



Federal Reserve Banks Combined Financial Statements

As of and for the Years Ended
December 31, 2019 and 2018 and
Independent Auditors' Report

Federal Reserve Banks

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Independent Auditors' Report

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, 2019 and 2018, and the related combined statements of operations and changes in capital for the years then ended. These combined financial statements are the responsibility of the Division of Reserve Bank Operations and Payment Systems' management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 3 to the combined financial statements, the Division of Reserve Bank Operations and Payment Systems has prepared these combined financial statements in conformity with the accounting principles established by the Board of Governors of the Federal Reserve System (the "Board"), as set forth in the *Financial Accounting Manual for Federal Reserve Banks*, which is a basis of accounting other than U.S. generally accepted accounting principles.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Reserve Banks as of December 31, 2019 and 2018, and the results of its operations for the years then ended, on the basis of accounting described in Note 3.

KPMG LLP

Washington, DC
March 6, 2020

Federal Reserve Banks

Abbreviations

| | |
|---------------|--|
| ACH | Automated clearinghouse |
| ASC | Accounting Standards Codification |
| ASU | Accounting Standards Update |
| BEP | Benefit Equalization Retirement Plan |
| Bureau | Bureau of Consumer Financial Protection |
| CIP | Committee on Investment Performance (related to System Retirement Plan) |
| DFMU | Designated financial market utility |
| FAM | <i>Financial Accounting Manual for Federal Reserve Banks</i> |
| FASB | Financial Accounting Standards Board |
| FOMC | Federal Open Market Committee |
| FRBNY | Federal Reserve Bank of New York |
| GAAP | Accounting principles generally accepted in the United States of America |
| GSE | Government-sponsored enterprise |
| IMF | International Monetary Fund |
| JPMC | JPMorgan Chase & Co. |
| LLC | Limited liability company |
| MBS | Mortgage-backed securities |
| ML | Maiden Lane LLC |
| OEB | Office of Employee Benefits of the Federal Reserve System |
| SDR | Special drawing rights |
| SERP | Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks |
| SOMA | System Open Market Account |
| STRIPS | Separate Trading of Registered Interest and Principal of Securities |
| TBA | To be announced |
| TDF | Term Deposit Facility |
| TIPS | Treasury Inflation-Protected Securities |
| VIE | Variable interest entity |

Federal Reserve Banks

Combined Statements of Condition

As of December 31, 2019 and December 31, 2018

(in millions)

| | 2019 | 2018 |
|---|---------------------|---------------------|
| <u>ASSETS</u> | | |
| Gold certificates | \$ 11,037 | \$ 11,037 |
| Special drawing rights certificates | 5,200 | 5,200 |
| Coin | 1,657 | 1,726 |
| Loans | 42 | 61 |
| System Open Market Account: | | |
| Securities purchased under agreements to resell | 255,619 | - |
| Treasury securities, net (of which \$41,602 and \$25,102 is lent as of December 31, 2019 and 2018, respectively) | 2,401,604 | 2,302,462 |
| Government-sponsored enterprise debt securities, net (of which \$0 is lent as of December 31, 2019 and 2018) | 2,657 | 2,741 |
| Federal agency and government-sponsored enterprise mortgage-backed securities, net | 1,446,989 | 1,683,532 |
| Foreign currency denominated investments, net | 20,711 | 20,906 |
| Central bank liquidity swaps | 3,728 | 4,207 |
| Accrued interest receivable | 20,746 | 22,236 |
| Bank premises and equipment, net | 2,544 | 2,553 |
| Items in process of collection | 82 | 236 |
| Other assets | 1,025 | 983 |
| Total assets | <u>\$ 4,173,641</u> | <u>\$ 4,057,880</u> |
| <u>LIABILITIES AND CAPITAL</u> | | |
| Federal Reserve notes outstanding, net | \$ 1,759,427 | \$ 1,671,437 |
| System Open Market Account: | | |
| Securities sold under agreements to repurchase | 336,649 | 304,012 |
| Other liabilities | 129 | 34 |
| Deposits: | | |
| Depository institutions | 1,548,849 | 1,555,954 |
| Treasury, general account | 403,853 | 402,138 |
| Other deposits | 79,256 | 78,317 |
| Interest payable to depository institutions and others | 954 | 1,381 |
| Accrued benefit costs | 2,862 | 2,558 |
| Deferred credit items | 725 | 1,006 |
| Accrued remittances to the Treasury | 2,114 | 1,597 |
| Other liabilities | 300 | 286 |
| Total liabilities | <u>4,135,118</u> | <u>4,018,720</u> |
| Capital paid-in | 31,698 | 32,335 |
| Surplus (including accumulated other comprehensive loss of \$3,143 and \$3,292 at December 31, 2019 and 2018, respectively) | 6,825 | 6,825 |
| Total capital | <u>38,523</u> | <u>39,160</u> |
| Total liabilities and capital | <u>\$ 4,173,641</u> | <u>\$ 4,057,880</u> |

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

Federal Reserve Banks

Combined Statements of Operations

For the years ended December 31, 2019 and December 31, 2018

(in millions)

| | | 2019 | 2018 |
|---|------------|----------------|-------------------|
| <u>INTEREST INCOME</u> | | | |
| Loans | Note 4 | \$ 1 | \$ 3 |
| System Open Market Account: | Note 5 | | |
| Securities purchased under agreements to resell | | 971 | - |
| Treasury securities, net | | 58,532 | 62,807 |
| Government-sponsored enterprise debt securities, net | | 137 | 175 |
| Federal agency and government-sponsored enterprise mortgage-backed securities, net | | 43,124 | 49,289 |
| Foreign currency denominated investments, net | | (33) | (29) |
| Central bank liquidity swaps | | 6 | 15 |
| Total interest income | | <u>102,738</u> | <u>112,260</u> |
| <u>INTEREST EXPENSE</u> | | | |
| System Open Market Account: | Note 5 | | |
| Securities sold under agreements to repurchase | | 6,012 | 4,559 |
| Other | | 1 | 4 |
| Deposits: | | | |
| Depository institutions and others | | 34,937 | 38,484 |
| Term Deposit Facility | | 2 | 2 |
| Total interest expense | | <u>40,952</u> | <u>43,049</u> |
| Net interest income | | <u>61,786</u> | <u>69,211</u> |
| <u>OTHER ITEMS OF INCOME (LOSS)</u> | | | |
| System Open Market Account: | Note 5 | | |
| Treasury securities gains, net | | - | 5 |
| Federal agency and government-sponsored enterprise mortgage-backed securities gains (losses), net | | 9 | (3) |
| Foreign currency translation losses, net | | (168) | (390) |
| Other | | 34 | 21 |
| Income from services | | 444 | 443 |
| Reimbursable services to government agencies | | 729 | 706 |
| Other components of net benefit costs | Note 8, 9 | (10) | 110 |
| Other | | 70 | 75 |
| Total other items of-income | | <u>1,108</u> | <u>967</u> |
| <u>OPERATING EXPENSES</u> | | | |
| Salaries and benefits | | 3,453 | 3,223 |
| System pension service cost | Note 8 | 510 | 577 |
| Occupancy | | 347 | 338 |
| Equipment | | 193 | 193 |
| Other | | 763 | 722 |
| Assessments: | | | |
| Board of Governors operating expenses and currency costs | | 1,651 | 1,687 |
| Bureau of Consumer Financial Protection | | 519 | 337 |
| Total operating expenses | | <u>7,436</u> | <u>7,077</u> |
| Net income before providing for remittances to the Treasury | | 55,458 | 63,101 |
| Earnings remittances to the Treasury | Note 3p | 54,893 | 65,319 |
| Net income (loss) after providing for remittances to the Treasury | | <u>565</u> | <u>(2,218)</u> |
| Change in prior service costs related to benefit plans | Notes 8, 9 | 17 | 31 |
| Change in actuarial gains related to benefit plans | Notes 8, 9 | 132 | 11 |
| Total other comprehensive income | | <u>149</u> | <u>42</u> |
| Comprehensive income (loss) | | <u>\$ 714</u> | <u>\$ (2,176)</u> |

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, 2019 and December 31, 2018

(in millions, except share data)

| | Surplus | | | | |
|---|-----------------|---------------------|---|---------------|---------------|
| | Capital paid-in | Net income retained | Accumulated other comprehensive income (loss) | Total surplus | Total capital |
| Balance at December 31, 2017 (627,772,211 shares) | \$ 31,389 | \$ 13,334 | \$ (3,334) | \$ 10,000 | \$ 41,389 |
| Net change in capital stock issued (18,931,796 shares) | 946 | - | - | - | 946 |
| Comprehensive income: | | | | | |
| Net loss | - | (2,218) | - | (2,218) | (2,218) |
| Other comprehensive income | - | - | 42 | 42 | 42 |
| Dividends on capital stock | - | (999) | - | (999) | (999) |
| Net change in capital | 946 | (3,217) | 42 | (3,175) | (2,229) |
| Balance at December 31, 2018 (646,704,007 shares) | \$ 32,335 | \$ 10,117 | \$ (3,292) | \$ 6,825 | \$ 39,160 |
| Net change in capital stock redeemed (12,742,050 shares) | (637) | - | - | - | (637) |
| Comprehensive income: | | | | | |
| Net income | - | 565 | - | 565 | 565 |
| Other comprehensive income | - | - | 149 | 149 | 149 |
| Dividends on capital stock | - | (714) | - | (714) | (714) |
| Net change in capital | (637) | (149) | 149 | - | (637) |
| Balance at December 31, 2019 (633,961,957 shares) | \$ 31,698 | \$ 9,968 | \$ (3,143) | \$ 6,825 | \$ 38,523 |

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

Federal Reserve Banks

Notes to Combined Financial Statements

(1) STRUCTURE

The 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 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 director 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 transfers of funds, automated clearinghouse (ACH) operations, and check collection; distributing coin and currency; performing fiscal agency functions for the U.S. Department of the Treasury (Treasury), certain federal agencies, and other entities; serving as the federal government's bank; providing short-term loans to depository institutions; providing loans to participants in programs or facilities with broad-based eligibility in unusual and exigent circumstances; serving consumers and communities by providing educational materials and information regarding financial consumer protection rights and laws and information on community development programs and activities; and supervising bank holding companies, state member banks, savings and loan holding companies, U.S. offices of foreign banking organizations, Edge and agreement corporations, and certain financial market utilities that have been designated as systemically important. Certain services are provided to foreign official and international account holders, primarily by the FRBNY.

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

To be prepared to meet the needs specified by the FOMC to carry out the System's central bank responsibilities, the FOMC authorized and directed the FRBNY to execute standalone spot and forward foreign exchange

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Notes to Combined Financial Statements

transactions in certain foreign currencies, to hold balances in those currencies, and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY holds these securities and agreements in the SOMA. The FOMC also authorized and directed the FRBNY to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of \$2 billion and \$3 billion, respectively, and at the request of the Treasury to conduct swap transactions with the United States Exchange Stabilization Fund in the maximum amount of \$5 billion, also known as warehousing.

Because of the global character of bank funding markets, the System has, at times, coordinated with other central banks to provide liquidity. The FOMC authorized and directed the FRBNY to maintain standing U.S. dollar liquidity swap arrangements and standing foreign currency liquidity swap arrangements with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank. The FRBNY holds amounts outstanding under these liquidity swap lines in the SOMA. These liquidity swap lines are subject to annual review and approval by the FOMC.

The FOMC has authorized and directed the FRBNY to conduct small-value exercises periodically for the purpose of testing operational readiness.

Although the Reserve Banks are separate legal entities, they collaborate on the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements among 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) SIGNIFICANT ACCOUNTING POLICIES

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

Due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy, the Board has adopted accounting principles and practices in the FAM that differ from accounting principles generally accepted in the United States of America (GAAP). The more significant differences are the presentation of all SOMA securities holdings at amortized cost, adjusted for credit impairment, if any, and the recording of all SOMA securities on a settlement-date basis. Amortized cost, rather than the fair value presentation, more appropriately reflects the financial position associated with the Reserve Banks' securities holdings given the System's unique responsibility to conduct monetary policy. Although the application of fair value measurements to the securities holdings may result in values substantially greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are primarily motivated by monetary policy and financial stability objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities. Accounting for these securities on a settlement-date basis,

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rather than the trade-date basis required by GAAP, better reflects the timing of the transaction's effect on the quantity of reserves in the banking system.

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 Banks' unique powers and responsibilities as a central bank. Other information regarding the Reserve Banks' activities is provided in, or may be derived from, the Combined Statements of Condition, Operations, and Changes in Capital, and the accompanying notes to the combined financial statements. Other than those described above, the accounting policies described in FAM are generally consistent with those in GAAP and the references to GAAP in the notes to the combined financial statements highlight those areas where FAM is consistent with 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 combined financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Certain amounts relating to the prior year have been reclassified in the Combined Statements of Operations to conform to the current year presentation.

In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, \$53 million of postretirement benefit costs previously reported as "Operating expenses: Salaries and benefits" for the year ended December 31, 2018 and (\$163) million of pension benefit costs previously reported as "Operating expenses: Net periodic pension expense" for the year ended December 31, 2018 have been reclassified to a new line titled "Other items of income (loss): Other components of net benefit costs", and \$70 million of net cost related to the Benefit Equalization Retirement Plan (BEP) and the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP) previously reported as "Operating expenses: Net periodic pension expense" for the year ended December 31, 2018 have been reclassified to "Operating expenses: Salaries and benefits." In addition, the description of the line item "Operating expenses: Net periodic pension expense" has been revised to "Operating expenses: System pension service cost" in 2019 to better reflect the nature of the item.

Due to the immaterial nature of the consolidated variable interest entity (VIE) for the year ended December 31, 2019, \$9 million previously reported as "Other items of income (loss): Income from investments held by consolidated variable interest entity, net" for the year ended December 31, 2018 has been reclassified to "Other items of income (loss): Other."

Significant accounts and accounting policies are explained below.

a. Consolidation

The combined financial statements include the accounts and results of operations of the Banks as well as a (VIE), Maiden Lane Limited Liability Company (LLC) (ML). The consolidation of the VIE was assessed in accordance with (FASB) Accounting Standards Codification (ASC) Topic 810 (ASC 810), *Consolidation*, which requires a VIE to be consolidated by its controlling financial interest holder. Intercompany balances and transactions have been eliminated in consolidation. See Note 3h for additional information on the VIE. The combined financial statements of the Reserve Banks also include accounts and results of operations of Maiden & Nassau LLC, a Delaware LLC wholly-owned by the FRBNY, which was formed to own and operate the 33 Maiden Lane building.

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

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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 or if there is an event that requires consideration.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that has supervisory authority over some institutions previously supervised by the Reserve Banks in connection with those institutions' compliance with consumer protection statutes. Section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the System. The Board of Governors funds the Bureau 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 relationship to the Bureau and determined that it should not be consolidated in the Banks' combined financial statements.

b. Gold and Special Drawing Rights Certificates

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks. Upon authorization, the Reserve Banks acquire gold certificates by crediting equivalent amounts in dollars to the account established for the Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold owned by the Treasury. The Treasury may reacquire the gold certificates at any time, and the Reserve Banks must deliver them to the Treasury. At such time, the Treasury's account is charged, and the Reserve Banks' gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at \$42 2/9 per fine troy ounce. Gold certificates are recorded by the Reserve Banks at original cost. The Board of Governors allocates the gold certificates among the Reserve Banks once a year based on each Reserve Bank's average Federal Reserve notes outstanding during the preceding 12 months.

Special drawing rights (SDR) are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange-stabilization operations. At the time SDR certificate transactions occur, the Board of Governors allocates the SDR certificates among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding calendar year. SDR certificates are recorded by the Reserve Banks at original cost.

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.

Loans are impaired when current information and events indicate that it is probable that the Reserve Banks will not receive the principal and interest that are due in accordance with the contractual terms of the loan agreement. Impaired loans are evaluated to determine whether an allowance for loan loss is required. The 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,

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borrowers, and other sources to assess the credit condition of the borrowers and, as appropriate, evaluating collateral values. Generally, the Reserve Banks would discontinue recognizing interest income on impaired loans until the borrower's repayment performance demonstrates principal and interest would be received in accordance with the terms of the loan agreement. If the 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.

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

The FRBNY may engage in purchases of securities under agreements to resell (repurchase agreements) with primary dealers. Transactions under these repurchase agreements are typically settled through a tri-party arrangement, in which a commercial custodial bank manages the collateral clearing, settlement, pricing, and pledging, and provides cash and securities custodial services for and on behalf of the FRBNY and the 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 agreements primarily includes Treasury securities (including Treasury Inflation-Protected Securities (TIPS), Separate Trading of Registered Interest and Principal of Securities (STRIPS), and Treasury Floating Rate Notes); direct obligations of several federal agencies and GSEs, including Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal Home Loan Banks; and pass-through federal agency and GSE MBS. The repurchase agreements are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. These repurchase agreements are reported at their contractual amounts as "System Open Market Account: Securities purchased under agreements to resell" and the related accrued interest receivable is reported as a component of "System Open Market Account: Accrued interest receivable" in the Combined Statements of Condition. Interest income is reported as "System Open Market Account: Securities purchased under agreements to resell" in the Combined Statements of Operations.

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase agreements) with primary dealers and with a set of expanded counterparties that includes banks, savings associations, GSEs, and domestic money market funds. Transactions under these reverse repurchase agreements are designed to have a margin of zero and are settled through a tri-party arrangement, similar to repurchase agreements. Reverse repurchase agreements 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, or federal agency and GSE MBS that are held in the SOMA. Reverse repurchase agreements are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These reverse repurchase agreements 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 "System Open Market Account: Other liabilities" in the Combined Statements of Condition. Interest expense is reported as "System Open Market Account: Securities sold under agreements to repurchase" in the Combined Statements of Operations.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers, typically overnight, to facilitate the effective conduct of open market operations. The amortized cost basis of securities lent continues to be reported as "System Open Market Account: Treasury securities, net" and "System Open Market Account: Government-sponsored enterprise debt securities, net," as appropriate, in the Combined Statements of Condition. Securities lending transactions are fully collateralized by Treasury securities based on the fair values of the securities lent increased by a margin determined by the FRBNY. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other items of income (loss): System Open Market Account: Other" in the Combined Statements of Operations.

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Notes to Combined Financial Statements

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

f. Treasury Securities, Government-Sponsored Enterprise Debt Securities, Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities, and Foreign Currency Denominated Investments

Interest income on Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign currency denominated investments included in the SOMA is recorded when earned and includes inflation compensation on TIPS and amortization of premiums and accretion of discounts using the effective interest method. Interest income on federal agency and GSE MBS also includes gains or losses associated with principal paydowns. Premiums and discounts related to federal agency and GSE MBS are amortized or accreted over the term of the security to stated maturity, and the amortization of premiums and accretion of discounts are accelerated when principal payments are received. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Treasury securities, GSE debt securities, and federal agency and GSE MBS are reported net of premiums and discounts in the Combined Statements of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts in the Combined Statements of Operations.

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell “to be announced” (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. During the years ended December 31, 2019 and 2018, the FRBNY executed dollar rolls to facilitate settlement of outstanding purchases of federal agency and GSE MBS. The FRBNY accounts for dollar rolls as individual purchases and sales, on a settlement-date basis. Accounting for these transactions as purchases and sales, rather than as financing transactions, is appropriate because the purchase or sale component of the MBS TBA dollar roll is paired off or assigned prior to settlement and, as a result, there is no transfer and return of securities. Net gains (losses) resulting from MBS transactions are reported as a component of “Other items of income (loss): System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains (losses), net” in the Combined Statements of Operations.

Foreign currency denominated investments, which can include foreign currency deposits, repurchase agreements, and government debt instruments, are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Any negative interest associated with these foreign currency denominated investments is included as a component of “Interest income: System Open Market Account: Foreign currency denominated investments, net” in the Combined Statements of Operations. Foreign currency translation gains and losses that result from the daily revaluation of foreign currency denominated investments are reported as “Other items of income (loss): System Open Market Account: Foreign currency translation gains (losses), net” in the Combined Statements of Operations.

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

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

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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 FRBNY's monetary policy operations. Foreign currency working balances are reported as a component of "Other assets" in the Combined Statements of Condition and the related foreign currency translation gains and losses that result from the daily revaluation of the foreign currency working balances and contracts are reported as a component of "Other items of income (loss): Other" in the Combined Statements of Operations.

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 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 a percentage basis, adjusted annually in the second quarter of each year, calculated as the ratio of each Reserve Bank's capital and surplus to the Reserve Banks' aggregate capital and surplus at the preceding December 31.

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 "System Open Market Account: Central bank liquidity swaps" in 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 amount outstanding and the rate under the swap agreement. The Reserve Banks recognize compensation received during the term of the swap transaction, which is reported as "Interest income: System Open Market Account: Central bank liquidity swaps" in the Combined Statements of Operations.

Foreign currency liquidity swaps

Foreign currency liquidity swap transactions involve 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 liquidity swap is recorded as a liability in the amount of foreign currency that the FRBNY receives.

h. Consolidated VIE – Investments and Liabilities

To facilitate the merger of The Bear Stearns Companies, Inc. (Bear Stearns) and JPMorgan Chase & Co. (JPMC), the Bank extended credit to ML in June 2008. ML is a Delaware LLC formed by the Bank to acquire certain assets of Bear Stearns and to manage those assets, which largely consisted of federal agency and GSE MBS, non-agency residential mortgage-back securities, commercial and residential mortgage loans, and derivatives and associated hedges and were valued at \$29.9 billion as of March 14, 2008, the date that the Bank committed to the transaction. The Bank 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, both of which were repaid in full plus interest in 2012.

During 2018, the Bank sold all remaining securities from the ML portfolio and in accordance with the ML agreements, net proceeds were distributed to the Bank. On November 1, 2018, ML LLC was dissolved. While its

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affairs are being wound up, ML LLC will retain minimal cash to meet trailing expenses and other obligations as required by law. The costs to wind up ML LLC are not expected to be material.

As of December 31, 2019 and 2018, balances and activity attributable to the consolidated VIE were immaterial.

i. Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from 2 to 50 years. Major alterations, renovations, and improvements are capitalized and 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. Reserve Banks may transfer assets to other Reserve Banks or may lease property of other Reserve Banks.

Costs incurred to acquire software are capitalized based on the purchase price. Costs incurred during the application development stage to develop internal-use software are capitalized based on the cost of direct services and materials associated with designing, coding, installing, and testing the software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which generally range from two to five years. Maintenance costs and minor replacements related to software are charged to operating expense in the year incurred. Leased assets that meet the criteria of FASB ASC Topic 840, *Leases*, are capitalized and amortized over the shorter of the useful life of the asset or the term of the lease.

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

j. Interdistrict Settlement Account

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

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

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 pledged as collateral under reverse repurchase agreements 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

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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 Reserve Banks’ Federal Reserve notes outstanding, reduced by the Reserve Banks’ currency holdings of \$196 billion and \$190 billion at December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, all Federal Reserve notes outstanding, net, were fully collateralized. At December 31, 2019 and 2018, all gold certificates, all SDR certificates, and \$1,743 billion and \$1,655 billion, respectively, of domestic securities held in the SOMA were pledged as collateral. At December 31, 2019 and 2018, no investments denominated in foreign currencies were pledged as collateral.

l. Deposits

Depository Institutions

Depository institutions’ deposits represent the reserve and service-related balances in the accounts that depository institutions hold at the Reserve Banks. Required reserve balances are those that a depository institution must hold to satisfy its reserve requirement. Reserve requirements are the amount of funds that a depository institution must hold in reserve against specified deposit liabilities. Excess reserves are those held by the depository institutions in excess of their required reserve balances. 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 expense on depository institutions’ deposits is accrued daily at the appropriate rate. Interest payable is reported as a component of “Interest payable to depository institutions and others” in 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 expense on deposits held by the Reserve Banks under the TDF is accrued daily at the appropriate rate. Interest payable is reported as a component of “Interest payable to depository institutions and others” in the Combined Statements of Condition. There were no deposits held by the Reserve Banks under the TDF at December 31, 2019 and 2018.

Treasury

The Treasury general account is the primary operational account of the Treasury and is held at the FRBNY.

Other

Other deposits include foreign central bank and foreign government deposits held at the FRBNY. Other deposits also include cash collateral, deposits of designated financial market utilities (DFMUs), and GSE deposits held by the Reserve Banks. The Reserve Banks pay interest on deposits held by DFMUs at the rate paid on balances maintained by depository institutions or another rate determined by the Board of Governors from time to time, not to exceed the general level of short term interest rates. Interest payable is reported as a component of “Interest payable to depository institutions and others” in the Combined Statements of Condition.

m. 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 represent 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.

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n. 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 have 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.

The Federal Reserve Act requires each Reserve Bank to pay each member bank an annual dividend based on the amount of the member bank's paid-in capital stock and a rate determined by the member bank's total consolidated assets. Member banks with total consolidated assets in excess of a threshold established in the Federal Reserve Act receive a dividend equal to the smaller of 6 percent or the rate equal to the high yield of the 10-year Treasury note auctioned at the last auction held prior to the payment of the dividend. Member banks with total consolidated assets equal to or less than the threshold receive a dividend of 6 percent. The threshold for total consolidated assets was \$10.5 billion and \$10.2 billion for the years ended December 31, 2019 and 2018, respectively. This threshold is adjusted annually based on the Gross Domestic Product Price Index, which is published by the Bureau of Economic Analysis. The dividend is paid semiannually and is cumulative.

o. Surplus

The Federal Reserve Act limits aggregate Reserve Bank surplus. Effective February 9, 2018, the Bipartisan Budget Act of 2018 (Budget Act) reduced the statutory limit on aggregate Reserve Bank surplus from \$10 billion to \$7.5 billion. Effective May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (Economic Growth Act), further reduced the statutory limit on aggregate Reserve Bank surplus from \$7.5 billion to \$6.825 billion. Reserve Bank surplus is allocated among the Reserve Banks based on the ratio of each Reserve Bank's capital paid-in to total Reserve Bank capital paid-in as of December 31 of each year. The amount reported as surplus by the Bank as of December 31, 2019 and 2018 represents the Bank's allocated portion of surplus.

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 8, 9, and 10.

p. Earnings Remittances to the Treasury

The Federal Reserve Act requires that any amounts of the surplus funds of the Reserve Banks that exceed, or would exceed, the aggregate surplus limitation shall be transferred to the Board of Governors for transfer to the Treasury. Reserve Banks remit excess earnings to the Treasury after providing for the cost of operations, payment of dividends, and reservation of an amount necessary to maintain surplus at a surplus limitation. Remittances to the Treasury are made on a weekly basis. The amount of the remittances to the Treasury is reported as "Earnings remittances to the Treasury" in the Combined Statements of Operations. The amount due to the Treasury is reported as "Accrued remittances to the Treasury" in the Combined Statements of Condition. See Note 11 for additional information on earnings remittances to the Treasury.

If earnings during the year are not sufficient to provide for the costs of operations, payment of dividends, and maintaining surplus at an amount equal to a Reserve Bank's allocated portion of the aggregate surplus limitation, remittances to the Treasury are suspended. This decrease in earnings remittances to the Treasury results in a deferred asset that represents the amount of net earnings a Reserve Bank will need to realize before remittances to the Treasury resume.

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q. 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 depository of the United States Government. By statute, the Treasury has appropriations to pay for these services. Revenue generated by the Bank in performing fiscal agent activities is recognized when the Bank's performance obligations are satisfied. During the years ended December 31, 2019 and 2018, the Banks were reimbursed for all services provided to the Treasury as fiscal agent.

r. Assessments

The Board of Governors assesses the Reserve Banks to fund its operations and the operations of the Bureau. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances. The Board of Governors also assesses each Reserve Bank for expenses related to producing, issuing, and retiring Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

The Dodd-Frank Act requires that, after the transfer of its responsibilities to the Bureau on July 21, 2011, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governor's 2009 annual report, which totaled \$4.98 billion. After 2013, the amount will be adjusted annually in accordance with the provisions of the Dodd-Frank Act. The percentage of total operating expenses of the System for the years ended December 31, 2019 and 2018 was 13.63 percent (\$678.9 million) and 13.31 percent (\$663.0 million), respectively. The Bank's assessment for Bureau funding is reported as "Operating expenses: Assessments: Bureau of Consumer Financial Protection" in the Combined Statements of Operations.

s. Fair Value

Assets of the Retirement Plan for Employees of the System are measured at fair value in accordance with FASB ASC Topic 820 (ASC 820), Fair Value Measurement. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level fair value hierarchy that distinguishes between assumptions developed using market data obtained from independent sources (observable inputs) and the Bank's assumptions developed using the best information available in the circumstances (unobservable inputs). The three levels established by ASC 820 are described as follows:

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

The inputs or methodology used for valuing assets and liabilities are not necessarily an indication of the risk associated with those assets and liabilities.

t. 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 \$56 million and \$53 million for the years ended December 31, 2019 and 2018,

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respectively, and are reported as a component of “Operating expenses: Occupancy” in the Combined Statements of Operations.

u. Restructuring Charges

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

The Banks had no significant restructuring activities in 2019 and 2018.

v. Recently Issued Accounting Standards

Other than the significant differences described in Note 3, the accounting policies described in FAM are generally consistent with those in GAAP. The following items represent recent GAAP accounting standards and describe how FAM was or will be revised to be consistent with these standards.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This update was issued to create common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The guidance is applicable to all contracts for the transfer of goods or services regardless of industry or type of transaction. This update requires recognition of revenue in a manner that reflects the consideration that the entity expects to receive in return for the transfer of goods or services to customers. Subsequently, the FASB issued a number of related ASUs including ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*; ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*; and ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. This revenue recognition accounting guidance was effective for the Reserve Banks for the year ended December 31, 2019, and did not have a material effect on the Reserve Banks’ combined financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this update eliminate the requirement to disclose methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet. This update was effective for the Reserve Banks for the year ended December 31, 2019, and did not have a material effect on the Reserve Banks’ combined financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This update revises the model to assess how a lease should be classified and provides guidance for lessees, requiring lessees to present right-of-use assets and lease liabilities on the balance sheet. Subsequently, the FASB issued a number of related ASUs, including in July 2018, ASU 2018-11, *Leases (Topic 842) Targeted Improvements*; in November 2018, ASU 2018-20, *Leases (Topic 842): Narrow-scope Improvements for Lessors*; and in November, 2019, ASU 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. The Board of Governors plans to early adopt this standard for the year ending December 31, 2020 and is considering the information and processes necessary to adopt the guidance. This update is not expected to have a material effect on the Reserve Banks’ combined financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This update revises the methodology for assessing expected credit losses and requires consideration of reasonable and supportable information to inform credit loss estimates.

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Although earlier adoption is permitted, this update is effective for the Reserve Banks for the year ending December 31, 2023, and is not expected to have a material effect on the Reserve Banks' combined financial statements based on the applicability of the zero loss expectation exception.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This update requires an employer to disaggregate the service cost component from the other components of net benefit cost. It also provides explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement and allows only the service cost component of net benefit cost to be eligible for capitalization. This update was effective for the Reserve Banks for the year ended December 31, 2019, and the relevant disclosures have been included in Notes 8 and 9 to the Reserve Banks' combined financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20) – Premium Amortization on Purchased Callable Debt Securities*. This update shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. This update was effective for the Reserve Banks for the year ended December 31, 2019, and did not have a material effect on the Reserve Banks' combined financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820)*. This update modifies disclosure requirements for fair value measurements in Topic 820 to provide users of financial statements with information about assets and liabilities measured at fair value, including the valuation techniques, the uncertainty in fair value measurements, and how changes in the measurements will affect financial performance. This update is effective for the Reserve Banks for the year ending December 31, 2020, and is expected to require disclosure updates to the Reserve Banks' combined financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation-Retirement Benefits-Defined Benefits Plans-General (Subtopic 715-20)*. This update modifies the disclosure requirements for pension and postretirement plans. The Board of Governors plans to early adopt this standard for the year ending December 31, 2020. This update is expected to require disclosure updates to the Reserve Banks' combined financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40)*. This update aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The Board of Governors early adopted this standard for the year ended December 31, 2019. This update did not have a material effect on the Reserve Banks' combined financial statements.

(4) LOANS

Loans to Depository Institutions

The Reserve Banks offer primary, secondary, and seasonal loans to eligible borrowers (depository institutions that maintain reservable transaction accounts or nonpersonal time deposits and have established discount window borrowing privileges). Each program has its own interest rate and interest is accrued using the applicable interest rate established at least every 14 days by the Reserve Banks' board of directors, subject to review and determination by the Board of Governors. Primary and secondary loans are extended on a short-term basis, typically overnight, whereas seasonal loans may be extended for a period of up to nine months.

Primary, secondary, and seasonal loans are collateralized to the satisfaction of the Reserve Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury

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securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; asset-backed securities; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Reserve Bank, which is typically fair value reduced by a margin. Loans to depository institutions are monitored daily to ensure that borrowers continue to meet eligibility requirements for these programs. If a borrower no longer qualifies for these programs, the Reserve Bank will generally request full repayment of the outstanding loan or, for primary or seasonal loans, may convert the loan to a secondary credit loan. Collateral levels are reviewed daily against outstanding obligations, and borrowers that no longer have sufficient collateral to support outstanding loans are required to provide additional collateral or to make partial or full repayment.

Loans to depository institutions were \$42 million and \$61 million as of December 31, 2019 and 2018, respectively, with a remaining maturity within 15 days.

At December 31, 2019 and 2018, the Reserve Banks did not have any loans that were impaired, restructured, past due, or on non-accrual status, and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2019 and 2018. Interest income attributable to loans to depository institutions was immaterial during the years ended December 31, 2019 and 2018.

(5) SYSTEM OPEN MARKET ACCOUNT

a. Domestic Securities Holdings

The FRBNY executes domestic open market operations and, on behalf of the Reserve Banks, holds the resulting securities in the SOMA. Pursuant to FOMC directives, during the period from January 2018 through July 2019, the FRBNY continued to reinvest in federal agency and GSE MBS the amount of principal payments from the SOMA holdings of GSE debt securities and federal agency and GSE MBS received during each calendar month that exceeded a monthly cap specified by the FOMC. The monthly cap for federal agency and GSE MBS, initially set at \$4 billion in October 2017, increased in steps of \$4 billion at three-month intervals until it reached \$20 billion per month. Additionally, the FRBNY continued to roll over principal payments from the SOMA holdings of Treasury securities maturing during each calendar month that exceeded the monthly cap. The monthly cap on Treasury redemptions, initially set at \$6 billion in October 2017, increased in steps of \$6 billion at three-month intervals until it reached \$30 billion per month. Beginning in May 2019, the FOMC directed FRBNY to slow the reduction of its holdings of Treasury securities by reducing the monthly cap on Treasury redemptions from \$30 billion to \$15 billion. Beginning in August 2019, the FOMC directed FRBNY to conclude the reduction of aggregate SOMA holdings; to reinvest up to \$20 billion per month of principal payments received from GSE debt securities and federal agency and GSE MBS in Treasury securities and reinvest principal payments in excess of \$20 billion per month in federal agency and GSE MBS; and to roll over at auction all maturing Treasury securities in the SOMA portfolio. Beginning in October 2019, the FOMC also directed FRBNY to purchase Treasury bills.

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The total Treasury securities, GSE debt securities, and federal agency and GSE MBS, net, excluding accrued interest, held in the SOMA at December 31, 2019 and 2018 was as follows (in millions):

| | 2019 | | | |
|----------------------------|---------------------|-------------------------|-------------------------|-------------------------|
| | Par | Unamortized premiums | Unaccreted discounts | Total amortized cost |
| Treasury securities | | | | |
| Bills | \$ 169,525 | \$ - | \$ (1,064) | \$ 168,461 |
| Notes | 1,290,107 | 3,275 | (3,181) | 1,290,201 |
| Bonds | 869,301 | 82,422 | (8,781) | 942,942 |
| Total Treasury securities | <u>\$ 2,328,933</u> | <u>\$ 85,697</u> | <u>\$ (13,026)</u> | <u>\$ 2,401,604</u> |
| GSE debt securities | <u>\$ 2,347</u> | <u>\$ 310</u> | <u>\$ -</u> | <u>\$ 2,657</u> |
| Federal agency and GSE MBS | <u>\$ 1,408,677</u> | <u>\$ 38,571</u> | <u>\$ (259)</u> | <u>\$ 1,446,989</u> |
| | | | | |
| | 2018 | | | |
| | Par | Unamortized premiums | Unaccreted discounts | Total amortized cost |
| Treasury securities | | | | |
| Notes | \$ 1,382,654 | \$ 5,434 | \$ (4,159) | \$ 1,383,929 |
| Bonds | 839,893 | 87,579 | (8,939) | 918,533 |
| Total Treasury securities | <u>\$ 2,222,547</u> | <u>\$ 93,013</u> | <u>\$ (13,098)</u> | <u>\$ 2,302,462</u> |
| GSE debt securities | <u>\$ 2,409</u> | <u>\$ 332</u> | <u>\$ -</u> | <u>\$ 2,741</u> |
| Federal agency and GSE MBS | <u>\$ 1,637,123</u> | <u>\$ 46,738</u> | <u>\$ (329)</u> | <u>\$ 1,683,532</u> |

During the years ended December 31, 2019 and 2018, the FRBNY entered into repurchase agreements and reverse repurchase agreements as part of its monetary policy activities. These operations have been undertaken as necessary to maintain the federal funds rate in a target range. In addition, reverse repurchase agreements are entered into as part of a service offering to foreign official and international account holders.

Financial information related to repurchase agreements allocated to the Bank and held in the SOMA for the years ended December 31, 2019 and 2018 was as follows (in millions):

| | Total SOMA | |
|---|------------|------|
| | 2019 | 2018 |
| Contract amount outstanding, end of year | \$ 255,619 | \$ - |
| Average daily amount outstanding, during the year | 56,971 | 1 |
| Maximum balance outstanding, during the year | 259,950 | 66 |
| Supplemental information - interest income: | | |
| Interest income - securities purchased under agreements to resell | \$ 971 | \$ - |

The contract amount outstanding as of December 31, 2019 of repurchase agreements that were transacted with primary dealers had a remaining term of 1 to 12 business days and matured by January 17, 2020.

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Financial information related to reverse repurchase agreements allocated to the Bank and held in the SOMA for the years ended December 31, 2019 and 2018 was as follows (in millions):

| | <u>2019</u> | <u>2018</u> |
|---|-----------------------|-----------------------|
| <u>Primary dealers and expanded counterparties:</u> | | |
| Contract amount outstanding, end of year | \$ 64,087 | \$ 41,848 |
| Average daily amount outstanding, during the year | 4,981 | 12,552 |
| Maximum balance outstanding, during the year | 64,087 | 319,595 |
| Securities pledged (par value), end of year | 60,490 | 42,485 |
| Securities pledged (fair value), end of year | 64,008 | 41,919 |
| <u>Foreign official and international accounts:</u> | | |
| Contract amount outstanding, end of year | \$ 272,562 | \$ 262,164 |
| Average daily amount outstanding, during the year | 269,399 | 236,818 |
| Maximum balance outstanding, during the year | 306,311 | 262,164 |
| Securities pledged (par value), end of year | 265,139 | 261,615 |
| Securities pledged (fair value), end of year | 272,579 | 262,184 |
| Total contract amount outstanding, end of year | <u>\$ 336,649</u> | <u>\$ 304,012</u> |
| Supplemental information - interest expense: | | |
| Primary dealers and expanded counterparties | \$ 102 | \$ 186 |
| Foreign official and international accounts | <u>5,910</u> | <u>4,373</u> |
| Total interest expense - securities sold under agreements to repurchase | <u>\$ 6,012</u> | <u>\$ 4,559</u> |

Securities pledged as collateral, at December 31, 2019 and 2018, consisted solely of Treasury securities. The contract amount outstanding as of December 31, 2019 of reverse repurchase agreements that were transacted with primary dealers and expanded counterparties had a remaining term of one business day and matured on January 2, 2020. The contract amount outstanding as of December 31, 2019 of reverse repurchase agreements that were transacted with foreign official and international account holders had a remaining term of one business day and matured on January 2, 2020.

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Notes to Combined Financial Statements

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, repurchase agreements, and reverse repurchase agreements at December 31, 2019 and 2018 was as follows (in millions):

| | Within 15 days | 16 days to 90 days | 91 days to 1 year | Over 1 year to 5 years | Over 5 years to 10 years | Over 10 years | Total |
|---|-------------------|-----------------------|----------------------|---------------------------|-----------------------------|------------------|--------------|
| December 31, 2019: | | | | | | | |
| Treasury securities (par value) | \$ 8,260 | \$ 115,689 | \$ 349,014 | \$ 893,832 | \$ 321,591 | \$ 640,547 | \$ 2,328,933 |
| GSE debt securities (par value) | - | - | - | - | 486 | 1,861 | 2,347 |
| Federal agency and GSE MBS (par value) ¹ | - | - | 12 | 1,135 | 73,528 | 1,334,002 | 1,408,677 |
| Securities purchased under agreements to resell (contract amount) | 205,619 | 50,000 | - | - | - | - | 255,619 |
| Securities sold under agreements to repurchase (contract amount) | 336,649 | - | - | - | - | - | 336,649 |
| December 31, 2018: | | | | | | | |
| Treasury securities (par value) | \$ 2,092 | \$ 92,622 | \$ 290,222 | \$ 958,065 | \$ 260,898 | \$ 618,648 | \$ 2,222,547 |
| GSE debt securities (par value) | - | 62 | - | - | - | 2,347 | 2,409 |
| Federal agency and GSE MBS (par value) ¹ | - | - | 4 | 214 | 62,706 | 1,574,199 | 1,637,123 |
| Securities purchased under agreements to resell (contract amount) | - | - | - | - | - | - | - |
| Securities sold under agreements to repurchase (contract amount) | 304,012 | - | - | - | - | - | 304,012 |

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

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted-average life of these securities, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, was approximately 5.3 and 7.0 years as of December 31, 2019 and 2018, respectively.

The amortized cost and par value of Treasury securities that were loaned from the SOMA under securities lending agreements at December 31, 2019 and 2018 were as follows (in millions):

| | 2019 | 2018 |
|--------------------------------------|-----------|-----------|
| Treasury securities (amortized cost) | \$ 41,602 | \$ 25,102 |
| Treasury securities (par value) | 41,450 | 24,761 |

Securities pledged as collateral by the counterparties in the securities lending arrangements at December 31, 2019 and 2018 consisted solely of Treasury securities. The securities lending agreements outstanding as of December 31, 2019 had a term of one business day and matured on January 2, 2020.

Federal Reserve Banks

Notes to Combined Financial Statements

The FRBNY enters into commitments to buy and sell Treasury securities and records the related securities on a settlement-date basis. As of December 31, 2019, the total purchase price of the Treasury securities under outstanding commitments was \$1 million.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2019, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was \$4,177 million, of which \$204 million was related to dollar rolls. These commitments, which had contractual settlement dates extending through January 2020, are for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. As of December 31, 2019, there were no outstanding sales commitments for federal agency and GSE MBS. MBS commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for MBS commitments as part of its risk management practices used to mitigate the counterparty credit risk.

Other assets held in the SOMA consist primarily of cash and short-term investments related to the federal agency and GSE MBS portfolio and were immaterial at December 31, 2019 and 2018. Other liabilities include the FRBNY's accrued interest payable related to repurchase agreements transactions, obligations to return cash margin posted by counterparties as collateral under commitments to purchase and sell federal agency and GSE MBS, and obligations that arise from the failure of a seller to deliver MBS to the FRBNY on the settlement date. Although the FRBNY has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount included in other liabilities represents the FRBNY's obligation to pay for the securities when delivered. The amount of other liabilities held in the SOMA at December 31, 2019 and 2018 was as follows (in millions):

| | <u>2019</u> | <u>2018</u> |
|--|---------------|--------------|
| Other liabilities: | | |
| Cash margin | \$ 115 | \$ 8 |
| Accrued interest payable | \$ 14 | \$ 25 |
| Obligations from MBS transaction fails | - | 1 |
| Total other liabilities | <u>\$ 129</u> | <u>\$ 34</u> |

Accrued interest receivable on domestic securities held in the SOMA was \$20,503 million and \$22,160 million as of December 31, 2019 and 2018, respectively. Accrued interest receivable on repurchase agreements was \$174 million as of December 31, 2019. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Combined Statements of Condition.

Federal Reserve Banks

Notes to Combined Financial Statements

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS held in the SOMA during the years ended December 31, 2019 and 2018, is summarized as follows (in millions):

| | Total SOMA | | | | | |
|--|------------|--------------|------------|---------------------------|---------------------|----------------------------|
| | Bills | Notes | Bonds | Total Treasury securities | GSE debt securities | Federal agency and GSE MBS |
| Balance at December 31, 2017 | \$ - | \$ 1,629,571 | \$ 916,162 | \$ 2,545,733 | \$ 4,752 | \$ 1,817,700 |
| Purchases ¹ | 126 | 192,346 | 15,560 | 208,032 | - | 121,190 |
| Sales ¹ | (47) | (49) | (65) | (161) | - | (253) |
| Realized gains (losses), net ² | - | (1) | 6 | 5 | - | (5) |
| Principal payments and maturities | (79) | (435,970) | (7,731) | (443,780) | (1,982) | (246,316) |
| Amortization of premiums and accretion of discounts, net | - | (2,929) | (7,781) | (10,710) | (29) | (8,784) |
| Inflation adjustment on inflation-indexed securities | - | 961 | 2,382 | 3,343 | - | - |
| Subtotal of activity | - | (245,642) | 2,371 | (243,271) | (2,011) | (134,168) |
| Balance at December 31, 2018 | \$ - | \$ 1,383,929 | \$ 918,533 | \$ 2,302,462 | \$ 2,741 | \$ 1,683,532 |
| Purchases ¹ | 190,009 | 273,742 | 50,899 | 514,650 | - | 34,259 |
| Sales ¹ | (50) | (50) | - | (100) | - | (316) |
| Realized gains (losses), net ² | - | - | - | - | - | 6 |
| Principal payments and maturities | (21,824) | (366,328) | (20,755) | (408,907) | (62) | (261,805) |
| Amortization of premiums and accretion of discounts, net | 326 | (1,828) | (7,468) | (8,970) | (22) | (8,687) |
| Inflation adjustment on inflation-indexed securities | - | 736 | 1,733 | 2,469 | - | - |
| Subtotal of activity | 168,461 | (93,728) | 24,409 | 99,142 | (84) | (236,543) |
| Balance at December 31, 2019 | \$ 168,461 | \$ 1,290,201 | \$ 942,942 | \$ 2,401,604 | \$ 2,657 | \$ 1,446,989 |
| Year-ended December 31, 2018 | | | | | | |
| Supplemental information - par value of transactions: | | | | | | |
| Purchases ³ | \$ 126 | \$ 193,093 | \$ 15,713 | \$ 208,932 | \$ - | \$ 118,762 |
| Sales ³ | (47) | (51) | (59) | (157) | - | (251) |
| Year-ended December 31, 2019 | | | | | | |
| Supplemental information - par value of transactions: | | | | | | |
| Purchases ³ | \$ 191,399 | \$ 273,096 | \$ 48,430 | \$ 512,925 | \$ - | \$ 33,662 |
| Sales | (50) | (50) | - | (100) | - | (304) |

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

² Realized gains (losses), net is the offset of the amount of realized gains and losses included in the reported sales amount.

³ Includes inflation compensation.

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Notes to Combined Financial Statements

b. Foreign Currency Denominated Investments

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

The FRBNY holds foreign currency deposits with foreign central banks and with the Bank for International Settlements (BIS). The FRBNY also invests in foreign government debt instruments of France, Germany, the Netherlands, and Japan. These foreign government debt instruments are backed by the full faith and credit of the issuing foreign governments. In addition, the FRBNY may enter into repurchase agreements to purchase government debt securities for which the accepted collateral is the debt instruments issued by a foreign government.

Information about foreign currency denominated investments recorded at amortized cost and valued at foreign currency market exchange rates held in the SOMA at December 31, 2019 and 2018 was as follows (in millions):

| | <u>2019</u> | <u>2018</u> |
|--------------------------------------|------------------|------------------|
| Euro: | | |
| Foreign currency deposits | \$ 6,892 | \$ 6,390 |
| French government debt instruments | 2,629 | 3,045 |
| Dutch government debt instruments | 1,443 | 1,511 |
| German government debt instruments | 1,145 | 1,440 |
| Japanese yen: | | |
| Foreign currency deposits | 7,752 | 7,286 |
| Japanese government debt instruments | 850 | 1,234 |
| Total | <u>\$ 20,711</u> | <u>\$ 20,906</u> |

At December 31, 2019 and 2018, there were no repurchase agreements outstanding and, consequently, no related foreign securities held as collateral.

Net interest income earned on foreign currency denominated investments for the years ended December 31, 2019 and 2018 held in the SOMA as follows (in millions):

| | <u>2019</u> | <u>2018</u> |
|---|----------------|----------------|
| Net interest income:¹ | | |
| Euro | \$ (34) | \$ (30) |
| Japanese yen | <u>1</u> | <u>1</u> |
| Total net interest income | <u>\$ (33)</u> | <u>\$ (29)</u> |

¹ As a result of negative interest rates in certain foreign currency denominated investments held in the SOMA, interest income on foreign currency denominated investments, net contains negative interest of \$44 million and \$43 million for the years ended December 31, 2019 and 2018, respectively.

Accrued interest receivable on foreign currency denominated investments, net was \$66 million and \$72 million as of December 31, 2019 and 2018, respectively. These amounts are reported as a component of “System Open Market Account: Accrued interest receivable” in the Combined Statements of Condition.

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Notes to Combined Financial Statements

The remaining maturity distribution of foreign currency denominated investments at December 31, 2019 and 2018 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 | Total |
|---------------------------|-------------------|-----------------------|----------------------|---------------------------|-----------------------------|------------------|
| December 31, 2019: | | | | | | |
| Euro | \$ 6,892 | \$ 48 | \$ 365 | \$ 2,744 | \$ 2,060 | \$ 12,109 |
| Japanese yen | 7,752 | 110 | 739 | 1 | - | 8,602 |
| Total | <u>\$ 14,644</u> | <u>\$ 158</u> | <u>\$ 1,104</u> | <u>\$ 2,745</u> | <u>\$ 2,060</u> | <u>\$ 20,711</u> |
| December 31, 2018: | | | | | | |
| Euro | \$ 6,425 | \$ 81 | \$ 448 | \$ 2,792 | \$ 2,640 | \$ 12,386 |
| Japanese yen | 7,286 | 90 | 301 | 843 | - | 8,520 |
| Total | <u>\$ 13,711</u> | <u>\$ 171</u> | <u>\$ 749</u> | <u>\$ 3,635</u> | <u>\$ 2,640</u> | <u>\$ 20,906</u> |

There were no foreign exchange contracts related to foreign currency operations outstanding as of December 31, 2019.

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, 2019, there were no outstanding commitments to purchase foreign government debt instruments. During 2019, there were purchases, sales, and maturities of foreign government debt instruments of \$1 million, \$4 million, and \$937 million, respectively.

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 monitoring procedures.

Foreign currency working balances held and foreign exchange contracts executed by the FRBNY to facilitate international payments and currency transactions made on behalf of foreign central banks and U.S. official institution customers were immaterial as of December 31, 2019 and 2018.

c. Central Bank Liquidity Swaps

U.S. Dollar Liquidity Swaps

The total foreign currency held in the SOMA under U.S. dollar liquidity swaps at December 31, 2019 and 2018 was \$3,728 million and \$4,207 million, respectively.

The remaining maturity distribution of U.S. dollar liquidity swaps at December 31, 2019 and 2018 was as follows (in millions):

| | 2019 | 2018 |
|--------------|-------------------|-------------------|
| | Within 15 days | Within 15 days |
| Euro | \$ 3,728 | \$ 4,197 |
| Japanese yen | - | 10 |
| Total | <u>\$ 3,728</u> | <u>\$ 4,207</u> |

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Foreign Currency Liquidity Swaps

At December 31, 2019 and 2018, there was no balance outstanding related to foreign currency liquidity swaps.

d. Fair Value of SOMA Assets and Liabilities

The fair value amounts below are presented solely for informational purposes and are not intended to comply with the fair value disclosures required by ASC 820. Although the fair value of SOMA security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. Because SOMA securities are recorded at amortized cost, cumulative unrealized gains (losses) are not recognized in the Combined Statements of Condition and the changes in cumulative unrealized gains (losses) are not recognized in the Combined Statements of Operations.

The fair value of the Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments held in the SOMA is subject to market risk, arising from movements in market variables such as interest rates and credit risk. The fair value of federal agency and GSE MBS is also affected by the expected rate of prepayments of mortgage loans underlying the securities. The fair value of foreign government debt instruments is also affected by currency risk. Based on evaluations performed as of December 31, 2019 and 2018, there are no credit impairments of SOMA securities holdings.

The following table presents the amortized cost, fair value, and cumulative unrealized gains (losses) on the Treasury securities, GSE debt securities, and federal agency and GSE MBS held in the SOMA at December 31, 2019 and 2018 (in millions):

| | 2019 | | | 2018 | | |
|---|----------------|--------------|---|----------------|--------------|---|
| | Amortized cost | Fair value | Cumulative unrealized gains (losses), net | Amortized cost | Fair value | Cumulative unrealized gains (losses), net |
| Treasury securities: | | | | | | |
| Bills | \$ 168,461 | \$ 168,479 | \$ 18 | \$ - | \$ - | \$ - |
| Notes | 1,290,201 | 1,303,576 | 13,375 | 1,383,929 | 1,370,515 | (13,414) |
| Bonds | 942,942 | 1,068,675 | 125,733 | 918,533 | 967,479 | 48,946 |
| Total Treasury securities | 2,401,604 | 2,540,730 | 139,126 | 2,302,462 | 2,337,994 | 35,532 |
| GSE debt securities | 2,657 | 3,344 | 687 | 2,741 | 3,222 | 481 |
| Federal agency and GSE MBS | 1,446,989 | 1,467,802 | 20,813 | 1,683,532 | 1,641,381 | (42,151) |
| Total domestic SOMA portfolio securities holdings | \$ 3,851,250 | \$ 4,011,876 | \$ 160,626 | \$ 3,988,735 | \$ 3,982,597 | \$ (6,138) |
| Memorandum - Commitments for: | | | | | | |
| Purchases of Treasury securities | \$ 1 | \$ 1 | \$ - | \$ - | \$ - | \$ - |
| Purchases of Federal agency and GSE MBS | 4,177 | 4,187 | 10 | 294 | 296 | 2 |
| Sales of Federal agency and GSE MBS | - | - | - | - | - | - |

The fair value of Treasury securities and GSE debt securities was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of federal agency and GSE MBS was determined using pricing services that utilize a model-based approach that considers observable inputs for similar securities.

The cost bases of repurchase agreements, reverse repurchase agreements, central bank liquidity swaps, and other investments held in the SOMA portfolio approximate fair value. Due to the short-term nature of these agreements and the defined amount that will be received upon settlement, the cost basis approximates fair value.

At December 31, 2019 and 2018, the fair value of foreign currency denominated investments held in the SOMA was \$20,829 million and \$20,957 million, respectively. The fair value of foreign government debt instruments was determined using pricing services that provide market consensus prices based on indicative quotes from various

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market participants. Due to the short-term nature of foreign currency deposits, the cost basis is estimated to approximate fair value.

The following table provides additional information on the amortized cost and fair value of the federal agency and GSE MBS portfolio held in the SOMA at December 31, 2019 and 2018 (in millions):

| Distribution of MBS holdings by coupon rate | 2019 | | 2018 | |
|--|----------------|--------------|----------------|--------------|
| | Amortized cost | Fair value | Amortized cost | Fair value |
| Total SOMA: | | | | |
| 2.0% | \$ 6,183 | \$ 6,116 | \$ 7,532 | \$ 7,296 |
| 2.5% | 79,991 | 79,661 | 92,877 | 89,530 |
| 3.0% | 538,642 | 540,588 | 601,805 | 577,317 |
| 3.5% | 498,727 | 506,691 | 585,114 | 571,406 |
| 4.0% | 242,353 | 247,915 | 297,546 | 294,038 |
| 4.5% | 56,789 | 60,551 | 69,474 | 71,559 |
| 5.0% | 19,377 | 20,921 | 23,296 | 24,128 |
| 5.5% | 4,266 | 4,633 | 5,097 | 5,277 |
| 6.0% | 578 | 635 | 691 | 722 |
| 6.5% | 83 | 91 | 100 | 108 |
| Total | \$ 1,446,989 | \$ 1,467,802 | \$ 1,683,532 | \$ 1,641,381 |

The following tables present the realized gains (losses) and the change in the cumulative unrealized gains (losses) related to SOMA domestic securities holdings held in the SOMA during the years ended December 31, 2019 and 2018 (in millions):

| | 2019 | | 2018 | |
|----------------------------|--|--|--|--|
| | Realized gains (losses), net ^{1,2} | Change in cumulative unrealized gains (losses) ³ | Realized gains (losses), net ^{1,2} | Change in cumulative unrealized gains (losses) ³ |
| Treasury securities | \$ - | \$ 103,594 | \$ 5 | \$ (51,743) |
| GSE debt securities | - | 206 | - | (150) |
| Federal agency and GSE MBS | 9 | 62,964 | (3) | (34,369) |
| Total | \$ 9 | \$ 166,764 | \$ 2 | \$ (86,262) |

¹ Realized gains (losses) for Treasury securities are reported in "Other items of income (loss): System Open Market Account: Treasury securities gains, net" in the Combined Statements of Operations.

² Realized gains (losses) for federal agency and GSE MBS are reported in "Other items of income (loss): System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities (losses) gains, net" in the Combined Statements of Operations.

³ Because SOMA securities are recorded at amortized cost, the change in the cumulative unrealized gains (losses) is not reported in the Combined Statements of Operations.

The amount of change in cumulative unrealized gains (losses) position, net related to foreign currency denominated investments was a gain of \$67 million and \$19 million for the years ended December 31, 2019 and 2018, respectively. Realized gains, net related to foreign currency denominated investments was immaterial for the years ended December 31, 2019 and 2018.

Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments are classified as Level 2 within the ASC 820 hierarchy because the fair values are based on indicative quotes and

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Notes to Combined Financial Statements

other observable inputs obtained from independent pricing services. The fair value hierarchy level of SOMA financial assets is not necessarily an indication of the risk associated with those assets.

(6) BANK PREMISES, EQUIPMENT, AND SOFTWARE

Bank premises and equipment at December 31, 2019 and 2018 were as follows (in millions):

| | <u>2019</u> | <u>2018</u> |
|---|-----------------|-----------------|
| Bank premises and equipment: | | |
| Land and land improvements | \$ 420 | \$ 418 |
| Buildings | 3,058 | 2,978 |
| Building machinery and equipment | 700 | 668 |
| Construction in progress | 63 | 68 |
| Furniture and equipment | <u>1,113</u> | <u>1,068</u> |
| Subtotal | 5,354 | 5,200 |
| Accumulated depreciation | <u>(2,810)</u> | <u>(2,647)</u> |
| Bank premises and equipment, net | <u>\$ 2,544</u> | <u>\$ 2,553</u> |
| Depreciation expense, for the years ended December 31 | <u>\$ 227</u> | <u>\$ 223</u> |

Reserve Bank premises and equipment at December 31, 2019 and 2018 included the following amounts for capitalized leases (in millions):

| | <u>2019</u> | <u>2018</u> |
|---|--------------|-------------|
| Leased premises and equipment under capital leases | \$ 31 | \$ 30 |
| Accumulated depreciation | <u>(20)</u> | <u>(21)</u> |
| Leased premises and equipment under capital leases, net | <u>\$ 11</u> | <u>\$ 9</u> |
| Depreciation expense related to leased premises and equipment under capital leases, for the years ended December 31 | <u>\$ 5</u> | <u>\$ 4</u> |

The Reserve Banks lease space to outside tenants with remaining lease terms ranging from 1 to 14 years. Rental income from such leases was \$42 million and \$41 million for the years ended December 31, 2019 and 2018, respectively, and is reported as a component of “Other items of income (loss): Other” in the Combined Statements

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Notes to Combined Financial Statements

of Operations. Future minimum lease payments that the Reserve Banks will receive under non-cancelable lease agreements in existence at December 31, 2019, are as follows (in millions):

| | | |
|------------|----|------------|
| 2020 | \$ | 39 |
| 2021 | | 37 |
| 2022 | | 33 |
| 2023 | | 29 |
| 2024 | | 24 |
| Thereafter | | 86 |
| Total | \$ | <u>248</u> |

The Reserve Banks had capitalized software assets, net of amortization, of \$428 million and \$436 million at December 31, 2019 and 2018, respectively. Amortization expense was \$122 million and \$134 million for the years ended December 31, 2019 and 2018, 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 Operations.

(7) COMMITMENTS AND CONTINGENCIES

In conducting their 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, 2019, the Reserve Banks were obligated under non-cancelable leases for premises and equipment with remaining terms ranging from 1 to 10 years. These leases provide for increased lease payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$14 million for the years ended December 31, 2019 and 2018, respectively.

Future minimum lease payments under non-cancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2019, are as follows (in millions):

| | | |
|-------------------------------|----|-------------------------|
| | | <u>Operating leases</u> |
| 2020 | \$ | 6 |
| 2021 | | 6 |
| 2022 | | 6 |
| 2023 | | 4 |
| 2024 | | 3 |
| Thereafter | | 5 |
| Future minimum lease payments | \$ | <u>30</u> |

At December 31, 2019, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2021 with a remaining fixed commitment of \$79 million. Purchases of \$50 million and \$36 million were made against these commitments during 2019 and 2018, respectively. These commitments represent maintenance of currency processing machines and development of new equipment and have variable and fixed components. The variable portion of the commitments is for additional services above the fixed

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Notes to Combined Financial Statements

contractual service limits. The fixed payments for the next five years under these commitments are as follows (in millions):

| | | |
|------|----|----|
| 2020 | \$ | 22 |
| 2021 | | 29 |
| 2022 | | 28 |

Under an insurance agreement of the Reserve Banks, each of the Reserve Banks has agreed to bear, on a per-incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne at the ratio of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2019 and 2018.

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 legal actions and claims will be resolved without material adverse effect on the financial position or results of operations of the Reserve Banks.

(8) RETIREMENT AND THRIFT PLANS

Retirement Plans

The Reserve Banks currently offer three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan).¹ Under the Dodd-Frank Act, eligible Bureau employees may participate in the System Plan and, during the years ended December 31, 2019 and 2018, certain costs associated with the System Plan were reimbursed by the Bureau. In addition, employees at certain compensation levels participate in the BEP and certain Reserve Bank officers participate in the SERP.

The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. The service cost related to the System Plan is reported as "Operating expenses: System pension service cost" in the Combined Statements of Operations and other net benefit costs related to the System Plan are reported as a component of "Other items of income (loss): Other components of net benefit costs" in the Combined Statements of Operations. Accrued pension benefit costs are reported as a component of "Prepaid pension benefit costs" if the funded status is a net asset or "Accrued benefit costs" if the funded status is a net liability in the Combined Statements of Condition.

¹ The OEB was established by the System to administer selected System benefit plans.

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Notes to Combined Financial Statements

Following is a reconciliation of the beginning and ending balances of the System Plan benefit obligation for the years ended December 31, 2019 and 2018 (in millions):

| | <u>2019</u> | <u>2018</u> |
|--|------------------|------------------|
| Estimated actuarial present value of projected benefit obligation at January 1 | \$ 15,633 | \$ 16,501 |
| Service cost-benefits earned during the period | 510 | 576 |
| Interest cost on projected benefit obligation | 699 | 622 |
| Actuarial loss (gain) | 2,708 | (1,621) |
| Contributions by plan participants | 4 | 6 |
| Special termination benefits | 14 | 12 |
| Benefits paid | <u>(497)</u> | <u>(463)</u> |
| Estimated actuarial present value of projected benefit obligation at December 31 | <u>\$ 19,071</u> | <u>\$ 15,633</u> |

Annually, the Society of Actuaries releases new mortality tables and updated mortality projection scales. The System analyzed these new tables relative to the System's actual retiree mortality experience. Based on these analyses, the System adopted for year-end 2018 the modified MP-2018 projections scales and RP-2014 mortality tables with various adjustments to reflect the System's recent mortality experience of System retirees. These adjustments resulted in reduction to the System Plan projected benefit obligation of approximately \$62 million in 2018.

Following is a reconciliation showing the beginning and ending balance of the System Plan assets, the funded status, and the accrued pension benefit costs for the years ended December 31, 2019 and 2018 (in millions):

| | <u>2019</u> | <u>2018</u> |
|--|-------------------|-------------------|
| Estimated plan assets at January 1 (of which \$15,389 and \$16,454 is measured at fair value as of January 1, 2019 and 2018, respectively) | \$ 15,414 | \$ 16,515 |
| Actual return on plan assets | 3,582 | (920) |
| Contributions by the employers | 241 | 276 |
| Contributions by plan participants | 4 | 6 |
| Benefits paid | <u>(497)</u> | <u>(463)</u> |
| Estimated plan assets at December 31 (of which \$18,732 and \$15,389 is measured at fair value as of December 31, 2019 and 2018, respectively) | <u>\$ 18,744</u> | <u>\$ 15,414</u> |
| Funded status and accrued pension benefit costs | <u>\$ (327)</u> | <u>\$ (219)</u> |
| Amounts included in accumulated other comprehensive loss are shown below: | | |
| Prior service cost | \$ (11) | \$ (20) |
| Net actuarial loss | <u>(3,030)</u> | <u>(3,167)</u> |
| Total accumulated other comprehensive loss | <u>\$ (3,041)</u> | <u>\$ (3,187)</u> |

The FRBNY, on behalf of the System, funded \$220 million and \$240 million during the years ended December 31, 2019 and 2018, respectively. The Bureau is required by the Dodd-Frank Act to fund the System plan for each Bureau employee based on an established formula. During the years ended December 2019 and 2018, the Bank received contributions from the Bureau of \$21 million and \$36 million, respectively.

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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 \$16,579 million and \$13,705 million at December 31, 2019 and 2018, respectively.

The weighted-average assumptions used in developing the accumulated pension benefit obligation for the System Plan as of December 31 were as follows:

| | <u>2019</u> | <u>2018</u> |
|-------------------------------|-------------|-------------|
| Discount rate | 3.48% | 4.36% |
| Rate of compensation increase | 4.25% | 4.25% |

Net periodic benefit expenses for the years ended December 31, 2019 and 2018 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:

| | <u>2019</u> | <u>2018</u> |
|-------------------------------|-------------|-------------|
| Discount rate | 4.36% | 3.65% |
| Expected asset return | 6.00% | 6.00% |
| Rate of compensation increase | 4.25% | 4.00% |

Discount rates reflect yields available on high-quality corporate and other taxable 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 various asset classes; and projected returns for equities and fixed income investments based on observable inputs for real interest rates, inflation expectations, and equity risk premiums. In 2018, a change in estimate was made to the discount rate methodology used by the actuaries to determine the System Plan's projected benefit obligation. Specifically, the discount rate methodology was refined to expand the universe of eligible fixed income securities and market pricing data. This change was applied prospectively and resulted in a reduction to the System Plan projected benefit obligation of approximately \$324 million for the year ended December 31, 2018.

The components of net periodic pension benefit expense (credit) for the System Plan for the years ended December 31, 2019 and 2018 are shown below (in millions):

| | <u>2019</u> | <u>2018</u> |
|---|---------------|---------------|
| Service cost-benefits earned during the period | \$ 510 | \$ 576 |
| Other components of periodic pension benefit expense: | | |
| Interest cost on projected benefit obligation | \$ 699 | \$ 622 |
| Amortization of prior service cost | 9 | 62 |
| Amortization of actuarial loss | 176 | 160 |
| Expected return on plan assets | (914) | (983) |
| Special termination benefits loss | 14 | 12 |
| Bureau of Consumer Financial Protection contributions | (21) | (36) |
| Other components of periodic pension benefit expense | (37) | (163) |
| Total periodic pension benefit expense | <u>\$ 473</u> | <u>\$ 413</u> |

The service cost component of periodic pension benefit expense is reported as "Operating expenses: System pension service cost" in the Combined Statements of Operations and the other components of periodic pension benefit

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expense are reported as a component of “Other items of income (loss): Other components of net benefit costs” in the Combined Statements of Operations.

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2020 are shown below (in millions):

| | |
|--------------------|---------------|
| Prior service cost | \$ 8 |
| Net actuarial loss | <u>113</u> |
| Total | <u>\$ 121</u> |

The recognition of special termination benefits is primarily the result of enhanced retirement benefits provided to employees in the normal course of operations. Following is a summary of expected benefit payments, excluding enhanced retirement benefits (in millions):

| | |
|-------------|-----------------|
| 2020 | \$ 575 |
| 2021 | 615 |
| 2022 | 656 |
| 2023 | 697 |
| 2024 | 740 |
| 2025 - 2029 | <u>4,328</u> |
| Total | <u>\$ 7,611</u> |

The System’s Committee on Plan Administration is responsible for oversight of the operations of the Retirement Plan, which includes the Retirement Plan trust and for determining the amounts necessary to maintain the Retirement Plan on an actuarially sound basis and the amounts that employers must contribute to pay the expenses of OEB and the Retirement Plan.

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. At December 31, 2019, the System Plan’s assets were held in 32 investment vehicles: 5 actively-managed long-duration fixed income portfolios, a passively-managed long-duration fixed income portfolio, an indexed U.S. equity fund, an indexed non-U.S. developed-markets equity fund, an indexed emerging-markets equity fund, 6 private equity limited partnerships, a private equity separate account, 4 core real estate funds, 12 real estate limited partnerships, and a money market fund.

The diversification of the System Plan’s investments is designed to limit concentration of risk and the risk of loss related to an individual asset class. The five actively-managed long-duration fixed income portfolios are separate accounts benchmarked to a custom benchmark of 55 percent Bloomberg Barclays Long Credit Index and 45 percent of either Bloomberg, Barclays or Citigroup 15+ years U.S. Treasury STRIPS Index. This custom benchmark was selected as a proxy to match the liabilities of the System Plan and the guidelines for these portfolios are designed to limit portfolio deviations from the benchmark. The passively-managed long-duration fixed-income portfolio is invested in 2 commingled funds and is benchmarked to 55 percent Bloomberg Barclays Long Credit Index and 45 percent Bloomberg Barclays 20+ STRIPS Index. The indexed U.S. equity fund is intended to track the overall U.S. equity market across market capitalizations and is benchmarked to the CRSP U.S. Total Market Index. The indexed non-U.S. developed-markets equity fund is intended to track the Morgan Stanley Capital International (MSCI) World ex-US Investible Markets Index (IMI), which includes stocks from 22 markets deemed by MSCI to be “developed markets.” The indexed emerging-markets equity fund is intended to track the MSCI Emerging Markets IMI Index, which includes stocks from 26 markets deemed by MSCI to be “emerging markets.”

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The 3 indexed equity funds include stocks from across the market capitalization spectrum (i.e., large-, mid- and small-cap stocks).

The 6 private equity limited partnerships invest globally across various private equity strategies and the private equity separate account invests in various private equity funds (both primary and secondary interests) and coinvestment opportunities globally in private companies and targets returns in excess of public markets over a complete market cycle.

The 4 core real estate funds invest in high quality, well leased, low leverage commercial real estate throughout the U.S.

The 12 real estate limited partnerships invest in non-core U.S. and international commercial real estate including development and repositioning of assets. Finally, the money market fund, which invests in short term Treasury and agency debt and repurchase agreements backed by Treasury and agency debt, is the repository for cash balances and adheres to a constant dollar methodology.

Permitted and prohibited investments, including the use of certain derivatives, are defined in either the trust agreement (for the passively-managed long-duration fixed income portfolio) or the investment guidelines (for the remaining investments). The CIP reviews the trust agreement and approves all investment guidelines as part of the selection of each investment to ensure that they are 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, 2019 and 2018 by asset category, are as follows:

| | 2019 | Actual asset allocations | |
|---------------------------|---------------|--------------------------|--------|
| | Policy weight | 2019 | 2018 |
| Fixed income | 50.0% | 46.1% | 51.6% |
| U.S. equities | 22.0% | 24.6% | 21.1% |
| International equities | 13.2% | 14.8% | 13.3% |
| Emerging markets equities | 4.8% | 5.1% | 4.4% |
| Private equity | 5.0% | 5.1% | 5.1% |
| Real estate | 5.0% | 3.9% | 3.8% |
| Cash | 0.0% | 0.4% | 0.7% |
| 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 anticipated funding level for 2020 is \$600 million. In 2020, the FRBNY plans to make monthly contributions of \$50 million and will reevaluate the monthly contributions upon completion of the 2020 actuarial valuation. The Reserve Banks' projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2019 and 2018, and for the years then ended, were immaterial.

Determination of Fair Value

The System Plan's publicly available 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.

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Collective trust funds are valued using the net asset value, calculated daily, based on the fair value of the underlying investments. Private equity and real estate investments are valued using the net asset value, as a practical expedient, which is based on the fair value of the underlying investments. The net asset value is adjusted for contributions, distributions, and both realized and unrealized gains and losses incurred during the period. The realized and unrealized gains and losses are based on reported valuation changes.

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, 2019 and 2018 by ASC 820 hierarchy (in millions):

| Description | 2019 | | | |
|--|----------|----------|---------|--------------------|
| | Level 1 | Level 2 | Level 3 | Total ¹ |
| Short-term investments | \$ 194 | \$ - | \$ - | \$ 194 |
| Treasury and Federal agency securities | 71 | 3,247 | - | 3,318 |
| Corporate bonds | - | 3,563 | - | 3,563 |
| Other fixed income securities | - | 435 | - | 435 |
| Collective trusts | 9,539 | - | - | 9,539 |
| Investments measured at net asset value ² | - | - | - | 1,690 |
| Total investments at fair value ³ | \$ 9,804 | \$ 7,245 | \$ - | \$ 18,739 |

¹ There were no transfers between Levels during the year ended December 31, 2019.

² Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy.

³ In addition to total investments, the System Plan holds future margin receivable of \$2 million and future margin payable of \$9 million at December 31, 2019.

| Description | 2018 | | | |
|--|----------|----------|---------|--------------------|
| | Level 1 | Level 2 | Level 3 | Total ¹ |
| Short-term investments | \$ 159 | \$ - | \$ - | \$ 159 |
| Treasury and Federal agency securities | 136 | 2,697 | - | 2,833 |
| Corporate bonds | - | 2,844 | - | 2,844 |
| Other fixed income securities | - | 327 | - | 327 |
| Collective trusts | 7,844 | - | - | 7,844 |
| Investments measured at net asset value ² | - | - | - | 1,375 |
| Total investments at fair value ³ | \$ 8,139 | \$ 5,868 | \$ - | \$ 15,382 |

¹ There were no transfers between Levels during the year ended December 31, 2018.

² Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy.

³ In addition to total investments at fair value, the System Plan holds future margin receivable of \$14 million and future margin payables of \$7 million at December 31, 2018.

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

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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 Combined 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.

At December 31, 2019 and 2018, a portion of short-term investments was available for futures trading. There were \$5 million of Treasury securities pledged as collateral for both years ended December 31, 2019 and 2018, respectively.

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 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. The Reserve Banks' Thrift Plan contributions totaled \$148 million and \$141 million for the years ended December 31, 2019 and 2018, respectively, and are reported as a component of "Operating expenses: Salaries and benefits" in the Combined Statements of Operations.

(9) POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

In addition to the Reserve Banks' retirement plans, employees who have met certain age and length-of-service requirements are eligible for both medical and life insurance benefits during retirement.

The Reserve Banks and plan participants fund benefits payable under the medical and life insurance plans as due and the plans have no assets.

Following is a reconciliation of the beginning and ending balances of the benefit obligation for the years ended December 31, 2019 and 2018 (in millions):

| | 2019 | 2018 |
|--|-----------------|-----------------|
| Accumulated postretirement benefit obligation at January 1 | \$ 1,827 | \$ 1,865 |
| Service cost benefits earned during the period | 76 | 86 |
| Interest cost on accumulated benefit obligation | 74 | 68 |
| Net actuarial loss (gain) | 8 | (117) |
| Contributions by plan participants | 30 | 28 |
| Benefits paid | (104) | (104) |
| Medicare Part D subsidies | 1 | 2 |
| Plan amendments | (39) | (1) |
| Special termination benefits | 1 | - |
| Accumulated postretirement benefit obligation at December 31 | <u>\$ 1,874</u> | <u>\$ 1,827</u> |

At December 31, 2019 and 2018, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 3.31 percent and 4.26 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. The System Plan discount rate assumption setting convention uses an unrounded rate.

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Following is a reconciliation of the beginning and ending balance of the plan assets, and the unfunded postretirement benefit obligation and accrued postretirement benefit costs for the years ended December 31, 2019 and 2018 (in millions):

| | <u>2019</u> | <u>2018</u> |
|---|-----------------|-----------------|
| Fair value of plan assets at January 1 | \$ - | \$ - |
| Contributions by the employer | 73 | 74 |
| Contributions by plan participants | 30 | 28 |
| Benefits paid | (104) | (104) |
| Medicare Part D subsidies | 1 | 2 |
| Fair value of plan assets at December 31 | <u>\$ -</u> | <u>\$ -</u> |
| Unfunded obligation and accrued postretirement benefit cost | <u>\$ 1,874</u> | <u>\$ 1,827</u> |

Amounts included in accumulated other comprehensive loss are shown below:

| | | |
|--|-----------------|-----------------|
| Prior service cost | \$ 105 | \$ 98 |
| Net actuarial (loss) | <u>(207)</u> | <u>(203)</u> |
| Total accumulated other comprehensive loss | <u>\$ (102)</u> | <u>\$ (105)</u> |

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, 2019 and 2018 are provided in the table below:

| | <u>2019</u> | <u>2018</u> |
|--|-------------|-------------|
| Health-care cost trend rate assumed for next year | 6.00% | 6.25% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 4.75% | 4.75% |
| Year that the rate reaches the ultimate trend rate | 2025 | 2025 |

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A one percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2019 (in millions):

| | <u>One percentage point increase</u> | <u>One percentage point decrease</u> |
|---|--|--|
| Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs | \$ 29 | \$ (23) |
| Effect on accumulated postretirement benefit obligation | 254 | (211) |

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The following is a summary of the components of net periodic postretirement benefit expense for the years ended December 31, 2019 and 2018 (in millions):

| | <u>2019</u> | <u>2018</u> |
|--|---------------|---------------|
| Service cost-benefits earned during the period | \$ 76 | \$ 86 |
| Other components of periodic postretirement benefit expense: | | |
| Interest cost on accumulated benefit obligation | \$ 74 | \$ 68 |
| Amortization of prior service cost | (31) | (32) |
| Amortization of net actuarial loss | 3 | 18 |
| Curtailment (gain) | - | (1) |
| Special termination benefits loss | 1 | - |
| Other components of periodic postretirement benefit expense | <u>47</u> | <u>53</u> |
| Total periodic postretirement benefit expense | <u>\$ 123</u> | <u>\$ 139</u> |

The service cost component of periodic postretirement benefit expense is reported as a component of “Operating expenses: Salaries and benefits” in the Combined Statements of Operations and the other components of periodic postretirement benefit expense are reported as a component of “Other items of income (loss): Other components of net benefit costs” in the Combined Statements of Operations.

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2020 are shown below:

| | |
|--------------------|----------------|
| Prior service cost | \$ (38) |
| Net actuarial loss | <u>11</u> |
| Total | <u>\$ (27)</u> |

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2019 and 2018, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 4.26 percent and 3.59 percent, respectively.

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 the actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were immaterial in the years ended December 31, 2019 and 2018. Expected receipts in 2020, related to benefits paid in the years ended December 31, 2019 and 2018, are immaterial.

Federal Reserve Banks Notes to Combined Financial Statements

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

| | Without subsidy | With subsidy |
|-------------|-----------------|--------------|
| 2020 | \$ 84 | \$ 83 |
| 2021 | 85 | 84 |
| 2022 | 89 | 88 |
| 2023 | 94 | 92 |
| 2024 | 99 | 97 |
| 2025 - 2029 | 563 | 552 |
| Total | \$ 1,014 | \$ 996 |

Postemployment Benefits

The Reserve Banks offer benefits to former qualifying or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of providing disability; medical, dental, and vision insurance; survivor income benefits, and certain workers' compensation expenses. The accrued postemployment benefit costs recognized by the Reserve Banks at December 31, 2019 and 2018 were \$111 million and \$110 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 2019 and 2018 operating expenses were \$17 million and \$3 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Combined Statements of Operations.

(10) ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive income (loss) as of December 31, 2019 and 2018 (in millions):

| | 2019 | | | 2018 | | |
|--|--|---|---|--|---|---|
| | Amount related to defined benefit retirement plan | Amount related to postretirement benefits other than retirement plans | Total accumulated other comprehensive income (loss) | 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 | \$ (3,187) | \$ (105) | \$ (3,292) | \$ (3,127) | \$ (207) | \$ (3,334) |
| Change in funded status of benefit plans: | | | | | | |
| Prior service costs arising during the year | - | 39 | 39 | - | 1 | 1 |
| Amortization of prior service cost | 9 ¹ | (31) ¹ | (22) | 62 ¹ | (32) ¹ | 30 |
| Change in prior service costs related to benefit plans | 9 | 8 | 17 | 62 | (31) | 31 |
| Net actuarial gain (loss) arising during the year | (39) | (8) | (47) | (282) | 116 | (166) |
| Amortization of net actuarial loss | 176 ¹ | 3 ¹ | 179 | 160 ¹ | 18 ¹ | 178 |
| Amortization of deferred curtailment gain | - | - | - | - | (1) | (1) |
| Change in actuarial gain (loss) related to benefit plans | 137 | (5) | 132 | (122) | 133 | 11 |
| Change in funded status of benefit plans - other comprehensive income (loss) | 146 | 3 | 149 | (60) | 102 | 42 |
| Balance at December 31 | \$ (3,041) | \$ (102) | \$ (3,143) | \$ (3,187) | \$ (105) | \$ (3,292) |

¹ Reclassification is reported as a component of "Other items of income (loss): Other components of net benefit costs" in the Combined Statements of Operations.

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Additional detail regarding the classification of accumulated other comprehensive loss is included in Notes 8 and 9.

(11) RECONCILIATION OF TOTAL DISTRIBUTION OF COMPREHENSIVE INCOME

In accordance with the Federal Reserve Act, the Reserve Banks remit excess earnings to the Treasury after providing for the cost of operations, payment of dividends, and reservation of an amount necessary to maintain the Reserve Bank's allocated portion of the aggregate surplus limitation.

In 2018, the Budget Act and the Economic Growth Act reduced the statutory limit on aggregate Reserve Bank surplus from \$10 billion to \$6.825 billion, which required Reserve Banks to make two lump sum payments to the Treasury totaling \$3.175 billion. These lump sum payments were reported as a component of "Earnings remittances to the Treasury" in the Combined Statements of Operations for the year ended December 31, 2018. The Federal Reserve Act currently limits aggregate Reserve Bank surplus to \$6.825 billion.

The following table presents the distribution of the System total comprehensive income for the years ended December 31, 2019 and 2018 (in millions):

| | 2019 | 2018 |
|---|------------------|------------------|
| Net income before providing for remittances to Treasury | \$ 55,458 | \$ 63,101 |
| Other comprehensive income | 149 | 42 |
| Comprehensive income - available for distribution | <u>\$ 55,607</u> | <u>\$ 63,143</u> |
| Distribution of comprehensive income (loss): | | |
| Transfer from surplus | \$ - | \$ (3,175) |
| Dividends | 714 | 999 |
| Earnings remittances to the Treasury ¹ | <u>54,893</u> | <u>65,319</u> |
| Total distribution of comprehensive income | <u>\$ 55,607</u> | <u>\$ 63,143</u> |

¹ Inclusive of lump-sum payments required by legislation enacted during the year ended December 31, 2018.

(12) SUBSEQUENT EVENTS

There were no subsequent events that required adjustments to or disclosures in the combined financial statements as of December 31, 2019. Subsequent events were evaluated through March 6, 2020, which is the date that the combined financial statements were available to be issued.