January. The distributions of overall and core inflation for 2011 and 2012, however, were little changed and remained fairly wide. The dispersion in participants' projections over the next few years was mainly due to differences in their judgments regarding the determinants of inflation, including their estimates of prevailing resource slack

3 Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1990 to 2009. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risk attending participants' projections.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2010–12 and over the longer run

Note: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2010–12 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2010–12 and over the longer run

NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2010–12

NOTE: Definitions of variables are in the general note to table 1.

and their assessments of the extent to which such slack affects actual and expected inflation. In contrast, the relatively tight distribution of participants' projections for longer-run inflation illustrates their substantial agreement about the measured rate of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policy-makers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 1.9 to 4.1 percent in the current year, 1.3 to 4.7 percent in the second year, and 1.2 to 4.8 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 to 2.9 percent in the current year, 1.0 to 3.0 percent in the second year, and 0.9 to 3.1 percent in the third year.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Meeting Held on June 22–23, 2010

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, June 22, 2010, at 2:00 p.m. and continued on Wednesday, June 23, 2010, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Donald L. Kohn

Sandra Pianalto

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Brian F. Madigan
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Thomas Baxter
Deputy General Counsel

Richard M. Ashton
Assistant General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Thomas A. Connors, William B. English, Jeff Fuhrer, Steven B. Kamin, Simon Potter, Lawrence Slifman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Jennifer J. Johnson
Secretary of the Board, Office of the Secretary, Board of Governors

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Robert deV. Frierson[1]
Deputy Secretary, Office of the Secretary, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

James A. Clouse
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson[2]
Assistant to the Board, Office of Board Members, Board of Governors

Nellie Liang, David Reifschneider, and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

William Nelson
Senior Associate Director, Division of Monetary Affairs, Board of Governors

Seth B. Carpenter
Associate Director, Division of Monetary Affairs, Board of Governors

Christopher J. Erceg
Deputy Associate Director, Division of International Finance, Board of Governors

Michael G. Palumbo and Joyce K. Zickler
Deputy Associate Directors, Division of Research and Statistics, Board of Governors

Brian J. Gross
Special Assistant to the Board, Office of Board Members, Board of Governors

Fabio M. Natalucci
Assistant Director, Division of Monetary Affairs, Board of Governors

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1 Attended Tuesday's session only.

2 Attended Wednesday's session only.

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Beth Anne Wilson
Section Chief, Division of International Finance, Board of Governors

John C. Driscoll and Jennifer E. Roush
Senior Economists, Division of Monetary Affairs, Board of Governors

Andrea L. Kusko
Senior Economist, Division of Research and Statistics, Board of Governors

John W. Schindler
Senior Economist, Division of International Finance, Board of Governors

Penelope A. Beattie
Assistant to the Secretary, Office of the Secretary, Board of Governors

Valerie Hinojosa and Randall A. Williams
Records Management Analysts, Division of Monetary Affairs, Board of Governors

Patrick K. Barron and John F. Moore
First Vice Presidents, Federal Reserve Banks of Atlanta and San Francisco, respectively

Loretta J. Mester, Harvey Rosenblum, and John C. Williams
Executive Vice Presidents, Federal Reserve Banks of Philadelphia, Dallas, and San Francisco, respectively

David Altig, Richard P. Dzina, Arthur Rolnick, and Mark E. Schweitzer
Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, Minneapolis, and Cleveland, respectively

Daniel Aaronson, Todd E. Clark, and Andreas L. Hornstein
Vice Presidents, Federal Reserve Banks of Chicago, Kansas City, and Richmond, respectively

Joshua L. Frost
Assistant Vice President, Federal Reserve Bank of New York

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the Committee met on April 27–28, 2010. He also briefed the Committee on the System's progress in developing tools for managing the supply of reserves, including reverse repurchase agreements and the Term Deposit Facility. In preparation for possible future reserve draining operations, in June the Federal Reserve conducted the first of several small-value auctions to test the Term Deposit Facility. In addition, the Manager reported on System open market operations during the intermeeting period. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account over the intermeeting period.

In his presentation to the Committee, the Manager noted that "fails to deliver" in the mortgage-backed securities (MBS) market had reached very high levels in recent months. Under these conditions, dealers had experienced difficulty in arranging delivery of a small amount—including about $9 billion of securities with 5.5 percent coupons issued by Fannie Mae—of the $1.25 trillion of MBS that the Desk at the Federal Reserve Bank of New York had purchased between January 2009 and March 2010. The Desk had postponed settlement of some of these transactions through the use of dollar rolls. The Manager discussed alternative methods of settling the outstanding transactions and recommended that the Committee authorize the Desk to engage in coupon swap transactions to facilitate the settlement of these purchases. The Manager noted that a coupon swap is a common transaction in the market for MBS in which the two counterparties exchange securities at market prices. By engaging in a coupon swap, the Federal Reserve would effectively sell the scarce securities that it had not yet received and purchase instead securities that are more readily available in the market. After discussing various approaches, meeting participants agreed that coupon swaps were an appropriate method to achieve settlement of outstanding transactions.

As background for the Committee's continuing consideration of its portfolio management policies, the Manager gave a presentation on alternative strategies for reinvesting the proceeds from maturing Treasury securities. Under current practice, the Desk reinvests the proceeds of maturing Treasury coupon securities in new Treasury securities that are issued on the date the older securities mature, allocating the investments across the new securities in proportion to the issuance amounts. The Manager presented two alternatives to the status quo. First, the Committee could consider halting all reinvestment of the proceeds of maturing securities. Such a strategy would shrink the size of the Federal Reserve's balance sheet and reduce the quantity of reserve balances in the banking system gradually over time. Second, the Committee could reinvest the proceeds of maturing securities only in new issues of Treasury securities with relatively short maturities—bills only, or bills as well as coupon issues with terms of three years or less. This strategy would maintain the size of the Federal Reserve's balance sheet but would reduce somewhat the average maturity of the portfolio and increase its liquidity. One participant favored halting all reinvestment, and many saw benefits to eventually adopting an approach of reinvesting in bills and shorter-term coupon issues to shift the maturity composition of the portfolio toward the structure that had prevailed prior to the financial crisis. However, the Committee made no change to its reinvestment policy at this meeting.

Continuing a discussion from previous meetings, participants again addressed issues regarding asset sales. Participants continued to agree that gradual sales of MBS should be undertaken, at some point, to speed the return to a Treasury-securities-only portfolio. A few participants supported beginning such sales fairly soon; they noted that, given the evident demand in the market for safe, longer-term assets, modest sales of MBS might not put much, if any, upward pressure on long-term interest rates or be disruptive to the functioning of financial markets. However, many participants still saw asset sales as potentially tightening financial conditions to some extent. Most participants continued to judge it appropriate to defer asset sales for some time; several noted the modest weakening in the economic outlook since the Committee's last meeting as an additional reason to do so. A majority of participants continued to anticipate that asset sales would start after the Committee had begun to firm policy by increasing short-term interest rates; such an approach would postpone asset sales until the economic recovery was well established and maintain short-term interest rates as the Committee's key monetary policy tool. A few participants suggested selling MBS and using the proceeds to purchase Treasury securities of comparable duration, arguing that doing so would hasten the move toward a Treasury-securities-only portfolio without tightening financial conditions. Participants agreed that it would be important to maintain flexibility regarding the appropriate timing and pace of asset sales, given the uncertainties associated with the unprecedented size and composition of the Federal Reserve's balance sheet and its effects on financial conditions. Overall, participants emphasized that any decision to engage in asset sales would need to be communicated well in advance of the initiation of such transactions, and that sales should be conducted at a gradual pace and potentially be adjusted in response to developments in economic and financial conditions.

Staff Review of the Economic Situation

The information reviewed at the June 22–23 meeting suggested that the economic recovery was proceeding at a moderate pace in the second quarter. Businesses continued to increase employment and lengthen workweeks in April and May, but the unemployment rate remained elevated. Industrial production registered strong and widespread gains, and business investment in equipment and software rose rapidly. Consumer spending appeared to have moved up further in April and May. However, housing starts dropped in May, and nonresidential construction remained depressed. Falling energy prices held down headline consumer prices in April and May while core consumer prices edged up.

Labor demand continued to firm in recent months. While the change in total nonfarm payroll employment in May was boosted significantly by the hiring of temporary workers for the decennial census, private employment posted only a small increase. This increase, however, followed sizable gains in March and April, and the average workweek of all private-sector employees increased over the March-to-May period. As a result, aggregate hours worked by employees on private nonfarm payrolls rose substantially through May. The unemployment rate moved up in April but dropped back in May to 9.7 percent, its first-quarter average. The labor force participation rate was, on average, higher in recent months than in the first quarter, as rising employment was accompanied by an increasing number of jobseekers. Although the number of workers who were employed part time for economic reasons leveled off in recent months, the proportion of unemployed workers who were jobless for more than 26 weeks continued to move up. Initial claims for unemployment insurance were little changed over the intermeeting period, remaining at a still-elevated level.

Industrial production rose at a robust rate in April and May, with production increases broadly based across industries. Firming domestic demand, rising exports, and business inventory restocking appeared to have provided upward impetus to factory production. In April and May, production in high-technology industries again rose strongly, with substantial gains in the output of semiconductors and further solid increases in the production of computers and communications equipment. The production of other types of business equipment continued to rebound, and the output of construction supplies advanced further. Production of light motor vehicles turned up in May; nonetheless, dealers' inventories remained lean. Capacity utilization in manufacturing rose in May to a rate noticeably above the low reached in mid-2009, but it was still substantially below its longer-run average.

The rise in consumer spending slowed in recent months after a brisk increase in the first quarter. Although sales of light motor vehicles continued to trend higher, nominal sales of non-auto consumer goods and food services were little changed in April and May. The moderation in spending appeared, on balance, to be aligning the pace of consumption with recent trends in income, wealth, and consumer sentiment. Real disposable personal income moved up at a solid rate in March and April, reflecting increases in employment and hours worked as well as slightly higher real wages, but home values declined in recent months and equity prices moved down since the April meeting. Measures of consumer sentiment improved in May and early June but were still at relatively low levels.

The anticipated expiration of the homebuyer tax credit appeared to have pulled home sales forward, boosting their level in recent months. Sales of existing single-family homes rose strongly in April, and, although they moved down in May, these sales were still above their level earlier in the year. Purchases of new single-family homes also jumped in April, but then fell steeply in May. On net, the upswing in the volume of real estate transactions in recent months was likely to boost the brokers' commissions component of residential investment in the second quarter. However, starts of new single-family homes, which had trended higher in the first four months of the year, declined sharply in May. In addition, the number of permits for new homes, which tends to lead starts, fell for a second month in May. House prices declined somewhat in recent months, reversing some of the modest increases that occurred in the spring and summer of 2009. After changing little on net during the preceding year, interest rates for 30-year fixed-rate conforming mortgages moved lower in May and June.

Real spending on equipment and software increased further early in the second quarter. Business outlays for computing equipment and software continued to rise at a brisk pace through April, and shipments of aircraft to domestic carriers rebounded. Orders and shipments of nondefense capital goods excluding transportation and high-tech equipment stayed on a noticeable uptrend, on net, in March and April, with the increases broadly based by type of equipment. The recovery in equipment and software spending was consistent with the relatively strong gains in production in recent months, improved financial conditions over the first part of the year, and the positive readings from surveys on business conditions and earnings reports for producers of capital goods. Business outlays for nonresidential construction appeared to be contracting further, on balance, in March and April, although the rate of decline seemed to be moderating. Outlays for new power plants and for manufacturing facilities firmed, and investment in drilling and mining structures continued to rise strongly. However, spending on office and commercial structures was still falling steeply through April, with the weakness likely related to high vacancy rates, falling property prices, and the light volume of sales.

Businesses appeared to have begun to restock their inventories. Real nonfarm inventory investment turned positive in the first quarter, and data for April pointed to further modest accumulation. Ratios of inventories to sales for most industries looked to be within comfortable ranges.

Consumer price inflation remained low in April and May. The core consumer price index rose only slightly over the period, and the year-over-year change in the index was lower than earlier this year. Core goods prices continued to decline, on net, and prices of non-energy services remained soft. The headline consumer price index edged down in both months, as the drop in the price of crude oil since April led consumer energy prices to retrace a portion of the run-up that occurred during the nine months ending in January. At earlier stages of processing, producer prices of core intermediate materials rose moderately in May after five months of large increases. Inflation compensation based on Treasury inflation-protected securities decreased recently in response to low readings on inflation and falling oil prices. Survey measures of both short- and long-term inflation expectations remained relatively stable.

Unit labor costs continued to be restrained by weakness in hourly compensation and further gains in productivity. Revised estimates of labor compensation indicated that hourly compensation in the nonfarm business sector was about flat, on net, during the fourth quarter of 2009 and the first quarter of 2010. The employment cost index showed a moderate rise over the period, boosted by a sizable increase in benefit costs in the first quarter. The year-over-year increase in average hourly earnings of all employees was also moderate through May. Output per hour in the nonfarm business sector, which rose rapidly in 2009, posted a more moderate but still-solid gain in the first quarter of 2010.

The U.S. international trade deficit widened slightly in April, as nominal exports fell a bit more than nominal imports. The April declines in both exports and imports followed robust increases in March. The April fall in exports reflected declines in exports of consumer goods, primarily due to a drop in pharmaceuticals, and in agricultural goods. Exports of industrial supplies moved up while exports of capital goods were flat after increasing strongly in March. Imports in April were pulled down by lower imports of consumer goods, which more than offset sharply higher imports of capital goods, particularly computing equipment. Imports of automotive products and non-oil industrial supplies declined slightly, and imports of petroleum products were flat following a large increase in March.

Incoming data suggested that economic activity abroad continued to expand at a strong pace in the first half of the year. Among the advanced foreign economies, growth of real gross domestic product (GDP) in the first quarter was particularly strong in Canada and Japan, and recent indicators for those countries pointed to continued solid increases in the second quarter. In contrast, the rise in economic activity in the euro area was subdued, as favorable readings for the manufacturing sector were counterbalanced by weakness in domestic demand. Since the time of the April meeting of the Federal Open Market Committee (FOMC), concerns about the fiscal situation of several euro-area countries intensified sharply. In response, European authorities announced a number of policy measures, including acceleration of fiscal consolidation plans in some countries, finalization of an International Monetary Fund (IMF) and European Union (EU) assistance package for Greece, and the introduction of a broader €500 billion financial assistance program that could be complemented by bilateral IMF lending. The European Central Bank (ECB) also announced further measures to improve liquidity conditions in impaired markets, including a program to purchase sovereign and private debt.

Economic activity in emerging market economies continued to expand briskly in the first half of this year. Growth of economic activity was particularly robust in emerging Asia, driven in part by strong increases in industrial production and exports associated with solid gains in final demand as well as the turn in the inventory cycle. The rise of real GDP in Latin America appeared to have stalled in the first quarter, but this development reflected a contraction in Mexico that more-favorable monthly indicators suggested should prove temporary. In contrast, the increase in Brazilian real GDP was very strong. Consumer price inflation in the foreign economies in aggregate was buoyed by higher food and energy prices in the first quarter, while core inflation generally remained subdued. More recent information suggested some moderation in foreign inflation in the second quarter.

Staff Review of the Financial Situation

The FOMC's decision at its April meeting to maintain the 0 to ¼ percent target range for the federal funds rate and the wording of the accompanying statement were largely in line with expectations and prompted little market reaction. Economic data releases were mixed, on balance, over the intermeeting period, but market participants were especially attentive to incoming information on the labor market—most notably, the private payroll figures in the employment report for May, which were considerably weaker than investors expected. Those data, combined with heightened concerns about the global economic outlook stemming in part from Europe's sovereign debt problems, contributed to a downward revision in the expected path of policy implied by money market futures rates.

In the market for Treasury coupon securities, 2- and 10-year nominal yields fell considerably over the intermeeting period. Market participants pointed to flight-to-quality flows and greater concern about the economic outlook as factors boosting the demand for Treasury securities. The drop in Treasury yields was accompanied by a small widening of swap spreads.

Conditions in short-term funding markets deteriorated somewhat, particularly for European financial institutions. Spreads of the term London interbank offered rate, or Libor, over rates on overnight index swaps widened noticeably, with the availability of funding at maturities longer than one week reportedly quite limited. Market participants also reduced holdings of commercial paper sponsored by entities thought to have exposures to peripheral European financial institutions and governments. Even so, spreads of high-grade unsecured financial commercial paper to nonfinancial commercial paper widened only modestly over the intermeeting period. In secured funding markets, spreads on asset-backed commercial paper also widened modestly, while rates on repurchase agreements involving Treasury and agency collateral changed little. In the inaugural Senior Credit Officer Opinion Survey on Dealer Financing Terms, which was conducted by the Federal Reserve between May 24 and June 4, dealers generally reported that the terms on which they provided credit remained tight relative to those at the end of 2006. However, they noted some loosening of terms for both securities financing and over-the-counter derivatives transactions, on net, over the previous three months for certain classes of clients—including hedge funds, institutional investors, and nonfinancial corporations—and intensified efforts by those clients to negotiate more-favorable terms. At the same time, they reported a pickup in demand for financing across several collateral types over the past three months.

Broad U.S. stock price indexes fell over the intermeeting period, in part reflecting deepening concerns about the European fiscal situation and its potential for adverse spillovers to global economic growth. Option-implied volatility on the S&P 500 index spiked in mid-May, to more than double its value at the time of the April FOMC meeting, but largely reversed its run-up by the time of the June meeting. The spread between the staff's estimate of the expected real return on equities over the next 10 years and an estimate of the expected real return on a 10-year Treasury note—a measure of the equity risk premium—increased from its already elevated level.

Investors' attitudes toward financial institutions deteriorated somewhat, as the equity of financial firms underperformed the broader market amid uncertainty about the implications of developments in Europe and the potential effects of financial regulatory reform. Yields on investment- and speculative-grade corporate bonds moved higher over the intermeeting period, and high-yield bond mutual funds recorded substantial net outflows. Spreads on corporate bonds widened, although they remained within the range prevailing since last summer. Secondary-market bid prices on syndicated leveraged loans fell, while bid-asked spreads in that market widened.

Net debt financing by nonfinancial corporations increased in April and May relative to its pace in the first quarter. Gross bond issuance by investment-grade nonfinancial corporations in the United States remained solid, on average, over those two months; nonfinancial commercial paper outstanding increased as well. High-yield corporate bond issuance in the United States briefly paused in May, reflecting the market's pullback from risky assets, although speculative-grade U.S. firms continued to issue bonds abroad and a few placed issues domestically in the first half of June. Gross equity issuance fell a bit, on net, in April and May, likely due in part to recent declines in equity prices and elevated market volatility. Measures of the credit quality of nonfinancial firms generally continued to improve, and first-quarter profits for firms in the S&P 500 jumped substantially, primarily reflecting an upturn in financial sector profits from quite depressed levels. The outlook in commercial real estate markets stayed weak; prices of commercial properties fell a bit further in the first quarter, and the volume of commercial property sales remained light. The delinquency rate for securitized commercial mortgages continued to climb in May, and indexes of prices of credit default swaps on commercial mortgages declined, on net, over the intermeeting period.

Consumer credit contracted again in recent months, as revolving credit continued on a steep downtrend. Issuance of consumer credit asset-backed securities (ABS) increased in May, although the pace was still well below that observed before the onset of the financial crisis. Credit card ABS issuance remained subdued, partly reflecting regulatory changes that made financing credit card receivables via securitization less desirable. In primary markets, spreads of credit card interest rates over those on Treasury securities remained extremely high in April, while interest rate spreads on auto loans stayed near their average level of the past decade. Consumer credit quality improved further, with delinquency rates on credit cards and auto loans moving down a bit in April.

Bank credit declined, on average, in April and May at about the same pace as in the first quarter. Commercial and industrial loans, after dropping rapidly in April, decreased at a slower pace in May. While commercial real estate and home equity loans fell at a slightly faster rate than in recent quarters, the contraction in closed-end residential loans abated, partly because of a reduced pace of sales to Fannie Mae and Freddie Mac. Consumer loans declined again, on average, in April and May. The amount of Treasury and agency securities held by large domestic banks and foreign-related institutions declined in May, contributing to a sizable drop in banks' securities holdings.

On a seasonally adjusted basis, M2 contracted in April but surged in May, with much of the month-to-month variation apparently associated with the effects of federal tax payments and refunds. Averaging across the two months, M2 expanded moderately after having been about unchanged in the first quarter; liquid deposits accounted for most of the net change.

The threat to global economic growth and financial stability posed by the fiscal situation in some European nations sparked widespread flight-to-quality flows over most of the intermeeting period. This retreat led to a broad appreciation of the dollar as well as declines in equity prices abroad and in yields on benchmark sovereign bonds. However, investor sentiment improved near the end of the period, leading to a partial reversal in some of these movements, despite Moody's downgrade of Greece to below-investment-grade status in mid-June. On net, the dollar ended the intermeeting period up, most headline equity indexes fell, and benchmark government bond yields declined. Strains in euro-area bank funding markets reemerged during the period. In response, the ECB announced some changes to its liquidity operations that would provide greater market access to term funding in euros.[3] Difficulties also appeared in corporate debt markets as both nonfinancial and financial corporate debt issuance dropped substantially in May. In addition, pressures in dollar funding markets reappeared for foreign financial institutions, especially those thought to have significant exposure to Greece and other peripheral euro-area countries. To help contain these pressures and to prevent their spread to other institutions and regions, the Federal Reserve reestablished dollar liquidity swap arrangements with the ECB, the Bank of England, the Bank of Japan, the Bank of Canada, and the Swiss National Bank.

Yields on the sovereign obligations of peripheral European countries declined noticeably following a May 10 announcement of a framework established by the EU for providing financial aid to euro-area governments and of the ECB's intention to purchase euro-area sovereign debt. However, yields remained high even after these announcements and moved up subsequently, notwithstanding the ECB's purchases of government debt. Amid a weakening outlook for economic growth in Europe, central banks in several emerging European economies began to decrease policy rates. By contrast, brighter economic prospects in Canada and China prompted the Bank of Canada to raise its target for the overnight rate to 50 basis points at its June meeting and Chinese authorities to raise banks' reserve requirement further in May. In addition, the People's Bank of China announced late in the period that it would allow the renminbi to move more flexibly, and the currency appreciated slightly immediately following the announcement.

Staff Economic Outlook

In the economic forecast prepared for the June FOMC meeting, the staff continued to anticipate a moderate recovery in economic activity through 2011, supported by accommodative monetary policy, an attenuation of financial stress, and strengthening consumer and business confidence. While the recent data on production and spending were broadly in line with the staff's expectations, the pace of the expansion over the next year and a half was expected to be somewhat slower than previously predicted. The intensifying concerns among investors about the implications of the fiscal difficulties faced by some European countries contributed to an increase in the foreign exchange value of the dollar and a drop in equity prices, which seemed likely to damp somewhat the expansion of domestic demand. The implications of these less-favorable factors for U.S. economic activity appeared likely to be only partly offset by lower interest rates on Treasury securities, other highly rated securities, and mortgages, as well as by a lower price for crude oil. The staff still expected that the pace of economic activity through 2011 would be sufficient to reduce the existing margins of economic slack, although the anticipated decline in the unemployment rate was somewhat slower than in the previous projection.

The staff's forecasts for headline and core inflation were also reduced slightly. The changes were a response to the lower prices of oil and other commodities, the appreciation of the dollar, and the greater amount of economic slack in the forecast. Despite these developments, inflation expectations had remained stable, likely limiting movements in inflation. On balance, core inflation was expected to continue at a subdued rate over the projection period.

3 The ECB reinstituted a six-month lending operation and switched its three-month lending operations from fixed-quantity auctions to full-allotment offerings at a fixed rate of 1 percent.

As in earlier forecasts, headline inflation was projected to move into line with the core rate by 2011.

Participants' Views of Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants—the five members of the Board of Governors and the presidents of the 12 Federal Reserve Banks—provided projections of economic growth, the unemployment rate, and consumer price inflation for each year from 2010 through 2012 and over a longer horizon. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks. Participants' forecasts through 2012 and over the longer run are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, meeting participants generally saw the incoming data and information received from business contacts as consistent with a continued, moderate recovery in economic activity. Participants noted that the labor market was improving gradually, household spending was increasing, and business spending on equipment and software had risen significantly. With private final demand having strengthened, inventory adjustments and fiscal stimulus were no longer the main factors supporting economic expansion. In light of stable inflation expectations and incoming data indicating low rates of inflation, policymakers continued to anticipate that both overall and core inflation would remain subdued through 2012. However, financial markets were generally seen as recently having become less supportive of economic growth, largely reflecting international spillovers from European fiscal strains. In part as a result of the change in financial conditions, most participants revised down slightly their outlook for economic growth, and about one-half of the participants judged the balance of risks to growth as having moved to the downside. Most participants continued to see the risks to inflation as balanced. A number of participants expressed the view that, over the next several years, both employment and inflation would likely be below levels they consider to be consistent with their dual mandate, but they anticipated that, with appropriate monetary policy, both would rise over time to levels consistent with the Federal Reserve's objectives.

Financial markets had become somewhat less supportive of economic growth since the April meeting, with the developments in Europe cited as a leading cause of greater global financial market tensions. Risk spreads for many corporate borrowers had widened noticeably, equity prices had fallen appreciably, and the dollar had risen in value against a broad basket of other currencies. Participants saw these changes as likely to weigh to some degree on household and business spending over coming quarters. Participants also noted ongoing difficulties in financing commercial real estate. Nonetheless, reports suggested that more-creditworthy business borrowers were still able to obtain funding in the open markets on fairly attractive terms, and a couple of participants noted that credit from the banking sector, which had been contracting for some time, was showing some tentative signs of stabilizing. Moreover, several participants observed that the decline in yields on Treasury securities resulting from the global flight to quality was positive for the domestic economy; in particular, the associated decline in mortgage rates was seen as potentially helpful in supporting the housing sector.

Supporting the view of a continued recovery, incoming data and anecdotal reports pointed to strength in a number of business sectors, particularly manufacturing and transportation. Policymakers noted that firms' investment in equipment and software had advanced rapidly of late, and they anticipated that such spending would continue to rise, though perhaps at a somewhat slower pace. Business contacts suggested that investment spending had been supported by the replacement and upgrading of existing capital, making up for some spending that had been postponed in the downturn, and this component of investment demand was seen as unlikely to remain robust. In addition, inventory accumulation, which had been a significant contributor to recent gains in production, appeared likely to provide less impetus to growth in coming quarters. Participants also noted that several uncertainties, including those related to legislative changes and to developments in global financial markets, were generating a heightened level of caution that could lead some firms to delay hiring and planned investment outlays.

Participants commented that household spending continued to advance, with notable increases in auto sales and expenditures on other durable goods. Going forward, consumption spending was expected to continue to post moderate gains, with the effects of income growth and improved confidence as the economy recovers more than offsetting the effects of lower stock prices and housing wealth. However, continued labor market weakness could weigh on consumer sentiment, and households were still repairing their balance sheets; both factors could restrain consumer spending going forward. Although readings from the housing sector had been strong through mid-spring, participants noted that the strength likely reflected the effects of the temporary tax credits for homebuyers. Indeed, data for the most recent month suggested that, with the expiration of those provisions, home sales and starts had stepped down noticeably and could remain weak in the near term; with lower demand and a continuing supply of foreclosed houses coming to market, participants judged that house prices were likely to remain flat or decline somewhat further in the near term.

Meeting participants interpreted the data on the labor market as consistent with their outlook for gradual recovery. Employers were adding hours to the workweek and hiring temporary workers, suggesting a pickup in labor demand; however, the most recent data on employment had been disappointing, and new claims for unemployment insurance remained elevated. Reportedly, employers were still cautious about adding to payrolls, given uncertainties about the outlook for the economy and government policies. Participants expected the pace of hiring to remain low for some time. Indeed, the unemployment rate was generally expected to remain noticeably above its long-run sustainable level for several years, and participants expressed concern about the extended duration of unemployment spells for a large number of workers. Participants also noted a risk that continued rapid growth in productivity, though clearly beneficial in the longer term, could in the near term act to moderate growth in the demand for labor and thus slow the pace at which the unemployment rate normalizes.

A broad set of indicators suggested that underlying inflation remained subdued and was, on net, trending lower. The latest readings on core inflation—which excludes the relatively volatile prices of food and energy—had slowed, and other measures of the underlying trajectory of inflation, such as median and trimmed-mean measures, also had moved down this year. Crude oil prices declined somewhat over the intermeeting period, a factor that was likely to damp headline inflation at the consumer level in coming months. Other commodity prices were moderating, and nominal wages appeared to be rising only slowly. Some participants indicated that they viewed the substantial slack in labor and resource markets as likely to reduce inflation. The financial strains in Europe had led to an increase in the foreign exchange value of the dollar, and the resulting downward pressure on import prices also was expected to weigh on consumer prices for a time. However, inflation expectations were seen by most participants as well anchored, which would tend to curb any tendency for actual inflation to decline. On balance, meeting participants revised down modestly their outlook for inflation over the next couple of years; they generally expected inflation to be quite low in the near term and to trend slightly higher over time.

Some participants judged the risks to the outlook for inflation as tilted to the downside, particularly in the near term, in light of the large amount of resource slack already prevailing in the economy, the significant downside risks to the outlook for real activity, and the possibility that inflation expectations could begin to decline in response to low actual inflation. A few participants cited some risk of deflation. Other participants, however, thought that inflation was unlikely to fall appreciably further given the stability of inflation expectations in recent years and very accommodative monetary policy. Over the medium term, participants saw both upside and downside risks to inflation. Several participants noted that a continuation of lower-than-expected inflation and high unemployment could eventually lead to a downward movement in inflation expectations that would reinforce disinflationary pressures. By contrast, a few participants noted the possibility that a potentially unsustainable fiscal position and the size of the Federal Reserve's balance sheet could boost inflation expectations and actual inflation over time.

Committee Policy Action

In their discussion of monetary policy for the period ahead, members agreed that it would be appropriate to maintain the target range of 0 to 1/4 percent for the federal funds rate. The economic outlook had softened somewhat and a number of members saw the risks to the outlook as having shifted to the downside. Nonetheless, all saw the economic expansion as likely to be strong enough to continue raising resource utilization, albeit more slowly than they had previously anticipated. In addition, they saw inflation as likely to stabilize near recent low readings in coming quarters and then gradually rise toward more desirable levels. In sum, the changes to the outlook were viewed as relatively modest and as not warranting policy accommodation beyond that already in place. However, members noted that in addition to continuing to develop and test instruments to exit from the period of unusually accommodative monetary policy, the Committee would need to consider whether further policy stimulus might become appropriate if the outlook were to worsen appreciably. Given the slightly softer cast of recent data and the shift to less accommodative financial conditions, members agreed that some changes to the statement's characterization of the economic and financial situation were necessary. Nearly all members judged that it was appropriate to reiterate the expectation that economic conditions—including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period. One member, however, believed that continuing to communicate an expectation in the Committee's statement that the federal funds rate would remain at an exceptionally low level for an extended period would create conditions that could lead to macroeconomic and financial imbalances.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in April suggests that the economic recovery is proceeding and that the labor market is improving gradually. Household spending is increasing but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software has risen significantly; however, investment in nonresidential structures continues to be weak and employers remain reluctant to add to payrolls. Housing starts remain at a depressed level. Financial conditions have become less supportive of economic growth on balance, largely reflecting developments abroad. Bank lending has continued to contract in recent months. Nonetheless, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, although the pace of economic recovery is likely to be moderate for a time.
>
> Prices of energy and other commodities have declined somewhat in recent months, and underlying inflation has trended lower. With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.
>
> The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.
>
> The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to promote economic recovery and price stability."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Donald L. Kohn, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he believed that, as the economy completed its first year of modest recovery, it was no longer advisable to indicate that economic and financial conditions were likely to warrant "exceptionally low levels of the federal funds rate for an extended period." Although risks to the forecast remained, Mr. Hoenig was concerned that communicating such an expectation would limit the Committee's flexibility to begin raising rates modestly in a timely fashion and could result in a buildup of future financial imbalances and increase the risks to longer-run macroeconomic and financial stability.

By unanimous vote, the Committee selected William B. English to serve as Secretary and Economist, and James A. Clouse to serve as Associate Economist, effective July 23, 2010, until the selection of their successors at the first regularly scheduled meeting of the Committee in 2011.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 10, 2010. The meeting adjourned at 12:10 p.m. on June 23, 2010.

Conference Call

On May 9, 2010, the Committee met by conference call to discuss developments in global financial markets and possible policy responses. Over the previous several months, market concerns about the ability of Greece and some other euro-area countries to contain their sizable budget deficits and finance their debt had increased. By early May, financial strains had intensified, reflecting investors' uncertainty about whether fiscally stronger euro-area governments would provide financial support to the weakest members, the extent of the drag on euro-area economies that could result from efforts at fiscal consolidation, and the degree of exposure of major European banks and financial institutions to vulnerable countries. Conditions in short-term funding markets in Europe had also deteriorated, and global financial markets more generally had been volatile and less supportive of economic growth.

The Chairman indicated that European authorities were considering a number of measures to promote fiscal sustainability and to provide increased liquidity and support to money markets and markets for European sovereign debt. In connection with the possible implementation of these measures, some major central banks had requested that dollar liquidity swap lines with the Federal Reserve be reestablished. These swap lines would enhance the ability of these central banks to provide support for dollar funding markets in their jurisdictions. The terms and conditions of the swap lines would generally be similar to those in place prior to their expiration earlier in the year.

The Committee discussed considerations surrounding the possible reestablishment of dollar liquidity swap lines. Participants agreed that such arrangements could be helpful in limiting the strains in dollar funding markets and the adverse implications of recent developments for the U.S. economy. Participants observed that, in current circumstances, the dollar swap lines should be made available to a smaller number of major foreign central banks than previously. In order to promote the transparency of these arrangements, participants agreed that it would be appropriate for the Federal Reserve to publish the swap contracts and to release on a weekly basis the amounts of draws under the swap lines by central bank counterparty. It was recognized that the Committee would need to consider the implications of swap lines for bank reserves and overall management of the Federal Reserve's balance sheet. Participants noted the importance of appropriate consultation with U.S. government officials and emphasized that a reestablishment of the lines should be contingent on strong and effective actions by authorities in Europe to address fiscal sustainability and support financial markets.

At the conclusion of the discussion, the Committee voted unanimously to approve the following resolution:

> "The Committee authorizes the Chairman to agree to establish swap lines with the European Central Bank, the Bank of England, the Swiss National Bank, the Bank of Japan, and the Bank of Canada, as discussed by the Committee today."

> Secretary's note: Later on May 9, 2010, the Federal Reserve, in coordination with the Bank of Canada, the Bank of England, the European Central Bank (ECB), and the Swiss National Bank, announced that U.S. dollar liquidity swap facilities had been reestablished with those central banks. The arrangements with the Bank of England, the ECB, and the Swiss National Bank provide these central banks with the capacity to conduct tenders of U.S. dollars in their local markets at fixed rates for full allotment, similar to arrangements that had been in place previously. The arrangement with the Bank of Canada would support drawings of up to $30 billion, as was the case previously. On May 10, the Federal Reserve and the Bank of Japan (BOJ) announced that a temporary U.S.

dollar liquidity swap arrangement had been established that would provide the BOJ with the capacity to conduct tenders of U.S. dollars at fixed rates for full allotment.

Notation Vote

By notation vote completed on May 17, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on April 27–28, 2010.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the June 22–23, 2010, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation for the years 2010 to 2012 and over the longer run. The projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

FOMC participants' forecasts for economic activity and inflation suggested that they expected the recovery to continue and inflation to remain subdued, but with, on balance, slightly weaker real activity and a bit lower inflation than in the projections they made in conjunction with the April 2010 FOMC meeting. As depicted in **figure 1**, the economic recovery was anticipated to be gradual, with real gross domestic product (GDP) expanding at a pace only moderately above the participants' assessment of its longer-run sustainable growth rate and the unemployment rate slowly trending lower over the next few years. Most participants also anticipated that inflation would remain relatively low over the forecast period. As indicated in **table 1**, participants generally made modest downward revisions to their projections for real GDP growth for the years 2010 to 2012, as well as modest upward revisions to their projections for the unemployment rate for the same period. Participants also revised down a little their projections for inflation over the forecast period. Several participants noted that these revisions were largely the result of the incoming economic data and the anticipated effects of developments abroad on U.S. financial markets and the economy. Overall, participants con-

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, June 2010
Percent

Variable	Central tendency[1]				Range[2]			
	2010	2011	2012	Longer run	2010	2011	2012	Longer run
Change in real GDP	3.0 to 3.5	3.5 to 4.2	3.5 to 4.5	2.5 to 2.8	2.9 to 3.8	2.9 to 4.5	2.8 to 5.0	2.4 to 3.0
April projection	3.2 to 3.7	3.4 to 4.5	3.5 to 4.5	2.5 to 2.8	2.7 to 4.0	3.0 to 4.6	2.8 to 5.0	2.4 to 3.0
Unemployment rate	9.2 to 9.5	8.3 to 8.7	7.1 to 7.5	5.0 to 5.3	9.0 to 9.9	7.6 to 8.9	6.8 to 7.9	5.0 to 6.3
April projection	9.1 to 9.5	8.1 to 8.5	6.6 to 7.5	5.0 to 5.3	8.6 to 9.7	7.2 to 8.7	6.4 to 7.7	5.0 to 6.3
PCE inflation	1.0 to 1.1	1.1 to 1.6	1.0 to 1.7	1.7 to 2.0	0.9 to 1.8	0.8 to 2.4	0.5 to 2.2	1.5 to 2.0
April projection	1.2 to 1.5	1.1 to 1.9	1.2 to 2.0	1.7 to 2.0	1.1 to 2.0	0.9 to 2.4	0.7 to 2.2	1.5 to 2.0
Core PCE inflation[3]	0.8 to 1.0	0.9 to 1.3	1.0 to 1.5		0.7 to 1.5	0.6 to 2.4	0.4 to 2.2	
April projection	0.9 to 1.2	1.0 to 1.5	1.2 to 1.6		0.7 to 1.6	0.6 to 2.4	0.6 to 2.2	

Note: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The April projections were made in conjunction with the meeting of the Federal Open Market Committee on April 27–28, 2010.

[1] The central tendency excludes the three highest and three lowest projections for each variable in each year.

[2] The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.

[3] Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2010–12 and over the longer run

NOTE: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

tinued to expect the pace of the economic recovery to be held back by a number of factors, including household and business uncertainty, persistent weakness in real estate markets, only gradual improvement in labor market conditions, waning fiscal stimulus, and slow easing of credit conditions in the banking sector. Participants generally anticipated that, in light of the severity of the economic downturn, it would take some time for the economy to converge fully to its longer-run path as characterized by sustainable rates of output growth, unemployment, and inflation consistent with participants' interpretation of the Federal Reserve's dual objectives; most expected the convergence process to take no more than five to six years. About one-half of the participants now judged the risks to the growth outlook to be tilted to the downside, while most continued to see balanced risks surrounding their inflation projections. Participants generally continued to judge the uncertainty surrounding their projections for both economic activity and inflation to be unusually high relative to historical norms.

The Outlook

Participants' projections for real GDP growth in 2010 had a central tendency of 3.0 to 3.5 percent, slightly lower than in April. Participants noted that the economic recovery was proceeding. Consumer spending was increasing, supported by rising disposable income as labor markets gradually improved. Business outlays on equipment and software were also rising, driven by replacement spending, the low cost of capital, and increased production. Participants pointed to a number of factors that would provide ongoing support to economic activity, including accommodative monetary policy and still generally supportive conditions in financial markets. Fiscal policy was also seen as currently contributing to economic growth, although participants expected that the effects of fiscal stimulus would diminish going forward and also anticipated that budgetary pressures would continue to weigh on spending at the state and local levels. Participants noted that financial conditions had tightened somewhat because of developments abroad. The effects of a stronger dollar, a lower stock market, and wider corporate credit spreads were expected to be offset only partially by lower oil and commodity prices and a decline in Treasury yields. Many participants anticipated that the economic expansion would be held back by firms' caution in hiring and spending in light of the considerable uncertainty regarding the economic outlook, by households' focus on repairing balance sheets weakened by equity and house price declines, and by tight credit conditions for small businesses and households.

Looking further ahead, the central tendencies of participants' projections for real GDP growth were 3.5 to 4.2 percent in 2011 and 3.5 to 4.5 percent in 2012. Participants generally expected a rebound in spending on housing, consumer durables, and business capital equipment as household income and balance sheets strengthen, credit becomes more widely available, and the recovery is seen by households and firms as more firmly established. Nevertheless, participants cited several factors that could restrain the pace of expansion over the next two years, including a rising household saving rate as households seek to make further progress in repairing balance sheets, persistent uncertainty on the part of households and businesses about the strength of the recovery, spillovers from fiscal strains abroad to U.S. financial markets and the U.S. economy, and continued weakness in residential construction. Moreover, despite improvements in the condition of banking institutions, strains in the commercial real estate sector were seen as posing risks to the balance sheets of such institutions for some time. Terms and standards on bank loans continued to be restrictive, and participants anticipated only a gradual loosening of credit conditions for many households and smaller firms. In the absence of further shocks, participants generally expected that real GDP growth would eventually settle down at an annual rate of 2.5 to 2.8 percent, a pace that appeared to be sustainable in view of expected long-run trends in the labor force and labor productivity.

Participants anticipated that labor market conditions would improve slowly over the next several years. The central tendency of their projections for the average unemployment rate in the fourth quarter of 2010 was 9.2 to 9.5 percent. Consistent with their expectations of a gradual economic recovery, participants generally anticipated that the unemployment rate would decline to 7.1 to 7.5 percent by the end of 2012, remaining well above their assessments of its longer-run sustainable rate. Although a few participants were concerned about a possible decrease in the sustainable level of employment resulting from ongoing structural adjustments in product and labor markets, participants' longer-term unemployment projections had a central tendency of 5.0 to 5.3 percent, the same as in April.

Participants noted that prices of energy and other commodities declined somewhat in recent months, and underlying inflation trended lower. They generally expected inflation to remain subdued over the next several years. Indeed, most of the participants marked down a bit their projections for inflation over the forecast period: The central tendency of their projections for personal consumption expenditures (PCE) inflation was 1.0 to 1.1 percent for 2010, 1.1 to 1.6 percent for 2011, and 1.0 to 1.7 percent for 2012, generally about ¼ percentage point lower than in April. The central tendencies of participants' projections for core PCE inflation followed a broadly similar path, although headline PCE inflation was expected to run slightly above core PCE inflation over the forecast period, reflecting somewhat more rapid increases in food and energy prices. Most participants anticipated that, with appropriate monetary policy, inflation would rise gradually toward the inflation rate that they individually consider most consistent with the Federal Reserve's dual mandate for maximum employment and stable prices. The central tendency of participants' projections of the longer-run, mandate-consistent inflation rate was 1.7 to 2.0 percent, unchanged from April. A majority of participants anticipated that inflation in 2011 and 2012 would continue to be below their assessments of the mandate-consistent inflation rate.

Uncertainty and Risks

Most participants judged that their projections of future economic activity and unemployment continued to be subject to greater-than-average uncertainty, while a few viewed the uncertainty surrounding their outlook for growth and unemployment as in line with typical levels.[4] About one-half of the participants saw the risks to their growth outlook as tilted to the downside; in contrast, in April a large majority of participants saw the risks to growth as balanced. In the current survey, a substantial number of participants also viewed the risks to unemployment as tilted to the upside. The remaining participants saw the risks to the projections for economic growth and unemployment as roughly balanced. Participants pointed to developments abroad and their possible ramifications for U.S. financial markets and the U.S. economy as suggesting somewhat greater uncertainty about the path of economic growth. In addition, some participants cited the unusual rise in the unemployment rate last year, which was associated with rapid growth in labor productivity, as contributing to increased uncertainty regarding the outlook for employment and economic activity. Participants who judged that the risks to their growth outlook were tilted to the downside pointed to recent developments abroad and the risk of further contagion, together with the potential for an increase in risk aversion among investors, as important factors contributing to their assessment. Participants noted that problems in the commercial real estate market and the effects of financial regulatory reform could lead to greater constraints on credit availability, thereby restraining growth of output and employment. However, some participants viewed the downside risks to the growth outlook as roughly balanced by upside risks; they saw the possibility that monetary policy might remain accommodative for too long as one reason that growth could prove stronger than expected.

As in April, most participants continued to see the uncertainty surrounding their inflation projections as above average. Still, a few judged that uncertainty in the outlook for inflation was about in line with or lower than typical levels. Most participants judged the risks to the inflation outlook as roughly balanced. As factors accounting for elevated uncertainty regarding the outlook for inflation, participants pointed to the extraordinary degree of monetary policy accommodation, the uncertain timing of the exit from accommodation, and the unusually large gap between expected inflation, as measured by surveys of households and businesses, and current infla-

Table 2. Average historical projection error ranges
Percentage points

Variable	2010	2011	2012
Change in real GDP[1]	±1.0	±1.6	±1.8
Unemployment rate[1]	±0.4	±1.2	±1.5
Total consumer prices[2]	±0.9	±1.0	±1.1

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1990 through 2009 that were released in the summer by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 For definitions, refer to general note in table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

4 Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1990 to 2009. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risk attending participants' projections.

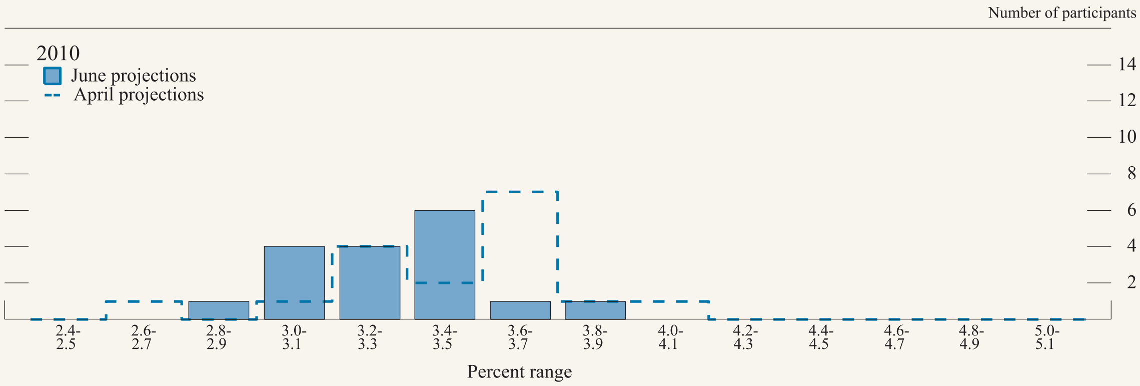
tion. Participants noted that, despite the downward trend in underlying inflation in recent months, inflation expectations continued to be well anchored. Nonetheless, the possibility that inflation expectations might start to decline in response to persistently low levels of actual inflation and the potential effects of continued weakness of the economy on price trends were seen by a few participants as posing some downside risks to the inflation outlook.

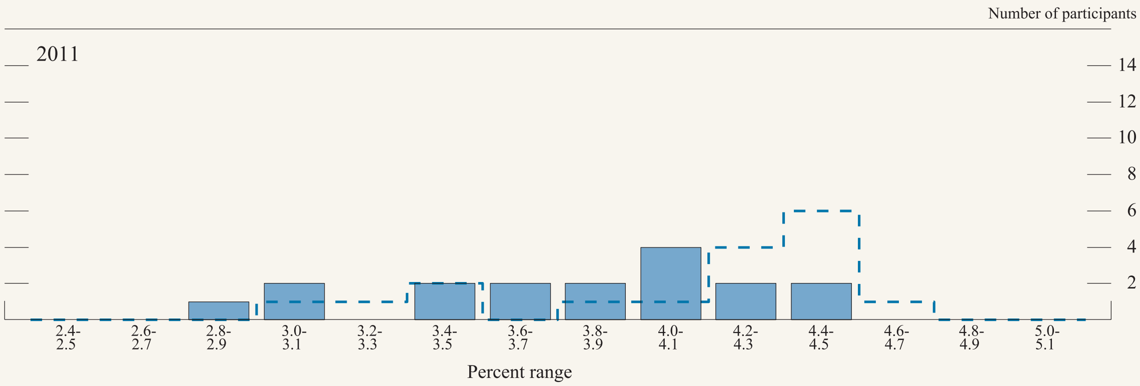
Diversity of Views

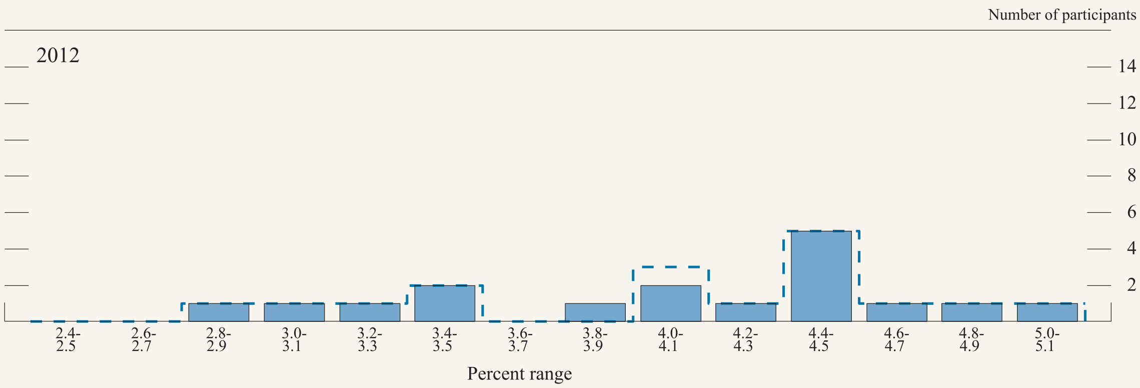
Figures 2.A and 2.B provide further details on the diversity of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate. The distribution of participants' projections for real GDP growth this year was slightly narrower than the distribution in April, but the distributions for real GDP growth in 2011 and 2012 were about unchanged. As in earlier projections, the dispersion in forecasts for output growth appeared to reflect the diversity of their assessments regarding the current degree of underlying momentum in economic activity, the evolution of consumer and business sentiment, the degree of support to economic growth provided by financial markets, the effects of monetary policy accommodation, and other factors. Regarding participants' projections for the unemployment rate, the distributions shifted somewhat higher for the years 2010 to 2012. The distributions of their estimates of the longer-run sustainable rates of output growth and unemployment were little changed from April.

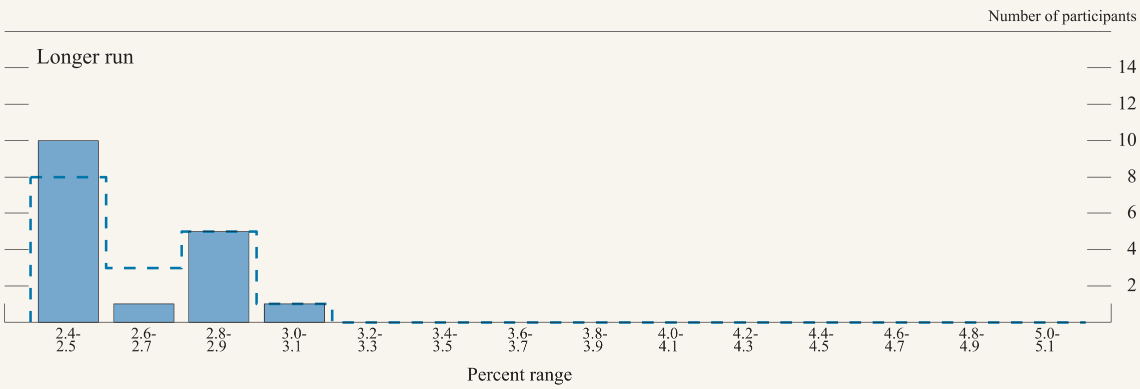
Corresponding information about the diversity of participants' views regarding the inflation outlook is provided in figures 2.C and 2.D . The distributions of projections for overall and core PCE inflation for 2010 shifted lower relative to the distributions in April, and the distributions were noticeably more tightly concentrated. The distributions of overall and core inflation for 2011 and 2012, however, were generally little changed and remained fairly wide. The dispersion in participants' projections over the next few years was mainly due to differences in their judgments regarding the determinants of inflation, including their estimates of prevailing resource slack and their assessments of the extent to which such slack affects actual and expected inflation. In contrast, the relatively tight distribution of participants' projections for longer-run inflation illustrates their substantial agreement about the measured rate of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2010–12 and over the longer run



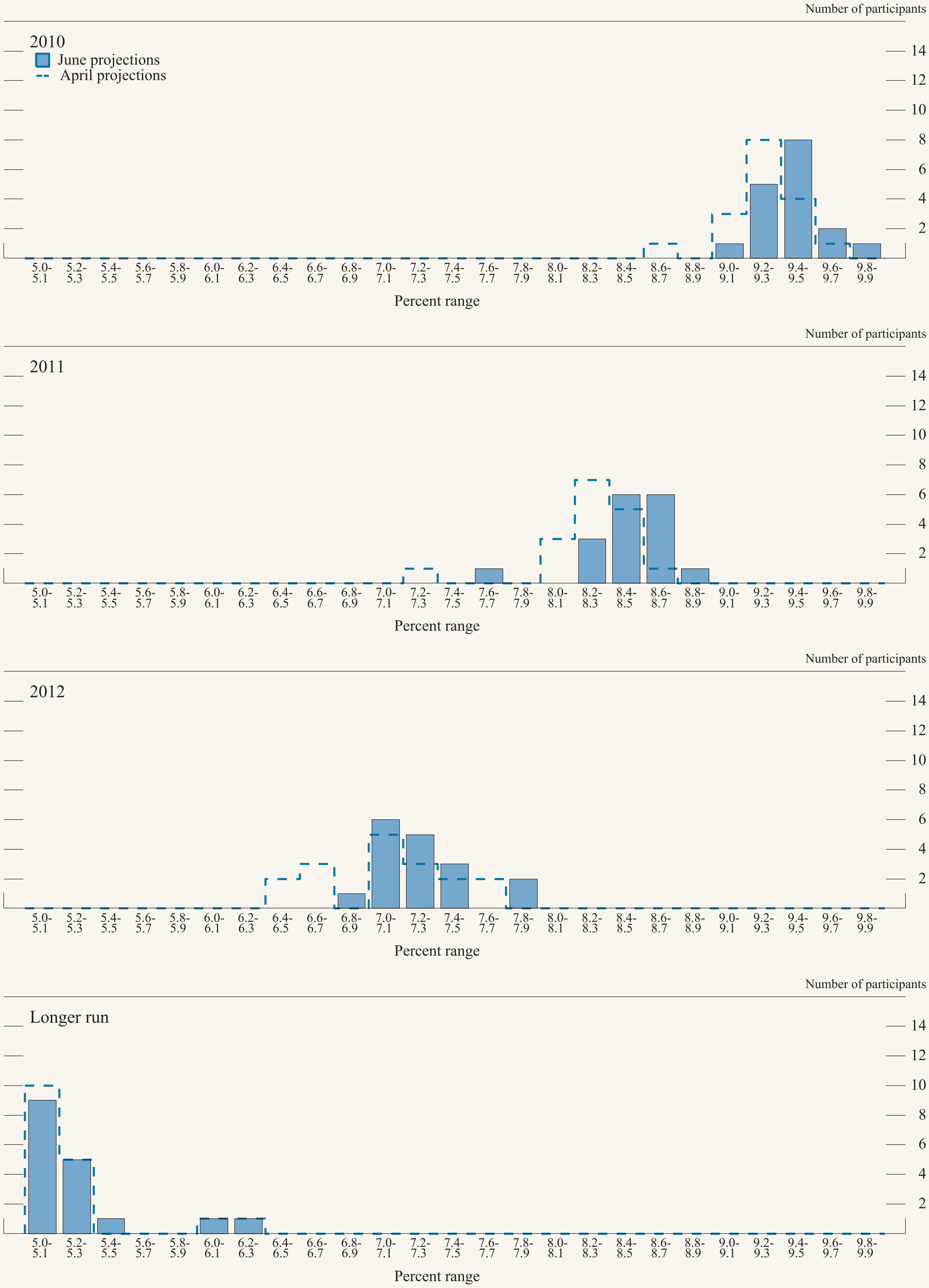






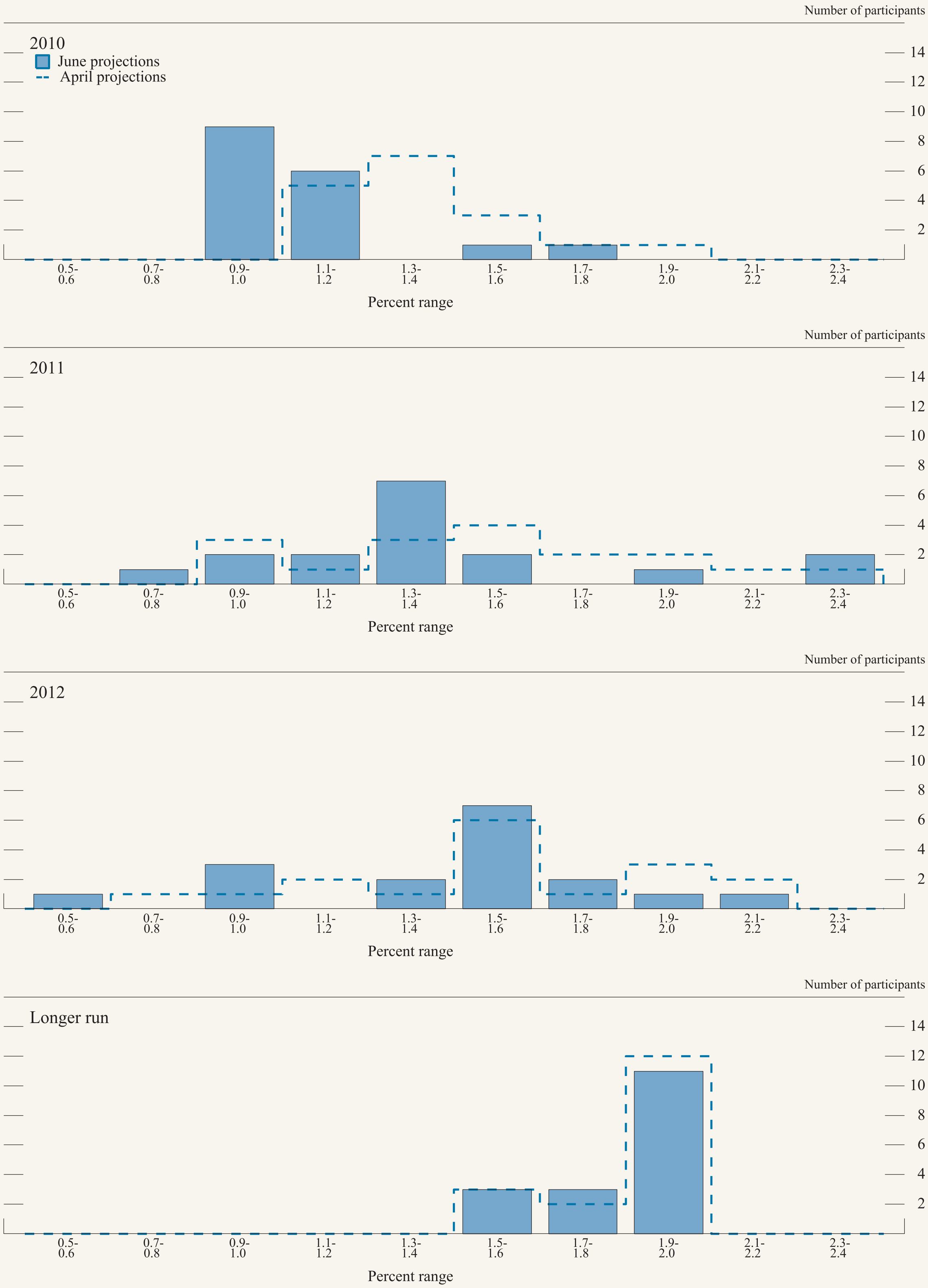
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2010–12 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2010–12 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2010–12

Note: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past Monetary Policy Reports and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.0 to 4.0 percent in the current year, 1.4 to 4.6 percent in the second year, and 1.2 to 4.8 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 to 2.9 percent in the current year, 1.0 to 3.0 percent in the second year, and 0.9 to 3.1 percent in the third year.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Meeting Held on August 10, 2010

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, August 10, 2010, at 8:00 a.m.

Present

Ben Bernanke,
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Donald L. Kohn

Sandra Pianalto

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Christine Cumming, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Thomas C. Baxter
Deputy General Counsel

Richard M. Ashton
Assistant General Counsel

Nathan Sheets
Economist

James A. Clouse, Thomas A. Connors, Steven B. Kamin, Lawrence Slifman, Mark S. Sniderman, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Jennifer J. Johnson
Secretary of the Board, Office of the Secretary, Board of Governors

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Robert deV. Frierson
Deputy Secretary, Office of the Secretary, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

William Nelson
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Seth B. Carpenter
Senior Associate Director, Division of Monetary Affairs, Board of Governors

David Reifschneider and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

Stephen A. Meyer
Senior Adviser, Division of Monetary Affairs, Board of Governors

Stephen D. Oliner
Senior Adviser, Division of Research and Statistics, Board of Governors

Brian J. Gross
Special Assistant to the Board, Office of Board Members, Board of Governors

Eric M. Engen
Assistant Director, Division of Research and Statistics, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

John C. Driscoll and Jennifer E. Roush
Senior Economists, Division of Monetary Affairs, Board of Governors

Penelope A. Beattie
Assistant to the Secretary, Office of the Secretary, Board of Governors

Kimberley E. Braun
Records Project Manager, Division of Monetary Affairs, Board of Governors

Randall A. Williams
Records Management Analyst, Division of Monetary Affairs, Board of Governors

David Sapenero
First Vice President, Federal Reserve Bank of St. Louis

Loretta J. Mester and Robert H. Rasche
Executive Vice Presidents, Federal Reserve Banks of Philadelphia and St. Louis, respectively

David Altig, Ron Feldman, Craig S. Hakkio, Glenn D. Rudebusch, Daniel G. Sullivan, and Geoff Tootell
Senior Vice Presidents, Federal Reserve Banks of Atlanta, Minneapolis, Kansas City, San Francisco, Chicago, and Boston, respectively

Linda Goldberg
Vice President, Federal Reserve Bank of New York

Annmarie S. Rowe-Straker
Assistant Vice President, Federal Reserve Bank of New York

Pia Orrenius
Research Officer, Federal Reserve Bank of Dallas

Robert L. Hetzel
Senior Economist, Federal Reserve Bank of Richmond

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the Committee met on June 22–23, 2010. He also reported on System open market operations during the intermeeting period, noting that the Desk at the Federal Reserve Bank of New York had engaged in coupon swap transactions in agency mortgage-backed securities (MBS) to substantially reduce the number of the Committee's earlier agency MBS purchases that remained to be settled. In addition, the Manager briefed the Committee on the System's progress in developing tools for possible future reserve draining operations. The Federal Reserve successfully conducted two more small-value auctions of term deposits to confirm operational readiness for such auctions at the Federal Reserve and at the depository institutions that chose to participate. The Manager noted that the staff was developing plans for additional small-value tests of the Term Deposit Facility. In early August, the Federal Reserve successfully executed a few small-value term reverse repurchase operations, including the first the Federal Reserve conducted using agency MBS as collateral, to ensure operational readiness for such transactions at the Federal Reserve, the clearing banks, and the primary dealers. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions over the intermeeting period.

The Manager also noted the staff's projection that, if mortgage rates were to remain near their levels at the time of the meeting, repayments of principal on the agency MBS held in the SOMA likely would reduce the face value of those holdings by roughly $340 billion from August 2010 through the end of 2011. The level of repayments would be expected to increase further if mortgage rates were to decline from those levels. In addition, about $55 billion of agency debt held in the SOMA portfolio would mature over the same time frame.

Staff Review of the Economic Situation

The information reviewed at the August 10 meeting indicated that the pace of the economic recovery slowed in recent months and that inflation remained subdued. In addition, revised data for 2007 through 2009 from the Bureau of Economic Analysis showed that the recent recession was deeper than previously thought, and, as a result, the level of real gross domestic product (GDP) at the end of 2009 was noticeably lower than estimated earlier. Private employment increased slowly in June and July, and industrial production was little changed in June after a large increase in May. Consumer spending continued to rise at a modest rate in June, and business outlays for equipment and software moved up further. However, housing activity dropped back, and nonresidential construction remained weak. Additionally, the trade deficit widened sharply in May. A further decline in energy prices and unchanged prices for core goods and services led to a fall in headline consumer prices in June.

Private nonfarm employment expanded slowly in recent months. The average monthly gain in private payroll employment during the three months ending in July was small, considerably less than the average increase over the preceding three months. However, average weekly hours of all employees continued to recover. The net addition of jobs in manufacturing and related industries, and in nonbusiness services such as health and education, continued to contribute importantly to the net increase in private employment. Employment in construction and financial activities fell further. The unemployment rate moved down in June from its level earlier in the year, and was unchanged in July, as declining civilian employment was accompanied by decreases in labor force participation. Initial claims for unemployment insurance remained at an elevated level over the intermeeting period.

Industrial production was little changed in June after three months of strong increases. The output of utilities was boosted by unseasonably hot weather while manufacturing production declined. The drop in manufacturing output included a reduction in motor vehicle assemblies, but they were scheduled to increase noticeably in July. The June decrease in factory output also reflected weaker production in industries producing non-automotive consumer goods and construction and business supplies. The output of high-technology items and other business equipment continued to rise. Capacity utilization in manufacturing in June stood well above its mid-2009 low, but it was still substantially short of its longer-run average.

Revised data indicated that consumer spending fell more sharply in 2008 and in the first half of 2009, and subsequently recovered more slowly, than previously estimated. Real personal consumption expenditures (PCE) rose gradually during the second quarter. Sales of light motor vehicles continued to move up, on balance, with the level of sales in July slightly higher than the second-quarter average. Real disposable personal income increased at a noticeably stronger pace than spending in recent months, and the personal saving rate moved up further from the upwardly revised level reported in the revisions to the national income and product accounts. Indicators of household net worth—such as stock prices and house prices—were little changed, on net, over the intermeeting period. Consumer confidence fell back in July, with households expressing greater concern about their personal finances and the outlook for the recovery.

The housing market, which had been supported earlier in the year by activity associated with the homebuyer tax credits, was quite soft for a second consecutive month in June. Sales of new single-family homes rebounded some in June after their sharp drop in May, but they remained at a depressed level. Sales of existing homes fell for a second month in June, and the index of pending home sales suggested another decline in July. Starts of new single-family houses, which had dropped steeply in May, edged down in June to the lowest level since the spring of 2009. The low number of new permits issued in June appeared to signal that little improvement in new homebuilding was likely in July. House prices were largely stable, on balance, in recent months. The interest rate on 30-year fixed-rate conforming mortgages fell further during July, reaching a record low for the 39-year history of the series.

Real business spending on equipment and software rose strongly again in the second quarter, with increases widespread across the categories of spending. New orders for nondefense capital goods excluding aircraft remained on a solid uptrend, although their three-month change for the period ending in June was less rapid than earlier in the year. Survey indicators of business conditions and sentiment softened in July but remained consistent with further gains in production and capital spending in the near term. Business investment in nonresidential structures turned up in the second quarter, with spending boosted by the rise in outlays for drilling and mining structures. The decline in spending for other types of nonresidential buildings appeared to be slowing, and there were a few signs that financial conditions in commercial real estate markets, though still difficult, were stabilizing. In the second quarter, businesses appeared to add to inventories at a faster rate. However, ratios of inventories to sales for most industries did not point to any sizable overhangs.

Inflation remained subdued in recent months. Headline consumer prices declined in May and June because of sizable drops in consumer energy prices. At the same time, the core PCE price index moved up only slightly, and the year-over-year increase in the index in June was lower than earlier in the year. In recent months, prices of core consumer goods continued to decline while prices of non-energy services rose moderately. At earlier stages of production, producer prices of core intermediate materials fell back in June; in contrast, most indexes of spot commodity prices moved up during July. Inflation compensation based on Treasury inflation-protected securities moved down further over the intermeeting period, partly in response to softer-than-expected data on economic activity, but survey measures of short- and long-term inflation expectations were largely stable.

Nominal hourly labor compensation—as measured by compensation per hour in the nonfarm business sector and the employment cost index—rose modestly during the year ending in the second quarter. Average hourly earnings of all employees rose slowly over the 12 months ending in July. Output per hour in the nonfarm business sector declined in the second quarter after rising rapidly in the preceding three quarters. On net, unit labor costs remained well below their level one year earlier.

The U.S. international trade deficit widened sharply in May, as a significant increase in exports was more than offset by a surge in imports. The corresponding decline in real net exports made a significant negative contribution to U.S. GDP growth in the second quarter. The increase in exports was broadly based, with particular strength in exports of capital equipment. Imports of capital goods also were strong, as were imports of consumer goods and automotive products. In contrast, imports of petroleum products fell in May, held back by both lower prices and reduced volumes.

Available data suggested that aggregate GDP growth in foreign economies remained strong in the second quarter. Recent indicators of economic activity for the euro area showed little imprint of the fiscal stresses that emerged in the spring. Industrial production continued to grow in May, with particularly solid gains in Germany and France, and purchasing managers indexes and economic sentiment turned up in July. In Japan, exports continued to support economic growth, even as indicators of household spending remained weak. Machinery orders declined in May, however, and industrial production moved down in June, suggesting some deceleration in economic activity. In the emerging market economies (EMEs), incoming data generally pointed to a moderation of economic growth, albeit to a still-solid pace, with a notable slowing in China in the second quarter. In other EMEs, purchasing managers indexes generally still pointed to expansions in manufacturing activity, though industrial production in many countries began to decelerate. In contrast, Mexican indicators suggested that economic activity rebounded in the second quarter after contracting in the first quarter. Headline inflation rates generally declined abroad, reflecting prior declines in oil and other commodity prices.

Staff Review of the Financial Situation

The decision taken by the Federal Open Market Committee (FOMC) at its June meeting to maintain the 0 to 1/4 percent target range for the federal funds rate was about in line with investor expectations and elicited little market reaction; the same was true of the wording of the accompanying statement. Over the intermeeting period, investors appeared to mark down the path for monetary policy in response to weaker-than-expected economic data releases and Federal Reserve communications that were read as suggesting that policymakers' concerns about the economic outlook had increased.

Reflecting the same factors, yields on nominal Treasury coupon securities fell noticeably on net. Treasury auctions were generally well received, with bid-to-cover ratios mostly exceeding historical averages. Yields on investment- and speculative-grade corporate bonds decreased, and their spreads relative to yields on comparable-maturity Treasury securities declined moderately. Secondary-market bid prices on syndicated leveraged loans rose a bit, while bid-asked spreads in that market edged down.

Conditions in short-term funding markets improved somewhat over the intermeeting period. Spreads of term London interbank offered rates (Libor) over rates on overnight index swaps moved down at most horizons, and liquidity in term funding markets reportedly increased. Spreads on unsecured commercial paper were little changed. In secured funding markets, spreads on asset-backed commercial paper moved down, while rates and haircuts on collateral for repurchase agreements involving Treasury and agency collateral held steady.

Broad U.S. equity price indexes increased slightly, on net, as generally positive corporate earnings news and an easing of investors' worries about the potential effects of fiscal strains in Europe were partly offset by concerns about the strength of the economic recovery. Most firms in the S&P 500 reported second-quarter earnings that exceeded analysts' forecasts. Option-implied volatility on the S&P 500 index declined but remained somewhat elevated by historical standards. The spread between the staff's estimate of the expected real return on equities over the next 10 years and an estimate of the expected real return on a 10-year Treasury note—a rough measure of the equity risk premium—was little changed at an elevated level. Financial stock prices moved about in line with broader indexes, and credit default swap spreads for large financial institutions narrowed moderately.

Gross bond issuance by U.S. investment-grade nonfinancial corporations rebounded in July from relatively subdued levels in May and June. Nonfinancial commercial paper outstanding also increased. Issuance of syndicated leveraged loans rose in the second quarter, but terms on such deals reportedly tightened somewhat. Measures of the credit quality of nonfinancial firms remained solid. Gross equity issuance was moderate in June and July.

Prices of commercial real estate appeared to have increased in the second quarter, though the number of transactions was small. Nonetheless, commercial real estate markets remained under pressure. Delinquency rates for securitized commercial mortgages continued to rise in June, and commercial mortgage debt was estimated to have contracted by a sizable amount again in the second quarter. However, investor demand for high-quality commercial mortgage-backed securities (CMBS) reportedly was robust, although issuance of CMBS remained muted.

Consumer credit contracted again in the second quarter, as revolving credit continued to decline and nonrevolving credit edged down. Issuance of consumer asset-backed securities slowed a bit in July, reflecting, in part, typical seasonal patterns. Consumer credit quality continued to show improvement. Delinquency and charge-off rates for most types of consumer loans moved down in recent months, although these rates remained elevated. Spreads of credit card interest rates over those on Treasury securities stayed elevated in May, while interest rate spreads on auto loans remained near their average level over the past decade.

Commercial banks' core loans—the sum of commercial and industrial (C&I), real estate, and consumer loans—continued to contract in June and July. However, the recent runoff in core loans was appreciably smaller than the declines posted earlier in the year, reflecting a more modest contraction in C&I loans. The July Senior Loan Officer Opinion Survey on Bank Lending Practices showed, for the second straight quarter, that a small net fraction of respondents had eased standards for C&I loans over the previous three months. Commercial real estate loans continued to decline steeply in June and July, and residential real estate loans also decreased. Consumer loans at commercial banks were about flat, on balance, as reductions in credit card loans about offset an increase in nonrevolving consumer loans. Securities holdings by banks increased substantially in recent weeks.

M2 was little changed in July after expanding slightly in the second quarter. Its subdued growth in recent months likely reflected a continued unwinding of earlier safe-haven flows as well as the very low rates of return on some components of M2, particularly small time deposits and retail money market mutual funds.

In foreign exchange markets, the value of the dollar declined on balance over the intermeeting period, likely reflecting some reversal of flight-to-safety flows, better-than-expected European economic data, and the softer economic outlook for the United States. The release of the results of the European Union stress-test exercise, including data on European banks' exposures to sovereign debt, appeared to ease concerns about the potential for severe financial dislocations in Europe. Investors also seemed to take comfort from several oversubscribed auctions of government debt by Spain, Portugal, Ireland, and Greece. Accordingly, risk spreads on these governments' bonds, though elevated, generally declined, and European banks' access to dollar funding improved somewhat. The lack of any disruption to market functioning following the expiration, on July 1, of the European Central Bank's first one-year refinancing operation also supported investor sentiment. Market indicators of expectations for future overnight rates in the euro area shifted up during the period. No changes were made to policy interest rates in the euro area, the United Kingdom, or Japan. The Bank of Canada tightened policy a step further during the period, raising its target for the overnight rate 25 basis points to $3/4$ percent.

Notwithstanding the improved investor sentiment toward Europe, data releases pointing to lower-than-expected growth in economic activity in the United States and China may have weighed on global sovereign bond yields, which declined on net in Canada, Germany, the United Kingdom, and Japan. Equity prices, while up in Europe over the intermeeting period, were little changed in Canada and down in

Japan. By contrast, share prices rose in emerging markets and flows into emerging market equity funds continued to be strong. The central banks of a number of EMEs, including Brazil, Chile, India, Malaysia, South Korea, Taiwan, and Thailand, increased policy interest rates.

Staff Economic Outlook

In the economic forecast prepared for the August FOMC meeting, the staff lowered its projection for the increase in real economic activity during the second half of 2010 but continued to anticipate a moderate strengthening of the expansion in 2011. The softer tone of incoming economic data suggested that the pace of the expansion would be slower over the near term than previously projected. Financial conditions, however, became somewhat more supportive of economic growth. Interest rates on Treasury securities, corporate bonds, and mortgages moved down further over the intermeeting period; the dollar reversed its April to June appreciation; and equity prices edged higher. Over the medium term, the recovery in economic activity was expected to receive support from accommodative monetary policy, further improvement in financial conditions, and greater household and business confidence. Over the forecast period, the increase in real GDP was projected to be sufficient to slowly reduce economic slack, although resource slack was still anticipated to remain quite elevated at the end of 2011.

Overall inflation was projected to remain subdued over the next year and a half. The staff's forecasts for headline and core inflation in 2010 were revised up slightly in response to the higher prices of oil and other commodities and the depreciation of the dollar. Even so, the wide margin of economic slack was projected to contribute to some slowing in core inflation in 2011, though the extent of that slowing would be tempered by stable inflation expectations.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants generally characterized the economic information received during the intermeeting period as indicating a slowing in the pace of recovery in output and employment in recent months. Real GDP growth was noticeably weaker in the second quarter of 2010 than most had anticipated, and monthly data suggested that the pace of recovery remained sluggish going into the third quarter. Private payrolls and consumer spending had risen less than expected. Business spending on equipment and software had increased strongly but reportedly was concentrated in replacements and upgrades that had been postponed during the economic downturn. Investment in nonresidential structures continued to be weak. Housing starts and sales remained at depressed levels, falling back after the expiration of the temporary homebuyer tax credits. The incoming data suggested that economic growth abroad had been somewhat stronger than anticipated and remained solid, boosting U.S. exports and supporting a pickup in U.S. manufacturing output and employment, though a surprising surge in imports in the second quarter widened the U.S. trade deficit. Conditions in financial markets had become somewhat more supportive of growth over the intermeeting period, in part reflecting perceptions of diminished risk of financial dislocations in Europe: Medium- and longer-term interest rates had fallen, some risk spreads had narrowed, and the decline in equity prices that had occurred in the months before the Committee's June meeting had been partly reversed. Moreover, participants saw some indications that credit conditions for households and smaller businesses were beginning to improve, albeit gradually. Thus, while they saw growth as likely to be more modest in the near term, participants continued to anticipate that growth would pick up in 2011.

Revised national income and product account data showed that the contraction in aggregate output during the recent recession had been larger than previously reported. In particular, consumer spending had contracted more over the course of 2008 and the first half of 2009, and recovered less rapidly, than previously estimated, even as households' after-tax incomes had increased more than shown by the earlier data. In combination, these revisions indicated that the personal saving rate had been higher and had risen somewhat more during the past three years than previously thought. Participants recognized that the implications of these new data for the outlook were unclear. On the one hand, the revised data might indicate that households have made greater progress in repairing their balance sheets than had been realized, potentially allowing stronger growth in consumer spending as the recovery proceeds. On the other hand, the revised data might signify that households are seeking to raise their net worth more substantially than previously understood, or to build greater precautionary balances in what they perceive to be a more uncertain economic environment, with the result that growth in consumer spending could remain restrained for some time.

Many participants noted that the protracted downturn in house prices and in residential investment seemed to have ended, although ups and downs in housing starts and home sales associated with the temporary tax credit for homebuyers made it difficult to be certain. A few commented that home sales and prices appeared to be edging up in their Districts. While recognizing that the housing sector likely had bottomed out, participants observed that large inventories of vacant and unsold homes, along with continuing foreclosures that would increase the number of houses for sale, likely would continue to damp residential construction, indicating that a sustained upturn from very low levels was not imminent.

Business investment in equipment and software had grown at a robust pace, but growth in new orders for nondefense capital goods, though volatile from month to month, appeared to have stepped down. Many participants noted that capital investment was heavily concentrated in replacement investment and upgrades that firms had postponed during the economic downturn. A number of participants reported that business contacts again indicated that their uncertainty about the fiscal and regulatory environment made them reluctant to expand capacity. Other participants cited business surveys and reports from business contacts indicating that slow growth in sales and uncertainty about the strength and durability of the recovery likely were more important factors. Except in the extractive industries (drilling and mining), investment in nonresidential structures had continued to decline. The near-term outlook for commercial real estate investment remained weak despite a decline in vacancy rates in some markets.

Participants agreed that credit conditions did not appear to be an important restraint on investment spending by larger firms that have access to the capital markets. Such firms were able to borrow readily and at relatively low rates; moreover, many businesses held substantial cash balances. In addition, survey results suggested that a sizable fraction of banks had eased loan terms, and a few had eased lending standards, on C&I loans. Some participants observed that small businesses continued to find credit hard to obtain. However, several participants noted recent survey evidence indicating that most small firms that requested credit were able to borrow, and that relatively few small firms thought that access to credit was their most important problem. Standards for commercial real estate loans and residential mortgages remained very tight, and banks did not appear to be easing standards on such loans. Some limited easing of lending standards was noted for consumer loans, but credit availability remained a constraint and consumer credit continued to contract. However, several participants noted that with credit quality improving, some bankers were more actively seeking loan growth, though the same bankers also indicated that the demand for loans remained weak.

Many participants noted that European countries' efforts to address their fiscal imbalances, and the release of the results of the stress test of European banks along with information about their exposures to sovereign debt, had reduced investor concern about downside risks in Europe. These factors appeared to have supported improvements in financial markets both here and abroad. Moreover, growth in Europe and Asia apparently remained solid, boosting U.S. exports. Nonetheless, a continuation of strong foreign growth would require a pickup in private demand abroad to offset a decline in policy stimulus and a smaller boost from inventory investment. Several participants noted that the same shift in the sources of demand would need to take place in the United States: Waning fiscal stimulus on the part of the federal government and continuing retrenchment in spending by state and local governments would weigh on the economic recovery, and recent data raised questions as to whether private demand would strengthen enough to increase resource utilization.

The incoming data on the labor market were weaker than meeting participants had anticipated. Private-sector payrolls grew sluggishly in recent months. The unemployment rate declined a bit, but that reflected a decrease in labor force participation rather than an increase in employment. Policymakers discussed a variety of factors that appeared to be contributing to the slow pace of job growth. A number of participants reported that business contacts again indicated that uncertainty about future taxes, regulations, and health-care costs made them reluctant to expand their workforces. Instead, businesses had continued to meet growth in demand for their products largely through productivity gains and by increasing existing employees' hours. Several participants suggested that structural factors such as mismatches between unemployed workers' skills and the needs of employers with job openings, or unemployed workers' inability to move to a new locale, were contributing to the elevated level and long average duration of unemployment. Other participants, while agreeing that such factors could restrain job growth and contribute to high rates of unemployment, noted that employment was lower than a year earlier and that job openings were only slightly above their lowest level in 10 years, indicating that few firms saw a need to add employees. Most participants viewed weak demand for firms' outputs as the primary problem; they saw substantial scope for stronger aggregate demand for goods and services to spur employment in a wide range of industries.

Weighing the available information, participants again expected the recovery to continue and to gather strength in 2011. Nonetheless, most saw the incoming data as indicating that the economy was operating farther below its potential than they had thought, that the pace of recovery had slowed in recent months, and that growth would be more modest during the second half of 2010 than they had anticipated at the time of the Committee's June meeting. Some policymakers whose forecasts for growth had been in the low end of the range of participants' earlier projections viewed the recent data as consistent with their earlier forecasts for a weak recovery. A few participants, observing that month-to-month data releases are noisy and subject to revision, did not see the recent data as clearly indicating a change in the outlook. Many policymakers judged that downside risks to the U.S. recovery had become somewhat larger; a few saw the incoming data as suggesting a greater risk that private demand for goods and services might not grow enough to offset waning fiscal stimulus and a smaller impetus from inventory restocking. In contrast, most saw a reduced risk of financial turmoil in Europe and attendant spillovers to U.S. financial markets.

Policymakers generally saw the inflation outlook as little changed. They observed that a range of measures continued to indicate subdued underlying inflation and that growth in wages and compensation remained quite moderate. Many said they expected underlying inflation to stay, for some time, below levels they judged most consistent with the dual mandate to promote maximum employment and price stability. Participants viewed the risk of deflation as quite small, but a number judged that the risk of further disinflation had increased somewhat despite the stability of longer-run inflation expectations. One noted that survey measures of longer-run inflation expectations had remained positive in Japan throughout that country's bout of deflation. A few saw the continuation of exceptionally accommodative monetary policy in the United States as posing some upside risk to inflation expectations and actual inflation in the medium run.

Committee Policy Action

In their discussion of monetary policy for the period ahead, Committee members agreed that it would be appropriate to maintain the target range of 0 to 1/4 percent for the federal funds rate. Members still saw the economic expansion continuing, and most believed that inflation was likely to stabilize near recent low readings in coming quarters and then gradually rise toward levels they consider more consistent with the Committee's dual mandate for maximum employment and price stability. Nonetheless, members generally judged that the economic outlook had softened somewhat more than they had anticipated, particularly for the near term, and some saw increased downside risks to the outlook for both growth and inflation. Some members expressed a concern that in this context any further adverse shocks could have disproportionate effects, resulting in a significant slowing in growth going forward. While no member saw an appreciable risk of deflation, some judged that the risk of further near-term disinflation had increased somewhat. More broadly, members generally saw both employment and inflation as likely to fall short of levels consistent with the dual mandate for longer than had been anticipated.

Against this backdrop, the Committee discussed the implications for financial conditions and the economic outlook of continuing its policy of not reinvesting principal repayments received on MBS or maturing agency debt. The decline in mortgage rates since spring was generating increased mortgage refinancing activity that would accelerate repayments of principal on MBS held in the SOMA. Private investors would have to hold more longer-term securities as the Federal Reserve's holdings ran off, making longer-term interest rates somewhat higher than they would be otherwise. Most members thought that the resulting tightening of financial conditions would be inappropriate, given the economic outlook. However, members noted that the magnitude of the tightening was uncertain, and a few thought that the economic effects of reinvesting principal from agency debt and MBS likely would be quite small. Most members judged, in light of current conditions in the MBS market and the Committee's desire to normalize the composition of the Federal Reserve's portfolio, that it would be better to reinvest in longer-term Treasury securities than in MBS. While reinvesting in Treasury securities was seen as preferable given current market conditions, reinvesting in MBS might become desirable if conditions were to change. A few members worried that reinvesting principal from agency debt and MBS in Treasury securities could send an inappropriate signal to investors about the Committee's readiness to resume large-scale asset purchases. Another member argued that reinvesting repayments of principal from agency debt and MBS, thereby postponing a reduction in the size of the Federal Reserve's balance sheet, was likely to complicate the eventual exit from the period of exceptionally accommodative monetary policy and could have adverse macroeconomic consequences in future years.

All but one member concluded that it would be appropriate to begin reinvesting principal received from agency debt and MBS held in the SOMA by purchasing longer-term Treasury securities in order to keep constant the face value of securities held in the SOMA and thus avoid the upward pressure on longer-term interest rates that might result if those holdings were allowed to decline. Several members emphasized that in addition to continuing to develop and test instruments to facilitate an eventual exit from the period of unusually accommodative monetary policy, the Committee would need to consider steps it could take to provide additional policy stimulus if the outlook were to weaken appreciably further. Given the softer tone of recent data and the more modest near-term outlook, members agreed that some changes to the statement's characterization of the economic and financial situation were necessary. All members but one judged that it was appropriate to reiterate the expectation that economic conditions—including low levels of resource utilization, subdued inflation trends, and stable inflation expectations—were likely to warrant exceptionally low levels of the federal funds rate for an extended period. One member argued that the recovery was proceeding about as outlined earlier this year and that starting a gradual process of removing policy accommodation fairly soon would better foster the Committee's long-run objectives of maximum employment and price stability.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to maintain the total face value of domestic securities held in the System Open Market Account at approximately $2 trillion by reinvesting principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. The Committee directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in June indicates that the pace of recovery in output and employment has slowed in recent months. Household spending is increasing gradually, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising; however, investment in nonresidential structures continues to be weak and employers remain reluctant to add to payrolls. Housing starts remain at a depressed level. Bank lending has continued to contract. Nonetheless, the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, although the pace of economic recovery is likely to be more modest in the near term than had been anticipated.
>
> Measures of underlying inflation have trended lower in recent quarters and, with substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to be subdued for some time.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

To help support the economic recovery in a context of price stability, the Committee will keep constant the Federal Reserve's holdings of securities at their current level by reinvesting principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities.[1] The Committee will continue to roll over the Federal Reserve's holdings of Treasury securities as they mature.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to promote economic recovery and price stability.

[1] The Open Market Desk will issue a technical note shortly after the statement providing operational details on how it will carry out these transactions."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Donald L. Kohn, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he thought it was not appropriate to indicate that economic and financial conditions were "likely to warrant exceptionally low levels of the federal funds rate for an extended period" or to reinvest principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. Mr. Hoenig felt that the "extended period" expectation could limit the Committee's flexibility to begin raising rates modestly in a timely fashion, and he believed that the recovery, which had entered its second year and was expected to continue at a moderate pace, did not require support from additional accommodation in monetary policy. Mr. Hoenig was also concerned that these accommodative policy positions could result in the buildup of future financial imbalances and increase the risks to longer-run macroeconomic and financial stability.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 21, 2010. The meeting adjourned at 1:35 p.m. on August 10, 2010.

Notation Vote

By notation vote completed on July 13, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on June 22–23, 2010.

William B. English
Secretary

Meeting Held on September 21, 2010

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, September 21, 2010, at 8:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Sandra Pianalto

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Christine Cumming, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and Janet L. Yellen
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Alan D. Barkema, James A. Clouse, Thomas A. Connors, Jeff Fuhrer, Steven B. Kamin, Lawrence Slifman, Mark S. Sniderman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack, Manager
System Open Market Account

Jennifer J. Johnson
Secretary of the Board, Office of the Secretary, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director, Board of Governors

Maryann F. Hunter
Deputy Director, Division of Banking Supervision and Regulation, Board of Governors

William Nelson
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

David Reifschneider and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

Eric M. Engen and Michael G. Palumbo
Deputy Associate Directors, Division of Research and Statistics, Board of Governors

Brian J. Gross
Special Assistant to the Board, Office of Board Members, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Jennifer E. Roush
Senior Economist, Division of Monetary Affairs, Board of Governors

Penelope A. Beattie
Assistant to the Secretary, Office of the Secretary, Board of Governors

Randall A. Williams
Records Management Analyst, Division of Monetary Affairs, Board of Governors

Gordon Werkema
First Vice President, Federal Reserve Bank of Chicago

Harvey Rosenblum and Daniel G. Sullivan
Executive Vice Presidents, Federal Reserve Banks of Dallas and Chicago, respectively

David Altig, John A. Weinberg, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, and Minneapolis, respectively

Chris Burke, John Fernald, James M. Nason
Vice Presidents, Federal Reserve Banks of New York, San Francisco, and Philadelphia, respectively

Gauti B. Eggertsson
Research Officer, Federal Reserve Bank of New York

By unanimous vote, the Committee selected Deborah J. Danker to serve as Deputy Secretary until the selection of a successor at the first regularly scheduled meeting of the Committee in 2011.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets during the period since the Committee met on August 10, 2010. He also reported on System open market operations during the intermeeting period, including the implementation of the Committee's decision at the August meeting to reinvest principal payments on agency debt and agency mortgage-backed securities (MBS) in longer-term Treasury securities. Following the August meeting, the Open Market Desk at the Federal Reserve Bank of New York announced that purchase operations would follow a schedule that would be released in the middle of each month, with the amounts calibrated to offset the amount of principal payments from agency debt and agency MBS expected to be received from the middle of the month to the middle of the following month. The Desk conducted 12 such operations over the intermeeting period and purchased about $28 billion of Treasury securities, with maturities concentrated in the 2- to 10-year sector of the nominal Treasury curve, although purchases were made across both the nominal and inflation-protected Treasury coupon yield curves. The Manager also briefed the Committee on progress in developing temporary reserve draining tools. Over the intermeeting period, the Federal Reserve announced a schedule for ongoing small-value auctions of term deposits. The auctions, which will be held about every other month, are intended to ensure the operational readiness of the term deposit facility and to increase the familiarity of eligible participants with the auction procedures. In addition, the Desk continued to conduct small-scale tri-party reverse repurchase operations using MBS collateral with the primary dealers, and it published a list of money market mutual funds that have been accepted as counterparties for reverse repurchase operations. The Manager also discussed plans to publish a new set of criteria that would allow a broader set of money market funds to become eligible counterparties. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions over the intermeeting period.

Staff Review of the Economic Situation

The information reviewed at the September 21 meeting indicated that the pace of the economic expansion slowed in recent months and that inflation remained low. Private businesses increased employment modestly in August, but the length of the workweek was unchanged and the unemployment rate remained elevated. Industrial production advanced at a solid pace in July and rose further in August. Consumer spending continued to increase at a moderate rate in July and appeared to move up again in August. The rise in business outlays for equipment and software looked to have moderated recently following outsized gains in the first half of the year. Housing activity weakened further, and nonresidential construction remained depressed. After falling in the previous three months, headline consumer prices rose in July and August as energy prices retraced some of their earlier decline while prices for core goods and services edged up slightly.

The labor market situation continued to improve only slowly. The average monthly increase in private payroll employment over the three months ending in August was small and was less than the average gain earlier in the year. Moreover, average weekly hours of all employees were little changed, on net, in recent months after rising during the first half of the year. The unemployment rate ticked up in August and remained close to the level that has prevailed since the beginning of this year. The labor force participation rate moved up a little in August but was still low. Initial claims for unemployment insurance remained at an elevated level over the intermeeting period. In addition, other indicators of labor demand, such as measures of hiring and job vacancies, did not improve.

Industrial production increased solidly in July and then rose more moderately in August. Manufacturing production was boosted in July by a pickup in motor vehicle assemblies as automakers replenished lean stocks at dealers. However, the production of motor vehicles was pared back in August. More broadly, the output of high-technology items and other business equipment expanded at a solid pace in July and August. The output of utilities declined over the past two months after it was boosted by unseasonably hot weather in the preceding two months. Capacity utilization in manufacturing ticked up further in August from its mid-2009 low, but it was still substantially below its longer-run average.

Real personal consumption expenditures rose modestly in July, similar to the average increase over the preceding two months. Data for retail sales and the sales of light motor vehicles pointed to a moderate gain in real consumer spending in August. Real disposable personal income declined a bit in July after increasing at a solid pace in the second quarter. The personal saving rate edged down in July but remained near the high level registered in the second quarter. Indicators of household net worth were mixed; home prices moved down in July, while equity prices inched up, on balance, over the intermeeting period. After falling back in July, consumer confidence remained downbeat in August and early September, with households more pessimistic about the outlook for their personal financial situations and general economic conditions.

Housing activity, which had been supported earlier in the year by the availability of homebuyer tax credits, softened further in July. Sales of new single-family homes remained at a depressed level. Sales of existing homes fell substantially in July, and the index of pending home sales suggested that sales were muted in August. Starts of new single-family houses in July and August were below the low level seen in June, and the number of new permits issued in August appeared to signal that little improvement in new homebuilding was likely in September. House prices declined modestly in July after changing little, on net, in recent months. The interest rate for 30-year fixed-rate conforming mortgages remained essentially unchanged over the intermeeting period at a historically low level.

Real business spending on equipment and software appeared to have slowed in July after expanding rapidly over the preceding three quarters. Both new orders and shipments of nondefense capital goods excluding aircraft dipped in July. Moreover, survey indicators of business conditions softened further in August. Incoming construction data indicated that business investment in nonresidential structures decreased in the second quarter but at a slower pace than over the preceding year. Increases in spending for drilling and mining structures were more than offset by continued declines in outlays for other types of nonresidential buildings. Despite some indications that the difficult financial conditions in commercial real estate markets might be stabilizing, credit was still tight and vacancy rates for office and commercial space remained high. In the second quarter, businesses appeared to build their inventories at a faster pace than earlier in the year, but ratios of inventories to sales for most industries did not point to any sizable overhangs.

Inflation remained subdued in recent months. Headline consumer prices rose in July and August as energy prices rebounded after their decline over the previous three months. At the same time, prices for core goods and services moved up slightly. At earlier stages of production, producer prices of core intermediate materials moved down, on net, during July and August while most indexes of spot commodity prices increased. Survey measures of short- and long-term inflation expectations were essentially unchanged.

Unit labor costs at the end of the second quarter remained below their level one year earlier, as labor compensation continued to increase only slowly and labor productivity stayed near its recent high level. Hourly labor compensation—as measured by compensation per hour in the nonfarm business sector and the employment cost index—rose modestly during the year ending in the second quarter. More recently, the year-over-year change in average hourly earnings of all employees in July and August remained subdued. While output per hour in the nonfarm business sector declined in the second quarter following large increases in the preceding three quarters, productivity was still well above its level one year earlier.

The U.S. international trade deficit narrowed in July after widening in June. The rise in exports in July more than offset their decline in June, as overseas sales of capital goods rose sharply. Most other major categories of exports were little changed in July, although exports of automotive products posted their first decline since May 2009. The narrowing of the trade deficit in July also reflected a broad-based decline in imports following their large increase in June. Imports of consumer goods fell substantially in July, while imports of industrial supplies, capital goods, and automotive products also moved down. In contrast, imports of petroleum products remained about flat in July.

Increases in foreign economic activity were robust, on average, in the second quarter. In particular, gross domestic product (GDP) grew strongly in the emerging market economies, even though gains in China apparently moderated. Among the advanced foreign economies, Europe posted a notable rise in economic activity in the second quarter; rapid expansion in Germany more than offset weaker outcomes in other euro-area economies, particularly those experiencing financial stress related to concerns about their fiscal situations and potential vulnerabilities in their banking sectors. In Canada and Japan, the rise in real GDP slowed noticeably in the second quarter. Recent indicators of foreign economic activity for the third quarter, including data on exports, production, and purchasing managers indexes, generally pointed to a slowing in the pace of expansion in economic activity abroad. Headline inflation rates in foreign economies generally were restrained in the second quarter by a deceleration in food and energy prices, but prices appeared to be rising a bit more rapidly of late.

Staff Review of the Financial Situation

The decision by the Federal Open Market Committee (FOMC) at its August meeting to maintain the 0 to 1⁄4 percent target range for the federal funds rate was widely anticipated, but Treasury yields declined as investors reportedly focused on the indication in the accompanying statement that principal payments from agency debt and MBS in the Federal Reserve's portfolio would be reinvested in longer-term Treasury securities and also on the characterization of the economic outlook, which was seen as somewhat more downbeat than expected. The expected path of the federal funds rate moved down early in the intermeeting period in response to weaker-than-expected economic data. The Chairman's Jackson Hole speech was reportedly viewed by market participants as more encouraging about economic prospects and as providing more clarity about the policy options available to the FOMC, but it did not have a sustained effect on policy expectations. The expected path of the federal funds rate rose for a time following the more-positive-than-expected data on manufacturing activity and the labor market released in early September, but the path ended the intermeeting period down on balance.

Yields on nominal Treasury coupon securities were volatile and ended the period somewhat lower, particularly for intermediate- and longer-term maturities. In addition to Federal Reserve communications and news about the economic outlook, market participants pointed to strong demand for long-duration assets by institutional investors and speculation about additional large-scale asset purchases by the Federal Reserve as factors contributing to the drop in longer-term yields. Five-year inflation compensation based on Treasury inflation-protected securities (TIPS) fell, while forward inflation compensation 5 to 10 years ahead edged up, on net, over the intermeeting period but remained at a lower level than in the spring. Treasury auctions over the intermeeting period were generally well received. Yields on investment- and speculative-grade corporate bonds moved roughly in line with those on comparable-maturity Treasury securities, leaving risk spreads little changed. Measures of liquidity in secondary markets for corporate bonds remained stable. In the secondary market for syndicated leveraged loans, the average bid price moved up and bid-asked spreads edged down.

Conditions in short-term funding markets continued to improve following the recent stresses related to concerns about financial stability in Europe. In dollar funding markets, spreads of term London interbank offered rates (or Libor) over those on overnight index swaps fell further at most horizons over the intermeeting period. Spreads on unsecured financial commercial paper were little changed at low levels. In secured funding markets, spreads on asset-backed commercial paper remained narrow, and rates on repurchase agreements involving various types of collateral held steady. In the September Senior Credit Officer Opinion Survey on Dealer Financing Terms (SCOOS), dealers indicated, on net, that they loosened credit terms applicable to several important classes of counterparties and types of collateral over the past three months amid increased demand for funding for most types of securities covered in the survey.

Broad U.S. stock price indexes edged up, on balance, over the intermeeting period, and option-implied volatility on the S&P 500 index was little changed on net. The spread between the staff's estimate of the expected real return on equities over the next 10 years and an estimate of the expected real return on a 10-year Treasury note—a rough measure of the equity risk premium—remained at an elevated level. Bank stocks underperformed the broader equity market and continued to be more volatile, while credit default swap spreads for large banking organizations edged up. The greater volatility in bank stocks reportedly reflected, in part, the effects of domestic and international financial regulatory reform efforts.

Net debt financing by U.S. nonfinancial corporations remained robust in August. Gross bond issuance was strong, a pattern that appeared to persist into the first part of September. Meanwhile, nonfinancial commercial paper outstanding contracted as very low yields on corporate bonds led to some substitution toward longer-term debt. Measures of the credit quality of nonfinancial corporations remained solid. The pace of initial public offerings and seasoned equity offerings by nonfinancial firms slowed in August, partly reflecting typical seasonal patterns.

Commercial real estate markets continued to face difficult financial conditions, although some further signs emerged that this sector might be stabilizing. The prices of commercial properties appeared to have edged up in the first half of the year, and the volume of commercial real estate sales rose again in August. A few small commercial mortgage-backed securities (CMBS) deals were issued over the intermeeting period and were reportedly well received by investors, consistent with an easing of conditions and renewed interest in the CMBS market since the beginning of the year that was reported in the SCOOS. Nonetheless, the volume of CMBS issuance in 2010 remained quite low compared with the levels seen before the onset of the financial crisis, and total commercial mortgage debt continued to contract amid further increases in delinquency rates on commercial mortgages.

For households, record-low mortgage rates supported a relatively high level of refinancing activity, but many borrowers reportedly remained unable to refinance because of insufficient home equity or poor credit histories. Consumer credit declined in the second quarter and appeared to contract further in July. Issuance of consumer asset-backed securities in August proceeded at a moderate pace that was similar to that posted in July. Spreads of interest rates on consumer loans relative to the yield on the two-year Treasury note were little changed on balance. The credit quality of consumer loans continued to improve; delinquency and charge-off rates for most types of loans dropped further in recent months, although they remained elevated.

Bank credit expanded in August, reflecting significant purchases of Treasury securities and agency MBS by large banks. Bank loans continued to contract, but the pace of contraction slowed noticeably from earlier in the year. Commercial and industrial loans rose slightly in July, the first increase on a monthly basis since late 2008, and held steady in August. In addition, holdings of closed-end residential mortgage loans expanded moderately in August, reportedly spurred by refinancing activity. However, both home equity loans and commercial real estate loans contracted further in August, while consumer loans fell sharply.

On average over July and August, M2 expanded at a rate slightly above its pace in the second quarter. Liquid deposits grew fairly rapidly over the two months, reflecting in part a compositional shift from other lower-yielding M2 assets. Currency trended higher, while small time deposits and retail money market mutual funds contracted further, as yields on these assets remained at extremely low levels.

In foreign markets, concerns about the global economic outlook prompted substantial drops in equity prices and benchmark sovereign bond yields in many countries in August, and the dollar appreciated broadly on safe-haven demands. In September, however, as better economic news led to some improvement in investor sentiment, equity prices and bond yields moved back up, and the dollar retraced its earlier appreciation. Yield spreads relative to German bunds on the 10-year sovereign bonds of Greece, Ireland, and Portugal widened to near-record levels over the period. Moreover, euro-area bank stock prices fell on continued concerns about the condition of some troubled institutions.

With the yen at a 15-year high against the dollar in nominal terms, Japan's Ministry of Finance intervened in currency markets on September 15 to buy dollars against yen, and the Bank of Japan (BOJ) noted that it would continue to provide ample liquidity. In reaction, the yen depreciated about 3 percent against the dollar, essentially reversing its rise over the preceding part of the intermeeting period. The European Central Bank (ECB) said that it would continue to provide term liquidity by offering several more full-allotment three-month refinancing operations through the end of the year. In contrast to the continued accommodative stance of the ECB and the BOJ, the Bank of Canada increased its target for the overnight rate by 25 basis points to 1 percent, its third hike since June. Several other central banks tightened monetary policy over the intermeeting period, including those of Chile, India, Indonesia, Sweden, and Thailand.

Staff Economic Outlook

In the economic forecast prepared for the September FOMC meeting, the staff lowered its projection for the increase in real economic activity over the second half of 2010. The staff also reduced slightly its forecast of growth next year but continued to anticipate a moderate strengthening of the expansion in 2011 as well as a further pickup in economic growth in 2012. The softer tone of incoming economic data suggested that the underlying level of demand was weaker than projected at the time of the August meeting. Moreover, the outlook for foreign economic activity also appeared a bit weaker. In the medium term, the recovery in economic activity was expected to receive support from accommodative monetary policy, further improvements in financial conditions, and greater household and business confidence. Over the forecast period, the increase in real GDP was projected to be sufficient to slowly reduce economic slack, although resource slack was anticipated to still remain elevated at the end of 2012.

Overall inflation was projected to remain subdued, with the staff's forecasts for headline and core inflation little changed from the previous projection. The current and projected wide margins of economic slack were expected to contribute to a small slowing in core inflation in 2011, which was anticipated to be tempered by stable inflation expectations. Inflation was projected to change little in 2012, as considerable economic slack was expected to remain even as economic activity was anticipated to strengthen.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants generally agreed that the incoming data indicated that output and employment were increasing only slowly and at rates well below those recorded earlier in the year. Although participants considered it unlikely that the economy would reenter a recession, many expressed concern that output growth, and the associated progress in reducing the level of unemployment, could be slow for some time. Participants noted a number of factors that were restraining growth, including low levels of household and business confidence, heightened risk aversion, and the still weak financial conditions of some households and small firms. A few participants noted that economic recoveries were often uneven and were typically slow following downturns triggered by financial crises. A number of participants observed that the sluggish pace of growth and continued high levels of slack left the economy exposed to potential negative shocks. Nevertheless, participants judged the economic recovery to be continuing and generally expected growth to pick up gradually next year.

Indicators of spending by businesses and households were mixed. Several participants observed that data on retail sales had been a bit stronger than expected over the intermeeting period, although business contacts indicated that shoppers remained very price sensitive. There were some reports of retailers cautiously boosting inventories ahead of the holiday season by somewhat more than they did a year ago. Households were continuing efforts to repair their balance sheets by saving more and paying down debt. Participants noted that elevated uncertainty about employment prospects continued to weigh on consumption spending. Many businesses had built up large reserves of cash, in part by issuing long-term debt, but were refraining from adding workers or expanding plants and equipment. A number of business contacts indicated that they were holding back on hiring and spending plans because of uncertainty about future fiscal and regulatory policies. However, businesses also indicated that concerns about actual and anticipated demand were important factors limiting investment and hiring. Businesses reported continued strong foreign demand for their products, particularly from Asia.

Participants noted that the housing sector, including residential construction and home sales, continued to be very weak. Despite efforts aimed at mitigation, foreclosures continued to add to the elevated supply of available homes, putting downward pressure on home prices and housing construction.

Financial developments were mixed over the intermeeting period. Banks remained generally cautious and uncertain about the regulatory outlook, although investors appeared confident that U.S. banks could meet the new international standards for bank capital and liquidity that were announced over the intermeeting period. Improving household financial conditions were contributing to better consumer loan performance, and credit problems more broadly appeared to have mostly peaked, although banks continued to report elevated losses on commercial real estate loans, especially construction and land development loans. Credit remained readily available for larger corporations with access to financial markets, and there were some signs that credit conditions had begun to improve for smaller firms. Asset prices had been relatively sensitive to incoming economic data over the intermeeting period but generally ended the period little changed on net. Stresses in European financial markets remained broadly contained but bore watching going forward.

A number of participants noted that the current sluggish pace of employment growth was insufficient to reduce unemployment at a satisfactory pace. Several participants reported feedback from business contacts who were delaying hiring until the economic and regulatory outlook became more certain. Participants discussed the possible extent to which the unemployment rate was being boosted by structural factors such as mismatches between the skills of the workers who had lost their jobs and the skills needed in the sectors of the economy with vacancies, the inability of the unemployed to relocate because their homes were worth less than their mortgages, and the effects of extended unemployment benefits. Participants agreed that factors like these were pushing the unemployment rate up, but they differed in their assessments of the extent of such effects. Nevertheless, many participants saw evidence that the current unemployment rate was considerably above levels that could be explained by structural factors alone, pointing, for example, to declines in employment across a wide range of industries during the recession, job vacancy rates that were relatively low, and reports that weak demand for goods and services remained a key reason why firms were adding employees only slowly.

Inflation had declined since the start of the recession, and most participants indicated that underlying inflation was at levels somewhat below those that they judged to be consistent with the Committee's dual mandate for maximum employment and price stability. Although prices of some commodities and imported goods had risen recently, many business contacts reported that they currently had little pricing power and that they anticipated limited, if any, increases in labor costs. Meeting participants noted that several measures of inflation expectations had changed little, on net, over the intermeeting period and that analysis of the components of price indexes suggested disinflation might be abating. However, TIPS-based inflation compensation had declined, on balance, in recent quarters. While underlying inflation remained subdued, participants saw only small odds of deflation.

Participants discussed the medium-term outlook for monetary policy and issues related to monetary policy implementation. Many participants noted that if economic growth remained too slow to make satisfactory progress toward reducing the unemployment rate or if inflation continued to come in below levels consistent with the FOMC's dual mandate, it would be appropriate to provide additional monetary policy accommodation. However, others thought that additional accommodation would be warranted only if the outlook worsened and the odds of deflation increased materially. Meeting participants discussed several possible approaches to providing additional accommodation but focused primarily on further purchases of longer-term Treasury securities and on possible steps to affect inflation expectations. Participants reviewed the likely benefits and costs associated with a program of purchasing additional longer-term assets—with some noting that the economic benefits could be small in current circumstances—as well as the best means to calibrate and implement such purchases. A number of participants commented on the important role of inflation expectations for monetary policy: With short-term nominal interest rates constrained by the zero bound, a decline in short-term inflation expectations increases short-term real interest rates (that is, the difference between nominal interest rates and expected inflation), thereby damping aggregate demand. Conversely, in such circumstances, an increase in inflation expectations lowers short-term real interest rates, stimulating the economy. Participants noted a number of possible strategies for affecting short-term inflation expectations, including providing more detailed information about the rates of inflation the Committee considered consistent with its dual mandate, targeting a path for the price level rather than the rate of inflation, and targeting a path for the level of nominal GDP. As a general matter, participants felt that any needed policy accommodation would be most effective if enacted within a framework that was clearly communicated to the public. The minutes of FOMC meetings were seen as an important channel for communicating participants' views about monetary policy.

Committee Policy Action

In their discussion of monetary policy for the period immediately ahead, nearly all of the Committee members agreed that it would be appropriate to maintain the target range for the federal funds rate of 0 to ¼ percent and to leave unchanged the level of the combined holdings of Treasury, agency debt, and agency mortgage-backed securities in the SOMA. Although many members considered the recent and anticipated progress toward meeting the Committee's mandate of maximum employment and price stability to be unsatisfactory, members observed that incoming data over the intermeeting period indicated that the economic recovery was continuing, albeit slowly. Moreover, the data had been mixed, with readings early in the period generally weaker than anticipated but the more-recent data coming in on the strong side of expectations. In light of the considerable uncertainty about the current trajectory for the economy, some members saw merit in accumulating further information before reaching a decision about providing additional monetary stimulus. In addition, members wanted to consider further the most effective framework for calibrating and communicating any additional steps to provide such stimulus. Several members noted that unless the pace of economic recovery strengthened or underlying inflation moved back toward a level consistent with the Committee's mandate, they would consider it appropriate to take action soon.

With respect to the statement to be released following the meeting, members agreed that it was appropriate to adjust the statement to make it clear that underlying inflation had been running below levels that the Committee judged to be consistent with its mandate for maximum employment and price stability, in part to help anchor inflation expectations. Nearly all members agreed that the statement should reiterate the expectation that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. One member, however, believed that continuing to communicate that expectation in the Committee's statement would create conditions that could lead to macroeconomic and financial imbalances. Members generally thought that the statement should note that the Committee was prepared to provide additional accommodation if needed to support the economic recovery and to return inflation, over time, to levels consistent with its mandate. Such an indication accorded with the members' sense that such accommodation may be appropriate before long, but also made clear that any decisions would depend upon future information about the economic situation and outlook.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to maintain the total face value of domestic securities held in the System Open Market Account at approximately $2 trillion by reinvesting principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in August indicates that the pace of recovery in output and employment has slowed in recent months. Household spending is increasing gradually, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, though less rapidly than earlier in the year, while investment in nonresidential structures continues to be weak. Employers remain reluctant to add to payrolls. Housing starts are at a depressed level. Bank lending has continued to contract, but at a reduced rate in recent months. The Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, although the pace of economic recovery is likely to be modest in the near term.

Measures of underlying inflation are currently at levels somewhat below those the Committee judges most consistent, over the longer run, with its mandate to promote maximum employment and price stability. With substantial resource slack continuing to restrain cost pressures and longer-term inflation expectations stable, inflation is likely to remain subdued for some time before rising to levels the Committee considers consistent with its mandate.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period. The Committee also will maintain its existing policy of reinvesting principal payments from its securities holdings.

The Committee will continue to monitor the economic outlook and financial developments and is prepared to provide additional accommodation if needed to support the economic recovery and to return inflation, over time, to levels consistent with its mandate."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Sandra Pianalto, Eric Rosengren, Daniel K. Tarullo, and Kevin Warsh.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented, emphasizing that the economy was entering the second year of moderate recovery and that, while the zero interest rate policy and "extended period" language were appropriate during the crisis and its immediate aftermath, they were no longer appropriate with the recovery under way. Mr. Hoenig also emphasized that, in his view, the current high levels of unemployment were not caused by high interest rates but by an extended period of exceptionally low rates earlier in the decade that contributed to the housing bubble and subsequent collapse and recession. He believed that holding rates artificially low would invite the development of new imbalances and undermine long-run growth. He would prefer removing the "extended period" language and thereafter moving the federal funds rate upward, consistent with his views at past meetings that it approach 1 percent, before pausing to determine what further policy actions were needed. Also, given current economic and financial conditions, Mr. Hoenig did not believe that continuing to reinvest principal payments from SOMA securities holdings was required to support the Committee's policy objectives.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, November 2–3, 2010. The meeting adjourned at 1:10 p.m. on September 21, 2010.

Notation Vote

By notation vote completed on August 30, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on August 10, 2010.

William B. English
Secretary

Meeting Held on November 2–3, 2010

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, November 2, 2010, at 1:00 p.m. and continued on Wednesday, November 3, 2010, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Sandra Pianalto

Sarah Bloom Raskin

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Janet L. Yellen

Christine Cumming, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker and Dennis P. Lockhart
Presidents of the Federal Reserve Banks of Richmond and Atlanta, respectively

John F. Moore
First Vice President, Federal Reserve Bank of San Francisco

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

James A. Clouse, Thomas A. Connors, Jeff Fuhrer, Steven B. Kamin, Simon Potter, Lawrence Slifman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

William Nelson
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director, Board of Governors

Seth B. Carpenter and Andrew T. Levin
Senior Associate Directors, Division of Monetary Affairs, Board of Governors

Michael Leahy
Senior Associate Director, Division of International Finance, Board of Governors

David Reifschneider
Senior Associate Director, Division of Research and Statistics, Board of Governors

Stephen A. Meyer
Senior Adviser, Division of Monetary Affairs, Board of Governors

Daniel M. Covitz and David E. Lebow
Deputy Associate Directors, Division of Research and Statistics, Board of Governors

Gretchen C. Weinbach
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Brian J. Gross
Special Assistant to the Board, Office of Board Members, Board of Governors

Mark A. Carlson
Economist, Division of Monetary Affairs, Board of Governors

Randall A. Williams
Records Management Analyst, Division of Monetary Affairs, Board of Governors

Sarah G. Green
First Vice President, Federal Reserve Bank of Richmond

Loretta J. Mester, Harvey Rosenblum, Daniel G. Sullivan, and John C. Williams
Executive Vice Presidents, Federal Reserve Banks of Philadelphia, Dallas, Chicago, and San Francisco, respectively

David Altig, Richard P. Dzina, Mark E. Schweitzer, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, Cleveland, and Minneapolis, respectively

Todd E. Clark
Vice President, Federal Reserve Bank of Kansas City

Robert L. Hetzel
Senior Economist, Federal Reserve Bank of Richmond

The meeting opened with a short discussion regarding communicating with the public about monetary policy deliberations and decisions. Meeting participants supported a review of the Committee's communication guidelines with the aim of ensuring that the public is well informed about monetary policy issues while preserving the necessary confidentiality of policy discussions until their scheduled release. Governor Yellen agreed to chair a subcommittee to conduct such a review.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets since the Committee met on September 21, 2010. He also reported on System open market operations, including the continuing reinvestment into longer-term Treasury securities of principal payments received on the SOMA's holdings of agency debt and agency-guaranteed mortgage-backed securities (MBS). The Open Market Desk at the Federal Reserve Bank of New York purchased a total of about $65 billion of Treasury securities since the Committee decided, on August 10, to begin reinvesting such principal payments. Purchases were concentrated in nominal Treasury securities with maturities of 2 to 10 years, though some shorter-term and some longer-term securities were purchased along with some Treasury inflation-protected securities (TIPS). Over the intermeeting period, the Desk also conducted a number of small-value tri-party reverse repurchase operations with the primary dealers and with money market mutual funds that have been accepted as counterparties for such operations; these transactions, which the Desk conducted to ensure continuing operational and systems readiness, used Treasury securities, agency debt, and agency-guaranteed MBS as collateral. In addition, the Federal Reserve conducted another small-value auction of term deposits to ensure the continued operational readiness of the term deposit facility and to increase the familiarity of eligible depository institutions with the auction procedures. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions over the intermeeting period.

The Manager described the tentative plans the Desk had prepared for implementing a possible Committee decision to expand further the System's holdings of longer-term Treasury securities. Purchases would continue to be concentrated in nominal Treasury securities with remaining maturities between 2 and 10 years, with some purchases of shorter- and longer-term securities and of TIPS; with this maturity distribution, newly purchased securities would be expected to have an average duration of 5 to 6 years, essentially the same as the average duration of the System's existing holdings of Treasury securities. The Desk planned to publish additional information about its transactions to increase the transparency of, and encourage wider participation in, future purchase operations. The Desk judged that if it continued reinvesting principal payments from the Federal Reserve System's holdings of agency debt and agency MBS in longer-term Treasury securities, then it could purchase additional longer-term Treasury securities at a pace of about $75 billion per month while avoiding disruptions in market functioning. The Manager indicated that implementing a sizable increase in the System's holdings of Treasury securities most effectively likely would entail a temporary relaxation of the 35 percent per-issue limit on SOMA holdings under which the Desk had been operating; whether, and to what extent, the System's holdings of some issues would exceed 35 percent would depend on the specific securities that dealers choose to offer at future auctions. Finally, the Manager summarized the implications for the Federal Reserve's balance sheet and income statement of alternative decisions that the Committee might make about the size and maturity distribution of the SOMA's securities holdings. Participants discussed the Desk's tentative operational plans; they also discussed the potential effects of an expansion of the System's holdings of longer-term securities on financial markets and institutions and on the economy, and the channels through which those effects could occur.

Staff Review of the Economic Situation

The information reviewed at the November 2–3 meeting indicated that the economic recovery proceeded at a modest rate in recent months, with only a gradual improvement in labor market conditions, and was accompanied by a continued low rate of inflation. Consumer spending, business investment in equipment and software, and exports posted further gains in the third quarter, and nonfarm inventory investment stepped up. But construction activity in both the residential and nonresidential sectors remained depressed, and a significant portion of the rise in domestic demand was again met by imports. U.S. industrial production slowed noticeably in August and September, hiring at private businesses remained modest, and the unemployment rate stayed elevated. Headline consumer price inflation was subdued in recent months, despite a rise in energy prices, as core consumer price inflation trended lower.

Private businesses continued to increase their demand for labor only modestly. In September, private nonfarm payroll employment remained on a gradual uptrend, and the average workweek of all private-sector employees was unchanged for a third month. In addition, the number of individuals working part time for economic reasons moved back up for a second month, and the available measures of job openings and hiring were still low. The unemployment rate remained at 9.6 percent in September, leaving the average rate for the third quarter only slightly below its average over the first half of the year. Long-duration unemployment continued to recede somewhat but was still very high. Indicators of layoffs remained elevated, although initial claims for unemployment insurance drifted down a little during October. The labor force participation rate in September was unchanged at a level lower than earlier in the year.

After rising rapidly from mid-2009 to mid-2010, industrial production decelerated in August and edged down in September. In the manufacturing sector, output gains across a wide range of industries were smaller in recent months, and capacity utilization leveled off at a rate still well below its longer-run average. Production of motor vehicles picked up during the third quarter as automakers replenished dealers' stocks, but motor vehicle assemblies were scheduled to drop back in coming months. More broadly, October surveys of new orders received by manufacturers suggested that demand for factory goods had continued to increase.

Real personal consumption expenditures (PCE) rose at a moderate rate in the third quarter. Rising equity prices likely resulted in some further improvement in net worth over the same period. However, real disposable personal income, which rose strongly in the first half of the year, increased only slightly in the third quarter. As a result, the personal saving rate dropped back somewhat in the third quarter, although it remained near the high levels that have prevailed since late 2008. Bank lending standards were still relatively tight, and household borrowing remained low. Surveys taken in September and October indicated that consumers were slightly more pessimistic about the economic outlook than earlier in the year.

Activity in the housing market remained exceptionally weak. Although sales of new and existing homes turned up in August and September, the still-low level of demand suggested that the payback for the earlier boost to sales from the homebuyer tax credit had not yet faded. Moreover, despite further declines in mortgage interest rates in recent months, other factors continued to restrain housing demand, including consumer pessimism about the outlook for jobs and income, the depressed rate of household formation, and tight underwriting standards for mortgages. In addition, the moratoriums recently announced by some banks on the sale of properties they had seized in foreclosures were likely to damp home sales further in the near term. Starts of new single-family houses rose somewhat in August and September, but the pace of construction was still noticeably below the already-depressed level of the preceding year. New homebuilding appeared to be weighed down by the backlog of unsold existing homes and tight lending conditions for acquisition, development, and construction loans.

After a very strong increase in the first half of the year, business investment in equipment and software posted a smaller, but still solid, gain in the third quarter. Nominal shipments of nondefense capital goods from domestic manufacturers remained on a moderate uptrend through September. But rising demand for equipment and software during the third quarter was also satisfied in part by a further rise in imports of capital goods. Near-term indicators of business spending on equipment and software were generally positive. New orders for nondefense capital goods, excluding aircraft, continued to outpace shipments through September. Credit conditions improved further in the third quarter, particularly for larger firms with access to the capital markets. Financing flows to smaller firms, which are more dependent on banks, were more subdued.

Real nonfarm inventory investment was estimated to have picked up during the third quarter. Rebuilding of dealers' stocks of motor vehicles accounted for part of the step-up, but some of it likely reflected another large increase in imports. In August, inventory-to-sales ratios for most industries remained well below their previous peaks. Surveys of purchasing managers in September and October indicated that most did not perceive their customers' inventories to be too high. Business investment in nonresidential structures was about flat in the third quarter as another strong increase in spending for drilling and mining structures offset further declines in outlays on commercial and industrial buildings.

Consumer price inflation remained low in recent months. The total PCE price index increased slightly in September as consumer energy prices moved up noticeably for a third month. The core PCE price index was unchanged in September, and the 12-month increase in this index continued to trend down. At earlier stages of processing, the rise in producer prices for intermediate materials remained moderate in September, but prices of globally traded industrial and agricultural commodities accelerated considerably in October, reflecting in part the lower foreign exchange value of the dollar as well as concerns about supply for certain commodities. In September and October, survey measures of households' short- and long-term expectations for inflation remained in the ranges that have prevailed since the spring of 2009.

Labor compensation rose at a moderate rate in the third quarter. Private-sector wage increases, as measured by both average hourly earnings of all employees and the employment cost index (ECI), remained subdued. However, according to the ECI, employer benefit costs accelerated this year after posting a very small increase in 2009.

The U.S. international trade deficit widened in August, after narrowing in July, as a modest increase in nominal exports was more than offset by a strong increase in imports. Following widespread declines in July, most major categories of imports rebounded in August, with imports of consumer goods and capital goods exhibiting particular strength. Imports of petroleum products also increased substantially, reflecting both higher volumes and higher prices. The increase in exports was concentrated in agricultural goods, partly boosted by rising prices, and in services; most other major categories either declined or were flat.

Recent indicators of foreign economic activity suggested that growth abroad had slowed appreciably after midyear. Following an unsustainably high rate of expansion in the second quarter, growth of real gross domestic product (GDP) in the emerging market economies appeared to have slowed markedly, notwithstanding an apparent acceleration in economic activity in China. Real GDP growth apparently moderated in the advanced foreign economies as well. In the euro area, industrial production rose sharply in August, but purchasing managers indexes moved down in recent months. The German economy continued to perform strongly, while recent data showed weakness in the peripheral euro-area countries. A reacceleration of food and energy prices helped push up inflation abroad, albeit generally to still-moderate levels, in the third quarter.

Staff Review of the Financial Situation

The decision by the Federal Open Market Committee (FOMC) at its September meeting to maintain the 0 to ¼ percent target range for the federal funds rate was widely anticipated. However, yields declined as market participants reportedly interpreted the language of the accompanying statement to imply higher odds of additional asset purchases and a longer period of exceptionally low short-term interest rates. Investors took particular note of the statement's indication that inflation was below the levels consistent with the FOMC's dual mandate for maximum employment and price stability. In the weeks following the FOMC meeting, Federal Reserve communications, along with economic data releases that continued to point to a tepid economic outlook, appeared to reinforce market expectations that additional policy accommodation would be forthcoming in the near term.

Yields on nominal Treasury coupon securities and those on TIPS declined, on net, over the intermeeting period, largely in response to Federal Reserve communications and somewhat weaker-than-expected economic data releases. Five-year inflation compensation increased over the intermeeting period, and forward inflation compensation 5 to 10 years ahead also rose. Anecdotal reports pointed to the increased likelihood of additional asset purchases by the Federal Reserve and to FOMC communications noting that the Committee viewed underlying inflation as somewhat below the levels judged to be most consistent with the Committee's dual mandate as factors contributing to lower yields and to the increase in inflation compensation over the period. Yields on investment- and speculative-grade corporate bonds declined somewhat more than those on comparable-maturity Treasury securities, leaving risk spreads slightly lower. In the secondary market for syndicated leveraged loans, prices of loans continued to move up and bid-asked spreads narrowed a bit further.

Conditions in short-term funding markets were generally stable over the intermeeting period. In dollar funding markets, spreads of term London interbank offered rates (or Libor) over those on overnight index swaps edged up but remained at levels similar to those observed prior to the emergence of euro-area concerns earlier this year. Spreads on unsecured financial commercial paper and on asset-backed commercial paper remained low. Rates on repurchase agreements (repos) involving various types of collateral were little changed on net. Bid-asked spreads in most repo transactions generally declined while changes in haircuts on different types of repo collateral were mixed.

Broad U.S. stock price indexes rose, on balance, over the intermeeting period, reflecting investor expectations of further monetary policy accommodation and better-than-expected third-quarter earnings news; option-implied volatility on the S&P 500 index was little changed. The spread between the staff's estimate of the expected real return on equities over the next 10 years and an estimate of the expected real return on a 10-year Treasury note—a rough measure of the equity risk premium—narrowed a bit but remained at an elevated level. Bank stocks generally underperformed the broader market amid concerns about the handling of mortgage foreclosure documents and possible lack of compliance with securitization agreements.

Net debt financing by U.S. nonfinancial corporations was very strong in September, with sizable gross corporate bond issuance across the credit spectrum and a substantial increase in commercial paper outstanding, but data for October pointed to a moderation in these flows. Issuance of syndicated leveraged loans in the third quarter remained near the average pace recorded in the first half of the year. Measures of the credit quality of nonfinancial corporations remained solid. The pace of gross public equity issuance from seasoned and initial public offerings by nonfinancial firms remained moderate in September and appeared to slow in October.

Commercial real estate markets remained strained. Commercial mortgage debt in the third quarter was estimated to have declined at a rate similar to the drop in the second quarter, and the delinquency rate for securitized commercial mortgages continued to climb in September. However, some signals offered modest encouragement. In particular, vacancy rates for commercial buildings stabilized in the third quarter, and the pipeline of new commercial mortgage-backed securities picked up a bit from very low levels.

Residential mortgage refinancing activity moved up in late September and early October, from an already high level, as the average interest rate on fixed-rate mortgages fell further over the intermeeting period. In contrast, the level of applications for mortgages to purchase homes remained anemic. Total consumer credit contracted in August at a pace roughly in line with the declines posted earlier in the year. Issuance of consumer asset-backed securities was solid in September. Consumer credit quality generally continued to improve, though delinquency rates remained elevated.

Bank credit edged up in September and October, as brisk growth in banks' holdings of securities more than offset a further decline in total loans. Commercial and industrial (C&I) loans turned down in September after having increased slightly over the two previous months. A moderate net fraction of banks reported, in their responses to the October Senior Loan Officer Opinion Survey on Bank Lending Practices, that they had eased standards on C&I loans and narrowed spreads of C&I loan rates over their cost of funds; demand for such loans reportedly declined, on net, over the preceding three months.

Commercial real estate loans, home equity loans, and consumer loans contracted. However, closed-end residential mortgage loans on banks' books increased modestly for the second month in a row.

Over September and October, M2 expanded at an average annual rate that was noticeably above its pace earlier in the year. The growth rate of liquid deposits moved up, while small time deposits and retail money market mutual funds continued to contract. The compositional shift likely reflected the relatively attractive yields on liquid deposits. Currency growth strengthened, with indicators suggesting strong demand from abroad.

The dollar declined about 3 percent against a broad array of other currencies during the intermeeting period, depreciating even more against the euro and the yen. In addition, Chinese authorities allowed the renminbi to appreciate slightly against the dollar. Market commentary highlighted the possibility that major central banks would further ease monetary policy, and the Bank of Japan expanded its asset purchase program and reduced its policy target rate to a range of 0 to 10 basis points. Benchmark 10-year sovereign yields generally declined in the major advanced foreign economies, but the overnight rate in the euro area increased as the European Central Bank continued to allow the amount of liquidity provided to the banking system to decline. Spreads relative to German bunds on the 10-year sovereign bonds of most peripheral euro-area countries either declined or were little changed over the period, but Irish sovereign spreads moved higher on concerns over the fiscal burdens associated with losses in the Irish banking sector. Major equity indexes in the euro area and in the United Kingdom increased moderately, whereas the Nikkei index declined.

Several emerging market central banks tightened monetary policy, including the People's Bank of China. Against the backdrop of interest rate declines in many of the advanced economies, as well as heavy capital flows toward emerging market countries, many emerging market currencies strengthened, reportedly prompting further official intervention in foreign exchange markets.

Staff Economic Outlook

Because the recent data on production and spending were broadly in line with the staff's expectations, the forecast for economic activity that was prepared for the November FOMC meeting showed little change to the staff's near-term outlook relative to the forecast prepared for the September FOMC meeting. However, the staff revised up its forecast for economic activity in 2011 and 2012. In light of asset market developments over the intermeeting period, which in large part appeared to reflect heightened expectations among investors that the Federal Reserve would undertake additional purchases of longer-term securities, the November forecast was conditioned on lower long-term interest rates, higher stock prices, and a lower foreign exchange value of the dollar than was the staff's previous forecast. These factors were expected to provide additional support to the recovery in economic activity. Accordingly, the unemployment rate was anticipated to recede somewhat more than in the previous forecast, although the margin of slack at the end of 2011 was still expected to be substantial.

The staff's forecast continued to show subdued rates of headline and core inflation during 2011 and 2012. However, the downward pressure on inflation from slack in resource utilization was expected to be slightly less than previously projected, and prices of imported goods were anticipated to rise somewhat faster. As in previous forecasts, further disinflation was expected to be checked by the ongoing stability of inflation expectations.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants—the six members of the Board of Governors and the heads of the 12 Federal Reserve Banks—provided projections of output growth, the unemployment rate, and inflation for each year from 2010 through 2013 and over the longer run. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks. Participants' forecasts are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, meeting participants generally agreed that the incoming data indicated that output and employment were continuing to increase, but only slowly. Progress toward the Committee's dual objectives of maximum employment and price stability was described as disappointingly slow. Participants variously noted a number of factors that were restraining growth, including low levels of household and business confidence, concerns about the durability of the economic recovery, continuing uncertainty about the future tax and regulatory environment, still-weak financial conditions of some households and small businesses, the depressed housing market, and waning fiscal stimulus. Although participants considered it quite unlikely that the economy would slide back into recession, some noted that continued slow growth and high levels of resource slack could leave the economic expansion vulnerable to negative shocks. In the absence of such shocks, and assuming appropriate monetary policy, participants' economic projections generally showed growth picking up to a moderate pace and the unemployment rate declining somewhat next year. Participants generally expected growth to strengthen further and unemployment to decline somewhat more rapidly in 2012 and 2013.

Indicators of spending by households and businesses remained mixed. Consumer spending was expanding gradually. Participants noted that households were continuing their efforts to repair their balance sheets, a process that was restraining growth in consumer spending. Sluggish employment growth and elevated uncertainty about job prospects also continued to weigh on household spending. With respect to business spending, contacts generally reported that they were investing to reduce costs but were refraining from adding workers or expanding capacity in the United States. Energy producers were an exception. Participants observed that firms had generated rising profits, but that business contacts indicated those gains largely reflected cost-cutting rather than top-line growth in revenues. A number of businesses continued to report that they were holding back on hiring and capital spending because of uncertainty about future taxes, health-care costs, and regulations. But concerns about actual and anticipated demand also were important factors limiting investment and hiring. Firms continued to report strong foreign demand for their products, particularly from Asia.

Participants noted that the housing sector, including residential construction and home sales, remained depressed. Foreclosures were adding to the elevated supply of available homes and putting downward pressure on home prices and housing construction. Some participants saw disputes over mortgage and foreclosure documents as likely to delay the eventual recovery in housing markets. Commercial real estate markets also were weak, and the availability of credit for commercial real estate transactions remained limited, but low interest rates were helping stabilize prices.

Participants agreed that progress in reducing unemployment was disappointing; indeed, several noted that the recent rate of output growth, if continued, would more likely be associated with an increase than a decrease in the unemployment rate. Participants again discussed the extent to which employment was being held down, and the unemployment rate boosted, by structural factors such as mismatches between the skills of the workers who had lost their jobs and the skills needed in the sectors of the economy with vacancies, the inability of the unemployed to relocate because their homes were worth less than the principal they owed on their mortgages, and the effects of extended unemployment benefits on the duration of unemployed workers' search for a new job. Participants agreed that such factors were contributing to continued high unemployment but differed in their assessments of the magnitude of such effects. Many participants saw evidence that the current unemployment rate was well above levels that could be explained by structural factors alone, noting, for example, reports from business contacts indicating that weak growth in demand for their firms' products remained a key reason why they were reluctant to add employees, and job vacancy rates that were low relative to historical experience. A number of participants noted that continued high unemployment, particularly with large numbers of workers suffering very long spells of unemployment, would lead to an erosion of workers' skills that would have adverse consequences for those workers and for the economy's potential level of output in the longer term.

Participants saw financial conditions as having become more supportive of growth over the course of the intermeeting period; most, though not all, of the change appeared to reflect investors' increasing anticipation of a further easing of monetary policy. Most longer-term nominal interest rates declined, real interest rates fell even more, credit spreads tightened, and equity prices rose, in part reflecting better-than-expected corporate earnings reports. Inflation compensation rose noticeably, returning to a level more typical of recent years. Participants noted that credit remained readily available—in debt markets and from banks—for larger corporations, and there were some signs that credit conditions had begun to improve for smaller firms that obtain credit primarily from banks. Banking institutions reported signs of improving credit quality. Improvements in household financial conditions were contributing to better performance of consumer loans. However, banks continued to report elevated losses on commercial real estate loans, especially construction and land development loans. Participants noted the risk of losses at financial institutions stemming from investors putting mortgages back to sellers if the quality of the loans was misrepresented when the mortgages were sold into securitization vehicles.

Measures of price inflation had generally trended lower since the start of the recession; the same was true of nominal wage growth. Most participants indicated that underlying inflation was somewhat low relative to levels that they judged to be consistent with the Committee's statutory mandate to foster maximum employment and price stability. While underlying inflation remained subdued, meeting participants generally saw only small odds of deflation, given the stability of longer-term inflation expectations and the anticipated recovery in economic activity. They generally did not expect appreciably higher inflation, either. While prices of some commodities and imported goods had risen recently, business contacts reported that they currently had little pricing power and that they would continue to seek productivity gains to offset higher input costs. Small wage increases, coupled with productivity gains, meant that unit labor costs were lower than a year earlier. Many participants pointed to substantial slack in resource utilization, along with well-anchored inflation expectations, as likely to contribute to subdued inflation for some time. A few participants expected that continuing resource slack would lead to some further disinflation in coming years. However, a few others thought that the exceptionally accommodative stance of monetary policy, coupled with rising prices of energy and other commodities as well as rising prices of other imports, made it more likely that inflation would increase, within a year or two, to levels they judged consistent with the Committee's dual mandate.

Participants generally agreed that the most likely economic outcome would be a gradual pickup in growth with slow progress toward maximum employment. They also generally expected that inflation would remain, for some time, below levels the Committee considers most consistent, over the longer run, with maximum employment and price stability. However, participants held a range of views about the risks to that outlook. Most saw the risks to growth as broadly balanced, but many saw the risks as tilted to the downside. Similarly, a majority saw the risks to inflation as balanced; some, however, saw downside risks predominating while a couple saw inflation risks as tilted to the upside. Participants also differed in their assessments of the likely benefits and costs associated with a program of purchasing additional longer-term securities in an effort to provide additional monetary stimulus, though most saw the benefits as exceeding the costs in current circumstances. Most participants judged that a program of purchasing additional longer-term securities would put downward pressure on longer-term interest rates and boost asset prices; some observed that it could also lead to a reduction in the foreign exchange value of the dollar. Most expected these changes in financial conditions to help promote a somewhat stronger recovery in output and employment while also helping return inflation, over time, to levels consistent with the Committee's mandate. In addition, several participants argued that the stimulus provided by additional securities purchases would help protect against further disinflation and the small probability that the U.S. economy could fall into persistent deflation—an outcome that they thought would be very costly. Some participants, however, anticipated that additional purchases of longer-term securities would have only a limited effect on the pace of the recovery; they judged that the economy's slow growth largely reflected the effects of factors that were not likely to respond to additional monetary policy stimulus and thought that additional action would be warranted only if the outlook worsened and the odds of deflation increased materially. Some participants noted concerns that additional expansion of the Federal Reserve's balance sheet could put unwanted downward pressure on the dollar's value in foreign exchange markets. Several participants saw a risk that a further increase in the size of the Federal Reserve's asset portfolio, with an accompanying increase in the supply of excess reserves and in the monetary base, could cause an undesirably large increase in inflation. However, it was noted that the Committee had in place tools that would enable it to remove policy accommodation quickly if necessary to avoid an undesirable increase in inflation.

Committee Policy Action

Though the economic recovery was continuing, members considered progress toward meeting the Committee's dual mandate of maximum employment and price stability as having been disappointingly slow. Moreover, members generally thought that progress was likely to remain slow. Accordingly, most members judged it appropriate to take action to promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with the Committee's mandate. In their discussion of monetary policy for the period immediately ahead, nearly all Committee members agreed to keep the federal funds rate at its effective lower bound by maintaining the target range for that rate at 0 to 1⁄4 percent and to expand the Federal Reserve's holdings of longer-term securities. To increase its securities holdings, the Committee decided to continue its existing policy of reinvesting principal payments from its securities holdings into longer-term Treasury securities and intended to purchase a further $600 billion of longer-term Treasury securities at a pace of about $75 billion per month through the second quarter of 2011. One member dissented from this action, judging that the risks of additional securities purchases outweighed the benefits. Members agreed that the Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster its goals of maximum employment and price stability.

With respect to the statement to be released following the meeting, members agreed that it was appropriate to adjust the statement to make it clear that the unemployment rate was elevated, and that measures of underlying inflation were somewhat low, relative to levels that the Committee judged to be consistent, over the longer run, with its dual mandate. Nearly all members agreed that the statement should reiterate the expectation that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. Members agreed that the statement should note that the Committee will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to 1⁄4 percent. The Committee directs the Desk to execute purchases of longer-term Treasury securities by the end of June 2011 in order to increase the total face value of domestic securities held in the System Open Market Account to approximately $2.6 trillion. The Committee also directs the Desk to reinvest principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in September confirms that the pace of recovery in output and employment continues to be slow. Household spending is increasing gradually, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, though less rapidly than earlier in the year, while investment in nonresidential structures continues to be weak. Employers remain reluctant to add to payrolls. Housing starts continue to be depressed. Longer-term inflation expectations have remained stable, but measures of underlying inflation have trended lower in recent quarters.
>
> Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Currently, the unemployment rate is elevated, and measures of underlying inflation are somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate. Although the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, progress toward its objectives has been disappointingly slow.
>
> To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Com-

mittee decided today to expand its holdings of securities. The Committee will maintain its existing policy of reinvesting principal payments from its securities holdings. In addition, the Committee intends to purchase a further $600 billion of longer-term Treasury securities by the end of the second quarter of 2011, a pace of about $75 billion per month. The Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of incoming information and will adjust the program as needed to best foster maximum employment and price stability.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Sandra Pianalto, Sarah Bloom Raskin, Eric Rosengren, Daniel K. Tarullo, Kevin Warsh, and Janet L. Yellen.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he judged that additional accommodation would do little to accelerate the economy's continuing, gradual recovery. In his assessment, the risks of additional purchases of Treasury securities outweighed the benefits. Mr. Hoenig believed that additional purchases would risk a further misallocation of resources and future financial imbalances that could destabilize the economy. He also saw a potential for additional purchases to undermine the Federal Reserve's independence and cause long-term inflation expectations to rise. Mr. Hoenig also believed it was not appropriate to indicate that economic and financial conditions were "likely to warrant exceptionally low levels of the federal funds rate for an extended period" or to reinvest principal payments from agency debt and mortgage-backed securities in long-term Treasury securities. In his assessment, this continued high level of monetary policy accommodation could put at risk the achievement of the Committee's long-run policy objectives.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 14, 2010. The meeting adjourned at 1:15 p.m. on November 3, 2010.

Notation Vote

By notation vote completed on October 8, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on September 21, 2010.

Videoconference Meeting of October 15

The Committee met by videoconference on October 15 to discuss issues associated with its monetary policy framework, including alternative ways to express and communicate the Committee's objectives, possibilities for supplementing the Committee's communication about its policy decisions, the merits of smaller and more frequent adjustments in the Federal Reserve's intended securities holdings versus larger and less frequent adjustments, and the potential costs and benefits of targeting a term interest rate. The agenda did not contemplate any policy decisions and none were taken.

Participants agreed that greater public understanding of the Committee's interpretation of its statutory objectives could contribute to better macroeconomic outcomes. Participants expressed a range of views about the potential costs and benefits of quantifying the Committee's interpretation of its statutory mandate to promote price stability by adopting a numerical inflation objective or a target path for the price level. In the end, participants noted that the longer-run projections contained in the Summary of Economic Projections, which is released once per quarter in conjunction with the minutes of four of the Committee's meetings, convey considerable information about participants' assessments of their statutory objectives. Participants discussed whether it might be useful for the Chairman to hold occasional press briefings to provide more detailed information to the public regarding the Committee's assessment of the outlook and its policy decisionmaking than is included in Committee's short post-meeting statements.

In their discussion of the relative merits of smaller and more frequent adjustments versus larger and less frequent adjustments in the Federal Reserve's intended securities holdings, participants generally agreed that large adjustments had been appropriate when economic activity was declining sharply in response to the financial crisis. In current circumstances, however, most saw advantages to a more incremental approach that would involve smaller changes in the Committee's holdings of securities calibrated to incoming data.

Finally, participants discussed the potential benefits and costs of setting a target for a term interest rate. Some noted that targeting the yield on a term security could be an effective way to reduce longer-term interest rates and thus provide additional stimulus to the economy. But participants also noted potentially large risks, including the risk that the Federal Reserve might find itself buying undesirably large amounts of the relevant security in order to keep its yield close to the target level.

William B. English
Secretary

Addendum: Summary of Economic Projections

In conjunction with the November 2–3, 2010, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in the deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation for the years 2010 to 2013 and over the longer run. The projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

As depicted in **figure 1**, FOMC participants' projections of economic activity over the next several years indicated that they expected the economic recovery to continue, with unemployment declining slowly and inflation remaining subdued. As indicated in **table 1**, relative to their previous projections in June, participants saw weaker real activity this year and expected a somewhat more gradual economic recovery over the next several years. Most participants expected the unemployment rate would slowly decline over the forecast horizon, while the rate of inflation would edge up but stay subdued. Participants generally indi-

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, November 2010
Percent

Variable	Central tendency[1]					Range[2]				
	2010	2011	2012	2013	Longer run	2010	2011	2012	2013	Longer run
Change in real GDP	2.4 to 2.5	3.0 to 3.6	3.6 to 4.5	3.5 to 4.6	2.5 to 2.8	2.3 to 2.5	2.5 to 4.0	2.6 to 4.7	3.0 to 5.0	2.4 to 3.0
June projection	3.0 to 3.5	3.5 to 4.2	3.5 to 4.5	n.a.	2.5 to 2.8	2.9 to 3.8	2.9 to 4.5	2.8 to 5.0	n.a.	2.4 to 3.0
Unemployment rate	9.5 to 9.7	8.9 to 9.1	7.7 to 8.2	6.9 to 7.4	5.0 to 6.0	9.4 to 9.8	8.2 to 9.3	7.0 to 8.7	5.9 to 7.9	5.0 to 6.3
June projection	9.2 to 9.5	8.3 to 8.7	7.1 to 7.5	n.a.	5.0 to 5.3	9.0 to 9.9	7.6 to 8.9	6.8 to 7.9	n.a.	5.0 to 6.3
PCE inflation	1.2 to 1.4	1.1 to 1.7	1.1 to 1.8	1.2 to 2.0	1.6 to 2.0	1.1 to 1.5	0.9 to 2.2	0.6 to 2.2	0.4 to 2.0	1.5 to 2.0
June projection	1.0 to 1.1	1.1 to 1.6	1.0 to 1.7	n.a.	1.7 to 2.0	0.9 to 1.8	0.8 to 2.4	0.5 to 2.2	n.a.	1.5 to 2.0
Core PCE inflation[3]	1.0 to 1.1	0.9 to 1.6	1.0 to 1.6	1.1 to 2.0		0.9 to 1.4	0.7 to 2.0	0.6 to 2.0	0.5 to 2.0	
June projection	0.8 to 1.0	0.9 to 1.3	1.0 to 1.5	n.a.		0.7 to 1.5	0.6 to 2.4	0.4 to 2.2	n.a.	

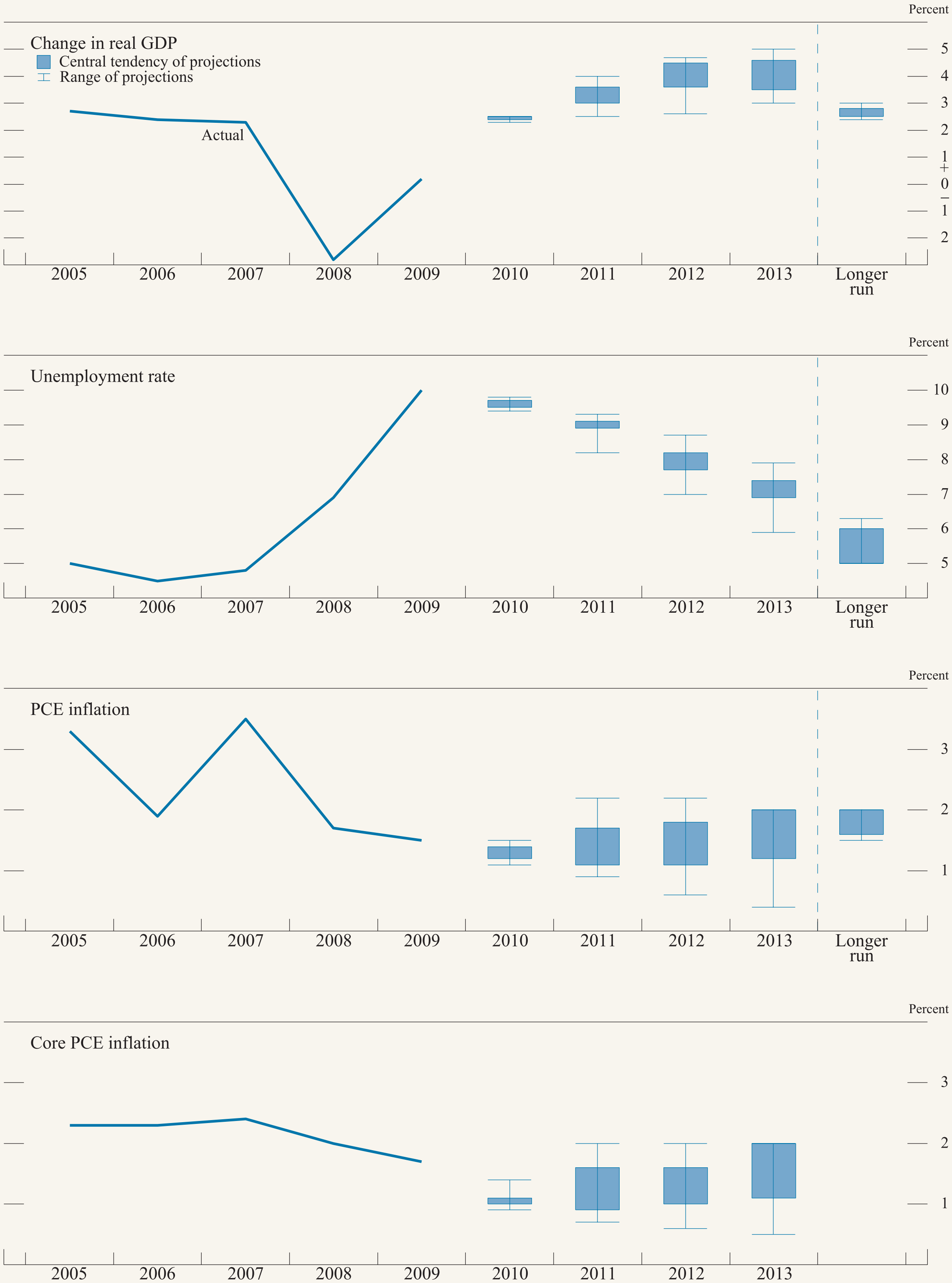
Note: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The June projections were made in conjunction with the meeting of the Federal Open Market Committee on June 22–23, 2010.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.

3 Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2010–13 and over the longer run



NOTE: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

cated that the pace of expansion in real gross domestic product (GDP) would rise over the projection period to one that was somewhat above their assessment of the economy's longer-run rate of growth. They judged that the pickup in economic activity would be spurred in part by accommodative monetary policy and a gradual easing in credit conditions that would help buoy spending by consumers and businesses. Stronger spending, in turn, would lead to improved confidence in the economy, a pickup in hiring, and a further improvement in credit conditions—forces that would continue to support spending. But participants thought that several factors would likely continue to restrain economic growth for a while, including a high degree of caution exhibited by consumers and businesses, persistent weakness in the residential and commercial real estate sectors of the economy, and still-tight credit conditions. Somewhat more than half of the participants judged that, in the absence of any additional shocks to the economy, the economy would converge fully to its longer-run rates of output growth, unemployment, and inflation within about five or six years; the rest indicated that it could take longer for unemployment to fall back to its longer-run rate or for inflation to rise back to the level they deemed desirable in the longer run. Participants continued to attach an unusually high degree of uncertainty to their projections relative to longer-run norms. While many participants judged the risks surrounding their projections of each variable to be broadly balanced, a similar number indicated that the combination of downside risks to growth and upside risks to unemployment predominated.

The Outlook

The central tendency of participants' projections of real GDP growth in 2010 was a narrow band from 2.4 to 2.5 percent, down from 3.0 to 3.5 percent in June. Participants stated that incoming economic data had weighed heavily on their forecasts for growth this year. The Bureau of Economic Analysis published its comprehensive annual revisions and advance estimate of second-quarter GDP after participants submitted their June projections, and these data showed that the expansion in real GDP in the first half of the year had been slower than the participants had expected. The most recent data on output growth in the third quarter indicated that the economy had continued to expand modestly. Participants noted that consumer spending appeared restrained by lower household wealth, relatively tight credit conditions in some markets, and households' ongoing desire to repair their balance sheets. In addition, participants generally viewed the incoming data on housing, manufacturing, trade, and labor market activity as weaker than they had expected at the time of the June meeting. Participants also noted that the support to growth from earlier fiscal stimulus and inventory investment had waned.

Participants continued to expect a modest pickup in the pace of the recovery over the next couple of years. The central tendency of their projections for output growth in 2011 was 3.0 to 3.6 percent, followed by central tendencies of 3.6 to 4.5 percent in 2012 and 3.5 to 4.6 percent in 2013. Participants noted that factors such as previously deferred spending on consumer durables and business equipment and software, stabilization in residential investment, accommodative conditions in financial markets, and some easing in credit conditions would likely provide impetus to economic growth going forward. However, participants cited several forces that were likely to weigh on the pace of the economic expansion over the next few years, including the ongoing poor performance of the commercial real estate sector, the uneven pace of the recovery in housing markets, the potential effects of the home mortgage documentation problems that had recently surfaced, the restraint in government spending resulting from the strained fiscal conditions of many states and municipalities, and credit conditions at banks that were likely to ease fairly slowly. Participants anticipated that, in the absence of further shocks, the economy would converge over time to a longer-run rate of real GDP growth of 2.5 to 2.8 percent, unchanged from June.

Participants expected that conditions in labor markets would improve gradually beginning next year. The central tendency of their projections of the average unemployment rate in the fourth quarter of this year was 9.5 to 9.7 percent. Uncertainty on the part of employers about the sustainability of the recovery was generally anticipated to ebb over the forecast period, and participants expected that hiring would gradually pick up and unemployment would decline slowly. The central tendency of their unemployment rate projections for the end of the forecast period in 2013 was 6.9 to 7.4 percent. On the whole, the projections suggest a more gradual decline in unemployment over the next few years than had been expected in June, consistent with the participants' assessments of somewhat weaker growth prospects. Participants noted that the more gradual recovery was reflected in improvements in the labor market to date that had been slower to materialize than previously anticipated. Some participants attributed a portion of the upward revision in their projections of unemployment over the next two years to longer-lived structural adjustments in labor markets, and they raised their estimates of the unemployment rate that would prevail in the longer run accordingly. As a result, participants' longer-run projections of unemployment exhibited a central tendency of 5.0 to 6.0 percent, substantially wider than the central tendency of 5.0 to 5.3 percent reported in June.

Participants' inflation projections edged up since June but continued to indicate that inflation was expected to remain subdued over the next several years. Participants noted that the high degree of slack in resource markets would help keep inflation relatively low over the forecast horizon. At the same time, appropriate monetary policy, combined with well-anchored inflation expectations, was seen as likely to result in a modest level of inflation, avoiding either an undesirable increase or a further decrease in inflation. The central tendency of participants' projections for personal consumption expenditures (PCE) inflation was 1.2 to 1.4 percent in 2010, 1.1 to 1.7 percent in 2011, 1.1 to 1.8 percent in 2012, and 1.2 to 2.0 percent in 2013. Increases in energy and other commodity prices were expected to boost headline PCE inflation over the forecast period, with core inflation likely to run at a somewhat lower pace. Most participants' projections of inflation over the next several years did not exceed the rate of longer-run inflation that they individually considered most consistent with the Federal Reserve's dual mandate for maximum employment and stable prices. Participants' projections of this mandate-consistent rate of inflation exhibited a central tendency of 1.6 to 2.0 percent, little changed from June.

Uncertainty and Risks

As they did in June, most participants attached a higher degree of uncertainty to their projections of output growth and unemployment over the forecast horizon than is historically typical.[1] While a majority of participants judged the risks to output growth as broadly balanced, many participants viewed the risks to their forecast of output growth as weighted to the downside, the risks to their forecast of unemployment as tilted to the upside, or both. Some of these participants noted that it would be more difficult than usual to address future negative shocks to the real economy, should they materialize, because the Federal Reserve had already moved nominal short-term interest rates close to zero, and because they saw the likelihood of further fiscal stimulus as being quite limited. In addition, some of these participants noted that the anticipated recovery of the housing market might take longer than expected.

Regarding inflation, a few participants judged that the uncertainty surrounding their projections was broadly similar to historical norms, but most continued to attach an unusually high degree of uncertainty to these projections. Most participants continued to assess the risks to their inflation forecasts as broadly balanced, although some judged that downside risks predominated and a couple judged that upside risks predominated. Participants citing downside risks noted concerns about the degree to which lingering resource slack in the economy was putting downward pressure on inflation, or about the possible effects that an extended period of low readings on actual inflation might have in reducing inflation expectations. Those who indicated upside risks to inflation generally pointed to concerns relating to the unusual size of the Federal Reserve's balance sheet, which, if left in place for too long, might eventually begin to erode the stability of longer-term inflation expectations.

Table 2. Average historical projection error ranges
Percentage points

Variable	2010	2011	2012	2013
Change in real GDP[1]	±0.6	±1.4	±1.8	±1.8
Unemployment rate[1]	±0.2	±0.9	±1.4	±1.5
Total consumer prices[2]	±0.5	±1.0	±1.1	±1.1

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1990 through 2009 that were released in the fall by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 For definitions, refer to general note in table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

1 Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1989 to 2009. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risks attending participants' projections.

Diversity of Views

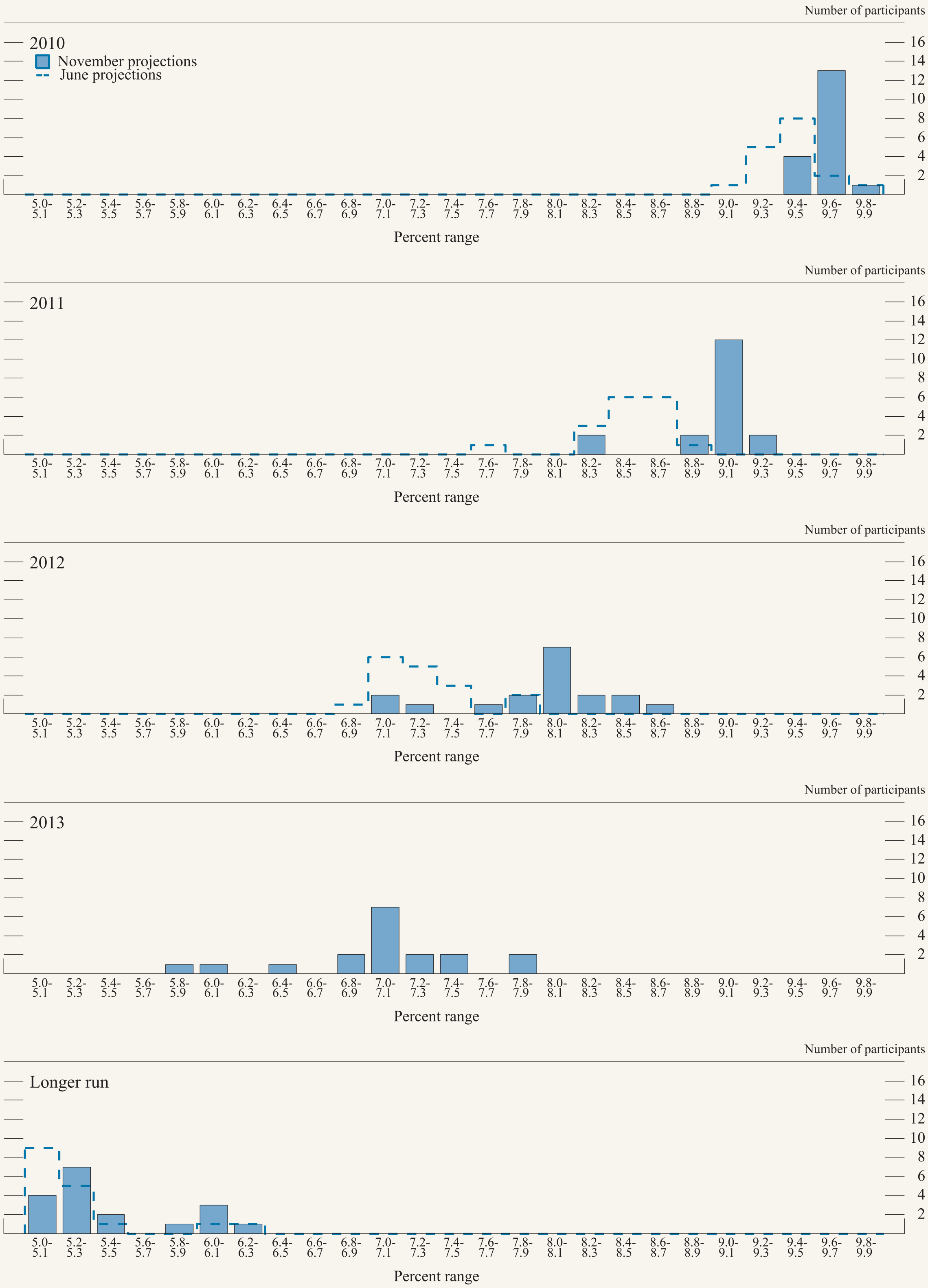
Information about the diversity of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate over the next few years is provided in **figures 2.A** and **2.B**, respectively. The dispersion in these projections reflects differences in participants' assessments of many factors, including the current degree of underlying momentum in economic activity, the amount of restraint on economic activity likely to result from low readings on consumer and business sentiment and relatively tight credit conditions, how quickly and to what degree particularly hard-hit sectors of the economy will recover, the degree of support for economic activity from conditions in financial markets, and the form and degree of appropriate future monetary policy and its effects on economic activity. With much of the data for 2010 now in hand, the dispersion of participants' projections of output growth this year narrowed quite a bit relative to June. While the distributions of participants' projections of real GDP growth in 2011 and 2012 shifted lower since June, the degree of dispersion displayed in these projections was little changed. The dispersion associated with participants' longer-run projections of output growth also changed little from June. Regarding unemployment, the distributions of participants' projections of this variable for 2010 through 2012 generally shifted up somewhat, and the distribution of their forecasts for 2012 widened noticeably, relative to June. The distribution of their estimates of the longer-run rate of unemployment showed modest changes since June, and, as noted previously, the central tendency of these projections widened.

Figures 2.C and **2.D** provide corresponding information about the diversity of participants' outlooks for inflation. The distributions of participants' projections for overall and core PCE inflation in 2010 narrowed somewhat and moved a bit higher compared with the patterns these projections displayed in June. Most of the distributions of the participants' inflation projections for 2011 and 2012 also became somewhat more concentrated relative to June. Participants' forecasts of overall inflation over the longer run remained in a relatively narrow band. In general, participants' projections of inflation over the next few years exhibit dispersion because of differences in their judgments regarding the determinants of inflation, including their estimates of the degree of resource slack and their assessments of the extent to which such slack influences inflation outcomes and expectations. By contrast, the relatively concentrated distribution of participants' longer-run inflation projections shows the substantial similarity in the participants' assessments of the approximate level of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2.A. Distribution of participants' projections for change in real GDP, 2010–13 and over the longer run

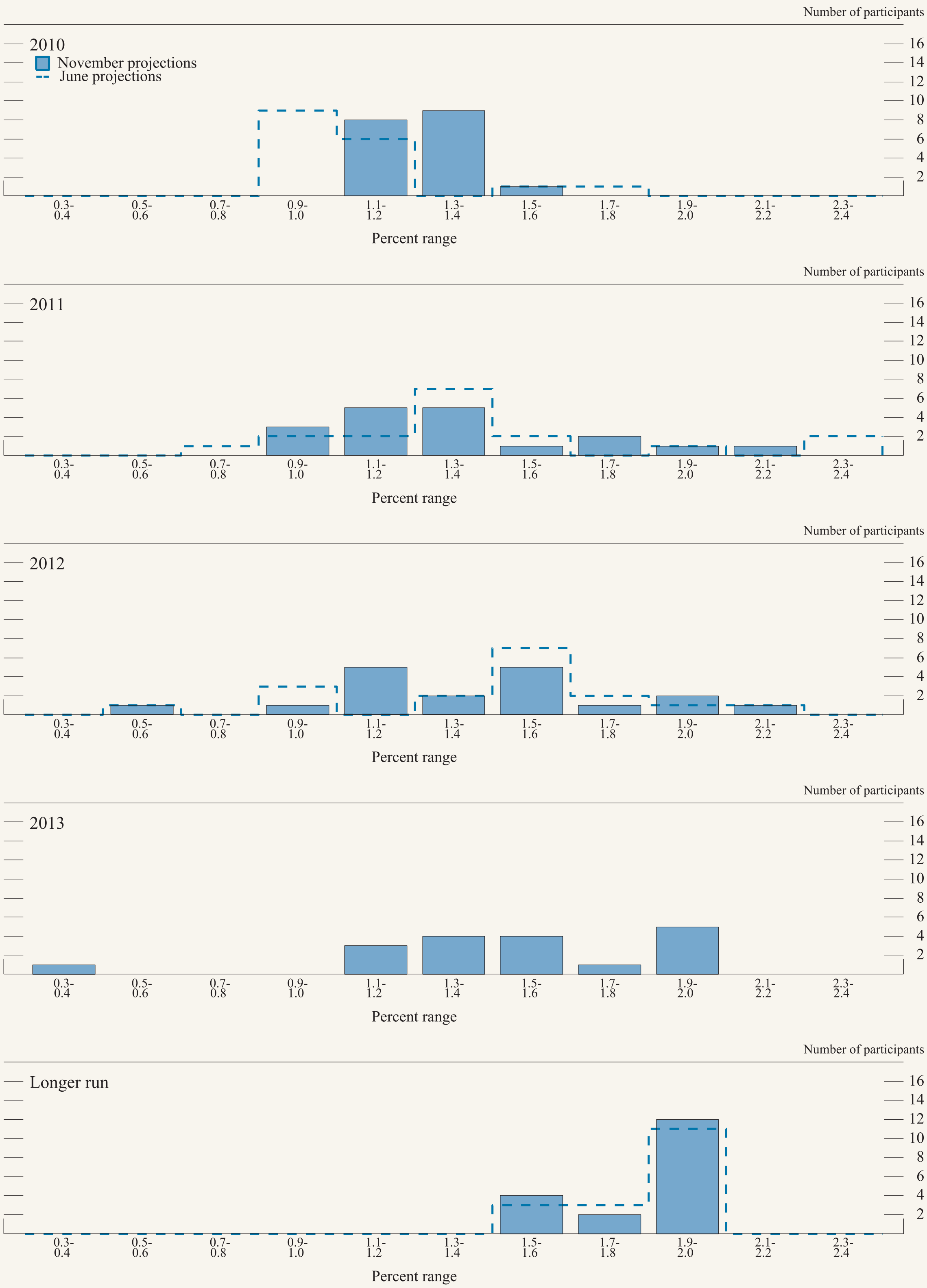
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2010–13 and over the longer run



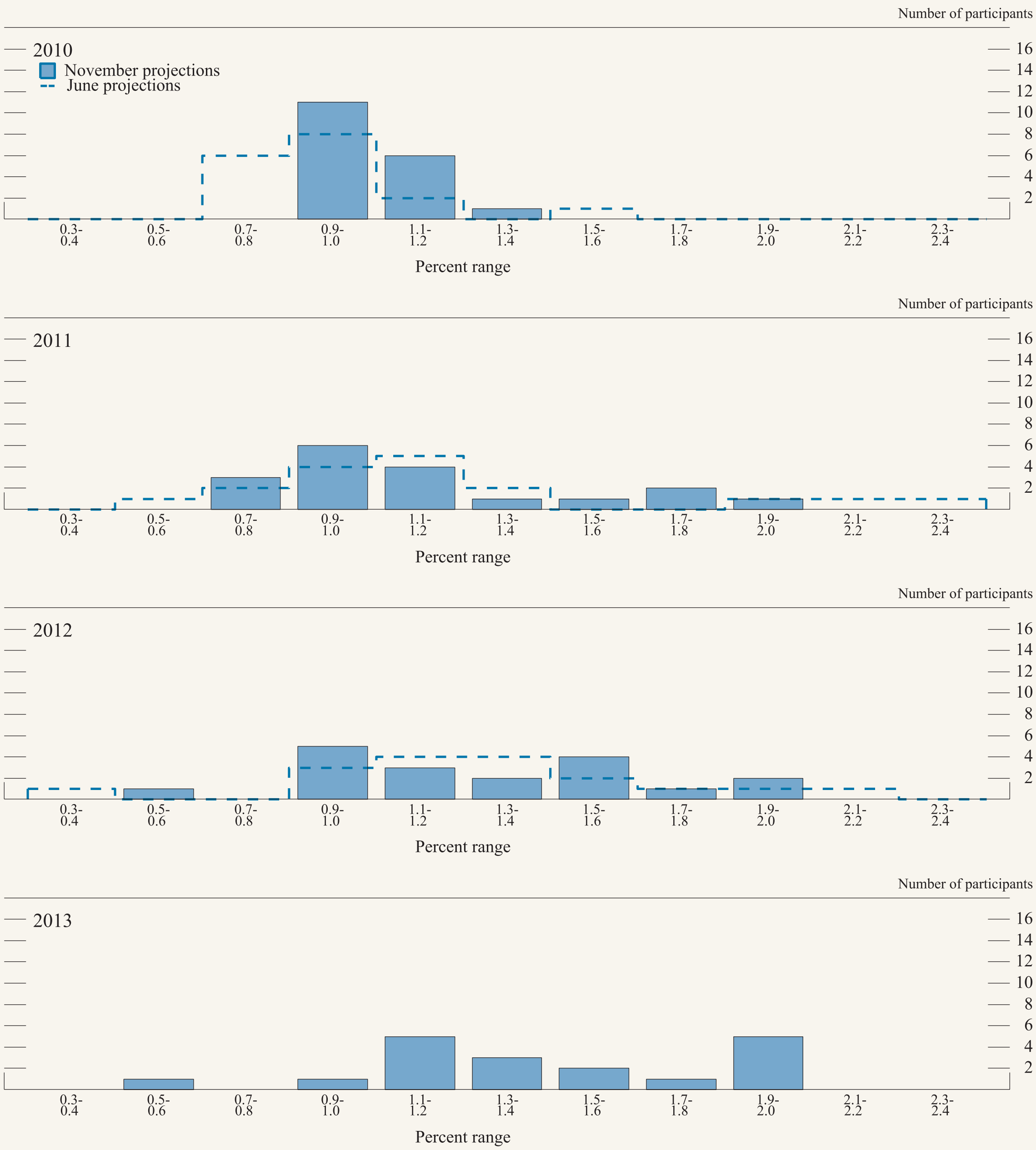
Note: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2010–13 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2010–13



NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Report* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.4 to 3.6 percent in the current year, 1.6 to 4.4 percent in the second year, and 1.2 to 4.8 percent in the third and fourth years. The corresponding 70 percent confidence intervals for overall inflation would be 1.5 to 2.5 percent in the current year, 1.0 to 3.0 percent in the second year, and 0.9 to 3.1 percent in the third and fourth years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Meeting Held on December 14, 2010

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, December 14, 2010, at 8:30 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Thomas M. Hoenig

Sandra Pianalto

Sarah Bloom Raskin

Eric Rosengren

Daniel K. Tarullo

Kevin Warsh

Janet L. Yellen

Christine Cumming, Charles L. Evans, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker and Dennis P. Lockhart
Presidents of the Federal Reserve Banks of Richmond and Atlanta, respectively

John F. Moore
First Vice President, Federal Reserve Bank of San Francisco

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Nathan Sheets
Economist

David J. Stockton
Economist

Alan D. Barkema, James A. Clouse, Thomas A. Connors, Jeff Fuhrer, Steven B. Kamin, Lawrence Slifman, Christopher J. Waller, and David W. Wilcox
Associate Economists

Brian Sack
Manager, System Open Market Account

Patrick M. Parkinson
Director, Division of Bank Supervision and Regulation, Board of Governors

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

William Nelson
Deputy Director, Division of Monetary Affairs, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Charles S. Struckmeyer
Deputy Staff Director, Office of the Staff Director, Board of Governors

David Reifschneider and William Wascher
Senior Associate Directors, Division of Research and Statistics, Board of Governors

Andrew T. Levin
Senior Adviser, Office of Board Members, Board of Governors

Michael G. Palumbo and Joyce K. Zickler
Deputy Associate Directors, Division of Research and Statistics, Board of Governors

Gretchen C. Weinbach
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Fabio M. Natalucci
Assistant Director, Division of Monetary Affairs, Board of Governors

Randall A. Williams
Records Management Analyst, Division of Monetary Affairs, Board of Governors

Dale Roskom
First Vice President, Federal Reserve Bank of Cleveland

Harvey Rosenblum, Daniel G. Sullivan, and John C. Williams
Executive Vice Presidents, Federal Reserve Banks of Dallas, Chicago, and San Francisco, respectively

David Altig, Richard P. Dzina, Mark E. Schweitzer, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, Cleveland, and Minneapolis, respectively

Tobias Adrian
Vice President, Federal Reserve Bank of New York

Satyajit Chatterjee
Senior Economic Adviser, Federal Reserve Bank of Philadelphia

Alexander L. Wolman
Senior Economist, Federal Reserve Bank of Richmond

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets since the Federal Open Market Committee (FOMC) met on November 2–3, 2010. He also reported on System open market operations, including the continuing reinvestment into longer-term Treasury securities of principal payments received on the SOMA's holdings of agency debt and agency-guaranteed mortgage-backed securities (MBS) as well as the ongoing purchases of additional Treasury securities authorized at the November 2–3 FOMC meeting. Since the last meeting, the Open Market Desk at the Federal Reserve Bank of New York purchased a total of about $105 billion of Treasury securities, reflecting about $30 billion of purchases with the proceeds of principal payments and about $75 billion as part of the authorized expansion of the Federal Reserve's securities holdings. Purchases were concentrated in nominal Treasury securities with maturities of 2 to 10 years, though some longer-term securities were purchased along with some Treasury inflation-protected securities (TIPS). The Manager also discussed the Desk's intention to place additional limits on its purchases of individual securities, as the Federal Reserve's holdings of such securities increased beyond 35 percent of the total outstanding; these limits were intended to help ensure that Federal Reserve purchases do not impair the liquidity in Treasury markets. In addition, the Manager updated the Committee on the SOMA's holdings of foreign-currency instruments. There were no open market operations in foreign currencies for the System's account over the intermeeting period. By unanimous vote, the Committee ratified the Desk's transactions over the intermeeting period.

In light of ongoing strains in some foreign financial markets, the Committee considered a proposal to extend its dollar liquidity swap arrangements with foreign central banks past January 31, 2011. After discussing possible alternative periods for such an extension, the Committee unanimously approved the following resolution:

> The Federal Open Market Committee directs the Federal Reserve Bank of New York to extend the existing temporary reciprocal currency arrangements ("swap arrangements") for the System Open Market Account with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank. The swap arrangements shall now terminate on August 1, 2011, unless further extended by the Committee.

Staff Review of the Economic Situation

The information reviewed at the December 14 meeting indicated that economic activity was increasing at a moderate rate, but that the unemployment rate remained elevated. The pace of consumer spending picked up in October and November, exports rose rapidly in October, and the recovery in business spending on equipment and software (E&S) appeared to be continuing. In contrast, residential and nonresidential construction activity was still depressed. Manufacturing production registered a solid gain in October. Nonfarm businesses continued to add workers in October and November, and the average workweek moved up. Longer-run inflation expectations were stable, but core inflation continued to trend lower.

Labor demand rose further in recent months, but unemployment stayed at a high level. The average increase in private nonfarm payroll employment in October and November was close to the pace over the preceding six months, while the average workweek for all employees edged higher. The bulk of the private-sector job gains continued to be in the services industries; employment in manufacturing, construction, and retail trade declined, on average, in October and November. Employment at state and local governments rose slightly over the two-month period. A number of indicators of job openings and hiring plans improved in October and November, and initial claims for unemployment insurance trended steadily lower through November and early December. However, the unemployment rate, which remained at 9.6 percent during the preceding three months, increased to 9.8 percent in November, while the labor force participation rate and the employment-population ratio remained depressed.

Industrial production in the manufacturing sector increased at a solid pace in October, with advances widespread across industries; total industrial production was unchanged due to an offsetting weather-related drop in the output of utilities. The manufacturing capacity utilization rate continued to move up in October, although it remained significantly below its 1972–2009 average. Most indicators of near-term industrial activity, such as the new orders diffusion indexes in the national and regional manufacturing surveys, were at levels consistent with moderate gains in industrial production in the near term. Motor vehicle assemblies, which rose in October, fell back in November but were scheduled to move up again in coming months.

The pace of consumer spending picked up in recent months from the modest rate that prevailed earlier in the year. Nominal retail sales, excluding purchases at motor vehicles and parts outlets, posted a strong gain in November, and revised estimates showed larger increases in September and October than previously reported. In addition, sales of new light motor vehicles stepped up in October and remained at that higher level in November. A number of factors supporting consumer spending also improved. Revised data on personal income indicated that it was stronger last spring and summer than previously reported. Household net worth rose further in the third quarter, as an increase in equity values more than offset the effect of a drop in house prices. Consumer sentiment turned more positive in November and early December, retracing most of the decline that occurred during the summer. However, while consumer credit outstanding showed signs of stabilizing after two years of runoffs, credit terms were still noticeably less favorable than in the past, and demand for credit appeared to remain weak.

Activity in the housing market was still quite depressed. In October, starts of new single-family homes remained at the very low level that had prevailed since August. Moreover, the level of permit issuance, which is typically a near-term indicator of new homebuilding, continued to run below starts. The persistence of a large excess supply of existing homes on the market and tight credit conditions for construction appeared to constitute a significant restraint on new homebuilding. Demand for housing also remained very weak: Sales of new homes in October were at the lowest level in the 48-year history of the series. Purchases of existing homes edged lower in October; in part, the still-low level of sales likely reflected the payback from the earlier surge in sales associated with the homebuyer tax credit and also the moratoriums on sales of bank-owned properties. Measures of house prices declined recently, and households' concerns that home values might continue to fall, their pessimism about the outlook for employment and income, and the tight standards faced by many mortgage borrowers appeared to be weighing on demand.

Real business investment in equipment and software appeared to be increasing, although the pace of spending seemed to have moderated from the rapid rate of the first half of the year. The rise in E&S spending during the third quarter, while somewhat slower than earlier in the year, remained solid and broad based, but the available data for the fourth quarter were mixed. Nominal orders and shipments of nondefense capital goods excluding aircraft declined in October, and business purchases of new vehicles in October and November were down a bit from their third-quarter level. In contrast, sales of software still appeared to be on a solid uptrend, and deliveries of completed aircraft picked up in November. Surveys of purchasing managers reported plans to step up capital spending in 2011; however, reports from small businesses on their planned expenditures remained downbeat. Business outlays on nonresidential structures appeared to be declining further, with a drop in spending on building construction offset only slightly by increased investment in drilling and mining structures. Overall borrowing by nonfinancial corporations was robust again in November, indicators of credit quality continued to improve, and small businesses noted some easing in credit availability. However, financing conditions for commercial real estate remained tight.

Real inventory investment rose sharply in the third quarter, but book-value data for October suggested that the pace of accumulation was slowing. Although inventory-sales ratios rose during the third quarter, survey data implied that few businesses perceived inventory stocks as being too high.

Consumer price inflation trended lower in October. The 12-month change in the total personal consumption expenditures (PCE) price index reached its lowest level of the past year; the 12-month change in the PCE price index for core goods and services also moved down. In October, core PCE prices were unchanged for a second month, as goods prices declined and prices of non-energy services posted a small increase. The broad-based deceleration in underlying inflation was also apparent in other measures, such as the trimmed-mean PCE price index and a diffusion index of PCE price changes. Despite the rise in agricultural commodity prices, the increase in retail food prices was modest. In contrast, consumer energy prices continued to rise rapidly in October, and spot prices of imported crude oil moved higher, on net, during November and early December. The rise in prices of nonfuel industrial commodities moderated over the intermeeting period as spot prices of metals declined, but the producer price index for domestically manufactured intermediate goods accelerated in October and November. In November and early December, survey measures of households' short- and long-term inflation expectations remained in the ranges that have prevailed since the spring of 2009.

Available measures of labor compensation showed that labor cost pressures were still restrained. The 12-month change in average hourly earnings for all employees remained low in November. In the third quarter, the modest rise in hourly compensation in the nonfarm business sector was matched by a similar increase in productivity.

The U.S. international trade deficit narrowed considerably in October, shrinking to its lowest level since the beginning of the year, as exports surged and imports edged down. The strength in exports was relatively broad based. Exports of industrial supplies and agricultural goods registered the largest increases, although rising prices accounted for some of those gains. Exports of machinery and automotive products also rose strongly. The decrease in imports was concentrated in petroleum products, reflecting lower volumes, and in computers. In contrast, imports of consumer goods posted a noticeable increase.

Recent data releases confirmed that, in the aggregate, the rise in foreign real gross domestic product (GDP) slowed sharply in the third quarter from the very rapid pace earlier in the year. The slowdown was most pronounced in the emerging market economies (EMEs), where economic activity was restrained by the abatement of inventory rebuilding and the associated waning of the rebound in global trade, the unwinding of fiscal stimulus measures, and a continued tightening of monetary policies in several countries. More recent indicators for the EMEs, including purchasing managers indexes (PMIs), pointed to a rebound in economic activity in the fourth quarter. The advanced foreign economies (AFEs) also saw a slower rise in real economic activity in the third quarter than occurred earlier in the year. In the euro area, economic performance continued to diverge across countries. The increase in German economic activity in the third quarter was nearly twice the euro-area average rate, and recent indicators, including PMIs and consumer and business sentiment, showed further solid performance. In contrast, Spanish economic activity stagnated in the third quarter, Greek GDP extended its decline, and more-recent indicators point to continued weakness in peripheral European economies. Headline inflation rates generally picked up in the foreign economies, driven largely by food and energy prices; measures of inflation excluding food and energy prices were relatively steady.

Staff Review of the Financial Situation

The decision by the FOMC at its November meeting to maintain the 0 to ¼ percent target range for the federal funds rate was widely anticipated. The decision to expand its holdings of longer-term securities by $600 billion by the end of the second quarter of 2011 was also roughly in line with market expectations, although market participants appeared to expect the purchase program would be increased over time. In the weeks following the November meeting, yields on nominal Treasury securities increased significantly, as investors reportedly revised down their estimates of the ultimate size of the FOMC's new asset-purchase program. Incoming economic data that were viewed, on balance, as favorable to the outlook and news of a tentative agreement between the Administration and some members of the Congress regarding a package of fiscal measures also reportedly contributed to the backup in yields. Market participants pointed to abrupt changes in investor positions, the effects of the approaching year-end on market liquidity, and hedging flows associated with investors' holdings of MBS as factors that may have amplified the rise in yields. Futures quotes suggested that the path for the federal funds rate expected by market participants rose over the intermeeting period.

The increase in yields on nominal Treasury coupon securities was accompanied by increases in yields on TIPS. TIPS-based inflation compensation moved up at the 5-year horizon amid rising energy prices, but forward inflation compensation 5 to 10 years ahead was about unchanged. Yields on investment-grade corporate bonds rose about in line with those on comparable-maturity Treasury securities, leaving risk spreads about unchanged; spreads on speculative-grade corporate bonds moved down somewhat. Secondary-market prices for leveraged loans rose slightly over the intermeeting period, while bid-asked spreads in that market continued to drift down.

Some signs of modest stress emerged in certain short-term funding markets over the intermeeting period as investors focused increasingly on the evolving situation in Europe. The spread of the three-month London interbank offered rate (or Libor) forward rate agreement over the three-month forward overnight index swap (OIS) rate moved a bit higher, on balance, perhaps pointing to heightened concerns about future funding conditions. In the commercial paper market, spreads increased on paper issued by financial institutions with parents in peripheral European countries, and the amount outstanding of such paper declined. Spreads on asset-backed commercial paper were somewhat volatile over the intermeeting period. Nonetheless, spreads on nonfinancial commercial paper remained at low levels, as did the spreads of dollar Libor over OIS rates at one- and three-month maturities.

Broad U.S. equity price indexes increased moderately, on net, over the intermeeting period, in part reflecting incoming economic data that were read by investors as suggesting that the recovery could be gaining traction, at least outside the housing sector. Stock prices for domestic commercial banks were volatile but outperformed broad indexes on balance. Option-implied volatility on the S&P 500 index fell modestly, and the spread between the staff's estimate of the expected real return on equity for S&P 500 firms and the real 10-year Treasury yield—a rough measure of the equity risk premium—narrowed a bit, although it remained elevated relative to longer-run norms.

In the December 2010 Senior Credit Officer Opinion Survey on Dealer Financing Terms, dealers reported an easing of credit terms over the preceding three months with respect to securities financing transactions and across a range of counterparties. Dealers also noted that demand for funding of all types of securities increased over the same reference period.

Net debt financing by U.S. nonfinancial corporations continued to be robust in November. Gross issuance of corporate bonds was very heavy, particularly for speculative-grade firms. Investor demand for syndicated leveraged loans also appeared to have remained high. Nonfinancial commercial paper outstanding declined noticeably during October and November, in part because some firms reportedly shifted to bond financing. Gross public equity issuance by nonfinancial firms through seasoned and initial public offerings was particularly strong in November. Measures of the credit quality of nonfinancial corporations continued to improve.

Conditions in the commercial real estate market remained tight. Commercial mortgage debt was estimated to have declined in the third quarter, and the delinquency rates for securitized commercial mortgages and those for existing properties at commercial banks increased further. However, some modest signs of improvement continued to surface. Prices of commercial real estate changed little, on balance, over September and October, holding in the relatively narrow range that had prevailed since the spring when the steep decline in these prices ended. Issuance of commercial mortgage-backed securities increased in November but was still far below pre-crisis levels.

Residential mortgage rates rose considerably over the intermeeting period, though not by as much as rates on longer-term Treasury securities. The spread between mortgage rates and MBS yields dropped back, reversing the widening of the spread that occurred over the preceding several months. Refinancing activity declined in response to the higher mortgage rates. Outstanding residential mortgage debt was estimated to have contracted in the third quarter at about the average rate of decline seen over the preceding year. Delinquency rates on prime and subprime mortgages ticked down but remained extremely elevated.

In contrast, the consumer credit market exhibited continued signs of stabilization. Although consumer credit contracted in the third quarter, the decline was the smallest since late 2008, and consumer credit edged higher in October. The pace of issuance of consumer asset-backed securities in November was slightly above the average for the year to date, and the delinquency rate on consumer loans at banks declined further in the third quarter.

Commercial bank credit was about flat, on average, during October and November. Banks continued to increase their holdings of securities, while core loans—the sum of commercial and industrial (C&I), real estate, and consumer loans—decreased moderately. The declines were attributable to a drop in consumer loans as well as to continued runoffs in commercial real estate and home equity loans. In contrast, C&I loans edged up, ending a nearly two-year string of monthly declines. In addition, the Survey of Terms of Business Lending conducted in the first week of November showed that interest rates on C&I loans were generally little changed while spreads remained extremely wide.

According to the latest Call Report data, bank profitability was little changed in the third quarter, remaining positive but well below pre-crisis levels. As in the second quarter, banks' net incomes were supported by declines in loan loss provisioning, while revenues declined. Banks continued to boost regulatory capital ratios, likely, at least in part, in anticipation of the need to eventually meet stricter Basel III standards.

M2 expanded at a moderate rate in November. Interest rates available on all M2 assets remained very low, and households continued to shift their holdings of M2 assets toward liquid deposits, which continued to rise rapidly, and away from small time deposits and retail money market mutual funds. Currency increased strongly, with indicators suggesting robust demand from abroad.

The foreign exchange value of the dollar, which depreciated immediately following the FOMC's November announcement of further asset purchases, subsequently appreciated amid intensifying concerns about stresses in the euro area and some apparent reassessment by investors of the monetary policy outlook in the United States. On net, the dollar ended the intermeeting period up against most currencies, with particularly large gains against the euro. The announcement of the European Union (EU)-International Monetary Fund (IMF) financial aid package for Ireland on November 28 did little to reverse the depreciation of the euro, as investors reportedly became increasingly concerned about other euro-area economies and the adequacy of resources available to support them should they come under stress. Spreads of sovereign yields in some peripheral euro-area countries over those on German bunds rose to new highs, although they fell back near the end of the intermeeting period amid reports that the European Central Bank (ECB) had increased its purchases of Irish and Portuguese sovereign debt. Banks in the euro-area periphery continued to rely heavily on funding from the ECB, and some signs of increased dollar funding pressures emerged. Implied short-term interest rates for the coming year shifted down in the euro area, as market participants apparently scaled back the pace at which they expected the ECB to normalize policy, but rose in some other AFEs. Ten-year sovereign yields increased significantly throughout the AFEs, although by less than yields in the United States. Headline stock price indexes in the AFEs generally ended the period higher, whereas bank stocks in Europe declined.

The People's Bank of China raised the required reserve ratio for banks a cumulative 150 basis points over the intermeeting period, and other central banks in emerging Asia increased policy rates. China's Shanghai Composite Index fell in the wake of Chinese policy actions, while other emerging market stock indexes were mixed over the period. In Latin America, Brazil's central bank also raised reserve requirements late in the period. The dollar appreciated slightly, on average, against the emerging market currencies, although it edged down against the Chinese renminbi.

Staff Economic Outlook

With the recent data on production and spending stronger, on balance, than the staff anticipated at the time of the November FOMC meeting, the staff revised up its projected increase in real GDP in the near term. However, the staff's outlook for real economic activity over the medium term was little changed, on net, relative to the projection prepared for the November meeting. The staff forecast incorporated the assumption that new fiscal actions, some of which had not been anticipated in its previous forecast, were likely to boost the level of real GDP in 2011 and 2012. But, compared with the November forecast, a number of other conditioning assumptions were less favorable: House prices and housing activity were likely to be lower, while interest rates, oil prices, and the foreign exchange value of the dollar were projected to be higher, on average, than previously assumed. As a result, although the staff projection showed a higher level of real GDP, the average pace of growth over 2011 and 2012 was little changed from the November forecast, and the unemployment rate was still projected to decline slowly.

The underlying rate of consumer price inflation in recent months was lower than the staff expected at the time of the November meeting, and the staff forecast anticipated that core PCE prices would rise a bit more slowly in 2011 and 2012 than previously projected. As in earlier forecasts, the persistent wide margin of economic slack in the projection was expected to sustain downward pressure on inflation, but the ongoing stability in inflation expectations was anticipated to stem further disinflation. The staff anticipated that relatively rapid increases in energy prices would raise total consumer price inflation above the core rate in the near term, but that this upward pressure would dissipate by 2012.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants saw the information received during the intermeeting period as pointing to some improvement in the near-term outlook, and they expected that economic growth, which had been moderate, would pick up somewhat going forward. Indicators of production and household spending had strengthened, and the tone of the labor market was a little better on balance. The new fiscal package was generally expected to support the pace of recovery next year. However, a number of factors were seen as likely to continue restraining growth, including the depressed housing market, employers' continued reluctance to add to payrolls, and ongoing efforts by some households and businesses to delever. Moreover, the recovery remained subject to some downside risks, such as the possibility of a more extended period of weak activity and lower prices in the housing sector and potential financial and economic spillovers if the banking and sovereign debt problems in Europe were to worsen. In light of recent readings on consumer inflation, participants noted that underlying inflation had continued trending downward, but several saw the risk of deflation as having receded somewhat.

In the household sector, incoming data on retail sales were somewhat stronger than expected, and there were some reasonably upbeat reports from business contacts regarding holiday spending. Consumer confidence appeared to be improving. Financial obligations and debt service costs had been declining as a share of household income, and that process was seen as providing greater latitude for a pickup in discretionary purchases. Nonetheless, there were indications that retail spending by middle- and lower-income households had risen less than spending by high-income households, suggestive of ongoing financial pressures on those of more modest means. Furthermore, the housing sector, including residential construction and home sales, continued to be depressed. Some participants noted that the elevated supply of available homes and the overhang of foreclosed homes were contributing to a further decline in house prices. The lower house prices, in turn, were seen as reducing household wealth and thus restraining growth in consumer spending.

A number of participants noted that their business contacts had become more optimistic about the outlook for sales and production. Nonetheless, many contacts remained cautious about hiring and investment, with some reportedly concerned about the potential effects of government policies. The manufacturing, agriculture, and energy sectors showed particular signs of strength, and the high-tech sector appeared to be improving. However, nonresidential construction remained very weak, apart from drilling and mining. It was noted that credit conditions had eased further, although nonfinancial corporations continued to hold very high levels of cash.

Conditions in the labor market appeared to be improving on balance. That improvement was reflected in a range of recent indicators, including a declining number of new jobless claims, an increase in job openings, and an uptick in the average workweek. Nonetheless, participants noted that the pace of hiring was still sluggish; indeed, the unemployment rate had edged higher in November, and the employment-population ratio remained very low.

Interest rates at intermediate and longer maturities rose substantially over the intermeeting period, while credit spreads were roughly unchanged and equity prices rose moderately. Participants pointed to a number of factors that appeared to have contributed to the significant backup in yields, including an apparent downward reassessment by investors of the likely ultimate size of the Federal Reserve's asset-purchase program, economic data that were seen as suggesting an improved economic outlook, and the announcement of a package of fiscal measures that was expected to bolster economic growth and increase the deficit over coming quarters. It was noted that the backup in rates may have been amplified by year-end positioning, as well as by some reported mortgage-related hedging flows. A number of participants indicated that, because the backup in rates appeared to importantly reflect changes in investors' expectations about the size of Federal Reserve asset purchases, the backup was consistent with purchases helping to keep longer-term yields lower than would otherwise be the case. Several meeting participants mentioned the communications challenges faced in conducting effective policy, including the need to clearly convey the Committee's views while appropriately airing individual perspectives.

Measures of underlying inflation continued to trend downward over the intermeeting period, with the slowdown in price increases evident across categories of goods and services and across different inflation measures. Although the prices of some commodities and imported goods had risen appreciably, several participants noted that businesses seemed to have little ability to pass these increases on to their customers, given the significant slack in the economy. Also, the high level of unemployment was limiting gains in wages and thereby contributing to the low level of inflation. TIPS-based measures of inflation compensation had risen modestly over the intermeeting period, while surveys of households and professional forecasters continued to suggest that longer-term inflation expectations remained stable.

Regarding their overall outlook for economic activity, participants generally agreed that, even with the positive news received over the intermeeting period, the most likely outcome was a gradual pickup in growth with slow progress toward maximum employment. However, they held a range of views about the risks to that outlook. A few mentioned the possibility that growth could pick up more rapidly than expected, particularly in light of the very accommodative stance of monetary policy currently in place. It was noted that such an acceleration would likely be accompanied by significantly more rapid growth in bank lending and in the monetary aggregates, suggesting that such indicators might prove to be useful sources of information. Others pointed to downside risks to growth. One common concern was that the housing sector could weaken further in light of the considerable supply of houses either on the market or likely to come to market. Another concern was the ongoing deterioration in the fiscal position of U.S. states and localities, which could lead to sharp cuts in spending and increases in taxes. In addition, participants expressed concerns about a possible worsening of the banking and financial strains in Europe, which could spill over to U.S. financial markets and institutions, and so to the broader U.S. economy. They observed that market stresses in Europe intensified during the intermeeting period, requiring an assistance package for Ireland from the EU and the IMF, and that after that package was announced, market attention appeared to shift to other European countries. Participants noted, however, that the European authorities were taking steps to stabilize conditions in the euro area.

Regarding the outlook for inflation, participants generally anticipated that inflation would remain for some time below levels judged to be most consistent, over the longer run, with maximum employment and price stability. In particular, most participants expected that underlying measures of inflation would bottom out around current levels and then move gradually higher as the recovery progresses. A few participants pointed to the risk that the ongoing expansion of the Federal Reserve's balance sheet and the sustained low level of short-term interest rates could trigger undesirable increases in inflation expectations and so in actual inflation. To minimize such risks, it was noted that the Committee should continue its planning for the eventual exit from the current exceptionally accommodative stance of policy. Other participants noted that, with substantial resource slack persisting, underlying inflation might fall further below the levels that the Committee sees as consistent with its mandate. Nonetheless, several participants saw the risk of deflation as having receded somewhat over recent months.

Committee Policy Action

Members noted that, while incoming information over the intermeeting period had increased their confidence in the economic recovery, progress toward the Committee's dual objectives of maximum employment and price stability was disappointingly slow. In addition, members generally expected that progress was likely to remain modest, with unemployment and inflation deviating from the Committee's objectives for some time. Accordingly, in their discussion of monetary policy for the period immediately ahead, nearly all Committee members agreed to continue expanding the Federal Reserve's holdings of longer-term securities as announced in November in order to promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with the Committee's mandate. The Committee decided to maintain its existing policy of reinvesting principal payments from its securities holdings into longer-term Treasury securities. In addition, the Committee agreed to continue buying longer-term Treasury securities with the intention of purchasing $600 billion of such securities by the end of the second quarter of 2011, a pace of about $75 billion per month. While the economic outlook was seen as improving, members generally felt that the change in the outlook was not sufficient to warrant any adjustments to the asset-purchase program, and some noted that more time was needed to accumulate information on the economy before considering any adjustment. Members emphasized that the pace and overall size of the purchase program would be contingent on economic and financial developments; however, some indicated that they had a fairly high threshold for making changes to the program. The Committee also decided to maintain the target range for the federal funds rate at 0 to ¼ percent and to reiterate its expectation that economic conditions are likely to warrant exceptionally low levels for the federal funds rate for an extended period. One member dissented from the Committee's policy decision, judging that, in light of the improving economy, a continued high level of monetary accommodation would increase the risks of future economic and financial imbalances. Members agreed that the Committee should continue to regularly review the pace of its securities purchases and the overall size of the program in light of incoming information—including information on the economic outlook, the efficacy of the program, and any unintended consequences that might arise—and make adjustments as needed to best foster maximum employment and price stability. With respect to the statement to be released following the meeting, members agreed that only small changes were necessary to reflect the modest improvement in the near-term economic outlook.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to execute purchases of longer-term Treasury securities in order to increase the total face value of domestic securities held in the System Open Market Account to approximately $2.6 trillion by the end of June 2011. The Committee also directs the Desk to reinvest principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in November confirms that the economic recovery is continuing, though at a rate that has been insufficient to bring down unemployment. Household spending is increasing at a moderate pace, but remains constrained by high unemployment, modest income growth, lower housing wealth, and tight credit. Business spending on equipment and software is rising, though less rapidly than earlier in the year, while investment in nonresidential structures continues to be weak. Employers remain reluctant to add to payrolls. The housing sector continues to be depressed. Longer-term inflation expectations have remained stable, but measures of underlying inflation have continued to trend downward.
>
> Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. Currently, the unemployment rate is elevated, and measures of underlying inflation are somewhat low, relative to levels that the Committee judges to be consistent, over the longer run, with its dual mandate. Although the Committee anticipates a gradual return to higher levels of resource utilization in a context of price stability, progress toward its objectives has been disappointingly slow.
>
> To promote a stronger pace of economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate, the Committee decided today to continue expanding its holdings of securities as announced in November. The Committee will maintain its existing policy of reinvesting principal payments from its securities holdings. In addition, the Committee intends to purchase $600 billion of longer-term Treasury securities by the end of the second quarter of 2011, a pace of about $75 billion per month. The Committee will regularly review the pace of its securities purchases and the overall size of the asset-purchase program in light of

incoming information and will adjust the program as needed to best foster maximum employment and price stability.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period.

The Committee will continue to monitor the economic outlook and financial developments and will employ its policy tools as necessary to support the economic recovery and to help ensure that inflation, over time, is at levels consistent with its mandate."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Sandra Pianalto, Sarah Bloom Raskin, Eric Rosengren, Daniel K. Tarullo, Kevin Warsh, and Janet L. Yellen.

Voting against this action: Thomas M. Hoenig.

Mr. Hoenig dissented because he judged that economic conditions were improving, and that the current highly accommodative stance of monetary policy was inconsistent with the Committee's long-run mandate. Mr. Hoenig noted that the economic recovery was shifting from transitory to more sustainable sources of growth and was picking up momentum. In his assessment, maintaining highly accommodative monetary policy in the current economic environment would increase the risk of future imbalances and, over time, cause an increase in longer-term inflation expectations. Mr. Hoenig also was concerned that the eventual orderly reduction of policy accommodation would become more difficult the longer the first step in that process was delayed. In Mr. Hoenig's view, the Committee should begin preparing markets for a reduction in policy accommodation. Accordingly, he thought the press statement should indicate that sufficient monetary stimulus was in place to support the recovery.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, January 25–26, 2011. The meeting adjourned at 12:55 p.m. on December 14, 2010.

Notation Vote

By notation vote completed on November 22, 2010, the Committee unanimously approved the minutes of the FOMC meeting held on November 2–3, 2010.

William B. English
Secretary

Litigation

During 2010, the Board of Governors was a party in six lawsuits or appeals filed that year and was a party in nine other cases pending from previous years, for a total of 15 cases. In 2009, the Board had been a party in a total of 17 cases. As of December 31, 2010, 11 cases were pending.

McKinley v. Board of Governors, No. 10-5353 (District of Columbia Circuit, filed October 22, 2010), is an appeal from an order of the district court granting the Board's motion for summary judgment in a Freedom of Information Act case (see 2010 WL 3833667, issued September 29, 2010).

TCF National Bank v. Bernanke, No. 10-4149 (D. South Dakota, filed October 12, 2010), is a challenge to the constitutionality of section 1075 of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act, requiring the Board to set standards for debit card interchange fees.

Qader v. Federal Reserve Board, No. 10-3696 (Second Circuit, filed August 18, 2010), is an appeal of the district court's dismissal of an action arising out of appellant's dispute with a bank.

McKinley v. Board of Governors, No. 10-00751 (D. District of Columbia, filed May 11, 2010), is a Freedom of Information Act case.

Fox News Network v. Board of Governors, No. 10-3320 (S.D. New York, filed April 20, 2010), is a Freedom of Information Act case.

Weirich v. Board of Governors, No. 2:10-cv-5031 (E.D. Washington, filed March 23, 2010), was a Freedom of Information Act case. On November 15, 2010, the district court granted the Board's motion to dismiss the action.

Gold Anti-Trust Action Committee Inc. v. Board of Governors, No. 09-2436 (D. District of Columbia, filed December 30, 2009), is a Freedom of Information Act case.

Judicial Watch Inc. v. Board of Governors, No. 09-2138 (D. District of Columbia, filed November 13, 2009), is a Freedom of Information Act case.

Citizens for Responsibility and Ethics in Washington v. Board of Governors, No. 09-2113 (D. District of Columbia, filed November 10, 2009), was a Freedom of Information Act case. On April 1, 2010, the parties stipulated to the dismissal of the case.

Bloomberg L.P. v. Board of Governors, 09-4083 (Second Circuit, filed October 1, 2009), is an appeal of a judgment for Bloomberg L.P. in a Freedom of Information Act case (see 649 F. Supp. 2d 262). On March 19, 2010, the court of appeals affirmed the district court's judgment. 601 F.3d 143. On October 26, 2010, The Clearing House, which had intervened in the case, filed a petition for a writ of certiorari with the United States Supreme Court (No. 10-543).

Fox News Network v. Board of Governors, No. 09-3795 (Second Circuit, filed September 9, 2009), is an appeal of a judgment for the Board in a Freedom of Information Act case (see 639 F. Supp. 2d 384). On March 19, 2010, the court of appeals vacated the district court's judgment and remanded the matter to the district court. 601 F.3d 158. On November 18, 2010, The Clearing House, which had intervened in the case, filed a petition for a writ of certiorari with the United States Supreme Court (No. 10-660).

Artis v. Greenspan, No. 09-5121 (District of Columbia Circuit, filed April 9, 2009), is an appeal from the district court's dismissal of the plaintiffs' employment discrimination claim. On January 11, 2011, the court of appeals vacated the district court order and remanded the case to the district court.

Murray v. Board of Governors, No. 08-cv-15147 (E.D. Michigan, filed December 15, 2008), is a challenge to the constitutionality of federal expenditures relating to American International Group (AIG). On January 14, 2011, the district court granted the Board's motion for summary judgment, and the plaintiff filed a notice of appeal.

Schulz v. United States Federal Reserve System, No. 08-4810 (Second Circuit, filed September 30, 2008 (N.D. New York, filed September 18, 2008)), was an appeal of the district court's dismissal of an action relating to the Federal Reserve's loan to American International Group. On March 23, 2010, the court of appeals affirmed the district court's dismissal.

Jones v. Greenspan, No. 04-1696 (D. District of Columbia, filed October 4, 2004), was an employment discrimination case. On March 10, 2008, the district court granted the Board's motion and dismissed the plaintiff's claims. On the plaintiff's appeal (No. 08-5092, filed April 21, 2008), the District of Columbia Circuit affirmed in part and reversed in part, and remanded the action to the district court. 557 F.3d 670. On July 27, 2010, the plaintiff voluntarily dismissed the action.

Statistical Tables

Table 1. Federal Reserve open market transactions, 2010

Millions of dollars

Type of security and transaction	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
U.S. Treasury securities[1]													
Outright transactions[2]													
Treasury bills													
Gross purchases	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	18,423	27,519	18,633	20,841	18,423	21,639	24,361	21,838	22,204	18,423	18,423	24,708	255,435
For new bills	18,423	27,519	18,633	20,841	18,423	21,639	24,361	21,838	22,204	18,423	18,423	24,708	255,435
Redemptions	0	0	0	0	0	0	0	0	0	0	0	0	0
Others within 1 year													
Gross purchases	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	0	0	0	0	0	0	0	0	0	0	0	0	0
1 to 5 years													
Gross purchases	0	0	0	0	0	0	0	3,888	13,287	10,202	33,294	57,155	117,826
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
5 to 10 years													
Gross purchases	0	0	0	0	0	0	0	3,622	11,787	12,592	34,944	45,963	108,908
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
More than 10 years													
Gross purchases	0	0	0	0	0	0	0	1,775	253	4,925	2,680	7,373	17,006
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Discount notes	0	0	0	0	0	0	0	0	0	0	0	0	0
All maturities													
Gross purchases	0	0	0	0	0	0	0	9,285	25,327	27,719	70,918	110,491	243,740
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	0	0	0	0	0	0	0	0	0	0	0	0	0
Net change in U.S. Treasury securities	0	0	0	0	0	0	0	9,285	25,327	27,719	70,918	110,491	243,740
Federal agency obligations													
Outright transactions[2]													
Gross purchases	3,862	5,361	3,000	0	0	0	0	0	0	0	0	0	12,223
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	68	1,523	1,523	876	1,397	1,953	5,381	2,879	2,397	4,424	1,503	718	24,642
Net change in federal agency obligations	3,794	3,838	1,477	-876	-1,397	-1,953	-5,381	-2,879	-2,397	-4,424	-1,503	-718	-12,419
Mortgage-backed securities[3]													
Net settlements[2]													
Net change in mortgage-backed securities	61,748	56,659	41,919	28,596	16,219	4,614	-538	-14,420	-24,630	-27,502	-28,384	-30,512	83,770

(continued on next page)

Table 1—*continued*

Type of security and transaction	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
Temporary transactions													
Repurchase agreements[4]													
Gross purchases	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Reverse repurchase agreements[5]													
Gross purchases	1,212,833	1,048,567	1,290,814	1,197,845	1,130,219	1,351,516	1,321,719	1,339,291	1,278,890	1,205,451	1,224,830	1,210,365	14,812,340
Gross sales	1,194,260	1,046,105	1,291,882	1,200,397	1,129,118	1,359,522	1,317,549	1,338,459	1,282,296	1,209,256	1,219,749	1,216,195	14,804,788
Net change in temporary transactions	18,572	2,461	-1,068	-2,552	1,101	-8,006	4,170	832	-3,406	-3,805	5,081	-5,829	7,551
Total net change in System Open Market Account	**84,114**	**62,958**	**42,328**	**25,168**	**15,923**	**-5,345**	**-1,749**	**-7,182**	**-5,106**	**-8,012**	**46,112**	**73,432**	**322,642**

Note: Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Components may not sum to totals because of rounding.

1 Transactions exclude changes in compensation for the effects of inflation on the principal of inflation-indexed securities. Transactions include the rollover of inflation compensation into new securities.

2 Excludes the effect of temporary transactions—repurchase agreements and reverse repurchase agreements.

3 Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Monthly net change in face value of the securities held, which is the remaining principal balance of the underlying mortgages.

4 Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.

5 Cash value of agreements, which are collateralized by U.S. Treasury securities and federal agency debt securities.

Table 2. Federal Reserve Bank holdings of U.S. Treasury and federal agency securities, December 31, 2008–10
Millions of dollars

Description	December 31			Change	
	2010	2009	2008	2009 to 2010	2008 to 2009
U.S. Treasury securities					
Held outright[1]	**1,021,493**	**776,588**	**475,921**	**244,905**	**300,667**
By remaining maturity					
Bills					
1–90 days	18,423	18,423	153,829	0	-135,406
91 days to 1 year	0	0	74,012	0	-74,012
Notes and bonds					
1 year or less	54,253	72,818	85,011	-18,565	-12,193
More than 1 year through 5 years	439,594	326,874	173,328	112,720	153,546
More than 5 years through 10 years	333,955	213,720	97,325	120,235	116,395
More than 10 years	159,072	144,753	101,834	14,319	42,919
By type					
Bills	18,423	18,423	18,423	0	0
Notes	773,285	568,323	334,779	204,962	233,544
Bonds	229,786	189,843	122,719	39,943	67,124
Federal agency securities					
Held outright[1]	**147,460**	**159,879**	**19,708**	**-12,419**	**140,171**
By remaining maturity					
Discount notes					
1–90 days	0	0	3,731	0	-3,731
91 days to 1 year	0	0	946	0	-946
Coupons					
1 year or less	43,466	24,642	4,707	18,824	19,935
More than 1 year through 5 years	71,050	99,402	11,361	-28,352	88,041
More than 5 years though 10 years	30,597	33,788	3,640	-3,191	30,148
More than 10 years	2,347	2,047	0	300	2,047
By type					
Discount notes	0	0	4,677	0	-4,677
Coupons	147,460	159,879	15,031	-12,419	144,848
By issuer					
Federal Home Loan Mortgage Corporation	57,515	61,769	9,556	-4,254	52,213
Federal National Mortgage Association	58,568	63,662	7,091	-5,094	56,571
Federal Home Loan Banks	31,377	34,448	3,061	-3,071	31,387
Mortgage-backed securities[2]					
Held outright[1]	**992,141**	**908,371**	**0**	**83,770**	**908,371**
By remaining maturity					
1 year or less	0	0	0	0	0
More than 1 year through 5 years	24	12	0	12	12
More than 5 years though 10 years	20	20	0	0	20
More than 10 years	992,097	908,340	0	83,757	908,340
By issuer					
Federal Home Loan Mortgage Corporation	346,959	304,964	0	41,995	304,964
Federal National Mortgage Association	547,545	513,398	0	34,147	513,398
Government National Mortgage Association	97,637	90,010	0	7,627	90,010
Temporary transactions					
Repurchase agreements[3]	**0**	**0**	**80,000**	**0**	**-80,000**
Reverse repurchase agreements[4]	**59,703**	**77,732**	**88,352**	**-18,029**	**-10,620**
Foreign official and international accounts	59,703	77,732	88,352	-18,029	-10,620
Dealers	0	0	0	0	0

Note: Components may not sum to totals because of rounding.

1 Excludes the effect of temporary transactions—repurchase agreements and reverse repurchase agreements.

2 Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae.

3 Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.

4 Cash value of agreements, which are collateralized by U.S. Treasury securities and federal agency debt securities.

Table 3. Federal Reserve Bank interest rates on loans to depository institutions
Percent

Reserve Bank	Rates on selected loans as of December 31, 2010[1]		
	Primary credit	Secondary credit	Seasonal credit
All banks	0.75	1.25	0.25

[1] For details on rate changes over the course of 2010, see the section on discount rates on page 161 in the chapter "Record of Policy Actions of the Board of Governors." In ordinary circumstances, *primary credit* is available for very short terms as a backup source of liquidity to depository institutions that are in generally sound financial condition in the judgment of the lending Federal Reserve Bank. Over the period from mid-August 2007 to early 2010, the Federal Reserve allowed depository institutions to borrow primary credit for longer periods to address liquidity pressures during the financial crisis. In March 2010, the Federal Reserve returned to its usual practice of extending primary credit for shorter terms, typically overnight. *Secondary credit* is available in appropriate circumstances to depository institutions that do not qualify for primary credit. *Seasonal credit* is available to help relatively small depository institutions meet regular seasonal needs for funds that arise from a clear pattern of intra-yearly movements in their deposits and loans. The discount rate on seasonal credit takes into account rates on market sources of funds and is reestablished on the first business day of each two-week reserve maintenance period.

Table 4. Reserve requirements of depository institutions, December 31, 2010

Type of deposit	Requirements	
	Percentage of deposits	Effective date
Net transaction accounts[1]		
\$0 million–\$10.7 million[2]	0	12/30/2010
More than \$10.7 million–\$58.8 million[3]	3	12/30/2010
More than \$58.8 million	10	12/30/2010
Nonpersonal time deposits	0	12/27/1990
Eurocurrency liabilities	0	12/27/1990

Note: Required reserves must be held in the form of vault cash and, if vault cash is insufficient, also in the form of a deposit with a Federal Reserve Bank. An institution must hold that deposit directly with a Reserve Bank or with another institution in a pass-through relationship. Reserve requirements are imposed on commercial banks, savings banks, savings and loan associations, credit unions, U.S. branches and agencies of foreign banks, Edge corporations, and agreement corporations.

[1] Total transaction accounts consist of demand deposits, automatic transfer service (ATS) accounts, NOW accounts, share draft accounts, telephone or preauthorized transfer accounts, ineligible acceptances, and affiliate-issued obligations maturing in seven days or less. Net transaction accounts are total transaction accounts less amounts due from other depository institutions and less cash items in the process of collection.

For a more detailed description of these deposit types, see Form FR 2900.

[2] The amount of net transaction accounts subject to a reserve requirement ratio of 0 percent (the "exemption amount") is adjusted each year by statute. The exemption amount is adjusted upward by 80 percent of the previous year's (June 30 to June 30) rate of increase in total reservable liabilities at all depository institutions. No adjustment is made in the event of a decrease in such liabilities.

[3] The amount of net transaction accounts subject to a reserve requirement ratio of 3 percent is the "low reserve tranche." By statute, the upper limit of the low reserve tranche is adjusted each year by 80 percent of the previous year's (June 30 to June 30) rate of increase or decrease in net transaction accounts held by all depository institutions.

Table 5. Banking offices and banks affiliated with bank holding companies in the United States, December 31, 2009 and 2010

Type of office	Total	Commercial banks[1]						State-chartered savings banks
		Total	Member			Nonmember		
			Total	National	State			
All banking offices								
Banks								
Number, Dec. 31, 2009	7,158	6,808	2,286	1,445	841	4,522		350
Changes during 2010								
New banks	17	14	7	6	1	7		3
Banks converted into branches	-174	-171	-55	-38	-17	-116		-3
Ceased banking operations[2]	-156	-148	-52	-33	-19	-96		-8
Other[3]	0	0	7	-12	19	-7		0
Net change	-313	-305	-93	-77	-16	-212		-8
Number, Dec. 31, 2010	6,845	6,503	2,193	1,368	825	4,310		342
Branches & additional offices								
Number, Dec. 31, 2009	84,563	81,385	57,718	43,244	14,474	23,667		3,178
Changes during 2010								
New branches	1,571	1,508	1,041	867	174	467		63
Banks converted to branches	174	169	74	17	57	95		5
Discontinued[2]	-1,926	-1,877	-1,394	-987	-407	-483		-49
Other[3]	0	-1	255	149	106	-256		1
Net change	-181	-201	-24	46	-70	-177		20
Number, Dec. 31, 2010	84,382	81,184	57,694	43,290	14,404	23,490		3,198
Banks affiliated with bank holding companies								
Banks								
Number, Dec. 31, 2009	5,785	5,656	2,010	1,269	741	3,646		129
Changes during 2010								
BHC-affiliated new banks	42	41	16	9	7	25		1
Banks converted into branches	-161	-159	-51	-35	-16	-108		-2
Ceased banking operations[2]	-146	-141	-51	-31	-20	-90		-5
Other[3]	0	0	8	-11	19	-8		0
Net Change	-265	-259	-78	-68	-10	-181		-6
Number, Dec. 31, 2010	5,520	5,397	1,932	1,201	731	3,465		123

Note: Includes banks, banking offices, and bank holding companies in U.S. territories and possessions (affiliated insular areas).

1 For purposes of this table, banks are entities that are defined as banks in the Bank Holding Company Act, as amended, which is implemented by Federal Reserve Regulation Y. Generally, a bank is any institution that accepts demand deposits and is engaged in the business of making commercial loans or any institution that is defined as an insured bank in section 3(h) of the FDIC Act.

2 Institutions that no longer meet the Regulation Y definition of a bank.

3 Interclass changes and sales of branches.

Table 6A. Reserves of depository institutions, Federal Reserve Bank credit, and related items, year-end 1984–2010 and month-end 2010

Millions of dollars

Period	Factors supplying reserve funds								
	Federal Reserve Bank credit outstanding						Gold stock	Special drawing rights certificate account	Treasury currency outstanding[4]
	Securities held outright[1]	Repurchase agreements[2]	Loans and other credit extensions[3]	Float	Other Federal Reserve assets	Total			
1984	167,612	2,015	3,577	833	12,347	186,384	11,096	4,618	16,418
1985	186,025	5,223	3,060	988	15,302	210,598	11,090	4,718	17,075
1986	205,454	16,005	1,565	1,261	17,475	241,760	11,084	5,018	17,567
1987	226,459	4,961	3,815	811	15,837	251,883	11,078	5,018	18,177
1988	240,628	6,861	2,170	1,286	18,803	269,748	11,060	5,018	18,799
1989	233,300	2,117	481	1,093	39,631	276,622	11,059	8,518	19,628
1990	241,431	18,354	190	2,222	39,897	302,091	11,058	10,018	20,402
1991	272,531	15,898	218	731	34,567	323,945	11,059	10,018	21,014
1992	300,423	8,094	675	3,253	30,020	342,464	11,056	8,018	21,447
1993	336,654	13,212	94	909	33,035	383,904	11,053	8,018	22,095
1994	368,156	10,590	223	-716	33,634	411,887	11,051	8,018	22,994
1995	380,831	13,862	135	107	33,303	428,239	11,050	10,168	24,003
1996	393,132	21,583	85	4,296	32,896	451,992	11,048	9,718	24,966
1997	431,420	23,840	2,035	719	31,452	489,466	11,047	9,200	25,543
1998	452,478	30,376	17	1,636	36,966	521,475	11,046	9,200	26,270
1999	478,144	140,640	233	-237	35,321	654,100	11,048	6,200	28,013
2000	511,833	43,375	110	901	36,467	592,686	11,046	2,200	31,643
2001	551,685	50,250	34	-23	37,658	639,604	11,045	2,200	33,017
2002	629,416	39,500	40	418	39,083	708,457	11,043	2,200	34,597
2003[r]	666,665	43,750	62	-319	40,847	751,005	11,043	2,200	35,468
2004	717,819	33,000	43	925	42,219	794,007	11,045	2,200	36,434
2005	744,215	46,750	72	885	39,611	831,532	11,043	2,200	36,540
2006	778,915	40,750	67	-333	39,895	859,294	11,041	2,200	38,206
2007[r]	740,611	46,500	72,636	-19	41,799	901,528	11,041	2,200	38,681
2008[r]	495,629	80,000	1,605,848	-1,494	43,553	2,223,537	11,041	2,200	38,674
2009[r]	1,844,838	0	281,095	-2,097	92,851	2,216,687	11,041	5,200	42,691
2010	2,161,094	0	138,311	-1,421	110,261	2,408,245	11,041	5,200	43,563
Jan	1,910,416	0	226,508	-1,680	95,962	2,231,206	11,041	5,200	42,727
Feb	1,970,826	0	200,531	-1,438	93,336	2,263,254	11,041	5,200	42,743
Mar	2,014,390	0	182,646	-1,625	94,057	2,289,468	11,041	5,200	42,745
Apr	2,042,123	0	176,805	-1,422	96,561	2,314,066	11,041	5,200	43,056
May	2,057,135	0	171,114	-1,391	93,244	2,320,103	11,041	5,200	43,090
Jun	2,059,878	0	162,780	-1,948	93,141	2,313,849	11,041	5,200	43,205
Jul	2,053,994	0	160,566	-1,374	96,144	2,309,330	11,041	5,200	43,266
Aug	2,045,954	0	151,447	-2,151	91,747	2,286,997	11,041	5,200	43,341
Sep	2,044,313	0	142,992	-1,574	94,376	2,280,107	11,041	5,200	43,413
Oct	2,040,235	0	142,484	-1,342	99,439	2,280,817	11,041	5,200	43,455
Nov	2,081,470	0	141,342	-2,070	100,845	2,321,586	11,041	5,200	43,493
Dec	2,161,094	0	138,311	-1,421	110,261	2,408,245	11,041	5,200	43,563

Note: Components may not sum to totals because of rounding.

1 Includes U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities. U.S. Treasury securities and federal agency debt securities include securities lent to dealers, which are fully collateralized by U.S. Treasury securities, federal agency securities, and other highly rated debt securities.

2 Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and agency mortgage-backed securities.

3 Refer to table 6B for detail.

4 Includes currency and coin (other than gold) issued directly by the U.S. Treasury. The largest components are fractional and dollar coins. For details refer to "U.S. Currency and Coin Outstanding and in Circulation," *Treasury Bulletin*.

(continued on next page)

Table 6A—*continued*

Period	Factors absorbing reserve funds										Reserve balances with Federal Reserve Banks
	Currency in circulation	Reverse repurchase agreements[5]	Treasury cash holdings[6]	Deposits with Federal Reserve Banks, other than reserve balances					Required clearing balances	Other Federal Reserve liabilities and capital[7]	
				Term deposits	Treasury general account	Treasury supplementary financing account	Foreign	Other			
1984	183,796	0	513	…	5,316	…	253	867	1,126	5,952	20,693
1985	197,488	0	550	…	9,351	…	480	1,041	1,490	5,940	27,141
1986	211,995	0	447	…	7,588	…	287	917	1,812	6,088	46,295
1987	230,205	0	454	…	5,313	…	244	1,027	1,687	7,129	40,097
1988	247,649	0	395	…	8,656	…	347	548	1,605	7,683	37,742
1989	260,456	0	450	…	6,217	…	589	1,298	1,618	8,486	36,713
1990	286,963	0	561	…	8,960	…	369	528	1,960	8,147	36,081
1991	307,756	0	636	…	17,697	…	968	1,869	3,946	8,113	25,051
1992	334,701	0	508	…	7,492	…	206	653	5,897	7,984	25,544
1993	365,271	0	377	…	14,809	…	386	636	6,332	9,292	27,967
1994	403,843	0	335	…	7,161	…	250	1,143	4,196	11,959	25,061
1995	424,244	0	270	…	5,979	…	386	2,113	5,167	12,342	22,960
1996	450,648	0	249	…	7,742	…	167	1,178	6,601	13,829	17,310
1997	482,327	0	225	…	5,444	…	457	1,171	6,684	15,500	23,447
1998	517,484	0	85	…	6,086	…	167	1,869	6,780	16,354	19,164
1999	628,359	0	109	…	28,402	…	71	1,644	7,481	17,256	16,039
2000	593,694	0	450	…	5,149	…	216	2,478	6,332	17,962	11,295
2001	643,301	0	425	…	6,645	…	61	1,356	8,525	17,083	8,469
2002	687,518	21,091	367	…	4,420	…	136	1,266	10,534	18,977	11,988
2003[r]	724,187	25,652	321	…	5,723	…	162	995	11,829	19,793	11,054
2004	754,877	30,783	270	…	5,912	…	80	1,285	9,963	26,378	14,137
2005	794,014	30,505	202	…	4,573	…	83	2,144	8,651	30,466	10,678
2006	820,176	29,615	252	…	4,708	…	98	972	6,842	36,231	11,847
2007[r]	828,938	43,985	259	…	16,120	…	96	1,830	6,614	41,622	13,986
2008[r]	889,898	88,352	259	…	106,123	259,325	1,365	21,221	4,387	48,921	855,599
2009[r]	928,249	77,732	239	…	186,632	5,001	2,411	35,262	3,020	63,219	973,854
2010	982,772	59,703	177	0	140,773	199,964	3,337	13,631	2,378	99,602	965,714
Jan	917,637	59,159	233	0	84,536	5,001	4,050	395	2,754	65,249	1,151,160
Feb	931,242	56,698	200	0	14,779	24,997	2,689	433	2,741	66,730	1,221,731
Mar	934,589	57,766	223	0	91,519	124,979	1,668	19,463	2,688	64,994	1,050,565
Apr	935,398	60,318	202	0	98,277	199,958	4,115	392	2,662	71,648	1,000,391
May	943,135	59,217	205	0	19,925	199,958	2,057	393	2,643	71,810	1,080,089
Jun	945,131	67,223	233	1,152	87,615	199,965	1,214	27,516	2,475	70,931	969,841
Jul	943,741	63,054	212	2,119	3,191	199,960	2,914	480	2,457	74,138	1,076,570
Aug	949,283	60,404	239	2,119	75,533	199,956	2,052	387	2,434	72,410	981,762
Sep	954,749	63,810	237	2,119	107,888	199,962	2,473	4,152	2,407	71,953	930,012
Oct	962,959	58,955	188	5,113	24,212	199,960	2,641	727	2,396	76,102	1,007,260
Nov	978,210	53,874	197	0	79,426	199,959	2,847	1,103	2,366	99,832	963,505
Dec	982,772	59,703	177	0	140,773	199,964	3,337	13,631	2,378	99,602	965,714

5 Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and agency mortgage-backed securities.

6 Coin and paper currency held by the Treasury.

7 Includes funds from American International Group, Inc. asset dispositions, held as agent.

…Not applicable.

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Table 6B. Loans and other credit extensions, by type, year-end 1984–2010 and month-end 2010

Millions of dollars

Period	Total loans and other credit extensions	Term auction credit	Other loans					Net portfolio holdings of						Preferred interests in AIA/ ALICO LLCs[10]	Central bank liquidity swaps[11]
			Primary, secondary, and seasonal credit[1]	Primary dealer and other broker-dealer credit[2]	AMLF[3]	TALF[4]	AIG[5]	CPFF LLC[6]	MMIFF LLC[7]	Maiden Lane LLC[8]	Maiden Lane II LLC[8]	Maiden Lane III LLC[8]	TALF LLC[9]		
1984	3,577	…	3,577	…	…	…	…	…	…	…	…	…	…	…	…
1985	3,060	…	3,060	…	…	…	…	…	…	…	…	…	…	…	…
1986	1,565	…	1,565	…	…	…	…	…	…	…	…	…	…	…	…
1987	3,815	…	3,815	…	…	…	…	…	…	…	…	…	…	…	…
1988	2,170	…	2,170	…	…	…	…	…	…	…	…	…	…	…	…
1989	481	…	481	…	…	…	…	…	…	…	…	…	…	…	…
1990	190	…	190	…	…	…	…	…	…	…	…	…	…	…	…
1991	218	…	218	…	…	…	…	…	…	…	…	…	…	…	…
1992	675	…	675	…	…	…	…	…	…	…	…	…	…	…	…
1993	94	…	94	…	…	…	…	…	…	…	…	…	…	…	…
1994	223	…	223	…	…	…	…	…	…	…	…	…	…	…	…
1995	135	…	135	…	…	…	…	…	…	…	…	…	…	…	…
1996	85	…	85	…	…	…	…	…	…	…	…	…	…	…	…
1997	2,035	…	2,035	…	…	…	…	…	…	…	…	…	…	…	…
1998	17	…	17	…	…	…	…	…	…	…	…	…	…	…	…
1999	233	…	233	…	…	…	…	…	…	…	…	…	…	…	…
2000	110	…	110	…	…	…	…	…	…	…	…	…	…	…	…
2001	34	…	34	…	…	…	…	…	…	…	…	…	…	…	…
2002	40	…	40	…	…	…	…	…	…	…	…	…	…	…	…
2003	62	…	62	…	…	…	…	…	…	…	…	…	…	…	…
2004	43	…	43	…	…	…	…	…	…	…	…	…	…	…	…
2005	72	…	72	…	…	…	…	…	…	…	…	…	…	…	…
2006	67	…	67	…	…	…	…	…	…	…	…	…	…	…	…
2007	72,636	40,000	8,636	…	…	…	…	…	…	…	…	…	…	…	24,000
2008	1,605,848	450,219	93,791	37,404	23,765	…	38,914	334,102	0	27,023	20,117	26,785	…	…	553,728
2009	281,095	75,918	20,700	0	0	47,532	22,184	14,064	…	26,701	15,659	22,661	298	25,106	10,272
2010	138,311	0	221	…	…	24,703	19,953	…	…	26,967	16,198	23,143	665	26,385	75
Jan	226,508	38,531	15,804	0	0	47,352	25,846	8,664	…	26,784	15,497	22,488	334	25,106	100
Feb	200,531	15,425	14,592	…	…	46,801	25,293	7,743	…	27,233	15,562	22,403	372	25,106	0
Mar	182,646	3,410	8,113	…	…	47,221	25,377	7,786	…	27,364	15,405	22,150	404	25,416	0
Apr	176,805	0	5,921	…	…	45,168	27,087	4,891	…	28,226	16,061	23,595	439	25,416	0
May	171,114	0	498	…	…	44,032	26,420	1	…	28,334	15,908	23,385	478	25,416	6,642
Jun	162,780	0	673	…	…	42,477	24,676	1	…	28,498	15,763	23,208	506	25,733	1,245
Jul	160,566	0	112	…	…	40,239	23,554	1	…	29,424	16,172	23,546	540	25,733	1,246
Aug	151,447	0	115	…	…	36,531	20,055	…	…	29,030	16,029	23,336	575	25,733	44
Sep	142,992	0	296	…	…	29,699	18,891	…	…	28,473	15,875	23,040	601	26,057	61
Oct	142,484	0	123	…	…	28,002	19,124	…	…	28,484	16,475	23,537	622	26,057	60
Nov	141,342	0	142	…	…	25,637	21,524	…	…	27,587	16,336	23,351	648	26,057	60
Dec	138,311	0	221	…	…	24,703	19,953	…	…	26,967	16,198	23,143	665	26,385	75

Note: Components may not sum to totals because of rounding.

1 Prior to 2003, category was "Adjustment, extended, and seasonal credit."

2 Includes credit extended through the Primary Dealer Credit Facility (PDCF) and credit extended to certain other broker-dealers. The PDCF was dissolved in February 2010.

3 Includes credit extended through the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF). The AMLF was dissolved in February 2010.

4 Includes credit extended by the Federal Reserve Bank of New York (FRBNY) to eligible borrowers through the Term Asset-Backed Securities Loan Facility (TALF), net of unamortized deferred administrative fees. The TALF was discontinued in June 2010.

5 Credit extended to American International Group, Inc., includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring. Excludes credit extended to consolidated LLCs.

6 Net portfolio holdings of Commercial Paper Funding Facility (CPFF) LLC. The CPFF was discontinued in February 2010.

7 Net portfolio holdings of Money Market Investor Funding Facility (MMIFF) LLC. The MMIFF was discontinued in October 2009.

8 Net portfolio holdings at fair value.

9 Net portfolio holdings of TALF LLC, a limited liability company formed to purchase and manage any asset-backed securities that might be surrendered by a TALF borrower or otherwise claimed by the FRBNY in connection with its enforcement rights to the TALF collateral.

10 Preferred interests in AIA Aurora LLC and ALICO Holdings LLC at book value.

11 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

…Not applicable.

Table 6C. Reserves of depository institutions, Federal Reserve Bank credit, and related items, year-end 1918–1983
Millions of dollars

Period	Factors supplying reserve funds									
	Federal Reserve Bank credit outstanding							Gold stock[6]	Special drawing rights certificate account	Treasury currency outstanding[7]
	Securities held outright[1]	Repurchase agreements[2]	Loans	Float[3]	All other[4]	Other Federal Reserve assets[5]	Total			
1918	239	0	1,766	199	294	0	2,498	2,873	...	1,795
1919	300	0	2,215	201	575	0	3,292	2,707	...	1,707
1920	287	0	2,687	119	262	0	3,355	2,639	...	1,709
1921	234	0	1,144	40	146	0	1,563	3,373	...	1,842
1922	436	0	618	78	273	0	1,405	3,642	...	1,958
1923	80	54	723	27	355	0	1,238	3,957	...	2,009
1924	536	4	320	52	390	0	1,302	4,212	...	2,025
1925	367	8	643	63	378	0	1,459	4,112	...	1,977
1926	312	3	637	45	384	0	1,381	4,205	...	1,991
1927	560	57	582	63	393	0	1,655	4,092	...	2,006
1928	197	31	1,056	24	500	0	1,809	3,854	...	2,012
1929	488	23	632	34	405	0	1,583	3,997	...	2,022
1930	686	43	251	21	372	0	1,373	4,306	...	2,027
1931	775	42	638	20	378	0	1,853	4,173	...	2,035
1932	1,851	4	235	14	41	0	2,145	4,226	...	2,204
1933	2,435	2	98	15	137	0	2,688	4,036	...	2,303
1934	2,430	0	7	5	21	0	2,463	8,238	...	2,511
1935	2,430	1	5	12	38	0	2,486	10,125	...	2,476
1936	2,430	0	3	39	28	0	2,500	11,258	...	2,532
1937	2,564	0	10	19	19	0	2,612	12,760	...	2,637
1938	2,564	0	4	17	16	0	2,601	14,512	...	2,798
1939	2,484	0	7	91	11	0	2,593	17,644	...	2,963
1940	2,184	0	3	80	8	0	2,274	21,995	...	3,087
1941	2,254	0	3	94	10	0	2,361	22,737	...	3,247
1942	6,189	0	6	471	14	0	6,679	22,726	...	3,648
1943	11,543	0	5	681	10	0	12,239	21,938	...	4,094
1944	18,846	0	80	815	4	0	19,745	20,619	...	4,131
1945	24,262	0	249	578	2	0	25,091	20,065	...	4,339
1946	23,350	0	163	580	1	0	24,093	20,529	...	4,562
1947	22,559	0	85	535	1	0	23,181	22,754	...	4,562
1948	23,333	0	223	541	1	0	24,097	24,244	...	4,589
1949	18,885	0	78	534	2	0	19,499	24,427	...	4,598
1950	20,725	53	67	1,368	3	0	22,216	22,706	...	4,636
1951	23,605	196	19	1,184	5	0	25,009	22,695	...	4,709
1952	24,034	663	156	967	4	0	25,825	23,187	...	4,812
1953	25,318	598	28	935	2	0	26,880	22,030	...	4,894
1954	24,888	44	143	808	1	0	25,885	21,713	...	4,985
1955	24,391	394	108	1,585	29	0	26,507	21,690	...	5,008
1956	24,610	305	50	1,665	70	0	26,699	21,949	...	5,066
1957	23,719	519	55	1,424	66	0	25,784	22,781	...	5,146
1958	26,252	95	64	1,296	49	0	27,755	20,534	...	5,234
1959	26,607	41	458	1,590	75	0	28,771	19,456	...	5,311
1960	26,984	400	33	1,847	74	0	29,338	17,767	...	5,398
1961	28,722	159	130	2,300	51	0	31,362	16,889	...	5,585
1962	30,478	342	38	2,903	110	0	33,871	15,978	...	5,567
1963	33,582	11	63	2,600	162	0	36,418	15,513	...	5,578
1964	36,506	538	186	2,606	94	0	39,930	15,388	...	5,405
1965	40,478	290	137	2,248	187	0	43,340	13,733	...	5,575
1966	43,655	661	173	2,495	193	0	47,177	13,159	...	6,317
1967	48,980	170	141	2,576	164	0	52,031	11,982	...	6,784
1968	52,937	0	186	3,443	58	0	56,624	10,367	...	6,795

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Table 6C—*continued*

Period	Factors supplying reserve funds									
	Federal Reserve Bank credit outstanding							Gold stock[6]	Special drawing rights certificate account	Treasury currency outstanding[7]
	Securities held outright[1]	Repurchase agreements[2]	Loans	Float[3]	All other[4]	Other Federal Reserve assets[5]	Total			
1969	57,154	0	183	3,440	64	2,743	63,584	10,367	...	6,852
1970	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	13,083
1980	128,038	2,554	1,809	4,467	776	8,739	146,383	11,160	2,518	13,427
1981	136,863	3,485	1,601	1,762	195	9,230	153,136	11,151	3,318	13,687
1982	144,544	4,293	717	2,735	1,480	9,890	163,659	11,148	4,618	13,786
1983	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732

Note: For a description of figures and discussion of their significance, see *Banking and Monetary Statistics*, 1941–1970 (Board of Governors of the Federal Reserve System, 1976), pp. 507–23. Components may not sum to totals because of rounding.

1 In 1969 and thereafter, includes securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale–purchase transactions. On September 29, 1971, and thereafter, includes federal agency issues bought outright.

2 On December 1, 1966, and thereafter, includes federal agency obligations held under repurchase agreements.

3 In 1960 and thereafter, figures reflect a minor change in concept; refer to *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

4 Principally acceptances and, until August 21, 1959, industrial loans, the authority for which expired on that date.

5 For the period before April 16, 1969, includes the total of Federal Reserve capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets, and is reported as "Other Federal Reserve accounts;" thereafter, "Other Federal Reserve assets'' and "Other Federal Reserve liabilities and capital'' are shown separately.

6 Before January 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

7 Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details refer to "U.S. Currency and Coin Outstanding and in Circulation,'' *Treasury Bulletin*.

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Table 6C. Reserves of depository institutions, Federal Reserve Bank credit, and related items, year-end 1918–1983—*continued*

Millions of dollars

Period	Factors absorbing reserve funds								Member bank reserves[9]			
	Currency in circulation	Treasury cash holdings[8]	Deposits with Federal Reserve Banks, other than reserve balances			Other Federal Reserve accounts[5]	Required clearing balances	Other Federal Reserve liabilities and capital[5]	With Federal Reserve Banks	Currency and coin[10]	Required[11]	Excess[11,12]
			Treasury	Foreign	Other							
1918	4,951	288	51	96	25	118	0	0	1,636	…	1,585	51
1919	5,091	385	31	73	28	208	0	0	1,890	…	1,822	68
1920	5,325	218	57	5	18	298	0	0	1,781	…	…	…
1921	4,403	214	96	12	15	285	0	0	1,753	…	1,654	99
1922	4,530	225	11	3	26	276	0	0	1,934	…	…	…
1923	4,757	213	38	4	19	275	0	0	1,898	…	1,884	14
1924	4,760	211	51	19	20	258	0	0	2,220	…	2,161	59
1925	4,817	203	16	8	21	272	0	0	2,212	…	2,256	-44
1926	4,808	201	17	46	19	293	0	0	2,194	…	2,250	-56
1927	4,716	208	18	5	21	301	0	0	2,487	…	2,424	63
1928	4,686	202	23	6	21	348	0	0	2,389	…	2,430	-41
1929	4,578	216	29	6	24	393	0	0	2,355	…	2,428	-73
1930	4,603	211	19	6	22	375	0	0	2,471	…	2,375	96
1931	5,360	222	54	79	31	354	0	0	1,961	…	1,994	-33
1932	5,388	272	8	19	24	355	0	0	2,509	…	1,933	576
1933	5,519	284	3	4	128	360	0	0	2,729	…	1,870	859
1934	5,536	3,029	121	20	169	241	0	0	4,096	…	2,282	1,814
1935	5,882	2,566	544	29	226	253	0	0	5,587	…	2,743	2,844
1936	6,543	2,376	244	99	160	261	0	0	6,606	…	4,622	1,984
1937	6,550	3,619	142	172	235	263	0	0	7,027	…	5,815	1,212
1938	6,856	2,706	923	199	242	260	0	0	8,724	…	5,519	3,205
1939	7,598	2,409	634	397	256	251	0	0	11,653	…	6,444	5,209
1940	8,732	2,213	368	1,133	599	284	0	0	14,026	…	7,411	6,615
1941	11,160	2,215	867	774	586	291	0	0	12,450	…	9,365	3,085
1942	15,410	2,193	799	793	485	256	0	0	13,117	…	11,129	1,988
1943	20,449	2,303	579	1,360	356	339	0	0	12,886	…	11,650	1,236
1944	25,307	2,375	440	1,204	394	402	0	0	14,373	…	12,748	1,625
1945	28,515	2,287	977	862	446	495	0	0	15,915	…	14,457	1,458
1946	28,952	2,272	393	508	314	607	0	0	16,139	…	15,577	562
1947	28,868	1,336	870	392	569	563	0	0	17,899	…	16,400	1,499
1948	28,224	1,325	1123	642	547	590	0	0	20,479	…	19,277	1,202
1949	27,600	1,312	821	767	750	706	0	0	16,568	…	15,550	1,018
1950	27,741	1,293	668	895	565	714	0	0	17,681	…	16,509	1,172
1951	29,206	1,270	247	526	363	746	0	0	20,056	…	19,667	389
1952	30,433	1,270	389	550	455	777	0	0	19,950	…	20,520	-570
1953	30,781	761	346	423	493	839	0	0	20,160	…	19,397	763
1954	30,509	796	563	490	441	907	0	0	18,876	…	18,618	258
1955	31,158	767	394	402	554	925	0	0	19,005	…	18,903	102
1956	31,790	775	441	322	426	901	0	0	19,059	…	19,089	-30
1957	31,834	761	481	356	246	998	0	0	19,034	…	19,091	-57
1958	32,193	683	358	272	391	1,122	0	0	18,504	…	18,574	-70
1959	32,591	391	504	345	694	841	0	0	18,174	310	18,619	-135
1960	32,869	377	485	217	533	941	0	0	17,081	2,544	18,988	637
1961	33,918	422	465	279	320	1,044	0	0	17,387	2,823	20,114	96
1962	35,338	380	597	247	393	1,007	0	0	17,454	3,262	20,071	645
1963	37,692	361	880	171	291	1,065	0	0	17,049	4,099	20,677	471
1964	39,619	612	820	229	321	1,036	0	0	18,086	4,151	21,663	574
1965	42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	-238
1966	44,663	1,176	416	174	588	-147	0	0	19,779	4,310	24,321	-232
1967	47,226	1,344	1,123	135	653	-773	0	0	21,092	4,631	25,905	-182

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Table 6C—*continued*

Period	Factors absorbing reserve funds								Member bank reserves[9]			
	Currency in circulation	Treasury cash holdings[8]	Deposits with Federal Reserve Banks, other than reserve balances			Other Federal Reserve accounts[5]	Required clearing balances	Other Federal Reserve liabilities and capital[5]	With Federal Reserve Banks	Currency and coin[10]	Required[11]	Excess[11,12]
			Treasury	Foreign	Other							
1968	50,961	695	703	216	747	-1,353	0	0	21,818	4,921	27,439	-700
1969	53,950	596	1,312	134	807	0	0	1,919	22,085	5,187	28,173	-901
1970	57,093	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	-460
1971	61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
1972	66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98
1973	72,497	317	2,542	251	1,149[13]	0	0	2,669	27,060	6,781	35,268	-1,360
1974	79,743	185	3,113	418	1,275[13]	0	0	2,935	25,843	7,370	37,011	-3,798
1975	86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	-1,103[14]
1976	93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	-1,535
1977	103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	-1,265
1978	114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	-893
1979	125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	-2,835
1980	136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
1981	144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	-1,442
1982	154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
1983	171,935	479	3,661	191	851	0	1013	5,392	20,413	17,821	39,179	-945

8 Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

9 In November 1979 and thereafter, includes reserves of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks. On November 13, 1980, and thereafter, includes reserves of all depository institutions.

10 Between December 1, 1959, and November 23, 1960, part was allowed as reserves; thereafter, all was allowed.

11 Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call date was December 29). Since September 12, 1968, the amount has been based on close-of-business figures for the reserve period two weeks before the report date.

12 For the week ending November 15, 1972, and thereafter, includes $450 million of reserve deficiencies on which Federal Reserve Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective November 9, 1972. Allowable deficiencies are as follows (beginning with first statement week of quarter, in millions): 1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; 1974—Q1, $67; Q2, $58. The transition period ended with the second quarter of 1974.

13 For the period before July 1973, includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with Federal Reserve Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System program of credit restraint. As of December 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at Federal Reserve Banks that are associated with marginal reserves is no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States and (2) Eurodollar liabilities.

14 Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy, effective November 19, 1975.

…Not applicable.

Table 7. Principal assets and liabilities of insured commercial banks, by class of bank, June 30, 2010 and 2009

Millions of dollars, except as noted

Item	Total	Member banks			Nonmember banks
		Total	National	State	
2010					
Assets					
Loans and investments	8,371,801	6,787,197	5,624,413	1,162,784	1,584,605
Loans, gross	6,165,112	4,915,308	4,094,863	820,445	1,249,804
Net	6,164,923	4,915,121	4,094,732	820,390	1,249,802
Investments	2,206,689	1,871,888	1,529,550	342,338	334,801
U.S. Treasury and federal agency securities	401,552	304,475	251,340	53,135	97,077
Other	1,805,138	1,567,413	1,278,210	289,204	237,724
Cash assets, total	758,748	605,277	470,459	134,818	153,470
Liabilities					
Deposits, total	6,715,615	5,284,410	4,304,167	980,243	1,431,205
Interbank	104,002	81,377	64,552	16,825	22,625
Other transactions	805,822	609,825	470,208	139,616	195,997
Other nontransactions	5,805,791	4,593,208	3,769,406	823,802	1,212,583
Equity capital	1,336,929	1,128,279	929,954	198,326	208,650
Number of banks	6,649	2,248	1,425	823	4,401
2009					
Assets					
Loans and investments	8,242,505	6,603,148	5,414,826	1,188,322	1,639,357
Loans, gross	6,238,169	4,933,958	4,048,106	885,853	1,304,210
Net	6,236,242	4,933,137	4,047,602	885,535	1,303,104
Investments	2,004,336	1,669,190	1,366,720	302,469	335,146
U.S. Treasury and federal agency securities	249,731	172,378	123,917	48,461	77,352
Other	1,754,605	1,496,811	1,242,803	254,008	257,794
Cash assets, total	615,637	485,460	379,577	105,883	130,176
Liabilities					
Deposits, total	6,548,003	5,080,081	4,138,166	941,915	1,467,921
Interbank	138,693	115,114	98,413	16,702	23,579
Other transactions	777,885	590,655	468,296	122,360	187,229
Other nontransactions	5,631,425	4,374,312	3,571,458	802,853	1,257,113
Equity capital	1,248,840	1,040,403	861,931	178,471	208,437
Number of banks	6,963	2,346	1,502	844	4,617

Note: Includes U.S.-insured commercial banks located in the United States but not U.S.-insured commercial banks operating in U.S. territories or possessions. Data are domestic assets and liabilities (except for those components reported on a consolidated basis only). Components may not sum to totals because of rounding. Data for 2009 have been revised.

Table 8. Initial margin requirements under Regulations T, U, and X
Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only[1]
1934, Oct. 1	25–45	...	...
1936, Feb. 1	25–55	...	...
1936, Apr. 1	55	...	...
1937, Nov. 1	40	...	50
1945, Feb. 5	50	...	50
1945, July 5	75	...	75
1946, Jan. 21	100	...	100
1947, Feb. 1	75	...	75
1949, Mar. 3	50	...	50
1951, Jan. 17	75	...	75
1953, Feb. 20	50	...	50
1955, Jan. 4	60	...	60
1955, Apr. 23	70	...	70
1958, Jan. 16	50	...	50
1958, Aug. 5	70	...	70
1958, Oct. 16	90	...	90
1960, July 28	70	...	70
1962, July 10	50	...	50
1963, Nov. 6	70	...	70
1968, Mar. 11	70	50	70
1968, June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50

Note: These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit that may be extended for the purpose of purchasing or carrying margin securities (as defined in the regulations) when the loan is collateralized by such securities. The margin requirement, expressed as a percentage, is the difference between the market value of the securities being purchased or carried (100 percent) and the maximum loan value of the collateral as prescribed by the Board. Regulation T was adopted effective October 1, 1934; Regulation U, effective May 1, 1936; and Regulation X, effective November 1, 1971. The former Regulation G, which was adopted effective March 11, 1968, was merged into Regulation U, effective April 1, 1998.

1 From October 1, 1934, to October 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

...Not applicable.

Table 9A. Statement of Condition of the Federal Reserve Banks, by Bank, December 31, 2010 and 2009

Millions of dollars

Item	Total		Boston		New York		Philadelphia		Cleveland		Richmond	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Assets												
Gold certificate account	11,037	11,037	369	412	4,038	3,895	404	450	463	467	846	882
Special drawing rights certificate account	5,200	5,200	196	196	1,818	1,818	210	210	237	237	412	412
Coin	2,180	2,053	47	64	71	77	172	165	164	154	354	293
Loans and securities												
Term auction credit	0	75,918	0	4,052	0	58,254	0	1,613	0	751	0	995
Primary, secondary, and seasonal loans	221	20,700	1	109	36	19,504	0	122	0	1	61	102
Term Asset-Backed Securities Loan Facility (TALF)[1]	24,732	47,626	...	...	24,732	47,626	...	...	...	...	...	...
Credit extended to American International Group, Inc., net[2]	20,603	21,250	...	...	20,603	21,250	...	...	...	...	...	...
Treasury securities, bought outright[3]	1,021,493	776,588	25,851	14,897	416,823	303,549	23,855	12,048	34,706	30,681	116,337	27,986
Government-sponsored enterprise debt securities, bought outright[3]	147,460	159,879	3,732	3,067	60,171	62,493	3,444	2,480	5,010	6,317	16,794	5,762
Federal agency and government-sponsored enterprise mortgage-backed securities, bought outright	992,141	908,371	25,108	17,425	404,846	355,060	23,169	14,093	33,709	35,888	112,994	32,735
Total loans and securities	2,206,650	2,010,332	54,691	39,550	927,212	867,735	50,468	30,356	73,425	73,638	246,186	67,579
Net portfolio holdings of consolidated variable interest entities[4]	68,666	81,380	...	...	68,666	81,380	...	...	...	...	...	...
Preferred interests[5]	26,385	25,106	...	...	26,385	25,106	...	...	...	...	...	...
Foreign currency denominated assets[6]	26,049	25,272	959	1,012	7,560	6,724	2,847	2,776	1,941	1,861	7,253	7,171
Central bank liquidity swaps[7]	75	10,272	3	411	22	2,733	8	1,128	6	756	21	2,915
Other assets												
Items in process of collection	510	611	10	19	0	0	74	51	89	182	8	9
Bank premises	2,228	2,249	126	121	258	263	69	71	140	144	240	239
All other assets[8]	81,910	65,459	2,096	1,274	33,400	25,557	1,933	1,338	2,784	2,541	9,372	2,748
Interdistrict settlement account	0	0	4,414	25,668	225,756	120,324	12,749	35,084	-15,854	-19,789	-62,496	111,074
Total assets	**2,430,890**	**2,238,971**	**62,912**	**68,728**	**1,295,186**	**1,135,612**	**68,932**	**71,630**	**63,395**	**60,192**	**202,195**	**193,321**
Liabilities												
Federal Reserve notes outstanding	1,121,643	1,080,987	41,012	35,787	383,595	398,052	45,360	38,422	45,905	44,922	89,693	82,410
Less: Notes held by Federal Reserve Bank	180,082	193,141	4,714	3,618	64,698	71,925	4,826	5,591	7,304	7,535	12,999	10,026
Federal Reserve notes outstanding, net	941,561	887,846	36,297	32,169	318,897	326,127	40,533	32,831	38,601	37,387	76,694	72,384
Securities sold under agreements to repurchase[9]	59,703	77,732	1,511	1,491	24,362	30,383	1,394	1,206	2,028	3,071	6,800	2,801
Deposits												
Depository institutions	968,052	976,988	22,935	32,934	536,589	525,907	21,083	31,597	18,152	15,198	105,026	103,288
Treasury, general account	140,773	186,632	...	...	140,773	186,632	...	...	...	...	...	...
Treasury, supplementary financing account[10]	199,964	5,001	...	...	199,964	5,001	...	...	...	...	...	...
Foreign, official accounts	3,337	2,411	1	2	3,308	2,382	4	4	3	3	11	11
Other[11]	13,630	35,627	5	18	13,461	34,787	1	0	1	24	63	61
Total deposits	1,325,756	1,206,659	22,942	32,954	894,095	754,710	21,088	31,602	18,156	15,225	105,101	103,360

(continued on next page)

Table 9A—*continued*

Item	Total		Boston		New York		Philadelphia		Cleveland		Richmond	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Other liabilities												
Funds from American International Group, Inc. asset disposition, held as agent[12]	26,896	…	…	…	26,896	…	…	…	…	…	…	…
Interest on Federal Reserve notes due to U.S. Treasury[13]	5,124	…	90	…	1,877	…	334	…	26	…	2,041	…
Deferred credit items	1,931	2,206	71	56	10	14	271	220	410	422	74	73
Consolidated variable interest entities[14]	10,972	6,411	…	…	10,972	6,411	…	…	…	…	…	…
All other liabilities[15]	5,899	6,836	168	169	2,712	3,083	173	168	239	267	608	423
Total liabilities	**2,377,842**	**2,187,690**	**61,079**	**66,839**	**1,279,822**	**1,120,728**	**63,794**	**66,026**	**59,460**	**56,371**	**191,318**	**179,042**
Capital accounts												
Capital paid in	26,524	25,640	917	944	7,682	7,442	2,569	2,802	1,968	1,910	5,439	7,140
Surplus (including accumulated other comprehensive loss)	26,524	25,640	917	944	7,682	7,442	2,569	2,802	1,968	1,910	5,439	7,140
Total liabilities and capital accounts	**2,430,890**	**2,238,971**	**62,912**	**68,728**	**1,295,186**	**1,135,612**	**68,932**	**71,630**	**63,395**	**60,192**	**202,195**	**193,321**

Note: Components may not sum to totals because of rounding.

1 Includes remaining principal balance. TALF loans are recorded at fair value, and the fair value adjustment as of December 31 is reported in "All other assets."

2 Includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring. Excludes credit extended to Maiden Lane II LLC and Maiden Lane III LLC.

3 Includes securities loaned—fully collateralized by U.S. Treasury securities, other investment-grade securities, and collateral eligible for triparty repurchase agreements pledged with Federal Reserve Banks.

4 The Federal Reserve Bank of New York is the primary beneficiary of Commercial Paper Funding Facility LLC, TALF LLC, Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC and, as a result, the accounts and results of operations of these entities are included in the combined financial statements of the Federal Reserve Banks. For additional details, see "Table 6. Key Financial Data for Consolidated Limited Liability Companies" on page 133.

5 In March 2009, the Federal Reserve Bank of New York received preferred interests in two special purpose vehicles, AIA Aurora LLC and ALICO Holdings LLC, in exchange for the reduction of the outstanding balance of revolving credit provided to American International Group, Inc. (AIG). The preferred interests are recorded at cost.

6 Valued daily at market exchange rates.

7 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

8 Includes premiums on securities, accrued interest, the fair value adjustment for TALF loans, and depository institution overdrafts.

9 Contract amount of agreements.

10 Represents amounts deposited by the U.S. Treasury that result from a temporary supplementary program that offsets, in part, the reserve impact of the Reserve Banks' lending and liquidity initiatives.

11 Includes deposits of government-sponsored enterprises, the Consumer Financial Protection Bureau, and international organizations. These deposits are primarily held by the Federal Reserve Bank of New York.

12 Pending the closing of the recapitalization plan announced by AIG on September 30, 2010, the cash proceeds from the disposition of certain AIG assets were held by FRBNY as agent. At the closing of the recapitalization plan which occurred January 14, 2011, the proceeds were used first to repay in full the credit extended to AIG by the FRBNY under the revolving credit facility and then to redeem a portion of the FRBNY's preferred interests in ALICO Holdings LLC (preferred interests).

13 Represents the estimated weekly remittances to U.S. Treasury as interest on Federal Reserve notes or, in those cases where the Reserve Bank's net earnings are not sufficient to equate surplus to capital paid-in, the deferred asset for interest on Federal Reserve notes. The amounts on this line are calculated in accordance with Board of Governors policy, which requires the Federal Reserve Banks to remit residual earnings to the U.S. Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and the amount necessary to equate surplus with capital paid-in.

14 The other beneficial interest holder related to the TALF LLC is the U.S. Treasury; to Maiden Lane LLC, it is JPMorgan Chase; and to Maiden Lane II and Maiden Lane III LLCs, it is AIG.

15 Includes discounts on securities, accrued benefit costs.

…Not applicable.

(continued on next page)

Table 9A. Statement of Condition of the Federal Reserve Banks, by Bank, December 31, 2010 and 2009—*continued*

Millions of dollars

Item	Atlanta		Chicago		St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Assets														
Gold certificate account	1,385	1,356	887	911	324	329	203	197	296	335	652	621	1,170	1,182
Special drawing rights certificate account	654	654	424	424	150	150	90	90	153	153	282	282	574	574
Coin	188	220	336	301	35	32	60	62	161	140	239	214	353	329
Loans and securities														
Term auction credit	0	363	0	1,934	0	593	0	214	0	941	0	390	0	5,818
Primary, secondary, and seasonal loans	14	175	79	459	2	26	8	28	7	7	0	2	14	166
Term Asset-Backed Securities Loan Facility (TALF)[1]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Credit extended to American International Group, Inc., net[2]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Treasury securities, bought outright[3]	96,661	93,568	77,007	84,035	26,312	30,424	13,984	12,857	35,041	35,055	42,893	37,549	112,023	93,939
Government-sponsored enterprise debt securities, bought outright[3]	13,954	19,263	11,116	17,301	3,798	6,263	2,019	2,647	5,058	7,217	6,192	7,730	16,171	19,339
Federal agency and government-sponsored enterprise mortgage-backed securities, bought outright	93,884	109,446	74,794	98,296	25,556	35,586	13,582	15,038	34,034	41,003	41,660	43,921	108,804	109,880
Total loans and securities	204,513	222,815	162,996	202,025	55,668	72,892	29,593	30,784	74,141	84,223	90,745	89,593	237,013	229,142
Net portfolio holdings of consolidated variable interest entities[4]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Preferred interests[5]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Foreign currency denominated assets[6]	1,606	1,933	629	844	244	251	723	389	213	249	358	325	1,714	1,737
Central bank liquidity swaps[7]	5	785	2	343	1	102	2	158	1	101	1	132	5	706
Other assets														
Items in process of collection	149	178	40	31	12	19	69	26	16	24	21	33	22	39
Bank premises	218	221	209	207	136	136	107	111	265	268	247	253	214	214
All other assets[8]	7,741	7,719	6,134	6,902	2,126	2,523	1,143	1,084	2,805	2,896	3,447	3,121	8,930	7,756
Interdistrict settlement account	-48,131	-83,531	-31,780	-75,509	-18,011	-35,273	-8,382	-8,558	-14,671	-30,440	-3,007	-17,174	-40,587	-21,875
Total assets	**168,328**	**152,351**	**139,878**	**136,478**	**40,685**	**41,162**	**23,607**	**24,342**	**63,379**	**57,950**	**92,985**	**77,399**	**209,407**	**219,804**
Liabilities														
Federal Reserve notes outstanding	142,659	136,496	86,072	85,293	32,240	31,054	19,855	19,330	33,041	28,699	76,154	63,373	126,059	117,148
Less: Notes held by Federal Reserve Bank	20,851	32,645	12,147	12,092	4,381	4,106	5,781	2,628	3,560	3,022	11,980	13,731	26,839	26,221
Federal Reserve notes outstanding, net	121,807	103,851	73,925	73,201	27,858	26,948	14,074	16,702	29,481	25,677	64,174	49,642	99,219	90,927
Securities sold under agreements to repurchase[9]	5,650	9,366	4,501	8,411	1,538	3,045	817	1,287	2,048	3,509	2,507	3,758	6,547	9,403
Deposits														
Depository institutions	37,040	34,951	59,416	52,624	10,492	10,315	6,657	4,502	31,063	27,940	25,112	22,826	94,486	114,905
Treasury, general account	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Treasury, supplementary financing account[10]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Foreign, official accounts	2	3	1	1	0	0	1	1	0	0	1	1	3	3
Other[11]	2	176	26	244	56	61	3	19	4	54	-	54	8	128
Total deposits	37,044	35,130	59,443	52,869	10,548	10,377	6,662	4,522	31,067	27,994	25,113	22,881	94,497	115,036

(continued on next page)

Table 9A—*continued*

Item	Atlanta		Chicago		St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Other liabilities														
Funds from American International Group, Inc. asset disposition, held as agent[12]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Interest on Federal Reserve notes due to U.S. Treasury[13]	248	…	118	…	69	…	37	…	56	…	69	…	158	…
Deferred credit items	98	218	151	178	67	67	263	271	81	112	73	109	361	466
Consolidated variable interest entities[14]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
All other liabilities[15]	440	624	395	579	173	245	116	137	169	239	245	303	461	599
Total liabilities	**165,288**	**149,189**	**138,534**	**135,239**	**40,253**	**40,682**	**21,969**	**22,918**	**62,902**	**57,531**	**92,181**	**76,694**	**201,244**	**216,430**
Capital Accounts														
Capital paid in	1,520	1,581	672	619	216	240	819	712	239	210	402	353	4,082	1,687
Surplus (including accumulated other comprehensive loss)	1,520	1,581	672	619	216	240	819	712	239	210	402	353	4,082	1,687
Total liabilities and capital accounts	**168,328**	**152,351**	**139,878**	**136,478**	**40,685**	**41,162**	**23,607**	**24,342**	**63,379**	**57,950**	**92,985**	**77,399**	**209,407**	**219,804**

Note: Components may not sum to totals because of rounding.

1 Includes remaining principal balance. TALF loans are recorded at fair value, and the fair value adjustment as of December 31 is reported in “All other assets.”

2 Includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring. Excludes credit extended to Maiden Lane II LLC and Maiden Lane III LLC.

3 Includes securities loaned—fully collateralized by U.S. Treasury securities, other investment-grade securities, and collateral eligible for triparty repurchase agreements pledged with Federal Reserve Banks.

4 The Federal Reserve Bank of New York is the primary beneficiary of Commercial Paper Funding Facility LLC, TALF LLC, Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC and, as a result, the accounts and results of operations of these entities are included in the combined financial statements of the Federal Reserve Banks. For additional details, see “Table 6. Key Financial Data for Consolidated Limited Liability Companies” on page 133.

5 In March 2009, the Federal Reserve Bank of New York received preferred interests in two special purpose vehicles, AIA Aurora LLC and ALICO Holdings LLC, in exchange for the reduction of the outstanding balance of revolving credit provided to American International Group, Inc. (AIG). The preferred interests are recorded at cost.

6 Valued daily at market exchange rates.

7 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

8 Includes premiums on securities, accrued interest, the fair value adjustment for TALF loans, and depository institution overdrafts.

9 Contract amount of agreements.

10 Represents amounts deposited by the U.S. Treasury that result from a temporary supplementary program that offsets, in part, the reserve impact of the Reserve Banks' lending and liquidity initiatives.

11 Includes deposits of government-sponsored enterprises, the Consumer Financial Protection Bureau, and international organizations. These deposits are primarily held by the Federal Reserve Bank of New York.

12 Pending the closing of the recapitalization plan announced by AIG on September 30, 2010, the cash proceeds from the disposition of certain AIG assets were held by FRBNY as agent. At the closing of the recapitalization plan which occurred January 14, 2011, the proceeds were used first to repay in full the credit extended to AIG by the FRBNY under the revolving credit facility and then to redeem a portion of the FRBNY's preferred interests in ALICO Holdings LLC (preferred interests).

13 Represents the estimated weekly remittances to U.S. Treasury as interest on Federal Reserve notes or, in those cases where the Reserve Bank's net earnings are not sufficient to equate surplus to capital paid-in, the deferred asset for interest on Federal Reserve notes. The amounts on this line are calculated in accordance with Board of Governors policy, which requires the Federal Reserve Banks to remit residual earnings to the U.S. Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and the amount necessary to equate surplus with capital paid-in.

14 The other beneficial interest holder related to the TALF LLC is the U.S. Treasury; to Maiden Lane LLC, it is JPMorgan Chase; and to Maiden Lane II and Maiden Lane III LLCs, it is AIG.

15 Includes discounts on securities, accrued benefit costs.

…Not applicable.

Table 9B. Statement of Condition of the Federal Reserve Banks, December 31, 2010 and 2009
Supplemental information—collateral held against Federal Reserve notes: Federal Reserve agents' accounts
Millions of dollars

Item	2010	2009
Federal Reserve notes outstanding	1,121,643	1,080,987
Less: Notes held by Federal Reserve Banks not subject to collateralization	180,082	193,141
Collateralized Federal Reserve notes	**941,561**	**887,846**
Collateral for Federal Reserve notes		
Gold certificate account	11,037	11,037
Special drawing rights certificate account	5,200	5,200
U.S. Treasury securities and government-sponsored enterprise debt securities[1]	925,324	858,607
Other eligible assets	0	13,002
Total collateral	**941,561**	**887,846**

1 Face value. Includes compensation to adjust for the effect of inflation on the original face value of inflation-indexed securities, cash value of repurchase agreements, and par value of reverse repurchase agreements.

Table 10. Income and expenses of the Federal Reserve Banks, by Bank, 2010
Thousands of dollars

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Current income													
Interest income													
Term auction credit, primary, secondary, and seasonal loans	50,319	907	43,424	575	161	482	450	1,168	291	186	201	520	1,955
Term Asset-Backed Securities Loan Facility	750,456	…	750,456	…	…	…	…	…	…	…	…	…	…
American International Group, Inc., net	2,727,790	…	2,727,790	…	…	…	…	…	…	…	…	…	…
Treasury securities	26,372,927	621,472	10,632,686	557,078	937,542	2,419,554	2,689,596	2,234,404	779,979	382,537	985,982	1,155,131	2,976,967
Government-sponsored enterprise debt securities	3,510,486	82,393	1,414,384	73,729	125,094	317,863	359,406	299,192	104,547	51,074	131,828	154,102	396,872
Federal agency and government-sponsored enterprise mortgage-backed securities	44,839,169	1,055,222	18,073,722	945,345	1,595,274	4,095,868	4,578,771	3,806,452	1,329,195	651,045	1,678,848	1,965,408	5,064,020
Foreign currency denominated assets	222,801	8,266	64,219	24,358	16,584	62,137	14,011	5,553	2,099	5,959	1,852	3,047	14,715
Central bank liquidity swaps[1]	11,547	437	3,263	1,264	857	3,234	766	313	110	276	101	156	771
Other investments[2]	441	11	178	9	16	42	45	37	13	6	16	19	50
Total interest income	78,485,935	1,768,708	33,710,121	1,602,358	2,675,528	6,899,180	7,643,045	6,347,119	2,216,234	1,091,083	2,798,828	3,278,383	8,455,350
Priced services	566,735	…	74,853	…	…	…	420,010	71,871	…	…	…	…	…
Compensation received for services provided[3]	233,565	19,363	3,742	7,015	27,058	19,788	438	24,892	3,762	51,988	41,887	13,379	20,252
Securities lending fees	6,638	155	2,671	138	238	585	685	573	200	97	252	293	753
Other income	8,065	7	7,807	115	5	22	19	22	6	15	7	23	16
Total current income	**79,300,937**	**1,788,232**	**33,799,194**	**1,609,626**	**2,702,829**	**6,919,575**	**8,064,197**	**6,444,475**	**2,220,202**	**1,143,184**	**2,840,974**	**3,292,076**	**8,476,372**
Current expenses													
Interest expense on securities sold under agreements to repurchase	94,465	2,290	38,264	2,077	3,300	9,479	9,364	7,661	2,654	1,340	3,419	4,071	10,545
Interest on reserves and term deposits[4]	2,683,942	42,217	1,412,598	81,963	41,025	446,346	98,478	110,868	27,871	41,070	63,955	51,200	266,352
Earnings credits costs	2,730	184	361	147	104	206	194	253	67	94	107	225	787
Personnel													
Salaries and other personnel expenses	1,673,334	86,014	406,186	74,811	91,909	237,445	144,628	122,587	82,328	80,019	99,584	91,061	156,762
Retirement and other benefits	554,448	27,919	118,185	28,582	36,977	75,589	49,825	42,289	27,572	25,726	30,002	34,215	57,567
Net periodic pension expense[5]	528,936	1,511	512,447	1,401	756	1,448	1,740	1,645	1,328	1,312	1,085	846	3,417
Administrative													
Fees	198,351	2,547	65,704	5,154	3,039	63,144	25,920	7,291	10,110	2,659	6,278	2,512	3,994
Travel	76,471	3,003	11,528	2,690	4,067	12,479	8,478	8,248	4,608	3,204	5,210	4,337	8,620
Postage and other shipping costs	30,168	322	1,146	346	2,224	763	17,931	440	768	518	920	1,433	3,358

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Table 10—*continued*

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Communications	46,072	864	5,479	682	818	26,741	1,983	1,910	1,313	1,533	1,137	1,790	1,823
Materials and supplies	58,669	3,583	20,107	4,758	2,912	5,358	5,087	3,805	2,287	1,309	2,390	3,492	3,581
Building													
Taxes on real estate	41,037	5,898	7,852	1,589	1,918	2,398	3,385	3,432	664	2,701	3,681	3,255	4,264
Property depreciation	120,283	9,337	18,903	5,679	7,751	13,877	11,231	13,887	7,481	4,299	7,642	10,002	10,193
Utilities	40,851	3,992	8,438	2,587	2,421	4,240	3,827	2,251	1,793	1,841	2,033	4,202	3,224
Rent	46,177	1,446	22,471	913	22	17,135	351	936	1,020	271	738	210	663
Other building	49,680	3,963	7,665	3,827	3,696	4,944	4,041	6,944	2,270	1,909	1,814	5,224	3,382
Equipment/software													
Purchases	30,096	4,134	5,643	1,109	1,119	6,342	1,232	2,120	1,303	1,419	1,806	2,346	1,523
Rentals	3,502	295	1,410	372	333	164	453	289	25	9	12	48	92
Depreciation	86,433	5,123	12,108	4,686	3,507	32,169	4,335	4,321	2,835	1,738	4,709	4,478	6,423
Repairs and maintenance	61,768	4,156	7,140	2,906	3,002	17,386	7,811	4,369	1,732	1,503	2,195	3,450	6,116
Software	171,401	5,046	32,277	8,588	3,306	57,792	10,227	3,903	2,983	4,961	5,998	9,032	27,288
Other expenses													
Compensation paid for service costs incurred[3]	233,565	…	31,571	…	…	…	193,246	8,748	…	…	…	…	…
Other expenses	68,678	11,712	58,816	10,179	3,862	-243,911	49,433	50,048	67,792	18,393	5,400	17,119	19,835
Recoveries	-139,681	-17,183	-17,320	-4,398	-5,212	-36,807	-13,821	-12,037	-3,646	-2,306	-7,324	-12,500	-7,127
Expenses capitalized[6]	-34,424	-3,266	-10,626	-2,037	-1,381	-1,981	-1,254	-2,018	-653	-5,592	-1,029	-1,384	-3,202
Total current expenses	**6,726,952**	**205,107**	**2,778,353**	**238,611**	**211,474**	**752,746**	**638,125**	**394,191**	**246,505**	**189,931**	**241,761**	**240,664**	**589,481**
Reimbursements	-456,532	-30,041	-114,539	-34,065	-45,789	-39,664	-16,234	-3,778	-105,066	-27,317	-12,368	-14,286	-13,386
Net expenses	6,270,420	175,066	2,663,814	204,547	165,685	713,083	621,891	390,413	141,439	162,614	229,393	226,378	576,095
Profit and loss													
Current net income	73,030,517	1,613,166	31,135,381	1,405,080	2,537,144	6,206,492	7,442,306	6,054,061	2,078,764	980,570	2,611,581	3,065,698	7,900,277
Additions to (+) and deductions from (-) current net income													
Profit on sales of federal agency and government-sponsored enterprise mortgage-backed securities	782,267	17,566	312,949	15,413	28,593	60,734	83,443	70,928	25,037	11,753	30,782	35,165	89,903
Foreign currency gains (losses)	554,079	20,460	160,426	60,558	41,269	154,371	34,403	13,534	5,202	15,189	4,556	7,603	36,508
Dividends on preferred interests	1,279,041	…	1,279,041	…	…	…	…	…	…	…	…	…	…
Term Asset-Backed Securities Loan Facility unrealized losses[7]	-436,045	…	-436,045	…	…	…	…	…	…	…	…	…	…
Net income from consolidated variable interest entities[8]	7,560,077	…	7,560,077	…	…	…	…	…	…	…	…	…	…
Other additions	115,968	3	115,882	16	1	2	…	24	1	…	1	21	17
Total additions	9,855,388	38,029	8,992,331	75,987	69,864	215,107	117,846	84,487	30,240	26,942	35,338	42,789	126,428
Other deductions	-109,818	-1	-103,067	0	0	0	0	-4	0	0	0	0	-6,746
Total deductions	-109,818	-1	-103,067	0	0	0	0	-4	0	0	0	0	-6,746
Net addition to (+) current net income	9,745,570	38,028	8,889,264	75,987	69,864	215,107	117,846	84,483	30,240	26,942	35,338	42,789	119,682
Cost of unreimbursed Treasury services	7	…	7	…	…	…	…	…	…	…	…	…	…

(continued on next page)

Table 10—*continued*

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Assessments by Board													
Board expenditures[9]	422,200	15,267	122,485	45,652	31,095	109,294	25,600	10,069	3,902	11,970	3,421	5,920	37,525
Cost of currency	622,846	29,390	128,669	32,047	33,558	60,546	91,868	59,147	20,861	14,168	22,883	41,805	87,903
Consumer Financial Protection Bureau and Office of Financial Research[10]	42,286	1,500	12,305	4,530	3,082	10,131	2,521	1,016	374	1,222	341	605	4,658
Net income before distributions	81,688,747	1,605,037	39,761,179	1,398,838	2,539,273	6,241,627	7,440,163	6,068,312	2,083,866	980,153	2,620,274	3,060,157	7,889,873
Change in funded status of benefit plans	45,881	9,083	27,560	6,091	-17,656	10,870	5,335	-3,181	1,031	1,479	1,638	4,202	-570
Comprehensive income before distributions	81,734,628	1,614,120	39,788,739	1,404,929	2,521,617	6,252,497	7,445,498	6,065,131	2,084,897	981,632	2,621,912	3,064,359	7,889,303
Dividends paid	1,582,785	55,160	455,362	170,590	114,996	348,978	93,754	38,615	13,619	46,470	12,877	23,608	208,755
Payments to U.S. Treasury (interest on Federal Reserve notes)	79,268,124	1,586,761	39,092,783	1,467,087	2,349,504	7,604,335	7,412,843	5,974,018	2,095,393	827,941	2,579,833	2,991,405	5,286,222
Transferred to/from surplus and change in accumulated other comprehensive income	883,724	-27,799	240,593	-232,745	57,117	-1,700,816	-61,099	52,497	-24,115	107,222	29,201	49,344	2,394,327
Surplus, January 1	25,640,333	944,417	7,441,692	2,801,953	1,910,403	7,139,672	1,581,065	619,494	240,281	712,046	209,566	352,505	1,687,238
Surplus, December 31	26,524,057	916,618	7,682,284	2,569,208	1,967,519	5,438,856	1,519,966	671,991	216,166	819,267	238,767	401,849	4,081,565

Note: Components may not sum to totals because of rounding.

1 Represents interest income recognized on swap agreements with foreign central banks.

2 Represents interest income earned on short-term investments related to the federal agency and government-sponsored enterprise mortgage-backed securities portfolio.

3 The Federal Reserve Bank of Atlanta has overall responsibility for managing the Reserve Banks' provision of check and ACH services and recognizes total System revenue for these services. The Federal Reserve Bank of New York has overall responsibility for managing the Reserve Banks' provision of Fedwire funds transfer and securities transfer services, and recognizes the total System revenue for these services. The Federal Reserve Bank of Chicago has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions, and recognizes the total System revenue for these services. The Federal Reserve Bank of Atlanta, the Federal Reserve Bank of New York, and the Federal Reserve Bank of Chicago compensate the other Reserve Banks for the costs incurred in providing these services.

4 In October 2008, the Reserve Banks began to pay interest to depository institutions on qualifying balances held at the Federal Reserve Banks. In April 2010, the Reserve Banks began to pay interest on term deposits under the Term Deposit Facility.

5 Reflects the effect of the Financial Accounting Standards Board's Codification Topic (ASC 715) Compensation - Retirement Benefits. The System Retirement Plan for employees is recorded on behalf of the System on the books of the Federal Reserve Bank of New York. Net pension expense for the System, which was $492,956 thousand. is recorded in the books of the Federal Reserve Bank of New York. The Retirement Benefit Equalization Plan and the Supplemental Employee Retirement Plan are recorded by each Federal Reserve Bank.

6 Includes expenses for labor and materials capitalized and depreciated or amortized as charges to activities in the periods benefited.

7 Represents the valuation adjustment for TALF loans, which are recorded at fair value. In addition to the valuation adjustment, earnings on TALF loans include interest income of $750 million, administrative fees of $13 million, and the FRBNY's allocated share of TALF LLC's net income.

8 Represents the portion of the consolidated variable interest entities' net income recorded by the Federal Reserve Bank of New York. The amount includes interest income, interest expenses, realized and unrealized gains and losses, and professional fees.

9 For additional details, see the "Board of Governors Financial Statements" on page 322 in the "Federal Reserve System Audits" section of this report.

10 The Board of Governors assesses the Reserve Banks to fund the operations of the Consumer Financial Protection Bureau (CFPB) and Office of Financial Research (OFR). These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances as of the most recent quarter.

... Not applicable.

Table 11. Income and expenses of the Federal Reserve Banks, 1914–2010
Thousands of dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)[1]	Assessments by the Board of Governors			Change in funded status of benefit plans	Dividends paid	Distributions to the U.S. Treasury		Transferred to/from surplus[4]	Transferred to/from surplus and change in accumulated other comprehensive income[5]
				Board expenditures	Costs of currency	Consumer Financial Protection Bureau and Office of Financial Research[2]			Statutory transfers[3]	Interest on Federal Reserve notes		
All Banks												
1914–15	2,173	2,018	6	302	…	…	…	217	…	…	…	…
1916	5,218	2,082	-193	192	…	…	…	1,743	…	…	…	…
1917	16,128	4,922	-1,387	238	…	…	…	6,804	1,134	…	…	1,134
1918	67,584	10,577	-3,909	383	…	…	…	5,541	…	…	…	48,334
1919	102,381	18,745	-4,673	595	…	…	…	5,012	2,704	…	…	70,652
1920	181,297	27,549	-3,744	710	…	…	…	5,654	60,725	…	…	82,916
1921	122,866	33,722	-6,315	741	…	…	…	6,120	59,974	…	…	15,993
1922	50,499	28,837	-4,442	723	…	…	…	6,307	10,851	…	…	-660
1923	50,709	29,062	-8,233	703	…	…	…	6,553	3,613	…	…	2,546
1924	38,340	27,768	-6,191	663	…	…	…	6,682	114	…	…	-3,078
1925	41,801	26,819	-4,823	709	…	…	…	6,916	59	…	…	2,474
1926	47,600	24,914	-3,638	722	1,714	…	…	7,329	818	…	…	8,464
1927	43,024	24,894	-2,457	779	1,845	…	…	7,755	250	…	…	5,044
1928	64,053	25,401	-5,026	698	806	…	…	8,458	2,585	…	…	21,079
1929	70,955	25,810	-4,862	782	3,099	…	…	9,584	4,283	…	…	22,536
1930	36,424	25,358	-93	810	2,176	…	…	10,269	17	…	…	-2,298
1931	29,701	24,843	311	719	1,479	…	…	10,030	…	…	…	-7,058
1932	50,019	24,457	-1,413	729	1,106	…	…	9,282	2,011	…	…	11,021
1933	49,487	25,918	-12,307	800	2,505	…	…	8,874	…	…	…	-917
1934	48,903	26,844	-4,430	1,372	1,026	…	…	8,782	…	…	-60	6,510
1935	42,752	28,695	-1,737	1,406	1,477	…	…	8,505	298	…	28	607
1936	37,901	26,016	486	1,680	2,178	…	…	7,830	227	…	103	353
1937	41,233	25,295	-1,631	1,748	1,757	…	…	7,941	177	…	67	2,616
1938	36,261	25,557	2,232	1,725	1,630	…	…	8,019	120	…	-419	1,862
1939	38,501	25,669	2,390	1,621	1,356	…	…	8,110	25	…	-426	4,534
1940	43,538	25,951	11,488	1,704	1,511	…	…	8,215	82	…	-54	17,617
1941	41,380	28,536	721	1,840	2,588	…	…	8,430	141	…	-4	571
1942	52,663	32,051	-1,568	1,746	4,826	…	…	8,669	198	…	50	3,554
1943	69,306	35,794	23,768	2,416	5,336	…	…	8,911	245	…	135	40,327
1944	104,392	39,659	3,222	2,296	7,220	…	…	9,500	327	…	201	48,410
1945	142,210	41,666	-830	2,341	4,710	…	…	10,183	248	…	262	81,970
1946	150,385	50,493	-626	2,260	4,482	…	…	10,962	67	…	28	81,467
1947	158,656	58,191	1,973	2,640	4,562	…	…	11,523	36	75,284	87	8,366
1948	304,161	64,280	-34,318	3,244	5,186	…	…	11,920	…	166,690	…	18,523
1949	316,537	67,931	-12,122	3,243	6,304	…	…	12,329	…	193,146	…	21,462
1950	275,839	69,822	36,294	3,434	7,316	…	…	13,083	…	196,629	…	21,849
1951	394,656	83,793	-2,128	4,095	7,581	…	…	13,865	…	254,874	…	28,321
1952	456,060	92,051	1,584	4,122	8,521	…	…	14,682	…	291,935	…	46,334
1953	513,037	98,493	-1,059	4,100	10,922	…	…	15,558	…	342,568	…	40,337
1954	438,486	99,068	-134	4,175	6,490	…	…	16,442	…	276,289	…	35,888
1955	412,488	101,159	-265	4,194	4,707	…	…	17,712	…	251,741	…	32,710
1956	595,649	110,240	-23	5,340	5,603	…	…	18,905	…	401,556	…	53,983
1957	763,348	117,932	-7,141	7,508	6,374	…	…	20,081	…	542,708	…	61,604
1958	742,068	125,831	124	5,917	5,973	…	…	21,197	…	524,059	…	59,215
1959	886,226	131,848	98,247	6,471	6,384	…	…	22,722	…	910,650	…	-93,601
1960	1,103,385	139,894	13,875	6,534	7,455	…	…	23,948	…	896,816	…	42,613
1961	941,648	148,254	3,482	6,265	6,756	…	…	25,570	…	687,393	…	70,892
1962	1,048,508	161,451	-56	6,655	8,030	…	…	27,412	…	799,366	…	45,538
1963	1,151,120	169,638	615	7,573	10,063	…	…	28,912	…	879,685	…	55,864
1964	1,343,747	171,511	726	8,655	17,230	…	…	30,782	…	1,582,119	…	-465,823

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Table 11—*continued*

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)[1]	Assessments by the Board of Governors			Change in funded status of benefit plans	Dividends paid	Distributions to the U.S. Treasury		Transferred to/from surplus[4]	Transferred to/from surplus and change in accumulated other comprehensive income[5]
				Board expenditures	Costs of currency	Consumer Financial Protection Bureau and Office of Financial Research[2]			Statutory transfers[3]	Interest on Federal Reserve notes		
1965	1,559,484	172,111	1,022	8,576	23,603	…	…	32,352	…	1,296,810	…	27,054
1966	1,908,500	178,212	996	9,022	20,167	…	…	33,696	…	1,649,455	…	18,944
1967	2,190,404	190,561	2,094	10,770	18,790	…	…	35,027	…	1,907,498	…	29,851
1968	2,764,446	207,678	8,520	14,198	20,474	…	…	36,959	…	2,463,629	…	30,027
1969	3,373,361	237,828	-558	15,020	22,126	…	…	39,237	…	3,019,161	…	39,432
1970	3,877,218	276,572	11,442	21,228	23,574	…	…	41,137	…	3,493,571	…	32,580
1971	3,723,370	319,608	94,266	32,634	24,943	…	…	43,488	…	3,356,560	…	40,403
1972	3,792,335	347,917	-49,616	35,234	31,455	…	…	46,184	…	3,231,268	…	50,661
1973	5,016,769	416,879	-80,653	44,412	33,826	…	…	49,140	…	4,340,680	…	51,178
1974	6,280,091	476,235	-78,487	41,117	30,190	…	…	52,580	…	5,549,999	…	51,483
1975	6,257,937	514,359	-202,370	33,577	37,130	…	…	54,610	…	5,382,064	…	33,828
1976	6,623,220	558,129	7,311	41,828	48,819	…	…	57,351	…	5,870,463	…	53,940
1977	6,891,317	568,851	-177,033	47,366	55,008	…	…	60,182	…	5,937,148	…	45,728
1978	8,455,309	592,558	-633,123	53,322	60,059	…	…	63,280	…	7,005,779	…	47,268
1979	10,310,148	625,168	-151,148	50,530	68,391	…	…	67,194	…	9,278,576	…	69,141
1980	12,802,319	718,033	-115,386	62,231	73,124	…	…	70,355	…	11,706,370	…	56,821
1981	15,508,350	814,190	-372,879	63,163	82,924	…	…	74,574	…	14,023,723	…	76,897
1982	16,517,385	926,034	-68,833	61,813	98,441	…	…	79,352	…	15,204,591	…	78,320
1983	16,068,362	1,023,678	-400,366	71,551	152,135	…	…	85,152	…	14,228,816	…	106,663
1984	18,068,821	1,102,444	-412,943	82,116	162,606	…	…	92,620	…	16,054,095	…	161,996
1985	18,131,983	1,127,744	1,301,624	77,378	173,739	…	…	103,029	…	17,796,464	…	155,253
1986	17,464,528	1,156,868	1,975,893	97,338	180,780	…	…	109,588	…	17,803,895	…	91,954
1987	17,633,012	1,146,911	1,796,594	81,870	170,675	…	…	117,499	…	17,738,880	…	173,771
1988	19,526,431	1,205,960	-516,910	84,411	164,245	…	…	125,616	…	17,364,319	…	64,971
1989	22,249,276	1,332,161	1,254,613	89,580	175,044	…	…	129,885	…	21,646,417	…	130,802
1990	23,476,604	1,349,726	2,099,328	103,752	193,007	…	…	140,758	…	23,608,398	…	180,292
1991	22,553,002	1,429,322	405,729	109,631	261,316	…	…	152,553	…	20,777,552	…	228,356
1992	20,235,028	1,474,531	-987,788	128,955	295,401	…	…	171,763	…	16,774,477	…	402,114
1993	18,914,251	1,657,800	-230,268	140,466	355,947	…	…	195,422	…	15,986,765	…	347,583
1994	20,910,742	1,795,328	2,363,862	146,866	368,187	…	…	212,090	…	20,470,011	…	282,122
1995	25,395,148	1,818,416	857,788	161,348	370,203	…	…	230,527	…	23,389,367	…	283,075
1996	25,164,303	1,947,861	-1,676,716	162,642	402,517	…	…	255,884	5,517,716	14,565,624	…	635,343
1997	26,917,213	1,976,453	-2,611,570	174,407	364,454	…	…	299,652	20,658,972	0	…	831,705
1998	28,149,477	1,833,436	1,906,037	178,009	408,544	…	…	343,014	17,785,942	8,774,994	…	731,575
1999	29,346,836	1,852,162	-533,557	213,790	484,959	…	…	373,579	…	25,409,736	…	479,053
2000	33,963,992	1,971,688	-1,500,027	188,067	435,838	…	…	409,614	…	25,343,892	…	4,114,865
2001	31,870,721	2,084,708	-1,117,435	295,056	338,537	…	…	428,183	…	27,089,222	…	517,580
2002	26,760,113	2,227,078	2,149,328	205,111	429,568	…	…	483,596	…	24,495,490	…	1,068,598
2003	23,792,725	2,462,658	2,481,127	297,020	508,144	…	…	517,705	…	22,021,528	…	466,796
2004	23,539,942	2,238,705	917,870	272,331	503,784	…	…	582,402	…	18,078,003	…	2,782,587
2005	30,729,357	2,889,544	-3,576,903	265,742	477,087	…	…	780,863	…	21,467,545	…	1,271,672
2006	38,410,427	3,263,844	-158,846	301,014	491,962	…	…	871,255	…	29,051,678	…	4,271,828
2007	42,576,025	3,510,206	198,417	296,125	576,306	…	324,481	992,353	…	34,598,401	…	3,125,533
2008	41,045,582	4,870,374	3,340,628	352,291	500,372	…	-3,158,808	1,189,626	…	31,688,688	…	2,626,053
2009	54,463,121	5,978,795	4,820,204	386,400	502,044	…	1,006,813	1,428,202	…	47,430,237	…	4,564,460
2010	79,300,937	6,270,420	9,745,562	422,200	622,846	42,286	45,881	1,582,785	…	79,268,124	…	883,724
Total, 1914–2010	928,275,307	73,977,051	22,146,607	6,161,816	11,033,580	42,286	-1,781,633	13,931,743	44,113,958	766,913,410	-4	32,466,446[6]

(continued on next page)

Table 11—*continued*

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)[1]	Assessments by the Board of Governors			Change in funded status of benefit plans	Dividends paid	Distributions to the U.S. Treasury		Transferred to/from surplus[4]	Transferred to/from surplus and change in accumulated other comprehensive income[5]
				Board expenditures	Costs of currency	Consumer Financial Protection Bureau and Office of Financial Research[2]			Statutory transfers[3]	Interest on Federal Reserve notes		
Aggregate for each Bank, 1914–2010												
Boston	44,850,469	4,167,947	187,131	263,799	634,206	1,500	-4,159	610,043	2,579,504	35,665,561	135	1,092,581
New York	338,706,866	15,622,932[7]	13,678,194	1,559,905	3,252,777	12,305	-1,846,378	3,599,299	17,307,161	299,071,743	-433	10,057,872
Philadelphia	32,843,096	3,446,284	691,526	357,115	498,263	4,530	-167	965,291	1,312,118	24,215,455	291	2,722,930
Cleveland	50,696,563	4,016,748	719,322	447,132	621,557	3,082	-14,767	1,014,440	2,827,043	40,195,146	-10	2,311,292
Richmond	72,429,879	6,634,705	2,044,813	1,058,001	928,343	10,131	41,005	2,729,975	3,083,928	53,551,185	-72	6,497,760
Atlanta	62,879,531	9,702,453	1,003,032	456,719	975,799	2,521	12,500	978,405	2,713,230	47,225,305	5	1,829,956
Chicago	103,184,617	7,893,763	1,136,855	582,387	1,211,602	1,016	-117	1,117,860	4,593,811	87,830,240	12	1,097,024
St. Louis	30,625,809	3,118,007	213,608	129,420	397,741	374	10,855	257,298	1,833,837	24,773,710	-27	337,850
Minneapolis	15,885,099	3,133,265	267,008	171,323	210,064	1,222	4,440	377,527	416,227	10,869,497	65	974,402
Kansas City	32,905,522	4,223,650	292,092	160,963	409,767	341	-3,708	296,805	1,249,703	26,491,499	-9	357,911
Dallas	41,143,992	4,294,154	559,358	239,833	556,866	605	14,377	425,784	1,510,802	34,119,781	55	561,441
San Francisco	102,123,863	7,723,141	1,353,670	735,220	1,336,594	4,658	4,485	1,559,015	4,686,594	82,904,287	-17	4,533,667
Total	**928,275,307**	**73,977,051**	**22,146,607**	**6,161,816**	**11,033,580**	**42,286**	**-1,781,633**	**13,931,743**	**44,113,958**	**766,913,410**	**-4**	**32,374,684**

Note: Components may not sum to totals because of rounding.

1 For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

2 Starting in 2010, as required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Board of Governors began assessing the Reserve Banks to fund the operations of the Consumer Financial Protection Bureau and Office of Financial Research. These assessments are allocated to the Reserve Banks based on each Reserve Bank's capital and surplus balances as of the most recent quarter.

3 Represents transfers made as a franchise tax from 1917 through 1932; transfers made under section 13b of the Federal Reserve Act from 1935 through 1947; and transfers made under section 7 of the Federal Reserve Act for 1996 and 1997.

4 Transfers are made under section 13b of the Federal Reserve Act.

5 Transfers are made under section 7 of the Federal Reserve Act. Beginning in 2006, accumulated other comprehensive income is reported as a component of surplus.

6 The $32,466,446 thousand transferred to surplus was reduced by direct charges of $500 thousand for charge-off on Bank premises (1927), $139,300 thousand for contributions to capital of the Federal Deposit Insurance Corporation (1934), $4 thousand net upon elimination of section 13b surplus (1958), and $106,000 thousand (1996), $107,000 thousand (1997), $3,752,000 thousand transferred to the Treasury as statutorily required (2000), and $1,848,716 thousand related to the implementation of SFAS No. 158 (2006); and was increased by a transfer of $11,131 thousand from reserves for contingencies (1955), leaving a balance of $26,524,057 thousand on December 31, 2010.

7 This amount is reduced by $4,097,630 thousand for expenses of the System Retirement Plan. See note 5, table 10.

…Not applicable.

Table 12. Operations in principal departments of the Federal Reserve Banks, 2007–10

Operation	2010	2009	2008	2007
Millions of pieces				
Currency processed	32,143	31,891	33,256	35,653
Currency destroyed	5,948	6,049	6,517	6,509
Coin received	62,345	65,349	64,438	63,255
Checks handled				
U.S. government checks[1]	185	202	269	214
Postal money orders	121	131	146	164
All other change to "Commercial"	7,712	8,585	9,545	10,001
Securities transfers[2]	20	21	25	24
Funds transfers[3]	125	125	131	135
Automated clearinghouse transactions				
Commercial	10,233	9,966	10,040	9,363
Government	1,222	1,195	1,132	1,027
Millions of dollars				
Currency processed	569,249	561,013	604,882	642,168
Currency destroyed	120,049	92,708	148,460	104,082
Coin received	6,014	6,288	6,286	6,124
Checks handled				
U.S. government checks[1]	292,261	311,667	316,713	256,994
Postal money orders	23,210	23,675	25,544	31,626
All other change to "Commercial"	11,066,409	13,758,963	15,216,147	14,841,249
Securities transfers[2]	320,123,901	295,741,666	419,347,256	435,577,505
Funds transfers[3]	608,325,851	631,127,108	754,974,633	670,665,569
Automated clearinghouse transactions				
Commercial	16,941,077	15,418,718	15,662,805	14,547,234
Government	4,426,808	4,297,071	4,008,022	3,716,928

1 Includes government checks handled electronically (electronic checks).

2 Data on securities transfers do not include reversals. In 2006, the title of this category changed from previous years, but the composition of the category remained the same. Therefore, the data are comparable with data reported in previous years.

3 Data on funds transfers do not include non-value transfers.

Table 13. Number and annual salaries of officers and employees of the Federal Reserve Banks, December 31, 2010

Federal Reserve Bank (including branches)	President[1]	Other officers		Employees			Total	
	Annual salary (dollars)[2]	Number	Annual salaries (dollars)[2]	Number		Annual salaries (dollars)[2]	Number	Annual salaries (dollars)[2]
				Full-time	Part-time			
Boston	350,400	63	12,906,449	765	35	66,470,310	864	79,727,159
New York	410,780	406	94,432,384	2,534	42	256,567,921	2,983	351,411,085
Philadelphia	350,400	59	10,598,888	740	24	55,001,615	824	65,950,903
Cleveland	347,400	57	10,400,200	1,179	25	72,763,870	1,262	83,511,470
Richmond	347,400	78	13,534,900	1,339	30	100,683,036	1,448	114,565,336
Atlanta	314,400	87	17,491,030	1,523	16	111,098,660	1,627	128,904,090
Chicago	350,400	94	17,612,760	1,138	49	95,320,721	1,282	113,283,881
St. Louis	281,300	74	13,471,940	823	36	60,265,479	934	74,018,719
Minneapolis	313,500	48	8,485,225	912	51	63,334,083	1,012	72,132,808
Kansas City	380,500	71	13,102,500	1,108	14	73,171,732	1,194	86,654,732
Dallas	350,400	56	9,955,605	1,047	10	70,513,045	1,114	80,819,050
San Francisco[3]		74	16,115,623	1,413	24	124,088,889	1,511	140,204,512
Federal Reserve Information Technology	...	49	8,721,500	863	1	84,200,812	913	92,922,312
Office of Employee Benefits	...	11	2,631,525	35	1	3,417,805	47	6,049,330
Total	**3,796,880**	**1,227**	**249,460,529**	**15,419**	**358**	**1,236,897,978**	**17,015**	**1,490,155,387**

Note: Components may not sum to totals because of rounding.

1 Under current policy, appointment salaries are normally 85 percent of the salary-range midpoint (an 85 compa-ratio), with the exception of the New York Reserve Bank president, whose appointment salary normally is set at a 95 compa-ratio. The Board has discretion to approve a higher starting salary if requested by a Reserve Bank's board of directors.

Except as noted below, on January 1 each year, all presidents receive salary increases equal to the percentage increase in the midpoint of their respective salary ranges. In addition, on every third-year anniversary of his or her initial appointment (through year 9), each president receives a salary increase that results in a compa-ratio as follows: year 3: 95 (for the New York Bank: 105); year 6: 105 (New York: 115); year 9: 115 (New York: 125). In 2011, all presidents' salaries are frozen at their December 31, 2010, levels.

There are tiered salary ranges for Reserve Bank officers, including presidents, reflecting differences in the costs of labor in the head-office cities. The Board reviews Reserve Bank officer salary ranges and Reserve Bank placement in the salary tiers annually. Salaries for Reserve Bank officers, including presidents, are limited by compensation caps established for each tier. In 2010, the caps were $431,300 for tier 1; $419,600 for tier 2; and $400,000 for tier 3. In 2010, New York and San Francisco were in tier 1, which had a range midpoint for presidents' salaries of $432,400. Boston, Philadelphia, Chicago, Minneapolis, and Dallas were in tier 2, which had a midpoint for presidents' salaries of $368,800. Cleveland, Richmond, Atlanta, St. Louis, and Kansas City were in tier 3, which had a midpoint for presidents' salaries of $330,900. As noted above, salary midpoints are used to calculate presidents' compa-ratios.

2 Annualized salary liability (excluding outside agency costs) based on salaries in effect on December 31, 2010.

3 As of December 31, 2010, the San Francisco Bank's president position was vacant.

...Not applicable.

Table 14. Acquisition costs and net book value of the premises of the Federal Reserve Banks and Branches, December 31, 2010
Thousands of dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate[3]
	Land	Buildings (including vaults)[1]	Building machinery & equipment	Total[2]		
Boston	27,293	163,027	29,695	220,015	126,249	...
New York	20,900	334,276	79,268	434,443	257,659	...
Philadelphia	7,929	103,302	17,128	128,359	68,648	...
Cleveland	4,219	124,403	29,378	158,000	101,128	...
Cincinnati	3,075	28,012	15,987	47,073	20,764	...
Pittsburgh	2,751	19,638	16,791	39,180	18,375	...
Richmond	31,631	151,835	49,931	233,397	158,370	...
Baltimore	7,917	39,235	13,142	60,294	37,415	...
Charlotte	7,884	42,957	13,204	64,046	44,015	...
Atlanta	22,995	151,524	17,945	192,465	153,364	...
Birmingham	5,347	12,973	1,465	19,785	11,094	...
Jacksonville	1,779	23,035	4,729	29,542	17,392	...
Nashville	603	6,341	3,597	10,541	4,066	...
New Orleans	3,785	11,147	5,219	20,151	9,945	...
Miami	4,254	27,799	6,181	38,234	21,957	...
Chicago	4,512	196,401	25,783	226,696	123,450	...
Detroit	12,329	73,377	11,029	96,735	85,774	...
St. Louis	9,377	136,210	15,280	160,867	123,548	...
Memphis	2,472	14,999	5,160	22,632	12,177	...
Minneapolis	15,522	108,162	14,958	138,642	97,591	...
Helena	2,890	10,294	1,358	14,542	9,360	...
Kansas City	38,320	198,579	27,286	264,185	248,010	...
Denver	3,691	10,595	6,363	20,649	10,159	...
Omaha	3,559	7,692	1,933	13,185	6,438	...
Dallas	36,732	117,596	30,767	185,095	121,114	...
El Paso	262	3,426	1,843	5,531	692	...
Houston	25,119	103,575	9,020	137,714	120,721	7,204
San Antonio	826	8,082	2,491	11,399	4,341	...
San Francisco	20,988	109,885	26,811	157,684	90,017	...
Los Angeles	6,306	74,095	18,845	99,246	56,511	...
Salt Lake City	1,294	4,810	1,413	7,516	2,511	...
Seattle	13,098	49,976	6,741	69,815	64,809	3,400
Total	**349,658**	**2,467,260**	**510,739**	**3,327,657**	**2,227,664**	**10,604**

Note: Components may not sum to totals because of rounding.

1 Includes expenditures for construction at some offices, pending allocation to appropriate accounts.

2 Excludes charge-offs of $17,699 thousand before 1952.

3 Includes real estate held for future Bank use and Bank premises formerly occupied and being held pending sale.

...Not applicable.

Federal Reserve System Audits

The Board of Governors, the Federal Reserve Banks, and the Federal Reserve System as a whole are all subject to several levels of audit and review. The Board's financial statements, and its compliance with laws and regulations affecting those statements, are audited annually by an outside auditor retained by the Board's Office of Inspector General. The Office of Inspector General also conducts audits, reviews, and investigations relating to the Board's programs and operations as well as to Board functions delegated to the Reserve Banks.

The Reserve Banks' financial statements are audited annually by an independent outside auditor retained by the Board of Governors. In addition, the Reserve Banks are subject to annual examination by the Board. As discussed in the chapter "Federal Reserve Banks," the Board's examination includes a wide range of ongoing oversight activities conducted onsite and offsite by staff of the Board's Division of Reserve Bank Operations and Payment Systems.

Federal Reserve operations are also subject to review by the Government Accountability Office.

Board of Governors Financial Statements

The financial statements of the Board of Governors for 2010 and 2009 were audited by Deloitte & Touche LLP, independent auditors.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

February 28, 2011

MANAGEMENT'S ASSERTION

To the Committee on Board Affairs:

The management of the Board of Governors of the Federal Reserve System ("the Board") is responsible for the preparation and fair presentation of the balance sheet as of December 31, 2010, and for the related statement of revenues and expenses and changes in cumulative results of operations, and cash flows for the year then ended (the "Financial Statements"). The Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include some amounts which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with generally accepted accounting principles and include all disclosures necessary for such presentation.

Board management is also responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Committee on Board Affairs regarding the preparation of the Financial Statements in accordance with accounting principles generally accepted in the United States of America. Internal control includes self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal control are reported to management and appropriate corrective measures are implemented.

Even effective internal control—no matter how well designed—has inherent limitations, including the possibility of human error. Internal control, 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 specific controls may become inadequate because of changes in conditions or that the degree of compliance with policies or procedures may deteriorate.

Board management assessed its internal control over financial reporting reflected in the Financial Statements based upon the criteria established in the *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, we believe that the Board has maintained effective internal control over financial reporting as it relates to its Financial Statements.

Kevin M. Warsh
Administrative Governor

William L. Mitchell
Chief Financial Officer

Deloitte.

INDEPENDENT AUDITORS' REPORT

To the Board of Governors of the Federal Reserve System:

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the "Board") as of December 31, 2010 and 2009, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States), auditing standards of the Public Company Accounting Oversight Board (United States), and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Board's internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2011 expressed an unqualified opinion on the Board's internal control over financial reporting.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 28, 2011, on our tests of the Board's compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

February 28, 2011
McLean, VA

Deloitte.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Governors of the Federal Reserve System:

We have audited the internal control over financial reporting of the Board of Governors of the Federal Reserve System (the "Board") as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Board's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assertion report. Our responsibility is to express an opinion on the Board's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included 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 our audit provides a reasonable basis for our opinion.

The Board's internal control over financial reporting is a process designed by, or under the supervision of, the Board's principal executive and principal financial officers, or persons performing similar functions, and effected by the Board's Committee on Board Affairs, 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 accounting principles generally accepted in the United States of America. The Board'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 Board; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Board are being made only in accordance with authorizations of management and governors of the Board; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Board's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Board maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), generally accepted auditing standards as established by the Auditing Standards Board (United States), and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying balance sheet, statements of revenues and expenses and changes in cumulative results of operations, and cash flows as of and for the year ended December 31, 2010 of the Board and our report dated February 28, 2011 expressed an unqualified opinion on those financial statements.

Deloitte + Touche LLP

February 28, 2011
McLean, VA

Board of Governors of the Federal Reserve System Balance Sheets

	As of December 31,	
	2010	2009
ASSETS		
CURRENT ASSETS:		
Cash	$ 55,142,632	$ 54,792,831
Accounts receivable	3,234,076	2,948,984
Prepaid expenses and other assets	2,657,914	3,693,970
Total current assets	61,034,622	61,435,785
NONCURRENT ASSETS:		
Property, equipment, and software — net	156,767,186	159,267,605
Other assets	576,659	1,837,995
Total noncurrent assets	157,343,845	161,105,600
Total assets	$218,378,467	$222,541,385
LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 15,403,521	$ 20,765,464
Accrued payroll and related taxes	21,894,036	10,940,984
Accrued annual leave	26,337,190	24,821,044
Capital lease payable	544,878	533,110
Unearned revenues and other liabilities	556,846	2,982,629
Total current liabilities	64,736,471	60,043,231
LONG-TERM LIABILITIES:		
Capital lease payable	237,479	782,357
Accumulated retirement benefit obligation	21,979,219	13,021,387
Accumulated postretirement benefit obligation	10,219,672	9,304,324
Accumulated postemployment benefit obligation	13,813,254	14,463,965
Other long-term liabilities	3,545,936	415,324
Total long-term liabilities	49,795,560	37,987,357
Total liabilities	114,532,031	98,030,588
CUMULATIVE RESULTS OF OPERATIONS:		
Fund balance	118,473,958	133,677,902
Accumulated other comprehensive income (loss)	(14,627,522)	(9,167,105)
Total cumulative results of operations	103,846,436	124,510,797
TOTAL	$218,378,467	$222,541,385

See notes to financial statements.

Board of Governors of the Federal Reserve System Statements of Revenues and Expenses and Changes in Cumulative Results of Operations

	For the years ended December 31,	
	2010	2009
BOARD OPERATING REVENUES:		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$ 422,200,00	$386,399,900
Other revenues	8,693,489	9,413,565
Total operating revenues	430,893,489	395,813,465
BOARD OPERATING EXPENSES:		
Salaries	268,168,023	243,664,276
Retirement and insurance	56,788,740	50,458,964
Contractual services and professional fees	48,698,913	40,065,160
Depreciation, amortization, and net gains on disposals	15,865,704	13,885,165
Utilities	8,628,394	8,676,782
Travel	10,847,795	11,346,880
Software	8,057,580	8,699,031
Postage and supplies	7,100,302	8,157,780
Repairs and maintenance	3,384,994	5,115,155
Printing and binding	2,240,489	2,597,982
Other expenses	16,316,499	13,553,896
Total operating expenses	446,097,433	406,221,071
RESULTS OF OPERATIONS	(15,203,944)	(10,407,606)
CURRENCY COSTS:		
Assessments levied on Federal Reserve Banks for currency costs	622,858,648	502,144,883
Expenses for costs related to currency	622,858,648	502,144,883
Currency Assessments over (under) Expenses	-	-
BUREAU OF CONSUMER FINANCIAL PROTECTION (BUREAU):		
Assessments levied on Reserve Banks for the Bureau	32,770,000	-
Transfer to the Bureau	32,770,000	-
Bureau assessments over (under) transfers	-	-
OFFICE OF FINANCIAL RESEARCH (OFFICE):		
Assessments levied on Reserve Banks for the Office	9,515,944	-
Transfer to the Office	9,515,944	-
Office assessments over (under) transfers	-	-
Total Results of Operations	(15,203,944)	(10,407,606)
Cumulative Results of Operations, Beginning of year	124,510,797	134,811,346
OTHER COMPREHENSIVE INCOME:		
Prior service credit (cost) arising during the year	-	(315,842)
Amortization of prior service (credit) cost	518,195	541,162
Amortization of net actuarial (gain) loss	576,736	353,551
Net actuarial gain (loss) arising during the year	(6,555,348)	(471,814)
Total other comprehensive income (loss)	(5,460,417)	107,057
CUMULATIVE RESULTS OF OPERATIONS, End of year	$103,846,436	$124,510,797

See notes to financial statements.

Board of Governors of the Federal Reserve System Statements of Cash Flows

	For the years ended December 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Results of operations	$(15,203,944)	$(10,407,606)
Adjustments to reconcile results of operations to net cash provided by (used in) operating activities:		
Depreciation	15,877,105	13,869,221
Net loss (gain) on disposal of property and equipment	(11,401)	15,944
Other additional non-cash adjustments to results of operations	658,587	-
(Increase) decrease in assets:		
Accounts receivable, prepaid expenses and other assets	730,143	1,499,641
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	(822,981)	1,668,788
Accrued payroll and related taxes	10,953,052	1,627,747
Accrued annual leave	1,516,146	2,586,938
Unearned revenues and other liabilities	(2,425,783)	1,139,571
Net retirement benefit obligation	3,911,348	2,592,406
Net postretirement benefit obligation	501,415	445,903
Net postemployment benefit obligation	(650,711)	563,965
Other long-term liabilities	3,130,612	(233,210)
Net cash provided by (used in) operating activities	18,163,588	15,369,308
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from disposals	-	866
Capital expenditures	(17,296,078)	(18,346,427)
Net cash provided by (used in) investing activities	(17,296,078)	(18,345,561)
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital lease payments	(517,709)	(486,906)
Net cash provided by (used in) financing activities	(517,709)	(486,906)
NET INCREASE (DECREASE) IN CASH	349,801	(3,463,159)
CASH BALANCE—Beginning of year	54,792,831	58,255,990
CASH BALANCE—End of year	$ 55,142,632	$ 54,792,831

See notes to financial statements.

Board of Governors of the Federal Reserve System Notes to Financial Statements as of and for the Years ended December 31, 2010 and 2009

(1) Structure

The Federal Reserve System (the System) was established by Congress in 1913 and consists of the Board of Governors (the Board), the Federal Open Market Committee, the twelve regional Federal Reserve Banks, the Federal Advisory Council, and the private commercial banks that are members of the System. The Board, unlike the Reserve Banks, was established as a federal government agency and is supported by Washington, D.C. based staff numbering approximately 2,100, as it carries out its responsibilities in conjunction with other components of the Federal Reserve System.

The Board is required by the Federal Reserve Act (the Act) to report its operations to the Speaker of the House of Representatives. The Act also requires the Board, each year, to order a financial audit of each Federal Reserve Bank and to publish each week a statement of the financial condition of each such Reserve Bank and a consolidated statement for all of the Reserve Banks. Accordingly, the Board believes that the best financial disclosure consistent with law is achieved by issuing separate financial statements for the Board and for the Reserve Banks. Therefore, the accompanying financial statements include only the results of operations and activities of the Board. Combined financial statements for the Federal Reserve Banks are included in the Board's annual report to the Speaker of the House of Representatives.

(2) Operations and Services

The Board's responsibilities require thorough analysis of domestic and international financial and economic developments. The Board carries out those responsibilities in conjunction with other components of the Federal Reserve System. The Board also supervises and regulates the operations of the Federal Reserve Banks, exercises broad responsibility in the nation's payments system, and currently administers most of the nation's laws regarding consumer credit protection. Policy regarding open market operations is established by the Federal Open Market Committee. However, the Board has sole authority over changes in reserve requirements, and it must approve any change in the discount rate initiated by a Federal Reserve Bank. The Board also plays a major role in the supervision and regulation of the U.S. banking system. It has supervisory responsibilities for state-chartered banks that are members of the Federal Reserve System, bank holding companies, foreign activities of member banks, and U.S. activities of foreign banks.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which was signed into law and became effective on July 21, 2010, changed the scope of some services performed by the System. Among other things, the Dodd-Frank Act establishes a Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that will have rule-writing authority with respect to most federal financial consumer protection statutes and supervisory authority with respect to these statutes over some institutions previously supervised by the Board. The Dodd-Frank Act will also vest the Board with all supervisory and rule-writing authority for savings and loan holding companies. In addition, the Dodd-Frank Act creates a Financial Stability Oversight Council (FSOC) of which the Chairman of the Board is a member. Some of the FSOC's responsibilities include identifying systemically important nonbank financial companies to be supervised by the Board. The Dodd-Frank Act also establishes the Office of Financial Research (Office) within the U.S. Department of Treasury to provide support to the FSOC and the member agencies.

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 or the System. The Board has also determined that neither the FSOC nor the Office should be consolidated in the Board's financial statements. Accordingly, the Board's financial statements do not include financial data of the Bureau, the Office, or the FSOC other than the funding that the Board is required by the Dodd-Frank Act to provide. (See Notes 13 and 14)

(3) Significant Accounting Policies

Basis of Accounting — The Board prepares its financial statements in accordance with accounting principles generally accepted in the United States (GAAP).

Revenues — The Federal Reserve Act authorizes the Board to levy an assessment on the Reserve Banks to fund its operations. The Board levies the assessment based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year.

Assessments to Fund the Bureau and the Office — The Board assesses the Federal Reserve Banks for the funds transferred to the Bureau and the Office based on each Federal Reserve Bank's capital and surplus balances. These assessments and transfers are reported separately from the Board's operating activities in the Board's Statements of Revenues and Expenses and Changes in Cumulative Results of Operations.

Currency Costs — The Federal Reserve Board issues the nation's currency (in the form of Federal Reserve notes), and the Federal Reserve Banks distribute currency and coin through depository institutions. The Board incurs expenses and assesses the Reserve Banks for the expenses related to producing, issuing, and retiring Federal Reserve notes. The assessment is allocated based on each Reserve Bank's share of the number of notes comprising the Federal Reserve Bank System's net liability for Federal Reserve notes on December 31 of the prior year. These expenses and assessments are reported separately from the Board's operating activities in the Board's Statements of Revenues and Expenses and Changes in Cumulative Results of Operations.

Allowance for Doubtful Accounts — Accounts receivable are shown net of the allowance for doubtful accounts. Accounts receivable considered uncollectible are charged against the allowance account in the year they are deemed uncollectible. The allowance for doubtful accounts is adjusted monthly, based upon a review of outstanding receivables.

Property, Equipment, and Software — The Board's property, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets, which range from three to ten years for furniture and equipment, ten to fifty years for building equipment and structures, and two to ten years for software. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation or amortization are removed and any gain or loss is recognized.

The Board's internally developed software projects are each recorded at cost and capitalized and amortized over the project's useful life as required by the Internal Use Software Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC).

Art Collections — The Board has collections of works of art, historical treasures, and similar assets. These collections are maintained and held for public exhibition in furtherance of public service. Proceeds from any sales of collections are used to acquire other items for collections. As permitted by the Revenue Recognition Topic of the ASC, the cost of collections purchased by the Board is charged to expense in the year purchased and donated collection items are not recorded. The value of the Board's collections has not been determined.

Deferred Rent — The leases contain scheduled rent increases over the term of the lease. As required by the Leases Topic of the ASC, rent abatements and scheduled rent increases must be considered in determining the annual rent expense to be recognized. The deferred rent represents the difference between the actual lease payments and the rent expense recognized.

Estimates — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(4) Property, Equipment, and Software

The following is a summary of the components of the Board's property, equipment, and software, at cost, net of accumulated depreciation and amortization as of December 31, 2010 and 2009:

	As of December 31,	
	2010	2009
Land	$ 18,640,314	$ 18,640,314
Buildings and improvements	163,868,033	155,403,350
Furniture and equipment	68,789,408	66,411,669
Software in use	24,244,811	16,196,241
Software in process	1,985,544	6,276,842
Construction in process	4,810,307	8,100,559
	282,338,417	271,028,975
Less accumulated depreciation and amortization	(125,571,231)	(111,761,370)
Property, equipment, and software — net	$ 156,767,186	$ 159,267,605

Construction in process include costs incurred in the current or prior years for long-term projects and building enhancements.

(5) Leases

Capital Leases —The Board entered into capital leases in 2008 and 2009. Furniture and equipment includes $2,086,000 under capital leases in both 2010 and 2009. Accumulated depreciation includes $1,319,000 and $789,000 under capital leases as of 2010 and 2009, respectively.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2010, are as follows:

Years Ending December 31	Amount
2011	$ 978,315
2012	421,925
Total minimum lease payments	1,400,240
Less amount representing maintenance	(604,906)
Net minimum lease payments	795,334
Less amount representing interest	(12,977)
Present value of net minimum lease payments	782,357
Less current maturities of capital lease payments	(544,878)
Long-term capital lease obligations	$ 237,479

Operating Leases — The Board has entered into several operating leases to secure office, training and warehouse space. Minimum annual payments under the operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 2010, are as follows:

Years Ending December 31	
2011	$ 6,251,496
2012	6,414,807
2013	6,608,976
2014	6,788,468
After 2014	35,626,043
	$61,689,790

Rental expenses under the operating leases were $6,882,000 and $3,947,000 for the years ended December 31, 2010 and 2009, respectively. The Board entered into a new operating lease in January 2011. The estimated future minimum lease payments associated with the new lease total $78,702,000 over a ten year period.

The Board leases and subleases space, primarily to other governmental agencies. The revenues collected from these leases are $1,937,000 and $2,504,000 in 2010 and 2009, respectively.

Deferred Rent — The change in deferred rent was $528,000 and $1,666,000 for the years ended December 31, 2010 and 2009, respectively.

(6) Accumulated Retirement Benefits

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (the System Plan). The System Plan provides retirement benefits to employees of the Board, the Federal Reserve Banks, and the Office of Employee Benefits of the Federal Reserve System (OEB). In addition, under the Dodd-Frank Act, employees of the Bureau can elect to participate in the System Plan; however, there were no Bureau participants in the System Plan as of December 31, 2010. The Federal Reserve Bank of New York (FRB NY), on behalf of the System, recognizes the net assets and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

Employees of the Board who became employed prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who became employed after 1983 are covered by a non-contributory defined benefits program under the System Plan. Contributions to the System Plan are actuarially determined and funded by participating employers. In 2010, the System made $580 million in contributions to the System Plan; the contributions may be adjusted upon completion of the 2011 actuarial valuation. The Board was not assessed a contribution for 2010.

Effective January 1, 1996, Board employees covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan due to limitations imposed by Sections 401(a)(17), 415(b) and 415(e) of the Internal Revenue Code of 1986. Activity for the BEP as of December 31, 2010 and 2009, is summarized in the following tables:

	As of December 31,	
	2010	2009
Change in projected benefit obligation:		
Benefit obligation — beginning of year	$ 5,900,567	$ 4,591,374
Service cost	1,359,828	712,515
Interest cost	545,688	307,501
Plan participants' contributions		
Actuarial (gain) loss	4,155,013	(175,635)
Gross benefits paid	(27,661)	(27,649)
Plan amendments		492,461
Benefit obligation — end of year	$ 11,933,435	$ 5,900,567
Accumulated benefit obligation — end of year	$ 1,686,998	$ 1,245,465
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	5.50%	6.00%
Rate of compensation increase	5.00%	5.00%
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions	27,661	27,649
Plan participants' contributions		
Gross benefits paid	(27,661)	(27,649)
Fair value of plan assets — end of year	$ -	$ -
Funded status:		
Reconciliation of funded status — end of year:		
Fair value of plan assets	$ -	$ -
Benefit obligations	11,933,435	5,900,567
Funded status	(11,933,435)	(5,900,567)
Amount recognized — end of year	$ (11,933,435)	$ (5,900,567)
Amounts recognized in the statements of financial position consist of:		
Asset	$ -	$ -
Liability	(11,933,435)	(5,900,567)
Net amount recognized	$ (11,933,435)	$ (5,900,567)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 5,575,910	$ 1,708,854
Prior service cost (credit)	701,833	714,123
	$ 6,277,743	$ 2,422,977

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Table—*continued*

	As of December 31,	
	2010	2009
Expected cash flows:		
Expected employer contributions — 2011	$ 203,387	
Expected benefit payments:*		
2011	$ 203,387	
2012	245,726	
2013	270,697	
2014	288,871	
2015	317,411	
2016–2020	2,036,841	
Components of net periodic benefit cost:		
Service cost	$1,359,828	$ 712,515
Interest cost	545,688	307,501
Expected return on plan assets		
Amortization:		
Actuarial (gain) loss	287,957	146,780
Prior service (credit) cost	12,290	35,257
Net periodic benefit cost (credit)	$2,205,763	$1,202,053
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	6.00%	6.00%
Rate of compensation increase	5.00%	5.00%
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year prior service (credit) cost	$ -	$ 492,461
Current year actuarial (gain) loss	4,155,013	(175,635)
Amortization of prior service credit (cost)	(12,290)	(35,257)
Amortization of actuarial gain (loss)	(287,957)	(146,780)
Total recognized in other comprehensive income	$3,854,766	$ 134,789
Total recognized in net periodic benefit cost and other comprehensive income	$6,060,529	$1,336,842

* Expected benefit payments to be made from System assets.

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2011 are shown below:

Net actuarial (gain) loss	$446,472
Prior service (credit) cost	1,881
Total	$448,353

On October 30, 2008, the Board approved a non-qualified plan for Officers of the Board. The retirement benefits covered under the Board Officer Pension Enhancement (BOPE) increases the pension benefit calculation from 1.8% above the Social Security integration level to 2.0%. Activity for the BOPE as of December 31, 2010 and 2009, is summarized in the following tables:

	As of December 31,	
	2010	2009
Change in projected benefit obligation:		
Benefit obligation — beginning of year	$ 7,120,820	$ 6,275,285
Service cost	409,007	333,034
Interest cost	493,780	402,680
Plan participants' contributions		
Actuarial (gain) loss	1,935,668	286,440
Gross benefits paid	(9,638)	
Plan amendments	-	(176,619)
Benefit obligation — end of year	$ 9,949,637	$ 7,120,820
Accumulated benefit obligation — end of year	$ 7,063,653	$ 5,175,331
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	5.50%	6.00%
Rate of compensation increase	5.00%	5.00%
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions	9,638	
Plan participants' contributions		
Gross benefits paid	(9,638)	
Fair value of plan assets — end of year	$ -	$ -
Funded status:		
Reconciliation of funded status — end of year:		
Fair value of plan assets	$ -	$ -
Benefit obligations	9,949,637	7,120,820
Funded status	(9,949,637)	(7,120,820)
Amount recognized — end of year	$ (9,949,637)	$ (7,120,820)
Amounts recognized in the statements of financial position consist of:		
Asset	$ -	$ -
Liability	(9,949,637)	(7,120,820)
Net amount recognized	$ (9,949,637)	$ (7,120,820)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 3,465,859	$ 1,742,746
Prior service cost (credit)	3,243,278	3,774,673
	$ 6,709,137	$ 5,517,419
Expected cash flows:		
Expected employer contributions — 2011	$ 57,224	
Expected benefit payments:*		
2011	$ 57,224	
2012	101,577	
2013	152,569	
2014	211,829	
2015	275,788	
2016–2020	2,463,754	

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Table—*continued*

	As of December 31,	
	2010	2009
Components of net periodic benefit cost:		
Service cost	$ 409,007	$ 333,034
Interest cost	493,780	402,680
Expected return on plan assets		
Amortization:		
Actuarial (gain) loss	212,555	150,893
Prior service (credit) cost	531,395	531,395
Net periodic benefit cost (credit)	$1,646,737	$1,418,002
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	6.00%	6.00%
Rate of compensation increase	5.00%	5.00%
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year prior service (credit) cost	$ -	$ (176,619)
Current year actuarial (gain) loss	1,935,668	286,440
Amortization of prior service credit (cost)	(531,395)	(531,395)
Amortization of actuarial gain (loss)	(212,555)	(150,893)
Total recognized in other comprehensive income	$1,191,718	$ (572,467)
Total recognized in net periodic benefit cost and other comprehensive income	$2,838,455	$ 845,535

* Expected benefit payments to be made from System assets.

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2011 are shown below:

Net actuarial (gain) loss	$287,715
Prior service (credit) cost	531,395
Total	$819,110

The total accumulated retirement benefit obligation includes a liability for a supplemental retirement agreement and a benefits equalization plan under the Federal Reserve System's Thrift Plan. The total obligation as of December 31, 2010 and 2009 is summarized in the following table:

	2010	2009
Accumulated retirement benefit obligation:		
Benefit obligation — BEP	$11,933,435	$ 5,900,567
Benefit obligation — BOPE	9,949,637	7,120,820
Additional benefit obligation	96,147	-
Total accumulated retirement benefit obligation	$21,979,219	$13,021,387

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). These defined benefit plans are administered by the U.S. Office of Personnel Management, which determines the required employer contribution levels. The Board's contributions to these plans totaled $452,000 and $329,000 in 2010 and 2009, respectively. The Board has no liability for future payments to retirees under these programs and is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan or Roth 401(k). Board contributions to members' accounts were $16,695,000 and $14,342,000 in 2010 and 2009, respectively.

(7) Accumulated Postretirement Benefits

The Board provides certain life insurance programs for its active employees and retirees. Activity as of December 31, 2010 and 2009, is summarized in the following tables:

	As of December 31,	
	2010	2009
Change in projected benefit obligation:		
Benefit obligation — beginning of year	$ 9,304,324	$ 8,527,800
Service cost	188,357	169,687
Interest cost	532,592	516,194
Plan participants' contributions	-	-
Actuarial (gain) loss	464,667	361,009
Gross benefits paid	(270,268)	(270,366)
Curtailments	-	-
Benefit obligation — end of year	$ 10,219,672	$ 9,304,324
Weighted-average assumptions used to determine benefit obligation as of December 31 — discount rate	5.25%	5.75%
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions	270,268	270,366
Gross benefits paid	(270,268)	(270,366)
Fair value of plan assets — end of year	$ -	$ -
Funded status:		
Reconciliation of funded status — end of year:		
Fair value of plan assets	$ -	$ -
Benefit obligations	10,219,672	9,304,324
Funded status	(10,219,672)	(9,304,324)
Amount recognized — end of year	$ (10,219,672)	$ (9,304,324)
Amounts recognized in the statements of financial position consist of:		
Asset	$ -	$ -
Liability	(10,219,672)	(9,304,324)
Net amount recognized	$ (10,219,672)	$ (9,304,324)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 1,917,176	$ 1,528,733
Prior service cost (credit)	(276,534)	(302,024)
	$ 1,640,642	$ 1,226,709
Expected cash flows:		
Expected employer contributions — 2011	$ 337,952	
Expected benefit payments:*		
2011	$ 337,952	
2012	354,971	
2013	383,010	
2014	411,414	
2015	439,387	
2016–2020	2,623,724	

(continued on next page)

Table—*continued*

	As of December 31,	
	2010	2009
Components of net periodic benefit cost:		
Service cost	$ 188,357	$ 169,687
Interest cost	532,592	516,194
Expected return on plan assets	-	-
Amortization:		
Actuarial (gain) loss	76,224	55,878
Prior service (credit) cost	(25,490)	(25,490)
Net periodic benefit cost (credit)	$ 771,683	$ 716,269
Weighted-average assumptions used to determine net periodic benefit cost — discount rate	5.75%	6.00%
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year actuarial (gain) loss	$ 464,667	$ 361,009
Amortization of prior service credit (cost)	25,490	25,490
Amortization of actuarial gain (loss)	$ (76,224)	$ (55,878)
Total recognized in other comprehensive income	$ 413,933	$ 330,621
Total recognized in net periodic benefit cost and other comprehensive income	$1,185,616	$1,046,890

* Expected benefit payments to be made from System assets.

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2011 are shown below:

Net actuarial (gain) loss	$110,901
Prior service (credit) cost	(25,490)
Total	$ 85,411

(8) Accumulated Postemployment Benefits

The Board provides certain postemployment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. Postemployment costs were actuarially determined using a December 31 measurement date and discount rates of 3.50% and 4.00% as of December 31, 2010 and 2009, respectively. The accrued postemployment benefit costs recognized by the Board as of December 31, 2010 and 2009, were $701,000 and $1,754,000, respectively.

(9) Accumulated Other Comprehensive Income (Loss)

A reconciliation of beginning and ending balances of accumulated other comprehensive income (loss) for the years ended December 31, 2010 and 2009, is as follows:

	Amount Related to Defined Benefit Retirement Plans	Amount Related to Postretirement Benefits Other Than Pensions	Total Accumulated Other Comprehensive Income (Loss)
Balance — January 1, 2009	$ 8,378,074	$ 896,088	$ (9,274,162)
Change in funded status of benefit plans:			
Prior service (credit) cost arising during the year	315,842	-	(315,842)
Amortization of prior service credit (costs)	(566,652)	25,490	541,162
Amortization of net actuarial gain (loss)	(297,673)	(55,878)	353,551
Net actuarial (gain) loss arising during the year	110,805	361,009	(471,814)
Change in funded status of benefit plans — other comprehensive income (loss)	(437,678)	330,621	107,057
Balance — December 31, 2009	7,940,396	1,226,709	(9,167,105)
Change in funded status of benefit plans:			
Prior service (credit) cost arising during the year			
Amortization of prior service credit (costs)	(543,685)	25,490	518,195
Amortization of net actuarial gain (loss)	(500,512)	(76,224)	576,736
Net actuarial (gain) loss arising during the year	6,090,681	464,667	(6,555,348)
Change in funded status of benefit plans - other comprehensive income (loss)	5,046,484	413,933	(5,460,417)
Balance — December 31, 2010	$12,986,880	$1,640,642	$(14,627,522)

Additional detail regarding the classification of accumulated other comprehensive income (loss) is included in Notes 6 and 7.

(10) Federal Reserve Banks

The Board performs certain functions for the Reserve Banks in conjunction with its responsibilities for the System, and the Reserve Banks provide certain administrative functions for the Board. Activity related to the Board and Reserve Banks as of December 31, 2010 and 2009, is summarized in the following table:

	As of December 31,	
	2010	2009
Reserve Bank expenses charged to the Board:		
Data processing and communication	$ 919,889	$ 776,835
Contingency site	1,254,331	1,171,808
Total Reserve Bank expenses charged to the Board	$ 2,174,220	$ 1,948,643
Board expenses charged to the Reserve Banks:		
Assessments for currency costs:		
Printing	$ 598,238,821	$479,255,288
Shipping	16,900,584	15,367,546
Retirement	3,513,538	3,608,937
Research and development	4,205,705	3,913,112
Assessments for operating expenses of the Board	422,200,000	386,399,900
Data processing	483,512	635,235
Total Board expenses charged to the Reserve Banks	$1,045,542,160	$889,180,018
Accounts receivable due from the Reserve Banks	$ 856,685	$ 1,071,932

The Board contracted for audit services on behalf of entities that are included in the combined financial statements of the Federal Reserve Banks. The entities reimburse the Board for the cost of the audit services. The Board accrued liabilities of $322,000 and $138,000 in audit services and recorded receivables of $322,000 and $138,000 from the entities as of December 31, 2010 and 2009, respectively.

(11) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the Council), and currently performs certain management functions for the Council. The five agencies that are represented on the Council are the Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision.

The Board's financial statements do not include financial data for the Council. Activity related to the Board and Council, as of December 31, 2010 and 2009, is summarized in the following table:

	As of December 31,	
	2010	2009
Council expenses charged to the Board:		
Assessments for operating expenses	$ 126,469	$ 67,998
Assessments for examiner education	672,153	734,359
Central Data Repository	1,202,704	1,522,597
Uniform Bank Performance Report	154,877	210,293
Total Council expenses charged to the Board	$2,156,203	$2,535,247
Board expenses charged to the Council:		
Data processing related services	$4,897,107	$4,884,868
Administrative services	245,000	245,000
Total Board expenses charged to the Council	$5,142,107	$5,129,868
Accounts receivable due from the Council	$ 579,792	$ 618,861
Accounts payable due to the Council	290,047	209,922

In 2007, the Council began a rewrite of the Home Mortgage Disclosure Act processing system, for which the Board provides data processing services. The total cost of the rewrite for the Council is $2.7 million of which the Board expense to support this effort was $464,000 through December 31, 2010.

(12) The Office of Employee Benefits of the Federal Reserve System

The Office of Employee Benefits of the Federal Reserve System (OEB) administers certain System benefit programs on behalf of the Board and the Reserve Banks, and costs associated with the OEB's activities are assessed to the Board and Reserve Banks. The Board was assessed $2,371,000 and $2,166,000 as of December 31, 2010 and 2009, respectively.

(13) The Bureau of Consumer Financial Protection

Sec. 1017 of the Dodd-Frank Act requires the Board to fund the Bureau the amount needed to carry out the authorities granted to the Bureau under Federal consumer financial law. Beginning July 2011, the Act limits the amount to be transferred each fiscal year to a fixed percentage of the System's total operating expenses. During 2010, the Board received and processed funding requests for the Bureau totaling $32,770,000.

(14) The Office of Financial Research

Sec. 155(c) of the Dodd-Frank Act requires the Board to provide an amount sufficient to cover the expenses of the Office for the 2-year period following the date of the enactment (July 21, 2010). The expenses of the FSOC are included in the expenses of the Office. During 2010, the Board received and processed funding requests for the Office totaling $9,515,944.

(15) Bureau of Engraving and Printing

The Bureau of Engraving and Printing is the sole supplier for currency printing and also provides retirement services. The currency costs incurred as of December 31, 2010 and 2009, are reflected in the following table:

	As of December 31,	
	2010	2009
Currency expenses charged to the Board:		
Printing	$598,238,821	$479,255,288
Retirement	3,513,538	3,608,937
Total currency expenses charged to the Board	$601,752,359	$482,864,225

(16) Commitments and Contingencies

Commitments — The Board has entered into an agreement with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, through the Council, to fund a portion of the enhancements and maintenance fees for a central data repository project through 2010 with an option to extend maintenance through 2013. The estimated Board expense to support this effort is $7.9 million for the base period and $2.6 million for the option period.

Litigation and Contingent Liabilities — The Board is subject to contingent liabilities which arise from litigation cases and various business contracts. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available to management, it is management's opinion that the expected outcome of these matters, in the aggregate, will not have a materially adverse effect on the financial statements.

Civil cases against the Board arising out of The Freedom of Information Act permits recovery of attorneys fees in civil cases where the plaintiff "substantially prevails". There are two pending cases in which it is possible that the Board could be required to pay fees in excess of $205,000 per case.

(17) Subsequent Events

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2010. Subsequent events were evaluated through February 28, 2011, which is the date the financial statements were available to be issued.

Deloitte.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Governors of the Federal Reserve System:

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the "Board") as of and for the year ended December 31, 2010, and have issued our report thereon dated February 28, 2011. We conducted our audit in accordance generally accepted auditing standards as established by the Auditing Standards Board (United States), auditing standards of the Public Company Accounting Oversight Board (United States), and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In accordance with standards of the Public Company Accounting Oversight Board (United States) and *Government Auditing Standards*, we have also issued our report dated February 28, 2011, on our tests of the Board's internal control over financial reporting. The purpose of that report is to describe the scope and the results of that testing. That report is an integral part of an audit performed in accordance with standards of the Public Company Accounting Oversight Board (United States) and *Government Auditing Standards* and should be considered in assessing the results of our audit.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Distribution

This report is intended solely for the information and use of the Board, management, and others within the organization, Office of Inspector General, the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

February 28, 2011
McLean, VA

Federal Reserve Banks Combined Financial Statements

The combined financial statements of the Federal Reserve Banks were audited by Deloitte & Touche LLP, independent auditors, for the years ended December 31, 2010 and 2009.

INDEPENDENT AUDITOR'S REPORT

Deloitte.

To the Board of Governors of the Federal Reserve System and the Boards of Directors of the Federal Reserve Banks:

We have audited the accompanying Combined Statements of Condition of the Federal Reserve Banks (the "Reserve Banks") as of December 31, 2010 and 2009 and the related Combined Statements of Income and Comprehensive Income, and of Changes in Capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. These Combined Financial Statements are the responsibility of the Division of Reserve Bank Operations and Payment System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Reserve Banks are not required to have, nor were we engaged to perform, an audit of their internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Reserve Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 4 to the Combined Financial Statements, the Reserve Banks have prepared these Combined Financial Statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the *Financial Accounting Manual for Federal Reserve Banks,* which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such Combined Financial Statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 4.

In our opinion, such Combined Financial Statements referred to above present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 2010 and 2009, and the combined results of their operations for the years then ended, on the basis of accounting described in Note 4.

Deloitte & Touche LLP

March 22, 2011
Washington, DC

The Federal Reserve Banks

Abbreviations

ABCP	Asset-backed commercial paper
ABS	Asset-backed securities
ACH	Automated clearinghouse
AIA	American International Assurance Company Ltd.
AIG	American International Group, Inc.
AIG Trust	AIG Credit Facility Trust
AIGFP	AIG Financial Products Corp.
ALICO	American Life Insurance Company
AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ARM	Adjustable rate mortgage
ASC	Accounting Standards Codification
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
CDO	Collateralized debt obligation
CDS	Credit default swaps
CIP	Committee on Investment Performance (related to System Retirement Plan)
CMBS	Commercial mortgage-backed securities
CPFF	Commercial Paper Funding Facility
ESF	Exchange Stabilization Fund
FAM	*Financial Accounting Manual for Federal Reserve Banks*
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FFCB	Federal Farm Credit Banks
FHLB	Federal Home Loan Banks
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
FRBC	Federal Reserve Bank of Chicago
FRBNY	Federal Reserve Bank of New York
FRBR	Federal Reserve Bank of Richmond
FRBSF	Federal Reserve Bank of San Francisco
GAAP	Accounting principles generally accepted in the United States of America
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
IRS	Interest rate swaps
JPMC	JPMorgan Chase & Co.
Libor	London interbank offered rate

LLC	Limited liability company
MBS	Mortgage-backed securities
ML	Maiden Lane LLC
ML II	Maiden Lane II LLC
ML III	Maiden Lane III LLC
MTM	Mark-to-market
OEB	Office of Employee Benefits of the Federal Reserve System
OFR	Office of Financial Research
OIS	Overnight indexed swap
PDCF	Primary Dealer Credit Facility
RMBS	Residential mortgage-backed securities
SBA	Small Business Administration
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SFAS	Statement of Financial Accounting Standards
SOMA	System Open Market Account
STRIP	Separate Trading of Registered Interest and Principal of Securities
TAF	Term Auction Facility
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TBA	To be announced
TCE	Transitional Credit Extension
TDF	Term Deposit Facility
TIPS	Treasury Inflation-Protected Securities
TRS	Total return swap agreement
TOP	Term Securities Lending Facility Options Program
TSLF	Term Securities Lending Facility
VIE	Variable interest entity

Federal Reserve Banks Combined Statements of Condition as of December 31, 2010 and December 31, 2009
(in millions)

	2010	2009
Assets		
Gold certificates	$ 11,037	$ 11,037
Special drawing rights certificates	5,200	5,200
Coin	2,180	2,053
Items in process of collection	374	507
Loans:		
Depository institutions	221	96,618
Term Asset-Backed Securities Loan Facility (measured at fair value)	24,853	48,183
American International Group, Inc., net	20,603	21,250
System Open Market Account:		
Treasury securities, net	1,066,952	805,972
Government-sponsored enterprise debt securities, net	152,972	167,362
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,004,695	918,927
Foreign currency denominated assets, net	26,049	25,272
Central bank liquidity swaps	75	10,272
Other investments	-	5
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities (of which $68,469 and $71,648 is measured at fair value as of December 31, 2010 and 2009, respectively)	68,666	81,380
Preferred interests	26,385	25,106
Accrued interest receivable	14,231	12,641
Bank premises and equipment, net	2,613	2,624
Other assets	738	638
Total assets	$2,427,844	$2,235,047
Liabilities and Capital		
Federal Reserve notes outstanding, net	$ 941,561	$ 887,846
System Open Market Account:		
Securities sold under agreements to repurchase	59,703	77,732
Other liabilities	-	601
Consolidated variable interest entities:		
Beneficial interest in consolidated variable interest entities (measured at fair value)	10,051	5,095
Other liabilities (of which $203 and $143 is measured at fair value as of December 31, 2010 and 2009, respectively)	921	1,316
Deposits:		
Depository institutions	968,052	976,988
Treasury, general account	140,773	186,632
Treasury, supplementary financing account	199,964	5,001
Other deposits	16,967	36,228
Funds from American International Group, Inc. asset dispositions, held as agent	26,896	-
Interest payable to depository institutions	113	113
Accrued benefit costs	2,597	2,631
Deferred credit items	1,794	2,103
Accrued interest on Federal Reserve notes	5,124	1,191
Other liabilities	280	290
Total liabilities	2,374,796	2,183,767
Capital paid-in	26,524	25,640
Surplus (including accumulated other comprehensive loss of $3,630 and $3,676 at December 31, 2010 and 2009, respectively)	26,524	25,640
Total capital	53,048	51,280
Total liabilities and capital	$2,427,844	$2,235,047

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

Federal Reserve Banks Combined Statements of Income and Comprehensive Income for the years ended December 31, 2010 and December 31, 2009
(in millions)

	2010	2009
Interest Income		
Loans:		
Depository institutions	$ 50	$ 990
Term Asset-Backed Securities Loan Facility	750	414
American International Group, Inc., net	2,728	3,996
Other	-	109
System Open Market Account:		
Securities purchased under agreements to resell	-	13
Treasury securities, net	26,373	22,873
Government-sponsored enterprise debt securities, net	3,510	2,048
Federal agency and government-sponsored enterprise mortgage-backed securities, net	44,839	20,407
Foreign currency denominated assets, net	223	296
Central bank liquidity swaps	12	2,168
Other investments	-	1
Investments held by consolidated variable interest entities	4,440	9,820
Total interest income	82,925	63,135
Interest Expense		
System Open Market Account:		
Securities sold under agreements to repurchase	94	98
Beneficial interest in consolidated variable interest entities	277	267
Deposits:		
Depository institutions	2,680	2,183
Term Deposit Facility	4	-
Total interest expense	3,055	2,548
Provision for loan restructuring	-	(2,621)
Net interest income after provision for loan restructuring	79,870	57,966
Non-Interest Income (Loss)		
Term Asset-Backed Securities Loan Facility, unrealized (losses) gains	(436)	557
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	782	879
Foreign currency gains, net	554	172
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities gains (losses), net	8,180	(1,937)
Beneficial interest in consolidated variable interest entities (losses), net	(4,679)	(1,903)
Dividends on preferred interests	1,279	106
Income from services	567	663
Reimbursable services to government agencies	457	450
Other income	187	443
Total non-interest income (loss)	6,891	(570)
Operating Expenses		
Salaries and benefits	2,722	2,802
Occupancy	297	280
Equipment	180	183
Assessments:		
Board of Governors operating expenses and currency costs	1,045	888
Bureau of Consumer Financial Protection	33	-
Office of Financial Research	10	-
Professional fees related to consolidated variable interest entities	104	125
Other	681	702
Total operating expenses	5,072	4,980
Net income prior to distribution	81,689	52,416
Change in funded status of benefit plans	46	1,007
Comprehensive income prior to distribution	$81,735	$53,423
Distribution of comprehensive income:		
Dividends paid to member banks	$ 1,583	$ 1,428
Transferred to surplus and change in accumulated other comprehensive loss	884	4,564
Payments to Treasury as interest on Federal Reserve notes	79,268	47,431
Total distribution	$81,735	$53,423

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

Federal Reserve Banks Combined Statements Of Changes In Capital for the years ended December 31, 2010 and December 31, 2009

(in millions, except share data)

	Capital paid-in	Surplus			Total capital
		Net income retained	Accumulated other comprehensive (loss)	Total surplus	
Balance at January 1, 2009 (421,517,467 shares)	$21,076	$25,759	$(4,683)	$21,076	$42,152
Net change in capital stock issued (91,289,192 shares)	4,564	-	-	-	4,564
Transferred to surplus and change in accumulated other comprehensive income	-	3,557	1,007	4,564	4,564
Balance at December 31, 2009 (512,806,659 shares)	$25,640	$29,316	$(3,676)	$25,640	$51,280
Net change in capital stock issued (17,674,477 shares)	884	-	-	-	884
Transferred to surplus and change in accumulated other comprehensive income	-	838	46	884	884
Balance at December 31, 2010 (530,481,136 shares)	$26,524	$30,154	$(3,630)	$26,524	$53,048

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

(1) Structure

The twelve Federal Reserve Banks (Reserve Banks) are part of the Federal Reserve System (System) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics.

In accordance with the Federal Reserve Act, supervision and control of each Reserve 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 individuals, partnerships, and corporations in unusual and exigent circumstances; serving consumers and communities by providing educational materials and information regarding financial consumer protection rights and laws and information on community development programs and activities; and supervising bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

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

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

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes the FRBNY to conduct operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities. Specifically, the FOMC authorizes and directs the FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, 14 foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico and to "warehouse" foreign currencies for the Treasury and the Exchange Stabilization Fund (ESF).

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

(3) Financial Stability Activities

The Reserve Banks have implemented the following programs that support the liquidity of financial institutions and foster improved conditions in financial markets.

Large-Scale Asset Purchase Programs

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

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

Central Bank Liquidity Swaps

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

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

Lending to Depository Institutions

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

Lending to Primary Dealers

The Term Securities Lending Facility (TSLF) promoted liquidity in the financing markets for Treasury securities. Under the TSLF, the FRBNY could lend up to an aggregate amount of $200 billion of Treasury securities held in the SOMA to primary dealers on a secured basis for a term of 28 days. The authorization for the TSLF expired on February 1, 2010.

The Term Securities Lending Facility Options Program (TOP) offered primary dealers the opportunity to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program was suspended effective with the maturity of the June 2009 TOP options, and authorization for the program expired on February 1, 2010.

The Primary Dealer Credit Facility (PDCF) was designed to improve the ability of primary dealers to provide financing to participants in the securitization markets. Primary dealers could obtain secured overnight financing under the PDCF in the form of repurchase transactions. The authorization for the PDCF expired on February 1, 2010, and the last loan matured on May 13, 2009.

The Transitional Credit Extension (TCE) program provided liquidity support through secured loans to broker-dealers that were in the process of transitioning to the bank holding company structure. The authorization for the TCE program expired on February 1, 2010, and the last loan matured on April 29, 2009.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) provided funding to depository institutions and bank holding companies to finance the purchase of eligible high-quality asset-backed commercial paper (ABCP) from money market mutual funds. The Federal Reserve Bank of Boston administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. The authorization for the AMLF expired on February 1, 2010.

The Commercial Paper Funding Facility (CPFF program) enhanced the liquidity of the commercial paper market in the U.S. by increasing the availability of term commercial paper funding to issuers and by providing greater assurance to both issuers and investors that issuers would be able to roll over their maturing commercial paper. The authorization to purchase high-quality commercial paper through the CPFF program expired on February 1, 2010. The Commercial Paper Funding Facility LLC (CPFF) was a Delaware limited liability company formed on October 14, 2008, in connection with the implementation of the CPFF program, to purchase eligible three-month unsecured commercial paper and ABCP directly from eligible issuers using the proceeds of loans made to CPFF by the FRBNY. The FRBNY's loans to CPFF were eliminated in consolidation of CPFF into the combined financial statements. The last commercial paper purchased by the CPFF matured on April 26, 2010, and the CPFF was dissolved on August 30, 2010. CPFF's financial statements as of May 31, 2010 and for the period January 1, 2010, through May 31, 2010, and as of and for the year ended December 31, 2009 were last published on August 30, 2010.

The Term Asset-Backed Securities Loan Facility (TALF) assisted financial markets in accommodating the credit needs of consumers and businesses of all sizes by facilitating the issuance of asset-backed securities (ABS) collateralized by a variety of consumer and business loans. The Board of Governors authorized the offering of TALF loans collateralized by newly-issued ABS and legacy commercial mortgage-backed securities (CMBS) until March 31, 2010, and TALF loans collateralized by newly-issued CMBS until June 30, 2010. Under the TALF, the FRBNY was authorized to lend up to $200 billion to eligible borrowers.

TALF loans have maturities up to five years and are secured by eligible collateral, with the FRBNY having lent an amount equal to the value of the collateral, as determined by the Bank, less a margin. Loan proceeds were disbursed to the borrower contingent on receipt by the FRBNY's custodian of the eligible collateral, an administrative fee, and, if applicable, a margin.

The TALF loans were extended on a nonrecourse basis. If the borrower does not repay the loan, the FRBNY will enforce its rights in the collateral and may sell the collateral to TALF LLC, a Delaware limited liability company, established on February 4, 2009, for the purpose of purchasing such assets. As of December 31, 2010, the FRBNY has not enforced its rights to the collateral because there have been no defaults.

Pursuant to a put agreement with the FRBNY, TALF LLC has committed to purchase assets that secure a TALF loan at a price equal to the principal amount outstanding plus accrued but unpaid interest, regardless of the fair value of the collateral. Funding for the TALF LLC's purchases of these securities is derived first through the fees received by TALF LLC from the FRBNY for this commitment and any interest earned on its investments. In the event that such funding proves insufficient for the asset purchases that TALF LLC has committed to make under the put agreement, the Treasury committed to lend up to $20 billion, and on March 25, 2009, the Treasury funded $100 million. On July 19, 2010, this commitment was reduced to $4.3 billion to reflect the fact that only $43 billion of TALF loans were outstanding when the program closed to new lending on June 30, 2010. Treasury's loan to TALF LLC bears interest at a rate of the one-month London interbank offered rate (Libor) plus 300 basis points. In addition to Treasury's commitment, the FRBNY committed, as a senior lender, to lend up to $180 billion to TALF LLC if it needed the funding to purchase assets pursuant to the put agreement. The FRBNY's maximum exposure was subsequently reduced to $38.7 billion when the program closed to new lending. Any loan that the FRBNY makes to TALF LLC would be senior to any Treasury loan and would bear interest at a rate of the one-month Libor plus 100 basis points. To the extent that Treasury and the FRBNY have extended credit to TALF LLC, their loans are secured by all of the assets of TALF LLC. The FRBNY is the managing member and the controlling party of TALF LLC and will remain the controlling party as long as it retains an economic interest in TALF LLC. After TALF LLC has paid all operating expenses and principal due to the FRBNY, the remaining proceeds of the portfolio holdings will be distributed in the following order: principal due to Treasury, interest due to the FRBNY, and interest due to Treasury. Any residual cash flows will be shared between the FRBNY, which will receive 10 percent, and the Treasury, which will receive 90 percent.

Support for Specific Institutions

Bear Stearns Companies, Inc.

To facilitate the merger of The Bear Stearns Companies, Inc. (Bear Stearns) and JPMorgan Chase & Co. (JPMC), the FRBNY extended credit to Maiden Lane LLC (ML) in June 2008. ML is a Delaware limited liability company formed by the FRBNY to acquire certain assets of Bear Stearns and to manage those assets over time, in order to maximize the potential for the repayment of the credit extended to ML and to minimize disruption to the financial markets. The assets acquired by ML were valued at $29.9 billion as of March 14, 2008, the date that the FRBNY committed to the transaction, and largely consisted of Federal agency and GSE MBS, non-agency residential mortgage-backed securities (RMBS), commercial and residential mortgage loans, and derivatives and associated hedges.

The FRBNY extended a senior loan of approximately $28.8 billion and JPMC extended a subordinated loan of $1.15 billion to finance the acquisition of the assets. The loans are collateralized by all of the assets of ML through a pledge to the collateral agent. The FRBNY is the sole and managing member and the controlling party of ML and will remain as such as long as the FRBNY retains an economic interest in ML. The interest rate on the senior loan is the primary credit rate in effect from time to time. The interest rate on the JPMC subordinated loan is the primary credit rate plus 450 basis points. JPMC bears losses associated with the portfolio through its subordinated loan plus accrued interest on the loan. Once the principal and interest are paid, residual gains, if any, will be allocated to the FRBNY. The two-year accumulation period that followed the closing date for ML ended on June 26, 2010. Consistent with the terms of the ML transaction, the distributions of the proceeds realized on the asset portfolio held by ML, after payment of certain fees and expenses, now occur on a monthly basis unless otherwise directed by the Federal Reserve.

American International Group, Inc.

In September 2008, the Board of Governors authorized the FRBNY to lend to American International Group, Inc., (AIG). Initially, the FRBNY provided AIG with a revolving line of credit collateralized by the pledge of a substantial portion of the assets of AIG. Under the provisions of the original agreement, the FRBNY was authorized to lend up to $85 billion to AIG for two years at the three-month Libor, with a floor of 350 basis points, plus 850 basis points. In addition, the FRBNY assessed AIG a one-time commitment fee of 200 basis points on the full amount of the commitment and a fee of 850 basis points per annum on the undrawn credit line. A condition of the credit agreement was that AIG would issue to a trust, for the sole benefit of the fiscal treasury, preferred shares convertible to approximately 78 percent of the issued and outstanding shares of the common stock of AIG. The AIG Credit Facility Trust (AIG Trust) was formed January 16, 2009 and the preferred shares were issued to the AIG Trust on March 4, 2009. The AIG Trust had three independent trustees who control the AIG Trust's voting and consent rights. The FRBNY cannot exercise voting or consent rights.

The Board and the Treasury announced a restructuring of the government's financial support to AIG in November 2008. As part of the restructuring, the Treasury purchased $40 billion of newly-issued AIG preferred shares under the Troubled Asset Relief Program (TARP). The majority of the TARP funds were used to pay down AIG's debt to the FRBNY. In addition, the terms of the original credit agreement were modified to reduce the revolving line of credit to $60 billion; reduce the interest rate to the three-month Libor with a floor of 350 basis points, plus 300 basis points; reduce the fee on undrawn funds to 75 basis points; and extend the term of the agreement to five years. The other material terms of the funding were unchanged. These revised terms were more consistent with terms generally available to other entities with similar credit risk.

Concurrent with the November 2008 restructuring of its financial support to AIG, the FRBNY established two limited liability companies (LLCs). The FRBNY extended credit to Maiden Lane II LLC (ML II), a Delaware limited liability company formed to purchase non-agency RMBS from the reinvestment pool of the securities lending portfolios of several regulated U.S. insurance subsidiaries of AIG. ML II borrowed $19.5 billion from the FRBNY and used the proceeds to purchase non-agency RMBS that had an approximate fair value of $20.8 billion as of October 31, 2008 from AIG's domestic insurance subsidiaries. The FRBNY is the sole and managing member and the controlling party of ML II and will remain as the controlling party as long as the FRBNY retains an economic interest in ML II. As part of the agreement, the AIG subsidiaries also received from ML II a fixed deferred purchase price of up to $1.0 billion, plus interest on any such fixed deferred purchase price outstanding. The interest rate on the FRBNY's senior loan is one-month Libor plus 100 basis points, and the interest rate on the fixed deferred purchase price is one-month Libor plus 300 basis points. After ML II has first paid the FRBNY's senior loan, including accrued and unpaid interest, and then the fixed deferred purchase price in full, including accrued and unpaid interest, any net proceeds will be divided between the FRBNY, which is entitled to receive five-sixths, and the AIG subsidiaries, which are entitled to receive one-sixth. The FRBNY's loan and the fixed deferred purchase price payable to the AIG subsidiaries are collateralized by all of the assets of ML II through a pledge to the collateral agent.

The FRBNY also extended credit to Maiden Lane III LLC (ML III), a Delaware limited liability company formed to purchase ABS collateralized debt obligations (CDOs) from certain third-party counterparties of AIG Financial Products Corp. (AIGFP). In connection with the acquisitions, the third-party counterparties agreed to terminate their related credit default swap (CDS) contracts with AIGFP. ML III borrowed approximately $24.3 billion from the FRBNY, and AIG provided an equity contribution of $5 billion to ML III. The proceeds were used to purchase ABS CDOs with a fair value of $29.6 billion. The counterparties received $26.8 billion net of principal, interest received, and finance charges paid. ML III also made a payment to AIGFP of $2.5 billion, representing the return of excess collateral previously posted by AIGFP with the counterparties. The FRBNY is the managing member and the controlling party of ML III and will remain as the controlling party as long as the FRBNY retains an economic interest in ML III. Net proceeds received by ML III will first be applied to repay the FRBNY's senior loan plus interest at one-month Libor plus 100 basis points. The FRBNY's senior loan is collateralized by all of the assets of ML III through a pledge to the collateral agent. After the FRBNY is paid in full, AIG, or its assignee, is entitled to receive repayment of its equity contribution plus interest at the one-month Libor plus 300 basis points. After ML III has paid the FRBNY's senior loan and AIG's equity contribution in full, the FRBNY will be entitled to receive 67 percent of any additional net proceeds received by ML III as a contingent interest on the senior loan and AIG, or its assignee, will be entitled to receive 33 percent of any net proceeds received by ML III as contingent distributions on its equity interest.

On April 17, 2009, the FRBNY, as part of the U.S. government's commitment to the orderly restructuring of AIG over time, in the face of continuing market dislocations, further restructured the AIG loan by eliminating the 350 basis-point floor on the Libor used to calculate the interest rate on the loan. The interest rate on the modified loan is the three-month Libor plus 300 basis points.

On December 1, 2009, the FRBNY's commitment to lend to AIG was reduced to $35 billion from $60 billion when the outstanding balance of the FRBNY's loan to AIG was reduced by $25 billion in exchange for a liquidation preference of nonvoting perpetual preferred interests in two limited liability companies. AIG created these limited liability companies to hold, directly or indirectly, all of the outstanding common stock of American Life Insurance Company (ALICO) and American International Assurance Company Ltd. (AIA), two life insurance holding company subsidiaries of AIG. The FRBNY was to be paid a 5 percent cumulative dividend on its nonvoting preferred interests through September 22, 2013 and a 9 percent cumulative dividend thereafter. Although the FRBNY had certain governance rights to protect its interests, AIG retained control of the LLCs and the underlying operating companies. The initial value of the FRBNY's preferred interests as of December 1, 2009 was $16 billion for the AIA Aurora LLC (AIA LLC) and $9 billion for the ALICO Holdings LLC (ALICO LLC), which represented a percentage of the fair market value of AIA and ALICO, respectively.

On September 30, 2010, AIG announced an agreement with the Treasury, FRBNY, and the trustees of the AIG Trust on a comprehensive recapitalization plan designed to repay all its obligations to American taxpayers. The agreement included an accelerated repayment of the outstanding balance of the FRBNY revolving line of credit including all accrued interest and fees, termination of that facility, the repayment of the FRBNY's preferred interests in AIA LLC and ALICO LLC, and the conversion of the AIG preferred stock currently owned by the Treasury and the AIG Trust into common equity of AIG.

Pending the closing of the recapitalization plan, the cash proceeds from certain AIG asset dispositions were held by the FRBNY as agent. On October 29, 2010, AIG completed the initial public offering (IPO) of AIA, successfully obtaining a listing on the Hong Kong Stock Exchange and raising total gross proceeds of $20.5 billion. On November 1, 2010, AIG completed the sale of ALICO to MetLife, initially announced on March 8, 2010, for approximately $15.5 billion, including $6.8 billion in cash and the remainder in equity and equity-linked securities of MetLife.

On January 14, 2011, upon closing of the recapitalization plan, the cash proceeds from certain asset dispositions, specifically the initial public offering of AIA and the sale of ALICO, were used first to repay in full the revolving line of credit extended to AIG by the FRBNY, including accrued interest and fees, and then to redeem a portion of the FRBNY's preferred interests in ALICO LLC taken earlier by the FRBNY in satisfaction of a portion of the revolving line of credit. The remaining FRBNY preferred interests in ALICO LLC and AIA LLC, valued at approximately $20 billion, were purchased by AIG through a draw on the Treasury's Series F preferred stock commitment and then transferred by AIG to the Treasury as partial consideration for the transfer to AIG of all outstanding Series F shares. In addition, the FRBNY's commitment to lend any funds under the revolving line of credit was terminated.

Citigroup, Inc.

The Board of Governors, the Treasury, and the Federal Deposit Insurance Corporation (FDIC) (parties) jointly announced on November 23, 2008, that they would provide financial support to Citigroup, Inc. (Citigroup). The agreement, which was executed on January 16, 2009, provided funding support for possible future principal losses relating to a designated pool of up to $301 billion of Citigroup's assets. The funding support was for a period of 10 years for residential assets and 5 years for nonresidential assets. No funding support was provided to Citigroup under this agreement, and on December 23, 2009, the parties terminated the agreement. As a result, the Bank had no contractual obligation at December 31, 2010 or 2009. As consideration for terminating the agreement, Citigroup paid the FRBNY a $50 million termination fee and reimbursed the FRBNY for its out-of-pocket expenses. The termination fee was recognized during the year-ended December 31, 2009, and is reported as a component of "Other income" in the Consolidated Statements of Income.

Bank of America Corporation

The Board of Governors, the Treasury, and the FDIC (parties) jointly announced on January 15, 2009 that they would provide financial support to Bank of America Corporation (Bank of America). Under this arrangement, the Federal Reserve Bank of Richmond (FRBR) would have provided funding support for possible future principal losses relating to a designated pool of up to $118 billion of financial instruments. On September 21, 2009, the parties announced that they had reached an agreement with Bank of America to terminate the agreement. As part of the termination of the agreement, Bank of America paid $57 million in compensation for out-of-pocket expenses incurred by the FRBR and for commitment fees required by the agreement.

(4) Significant Accounting Policies

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

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

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

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

a. Consolidation

The combined financial statements include the accounts and results of operations of the Reserve Banks as well as several variable interest entities (VIEs), which include ML, ML II, ML III, CPFF, and TALF LLC. The consolidation of the VIEs was assessed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810 (ASC 810) *Consolidation*, which requires a variable interest entity to be consolidated by its controlling financial interest holder. Intercompany balances and transactions have been eliminated in consolidation.

A Reserve Bank consolidates a VIE if it has a controlling financial interest, which is defined as the power to direct the significant economic activities of the entity and the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the VIE. To determine whether it is the controlling financial interest holder of a VIE, the Reserve Bank evaluates the VIE's design, capital structure, and relationships with the variable interest holders. The Reserve Bank reconsiders whether it has a controlling financial interest in a VIE, as required by ASC 810, at each reporting date.

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

b. Gold and Special Drawing Rights Certificates

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

SDR certificates are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. SDRs are recorded by the Reserve Banks at original cost. In 2009, the Treasury issued $3 billion in SDR certificates to the Reserve Banks. There were no SDR transactions in 2010.

c. Coin

The amount reported as coin in the Combined Statements of Condition represents the face value of all United States coin held by the Reserve Banks. The Reserve Banks buy 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.

The FRBNY records the TALF loans at fair value in accordance with the fair value option provisions of FASB ASC Topic 825 (ASC 825) *Financial Instruments*. Unrealized gains (losses) on TALF loans that are recorded at fair value are reported as "Non-interest income (loss): Term Asset-Backed Securities Loan Facility, unrealized gains (losses)" in the Combined Statements of Income and Comprehensive Income. The interest income on TALF loans is recognized based on the contracted rate and is reported as a component of "Interest Income: Term Asset-Backed Securities Loan Facility" in the Combined Statements of Income and Comprehensive Income. Administrative fees paid by borrowers at the initiation of each TALF loan, which are recognized as incurred and not deferred, are reported as a component of "Non-interest income (loss): Other income" in the Combined Statements of Income and Comprehensive Income.

The loan to AIG is reported at the outstanding principal balance net of unamortized administrative and commitment fees, and interest income is recognized on an accrual basis. Loan administrative and commitment fees are deferred and amortized on a straight-line basis, rather than using the interest method required by GAAP, over the term of the loan or commitment period. This method results in an interest amount that approximates the amount determined using the interest method.

Loans, other than those recorded at fair value, are impaired when current information and events indicate that it is probable that the Reserve Banks will not receive the principal and interest that is due in accordance with the contractual terms of the loan agreement. Impaired loans are evaluated to determine whether an allowance for loan loss is required. The Reserve Banks have 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 Reserve Banks 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 Reserve Banks discontinue 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.

Impaired loans include loans that have been modified in debt restructurings involving borrowers experiencing financial difficulties. The allowance for loan restructuring is determined by discounting the restructured cash flows using the original effective rate for the loan. Unless the borrower can demonstrate that it can meet the restructured terms, the Reserve Banks discontinue recognizing interest income. Performance prior to the restructuring, or significant events that coincide with the restructuring, are considered in assessing whether the borrower can meet the new terms.

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a tri-party arrangement. In a tri-party arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the 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 TIPS and STRIP Treasury securities); direct obligations of several Federal agency and GSE-related agencies, including Fannie Mae and Freddie Mac; and pass-through MBS of Fannie Mae, Freddie Mac, and Ginnie Mae. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. Repurchase transactions are reported at their contractual amount as "System Open Market Account: Securities purchased under agreements to resell," and the related accrued interest receivable is reported as a component of "Accrued interest receivable" in the Combined Statements of Condition.

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

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

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

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

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the FRBNY entered into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell "to be announced" (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. The FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. The FRBNY's participation in the dollar roll and coupon swap markets furthered the MBS purchase program goal of providing support to the mortgage and housing markets and fostered improved conditions in financial markets more generally. The FRBNY accounted for outstanding commitments under dollar roll and coupon swaps on a settlement-date basis. Based on the terms of the FRBNY dollar roll and coupon swap transactions, transfers of MBS upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Transfers and Servicing*, and the related outstanding commitments are accounted for as sales or purchases upon settlement. Net gains (losses) resulting from dollar roll and coupon swap transactions are reported as "Non-interest income (loss): System Open

Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains (losses), net" in the Combined Statements of Income and Comprehensive Income.

Foreign currency denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on foreign currency denominated assets are reported as "Foreign currency gains, net" in the Combined Statements of Income and Comprehensive Income.

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

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

The FRBNY is authorized to hold foreign currency working balances and execute foreign exchange contracts to facilitate international payments and currency transactions it makes on behalf of foreign central bank and U.S. official institution customers. These foreign currency working balances and contracts are not related to the Bank's monetary policy operations. Foreign currency working balances are reported as a component of "Other assets" in the Consolidated Statements of Condition and the related foreign currency valuation gains and losses that result from the daily revaluation of the foreign currency working balances and contracts are reported as a component of "Non-interest income (loss): Other income" in the Combined Statements of Income and Comprehensive Income.

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as "Interest income: Central bank liquidity swaps" in the Combined 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 Reserve Banks.

h. Investments Held by Consolidated Variable Interest Entities

The investments held by consolidated VIEs include investments in Federal agency and GSE MBS, non-agency RMBS, commercial and residential real estate mortgage loans, CDOs, commercial paper, other investment securities, other real estate owned, and derivatives and associated hedges. Investments are reported as "Consolidated variable interest entities: Investments held by consolidated variable interest entities" in the Combined Statements of Condition. These investments are accounted for and classified as follows:

- Commercial paper held by the CPFF was designated as held-to-maturity under FASB ASC Topic 320 (ASC 320) *Investments–Debt and Equity Securities* according to the terms of the CPFF program. The FRBNY had the positive intent and the ability to hold the securities to maturity, and, therefore, the commercial paper was recorded at amortized cost. The amortization of premiums and accretion of discounts was recorded on a straight-line basis, which was not materially different from the interest method. All other investments, consisting of short-term highly liquid assets, held by the CPFF were classified as trading securities under ASC 320 and were recorded at fair value.
- ML's investments in debt securities are accounted for in accordance with ASC 320 and ML elected the fair value option for all eligible assets and liabilities in accordance with ASC 825. Other financial instruments, including swap contracts and other derivatives instruments in ML, are recorded at fair value in accordance with FASB ASC Topic 815 (ASC 815) *Derivatives and Hedging*. Other real estate owned may be acquired by ML as a result of default on the related loan. Other real estate owned are considered held-for-sale, and are recorded initially at fair value, less estimated selling costs, in accordance with FASB ASC Topic 360

(ASC 360) *Property, Plant, and Equipment*. Consistent with the requirements of ASC 360, the assets are not depreciated, and are adjusted for subsequent changes in fair value up to the original fair value basis.

- ML II and ML III qualify as nonregistered investment companies under the provisions of FASB ASC Topic 946 (ASC 946) *Financial Services–Investment Companies* and, therefore, all investments are recorded at fair value in accordance with ASC 946.
- TALF LLC follows the guidance in ASC 320 when accounting for any acquired ABS investments, and has elected the fair value option for all eligible assets in accordance with ASC 825.

i. Preferred Interests

The FRBNY presents its preferred interests in AIA LLC and ALICO LLC at cost consistent with ASC 320. The 5 percent cumulative dividends accrued by the FRBNY on the preferred interests are reported as "Dividends on preferred interests" on the Combined Statements of Income and Comprehensive Income. On a quarterly basis, the accrued dividends are capitalized and increase the recorded cost of the FRBNY's preferred interests in AIA LLC and ALICO LLC. A preferred interest is impaired if its fair value falls below its recorded value and the decline is considered other-than-temporary. An other-than-temporary impairment occurs if (1) the FRBNY has the intent to sell the interest, (2) it is more likely than not that the FRBNY will be required to sell the interest before recovery of its recorded investment, or (3) the FRBNY does not expect to recover the entire amortized cost basis of the interest even if it does not intend to sell the security. Dividends are accrued unless the impairment analysis indicates that the dividends will not be collected.

j. Bank Premises, Equipment, and Software

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

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

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

k. 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 Reserve Banks' 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 Combined Statements of Condition represents the Federal Reserve notes outstanding, reduced by the Reserve Banks' currency holdings of $180 billion and $193 billion at December 31, 2010 and 2009, respectively.

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

l. Beneficial Interest in Consolidated Variable Interest Entities

ML, ML II, and ML III have outstanding senior and subordinated financial interests, inclusive of a fixed deferred purchase price in ML II and an equity contribution in ML III, and TALF LLC has an outstanding financial interest. Upon issuance of the financial interests, ML, ML II, ML III, and TALF LLC each elected to measure these obligations at fair value in accordance with ASC 825. Principal, interest, and changes in fair value on the senior financial interest, which were extended by the FRBNY, are eliminated in consolidation. The financial interests are recorded at fair value as "Beneficial interest in consolidated variable interest entities" in the Combined Statements of Condition. Interest expense and changes in fair value of the financial interest are recorded in "Interest expense: Beneficial interest in consolidated variable interest entities" and "Non-interest income (loss): Beneficial interest in consolidated variable interest entities (losses), net," respectively, in the Combined Statements of Income and Comprehensive Income.

m. Deposits

Depository Institutions

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

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

Treasury

The Treasury general account is the primary operational account of the Treasury and is held at the FRBNY.

The Treasury's temporary supplementary financing program consists of a series of Treasury bill auctions, in addition to Treasury's standard borrowing program. The proceeds of this debt are held in an account at the FRBNY that is separate from the Treasury's general account, and this separate account is reported as "Treasury, supplementary financing account" in the Combined Statements of Condition. The purpose of placing funds in this account is to drain reserves from the banking system and partially offset the reserve impact of the Reserve Banks' lending and liquidity initiatives.

Other

Other deposits include foreign central bank and foreign government deposits held at the FRBNY. Other deposits also include GSE deposits held by the Bank.

n. Funds from American International Group, Inc. Asset Dispositions, Held as Agent

Pending the closing of the AIG recapitalization plan discussed in Note 3, the cash proceeds from certain AIG asset dispositions were held by the FRBNY as agent.

o. Items in Process of Collection and Deferred Credit Items

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

p. Capital Paid-in

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

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

q. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. Accumulated other comprehensive income is reported as a component of "Surplus" in the Combined Statements of Condition and the Combined Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 13, 14, and 15.

r. Interest on Federal Reserve Notes

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to Treasury as interest on Federal Reserve notes" in the Combined Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued interest on Federal Reserve notes" in the Combined Statements of Condition.

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

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

s. Income and Costs Related to Treasury Services

When directed by the Secretary of the Treasury, the Reserve Banks are 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, 2010 and 2009, the Reserve Banks were reimbursed for substantially all services provided to the Treasury as its fiscal agent.

t. Assessments

The Board of Governors assesses the Reserve Banks to fund its operations and the operations of the Bureau and, for a two-year period, the OFR. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year for the Board of Governor's operations and as of the most recent quarter for the Bureau and OFR operations. The Board of Governors also assesses each Reserve Bank for the expenses incurred by the Treasury to produce and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

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

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

u. Fair Value

Certain assets and liabilities reported on the Reserve Banks' Combined Statements of Condition are measured at fair value in accordance with ASC 820, including TALF loans, investments and beneficial interests of the consolidated VIE's, and assets of the Retirement Plan for Employees of the Federal Reserve System. 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 Reserve 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 Reserve 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 inputs or methodology used for valuing assets and liabilities are not necessarily an indication of the risk associated with those assets and liabilities.

v. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Reserve Banks' real property taxes were $41 million and $37 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Combined Statements of Income and Comprehensive Income.

w. 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 Reserve

Banks commit to a formalized restructuring plan or execute the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 16 describes the Reserve Banks' restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain Reserve Banks' assets are discussed in Note 11. 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 and discussed in Note 13. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 14.

x. Recently Issued Accounting Standards

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

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, (codified in ASC 810), which expands the scope of Interpretation 46R, *Consolidation of Variable Interest Entities* and changes the approach for determining whether an entity has a controlling interest in a VIE by making a qualitative assessment of its financial interests. Additional disclosures are required for a variable interest in a VIE. The adoption of this accounting guidance was effective for the Reserve Banks for the year beginning on January 1, 2010, and earlier adoption was prohibited. The adoption of this accounting guidance did not have a material effect on the Reserve Banks' combined financial statements.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures* (Topic 820). New requirements for disclosure of information about transfers among the hierarchy's classification and the level of disaggregation of classes of assets were effective for the Reserve Banks for the year beginning on January 1, 2010, and the required disclosures are included in Note 5, Note 9, and Note 13. Other requirements, including the gross presentation of purchases, sales, issuances, and settlements in the reconciliation for Level 3 fair value measurements are effective for the Reserve Banks in 2011 and are not expected to have a material effect on the Reserve Banks' combined financial statements.

In March 2010, the FASB issued Accounting Standards Update 2010-11, *Derivatives and Hedging,* (Topic 815), which clarifies embedded credit derivatives that are subject to the FASB's guidance on derivatives and hedging and defines the embedded credit derivatives that are required to be evaluated for bifurcation and separate accounting. The adoption of this accounting guidance was effective for the Reserve Banks on July 1, 2010 and did not have a material effect on the Reserve Banks' combined financial statements.

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

(5) Loans

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

	2010				2009
	Within 15 days	16 days to 90 days	Over 1 year to 5 years	Total	Total
Primary, secondary, and seasonal credit	$215	$6	$ -	$ 221	$20,700
TAF	-	-	-	-	$75,918
Loans to depository institutions	$215	$6	$ -	$ 221	$96,618
TALF loans, fair value	$ -	$ -	$24,853	$24,853	$48,183
AIG loan, net	$ -	$ -	$20,603	$20,603	$21,250

Loans to Depository Institutions

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

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of each Reserve 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 (ABS); 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 each Reserve Bank, which is typically fair value reduced by a margin.

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

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

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

At December 31, 2010 and 2009, the Reserve Banks did not have any impaired loans and no allowances for loan losses were required. There were no impaired loans during the years ended December 31, 2010 and 2009.

TALF

TALF loans are non-recourse loans secured by eligible collateral. Each TALF loan has a three-year maturity, except loans secured by SBA Pool Certificates, loans secured by SBA Development Company Participation Certificates, or ABS backed by student loans or commercial mortgage loans, which have a five-year maturity if the borrower so elects.

The FRBNY has elected the fair value option for all TALF loans in accordance with ASC 825. Recording all TALF loans at fair value, rather than at the remaining principal amount outstanding, improves accounting consistency and provides the most appropriate presentation on the financial statements by matching the change in fair value of TALF loans, the related put agreement with TALF LLC, and the valuation of the beneficial interests in TALF LLC. Information regarding the TALF LLC's assets and liabilities is presented in Note 9.

In certain cases where there is limited activity around inputs to the valuation, loans are classified within Level 3 of the valuation hierarchy. Because external price information was not available, market-based models were used to determine the fair value of the TALF loans. The fair value of the TALF loans was determined by valuing the future cash flows from loan interest income and the estimated fair value losses associated with collateral that may be put to the FRBNY. The valuation model takes into account a range of outcomes on TALF loan repayments, market prices of the collateral, risk premiums estimated using market prices, and the volatilities of market risk factors. Other methodologies employed or assumptions made in determining fair value could result in an amount that differs significantly from the amount reported.

The following table presents the TALF loans at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2010	2009
Level 3	$24,853	$48,183
Total fair value	$24,853	$48,183

The following table presents a reconciliation of TALF loans measured at fair value using significant unobservable inputs (Level 3) during the year-ended December 31, 2010 and for the period February 4, 2009, to December 31, 2009, (in millions):

	TALF Loans
Fair value at February 4, 2009	$ -
Net loans originated	61,626
Loan repayments and prepayments	(14,000)
Total realized and unrealized gains (losses)	557
Fair value at December 31, 2009	$ 48,183
Net loans originated	9,484
Loan repayments and prepayments	(32,378)
Total realized and unrealized gains (losses)	(436)
Fair value at December 31, 2010	$ 24,853

The fair value of TALF loans reported in the Combined Statements of Condition as of December 31, 2010 and 2009 includes $121 million and $557 million in unrealized gains, respectively. FRBNY attributes substantially all changes in fair value of non-recourse loans to changes in instrument-specific credit spreads.

Eligible collateral includes U.S. dollar-denominated ABS that are backed by auto loans, student loans, credit card loans, equipment loans, floorplan loans, insurance premium financial loans, loans guaranteed by the SBA, residential mortgage servicing advances, or commercial mortgage loans. To be considered eligible, collateral must have a credit rating in the highest investment-grade rating category from at least two eligible nationally-recognized statistical rating organizations (NRSROs) and must not have a credit rating below the investment-grade rating category from an eligible NRSRO. In addition to the aforementioned eligibility requirements, collateral also must meet other criteria as stipulated in the TALF program's terms and conditions. The following table presents the collateral concentration and maturity distribution for the remaining unpaid principal and accrued interest as of December 31, 2010 (in millions):

Collateral type and credit rating[1]	Years to maturity		
	1 - 3	4 - 5	Total
Student Loan	$ 2,427	$4,556	$ 6,983
Credit Card	6,918	-	6,918
CMBS	2,504	1,725	4,229
Floorplan	2,489	-	2,489
Auto	1,673	-	1,673
SBAs	424	228	652
Other[2]	1,788	-	1,788
Total	$18,223	$6,509	$24,732

1 All credit ratings are AAA.

2 Includes equipment loans, insurance premium financial loans, and residential mortgage servicing advances.

The aggregate remaining principal amount outstanding on TALF loans as of December 31, 2010 and 2009, was $24,703 million and $47,574 million, respectively.

At December 31, 2010 and 2009, no TALF loans were over 90 days past due or in nonaccrual status.

Earnings reported by the FRBNY related to the TALF include income and unrealized gains and losses on TALF loans as well as the FRBNY's allocated share of the TALF LLC's net income. Additional information regarding the income of the TALF LLC is presented in Note 9. The following table presents the components of TALF earnings recorded by the FRBNY for the years ended December 31 (in millions):

	2010	2009
Interest income	$ 750	$ 414
Administrative fee income	13	54
Unrealized gains (losses)	(436)	557
Total income on TALF loans	$ 327	$1,025
Allocated share of TALF LLC	71	(702)
Earnings of TALF	$ 398	$ 323

AIG loan, net

The following table presents the components of the AIG loan at December 31 (in millions):

Loan components	2010	2009
Line of credit drawn	$14,621	$17,900
Capitalized interest	4,663	3,835
Capitalized commitment fees	1,700	1,700
AIG loan, gross	$20,984	$23,435
Unamortized deferred commitment fees	(335)	(697)
Allowance for loan restructuring, net	(46)	(1,488)
AIG loan, net	$20,603	$21,250

The fair value of the AIG revolving line of credit provided by the FRBNY, based on estimated and actual draws and repayments, was not materially different from the net amount reported in the Combined Statements of Condition as of December 31, 2010 and 2009.

The activity related to the allowance for AIG loan restructuring for the years-ended December 31 was as follows (in millions):

	2010	2009
Allowance for loan restructuring January 1	$(1,488)	$ -
Provision for loan restructuring	-	(2,621)
Adjustments to the allowance	1,442	1,133
Allowance for loan restructuring December 31	$ (46)	$(1,488)

The allowance for loan restructuring represented the economic effect of the reduction of the interest rate on loans the FRBNY made to AIG prior to April 17, 2009 as part of the loan restructuring that occurred on that date. The restructuring charges were recovered over the remaining term of the related loan as adjustments to the allowance, which resulted from periodic evaluations and are reported as a component of "Interest income: American International Group, Inc., net" on the Combined Statements of Income and Comprehensive Income. The average balance of the loans to AIG under the revolving line of credit, net of the allowance for restructuring, during the year ended December 31, 2010 and 2009, was $22,874 million and $39,099 million, respectively.

As a result of the closing of the AIG recapitalization plan on January 14, 2011, all outstanding draws under the revolving line of credit and the related accrued interest, capitalized interest and capitalized commitment fees were paid in full. The remaining amount of the unamortized deferred commitment fees and the allowance for loan restructuring as of the closing of the recapitalization were fully recognized at that date.

(6) Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Securities Purchased Under Agreements to Resell Securities Sold Under Agreements to Repurchase; and Securities Lending

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA.

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

	2010				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 18,423	$ -	$ (1)	$ 18,422	$ 18,422
Notes	773,284	14,056	(765)	786,575	804,703
Bonds	229,786	32,739	(570)	261,955	289,757
Total Treasury securities	$1,021,493	$46,795	$(1,336)	$1,066,952	$1,112,882
GSE debt securities	$ 147,460	$ 5,532	$ (20)	$ 152,972	$ 156,780
Federal agency and GSE MBS	$ 992,141	$14,106	$(1,552)	$1,004,695	$1,026,003

	2009				
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 18,423	$ -	$ -	$ 18,423	$ 18,422
Notes	568,323	6,544	(991)	573,876	583,040
Bonds	189,843	24,460	(630)	213,673	230,717
Total Treasury securities	$776,589	$31,004	$(1,621)	$805,972	$832,179
GSE debt securities	$159,879	$ 7,509	$ (26)	$167,362	$167,444
Federal agency and GSE MBS	$908,371	$12,110	$(1,554)	$918,927	$914,290

The fair value amounts in the above tables are presented solely for informational purposes. Although the fair value of security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value of Federal agency and GSE MBS was determined using a model-based approach that considers observable inputs for similar securities; fair value for all other SOMA security holdings was determined by reference to quoted prices for identical securities.

The fair value of the fixed-rate Treasury securities, GSE debt securities, and Federal agency and GSE MBS in the SOMA's holdings is subject to market risk, arising from movements in market variables, such as interest rates and securities prices. The fair value of Federal agency and GSE MBS is also affected by the rate of prepayments of mortgage loans underlying the securities.

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

Distribution of MBS holdings by coupon rate	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
SOMA:				
3.5%	$ 341	$ 352	$ 363	$ 365
4.0%	167,675	168,403	170,119	165,740
4.5%	497,672	508,798	434,352	431,646
5.0%	231,420	237,545	195,418	196,411
5.5%	93,119	95,873	103,379	104,583
6.0%	12,910	13,376	12,710	12,901
6.5%	1,558	1,656	2,586	2,644
Total	$1,004,695	$1,026,003	$918,927	$914,290

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

	Securities purchased under agreements to resell		Securities sold under agreements to repurchase	
	2010	2009	2010	2009
Contract amount outstanding, end of year	$-	$ -	$59,703	$77,732
Average daily amount outstanding, during the year	-	3,616	58,476	67,837
Maximum balance outstanding, during the year	-	80,000	77,732	89,525
Securities pledged (par value), end of year	-	-	43,642	77,860

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

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

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	$ 9,802	$24,816	$54,254	$439,594	$333,955	$159,072	$1,021,493
GSE debt securities (par value)	1,129	13,836	28,501	71,050	30,597	2,347	$ 147,460
Federal agency and GSE MBS (par value)	-	-	-	24	20	992,097	$ 992,141
Securities sold under agreements to repurchase (contract amount)	59,703	-	-	-	-	-	$ 59,703

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2010, which differs from the stated maturity primarily because it factors in prepayment assumptions, is approximately 4.2 years.

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

	SOMA	
	2010	2009
Treasury securities	$22,081	$20,502
GSE debt securities	1,610	1,108

Other investments consist of cash and short-term investments related to the Federal agency and GSE MBS portfolio. Other liabilities, which are related to purchases of Federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the Reserve Banks have ownership of and records their investments in the MBS as of the contractual settlement date, they are not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Reserve Banks' obligation to pay for the securities when delivered. The amount of other investments and other liabilities held in the SOMA at December 31 was as follows (in millions):

	2010	2009
Other investments	-	$ 5
Other liabilities	-	601

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

The FRBNY enters into commitments to buy Federal agency and GSE MBS and records the related MBS on a settlement-date basis. There were no commitments to buy or sell Federal agency or GSE MBS as of December 31, 2010.

During the years ended December 31, 2010 and 2009, the Reserve Banks recorded net gains from dollar roll and coupon swap related transactions of $782 million and $879 million, respectively. These net gains are reported as "Non-interest income (loss): Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Combined Statements of Income and Comprehensive Income.

(7) Foreign Currency Denominated Assets

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

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

	2010	2009
Euro:		
Foreign currency deposits	$ 7,057	$ 7,396
Securities purchased under agreements to resell	2,467	2,591
Government debt instruments	4,603	4,936
Japanese yen:		
Foreign currency deposits	3,883	3,403
Government debt instruments	8,039	6,946
Total	$26,049	$25,272

At December 31, 2010 and 2009, the fair value of foreign currency denominated assets, including accrued interest, was $26,213 million and $25,480 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the Treasury securities, GSE debt securities, and Federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value is presented solely for informational purposes.

The remaining maturity distribution of foreign currency denominated assets at December 31, 2010, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
Euro	$5,422	$3,000	$2,023	$3,682	$14,127
Japanese yen	4,102	560	2,437	4,823	11,922
Total	$9,524	$3,560	$4,460	$8,505	$26,049

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

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

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2010.

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

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

Foreign currency working balances held and foreign exchange contracts executed by the FRBNY to facilitate international payments and currency transactions it makes on behalf of foreign central banks and U.S. official institution customers were not material as of December 31, 2010 and 2009.

(8) Central Bank Liquidity Swaps

U.S. Dollar Liquidity Swaps

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2010 and 2009, was $75 million and $10,272 million, respectively.

All of the U.S. dollar liquidity swaps outstanding at December 31, 2010 were transacted with the European Central Bank and had remaining maturity distributions of less than 15 days.

Foreign Currency Liquidity Swaps

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

(9) Investments Held By Consolidated Variable Interest Entities

a. Summary Information for Consolidated Variable Interest Entities

The total assets of consolidated VIEs, including cash, cash equivalents, and accrued interest, at December 31 were as follows (in millions):

	2010	2009
ML	$27,961	$28,140
ML II	16,457	15,912
ML III	23,583	22,797
TALF LLC	665	298
CPFF	-	14,233
Total	$68,666	$81,380

The FRBNY's maximum exposure to loss at December 31, 2010 and 2009 was $55,434 million and $73,879 million, respectively. These estimates incorporate potential losses associated with assets recorded on the FRBNY's Consolidated Statements of Condition, net of the fair value of subordinated interests (beneficial interest in consolidated VIEs).

The classification of significant assets and liabilities of the consolidated VIEs at December 31 was as follows (in millions):

	2010	2009
Assets:		
CDOs	$23,112	$22,650
Non-agency RMBS	18,360	17,552
Federal agency and GSE MBS	16,842	18,149
Commercial mortgage loans	5,130	4,025
Swap contracts	851	1,127
Residential mortgage loans	603	583
Commercial paper	-	9,421
Other investments	587	5,467
Subtotal	$65,485	$78,974
Cash, cash equivalents, and accrued interest receivable	3,181	2,406
Total investments held by consolidated VIEs	$68,666	$81,380
Liabilities:		
Beneficial interest in consolidated VIEs	$10,051	$ 5,095
Other liabilities[1]	$ 921	$ 1,316

[1] The amount reported as "Consolidated variable interest entities: Other liabilities" in the Combined Statements of Condition includes $695 million and $980 million related to cash collateral received on swap contracts at December 31, 2010 and 2009, respectively. The amount also includes accrued interest, unearned registration fees, and accrued other expenses.

Total realized and unrealized gains (losses) for the year-ended December 31, 2010, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/ unrealized gains (losses)
CDOs	$ 52	$3,201	$3,253
Non-agency RMBS	108	3,082	3,190
Federal agency and GSE MBS	291	320	611
Commercial mortgage loans[1]	(879)	2,319	1,440
Residential mortgage loans[1]	(86)	197	111
Swap contracts	(150)	(255)	(405)
Other investments	53	103	156
Other assets	(203)	27	(176)
Total	$(814)	$8,994	$8,180

[1] Substantially all unrealized gains (losses) on the commercial and residential mortgage loans are attributable to changes in instrument-specific credit risk.

Total realized and unrealized gains (losses) for the year-ended December 31, 2009, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/ unrealized gains (losses)
CDOs	$ (3)	$(1,211)	$(1,214)
Non-agency RMBS	217	(991)	(774)
Federal agency and GSE MBS	322	521	843
Commercial mortgage loans[1]	(47)	(1,177)	(1,224)
Residential mortgage loans[1]	(48)	(219)	(267)
Swap contracts	(119)	212	93
Other investments	12	712	724
Other assets	(182)	64	(118)
Total	$ 152	$(2,089)	$(1,937)

[1] Substantially all unrealized gains (losses) on the commercial and residential mortgage loans are attributable to changes in instrument-specific credit risk.

The net income (loss) attributable to ML, ML II, ML III, CPFF, and TALF LLC for the year-ended December 31, 2010 was as follows (in millions):

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	$ 1,133	$ 794	$ 2,299	$213	$ 1	$ 4,440
Less: Interest expense	66	34	173	-	4	277
Net interest income	1,067	760	2,126	213	(3)	4,163
Non-interest income:						
Portfolio holdings gains	2,571	2,467	3,141	1	-	8,180
Less: Unrealized gains (losses) on beneficial interest in consolidated VIEs	(1,135)	(1,353)	(2,266)	-	75[1]	(4,679)
Net non-interest income	1,436	1,114	875	1	75	3,501
Total net interest income and non-interest income	2,503	1,874	3,001	214	72	7,664
Less: Professional fees	69	10	22	2	1	104
Net income attributable to consolidated VIEs	$ 2,434	$ 1,864	$ 2,979	$212	$ 71[2]	$ 7,560

[1] The TALF LLC's unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2010.

[2] Additional information regarding TALF-related income recorded by the FRBNY is presented in Note 5.

The net income (loss) attributable to ML, ML II, ML III, and CPFF for the year-ended December 31, 2009 and for TALF LLC from the inception date of February 4, 2009 to December 31, 2009 was as follows (in millions):

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	$1,476	$1,088	$ 3,032	$4,224	$ -	$ 9,820
Less: Interest expense	61	33	171	-	2	267
Net interest income	1,415	1,055	2,861	4,224	(2)	9,553
Non-interest income:						
Portfolio holdings (losses) gains	(102)	(604)	(1,239)	8	-	(1,937)
Less: Unrealized gains (losses) on beneficial interest in consolidated VIEs	61	34	(1,299)	-	(699)[1]	(1,903)
Net non-interest (loss) income	(41)	(570)	(2,538)	8	(699)	(3,840)
Total net interest income and non-interest income	1,374	485	323	4,232	(701)	5,713
Less: Professional fees	55	12	27	30	1	125
Net income (loss) attributable to consolidated VIEs	$1,319	$ 473	$ 296	$4,202	(702)[2]	$ 5,588

[1] The TALF LLC's unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2009.

[2] Additional information regarding TALF-related income recorded by the FRBNY is presented in Note 5.

Following is a summary of the consolidated VIEs' subordinated financial interest for the years ended December 31, 2010 and 2009 (in millions):

	ML subordinated loan	ML II deferred purchase price	ML III equity contribution	TALF financial interest	Total
Fair value, January 31, 2009	$ -	$ -	$2,824	$ -	$ 2,824
Interest accrued and capitalized	61	34	171	2	268
Treasury loan	-	-	-	100	100
Unrealized gain/(loss)	(61)	(34)	1,299	699	1,903
Fair value, December 31, 2009	$ -	$ -	$4,294	$801	$ 5,095
Interest accrued and capitalized	66	34	173	4	277
Unrealized (gain)/loss	1,135	1,353	2,266	(75)	4,679
Fair value, at December 31, 2010	$1,201	$1,387	$6,733	$730	$10,051

b. Commercial Paper Funding Facility LLC

The CPFF Program charged a lending rate for unsecured commercial paper equal to a three-month overnight indexed swap (OIS) rate plus 100 basis points per annum, with an additional surcharge of 100 basis points per annum as an unsecured credit enhancement fee. The rate imposed for ABCP was the three-month OIS rate plus 300 basis points. The credit enhancement and registration fees were amortized on a straight-line basis over the term of the commercial paper.

c. Maiden Lane LLC

ML's investment portfolio consists primarily of Federal agency and GSE MBS, non-agency RMBS, commercial and residential mortgage loans, and derivatives and associated hedges. Following is a description of the significant holdings at December 31, 2010 and the associated credit risk for each holding:

i. Debt Securities

Federal agency and GSE MBS represent fractional ownership interests in MBS guaranteed by Federal agencies and GSEs. The rate of delinquencies and defaults on the underlying residential mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower. Changes in economic conditions, including delinquencies and defaults on assets underlying these securities, can affect the securities' value, income, and liquidity.

ML's non-agency RMBS investment portfolio is subject to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS were issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying mortgage loans themselves, often referred to as an "available funds cap." As a result of this cap, the return to ML on such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher interest rate.

As of December 31, 2010, approximately 38.3 percent and 12.3 percent of the properties collateralizing the non-agency RMBS held by ML were located in California and Florida, respectively, based on the total unpaid principal balance of the underlying loans.

The fair value of any particular non-agency RMBS asset may be subject to substantial variation. The entire market or particular instruments traded on a market may decline in value, even if projected cash flow or other factors improve, because the prices of such instruments are subject to numerous other factors that have little or no correlation to the performance of a particular instrument. Adverse developments in the non-agency RMBS market could have a considerable effect on ML because of its investment concentration in non-agency RMBS.

At December 31, 2010, the ratings breakdown of the $19.6 billion of debt securities, which are recorded at fair value in the ML portfolio as a percentage of aggregate fair value of all securities in the portfolio was as follows:

Security Type:[1]	Ratings[2,3]						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower[4]	Government/ agency	Total
Federal agency and GSE MBS	0.0%	0.0%	0.0%	0.0%	0.0%	85.8%	85.8%
Non-agency RMBS	0.3%	0.4%	0.2%	0.2%	8.4%	0.0%	9.5%
Other[5]	0.6%	0.9%	0.2%	1.5%	1.4%	0.0%	4.7%
Total	1.0%	1.3%	0.4%	1.7%	9.8%	85.8%	100.0%

1 This table does not include ML swaps and other derivative contracts, commercial and residential mortgage loans, or TBA investments.

2 Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

3 Rows and columns may not total due to rounding.

4 BB+ and lower includes debt securities that were not rated as of December 31, 2010.

5 Includes all asset sectors that, individually, represent less than 5 percent of aggregate portfolio fair value.

ii. Commercial and Residential Mortgage Loans

Commercial and residential mortgage loans are subject to a high degree of credit risk because of exposure to loss from loan defaults. Default rates are subject to a wide variety of factors, including, but not limited to, property performance, property management, supply and demand, construction trends, consumer behavior, regional economic conditions, interest rates, and other factors.

The performance profile for the commercial and residential mortgage loans at December 31, 2010, was as follows (in millions):

	Unpaid principal balance	Fair value	Fair value as a percentage of unpaid principal balance
Performing loans:			
Commercial	$6,454	$4,966	76.9%
Residential	788	440	55.8%
Subtotal	7,242	5,406	74.6%
Non-performing/Non-accrual loans:[1]			
Commercial	315	164	52.1%
Residential	491	163	33.2%
Subtotal	806	327	40.6%
Total:			
Commercial	6,769	5,130	75.8%
Residential	1,279	603	47.1%
Total loans	$8,048	$5,733	71.2%

1 Non-performing/non-accrual loans include loans with payments past due greater than 90 days.

The following table summarizes the state in which residential mortgage loans are collateralized and the property types of the commercial mortgage loans held in the ML portfolio at December 31, 2010:

	Concentration of unpaid principal balances	
	Residential	Commercial[1]
By state:		
California	36.7%	
Florida	8.9%	
Other[2]	54.4%	
Total	100.0%	
By property:		
Hospitality		81.8%
Office		11.0%
Other[2]		7.2%
Total		100.0%

[1] One borrower represents approximately 55 percent of total unpaid principal balance of the commercial mortgage loan portfolio.

[2] No other individual state or property type comprises more than 5 percent of the total.

Commercial mortgage loans held by ML are composed of different levels of subordination with respect to the underlying properties, and relative to each other. Senior mortgage loans are secured property loans evidenced by a first mortgage that is senior to any subordinate or mezzanine financing. Subordinate mortgage interests, sometimes known as B Notes, are loans evidenced by a junior note or a junior participation in a mortgage loan. Mezzanine loans are loans made to the direct or indirect owner of the property-owning entity. Mezzanine loans are not secured by a mortgage on the property but rather by a pledge of the mezzanine borrower's direct or indirect ownership interest in the property-owning entity.

The following table summarizes commercial mortgage loans held by ML at December 31, 2010 (in millions):

Loan type	Unpaid principal balances	Concentration of unpaid principal balances
Senior mortgage loan	$3,886	57.4%
Subordinate mortgage interests	63	0.9%
Mezzanine loans	2,820	41.7%
Total	6,769	100.0%

iii. Derivative Instruments

Derivative contracts are instruments, such as futures or swap contracts, that derive their value from underlying assets, indices, reference rates or a combination of these factors. The ML portfolio includes various derivative financial instruments, primarily consisting of a total return swap agreement (TRS) with JPMC. ML and JPMC entered into the TRS with reference obligations representing single-name CDS primarily on RMBS and CMBS, and interest rate swaps (IRS) with various market participants, including JPMC. ML, through its investment manager, currently manages the CDS contracts within the TRS as a runoff portfolio and may unwind, amend, or novate reference obligations on an ongoing basis.

ML enters into additional derivative contracts consisting of futures and IRS to economically hedge its exposure to interest rates. For 2010, there were 29 trades executed as IRS. All derivatives are recorded at fair value in accordance with ASC

815. None of the derivatives held by ML are designated as hedging instruments for accounting purposes.

On an ongoing basis, ML pledges collateral for credit or liquidity related shortfalls based on 20 percent of the notional amount of sold CDS protection and 10 percent of the present value of future premiums on purchased CDS protection. Failure to post this collateral constitutes a TRS event of default. Separately, ML and JPMC engage in bilateral posting of collateral to cover the net mark-to-market (MTM) variations in the swap portfolio. ML nets the collateral received from JPMC from the bilateral MTM posting only to the extent that the reference obligations indicate JPMC as the original counterparty to Bear Stearns on March 14, 2008. The values of ML's cash equivalents and investments, purchased by the re-hypothecation of cash collateral associated with the TRS, were $0.8 billion and $0 billion, respectively, as of December 31, 2010, and $0.8 billion and $0.5 billion, respectively, as of December 31, 2009. In addition, ML has pledged $1.0 billion and $1.5 billion of Federal agency and GSE MBS to JPMC as of December 31, 2010 and 2009, respectively.

The following risks are associated with the derivative instruments held by ML as part of the TRS agreement with JPMC as well as any derivatives outside of the TRS:

Market Risk

CDS are agreements that provide protection for the buyer against the loss of principal and, in some cases, interest on a bond or loan in case of a default by the issuer. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the CDS pays a premium in return for payment protection upon the occurrence, if any, of a credit event. Upon the occurrence of a triggering credit event, the maximum potential amount of future payments the seller could be required to make under a CDS is equal to the notional amount of the contract. Such future payments could be reduced or offset by amounts recovered under recourse or by collateral provisions outlined in the contract, including seizure and liquidation of collateral pledged by the buyer. ML's derivatives portfolio consists of purchased credit protection with underlying referenced names not correlated to offset its exposure to sold credit protection.

IRS obligate two parties to exchange one or more payments typically calculated with reference to fixed or periodically reset rates of interest applied to a specified notional principal amount. Notional principal is the amount to which interest rates are applied to determine the payment streams under IRS. Such notional principal amounts often are used to express the volume of these transactions but are not actually exchanged between the counterparties.

Futures contracts are agreements to buy and sell financial instruments for a set price on a future date. Initial margin deposits are made upon entering into futures contracts in the form of cash or securities. During the period that a futures contract is open, changes in the value of the contract are recorded as unrealized gains or losses by revaluing the contracts daily to reflect the market value of the contract at the end of each day's trading. Variation margin payments are paid or received, depending upon whether unrealized gains or losses result. When the contract is closed, ML will record a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and ML's cost basis in the contract. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates, and the underlying hedged assets. ML is also at risk of not being able to enter into a closing transaction for the futures contract because of an illiquid secondary market. ML had pledged cash collateral related to future contracts of $18 million and $40 million as of December 31, 2010 and 2009, respectively.

Credit Risk

Credit risk is the risk of financial loss resulting from failure by a counterparty to meet its contractual obligations to ML. This can be caused by factors directly related to the counterparty, such as business or management. Taking collateral is the most common way to mitigate credit risk. ML takes financial collateral in the form of cash and marketable securities to cover JPMC counterparty risk as part of the TRS agreement with JPMC as well as the over-the-counter derivatives activities outside of the TRS.

The following table summarizes the notional amounts of derivative contracts outstanding as of December 31, 2010 and 2009, and the change in notional amounts is representative of the volume of activity for the year ended December 31, 2010 (in millions):

	Notional amounts[1,2]	
	2010	2009
Interest rate contracts:		
IRS	$ 4,130	$ 3,185
Futures and options on futures[3]	18	70
Credit derivatives:		
CDS	5,856	7,323
Total	$10,004	$10,578

1 Represents the sum of gross long and short notional derivative contracts.

2 There were 1,400 and 1,764 CDS and IRS contracts outstanding as of December 2010, and 2009, respectively.

3 Futures and options on futures relate to contract obligations and not gross notional amounts

The following table summarizes the fair value of derivative instruments by contract type on a gross basis as of December 31, 2010 and 2009, which is reported as a component of "Consolidated variable interest entities: Investments held by consolidated variable interest entities" in the Combined Statement of Condition (in millions):

	2010		2009	
	Gross derivative assets	Gross derivative liabilities	Gross derivative assets	Gross derivative liabilities
Interest rate contracts:				
IRS	$ 9	$ 229	$ 5	$ 195
Futures and options on futures	4	2	20	-
Credit derivatives:				
CDS	2,317	1,347	3,271	1,816
Counterparty netting	(1,375)	(1,374)	(1,868)	(1,868)
Cash collateral	(100)	-	(281)	-
Total	$ 855	$ 204	$ 1,147	$ 143

The table below summarizes certain information regarding protection sold through CDS as of December 31 (in millions):

Credit ratings of the reference obligation	Maximum potential payout/notional							
	2010						2009	
	Years to maturity					Fair value	Total	Fair value
	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset/ (liability)		Asset/ (liability)
Investment grade (AAA to BBB-)	$ -	$ -	$-	$ 120	$ 120	$ (23)	$ 350	$ (154)
Non-investment grade	10	250	-	1,564	1,824	(1,284)	2,099	(1,640)
Total credit protection sold	$10	$250	$-	$1,684	$1,944	$(1,307)	$2,449	$(1,794)

The table below summarizes certain information regarding protection bought through CDS as of December 31 (in millions):

Credit ratings of the reference obligation	Maximum potential recovery/notional							
	2010						2009	
	Years to maturity					Fair value	Total	Fair value
	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset/ (liability)		Asset/ (liability)
Investment grade (AAA to BBB-)	$ -	$ -	$ -	$ 263	$ 263	$ 76	$ 702	$ 404
Non-investment grade	38	501	5	3,104	3,648	2,190	4,172	2,808
Total credit protection bought	$38	$501	$5	$3,367	$3,911	$2,266	$4,874	$3,212

Other Assets

Other assets are primarily composed of other real estate owned of approximately $19 million, and options of $4 million.

d. Maiden Lane II LLC

ML II's investments in non-agency RMBS are subject to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying residential mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS are issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying residential mortgage loans themselves, often referred to as an "available funds cap." As a result of this cap, the return to the holder of such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher rate of interest.

The fair value of any particular non-agency RMBS asset may be subject to substantial variation. The entire market or particular instruments traded on a market may decline in value, even if projected cash flow or other factors improve, because the prices of such instruments are subject to numerous other factors that have little or no correlation to the performance of a particular instrument. Adverse developments in the non-agency RMBS market could have a considerable effect on ML II because of its investment concentration in non-agency RMBS.

At December 31, 2010, the type/sector and rating composition of the ML II's $16.2 billion non-agency RMBS portfolio, recorded at fair value, as a percentage of aggregate fair value, were as follows:

Asset Type:	Rating[1,2]					
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower	Total
Alt-A ARM	0.3%	1.3%	0.9%	0.3%	26.5%	29.4%
Subprime	4.1%	2.6%	1.3%	1.2%	46.4%	55.6%
Option ARM	0.0%	0.0%	0.0%	0.0%	6.8%	6.8%
Other[3]	0.0%	0.5%	1.1%	0.1%	6.4%	8.2%
Total	4.5%	4.4%	3.3%	1.6%	86.2%	100.0%

1 Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

2 Rows and columns may not total due to rounding.

3 Includes all asset types that, individually, represent less than 5% of aggregate portfolio fair value.

At December 31, 2010, approximately 30 percent and 13 percent of the properties collateralizing the non-agency RMBS held by ML II were located in California and Florida, respectively, based on the geographical location data available for the underlying loans by aggregate unpaid principal balance.

e. Maiden Lane III LLC

The primary holdings within ML III are ABS CDOs. An ABS CDO is a security issued by a bankruptcy-remote entity that is backed by a diversified pool of debt securities, which in the case of ML III are primarily RMBS and CMBS. The cash flows of ABS CDOs can be split into multiple segments, called "tranches," which vary in risk profile and yield. The junior tranches bear the initial risk of loss, followed by the more senior tranches. The ABS CDOs in the ML III portfolio represent senior tranches. Because they are shielded from defaults by the subordinated tranches, senior tranches typically have higher credit ratings and lower yields than the underlying securities, and will often receive investment-grade ratings from one or more of the nationally recognized rating agencies. Despite the protection afforded by the subordinated tranches, senior tranches can experience substantial losses from actual defaults on the underlying non-agency RMBS or CMBS.

Certain ABS CDO issuers can issue short-term eligible investments under Rule 2a-7 of the Investment Company Act of 1940 if the ABS CDO contains arrangements to remarket the securities at defined periods. The investments must contain put options (2a-7 Puts) that allow the purchasers to sell the ABS CDO at par to a third-party (Put Provider), if a scheduled remarketing is unsuccessful due to reasons other than a credit or bankruptcy event. The total notional value of ABS CDOs held by ML III with embedded 2a-7 Puts, for which AIGFP was, directly or indirectly, the Put Provider, was $1.6 billion at 2009. There were no remaining ABS CDO investments held by the LLC with embedded 2a-7 puts as of December 31, 2010.

ML III's investment in CMBS and RMBS contain varying levels of credit, interest rate, liquidity, and concentration risk. Credit-related risk arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the securities are issued. The rate of delinquencies and defaults on residential and commercial mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower. Adverse developments in the RMBS and CMBS markets could have a considerable effect on ML III because of its investment concentration in CDOs backed by CMBS and RMBS.

At December 31, 2010, the investment type/vintage and rating composition of ML III's $23 billion portfolio, recorded at fair value, as a percentage of aggregate fair value of all securities in the portfolio was as follows:

	Rating[1,2,3]						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower	Not rated	Total
ABS CDOs:							
High-grade ABS CDOs	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**64.2%**	**1.0%**	**65.3%**
Pre-2005	0.0%	0.0%	0.0%	0.0%	22.1%	0.0%	22.1%
2005	0.0%	0.0%	0.0%	0.0%	29.1%	1.0%	30.1%
2006	0.0%	0.0%	0.0%	0.0%	6.3%	0.0%	6.3%
2007	0.0%	0.0%	0.0%	0.0%	6.7%	0.0%	6.7%
Mezzanine ABS CDOs	**0.0%**	**0.0%**	**0.0%**	**0.1%**	**8.2%**	**0.1%**	**8.5%**
Pre-2005	0.0%	0.0%	0.0%	0.1%	4.7%	0.1%	4.9%
2005	0.0%	0.0%	0.0%	0.0%	2.9%	0.0%	2.9%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	0.0%	0.0%	0.6%	0.0%	0.6%
Commercial Real-Estate CDOs	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**25.1%**	**0.0%**	**25.1%**
Pre-2005	0.0%	0.0%	0.0%	0.0%	3.2%	0.0%	3.2%
2005	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	0.0%	0.0%	21.9%	0.0%	21.9%
RMBS, CMBS, & Other:	**0.1%**	**0.2%**	**0.1%**	**0.0%**	**0.9%**	**0.0%**	**1.3%**
Pre-2005	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.2%
2005	0.1%	0.2%	0.1%	0.0%	0.7%	0.0%	1.1%
2006	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.1%
2007	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total investments	0.1%	0.2%	0.1%	0.1%	98.4%	1.2%	100.0%

[1] Lowest of all ratings was used for the purpose of this table if rated by two or more nationally recognized statistical rating organizations.

[2] The year of issuance with the highest concentration of underlying assets as measured by outstanding principal balance determines the vintage of the CDO.

[3] Rows and columns may not total due to rounding.

f. TALF LLC

Cash receipts resulting from the put option fees paid to TALF LLC and proceeds from the Treasury's loan are invested in the following types of U.S. dollar-denominated short-term investments and cash equivalents eligible for purchase by the LLC: (1) US Treasury securities, (2) Federal agency securities that are senior, negotiable debt obligations of the Fannie Mae, Freddie Mac, Federal Home Loan Banks (FHLB) and Federal Farm Credit Banks (FFCB), which have a fixed rate of interest, (3) repurchase agreements that are collateralized by Treasury and Federal agency securities and fixed-rate agency mortgage-backed securities, and (4) money market mutual funds registered with the Securities and Exchange Commission and regulated under Rule 2a-7 of the Investment Company Act that invest exclusively in US Treasury and Federal agency securities. Cash may also be invested in a demand interest-bearing account held at the Bank of New York Mellon.

g. Fair Value Measurement

The consolidated VIEs have adopted ASC 820 and ASC 825 and have elected the fair value option for all securities and commercial and residential mortgages held by ML and TALF LLC. ML II and ML III qualify as nonregistered investment companies under the provisions of ASC 946 and, therefore, all investments are recorded at fair value in accordance with ASC 820. In addition, the FRBNY has elected to record the beneficial interests in ML, ML II, ML III, and TALF LLC at fair value.

The accounting and classification of these investments appropriately reflect the VIEs' and the FRBNY's intent with respect to the purpose of the investments and most closely reflect the amount of the assets available to liquidate the entities' obligations.

i. Determination of Fair Value

The consolidated VIEs value their investments on the basis of the last available bid prices or current market quotations provided by dealers or pricing services selected by the designated investment managers. To determine the value of a particular investment, pricing services may use information on transactions in such investments; quotations from dealers; pricing metrics; market transactions in comparable investments; relationships observed in the market between investments; and calculated yield measures based on valuation methodologies commonly employed in the market for such investments.

Market quotations may not represent fair value in circumstances in which the investment manager believes that facts and circumstances applicable to an issuer, a seller, a purchaser, or the market for a particular security result in the current market quotations reflecting an inaccurate fair value of the security. To determine fair value, the investment manager applies proprietary valuation models that use collateral performance scenarios and pricing metrics derived from the reported performance of the universe of bonds with similar characteristics as well as the observable market.

Because of the uncertainty inherent in determining the fair value of investments that do not have a readily available fair value, the fair value of these investments may differ significantly from the values that would have been reported if a readily available fair value had existed for these investments and may differ materially from the values that may ultimately be realized.

The fair value of the liability for the beneficial interests of consolidated VIEs is estimated based upon the fair value of the underlying assets held by the VIEs. The holders of these beneficial interests do not have recourse to the general credit of the FRBNY.

ii. Valuation Methodologies for Level 3 Assets and Liabilities

In certain cases where there is limited activity around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. For example, in valuing CDOs, certain collateralized mortgage obligations, and commercial and residential mortgage loans, the determination of fair value is based on collateral performance scenarios. These valuations also incorporate pricing metrics derived from the reported performance of the universe of bonds and from observations and estimates of market data. Because external price information is not available, market-based models are used to value these securities. Key inputs to the model may include market spreads or yield estimates for comparable instruments, data for each credit rating, valuation estimates for underlying property collateral, projected cash flows, and other relevant contractual features. Because there is lack of observable pricing, securities and investment loans that are carried at fair value are classified within Level 3.

The following tables present the financial instruments recorded in VIEs at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2010				
	Level 1	Level 2	Level 3	Netting[1]	Total fair value
Assets:					
CDOs	$ -	$ 301	$22,811	$ -	$23,112
Non-agency RMBS	-	11,551	6,809	-	18,360
Federal agency and GSE MBS	-	16,812	30	-	16,842
Commercial mortgage loans	-	3,199	1,931	-	5,130
Cash equivalents	3,003	-	-	-	3,003
Swap contracts	-	9	2,317	(1,475)	851
Residential mortgage loans	-	-	603	-	603
Other investments	85	400	79	-	564
Other assets	-	4	-	-	4
Total assets	$3,088	$32,276	$34,580	$(1,475)	$68,469
Liabilities:					
Beneficial interest in consolidated VIEs	$ -	$ -	$10,051	$ -	$10,051
Swap contracts	-	229	1,347	(1,375)	201
Other liabilities	2	-	-	-	2
Total liabilities	$ 2	$ 229	$11,398	$(1,375)	$10,254

[1] Derivative receivables and payables and the related cash collateral received and paid are shown netted when a master netting agreement exists.

	2009				
	Level 1	Level 2	Level 3	Netting[1]	Total fair value
Assets:					
CDOs	$ -	$ 241	$22,409	$ -	$22,650
Federal agency and GSE MBS	-	18,125	24	-	18,149
Non-agency RMBS	-	9,461	8,091	-	17,552
Commercial mortgage loans	-	-	4,025	-	4,025
Cash equivalents	1,933	142	-	-	2,075
Swap contracts	-	5	3,272	(2,150)	1,127
Residential mortgage loans	-	-	583	-	583
Other investments	31	5,413	23	-	5,467
Other assets	20	-	-	-	20
Total assets	$1,984	$33,387	$38,427	$(2,150)	$71,648
Liabilities:					
Beneficial interest in consolidated VIEs	$ -	$ -	$ 5,095	$ -	$ 5,095
Swap contracts	-	195	1,816	(1,868)	143
Total liabilities	$ -	$ 195	$ 6,911	$(1,868)	$ 5,238

[1] Derivative receivables and payables and the related cash collateral received and paid are shown netted when a master netting agreement exists.

The tables below present a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2010 and 2009 (in millions). Unrealized gains and losses related to those assets still held at December 31, 2010 and 2009, are reported as a component of "Consolidated variable interest entities: Investments held by consolidated variable interest entities, net" in the Combined Statements of Condition.

	2010					
	Fair value January 1	Net purchases, sales, and settlements	Total realized/ unrealized gains (losses)	Net transfers in or out[1,2,3,4]	Fair value December 31	Change in unrealized gains (losses) related to financial instruments held at December 31, 2010
Assets:						
CDOs[5]	$22,200	$(2,474)	$ 3,096	$ (11)	$ 22,811	$ 3,043
Non-agency RMBS[5]	8,300	(1,046)	1,144	(1,589)	6,809	1,044
Commercial mortgage loans	4,025	(335)	681	(2,440)	1,931	542
Residential mortgage loans	583	(91)	111	-	603	197
Federal agency and GSE MBS	24	(34)	2	38	30	2
Other investments	23	(39)	65	30	79	11
Total assets	$35,155	$(4,019)	$ 5,099	$(3,972)	$ 32,263	$ 4,839
Net swap contracts[6]	$ 1,456	$ (325)	$ (161)	$ -	$ 970	$ (137)
Liabilities:						
Beneficial interest in consolidated VIEs	$ (5,095)	$ (277)[7]	$(4,679)	$ -	$(10,051)	$(4,679)

1 The amount of transfers is based on the fair values of the transferred assets at the beginning of the reporting period.

2 There were no significant transfers between Level 1 and Level 2 during the year-ended December 31, 2010.

3 Commercial mortgage loans, with a December 31, 2009 fair value of $2,440 million, were transferred from Level 3 to Level 2 because they are valued at December 31, 2010 based on quoted prices for identical or similar instruments in non-active markets (Level 2). These investments were valued in the prior year based on non-observable inputs (Level 3).

4 Non-agency RMBS, with a December 31, 2009 fair value of $3,830 million, were transferred from Level 3 to Level 2 because they are valued at December 31, 2010 based on quoted prices in non-active markets (Level 2). These investments were valued in the prior year on non-observable model based inputs (Level 3). There were also certain non-agency RMBS for which valuation inputs became less observable during the year ended December 31, 2010 which resulted in $2,647 million in transfers from Level 2 to Level 3. There were no other significant transfers between Level 2 and Level 3 during the year.

5 Investments with a fair value of $209 million as of December 31, 2009 were reclassified from CDOs to Non-agency RMBS.

6 Level 3 derivative assets and liabilities are presented net for purposes of this table.

7 Includes $277 million in capitalized interest.

	2009					
	Fair value January 1	Net purchases, sales, and settlements	Total realized/ unrealized gains (losses)	Net transfers in or out	Fair value December 31	Change in unrealized gains/(losses) related to financial instruments held at December 31, 2009
Assets:						
CDOs	$26,802	$(3,123)	$(1,267)	$ (3)	$22,409	$(1,265)
Non-agency RMBS	12,510	(1,481)	(499)	(2,439)	8,091	(533)
Commercial mortgage loans	5,553	(305)	(1,223)	-	4,025	(1,177)
Residential mortgage loans	937	(86)	(268)	-	583	(219)
Federal agency and GSE MBS	895	(248)	-	(623)	24	-
Other investments	348	(263)	30	(92)	23	29
Total assets	$47,045	$(5,506)	$(3,227)	$(3,157)	$35,155	$(3,165)
Net swap contracts[1]	$ 2,454	$ (906)	$ 94	$ (186)	$ 1,456	$ 212
Liabilities:						
Beneficial interest in consolidated VIEs	$ (2,824)	(368)[2]	$(1,903)	$ -	$ (5,095)	$(1,903)

1 Level 3 derivative assets and liabilities are presented net for the purposes of this table.
2 Includes $268 million in capitalized interest.

h. Professional Fees

The consolidated VIEs have recorded costs for professional services provided, among others, by several nationally recognized institutions that serve as investment managers, administrators, and custodians for the VIEs' assets. The fees charged by the investment managers, custodians, administrators, auditors, attorneys, and other service providers, are recorded in "Professional fees related to consolidated variable interest entities" in the Combined Statements of Income and Comprehensive Income.

(10) Non-consolidated Variable Interest Entities

In December 2009, the FRBNY received preferred interests in two VIEs, AIA LLC and ALICO LLC. The FRBNY does not consolidate these VIEs because it does not have a controlling financial interest. The FRBNY's maximum exposure to any potential losses of the VIEs, should any occur, is limited to the recorded value of the FRBNY's investment in the preferred interests and dividends receivable from the VIEs. The following table shows financial information as of December 31, 2010 (in millions):

	2010		
	AIA LLC	ALICO LLC	Total non-consolidated VIEs
Total assets	$31,223	$17,417	$48,640
Total liabilities	-	898	898
Maximum exposure to loss	16,886	9,499	26,385

The recorded value of the FRBNY's preferred interests, including capitalized dividends, was $16,886 million and $16,068 million for AIA LLC and $9,499 million and $9,038 million for ALICO LLC at December 31, 2010 and 2009, respectively. The FRBNY's preferred interests and capitalized dividends are reported as "Preferred interests" and dividends receivable are reported as a component of "Other Assets" in the Combined Statements of Condition.

The fair value of FRBNY's preferred interests in AIA LLC and ALICO LLC was not materially different from the amounts reported as "Preferred interests" in the Combined Statements of Condition as of December 31, 2010 and 2009.

As a result of the closing of the AIG recapitalization plan on January 14, 2011, the FRBNY was paid in full for its preferred interests in AIA LLC and ALICO LLC, including accrued dividends.

(11) Bank Premises, Equipment, and Software

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

	2010	2009
Bank premises and equipment:		
Land and land improvements	$ 350	$ 344
Buildings	2,436	2,378
Building machinery and equipment	511	492
Construction in progress	31	43
Furniture and equipment	1,034	1,010
Subtotal	4,362	4,267
Accumulated depreciation	(1,749)	(1,643)
Bank premises and equipment, net	$ 2,613	$ 2,624
Depreciation expense, for the years ended December 31	$ 204	$ 202

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

	2010	2009
Leased premises and equipment under capital leases	$18	$10
Accumulated depreciation	(8)	(6)
Leased premises and equipment under capital leases, net	$10	$ 4
Depreciation expense related to leased premises and equipment under capital leases	$ 3	$ 2

The Reserve Banks lease space to outside tenants with remaining lease terms ranging from one to fourteen years. Rental income from such leases was $34 million and $32 million for the years ended December 31, 2010 and 2009, respectively, and is reported as a component of "Other income" in the Combined Statements of Income and Comprehensive Income. Future minimum lease payments that the Reserve Banks will receive under noncancelable lease agreements in existence at December 31, 2010 are as follows (in millions):

2011	$ 28
2012	24
2013	24
2014	24
2015	19
Thereafter	41
Total	$160

The Reserve Banks had capitalized software assets, net of amortization, of $146 million and $134 million at December 31, 2010 and 2009, respectively. Amortization expense was $54 million and $52 million for the years ended December 31, 2010 and 2009, respectively. Capitalized software assets are reported as a component of "Other assets" in the Combined Statements of Condition and the related amortization is reported as a component of "Operating expenses: Other" in the Combined Statements of Income and Comprehensive Income.

In 2008, after relocating operations to a new facility, the Federal Reserve Bank of San Francisco (FRBSF) classified its former Seattle branch office building as held for sale, and the building is reported at fair value as a component of "Other Assets" in the Combined Statements of Condition. During the year ended December 31, 2010, the FRBSF recorded an adjustment of $6.7 million to the fair value of the building and reported the charge as a component of "Operating expenses:

Other" in the Combined Statements of Income and Comprehensive Income. The fair value of the building as of December 31, 2010 was based on appraised valuation.

The FRBSF disclosed a subsequent event in its 2009 financial statements, related to the termination of a contract for software development. The FRBSF has determined that a portion of the software development program will not be used, and in 2010 reduced the carrying value of the asset by $20.2 million. The adjustment to the asset value is reported as a component of "Operating expenses: Other" in the Combined Statements of Income and Comprehensive Income. The FRBSF expects the remaining asset value will be recovered through use in other continuing software development programs.

(12) Commitments and Contingencies

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

At December 31, 2010, the Reserve Banks were obligated under noncancelable leases for premises and equipment with remaining terms ranging from one to approximately thirteen years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was $30 million and $27 million for the years ended December 31, 2010 and 2009, respectively.

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

	Operating leases
2011	$ 13
2012	12
2013	12
2014	11
2015	11
Thereafter	85
Future minimum rental payments	$144

At December 31, 2010, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2021 with a remaining fixed commitment of $178 million. Purchases of $54 million and $28 million were made against these commitments during 2010 and 2009, respectively. These commitments are for maintenance of currency processing machines and have variable and/or fixed components. The variable portion of the commitments is for additional services above the fixed contractual service limits.

The fixed payments for the next five years under these commitments are as follows (in millions):

2011	$ 2
2012	26
2013	45
2014	27
2015	25

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

Other Commitments

In support of financial market stability activities, the Reserve Banks entered into commitments to provide financial assistance to financial institutions. The contractual amounts shown below are the Reserve Banks' maximum exposures to loss in the event that the commitments are fully funded and there is a default by the borrower or total loss in value of pledged collateral. Total commitments at December 31, 2010 and 2009 were as follows (in millions):

	2010		2009	
	Contractual amount	Unfunded amount	Contractual amount	Unfunded amount
Secured revolving line of credit (AIG)	$24,512	$9,891	$35,000	$17,100
Commercial loan commitments (ML)	72	72	157	157
Additional loan commitments (ML)[1]	9	9	-	-
Total	$24,593	$9,972	$35,157	$17,257

[1] In 2010, there is additional restricted cash totaling $9 million that may be required to be advanced by ML for property level expenses or improvements.

The contractual amount of the commitment related to the AIG secured revolving line of credit represents the maximum commitment at December 31, 2010, to lend to AIG and the unfunded amount represents the maximum commitment reduced by draws outstanding. The amount of the FRBNY's commitment to lend to AIG was reduced during the year ended December 31, 2009 as a result of the debt restructurings described in Note 3, Note 4, and Note 5. The FRBNY's commitment was further reduced during the year ended December 31, 2010, as a result of AIG asset sales. Collateral to secure the FRBNY's loan to AIG includes equity interests of various AIG subsidiaries. The FRBNY did not incur any losses related to the unfunded commitment as of December 31, 2010.

As a result of the closing of the AIG recapitalization plan on January 14, 2011, the revolving line of credit was paid in full, including interest and fees, and FRBNY's commitment to lend any further funds was terminated.

The undrawn portion of the FRBNY's commercial loan commitments relates to commercial mortgage loan commitments acquired by ML.

(13) Retirement and Thrift Plans

Retirement Plans

The Reserve Banks currently offer three defined benefit retirement plans to their employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP) and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP). Under the Dodd-Frank Act, employees of the Bureau can elect to participate in the System Plan. As of December 31, 2010, there were no Bureau participants in the System Plan.

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

Following is a reconciliation of the beginning and ending balances of the System Plan benefit obligation (in millions):

	2010	2009
Estimated actuarial present value of projected benefit obligation at January 1	$7,364	$7,031
Service cost-benefits earned during the period	223	204
Interest cost on projected benefit obligation	450	427
Actuarial loss (gain)	508	(28)
Contributions by plan participants	9	3
Special termination benefits	11	9
Benefits paid	(307)	(291)
Plan amendments	-	9
Estimated actuarial present value of projected benefit obligation at December 31	$8,258	$7,364

Following is a reconciliation showing the beginning and ending balance of the System Plan assets, the funded status, and the accrued pension benefit costs (in millions):

	2010	2009
Estimated plan assets at January 1 (of which $6,252 and $5,037 is measured at fair value as of January 1, 2010 and 2009, respectively)	$ 6,281	$ 5,053
Actual return on plan assets	710	1,016
Contributions by the employer	580	500
Contributions by plan participants	9	3
Benefits paid	(307)	(291)
Estimated plan assets at December 31 (of which $6,998 and $6,252 is measured at fair value as of December 31, 2010 and 2009, respectively)	$ 7,273	$ 6,281
Funded status and accrued pension benefit costs	$ (985)	$(1,083)
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (771)	$ (883)
Net actuarial loss	(2,589)	(2,488)
Total accumulated other comprehensive loss	$(3,360)	$(3,371)

Accrued pension benefit costs are reported as a component of “Accrued benefit costs” in the Combined Statements of Condition.

The accumulated benefit obligation for the System Plan, which differs from the estimated actuarial present value of projected benefit obligation because it is based on current rather than future compensation levels, was $7,136 million and $6,430 million at December 31, 2010 and 2009, respectively.

The weighted-average assumptions used in developing the accumulated pension benefit obligation for the System Plan as of December 31 were as follows:

	2010	2009
Discount rate	5.50%	6.00%
Rate of compensation increase	5.00%	5.00%

Net periodic benefit expenses for the years ended December 31, 2010 and 2009, were actuarially determined using a January 1 measurement date. The weighted-average assumptions used in developing net periodic benefit expenses for the System Plan for the years were as follows:

	2010	2009
Discount rate	6.00%	6.00%
Expected asset return	7.75%	7.75%
Rate of compensation increase	5.00%	5.00%

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the System Plan’s benefits when due. The expected long-term rate of return on assets is an estimate that is based on a combination of factors, including the System Plan’s asset allocation strategy and historical returns; surveys of expected rates of return for other entities’ plans; a projected return for equities and fixed income investments based on real interest rates, inflation expectations, and equity risk premiums; and surveys of expected returns in equity and fixed income markets.

The components of net periodic pension benefit expense for the System Plan for the years ended December 31 are shown below (in millions):

	2010	2009
Service cost-benefits earned during the period	$ 223	$ 204
Interest cost on accumulated benefit obligation	450	427
Amortization of prior service cost	112	116
Amortization of net loss	188	285
Expected return on plan assets	(491)	(389)
Net periodic pension benefit expense	482	643
Special termination benefits	11	9
Total periodic pension benefit expense	$ 493	$ 652

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

Prior service cost	$110
Net actuarial loss	182
Total	$292

The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 16.

Following is a summary of expected benefit payments, excluding enhanced retirement benefits (in millions):

	Expected benefit payments
2011	$ 326
2012	347
2013	370
2014	394
2015	417
2016-2019	2,454
Total	$4,308

The System's Committee on Investment Performance (CIP) is responsible for establishing investment policies, selecting investment managers, and monitoring the investment managers' compliance with its policies. The CIP is supported by staff in the OEB in carrying out these responsibilities. At December 31, 2010, the System Plan's assets were held in seven investment vehicles: a liability-linked account, two actively managed long-duration fixed income portfolios, an indexed U.S. investment-grade bond fund, an indexed U.S. equity fund, an indexed non-U.S. developed-markets fund, and a money market fund.

The diversification of the Plan's investments is designed to limit concentration of risk and the risk of loss related to an individual asset class. The liability-linked account, funded in 2008, seeks to defease a portion of the System Plan's liability related to retired lives using a Treasury securities portfolio. The policy governing this account calls for cash-matching the first two years of a portion of retiree benefits payments and immunizing the remaining obligation. The two long-duration fixed income portfolios are separate accounts benchmarked to the Barclays Long Government/Credit Index, which was selected as a proxy for the liabilities of the Plan. While these portfolios are both actively managed, the guidelines are designed to limit portfolio deviations from the benchmark. The indexed U.S. investment-grade bond fund tracks the Barclays U.S. Aggregate Index, which is a broader fixed income index than the Barclays Long Government/Credit Index, but has a shorter duration and average maturity. The indexed U.S. equity fund is intended to track the overall U.S. equity market across market capitalizations. The indexed non-U.S. developed markets equity fund is intended to track the Morgan Stanley Capital International (MSCI) Emerging Markets Index, Europe, Australia, Far East plus Canada Index, which includes stocks from 23 markets deemed by MSCI to be "developed markets". Finally, the money market fund, which invests in high-quality money market securities, is the repository for cash balances and adheres to a constant dollar methodology.

Permitted and prohibited investments, including the use of derivatives, are defined in either the trust agreement (for commingled index vehicles) or the investment guidelines (for the three separate accounts). The CIP reviews the trust agreement and approves all investment guidelines as part of the selection of each investment to ensure that the trust agreement is consistent with the CIP's investment objectives for the System Plan's assets.

The System Plan's policy weight and actual asset allocations at December 31, by asset category, are as follows:

	Policy Weight	Actual Asset Allocations	
		2010	2009
U.S. equities	42.8%	45.4%	53.0%
International equities	12.2%	12.6%	12.9%
Fixed income	45.0%	41.7%	33.8%
Cash	0.0%	0.3%	0.3%
Total	100.0%	100.0%	100.0%

Employer contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System Plan's actuarial funding method is expected to produce a recommended annual funding range between \$350 and \$400 million. In 2011, the System will make monthly contributions of \$35 million and will reevaluate the monthly contributions upon completion of the 2011 actuarial valuation. The Reserve Banks' projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2010 and 2009, and for the years then ended, were not material.

The System Plan's investments are reported at fair value as required by ASC 820. ASC 820 establishes a three-level fair value hierarchy that distinguishes between market participant assumptions developed using market data obtained from independent sources (observable inputs) and the Reserve Banks' assumptions about market participant assumptions developed using the best information available in the circumstances (unobservable inputs).

Determination of Fair Value

The System Plan's investments are valued on the basis of the last available bid prices or current market quotations provided by dealers, or pricing services. To determine the value of a particular investment, pricing services may use information on transactions in such investments; quotations from dealers; pricing metrics; market transactions in comparable investments; relationships observed in the market between investments; and calculated yield measures based on valuation methodologies commonly employed in the market for such investments.

Because of the uncertainty inherent in determining the fair value of investments that do not have a readily available fair value, the fair value of these investments may differ significantly from the values that would have been reported if a readily available fair value had existed for these investments and may differ materially from the values that may ultimately be realized.

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

Description	2010			
	Level 1	Level 2	Level 3	Total
Short-term investments	$ -	$ 30	$-	$ 30
Treasury and Federal agency securities	1,065	39	-	1,104
GSE debt securities	-	-	-	-
Other fixed income securities	-	644	-	644
Common stocks	-	-	-	-
Commingled funds	-	5,220	-	5,220
Total	$1,065	$5,933	$-	$6,998

Description	2009			
	Level 1	Level 2	Level 3	Total
Short-term investments	$ -	$ 24	$-	$ 24
Treasury and Federal agency securities	677	38	-	715
GSE debt securities	-	156	-	156
Other fixed income securities	-	128	-	128
Common stocks	883	-	-	883
Commingled funds	-	4,346	-	4,346
Total	$1,560	$4,692	$-	$6,252

The System Plan enters into futures contracts, traded on regulated exchanges, to manage certain risks and to maintain appropriate market exposure in meeting the investment objectives of the System Plan. The System Plan bears the market risk that arises from any unfavorable changes in the value of the securities or indexes underlying these futures contracts. The use of futures contracts involves, to varying degrees, elements of market risk in excess of the amount recorded in the Statements of Condition. The guidelines established by the CIP further reduce risk by limiting the net futures positions, for most fund managers, to 15 percent of the market value of the advisor's portfolio. No limit has been established on the futures positions of the liability-driven investments because the fund manager only executes Treasury futures.

At December 31, 2010 and 2009, a portion of short-term investments was available for futures trading. There were $1 million of Treasury securities pledged as collateral for each of the years ended December 31, 2010 and 2009.

Thrift Plan

Employees of the Reserve Banks participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Reserve Banks match employee contributions based on a specified formula. Effective April 1, 2009, the Reserve Banks match 100 percent of the first 6 percent of employee contributions from the date of hire and provide an automatic employer contribution of 1 percent of eligible pay. For the first three months of the year ended December 31, 2009, the Reserve Banks matched 80 percent of the first 6 percent of employee contributions for employees with less than five years of service and 100 percent of the first 6 percent of employee contributions for employees with five or more years of service. The Reserve Banks' Thrift Plan contributions totaled $94 million and $82 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

(14) Postretirement Benefits Other Than Retirement Plans and Postemployment Benefits

Postretirement Benefits Other Than Retirement Plans

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

The Reserve Banks funds benefits payable under the medical and life insurance plans as due and, accordingly, have no plan assets.

Following is a reconciliation of the beginning and ending balances of the benefit obligation (in millions):

	2010	2009
Accumulated postretirement benefit obligation at January 1	$1,324	$1,221
Service cost-benefits earned during the period	47	40
Interest cost on accumulated benefit obligation	76	74
Net actuarial loss (gain)	(9)	54
Special termination benefits loss	1	1
Contributions by plan participants	18	16
Benefits paid	(88)	(79)
Medicare Part D subsidies	5	5
Plan amendments	(16)	(8)
Accumulated postretirement benefit obligation at December 31	$1,358	$1,324

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

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

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit costs (in millions):

	2010	2009
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	65	58
Contributions by plan participants	18	16
Benefits paid	(88)	(79)
Medicare Part D subsidies	5	5
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$1,358	$1,324
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 31	$ 33
Net actuarial (loss)	(301)	(338)
Total accumulated other comprehensive loss	$ (270)	$ (305)

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

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

	2010	2009
Health care cost trend rate assumed for next year	8.00%	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	2017	2015

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

	1 percentage point increase	1 percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 17	$ (14)
Effect on accumulated postretirement benefit obligation	$140	$(120)

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

	2010	2009
Service cost-benefits earned during the period	$ 47	$ 40
Interest cost on accumulated benefit obligation	76	74
Amortization of prior service cost	(18)	(20)
Amortization of net actuarial loss	28	29
Total periodic expense	133	123
Curtailment (gain)	-	(4)
Special termination benefits loss	1	1
Net periodic postretirement benefit expense	$134	$120

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

Prior service cost	$ (8)
Net actuarial loss	21
Total	$13

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

Net periodic postretirement benefit expense is reported as a component of "Salaries and benefits" in the Combined 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 Reserve Banks' 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 (gain) in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were $4.3 million and $6.4 million in the years ended December 31, 2010 and 2009, respectively. Expected receipts in 2011, related to benefits paid in the years ended December 31, 2010 and 2009, are $1 million.

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

	Without subsidy	With subsidy
2011	$ 75	$ 70
2012	79	73
2013	83	77
2014	87	80
2015	92	83
2016–2020	523	469
Total	$939	$852

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Reserve Banks at December 31, 2010 and 2009, were $146 million and $153 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Combined Statements of Condition. Net periodic postemployment benefit expense included in 2010 and 2009 operating expenses were $11 million and $56 million, respectively, and are recorded as a component of "Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

(15) Accumulated Other Comprehensive Income And Other Comprehensive Income

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

	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than retirement plans	Total accumulated other comprehensive income (loss)
Balance at January 1, 2009	$(4,418)	$(265)	$(4,683)
Change in funded status of benefit plans:			
Prior service costs arising during the year	(10)	9	(1)
Net actuarial gain (loss) arising during the year	656	(54)	602
Amortization of prior service cost	116	(20)	96
Amortization of net actuarial loss	285	29	314
Amortization of deferred curtailment gain	-	(4)	(4)
Change in funded status of benefit plans–other comprehensive income (loss)	1,047	(40)	1,007
Balance at December 31, 2009	$(3,371)	$(305)	$(3,676)
Change in funded status of benefit plans:			
Prior service costs arising during the year	-	16	16
Net actuarial gain (loss) arising during the year	(289)	9	(280)
Amortization of prior service cost	112	(18)	94
Amortization of net actuarial loss	188	28	216
Change in funded status of benefit plans–other comprehensive income	11	35	46
Balance at December 31, 2010	$(3,360)	$(270)	$(3,630)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Notes 13 and 14.

(16) Business Restructuring Charges

In 2010, the Reserve Banks announced the consolidation of some of their currency processing operations. As a result of this initiative, currency processing operations performed by two Reserve Bank Branch offices will be consolidated.

In 2009, the Reserve Banks continued their check restructuring initiatives to align check processing infrastructure and operations with declining check processing volumes. Additional announcements in 2009 included restructuring plans associated with discontinuing check print sites.

Restructuring plans announced prior to 2009 included the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites; one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing. Additional announcements in 2008 included restructuring plans associated with the closure of a check processing contingency center and the consolidation of check adjustments sites.

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

	2010 restructuring plans	2009 restructuring plans	2008 and prior restructuring plans	Total
Information related to restructuring plans as of December 31, 2010:				
Total expected costs related to restructuring activity	$ 4	$ 4	$ 53	$ 61
Estimated future costs related to restructuring activity	1	-	-	1
Expected completion date	2011	2010	2010	
Reconciliation of liability balances:				
Balance at January 1, 2009	$ -	$ -	$ 40	$ 40
Employee separation costs	-	4	-	4
Adjustments	-	-	(2)	(2)
Payments	-	-	(23)	(23)
Balance at December 31, 2009	$ -	$ 4	$ 15	$ 19
Employee separation costs	3	-	-	3
Contract termination costs	-	-	1	1
Adjustments	-	(1)	(1)	(2)
Payments	-	(2)	(9)	(11)
Balance at December 31, 2010	$ 3	$ 1	$ 6	$ 10

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

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

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

Restructuring costs associated with the impairment of certain Bank assets, including software and buildings, are discussed in Note 11.

(17) Subsequent Events

The closing of the AIG recapitalization plan, which occurred on January 14, 2011, is discussed in Note 3. On February 11, 2011, Treasury announced the consolidation of the Treasury Retail Securities operations and, as a result, the related operations currently performed at the Federal Reserve Bank of Cleveland will be consolidated at the Federal Reserve Bank of Minneapolis. Treasury plans to complete the consolidation by the end of 2011, and the Federal Reserve Bank of Cleveland is evaluating the consolidation efforts and has not yet determined the effects on the 2011 financial statements. There were no other subsequent events that require adjustments to or disclosures in the combined financial statements as of December 31, 2010. Subsequent events were evaluated through March 22, 2011, which is the date that the Board issued the combined financial statements.

Office of Inspector General Activities

The Office of Inspector General (OIG) for the Federal Reserve Board operates in accordance with the Inspector General Act of 1978, as amended. The OIG conducts activities and makes recommendations to promote economy and efficiency; enhance policies and procedures; and prevent and detect waste, fraud, and abuse in Board programs and operations, including functions that the Board has delegated to the Federal Reserve Banks. Accordingly, the OIG plans and conducts audits, inspections, evaluations, investigations, and other reviews relating to Board and Board-delegated programs and operations. It also retains an independent auditor to annually audit the Board's and the Federal Financial Institutions Examination Council's financial statements. In addition, the OIG keeps the Congress and the Board of Governors fully informed about serious abuses and deficiencies.

During 2010, the OIG completed 21 audits, inspections, and evaluations (**table 1**) and conducted a number of follow-up reviews to evaluate action taken on prior recommendations. Due to the sensitive nature of some of the material, certain reports were only issued internal to the Board, as indicated. OIG investigative work resulted in five arrests, five indictments, one criminal information, six convictions, and one termination, as well as $837,148 in monetary recoveries and $3,810,050 in criminal fines and restitution. Two investigations were closed during the year. The OIG also issued two semiannual reports to Congress and performed approximately 50 reviews of legislation and regulations related to the operations of the Board and/or the OIG.

For more information, visit the OIG website at www.federalreserve.gov/oig/.

Table 1. OIG audit, inspection, and evaluation reports issued in 2010

Report title	Month issued
Material Loss Review of Neighborhood Community Bank	January
Material Loss Review of Community Bank of West Georgia	January
Material Loss Review of BankFirst	February
Material Loss Review of Community First Bank	March
Material Loss Review of CapitalSouth Bank	March
Material Loss Review of Community Bank of Nevada	March
Federal Financial Institutions Examination Council Financial Statements as of and for the Years Ended December 31, 2009 and 2008, and Independent Auditors' Report	March
Board of Governors of the Federal Reserve System Financial Statements as of and for the Years Ended December 31, 2009 and 2008, and Independent Auditors' Report	March
Material Loss Review of Warren Bank	April
Material Loss Review of Irwin Union Bank and Trust	April
Material Loss Review of Bank of Elmwood	May
Material Loss Review of San Joaquin Bank	May
Material Loss Review of Orion Bank	June
Material Loss Review of SolutionsBank	June
Security Control Review of the Lotus Notes and Lotus Domino Infrastructure (Internal Report)	June
Material Loss Review of Barnes Banking Company	September
Review of the Failure of Marco Community Bank	September
Audit of the Board's Information Security Program	November
The Federal Reserve's Section 13(3) Lending Facilities to Support Overall Market Liquidity: Function, Status, and Risk Management	November
Material Loss Review of Midwest Bank and Trust Company	December
Security Control Review of the Internet Electronic Submission System (Internal Report)	December

Government Accountability Office Reviews

The Federal Banking Agency Audit Act (Pub. L. No. 95–320) authorizes the Government Accountability Office (GAO) to audit certain aspects of Federal Reserve System operations. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) directs GAO to conduct additional audits with respect to these operations. For example, under the Dodd-Frank Act, GAO is required to conduct a one-time audit of the existing credit facilities established by the Federal Reserve under section 13(3) of the Federal Reserve Act between December 1, 2007, and July 21, 2010. GAO is instructed to examine the involvement of the Reserve Banks in the establishment and operation of any such emergency facility or program. The Dodd-Frank Act also instructs GAO to conduct operational audits of all future credit facilities established under section 13(3), and of discount window and open market transactions engaged in after July 21, 2010. However, GAO is prohibited from disclosing participant- and transaction-specific information until the Federal Reserve Board is required to disclose this information. Additionally, GAO is required to complete an audit of Reserve Bank governance no later than July 21, 2011.

In 2010, the GAO completed eight reports on selected aspects of Federal Reserve operations (**table 1**). In addition, 10 projects concerning the Federal Reserve were in various stages of completion at year-end, 5 of which were required under the Dodd-Frank Act (**table 2**). The Federal Reserve also provided information to the GAO during the year on numerous other GAO investigations, including 4 completed reviews and 15 ongoing reviews, 8 of which resulted from the Dodd-Frank Act. The reports are available directly from the GAO website.

Table 1. Reports completed during 2010

Report title	Report number	Month issued (2010)
Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-Making Process on the Term Asset-Backed Securities Loan Facility	GAO-10-25	February
Federal Deposit Insurance Act: Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision	GAO-10-100	April
Troubled Asset Relief Program: Update of Government Assistance Provided to AIG	GAO-10-475	April
Federal Reserve Banks: Areas for Improvement in Information Security Controls	GAO-10-640R	April
Financial Assistance: Ongoing Challenges and Guiding Principles Related to Government Assistance for Private Sector Companies	GAO-10-719	August
Troubled Asset Relief Program: Bank Stress Test Offers Lessons as Regulators Take Further Actions to Strengthen Supervisory Oversight	GAO-10-861	September
Troubled Asset Relief Program: Opportunities Exist to Apply Lessons Learned from the Capital Purchase Program to Similarly Designed Programs and to Improve the Repayment Process	GAO-11-47	October
Financial Audit: Bureau of the Public Debt's Fiscal Years 2010 and 2009 Schedules of Federal Debt	GAO-11-52	November

Table 2. Projects active at year-end 2010

Subject of project	Month initiated (2010)
Second Anniversary TARP Report	March
Troubled Asset Relief Program: Update of AIG indicators	May
AIG federal assistance	May
Bank examinations and credits	June
Reserve bank governance	July
Prompt corrective action	July
Emergency lending and other facilities	July
Proprietary trading	October
Overseeing mortgage servicer foreclosure procedures	October
Capital requirements	December

Federal Reserve System Organization

Congress designed the Federal Reserve System to give it a broad perspective on the economy and on economic activity in all parts of the nation. As such, the System is composed of a central, governmental agency—the Board of Governors—in Washington, D.C., and 12 regional Federal Reserve Banks. This section lists key officials across the System, including the Board of Governors, its officers, Federal Open Market Committee members, several system councils, and Federal Reserve Bank and Branch directors and officers.

Board of Governors

Members

The Board of Governors of the Federal Reserve System is composed of seven members, who are nominated by the President and confirmed by the Senate. The Chairman and the Vice Chairman of the Board are also named by the President from among the members and are confirmed by the Senate. Two positions on the Board are currently vacant. For a full listing of Board members from 1913 through the present, visit www.federalreserve.gov/bios/boardmembership.htm.

Ben S. Bernanke
Chairman

Janet L. Yellen
Vice Chair

Kevin M. Warsh

Elizabeth A. Duke

Daniel K. Tarullo

Sarah Bloom Raskin

Divisions and Officers

Thirteen divisions support and carry out the mission of the Board of Governors, which is based in Washington, D.C.

Office of Board Members

Michelle A. Smith
Director

Linda L. Robertson
Assistant to the Board

Laricke D. Blanchard
Assistant to the Board

Rosanna Pianalto-Cameron
Assistant to the Board

David W. Skidmore
Assistant to the Board

Brian J. Gross
Special Assistant to the Board for Congressional Liaison

Lucretia M. Boyer
Special Assistant to the Board for Public Information

Winthrop P. Hambley
Senior Adviser

Legal Division

Scott G. Alvarez
General Counsel

Richard M. Ashton
Deputy General Counsel

Kathleen M. O'Day
Deputy General Counsel

Stephanie Martin
Associate General Counsel

Ann Misback
Associate General Counsel

Katherine H. Wheatley
Associate General Counsel

Kieran J. Fallon
Associate General Counsel

Stephen H. Meyer
Assistant General Counsel

Cary K. Williams
Assistant General Counsel

Office of the Secretary

Jennifer J. Johnson
Secretary

Robert deV. Frierson
Deputy Secretary

Margaret M. Shanks
Associate Secretary

Division of International Finance

D. Nathan Sheets
Director

Thomas A. Connors
Deputy Director

Steven B. Kamin
Deputy Director

Michael P. Leahy
Senior Associate Director

Trevor A. Reeve
Associate Director

Ralph W. Tryon
Associate Director

Christopher J. Erceg
Deputy Associate Director

David H. Bowman
Assistant Director

Charles P. Thomas
Assistant Director

Mark S. Carey
Senior Adviser

John H. Rogers
Senior Adviser

Jane Haltmaier
Adviser

Office of Financial Stability Policy and Research

J. Nellie Liang
Director

Andreas W. Lehnert
Deputy Director

Seth F. Wheeler
Chief of Staff

Division of Monetary Affairs

William B. English
Director

James A. Clouse
Deputy Director

Deborah J. Danker
Deputy Director

William Nelson
Deputy Director

Seth B. Carpenter
Senior Associate Director

Gretchen C. Weinbach
Deputy Associate Director

Egon Zakrajsek
Deputy Associate Director

William F. Bassett
Assistant Director

Margaret G. DeBoer
Assistant Director

Jane E. Ihrig
Assistant Director

J. David Lopez-Salido
Assistant Director

Matthew M. Luecke
Assistant Director

Fabio M. Natalucci
Assistant Director

Stephen A. Meyer
Senior Adviser

Andrew T. Levin
Senior Adviser

Mary T. Hoffman
Adviser

Division of Research and Statistics

David J. Stockton
Director

David W. Wilcox
Deputy Director

David L. Reifschneider
Senior Associate Director

Lawrence Slifman
Senior Associate Director

William L. Wascher III
Senior Associate Director

Alice Patricia White
Senior Associate Director

Michael S. Gibson
Associate Director

S. Wayne Passmore
Associate Director

Janice Shack-Marquez
Associate Director

Daniel E. Sichel
Associate Director

Daniel M. Covitz
Deputy Associate Director

Michael S. Cringoli
Deputy Associate Director

Matthew J. Eichner
Deputy Associate Director

Eric M. Engen
Deputy Associate Director

Diana Hancock
Deputy Associate Director

Michael T. Kiley
Deputy Associate Director

David E. Lebow
Deputy Associate Director

Michael G. Palumbo
Deputy Associate Director

Robin A. Prager
Deputy Associate Director

Joyce K. Zickler
Deputy Associate Director

Sean D. Campbell
Assistant Director

Jeffrey C. Campione
Assistant Director

Sandra A. Cannon
Assistant Director

Joshua Gallin
Assistant Director

Arthur B. Kennickell
Assistant Director

Mary M. West
Assistant Director

Glenn B. Canner
Senior Adviser

Stephen D. Oliner
Senior Adviser

Division of Banking Supervision and Regulation

Patrick M. Parkinson
Director

Maryann F. Hunter
Deputy Director

Barbara J. Bouchard
Senior Associate Director

Michael R. Foley
Senior Associate Director

Jack P. Jennings II
Senior Associate Director

Arthur W. Lindo
Senior Associate Director

Peter J. Purcell
Senior Associate Director

William G. Spaniel
Senior Associate Director

Mark E. VanDer Weide
Senior Associate Director

Kevin M. Bertsch
Associate Director

Betsy Cross
Associate Director

Nida Davis
Associate Director

Gerald A. Edwards Jr.
Associate Director

David S. Jones
Associate Director

Philip Aquilino
Assistant Director

Robert T. Ashman
Assistant Director

Kevin J. Clarke
Assistant Director

Lisa M. DeFerrari
Assistant Director

Adrienne T. Haden
Assistant Director

Anna L. Hewko
Assistant Director

Michael J. Kraemer
Assistant Director

Robert T. Maahs
Assistant Director

Richard A. Naylor II
Assistant Director

Dana E. Payne
Assistant Director

Nancy J. Perkins
Assistant Director

Sarkis Yoghourtdjian
Assistant Director

Norah M. Barger
Senior Adviser

Timothy P. Clark
Senior Adviser

Charles H. Holm
Senior Adviser

William F. Treacy
Adviser

Division of Consumer and Community Affairs

Sandra F. Braunstein
Director

Leonard Chanin
Deputy Director

Timothy R. Burniston
Senior Associate Director

Tonda E. Price
Senior Associate Director

Anna Alvarez Boyd
Associate Director

Joseph A. Firschein
Assistant Director

Allen J. Fishbein
Assistant Director

Suzanne G. Killian
Assistant Director

James A. Michaels
Assistant Director

Division of Reserve Bank Operations and Payment Systems

Louise L. Roseman
Director

Donald V. Hammond
Deputy Director

Jeffrey C. Marquardt
Deputy Director

Kenneth D. Buckley
Associate Director

Dorothy LaChapelle
Associate Director

Jeff J. Stehm
Associate Director

Gregory L. Evans
Deputy Associate Director

Susan V. Foley
Deputy Associate Director

Lisa K. Hoskins
Deputy Associate Director

Michael J. Lambert
Assistant Director

Michael J. Stan
Assistant Director

Leonard J. Tanis
Assistant Director

Paul W. Bettge
Senior Adviser

Office of Staff Director

Stephen R. Malphrus
Staff Director

Charles S. Struckmeyer
Deputy Staff Director

Sheila Clark
Equal Employment Opportunity Programs Director

Lynn S. Fox
Senior Adviser

Adrienne D. Hurt
Adviser

Management Division

H. Fay Peters
Director

Michell C. Clark
Deputy Director

Donald A. Spicer
Deputy Director

William L. Mitchell
Senior Associate Director

Christine M. Fields
Associate Director

Charles F. O'Malley
Associate Director

James R. Riesz
Associate Director

Marie S. Savoy
Associate Director

Elaine M. Boutilier
Deputy Associate Director

Tara C. Tinsley-Pelitere
Deputy Associate Director

Keith F. Bates
Assistant Director

Jeffrey R. Peirce
Assistant Director

Theresa A. Trimble
Assistant Director

Karen L. Vassallo
Assistant Director

Todd A. Glissman
Senior Adviser

Billy J. Sauls
Senior Adviser

Carol A. Sanders
Special Adviser

Christopher J. Suma
Special Adviser

Division of Information Technology

Maureen T. Hannan
Director

Geary L. Cunningham
Deputy Director

Wayne A. Edmondson
Deputy Director

Sharon L. Mowry
Deputy Director

Po Kyung Kim
Deputy Associate Director

Susan F. Marycz
Deputy Associate Director

Raymond Romero
Deputy Associate Director

Lisa M. Bell
Assistant Director

Glenn S. Eskow
Assistant Director

Kofi A. Sapong
Assistant Director

Rajasekhar R. Yelisetty
Assistant Director

Tillena G. Clark
Adviser

Office of Inspector General

Elizabeth A. Coleman
Inspector General

Jacqueline M. Becker
Associate Inspector General

Anthony J. Castaldo
Associate Inspector General

Elise M. Ennis
Associate Inspector General

Andrew Patchan Jr.
Associate Inspector General

Harvey Witherspoon
Associate Inspector General

Federal Open Market Committee

The Federal Open Market Committee is made up of the seven members of the Board of Governors; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis. During 2010 the Federal Open Market Committee held eight regularly scheduled meetings and two conference calls (see "Minutes of Federal Open Market Committee Meetings" on page 163).

Members

Ben S. Bernanke
Chairman, Board of Governors

William C. Dudley
Vice Chairman, President, Federal Reserve Bank of New York

Jim Bullard
President, Federal Reserve Bank of St. Louis

Elizabeth A. Duke
Board of Governors

Thomas M. Hoenig
President, Federal Reserve Bank of Kansas City

Sandra Pianalto
President, Federal Reserve Bank of Cleveland

Sarah Bloom Raskin
Board of Governors

Eric S. Rosengren
President, Federal Reserve Bank of Boston

Daniel K. Tarullo
Board of Governors

Kevin M. Warsh
Board of Governors

Janet L. Yellen
Board of Governors

Alternate Members

Christine M. Cumming
First Vice President, Federal Reserve Bank of New York

Charles L. Evans
President, Federal Reserve Bank of Chicago

Richard W. Fisher
President, Federal Reserve Bank of Dallas

Narayana Kocherlakota
President, Federal Reserve Bank of Minneapolis

Charles I. Plosser
President, Federal Reserve Bank of Philadelphia

Officers

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter Jr.
Deputy General Counsel

Richard M. Ashton
Assistant General Counsel

D. Nathan Sheets
Economist

David J. Stockton
Economist

Alan D. Barkema
Associate Economist

James A. Clouse
Associate Economist

Thomas A. Connors
Associate Economist

Jeffrey Fuhrer
Associate Economist

Steven B. Kamin
Associate Economist

Simon Potter
Associate Economist

Lawrence Slifman
Associate Economist

Mark S. Sniderman
Associate Economist

Christopher J. Waller
Associate Economist

David W. Wilcox
Associate Economist

Brian Sack
Manager, System Open Market Account

Board of Governors Advisory Councils

The Federal Reserve System uses advisory committees in carrying out its varied responsibilities. Three of these committees advise the Board of Governors directly: the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council. These councils, whose members are drawn from each of the 12 Federal Reserve Districts, meet two to four times a year. The individual Reserve Banks have advisory committees as well, including thrift institutions advisory committees, small business committees, and agricultural advisory committees. Moreover, officials from all Reserve Banks meet periodically in various committees. To learn more, visit www.federalreserve.gov/aboutthefed/advisorydefault.htm.

Federal Advisory Council

The Federal Advisory Council—a statutory body established under the Federal Reserve Act—consults with, and advises, the Board of Governors on all matters within the Board's jurisdiction. It is composed of one representative from each Federal Reserve District, chosen by the Reserve Bank in that District. The Federal Reserve Act requires the council to meet in Washington, D.C., at least four times a year. Three members of the council serve as its president, vice president, and secretary. In 2010, it met on February 11–12, May 6–7, September 2–3, and December 2–3. The council met with the Board on February 12, May 7, September 3, and December 3, 2010.

Members

District 1
Ellen Alemany
Chairman and Chief Executive Office, RBS Americas/Citizens Financial Group, Greenwich, CT

District 2
Robert P. Kelly
Chairman and Chief Executive Officer, The Bank of New York Mellon, New York, NY

District 3
R. Scott Smith Jr.
Chairman, President, and Chief Executive Officer, Fulton Financial Corporation, Lancaster, PA

District 4
Henry L. Meyer III
Chairman, President, and Chief Executive Officer, KeyCorp, Cleveland, OH

District 5
Richard D. Fairbank
Chief Executive Officer and Chairman, Capital One Financial Corporation, McLean, VA

District 6
Richard G. Hickson
Chairman and Chief Executive Officer, Trustmark Corporation, Jackson, MS

District 7
David W. Nelms
Chairman and Chief Executive Officer, Discover Financial Services, Riverwoods, IL

District 8
Bryan Jordan
President and Chief Executive Officer, First Horizon National Corporation, Memphis, TN

District 9
Richard K. Davis
Chairman, President, and Chief Executive Officer, U.S. Bancorp, Minneapolis, MN

District 10
Bruce R. Lauritzen
Chairman, First National Bank of Omaha, Omaha, NE

District 11
Richard W. Evans Jr.
Chairman and Chief Executive Officer, Cullen/Frost Bankers Inc., San Antonio, TX

District 12
Russell Goldsmith
Chairman and Chief Executive Officer, City National Bank, Beverly Hills, CA

Officers

Robert P. Kelly
President

Russell Goldsmith
Vice President

James E. Annable
Secretary

Consumer Advisory Council

The Consumer Advisory Council—a statutory body established pursuant to the 1976 amendments to the Equal Credit Opportunity Act—advises the Board of Governors on consumer financial services. Its members, who are appointed by the Board, are academics, state and local government officials, and representatives of the financial services industry and of consumer and community interests. In 2010, the Council met with the Board on March 25, June 17, and October 21.

Members

Maeve Elise Brown
Executive Director, Housing and Economic Rights Advocates, Oakland, CA

Paula Bryant-Ellis
Senior Vice President, Community Development Banking Group, BOK Financial Corporation, Tulsa, OK

Joanne Budde
President and Chief Executive Officer, Consumer Credit Counseling Service of San Francisco, San Francisco, CA

Alan Cameron
President and Chief Executive Officer, Idaho Credit Union League, Boise, ID

John P. Carey
Chief Administrative Officer, Consumer Banking, North America, Citigroup, New York, NY

Tino Diaz
Managing Director and Chief Executive Officer, CharisPros – Mortgage Center, Miami, FL

Kerry Doi
President and Chief Executive Officer, Pacific Asian Consortium in Employment, Los Angeles, CA

Kathleen Engel
Professor of Law, Suffolk University Law School, Boston, MA

Betsy Flynn
Chief Executive Officer, President, and Chairman, Community Financial Services Bank, Benton, KY

Patricia Garcia Duarte
President and Chief Executive Officer, Neighborhood Housing Services of Phoenix, Phoenix, AZ

Ira Goldstein
Director, Policy Solutions, The Reinvestment Fund, Philadelphia, PA

Mike Griffin
Senior Vice President, KeyBank, N.A., Cleveland, OH

Greta Harris
Vice President–Southeast Region, Local Initiatives Support Corporation, Richmond, VA

Brian Hudson Sr.
Executive Director and Chief Executive Officer, Pennsylvania Housing Finance Agency, Harrisburg, PA

Kirsten Keefe
Senior Staff Attorney, Empire Justice Center, Albany, NY

Lorenzo Littles
Consultant, Foundation for Community Empowerment, Grapevine, TX

Larry B. Litton Jr.
President and Chief Executive Officer, Litton Loan Servicing LP, Houston, TX

Saurabh Narain
Chief Fund Advisor, National Community Investment Fund, Chicago, IL

Andy Navarrete
Senior Vice President, Chief Counsel–National Lending, Capital One Financial Corporation, McLean, VA

Ronald Phillips
President, Coastal Enterprises, Inc., Wiscasset, ME

Dory Rand
President, Woodstock Institute, Chicago, IL

Kevin Rhein
Group Executive Vice President, Card Services and Consumer Lending, Wells Fargo & Co., Minneapolis, MN

Phyllis Salowe-Kaye
Executive Director, New Jersey Citizen Action, Newark, NJ

Shanna Smith
President and Chief Executive Officer, National Fair Housing Alliance, Washington, DC

Corey Stone
Chair, First Community Bank of New Haven, New Haven, CT

Jennifer Tescher
Director, Center for Financial Services Innovation, Chicago, IL

Mary Tingerthal
President, Capital Markets Companies, Housing Partnership Network, St. Paul, MN

Mark Wiseman
Principal Assistant Attorney General, Consumer Protection Section, Ohio Attorney General's Office, Cleveland, OH

Officers

Michael Calhoun
Council Chair, President, Center for Responsible Lending, Durham, NC

Jim Park
Council Vice Chair, Chief Executive Officer, New Vista Asset Management, San Diego, CA

Thrift Institutions Advisory Council

The Thrift Institutions Advisory Council was established by the Board of Governors to consult with, and advise, the Board on issues pertaining to the thrift industry and on other matters within the Board's jurisdiction. Its members, who are appointed by the Board, represent credit unions, savings and loan associations, and savings banks. In 2010, the council met with the Board on February 26, June 25, and December 17. The Council was replaced with the new Community Depository Institutions Advisory Council, whose first meeting will be in 2011.

Members

F. Edward Broadwell Jr.
Chairman and Chief Executive Officer, Home Trust Bank, Asheville, NC

Barrie G. Christman
Chairman, Principal Bank, Des Moines, IA

Howard T. Boyle
President and Chief Executive Officer, Home Savings Bank, Kent, OH

Peter J. Johnson
President and Chief Executive Officer, American Federal Savings Bank, Helena, MT

Michael Kloiber
President and Chief Executive Officer, Tinker Federal Credit Union, Tinker Air Force Base, OK

William T. Stapleton
President and Chief Executive Officer, Northampton Co-Operative Bank, Northampton, MA

Dennis M. Terry
President and Chief Executive Officer, First Clover Leaf Bank, Edwardsville, IL

Richard J. Green
Chief Executive Officer, Firstrust Bank, Conshohocken, PA

Richard G. Harwood
President and Chief Executive Officer, Newport Federal Bank, Newport, TN

Kay M. Hoveland
President and Chief Executive Officer, Kaiser Federal Bank and K-Fed Bancorp, Covina, CA

Randy M. Smith
Chief Executive Officer and President, Randolph-Brooks Federal Credit Union, Universal City, TX

William R. White
Chairman and Chief Executive Officer, Dearborn Federal Savings Bank, Dearborn, MI

Officer

F. Edward Broadwell Jr.
President

Federal Reserve Bank Branches

To carry out the day-to-day operations of the Federal Reserve System, the nation has been divided into 12 Federal Reserve Districts, each with a Reserve Bank. As required by the Federal Reserve Act of 1913, each of the Reserve Banks is supervised by a board of directors who are familiar with economic and credit conditions in the District. Similarly, each of the 24 Reserve Bank Branches has a board of directors who are familiar with conditions in the area encompassed by the Branch.

Reserve Bank and Branch Directors

Each Federal Reserve Bank's board is made up of three Class A and three Class B directors, who are elected by the stockholding member banks, and three Class C directors, who are appointed by the Board of Governors.[1] Federal Reserve Branches have either five or seven directors, a majority of whom are appointed by the parent Federal Reserve Bank; the others are appointed by the Board of Governors. One of the directors appointed by the Board is designated annually as chair of the board of that Branch in a manner prescribed by the parent Federal Reserve Bank.

The directors of the Banks and Branches are listed below. For each director, the class of directorship, the director's principal organizational affiliation, and the date the director's term expires are shown.

District 1–Boston

Class A

James C. Smith, 2010
Chairman, President, and Chief Executive Officer, Webster Bank, N.A., Waterbury, CT

Kathryn G. Underwood, 2011
President and Chief Executive Officer, Ledyard National Bank, Hanover, NH

David A. Lentini, 2012[2]
Chairman, President, and Chief Executive Officer, The Connecticut Bank and Trust Company, Hartford, CT

Class B

John F. Fish, 2010
Chief Executive Officer, Suffolk Construction Company, Inc., Boston, MA

Michael T. Wedge, 2011
Former President and Chief Executive Officer, BJ's Wholesale Club, Inc., Natick, MA

William D. Nordhaus, 2012
Sterling Professor of Economics, Yale University, New Haven, CT

Class C

Kirk A. Sykes, 2010
President, Urban Strategy America Fund, L.P., Boston, MA

Henri A. Termeer, 2011
Chairman, President, and Chief Executive Officer, Genzyme Corporation, Cambridge, MA

Catherine D'Amato, 2012
President and Chief Executive Officer, The Greater Boston Food Bank, Boston, MA

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1 Class A directors represent the stockholding member banks in each Federal Reserve District. Class B and Class C directors represent the public and are chosen with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers; they may not be officers, directors, or employees of any bank or bank holding company. In addition, Class C directors may not be stockholders of any bank or bank holding company. For the election of Class A and Class B directors, the member banks of each Federal Reserve District are classified into three groups. Each group, which comprises banks with similar capitalization, elects one Class A director and one Class B director. Annually, the Board of Governors designates one of the Class C directors as chair of the board and Federal Reserve agent of each District Bank, and it designates another Class C director as deputy chair. For more information on Bank and Branch directors, see www.federalreserve.gov/pubs/frseries/frseri4.htm.

2 Director's term expires on December 31 of the year indicated.

District 2–New York

Class A

Richard L. Carrión, 2010
Chairman, President, and Chief Executive Officer, Popular, Inc., San Juan, PR

Charles V. Wait, 2011
President, Chief Executive Officer, and Chairman, The Adirondack Trust Company, Saratoga Springs, NY

James Dimon, 2012
Chairman and Chief Executive Officer, JPMorgan Chase & Co., New York, NY

Class B

James S. Tisch, 2010
President and Chief Executive Officer, Loews Corporation, New York, NY

Jeffrey R. Immelt, 2011
Chairman and Chief Executive Officer, General Electric Company, Fairfield, CT

Jeffrey B. Kindler, 2012
Former Chairman and Chief Executive Officer, Pfizer, Inc., New York, NY

Class C

Kathryn S. Wylde, 2010
President and Chief Executive Officer, Partnership for New York City, New York, NY

Denis M. Hughes, 2011
President, New York State AFL-CIO, New York, NY

Lee C. Bollinger, 2012
President, Columbia University, New York, NY

District 3–Philadelphia

Class A

Vacancy, 2010

Frederick C. Peters, 2011
Chairman and Chief Executive Officer, Bryn Mawr Trust Company, Bryn Mawr, PA

Aaron L. Groff Jr., 2012
Chairman, President, and Chief Executive Officer, Ephrata National Bank, Ephrata, PA

Class B

Keith S. Campbell, 2010
Chairman, Mannington Mills, Inc., Salem, NJ

Michael F. Camardo, 2011
Retired Executive Vice President, Lockheed Martin ITS, Cherry Hill, NJ

Deborah M. Fretz, 2012
Retired President and Chief Executive Officer, Sunoco Logistics Partners, Philadelphia, PA

Class C

Jeremy Nowak, 2010
President and Chief Executive Officer, The Reinvestment Fund, Philadelphia, PA

Charles P. Pizzi, 2011
President and Chief Executive Officer, Tasty Baking Company, Philadelphia, PA

James E. Nevels, 2012
Chairman, The Swarthmore Group, Philadelphia, PA

District 4–Cleveland

Class A

James E. Rohr, 2010
Chairman and Chief Executive Officer, The PNC Financial Services Group, Inc., Pittsburgh, PA

Charlotte W. Martin, 2011
President and Chief Executive Officer, Great Lakes Bankers Bank, Worthington, OH

C. Daniel DeLawder, 2012
Chairman and Chief Executive Officer, Park National Bank, Newark, OH

Class B

Les C. Vinney, 2010
Chairman, Cleveland HeartLab, Cleveland, OH

Tilmon F. Brown, 2011
President and Chief Executive Officer, New Horizons Baking Company, Norwalk, OH

Susan Tomasky, 2012
President, AEP Transmission, Columbus, OH

Class C

Roy W. Haley, 2010
Chairman, WESCO International, Inc., Pittsburgh, PA

Alfred M. Rankin Jr., 2011
Chairman, President, and Chief Executive Officer, NACCO Industries, Inc., Cleveland, OH

Richard K. Smucker, 2012
Executive Chairman and Co-Chief Executive Officer, The J.M. Smucker Company, Orrville, OH

Cincinnati Branch

Appointed by the Federal Reserve Bank

Vacancy, 2010

Gregory B. Kenny, 2011
President and Chief Executive Officer, General Cable Corporation, Highland Heights, KY

Janet B. Reid, 2011
Managing Partner and Director, Global Novations, LLC, Cincinnati, OH

Donald E. Bloomer, 2012
President and Chief Executive Officer, Citizens National Bank, Somerset, KY

Appointed by the Board of Governors

Peter S. Strange, 2010
Chairman, Messer, Inc., Cincinnati, OH

James M. Anderson, 2011
Advisor to the President, Cincinnati Children's Hospital Medical Center, Cincinnati, OH

Daniel B. Cunningham, 2012
President and Chief Executive Officer, Long-Stanton Manufacturing Companies, Cincinnati, OH

Pittsburgh Branch

Appointed by the Federal Reserve Bank

Todd D. Brice, 2010
Chief Executive Officer, S&T Bancorp, Inc., Indiana, PA

Howard W. Hanna III, 2011
Chairman and Chief Executive Officer, Howard Hanna Real Estate Services, Pittsburgh, PA

Petra Mitchell, 2011
President, Catalyst Connection, Pittsburgh, PA

Vacancy, 2012

Appointed by the Board of Governors

Glenn R. Mahone, 2010
Partner and Attorney at Law, Reed Smith LLP, Pittsburgh, PA

Sunil T. Wadhwani, 2011
Co-Chairman, iGATE Corporation, Pittsburgh, PA

Robert A. Paul, 2012
Chairman and Chief Executive Officer, Ampco-Pittsburgh Corporation, Pittsburgh, PA

District 5–Richmond

Class A

Robert H. Gilliam Jr., 2010
President and Chief Executive Officer, First National Bank, Altavista, VA

Kelly S. King, 2011
Chief Executive Officer, BB&T Corporation, Winston-Salem, NC

Richard J. Morgan, 2012
President and Chief Executive Officer, CommerceFirst Bank, Annapolis, MD

Class B

Patrick C. Graney III, 2010
Maxum East Regional President, Maxum Petroleum, Belle, WV

Dana S. Boole, 2011
President and Chief Executive Officer, Community Affordable Housing Equity Corporation, Raleigh, NC

Wilbur E. Johnson, 2012
Managing Partner, Young Clement Rivers, LLP, Charleston, SC

Class C

Margaret E. McDermid, 2010
Senior Vice President and Chief Information Officer, Dominion Resources, Inc., Richmond, VA

Linda D. Rabbitt, 2011
Chairman and Chief Executive Officer, Rand Construction Corporation, Washington, DC

Lemuel E. Lewis, 2012
President, LocalWeather.com, Suffolk, VA

Baltimore Branch

Appointed by the Federal Reserve Bank

William B. Grant, 2010
Chairman and Chief Executive Officer, First United Corp. and First United Bank & Trust, Oakland, MD

Biana J. Arentz, 2011
President and Chief Executive Officer, Hemingway's Inc., Stevensville, MD

James T. Brady, 2012
Managing Director–Mid-Atlantic, Ballantrae International, Ltd., Ijamsville, MD

Anita G. Newcomb, 2012
President and Managing Director, A.G. Newcomb & Co., Columbia, MD

Appointed by the Board of Governors

William R. Roberts, 2010
President–Verizon Maryland/DC, Verizon Maryland Inc., Baltimore, MD

Jenny G. Morgan, 2011
President, basys, inc., Linthicum, MD

Ronald Blackwell, 2012
Chief Economist, AFL-CIO, Washington, DC

Charlotte Branch

Appointed by the Federal Reserve Bank

Barry L. Slider, 2010
President and Chief Executive Officer, First South Bancorp, Inc. and First South Bank, Spartanburg, SC

James H. Speed Jr., 2011
President and Chief Executive Officer, North Carolina Mutual Life Insurance Company, Durham, NC

Lucia Z. Griffith, 2012
Chief Executive Officer and Principal, METRO Landmarks, Charlotte, NC

John S. Kreighbaum, 2012
President and Chief Executive Officer, Carolina Premier Bank, Charlotte, NC

Appointed by the Board of Governors

Claude C. Lilly, 2010
Dean, Clemson University, College of Business and Behavioral Science, Clemson, SC

Linda L. Dolny, 2011
Former President, PML Associates, Inc., Greenwood, SC

David J. Zimmerman, 2012
President, Southern Shows, Inc., Charlotte, NC

District 6–Atlanta

Class A

T. Anthony Humphries, 2010
President and Chief Executive Officer, NobleBank and Trust, N.A., Anniston, AL

James M. Wells III, 2011
Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, GA

Rudy E. Schupp, 2012
President and Chief Executive Officer, 1st United Bank, West Palm Beach, FL

Class B

Lee M. Thomas, 2010
Chairman and Chief Executive Officer, Rayonier, Jacksonville, FL

Renée Lewis Glover, 2011
President and Chief Executive Officer, Atlanta Housing Authority, Atlanta, GA

Clarence Otis Jr., 2012
Chairman and Chief Executive Officer, Darden Restaurants, Inc., Orlando, FL

Class C

Carol B. Tomé, 2010
Chief Financial Officer and Executive Vice President, The Home Depot, Atlanta, GA

Thomas I. Barkin, 2011
Director, McKinsey & Company, Atlanta, GA

Richard H. Anderson, 2012
Chief Executive Officer, Delta Air Lines, Inc., Atlanta, GA

Birmingham Branch

Appointed by the Federal Reserve Bank

C. Richard Moore Jr., 2010
Chairman, President, and Chief Executive Officer, Peoples Southern Bank, Clanton, AL

Macke B. Mauldin, 2011
President, Bank Independent, Sheffield, AL

John A. Langloh, 2012
President and Chief Executive Officer, United Way of Central Alabama, Birmingham, AL

Vacancy, 2012

Appointed by the Board of Governors

Maryam B. Head, 2010
Chairman, Ram Tool and Supply Company, Inc., Birmingham, AL

Thomas R. Stanton, 2011
Chairman and Chief Executive Officer, ADTRAN, Inc., Huntsville, AL

F. Michael Reilly, 2012
Chairman, President, and Chief Executive Officer, Randall-Reilly Publishing Co., LLC, Tuscaloosa, AL

Jacksonville Branch

Appointed by the Federal Reserve Bank

Jack B. Healan Jr., 2010
President, Amelia Island Company, Amelia Island, FL

Hugh F. Dailey, 2011
President and Chief Executive Officer, Community Bank & Trust of Florida, Ocala, FL

Oscar J. Horton, 2012
President, Sun State International Trucks, LLC, Tampa, FL

D. Kevin Jones, 2012
President and Chief Executive Officer, MIDFLORIDA Credit Union, Lakeland, FL

Appointed by the Board of Governors

H. Britt Landrum Jr., 2010
President and Chief Executive Officer, Landrum Human Resource Companies, Inc., Pensacola, FL

Lynda L. Weatherman, 2011
President and Chief Executive Officer, Economic Development Commission of Florida's Space Coast, Rockledge, FL

Leerie T. Jenkins Jr., 2012
Chairman and Chief Executive Officer, Reynolds, Smith and Hills, Inc., Jacksonville, FL

Miami Branch

Appointed by the Federal Reserve Bank

Dennis S. Hudson III, 2010
Chairman and Chief Executive Officer, Seacoast Banking Corporation of Florida, Stuart, FL

Walter Banks, 2011
President, Lago Mar Resort and Club, Fort Lauderdale, FL

Thomas H. Shea, 2011
Chief Executive Officer, Florida/Caribbean Region, Right Management, Fort Lauderdale, FL

Leonard L. Abess, 2012
Chief Executive Officer, City National Bank of Florida, Miami, FL

Appointed by the Board of Governors

Gay Rebel Thompson, 2010
President and Chief Executive Officer, Cement Industries, Inc., Fort Myers, FL

W. Cody Estes Sr., 2011
President and Owner, Estes Citrus, Inc., Vero Beach, FL

Eduardo J. Padrón, 2012
President, Miami Dade College, Miami, FL

Nashville Branch

Appointed by the Federal Reserve Bank

Paul G. Willson, 2010
Chairman and Chief Executive Officer, Citizens National Bank, Athens, TN

Dan W. Hogan, 2011
President and Chief Executive Officer, Fifth Third Bank, Tennessee, Nashville, TN

Cordia W. Harrington, 2012
President and Chief Executive Officer, Tennessee Bun Company, Nashville, TN

Jennifer S. Banner, 2012
Chief Executive Officer, Schaad Companies, LLC, Knoxville, TN

Appointed by the Board of Governors

Debra K. London, 2010
Retired President and Chief Executive Officer, Mercy Health Partners, Knoxville, TN

Richard Q. Ford, 2011
President, Hylant Group of Nashville, Nashville, TN

William J. Krueger, 2012
Senior Vice President–The Americas, Manufacturing, Purchasing, Supply Chain Management and Total Customer Satisfaction, Nissan North America, Inc., Franklin, TN

New Orleans Branch

Appointed by the Federal Reserve Bank

Gerard R. Host, 2010
President and Chief Operating Officer, Trustmark National Bank, Jackson, MS

R. King Milling, 2011
Member, Board of Directors, Whitney Holding Corporation and Whitney National Bank, New Orleans, LA

Matthew G. Stuller Sr., 2012
Chairman and Chief Executive Officer, Stuller, Inc., Lafayette, LA

Anthony J. Topazi, 2012
Executive Vice President and Chief Operating Officer, Southern Company, Birmingham, AL

Appointed by the Board of Governors

Christel C. Slaughter, 2010
Partner, SSA Consultants, LLC, Baton Rouge, LA

José S. Suquet, 2011
Chairman, President, and Chief Executive Officer, Pan-American Life Insurance Group, New Orleans, LA

Robert S. Boh, 2012
President and Chief Executive Officer, Boh Bros. Construction Co., LLC, New Orleans, LA

District 7–Chicago

Class A

Mark C. Hewitt, 2010
President and Chief Executive Officer, Clear Lake Bank & Trust Company, Clear Lake, IA

Frederick H. Waddell, 2011
Chairman, President, and Chief Executive Officer, Northern Trust Corporation and The Northern Trust Company, Chicago, IL

Stephen J. Goodenow, 2012
President and Chief Executive Officer, Bank Midwest, Spirit Lake, IA

Class B

Ann D. Murtlow, 2010
President and Chief Executive Officer, Indianapolis Power & Light Company, Indianapolis, IN

Vacancy, 2011

Terry Mazany, 2012
President and Chief Executive Officer, The Chicago Community Trust, Chicago, IL

Class C

Thomas J. Wilson, 2010
Chairman, President, and Chief Executive Officer, The Allstate Corporation, Northbrook, IL

Jeffrey A. Joerres, 2011
Chairman and Chief Executive Officer, Manpower Inc., Milwaukee, WI

William C. Foote, 2012
Chairman and Chief Executive Officer, USG Corporation, Chicago, IL

Detroit Branch

Appointed by the Federal Reserve Bank

Michael M. Magee Jr., 2010
President and Chief Executive Officer, Independent Bank Corporation, Ionia, MI

Mark T. Gaffney, 2011
President, Michigan AFL-CIO, Lansing, MI

Brian C. Walker, 2011
President and Chief Executive Officer, Herman Miller, Inc., Zeeland, MI

Sheilah P. Clay, 2012
President and Chief Executive Officer, Neighborhood Service Organization, Detroit, MI

Appointed by the Board of Governors

Carl T. Camden, 2010
President and Chief Executive Officer, Kelly Services, Inc., Troy, MI

Timothy M. Manganello, 2011
Chairman and Chief Executive Officer, BorgWarner Inc., Auburn Hills, MI

Lou Anna K. Simon, 2012
President, Michigan State University, East Lansing, MI

District 8–St. Louis

Class A

Robert G. Jones, 2010
President and Chief Executive Officer, Old National Bancorp, Evansville, IN

J. Thomas May, 2011
Chairman and Chief Executive Officer, Simmons First National Corporation, Pine Bluff, AR

William E. Chappell, 2012
President and Chief Executive Officer, The First National Bank, Vandalia, IL

Class B

Paul T. Combs, 2010
President, Baker Implement Company, Kennett, MO

Gregory M. Duckett, 2011
Senior Vice President and Corporate Counsel, Baptist Memorial Health Care Corporation, Memphis, TN

Sonja Yates Hubbard, 2012
Chief Executive Officer, E-Z Mart Stores, Inc., Texarkana, TX

Class C

Sharon D. Fiehler, 2010
Executive Vice President and Chief Administrative Officer, Peabody Energy, St. Louis, MO

Ward M. Klein, 2011
Chief Executive Officer, Energizer Holdings, Inc., St. Louis, MO

Steven H. Lipstein, 2012
President and Chief Executive Officer, BJC HealthCare, St. Louis, MO

Little Rock Branch

Appointed by the Federal Reserve Bank

Sharon Priest, 2010
Executive Director, Downtown Little Rock Partnership, Little Rock, AR

Phillip N. Baldwin, 2011
President and Chief Executive Officer, Southern Bancorp, Arkadelphia, AR

Robert A. Young III, 2011
Chairman, Arkansas Best Corporation, Fort Smith, AR

William C. Scholl, 2012
President, First Security Bancorp, Searcy, AR

Appointed by the Board of Governors

Kaleybra Mitchell Morehead, 2010,
Vice President for College Affairs/Advancement, Southeast Arkansas College, Pine Bluff, AR

Cal McCastlain, 2011
Partner, Dover Dixon Horne PLLC, Little Rock, AR

C. Sam Walls, 2012
Chief Executive Officer, Arkansas Capital Corporation, Little Rock, AR

Louisville Branch

Appointed by the Federal Reserve Bank

Steven E. Trager, 2010
Chairman and Chief Executive Officer, Republic Bank & Trust Company, Louisville, KY

John C. Schroeder, 2011
President, Wabash Plastics, Inc., Evansville, IN

Kevin Shurn, 2011
President and Owner, Superior Maintenance Co., Elizabethtown, KY

Jon A. Lawson, 2012
President, Chief Executive Officer and Chairman, Bank of Ohio County, Beaver Dam, KY

Appointed by the Board of Governors

Gary A. Ransdell, 2010
President, Western Kentucky University, Bowling Green, KY

John A. Hillerich IV, 2011
President and Chief Executive Officer, Hillerich & Bradsby Co., Inc., Louisville, KY

Barbara Ann Popp, 2012
Chief Executive Officer, Schuler Bauer Real Estate Services, New Albany, IN

Memphis Branch

Appointed by the Federal Reserve Bank

Thomas G. Miller, 2010
President, Southern Hardware Co., Inc., West Helena, AR

Clyde Warren Nunn, 2011
Chairman and President, Security Bancorp of Tennessee, Inc., Halls, TN

Susan S. Stephenson, 2011
Co-Chairman and President, Independent Bank, Memphis, TN

Allegra C. Brigham, 2012
Interim President, Mississippi University for Women, Columbus, MS

Appointed by the Board of Governors

Charles S. Blatteis, 2010
Managing Member/President, Blatteis & Associates, PLLC, Memphis, TN

Lawrence C. Long, 2011
Partner, St. Rest Planting Co., Indianola, MS

Vacancy, 2012

District 9–Minneapolis

Class A

James A. Espeland, 2010
President and Chief Executive Officer, First National Bank, Henning, MN

Michael J. O'Meara, 2011
Chairman, Peoples Bank of Wisconsin, Eau Claire, WI

Richard L. Westra, 2012
President and Chief Executive Officer, Dacotah Banks, Inc., Aberdeen, SD

Class B

Todd L. Johnson, 2010
Chairman, President, and Chief Executive Officer, Reuben Johnson & Son, Inc. & Affiliated Companies, Superior, WI

Howard A. Dahl, 2011
President and Chief Executive Officer, Amity Technology, LLC, Fargo, ND

William J. Shorma, 2012
President, Shur-Co., Yankton, SD

Class C

Mary K. Brainerd, 2010
President and Chief Executive Officer, HealthPartners, Minneapolis, MN

John W. Marvin, 2011
Chairman and Chief Executive Officer, Marvin Windows and Doors, Warroad, MN

Randall J. Hogan, 2012
Chairman and Chief Executive Officer, Pentair, Incorporated, Minneapolis, MN

Helena Branch

Appointed by the Federal Reserve Bank

Vacancy, 2010

John L. Franklin, 2011
President and Chief Executive Officer, 1st Bank, Sidney, MT

Timothy J. Bartz, 2012
Chief Executive Officer, Anderson ZurMuehlen & Company, P.C., Helena, MT

Appointed by the Board of Governors

David B. Solberg, 2011
Owner, Seven Blackfoot Ranch Company, Billings, MT

Joseph F. McDonald, 2012
President Emeritus, Salish Kootenai College, Pablo, MT

District 10–Kansas City

Class A

Robert C. Fricke, 2010
President and Chief Executive Officer, Farmers and Merchants Bank of Ashland, Ashland, NE

John A. Ikard, 2011
President and Chief Executive Officer, FirstBank Holding Company, Lakewood, CO

David W. Brownback, 2012
President and Chief Executive Officer, Citizens State Bank & Trust Company, Ellsworth, KS

Class B

Mark Gordon, 2010
Owner, Merlin Ranch, Buffalo, WY

Richard K. Ratcliffe, 2011
Chairman, Ratcliffe's Inc., Weatherford, OK

John T. Stout Jr., 2012
Chief Executive Officer, Plaza Belmont Management Group LLC, Shawnee Mission, KS

Class C

Terry L. Moore, 2010
President, Omaha Federation of Labor, AFL-CIO, Omaha, NE

Lu M. Córdova, 2011
Chief Executive Officer, Corlund Industries; *President and General Manager*, Almacen Storage Group, Boulder, CO

Paul DeBruce, 2012
Chief Executive Officer and Founder, DeBruce Grain, Inc., Kansas City, MO

Denver Branch

Appointed by the Federal Reserve Bank

Mark A. Zaback, 2010
President and Chief Executive Officer, Jonah Bank of Wyoming, Casper, WY

Bruce K. Alexander, 2011
President and Chief Executive Officer, Vectra Bank Colorado, Denver, CO

Charles H. Brown III, 2012
President, C.H. Brown Co., Wheatland, WY

Anne Haines Yatskowitz, 2012
President and Chief Executive Officer, ACCION New Mexico–Arizona–Colorado, Albuquerque, NM

Appointed by the Board of Governors

Margaret M. Kelly, 2010
Chief Executive Officer, RE/MAX International Inc., Denver, CO

Larissa L. Herda, 2011
Chairman, Chief Executive Officer, and President, tw telecom inc., Littleton, CO

Barbara Mowry, 2012
Senior Vice President, Oracle, Broomfield, CO

Oklahoma City Branch

Appointed by the Federal Reserve Bank

Jacqueline R. Fiegel, 2010
Senior Executive Vice President and Chief Operating Officer, Coppermark Bank, Oklahoma City, OK

Douglas E. Tippens, 2010
President and Chief Executive Officer, Bank of Commerce, Yukon, OK

K. Vasudevan, 2011
Chairman and Founder, Service & Technology Corporation, Bartlesville, OK

Rose Washington Rentie, 2012
Executive Director, TEDC CreativeCapital, Tulsa, OK

Appointed by the Board of Governors

Steven C. Agee, 2010
Professor of Economics and Director, Economic Research and Policy Institute, Meinders School of Business Oklahoma City University, Oklahoma City, OK

James D. Dunn, 2011
Chairman, MillCreek Lumber & Supply Company, Tulsa, OK

Bill Anoatubby, 2012
Governor, Chickasaw Nation, Ada, OK

Omaha Branch

Appointed by the Federal Reserve Bank

JoAnn M. Martin, 2010
Chairman, President, and Chief Executive Officer, Ameritas Life Insurance Corp., Lincoln, NE

Mark A. Sutko, 2011
President and Chief Executive Officer, Platte Valley State Bank, Kearney, NE

Todd S. Adams, 2012
Chief Executive Officer, Adams Bank & Trust, Ogallala, NE

James L. Thom, 2012
Vice President, T-L Irrigation Co., Hastings, NE

Appointed by the Board of Governors

Lyn Wallin Ziegenbein, 2010
Executive Director, Peter Kiewit Foundation, Omaha, NE

James C. Farrell, 2011
President and Chief Executive Officer, Farmers National Company, Omaha, NE

G. Richard Russell, 2012
President and Chief Executive Officer, Millard Lumber Inc., Omaha, NE

District 11–Dallas

Class A

Joe Kim King, 2010
Chief Executive Officer and Chairman of the Board, Texas Country Bancshares, Inc., Brady, TX

George F. Jones Jr., 2011
Chief Executive Officer Texas Capital Bank, Dallas, TX

Pete Cook, 2012
Chief Executive Officer, First National Bank in Alamogordo, Alamogordo, NM

Class B

Robert A. Estrada, 2010
Chairman, Estrada Hinojosa & Company, Inc., Dallas, TX

James B. Bexley, 2011
Professor, Finance, Sam Houston State University, Huntsville, TX

Margaret H. Jordan, 2012
President and Chief Executive Officer, Dallas Medical Resource, Dallas, TX

Class C

Herbert D. Kelleher, 2010
Founder and Chairman Emeritus, Southwest Airlines, Dallas, TX

James T. Hackett, 2011
Chairman, President, and Chief Executive Officer, Anadarko Petroleum Corporation, Houston, TX

Myron E. Ullman III, 2012
Chief Executive Officer and Chairman of the Board, J.C. Penney Company, Inc., Plano, TX

El Paso Branch

Appointed by the Federal Reserve Bank

Larry L. Patton, 2010
President and Chief Executive Officer, Bank of the West, El Paso, TX

Laura M. Conniff, 2011
Qualifying Broker, Mathers Realty, Inc., Las Cruces, NM

Martha I. Dickason, 2011
President, dmDickason Personnel Services, El Paso, TX

Vacancy, 2012

Appointed by the Board of Governors

Cindy J. Ramos-Davidson, 2010
President and Chief Executive Officer, El Paso Hispanic Chamber of Commerce, El Paso, TX

Robert E. McKnight Jr., 2011
Owner, McKnight Ranch Company, Fort Davis, TX

D. Kirk Edwards, 2012
President, MacLondon Royalty Company, Odessa, TX

Houston Branch

Appointed by the Federal Reserve Bank

Jodie L. Jiles, 2010
Managing Director, RBC Capital Markets, Houston, TX

Kirk S. Hachigian, 2011
Chairman and Chief Executive Officer, Cooper Industries, Ltd., Houston, TX

Ann B. Stern, 2011
Executive Vice President, Texas Children's Hospital, Houston, TX

Paul B. Murphy Jr., 2012
President and Chief Executive Officer, Community Bancorp LLC, Houston, TX

Appointed by the Board of Governors

Douglas L. Foshee, 2010
President and Chief Executive Officer, El Paso Corporation, Houston, TX

Paul W. Hobby, 2011
Chairman and Chief Executive Officer, Alpheus Communications, Houston, TX

Jorge A. Bermudez, 2012
President and Chief Executive Officer, Byebrook Group, College Station, TX

San Antonio Branch

Appointed by the Federal Reserve Bank

GP Singh, 2010
Chief Executive Officer, Gur Parsaad Properties, Ltd., San Antonio, TX

Ygnacio D. Garza, 2011
CPA, Long Chilton LLP, Brownsville, TX

Guillermo F. Trevino, 2011
President, Southern Distributing, Laredo, TX

Thomas E. Dobson, 2012
Chairman and Chief Executive Officer, Whataburger Restaurants, LP, San Antonio, TX

Appointed by the Board of Governors

Ricardo Romo, 2010
President, The University of Texas at San Antonio, San Antonio, TX

Steven R. Vandegrift, 2011
Founder and President, SRV Holdings, Austin, TX

Catherine M. Burzik, 2012
President and Chief Executive Officer, Kinetic Concepts, Inc., San Antonio, TX

District 12–San Francisco

Class A

Arnold T. Grisham, 2010
Director, Alta Alliance Bank, Oakland, CA

Dann H. Bowman, 2011
President and Chief Executive Officer, Chino Commercial Bank, N.A., Chino, CA

Kenneth P. Wilcox, 2012
Chief Executive Officer, SVB Financial Group, Santa Clara, CA

Class B

William D. Jones, 2010
President and Chief Executive Officer, CityLink Investment Corporation, San Diego, CA

Karla S. Chambers, 2011
Vice President and Co-Owner, Stahlbush Island Farms, Inc., Corvallis, OR

Blake W. Nordstrom, 2012
President, Nordstrom, Inc., Seattle, WA

Class C

Patricia E. Yarrington, 2010
Vice President and Chief Financial Officer, Chevron Corporation, San Ramon, CA

Douglas W. Shorenstein, 2011
Chairman and Chief Executive Officer, Shorenstein Properties LLC, San Francisco, CA

T. Gary Rogers, 2012
Former Chairman of the Board, Levi Strauss & Co., San Francisco, CA

Los Angeles Branch

Appointed by the Federal Reserve Bank

Dominic Ng, 2010
Chairman and Chief Executive Officer, East West Bank, Pasadena, CA

Keith E. Smith, 2011
President and Chief Executive Officer, Boyd Gaming Corporation, Las Vegas, NV

James L. Sanford, 2012
Consultant, Northrop Grumman Corporation, Los Angeles, CA

Vacancy, 2012

Appointed by the Board of Governors

Grace Evans Cherashore, 2010
President and Chief Executive Officer, Evans Hotels, San Diego, CA

Ann E. Sewill, 2011
President, Community Foundation Land Trust, California Community Foundation, Los Angeles, CA

Andrew J. Sale, 2012
Partner, Retail, Consumer Products and Media & Entertainment Leader–West Region, Ernst & Young LLP, Los Angeles, CA

Portland Branch

Appointed by the Federal Reserve Bank

Roger W. Hinshaw, 2010
President, Oregon and SW Washington, Bank of America Oregon, N.A., Portland, OR

Peggy Y. Fowler, 2011
Retired Chief Executive Officer and President, Portland General Electric, Portland, OR

Vacancy, 2011

Megan F. Clubb, 2012
President and Chief Executive Officer, Baker Boyer National Bank, Walla Walla, WA

Appointed by the Board of Governors

James H. Rudd, 2010
Chief Executive Officer and Principal, Ferguson Wellman Capital Management, Inc., Portland, OR

Roderick C. Wendt, 2011
President and Chief Executive Officer, JELD-WEN, Inc., Klamath Falls, OR

David Y. Chen, 2012
Managing Director, Equilibrium Capital Group LLC, Portland, OR

Salt Lake City Branch

Appointed by the Federal Reserve Bank

Michael M. Mooney, 2010
President, Idaho Region, Bank of the Cascades, Boise, ID

Annette Harder, 2011
President, Herman Consulting, LLC, Park City, UT

Robert A. Hatch, 2011
President, Regence BlueCross BlueShield of Utah, Salt Lake City, UT

Carol Carter, 2012
President and Chief Executive Officer, Industrial Compressor Products, Inc., Park City, UT

Appointed by the Board of Governors

Scott L. Hymas, 2010
Chief Executive Officer, RC Willey, Salt Lake City, UT

Clark D. Ivory, 2011
Chief Executive Officer, Ivory Homes, Ltd., Salt Lake City, UT

Edwin E. Dahlberg, 2012
Retired President and Chief Executive Officer, St. Luke's Health System, Boise, ID

Seattle Branch

Appointed by the Federal Reserve Bank

Richard Galanti, 2010
Executive Vice President and Chief Financial Officer, Costco Wholesale Corporation, Issaquah, WA

Vacancy, 2011

Patrick G. Yalung, 2011
Regional President, Washington, Wells Fargo Bank, N.A., Seattle, WA

Henry L. (Skip) Kotkins Jr., 2012
Chairman and Chief Executive Officer, Skyway Luggage Company, Seattle, WA

Appointed by the Board of Governors

William S. Ayer, 2010
Chairman, President, and Chief Executive Officer, Alaska Air Group, Seattle, WA

Ada M. Healey, 2011
Vice President, Real Estate, Vulcan Inc., Seattle, WA

Mary O. McWilliams, 2012
Executive Director, Puget Sound Health Alliance, Seattle, WA

Reserve Bank and Branch Officers

As mentioned, each Federal Reserve Bank and its branches has a board of directors. The officers of each Bank and Branch are drawn from this pool of directors. Specifically, two directors of each Reserve Bank are designated by the Board of Governors as chair[3] and deputy chair, respectively, of their nine-member board. Each Reserve Bank also has a president and first vice president, who are appointed by the board of directors of the Bank, subject to approval by the Board of Governors. Additionally, each District Branch also has a chair, who is selected from among those Branch directors appointed by the Board of Governors.

Boston

Henri A. Termeer, *Chair*

Kirk A. Sykes, *Deputy Chair*

Eric S. Rosengren, *President*

Paul M. Connolly, *First Vice President*

Additional office at Windsor Locks, CT

New York

Denis M. Hughes, *Chair*

Lee C. Bollinger, *Deputy Chair*

William C. Dudley, *President*

Christine M. Cumming, *First Vice President*

Additional office at East Rutherford, NJ

Philadelphia

Charles P. Pizzi, *Chair*

Jeremy Nowak, *Deputy Chair*

Charles I. Plosser, *President*

William H. Stone Jr., *First Vice President*

Cleveland

Alfred M. Rankin Jr., *Chair*

Richard K. Smucker, *Deputy Chair*

Sandra Pianalto, *President*

Dale Roskom, *First Vice President*

Cincinnati

James M. Anderson, *Chair*

LaVaughn M. Henry, *Officer in Charge*

Pittsburgh

Sunil T. Wadhwani, *Chair*

Robert B. Schaub, *Officer in Charge*

Richmond

Lemuel E. Lewis, *Chair*

Margaret E. McDermid, *Deputy Chair*

Jeffrey M. Lacker, *President*

Sarah G. Green, *First Vice President*

Baltimore

William R. Roberts, *Chair*

David E. Beck, *Officer in Charge*

Charlotte

Claude C. Lilly, *Chair*

Matthew A. Martin, *Officer in Charge*

Atlanta

Carol B. Tomé, *Chair*

Thomas I. Barkin, *Deputy Chair*

Dennis P. Lockhart, *President*

Patrick K. Barron, *First Vice President*

Birmingham

Maryam B. Head, *Chair*

Julius Weyman, *Officer in Charge*

Jacksonville

H. Britt Landrum Jr., *Chair*

Christopher L. Oakley, *Officer in Charge*

Miami

Gay Rebel Thompson, *Chair*

Juan del Busto, *Officer in Charge*

Nashville

Debra K. London, *Chair*

Lee C. Jones, *Officer in Charge*

New Orleans

Christel C. Slaughter, *Chair*

Robert J. Musso, *Officer in Charge*

Chicago

William C. Foote, *Chair*

Thomas J. Wilson, *Deputy Chair*

Charles L. Evans, *President*

Gordon Werkema, *First Vice President*

Additional office at DesMoines, IA and at Midway at Bedford Park, IL

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[3] The chair of a Federal Reserve Bank serves, by statute, as Federal Reserve agent.

Detroit

Timothy M. Manganello, *Chair*

Robert Wiley, *Officer in Charge*

St. Louis

Steven H. Lipstein, *Chair*

Ward M. Klein, *Deputy Chair*

James Bullard, *President*

David A. Sapenaro, *First Vice President*

Little Rock

C. Sam Walls, *Chair*

Robert A. Hopkins, *Officer in Charge*

Louisville

Gary A. Ransdell, *Chair*

Maria Gerwing Hampton, *Officer in Charge*

Memphis

Lawrence C. Long, *Chair*

Martha Perine Beard, *Officer in Charge*

Minneapolis

John W. Marvin, *Chair*

Mary K. Brainerd, *Deputy Chair*

Narayana R. Kocherlakota, *President*

James M. Lyon, *First Vice President*

Helena

David B. Solberg, *Chair*

R. Paul Drake, *Officer in Charge*

Kansas City

Lu M. Córdova , *Chair*

Paul DeBruce, *Deputy Chair*

Thomas M. Hoenig, *President*

Esther L. George, *First Vice President*

Denver

Barbara Mowry, *Chair*

Mark C. Snead, *Officer in Charge*

Oklahoma City

Steven C. Agee, *Chair*

Chad R. Wilkerson, *Officer in Charge*

Omaha

Lyn Wallin Ziegenbein, *Chair*

Jason R. Henderson, *Officer in Charge*

Dallas

James T. Hackett, *Chair*

Herbert D. Kelleher, *Deputy Chair*

Richard W. Fisher, *President*

Helen E. Holcomb, *First Vice President*

El Paso

D. Kirk Edwards, *Chair*

Robert W. Gilmer, *Officer in Charge*

Houston

Douglas L. Foshee, *Chair*

Robert Smith III, *Officer in Charge*

San Antonio

Steven R. Vandegrift, *Chair*

Blake Hastings, *Officer in Charge*

San Francisco

T. Gary Rogers, *Chair*

Douglas W. Shorenstein, *Deputy Chair*

Vacant, *President*

John F. Moore, *First Vice President*

Additional office at Phoenix, AZ

Los Angeles

Grace Evans Cherashore, *Chair*

Mark L. Mullinix, *Officer in Charge*

Portland

James H. Rudd, *Chair*

Steven H. Walker, *Officer in Charge*

Salt Lake City

Scott L. Hymas, *Chair*

Robin A. Rockwood, *Officer in Charge*

Seattle

Wiliam S. Ayer, *Chair*

Mark A. Gould, *Officer in Charge*

Officer Conferences

A number of the officers of each Bank also serve on councils that examine issues of importance to their districts.

Conference of Chairs

The chairs of the Federal Reserve Banks are organized into the Conference of Chairs, which meets to consider matters of common interest and to consult with and advise the Board of Governors. Such meetings, also attended by the deputy chairs, were held in Washington, D.C., on May 18 and 19 and November 16 and 17, 2010. The conference's executive committee members for 2010 and 2011 are listed below.

Conference of Chairs Executive Committee–2010

Lemuel E. Lewis, *Chair*,
Federal Reserve Bank of Richmond

Charles P. Pizzi, *Vice Chair*,
Federal Reserve Bank of Philadelphia

Alfred M. Rankin Jr., *Member*,
Federal Reserve Bank of Cleveland

Conference of Chairs Executive Committee–2011

Charles P. Pizzi, *Chair*,
Federal Reserve Bank of Philadelphia

Alfred M. Rankin Jr., *Vice Chair*,
Federal Reserve Bank of Cleveland

Herbert D. Kelleher, *Member*,
Federal Reserve Bank of Dallas

Conference of Presidents

The presidents of the Federal Reserve Banks are organized into the Conference of Presidents, which meets periodically to identify, define, and deliberate issues of strategic significance to the Federal Reserve System; to consider matters of common interest; and to consult with and advise the Board of Governors. Conference officers for 2010 are listed below.[4]

Conference of Presidents–2010

Jeffrey M. Lacker, *Chair*,
Federal Reserve Bank of Richmond

Richard W. Fisher, *Vice Chair*,
Federal Reserve Bank of Dallas

Sandra Tormoen, *Secretary*,
Federal Reserve Bank of Richmond

Harvey R. Mitchell, *Assistant Secretary,*
Federal Reserve Bank of Dallas

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[4] On October 5, 2010, the conference elected Richard W. Fisher as chair for 2011–12 and Charles I. Plosser, president of the Federal Reserve Bank of Philadelphia, as vice chair. The conference also elected Harvey R. Mitchell as secretary for 2011–12 and Frank J. Doto, Federal Reserve Bank of Philadelphia, as assistant secretary.

Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet periodically for the consideration of operations and other matters. Conference officers for 2010 are listed below.

Conference of First Vice Presidents–2010

Sally Green, *Chair,*
Federal Reserve Bank of
Richmond

Esther L. George, *Vice Chair,*
Federal Reserve Bank of
Kansas City

Anne C. Gossweiler, *Secretary,*
Federal Reserve Bank of
Richmond

W. Todd Mackey, *Assistant Secretary,*
Federal Reserve Bank of
Kansas City

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