

***The Federal Reserve  
Bank of Cleveland***

*Financial Statements as of and for the Years Ended  
December 31, 2014 and 2013 and  
Independent Auditors' Report*

# THE FEDERAL RESERVE BANK OF CLEVELAND

## Table of Contents

---

	<b>Page</b>
Management's Report on Internal Control Over Financial Reporting	1
Independent Auditors' Report	2-4
Abbreviations	5
Financial Statements:	
Statements of Condition as of December 31, 2014 and December 31, 2013	6
Statements of Income and Comprehensive Income for the years ended December 31, 2014 and December 31, 2013	7
Statements of Changes in Capital for the years ended December 31, 2014 and December 31, 2013	8
Notes to Financial Statements	9-38

# FEDERAL RESERVE BANK *of* CLEVELAND

CLEVELAND, OHIO 44101  
AREA CODE 216/599-2000

## Management's Report on Internal Control Over Financial Reporting

March 11, 2015

To the Board of Directors of the Federal Reserve Bank of Cleveland:

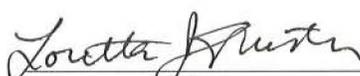
The management of the Federal Reserve Bank of Cleveland (Bank) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2014 and 2013, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (the financial statements). The financial statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the financial statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the FAM and include all disclosures necessary for such fair presentation.

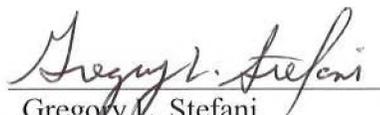
The management of the Bank is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the financial statements. The Bank's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial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

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

The management of the Bank assessed its internal control over financial reporting based upon the criteria established in the *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that the Bank maintained effective internal control over financial reporting.

Federal Reserve Bank of Cleveland

  
Loretta J. Mester  
President &  
Chief Executive Officer

  
Gregory L. Stefani  
First Vice President &  
Chief Operating Officer

  
Susan M. Steinbrick  
Senior Vice President &  
Chief Financial Officer

## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the Federal Reserve Bank of Cleveland ("FRB Cleveland"), which are comprised of the statements of condition as of December 31, 2014 and 2013, and the related statements of income and comprehensive income, and of changes in capital for the years then ended, and the related notes to the financial statements. We also have audited the FRB Cleveland's internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

### Management's Responsibility

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

### Auditors' Responsibility

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

An audit of the financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers

internal control relevant to the FRB Cleveland's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of the financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting involves obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

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

### **Definition of Internal Control Over Financial Reporting**

The FRB Cleveland's internal control over financial reporting is a process designed by, or under the supervision of, the FRB Cleveland's principal executive and principal financial officers, or persons performing similar functions, and effected by the FRB Cleveland's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the accounting principles established by the Board. The FRB Cleveland's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the FRB Cleveland; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the accounting principles established by the Board, and that receipts and expenditures of the FRB Cleveland are being made only in accordance with authorizations of management and directors of the FRB Cleveland; and (3) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the FRB Cleveland's assets that could have a material effect on the financial statements.

### **Inherent Limitations of Internal Control Over Financial Reporting**

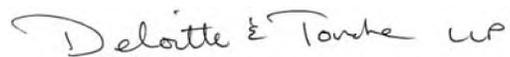
Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected and corrected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Opinions**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the FRB Cleveland as of December 31, 2014 and 2013, and the results of its operations for the years then ended in accordance with the basis of accounting described in Note 3 to the financial statements. Also, in our opinion, the FRB Cleveland maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

## Basis of Accounting

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

Deloitte & Touche LLP

March 11, 2015

## FEDERAL RESERVE BANK OF CLEVELAND

### Abbreviations:

ACH	Automated clearinghouse
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
FAM	<i>Financial Accounting Manual for Federal Reserve Banks</i>
FASB	Financial Accounting Standards Board
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
FRBNY	Federal Reserve Bank of New York
GAAP	Accounting principles generally accepted in the United States of America
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
MBS	Mortgage-backed securities
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
TBA	To be announced
TDF	Term Deposit Facility

**FEDERAL RESERVE BANK OF CLEVELAND**  
**STATEMENTS OF CONDITION**  
As of December 31, 2014 and December 31, 2013  
(in millions)

	2014	2013
<u>ASSETS</u>		
Gold certificates	\$ 464	\$ 512
Special drawing rights certificates	237	237
Coin	120	130
System Open Market Account:		
Treasury securities, net (of which \$243 and \$438 is lent as of December 31, 2014 and 2013, respectively)	56,685	60,257
Government-sponsored enterprise debt securities, net (of which \$14 and \$28 is lent as of December 31, 2014 and 2013, respectively)	873	1,510
Federal agency and government-sponsored enterprise mortgage-backed securities, net	39,062	39,173
Foreign currency denominated investments, net	1,662	1,851
Central bank liquidity swaps	122	21
Accrued interest receivable	565	605
Other assets	1	-
Bank premises and equipment, net	124	124
Deferred asset - remittances to the Treasury	5	-
Interdistrict settlement account	38,162	4,138
Other assets	30	29
Total assets	\$ 138,112	\$ 108,587
<u>LIABILITIES AND CAPITAL</u>		
Federal Reserve notes outstanding, net	\$ 60,838	\$ 53,472
System Open Market Account:		
Securities sold under agreements to repurchase	11,132	8,068
Other liabilities	18	34
Deposits:		
Depository institutions	61,513	42,425
Other deposits	3	3
Interest payable to depository institutions	3	1
Accrued benefit costs	139	115
Accrued remittances to the Treasury	-	84
Other liabilities	10	9
Total liabilities	133,656	104,211
Capital paid-in	2,228	2,188
Surplus (including accumulated other comprehensive (loss) income of (\$20) and \$3 at December 31, 2014 and 2013, respectively)	2,228	2,188
Total capital	4,456	4,376
Total liabilities and capital	\$ 138,112	\$ 108,587

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

**FEDERAL RESERVE BANK OF CLEVELAND**  
**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**  
For the years ended December 31, 2014 and December 31, 2013  
(in millions)

	<u>2014</u>	<u>2013</u>
<u>INTEREST INCOME</u>		
System Open Market Account:		
Treasury securities, net	\$ 1,435	\$ 1,316
Government-sponsored enterprise debt securities, net	36	55
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,169	934
Foreign currency denominated investments, net	6	8
Central bank liquidity swaps	-	2
Total interest income	<u>2,646</u>	<u>2,315</u>
<u>INTEREST EXPENSE</u>		
System Open Market Account:		
Securities sold under agreements to repurchase	3	2
Deposits:		
Depository institutions	81	51
Term Deposit Facility	3	-
Total interest expense	<u>87</u>	<u>53</u>
Net interest income	<u>2,559</u>	<u>2,262</u>
<u>NON-INTEREST LOSS</u>		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	2	1
Foreign currency translation losses, net	(231)	(97)
Other	-	1
Compensation received for service costs provided	6	5
Reimbursable services to government agencies	32	27
Other	3	3
Total non-interest loss	<u>(188)</u>	<u>(60)</u>
<u>OPERATING EXPENSES</u>		
Salaries and benefits	122	115
Occupancy	15	14
Equipment	6	5
Other	25	27
Assessments:		
Board of Governors operating expenses and currency costs	90	88
Bureau of Consumer Financial Protection	44	44
Total operating expenses	<u>302</u>	<u>293</u>
Net income before providing for remittances to the Treasury	2,069	1,909
Earnings remittances to the Treasury	1,873	1,749
Net income	<u>196</u>	<u>160</u>
Change in prior service costs related to benefit plans	(2)	(3)
Change in actuarial (losses) gains related to benefit plans	(21)	26
Total other comprehensive (loss) income	<u>(23)</u>	<u>23</u>
Comprehensive income	<u>\$ 173</u>	<u>\$ 183</u>

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

**FEDERAL RESERVE BANK OF CLEVELAND**  
**STATEMENTS OF CHANGES IN CAPITAL**  
For the years ended December 31, 2014 and December 31, 2013  
(in millions, except share data)

	Surplus				
	Capital paid-in	Net income retained	Accumulated other comprehensive income (loss)	Total surplus	Total capital
Balance at December 31, 2012 (42,684,796 shares)	\$ 2,134	\$ 2,154	\$ (20)	\$ 2,134	\$ 4,268
Net change in capital stock issued (1,067,757 shares)	54	-	-	-	54
Comprehensive income:					
Net income	-	160	-	160	160
Other comprehensive income	-	-	23	23	23
Dividends on capital stock	-	(129)	-	(129)	(129)
Net change in capital	54	31	23	54	108
Balance at December 31, 2013 (43,752,553 shares)	\$ 2,188	\$ 2,185	\$ 3	\$ 2,188	\$ 4,376
Net change in capital stock issued (799,174 shares)	40	-	-	-	40
Comprehensive income:					
Net income	-	196	-	196	196
Other comprehensive loss	-	-	(23)	(23)	(23)
Dividends on capital stock	-	(133)	-	(133)	(133)
Net change in capital	40	63	(23)	40	80
Balance at December 31, 2014 (44,551,727 shares)	\$ 2,228	\$ 2,248	\$ (20)	\$ 2,228	\$ 4,456

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

## **FEDERAL RESERVE BANK OF CLEVELAND NOTES TO FINANCIAL STATEMENTS**

### **1. STRUCTURE**

The Federal Reserve Bank of Cleveland (Bank) is part of the Federal Reserve System (System) and is one of the 12 Federal Reserve Banks (Reserve Banks) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank serves the Fourth Federal Reserve District, which includes Ohio and portions of Kentucky, Pennsylvania, and West Virginia.

In accordance with the Federal Reserve Act, supervision and control of the Bank is exercised by a board of directors. The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as chairman and deputy chairman, are appointed by the Board of Governors of the Federal Reserve System (Board of Governors) to represent the public, and six directors are elected by member banks. Banks that are members of the System include all nationally-chartered banks and any state-chartered banks that apply and are approved for membership. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

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

### **2. OPERATIONS AND SERVICES**

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

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

To be prepared to counter disorderly conditions in foreign exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities, the FOMC has authorized and directed the FRBNY to execute spot and forward foreign exchange transactions in 14 foreign currencies, to hold balances

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

in those currencies, and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY holds these securities and obligations in the SOMA. The FOMC has also authorized the FRBNY to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of \$2 billion and \$3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund in the maximum amount of \$5 billion.

Because of the global character of bank funding markets, the System has at times coordinated with other central banks to provide liquidity. The FOMC authorized and directed the FRBNY to establish U.S. dollar liquidity and reciprocal foreign currency liquidity swap lines with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. The FRBNY holds amounts outstanding under these swap lines in the SOMA. These swap lines, which were originally established as temporary arrangements, were converted to standing arrangements on October 31, 2013, and will remain in place until further notice.

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

**3. SIGNIFICANT ACCOUNTING POLICIES**

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

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

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

reflects the timing of the transaction's effect on the quantity of reserves in the banking system. The cost bases of Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP.

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

Preparing the financial statements in conformity with the FAM requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

In 2014, the description of certain line items presented in the Statements of Condition and the Statements of Income and Comprehensive Income have been revised to better reflect the nature of these items. Amounts related to these line items were not changed from the prior year, only the nomenclature for the line item was revised, as further noted below:

- The line item "System Open Market Account: Other investments" has been revised in the Statements of Condition to "System Open Market Account: Other assets."
- The line item "System Open Market Account: Foreign currency denominated assets, net" has been revised in the Statements of Income and Comprehensive Income to "System Open Market Account: Foreign currency denominated investments, net."

Certain amounts relating to the prior year have been reclassified in the Statements of Income and Comprehensive Income to conform to the current year presentation. \$1 million previously reported for the year ended December 31, 2013 as "Non-interest loss: Other" has been reclassified into a new line titled "Non-interest loss: System Open Market Account: Other."

Significant accounts and accounting policies are explained below.

**a. Consolidation**

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

**b. Gold and Special Drawing Rights Certificates**

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks. Upon authorization, the Reserve Banks acquire gold certificates by crediting equivalent amounts in dollars to the account established for the Treasury. The gold certificates held by the Reserve Banks are required to be

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

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

Special drawing rights (SDR) are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange-stabilization operations. At the time SDR certificate transactions occur, the Board of Governors allocates the SDR certificates among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding calendar year. SDR certificates are recorded by the Banks at original cost. There were no SDR certificate transactions during the years ended December 31, 2014 and 2013.

**c. *Coin***

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

**d. *Loans***

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

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

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are typically settled through a tri-party arrangement. In a tri-party arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the FRBNY and counterparty. The collateral pledged must exceed the principal amount of the transaction

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including Treasury Inflation-Protected Securities, Separate Trading of Registered Interest and Principal of Securities Treasury securities, and Treasury Floating Rate Notes); direct obligations of several federal and GSE-related agencies, including Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal Home Loan Banks; and pass-through federal agency and GSE MBS. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. These transactions are reported at their contractual amounts as “System Open Market Account: Securities purchased under agreements to resell” and the related accrued interest receivable is reported as a component of “System Open Market Account: Accrued interest receivable” in the Statements of Condition.

The FRBNY may engage in sales of securities under agreements to repurchase with primary dealers and with a set of expanded counterparties which includes banks, savings associations, GSEs, and domestic money market funds (Overnight and term reverse repurchase agreements). These reverse repurchase transactions, are settled through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, or federal agency and GSE MBS that are held in the SOMA. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts as “System Open Market Account: Securities sold under agreements to repurchase” and the related accrued interest payable is reported as a component of “System Open Market Account: Other liabilities” in the Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers, typically overnight, to facilitate the effective functioning of the domestic securities markets. The amortized cost basis of securities lent continues to be reported as “System Open Market Account: Treasury securities, net” and “System Open Market Account: Government-sponsored enterprise debt securities, net,” as appropriate, in the Statements of Condition. Securities lending transactions are fully collateralized by Treasury securities based on the fair values of the securities lent increased by a margin determined by the FRBNY. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of “Non-interest loss: System Open Market Account: Other” in the Statements of Income and Comprehensive Income.

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

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

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

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

reported net of the amortization of premiums and accretion of discounts in the Statements of Income and Comprehensive Income.

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell “to be announced” (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. During the years ended December 31, 2014 and 2013, the FRBNY executed dollar rolls to facilitate settlement of outstanding purchases of federal agency and GSE MBS. The FRBNY accounts for dollar rolls as purchases or sales on a settlement-date basis. In addition, TBA MBS transactions may be paired off or assigned prior to settlement. Net gains resulting from these MBS transactions are reported as “Non-interest loss: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net” in the Statements of Income and Comprehensive Income.

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

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

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

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

***g. Central Bank Liquidity Swaps***

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

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

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

*U.S. dollar liquidity swaps*

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

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

*Foreign currency liquidity swaps*

The structure of foreign currency liquidity swap transactions involves the transfer by the FRBNY, at the prevailing market exchange rate, of a specified amount of U.S. dollars to an account for the foreign central bank in exchange for its currency. The foreign currency amounts that the FRBNY receives are recorded as a liability.

**h. Bank Premises, Equipment, and Software**

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

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

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

**i. Interdistrict Settlement Account**

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

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

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

**j. *Federal Reserve Notes***

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

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

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of \$7,811 million and \$5,080 million at December 31, 2014 and 2013, respectively.

At December 31, 2014 and 2013, all Federal Reserve notes outstanding, reduced by the Reserve Bank's currency holdings, were fully collateralized. At December 31, 2014, all gold certificates, all special drawing rights certificates, and \$1,282 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2014, no investments denominated in foreign currencies were pledged as collateral.

**k. *Deposits***

***Depository Institutions***

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as a component of "Interest payable to depository institutions" in the Statements of Condition. There were no deposits held by the Bank under the TDF at December 31, 2014 and 2013.

***Other***

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

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

***l. Capital Paid-in***

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

By law, each Reserve Bank is required to pay each member bank an annual dividend of six percent on the paid-in capital stock. This cumulative dividend is paid semiannually.

***m. Surplus***

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

***n. Remittances to the Treasury***

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. Currently, remittances to the Treasury are made on a weekly basis. This amount is reported as "Earnings remittances to the Treasury" in the Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued remittances to the Treasury" in the Statements of Condition. See Note 12 for additional information on earnings remittances to the Treasury.

If earnings during the year are not sufficient to provide for the costs of operations, payment of dividends, and equating surplus and capital paid-in, remittances to the Treasury are suspended. A deferred asset is recorded that represents the amount of net earnings a Reserve Bank will need to realize before remittances to the Treasury resume. This deferred asset is periodically reviewed for impairment. The deferred asset is reported as "Deferred asset – remittances to the Treasury" in the Statements of Condition. As of December 31, 2014, no impairment existed.

***o. Income and Costs Related to Treasury Services***

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2014 and 2013, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

***p. Compensation Received for Service Costs Provided***

The Federal Reserve Bank of Atlanta (FRBA) has overall responsibility for managing the Reserve Banks' provision of check and ACH services to depository institutions, the FRBNY has overall responsibility for managing the Reserve Banks' provision of Fedwire funds and securities services, and the Federal Reserve Bank of Chicago has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions. The Reserve Bank that has overall responsibility for managing these services recognizes the related total System revenue in its Statements of Income and Comprehensive Income. The Bank is compensated for costs incurred to provide these services by the Reserve Banks responsible for managing these services and reports this compensation as "Non-interest loss:

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

Compensation received for service costs provided” in its Statements of Income and Comprehensive Income.

**q. Assessments**

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

The Dodd-Frank Act requires that, after the transfer of its responsibilities to the Bureau on July 21, 2011, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governors’ 2009 annual report, which totaled \$4.98 billion. After 2013, the amount will be adjusted annually in accordance with the provisions of the Dodd-Frank Act. The percentage of total operating expenses of the System for the years ended December 31, 2014 and 2013 was 12.22 percent (\$608.4 million) and 12 percent (\$597.6 million), respectively. The Bank’s assessment for Bureau funding is reported as “Assessments: Bureau of Consumer Financial Protection” in the Statements of Income and Comprehensive Income.

**r. Taxes**

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank’s real property taxes were \$2 million and \$1 million for the years ended December 31, 2014 and 2013, respectively, and are reported as a component of “Operating expenses: Occupancy” in the Statements of Income and Comprehensive Income.

**s. Restructuring Charges**

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

In 2014, the Treasury announced plans to consolidate the provision of substantially all fiscal agent services for the U.S. Treasury at the Bank, the Federal Reserve Bank of Kansas City, the FRBNY, and the Federal Reserve Bank of St. Louis. The implementation plan associated with this consolidation is expected to be completed in 2018.

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

The Bank had no significant restructuring activities in 2014 and 2013.

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

**t. Recently Issued Accounting Standards**

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. This update changes the requirements for reporting discontinued operations, which may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. This update is effective for the Bank for the year ending December 31, 2015, and is not expected to have a material effect on the Bank's financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This update was issued to create common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. The guidance is applicable to all contracts for the transfer of goods or services regardless of industry or type of transaction. This update requires recognition of revenue in a manner that reflects the consideration that the entity expects to receive in return for the transfer of goods or services to customers. This update is effective for the Bank for the year ending December 31, 2018, and is not expected to have a material effect on the Bank's financial statements.

In June 2014, the FASB issued ASU 2014-11, *Transfer and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*. This update requires changes in the accounting for repurchase to maturity transactions and repurchase financing transactions. Additionally, this update provides guidance for the disclosures for certain transfers of financial assets accounted for as sales, where the transferor retains substantially all of the exposure to economic return on the transferred financial asset; and repurchase agreements, securities lending transactions, and repurchase to maturity transactions that are accounted for as secured borrowings. This update is effective for the Bank for the year ending December 31, 2015, and is not expected to have a material effect on the Bank's financial statements.

**4. LOANS**

***Loans to Depository Institutions***

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

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

Loans to depository institutions were immaterial as of December 31, 2014. The Bank had no loans outstanding as of December 31, 2013.

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

At December 31, 2014 and 2013, the Bank did not have any loans that were impaired, restructured, past due, or on non-accrual status, and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2014 and 2013.

**5. SYSTEM OPEN MARKET ACCOUNT**

**a. Domestic Securities Holdings**

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

During the years ended December 31, 2014 and 2013, the FRBNY continued the purchase of Treasury securities and federal agency and GSE MBS under the large-scale asset purchase programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would reinvest principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In June 2012, the FOMC announced that it would continue this reinvestment policy. In September 2012, the FOMC announced that the Federal Reserve would purchase additional federal agency and GSE MBS at a pace of \$40 billion per month. In December 2012, the FOMC announced that the Federal Reserve would also purchase longer-term Treasury securities initially at a pace of \$45 billion per month after its program to extend the average maturity of its holdings of Treasury securities was completed in 2012. In December 2013, the FOMC announced that it would slow the pace of its additional asset purchases. In October 2014, the FOMC concluded its asset purchase program while maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction.

The Bank's allocated share of activity related to domestic open market operations was 2.183 percent and 2.554 percent at December 31, 2014 and 2013, respectively.

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

	2014			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Notes	\$ 35,697	\$ 604	\$ (169)	\$ 36,132
Bonds	18,043	2,721	(211)	20,553
Total Treasury securities	<u>\$ 53,740</u>	<u>\$ 3,325</u>	<u>\$ (380)</u>	<u>\$ 56,685</u>
GSE debt securities	<u>\$ 844</u>	<u>\$ 29</u>	<u>\$ -</u>	<u>\$ 873</u>
Federal agency and GSE MBS	<u>\$ 37,921</u>	<u>\$ 1,162</u>	<u>\$ (21)</u>	<u>\$ 39,062</u>
	2013			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Notes	\$ 37,476	\$ 853	\$ (146)	\$ 38,183
Bonds	18,933	3,283	(142)	22,074
Total Treasury securities	<u>\$ 56,409</u>	<u>\$ 4,136</u>	<u>\$ (288)</u>	<u>\$ 60,257</u>
GSE debt securities	<u>\$ 1,461</u>	<u>\$ 49</u>	<u>\$ -</u>	<u>\$ 1,510</u>
Federal agency and GSE MBS	<u>\$ 38,057</u>	<u>\$ 1,144</u>	<u>\$ (28)</u>	<u>\$ 39,173</u>

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

The FRBNY enters into transactions for the purchase of securities under agreements to resell and transactions to sell securities under agreements to repurchase as part of its monetary policy activities. These operations are for the purpose of further assessing the appropriate structure of such operations in supporting the implementation of monetary policy during normalization. In addition, transactions to sell securities under agreements to repurchase are entered into as part of a service offering to foreign official and international account holders.

There were no material transactions related to securities purchased under agreements to resell during the years ended December 31, 2014 and 2013. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	Allocated to the Bank		Total SOMA	
	2014	2013	2014	2013
<u>Overnight and term reverse repurchase agreements:</u>				
Contract amount outstanding, end of year	\$ 8,662	\$ 5,050	\$ 396,705	\$ 197,755
Average daily amount outstanding, during the year	2,931	106	130,281	4,161
Maximum balance outstanding, during the year	8,662	5,050	396,705	197,755
Securities pledged (par value), end of year	7,974	4,802	365,235	188,028
Securities pledged (market value), end of year	8,702	5,024	398,540	196,726
<u>Foreign official and international accounts:</u>				
Contract amount outstanding, end of year	\$ 2,470	\$ 3,018	\$ 113,132	\$ 118,169
Average daily amount outstanding, during the year	2,348	2,437	102,968	95,520
Maximum balance outstanding, during the year	3,018	3,018	122,232	118,169
Securities pledged (par value), end of year	2,366	3,127	108,355	122,424
Securities pledged (market value), end of year	2,470	3,018	113,132	118,175
Total contract amount outstanding, end of year	<u>\$ 11,132</u>	<u>\$ 8,068</u>	<u>\$ 509,837</u>	<u>\$ 315,924</u>

Securities pledged as collateral, at December 31, 2014 and 2013, consisted solely of Treasury securities.

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2014 and 2013 was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
<b>December 31, 2014:</b>							
Treasury securities (par value)	\$ -	\$ -	\$ 77	\$ 24,299	\$ 14,991	\$ 14,373	\$ 53,740
GSE debt securities (par value)	24	15	86	668	-	51	844
Federal agency and GSE MBS (par value) <sup>1</sup>	-	-	-	-	141	37,780	37,921
Securities sold under agreements to repurchase (contract amount)	11,132	-	-	-	-	-	11,132
<b>December 31, 2013:</b>							
Treasury securities (par value)	\$ -	\$ 8	\$ 4	\$ 19,495	\$ 22,083	\$ 14,819	\$ 56,409
GSE debt securities (par value)	59 <sup>2</sup>	193 <sup>2</sup>	221 <sup>2</sup>	926	2	60	1,461
Federal agency and GSE MBS (par value) <sup>1</sup>	-	-	-	-	65	37,992	38,057
Securities sold under agreements to repurchase (contract amount)	8,068	-	-	-	-	-	8,068

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

<sup>2</sup> These par amounts were omitted from the 2013 footnote and have no financial statement impact.

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, was approximately 5.7 and 6.5 years as of December 31, 2014 and 2013, respectively.

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

	Allocated to the Bank		Total SOMA	
	2014	2013	2014	2013
Treasury securities (amortized cost)	\$ 243	\$ 438	\$ 11,144	\$ 17,153
Treasury securities (par value)	221	395	10,105	15,447
GSE debt securities (amortized cost)	14	28	633	1,099
GSE debt securities (par value)	13	27	616	1,055

The FRBNY enters into commitments to buy and sell Treasury securities and records the related securities on a settlement-date basis. As of December 31, 2014, there were no outstanding commitments.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2014, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was \$28,692 million, none of which was related to dollar rolls. The total purchase price of outstanding purchase commitments allocated to the Bank was \$626 million, none of which was related to dollar rolls. As of December 31, 2014, there were no outstanding sales

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

commitments for federal agency and GSE MBS. These commitments, which had contractual settlement dates extending through January 2015, are principally for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for MBS commitments as part of its risk management practices used to mitigate the counterparty credit risk.

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

	Allocated to the Bank		Total SOMA	
	2014	2013	2014	2013
Other assets:				
MBS portfolio related cash and short term investments	\$ 1	\$ -	\$ 28	\$ 1
Other	-	-	1	1
Total other assets	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 29</u>	<u>\$ 2</u>
Other liabilities:				
Cash margin	\$ 17	\$ 34	\$ 793	\$ 1,320
Obligations from MBS transaction fails	1	-	30	11
Other	-	-	7	-
Total other liabilities	<u>\$ 18</u>	<u>\$ 34</u>	<u>\$ 830</u>	<u>\$ 1,331</u>

Accrued interest receivable on domestic securities holdings was \$25,561 million and \$23,405 million as of December 31, 2014 and 2013, respectively, of which \$558 million and \$598 million, respectively, was allocated to the Bank. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the years ended December 31, 2014 and 2013, is summarized as follows (in millions):

	Allocated to the Bank				
	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2012	\$ 29,040	\$ 16,957	\$ 45,997	\$ 2,021	\$ 24,161
Purchases <sup>1</sup>	9,148	5,259	14,407	-	22,046
Sales <sup>1</sup>	-	-	-	-	-
Realized gains, net <sup>2</sup>	-	-	-	-	-
Principal payments and maturities	(1)	-	(1)	(499)	(6,987)
Amortization of premiums and accretion of discounts, net	(154)	(242)	(396)	(20)	(179)
Inflation adjustment on inflation-indexed securities	7	17	24	-	-
Annual reallocation adjustment <sup>3</sup>	143	83	226	8	132
Balance at December 31, 2013	<u>\$ 38,183</u>	<u>\$ 22,074</u>	<u>\$ 60,257</u>	<u>\$ 1,510</u>	<u>\$ 39,173</u>
Purchases <sup>1</sup>	3,888	2,011	5,899	-	10,755
Sales <sup>1</sup>	-	-	-	-	(1)
Realized gains, net <sup>2</sup>	-	-	-	-	-
Principal payments and maturities	(11)	-	(11)	(442)	(4,589)
Amortization of premiums and accretion of discounts, net	(127)	(231)	(358)	(13)	(162)
Inflation adjustment on inflation-indexed securities	11	30	41	-	-
Annual reallocation adjustment <sup>3</sup>	(5,812)	(3,331)	(9,143)	(182)	(6,114)
Balance at December 31, 2014	<u>\$ 36,132</u>	<u>\$ 20,553</u>	<u>\$ 56,685</u>	<u>\$ 873</u>	<u>\$ 39,062</u>
Year-ended December 31, 2013					
Supplemental information - par value of transactions:					
Purchases <sup>4</sup>	\$ 9,100	\$ 4,718	\$ 13,818	\$ -	\$ 21,356
Sales	-	-	-	-	-
Year-ended December 31, 2014					
Supplemental information - par value of transactions:					
Purchases <sup>4</sup>	\$ 3,943	\$ 1,970	\$ 5,913	\$ -	\$ 10,394
Sales	-	-	-	-	(1)

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

<sup>2</sup> Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

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

<sup>4</sup> Includes inflation compensation.

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

	Total SOMA				
	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2012	\$ 1,142,219	\$ 666,969	\$ 1,809,188	\$ 79,479	\$ 950,321
Purchases <sup>1</sup>	358,656	206,208	564,864	-	864,538
Sales <sup>1</sup>	-	-	-	-	-
Realized gains, net <sup>2</sup>	-	-	-	-	-
Principal payments and maturities	(21)	-	(21)	(19,562)	(273,990)
Amortization of premiums and accretion of discounts, net	(6,024)	(9,503)	(15,527)	(795)	(7,008)
Inflation adjustment on inflation-indexed securities	285	645	930	-	-
Balance at December 31, 2013	<u>\$ 1,495,115</u>	<u>\$ 864,319</u>	<u>\$ 2,359,434</u>	<u>\$ 59,122</u>	<u>\$ 1,533,861</u>
Purchases <sup>1</sup>	165,306	85,826	251,132	-	466,384
Sales <sup>1</sup>	-	-	-	-	(30)
Realized gains, net <sup>2</sup>	-	-	-	-	-
Principal payments and maturities	(475)	-	(475)	(18,544)	(203,933)
Amortization of premiums and accretion of discounts, net	(5,545)	(10,132)	(15,677)	(588)	(7,199)
Inflation adjustment on inflation-indexed securities	500	1,327	1,827	-	-
Balance at December 31, 2014	<u>\$ 1,654,901</u>	<u>\$ 941,340</u>	<u>\$ 2,596,241</u>	<u>\$ 39,990</u>	<u>\$ 1,789,083</u>
Year-ended December 31, 2013	Supplemental information - par value of transactions:				
Purchases <sup>3</sup>	\$ 356,766	\$ 184,956	\$ 541,722	\$ -	\$ 837,490
Sales	-	-	-	-	-
Year-ended December 31, 2014	Supplemental information - par value of transactions:				
Purchases <sup>3</sup>	\$ 167,497	\$ 83,739	\$ 251,236	\$ -	\$ 450,633
Sales	-	-	-	-	(29)

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

<sup>2</sup> Realized gains, net offset the amount of realized gains and losses included in the reported sales amount.

<sup>3</sup> Includes inflation compensation.

**b. Foreign Currency Denominated Investments**

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

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

The Bank's allocated share of activity related to foreign currency operations was 7.953 percent and 7.801 percent at December 31, 2014 and 2013, respectively.

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

Information about foreign currency denominated investments valued at amortized cost and foreign currency market exchange rates at December 31 was as follows (in millions):

	Allocated to Bank		Total SOMA	
	2014	2013	2014	2013
<b>Euro:</b>				
Foreign currency deposits	\$ 552	\$ 588	\$ 6,936	\$ 7,530
Securities purchased under agreements to resell	-	199	-	2,549
German government debt instruments	198	187	2,494	2,397
French government debt instruments	293	187	3,687	2,397
<b>Japanese yen:</b>				
Foreign currency deposits	205	228	2,576	2,926
Japanese government debt instruments	414	462	5,207	5,925
<b>Total</b>	<b>\$ 1,662</b>	<b>\$ 1,851</b>	<b>\$ 20,900</b>	<b>\$ 23,724</b>

Accrued interest receivable on foreign currency denominated investments was \$83 million and \$88 million as of December 31, 2014 and 2013, respectively, of which \$7 million for each year ended was allocated to the Bank. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Statements of Condition.

The remaining maturity distribution of foreign currency denominated investments that were allocated to the Bank at December 31, 2014 and 2013, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
<b>December 31, 2014:</b>					
Euro	\$ 289	\$ 224	\$ 130	\$ 400	\$ 1,043
Japanese yen	219	31	123	246	619
<b>Total</b>	<b>\$ 508</b>	<b>\$ 255</b>	<b>\$ 253</b>	<b>\$ 646</b>	<b>\$ 1,662</b>
<b>December 31, 2013:</b>					
Euro	\$ 549	\$ 141	\$ 168	\$ 302	\$ 1,160
Japanese yen	243	30	146	272	691
<b>Total</b>	<b>\$ 792</b>	<b>\$ 171</b>	<b>\$ 314</b>	<b>\$ 574</b>	<b>\$ 1,851</b>

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2014.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2014, there were \$137 million of outstanding commitments to purchase foreign government debt instruments, of which \$11 million was allocated to the Bank. These securities settled on January 5, 2015, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date. During 2014, there were purchases and maturities of foreign government debt instruments of \$5,494 million and \$3,337 million, respectively, of which \$436 million and \$265 million, respectively, were allocated to the Bank. There were no sales of foreign government debt instruments in 2014.

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

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

At December 31, 2014 and 2013, there was no balance outstanding under the authorized warehousing facility.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2014 and 2013.

Foreign currency working balances held and foreign exchange contracts executed by the Bank to facilitate its international payments and currency transactions it made on behalf of foreign central banks and U.S. official institution customers were not material as of December 31, 2014 and 2013.

**c. Central Bank Liquidity Swaps**

***U.S. Dollar Liquidity Swaps***

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 7.953 percent and 7.801 percent at December 31, 2014 and 2013, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2014 and 2013, was \$1,528 million and \$272 million, respectively, of which \$122 million and \$21 million, respectively, was allocated to the Bank.

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

	2014			2013		
	Within 15 days	16 days to 90 days	Total	Within 15 days	16 days to 90 days	Total
Euro	\$ -	\$ -	\$ -	\$ 9	\$ 12	\$ 21
Japanese yen	122	-	122	-	-	-
Total	\$ 122	\$ -	\$ 122	\$ 9	\$ 12	\$ 21

***Foreign Currency Liquidity Swaps***

At December 31, 2014 and 2013, there was no balance outstanding related to foreign currency liquidity swaps.

**d. Fair Value of SOMA Assets and Liabilities**

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

The fair value of the Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments in the SOMA's holdings is subject to market risk, arising from movements in

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

market variables such as interest rates and credit risk. The fair value of federal agency and GSE MBS is also affected by the expected rate of prepayments of mortgage loans underlying the securities. The fair value of foreign government debt instruments is also affected by currency risk. Based on evaluations performed as of December 31, 2014, there are no credit impairments of SOMA securities holdings.

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

	Allocated to the Bank					
	2014			2013		
	Amortized cost	Fair value	Cumulative unrealized gains (losses)	Amortized cost	Fair value	Cumulative unrealized gains (losses)
Treasury securities:						
Notes	\$ 36,132	\$ 36,754	\$ 622	\$ 38,183	\$ 38,283	\$ 100
Bonds	20,553	22,989	2,436	22,074	21,512	(562)
Total Treasury securities	<u>\$ 56,685</u>	<u>\$ 59,743</u>	<u>\$ 3,058</u>	<u>\$ 60,257</u>	<u>\$ 59,795</u>	<u>\$ (462)</u>
GSE debt securities	873	928	55	1,510	1,589	79
Federal agency and GSE MBS	39,062	39,749	687	39,173	38,195	(978)
Total domestic SOMA portfolio securities holdings	<u>\$ 96,620</u>	<u>\$ 100,420</u>	<u>\$ 3,800</u>	<u>\$ 100,940</u>	<u>\$ 99,579</u>	<u>\$ (1,361)</u>
Memorandum - Commitments for:						
Purchases of Treasury securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Purchases of Federal agency and GSE MBS	626	628	2	1,516	1,510	(6)
Sales of Federal agency and GSE MBS	-	-	-	-	-	-
	Total SOMA					
	2014			2013		
	Amortized cost	Fair value	Cumulative unrealized gains (losses)	Amortized cost	Fair value	Cumulative unrealized gains (losses)
Treasury securities:						
Notes	\$ 1,654,901	\$ 1,683,377	\$ 28,476	\$ 1,495,115	\$ 1,499,000	\$ 3,885
Bonds	941,340	1,052,916	111,576	864,319	842,336	(21,983)
Total Treasury securities	<u>\$ 2,596,241</u>	<u>\$ 2,736,293</u>	<u>\$ 140,052</u>	<u>\$ 2,359,434</u>	<u>\$ 2,341,336</u>	<u>\$ (18,098)</u>
GSE debt securities	39,990	42,499	2,509	59,122	62,236	3,114
Federal agency and GSE MBS	1,789,083	1,820,544	31,461	1,533,860	1,495,572	(38,288)
Total domestic SOMA portfolio securities holdings	<u>\$ 4,425,314</u>	<u>\$ 4,599,336</u>	<u>\$ 174,022</u>	<u>\$ 3,952,416</u>	<u>\$ 3,899,144</u>	<u>\$ (53,272)</u>
Memorandum - Commitments for:						
Purchases of Treasury securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Purchases of Federal agency and GSE MBS	28,692	28,803	111	59,350	59,129	(221)
Sales of Federal agency and GSE MBS	-	-	-	-	-	-

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

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

At December 31, 2014 and 2013, the fair value of foreign currency denominated investments was \$20,996 million and \$23,802 million, respectively, of which \$1,670 million and \$1,857 million, respectively, was allocated to

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

the Bank. The fair value of foreign government debt instruments was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of foreign currency deposits and securities purchased under agreements to resell was determined by reference to market interest rates.

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

Distribution of MBS holdings by coupon rate	2014		2013	
	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
2.0%	\$ 279	\$ 276	\$ 362	\$ 346
2.5%	2,502	2,477	3,163	3,025
3.0%	11,207	11,054	13,326	12,368
3.5%	10,509	10,685	8,931	8,641
4.0%	9,346	9,633	5,880	5,902
4.5%	3,403	3,665	4,746	4,992
5.0%	1,431	1,544	2,127	2,247
5.5%	333	358	549	580
6.0%	46	50	78	82
6.5%	6	7	11	12
Total	<u>\$ 39,062</u>	<u>\$ 39,749</u>	<u>\$ 39,173</u>	<u>\$ 38,195</u>
Total SOMA:				
2.0%	\$ 12,788	\$ 12,618	\$ 14,191	\$ 13,529
2.5%	114,609	113,468	123,832	118,458
3.0%	513,289	506,280	521,809	484,275
3.5%	481,305	489,390	349,689	338,357
4.0%	428,047	441,204	230,256	231,113
4.5%	155,867	167,844	185,825	195,481
5.0%	65,544	70,719	83,290	87,968
5.5%	15,232	16,414	21,496	22,718
6.0%	2,110	2,287	3,051	3,225
6.5%	292	320	421	448
Total	<u>\$ 1,789,083</u>	<u>\$ 1,820,544</u>	<u>\$ 1,533,860</u>	<u>\$ 1,495,572</u>

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

The following tables present the realized gains and the change in the cumulative unrealized gains (losses) related to SOMA domestic securities holdings during the years ended December 31, 2014 and 2013 (in millions):

	Allocated to Bank			
	2014		2013	
	Realized gains <sup>1</sup>	Change in cumulative unrealized gains (losses) <sup>2</sup>	Realized gains <sup>1</sup>	Change in cumulative unrealized losses <sup>2</sup>
Treasury securities	\$ -	\$ 3,650	\$ -	\$ (4,680)
GSE debt securities	-	(14)	-	(62)
Federal agency and GSE MBS	2	1,616	1	(2,093)
Total	<u>\$ 2</u>	<u>\$ 5,252</u>	<u>\$ 1</u>	<u>\$ (6,835)</u>

	Total SOMA			
	2014		2013	
	Realized gains <sup>1</sup>	Change in cumulative unrealized gains (losses) <sup>2</sup>	Realized gains <sup>1</sup>	Change in cumulative unrealized losses <sup>2</sup>
Treasury securities	\$ -	\$ 158,150	\$ -	\$ (183,225)
GSE debt securities	-	(605)	-	(2,411)
Federal agency and GSE MBS	81	69,749	51	(81,957)
Total	<u>\$ 81</u>	<u>\$ 227,294</u>	<u>\$ 51</u>	<u>\$ (267,593)</u>

<sup>1</sup> Realized gains are reported in "Non-interest loss: System Open Market Account" in the Statements of Income and Comprehensive Income.

<sup>2</sup> Because SOMA securities are recorded at amortized cost, the change in the cumulative unrealized gains (losses) is not reported in the Statements of Income and Comprehensive Income.

The amount of change in cumulative unrealized gains (losses) position, net, related to foreign currency denominated investments was a gain of \$18 million and a loss of \$90 million for the years ended December 31, 2014 and 2013, respectively, of which \$1 million and \$7 million, respectively, were allocated to the Bank.

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

- Level 1 – Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

- Level 3 – Valuation is based on model-based techniques that use significant inputs and assumptions not observable in the market. These unobservable inputs and assumptions reflect the Bank’s estimates of inputs and assumptions that market participants would use in pricing the assets and liabilities. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments are classified as Level 2 within the ASC 820 hierarchy because the fair values are based on indicative quotes and other observable inputs obtained from independent pricing services. The fair value hierarchy level of SOMA financial assets is not necessarily an indication of the risk associated with those assets.

**6. BANK PREMISES, EQUIPMENT, AND SOFTWARE**

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

	2014	2013
Bank premises and equipment:		
Land and land improvements	\$ 7	\$ 7
Buildings	161	157
Building machinery and equipment	42	43
Construction in progress	1	-
Furniture and equipment	39	39
Subtotal	250	246
Accumulated depreciation	(126)	(122)
Bank premises and equipment, net	\$ 124	\$ 124
Depreciation expense, for the years ended December 31	\$ 9	\$ 8

The Bank leases space to outside tenants with remaining lease terms ranging from one to ten years. Rental income from such leases was \$2 million for each of the years ended December 31, 2014 and 2013, and is reported as a component of “Non-interest loss: Other” in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2014, are as follows (in millions):

2015	\$ 2
2016	1
2017	2
2018	2
2019	1
Thereafter	3
Total	\$ 11

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

The Bank had capitalized software assets, net of amortization, of \$14 million and \$13 million at December 31, 2014 and 2013, respectively. Amortization expense was \$5 million and \$4 million for the years ended December 31, 2014 and 2013, respectively. Capitalized software assets are reported as a component of “Other assets” in the Statements of Condition and the related amortization is reported as a component of “Operating expenses: Other” in the Statements of Income and Comprehensive Income.

As a result of the Bank’s restructuring plan as discussed in Note 11, the Bank sold its Pittsburgh facility during the third quarter of 2013. This sale resulted in a \$1.9 million loss of which \$1.7 million is reflected in “Operating expenses: Other” and \$0.2 million is reflected in “Operating expenses: Occupancy” in the Statements of Income and Comprehensive Income.

**7. COMMITMENTS AND CONTINGENCIES**

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

At December 31, 2014, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms of approximately eight years. These leases provide for increased lease payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent) was \$1.2 million for each of the years ended December 31, 2014 and 2013. Certain of the Bank’s leases have options to renew up to an additional ten years.

Future minimum lease payments under noncancelable operating leases with remaining terms of one year or more, at December 31, 2014, are as follows (in millions):

	<u>Operating leases</u>
2015	\$ 0.7
2016	0.7
2017	0.8
2018	0.7
2019	0.8
Thereafter	<u>2.3</u>
Future minimum lease payments	<u>\$ 6.0</u>

At December 31, 2014, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Reserve Banks, each of the Reserve Banks has agreed to bear, on a per-incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank’s capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2014 and 2013.

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

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

**8. RETIREMENT AND THRIFT PLANS**

*Retirement Plans*

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

The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2014 and 2013, certain costs associated with the System Plan were reimbursed by the Bureau.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2014 and 2013, and for the years then ended, were not material.

*Thrift Plan*

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. The Bank's Thrift Plan contributions totaled \$5 million for each of the years ended December 31, 2014 and 2013, and are reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

**9. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS**

*Postretirement Benefits Other Than Retirement Plans*

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

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets.

Following is a reconciliation of the beginning and ending balances of the benefit obligation (in millions):

	2014	2013
Accumulated postretirement benefit obligation at January 1	\$ 98.7	\$ 116.8
Service cost benefits earned during the period	3.8	4.7
Interest cost on accumulated benefit obligation	4.8	4.5
Net actuarial loss (gain)	21.0	(22.9)
Contributions by plan participants	1.7	1.5
Benefits paid	(6.6)	(5.9)
Medicare Part D subsidies	0.4	0.3
Plan amendments	(1.8)	(0.3)
Accumulated postretirement benefit obligation at December 31	\$ 122.0	\$ 98.7

At December 31, 2014 and 2013, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 3.96 percent and 4.79 percent, respectively.

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due. The System Plan discount rate assumption setting convention uses an unrounded rate.

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

Following is a reconciliation of the beginning and ending balance of the plan assets, and the unfunded postretirement benefit obligation and accrued postretirement benefit costs (in millions):

	<u>2014</u>	<u>2013</u>
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	4.5	4.1
Contributions by plan participants	1.7	1.5
Benefits paid	(6.6)	(5.9)
Medicare Part D subsidies	0.4	0.3
Fair value of plan assets at December 31	<u>\$ -</u>	<u>\$ -</u>
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 122.0</u>	<u>\$ 98.7</u>

Amounts included in accumulated other comprehensive (loss) income are shown below:

Prior service cost	\$ 11	\$ 13
Net actuarial loss	(31)	(10)
Total accumulated other comprehensive (loss) income	<u>\$ (20)</u>	<u>\$ 3</u>

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs” in the Statements of Condition.

For measurement purposes, the assumed health-care cost trend rates at December 31 are as follows:

	<u>2014</u>	<u>2013</u>
Health-care cost trend rate assumed for next year	6.60%	7.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.75%	5.00%
Year that the rate reaches the ultimate trend rate	2019	2019

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A one percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2014 (in millions):

	<u>One percentage point increase</u>	<u>One percentage point decrease</u>
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 2.1	\$ (1.6)
Effect on accumulated postretirement benefit obligation	20.0	(16.1)

**FEDERAL RESERVE BANK OF CLEVELAND**  
**NOTES TO FINANCIAL STATEMENTS**

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

	<u>2014</u>	<u>2013</u>
Service cost-benefits earned during the period	\$ 3.8	\$ 4.7
Interest cost on accumulated benefit obligation	4.8	4.4
Amortization of prior service cost	(3.6)	(3.6)
Amortization of net actuarial loss	-	3.3
Net periodic postretirement benefit expense	<u>\$ 5.0</u>	<u>\$ 8.8</u>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2015 are shown below:

Prior service cost	\$ (4.0)
Net actuarial loss	<u>2.4</u>
Total	<u>\$ (1.6)</u>

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2014 and 2013, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 4.79 percent and 3.75 percent, respectively.

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

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

Federal Medicare Part D subsidy receipts were \$407 thousand and \$257 thousand in the years ended December 31, 2014 and 2013, respectively. Expected receipts in 2015, related to benefits paid in the years ended December 31, 2014 and 2013, are \$136 thousand.

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

	<u>Without subsidy</u>	<u>With subsidy</u>
2015	\$ 4.9	\$ 4.6
2016	5.2	4.8
2017	5.5	5.1
2018	5.8	5.3
2019	6.0	5.5
2020 - 2024	<u>33.6</u>	<u>30.3</u>
Total	<u>\$ 61.0</u>	<u>\$ 55.6</u>

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

*Postemployment Benefits*

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical, dental, and vision insurance; survivor income; disability benefits; and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2014 and 2013, were \$12.7 million and \$13.1 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2014 and 2013 operating expenses were \$1.5 million and \$1.8 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

**10. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME**

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

	<u>2014</u>	<u>2013</u>
	Amount related to postretirement benefits other than retirement plans	Amount related to postretirement benefits other than retirement plans
Balance at January 1	\$ 3	\$ (20)
Change in funded status of benefit plans:		
Prior service costs arising during the year	2	1
Amortization of prior service cost	<u>(4)</u> <sup>1</sup>	<u>(4)</u> <sup>1</sup>
Change in prior service costs related to benefit plans	(2)	(3)
Net actuarial (loss) gain arising during the year	(21)	23
Amortization of net actuarial loss	<u>-</u> <sup>1</sup>	<u>3</u> <sup>1</sup>
Change in actuarial (loss) gain related to benefit plans	<u>(21)</u>	<u>26</u>
Change in funded status of benefit plans - other comprehensive (loss) income	<u>(23)</u>	<u>23</u>
Balance at December 31	<u>\$ (20)</u>	<u>\$ 3</u>

<sup>1</sup> Reclassification is reported as a component of "Operating expenses: Salaries and benefits" in the Statements of Income and Comprehensive Income.

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

**11. BUSINESS RESTRUCTURING CHARGES**

The Bank had no business restructuring charges in 2014 or 2013.

In years prior to 2013, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated paper and electronic check processing at the FRBA. In addition, the U.S. Treasury announced a restructuring initiative to consolidate the Treasury Retail Securities operations located in the Bank's Pittsburgh branch into the Federal Reserve Bank of Minneapolis. In coordination with the Treasury Retail Securities restructuring in Pittsburgh, the Bank announced the restructuring of support and overhead functions at the branch and the sale of the Pittsburgh branch facility. Additional information regarding the sale of the Pittsburgh facility is discussed in Note 6. Final payouts related to the restructuring costs occurred in 2013.

**FEDERAL RESERVE BANK OF CLEVELAND  
NOTES TO FINANCIAL STATEMENTS**

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

Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 8. Costs associated with enhanced postretirement benefits are disclosed in Note 9.

**12. DISTRIBUTION OF COMPREHENSIVE INCOME**

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

	<u>2014</u>	<u>2013</u>
Dividends on capital stock	\$ 133	\$ 129
Transfer to surplus - amount required to equate surplus with capital paid-in	40	54
Earnings remittances to the Treasury	<u>1,873</u>	<u>1,749</u>
Total distribution	<u>\$ 2,046</u>	<u>\$ 1,932</u>

**13. SUBSEQUENT EVENTS**

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2014. Subsequent events were evaluated through March 11, 2015, which is the date that the financial statements were available to be issued.