Federal Reserve Operations
Banking Supervision and Regulation

The Federal Reserve has supervisory and regulatory authority over a variety of financial institutions and activities. It plays an important role as the consolidated supervisor of bank holding companies (BHCs), including financial holding companies. And it is the primary federal supervisor of state banks that are members of the Federal Reserve System.

In the midst of general improvements in financial markets throughout the course of 2009, U.S. BHCs and state member banks continued to face substantial challenges. As a group, BHCs returned to profitability in 2009, reporting $14.5 billion in earnings following a $30.7 billion loss in 2008. But 41 percent of all BHCs representing 36.3 percent of assets reported losses in 2009. Improved market conditions boosted trading revenues and triggered appreciation in securities portfolios. Although BHC assets grew 15.2 percent from 2008, lending contracted 2.9 percent. The nonperforming assets ratio escalated to 4.7 percent of loans and foreclosed assets, an 18-year high. Weaknesses were broad based, encompassing residential mortgages (first-lien), commercial real estate—especially non-owner nonfarm nonresidential and construction other than single-family—and commercial and industrial (C&I) loans. BHC capital ratios improved substantially during 2009. Of the 596 BHCs that received funds from the U.S. Department of Treasury’s (Treasury) Troubled Asset Relief Program (TARP), 57 have repaid all funds received; approximately 66 percent of all funds distributed have been repaid.

State member banks faced challenges similar to those faced by BHCs in 2009. As a group, state member banks sustained losses of $4.4 billion in 2009—in part attributed to a special assessment by the Federal Deposit Insurance Corporation (FDIC) and somewhat less than the $4.8 billion loss incurred in 2008. Earnings remained lackluster due to elevated provision levels and a sizable increase in securities losses to $4.2 billion, but benefited from higher trading revenue as market conditions improved. Mirroring trends at BHCs, the nonperforming assets ratio escalated to 4.6 percent of loans and foreclosed assets, reflecting both contracting loan balances and weakening asset quality. Construction lending accounted for one-third of the growth in problem loans, but weakness encompassed nonfarm nonresidential lending, residential mortgages, and C&I loans. The risk-based capital ratios for state member banks improved over 2009 in the aggregate, but the percent of state member banks deemed well capitalized by ratios, consistent with the designation under prompt corrective action standards, dropped to 96 percent from 98 percent at year-end 2008. State member banks repaid approximately $19.3 billion or 48 percent of funds received from TARP. In 2009, 16 state member banks with $13.4 billion in assets failed, with losses of $3.6 billion according to FDIC estimates.

In response to the market turmoil of 2008, Treasury and the Federal Reserve, working with other federal banking agencies, initiated the Supervisory Capital Assessment Program
(SCAP). Popularly known as the bank “stress test,” the SCAP was designed to ensure that 19 of the largest U.S. BHCs had sufficient financial strength to absorb losses under a more adverse than expected macroeconomic scenario, while remaining sufficiently capitalized to meet the needs of their creditworthy borrowers. As a result of our analysis, it was determined that 10 of the BHCs assessed under SCAP needed to augment their capital by a combined total of $185 billion, almost all in the form of common equity. The transparency around supervisors’ loss estimates increased investor confidence in the banking system and helped open the public equity markets to these institutions. Actions taken by the 10 BHCs needing to increase their capital buffer, together with related actions to support repayment of Treasury capital by the 19 banking organizations, increased their aggregate tier 1 common capital by nearly $200 billion. In conjunction with these efforts, the Federal Reserve issued guidance on BHCs’ capital planning in March 2009. All of these actions have significantly improved the quality of capital across the largest U.S. banking organizations.

In October 2009, the Federal Reserve issued interagency guidance on commercial real estate (CRE) loan restructurings and workouts. This policy statement provides guidance for examiners and for financial institutions that are working with CRE borrowers who are experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties. The statement is especially relevant to small businesses because owner-occupied CRE often serves as collateral for many small business loans. To underscore expectations regarding the guidance, the Federal Reserve conducted extensive outreach to examiners and the industry.

During 2009, the Federal Reserve continued to work with banking organizations to correct some of the risk-management weaknesses revealed by the financial crisis that began in mid-2007. These supervisory activities covered a number of areas, including firmwide risk identification, senior management oversight, and liquidity risk management. Where institutions did not make appropriate progress, supervisors downgraded supervisory ratings and used enforcement tools to bring about corrective action.

Federal Reserve staff continued to work with the other federal banking agencies to implement the advanced approaches of the Basel II Capital Accord in the United States, with the final rule taking effect on April 1, 2008. A number of institutions have begun their transition to the new rules after having developed implementation plans and worked to put in place systems that will comply with the final rule’s qualification requirements.

In light of identified supervisory lessons learned, the Federal Reserve plans to augment its processes for conducting


2. The Basel II Capital Accord, an international agreement formally titled “International Convergence of Capital Measurement and Capital Standards: A Revised Framework,” was developed by the Basel Committee on Banking Supervision, which is made up of representatives of the central banks or other supervisory authorities of 19 countries. The original document was issued in 2004; the original version and an updated version issued in November 2005 are available on the website of the Bank for International Settlements (www.bis.org).
examinations and inspections as needed, as well as its processes for ensuring that there is appropriate follow-up with institutions about issues identified during examinations and inspections.

**Scope of Responsibilities for Supervision and Regulation**

The Federal Reserve is the federal supervisor and regulator of all U.S. BHCs, including financial holding companies formed under the authority of the 1999 Gramm-Leach-Bliley Act, and state-chartered commercial banks that are members of the Federal Reserve System. In overseeing these organizations, the Federal Reserve seeks primarily to promote their safe and sound operation, including their compliance with laws and regulations.

The Federal Reserve also has responsibility for supervising the operations of all Edge Act and agreement corporations, the international operations of state member banks and U.S. BHCs, and the U.S. operations of foreign banking organizations.

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

**Supervision for Safety and Soundness**

To promote the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations and inspections and off-site surveillance and monitoring. It also takes enforcement and other supervisory actions as necessary.

**Examinations and Inspections**

The Federal Reserve conducts examinations of state member banks, the U.S. branches and agencies of foreign banks, and Edge Act and agreement corporations. In a process distinct from examinations, it conducts inspections of BHCs and their nonbank subsidiaries. Whether an examination or an inspection is being conducted, the review of operations entails (1) an evaluation of the adequacy of governance provided by the board and senior management, including an assessment of internal policies, procedures, controls, and operations; (2) an assessment of the quality of the risk-management and internal control processes in place to identify, measure, monitor, and control risks; (3) an assessment of the key financial factors of capital, asset quality, earnings, and liquidity; and (4) a review for compliance with applicable laws and regulations. The accompanying table (see next page) provides information on examinations and inspections conducted by the Federal Reserve during the past five years.

Inspections of BHCs, including financial holding companies, are built around a rating system introduced in 2005 that reflects the shift in supervisory practices away from a historical
analysis of financial condition toward a more dynamic, forward-looking assessment of risk-management practices and financial factors. Under the system, known as RFI but more fully termed RFI/C(D), holding companies are assigned a composite rating (C) that is based on assessments of three components: Risk Management (R), Financial Condition (F), and the potential Impact (I) of the parent company and its non-depository subsidiaries on the subsidiary depository institution. The fourth component, Depository Institution (D), is intended to mirror the primary supervisor’s rating of the subsidiary depository institution.

The Federal Reserve uses a risk-focused approach to supervision, with activities focused on identifying the areas of greatest risk to banking organizations and assessing the ability of the organizations’ management processes for identifying, measuring, monitoring, and controlling those risks. Key aspects of the risk-focused approach to consolidated supervision of large complex banking organizations (LCBOs) include (1) developing an understanding of each LCBO’s legal and operating structure, and its primary strategies, business lines, and risk-management and internal control functions; (2) developing and executing a tailored supervisory plan outlining the work required to maintain a comprehensive understanding and assessment of each LCBO, incorporating reliance to the

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

2. Total assets (billions of dollars) includes foreign bank holding companies.

3. Each of the first two components has four subcomponents: Risk Management—(1) Board and Senior Management Oversight; (2) Policies, Procedures, and Limits; (3) Risk Monitoring and Management Information Systems; and (4) Internal Controls. Financial Condition—(1) Capital; (2) Asset Quality; (3) Earnings; and (4) Liquidity.
fullest extent possible on assessments and information developed by other relevant domestic and foreign supervisors and functional regulators; (3) maintaining continual supervision of these organizations—including through meetings with banking organization management and analysis of internal and external information—so that the Federal Reserve’s understanding and assessment of each organization’s condition remains current; (4) assigning to each LCBO a supervisory team composed of Reserve Bank staff members who have skills appropriate for the organization’s risk profile (the team leader is the Federal Reserve System’s central point of contact for the organization, has responsibility for only one LCBO, and is supported by specialists capable of evaluating the risks of LCBO business activities and functions and assessing the LCBO’s consolidated financial condition); and (5) promoting Systemwide and interagency information-sharing through automated systems and other mechanisms.

For other banking organizations, the risk-focused consolidated supervision program provides that examination and inspection procedures are tailored to each banking organization’s size, complexity, risk profile, and condition. As with the LCBOs, these supervisory programs entail both off-site and on-site work, including planning, preexamination visits, detailed documentation, and examination reports tailored to the scope and findings of the examination.

State Member Banks

At the end of 2009, 845 state-chartered banks (excluding nondepository trust companies and private banks) were members of the Federal Reserve System. These banks represented approximately 12 percent of all insured U.S. commercial banks and held approximately 14 percent of all insured commercial bank assets in the United States.

The guidelines for Federal Reserve examinations of state member banks are fully consistent with section 10 of the Federal Deposit Insurance Act, as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994. A full-scope, on-site examination of these banks is required at least once a year, although certain well-capitalized, well-managed organizations having total assets of less than $500 million may be examined once every 18 months. The Federal Reserve conducted 655 exams of state member banks in 2009.

Bank Holding Companies

At year-end 2009, a total of 5,634 U.S. BHCs were in operation, of which 4,974 were top-tier BHCs. These organizations controlled 5,710 insured commercial banks and held approximately 99 percent of all insured commercial bank assets in the United States.

Federal Reserve guidelines call for annual inspections of large BHCs and complex smaller companies. In judging the financial condition of the subsidiary banks owned by holding companies, Federal Reserve examiners consult examination reports prepared by the federal and state banking authorities that have primary responsibility for the supervision of those banks, thereby

4. The Financial Services Regulatory Relief Act of 2006, which became effective in October 2006, authorized the federal banking agencies to raise the threshold from $250 million to $500 million, and final rules incorporating the change into existing regulations were issued on September 21, 2007.
minimizing duplication of effort and reducing the supervisory burden on banking organizations. Noncomplex BHCs with consolidated assets of $1 billion or less are subject to a special supervisory program that permits a more flexible approach. In 2009, the Federal Reserve conducted 640 inspections of large BHCs and 3,109 inspections of small, noncomplex BHCs.

Financial Holding Companies

Under the Gramm-Leach-Bliley Act, BHCs that meet certain capital, managerial, and other requirements may elect to become financial holding companies and thereby engage in a wider range of financial activities, including full-scope securities underwriting, merchant banking, and insurance underwriting and sales. The statute streamlines the Federal Reserve’s supervision of all BHCs, including financial holding companies, and sets forth parameters for the supervisory relationship between the Federal Reserve and other regulators. The statute also differentiates between the Federal Reserve’s relations with regulators of depository institutions and its relations with functional regulators.

As of year-end 2009, 479 domestic BHCs and 46 foreign banking organizations had financial holding company status. Of the domestic financial holding companies, 35 had consolidated assets of $15 billion or more; 111, between $1 billion and $15 billion; 74, between $500 million and $1 billion; and 259, less than $500 million.

International Activities

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

Foreign Operations of U.S. Banking Organizations

In supervising the international operations of state member banks, Edge Act and agreement corporations, and BHCs, the Federal Reserve generally conducts its examinations or inspections at the U.S. head offices of these organizations, where the ultimate responsibility for the foreign offices lies. Examiners also visit the overseas offices of U.S. banks to obtain financial and operating information and, in some instances, to evaluate the organization’s efforts to implement corrective measures or to test their adherence to safe and sound banking practices. Examinations abroad are conducted with the cooperation of the supervisory authorities of the countries in which they take place; for national banks, the examinations are coordinated with the Office of the Comptroller of the Currency (OCC).

At the end of 2009, 53 member banks were operating 557 branches in foreign countries and overseas areas of the United States; 32 national banks were operating 503 of these branches, and 21 state member banks were operating the remaining 54. In addition, 18 nonmember banks were operating 26 branches in foreign countries and overseas areas of the United States.

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

Edge Act corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international business, especially exports. Agreement corporations are similar organizations, state chartered or federally chartered, that enter into agreements with the Board to refrain from exercising any power that is not permissible for an Edge Act corporation.

Sections 25 and 25A of the Federal Reserve Act grant Edge Act and agreement corporations permission to engage in international banking and foreign financial transactions. These corporations, most of which are subsidiaries of member banks, may (1) conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions, and (2) make foreign investments that are broader than those permissible for member banks.

At year-end 2009, 55 banking organizations, operating 10 branches, were chartered as Edge Act or agreement corporations. These corporations are examined annually.

**U.S. Activities of Foreign Banks**

The Federal Reserve has broad authority to supervise and regulate the U.S. activities of foreign banks that engage in banking and related activities in the United States through branches, agencies, representative offices, commercial lending companies, Edge Act corporations, commercial banks, BHCs, and certain nonbanking companies. Foreign banks continue to be significant participants in the U.S. banking system.

As of year-end 2009, 176 foreign banks from 53 countries were operating 204 state-licensed branches and agencies, of which 6 were insured by the FDIC, and 50 OCC-licensed branches and agencies, of which 4 were insured by the FDIC. These foreign banks also owned 8 Edge Act and agreement corporations and 3 commercial lending companies; in addition, they held a controlling interest in 58 U.S. commercial banks. Altogether, the U.S. offices of these foreign banks at the end of 2009 controlled approximately 17 percent of U.S. commercial banking assets. These 176 foreign banks also operated 78 representative offices; an additional 58 foreign banks operated in the United States through a representative office.

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

In cooperation with the other federal and state banking agencies, the Federal Reserve conducts a joint program for supervising the U.S. operations of foreign banking organizations. The program has two main parts. One part involves examination of those foreign banking organizations that have multiple U.S. operations and is intended to ensure coordination among the various U.S. supervisory agencies. The other part is a review of the financial and operational profile of each organization to assess its general ability to support its U.S. operations and to determine what risks, if any, the organization poses through its U.S. operations. Together, these two processes provide critical information to U.S. supervisors in a logical, uniform, and timely manner. The Federal Reserve conducted or partici-
pated with state and federal banking agencies in 430 examinations in 2009.

Compliance with Regulatory Requirements

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

Anti-Money-Laundering Examinations

The Treasury regulations implementing the Bank Secrecy Act (BSA) generally require banks and other types of financial institutions to file certain reports and maintain certain records that are useful in criminal, tax, or regulatory proceedings. The BSA and separate Board regulations require banking organizations supervised by the Board to file reports on suspicious activity related to possible violations of federal law, including money laundering, terrorism financing, and other financial crimes. In addition, BSA and Board regulations require that banks develop written BSA compliance programs and that the programs be formally approved by bank boards of directors. The Federal Reserve is responsible for examining institutions for compliance with applicable anti-money-laundering laws and regulations and conducts such examinations in accordance with the Federal Financial Institutions Examination Council (FFIEC) Bank Secrecy Act/Anti-Money Laundering Examination Manual.6

Specialized Examinations

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

Information Technology Activities

In recognition of the importance of information technology to safe and sound operations in the financial industry, the Federal Reserve reviews the information technology activities of supervised banking organizations as well as certain independent data centers that provide information technology services to these organizations. All safety and soundness examinations include a risk-focused review of information technology risk-management activities. During 2009, the Federal Reserve continued as

6. The FFIEC is an interagency body of financial regulatory agencies established to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the chair of the State Liaison Committee.
the lead agency in three interagency examinations of large, multiregional data processing servicers, and it assumed leadership in one additional examination.

**Fiduciary Activities**

The Federal Reserve has supervisory responsibility for state member banks and state member nondepository trust companies that reported $43.3 trillion and $33.9 trillion of assets, respectively, as of year-end 2009, held in various fiduciary and custodial capacities. On-site examinations of fiduciary and custody activities are risk-focused and entail the review of an organization’s compliance with laws, regulations, and general fiduciary principles, including effective management of conflicts of interest; management of legal, operational, and reputational risk exposures; and audit and control procedures. In 2009, Federal Reserve examiners conducted 68 on-site fiduciary examinations, excluding transfer agent examinations, of state member banks.

**Transfer Agents**

As directed by the Securities Exchange Act of 1934, the Federal Reserve conducts specialized examinations of those state member banks and BHCs that are registered with the Board as transfer agents. Among other things, transfer agents countersign and monitor the issuance of securities, register the transfer of securities, and exchange or convert securities. On-site examinations focus on the effectiveness of an organization’s operations and its compliance with relevant securities regulations. During 2009, the Federal Reserve conducted on-site transfer agent examinations at 16 of the 49 state member banks and BHCs that were registered as transfer agents.

**Government and Municipal Securities Dealers and Brokers**

The Federal Reserve is responsible for examining state member banks and foreign banks for compliance with the Government Securities Act of 1986 and with the Treasury regulations governing dealing and brokering in government securities. Eleven state member banks and four state branches of foreign banks have notified the Board that they are government securities dealers or brokers not exempt from the Treasury’s regulations. During 2009, the Federal Reserve conducted five examinations of broker-dealer activities in government securities at these organizations. These examinations are generally conducted concurrently with the Federal Reserve’s examination of the state member bank or branch.

The Federal Reserve is also responsible for ensuring that state member banks and BHCs that act as municipal securities dealers comply with the Securities Act Amendments of 1975. Municipal securities dealers are examined pursuant to the Municipal Securities Rulemaking Board’s rule G-16 at least once every two calendar years. Of the 11 entities that dealt in municipal securities during 2009, five were examined during the year.

**Securities Credit Lenders**

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

At the end of 2009, 566 lenders other than banks, brokers, or dealers were registered with the Federal Reserve. Other federal regulators supervised 186 of these lenders, and the remaining 380 were subject to limited Federal Reserve supervision. The Federal Reserve exempted 168 lenders from its on-site inspection program on the basis of their regulatory status and annual reports. Fifty-one inspections were conducted during the year.

Business Continuity/Pandemic Preparedness

In 2009, the Federal Reserve continued its efforts to strengthen the resilience of the U.S. financial system in the event of unexpected disruptions, including focused supervisory efforts to evaluate the resiliency of the banking institutions under its jurisdiction. Particular emphasis was placed on large institutions’ preparedness for a pandemic-like event and on the resiliency requirements imposed on core and significant market firms under the Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System.7

The Federal Reserve, together with other federal and state financial regulators, is a member of the Financial Banking Information Infrastructure Committee (FBIIIC), which was formed to improve coordination and communication among financial regulators, enhance the resilience of the U.S. financial sector, and promote the public/private partnership. The FBIIIC has established emergency communication protocols to maintain effective communication among members in the event of an emergency. The FBIIIC protocols were active at various points in 2009 to monitor the status and impact of the H1N1 flu outbreak and each time a significant storm made landfall in the United States.

In January 2009, the Federal Reserve and the other FFIEC agencies participated in a pandemic-related tabletop exercise conducted through the FFIEC Task Force on Supervision. The exercise accomplished the following main objectives: validate current interagency pandemic planning and identify existing gaps in communications; share agency key response triggers, emphasizing response activation and resumption of normal business; consider ramifications of national infrastructure limitations; and review response context for any needed policymaking.

In September 2009, the Federal Reserve joined other financial regulatory agencies, the Financial Services Sector Coordinating Council, and the Financial Services Information Sharing and Analysis Center in conducting the Cyber Financial Industry and Regulators Exercise of 2009. This exercise brought together 76 registered partici-

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7. The population under review included core clearing and settlement organizations and firms that play a critical role in financial markets and are subject to resiliency guidelines issued in April 2003, also called the “Sound Practices Paper.”
pants, including regulators, exchanges, and firms from across the financial services sector to respond to a series of disruptive scenario events. One of the primary objectives of the exercise was to develop a better understanding of the dependencies of the sector upon the information and communications infrastructure that may impact the sector’s security and resilience.

Enforcement Actions

The Federal Reserve has enforcement authority over the banking organizations it supervises and their affiliated parties. Enforcement actions may be taken to address unsafe and unsound practices or violations of any law or regulation. Formal enforcement actions include cease-and-desist orders, written agreements, removal and prohibition orders, and civil money penalties. In 2009, the Federal Reserve completed 191 formal enforcement actions. Civil money penalties totaling $249,570 were assessed. As directed by statute, all civil money penalties are remitted to either the Treasury or the Federal Emergency Management Agency. Enforcement orders and prompt corrective action directives, which are issued by the Board, and written agreements, which are executed by the Reserve Banks, are made public and are posted on the Board’s website (www.federalreserve.gov/boardeocs/enforcement/).

In addition to taking these formal enforcement actions, the Reserve Banks completed 467 informal enforcement actions in 2009. Informal enforcement actions include memoranda of understanding and board of directors resolutions. Information about these actions is not available to the public.

Surveillance and Off-Site Monitoring

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

The primary off-site monitoring tool used by the Federal Reserve is the Supervision and Regulation Statistical Assessment of Bank Risk model (SR-SABR). Drawing mainly on the financial data that banks report on their Reports of Condition and Income (Call Reports), SR-SABR uses econometric techniques to identify banks that report financial characteristics weaker than those of other banks assigned similar supervisory ratings. To supplement the SR-SABR screening, the Federal Reserve also monitors various market data, including equity prices, debt spreads, agency ratings, and measures of expected default frequency, to gauge market perceptions of the risk in banking organizations. In addition, the Federal Reserve prepares quarterly Bank Holding Company Performance Reports (BHCPRs) for use in monitoring and inspecting supervised banking organizations. The BHCPRs, which are compiled from data provided by large BHCs in quarterly regulatory reports (FR Y-9C and FR Y-9LP), contain, for individual companies, financial statistics and comparisons with peer companies. BHCPRs are made available to the public on the National Information Center (NIC) website, which can be accessed at www.ffiec.gov.
During 2009, three major upgrades to the web-based Performance Report Information and Surveillance Monitoring (PRISM) application were completed. PRISM is a querying tool used by Federal Reserve analysts to access and display financial, surveillance, and examination data. In the analytical module, users can customize the presentation of institutional financial information drawn from Call Reports, Uniform Bank Performance Reports, FR Y-9 statements, BHCPRs, and other regulatory reports. In the surveillance module, users can generate reports summarizing the results of surveillance screening for banks and BHCs.

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

International Training and Technical Assistance

In 2009, the Federal Reserve continued to provide technical assistance on bank supervisory matters to foreign central banks and supervisory authorities. Technical assistance involves visits by Federal Reserve staff members to foreign authorities as well as consultations with foreign supervisors who visit the Board or the Reserve Banks. The Federal Reserve, along with the OCC, the FDIC, and the Treasury, was an active participant in the Middle East and North Africa Financial Regulators’ Training Initiative, which is part of the U.S. government’s Middle East Partnership Initiative. The Federal Reserve also contributes to the regional training provision under the Asia Pacific Economic Cooperation Financial Regulators’ Training Initiative.

In 2009, the Federal Reserve offered a number of training courses exclusively for foreign supervisory authorities, both in the United States and in a number of foreign jurisdictions. System staff also took part in technical assistance and training missions led by the International Monetary Fund, the World Bank, the Asian Development Bank, the Basel Committee on Banking Supervision (Basel Committee), and the Financial Stability Institute.

The Federal Reserve is also an associate member of the Association of Supervisors of Banks of the Americas (ASBA), an umbrella group of bank supervisors from countries in the Western Hemisphere. The group, headquartered in Mexico, promotes communication and cooperation among bank supervisors in the region; coordinates training programs throughout the region with the help of national banking supervisors and international agencies; and aims to help members develop banking laws, regulations, and supervisory practices that conform to international best practices. The Federal Reserve contributes significantly to ASBA’s organizational management and to its training and technical assistance activities.

Initiatives for Minority-Owned and De Novo Depository Institutions

Partnership for Progress is a program created by the Federal Reserve to foster the strength and vitality of the nation’s minority-owned and de novo depository institutions. Launched in 2008, the program seeks to help these institutions compete effectively in today’s marketplace by offering a combination of one-on-one guidance and targeted workshops on topics of particular relevance to starting and growing a bank in a safe and sound manner.

Designated Partnership for Progress contacts in each of the 12 Reserve
Bank Districts and at the Board answer questions and coordinate assistance for institutions requesting guidance. These contacts also host regional conferences and conduct other outreach activities within their Districts in support of minority and de novo institutions. In 2009, the Reserve Banks hosted over 15 such regional training sessions, workshops, and conferences to provide assistance on key aspects of banking supervision. In December 2009, the staff met with select CEOs from these institutions to learn about their business challenges and opportunities and solicit inputs for improving Partnership for Progress.

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

Additional information on the Partnership for Progress can be found online at www.fedpartnership.gov/.

Supervisory Capital Assessment Program

The weak economic outlook entering 2009 contributed to uncertainty around the health and viability of U.S. financial institutions, jeopardizing the critical role banks play in lending to creditworthy households and businesses. With financial markets unwilling to provide capital to financial firms given this uncertainty, the Treasury worked with the Federal Reserve and the other federal banking agencies to initiate a supervisory exercise to assess whether major U.S. banking organizations needed an additional capital buffer, and to offer Treasury-contingent common equity to firms unable to raise the necessary capital through market issuance.

Beginning in February, the Federal Reserve led the effort to estimate potential losses—and resources available to absorb those losses—at 19 of the largest U.S. banking organizations, assuming an economic scenario more severe than was anticipated. This effort was designed to ensure that the firms would remain strongly capitalized and able to fulfill their function of providing credit to creditworthy borrowers. Termed the “Supervisory Capital Assessment Program,” or “SCAP,” this unprecedented effort involved over 150 examiners and analysts from across the Federal Reserve System and other federal banking agencies. Supervisors, economists, accountants, market specialists, and attorneys from the various agencies played a significant role in designing and executing the SCAP framework. The SCAP was unusually transparent for a supervisory exercise, as the Federal Reserve published a white paper detailing the methodology, process, and key economic assumptions underlying the analysis. The results were also published, with supervisors estimating total losses over 2009 and 2010 of $600 billion under the more adverse scenario.

In the aggregate, the 19 banking organizations were found to need $185 billion of capital, with the vast majority in the form of common equity, to establish the required capital buffer. The SCAP’s emphasis on common equity reflects the fact that it is the first element of the capital structure to absorb losses, offers protection to more senior parts of the capital structure, and low-
ers the risk of insolvency. The 10 BHCs projected to have inadequate common stock under the stress test were required to submit a plan for raising such capital by early November. The Federal Reserve’s identification of these organizations’ capital needs, and its supervisory directive to these banking organizations to raise much-needed capital, helped restore confidence in the banking system and helped reopen the public equity markets to these institutions. In fact, the SCAP process, and related analysis of capital needed to support repayment of Treasury capital (led by the Federal Reserve), caused these 19 banking organizations to increase their tier 1 common capital by nearly $200 billion in 2009. These efforts have contributed to the recovery of nearly 70 percent of Treasury investments in the banking system.

The SCAP has served as a model for developing more effective and comprehensive supervision of the financial system. In the future, the Federal Reserve will increase its use of horizontal examinations and scenario analysis. As with the SCAP, these activities will involve multi-disciplinary perspectives, data-driven analysis to facilitate benchmarking across institutions, and expanded cooperation with primary and functional supervisors.

**Supervisory Policy**

In December, the Board approved a final rule amending the risk-based capital adequacy frameworks for state member banks and BHCs following changes to the U.S. generally accepted accounting principles from the Financial Accounting Standard Board’s (FASB’s) Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140*, and Statement of Financial Accounting Standards 167, *Amendment to FASB Interpretation No. 46(R)* (FAS 166 and FAS 167). The final rule eliminates the exclusion of certain consolidated asset-backed commercial paper programs from risk-weighted assets; provides for a transitional phase-in of the effect on risk-weighted assets and tier 2 capital resulting from the implementation of FAS 166 and FAS 167; and adds a reservation of authority addressing off-balance sheet entities. The final rule was issued by the federal banking agencies in January 2010.

During the year, the Board, in some instances together with the other federal banking agencies, issued several rulemakings and guidance documents:

- The Board issued for comment proposed guidance designed to help ensure that incentive compensation policies at banking organizations do not encourage excessive risk taking and are consistent with the safety and soundness of the organization. The Board also announced two supervisory initiatives designed to spur and monitor progress towards safe and sound incentive compensation arrangements, to identify emerging best practices, and to advance the state of practice more generally in the industry. The Board’s initiatives are consistent with the *Principles for Sound Compensation Practices* issued in April 2009 by the Financial Stability Board and with the associated implementation standards. Final guidance is expected to be issued in 2010.
- The Board issued guidance regarding BHCs’ declaration and payment of dividends, capital redemptions, and capital repurchases in the context of their capital planning processes. The
guidance largely reiterates Board supervisory policies and guidance in light of recent market events and highlights expectations regarding when a BHC should inform and consult with the Federal Reserve in advance of taking capital-related actions that could raise safety-and-soundness concerns. In addition, the Board issued Dividend Increases and Other Capital Distributions for the 19 Supervisory Capital Assessment Firms, a temporary addendum to the guidance advising certain BHCs to consult with Federal Reserve staff before taking any actions that could result in a diminished capital base, including increasing dividends or redeeming or repurchasing capital instruments.

- The Board issued supervisory guidance for BHCs and state member banks subject to the market risk capital rule that emphasizes some of the rule’s core requirements and provides additional information and clarification on certain technical aspects of the rule. The guidance emphasizes requirements around the application of the market risk capital rule to all positions covered by the rule; risk capture in market risk models and model backtesting; and banking organizations’ independent reviews of their market risk-management and measurement systems.

- The federal banking agencies issued guidance to banking organizations on the appropriate risk weighting of California-registered warrants for risk-based capital purposes. The guidance also discussed risk-management considerations with respect to accepting these warrants.

- Recognizing the challenges faced by banking organizations in raising capital in the uncertain economic environment, the Board adopted a final rule that delays until March 31, 2011, the effective date of new limits on the inclusion of trust preferred securities and other restricted core capital elements in tier 1 capital.

- The federal banking agencies issued a final rule providing that mortgage loans modified under the Treasury’s Home Affordable Mortgage Program will generally retain the risk weight appropriate to the mortgage loan prior to modification.

- The federal banking agencies, together with the FCA and the NCUA, issued jointly for comment proposed rules requiring mortgage loan originators who are employees of institutions regulated by these agencies to meet the registration requirements of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the S.A.F.E. Act). The S.A.F.E. Act requires these agencies to jointly develop and maintain a system for registering residential mortgage loan originators who are employees of certain regulated institutions, including national and state banks, savings associations, credit unions, and Farm Credit System institutions, and certain of their subsidiaries. A final rule is expected to be issued in 2010.

Capital Adequacy Standards

In 2009, Board and Reserve Bank staff conducted supervisory analyses of a large number of complex capital issuances, private capital investments, and novel transactions to determine their qualification for inclusion in regulatory capital and consistency with safety and soundness. Much of the work involved evaluating enhanced forms of trust preferred securities, mandatory convertible securities, perpetual preferred stock,
and convertible perpetual preferred stock (mandatory and optionally convertible). Board and Reserve Bank analyses of these capital issuances focused on compliance with the qualifying standards for tier 1 capital under the Board’s capital rules, as well as consistency with safety and soundness. Staff required banking organizations to make changes needed for instruments to satisfy these criteria. Much of such staff review during 2009 focused on large amounts of common stockholders’ equity raised under the SCAP process discussed above, as well as other banking organizations’ capital issuances.

Board staff also participated in the review of many applications for private capital investments by private equity firms and other private investors to invest in banking organizations, including banking organizations in severely impaired financial condition. The focus of the analyses of such capital investments is compliance with the Board’s capital standards for inclusion in tier 1 capital, as well as consistency with safety and soundness to ensure that the terms of such private investments do not (1) impede prudent action by issuing banking organizations to address financial issues or (2) impair the Federal Reserve’s ability to take appropriate supervisory action.

Board and Reserve Bank staff also reviewed a significant number of exchange transactions conducted for the purpose of increasing GAAP equity to determine consistency with safety and soundness. These exchange transactions generally involved the exchange of billions of dollars of trust preferred securities at a deep discount in exchange for common stock, thereby increasing the percentage of banking organizations’ tier 1 capital comprised of common stock.

Board staff also continued in 2009 to work closely with the Treasury on the terms of the capital instruments issued by banking organizations under the Capital Purchase Program (CPP), initiated in 2008, and the Capital Assistance Program (CAP), initiated in 2009. The purpose of these programs was to buttress the financial strength of banking organizations and the overall banking and financial systems to enable them to withstand severe financial stresses during 2009. Board staff reviewed the terms of securities structured by the Treasury for issuance by banking organizations under the CPP and CAP to determine their qualification for inclusion in tier 1 capital and consistency with safety and soundness. The Board issued interim final and final rules authorizing the inclusion in BHCs’ tier 1 capital of CPP and CAP securities issued by publicly traded banking organizations. The Board also issued an interim final rule allowing the inclusion in BHCs’ tier 1 capital of TARP securities issued by S corporations and mutual banking organizations to the Treasury.

Other Policy Issues

In 2009, the Board evaluated the condition of banking organizations applying to participate in the Treasury’s CPP, assessed the ongoing capital requirements of large banking organizations through the SCAP, and provided transparent guidelines regarding the capital requirements of banking organizations preparing applications to redeem the Treasury’s capital investment in their firms. Among these activities during 2009 were the following:

- The Board issued with the federal banking agencies and Treasury a joint statement on the CAP that
described the SCAP, which assessed the amount and quality of capital of the largest banking organizations under challenging economic scenarios.

- The Board published a white paper on process and methodologies employed by federal banking agencies in capital assessment of large U.S. BHCs (SCAP).
- The Board, with Treasury, FDIC, and OCC, issued a joint statement on the CAP and SCAP and released the results of the assessments of the 19 largest BHCs.

Accounting Policy

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

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

During 2009, Federal Reserve staff participated in activities arising from global market conditions and in support of efforts related to financial stability. The financial crisis raised accounting and reporting challenges for the financial sector. Addressing these challenges was a priority for Federal Reserve staff members. Significant issues arising from stressed market conditions included accounting for financial instruments at fair value, accounting for impairment in securities and other financial instruments, and accounting for asset securitizations and other off-balance-sheet items. Staff members participated in a number of discussions with accounting and auditing standard-setters and provided commentary on a number of proposals relevant to the financial sector. For example, staff provided comment letters to the FASB on proposals related to the use of fair value when inactive markets and distressed transactions exist and the recognition and presentation of impairment on investment securities. Staff also contributed to the development of numerous comment letters related to accounting and auditing matters that were submitted to the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board through the Basel Committee.

With respect to the future of financial reporting, Federal Reserve staff
provided a comment letter to the Securities and Exchange Commission (SEC) on a roadmap for potential use of International Financial Reporting Standards in the United States. This letter supported the long-term goal of a single set of high-quality global standards and also identified a few challenges that would need to be addressed before establishing a date for U.S. companies to utilize International Financial Reporting Standards. The Federal Reserve supported the efforts of the FASB and the IASB to continue toward the achievement of converged standards, which should help to improve comparability of financial reporting across national jurisdictions and promote more efficient capital allocation. The Federal Reserve was actively involved in monitoring standard-setting projects that affect convergence, particularly with regard to financial instrument accounting, off-balance-sheet accounting, fair-value measurements, and provisioning. Federal Reserve staff continued to stress the importance of effective financial reporting and global convergence of accounting standards through regular interactions with the FASB and the IASB.

Given the Federal Reserve’s unique perspectives on the challenges facing financial institutions and our role in the financial markets, staff participated on the joint FASB and IASB Financial Crisis Advisory Group, which published in July its review of standard-setting activities following the global financial crisis. Federal Reserve staff also participated on the FASB’s Valuation Resource Group, which was created to assist the FASB in matters involving valuation for financial reporting purposes.

The Federal Reserve issued supervisory guidance to financial institutions and supervisory staff on accounting matters as appropriate. In addition, Federal Reserve policy staff support the efforts of the Reserve Banks in financial institution supervisory activities related to financial accounting, auditing, reporting, and disclosure.

Compliance Risk Management

Bank Secrecy Act and Anti-Money-Laundering Compliance

In 2009, the Federal Reserve provided training for staff on risk-focusing and the use of the FFIEC minimum BSA/Anti-Money-Laundering (AML) examination procedures in conjunction with broader efforts to increase consistency and address industry concerns about regulatory burden. The Federal Reserve currently chairs the FFIEC BSA/AML working group, which is a forum for the discussion of all pending BSA policy and regulatory matters, and participates in the Treasury-led Bank Secrecy Act Advisory Group, which includes representatives of regulatory agencies, law enforcement, and the financial services industry and covers all aspects of the BSA. Beginning in 2009, the FFIEC BSA/AML working group meeting participation was expanded, on a quarterly basis, to include the SEC, the Commodity Futures Trading Commission, the Internal Revenue Service, and the Office of Foreign Assets Control (OFAC) in an effort to share and discuss information on BSA/AML examination procedures and general trends.

The Federal Reserve and other federal banking agencies continued during 2009 to regularly share examination findings and enforcement proceedings with the Financial Crimes Enforcement Network under the interagency memorandum of understanding (MOU) that was finalized in 2004, and with the
International Coordination on Sanctions, Anti-Money Laundering, and Counter-Terrorism Financing

The Federal Reserve participates in a number of international coordination initiatives related to sanctions, money laundering, and terrorism financing. For example, the Federal Reserve has a long-standing role in the U.S. delegation to the intergovernmental Financial Action Task Force and its working groups, contributing a banking supervisory perspective to formulation of international standards on these matters.

The Federal Reserve also continues to contribute to international efforts to promote transparency and address risks faced by financial institutions involved in international funds transfers. The Federal Reserve participates in a subcommittee of the Basel Committee that focuses on AML/counter-terrorism financing issues. In May 2009, the Basel Committee released a paper titled *Due Diligence and Transparency regarding Cover Payment Messages Related to Cross-Border Wire Transfers*. The Federal Reserve, together with the other U.S. federal banking supervisors, issued interagency guidance clarifying the supervisors’ perspective on certain points in the Basel Committee paper, including expectations for intermediary banks on OFAC sanctions screening and transaction monitoring to comply with BSA/AML requirements.

Corporate Compliance

Federal Reserve staff conducted training and industry outreach to clarify supervisory expectations with respect to compliance risk management and to implement the Federal Reserve’s 2008 guidance relating to firmwide compliance-risk management programs and oversight at large banking organizations with complex compliance profiles.

International Guidance on Supervisory Policies

As a member of the Basel Committee, the Federal Reserve participates in efforts to advance sound supervisory policies for internationally active banking organizations and to improve the stability of the international banking system. During 2009, the Federal Reserve participated in ongoing cooperative work on strategic responses to the financial markets crisis, initiatives to enhance and implement Basel II, and many other policies. The Federal Reserve contributed to supervisory policy recommendations, reports, and papers issued by the Basel Committee, which were generally aimed at improving the supervision of banking organizations’ risk-management practices. Among these final papers, consultative papers, and other publications were the following:

Final papers:

- *Guidelines for computing capital for incremental risk in the trading book*, published in July (consultative paper previously issued in January)
- *Revisions to the Basel II market risk framework*, published in July (consultative paper previously issued in January)
- *Enhancements to the Basel II framework*, published in July (consultative paper previously issued in January)
- *Principles for sound stress testing practices and supervision*, published in May (consultative paper previously issued in January)
Consultative papers:
- International framework for liquidity risk measurement, standards and monitoring, published in December
- Strengthening the resilience of the banking sector, published in December

Other publications:
- Loss given default floors
- Analysis of the trading book quantitative impact study
- Stocktaking on the use of credit ratings
- Findings on the interaction of market and credit risk
- Report on special purpose entities
- Report and recommendations of the Cross-border Bank Resolution Group
- Range of practices and issues in economic capital frameworks

Joint Forum
In 2009, the Federal Reserve continued to participate in the Joint Forum—an international group of supervisors of the banking, securities, and insurance industries established to address varied issues crossing the traditional borders of these sectors, including the regulation of financial conglomerates. The Joint Forum operates under the aegis of the Basel Committee, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. National supervisors of these three sectors, who are members of the Joint Forum’s founding organizations, jointly meet and work together to carry out the responsibilities of the Joint Forum.

During the year, the Federal Reserve contributed to the development of supervisory policy papers, reports, and recommendations that may be issued in the near future. The Joint Forum, through its founding organizations, issued a comprehensive report on the structure and use of special purpose vehicles, Report on Special Purpose Vehicles, published on September 28, 2009. On June 15, 2009, the Joint Forum also published a final paper, Stocktaking on the Use of Credit Ratings.

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

Prudent Commercial Real Estate Loan Workouts
In October, the Federal Reserve, along with the other financial regulators of the FFIEC, issued a policy statement on Prudent Commercial Real Estate Loan Workouts. This statement was issued to update longstanding guidance regarding the classification and workout of CRE loans, especially in light of recent increases in loan workouts. The guidance promotes prudent CRE loan workouts at regulated financial institutions and instructs examiners to take a balanced and consistent approach in reviewing institutions’ workout activities. Further, examiners were reminded that renewed or restructured loans to creditworthy borrowers on reasonable terms should not be subject to adverse classification solely because the value of the underlying collateral has declined.

As discussed in the statement, prudent workouts are often in the best interest of both the institution and the borrower. The Federal Reserve expects
examiners to evaluate a regulated institution’s loan workouts, considering a project’s current and stabilized cash flows, debt service capacity, guarantor support, and other factors relevant to a borrower’s ability and willingness to repay the debt. The statement sets forth the appropriate standards for evaluating the management practices, workout arrangements, credit classification, regulatory reporting, and accounting for CRE loan workouts. The statement includes examples of CRE loan workouts, illustrating an examiner’s analytical process for credit classifications and assessment of an institution’s accounting and reporting treatments for restructured loans.

**Shared National Credit Program**

In September, the Federal Reserve, FDIC, OCC, and Office of Thrift Supervision released summary results of the 2009 annual review of the Shared National Credit (SNC) Program. The agencies established the program in 1977 to promote an efficient and consistent review and classification of shared national credits. A SNC is any loan or formal loan commitment—and any asset, such as other real estate, stocks, notes, bonds, and debentures taken as debts previously contracted—extended to borrowers by a supervised institution, its subsidiaries, and affiliates. A SNC must have an original loan amount that aggregates to $20 million or more and either (1) is shared by three or more unaffiliated supervised institutions under a formal lending agreement or (2) a portion of which is sold to two or more unaffiliated supervised institutions, with the purchasing institutions assuming their pro rata share of the credit risk.

The 2009 SNC review was based on analyses of credit data as of December 31, 2008, provided by federally supervised institutions. The 2009 review found that the commitment volume of SNCs rose 3.3 percent over the 2008 review, to $2.9 trillion. However, the number of credits remained virtually unchanged. “Criticized” assets represented 22.3 percent of the SNC portfolio, compared with 13.4 percent in the 2008 review. Criticized assets were mainly associated with the media and telecom, utilities, finance and insurance, and oil and gas sectors. Within the “criticized” category, “special mention” (potentially weak) credits declined to $195 billion, accounting for 6.8 percent of the SNC portfolio, compared with 7.5 percent in the 2008 review; and “classified” credits (credits having well-defined weaknesses) rose to $447 billion from $163 billion, accounting for 15.5 percent of the SNC portfolio compared with 5.8 percent in the 2008 review. The rise in classified and criticized credits in part resulted from the deterioration in large, leveraged credits used to finance merger and acquisition activity over the past several years. The reasons for this decline in credit quality include reliance on overly optimistic projections, weak covenant protection, and borrower’s inability to obtain new funding.

Underwriting standards in 2008 improved from prior years, with examiners identifying fewer loans with structurally weak underwriting characteristics compared to credits written in 2006 and 2007. However, the SNC portfolio contained loans with structurally weak underwriting characteristics that were committed before mid-2007 that contributed significantly to the increase in criticized assets.
Banks’ Securities Activities

In 2009, the Federal Reserve provided examiner training on Regulation R, adopted jointly by the Board and the SEC in September 2007, with a compliance date of January 1, 2009, for most banks. Regulation R implemented certain key exceptions for banks from the definition of the term “broker” under section 3(a) (4) of the Securities Exchange Act of 1934, as amended by the Gramm-Leach-Bliley Act.

Regulatory Reports

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

Bank Holding Company Regulatory Reports

The Federal Reserve requires that U.S. BHCs periodically submit reports providing financial and structure information. The information is essential in supervising the companies and in formulating regulations and supervisory policies. It is also used in responding to requests from Congress and the public for information about BHCs and their nonbank subsidiaries. Foreign banking organizations also are required to periodically submit reports to the Federal Reserve.

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

During 2009, a number of revisions to the FR Y-9C report were implemented, including (1) new data items and revisions to existing data items on trading assets and liabilities, (2) new
data items associated with the Treasury CPP, (3) new data items and revisions to existing data items on regulatory capital requirements, (4) new data items and revisions to several data items applicable to noncontrolling (minority) interests in consolidated subsidiaries, (5) clarification of the definition of loans secured by real estate, (6) clarification of the instructions for reporting unused commitments, (7) exemptions from reporting certain existing data items for BHCs with less than $1 billion in total assets, (8) instructional guidance on quantifying misstatements, (9) new data items and deletion of existing items for holdings of collateralized debt obligations and other structured financial products, (10) new data items and revisions to existing data items for holdings of commercial mortgage-backed securities, (11) new data items and revisions to existing data items for holdings of unused commitments with an original maturity of one year or less to asset-backed commercial paper conduits, (12) new data items and revisions to existing data items for fair-value measurements by level for asset and liability categories reported at fair value on a recurring basis, (13) new data items for pledged loans and pledged trading assets, (14) new data items for collateral held against over-the-counter derivative exposures (for BHCs with $10 billion or more in total assets), (15) new data items and revisions and deletions of existing data items for investments in real estate ventures, and (16) new data items and revisions to existing data items for credit derivatives.

Also effective in March 2009, the Consolidated Report of Condition and Income for Edge and Agreement Corporations (FR 2886b) was revised to reduce the reporting frequency to annual for Edge Act and agreement corporations with total assets of $50 million or less; collect a new Schedule RC-D, Trading Assets and Liabilities, comparable to, but less detailed than, Schedule HC-D, Trading Assets and Liabilities, on the FR Y-9C report; and collect additional information on option contracts and other swaps.

In addition, effective March 2009, the FR Y-11, FR 2314, and FR Y-7N reports were revised to collect new information on assets held in trading accounts.

Effective June 2009, the FR Y-9SP was revised to also collect new data items associated with the Treasury’s CPP, and the FR Y-8 was revised to require respondents to submit all reports electronically.

Effective December 2009, the FR Y-10 report was updated to reference the accounting standard (FAS 167) with respect to the exclusion of reporting of variable interest entities. In addition, the instructions for the FR Y-6 were modified to incorporate the extended deadline for completion of the annual audit for nonpublic companies as amended by part 363 of section 112 of the Federal Deposit Insurance Corporation Improvement Act, to include the reporting of warrants issued to the Treasury through the TARP CPP program when the warrants represent 5 percent or more of voting stock, and to elucidate the legal responsibilities of the person attesting to the validity of the report.

In 2009, the Federal Reserve proposed a number of revisions to the FR Y-9C for implementation in 2010. The proposed revisions include items to identify other-than-temporary impairment losses on debt securities; additional items for unused credit card lines and other unused commitments and a related additional item for other loans; reformatting of the schedule that
collects information on quarterly averages; additional items for assets covered by FDIC loss-sharing agreements; and clarification of the instructions for unused commitments.

**Commercial Bank\nRegulatory Financial Reports**

As the federal supervisor of state member banks, the Federal Reserve, along with the other banking agencies through the FFIEC, requires banks to submit quarterly Call Reports. Call Reports are the primary source of data for the supervision and regulation of banks and the ongoing assessment of the overall soundness of the nation’s banking system. Call Report data, which also serve as benchmarks for the financial information required by many other Federal Reserve regulatory financial reports, are widely used by state and local governments, state banking supervisors, the banking industry, securities analysts, and the academic community.

During 2009, the FFIEC implemented revisions to the Call Report to enhance the banking agencies’ surveillance and supervision of individual banks and enhance their monitoring of the industry’s condition and performance. The revisions included new items on (1) the date on which the bank’s fiscal year ends; (2) real estate construction and development loans on which interest is capitalized; (3) holdings of commercial mortgage-backed securities and structured financial products, such as collateralized debt obligations; (4) fair value measurements for assets and liabilities reported at fair value on a recurring basis; (5) pledged loans and pledged trading assets; (6) collateral and counterparties associated with over-the-counter derivatives exposures; (7) credit derivatives; (8) remaining maturities of unsecured other borrowings and subordinated notes and debentures; (9) unused short-term commitments to asset-backed commercial paper conduits; (10) investments in real estate ventures; and (11) held-to-maturity and available-for-sale securities in domestic offices. In addition, revisions were made to (1) modify several data items relating to noncontrolling (minority) interests in consolidated subsidiaries; (2) provide for exemptions from reporting certain existing items by banks having less than $1 billion in total assets; (3) clarify the definition of the term “loan secured by real estate”; (4) provide guidance in the reporting instructions on quantifying misstatements in the Call Report; (5) eliminate the confidential treatment of data collected from trust institutions on fiduciary income, expenses, and losses; and (6) expand information collected on trust department activities.

In addition, during 2009, the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) was revised. Effective in March, a number of items were eliminated from Schedule O—Other Data for Deposit Insurance Assessment. In June, additional space was provided in the USA Patriot Act Section 314(a) Anti-Money Laundering section to allow for the optional reporting of additional contact information. In September, revisions were made to Schedule O in response to the temporary increase in the deposit insurance limit from $100,000 to $250,000 that has been extended through December 31, 2013.

Also during 2009, the FFIEC proposed a number of revisions to the Call Report for implementation in 2010. The proposed revisions include items to identify other-than-temporary
impairment losses on debt securities; additional items for unused credit card lines and other unused commitments and a related additional item for other loans; new items pertaining to reverse mortgages; an additional item on time deposits and revisions to reporting of brokered deposits; and additional items for assets covered by FDIC loss-sharing agreements. In addition, revisions were proposed to change the reporting frequency of the number of certain deposit accounts from annually to quarterly; eliminate an item for internal allocations of income and expense from foreign offices; clarify the instructions for unused commitments; and change the reporting frequency of loans to small businesses and small farms from annually to quarterly.

**Supervisory Information Technology**

Information technology supporting Federal Reserve supervisory activities is managed within the System Supervisory Information Technology (SSIT) function in the Board’s Division of Banking Supervision and Regulation. SSIT works through assigned staff at the Board and the Reserve Banks, as well as through System committees, to ensure that key staff members throughout the System participate in identifying requirements and setting priorities for information technology initiatives.

In 2009, the SSIT function completed an update to the supervision function’s IT strategic plan. In addition, the following strategic initiatives were initiated or completed: (1) with the other federal regulatory agencies, continued the phased implementation of the new SNC system; (2) implemented new tools to improve secure document exchange and work team collaboration; (3) developed an IT architecture blueprint and roadmap; (4) adopted a strategy to simplify application security; (5) identified and implemented improvements to make technology and data more accessible to staff working in the field; (6) broadened the use of business intelligence tools to integrate supervisory and management information systems that support both office-based and field staff; and (7) implemented a tool for comprehensively tracking exam findings System-wide.

**National Information Center**

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

Within the NIC, the supporting systems have been modified over time to extend their useful lives and improve business workflow efficiency. During 2009, work continued on upgrading the entire NIC infrastructure to provide easier access to information, a consistent Federal Reserve enterprise information data repository, a comprehensive metadata repository, and uniform
security across the Federal Reserve System. Comprehensive testing was performed and application developers throughout the System were briefed on upcoming changes. Implementation was extended to begin in April 2010 and is expected to continue throughout 2010 as System applications are transitioned to use the new infrastructure. Also during the year, numerous programming changes were made to NIC applications in support of business needs, primarily to ensure NIC information remains current with the changing needs based on the continuing changes with the financial and banking markets.

NIC support also includes supporting the Shared National Credit Modernization Project (SNC Mod). The SNC Program is an interagency program established in 1977 to provide periodic credit-risk assessments of the largest and most complex credit facilities owned or agented by federally supervised institutions. The SNC Mod is a multi-year, interagency, information technology effort led by the Federal Reserve to improve the efficiency and effectiveness of the IT systems that support the SNC Program. SNC Mod focuses on a complete rewrite of the current legacy systems to take advantage of modern technology to enhance and extend the system’s capabilities. A significant milestone was reached in December 2009 when the project team implemented the second phase of SNC Mod. This phase of the project was primarily focused on improving the data collection and validation processes including (1) collection of additional data elements to further describe the credits; (2) collection of Basel II metrics at the credit level; (3) collection of SNC data from banks that are participants in syndicated loans; (4) ability to collect SNC data from some banks on a quarterly basis rather than annually; and (5) improvements in data quality and the data validation processes by providing immediate feedback to reporting banks regarding the quality of their reported data. This significantly improves the efficiency of the data collection process and improves the quality of the data.

Finally, the Federal Reserve participated in a number of technology-related initiatives supporting the supervision function as part of FFIEC task forces and subgroups.

Staff Development
The Federal Reserve’s staff development program is responsible for the ongoing development of nearly 2,400 professional supervisory staff and ensuring that these staff have the skills necessary to meet supervisory responsibilities today and in the future. The Federal Reserve also provides course offerings to staff at state banking agencies. Training activities in 2009 are summarized in the table opposite.

Examiner Commissioning Program
The Examiner Commissioning Program (ECP) involves approximately 22 weeks of instruction. Individuals move through a combination of classroom offerings, self-paced assignments, and on-the-job training over a period of two to five years. Achievement is measured by two professionally validated proficiency examinations: the first proficiency exam is required of all ECP participants; the second proficiency exam is offered in two specialty areas—safety and soundness, and consumer affairs. A third specialty, in information technology, requires that individuals earn the Certified Information Systems Auditor certification offered by the
Information Systems Audit Control Association. In 2009, 164 examiners passed the first proficiency exam and 98 passed the second proficiency exam (75 in safety and soundness and 23 in consumer affairs).

Continuing Professional Development

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

Regulation of the U.S. Banking Structure

The Federal Reserve administers five federal statutes that apply to BHCs, financial holding companies, member banks, and foreign banking organizations—the Bank Holding Company Act, the Bank Merger Act, the Change in Bank Control Act, the Federal Reserve Act, and the International Banking Act. In administering these statutes, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of the U.S. banking system at the local, regional, and national levels; the international operations of domestic banking organizations; or the U.S. banking operations of foreign banks. The proposals concern BHC formations and acquisitions, bank mergers, and other transactions involving bank or nonbank firms. In 2009, the Federal Reserve acted on 633 proposals representing 2,143 individual applications filed under the five statutes. As a result of the declining economic conditions, an increased number of these proposals involved banking organizations in less than satisfactory financial condition.

Bank Holding Company Act

Under the Bank Holding Company Act, a corporation or similar legal entity must obtain the Federal Reserve’s approval before forming a BHC through the acquisition of one or more banks in the United States. Once formed, a BHC must receive Federal Reserve approval

### Training for Banking Supervision and Regulation, 2009

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before acquiring or establishing additional banks. Also, BHCs generally may engage in only those nonbanking activities that the Board has previously determined to be closely related to banking under section 4(c)(8) of the Bank Holding Company Act. Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement.\textsuperscript{8}

When reviewing a BHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, the competitive effects of the proposal, and the applicant’s ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law. In the case of a foreign banking organization seeking to acquire control of a U.S. bank, the Federal Reserve also considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. In 2009, the Federal Reserve acted on 250 applications and notices filed by BHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities, including proposals involving private equity firms.

A BHC may repurchase its own shares from its shareholders. When the company borrows money to buy the shares, the transaction increases the company’s debt and decreases its equity. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board’s capital adequacy guidelines. In 2009, the Federal Reserve acted on one stock repurchase proposal by a BHC.

The Federal Reserve also reviews elections submitted by BHCs seeking financial holding company status under the authority granted by the Gramm-Leach-Bliley Act. Bank holding companies seeking financial holding company status must file a written declaration with the Federal Reserve. In 2009, 16 domestic financial holding company declarations and one foreign bank declaration were approved.

**Bank Merger Act**

The Bank Merger Act requires that all proposals involving the merger of insured depository institutions be acted on by the relevant federal banking agency. The Federal Reserve has primary jurisdiction if the institution surviving the merger is a state member bank. Before acting on a merger proposal, the Federal Reserve considers the financial and managerial resources of the applicant, the future prospects of the existing and combined organizations, the convenience and needs of the community(ies) to be served, and the competitive effects of the proposed merger. The Federal Reserve also must consider the views of the U.S. Department of Justice regarding the competitive aspects of any proposed bank merger involving unaffiliated insured depository institutions. In 2009, the Federal Reserve approved 61 merger applications under the act.

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\textsuperscript{8} Since 1996, the act has provided an expedited prior notice procedure for certain permissible nonbank activities and for acquisitions of small banks and nonbank entities. Since that time the act has also permitted well-run bank holding companies that satisfy certain criteria to commence certain other nonbank activities on a de novo basis without first obtaining Federal Reserve approval.
Change in Bank Control Act

The Change in Bank Control Act requires individuals and certain other parties that seek control of a U.S. bank or BHC to obtain approval from the relevant federal banking agency before completing the transaction. The Federal Reserve is responsible for reviewing changes in the control of state member banks and BHCs. In its review, the Federal Reserve considers the financial position, competence, experience, and integrity of the acquiring person; the effect of the proposed change on the financial condition of the bank or BHC being acquired; the future prospects of the institution to be acquired; the effect of the proposed change on competition in any relevant market; the completeness of the information submitted by the acquiring person; and whether the proposed change would have an adverse effect on the Deposit Insurance Fund. A proposed transaction should not jeopardize the stability of the institution or the interests of depositors. During its review of a proposed transaction, the Federal Reserve may contact other regulatory or law enforcement agencies for information about relevant individuals. In 2009, the Federal Reserve approved 119 change in control notices related to state member banks and BHCs, including proposals involving private equity firms.

Federal Reserve Act

Under the Federal Reserve Act, a member bank may be required to seek Federal Reserve approval before expanding its operations domestically or internationally. State member banks must obtain Federal Reserve approval to establish domestic branches, and all member banks (including national banks) must obtain Federal Reserve approval to establish foreign branches. When reviewing proposals to establish domestic branches, the Federal Reserve considers, among other things, the scope and nature of the banking activities to be conducted. When reviewing proposals for foreign branches, the Federal Reserve considers, among other things, the condition of the bank and the bank’s experience in international banking. In 2009, the Federal Reserve acted on new and merger-related branch proposals for 1,503 domestic branches and granted prior approval for the establishment of three new foreign branches.

State member banks must also obtain Federal Reserve approval to establish financial subsidiaries. These subsidiaries may engage in activities that are financial in nature or incidental to financial activities, including securities-related and insurance agency-related activities. In 2009, one financial subsidiary application was approved.

Overseas Investments by U.S. Banking Organizations

U.S. banking organizations may engage in a broad range of activities overseas. Many of the activities are conducted indirectly through Edge Act and agreement corporation subsidiaries. Although most foreign investments are made under general consent procedures that involve only after-the-fact notification to the Federal Reserve, large and other significant investments require prior approval. In 2009, the Federal Reserve approved 47 applications and notices for overseas investments by U.S. banking organizations, many of which represented investments through an Edge Act or agreement corporation.
International Banking Act

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

In reviewing proposals, the Federal Reserve generally considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. It also considers whether the home-country supervisor has consented to the establishment of the U.S. office; the financial condition and resources of the foreign bank and its existing U.S. operations; the managerial resources of the foreign bank; whether the home-country supervisor shares information regarding the operations of the foreign bank with other supervisory authorities; whether the foreign bank has provided adequate assurances that information concerning its operations and activities will be made available to the Federal Reserve, if deemed necessary to determine and enforce compliance with applicable law; whether the foreign bank has adopted and implemented procedures to combat money laundering and whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering; and the record of the foreign bank with respect to compliance with U.S. law. In 2009, the Federal Reserve approved seven applications by foreign banks to establish branches, agencies, or representative offices in the United States.

Public Notice of Federal Reserve Decisions

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

Enforcement of Other Laws and Regulations

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

Financial Disclosures by State Member Banks

State member banks that are not members of BHCs and that issue securities registered under the Securities Exchange Act of 1934 must disclose cer-
tain information of interest to investors, including annual and quarterly financial reports and proxy statements. By statute, the Board’s financial disclosure rules must be substantially similar to those of the SEC. At the end of 2009, 14 state member banks were registered with the Board under the Securities Exchange Act.

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

Several regulatory agencies enforce the Board’s securities credit regulations. The SEC, the Financial Industry Regulatory Authority (formed through the combination of the National Association of Securities Dealers and the regulation, enforcement, and arbitration functions of the New York Stock Exchange), and the Chicago Board Options Exchange examine brokers and dealers for compliance with Regulation T. With respect to compliance with Regulation U, the federal banking agencies examine banks under their respective jurisdictions; the FCA and the NCUA examine lenders under their respective jurisdictions; and the Federal Reserve examines other Regulation U lenders.

Federal Reserve Membership
At the end of 2009, 2,288 banks were members of the Federal Reserve System and were operating 57,663 branches. These banks accounted for 34 percent of all commercial banks in the United States and for 71 percent of all commercial banking offices.
Consumer and Community Affairs

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

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

Rulemaking and Regulations

Credit Card Reform

In May 2009, the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (the Credit Card Act) codified and expanded existing Federal Reserve regulations prohibiting unfair credit card practices. Among other things, the new rules ban harmful practices and require greater transparency in the disclosure of the terms and conditions of credit card accounts. Throughout 2009, the Federal Reserve worked to implement the Credit Card Act.

Consistent with the effective dates set by Congress in the legislation, the Federal Reserve’s rulemakings to implement the Credit Card Act were divided into three stages. As discussed below, the Board has completed the first two stages of rulemaking. The third stage will be completed later in 2010.
Stage One

The first stage of the Board’s implementation of the Credit Card Act includes provisions with an effective date of August 2009.¹

45-Day Notice Requirement for Significant Changes

The new rules require creditors to provide written notice to consumers 45 days before increasing an annual percentage rate (APR) on, or making another significant change to the terms of, a credit card account. The notice requirement is triggered by increases in rates applicable to purchases, cash advances, and balance transfers. Creditors must also provide notice when changes are made to the terms that are required to be disclosed at account opening, including those terms that are most important to consumers and that can have a significant impact on the cost of credit for a consumer: key penalty fees, transaction fees, fees imposed for the issuance or availability of credit, any grace period, and the balance computation method.

Consumer’s Right to Reject Rate Increase or Change in Terms

In addition to the advance notice, consumers must be informed of their right to reject the increase or change before it goes into effect. If a consumer rejects the increase or change, the creditor may not impose a fee or charge, treat the account as in default, or require immediate repayment of the balance on the account.

Stage Two

The second stage of the Board’s implementation of the Credit Card Act includes provisions with an effective date of February 22, 2010.²

Restricting Rate Increases for Existing Balances

An increase in the interest rate that applies to existing balances on a credit card account can come as a costly surprise to consumers who relied on the rate in effect at the time they opened the account or used the account for transactions. Subject to certain exceptions, the new rules generally prohibit credit card issuers from increasing the rates and fees that apply to existing balances, including when an account is closed, when an account is acquired by another institution, and when the balance is transferred to another account issued by the same creditor. The exceptions include temporary rates that expire after a specified period, rates that vary with an index, and accounts that are more than 60 days delinquent.

Evaluation of Consumer’s Ability to Pay

Under the new rules, credit card issuers are required to establish and maintain reasonable policies and procedures to consider a consumer’s ability to make required minimum payments each billing cycle (based on the full credit line and including any mandatory fees) before opening a new credit card account or increasing the credit limit for an existing account. Reasonable policies and procedures include consideration of at least one of the following in assessing the consumer’s ability to pay: (1) the consumer’s ratio of debt to income; (2) the consumer’s ratio of debt to assets; or (3) the income the consumer will have after paying existing debt obligations.

Age Restrictions

The rules also impose specific requirements for opening a credit card account or increasing the credit limit on an existing account when the consumer is under the age of 21. In particular, an issuer cannot issue a credit card to a consumer younger than 21 unless their application includes either: (1) information indicating that the underage consumer has independent ability to make the required minimum payments for the account, or (2) the signature of a cosigner over age 21 who has the ability to make those payments and who assumes joint liability for any debt on the account.

Rules for Marketing Credit Cards to Students

The rules also prohibit creditors from offering a college student any tangible items (such as t-shirts, gift cards, or magazine subscriptions) to induce the student to apply for a credit card or other open-end credit product if the offer is made on or near a college campus or at an event sponsored by a college. In addition, colleges must publicly disclose their agreements with credit card issuers for marketing credit cards, and card issuers must make annual reports to the Board regarding those agreements.

Restricting Over-the-Limit Fees

The rules generally require creditors to obtain a consumer’s express election (or “opt in”) to the payment of transactions that exceed the account’s credit limit before the creditor may impose any fee for those transactions. Credit card issuers are also prohibited from imposing more than one over-the-limit fee per billing cycle and may not impose an over-the-limit fee for the same transaction in more than three consecutive billing cycles.

The rules also prohibit credit card issuers from

- assessing an over-the-limit fee because the issuer did not promptly replenish the consumer’s available credit (such as after the consumer makes a payment);
- conditioning the amount of available credit on the consumer’s consent to payment of over-the-limit transactions; and
- imposing an over-the-limit fee if the consumer’s credit limit is exceeded solely because of accrued interest charges or fees on the account.

Additional Consumer Protections

The wide-ranging consumer protection regulations adopted by the Board also include
• Credit card issuers are required to establish procedures to ensure that the administrator of an estate can resolve the outstanding credit card balance of a deceased accountholder in a timely manner.

• Credit card issuers are required to allocate a consumer’s payment in excess of the required minimum payment first to the balance with the highest rate.

• Credit card fees charged to a credit card account during the first year after account opening may not exceed 25 percent of the initial credit limit.

• Credit card issuers may not impose interest charges on balances for days in previous billing cycles as a result of the loss of a grace period (a practice sometimes referred to as “double-cycle billing”). Card issuers also are prohibited from imposing interest charges on the portion of the balance that has been repaid when a consumer pays some but not all of a balance prior to expiration of a grace period.

• Credit card issuers may not charge a fee for making a payment except for payments involving an expedited service by a service representative of the issuer.

• Credit card issuers must disclose on the periodic statement sent to consumers: (1) the amount of time and total cost (interest and principal) involved in paying the consumer’s balance in full by making only the required minimum payments; and (2) the monthly payment amount required to pay off the consumer’s balance in 36 months and the total cost (interest and principal) of repaying the balance in 36 months.

**Overdraft Services and Gift Card Rules**

**Restrictions on Overdraft Fees**

In November, the Board announced rules that prohibit financial institutions from charging consumers fees for paying overdrafts on automated teller machine (ATM) and one-time debit card transactions, unless a consumer opts in, or affirmatively consents, to overdraft services for these transactions. Overdraft fees can be particularly costly in connection with debit card overdrafts because the dollar amount of the fee may considerably exceed the dollar amount of the overdraft.

Consumers often are enrolled in overdraft services automatically, without their express consent. Consumer testing by the Board indicated that many consumers are unaware that they can incur overdrafts for ATM or one-time debit transactions, believing instead that these transactions will be declined. In contrast, consumer testing by the Board showed that consumers generally want their checks and automated clearing house (ACH) transactions paid even if the payment results in an overdraft fee being assessed.

**Opt-In Requirement**

The Board’s rules require institutions to provide consumers with the right to opt in, or affirmatively consent, to the institution’s overdraft service for ATM and one-time debit card transactions. The notice of the opt-in right must be provided, and the consumer’s affirmative consent obtained, before fees or

charges may be assessed on the consumer’s account for paying such overdrafts. The opt-in requirement applies to both existing and new accounts.

**Protections for Consumers Declining Overdraft Coverage**

The rules prohibit institutions from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions on the consumer consenting to the institution’s payment of overdrafts for ATM and one-time debit card transactions. For consumers who do not consent to the institution’s overdraft service for ATM and one-time debit card transactions, the rules require institutions to provide those consumers with account terms, conditions, and features that are otherwise identical to those they provide to consumers who do consent. The rules include a model form developed through consumer testing that institutions may use to satisfy the opt-in notice requirement.

The Board’s overdraft rules are issued under the Electronic Fund Transfer Act and have an effective date of July 1, 2010.

**Restrictions on Gift Card Fees and Expiration Dates**

In November, the Board proposed rules that would restrict the fees and expiration dates that may apply to gift cards. The rules would protect consumers from certain unexpected costs and would require that gift card terms and conditions be clearly stated.4

The Board’s proposed rules generally cover retail gift cards, which can be used to buy goods or services at a single merchant or affiliated group of merchants, and network-branded gift cards, which are redeemable at any merchant that accepts the card brand (such as Visa or MasterCard).

**Dormancy, Inactivity, or Service Fees and Expiration Dates**

The proposed rules would prohibit dormancy, inactivity, and service fees on gift cards unless: (1) there has been at least one year of inactivity on the gift card; (2) no more than one such fee is charged per month; and (3) the consumer is given clear and conspicuous disclosures about the fees on the card and before the card is purchased.

The proposed rules would also provide that expiration dates for funds underlying a gift card must be at least five years from the date the card was issued or the date when funds were last loaded onto the card. This information would have to be clearly and conspicuously disclosed on the card and before the card is purchased.

**Additional Disclosure Requirements**

The proposed rules also would require the disclosure of all other fees imposed in connection with a gift card. These disclosures would have to be provided on or with the card and prior to purchase. The proposed rules also would require the disclosure on the card of a toll-free telephone number and, if one is maintained, a website that a consumer may use to obtain fee information or replacement cards.

The Board’s proposed rules would implement statutory requirements set forth in the Credit Card Act that become effective on August 22, 2010.

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Mortgage and Home Equity Lending Reform

The Board proposed significant new rules designed to (1) improve the disclosures consumers receive in connection with closed-end mortgages and home-equity lines of credit (HELOCs) and (2) provide new consumer protections for all home-secured credit.5 The Board also adopted new rules to implement provisions of 2009’s Helping Families Save Their Homes Act and the Mortgage Disclosure Improvement Act of 2008 (MDIA).

To shop for and understand the cost of a home-secured loan, consumers must be able to identify and understand the key terms that determine whether a particular loan is appropriate for them. The Board, working with a consultant, conducted focus groups and one-on-one cognitive interviews with more than 180 consumers from nine metropolitan areas across the United States in order to understand consumers’ key concerns when shopping for home-secured credit. The results of these sessions informed the Board’s rulemaking, which aims to ensure that required disclosures are presented in clear, understandable language and formatting so as to provide consumers with essential information at the appropriate time in the loan process.

Providing Meaningful Disclosures about Mortgages

The Board proposed rules in July 2009 to make disclosures about closed-end mortgages more meaningful and useful to consumers by highlighting potentially risky loan features, such as adjustable rates, prepayment penalties, and negative amortization. Specifically, the proposal would include several requirements:

- At application, lenders would have to provide consumers with a one-page list of key questions to ask about the loan being offered. The new disclosures are designed to answer those questions.
- The information consumers receive within three days after application would highlight risky mortgage features (such as possible payment increases or negative amortization).
- For adjustable-rate mortgages, lenders would be required to show consumers how their payments might change, including by illustrating the highest monthly amount the consumer might pay during the life of the loan.
- The computation of the APR would be revised to include most fees and settlement costs, making it a better measure of the total cost of the loan.
- Disclosures would show consumers in a simple graph how their loan’s APR compares to the average rate offered to borrowers with excellent credit.
- In addition to the early disclosures provided at application, lenders would also be required to provide final disclosures to consumers at least three days before the loan closing.
- For adjustable-rate mortgages, lenders would have to notify consumers 60 days in advance of a change in their monthly payment. (Currently, notice may be given 25 days in advance.)
- Creditors would have to provide monthly statements to consumers with loans that have payment options that could result in negative amortization.

Early Disclosures for Mortgage Loans

In May 2009, the Board issued final rules revising the disclosure requirements for mortgage loans in order to ensure that consumers receive information about loan costs earlier in the mortgage process. These new rules implement provisions of MDIA and were effective July 30, 2009.

The new rules expand on rules published by the Board in July 2008, which require, among other things, that a creditor give a consumer transaction-specific information about costs shortly after the consumer applies for a closed-end mortgage loan secured by the consumer’s principal dwelling (“early disclosures”). These early disclosures must be provided before the consumer pays any fee other than a reasonable fee for obtaining the consumer’s credit history. The May 2009 final rules apply these provisions to loans secured by a dwelling even when it is not the consumer’s principal dwelling, such as a second home.

Moreover, these rules require that:

- Creditors must deliver or mail early disclosures at least seven business days before closing.
- If the APR contained in the early disclosures becomes inaccurate (for example, due to a change in loan terms), creditors must provide corrected disclosures to the consumer at least three business days before closing.
- The disclosures must inform the consumer that they are not obligated to complete the transaction simply because disclosures were provided or because the consumer has applied for a loan.

The new rules also permit a consumer to waive the waiting periods and expedite closing to address a personal financial emergency, such as foreclosure.

Anti-Steering Protections

Disclosures alone may not always be sufficient to protect consumers from unfair practices. For example, yield spread premiums, which are payments from a lender to a mortgage broker or loan officer (loan originator) based on the interest rate, can create incentives for mortgage loan originators to “steer” borrowers to riskier loans with higher rates for which the loan originators will receive greater compensation. Consumers generally are not aware of the mortgage broker’s or loan officer’s conflict of interest and cannot reasonably protect themselves against it. Yield spread premiums may provide some benefit to consumers who choose to pay a higher rate so that the lender will fund origination costs that would otherwise be paid by the consumer.

To prevent mortgage loan originators from steering consumers to more expensive loans, the Board proposed rules that would:

- prohibit payments to a mortgage broker or a loan officer based on the loan’s interest rate or other terms, and
- prohibit mortgage brokers or loan officers from steering consumers to a lender offering less favorable terms in order to increase their compensation.

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Home Equity Lines of Credit (HELOCs)

In July 2009, the Board proposed rules to enhance consumer protections for HELOCs and improve the timing, content, and format of information that creditors provide to consumers at application and throughout the life of such accounts.

The proposed rules would require certain disclosures:

- At application, the lengthy, generic disclosure consumers currently receive would be replaced with a new one-page summary of the basic information and risks about HELOCs.
- Within three days after receiving a consumer’s application for a HELOC, lenders would be required to provide disclosures specifically tailored to the actual credit terms for which the consumer qualifies. These disclosures would provide information about costs and risky mortgage features in a tabular format.
- At account opening, lenders would provide final disclosures in the same format, allowing consumers to more easily compare them with earlier disclosures.
- Throughout the life of the HELOC plan, lenders would provide enhanced periodic statements showing the total amount of interest and fees charged for the statement period and the year to date.

The proposed rules also would enhance certain consumer protections applicable to HELOCs:

- To the extent a lender can change any terms of a consumer’s HELOC plan, the lender would have to notify the consumer 45 days in advance of the change. The proposal would also improve the form and content of these notices.
- Lenders could not terminate an account for delinquency until payment is more than 30 days late.
- When a consumer’s credit line has been suspended or reduced, creditors would have to provide additional information about the reasons for the action and the consumer’s right to request reinstatement.

Notifying Consumers When Mortgage Loans Are Sold or Transferred

One of the consumer protection provisions of the Helping Families Save Their Home Act aims to ensure that consumers know who owns their mortgage loan. Because mortgages may be sold and transferred several times, borrowers can face difficulties in determining who owns their loan and who to contact about their loan. The Helping Families Save Their Home Act, which was enacted in May 2009, requires a purchaser or assignee that acquires a mortgage loan to provide the required disclosures to consumers in writing within 30 days of acquiring the loan. Although the statutory provision became effective immediately upon enactment, in November 2009, the Board issued interim final rules which provide guidance for complying with the statute.7

Private Education Loan Rules

In 2009, the Board revised Truth in Lending Act rules for private education

loans—loans made to a consumer by a private lender in whole or in part for postsecondary educational expenses. The Board’s rules implement provisions of the Higher Education Opportunity Act (HEOA) and apply to loan applications received by creditors on or after February 14, 2010.

Improved Disclosure

To enhance disclosure about private education loans, the Board worked with a consultant to conduct one-on-one cognitive interviews with consumers in order to develop effective disclosures that consumers can use to understand the costs and features of these loans.

The rules specify disclosures that creditors must provide at three different times in the loan origination process: (1) with the loan application or solicitation, (2) when the loan is approved, and (3) after the consumer accepts the loan but at least three days before funds are disbursed.

Under the Board’s rules, with applications and solicitations, creditors must provide consumers general information about loan rates, fees, and terms, including an example of the total cost of a loan based on the maximum interest rate the creditor can charge. The disclosure must also inform the consumer about the availability of federal student loans, their interest rates, and where the consumer can find additional information regarding those loans.

Creditors must also provide a set of transaction-specific disclosures when the loan is approved and at consummation. These disclosures must include specific information about the rate, fees, and other terms of the loan that are offered to the consumer. The creditor must disclose, for example, estimates of the total repayment amount based on both the current interest rate and the maximum interest rate that may be charged. The creditor must also disclose the monthly payment at the maximum rate of interest.

30-Day Period to Accept or Reject Loan

Under the Board’s rules, a consumer has the right to accept the rates and terms offered at any time within 30 days after receiving the transaction-specific disclosure provided at approval.

Three-Day Right to Cancel

A creditor must provide additional disclosures after a consumer accepts a private education loan. A consumer has the right to cancel the loan without penalty for up to three business days after receipt of this disclosure and the loan funds may not be disbursed until the three-day period expires.

Prohibition on Co-Branding

The rules prohibit creditors from using an educational institution’s name, logo, or mascot in its marketing materials to imply that the educational institution endorses the loans offered by the creditor, unless the creditor and educational institution have a preferred lender arrangement under which the educational institution issues a permissible endorsement of the creditor’s loans.

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Consumer Credit Reporting and Risk-Based Pricing Rules

Credit reports are used to determine whether, and on what terms, consumers may obtain credit and other important products and services, and are also widely used to determine a consumer’s eligibility for employment, insurance, and rental housing. Therefore, it is essential that the substantive information included in those reports is accurate. In 2009, the Board worked with other federal financial agencies to implement provisions of the Fair and Accurate Credit Transactions Act, which amends the Fair Credit Reporting Act, to impose new responsibilities on credit information furnishers and allow consumers to play a more active role in ensuring the accuracy of their own credit reports.

Credit Reporting Rules

Accuracy of Information Reported to Credit Bureaus

In July, the Board collaborated with other federal financial regulatory agencies and the Federal Trade Commission to publish rules and guidelines promoting the accuracy and integrity of information furnished to credit bureaus and other consumer reporting agencies.9 The rules require entities that furnish consumer information to credit bureaus (furnishers) to establish and implement reasonable written policies and procedures to ensure the accuracy and integrity of the information that is reported about consumers. Furnishers’ policies and procedures should address matters including recordkeeping, internal controls, staff training, oversight of third-party service providers, and periodic self-evaluations.

The rules also require furnishers to include the consumer’s credit limit (if applicable) among the information provided to a credit bureau. The Board and other agencies also published an advance notice of proposed rulemaking seeking to identify additional consumer information that furnishers should be required to provide to credit bureaus.

Right to Submit Disputes Directly to Information Furnisher

Under the credit reporting rules, if a consumer believes his or her credit report includes inaccurate information, the consumer may submit a dispute directly to the furnisher of the information and the furnisher must investigate the dispute. If the furnisher’s investigation reveals that the information reported to a credit bureau was inaccurate, the furnisher must promptly notify each credit bureau to which the inaccurate information was provided and provide corrected information. The rules become effective July 1, 2010.

Risk-Based Pricing Rules

In December, the Board, along with the Federal Trade Commission, announced rules requiring creditors to notify consumers when, based on the consumer’s credit report, the creditor provides credit on less favorable terms than it provides to other consumers. For example, if a consumer, because of information in his or her credit report, receives a mortgage with an APR higher than that offered to a substantial proportion of other consumers by that creditor, such that the consumer’s cost of credit is significantly higher, the creditor must

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send the consumer a “risk-based pricing” notice.\textsuperscript{10}

Risk-based pricing refers to the practice of setting or adjusting the price and other terms of credit offered or extended to a particular consumer to reflect the risk of nonpayment by that consumer. Information from a consumer’s credit report is often used in evaluating the risk posed by the consumer.

The rules require that a notice include a statement that the terms offered to the consumer may be less favorable than the terms offered to consumers with better credit histories. The notice also must contain a statement informing the consumer that he or she may obtain a free copy of his or her credit report from the credit reporting agency identified by the creditor in the notice.

The rules give creditors the option of providing consumers with a free credit score and information about their credit score as an alternative to providing risk-based pricing notices. Creditors that use the credit score disclosure alternative generally must provide free credit scores to any consumer who applies for credit before the consumer becomes obligated for the credit. The rules become effective on January 1, 2011.

\textbf{Information Privacy Rules}

In November, the Board, along with seven other federal regulatory agencies, released a model privacy notice designed to make it easier for consumers to understand how financial institutions collect and share consumer information.\textsuperscript{11}

The Board and other agencies developed the model privacy notice based on extensive consumer testing that involved approximately 1,000 consumers from five locations across the United States. Consumer testing confirmed the effectiveness of the model notice as compared with other privacy notices, including a form of notice commonly used by financial institutions.

To ensure that privacy information is provided to consumers in a form that is readable and understandable, the model privacy notice uses a standardized tabular format and presents information in a question-and-answer format. The rules specify the format, typeface, font size, and presentation to make it easy for consumers to find specific information on the form and compare information provided by various institutions. A financial institution that uses the model form obtains a “safe harbor” for compliance with the regulatory requirements for privacy notices.

The rule, which was issued under Regulation P, became effective on December 31, 2009.

\textbf{Community Reinvestment Act Rules}

In June, the Board, along with other federal financial regulators, proposed revisions to regulations under the Community Reinvestment Act (CRA) that would require the Board to consider low-cost education loans provided to low-income borrowers when assessing a bank’s record of meeting community credit needs under the CRA. Under


current CRA regulations, education loans are considered consumer loans, which may not be evaluated as part of a CRA assessment in some cases. The proposed revision reflects statutory changes made to the CRA by the Higher Education Opportunity Act.\(^\text{12}\)

The proposal would also incorporate into the CRA regulations statutory language allowing the Board to consider capital investments, loan participations, and other ventures undertaken in cooperation with minority- and women-owned financial institutions and low-income credit unions when assessing a bank’s CRA record.

**Oversight and Enforcement**

The Board’s Division of Consumer and Community Affairs supports and oversees supervisory policy and examination procedures for consumer protection and community reinvestment laws in the oversight of state-chartered, depository institutions, and foreign banking organizations that are members of the Federal Reserve System. In addition, the division oversees the efforts of the Reserve Banks to ensure that consumer protection laws and regulations are fully and fairly enforced. Division staff provide guidance and expertise to the Reserve Banks on consumer protection regulations, bank application analysis and processing, examination and enforcement techniques, examiner training, and emerging issues. The staff develop and update examination policies, procedures and guidelines, as well as review Reserve Bank supervisory reports, examination work products, and consumer complaint analyses. Staff members also participate in interagency activities that promote uniformity in examination principles and standards.

Examinations are the Federal Reserve’s primary method of enforcing compliance with consumer protection laws and assessing the adequacy of risk management systems for consumer protection. During the 2009 reporting period, the Reserve Banks conducted 282 consumer compliance examinations of the System’s 782 state member banks and one foreign banking organization.\(^\text{13}\)

**Community Reinvestment Act Compliance**

The Community Reinvestment Act (CRA) requires that the Federal Reserve and other federal banking and thrift agencies encourage financial institutions to help meet the credit needs of the local communities in which they do business, consistent with safe and sound operations.\(^\text{14}\) To carry out this mandate, the Federal Reserve

- examines state member banks to assess their compliance with the CRA;
- analyzes applications for mergers and acquisitions by state member

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\(^\text{13}\) The foreign banking organizations examined by the Federal Reserve are organizations that operate under section 25 or 25A of the Federal Reserve Act (Edge Act and agreement corporations) and state-chartered commercial lending companies owned or controlled by foreign banks. These institutions are not subject to the Community Reinvestment Act and typically engage in relatively few activities covered by consumer protection laws.

\(^\text{14}\) Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS).
banks and bank holding companies in relation to CRA performance; and
• disseminates information on community development techniques to bankers and the public through community affairs offices at the Reserve Banks.

The Federal Reserve assesses and rates the CRA performance of state member banks in the course of examinations conducted by staff at the 12 Reserve Banks. During the 2009 reporting period, the Reserve Banks conducted CRA examinations of 229 banks: 40 were rated “Outstanding,” 187 were rated “Satisfactory,” and two were rated “Needs to Improve.”

In June 2009, the Federal Reserve and other federal banking and thrift regulatory agencies proposed two revisions to the CRA that would incorporate new statutory requirements into the CRA regulations. The first revision would implement Section 1031 of the Higher Education Opportunity Act, which requires the agencies to consider low-cost education loans provided to low-income borrowers when assessing a financial institution’s record of meeting community credit needs. The second revision would incorporate the CRA statutory language that allows the agencies to consider and take into account capital investments, loan participations, and other ventures between nonminority- and nonwomen-owned financial institutions and minority- and women-owned institutions and low-income credit unions.

Mergers and Acquisitions in Relation to the CRA

During 2009, the Board considered and approved four banking merger applications:

• An application by Allied Irish Banks, p.l.c., Dublin, Ireland, and its subsidiary, M&T Bank Corporation, Buffalo, NY, to acquire Provident Bancshares Corporation, Baltimore, MD, was approved in May.
• An application by Morgan Stanley, New York, NY, to acquire 9.9 percent of Heritage Bank, N.A., New York, NY, was approved in June.
• An application by Morgan Stanley, New York, NY, to acquire 9.9 percent of Chinatrust Financial Holding Company, Ltd., Taipei, Taiwan, Republic of China, was approved in June.
• An application by Morgan Stanley, New York, NY, to acquire 9.9 percent of United Western Bancorp, Inc., Denver, CO, was approved in October.

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

Members of the public had the opportunity to submit comments on the applications; their comments raised various issues. Some comments referenced pricing information on residential mortgage loans and concerns that minority applicants were more likely than nonminority applicants to receive higher-priced mortgages. Other comments alleged that certain minority groups received preferential treatment in comparison to other minority groups; that lenders failed to make credit available to certain minority groups and to low- and moderate-income individuals and in low- and moderate-income geographies; that

15. The 2009 reporting period for examination data includes examinations with end dates between July 1, 2008, and June 30, 2009.
lenders deliberately omitted reporting race information about certain applicants, information that is required by the Home Mortgage Disclosure Act (HMDA); and that lenders had not fulfilled their CRA responsibilities. In addition, some commenters claimed that lenders engaged in high-cost predatory lending and less-than-satisfactory loan servicing activities that contributed to the current foreclosure crisis.

The Board also considered 51 applications with outstanding issues involving compliance with consumer protection statutes and regulations, including fair lending laws and the CRA; 34 of those applications were approved and 17 were withdrawn. The number of applications with CRA issues, consumer compliance issues, or both was somewhat lower in 2009 than in 2008, as was the total number of all applications received, due, in part, to the financial crisis in the banking industry. However, the applications reviewed contained significantly more complex fair lending concerns than in previous years.

**Fair Lending Enforcement**

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

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

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

During 2009, the Board referred the following six matters to the DOJ:

- One referral involved redlining, or discrimination against potential bor-
rowers based upon the racial composition of their neighborhoods, in violation of the ECOA and the Fair Housing Act. Based on an analysis of the bank’s lending practices, its marketing, the location of its branches, and its delineated assessment area under the CRA, the Board determined that the bank avoided lending in minority neighborhoods.

- Two referrals involved discrimination in mortgage pricing, in violation of the ECOA and the Fair Housing Act. In one matter, the Board found that Hispanic and African-American borrowers paid higher annual percentage rates (APRs) and overages than non-Hispanic white borrowers. In another matter, the Board found that African-American borrowers paid higher APRs than non-Hispanic white borrowers. Legitimate pricing factors failed to explain the pricing disparities in either matter.

- Two referrals involved discrimination on the basis of marital status, in violation of the ECOA. One referral involved a bank’s policy and practice of requiring spousal guarantees on commercial loans, in violation of Regulation B. In the other referral, an institution improperly required spousal signatures for its agricultural, consumer, and commercial loans, in violation of Regulation B.

- One referral involved discrimination on the basis of age, in violation of the ECOA. The lender offered customers over 50 years of age membership in a special club with preferential credit features, including a 25 basis point discount on non-mortgage loans. The ECOA generally prohibits creditors from considering age when evaluating creditworthiness, except that a creditor may consider the age of an applicant 62 years or older in the applicant’s favor.

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

Evaluating Pricing Discrimination Risk by Analyzing HMDA Data and Other Information

The two previously mentioned referrals involving mortgage-pricing discrimination resulted from a process of targeted pricing reviews that the Federal Reserve initiated when Home Mortgage Disclosure Act (HMDA) pricing data first became available in 2005. Board staff developed—and continues to refine—HMDA screens that identify institutions that may warrant further review on the basis of an analysis of HMDA pricing data. Because HMDA data lack many of the factors lenders routinely use to make credit decisions and set loan prices, such as information about a borrower’s creditworthiness and loan-to-value ratios, HMDA data alone cannot be used to determine whether a lender discriminates. Thus, Board staff analyze HMDA data in conjunction with other supervisory information to evaluate a lender’s risk for engaging in discrimination.

Using 2008 HMDA pricing data—the most recent year for which the data
Analyzing HMDA Data

Enacted by Congress in 1975, the Home Mortgage Disclosure Act (HMDA) requires most mortgage lenders located in metropolitan areas to collect data about their housing-related lending activity, report the data annually to the federal government, and make the data publicly available. Data reporting requirements have expanded in recent years to capture reporting lenders’ pricing information for higher-priced consumer mortgage loans.

An article published in September 2009 by Federal Reserve staff in the Federal Reserve Bulletin uses 2008 HMDA data to describe the market for higher-priced loans and patterns of lending across loan products, borrowers, and neighborhoods of different races and incomes.1 The analysis documents the sharp contraction in total home lending between 2007 and 2008 (about 31 percent), led by a steep reduction in conventional lending. The analysis also provides a detailed assessment of the dramatic growth between 2007 and 2008 in home lending backed by the Federal Housing Administration’s (FHA) mortgage insurance program.

As in recent years, the 2008 HMDA data show that most reporting institutions originated few if any higher-priced loans in 2008: 53 percent of the lenders originated less than 10 higher-priced loans that year and 30 percent originated no higher-priced loans. Of the 8,388 home lenders reporting HMDA data, 947 made 100 or more higher-priced loans.

The HMDA data also show that the majority of all loan originations were not higher priced; in fact, owing in large part to the mortgage market turmoil that first showed signs of emerging in late 2006, the incidence of higher-priced lending fell from a high watermark of 29 percent in 2006 to 18 percent in 2007 and to 12 percent in 2008.

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Monitoring Emerging Fair Lending Issues

During the past year, economic conditions have shown signs of improvement; however, certain trends in credit markets continue to pose fair lending risk, especially related to credit tightening and loan modification activities. Lenders remain cautious and continue to reevaluate their lending practices. Some policies to tighten credit standards may fall disproportionately on minorities and raise fair lending concerns. For example, some lenders have implemented tighter credit standards in specific geographic markets, or have otherwise limited lending activity in certain geographic areas. In addition, the rapid increase of loan modifications and other loss mitigation efforts threatens to outpace compliance management programs.

In response to these trends, the Federal Reserve continues to carefully...
monitor lenders’ practices for potential fair lending violations. Additionally, the Federal Reserve, in conjunction with other Federal Financial Institutions Examination Council (FFIEC) agencies, revised the Interagency Fair Lending Examination Procedures to better protect consumers from discriminatory practices. The updated procedures revise examination guidance for detecting pricing, steering, reverse redlining, and redlining violations. In accordance with these procedures, the Federal Reserve conducts examinations to (1) evaluate whether lenders’ policies may violate fair lending laws by having an illegal disparate impact on minorities, and (2) identify steering, redlining, reverse redlining, and other fair lending violations.

Flood Insurance

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

During 2009, the Board imposed civil money penalties (CMPs) against seven state member banks. The dollar amount of the penalties, which were assessed via consent orders, totaled $221,205.

Coordination with Other Federal Banking Agencies

The member agencies of the FFIEC develop uniform examination principles, standards, procedures, and report formats. In 2009, the FFIEC issued the following work products:

- Interagency Examination Procedures for the Servicemembers Civil Relief Act (SCRA) – The procedures are used to determine institution compliance with SCRA, including provisions related to interest rate reduction to six percent for active duty servicemembers, foreclosure protection, and protection of servicemembers’ rights with regard to suspension of life insurance premiums, taxes, and business obligations.

- Interagency Questions and Answers Regarding Flood Insurance – The questions and answers supersede the 1997 questions and answers document, and it supplements other recent guidance and interpretations issued by the agencies and FEMA.

17. The FFIEC member agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).


• Interagency Fair Lending Examination Procedures (revised) – The revised examination procedures reflect significant changes in credit markets, credit products, and credit practices since the procedures were last updated. The procedures clarify examination procedures related to pricing, steering, redlining, broker activity, performing examinations with small sample sizes, and data accuracy.20

• Interagency Examination Procedures for Regulation Z (revised) – The revised examination procedures incorporate the 2008 amendments to Regulation Z. The amendments were designed to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. Among other things, the changes apply protections to a newly defined category of “higher-priced mortgages” that includes virtually all closed-end subprime loans secured by a consumer’s principal dwelling.21

• Interagency Examination Procedures for the Home Mortgage Disclosure Act (revised) – The revised examination procedures incorporate the 2008 amendments to Regulation C for reporting pricing information on higher-priced loans. The changes to Regulation C conformed the threshold for rate spread reporting to the definition of “higher-priced mortgage loans” included in 2008 amendments to Regulation Z.22

• Interagency Examination Procedures for the Real Estate Settlement Procedures Act (RESPA) (revised) – The revised examination procedures incorporate the changes to RESPA that HUD issued in its 2008 final RESPA reform rule (73 F.R. 68204), which included both technical and substantive changes to its Regulation X. The key technical changes provide streamlined mortgage servicing disclosure language, eliminate outdated escrow account provisions regarding the phase-in period, and permit an “average charge” to be listed on the Good Faith Estimate (GFE) and HUD-1/1A Settlement Statement. The key substantive changes include implementation of a standardized and binding GFE form and revised HUD-1/1A Settlement Statement.23

• Interagency Examination Procedures for Regulation DD (revised) – The revised examination procedures incorporate changes to Regulation DD that address depository institutions’ disclosure practices related to overdrafts. The changes require institutions to disclose the aggregate dollar amounts charged for overdraft fees and returned item fees on a periodic statement and, for institutions that provide account balance information through an automated system, to provide a balance that does not include additional funds that may be made available to cover overdrafts.24

Training for Bank Examiners

Ensuring that financial institutions comply with laws that protect consumers and encourage community reinvestment is an important part of the bank examination and supervision process. As the number and complexity of consumer financial transactions grow, training for the examiners who review the organizations under the Federal Reserve’s supervisory responsibility becomes even more important.

The consumer compliance examiner training curriculum consists of six courses focused on various consumer protection laws, regulations, and examination concepts. In 2009, the Board held 11 training sessions for 158 System consumer compliance examiners and professional staff, 25 state examiners, and one examiner from another regulatory agency. Several courses use a combination of instructional methods: (1) specially developed computer-based instruction that includes interactive self-check exercises, and (2) classroom instruction focused on case studies.

To keep the course materials current, Board and Reserve Bank staff routinely review examiner training materials, updating subject matter and adding new elements as appropriate. Periodically, staff members conduct in-depth reviews of a course curriculum, including the course objectives, content, and presentation methods. During 2009, staff reviewed two curricula: the Consumer Affairs Risk-focused Examination Techniques course, which provides training on all major aspects of risk-focused supervision, including scoping and risk assessment, report writing, ratings, supervisory enforcement actions, and the Board’s referral processes; and the Commercial Lending Essentials for Consumer Affairs course, which provides assistant examiners with the fundamentals of commercial lending.

Board and Reserve Bank staff members are charged with providing updates to the System’s content mapping initiative. This mapping tool, which provides a detailed view of training content in each and every System course, allows staff to more quickly identify and revise course materials that may be affected by regulatory, legal, or other changes. This year, FedLearn skill level definitions were identified for each training objective for consumer compliance courses and were included in the content map.

In addition to providing core training for non-commissioned assistant examiners, the examiner curriculum emphasizes the importance of continuing professional development for all examiners. Opportunities for continuing development include special projects and assignments, self-study programs, rotational assignments, the opportunity to instruct at System schools, mentoring programs, and an annual senior examiner forum. For example, in response to an ever-changing regulatory environment, System staff conducted two real estate workshops for experienced examination staff. The focus of the workshops was the new and revised mortgage rules and the RESPA reform. In addition, in 2009 the System continued to offer Rapid Response sessions, a mass-training effort using multi-media to deliver training, focusing on 12 time-sensitive or emerging consumer compliance topics. These sessions were designed, developed, and presented to System staff within days or weeks of perceived need.
Agency Reports on Compliance with Consumer Protection Laws

The Board reports annually on compliance with consumer protection laws by entities supervised by federal agencies. This section summarizes data collected from the 12 Federal Reserve Banks, the FFIEC member agencies, and other federal enforcement agencies.²⁵

Regulation B (Equal Credit Opportunity)

The FFIEC agencies reported that approximately 81 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation B, compared with 85 percent for the 2008 reporting period. The most frequently cited violations involved

- failure to provide notice of approval, counteroffer, or adverse action within 30 days after receiving a completed credit application;
- failure to provide a written notice of denial or other adverse action to a credit applicant, containing the specific reason for the adverse action, along with other required information;
- failure to collect information about applicants seeking credit primarily for the purchase or refinancing of a principal residence, including applicants’ race, ethnicity, sex, marital status, and age, for government monitoring purposes; and
- improperly collecting information on applicants’ race, color, religion, national origin, or sex when not permitted by the regulation.

The Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) each initiated one formal Regulation B-related public enforcement action during the reporting period, while the Federal Deposit Insurance Corporation (FDIC) initiated 13.²⁶ There were no other enforcement actions by FFIEC agencies. The Federal Trade Commission (FTC) filed a complaint against a mortgage company alleging that it violated Regulation B (and the FTC Act).

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

²⁵ Because the agencies use different methods to compile the data, the information presented here supports only general conclusions. The 2009 reporting period was July 1, 2008, through June 30, 2009.

²⁶ Public enforcement actions are categorized by regulation throughout the report. Because some enforcement actions include violations of more than one regulation, the overall sum of actions derived from each regulation will be greater than the actual total number of enforcement actions initiated, which was 30.
Regulation E (Electronic Fund Transfers)
The FFIEC agencies reported that approximately 94 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation E, which is comparable with the 2008 reporting period. The most frequently cited violations involved failure to:

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

The OCC initiated one formal Regulation E-related enforcement action during the reporting period, while the FDIC initiated five. There were no other enforcement actions by FFIEC agencies.

Regulation P (Privacy of Consumer Financial Information)
The FFIEC agencies reported that approximately 98 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation P, compared with 97 percent for the 2008 reporting period. The most frequently cited violations involved failure to:

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

The OCC initiated one formal Regulation P-related enforcement action during the reporting period, while the FDIC initiated five. There were no other enforcement actions by FFIEC agencies.

Regulation Z (Truth in Lending)
The FFIEC agencies reported that 92 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation Z, compared with 81 percent for the 2008 re-

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27. The FDIC’s reported information in this area relates to Part 332—Privacy of Consumer Financial Information—of the agency’s regulations and not Regulation P.
porting period. The most frequently cited violations involved

- failure to accurately disclose the finance charge in closed-end credit transactions;
- failure to accurately disclose the APR in a closed-end credit transaction;
- failure to disclose the fact that a creditor has or will acquire an interest in a property purchased as part of a transaction; and
- on certain residential mortgage transactions, failure to provide a good faith estimate of the required disclosures before consummation, or not later than three business days after receipt of a written loan application.

In addition, 182 banks supervised by the Federal Reserve, FDIC, OCC, and OTS were required, under the Interagency Enforcement Policy in Regulation Z, to reimburse a total of approximately $3.14 million to consumers for understating APRs or finance charges in their consumer loan disclosures.

The OTS and the OCC each initiated one formal Regulation Z-related enforcement action during the reporting period, while the FDIC had 12. There were no other enforcement actions by FFIEC agencies.

Regulation AA (Unfair or Deceptive Acts or Practices)

The FFIEC agencies reported that more than 99 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation AA, which is comparable with the 2008 reporting period. The OTS initiated three formal Regulation AA-related enforcement actions, the OCC initiated one, and the FDIC initiated six during the reporting period. There were no other enforcement actions by FFIEC agencies.

Regulation CC (Availability of Funds and Collection of Checks)

The FFIEC agencies reported that 90 percent of institutions examined during the 2009 reporting period were in compliance with Regulation CC, compared with 89 percent for the 2008 reporting period. The most frequently cited violations involved failure to

- make available on the next business day the lesser of $100 or the aggregate amount of checks deposited that are not subject to next-day availability;
- follow procedures when invoking the exception for large-dollar deposits;
- provide required information when placing an exception hold on an account; and
- make funds deposited from local and certain other checks available for withdrawal within the times prescribed by the regulation.

The OCC initiated four formal Regulation CC-related enforcement actions during the reporting period, while the FDIC initiated six. There were no other enforcement actions by FFIEC agencies.
Regulation DD (Truth in Savings)

The FFIEC agencies reported that 87 percent of institutions examined during the 2009 reporting period were in compliance with Regulation DD, compared with 86 percent for the 2008 reporting period. The most frequently cited violations involved:

- failure to provide account disclosures containing all required information;
- inappropriate use of the phrase “annual percentage yield” in an advertisement without providing required additional terms and conditions;
- failure to provide account disclosures clearly and conspicuously, in writing, and in a form that the consumer may keep; and
- failure to provide timely, subsequent disclosures before maturity of time accounts.

The OTS and the OCC each initiated one formal Regulation DD-related enforcement action during the reporting period, while the FDIC initiated nine. There were no other enforcement actions by FFIEC agencies.

Responding to Consumer Complaints and Inquiries

The Federal Reserve investigates complaints against state member banks and selected nonbank subsidiaries of bank holding companies, and forwards complaints against other creditors and businesses to the appropriate enforcement agency. Each Reserve Bank investigates complaints against state member banks and selected nonbank subsidiaries in its District. The Federal Reserve also responds to consumer inquiries on a broad range of banking topics, including consumer protection questions.

In late 2007, the Federal Reserve established Federal Reserve Consumer Help (FRCH) to centralize the processing of consumer complaints and inquiries. In 2009, its second full year of operation, FRCH processed 53,904 cases. Of these cases, half (26,497) were inquiries and half (26,925) were complaints, with most cases received directly from consumers. Approximately three percent of cases were referred from other agencies.

While consumers can contact FRCH by telephone, fax, mail, e-mail, or online, most FRCH consumer contacts occurred by telephone (78 percent).

Complaints against State Member Banks and Selected Nonbank Subsidiaries of Bank Holding Companies about Regulated Practices, by Regulation/Act, 2009

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<td>Real Estate Settlement Procedures Act</td>
<td>80</td>
</tr>
<tr>
<td>Right to Financial Privacy Act</td>
<td>11</td>
</tr>
</tbody>
</table>

Total | 1,638

Nevertheless, 40 percent (10,643) of complaint submissions were made online, and the online form page received nearly 395,000 visits during the year.

Consumer Complaints

Complaints against state member banks and selected nonbank subsidiaries of bank holding companies totaled 8,073 in 2009. Nearly 40 percent (3,151) of these complaints were closed without investigation pending the receipt of additional information from consumers. Of the remaining complaints, 67 percent (3,284) involved unregulated practices and 33 percent (1,638) involved regulated practices.

Complaints about Regulated Practices

The majority of regulated practice complaints concerned checking accounts (34 percent), real estate (26 percent), and credit cards (13 percent). The most common checking account complaints related to insufficient funds or overdraft charges and procedures (52 percent), funds availability not as expected (9 percent), disputed withdrawal of funds (7 percent), and forgery, fraud, embezzlement, or theft (7 percent). The most common real estate complaints by problem code related to: “credit – other rates, terms, and fees” (13 percent), payment errors and delays (12 percent), credit denial - other (10 percent), and escrow account problems (7 percent); complaints by product code related to: home-purchase loans (51 percent), home refinance and closed-end loans (23 percent), and home equity credit lines (19 percent). The most common credit card complaints related to debt collection practices (12 percent), “other rates, terms, and fees” (10 percent), and billing error resolutions (10 percent).

Thirty-one regulated complaints alleging discrimination were received. Of these, 18 complaints (one percent of total regulated complaints) alleged discrimination on the basis of prohibited borrower traits or rights. Thirty percent of indigent individuals’ housing needs have been met.

29. Real estate loans include adjustable-rate mortgages; residential construction loans; open-end home equity lines of credit; home improvement loans; home purchase loans; home refinance/closed-end loans; and reverse mortgages.

30. Prohibited basis includes: race, color, religion, national origin, sex, marital status, age, applicant income derived from public assistance programs or applicant reliance on provisions of the Consumer Credit Protection Act.
of discrimination complaints were related to the age of the applicant or borrower. Thirty-three percent of discrimination complaints were related to the race, color, national origin, or ethnicity of the applicant or borrower. The most common violations where discrimination was alleged involved real estate loans and other loans.

In 75 percent of investigated complaints against state member banks and selected nonbank subsidiaries of bank holding companies, evidence revealed that banks or subsidiaries correctly handled the situation. Of the remaining 25 percent, ten percent are open cases that are in process, 5 percent were deemed violations of law, one percent was regarding general errors, and the remainder primarily involved factual disputes or litigated matters. The most common violations involved checking accounts, real estate loans, and credit cards.

Complaints About Unregulated Practices

As required by Section 18(f) of the Federal Trade Commission Act, the Board continued to monitor complaints about banking practices not subject to existing regulations, with a focus on instances of potential unfair or deceptive practices. In 2009, the Board received 3,304 complaints against state member banks and selected nonbank subsidiaries of bank holding companies that involved these unregulated practices. Most complaints were related to checking account activity (35 percent), real estate concerns (25 percent), and credit cards (9 percent). More specifically, consumers most frequently complained about issues involving insufficient funds or overdraft charges and procedures; credit card interest rates, terms, and fees; debt collection/foreclosures; depository forgery, fraud, embezzlement, or theft; and opening and closing deposit accounts.

Complaint Referrals

In 2009, the Federal Reserve forwarded 18,360 complaints against other banks and creditors to the appropriate regulatory agencies and government offices for investigation. To minimize the time required to re-route complaints to these agencies, referrals were transmitted electronically.

The Federal Reserve forwarded eight complaints to the Department of Housing and Urban Development (HUD) that alleged violations of the Fair Housing Act. The Federal Reserve’s investigation of these complaints revealed no evidence of illegal credit discrimination.

Consumer Inquiries

The Federal Reserve received 26,979 consumer inquiries in 2009, covering a wide range of topics. The top three consumer protection issues documented with specific codes were: adverse action notices received pursuant to the Equal Credit Opportunity Act (11 percent); pre-approved credit solicitations (7 percent); and deposit forgery, fraud, embezzlement or theft (3 percent). Consumers were typically directed to other resources, including other federal agencies or written materials, to address their inquiries.

31. A memorandum of understanding between HUD and the federal bank regulatory agencies requires that complaints alleging a violation of the Fair Housing Act be forwarded to HUD.
Supporting Community Economic Development

The Board’s Division of Consumer and Community Affairs (DCCA) works to promote community economic development and fair access to credit for low- and moderate-income communities and populations. As a decentralized function, the Community Affairs Offices (CAOs) at each of the 12 Reserve Banks design activities to respond to the specific needs of the communities they serve, with oversight from Board staff. The CAOs provide information and promote awareness of investment opportunities to financial institutions, government agencies, and organizations that serve low- and moderate-income communities and populations. Similarly, the Board’s CAO promotes and coordinates Systemwide, high-priority efforts; in particular, Board community affairs staff focus on issues that have public policy implications.

Foreclosures and Neighborhood Stabilization

In 2009, issues related to high rates of foreclosure continued to dominate the System’s community affairs agenda. While each Reserve Bank addressed the impact of foreclosure on low- and moderate-income communities—through programming tailored to the particular needs of communities in their Districts—the entire System coordinated resources, knowledge, and expertise related to mortgage markets to address the foreclosure problem through the Mortgage Outreach and Research Efforts (MORE) Initiative.32

The MORE initiative aims to enhance the System’s response to the foreclosure crisis by improving understanding of the incidents and underlying causes of foreclosures, working to mitigate the impact of foreclosures on individual borrowers and communities, and enhancing the System’s communication of important research and policy findings to consumers, financial institutions, community development practitioners, state and local governments, and federal policymakers.

As part of the MORE initiative, for example, the System is conducting a study of the uses of funds distributed under the Neighborhood Stabilization Program (NSP), which was established by HUD to stabilize communities that have suffered from foreclosures and abandonment. In 2009, the System solicited input from various local stakeholders, which will serve as the foundation of a report to be issued in the spring of 2010 to describe the uses of NSP funds and to identify best practices for future funding expenditures. In addition, the Board worked with the Federal Reserve Banks of Boston and Cleveland on a publication addressing issues related to the acquisition and disposition of real estate owned (REO), a class of property owned by a lender, typically a bank, after an unsuccessful sale at a foreclosure auction. In addition, the System’s Foreclosure Toolkit, a web-based resource center for borrowers, housing counselors, and community development practitioners, was updated to provide links to new information on outreach programs and to allow for further customization at the District-level.

The Board also partnered with NeighborWorks America® (NWA) again in 2009 to continue to leverage the System’s resources with those of

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CRA Did Not Cause the Subprime Mortgage Crisis

As the recent financial crisis unfolded, many theories emerged about its underlying causes, including some claims that the Community Reinvestment Act (CRA) encouraged commercial banks and savings institutions (banking institutions) to undertake high-risk mortgage lending.

The Board rebuts claims that the CRA lies at the root of the crisis by making the following points.

The language and enforcement of the CRA do not portend excessively risky lending by banks.

The CRA encourages banking institutions to extend credit to low- and moderate-income (LMI) neighborhoods and households within the framework of safe and sound operation. Moreover, the CRA does not stipulate minimum targets or even goals for the volume of loans, services, or investments banking institutions must provide. Finally, while subprime mortgage lending grew most significantly in the early to mid 2000’s, the CRA rules and enforcement process have not changed substantively since 1995. These three considerations weaken the theoretical link between the CRA and the subprime mortgage boom and bust.

Only a small portion of subprime mortgage originations in 2005 and 2006 can reasonably be linked to the CRA.

Data collected under the Home Mortgage Disclosure Act in 2005 and 2006 also suggest a tenuous link between the CRA and subprime mortgage lending. First, institutions not covered by the CRA (independent nonbank institutions) accounted for about half of all higher-priced mortgage originations (a proxy for subprime originations). Second, about 60 percent of higher-priced originations went to middle- or higher-income borrowers or neighborhoods, populations not targeted by the CRA. Finally, and perhaps most tellingly, only six percent of all higher-priced mortgage originations were extended by CRA-regulated lenders (and their affiliates) to either lower-income borrowers or neighborhoods in the lenders’ CRA assessment areas (the geographies that are the focus of CRA evaluations).

Mortgage defaults and foreclosures have been severe even in middle- and higher-income neighborhoods, areas that are not the focus of the CRA.

Analysis of data on non-prime mortgages (subprime and near-prime loans) from First American LoanPerformance (LP) finds that the 90-days-or-more delinquency rate (as of August 2008) for loans originated between January 2006 and April 2008 is very high across geographies regardless of income. Similarly, data from RealtyTrac on foreclosure filings between January 2006 and August 2008 indicate that about 70 percent of filings have taken place in middle- or higher-income neighborhoods, and filings have increased more sharply in middle- or higher-income areas than in the lower-income areas targeted by the CRA. It is important to note, however, that the LP and RealtyTrac data do not identify borrower income, tempering the conclusions one can draw from these data.
the NWA network to address community stabilization in the wake of the record number of foreclosures. As part of the partnership, the Board co-sponsored the Neighborhood Stabilization Symposium, a featured program at NWA’s December 2009 Training Institute in Washington, D.C. Federal Reserve Board Governor Elizabeth Duke delivered opening remarks at the symposium, which featured discussions and presentations of strategies and best practices in neighborhood stabilization. The symposium attracted an audience of approximately 400 local practitioners and policymakers.

In 2009, the Board also hosted a series of forums to address the availability of affordable rental housing. Topics addressed in the series included the particular problems of tenants that rent properties from owners in foreclosure, strategies for managing scattered site properties, policies designed to create rental property from REO inventories, financing of small multifamily properties, and strategies for reviving the market for Low Income Housing Tax Credits (LIHTCs). The Federal Reserve Bank of St. Louis partnered with the Board for the LIHTC forum and published a collection of policy papers featured at the forum.

Other Community Development Initiatives

Beyond foreclosure and neighborhood stabilization issues, DCCA provided important policy leadership in several areas in 2009. The Federal Reserve Banks of Boston and San Francisco published Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act, a compendium of policy recommendations regarding the modernization of the Community Reinvestment Act. The Boston and San Francisco Banks, together with the Board, co-hosted a policy discussion that introduced the publication and attracted leaders from the financial services industry, community advocates, foundations, think tanks, and academic institutions.

In addition, the Federal Reserve Bank of San Francisco partnered with the Board and the Community Development Financial Institutions Fund to host a Community Development Finance Summit in Washington, D.C. The summit brought together leaders in community development finance and featured a robust discussion of strategies to respond to the economic crisis. The San Francisco Bank’s Center for Community Development Finance published materials that served as the basis for the discussion entitled The Economic Crisis and Community Development Finance: An Industry Assessment. The Federal Reserve Bank of Boston also partnered with the Board and the Aspen Institute to follow-up on a System initiative begun in 2004 to address the scale and sustainability of community development finance.

Consumer Education and Outreach: 
Meeting Consumers Where They Are

In today’s complex and ever-changing consumer financial services marketplace, it is critical that consumers know where they can go for reliable information to assist them in making financial choices, and be able to spot a scam or a deal that is “too good to be true.” The Federal Reserve has a wealth of unbiased, research-based consumer information, and, throughout the year, DCCA engaged in innovative ways to expand its outreach to connect consumers with these resources.

In 2009, high foreclosure rates gave rise to concerns about new risks for vulnerable consumers in the mortgage marketplace. With concern about an increase in foreclosure-related scams, the Board was among the first federal banking agencies to reach out to consumers to warn them. Board staff conducted research to determine the most effective strategy for delivering short information pieces to the greatest number of people. Data indicates that consumers go to the movies even in a down economy, so the Board began running ads in movie theaters in April that focused on helping consumers avoid foreclosure scams: “Having trouble keeping up with your mortgage payments? Are you facing foreclosure? Don’t be taken advantage of—it shouldn’t hurt to get help. Go to FederalReserve.gov and click on 5 Tips for Avoiding Foreclosure Scams.”

Messages on avoiding foreclosure and scams were later expanded, with ads running in theaters over Labor Day weekend.

The Board also alerted consumers to changes in laws and regulations that have increased consumer credit card protections. With sweeping new rules being implemented in 2009 and 2010 (see “Credit Card Reform” in this chapter), the Board wanted consumers to have information about their accounts and rights, so it ran additional movie ads over Thanksgiving weekend to encourage wise credit card usage, directing viewers to 5 Tips for Getting the Most from Your Credit Card.”


community organizations by hosting a forum on subsidies in community development.

In April, the System held the sixth biennial System Community Affairs Officer’s Research Conference. The conference, entitled Innovative Financial Services for the Underserved: Opportunities and Outcomes, explored the role, processes, and outcomes of innovation in financial services for low- and moderate-income consumers and underserved populations. Leading researchers presented original and objective research designed to inform innovative market and product development through a framework that addressed (1) individual consumer preferences and behaviors with respect to consumer finance products, (2) influences affecting market participation, such as financial education and institutional structures, (3) effects of mortgage products on performance and wealth creation, and (4) approaches for shaping market participation.

Meeting Data and Analysis Needs

The Federal Reserve made a concerted effort to address the data needs of community development practitioners in 2009. The Federal Reserve Bank of Philadelphia hosted a conference in June entitled Understanding the Housing and Mortgage Markets: What Data Do We Have? What Data Do We Need? The conference brought together researchers and government officials responsible for data collection to discuss existing data available from federal, state, and local sources to monitor economic and housing conditions in low- and moderate-income neighborhoods, as well as the limitations of the data and efforts to improve the quality and availability of data to address community development needs.

In addition, several Reserve Banks developed survey instruments to monitor economic conditions in low- and moderate-income communities. For more information, see the Federal Reserve Bank of Philadelphia, Community Development, Community Development Events. 2009, “Understanding the Housing and Mortgage Markets: What Data Do We Have? What Data Do We Need?”, www.phil.frb.org/...
example, the Federal Reserve Bank of Kansas City developed the *LMI Survey*, a quarterly survey that measures the economic conditions of low- and moderate-income communities and the organizations that serve them.\(^{39}\) The survey results are used to construct five indicators of economic conditions in low- and moderate-income communities and two indicators of the condition of organizations serving them. The *LMI Survey* is available on the Reserve Bank’s website and provides a gauge for service providers, policymakers, and others to evaluate and respond to changes in the economic conditions for low- and moderate-income individuals.

**Consumer Advisory Council**

The Board’s Consumer Advisory Council (the Council)—whose members represent consumer and community organizations, the financial services industry, academic institutions, and state agencies—advises the Board of Governors on matters of Board-administered laws and regulations as well as other consumer-related financial services issues. Council meetings, open to the public, were held in March, June, and October. For a list of members of the Council, see the “Federal Reserve System Organization” section in this report; also, visit the Board’s website for transcripts of Council meetings.\(^ {40}\)

Among the significant topics of discussion for the Council in 2009 were

- the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the Credit Card Act);
- proposed changes to Regulation Z regarding disclosures that consumers receive in connection with closed-end mortgages and home-equity lines of credit and amendments that would provide new consumer protections for home-secured credit;
- proposed rules regarding overdraft services;
- issues related to foreclosures; and
- strategies and challenges related to neighborhood stabilization.

**The Credit Card Act**

In the June and October meetings, the Council addressed certain provisions of the Credit Card Act amending the Truth in Lending Act (TILA) and proposed amendments to Regulation Z (Truth in Lending) to protect consumers who use credit cards from a number of potentially costly practices (see “Credit Card Reform”).

The Credit Card Act prohibits creditors from opening a new credit card account or increasing the credit limit for an existing account unless the creditor considers the consumer’s ability to make the required payments under the terms of the account. Industry representatives encouraged the Board to adopt a broad, flexible approach regarding issuers’ evaluation of a consumer’s ability to pay, stating that issuers should be permitted to use an array of factors in underwriting, including generic and custom credit scores as well as institutions’ internal information that is statistically derived from their portfolios. Consumer representa-
tives expressed concern about the ability of regulators to review and validate issuers’ underwriting models and methodologies due to their proprietary nature and about the use of credit scores for underwriting rather than a holistic assessment of consumers’ ability to repay their full potential indebtedness.

In response to the Board’s proposed rules to implement the ability-to-pay provision, industry members expressed support for the proposed rule requiring consideration of existing obligations as well as income or assets in assessing consumers’ ability to make the required minimum payments, but noted the challenge in obtaining income information for existing customers. They encouraged the Board to include payment history as an additional factor in the ability-to-pay analysis and to permit use of modeled income, based on empirically derived and statistically sound models, as a substitute for reported income. Consumer representatives cautioned that regulators should closely monitor such modeling. Industry representatives also supported the proposed rule requiring issuers to estimate minimum payments based on a consumer’s utilization of the full credit line, but encouraged the Board to clarify that the analysis would take into account only the credit line offered by the particular issuer, not the full utilization of a consumer’s other credit lines. A consumer representative expressed the view that issuers should consider the full utilization of all credit lines in determining ability to pay.

Regarding penalty fees associated with credit card accounts, consumer representatives expressed the view that any fees should be reasonably related to the cost incurred by the creditor as a result of the violation, as verified by empirical data; that basing fees on deterrence should also be supported empirically; and that the overall standards for penalty fees should be subject to rigorous validation. Industry representatives supported the adoption of a flexible set of criteria to consider in determining the reasonableness and proportionality of penalty fees and encouraged the inclusion of portfolio-based analysis and issuers’ loss rates as factors in addition to those specifically listed in the statute.

For over-the-limit fees, consumer representatives urged the Board to ensure that issuers provide appropriate disclosures regarding the opt-in requirement for extensions of credit that exceed the account’s credit limit and to require that consumers who do not opt in nevertheless receive the same account terms, conditions, and features provided to consumers who do opt in. A consumer representative encouraged the Board to prohibit the assessment of over-the-limit fees due to credit-line reductions. An industry representative stated that the opt-in requirement for the over-the-limit feature will help to regulate the reasonableness of that fee. A consumer representative expressed the view that the opt-in requirement for over-the-limit transactions and fees will foster consumer choice and competition in the marketplace, but urged regulators to monitor the ways in which issuers communicate the change to consumers. Industry representatives encouraged the Board to allow issuers to begin informing consumers in advance of the requirement’s February 22, 2010, implementation date that creditors obtain a consumer’s express consent before imposing over-the-limit fees.

Regarding the statutory requirement that issuers reevaluate interest rate increases that are based on the credit risk of the consumer, market conditions, or other factors, industry representatives encouraged the Board to
adopt a broad set of criteria for issuers to consider in making such decisions.

Consumer representatives expressed the view that issuers’ rate-setting and repricing methodologies should be subject to rigorous scrutiny and validation by regulators.

Industry representatives generally pointed to the emergence of a new business model in the credit card industry as issuers adjust to the elimination of “back-end” risk-management tools such as repricing and turn to more stringent “front-end” underwriting and overall higher pricing.

**Overdraft Services**

At the March meeting, Council members discussed the Board’s proposed amendments to Regulation E (Electronic Funds Transfer Act), which would provide consumers with certain choices relating to the use of overdraft services and the assessment of overdraft fees (see “Overdraft Services and Gift Card Rules”). The proposed rules would prohibit financial institutions from imposing a fee on a consumer’s asset account for paying an overdraft for an ATM or one-time debit card transaction unless the consumer is given notice of the right to opt out of the institution’s overdraft service, and the consumer does not opt out. As an alternative approach, the proposal would require a consumer’s affirmative consent, or opt-in, before such overdrafts could be paid by the financial institution and a fee imposed on the consumer’s account for the service.

Members commended the Board for its work on the proposed overdraft rules and incorporation of feedback from the Council in prior meetings. Several industry representatives expressed support for the opt-out approach, which they stated would allow consumers to retain control of their financial situation while averting potential operational disruptions at the point of sale and alleviating the burden on institutions to gain affirmative consent from existing account-holders. One member suggested that the Board adopt an opt-out approach for current accounts and an opt-in approach for new accounts as of a certain date. Industry representatives also supported the idea that financial institutions should be permitted to price differently those accounts that do not allow overdrafts for ATM withdrawals and one-time debit transactions, compared to accounts that allow the payment of such overdrafts.

A consumer representative stated that surveys show that consumers want a choice about whether overdrafts are paid for debit-card transactions and that consumers generally want the transaction to be declined. Consumer representatives generally supported the opt-in approach, which they stated would provide incentives for institutions to communicate clearly about overdraft services to their customers. They also expressed the view that institutions should not be permitted to alter the account terms, conditions, or features for consumers who do not opt in compared to those who do opt in. According to one consumer representative, if banks change their business models to move away from free checking accounts, any account fee should be uniform and applied to all account-holders. One member also urged the Board to adopt substantive protections regarding overdraft services, such as limiting the number of overdrafts a consumer could be charged for during a year.
Closed-End Mortgages and Home Equity Lines of Credit

In July 2009, the Board proposed changes to the disclosures that consumers receive in connection with closed-end mortgage loans and home equity lines of credit (HELOCs) with the goal of improving their content and format to make them more useful to consumers (see “Mortgage and Home Equity Lending Reform”). These disclosures are required by the Board’s Regulation Z. Many of the changes are based on the consumer testing conducted in connection with the review of Regulation Z. Council members strongly commended the Board’s work on the disclosures and the use of extensive consumer testing to inform the content and format of the disclosures. Several members urged the Board to do further testing regarding consumers’ experiences with mortgage transactions.

For closed-end mortgages, the Board’s proposal would revise the calculation of the finance charge and annual percentage rate (APR) so that they better capture most fees and costs paid by consumers in connection with the loan. Several industry representatives cautioned against including additional fees, such as third-party charges, in the APR because such a calculation could mean that more loans will exceed the high-cost threshold under federal and state laws. A consumer representative supported including all fees in the APR to make it a more useful number for consumers and suggested that fees should be amortized over a typical refinancing period or the actual term of the loan, whichever is shorter.

The Board’s proposal would require the creditor to provide a “final” TILA disclosure that the consumer must receive at least three business days before consummation, even if nothing has changed since the early TILA disclosure was provided. The proposal sets out two alternative approaches to address changes to loan terms and settlement charges during the three-business-day waiting period: receiving a new disclosure (and new waiting period) if any changes occur, or only when the APR becomes inaccurate or a variable rate feature is added. Consumer representatives and an industry member endorsed a strict three-day rule requiring a new disclosure and waiting period, with no waivers permitted. Other industry representatives supported a more flexible approach, such as allowing consumers to waive the three-day standard so that the closing could take place, and setting a threshold, with a de minimis exception, for the type or amount of changes that would trigger a new disclosure and waiting period.

The Board’s proposal would also amend Regulation Z to provide limits on compensation to mortgage brokers and to creditors’ employees who originate loans, prohibiting certain payments to originators based on the loan’s terms or conditions. Several industry representatives expressed the view that the rule should apply only to loan originators, not to institutions that function as mortgage brokers, such as credit unions, community banks, or mortgage broker businesses; they stated that a broader application of the rule would have the effect of diminishing competition. Consumer representatives supported the rule and its classifications according to function, opposing any exception for brokers. One member urged the Board to consider means to ensure that the rules regarding compensation are applied consistently to banks and non-banks. In response to the proposal’s prohibition on directing, or “steering,” consumers to transactions that are
not in their best interest in order to increase the originator’s compensation, both industry and consumer representatives urged the Board to set forth a clearer, bright-line rule for what would constitute steering. A consumer representative noted that there is less risk of steering when a consumer is presented with multiple loan options.

Regarding HELOCs, the Board’s proposal would prohibit creditors from terminating an account for payment-related reasons unless the consumer has failed to make a required minimum periodic payment for more than 30 days after the due date for that payment. An industry member supported the 30-day timeframe, but a consumer representative urged the Board to adopt a 60-day delinquency timeframe, consistent with the new delinquency period in the credit card context. The Board’s proposal also would establish a new safe harbor for suspensions and credit-limit reductions and would impose additional requirements regarding reinstating accounts that have been temporarily suspended or reduced. Some members noted the impact on small businesses when HELOCs are suspended or the credit limit is reduced. Consumer representatives expressed the view that there should be a clear appeals process regarding line suspensions or reductions and that the lender should bear the costs associated with reinstating accounts, especially if later analysis shows that the line should not have been changed. Industry representatives also supported an appeals process, but stated that consumers should bear some of the cost, which could be refunded if the appeal is successful. An industry representative supported the proposed 30-day timeframe for lenders to complete an investigation of a request for reinstatement, but encouraged clarification that the time period would be triggered when the lender receives complete information from the borrower.

**Foreclosure Issues**

In each of its meetings in 2009, the Council discussed loss-mitigation efforts for mortgages, including the Administration’s Making Home Affordable Program, the performance of modified mortgages, and other issues related to foreclosures. Members generally agreed on the need for more comprehensive and detailed data collection about mortgage delinquencies, foreclosures, and real estate owned (REO) properties.

Regarding the federal Making Home Affordable mortgage modification program, consumer representatives expressed concern about the capacity of servicers to handle the volume of requests and associated documentation, as well as delays in moving borrowers from trial modifications to permanent modifications. They also stated that some foreclosures are being filed while the borrower is in the trial modification period. Industry representatives stated that the need to fully document and completely underwrite loan modifications under the federal program leads to longer processing timeframes and compliance challenges. They also expressed the view that, in the early stages of the federal modification program, servicers were hampered by a lack of detailed technical guidelines and little advance notice of changes to the program, specifically noting the need for definition around the net-present-value model.

Later in 2009, some members pointed to signs of progress in the federal modification program, such as the increasing number of trial modifica-
tions initiated and borrowers evaluated for trial modifications. Industry representatives stated that, while participating servicers have increased their staffing and resources to implement the modification program, they face strict compliance requirements regarding documentation, as well as operational challenges in adjusting to changes to the program. Members agreed on the need for uniform loss-mitigation processes and guidelines to increase efficiency and reduce confusion among servicers and borrowers. One member noted that while most borrowers with trial modifications are making their payments, some are not able to do so because of economic hardship, such as job loss. Members generally agreed that the federal program does not adequately address the situations of jobless borrowers or those who are underwater on their loans.

A consumer representative expressed concern about the lack of information provided to borrowers who are denied a loan modification and the absence of an appeals process for the federal program. Members commended the Board for its work on fair-lending issues, particularly in the context of loan modifications. A consumer representative also urged the Board to monitor fair-lending issues related to the maintenance and disposition of REO properties by lenders.

Members raised concerns about the increasing prevalence of for-profit foreclosure consultants and foreclosure scams and emphasized the need for enforcement against such entities and warnings to consumers about not paying up-front fees for counseling or modification services. A consumer representative urged the provision of more resources for legitimate counseling agencies and legal services organizations to help guide distressed borrowers through the modification process. Members cited examples of successful collaborations among lenders, servicers, and nonprofit groups to engage in direct outreach with borrowers.

Several consumer and industry representatives endorsed a focus on principal write-downs as a key way to achieve sustainable modifications, and some members also suggested greater use of short sales in cases where an affordable modification cannot be achieved. Several consumer representatives expressed support for judicial mortgage modifications in the bankruptcy context and court-mediated resolution programs as additional tools to deal with foreclosures. Industry representatives cautioned that judicial modifications should be a last resort and should have reasonable limitations, such as being permitted only for subprime loans, and that the primary focus should be on achieving affordable modified payments for borrowers. Consumer and industry representatives disagreed about the value of second liens and the appropriate treatment of those loans both in the federal modification program and in the safety-and-soundness context.

**Neighborhood Stabilization**

Throughout 2009, the Council discussed the effects of foreclosures on the surrounding community, particularly in areas where foreclosures are concentrated, and efforts such as the federal Neighborhood Stabilization Program (NSP) to address the challenges of stabilizing communities. Members noted the negative effects of REO and vacant properties on neighborhoods, such as increased vandalism and crime, and the impact on the decisionmaking process of other homeowners who are struggling to stay current.
on their mortgage. They expressed concern about banks not maintaining their REO properties or not completing foreclosure sales, leading to “toxic titles,” and urged federal regulators to increase oversight of regulated institutions regarding these issues. One member urged lenders and servicers to be attentive to the valuation process in the sale of REO properties and the effects of their property-disposition activities on housing prices and to focus on selling REO properties to owner-occupants.

Members described challenges in the implementation of the Neighborhood Stabilization Program (NSP), such as a lack of government infrastructure in some communities for managing the influx of federal funds and the reimbursement feature of the program. They noted that, given the relatively short implementation timeframe for the NSP, many local governments have opted for less complicated projects such as land banks or closing-cost assistance, rather than more complex acquisition and rehabilitation efforts. They also pointed to some positive developments, such as the NSP’s provision of technical assistance and a move toward collaborative efforts on the local level, often led by community development organizations. They expressed support for initiatives to capitalize community development financial institutions (CDFIs) and other community development groups that can play important roles in neighborhood revitalization. Members noted that the CDFI industry serves as a key funding source for small businesses and other economic development activities, particularly in low- and moderate-income communities.

One member noted that the National Community Stabilization Trust is working to provide tools to address the issues of neighborhood stabilization and vacant and abandoned properties, such as a clearinghouse for REO properties between servicers and communities. However, members also described the difficulties in working with local governments regarding acquisition of REO properties due to the lack of standard purchase agreements. Members noted that nonprofit groups face significant challenges in addressing REO issues, from holding troubled properties to finding credit-worthy homebuyers and managing scattered-site rental properties. Finally, one member urged that further guidance be provided regarding the implementation of the Protecting Tenants at Foreclosure Act of 2009.

Other Discussion Topics
At the March meeting, the Council addressed issues related to the availability and quality of credit, particularly for consumers and small businesses. Members discussed measures that aim to restore the flow of critically important credit as well as the current state of lending, including the types and quality of credit products and terms that are available to consumers.

An industry representative commented on the experience of credit card issuers, which face increased funding costs and a sharp increase in loan losses and are responding by repricing and cutting credit lines; he also noted that Congressional action is likely to impact the overall business model of the credit card industry and access to credit. One member stated that increased monthly payments and interest rates for credit cards can exacerbate the cyclical problems that consumers and the industry are facing; another member expressed concern that individual issuers’ actions in terms of risk-based pricing for credit cards may
work to increase systemic risk. Some members also noted that credit cards and home-equity lines of credit are key sources of capital for small businesses, which face difficulties when those sources of funding are cut off.

A consumer representative stated that some consumers are still being offered credit products that raise concerns, and an industry representative noted the need for quality products that will help bring people who have experienced foreclosures or bankruptcy during the crisis back into the conventional credit market. One member urged attention to potentially problematic credit products, such as tax refund anticipation loans and short-term loans from banks, which may become more appealing to cash-strapped borrowers who cannot access other forms of credit. One member pointed to the need for both access to credit and quality of credit and the difficulties faced by individuals who have thin or no credit files; the member urged the Federal Reserve to study options for generating alternative sources of credit data to analyze consumers who do not have a traditional credit file.

Members praised the Federal Reserve’s steps to bolster the markets for securitized assets and recommended further attention to the markets for Small Business Administration loans and affordable multifamily financing through the Low Income Housing Tax Credit.

At the June meeting, Council members focused on the future of the Community Reinvestment Act (CRA), including possible changes in light of developments in the financial services industry. Members discussed the idea of extending the CRA beyond depository institutions, such as non-bank affiliates of depository institutions or to other non-bank financial services providers, such as credit unions or insurance companies. Several members noted that non-depository institutions benefited from government interventions during the financial crisis and should be subject to the responsibilities of CRA in exchange for such benefits. Members also expressed support for expanding the CRA to cover financial services and products beyond lending. One member noted that over the years regulators have added products for which institutions can receive CRA credit, but that the process of measuring the impact of such products needs improvement. A consumer representative suggested that CRA coverage should be extended to members of federally protected classes, such as racial and ethnic groups, women, and persons with disabilities, to ensure fair lending and the availability of quality financial products and services for those individuals.

Several industry representatives noted that the CRA’s original purpose focused on serving low- and moderate-income communities from which deposits were taken and cautioned that expanding the CRA, whether to include other products and institutions or to address fair-lending issues, could dilute that purpose and the regulation’s impact. An industry representative also expressed concern about the burden of complying with the CRA, particularly for smaller institutions. Both consumer and industry members agreed that any reexamination of the CRA should include attention to the quality and sustainability of credit, not just the quantity of credit.

Also at the June meeting, members provided input on the Board’s rulemaking regarding the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). Some members expressed the view that loss-mitigation personnel
should be exempt from the SAFE Act’s licensing requirements. Several members supported applying the requirements to personnel who provide refinancings. One member encouraged the Board to adopt a “grandfathering” approach for existing originators and to set stricter requirements for education and testing for loan officers at regulated depository institutions.
Federal Reserve Banks

The Federal Reserve Banks provide “payment services” to depository and certain other institutions, distribute the nation’s currency and coin to depository institutions, and serve as fiscal agents and depositories for the U.S. government and other entities. The Reserve Banks also contribute to setting national monetary policy and supervision and regulation of banks and other financial entities operating in the United States (discussed in the preceding chapters of this report).

Developments in Federal Reserve Priced Services

Federal Reserve Banks provide a range of payment and related services to depository institutions, including collecting checks, operating an automated clearinghouse (ACH) service, transferring funds and securities, and providing a multilateral settlement service. The Reserve Banks charge fees for providing these “priced services.”

The Monetary Control Act of 1980 requires that the Federal Reserve establish fees for priced services provided to depository institutions so as to recover, over the long run, all direct and indirect costs actually incurred as well as the imputed costs that would have been incurred—including financing costs, taxes, and certain other expenses—and the return on equity (profit) that would have been earned if a private business firm had provided the services. The imputed costs and imputed profit are collectively referred to as the private-sector adjustment factor (PSAF). Over the past 10 years, Reserve Banks have recovered 97.8 percent of their priced services costs, including the PSAF (see table, next page).

1. Financial data reported throughout this chapter—including revenue, other income, costs, income before taxes, and net income—can be linked to the pro forma financial statements at the end of this chapter.

2. In addition to income taxes and the return on equity, the PSAF includes three other imputed costs: interest on debt, sales taxes, and an assessment for deposit insurance by the Federal Deposit Insurance Corporation (FDIC). Board of Governors assets and costs that are related to priced services are also allocated to priced services; in the pro forma financial statements at the end of this chapter, Board assets are part of long-term assets, and Board expenses are included in operating expenses.

On March 31, 2009, the Board of Governors requested public comment on a proposal to replace the current correspondent bank model underlying the PSAF calculation with a model based on elements derived from publicly traded firms more broadly. The Board is currently analyzing further the proposed publicly traded firm model and an alternate model based on a peer group of publicly traded payments processors that was suggested by several commenters.

3. Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standards Board’s Statement of Financial Accounting Standards (SFAS) No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans [Accounting Standards Codification (ASC) Topic 715 (ASC 715), Compensation-Retirement Benefits], which has resulted in the recognition of a $478.3 million reduction in equity related to the priced services’ benefit plans through 2009. Including this reduction in equity, which represents a decline in economic value, results in cost recovery of 93.0 percent for the 10-year period. For details on how implementing ASC 715 affected the pro forma financial statements, refer to notes 3 and 5 at the end of this chapter.
In 2009, Reserve Banks recovered 92.8 percent of total priced services costs of $727.5 million, including the PSAF.\(^1\) Revenue from priced services amounted to $662.7 million, other income was $12.7 million, and costs were $707.5 million, resulting in a net loss to priced services of $32.1 million.\(^5\) During the year, the Banks raised prices, reduced operating costs, and accelerated the consolidation of their check-processing infrastructure to improve their overall cost recovery. These efforts, however, were not sufficient to offset reduced net income on clearing balances and increased pension costs.

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue from services(^4)</th>
<th>Operating expenses and imputed costs(^2)</th>
<th>Targeted return on equity(^3)</th>
<th>Total costs</th>
<th>Cost recovery (percent)(^4,5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>922.8</td>
<td>818.2</td>
<td>98.4</td>
<td>916.6</td>
<td>100.7</td>
</tr>
<tr>
<td>2001</td>
<td>960.4</td>
<td>901.9</td>
<td>109.2</td>
<td>1,011.1</td>
<td>95.0</td>
</tr>
<tr>
<td>2002</td>
<td>918.3</td>
<td>891.7</td>
<td>92.5</td>
<td>984.3</td>
<td>93.3</td>
</tr>
<tr>
<td>2003</td>
<td>881.7</td>
<td>931.3</td>
<td>104.7</td>
<td>1,036.1</td>
<td>85.1</td>
</tr>
<tr>
<td>2004</td>
<td>914.6</td>
<td>842.6</td>
<td>112.4</td>
<td>955.0</td>
<td>95.8</td>
</tr>
<tr>
<td>2005</td>
<td>994.7</td>
<td>834.7</td>
<td>103.0</td>
<td>937.7</td>
<td>106.1</td>
</tr>
<tr>
<td>2006</td>
<td>1,031.2</td>
<td>875.5</td>
<td>72.0</td>
<td>947.5</td>
<td>108.8</td>
</tr>
<tr>
<td>2007</td>
<td>1,012.3</td>
<td>913.3</td>
<td>80.4</td>
<td>993.7</td>
<td>101.9</td>
</tr>
<tr>
<td>2008</td>
<td>873.8</td>
<td>820.4</td>
<td>66.5</td>
<td>886.9</td>
<td>98.5</td>
</tr>
<tr>
<td>2009</td>
<td>679.4</td>
<td>707.5</td>
<td>19.9</td>
<td>727.5</td>
<td>92.8</td>
</tr>
<tr>
<td>2000–2009</td>
<td>9,185.2</td>
<td>8,537.2</td>
<td>859.0</td>
<td>9,396.3</td>
<td>97.8</td>
</tr>
</tbody>
</table>

Note: Here and elsewhere in this chapter, components may not sum to totals or yield percentages shown because of rounding.

1. For the 10-year period, includes revenue from services of $8,600.9 million and other income and expense (net) of $584.3 million.
2. For the 10-year period, includes operating expenses of $8,113.8 million, imputed costs of $140.8 million, and imputed income taxes of $282.5 million.
3. For 2009, in light of uncertainty about the long-term effect that the payment of interest on reserve balances held by depository institutions at the Reserve Banks would have on the level of clearing balances, the PSAF has been adjusted to reflect the actual clearing balance levels maintained throughout 2009.
4. Revenue from services divided by total costs.
5. For the 10-year period, cost recovery is 93.0 percent, including the net reduction in equity related to ASC 715 reported by the priced services in 2009.

In 2009, Reserve Banks recovered 92.8 percent of total priced services costs of $727.5 million, including the PSAF.\(^4\) Revenue from priced services amounted to $662.7 million, other income was $12.7 million, and costs were $707.5 million, resulting in a net loss to priced services of $32.1 million.\(^5\) During the year, the Banks raised prices, reduced operating costs, and accelerated the consolidation of their check-processing infrastructure to improve their overall cost recovery. These efforts, however, were not sufficient to offset reduced net income on clearing balances and increased pension costs.

The Reserve Banks are engaged in a number of technology initiatives that will modernize their priced services processing platforms over the next several years. The Banks are developing and planning to implement a new end-to-end electronic check-processing system to improve the efficiency and reliability of their current check-processing operations. They also continued efforts to migrate the FedACH and Fedwire Funds services off a mainframe system and to a distributed environment.

Commercial Check-Collection Service

In 2009, Reserve Banks recovered 92.8 percent of the total costs of their commercial check-collection service, including the PSAF. The Banks’ operating expenses and imputed costs totaled $514.6 million. Revenue from operations totaled $481.7 million and
other income totaled $9.2 million, resulting in a net loss of $23.7 million. Check-service fee revenue in 2009 decreased $123.5 million from 2008.6

Reserve Banks handled 8.6 billion checks in 2009, a decrease of 10.1 percent from 2008 (see table above). The decline in Reserve Bank check volume has been influenced by nationwide trends away from the use of checks and toward greater use of electronic payment methods.7 By year-end 2009, 98.6 percent of Reserve Bank check deposits and 94.3 percent of Reserve Bank check presentments were being made through Check 21 products.8

The Reserve Banks continued the consolidation of their check-processing offices in 2009. Because of the rapid adoption of electronic check processing, the Banks were able to reduce their check-processing infrastructure more quickly than originally expected. By year-end 2009, the Banks were processing paper checks at two sites nationwide, down from 13 at year-end 2008. This reduction is part of the Reserve Banks’ multiyear initiative, begun in 2003, to reduce the number of offices at which Banks process checks to meet their long-run cost-recovery requirement under the Monetary Control Act of 1980.

Commercial Automated Clearinghouse Services

In 2009, the Reserve Banks recovered 93.4 percent of the total costs of their commercial ACH services, including the PSAF. Reserve Bank operating expenses and imputed costs totaled $98.5 million. Revenue from ACH operations totaled $92.9 million and other income totaled $1.8 million, resulting in a net loss of $3.8 percent of Reserve Banks’ deposit volume was presented to paying banks using these products.

### Activity in Federal Reserve Priced Services, 2007–2009

<table>
<thead>
<tr>
<th>Service</th>
<th>2009</th>
<th>2008</th>
<th>2007</th>
<th>Percent change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2008 to 2009</td>
</tr>
<tr>
<td>Commercial check</td>
<td>8,584,929</td>
<td>9,545,424</td>
<td>10,001,289</td>
<td>−10.1</td>
</tr>
<tr>
<td>Commercial ACH</td>
<td>9,966,260</td>
<td>10,040,388</td>
<td>9,363,429</td>
<td>−0.7</td>
</tr>
<tr>
<td>Fedwire funds transfer</td>
<td>127,357</td>
<td>134,220</td>
<td>137,555</td>
<td>−5.1</td>
</tr>
<tr>
<td>National settlement</td>
<td>464</td>
<td>469</td>
<td>505</td>
<td>−1.1</td>
</tr>
<tr>
<td>Fedwire securities transfer</td>
<td>10,519</td>
<td>11,717</td>
<td>10,110</td>
<td>−10.2</td>
</tr>
</tbody>
</table>

**Note:** Activity in **commercial check** is the total number of commercial checks collected, including processed and fine-sort items; in **commercial ACH**, the total number of commercial items processed; in **Fedwire funds transfer** and **securities transfer**, the number of transactions originated online and offline; and in **national settlement**, the number of settlement entries processed.

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6. In 2008, the Reserve Banks discontinued the transportation of commercial checks between their check-processing offices. As a result, in 2009, there were no costs or imputed revenues associated with the transportation of commercial checks between Reserve Bank check-processing offices.


8. The Reserve Banks also offer non-Check 21 electronic-presentment products. In 2009, 1.3
Check 21 — Five Years Later

The Check Clearing for the 21st Century Act (Check 21), which became effective on October 28, 2004, promised a modernization of the nation’s largely paper-based check-clearing system. In the five years since, considerable progress has been made toward achieving the act’s purpose of improving the overall efficiency of the nation’s payments system by fostering innovation in the check-collection system.

When Check 21 was enacted, the nation’s retail payments system was already undergoing a transformation driven by changes in technology, rules, and consumer and business preferences. Federal Reserve research had revealed that, in 2003, the number of electronic payments had surpassed the number of check payments for the first time. However, the modernization of the check-collection system was stymied by laws that let banks demand that original checks be presented for payment. The banking industry’s extensive reliance on the physical movement of checks became apparent after the terrorist attacks of September 11, 2001, when air traffic came to a standstill resulting in delays in the clearing of many checks.

Check 21 addressed these issues indirectly by creating a new negotiable paper instrument, called a substitute check, that when properly prepared would be the legal equivalent of an original check. The law required banks that were either unable or unwilling to accept checks electronically to accept substitute checks in place of the originals. This statutory change, in turn, facilitated “check truncation,” whereby banks could stop forwarding original checks for collection or return and apply check-imaging technology in a more robust fashion to achieve the efficiencies and cost savings associated with electronic check clearing.

The Federal Reserve Banks began offering Check 21 services as soon as the law became effective. Initially, the move toward electronic check clearing unfolded gradually as many banks tried to determine how best to apply the provisions of the new law. The use of the Reserve Banks’ Check 21 services accelerated after banks developed their business strategies and made the investments necessary to support the exchange of check images. Banks

Fedwire Funds and National Settlement Services

In 2009, Reserve Banks recovered 92.1 percent of the costs of their Fedwire Funds and National Settlement Services, including the PSAF. Reserve Bank operating expenses and imputed costs totaled $69.3 million in 2009. Revenue from these operations totaled $64.4 million, and other income amounted to $1.3 million, resulting in a net loss of $3.6 million.
Fedwire Funds Service

The Fedwire Funds Service allows participants to use their balances at Reserve Banks to transfer funds to other participants. In 2009, the number of Fedwire funds transfers originated by depository institutions decreased 5.1 percent from 2008, to approximately 127 million. The average daily value of Fedwire funds transfers in 2009 was $2.5 trillion.

In 2009, the Reserve Banks implemented an enhanced Fedwire Funds Service message format to include additional information about cover payments. Cover payments are bank-to-bank funds transfers used to fund or settle underlying customer payment obligations. This message format provides the space to include identifying information about originators and beneficiaries of transfers, improving payment transparency and assisting banks in risk management and transparency.

National Settlement Service

The National Settlement Service is a multilateral settlement system that allows participants in private-sector clearing arrangements to settle transactions using Federal Reserve balances.
In 2009, the service processed settlement files for 41 local and national private-sector arrangements. The Reserve Banks processed slightly more than 10,500 files that contained almost 464,000 settlement entries for these arrangements in 2009.

Fedwire Securities Service

In 2009, the Reserve Banks recovered 93.8 percent of the total costs of their Fedwire Securities Service, including the PSAF. The Banks’ operating expenses and imputed costs for providing this service totaled $25.1 million in 2009. Revenue from the service totaled $23.7 million, and other income totaled $0.5 million, resulting in a net loss of $0.9 million.

The Fedwire Securities Service allows participants to transfer electronically to other participants in the service certain securities issued by the U.S. Treasury, federal government agencies, government-sponsored enterprises, and certain international organizations. In 2009, the number of non-Treasury securities transfers processed via the service decreased 10.2 percent from 2008, to approximately 10.5 million.

Float

The Federal Reserve had daily average credit float of $1,976.4 million in 2009, compared with credit float of $1,193.4 million in 2008.

Developments in Currency and Coin

The Federal Reserve Board issues the nation’s currency (in the form of Federal Reserve notes), and the Federal Reserve Banks distribute currency and coin through depository institutions. The Reserve Banks also receive currency and coin from circulation through these institutions.

The Reserve Banks received 35.2 billion Federal Reserve notes from circulation in 2009, a 4.1 percent decrease from 2008, and made payments of 35.8 billion notes into circulation in 2009, a 5.1 percent decrease from 2008. Although Reserve Bank payments into circulation decreased to pre-financial-crisis levels, receipts from circulation decreased to a greater extent, likely because consumers typically hold more currency in times of economic uncertainty. The value of currency in circulation increased 4.1 percent in 2009, to $887.8 billion, following a significant increase in 2008. The Banks received 65.3 billion coins from circulation in 2009, a 1.4 percent increase from 2008, and they made payments of 68.9 billion coins into circulation, a 4.7 percent decrease from 2008.

Board staff worked with Treasury, the U.S. Secret Service, and the Reserve Banks’ Currency Technology Office to develop a more-secure design for the $100 Federal Reserve note.

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9. The expenses, revenues, volumes, and fees reported here are for transfers of securities issued by federal government agencies, government-sponsored enterprises, and certain international organizations. Reserve Banks provide Treasury securities services in their role as the U.S. Treasury’s fiscal agent. These services are not considered priced services. For details, see the “Treasury Securities Service” section later in this chapter.

10. Credit float occurs when the Reserve Banks present items for collection to the paying bank prior to providing credit to the depositing bank (debit float occurs when the Reserve Banks credit the depositing bank prior to presenting items for collection to the paying bank).
new design was unveiled on April 21, 2010.

The Reserve Banks continued implementing a program to extend the useful life of the System’s BPS 3000 high-speed currency-processing machines. The program will replace the operating systems of the current equipment, which will help improve the Reserve Banks’ processing efficiency. By year-end 2009, the Banks had upgraded 90 of 131 machines. They expect to complete the program in 2010.

Reserve Banks are in the early stages of developing a new cash automation platform that will facilitate control of the Banks’ cash operations and improve their efficiency, provide an expansive and responsive management information reporting system with superior and flexible reporting tools, facilitate business continuity and contingency planning, and enhance the support provided to Reserve Bank customers and business partners. In 2009, the Banks refined the design for the new system.

Developments in Fiscal Agency and Government Depository Services

As fiscal agents and depositories for the federal government, the Federal Reserve Banks auction Treasury securities, process electronic and check payments for Treasury, collect funds owed to the federal government, maintain Treasury’s bank account, and invest Treasury balances. The Reserve Banks also provide certain fiscal agency and depository services to other entities; these services are primarily related to book-entry securities.

Treasury and other entities fully reimbursed the Reserve Banks for the costs of providing fiscal agency and depository services. In 2009, reimbursable expenses amounted to $450.3 million, compared with $461.1 million in 2008 (see table, next page). Support for Treasury programs accounted for 93.8 percent of the cost, and support for other entities accounted for 6.2 percent. The Reserve Banks actively monitor program expenses, and they strive to contain these costs while providing the resources necessary to accomplish program objectives.

Treasury Securities Services

The Reserve Banks work closely with Treasury’s Bureau of the Public Debt in support of the borrowing needs of the federal government. The Banks auction, issue, maintain, and redeem securities; provide customer service; and operate the automated systems supporting paper U.S. savings bonds and book-entry marketable Treasury securities (bills, notes, and bonds). Treasury securities services consist of retail securities programs (which primarily serve individual investors) and wholesale securities programs (which serve institutional customers).

Retail Securities Programs

The Reserve Banks continued to support Treasury’s efforts to improve the quality and efficiency of securities services provided to retail customers. The Banks process paper U.S. savings bonds transactions and book-entry marketable Treasury securities transactions for securities held in Legacy Treasury Direct. Treasury’s first application designed to support retail customers who purchase marketable Treasury securities. Reserve Bank operating expenses for the retail securities programs were $73.7 million in 2009, compared with $72.4 million in 2008. Although the Banks’ staffing levels declined slightly...
in response to lower activity levels, the associated costs savings were offset by other cost increases.

During the year, the Reserve Banks began working with the Bureau of the Public Debt on an initiative that will improve the quality, consistency, and efficiency of support provided to retail securities customers. Treasury’s Retail E-Services initiative aims to lower costs while providing a high-quality customer service experience, providing more opportunities for customer self-service, and eliminating duplicative processes.

Consistent with the trend from previous years, both the Legacy Treasury Direct and paper savings bonds programs experienced volume declines in 2009. The Legacy Treasury Direct system held $49.9 billion (par value) of Treasury securities as of December 31, a 21.2 percent decrease from 2008. This decrease is attributable to fewer reinvestments of maturing securities, fewer purchases of new securities, and higher dollar values of outgoing securities transfers.

The Reserve Banks also printed and mailed more than 20 million savings bonds in 2009, an 11.4 percent decrease from 2008. The decline in Legacy Treasury Direct holdings and in the number of paper savings bonds printed and mailed aligns with the Bureau of the Public Debt’s strategic goal to transition retail customers from these legacy products to Treasury’s web-based Treasury Direct application, which supports investments in book-entry Treasury securities and electronic savings bonds.

### Wholesale Securities Programs
The Reserve Banks also support wholesale securities programs through the

### Expenses of the Federal Reserve Banks for Fiscal Agency and Depository Services, 2007–2009

<table>
<thead>
<tr>
<th>Agency and service</th>
<th>2009</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DEPARTMENT OF THE TREASURY</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bureau of the Public Debt</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Treasury retail securities</td>
<td>73,678.5</td>
<td>72,373.7</td>
<td>74,149.2</td>
</tr>
<tr>
<td>Treasury securities safekeeping and transfer</td>
<td>8,814.6</td>
<td>9,304.7</td>
<td>8,687.7</td>
</tr>
<tr>
<td>Treasury auction</td>
<td>30,215.8</td>
<td>37,071.6</td>
<td>41,372.0</td>
</tr>
<tr>
<td>Computer infrastructure development and support</td>
<td>2,333.2</td>
<td>4,463.7</td>
<td>3,558.7</td>
</tr>
<tr>
<td>Other services</td>
<td>1,375.0</td>
<td>909.9</td>
<td>724.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>116,417.0</td>
<td>124,123.7</td>
<td>128,492.1</td>
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<tr>
<td><strong>Financial Management Service</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment services</td>
<td>104,354.8</td>
<td>108,218.5</td>
<td>105,326.8</td>
</tr>
<tr>
<td>Collection services</td>
<td>37,967.5</td>
<td>49,179.7</td>
<td>50,738.1</td>
</tr>
<tr>
<td>Cash-management services</td>
<td>49,045.7</td>
<td>48,676.4</td>
<td>44,742.7</td>
</tr>
<tr>
<td>Computer infrastructure development and support</td>
<td>66,958.5</td>
<td>65,058.6</td>
<td>70,999.9</td>
</tr>
<tr>
<td>Other services</td>
<td>7,392.9</td>
<td>7,577.4</td>
<td>7,245.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>265,719.3</td>
<td>278,710.6</td>
<td>279,053.2</td>
</tr>
<tr>
<td><strong>Other Treasury</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>40,390.3</td>
<td>27,017.2</td>
<td>19,609.6</td>
</tr>
<tr>
<td>Total, Treasury</td>
<td>422,526.6</td>
<td>429,851.5</td>
<td>427,154.9</td>
</tr>
<tr>
<td><strong>OTHER FISCAL PRINCIPALS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total, other agencies</td>
<td>27,757.9</td>
<td>31,292.3</td>
<td>31,031.1</td>
</tr>
<tr>
<td><strong>Total reimbursable expenses</strong></td>
<td>450,284.5</td>
<td>461,143.9</td>
<td>458,186.0</td>
</tr>
</tbody>
</table>

**Note:** Numbers in bold reflect restatements due to recategorization.
sale, issuance, safekeeping, and transfer of marketable Treasury securities. In support of Treasury’s strategic goal to finance government operations effectively at the lowest overall cost, the Banks worked to contain costs in the auction and book-entry securities services. Reserve Bank operating expenses in 2009 in support of Treasury securities auctions were $30.2 million, compared with $37.1 million in 2008. The decline in costs is attributable to lower staffing levels resulting from the implementation of the new Treasury auction application in April 2008. In 2009, the Banks conducted 283 Treasury securities auctions, compared with 263 in 2008. The increase in the number of auctions was attributable in part to the reintroduction of the seven-year Treasury note, which is auctioned monthly.

In addition, operating expenses associated with securities safekeeping and transfer activities were $8.8 million in 2009, compared with $9.3 million in 2008. The cost decline is attributable to the lower volume of Treasury security transfers during the year, due in part to consolidation of some Treasury securities dealers. In 2009, the number of Fedwire Treasury securities transfers decreased 22.0 percent from 2008, to approximately 10.0 million.

Payments Services

The Reserve Banks work closely with Treasury’s Financial Management Service and other government agencies to process payments to individuals and companies. The Banks process electronic and paper-based disbursements such as Social Security and veterans’ benefits, income tax refunds, and other types of payments. Reserve Bank operating expenses for payments-related activity totaled $104.4 million in 2009, compared with $108.2 million in 2008. The decline in costs is primarily attributable to the staff reductions in the Banks’ Treasury check operations.

In 2009, the Reserve Banks processed 1.2 billion ACH payments for Treasury, an increase of 5.4 percent from 2008. The Banks also processed 202.2 million Treasury checks, a decrease of 25.0 percent from 2008. The decrease in Treasury checks is roughly equivalent to the increase experienced in 2008 due to the economic stimulus payments issued that year.

The increase in the number of ACH payments (relative to check payments) is consistent with Treasury’s longstanding goal to make all payments electronically. Similar to the experience of the commercial check-collection service discussed earlier in this chapter, the proportion of Treasury checks presented to the Reserve Banks for processing in image form continued to increase as the number of depository institutions depositing checks in image form with the Banks increased. By year-end 2009, 99.1 percent of Treasury checks presented to the Banks were presented in image form. The shift in form from paper to images has increased the efficiency of processing Treasury checks, and resulted in lower staffing levels at the Banks and lower costs to the Treasury.

The Reserve Banks support Treasury’s ongoing effort to convert paper checks to electronic payments through support of the Go Direct initiative (www.godirect.org), which focuses on converting check benefit payments to direct deposit. In 2009, more than 692,000 check payments were converted to direct deposit, an increase of 20.0 percent from the number of conversions in 2008. The Banks also operate an international electronic payment service that supports government bene-
fit and other payments to more than 150 countries. In 2009, the Banks processed nearly $24.0 billion in international payments, compared with $22.5 billion in 2008. During the year, the Banks improved operational efficiency by reducing the number of service providers used to make international payments.

Collection Services

The Reserve Banks also work closely with Treasury’s Financial Management Service to collect funds owed the federal government—such as federal taxes—and fees for its goods and services.

Reserve Bank operating expenses related to collections services totaled $38.0 million in 2009, compared with $49.2 million in 2008. The decline in costs is due to the transition of two collection programs from the Reserve Banks to a commercial bank at the end of 2008.

Throughout 2009, the Reserve Banks and Treasury continued work on the Collections and Cash Management Modernization (CCMM) initiative, a multiyear Treasury effort to simplify, modernize, and improve the services, systems, and processes supporting Treasury’s collections and cash management programs. The Banks actively support various aspects of the CCMM initiative, including development of new applications to support both collection of funds and monitoring of collateral pledged to government programs.

To support the collection of federal taxes, the Reserve Banks operate several systems to process both electronic and paper tax payments. For example, the Banks operate the Federal Electronic Tax Application (FR-ETA), a same-day electronic federal tax payment system. In 2009, depository institutions submitted $452.2 billion in tax payments through FR-ETA.

The Reserve Banks also process paper federal tax deposit coupons submitted by depository institutions. The Banks processed 24.6 million coupons with a dollar value of $42.1 billion in 2009, compared with 29.5 million coupons with a dollar value of $54.9 billion in 2008. There are expected to be further declines in paper tax coupon payments in the coming years as the federal government continues to promote participation in electronic tax payment mechanisms.

In support of the collection of funds to pay for goods and services provided by the federal government, the Reserve Banks operate Pay.gov, a Treasury program that allows the public to use the Internet to authorize and initiate payments to federal agencies. During the year, the Pay.gov program was expanded to include several new agencies. In 2009, Pay.gov processed transactions worth $64.9 billion, compared with $44.1 billion in 2008.

The Reserve Banks also operate software that supports the settlement of transactions from Pay.gov and two other Treasury collection programs. In 2009, the Banks processed 62.9 million transactions valued at $99.5 billion, compared with 46.4 million transactions valued at $74.9 billion in 2008. As part of the CCMM initiative, the Banks are developing a more broadly based settlement framework that will support several additional collection applications. It is scheduled to replace the current system in 2010.

The Reserve Banks also support the government’s centralized delinquent debt-collection program. Specifically, the Banks developed software that facilitates the collection of delinquent debts owed to federal agencies and states by matching federal payments
against delinquent debts, including past-due child support payments owed to custodial parents. The Banks helped Treasury collect more than $4.8 billion through this program in fiscal year 2009.

Treasury Cash-Management Services

Treasury maintains an operating cash account at the Reserve Banks to support the various transactions discussed in the preceding sections of this chapter, and it may instruct the Banks to invest funds from its account in interest-bearing accounts with qualified depository institutions.

The Reserve Banks provide collateral-management and collateral-monitoring services for Treasury’s investment programs and other Treasury programs that have collateral requirements. Reserve Bank operating expenses related to these programs and other cash-management initiatives totaled $49.0 million in 2009, compared with $48.7 million in 2008. The slight cost increase is due to additional work associated with application development initiatives supporting Treasury’s CCMM initiative.

During 2009, the Reserve Banks continued to support Treasury’s effort to modernize its financial management processes, with a focus on improving centralized government accounting and reporting functions. The Banks worked with Treasury to identify potential, long-term efficiency improvements in the way the Banks account for government payments and collections. The Banks also collaborated with the Financial Management Service on several ongoing software development efforts. For example, the Banks support Treasury’s Governmentwide Accounting and Reporting Modernization initiative, which improves the timeliness of accounting data to support better financial analysis and decisionmaking.

To support Treasury’s investment programs, the Reserve Banks continued to maintain several software applications. Treasury investments are fully collateralized, and the Banks monitor the collateral pledged to Treasury. The Banks also monitor collateral pledged to other Treasury programs, such as collateral pledged to secure public funds held on deposit at financial institutions. In addition, as part of the CCMM initiative, the Banks began working with the Financial Management Service to develop a new collateral application that will replace the legacy applications and provide support to other new cash-management applications developed as part of the CCMM initiative.

Computer Infrastructure and Other Treasury Services

The Reserve Banks operate a web-application infrastructure and provide other technology-related services to Treasury. The infrastructure supports multiple Treasury applications, primarily for the Financial Management Service.

Reserve Bank operating expenses for the infrastructure and other technology-related services—the costs of which are shared by the Financial Management Service and the Bureau of the Public Debt—were $67.0 million in 2009, compared with $65.1 in 2008. The web-application infrastructure accounts for the majority of the costs, and the Banks worked closely with Treasury to contain these costs, even as the number of applications supported by the infrastructure continued to increase.

Although the Reserve Banks primarily work with the Financial Manage-
ment Service and Bureau of the Public Debt on fiscal programs, the Banks also support other fiscal programs, such as Treasury’s debt-management program and its exchange stabilization fund. Reserve Bank operating expenses for these programs were $40.4 million in 2009, compared with $27.0 million in 2008. The cost increase is primarily due to the development and implementation of a debt-management application.

Services Provided to Other Entities
When permitted by federal statute or when required by the Secretary of the Treasury, the Reserve Banks provide fiscal agency and depository services to other domestic and international entities.

Book-entry securities issuance and maintenance activities account for a significant amount of the work performed for other entities, with the majority performed for the Federal Home Loan Mortgage Association, the Federal National Mortgage Association, and the Government National Mortgage Association.

The Reserve Banks also process paid postal money orders for the United States Postal Service, activity that accounts for roughly a quarter of the Banks’ costs for services provided to other non-Treasury entities. Reserve Bank operating expenses for services provided to other entities were $27.8 million in 2009, compared with $31.3 million in 2008. The decline in costs is due in part to staff reductions in the Banks’ postal money orders processing operations. Like Treasury checks, postal money orders are processed primarily in image form now, resulting in operational improvements and lower staffing levels at the Banks and lower costs to the U.S. Postal Service.

Developments in Use of Federal Reserve Intraday Credit
The Board’s Payment System Risk (PSR) policy governs the use of Federal Reserve Bank intraday credit, also known as daylight overdrafts.

A daylight overdraft occurs when an institution’s account activity creates a negative balance in the institution’s Federal Reserve account at any time in the operating day. Daylight overdrafts enable institutions to send payments more freely throughout the day than if institutions were limited strictly by their available funds balance. In 2009, institutions held on average about $900 billion in their Federal Reserve accounts overnight, but the daily value of funds transferred over just the Federal Reserve’s funds transfer system was about $2.5 trillion.

In December 2008, the Board approved revisions to its PSR policy that will become effective in late 2010 or early 2011. The revisions will, in part, allow eligible institutions to collateralize daylight overdrafts and pay no fee for these overdrafts. The Reserve Banks have begun work to modify the systems they use to record collateral pledges and to track daylight overdrafts. In March 2009, the Board implemented an interim policy change for eligible foreign banking organiza-
tions (FBOs).\textsuperscript{13} The interim policy allows highly rated FBOs to use a streamlined procedure to apply for a max cap and allows these institutions to use 100 percent of their capital measure in calculating the deductible amount for daylight overdraft pricing. To remain eligible for the higher deductible value under the new policy, an FBO must have collateral pledged to its Reserve Bank equal to or greater than the amount of its deductible. Under the previous policy, FBOs were eligible to use up to 35 percent of their capital measure in the calculation of the deductible and net debit cap. FBOs introduce greater risks than do U.S.-chartered institutions in terms of the timeliness and scope of available supervisory information and other supervisory issues that may arise because of the cross-border nature of the FBO’s business (for example, application of different legal regimes).

Recent Trends in Daylight Overdraft Usage

During the periods of extreme market stress in 2008, the level of daylight overdrafts spiked and then dropped to historical lows as balances institutions held at the Reserve Banks spiked to historically high levels. Both daylight overdrafts and Federal Reserve account balances have remained at these historic levels throughout 2009. The average level of average daylight overdrafts in 2009 was about $10 billion, or about 84 percent lower than the average 2008 level.\textsuperscript{14} The average level of peak daylight overdrafts decreased to about $55 billion in 2009, a decrease of about 67 percent from 2008.\textsuperscript{15} Daylight overdraft fees paid by institutions also dropped sharply as daylight overdraft levels decreased. In 2008, institutions paid about $52 million in daylight overdraft fees but only $4 million in 2009.

The usage of daylight overdrafts spiked amid the market turmoil near the end of 2008, but dropped sharply as various liquidity programs initiated by the Federal Reserve took effect (see the chart, next page). During this period, the Federal Reserve also began paying interest on balances held at the Reserve Banks, increased its lending under the Term Auction Facility, and began purchasing government-sponsored enterprise mortgage-backed securities. These measures tended to increase balances institutions held at the Banks, which decreased the demand for intraday credit. In 2008, reserve balances averaged $180 billion and spiked about 400 percent, to an average of about $900 billion in 2009. Furthermore, in 2009 the rate paid on reserve balances remained, on average, about nine basis points more than the effective federal funds rate, which is the rate at which depository institutions lend balances to each other overnight. This spread gives institutions incentive to hold higher balances at the Federal Reserve, and it has likely contributed each minute of the Fedwire operating day (9 p.m. to 6:30 p.m. ET or 21.5 hours). This sum is then divided by the number of minutes in the day (1,291 minutes) to arrive at the average overdraft.

\textsuperscript{13} Details about the interim changes are available at www.federalreserve.gov/payment systems/psr_policy.htm#streamproc.

\textsuperscript{14} Average overdrafts are calculated daily by summing all negative balances incurred by institutions across the Federal Reserve System for each minute of the Fedwire operating day (9 p.m. to 6:30 p.m. ET or 21.5 hours). This sum is then divided by the number of minutes in the day (1,291 minutes) to arrive at the average overdraft.

\textsuperscript{15} Peak overdrafts are calculated daily by summing the negative balances of all institutions on a minute-by-minute basis throughout the Fedwire operating day (9 p.m. to 6:30 p.m. ET or 21.5 hours). The most negative of these minute-by-minute balances is the peak overdraft.
to very low daylight overdraft usage throughout the System.

**Electronic Access to Reserve Bank Services**

The Reserve Banks provide several options to enable customers to access the Banks’ financial services information and payment services electronically. Most depository institutions that directly access the Banks’ Fedwire Funds, Fedwire Securities, and FedACH services do so using FedLine Advantage connections, which provide web-based access. There were 5,673 FedLine Advantage connections at year-end 2009, 10 fewer than at year-end 2008.

The Reserve Banks’ largest customers use FedLine Direct connections, which enable unattended computer-to-computer access to the Banks’ financial services through dedicated connections. A large majority of the value transferred through the Banks’ financial services flow through FedLine Direct connections, of which there were 256 at year-end 2009, 20 fewer than a year earlier.

Like FedLine Direct, FedLine Command enables computer-to-computer access. It provides an unattended, batch-file solution to certain services at a cost lower than that for FedLine Direct. There were 39 FedLine Command connections at year-end 2009, 22 more than a year earlier.

Many institutions access Reserve Bank information services and perform limited transaction services through FedLine Web. There were 2,979 FedLine Web connections at year-end 2009, 43 more than a year earlier.

Also in 2009, the Federal Reserve Banks completed the Tier 1 Data De-
livery Service, a cross-business file transfer utility for nonpayment services. This service replaces the BulkData service previously used to transfer low-risk files between the Federal Reserve Banks and customers.

**Information Technology**

In 2009, the Federal Reserve Banks continued to develop and implement their information technology (IT) strategy by strengthening IT governance, managing information security risk, and analyzing and coordinating the System’s IT investments.

In 2009, Federal Reserve Information Technology (FRIT) continued to lead Reserve Bank efforts to transition to a more-robust information security model. FRIT initiated a transition to a new information security assurance program for infrastructure systems, based on guidance from the National Institute of Science and Technology. The new assurance program will allow the System to

- have a defined and consistent view of information security roles and responsibilities,
- enhance the security controls assessment testing program, and
- introduce an IS risk management function at all levels of the organization.

In 2009, the Reserve Banks approved the following initiatives:

- the consolidation of all Reserve Bank helpdesk functions into a national IT helpdesk
- a strategy to consolidate and centrally manage Reserve Bank servers and storage
- a network strategy that adopts an enterprise approach to the provision, operation, and management of hardware and software that provide data, video, and voice communication for the Reserve Banks.

**Examinations of the Federal Reserve Banks**

Section 21 of the Federal Reserve Act requires the Board of Governors to order an examination of each Reserve Bank at least once a year. The Board performs its own reviews and engages a public accounting firm. The public accounting firm annually audits the combined financial statements of the Reserve Banks (see the “Federal Reserve Banks Combined Financial Statements” in the “Audits of the Federal Reserve System” section of this report) as well as the annual financial statements of each of the 12 Banks and the consolidated limited liability company (LLC) entities.

The Reserve Banks use the framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to assess their internal controls over financial reporting, including the safeguarding of assets. In 2009, the Reserve Banks further enhanced their processes under the guidance of the COSO framework and the Sarbanes-Oxley Act of 2002.

Within this framework, the management of each Reserve Bank annually

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16. FRIT supplies national infrastructure and business line technology services to the Federal Reserve System, and provides thought leadership regarding the System information technology architecture and business use of technology.

17. NIST is a non-regulatory federal agency within the U.S. Department of Commerce whose mission is to promote U.S. innovation and industrial competitiveness by advancing measurement science, standards, and technology in ways that enhance economic security and improve quality of life.
provides an assertion letter to its board of directors that confirms adherence to COSO standards. Similarly, each LLC annually provides an assertion letter to the board of directors of the Federal Reserve Bank of New York (the New York Reserve Bank). A public accounting firm issues an attestation report to each Bank’s board of directors and to the Board of Governors.

In 2009, the Board engaged Deloitte & Touche LLP (D&T) to audit the individual and combined financial statements of the Reserve Banks and those of the consolidated LLC entities. Fees for D&T’s services totaled $10 million. Of the total fees, $2 million were for the audits of the consolidated LLC entities that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the New York Reserve Bank. To ensure auditor independence, the Board requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management deci-

Income, Expenses, and Distribution of Net Earnings of the Federal Reserve Banks, 2009 and 2008

<table>
<thead>
<tr>
<th>Item</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current income</td>
<td>54,463</td>
<td>41,046</td>
</tr>
<tr>
<td>Current expenses</td>
<td>4,820</td>
<td>3,341</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>3,694</td>
<td>3,232</td>
</tr>
<tr>
<td>Interest paid to depository institutions and earnings credits granted</td>
<td>2,187</td>
<td>901</td>
</tr>
<tr>
<td>Interest expense on securities sold under agreements to repurchase</td>
<td>98</td>
<td>737</td>
</tr>
<tr>
<td>Current net income</td>
<td>48,484</td>
<td>36,175</td>
</tr>
<tr>
<td>Profit on sales of U.S. Treasury securities</td>
<td>0</td>
<td>3,769</td>
</tr>
<tr>
<td>Profit on sales of federal agency and government-sponsored enterprise</td>
<td>879</td>
<td></td>
</tr>
<tr>
<td>Profit on foreign exchange transactions</td>
<td>172</td>
<td>1,266</td>
</tr>
<tr>
<td>Net income (loss) from consolidated limited liability companies</td>
<td>5,588</td>
<td>−1,693</td>
</tr>
<tr>
<td>Provisions for loan restructuring</td>
<td>−2,621</td>
<td></td>
</tr>
<tr>
<td>Other additions</td>
<td>802</td>
<td></td>
</tr>
<tr>
<td>Assessments by the Board of Governors</td>
<td>888</td>
<td>853</td>
</tr>
<tr>
<td>For Board expenditures</td>
<td>386</td>
<td>352</td>
</tr>
<tr>
<td>For currency costs</td>
<td>802</td>
<td>500</td>
</tr>
<tr>
<td>Change in funded status of benefit plans</td>
<td>1,007</td>
<td>−3,159</td>
</tr>
<tr>
<td>Comprehensive income before distributions to Treasury</td>
<td>53,423</td>
<td>35,504</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>1,428</td>
<td>1,190</td>
</tr>
<tr>
<td>Transferred to surplus and change in accumulated other</td>
<td>4,564</td>
<td>2,626</td>
</tr>
<tr>
<td>comprehensive income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distributions to U.S. Treasury</td>
<td>47,431</td>
<td>31,689</td>
</tr>
</tbody>
</table>

1. Includes a net periodic pension expense of $663 million in 2009 and $160 million in 2008.
2. In October 2008, the Reserve Banks began to pay interest to depository institutions on qualifying balances.
3. Represents the economic effect of the interest rate reduction made pursuant to the April 17, 2009, restructuring of the American International Group, Inc. loan.
4. Includes dividends on preferred securities, unrealized gain on Term Asset-Backed Securities Loan Facility loans, and compensation paid by Citigroup, Inc. and Bank of America Corporation for the New York Reserve Bank’s and Richmond Reserve Bank’s commitments to provide funding support, net of related expenses.
5. Interest on Federal Reserve notes.
. . . Not applicable.

18. Each LLC reimburses the Board of Governors for the fees related to the audit of its financial statements from the entity’s available net assets.
sions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2009, one Reserve Bank engaged D&T for nonaudit consulting services for which the fees were immaterial.

The Board’s annual examination of the Reserve Banks includes a wide range of off-site and on-site oversight activities, conducted primarily by the Division of Reserve Bank Operations and Payment Systems. Division personnel monitor the activities of each Bank and LLC on an ongoing basis and conduct a comprehensive on-site review of each Bank at least once every three years.

The reviews also include an assessment of the internal audit function’s conformance to International Standards for the Professional Practice of Internal Auditing, conformance to applicable policies and procedures, and the audit department’s efficiency.

To assess compliance with the policies established by the Federal Reserve’s Federal Open Market Committee (FOMC), the division also reviews the accounts and holdings of the System Open Market Account (SOMA) at the New York Reserve Bank and the foreign currency operations conducted by that Reserve Bank. In addition, D&T audits the year-end schedule of participated asset and liability accounts and the related schedule of participated income accounts. The FOMC receives the external audit reports and a report on the division’s examination.

**Income and Expenses**

The table on the previous page summarizes the income, expenses, and distributions of net earnings of the Reserve Banks for 2009 and 2008. Income in 2009 was $54,463 million, compared with $41,046 million in 2008.

Expenses totaled $6,867 million ($3,694 million in operating expenses, $2,187 million in interest paid to depository institutions on reserve balances and earnings credits granted to depository institutions, $98 million in interest expense on securities sold under agreements to repurchase, $386 million in assessments for Board of Governors expenditures, and $502 million for currency costs).¹⁹ Net additions to and deductions from current net income showed a net profit of $4,820 million, which consists of $879 million in realized gains on federal agency and government-sponsored enterprise mortgage-backed securities (GSE MBS), $5,588 million in net income associated with consolidated LLCs, $802 million of other additions, and $172 million in unrealized gains on investments denominated in foreign currencies revalued to reflect current market exchange rates. These net additions were offset by a $2,621 million provision for loan restructuring.²⁰ Dividends paid to member banks, set at 6 percent of paid-in capital by section 7(1) of the Federal Reserve Act, totaled $1,428 million, $238 million more than in 2008; this reflects an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Reserve Banks.

Distributions to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $47,431 million in 2009, up from $31,689 million in 2008; the distributions equal net income after the deduction of dividends paid and the amount necessary

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¹⁹. Effective October 9, 2008, the Reserve Banks began paying explicit interest on reserve balances held by depository institutions at the Reserve Banks as authorized by the Emergency Economic Stabilization Act of 2008.

²⁰. Represents the economic effect of the reduction of the interest note on loans made to American International Group, Inc. prior to April 17, 2009, as part of the loan restructuring that occurred on that date.
SOMA Holdings and Loans of the Federal Reserve Banks, 2009 and 2008

Millions of dollars except as noted

<table>
<thead>
<tr>
<th>Item</th>
<th>Average daily assets (+)/liabilities(−)</th>
<th>Current income (+)/expense (−)</th>
<th>Average interest rate (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Treasury securities</td>
<td>659,483</td>
<td>548,254</td>
<td>22,873</td>
</tr>
<tr>
<td>Government-sponsored enterprise debt securities</td>
<td>98,093</td>
<td>3,983</td>
<td>2,048</td>
</tr>
<tr>
<td>Federal agency and government-sponsored enterprise mortgage-backed securities</td>
<td>473,855</td>
<td>20,407</td>
<td></td>
</tr>
<tr>
<td>Investments denominated in foreign currencies</td>
<td>24,898</td>
<td>24,220</td>
<td>296</td>
</tr>
<tr>
<td>Central bank liquidity swaps</td>
<td>177,688</td>
<td>161,778</td>
<td>2,168</td>
</tr>
<tr>
<td>Securities purchased under agreements to resell</td>
<td>3,616</td>
<td>86,227</td>
<td>13</td>
</tr>
<tr>
<td>Other SOMA assets</td>
<td>458</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Securities sold under agreements to repurchase</td>
<td>−67,837</td>
<td>−55,169</td>
<td>−98</td>
</tr>
<tr>
<td>Other SOMA liabilities</td>
<td>−182</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total SOMA holdings</strong></td>
<td><strong>1,370,072</strong></td>
<td><strong>769,293</strong></td>
<td><strong>47,708</strong></td>
</tr>
<tr>
<td>Primary, secondary, and seasonal credit</td>
<td>40,405</td>
<td>32,254</td>
<td>204</td>
</tr>
<tr>
<td>Term auction credit</td>
<td>291,487</td>
<td>174,025</td>
<td>786</td>
</tr>
<tr>
<td><strong>Total loans to depository institutions</strong></td>
<td><strong>332,892</strong></td>
<td><strong>206,279</strong></td>
<td><strong>990</strong></td>
</tr>
<tr>
<td>Asset-Backed Commercial Paper Money Market</td>
<td>7,653</td>
<td>21,101</td>
<td>73</td>
</tr>
<tr>
<td>Mutual Fund Liquidity Facility (AMLF)</td>
<td>7,502</td>
<td>28,480</td>
<td>36</td>
</tr>
<tr>
<td>Primary Dealer Credit Facility (PDCF) and other broker-dealer credit</td>
<td>39,999</td>
<td>18,742</td>
<td>3,996</td>
</tr>
<tr>
<td>Credit extended to American International Group, Inc. (AIG), net</td>
<td>23,228</td>
<td>414</td>
<td></td>
</tr>
<tr>
<td>Term Asset-Backed Securities Loan Facility (TALF)</td>
<td>77,482</td>
<td>68,244</td>
<td>4,519</td>
</tr>
<tr>
<td><strong>Total loans to others</strong></td>
<td><strong>409,374</strong></td>
<td><strong>274,523</strong></td>
<td><strong>5,509</strong></td>
</tr>
<tr>
<td><strong>Total SOMA holding and loans</strong></td>
<td><strong>1,779,446</strong></td>
<td><strong>1,043,816</strong></td>
<td><strong>53,217</strong></td>
</tr>
</tbody>
</table>

1. Restatements due to changes in previously reported data and recategorization.
2. Face value, net of unamortized premiums and discounts.
3. Face value of the securities, which is the remaining principal balance of the underlying mortgages, net of unamortized premiums and discounts. Does not include unsettled transactions.
4. Includes accrued interest. Investments denominated in foreign currencies are revalued daily at market exchange rates.
5. Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.
7. Related to the purchases of federal agency and government-sponsored enterprise mortgage-backed securities that the seller fails to deliver on the settlement date.
8. Average daily balance includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring, and excludes undrawn amounts and credit extended to consolidated limited liability companies.
9. Represents the remaining principal balance. Excludes amount necessary to adjust TALF loans to fair value at December 31, which is reported in “Other assets” on the Statement of Condition of the Federal Reserve Banks in Table 9A in the “Statistical Tables” section of this report.

. . . Not applicable.

to equate the Reserve Banks’ surplus to paid-in capital.

In the “Statistical Tables” section of this report, table 10 details the income and expenses of each Reserve Bank for 2009, and table 11 shows a condensed statement for each Reserve Bank for the years 1914 through 2009; table 9 is a statement of condition for each Reserve Bank, and table 13 gives the number and annual salaries of officers and employees for each Reserve Bank.
A detailed account of the assessments and expenditures of the Board of Governors appears in the “Board of Governors Financial Statements” in the “Audits of the Federal Reserve System” section of this report.

**SOMA Holdings and Loans**
The Reserve Banks’ average net daily holdings of securities and loans during 2009 amounted to $1,779,446 million, an increase of $735,630 million from 2008 (see table, previous page).

**SOMA Securities Holdings**
The average daily holdings of Treasury securities increased by $111,229 million, to an average daily amount of $659,483 million. The average daily holdings of GSE debt securities increased by $94,110 million, to an average daily amount of $98,093 million. The average daily holdings of federal agency and GSE MBS totaled $473,855 million. The increases are due to the purchase of Treasury securities, GSE debt securities, and federal agency and GSE MBS through the large-scale asset purchase program. Average daily holdings of securities purchased under agreements to resell in 2009 were $3,616 million, a decrease of $82,611 million from 2008, while the average daily balance of securities sold under agreements to repurchase was $67,837 million, an increase of $12,668 million from 2008. Average daily holdings of investments denominated in foreign currencies and central bank liquidity swaps earned interest at average rates of 1.19 percent and 1.22 percent, respectively, in 2009.

**SOMA Holdings and Loans**
The Reserve Banks’ average net daily holdings of securities and loans during 2009 amounted to $1,779,446 million, an increase of $735,630 million from 2008 (see table, previous page).

**SOMA Securities Holdings**
The average daily holdings of Treasury securities increased by $111,229 million, to an average daily amount of $659,483 million. The average daily holdings of GSE debt securities increased by $94,110 million, to an average daily amount of $98,093 million. The average daily holdings of federal agency and GSE MBS totaled $473,855 million. The increases are due to the purchase of Treasury securities, GSE debt securities, and federal agency and GSE MBS through the large-scale asset purchase program. Average daily holdings of securities purchased under agreements to resell in 2009 were $3,616 million, a decrease of $82,611 million from 2008, while the average daily balance of securities sold under agreements to repurchase was $67,837 million, an increase of $12,668 million from 2008. Average daily holdings of investments denominated in foreign currencies and central bank liquidity swaps earned interest at average rates of 1.19 percent and 1.22 percent, respectively, in 2009.

**Lending**
In 2009, average daily primary, secondary, and seasonal credit extended increased $8,151 million to $40,405 million, and term auction credit extended under the Term Auction Facility increased $117,462 million to $291,487 million. The average rate of interest earned on primary, secondary, and seasonal credit decreased to 0.50 percent in 2009, from 1.59 percent in 2008, while the average interest rate on term auction credit decreased to 0.27 percent in 2009, from 1.90 percent in 2008.

During 2008, the Federal Reserve established several lending facilities under authority of section 13(3) of the Federal Reserve Act. These facilities included the Primary Dealer Credit Facility (PDCF), the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), and the American International Group, Inc. (AIG) credit extension. Amounts funded by the Reserve Banks under these programs are recorded as loans by the Banks. During 2009, the average daily holdings under the PDCF and AMLF were $7,502 million and $7,653 million, respectively, with average rates of interest earned of 0.48 percent and 0.95 percent, respectively. The average
## Key Financial Data for Consolidated Limited Liability Companies (LLCs), 2009 and 2008

### Millions of dollars

<table>
<thead>
<tr>
<th>Item</th>
<th>Commercial Paper Funding Facility LLC (CPFF)</th>
<th>TALF LLC</th>
<th>Maiden Lane LLC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net portfolio assets of the consolidated LLCs and the net position of the New York Reserve Bank (FRBNY) and subordinated interest holders</td>
<td>14,233</td>
<td>334,910</td>
<td>298</td>
</tr>
<tr>
<td>Liabilities of consolidated LLCs</td>
<td>−173</td>
<td>−812</td>
<td>0</td>
</tr>
<tr>
<td>Net portfolio assets available</td>
<td>14,060</td>
<td>334,098</td>
<td>298</td>
</tr>
<tr>
<td>Loans extended to the consolidated LLCs by the FRBNY</td>
<td>9,379</td>
<td>333,020</td>
<td>0</td>
</tr>
<tr>
<td>Other beneficial interests</td>
<td>102</td>
<td>1,248</td>
<td>1,188</td>
</tr>
<tr>
<td>Total loans and other beneficial interests</td>
<td>9,379</td>
<td>333,020</td>
<td>102</td>
</tr>
<tr>
<td>Cumulative change in net assets since the inception of the program</td>
<td>4,681</td>
<td>1,078</td>
<td>20</td>
</tr>
<tr>
<td>Allocated to FRBNY</td>
<td>4,681</td>
<td>1,078</td>
<td>20</td>
</tr>
<tr>
<td>Allocated to other beneficial interests</td>
<td>176</td>
<td>−1,248</td>
<td>−1,188</td>
</tr>
<tr>
<td>Cumulative change in net assets</td>
<td>4,681</td>
<td>1,078</td>
<td>196</td>
</tr>
<tr>
<td>Summary of consolidated LLC net income, including a reconciliation of total consolidated LLC net income to the consolidated LLC net income recorded by FRBNY</td>
<td>4,224</td>
<td>1,707</td>
<td>0</td>
</tr>
<tr>
<td>Portfolio interest income</td>
<td>−598</td>
<td>−620</td>
<td>0</td>
</tr>
<tr>
<td>Interest expense on loans extended by FRBNY</td>
<td>3</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Professional fees</td>
<td>30</td>
<td>12</td>
<td>−1</td>
</tr>
<tr>
<td>Net income (loss) of consolidated LLCs</td>
<td>3,604</td>
<td>1,078</td>
<td>−3</td>
</tr>
<tr>
<td>Less: Net income (loss) allocated to other beneficial interests</td>
<td>699</td>
<td>61</td>
<td>−1,188</td>
</tr>
<tr>
<td>Net income (loss) recorded by FRBNY</td>
<td>3,604</td>
<td>1,078</td>
<td>−702</td>
</tr>
<tr>
<td>Add: Interest expense on loans extended by FRBNY, eliminated in consolidation</td>
<td>598</td>
<td>620</td>
<td>0</td>
</tr>
<tr>
<td>Net income (loss) recorded by FRBNY</td>
<td>4,202</td>
<td>1,698</td>
<td>−702</td>
</tr>
</tbody>
</table>

1. CPFF LLC was formed to provide liquidity to the commercial paper market. TALF LLC was formed in 2009 to purchase assets of the Term Asset-Backed Securities Loan Facility, which was formed to improve market conditions for asset-backed securities. Maiden Lane LLC was formed to acquire certain assets of Bear Stearns; Maiden Lane II LLC and Maiden Lane III LLC were formed to acquire certain assets of AIG and its subsidiaries.
2. TALF, Maiden Lane, Maiden Lane II, and Maiden Lane III LLC holdings are recorded at fair value. Fair value reflects an estimate of the price that would be received upon selling an asset if the transaction were to be conducted in an orderly market on the measurement date. CPFF holdings are recorded at book value, which includes amortized cost and related fees.
3. Represents the net assets available for repayment of the loans extended by FRBNY and other beneficiaries of the consolidated LLCs.
4. Book value. Includes accrued interest.
5. The other beneficial interest holders are the U.S. Treasury for TALF LLC, JPMorgan Chase for Maiden Lane LLC, and AIG for Maiden Lane II LLC and Maiden Lane III LLC.
6. Represents the allocation of the change in net assets and liabilities of the consolidated LLCs that are available for repayment of the loans extended by FRBNY and the other beneficiaries of the consolidated LLCs. The differences between the fair value of the net assets available and the face value of the loans (including accrued interest) are indicative of gains or losses that would be incurred by the beneficiaries if the assets had been fully liquidated at prices equal to the fair value.
7. Interest income is recorded when earned and includes amortization of premiums, accretion of discounts, and paydown gains and losses.
8. Interest expense recorded by each consolidated LLC on the loans extended by FRBNY is eliminated when the LLCs are consolidated in FRBNY’s financial statements, and as a result, the consolidated LLCs’ net income (loss) recorded by FRBNY is increased by this amount.
9. FRBNY earned $1,025 million on TALF loans during the year ended December 31, 2009, which offsets the net loss attributable to TALF LLC. Earnings on TALF loans include interest income of $414 million, gains on the valuation of $357 million, and administrative fees of $54 million.
Key Financial Data for Consolidated LLCs, 2009 and 2008—continued

Millions of dollars

<table>
<thead>
<tr>
<th></th>
<th>Maiden Lane II LLC</th>
<th>Maiden Lane III LLC</th>
<th>Total LLCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>15,912</td>
<td>19,195</td>
<td>22,797</td>
<td>27,256</td>
</tr>
<tr>
<td>−2</td>
<td>−2</td>
<td>−3</td>
<td>−48</td>
</tr>
<tr>
<td>15,910</td>
<td>19,193</td>
<td>22,794</td>
<td>27,208</td>
</tr>
<tr>
<td>16,005</td>
<td>19,522</td>
<td>18,500</td>
<td>24,384</td>
</tr>
<tr>
<td>1,037</td>
<td>1,003</td>
<td>5,193</td>
<td>5,022</td>
</tr>
<tr>
<td>17,042</td>
<td>20,525</td>
<td>23,693</td>
<td>29,406</td>
</tr>
<tr>
<td>−95</td>
<td>−329</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>−1,037</td>
<td>−1,003</td>
<td>−899</td>
<td>−2,198</td>
</tr>
<tr>
<td>−1,132</td>
<td>−1,332</td>
<td>−899</td>
<td>−2,198</td>
</tr>
<tr>
<td>1,088</td>
<td>302</td>
<td>3,032</td>
<td>517</td>
</tr>
<tr>
<td>−238</td>
<td>−27</td>
<td>−296</td>
<td>−45</td>
</tr>
<tr>
<td>−33</td>
<td>−103</td>
<td>−171</td>
<td>−28</td>
</tr>
<tr>
<td>−604</td>
<td>−1,499</td>
<td>−1,239</td>
<td>−2,633</td>
</tr>
<tr>
<td>−12</td>
<td>−5</td>
<td>−27</td>
<td>−9</td>
</tr>
<tr>
<td>201</td>
<td>−1,332</td>
<td>1,299</td>
<td>−2,198</td>
</tr>
<tr>
<td>−34</td>
<td>−1,003</td>
<td>1,299</td>
<td>−2,198</td>
</tr>
<tr>
<td>235</td>
<td>−329</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>238</td>
<td>27</td>
<td>296</td>
<td>45</td>
</tr>
<tr>
<td>473</td>
<td>−302</td>
<td>296</td>
<td>45</td>
</tr>
</tbody>
</table>
ally accepted accounting principles, the assets and liabilities of these LLCs have been consolidated with the assets and liabilities of the New York Reserve Bank in the preparation of the statements of condition included in this report. The proceeds at the maturity or the liquidation of the consolidated LLCs’ assets will be used to repay the loans extended by the New York Reserve Bank. Information regarding the Reserve Banks’ lending to the consolidated LLCs and the asset portfolios of each consolidated LLC is as described in the table on the previous page.

**Federal Reserve Bank Premises**

Several Reserve Banks took action in 2009 to upgrade and refurbish their facilities. The multiyear renovation program at the New York Reserve Bank’s headquarters building continued, while the St. Louis Reserve Bank continued a long-term facility redevelopment program that now involves renovation of the Bank’s headquarters building. The New York Reserve Bank completed a program to enhance the business resiliency of its information technology systems and to upgrade facility support for the Bank’s open market operations, central bank services, and data center operations. The New York Reserve Bank also leased space in a nearby office building to accommodate staff growth. The Richmond Reserve Bank completed the construction of a new parking garage adjacent to its headquarters building.

Security-enhancement programs continued at several facilities, including the construction of security improvements to the Richmond Reserve Bank’s headquarters building, the construction of a remote vehicle-screening facility for the Philadelphia Reserve Bank, and the design of a remote vehicle-screening facility for the Dallas Reserve Bank. Additionally, the San Francisco Reserve Bank continued its efforts to sell the former Seattle Branch building.

For more information, see table 14 in the “Statistical Tables” section of this report, which details the acquisition costs and net book value of the Federal Reserve Banks and Branches.
Pro Forma Financial Statements for Federal Reserve Priced Services

Pro Forma Balance Sheet for Federal Reserve Priced Services, December 31, 2009 and 2008

<table>
<thead>
<tr>
<th>Millions of dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
</tr>
<tr>
<td><strong>Short-term assets</strong></td>
</tr>
<tr>
<td>Imputed reserve requirements on clearing balances</td>
</tr>
<tr>
<td>Imputed investments</td>
</tr>
<tr>
<td>Receivables</td>
</tr>
<tr>
<td>Materials and supplies</td>
</tr>
<tr>
<td>Prepaid expenses</td>
</tr>
<tr>
<td>Items in process of collection</td>
</tr>
<tr>
<td><strong>Total short-term assets</strong></td>
</tr>
<tr>
<td><strong>Long-term assets</strong></td>
</tr>
<tr>
<td>Premises</td>
</tr>
<tr>
<td>Furniture and equipment</td>
</tr>
<tr>
<td>Leases, leasehold improvements, and long-term prepayments</td>
</tr>
<tr>
<td>Prepaid pension costs</td>
</tr>
<tr>
<td>Prepaid FDIC asset</td>
</tr>
<tr>
<td>Deferred tax asset</td>
</tr>
<tr>
<td><strong>Total long-term assets</strong></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
</tr>
<tr>
<td><strong>Short-term liabilities</strong></td>
</tr>
<tr>
<td>Clearing balances</td>
</tr>
<tr>
<td>Deferred-availability items</td>
</tr>
<tr>
<td>Short-term debt</td>
</tr>
<tr>
<td>Short-term payables</td>
</tr>
<tr>
<td><strong>Total short-term liabilities</strong></td>
</tr>
<tr>
<td><strong>Long-term liabilities</strong></td>
</tr>
<tr>
<td>Long-term debt</td>
</tr>
<tr>
<td>Accrued benefit costs</td>
</tr>
<tr>
<td><strong>Total long-term liabilities</strong></td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
</tr>
<tr>
<td>Equity (including accumulated other comprehensive loss of $478.3 million and $690.6 million at December 31, 2009 and 2008, respectively)</td>
</tr>
<tr>
<td><strong>Total liabilities and equity</strong></td>
</tr>
</tbody>
</table>

**Note:** Components may not sum to totals because of rounding. Amounts in bold reflect restatements due to recategorization. The accompanying notes are an integral part of these pro forma priced services financial statements.
### Pro Forma Income Statement for Federal Reserve Priced Services, 2009 and 2008

**Millions of dollars**

<table>
<thead>
<tr>
<th>Item</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from services provided to depository institutions (Note 4)</td>
<td>662.7</td>
<td>773.4</td>
</tr>
<tr>
<td>Operating expenses (Note 5)</td>
<td>713.8</td>
<td>808.7</td>
</tr>
<tr>
<td>Income from operations</td>
<td>-51.1</td>
<td>-35.3</td>
</tr>
<tr>
<td>Imputed costs (Note 6)</td>
<td>-3.2</td>
<td>-22.4</td>
</tr>
<tr>
<td>Interest on float</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Sales taxes</td>
<td>9.1</td>
<td>9.4</td>
</tr>
<tr>
<td>FDIC Insurance</td>
<td>3.4</td>
<td>9.2</td>
</tr>
<tr>
<td>Income from operations after imputed costs</td>
<td>-60.3</td>
<td>-22.8</td>
</tr>
<tr>
<td>Other income and expenses (Note 7)</td>
<td>16.6</td>
<td>181.2</td>
</tr>
<tr>
<td>Earnings credits</td>
<td>-3.9</td>
<td>-80.7</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>-47.6</td>
<td>77.6</td>
</tr>
<tr>
<td>Imputed income taxes (Note 6)</td>
<td>-15.5</td>
<td>24.2</td>
</tr>
<tr>
<td>Net income</td>
<td>-32.1</td>
<td>53.4</td>
</tr>
<tr>
<td><strong>Memo: Targeted return on equity (Note 6)</strong></td>
<td>19.9</td>
<td>66.5</td>
</tr>
</tbody>
</table>

**Note:** Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

### Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 2009

**Millions of dollars**

<table>
<thead>
<tr>
<th>Item</th>
<th>Total</th>
<th>Commercial check collection</th>
<th>Commercial ACH</th>
<th>Fedwire funds</th>
<th>Fedwire securities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from services (Note 4)</td>
<td>662.7</td>
<td>481.7</td>
<td>92.9</td>
<td>64.4</td>
<td>23.7</td>
</tr>
<tr>
<td>Operating expenses (Note 5)</td>
<td>713.8</td>
<td>520.1</td>
<td>98.8</td>
<td>69.8</td>
<td>25.2</td>
</tr>
<tr>
<td>Income from operations</td>
<td>-51.1</td>
<td>-38.4</td>
<td>-5.9</td>
<td>-5.4</td>
<td>-1.4</td>
</tr>
<tr>
<td>Imputed costs (Note 6)</td>
<td>9.2</td>
<td>6.0</td>
<td>1.6</td>
<td>1.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Income from operations after imputed costs</td>
<td>-60.3</td>
<td>-44.3</td>
<td>-7.5</td>
<td>-6.6</td>
<td>-1.9</td>
</tr>
<tr>
<td>Other income and expenses, net (Note 7)</td>
<td>12.7</td>
<td>9.2</td>
<td>1.8</td>
<td>1.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Income before income taxes</td>
<td>-47.6</td>
<td>-35.2</td>
<td>-5.7</td>
<td>-5.4</td>
<td>-1.4</td>
</tr>
<tr>
<td>Imputed income taxes (Note 6)</td>
<td>-15.5</td>
<td>-11.5</td>
<td>-1.9</td>
<td>-1.8</td>
<td>-0.5</td>
</tr>
<tr>
<td>Net income</td>
<td>-32.1</td>
<td>-23.7</td>
<td>-3.8</td>
<td>-3.6</td>
<td>-0.9</td>
</tr>
<tr>
<td><strong>Memo: Targeted return on equity (Note 6)</strong></td>
<td>19.9</td>
<td>14.4</td>
<td>2.9</td>
<td>2.0</td>
<td>0.7</td>
</tr>
<tr>
<td>Cost recovery (percent) (Note 8)</td>
<td>92.8</td>
<td>92.8</td>
<td>93.4</td>
<td>92.1</td>
<td>93.8</td>
</tr>
</tbody>
</table>

**Note:** Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.
FEDERAL RESERVE BANKS
NOTES TO PRO FORMA FINANCIAL STATEMENTS FOR PRICED SERVICES

(1) Short-Term Assets

The imputed reserve requirement on clearing balances held at Reserve Banks by depository institutions reflects a treatment comparable to that of compensating balances held at correspondent banks by respondent institutions. The reserve requirement imposed on respondent balances must be held as vault cash or as balances maintained at a Reserve Bank; thus, a portion of priced services clearing balances held with the Federal Reserve is shown as required reserves on the asset side of the balance sheet. Another portion of the clearing balances is used to finance short-term and long-term assets. The remainder of clearing balances and deposit balances arising from float are assumed to be invested in a portfolio of investments, shown as imputed investments.

Receivables are comprised of fees due the Reserve Banks for providing priced services and the share of suspense-account and difference-account balances related to priced services.

Prepaid expenses include salary advances and travel advances for priced-service personnel.

Items in process of collection are gross Federal Reserve cash items in process of collection (CIPC), stated on a basis comparable to that of a commercial bank. They reflect adjustments for intra-System items that would otherwise be double-counted on a consolidated Federal Reserve balance sheet; adjustments for items associated with nonpriced items (such as those collected for government agencies); and adjustments for items associated with providing fixed availability or credit before items are received and processed. Among the costs to be recovered under the Monetary Control Act is the cost of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

(2) Long-Term Assets

Long-term assets consist of long-term assets used solely in priced services, the priced-service portion of long-term assets shared with nonpriced services, an estimate of the assets of the Board of Governors used in the development of priced services, an imputed prepaid FDIC asset (see Note 6), and a deferred tax asset related to the priced services pension and postretirement benefits obligation (see Note 3).

(3) Liabilities and Equity

Under the matched-book capital structure for assets, short-term assets are financed with short-term payables and clearing balances. Long-term assets are financed with long-term liabilities and core clearing balances. As a result, no short-or long-term debt is imputed. Other short-term liabilities include clearing balances maintained at Reserve Banks. Other long-term liabilities consist of accrued postemployment, postretirement, and qualified and nonqualified pension benefits costs and obligations on capital leases.

Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standard Board’s (FASB) Statement of Financial Accounting Standards (SFAS) No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans (codified in FASB Accounting Standards Codification (ASC) Topic 715 (ASC 715), Compensation-Retirement Benefits), which requires an employer to record the funded status of its benefit plans on its balance sheet. In order to reflect the funded status of its benefit plans, the Reserve Banks recognized the deferred items related to these plans, which include prior service costs and actuarial gains or losses, on the balance sheet. This resulted in an adjustment to the pension and benefit plans related to priced services and the recognition of an associated deferred tax asset with an offsetting adjustment, net of tax, to accumulated other comprehensive income (AOCI), which is included in equity. The Reserve Bank priced services recognized a net pension asset in 2009 and a net pension liability in 2008. The increase in the funded status resulted in a corresponding change in AOCI of $(212.3) million in 2009.

To satisfy the FDIC requirements for a well-capitalized institution, equity is imputed at 10 percent of total risk-weighted assets.
(4) Revenue

Revenue represents fees charged to depository institutions for priced services and is realized from each institution through one of two methods: direct charges to an institution’s account or charges against its accumulated earnings credits (see Note 7).

(5) Operating Expenses

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services plus the expenses of the Board of Governors related to the development of priced services. Board expenses were $7.8 million in 2009 and $7.2 million in 2008. Effective January 1, 1987, the Reserve Banks implemented SFAS No. 87, Employers’ Accounting for Pensions (codified in ASC 715). Accordingly, the Reserve Bank priced services recognized qualified pension-plan operating expenses of $121.2 million in 2009 and $28.8 million in 2008. Operating expenses also include the nonqualified pension expense of $2.3 million in 2009 and $5.4 million in 2008. The implementation of SFAS No. 158 (ASC 715) does not change the systematic approach required by generally accepted accounting principles to recognize the expenses associated with the Reserve Banks’ benefit plans in the income statement. As a result, these expenses do not include amounts related to changes in the funded status of the Reserve Banks’ benefit plans, which are reflected in AOCI (see Note 3).

The income statement by service reflects revenue, operating expenses, imputed costs, other income and expenses, and cost recovery. Certain corporate overhead costs not closely related to any particular priced service are allocated to priced services based on an expense-ratio method. Corporate overhead was allocated among the priced services during 2009 and 2008 as follows (in millions):

<table>
<thead>
<tr>
<th>Service</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Check</td>
<td>22.0</td>
<td>31.0</td>
</tr>
<tr>
<td>ACH</td>
<td>5.0</td>
<td>4.6</td>
</tr>
<tr>
<td>Fedwire Funds</td>
<td>3.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Fedwire Securities</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Total</td>
<td>32.1</td>
<td>41.2</td>
</tr>
</tbody>
</table>

(6) Imputed Costs

Imputed costs consist of income taxes, return on equity, interest on debt, sales taxes, an FDIC assessment, and interest on float. Many imputed costs are derived from the private-sector adjustment factor (PSAF) model. The cost of debt and the effective tax rate are derived from bank holding company data, which serves as the proxy for the financial data of a representative private-sector firm, and are used to impute debt and income taxes in the PSAF model. The after-tax rate of return on equity is based on the returns of the equity market as a whole and is applied to the equity on the balance sheet to impute the profit that would have been earned had the services been provided by a private-sector firm. On October 9, 2008, the Federal Reserve began paying interest on required reserve and excess balances held by depository institutions at Reserve Banks as authorized by the Emergency Economic Stabilization Act of 2008. In 2009, in contrast to previous years and in light of the uncertainty about the long-term effect that this change would have on the level of clearing balances on the balance sheet, the equity used to determine the imputed profit was adjusted to reflect actual clearing balance levels maintained throughout 2009.

Interest is imputed on the debt assumed necessary to finance priced-service assets; however, no debt was imputed in 2009 or 2008.

Effective in 2007, the Reserve Bank priced services imputed a one-time FDIC assessment credit. In 2009, the credit offset $8.0 million of the imputed $11.4 million assessment, resulting in zero remaining credit. The imputed FDIC assessment also reflects the increased rates and new assessment calculation methodology approved in 2009, which resulted in a prepaid FDIC asset of $31.2 million on the priced services balance sheet.

Interest on float is derived from the value of float to be recovered, either explicitly or through per-item fees, during the period. Float costs include costs for the Check, Fedwire Funds, National Settlement Service, ACH, and Fedwire Securities services.

Float cost or income is based on the actual float incurred for each priced service. Other imputed costs are allocated among priced services according to the ratio of operating expenses, less shipping expenses, for each service to the total expenses, less the total shipping expenses, for all services.
The following shows the daily average recovery of actual float by the Reserve Banks for 2009 in millions of dollars:

<table>
<thead>
<tr>
<th>Float Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total float</td>
<td>-1,974.1</td>
</tr>
<tr>
<td>Unrecovered float</td>
<td>4.7</td>
</tr>
<tr>
<td>Float subject to recovery</td>
<td>-1,978.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sources of recovery of float</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>As-of adjustments</td>
<td>2.3</td>
</tr>
<tr>
<td>Direct charges</td>
<td>10.9</td>
</tr>
<tr>
<td>Per-item fees</td>
<td>-1,992.0</td>
</tr>
</tbody>
</table>

Unrecovered float includes float generated by services to government agencies and by other central bank services. As-of adjustments and direct charges refer to float that is created by interterritory check transportation and the observance of non-standard holidays by some depository institutions. Such float may be recovered from the depository institutions through adjustments to institution reserve or clearing balances or by billing institutions directly. Float recovered through direct charges and per-item fees is valued at the federal funds rate; credit float recovered through per-item fees has been subtracted from the cost base subject to recovery in 2009.

(7) Other Income and Expenses

Other income and expenses consist of investment and interest income on clearing balances and the cost of earnings credits. Investment income on clearing balances for 2009 and 2008 represents the average coupon-equivalent yield on three-month Treasury bills plus a constant spread, based on the return on a portfolio of investments. Before October 9, 2008, the return was applied to the total clearing balance maintained, adjusted for the effect of reserve requirements on clearing balances. As a result of the Federal Reserve paying interest on required reserve and excess balances held by depository institutions at Reserve Banks beginning in October 2008 (see Note 6), the investment return is applied only to the required portion of the clearing balance. Other income also includes imputed interest on the portion of clearing balances set aside as required reserves. Expenses for earnings credits granted to depository institutions on their clearing balances are based on a discounted average coupon-equivalent yield on three-month Treasury bills.

(8) Cost Recovery

Annual cost recovery is the ratio of revenue, including other income, to the sum of operating expenses, imputed costs, imputed income taxes, and targeted return on equity.
The Board of Governors and the Government Performance and Results Act

The Government Performance and Results Act (GPRA) of 1993 requires that federal agencies, in consultation with Congress and outside stakeholders, prepare a strategic plan covering a multiyear period and submit an annual performance plan and performance report. Although the Federal Reserve is not covered by the GPRA, the Board of Governors voluntarily complies with the spirit of the act.

Strategic Plan, Performance Plan, and Performance Report

The Board’s strategic plan articulates the Board’s mission, sets forth major goals, outlines strategies for achieving those goals, and discusses the environment and other factors that could affect their achievement. It also addresses issues that cross agency jurisdictional lines, identifies key quantitative measures of performance, and discusses the evaluation of performance.

The performance plan includes specific targets for some of the performance measures identified in the strategic plan and describes the operational processes and resources needed to meet those targets. It also discusses validation of data and verification of results. The performance report discusses the Board’s performance in relation to its goals.

The strategic plan, performance plan, and performance report are available on the Board’s website, at www.federalreserve.gov/boarddocs/rptcongress. The Board’s mission statement and a summary of the Federal Reserve’s goals and objectives, as set forth in the most recently released strategic and performance plans, are listed below. Updated documents will be posted on the website as they are completed.

Mission

The mission of the Board is to foster the stability, integrity, and efficiency of the nation’s monetary, financial, and payment systems to promote optimal macroeconomic performance.

Goals and Objectives

The Federal Reserve has six primary goals with interrelated and mutually reinforcing elements.

Goal

Conduct monetary policy that promotes the achievement of the statutory objectives of maximum employment and stable prices.

Objectives

- Stay abreast of recent developments in and prospects for the U.S. economy and financial markets, and in those abroad, so that monetary policy decisions will be well informed.
- Enhance our knowledge of the structural and behavioral relationships in the macroeconomic and financial markets, and improve the quality of the data used to gauge economic per-
formance, through developmental research activities.

- Implement monetary policy effectively in rapidly changing economic circumstances and in an evolving financial market structure.

- Contribute to the development of U.S. international policies and procedures, in cooperation with the U.S. Department of the Treasury and other agencies, with respect to global financial markets and international institutions.

- Promote understanding of Federal Reserve policy among other government policy officials and the general public.

Goal

Promote a safe, sound, competitive, and accessible banking system and stable financial markets.

Objectives

- Promote overall financial stability, manage and contain systemic risk, and identify emerging financial problems early so that crises can be averted.

- Provide a safe, sound, competitive, and accessible banking system through comprehensive and effective supervision of U.S. banks, bank and financial holding companies, foreign banking organizations, and related entities. At the same time, remain sensitive to the burden on supervised institutions.

- Enhance efficiency and effectiveness, while remaining sensitive to the burden on supervised institutions, by addressing the supervision function’s procedures, technology, resource allocation, and staffing issues.

- Promote compliance by domestic and foreign banking organizations supervised by the Federal Reserve with applicable laws, rules, regulations, policies, and guidelines through a comprehensive and effective supervision program.

Goal

Develop regulations, policies, and programs designed to inform and protect consumers, to enforce federal consumer protection laws, to strengthen market competition, and to promote access to banking services in historically underserved markets.

Objectives

- Be a leader in, and help shape the national dialogue on, consumer protection in financial services.

- Promote, develop, and strengthen effective communications and collaborations within the Board, the Federal Reserve Banks, and other agencies and organizations.

Goal

Provide high-quality professional oversight of Reserve Banks.

Objective

- Produce high-quality assessments and oversight of Federal Reserve System strategies, projects, and operations, including adoption of technology to meet the business and operational needs of the Federal Reserve. The oversight process and outputs should help Federal Reserve management foster and strengthen sound internal control systems, efficient and reliable operations, effective performance, and sound project management and should assist the Board in the effective discharge of its oversight responsibilities.
Goal

Foster the integrity, efficiency, and accessibility of U.S. payment and settlement systems.

Objectives

- Develop sound, effective policies and regulations that foster payment system integrity, efficiency, and accessibility. Support and assist the Board in overseeing U.S. dollar payment and securities settlement systems by assessing their risks and risk-management approaches against relevant policy objectives and standards.
- Conduct research and analysis that contributes to policy development and increases the Board’s and others’ understanding of payment system dynamics and risk.

Goal

Foster the integrity, efficiency, and effectiveness of Board programs.

Objectives

- Develop appropriate policies, oversight mechanisms, and measurement criteria to ensure that the recruiting, training, and retention of staff meet Board needs.
- Establish, encourage, and enforce a climate of fair and equitable treatment for all employees regardless of race, creed, color, national origin, age, or sex.
- Provide strategic planning and financial management support needed for sound business decisions.
- Provide cost-effective and secure information resource management services to Board divisions, support divisional distributed-processing requirements, and provide analysis on information technology issues to the Board, Reserve Banks, other financial regulatory institutions, and central banks.
- Efficiently provide safe, modern, secure facilities and necessary support for activities conducive to efficient and effective Board operations.
Federal Legislative Developments

In May 2009, President Obama signed into law two significant pieces of legislation that include provisions affecting the Federal Reserve: the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (Pub. L. No. 111-24) (the “Credit Card Act”), which aims to improve practices in the credit card market, and the Helping Families Save Their Homes Act of 2009 (Pub. L. No. 111-22), which seeks to restore stability to the housing markets. Following is a summary of the key provisions of these laws as they relate to Federal Reserve System functions.

The Credit Card Act

The Federal Reserve played a key role in the development of the Credit Card Act, which introduces new substantive and disclosure requirements for creditors in an effort to strengthen consumer protections in the credit card market. Among other things, the Credit Card Act amends the Truth in Lending Act and the Electronic Fund Transfer Act, which are administered by the Board.

Several provisions of the Credit Card Act build on protections previously adopted by the Board. Specifically, in December 2008, the Board adopted two final rules pertaining to open-end credit (other than credit secured by a home):

- The first rule made comprehensive changes to Regulation Z (which implements the Truth in Lending Act), including amendments that affect credit card applications and solicitations, account-opening disclosures, periodic statements, notices of changes in terms, and advertisements.
- The second rule protected consumers by prohibiting certain unfair acts or practices, such as unexpected increases in interest rates, with respect to consumer credit card accounts.

The requirements of the Credit Card Act that pertain to credit cards or other open-end credit for which the Board has rulemaking authority become effective in three stages. The first set of provisions requires creditors to provide written notice to consumers 45 days before the creditor increases the annual percentage rate (APR) on a credit card account or makes a significant change to the terms of a credit card account. These notices also must inform consumers of their right to cancel the credit card account before the increase or change goes into effect. If a consumer exercises this right, the creditor generally is prohibited from applying the increase or change to the account prior to account closure. In addition, creditors are required to mail or deliver periodic statements for credit cards at least 21 days before payment is due. These Credit Card Act provisions became effective on August 20, 2009 (90 days after enactment). The Board approved interim final rules to implement these provisions on July 15, 2009.

A second set of Credit Card Act provisions protects consumers from certain types of increases in credit card interest rates and changes in terms. It does so by prohibiting, with certain exceptions, increases to an interest rate during the first year after an account has been opened, as well as increases to an
Interest rate that applies to an existing credit card balance. In addition, if a consumer makes a payment in excess of the minimum payment amount, creditors are required to allocate those excess funds first to the card balance with the highest interest rate, and then to each successive balance with the next highest rate, until the payment is exhausted. Creditors also are prohibited from:

- using the “two-cycle” billing method to impose interest charges;\(^1\)
- charging over-the-limit fees unless the cardholder has agreed to allow the issuer to complete over-the-limit transactions; and
- charging excessive fees on cards with low credit limits.

The Credit Card Act also requires that before opening a credit card account, or increasing the account limit, creditors consider the consumer’s ability to make the required payments under the card agreement. Furthermore, the Credit Card Act prohibits creditors from issuing a credit card to, or establishing an open-end credit plan on behalf of, a consumer who is younger than the age of 21, unless the creditor either determines that the consumer has the independent ability to make the required payments or obtains the signature of a parent or other cosigner with the ability to do so. Creditors are further prohibited from offering a tangible item on or near a college campus to induce college students to apply for or participate in an open-end consumer credit plan.

In addition, for each credit card account, creditors must provide the consumer with a payment due date that is the same day each month, and with a disclosure setting forth the time and cost of paying off the card balance if only minimum monthly payments are made. This second set of provisions became effective on February 22, 2010 (nine months after enactment). The Board approved final rules to implement these provisions on January 12, 2010.

A third group of Credit Card Act provisions addresses the reasonableness and proportionality of penalty fees and periodic review of rate increases by creditors. Under these provisions, the Board is charged with establishing standards for creditors to use in assessing whether or not a penalty fee or charge is reasonable and proportional to the corresponding violation or omission. In developing these standards, the Board must consider the cost sustained by the creditor for the violation or omission, the effect of the fee in deterring omissions or violations by the cardholder, the cardholder’s conduct, and other factors the Board considers necessary or appropriate. In addition, under certain circumstances, a credit card issuer who increases a cardholder’s interest rate is required to review the cardholder’s account at least every six months and assess whether a decrease in the rate is warranted due to a change in such factor(s). On March 3, 2010, the Board issued a proposed rule to implement the third group of Credit Card Act provisions. These provisions will become effective on August 22, 2010 (15 months after enactment).

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1. The “two-cycle” billing method has several permutations. Generally, a card issuer that uses the two-cycle method assesses interest not only on the balance for the current billing cycle but also on balances on days in the preceding billing cycle. The two-cycle method results in greater interest charges for consumers who pay their balance in full one month (and therefore generally qualify for a grace period) but not the next month (and therefore generally lose the grace period).
The Credit Card Act also amends provisions of the Electronic Fund Transfer Act and generally prohibits the imposition of dormancy, inactivity, or service fees with respect to a gift certificate, store gift card, or general-use prepaid card. The Credit Card Act provides an exception to this general prohibition if there has been at least one year of inactivity, no more than one fee is charged per month, and the consumer is provided with clear and conspicuous disclosures about the fees. In addition, the Credit Card Act prohibits the sale or issuance of a gift certificate, store gift card, or general-use prepaid card that is subject to an expiration date of less than five years. These provisions will become effective on August 22, 2010. The Board finalized rules to implement these provisions on March 23, 2010.

The Credit Card Act also mandates that creditors post their credit card agreements on their Internet sites, and provide these agreements to the Board. The Board is required to establish and maintain a central repository so that the public may easily access and retrieve these agreements. Finally, the Credit Card Act requires the Board to conduct and complete several studies, and to make several reports to Congress, on college credit card agreements, the reduction of consumer credit availability, and the use of credit cards by small businesses.

The Helping Families Save Their Homes Act

On May 20, 2009, President Obama signed into law the Helping Families Save Their Homes Act (the “Helping Families Act”) (Pub. L. No. 111-22), which, among other things, introduced new measures to aid families facing foreclosure. The Helping Families Act included a variety of provisions intended to encourage modification of home mortgages either in default or facing imminent default, including through the HOPE for Homeowners Program previously established by the Housing and Economic Recovery Act of 2008 (HERA) (Pub. L. No. 110-289). For example, the Helping Families Act included provisions that permit the Secretary of Housing and Urban Development (HUD) to authorize the modification of federally guaranteed rural housing loans and loans guaranteed by the Federal Housing Administration (FHA) either in default or facing imminent default, and to make payments to residential mortgage lenders in order to offset certain costs associated with modification. The Helping Families Act also provides certain liability protections to loan servicers who make modifications in compliance with the Act.

Described below are three provisions of the Act that directly relate to the activities and functions of the Federal Reserve or the banking organizations supervised by the Federal Reserve.

GAO Audit Authority

Title VIII of the Helping Families Act authorizes the Comptroller General of the U.S. Government Accountability Office (GAO) to conduct audits, including on-site examinations, of all the credit facilities authorized by the Board under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) for a single and specific partnership or corporation in order to protect financial stability and promote the flow of credit during the financial crisis.

Under this provision, the GAO has full authority to audit the special lend-
ing facilities that the Federal Reserve established under section 13(3) for American International Group, Inc.; Citigroup, Inc.; and Bank of America Corporation, and to facilitate the acquisition of The Bear Stearns Company, Inc. by JP Morgan Chase & Co., including Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC. The Helping Families Act prohibits an officer or employee of the GAO from disclosing to any person outside the GAO information obtained in audits or examinations conducted under this authority and maintained as confidential by the Board or the Federal Reserve Banks.

Title VI of the Helping Families Act also clarifies the GAO’s authority to audit the programs established by the Treasury Department under the Troubled Asset Relief Program (TARP), including the Term Asset-Backed Securities Loan Facility (TALF), which is a joint program of the Federal Reserve and Treasury. The Emergency Economic Stabilization Act of 2008 (EESA) (Pub. L. No. 110-343), which established the TARP, expressly authorizes the GAO to audit the programs and activities of the Treasury under the TARP for purposes of conducting ongoing oversight of the activities and performance of the TARP. Section 601 of the Helping Families Act clarifies and ensures the GAO’s ability to audit the TALF for purposes of assessing the performance of the TARP. Taken together, these provisions provide the GAO with the authority to audit the terms, conditions, and operations of the TALF, including those aspects of the TALF that are administered by the Federal Reserve, as necessary to understand and assess the performance of, and risks to, the TARP.

These provisions augment the GAO’s existing audit authority with respect to the Federal Reserve. For example, all of the Federal Reserve’s supervisory and regulatory functions are subject to audit by the GAO to the same extent as the supervisory and regulatory functions of the other federal banking agencies.

Temporary Increase in FDIC Borrowing Authority

The Helping Families Act also includes measures designed to preserve confidence in the deposit insurance fund and assist the Federal Deposit Insurance Corporation (FDIC) in recovering any costs of emergency assistance provided to help maintain financial stability during the financial crisis.

Specifically, the Helping Families Act increases, from $30 billion to $100 billion, the amount the FDIC may borrow from the Treasury for deposit insurance purposes. In addition, until December 31, 2010, the Helping Families Act allows the Secretary of the Treasury, after consulting with the President, to allow the FDIC to borrow up to $500 billion from Treasury if the Secretary determines that the increase is necessary after receiving the written recommendations of the Board of Directors of the FDIC and the Board of Governors of the Federal Reserve System (each by a vote of not less than two-thirds of the members of the respective board).

The Helping Families Act also permits the FDIC, with the concurrence of the Secretary of the Treasury, to make special assessments on depository institution holding companies, in addition to insured depository institutions, to recover any losses that the Deposit Insurance Fund may incur as a result of actions taken by the FDIC under the systemic risk exception to the least-cost resolution requirements in the Federal
Deposit Insurance Act (12 U.S.C. § 1823(c)(4)(G)). In establishing any such assessment rate, the FDIC must consider the types of entities that benefit from any action taken or assistance provided, economic conditions, the effects on the industry, and such other factors as the FDIC deems appropriate and relevant to the action taken or the assistance provided.

Moreover, the Helping Families Act extends, until December 31, 2013, the increase from $100,000 to $250,000 in FDIC deposit insurance coverage for insured depository institutions and National Credit Union Administration (NCUA) share insurance coverage for insured credit unions. This increase in deposit and share insurance initially was enacted as part of the EESA, but only through December 31, 2009.

The HOPE for Homeowners Program

Title II of the Helping Families Act makes several changes to the HOPE for Homeowners Program, a voluntary program designed to allow qualified, at-risk mortgage borrowers to refinance their existing mortgages into new mortgage loans guaranteed by the FHA, subject to certain conditions and restrictions. As originally enacted, the Board of Directors of the program (the “Oversight Board”) was provided authority to establish requirements and standards for the program, prescribe regulations, and issue guidance to implement those requirements and standards. The Oversight Board is composed of the Secretary of HUD, the Chairman of the Board of Governors of the Federal Reserve System, the Secretary of the Treasury, and the Chairperson of the Board of Directors of the FDIC, or the respective designee of each. The Helping Families Act transferred all responsibilities of the Oversight Board to the Secretary of HUD and converted the Oversight Board into an advisory body with responsibility for advising the Secretary regarding the program.

The Helping Families Act also gives HUD additional flexibility with respect to the fees assessed for providing government insurance to mortgages refinanced under the program. Specifically, the Act permits HUD to assess an up-front premium of up to 3 percent, and an annual premium of up to 1.5 percent, of the principal balance of the new mortgage, taking into consideration the financial integrity and purpose of the program. Previously, the upfront and annual premiums were fixed at 3 percent and 1.5 percent of the principal balance of the new mortgage, respectively. Additionally, the Helping Families Act allows HUD to make payments to the servicer for loans refinanced under the program, and to originators for new loans made through the program to encourage refinancings for eligible borrowers. HUD is also given greater flexibility in establishing the percentage of any appreciation realized by a borrower on the property refinanced into the program that the borrower must share with HUD. HUD is permitted to share its portion of any appreciation received with either a senior or subordinate mortgage holder whose loans were refinanced pursuant to the program. The Helping Families Act makes several other technical changes to the program to decrease administrative burdens, such as streamlining certifications and allowing conformity with current FHA practices to the extent possible.