

The Federal Reserve Banks

*Combined Financial Statements as of and for the Years
Ended December 31, 2010 and 2009 and
Independent Auditors' Report*

THE FEDERAL RESERVE BANKS

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INDEPENDENT AUDITORS' REPORT

To the Board of Governors of the Federal Reserve System
and the Boards of Directors of the Federal Reserve Banks:

We have audited the accompanying Combined Statements of Condition of the Federal Reserve Banks (the "Reserve Banks") as of December 31, 2010 and 2009 and the related Combined Statements of Income and Comprehensive Income, and of Changes in Capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. These Combined Financial Statements are the responsibility of the Division of Reserve Bank Operations and Payment System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Reserve Banks are not required to have, nor were we engaged to perform, an audit of their internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Reserve Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 4 to the Combined Financial Statements, the Reserve Banks have prepared these Combined Financial Statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the *Financial Accounting Manual for Federal Reserve Banks*, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such Combined Financial Statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 4.

In our opinion, such Combined Financial Statements referred to above present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 2010 and 2009, and the combined results of their operations for the years then ended, on the basis of accounting described in Note 4.

Deloitte & Touche LLP

March 22, 2011

THE FEDERAL RESERVE BANKS

Abbreviations:

ABCP	Asset-backed commercial paper
ABS	Asset-backed securities
ACH	Automated clearinghouse
AIA	American International Assurance Company Ltd.
AIG	American International Group, Inc.
AIG Trust	AIG Credit Facility Trust
AIGFP	AIG Financial Products Corp.
ALICO	American Life Insurance Company
AMLF	Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ARM	Adjustable rate mortgage
ASC	Accounting Standards Codification
BEP	Benefit Equalization Retirement Plan
Bureau	Bureau of Consumer Financial Protection
CDO	Collateralized debt obligation
CDS	Credit default swaps
CIP	Committee on Investment Performance (related to System Retirement Plan)
CMBS	Commercial mortgage-backed securities
CPFF	Commercial Paper Funding Facility
ESF	Exchange Stabilization Fund
FAM	<i>Financial Accounting Manual for Federal Reserve Banks</i>
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FFCB	Federal Farm Credit Banks
FHLB	Federal Home Loan Banks
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
FRBC	Federal Reserve Bank of Chicago
FRBNY	Federal Reserve Bank of New York
FRBR	Federal Reserve Bank of Richmond
FRBSF	Federal Reserve Bank of San Francisco
GAAP	Accounting principles generally accepted in the United States of America
GSE	Government-sponsored enterprise
IMF	International Monetary Fund
IRS	Interest rate swaps
JPMC	JPMorgan Chase & Co.
Libor	London interbank offered rate
LLC	Limited liability company
MBS	Mortgage-backed securities
ML	Maiden Lane LLC

ML II	Maiden Lane II LLC
ML III	Maiden Lane III LLC
MTM	Mark-to-market
OEB	Office of Employee Benefits of the Federal Reserve System
OFR	Office of Financial Research
OIS	Overnight indexed swap
PDCF	Primary Dealer Credit Facility
RMBS	Residential mortgage-backed securities
SBA	Small Business Administration
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SFAS	Statement of Financial Accounting Standards
SOMA	System Open Market Account
STRIP	Separate Trading of Registered Interest and Principal of Securities
TAF	Term Auction Facility
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TBA	To be announced
TCE	Transitional Credit Extension
TDF	Term Deposit Facility
TIPS	Treasury Inflation-Protected Securities
TRS	Total return swap agreement
TOP	Term Securities Lending Facility Options Program
TSLF	Term Securities Lending Facility
VIE	Variable interest entity

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CONDITION
As of December 31, 2010 and December 31, 2009
(in millions)

	2010	2009
<u>ASSETS</u>		
Gold certificates	\$ 11,037	\$ 11,037
Special drawing rights certificates	5,200	5,200
Coin	2,180	2,053
Items in process of collection	374	507
Loans:		
Depository institutions	221	96,618
Term Asset-Backed Securities Loan Facility (measured at fair value)	24,853	48,183
American International Group, Inc., net	20,603	21,250
System Open Market Account:		
Treasury securities, net	1,066,952	805,972
Government-sponsored enterprise debt securities, net	152,972	167,362
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,004,695	918,927
Foreign currency denominated assets, net	26,049	25,272
Central bank liquidity swaps	75	10,272
Other investments	-	5
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities (of which \$68,469 and \$71,648 is measured at fair value as of December 31, 2010 and 2009, respectively)	68,666	81,380
Preferred interests	26,385	25,106
Accrued interest receivable	14,231	12,641
Bank premises and equipment, net	2,613	2,624
Other assets	738	638
Total assets	\$ 2,427,844	\$ 2,235,047
<u>LIABILITIES AND CAPITAL</u>		
Federal Reserve notes outstanding, net	\$ 941,561	\$ 887,846
System Open Market Account:		
Securities sold under agreements to repurchase	59,703	77,732
Other liabilities	-	601
Consolidated variable interest entities:		
Beneficial interest in consolidated variable interest entities (measured at fair value)	10,051	5,095
Other liabilities (of which \$203 and \$143 is measured at fair value as of December 31, 2010 and 2009, respectively)	921	1,316
Deposits:		
Depository institutions	968,052	976,988
Treasury, general account	140,773	186,632
Treasury, supplementary financing account	199,964	5,001
Other deposits	16,967	36,228
Funds from American International Group, Inc. asset dispositions, held as agent	26,896	-
Interest payable to depository institutions	113	113
Accrued benefit costs	2,597	2,631
Deferred credit items	1,794	2,103
Accrued interest on Federal Reserve notes	5,124	1,191
Other liabilities	280	290
Total liabilities	2,374,796	2,183,767
Capital paid-in	26,524	25,640
Surplus (including accumulated other comprehensive loss of \$3,630 and \$3,676 at December 31, 2010 and 2009, respectively)	26,524	25,640
Total capital	53,048	51,280
Total liabilities and capital	\$ 2,427,844	\$ 2,235,047

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

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
For the years ended December 31, 2010 and December 31, 2009
(in millions)

	2010	2009
<u>INTEREST INCOME</u>		
Loans:		
Depository institutions	\$ 50	\$ 990
Term Asset-Backed Securities Loan Facility	750	414
American International Group, Inc., net	2,728	3,996
Other	-	109
System Open Market Account:		
Securities purchased under agreements to resell	-	13
Treasury securities, net	26,373	22,873
Government-sponsored enterprise debt securities, net	3,510	2,048
Federal agency and government-sponsored enterprise mortgage-backed securities, net	44,839	20,407
Foreign currency denominated assets, net	223	296
Central bank liquidity swaps	12	2,168
Other investments	-	1
Investments held by consolidated variable interest entities	4,440	9,820
Total interest income	82,925	63,135
<u>INTEREST EXPENSE</u>		
System Open Market Account:		
Securities sold under agreements to repurchase	94	98
Beneficial interest in consolidated variable interest entities	277	267
Deposits:		
Depository institutions	2,680	2,183
Term Deposit Facility	4	-
Total interest expense	3,055	2,548
Provision for loan restructuring	-	(2,621)
Net interest income after provision for loan restructuring	79,870	57,966
<u>NON-INTEREST INCOME (LOSS)</u>		
Term Asset-Backed Securities Loan Facility, unrealized (losses) gains	(436)	557
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	782	879
Foreign currency gains, net	554	172
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities gains (losses), net	8,180	(1,937)
Beneficial interest in consolidated variable interest entities (losses), net	(4,679)	(1,903)
Dividends on preferred interests	1,279	106
Income from services	567	663
Reimbursable services to government agencies	457	450
Other income	187	443
Total non-interest income (loss)	6,891	(570)
<u>OPERATING EXPENSES</u>		
Salaries and benefits	2,722	2,802
Occupancy	297	280
Equipment	180	183
Assessments:		
Board of Governors operating expenses and currency costs	1,045	888
Bureau of Consumer Financial Protection	33	-
Office of Financial Research	10	-
Professional fees related to consolidated variable interest entities	104	125
Other	681	702
Total operating expenses	5,072	4,980
Net income prior to distribution	81,689	52,416
Change in funded status of benefit plans	46	1,007
Comprehensive income prior to distribution	\$ 81,735	\$ 53,423
Distribution of comprehensive income:		
Dividends paid to member banks	\$ 1,583	\$ 1,428
Transferred to surplus and change in accumulated other comprehensive loss	884	4,564
Payments to Treasury as interest on Federal Reserve notes	79,268	47,431
Total distribution	\$ 81,735	\$ 53,423

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

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CHANGES IN CAPITAL
For the years ended December 31, 2010 and December 31, 2009
(in millions, except share data)

	Surplus				
	Capital paid-in	Net income retained	Accumulated other comprehensive (loss)	Total surplus	Total capital
Balance at January 1, 2009 (421,517,467 shares)	\$ 21,076	\$ 25,759	\$ (4,683)	\$ 21,076	\$ 42,152
Net change in capital stock issued (91,289,192 shares)	4,564	-	-	-	4,564
Transferred to surplus and change in accumulated other comprehensive income	-	3,557	1,007	4,564	4,564
Balance at December 31, 2009 (512,806,659 shares)	\$ 25,640	\$ 29,316	\$ (3,676)	\$ 25,640	\$ 51,280
Net change in capital stock issued (17,674,477 shares)	884	-	-	-	884
Transferred to surplus and change in accumulated other comprehensive income	-	838	46	884	884
Balance at December 31, 2010 (530,481,136 shares)	\$ 26,524	\$ 30,154	\$ (3,630)	\$ 26,524	\$ 53,048

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

**FEDERAL RESERVE BANKS
NOTES TO COMBINED FINANCIAL STATEMENTS**

1. STRUCTURE

The twelve Federal Reserve Banks (Reserve Banks) are part of the Federal Reserve System (System) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics.

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

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

2. OPERATIONS AND SERVICES

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

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which was signed into law and became effective on July 21, 2010, changed the scope of some services performed by the Reserve Banks. Among other things, the Dodd-Frank Act establishes a Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the Federal Reserve System that will have supervisory authority over some institutions previously supervised by the Reserve Banks under delegated authority from the Board of Governors in connection with those institutions' compliance with consumer protection statutes; limits the Reserve Banks' authority to provide loans in unusual and exigent circumstances to lending programs or facilities with broad-based eligibility; and vests the Board of Governors with all supervisory and rule-writing authority for savings and loan holding companies.

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, Federal agency and government-sponsored enterprise (GSE) debt securities, Federal agency and GSE mortgage-backed securities (MBS), the purchase of these securities under

**FEDERAL RESERVE BANKS
NOTES TO COMBINED FINANCIAL STATEMENTS**

agreements to resell, and the sale of these securities under agreements to repurchase. The FRBNY holds the resulting securities and agreements in a portfolio known as the System Open Market Account (SOMA). The FRBNY is authorized to lend the Treasury securities and Federal agency and GSE debt securities that are held in the SOMA.

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes the FRBNY to conduct operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities. Specifically, the FOMC authorizes and directs the FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, 14 foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico and to "warehouse" foreign currencies for the Treasury and the Exchange Stabilization Fund (ESF).

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

3. FINANCIAL STABILITY ACTIVITIES

The Reserve Banks have implemented the following programs that support the liquidity of financial institutions and foster improved conditions in financial markets.

Large-Scale Asset Purchase Programs

The FOMC authorized and directed the FRBNY to purchase \$300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The FRBNY began the purchases of these Treasury securities in March 2009 and completed them in October 2009. On August 10, 2010, the FOMC announced that the Federal Reserve will maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and Federal agency and GSE MBS in longer-term Treasury securities. On November 3, 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional \$600 billion by June 2011. The FOMC will regularly review the pace of these securities purchases and the overall size of the asset purchase program and will adjust the program as needed to best foster maximum employment and price stability.

The FOMC authorized and directed the FRBNY to purchase GSE debt securities and Federal agency and GSE MBS, with a goal to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally. The FRBNY was authorized to purchase up to \$175 billion in fixed-rate, non-callable GSE debt securities and \$1.25 trillion in fixed-rate Federal agency and GSE MBS. Purchases of GSE debt securities began in November 2008, and purchases of Federal agency and GSE MBS began in January 2009. The FRBNY completed the purchases of GSE debt securities and Federal agency and GSE MBS in March 2010. The settlement of all Federal agency and GSE MBS transactions was completed by August 2010.

Central Bank Liquidity Swaps

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which could be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements. U.S. dollar liquidity swap arrangements were authorized with 14 foreign central banks to provide liquidity in U.S. dollars to overseas markets. The authorization for these swap arrangements expired on February 1, 2010. In May 2010, U.S. dollar liquidity swap arrangements were reestablished with the Bank of Canada, the Bank of

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England, the European Central Bank, the Bank of Japan, and the Swiss National Bank; these arrangements will expire on August 1, 2011.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. The authorization for these swap arrangements expired on February 1, 2010.

Lending to Depository Institutions

The Term Auction Facility (TAF) promoted the efficient dissemination of liquidity by providing term funds to depository institutions. The last TAF auction was conducted on March 8, 2010, and the related loans matured on April 8, 2010.

Lending to Primary Dealers

The Term Securities Lending Facility (TSLF) promoted liquidity in the financing markets for Treasury securities. Under the TSLF, the FRBNY could lend up to an aggregate amount of \$200 billion of Treasury securities held in the SOMA to primary dealers on a secured basis for a term of 28 days. The authorization for the TSLF expired on February 1, 2010.

The Term Securities Lending Facility Options Program (TOP) offered primary dealers the opportunity to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program was suspended effective with the maturity of the June 2009 TOP options, and authorization for the program expired on February 1, 2010.

The Primary Dealer Credit Facility (PDCF) was designed to improve the ability of primary dealers to provide financing to participants in the securitization markets. Primary dealers could obtain secured overnight financing under the PDCF in the form of repurchase transactions. The authorization for the PDCF expired on February 1, 2010, and the last loan matured on May 13, 2009.

The Transitional Credit Extension (TCE) program provided liquidity support through secured loans to broker-dealers that were in the process of transitioning to the bank holding company structure. The authorization for the TCE program expired on February 1, 2010, and the last loan matured on April 29, 2009.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) provided funding to depository institutions and bank holding companies to finance the purchase of eligible high-quality asset-backed commercial paper (ABCP) from money market mutual funds. The Federal Reserve Bank of Boston administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. The authorization for the AMLF expired on February 1, 2010.

The Commercial Paper Funding Facility (CPFF program) enhanced the liquidity of the commercial paper market in the U.S. by increasing the availability of term commercial paper funding to issuers and by providing greater assurance to both issuers and investors that issuers would be able to roll over their maturing commercial paper. The authorization to purchase high-quality commercial paper through the CPFF program expired on February 1, 2010. The Commercial Paper Funding Facility LLC (CPFF) was a Delaware limited liability company formed on October 14, 2008, in connection with the implementation of the CPFF program, to purchase eligible three-month unsecured commercial paper and ABCP directly from eligible issuers using the proceeds of loans made to CPFF by the FRBNY. The FRBNY's loans to CPFF were eliminated in consolidation of CPFF into the combined financial statements. The last commercial paper purchased by the CPFF matured on April 26, 2010, and the CPFF was dissolved on August 30, 2010. CPFF's financial statements as of May 31, 2010 and for the period January 1, 2010, through May 31, 2010, and as of and for the year ended December 31, 2009 were last published on August 30, 2010.

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The Term Asset-Backed Securities Loan Facility (TALF) assisted financial markets in accommodating the credit needs of consumers and businesses of all sizes by facilitating the issuance of asset-backed securities (ABS) collateralized by a variety of consumer and business loans. The Board of Governors authorized the offering of TALF loans collateralized by newly-issued ABS and legacy commercial mortgage-backed securities (CMBS) until March 31, 2010, and TALF loans collateralized by newly-issued CMBS until June 30, 2010. Under the TALF, the FRBNY was authorized to lend up to \$200 billion to eligible borrowers.

TALF loans have maturities up to five years and are secured by eligible collateral, with the FRBNY having lent an amount equal to the value of the collateral, as determined by the Bank, less a margin. Loan proceeds were disbursed to the borrower contingent on receipt by the FRBNY's custodian of the eligible collateral, an administrative fee, and, if applicable, a margin.

The TALF loans were extended on a nonrecourse basis. If the borrower does not repay the loan, the FRBNY will enforce its rights in the collateral and may sell the collateral to TALF LLC, a Delaware limited liability company, established on February 4, 2009, for the purpose of purchasing such assets. As of December 31, 2010, the FRBNY has not enforced its rights to the collateral because there have been no defaults.

Pursuant to a put agreement with the FRBNY, TALF LLC has committed to purchase assets that secure a TALF loan at a price equal to the principal amount outstanding plus accrued but unpaid interest, regardless of the fair value of the collateral. Funding for the TALF LLC's purchases of these securities is derived first through the fees received by TALF LLC from the FRBNY for this commitment and any interest earned on its investments. In the event that such funding proves insufficient for the asset purchases that TALF LLC has committed to make under the put agreement, the Treasury committed to lend up to \$20 billion, and on March 25, 2009, the Treasury funded \$100 million. On July 19, 2010, this commitment was reduced to \$4.3 billion to reflect the fact that only \$43 billion of TALF loans were outstanding when the program closed to new lending on June 30, 2010. Treasury's loan to TALF LLC bears interest at a rate of the one-month London interbank offered rate (Libor) plus 300 basis points. In addition to Treasury's commitment, the FRBNY committed, as a senior lender, to lend up to \$180 billion to TALF LLC if it needed the funding to purchase assets pursuant to the put agreement. The FRBNY's maximum exposure was subsequently reduced to \$38.7 billion when the program closed to new lending. Any loan that the FRBNY makes to TALF LLC would be senior to any Treasury loan and would bear interest at a rate of the one-month Libor plus 100 basis points. To the extent that Treasury and the FRBNY have extended credit to TALF LLC, their loans are secured by all of the assets of TALF LLC. The FRBNY is the managing member and the controlling party of TALF LLC and will remain the controlling party as long as it retains an economic interest in TALF LLC. After TALF LLC has paid all operating expenses and principal due to the FRBNY, the remaining proceeds of the portfolio holdings will be distributed in the following order: principal due to Treasury, interest due to the FRBNY, and interest due to Treasury. Any residual cash flows will be shared between the FRBNY, which will receive 10 percent, and the Treasury, which will receive 90 percent.

Support for Specific Institutions

Bear Stearns Companies, Inc.

To facilitate the merger of The Bear Stearns Companies, Inc. (Bear Stearns) and JPMorgan Chase & Co. (JPMC), the FRBNY extended credit to Maiden Lane LLC (ML) in June 2008. ML is a Delaware limited liability company formed by the FRBNY to acquire certain assets of Bear Stearns and to manage those assets over time, in order to maximize the potential for the repayment of the credit extended to ML and to minimize disruption to the financial markets. The assets acquired by ML were valued at \$29.9 billion as of March 14, 2008, the date that the FRBNY committed to the transaction, and largely consisted of Federal agency and GSE MBS, non-agency residential mortgage-backed securities (RMBS), commercial and residential mortgage loans, and derivatives and associated hedges.

The FRBNY extended a senior loan of approximately \$28.8 billion and JPMC extended a subordinated loan of \$1.15 billion to finance the acquisition of the assets. The loans are collateralized by all of the assets of ML through a pledge to the collateral agent. The FRBNY is the sole and managing member and the controlling

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NOTES TO COMBINED FINANCIAL STATEMENTS**

party of ML and will remain as such as long as the FRBNY retains an economic interest in ML. The interest rate on the senior loan is the primary credit rate in effect from time to time. The interest rate on the JPMC subordinated loan is the primary credit rate plus 450 basis points. JPMC bears losses associated with the portfolio through its subordinated loan plus accrued interest on the loan. Once the principal and interest are paid, residual gains, if any, will be allocated to the FRBNY. The two-year accumulation period that followed the closing date for ML ended on June 26, 2010. Consistent with the terms of the ML transaction, the distributions of the proceeds realized on the asset portfolio held by ML, after payment of certain fees and expenses, now occur on a monthly basis unless otherwise directed by the Federal Reserve.

American International Group, Inc.

In September 2008, the Board of Governors authorized the FRBNY to lend to American International Group, Inc., (AIG). Initially, the FRBNY provided AIG with a revolving line of credit collateralized by the pledge of a substantial portion of the assets of AIG. Under the provisions of the original agreement, the FRBNY was authorized to lend up to \$85 billion to AIG for two years at the three-month Libor, with a floor of 350 basis points, plus 850 basis points. In addition, the FRBNY assessed AIG a one-time commitment fee of 200 basis points on the full amount of the commitment and a fee of 850 basis points per annum on the undrawn credit line. A condition of the credit agreement was that AIG would issue to a trust, for the sole benefit of the fiscal treasury, preferred shares convertible to approximately 78 percent of the issued and outstanding shares of the common stock of AIG. The AIG Credit Facility Trust (AIG Trust) was formed January 16, 2009 and the preferred shares were issued to the AIG Trust on March 4, 2009. The AIG Trust had three independent trustees who control the AIG Trust's voting and consent rights. The FRBNY cannot exercise voting or consent rights.

The Board and the Treasury announced a restructuring of the government's financial support to AIG in November 2008. As part of the restructuring, the Treasury purchased \$40 billion of newly-issued AIG preferred shares under the Troubled Asset Relief Program (TARP). The majority of the TARP funds were used to pay down AIG's debt to the FRBNY. In addition, the terms of the original credit agreement were modified to reduce the revolving line of credit to \$60 billion; reduce the interest rate to the three-month Libor with a floor of 350 basis points, plus 300 basis points; reduce the fee on undrawn funds to 75 basis points; and extend the term of the agreement to five years. The other material terms of the funding were unchanged. These revised terms were more consistent with terms generally available to other entities with similar credit risk.

Concurrent with the November 2008 restructuring of its financial support to AIG, the FRBNY established two limited liability companies (LLCs). The FRBNY extended credit to Maiden Lane II LLC (ML II), a Delaware limited liability company formed to purchase non-agency RMBS from the reinvestment pool of the securities lending portfolios of several regulated U.S. insurance subsidiaries of AIG. ML II borrowed \$19.5 billion from the FRBNY and used the proceeds to purchase non-agency RMBS that had an approximate fair value of \$20.8 billion as of October 31, 2008 from AIG's domestic insurance subsidiaries. The FRBNY is the sole and managing member and the controlling party of ML II and will remain as the controlling party as long as the FRBNY retains an economic interest in ML II. As part of the agreement, the AIG subsidiaries also received from ML II a fixed deferred purchase price of up to \$1.0 billion, plus interest on any such fixed deferred purchase price outstanding. The interest rate on the FRBNY's senior loan is one-month Libor plus 100 basis points, and the interest rate on the fixed deferred purchase price is one-month Libor plus 300 basis points. After ML II has first paid the FRBNY's senior loan, including accrued and unpaid interest, and then the fixed deferred purchase price in full, including accrued and unpaid interest, any net proceeds will be divided between the FRBNY, which is entitled to receive five-sixths, and the AIG subsidiaries, which are entitled to receive one-sixth. The FRBNY's loan and the fixed deferred purchase price payable to the AIG subsidiaries are collateralized by all of the assets of ML II through a pledge to the collateral agent.

The FRBNY also extended credit to Maiden Lane III LLC (ML III), a Delaware limited liability company formed to purchase ABS collateralized debt obligations (CDOs) from certain third-party counterparties of AIG Financial Products Corp. (AIGFP). In connection with the acquisitions, the third-party counterparties agreed to terminate their related credit default swap (CDS) contracts with AIGFP. ML III borrowed approximately \$24.3 billion from the FRBNY, and AIG provided an equity contribution of \$5 billion to ML III. The proceeds

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were used to purchase ABS CDOs with a fair value of \$29.6 billion. The counterparties received \$26.8 billion net of principal, interest received, and finance charges paid. ML III also made a payment to AIGFP of \$2.5 billion, representing the return of excess collateral previously posted by AIGFP with the counterparties. The FRBNY is the managing member and the controlling party of ML III and will remain as the controlling party as long as the FRBNY retains an economic interest in ML III. Net proceeds received by ML III will first be applied to repay the FRBNY's senior loan plus interest at one-month Libor plus 100 basis points. The FRBNY's senior loan is collateralized by all of the assets of ML III through a pledge to the collateral agent. After the FRBNY is paid in full, AIG, or its assignee, is entitled to receive repayment of its equity contribution plus interest at the one-month Libor plus 300 basis points. After ML III has paid the FRBNY's senior loan and AIG's equity contribution in full, the FRBNY will be entitled to receive 67 percent of any additional net proceeds received by ML III as a contingent interest on the senior loan and AIG, or its assignee, will be entitled to receive 33 percent of any net proceeds received by ML III as contingent distributions on its equity interest.

On April 17, 2009, the FRBNY, as part of the U.S. government's commitment to the orderly restructuring of AIG over time, in the face of continuing market dislocations, further restructured the AIG loan by eliminating the 350 basis-point floor on the Libor used to calculate the interest rate on the loan. The interest rate on the modified loan is the three-month Libor plus 300 basis points.

On December 1, 2009, the FRBNY's commitment to lend to AIG was reduced to \$35 billion from \$60 billion when the outstanding balance of the FRBNY's loan to AIG was reduced by \$25 billion in exchange for a liquidation preference of nonvoting perpetual preferred interests in two limited liability companies. AIG created these limited liability companies to hold, directly or indirectly, all of the outstanding common stock of American Life Insurance Company (ALICO) and American International Assurance Company Ltd. (AIA), two life insurance holding company subsidiaries of AIG. The FRBNY was to be paid a 5 percent cumulative dividend on its nonvoting preferred interests through September 22, 2013 and a 9 percent cumulative dividend thereafter. Although the FRBNY had certain governance rights to protect its interests, AIG retained control of the LLCs and the underlying operating companies. The initial value of the FRBNY's preferred interests as of December 1, 2009 was \$16 billion for the AIA Aurora LLC (AIA LLC) and \$9 billion for the ALICO Holdings LLC (ALICO LLC), which represented a percentage of the fair market value of AIA and ALICO, respectively.

On September 30, 2010, AIG announced an agreement with the Treasury, FRBNY, and the trustees of the AIG Trust on a comprehensive recapitalization plan designed to repay all its obligations to American taxpayers. The agreement included an accelerated repayment of the outstanding balance of the FRBNY revolving line of credit including all accrued interest and fees, termination of that facility, the repayment of the FRBNY's preferred interests in AIA LLC and ALICO LLC, and the conversion of the AIG preferred stock currently owned by the Treasury and the AIG Trust into common equity of AIG.

Pending the closing of the recapitalization plan, the cash proceeds from certain AIG asset dispositions were held by the FRBNY as agent. On October 29, 2010, AIG completed the initial public offering (IPO) of AIA, successfully obtaining a listing on the Hong Kong Stock Exchange and raising total gross proceeds of \$20.5 billion. On November 1, 2010, AIG completed the sale of ALICO to MetLife, initially announced on March 8, 2010, for approximately \$15.5 billion, including \$6.8 billion in cash and the remainder in equity and equity-linked securities of MetLife.

On January 14, 2011, upon closing of the recapitalization plan, the cash proceeds from certain asset dispositions, specifically the initial public offering of AIA and the sale of ALICO, were used first to repay in full the revolving line of credit extended to AIG by the FRBNY, including accrued interest and fees, and then to redeem a portion of the FRBNY's preferred interests in ALICO LLC taken earlier by the FRBNY in satisfaction of a portion of the revolving line of credit. The remaining FRBNY preferred interests in ALICO LLC and AIA LLC, valued at approximately \$20 billion, were purchased by AIG through a draw on the Treasury's Series F preferred stock commitment and then transferred by AIG to the Treasury as partial consideration for the transfer to AIG of all outstanding Series F shares. In addition, the FRBNY's commitment to lend any funds under the revolving line of credit was terminated.

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Citigroup, Inc.

The Board of Governors, the Treasury, and the Federal Deposit Insurance Corporation (FDIC) (parties) jointly announced on November 23, 2008, that they would provide financial support to Citigroup, Inc. (Citigroup). The agreement, which was executed on January 16, 2009, provided funding support for possible future principal losses relating to a designated pool of up to \$301 billion of Citigroup's assets. The funding support was for a period of 10 years for residential assets and 5 years for nonresidential assets. No funding support was provided to Citigroup under this agreement, and on December 23, 2009, the parties terminated the agreement. As a result, the Bank had no contractual obligation at December 31, 2010 or 2009. As consideration for terminating the agreement, Citigroup paid the FRBNY a \$50 million termination fee and reimbursed the FRBNY for its out-of-pocket expenses. The termination fee was recognized during the year-ended December 31, 2009, and is reported as a component of "Other income" in the Consolidated Statements of Income.

Bank of America Corporation

The Board of Governors, the Treasury, and the FDIC (parties) jointly announced on January 15, 2009 that they would provide financial support to Bank of America Corporation (Bank of America). Under this arrangement, the Federal Reserve Bank of Richmond (FRBR) would have provided funding support for possible future principal losses relating to a designated pool of up to \$118 billion of financial instruments. On September 21, 2009, the parties announced that they had reached an agreement with Bank of America to terminate the agreement. As part of the termination of the agreement, Bank of America paid \$57 million in compensation for out-of-pocket expenses incurred by the FRBR and for commitment fees required by the agreement.

4. SIGNIFICANT ACCOUNTING POLICIES

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

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

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In addition, the Reserve Banks do not present a Combined Statement of Cash Flows as required by GAAP because the liquidity and cash position of the Reserve Banks are not a primary concern given the Reserve Banks' unique powers and responsibilities. Other information regarding the Reserve Banks' activities is provided in, or may be derived from, the Combined Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the FAM and GAAP.

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

a. Consolidation

The combined financial statements include the accounts and results of operations of the Reserve Banks as well as several variable interest entities (VIEs), which include ML, ML II, ML III, CPFF, and TALF LLC. The consolidation of the VIEs was assessed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810 (ASC 810) *Consolidation*, which requires a variable interest entity to be consolidated by its controlling financial interest holder. Intercompany balances and transactions have been eliminated in consolidation.

A Reserve Bank consolidates a VIE if it has a controlling financial interest, which is defined as the power to direct the significant economic activities of the entity and the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the VIE. To determine whether it is the controlling financial interest holder of a VIE, the Reserve Bank evaluates the VIE's design, capital structure, and relationships with the variable interest holders. The Reserve Bank reconsiders whether it has a controlling financial interest in a VIE, as required by ASC 810, at each reporting date.

The Dodd-Frank Act established the Bureau as an independent bureau within the Federal Reserve System, and section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the Federal Reserve System. Section 152 of the Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury. The Board of Governors funds the Bureau and OFR through assessments on the Reserve Banks as required by the Dodd-Frank Act. The Reserve Banks reviewed the law and evaluated the design of and their relationships to the Bureau and the OFR and determined that neither should be consolidated in the Reserve Banks' combined financial statements.

b. Gold and Special Drawing Rights Certificates

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

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

FEDERAL RESERVE BANKS
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Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. SDRs are recorded by the Reserve Banks at original cost. In 2009, the Treasury issued \$3 billion in SDR certificates to the Reserve Banks. There were no SDR transactions in 2010.

c. Coin

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

d. Loans

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

The FRBNY records the TALF loans at fair value in accordance with the fair value option provisions of FASB ASC Topic 825 (ASC 825) *Financial Instruments*. Unrealized gains (losses) on TALF loans that are recorded at fair value are reported as "Non-interest income (loss): Term Asset-Backed Securities Loan Facility, unrealized gains (losses)" in the Combined Statements of Income and Comprehensive Income. The interest income on TALF loans is recognized based on the contracted rate and is reported as a component of "Interest Income: Term Asset-Backed Securities Loan Facility" in the Combined Statements of Income and Comprehensive Income. Administrative fees paid by borrowers at the initiation of each TALF loan, which are recognized as incurred and not deferred, are reported as a component of "Non-interest income (loss): Other income" in the Combined Statements of Income and Comprehensive Income.

The loan to AIG is reported at the outstanding principal balance net of unamortized administrative and commitment fees, and interest income is recognized on an accrual basis. Loan administrative and commitment fees are deferred and amortized on a straight-line basis, rather than using the interest method required by GAAP, over the term of the loan or commitment period. This method results in an interest amount that approximates the amount determined using the interest method.

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

Impaired loans include loans that have been modified in debt restructurings involving borrowers experiencing financial difficulties. The allowance for loan restructuring is determined by discounting the restructured cash flows using the original effective rate for the loan. Unless the borrower can demonstrate that it can meet the restructured terms, the Reserve Banks discontinue recognizing interest income. Performance

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prior to the restructuring, or significant events that coincide with the restructuring, are considered in assessing whether the borrower can meet the new terms.

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a tri-party arrangement. In a tri-party arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the FRBNY and counterparty. The collateral pledged must exceed the principal amount of the transaction by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including TIPS and STRIP Treasury securities); direct obligations of several Federal agency and GSE-related agencies, including Fannie Mae and Freddie Mac; and pass-through MBS of Fannie Mae, Freddie Mac, and Ginnie Mae. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. Repurchase transactions are reported at their contractual amount as "System Open Market Account: Securities purchased under agreements to resell," and the related accrued interest receivable is reported as a component of "Accrued interest receivable" in the Combined Statements of Condition.

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and, beginning August 2010, with selected money market funds as an open market operation. These reverse repurchase transactions may be executed through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, and Federal agency and GSE MBS that are held in the SOMA. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts as "System Open Market Account: Securities sold under agreements to repurchase" and the related accrued interest payable is reported as a component of "Other liabilities" in the Combined Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income" in the Combined Statements of Income and Comprehensive Income.

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

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

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

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based on average cost. Treasury securities, GSE debt securities, and Federal agency and GSE MBS are reported net of premiums and discounts on the Combined Statements of Condition and interest income on those securities is reported net of the amortization of premiums and accretion of discounts on the Combined Statements of Income and Comprehensive Income.

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the FRBNY entered into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell “to be announced” (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. The FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. The FRBNY’s participation in the dollar roll and coupon swap markets furthered the MBS purchase program goal of providing support to the mortgage and housing markets and fostered improved conditions in financial markets more generally. The FRBNY accounted for outstanding commitments under dollar roll and coupon swaps on a settlement-date basis. Based on the terms of the FRBNY dollar roll and coupon swap transactions, transfers of MBS upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Transfers and Servicing*, and the related outstanding commitments are accounted for as sales or purchases upon settlement. Net gains (losses) resulting from dollar roll and coupon swap transactions are reported as “Non-interest income (loss): System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains (losses), net” in the Combined Statements of Income and Comprehensive Income.

Foreign currency denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on foreign currency denominated assets are reported as “Foreign currency gains, net” in the Combined Statements of Income and Comprehensive Income.

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

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

The FRBNY is authorized to hold foreign currency working balances and execute foreign exchange contracts to facilitate international payments and currency transactions it makes on behalf of foreign central bank and U.S. official institution customers. These foreign currency working balances and contracts are not related to the Bank's monetary policy operations. Foreign currency working balances are reported as a component of “Other assets” in the Consolidated Statements of Condition and the related foreign currency valuation gains and losses that result from the daily revaluation of the foreign currency working balances and contracts are reported as a component of “Non-interest income (loss): Other income” in the Combined Statements of Income and Comprehensive Income.

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as "Interest income: Central bank liquidity swaps" in the Combined Statements of Income and Comprehensive Income.

Foreign currency liquidity swaps

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

h. Investments Held by Consolidated Variable Interest Entities

The investments held by consolidated VIEs include investments in Federal agency and GSE MBS, non-agency RMBS, commercial and residential real estate mortgage loans, CDOs, commercial paper, other investment securities, other real estate owned, and derivatives and associated hedges. Investments are reported as "Consolidated variable interest entities: Investments held by consolidated variable interest entities" in the Combined Statements of Condition. These investments are accounted for and classified as follows:

- Commercial paper held by the CPFF was designated as held-to-maturity under FASB ASC Topic 320 (ASC 320) *Investments – Debt and Equity Securities* according to the terms of the CPFF program. The FRBNY had the positive intent and the ability to hold the securities to maturity, and, therefore, the commercial paper was recorded at amortized cost. The amortization of premiums and accretion of discounts was recorded on a straight-line basis, which was not materially different from the interest method. All other investments, consisting of short-term highly liquid assets, held by the CPFF were classified as trading securities under ASC 320 and were recorded at fair value.
- ML's investments in debt securities are accounted for in accordance with ASC 320 and ML elected the fair value option for all eligible assets and liabilities in accordance with ASC 825. Other financial instruments, including swap contracts and other derivatives instruments in ML, are recorded at fair value in accordance with FASB ASC Topic 815 (ASC 815) *Derivatives and Hedging*. Other real estate owned may be acquired by ML as a result of default on the related loan. Other real estate owned are considered held-for-sale, and are recorded initially at fair value, less estimated selling costs, in accordance with FASB ASC Topic 360 (ASC 360) *Property, Plant, and Equipment*. Consistent with the requirements of ASC 360, the assets are not depreciated, and are adjusted for subsequent changes in fair value up to the original fair value basis.

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- ML II and ML III qualify as nonregistered investment companies under the provisions of FASB ASC Topic 946 (ASC 946) *Financial Services – Investment Companies* and, therefore, all investments are recorded at fair value in accordance with ASC 946.
- TALF LLC follows the guidance in ASC 320 when accounting for any acquired ABS investments, and has elected the fair value option for all eligible assets in accordance with ASC 825.

i. Preferred Interests

The FRBNY presents its preferred interests in AIA LLC and ALICO LLC at cost consistent with ASC 320. The 5 percent cumulative dividends accrued by the FRBNY on the preferred interests are reported as “Dividends on preferred interests” on the Combined Statements of Income and Comprehensive Income. On a quarterly basis, the accrued dividends are capitalized and increase the recorded cost of the FRBNY’s preferred interests in AIA LLC and ALICO LLC. A preferred interest is impaired if its fair value falls below its recorded value and the decline is considered other-than-temporary. An other-than-temporary impairment occurs if (1) the FRBNY has the intent to sell the interest, (2) it is more likely than not that the FRBNY will be required to sell the interest before recovery of its recorded investment, or (3) the FRBNY does not expect to recover the entire amortized cost basis of the interest even if it does not intend to sell the security. Dividends are accrued unless the impairment analysis indicates that the dividends will not be collected.

j. Bank Premises, Equipment, and Software

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

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

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

k. Federal Reserve Notes

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

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

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Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government.

“Federal Reserve notes outstanding, net” in the Combined Statements of Condition represents the Federal Reserve notes outstanding, reduced by the Reserve Banks’ currency holdings of \$180 billion and \$193 billion at December 31, 2010 and 2009, respectively.

At December 31, 2010 and 2009, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2010, all gold certificates, all special drawing right certificates, and \$925 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2010, no investments denominated in foreign currencies were pledged as collateral.

I. Beneficial Interest in Consolidated Variable Interest Entities

ML, ML II, and ML III have outstanding senior and subordinated financial interests, inclusive of a fixed deferred purchase price in ML II and an equity contribution in ML III, and TALF LLC has an outstanding financial interest. Upon issuance of the financial interests, ML, ML II, ML III, and TALF LLC each elected to measure these obligations at fair value in accordance with ASC 825. Principal, interest, and changes in fair value on the senior financial interest, which were extended by the FRBNY, are eliminated in consolidation. The financial interests are recorded at fair value as “Beneficial interest in consolidated variable interest entities” in the Combined Statements of Condition. Interest expense and changes in fair value of the financial interest are recorded in “Interest expense: Beneficial interest in consolidated variable interest entities” and “Non-interest income (loss): Beneficial interest in consolidated variable interest entities (losses), net,” respectively, in the Combined Statements of Income and Comprehensive Income.

m. Deposits

Depository Institutions

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as “Interest payable to depository institutions” on the Combined Statements of Condition. There were no deposits held by the Reserve Banks under the TDF at December 31, 2010.

Treasury

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

The Treasury’s temporary supplementary financing program consists of a series of Treasury bill auctions, in addition to Treasury’s standard borrowing program. The proceeds of this debt are held in an account at the FRBNY that is separate from the Treasury’s general account, and this separate account is reported as “Treasury, supplementary financing account” in the Combined Statements of Condition. The purpose of placing funds in this account is to drain reserves from the banking system and partially offset the reserve impact of the Reserve Banks’ lending and liquidity initiatives.

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Other

Other deposits include foreign central bank and foreign government deposits held at the FRBNY. Other deposits also include GSE deposits held by the Bank.

n. *Funds from American International Group, Inc. asset dispositions, held as agent*

Pending the closing of the AIG recapitalization plan discussed in Note 3, the cash proceeds from certain AIG asset dispositions were held by the FRBNY as agent.

o. *Items in Process of Collection and Deferred Credit Items*

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

p. *Capital Paid-in*

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to 6 percent of the capital and surplus of the member bank. These shares are nonvoting with a par value of \$100 and may not be transferred or hypothecated. As a member bank’s capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid in and the remainder is subject to call. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

By law, each Reserve Bank is required to pay each member bank an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. To meet the Federal Reserve Act requirement that annual dividends be deducted from net earnings, dividends are presented as a distribution of comprehensive income in the Combined Statements of Income and Comprehensive Income.

q. *Surplus*

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. Accumulated other comprehensive income is reported as a component of “Surplus” in the Combined Statements of Condition and the Combined Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 13, 14, and 15.

r. *Interest on Federal Reserve Notes*

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as “Payments to Treasury as interest on Federal Reserve notes” in the Combined Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as “Accrued interest on Federal Reserve notes” in the Combined Statements of Condition.

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

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In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the Treasury in the following year.

s. *Income and Costs Related to Treasury Services*

When directed by the Secretary of the Treasury, the Reserve Banks are required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2010 and 2009, the Reserve Banks were reimbursed for substantially all services provided to the Treasury as its fiscal agent.

t. *Assessments*

The Board of Governors assesses the Reserve Banks to fund its operations and the operations of the Bureau and, for a two-year period, the OFR. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year for the Board of Governor's operations and as of the most recent quarter for the Bureau and OFR operations. The Board of Governors also assesses each Reserve Bank for the expenses incurred by the Treasury to produce and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

During the period prior to the Bureau transfer date of July 21, 2011, there is no limit on the funding that can be provided to the Bureau and that is assessed to the Reserve Banks; the Board of Governors must provide the amount estimated by the Secretary of the Treasury needed to carry out the authorities granted to the Bureau under the Dodd-Frank Act and other federal law. After the transfer date, the Dodd-Frank Act requires the Board of Governors to fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the Federal Reserve System as reported in the Board of Governors' 2009 annual report. The fixed percentage of total operating expenses of the System is 10% for 2011, 11% for 2012, and 12% for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act.

The Board of Governors assesses the Reserve Banks to fund the operations of the OFR for the two-year period following enactment of the Dodd-Frank Act; thereafter, the OFR will be funded by fees assessed on certain bank holding companies.

u. *Fair Value*

Certain assets and liabilities reported on the Reserve Banks' Combined Statements of Condition are measured at fair value in accordance with ASC 820, including TALF loans, investments and beneficial interests of the consolidated VIE's, and assets of the Retirement Plan for Employees of the Federal Reserve System. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level fair value hierarchy that distinguishes between assumptions developed using market data obtained from independent sources (observable inputs) and the Reserve Bank's assumptions developed using the best information available in the circumstances (unobservable inputs). The three levels established by ASC 820 are described as follows:

- Level 1 – Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is based on model-based techniques that use significant inputs and assumptions not observable in the market. These unobservable inputs and assumptions reflect

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the Reserve Bank's estimates of inputs and assumptions that market participants would use in pricing the assets and liabilities. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

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

v. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Reserve Banks' real property taxes were \$41 million and \$37 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Combined Statements of Income and Comprehensive Income.

w. Restructuring Charges

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

Note 16 describes the Reserve Banks' restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain Reserve Banks' assets are discussed in Note 11. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY and discussed in Note 13. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 14.

x. Recently Issued Accounting Standards

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) 166, *Accounting for Transfers of Financial Assets – an amendment to FASB Statement No. 140*, (codified in ASC 860). The new standard revises the criteria for recognizing transfers of financial assets as sales and clarifies that the transferor must consider all arrangements when determining if the transferor has surrendered control. The adoption of this accounting guidance was effective for the Reserve Banks for the year beginning on January 1, 2010, and did not have a material effect on the Reserve Banks' combined financial statements.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, (codified in ASC 810), which expands the scope of Interpretation 46R, *Consolidation of Variable Interest Entities* and changes the approach for determining whether an entity has a controlling interest in a VIE by making a qualitative assessment of its financial interests. Additional disclosures are required for a variable interest in a VIE. The adoption of this accounting guidance was effective for the Reserve Banks for the year beginning on January 1, 2010, and earlier adoption was prohibited. The adoption of this accounting guidance did not have a material effect on the Reserve Banks' combined financial statements.

In January 2010, the FASB issued Accounting Standards Update 2010-06, *Fair Value Measurements and Disclosures* (Topic 820). New requirements for disclosure of information about transfers among the hierarchy's classification and the level of disaggregation of classes of assets were effective for the Reserve Banks for the year beginning on January 1, 2010, and the required disclosures are included in Note 5, Note 9, and Note 13. Other requirements, including the gross presentation of purchases, sales, issuances, and settlements in the reconciliation for Level 3 fair value measurements are effective for the Reserve Banks

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in 2011 and are not expected to have a material effect on the Reserve Banks' combined financial statements.

In March 2010, the FASB issued Accounting Standards Update 2010-11, *Derivatives and Hedging*, (Topic 815), which clarifies embedded credit derivatives that are subject to the FASB's guidance on derivatives and hedging and defines the embedded credit derivatives that are required to be evaluated for bifurcation and separate accounting. The adoption of this accounting guidance was effective for the Reserve Banks on July 1, 2010 and did not have a material effect on the Reserve Banks' combined financial statements.

In July 2010, the FASB issued Accounting Standards Update 2010-20, *Receivables* (Topic 310), which requires additional disclosures about the allowance for credit losses and the credit quality of loan portfolios. The additional disclosures include a rollforward of the allowance for credit losses on a disaggregated basis and more information, by type of receivable, on credit quality indicators, including the amount of certain past due receivables and troubled debt restructurings and significant purchases and sales. The adoption of this accounting guidance is effective for the Reserve Banks on December 31, 2011, and is not expected to have a material effect on the Reserve Banks' combined financial statements.

5. LOANS

The remaining maturity distribution of loans outstanding at December 31, 2010, and total loans outstanding at December 31, 2009, were as follows (in millions):

	2010			2009	
	Within 15 days	16 days to 90 days	Over 1 year to 5 years	Total	Total
Primary, secondary, and seasonal credit	\$ 215	\$ 6	\$ -	\$ 221	\$ 20,700
TAF	-	-	-	-	\$ 75,918
Loans to depository institutions	<u>\$ 215</u>	<u>\$ 6</u>	<u>\$ -</u>	<u>\$ 221</u>	<u>\$ 96,618</u>
TALF loans, fair value	\$ -	\$ -	\$ 24,853	\$ 24,853	\$ 48,183
AIG loan, net	\$ -	\$ -	\$ 20,603	\$ 20,603	\$ 21,250

Loans to Depository Institutions

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

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of each Reserve Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; asset-backed securities (ABS); corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by each Reserve Bank, which is typically fair value reduced by a margin.

Depository institutions that are eligible to borrow under the Reserve Banks' primary credit program were eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conducted auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans were extended on a short-term basis, with terms ranging from 28 to 84 days. All advances under the TAF program were collateralized to the satisfaction of each Reserve Bank. All TAF loan principal and accrued interest was fully repaid.

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Loans to depository institutions are monitored daily to ensure that borrowers continue to meet eligibility requirements for these programs. The financial condition of borrowers is monitored by the Reserve Banks and, if a borrower no longer qualifies for these programs, the Reserve Banks will generally request full repayment of the outstanding loan or, for primary or seasonal credit lending, may convert the loan to a secondary credit loan.

Collateral levels are reviewed daily against outstanding obligations and borrowers that no longer have sufficient collateral to support outstanding loans are required to provide additional collateral or to make partial or full repayment.

At December 31, 2010 and 2009, the Reserve Banks did not have any impaired loans and no allowances for loan losses were required. There were no impaired loans during the years ended December 31, 2010 and 2009.

TALF

TALF loans are non-recourse loans secured by eligible collateral. Each TALF loan has a three-year maturity, except loans secured by SBA Pool Certificates, loans secured by SBA Development Company Participation Certificates, or ABS backed by student loans or commercial mortgage loans, which have a five-year maturity if the borrower so elects.

The FRBNY has elected the fair value option for all TALF loans in accordance with ASC 825. Recording all TALF loans at fair value, rather than at the remaining principal amount outstanding, improves accounting consistency and provides the most appropriate presentation on the financial statements by matching the change in fair value of TALF loans, the related put agreement with TALF LLC, and the valuation of the beneficial interests in TALF LLC. Information regarding the TALF LLC's assets and liabilities is presented in Note 9.

In certain cases where there is limited activity around inputs to the valuation, loans are classified within Level 3 of the valuation hierarchy. Because external price information was not available, market-based models were used to determine the fair value of the TALF loans. The fair value of the TALF loans was determined by valuing the future cash flows from loan interest income and the estimated fair value losses associated with collateral that may be put to the FRBNY. The valuation model takes into account a range of outcomes on TALF loan repayments, market prices of the collateral, risk premiums estimated using market prices, and the volatilities of market risk factors. Other methodologies employed or assumptions made in determining fair value could result in an amount that differs significantly from the amount reported.

The following table presents the TALF loans at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2010	2009
Level 3	\$ 24,853	\$ 48,183
Total fair value	<u>\$ 24,853</u>	<u>\$ 48,183</u>

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The following table presents a reconciliation of TALF loans measured at fair value using significant unobservable inputs (Level 3) during the year-ended December 31, 2010 and for the period February 4, 2009, to December 31, 2009, (in millions):

	<u>TALF Loans</u>
Fair value at February 4, 2009	\$ -
Net loans originated	61,626
Loan repayments and prepayments	(14,000)
Total realized and unrealized gains (losses)	<u>557</u>
Fair value at December 31, 2009	<u>\$ 48,183</u>
Net loans originated	9,484
Loan repayments and prepayments	(32,378)
Total realized and unrealized gains (losses)	<u>(436)</u>
Fair value at December 31, 2010	<u>\$ 24,853</u>

The fair value of TALF loans reported in the Combined Statements of Condition as of December 31, 2010 and 2009 includes \$121 million and \$557 million in unrealized gains, respectively. FRBNY attributes substantially all changes in fair value of non-recourse loans to changes in instrument-specific credit spreads.

Eligible collateral includes U.S. dollar-denominated ABS that are backed by auto loans, student loans, credit card loans, equipment loans, floorplan loans, insurance premium financial loans, loans guaranteed by the SBA, residential mortgage servicing advances, or commercial mortgage loans. To be considered eligible, collateral must have a credit rating in the highest investment-grade rating category from at least two eligible nationally-recognized statistical rating organizations (NRSROs) and must not have a credit rating below the investment-grade rating category from an eligible NRSRO. In addition to the aforementioned eligibility requirements, collateral also must meet other criteria as stipulated in the TALF program's terms and conditions. The following table presents the collateral concentration and maturity distribution for the remaining unpaid principal and accrued interest as of December 31, 2010 (in millions):

Collateral type and credit rating ¹	<u>Years to maturity</u>		
	<u>1 - 3</u>	<u>4 - 5</u>	<u>Total</u>
Student Loan	\$ 2,427	\$ 4,556	\$ 6,983
Credit Card	6,918	-	6,918
CMBS	2,504	1,725	4,229
Floorplan	2,489	-	2,489
Auto	1,673	-	1,673
SBAs	424	228	652
Other ²	1,788	-	1,788
Total	<u>\$ 18,223</u>	<u>\$ 6,509</u>	<u>\$ 24,732</u>

¹ All credit ratings are AAA.

² Includes equipment loans, insurance premium financial loans, and residential mortgage servicing advances.

The aggregate remaining principal amount outstanding on TALF loans as of December 31, 2010 and 2009, was \$24,703 million and \$47,574 million, respectively.

At December 31, 2010 and 2009, no TALF loans were over 90 days past due or in nonaccrual status.

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Earnings reported by the FRBNY related to the TALF include income and unrealized gains and losses on TALF loans as well as the FRBNY's allocated share of the TALF LLC's net income. Additional information regarding the income of the TALF LLC is presented in Note 9. The following table presents the components of TALF earnings recorded by the FRBNY for the years ended December 31 (in millions):

	2010	2009
Interest income	\$ 750	\$ 414
Administrative fee income	13	54
Unrealized gains (losses)	(436)	557
Total income on TALF loans	<u>\$ 327</u>	<u>\$ 1,025</u>
Allocated share of TALF LLC	71	(702)
Earnings of TALF	<u>\$ 398</u>	<u>\$ 323</u>

AIG loan, net

The following table presents the components of the AIG loan at December 31 (in millions):

Loan components	2010	2009
Line of credit drawn	\$ 14,621	\$ 17,900
Capitalized interest	4,663	3,835
Capitalized commitment fees	1,700	1,700
AIG loan, gross	<u>\$ 20,984</u>	<u>\$ 23,435</u>
Unamortized deferred commitment fees	(335)	(697)
Allowance for loan restructuring, net	(46)	(1,488)
AIG loan, net	<u>\$ 20,603</u>	<u>\$ 21,250</u>

The fair value of the AIG revolving line of credit provided by the FRBNY, based on estimated and actual draws and repayments, was not materially different from the net amount reported in the Combined Statements of Condition as of December 31, 2010 and 2009.

The activity related to the allowance for AIG loan restructuring for the years-ended December 31 was as follows (in millions):

	2010	2009
Allowance for loan restructuring January 1	\$ (1,488)	\$ -
Provision for loan restructuring	-	(2,621)
Adjustments to the allowance	1,442	1,133
Allowance for loan restructuring December 31	<u>\$ (46)</u>	<u>\$ (1,488)</u>

The allowance for loan restructuring represented the economic effect of the reduction of the interest rate on loans the FRBNY made to AIG prior to April 17, 2009 as part of the loan restructuring that occurred on that date. The restructuring charges were recovered over the remaining term of the related loan as adjustments to the allowance, which resulted from periodic evaluations and are reported as a component of "Interest income: American International Group, Inc., net" on the Combined Statements of Income and Comprehensive Income. The average balance of the loans to AIG under the revolving line of credit, net of the allowance for restructuring, during the year ended December 31, 2010 and 2009, was \$22,874 million and \$39,099 million, respectively.

As a result of the closing of the AIG recapitalization plan on January 14, 2011, all outstanding draws under the revolving line of credit and the related accrued interest, capitalized interest and capitalized commitment fees

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were paid in full. The remaining amount of the unamortized deferred commitment fees and the allowance for loan restructuring as of the closing of the recapitalization were fully recognized at that date.

6. TREASURY SECURITIES; GOVERNMENT-SPONSORED ENTERPRISE DEBT SECURITIES; FEDERAL AGENCY AND GOVERNMENT-SPONSORED ENTERPRISE MORTGAGE-BACKED SECURITIES; SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL; SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE; AND SECURITIES LENDING

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA.

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

	2010				
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost	Fair value
Bills	\$ 18,423	\$ -	\$ (1)	\$ 18,422	\$ 18,422
Notes	773,284	14,056	(765)	786,575	804,703
Bonds	229,786	32,739	(570)	261,955	289,757
Total Treasury securities	<u>\$ 1,021,493</u>	<u>\$ 46,795</u>	<u>\$ (1,336)</u>	<u>\$ 1,066,952</u>	<u>\$ 1,112,882</u>
GSE debt securities	<u>\$ 147,460</u>	<u>\$ 5,532</u>	<u>\$ (20)</u>	<u>\$ 152,972</u>	<u>\$ 156,780</u>
Federal agency and GSE MBS	<u>\$ 992,141</u>	<u>\$ 14,106</u>	<u>\$ (1,552)</u>	<u>\$ 1,004,695</u>	<u>\$ 1,026,003</u>
	2009				
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost	Fair value
Bills	\$ 18,423	\$ -	\$ -	\$ 18,423	\$ 18,422
Notes	568,323	6,544	(991)	573,876	583,040
Bonds	189,843	24,460	(630)	213,673	230,717
Total Treasury securities	<u>\$ 776,589</u>	<u>\$ 31,004</u>	<u>\$ (1,621)</u>	<u>\$ 805,972</u>	<u>\$ 832,179</u>
GSE debt securities	<u>\$ 159,879</u>	<u>\$ 7,509</u>	<u>\$ (26)</u>	<u>\$ 167,362</u>	<u>\$ 167,444</u>
Federal agency and GSE MBS	<u>\$ 908,371</u>	<u>\$ 12,110</u>	<u>\$ (1,554)</u>	<u>\$ 918,927</u>	<u>\$ 914,290</u>

The fair value amounts in the above tables are presented solely for informational purposes. Although the fair value of security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value of Federal agency and GSE MBS was determined using a model-based approach that considers observable inputs for similar securities; fair value for all other SOMA security holdings was determined by reference to quoted prices for identical securities.

The fair value of the fixed-rate Treasury securities, GSE debt securities, and Federal agency and GSE MBS in the SOMA's holdings is subject to market risk, arising from movements in market variables, such as interest rates and securities prices. The fair value of Federal agency and GSE MBS is also affected by the rate of prepayments of mortgage loans underlying the securities.

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

Distribution of MBS holdings by coupon rate	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
SOMA:				
3.5%	\$ 341	\$ 352	\$ 363	\$ 365
4.0%	167,675	168,403	170,119	165,740
4.5%	497,672	508,798	434,352	431,646
5.0%	231,420	237,545	195,418	196,411
5.5%	93,119	95,873	103,379	104,583
6.0%	12,910	13,376	12,710	12,901
6.5%	1,558	1,656	2,586	2,644
Total	\$ 1,004,695	\$ 1,026,003	\$ 918,927	\$ 914,290

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	Securities purchased under agreements to resell		Securities sold under agreements to repurchase	
	2010	2009	2010	2009
Contract amount outstanding, end of year	\$ -	\$ -	\$ 59,703	\$ 77,732
Average daily amount outstanding, during the year	-	3,616	58,476	67,837
Maximum balance outstanding, during the year	-	80,000	77,732	89,525
Securities pledged (par value), end of year	-	-	43,642	77,860

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value. The FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed primarily to temporarily drain reserve balances from the banking system.

The remaining maturity distribution of Treasury securities, GSE debt securities, Federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase at December 31, 2010 was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	\$ 9,802	\$ 24,816	\$ 54,254	\$ 439,594	\$ 333,955	\$ 159,072	\$ 1,021,493
GSE debt securities (par value)	1,129	13,836	28,501	71,050	30,597	2,347	\$ 147,460
Federal agency and GSE MBS (par value)	-	-	-	24	20	992,097	\$ 992,141
Securities sold under agreements to repurchase (contract amount)	59,703	-	-	-	-	-	\$ 59,703

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2010, which differs from the stated maturity primarily because it factors in prepayment assumptions, is approximately 4.2 years.

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

	SOMA	
	2010	2009
Treasury securities	\$ 22,081	\$ 20,502
GSE debt securities	1,610	1,108

Other investments consist of cash and short-term investments related to the Federal agency and GSE MBS portfolio. Other liabilities, which are related to purchases of Federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the Reserve Banks have ownership of and records their investments in the MBS as of the contractual settlement date, they are not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Reserve Banks' obligation to pay for the securities when delivered. The amount of other investments and other liabilities held in the SOMA at December 31 was as follows (in millions):

	2010	2009
Other investments	\$ -	\$ 5
Other liabilities	-	601

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. There were no commitments to buy Treasury and GSE debt securities as of December 31, 2010.

The FRBNY enters into commitments to buy Federal agency and GSE MBS and records the related MBS on a settlement-date basis. There were no commitments to buy or sell Federal agency or GSE MBS as of December 31, 2010.

During the years ended December 31, 2010 and 2009, the Reserve Banks recorded net gains from dollar roll and coupon swap related transactions of \$782 million and \$879 million, respectively. These net gains are reported as "Non-interest income (loss): Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Combined Statements of Income and Comprehensive Income.

7. FOREIGN CURRENCY DENOMINATED ASSETS

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

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The Reserve Bank's foreign currency denominated assets, including accrued interest, valued at amortized cost and foreign currency market exchange rates at December 31 was as follows (in millions):

	<u>2010</u>	<u>2009</u>
Euro:		
Foreign currency deposits	\$ 7,057	\$ 7,396
Securities purchased under agreements to resell	2,467	2,591
Government debt instruments	4,603	4,936
Japanese yen:		
Foreign currency deposits	3,883	3,403
Government debt instruments	8,039	6,946
Total	<u>\$ 26,049</u>	<u>\$ 25,272</u>

At December 31, 2010 and 2009, the fair value of foreign currency denominated assets, including accrued interest, was \$26,213 million and \$25,480 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the Treasury securities, GSE debt securities, and Federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value is presented solely for informational purposes.

The remaining maturity distribution of foreign currency denominated assets at December 31, 2010, was as follows (in millions):

	<u>Within 15 days</u>	<u>16 days to 90 days</u>	<u>91 days to 1 year</u>	<u>Over 1 year to 5 years</u>	<u>Total</u>
Euro	\$ 5,422	\$ 3,000	\$ 2,023	\$ 3,682	\$ 14,127
Japanese yen	4,102	560	2,437	4,823	11,922
Total	<u>\$ 9,524</u>	<u>\$ 3,560</u>	<u>\$ 4,460</u>	<u>\$ 8,505</u>	<u>\$ 26,049</u>

At December 31, 2010 and 2009, the authorized warehousing facility was \$5 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2010 and 2009.

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2010.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2010, there were outstanding commitments to purchase Euro-denominated government debt instruments of \$209 million. These securities settled on January 4, 2011, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date.

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

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Foreign currency working balances held and foreign exchange contracts executed by the FRBNY to facilitate international payments and currency transactions it makes on behalf of foreign central banks and U.S. official institution customers were not material as of December 31, 2010 and 2009.

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2010 and 2009, was \$75 million and \$10,272 million, respectively.

All of the U.S. dollar liquidity swaps outstanding at December 31, 2010 were transacted with the European Central Bank and had remaining maturity distributions of less than 15 days.

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2010 and 2009.

9. INVESTMENTS HELD BY CONSOLIDATED VARIABLE INTEREST ENTITIES

a. Summary Information for Consolidated Variable Interest Entities

The total assets of consolidated VIEs, including cash, cash equivalents, and accrued interest, at December 31 were as follows (in millions):

	2010	2009
ML	\$ 27,961	\$ 28,140
ML II	16,457	15,912
ML III	23,583	22,797
TALF LLC	665	298
CPFF	-	14,233
Total	\$ 68,666	\$ 81,380

The FRBNY's maximum exposure to loss at December 31, 2010 and 2009 was \$55,434 million and \$73,879 million, respectively. These estimates incorporate potential losses associated with assets recorded on the FRBNY's Consolidated Statements of Condition, net of the fair value of subordinated interests (beneficial interest in consolidated VIEs).

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The classification of significant assets and liabilities of the consolidated VIEs at December 31 was as follows (in millions):

	2010	2009
Assets:		
CDOs	\$ 23,112	\$ 22,650
Non-agency RMBS	18,360	17,552
Federal agency and GSE MBS	16,842	18,149
Commercial mortgage loans	5,130	4,025
Swap contracts	851	1,127
Residential mortgage loans	603	583
Commercial paper	-	9,421
Other investments	587	5,467
Subtotal	\$ 65,485	\$ 78,974
Cash, cash equivalents, and accrued interest receivable	3,181	2,406
Total investments held by consolidated VIEs	\$ 68,666	\$ 81,380
Liabilities:		
Beneficial interest in consolidated VIEs	\$ 10,051	\$ 5,095
Other liabilities ¹	\$ 921	\$ 1,316

¹ The amount reported as “Consolidated variable interest entities: Other liabilities” in the Combined Statements of Condition includes \$695 million and \$980 million related to cash collateral received on swap contracts at December 31, 2010 and 2009, respectively. The amount also includes accrued interest, unearned registration fees, and accrued other expenses.

Total realized and unrealized gains (losses) for the year-ended December 31, 2010, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/unrealized gains (losses)
CDOs	\$ 52	\$ 3,201	\$ 3,253
Non-agency RMBS	108	3,082	3,190
Federal agency and GSE MBS	291	320	611
Commercial mortgage loans ¹	(879)	2,319	1,440
Residential mortgage loans ¹	(86)	197	111
Swap contracts	(150)	(255)	(405)
Other investments	53	103	156
Other assets	(203)	27	(176)
Total	\$ (814)	\$ 8,994	\$ 8,180

¹ Substantially all unrealized gains (losses) on the commercial and residential mortgage loans are attributable to changes in instrument-specific credit risk.

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Total realized and unrealized gains (losses) for the year-ended December 31, 2009, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/unrealized gains (losses)
CDOs	\$ (3)	\$ (1,211)	\$ (1,214)
Non-agency RMBS	217	(991)	(774)
Federal agency and GSE MBS	322	521	843
Commercial mortgage loans ¹	(47)	(1,177)	(1,224)
Residential mortgage loans ¹	(48)	(219)	(267)
Swap contracts	(119)	212	93
Other investments	12	712	724
Other assets	(182)	64	(118)
Total	<u>\$ 152</u>	<u>\$ (2,089)</u>	<u>\$ (1,937)</u>

¹ Substantially all unrealized gains (losses) on the commercial and residential mortgage loans are attributable to changes in instrument-specific credit risk.

The net income (loss) attributable to ML, ML II, ML III, CPFF, and TALF LLC for the year-ended December 31, 2010 was as follows (in millions):

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	\$ 1,133	\$ 794	\$ 2,299	\$ 213	\$ 1	\$ 4,440
Less: Interest expense	66	34	173	-	4	277
Net interest income	1,067	760	2,126	213	(3)	4,163
Non-interest income:						
Portfolio holdings gains	2,571	2,467	3,141	1	-	8,180
Less: Unrealized gains (losses) on beneficial interest in consolidated VIEs	(1,135)	(1,353)	(2,266)	-	75 ¹	(4,679)
Net non-interest income	1,436	1,114	875	1	75	3,501
Total net interest income and non-interest income	2,503	1,874	3,001	214	72	7,664
Less: Professional fees	69	10	22	2	1	104
Net income attributable to consolidated VIEs	<u>\$ 2,434</u>	<u>\$ 1,864</u>	<u>\$ 2,979</u>	<u>\$ 212</u>	<u>\$ 71²</u>	<u>\$ 7,560</u>

¹ The TALF LLC's unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2010.

² Additional information regarding TALF-related income recorded by the FRBNY is presented in Note 5.

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The net income (loss) attributable to ML, ML II, ML III, and CPFF for the year-ended December 31, 2009 and for TALF LLC from the inception date of February 4, 2009 to December 31, 2009 was as follows (in millions):

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	\$ 1,476	\$ 1,088	\$ 3,032	\$ 4,224	\$ -	\$ 9,820
Less: Interest expense	61	33	171	-	2	267
Net interest income	1,415	1,055	2,861	4,224	(2)	9,553
Non-interest income:						
Portfolio holdings (losses) gains	(102)	(604)	(1,239)	8	-	(1,937)
Less: Unrealized gains (losses) on beneficial interest in consolidated VIEs	61	34	(1,299)	-	(699)	(1,903)
Net non-interest (loss) income	(41)	(570)	(2,538)	8	(699)	(3,840)
Total net interest income and non-interest income	1,374	485	323	4,232	(701)	5,713
Less: Professional fees	55	12	27	30	1	125
Net income (loss) attributable to consolidated VIEs	<u>\$ 1,319</u>	<u>\$ 473</u>	<u>\$ 296</u>	<u>\$ 4,202</u>	<u>\$ (702)</u>	<u>\$ 5,588</u>

¹ The TALF LLC's unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2009.

² Additional information regarding TALF-related income recorded by the FRBNY is presented in Note 5.

Following is a summary of the consolidated VIEs' subordinated financial interest for the years ended December 31, 2010 and 2009 (in millions):

	ML subordinated loan	ML II deferred purchase price	ML III equity contribution	TALF financial interest	Total
Fair value, January 31, 2009	\$ -	\$ -	\$ 2,824	\$ -	\$ 2,824
Interest accrued and capitalized	61	34	171	2	268
Treasury loan	-	-	-	100	100
Unrealized gain / (loss)	(61)	(34)	1,299	699	1,903
Fair value, December 31, 2009	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,294</u>	<u>\$ 801</u>	<u>\$ 5,095</u>
Interest accrued and capitalized	66	34	173	4	277
Unrealized (gain) / loss	1,135	1,353	2,266	(75)	4,679
Fair value, at December 31, 2010	<u>\$ 1,201</u>	<u>\$ 1,387</u>	<u>\$ 6,733</u>	<u>\$ 730</u>	<u>\$ 10,051</u>

b. Commercial Paper Funding Facility LLC

The CPFF Program charged a lending rate for unsecured commercial paper equal to a three-month overnight indexed swap (OIS) rate plus 100 basis points per annum, with an additional surcharge of 100 basis points per annum as an unsecured credit enhancement fee. The rate imposed for ABCP was the three-month OIS rate plus 300 basis points. The credit enhancement and registration fees were amortized on a straight-line basis over the term of the commercial paper.

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c. Maiden Lane LLC

ML's investment portfolio consists primarily of Federal agency and GSE MBS, non-agency RMBS, commercial and residential mortgage loans, and derivatives and associated hedges. Following is a description of the significant holdings at December 31, 2010 and the associated credit risk for each holding:

i. Debt Securities

Federal agency and GSE MBS represent fractional ownership interests in MBS guaranteed by Federal agencies and GSEs. The rate of delinquencies and defaults on the underlying residential mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower. Changes in economic conditions, including delinquencies and defaults on assets underlying these securities, can affect the securities' value, income, and liquidity.

ML's non-agency RMBS investment portfolio is subject to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS were issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying mortgage loans themselves, often referred to as an "available funds cap." As a result of this cap, the return to ML on such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher interest rate.

As of December 31, 2010, approximately 38.3 percent and 12.3 percent of the properties collateralizing the non-agency RMBS held by ML were located in California and Florida, respectively, based on the total unpaid principal balance of the underlying loans.

The fair value of any particular non-agency RMBS asset may be subject to substantial variation. The entire market or particular instruments traded on a market may decline in value, even if projected cash flow or other factors improve, because the prices of such instruments are subject to numerous other factors that have little or no correlation to the performance of a particular instrument. Adverse developments in the non-agency RMBS market could have a considerable effect on ML because of its investment concentration in non-agency RMBS.

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At December 31, 2010, the ratings breakdown of the \$19.6 billion of debt securities, which are recorded at fair value in the ML portfolio as a percentage of aggregate fair value of all securities in the portfolio was as follows:

Security Type: ²	Ratings ^{1,5}						Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower ⁴	Government / agency	
Federal agency and GSE MBS	0.0%	0.0%	0.0%	0.0%	0.0%	85.8%	85.8%
Non-agency RMBS	0.3%	0.4%	0.2%	0.2%	8.4%	0.0%	9.5%
Other ³	0.6%	0.9%	0.2%	1.5%	1.4%	0.0%	4.7%
Total	1.0%	1.3%	0.4%	1.7%	9.8%	85.8%	100.0%

¹ Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

² This table does not include ML swaps and other derivative contracts, commercial and residential mortgage loans, or TBA investments.

³ Includes all asset sectors that, individually, represent less than 5 percent of aggregate portfolio fair value.

⁴ BB+ and lower includes debt securities that were not rated as of December 31, 2010.

⁵ Rows and columns may not total due to rounding.

ii. *Commercial and Residential Mortgage Loans*

Commercial and residential mortgage loans are subject to a high degree of credit risk because of exposure to loss from loan defaults. Default rates are subject to a wide variety of factors, including, but not limited to, property performance, property management, supply and demand, construction trends, consumer behavior, regional economic conditions, interest rates, and other factors.

The performance profile for the commercial and residential mortgage loans at December 31, 2010, was as follows (in millions):

	Unpaid principal balance	Fair value	Fair value as a percentage of unpaid principal balance
Performing loans:			
Commercial	\$ 6,454	\$ 4,966	76.9%
Residential	788	440	55.8%
Subtotal	7,242	5,406	74.6%
Non-performing / Non-accrual loans ¹			
Commercial	315	164	52.1%
Residential	491	163	33.2%
Subtotal	806	327	40.6%
Total			
Commercial	6,769	5,130	75.8%
Residential	1,279	603	47.1%
Total loans	\$ 8,048	\$ 5,733	71.2%

¹ Non-performing/non-accrual loans include loans with payments past due greater than 90 days.

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The following table summarizes the state in which residential mortgage loans are collateralized and the property types of the commercial mortgage loans held in the ML portfolio at December 31, 2010:

	Concentration of unpaid principal balances	
	Residential	Commercial ²
By State:		
California	36.7%	
Florida	8.9%	
Other ¹	54.4%	
Total	100.0%	
By Property:		
Hospitality		81.8%
Office		11.0%
Other ¹		7.2%
Total		100.0%

¹ No other individual state or property type comprises more than 5 percent of the total.

² One borrower represents approximately 55 percent of total unpaid principal balance of the commercial mortgage loan portfolio.

Commercial mortgage loans held by ML are composed of different levels of subordination with respect to the underlying properties, and relative to each other. Senior mortgage loans are secured property loans evidenced by a first mortgage that is senior to any subordinate or mezzanine financing. Subordinate mortgage interests, sometimes known as B Notes, are loans evidenced by a junior note or a junior participation in a mortgage loan. Mezzanine loans are loans made to the direct or indirect owner of the property-owning entity. Mezzanine loans are not secured by a mortgage on the property but rather by a pledge of the mezzanine borrower's direct or indirect ownership interest in the property-owning entity.

The following table summarizes commercial mortgage loans held by ML at December 31, 2010 (in millions):

Loan type	Unpaid principal balances	Concentration of unpaid principal balances
Senior mortgage loan	\$ 3,886	57.4%
Subordinate mortgage interests	63	0.9%
Mezzanine loans	2,820	41.7%
Total	6,769	100.0%

iii. Derivative Instruments

Derivative contracts are instruments, such as futures or swap contracts, that derive their value from underlying assets, indices, reference rates or a combination of these factors. The ML portfolio includes various derivative financial instruments, primarily consisting of a total return swap agreement (TRS) with JPMC. ML and JPMC entered into the TRS with reference obligations representing single-name CDS primarily on RMBS and CMBS, and interest rate swaps (IRS) with various market participants, including JPMC. ML, through its investment manager, currently manages the CDS contracts within the TRS as a runoff portfolio and may unwind, amend, or novate reference obligations on an ongoing basis.

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ML enters into additional derivative contracts consisting of futures and IRS to economically hedge its exposure to interest rates. For 2010, there were 29 trades executed as IRS. All derivatives are recorded at fair value in accordance with ASC 815. None of the derivatives held by ML are designated as hedging instruments for accounting purposes.

On an ongoing basis, ML pledges collateral for credit or liquidity related shortfalls based on 20 percent of the notional amount of sold CDS protection and 10 percent of the present value of future premiums on purchased CDS protection. Failure to post this collateral constitutes a TRS event of default. Separately, ML and JPMC engage in bilateral posting of collateral to cover the net mark-to-market (MTM) variations in the swap portfolio. ML nets the collateral received from JPMC from the bilateral MTM posting only to the extent that the reference obligations indicate JPMC as the original counterparty to Bear Stearns on March 14, 2008. The values of ML's cash equivalents and investments, purchased by the re-hypothecation of cash collateral associated with the TRS, were \$0.8 billion and \$0 billion, respectively, as of December 31, 2010, and \$0.8 billion and \$0.5 billion, respectively, as of December 31, 2009. In addition, ML has pledged \$1.0 billion and \$1.5 billion of Federal agency and GSE MBS to JPMC as of December 31, 2010 and 2009, respectively.

The following risks are associated with the derivative instruments held by ML as part of the TRS agreement with JPMC as well as any derivatives outside of the TRS:

Market Risk

CDS are agreements that provide protection for the buyer against the loss of principal and, in some cases, interest on a bond or loan in case of a default by the issuer. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the CDS pays a premium in return for payment protection upon the occurrence, if any, of a credit event. Upon the occurrence of a triggering credit event, the maximum potential amount of future payments the seller could be required to make under a CDS is equal to the notional amount of the contract. Such future payments could be reduced or offset by amounts recovered under recourse or by collateral provisions outlined in the contract, including seizure and liquidation of collateral pledged by the buyer. ML's derivatives portfolio consists of purchased credit protection with underlying referenced names not correlated to offset its exposure to sold credit protection.

IRS obligate two parties to exchange one or more payments typically calculated with reference to fixed or periodically reset rates of interest applied to a specified notional principal amount. Notional principal is the amount to which interest rates are applied to determine the payment streams under IRS. Such notional principal amounts often are used to express the volume of these transactions but are not actually exchanged between the counterparties.

Futures contracts are agreements to buy and sell financial instruments for a set price on a future date. Initial margin deposits are made upon entering into futures contracts in the form of cash or securities. During the period that a futures contract is open, changes in the value of the contract are recorded as unrealized gains or losses by revaluing the contracts daily to reflect the market value of the contract at the end of each day's trading. Variation margin payments are paid or received, depending upon whether unrealized gains or losses result. When the contract is closed, ML will record a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and ML's cost basis in the contract. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates, and the underlying hedged assets. ML is also at risk of not being able to enter into a closing transaction for the futures contract because of an illiquid secondary market. ML had pledged cash collateral related to future contracts of \$18 million and \$40 million as of December 31, 2010 and 2009, respectively.

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Credit Risk

Credit risk is the risk of financial loss resulting from failure by a counterparty to meet its contractual obligations to ML. This can be caused by factors directly related to the counterparty, such as business or management. Taking collateral is the most common way to mitigate credit risk. ML takes financial collateral in the form of cash and marketable securities to cover JPMC counterparty risk as part of the TRS agreement with JPMC as well as the over-the-counter derivatives activities outside of the TRS.

The following table summarizes the notional amounts of derivative contracts outstanding as of December 31, 2010 and 2009, and the change in notional amounts is representative of the volume of activity for the year ended December 31, 2010 (in millions):

	Notional amounts ^{1,2}	
	2010	2009
Interest rate contracts		
IRS	\$ 4,130	\$ 3,185
Futures and options on futures ³	18	70
Credit derivatives		
CDS	5,856	7,323
Total	<u>\$ 10,004</u>	<u>\$ 10,578</u>

¹ Represents the sum of gross long and short notional derivative contracts.

² There were 1,400 and 1,764 CDS and IRS contracts outstanding as of December 2010, and 2009, respectively.

³ Futures and options on futures relate to contract obligations and not gross notional amounts.

The following table summarizes the fair value of derivative instruments by contract type on a gross basis as of December 31, 2010 and 2009, which is reported as a component of "Consolidated variable interest entities: Investments held by consolidated variable interest entities" in the Combined Statement of Condition (in millions):

	2010		2009	
	Gross derivative assets	Gross derivative liabilities	Gross derivative assets	Gross derivative liabilities
Interest rate contracts:				
IRS	\$ 9	\$ 229	\$ 5	\$ 195
Futures and options on futures	4	2	20	-
Credit derivatives:				
CDS	2,317	1,347	3,271	1,816
Counterparty netting	(1,375)	(1,374)	(1,868)	(1,868)
Cash collateral	(100)	-	(281)	-
Total	<u>\$ 855</u>	<u>\$ 204</u>	<u>\$ 1,147</u>	<u>\$ 143</u>

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The table below summarizes certain information regarding protection sold through CDS as of December 31 (in millions):

Credit ratings of the reference obligation	Maximum potential payout / notional							
	2010					2009		
	Years to maturity					Fair value		Fair value
	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset / (liability)	Total	Asset / (liability)
Investment grade (AAA to BBB-)	\$ -	\$ -	\$ -	\$ 120	\$ 120	\$ (23)	\$ 350	\$ (154)
Non-investment grade	10	250	-	1,564	1,824	(1,284)	2,099	(1,640)
Total credit protection sold	\$ 10	\$ 250	\$ -	\$ 1,684	\$ 1,944	\$ (1,307)	\$ 2,449	\$ (1,794)

The table below summarizes certain information regarding protection bought through CDS as of December 31 (in millions):

Credit ratings of the reference obligation	Maximum potential recovery / notional							
	2010					2009		
	Years to maturity					Fair value		Fair value
	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset / (liability)	Total	Asset / (liability)
Investment grade (AAA to BBB-)	\$ -	\$ -	\$ -	\$ 263	\$ 263	\$ 76	\$ 702	\$ 404
Non-investment grade	38	501	5	3,104	3,648	2,190	4,172	2,808
Total credit protection bought	\$ 38	\$ 501	\$ 5	\$ 3,367	\$ 3,911	\$ 2,266	\$ 4,874	\$ 3,212

Other Assets

Other assets are primarily composed of other real estate owned of approximately \$19 million, and options of \$4 million.

d. Maiden Lane II LLC

ML II's investments in non-agency RMBS are subject to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying residential mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS are issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying residential mortgage loans themselves, often referred to as an "available funds cap." As a result of this cap, the return to the holder of such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher rate of interest.

The fair value of any particular non-agency RMBS asset may be subject to substantial variation. The entire market or particular instruments traded on a market may decline in value, even if projected cash flow or other factors improve, because the prices of such instruments are subject to numerous other factors that

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have little or no correlation to the performance of a particular instrument. Adverse developments in the non-agency RMBS market could have a considerable effect on ML II because of its investment concentration in non-agency RMBS.

At December 31, 2010, the type/sector and rating composition of the ML II's \$16.2 billion non-agency RMBS portfolio, recorded at fair value, as a percentage of aggregate fair value, were as follows:

Asset Type:	Rating ^{1,3}					
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower	Total
Alt-A ARM	0.3%	1.3%	0.9%	0.3%	26.5%	29.4%
Subprime	4.1%	2.6%	1.3%	1.2%	46.4%	55.6%
Option ARM	0.0%	0.0%	0.0%	0.0%	6.8%	6.8%
Other ²	0.0%	0.5%	1.1%	0.1%	6.4%	8.2%
Total	4.5%	4.4%	3.3%	1.6%	86.2%	100.0%

¹ Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

² Includes all asset types that, individually, represent less than 5% of aggregate portfolio fair value.

³ Rows and columns may not total due to rounding.

At December 31, 2010, approximately 30 percent and 13 percent of the properties collateralizing the non-agency RMBS held by ML II were located in California and Florida, respectively, based on the geographical location data available for the underlying loans by aggregate unpaid principal balance.

e. Maiden Lane III LLC

The primary holdings within ML III are ABS CDOs. An ABS CDO is a security issued by a bankruptcy-remote entity that is backed by a diversified pool of debt securities, which in the case of ML III are primarily RMBS and CMBS. The cash flows of ABS CDOs can be split into multiple segments, called "tranches," which vary in risk profile and yield. The junior tranches bear the initial risk of loss, followed by the more senior tranches. The ABS CDOs in the ML III portfolio represent senior tranches. Because they are shielded from defaults by the subordinated tranches, senior tranches typically have higher credit ratings and lower yields than the underlying securities, and will often receive investment-grade ratings from one or more of the nationally recognized rating agencies. Despite the protection afforded by the subordinated tranches, senior tranches can experience substantial losses from actual defaults on the underlying non-agency RMBS or CMBS.

Certain ABS CDO issuers can issue short-term eligible investments under Rule 2a-7 of the Investment Company Act of 1940 if the ABS CDO contains arrangements to remarket the securities at defined periods. The investments must contain put options (2a-7 Puts) that allow the purchasers to sell the ABS CDO at par to a third-party (Put Provider), if a scheduled remarketing is unsuccessful due to reasons other than a credit or bankruptcy event. The total notional value of ABS CDOs held by ML III with embedded 2a-7 Puts, for which AIGFP was, directly or indirectly, the Put Provider, was \$1.6 billion at 2009. There were no remaining ABS CDO investments held by the LLC with embedded 2a-7 puts as of December 31, 2010.

ML III's investment in CMBS and RMBS contain varying levels of credit, interest rate, liquidity, and concentration risk. Credit-related risk arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the securities are issued. The rate of delinquencies and defaults on residential and commercial mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the

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area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower. Adverse developments in the RMBS and CMBS markets could have a considerable effect on ML III because of its investment concentration in CDOs backed by CMBS and RMBS.

At December 31, 2010, the investment type/vintage and rating composition of ML III's \$23 billion portfolio, recorded at fair value, as a percentage of aggregate fair value of all securities in the portfolio was as follows:

	Rating ^{1,2,3}						Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower	Not rated	
ABS CDOs:							
High-Grade ABS CDOs	0.0%	0.0%	0.0%	0.0%	64.2%	1.0%	65.3%
Pre-2005	0.0%	0.0%	0.0%	0.0%	22.1%	0.0%	22.1%
2005	0.0%	0.0%	0.0%	0.0%	29.1%	1.0%	30.1%
2006	0.0%	0.0%	0.0%	0.0%	6.3%	0.0%	6.3%
2007	0.0%	0.0%	0.0%	0.0%	6.7%	0.0%	6.7%
Mezzanine ABS CDOs	0.0%	0.0%	0.0%	0.1%	8.2%	0.1%	8.5%
Pre-2005	0.0%	0.0%	0.0%	0.1%	4.7%	0.1%	4.9%
2005	0.0%	0.0%	0.0%	0.0%	2.9%	0.0%	2.9%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	0.0%	0.0%	0.6%	0.0%	0.6%
Commercial Real-Estate CDOs	0.0%	0.0%	0.0%	0.0%	25.1%	0.0%	25.1%
Pre-2005	0.0%	0.0%	0.0%	0.0%	3.2%	0.0%	3.2%
2005	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	0.0%	0.0%	21.9%	0.0%	21.9%
RMBS, CMBS, & Other:	0.1%	0.2%	0.1%	0.0%	0.9%	0.0%	1.3%
Pre-2005	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.2%
2005	0.1%	0.2%	0.1%	0.0%	0.7%	0.0%	1.1%
2006	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.1%
2007	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Investments	0.1%	0.2%	0.1%	0.1%	98.4%	1.2%	100.0%

¹ Lowest of all ratings was used for the purpose of this table if rated by two or more nationally recognized statistical rating organizations.

² The year of issuance with the highest concentration of underlying assets as measured by outstanding principal balance determines the vintage of the CDO.

³ Rows and columns may not total due to rounding.

f. TALF LLC

Cash receipts resulting from the put option fees paid to TALF LLC and proceeds from the Treasury's loan are invested in the following types of U.S. dollar-denominated short-term investments and cash equivalents eligible for purchase by the LLC: (1) US Treasury securities, (2) Federal agency securities that are senior, negotiable debt obligations of the Fannie Mae, Freddie Mac, Federal Home Loan Banks (FHLB) and Federal Farm Credit Banks (FFCB), which have a fixed rate of interest, (3) repurchase agreements that are collateralized by Treasury and Federal agency securities and fixed-rate agency mortgage-backed securities, and (4) money market mutual funds registered with the Securities and Exchange Commission and regulated under Rule 2a-7 of the Investment Company Act that invest exclusively in US Treasury and Federal agency securities. Cash may also be invested in a demand interest-bearing account held at the Bank of New York Mellon.

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g. Fair Value Measurement

The consolidated VIEs have adopted ASC 820 and ASC 825 and have elected the fair value option for all securities and commercial and residential mortgages held by ML and TALF LLC. ML II and ML III qualify as nonregistered investment companies under the provisions of ASC 946 and, therefore, all investments are recorded at fair value in accordance with ASC 820. In addition, the FRBNY has elected to record the beneficial interests in ML, ML II, ML III, and TALF LLC at fair value.

The accounting and classification of these investments appropriately reflect the VIEs' and the FRBNY's intent with respect to the purpose of the investments and most closely reflect the amount of the assets available to liquidate the entities' obligations.

i. Determination of Fair Value

The consolidated VIEs value their investments on the basis of the last available bid prices or current market quotations provided by dealers or pricing services selected by the designated investment managers. To determine the value of a particular investment, pricing services may use information on transactions in such investments; quotations from dealers; pricing metrics; market transactions in comparable investments; relationships observed in the market between investments; and calculated yield measures based on valuation methodologies commonly employed in the market for such investments.

Market quotations may not represent fair value in circumstances in which the investment manager believes that facts and circumstances applicable to an issuer, a seller, a purchaser, or the market for a particular security result in the current market quotations reflecting an inaccurate fair value of the security. To determine fair value, the investment manager applies proprietary valuation models that use collateral performance scenarios and pricing metrics derived from the reported performance of the universe of bonds with similar characteristics as well as the observable market.

Because of the uncertainty inherent in determining the fair value of investments that do not have a readily available fair value, the fair value of these investments may differ significantly from the values that would have been reported if a readily available fair value had existed for these investments and may differ materially from the values that may ultimately be realized.

The fair value of the liability for the beneficial interests of consolidated VIEs is estimated based upon the fair value of the underlying assets held by the VIEs. The holders of these beneficial interests do not have recourse to the general credit of the FRBNY.

ii. Valuation Methodologies for Level 3 Assets and Liabilities

In certain cases where there is limited activity around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. For example, in valuing CDOs, certain collateralized mortgage obligations, and commercial and residential mortgage loans, the determination of fair value is based on collateral performance scenarios. These valuations also incorporate pricing metrics derived from the reported performance of the universe of bonds and from observations and estimates of market data. Because external price information is not available, market-based models are used to value these securities. Key inputs to the model may include market spreads or yield estimates for comparable instruments, data for each credit rating, valuation estimates for underlying property collateral, projected cash flows, and other relevant contractual features. Because there is lack of observable pricing, securities and investment loans that are carried at fair value are classified within Level 3.

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The following tables present the financial instruments recorded in VIEs at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2010				
	Level 1	Level 2	Level 3	Netting ¹	Total fair value
Assets:					
CDOs	\$ -	\$ 301	\$ 22,811	\$ -	\$ 23,112
Non-agency RMBS	-	11,551	6,809	-	18,360
Federal agency and GSE MBS	-	16,812	30	-	16,842
Commercial mortgage loans	-	3,199	1,931	-	5,130
Cash equivalents	3,003	-	-	-	3,003
Swap contracts	-	9	2,317	(1,475)	851
Residential mortgage loans	-	-	603	-	603
Other investments	85	400	79	-	564
Other assets	-	4	-	-	4
Total assets	<u>\$ 3,088</u>	<u>\$ 32,276</u>	<u>\$ 34,580</u>	<u>\$ (1,475)</u>	<u>\$ 68,469</u>
Liabilities:					
Beneficial interest in consolidated VIEs	\$ -	\$ -	\$ 10,051	\$ -	\$ 10,051
Swap contracts	-	229	1,347	(1,375)	201
Other liabilities	2	-	-	-	2
Total liabilities	<u>\$ 2</u>	<u>\$ 229</u>	<u>\$ 11,398</u>	<u>\$ (1,375)</u>	<u>\$ 10,254</u>

¹ Derivative receivables and payables and the related cash collateral received and paid are shown netted when a master netting agreement exists.

	2009				
	Level 1	Level 2	Level 3	Netting ¹	Total fair value
Assets:					
CDOs	\$ -	\$ 241	\$ 22,409	\$ -	\$ 22,650
Federal agency and GSE MBS	-	18,125	24	-	18,149
Non-agency RMBS	-	9,461	8,091	-	17,552
Commercial mortgage loans	-	-	4,025	-	4,025
Cash equivalents	1,933	142	-	-	2,075
Swap contracts	-	5	3,272	(2,150)	1,127
Residential mortgage loans	-	-	583	-	583
Other investments	31	5,413	23	-	5,467
Other assets	20	-	-	-	20
Total assets	<u>\$ 1,984</u>	<u>\$ 33,387</u>	<u>\$ 38,427</u>	<u>\$ (2,150)</u>	<u>\$ 71,648</u>
Liabilities:					
Beneficial interest in consolidated VIEs	\$ -	\$ -	\$ 5,095	\$ -	\$ 5,095
Swap contracts	-	195	1,816	(1,868)	143
Total liabilities	<u>\$ -</u>	<u>\$ 195</u>	<u>\$ 6,911</u>	<u>\$ (1,868)</u>	<u>\$ 5,238</u>

¹ Derivative receivables and payables and the related cash collateral received and paid are shown netted when a master netting agreement exists.

The tables below present a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2010 and 2009 (in millions).

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Unrealized gains and losses related to those assets still held at December 31, 2010 and 2009, are reported as a component of “Consolidated variable interest entities: Investments held by consolidated variable interest entities, net” in the Combined Statements of Condition.

	2010					Change in unrealized gains (losses) related to financial instruments held at December 31, 2010
	Fair value January 1	Net purchases, sales, and settlements	Total realized/unrealized gains (losses)	Net transfers in or out ^{1,2,3,4}	Fair value December 31	
Assets:						
CDOs ⁷	\$ 22,200	\$ (2,474)	\$ 3,096	\$ (11)	\$ 22,811	\$ 3,043
Non-agency RMBS ⁷	8,300	(1,046)	1,144	(1,589)	6,809	1,044
Commercial mortgage loans	4,025	(335)	681	(2,440)	1,931	542
Residential mortgage loans	583	(91)	111	-	603	197
Federal agency and GSE MBS	24	(34)	2	38	30	2
Other investments	23	(39)	65	30	79	11
Total assets	<u>\$ 35,155</u>	<u>\$ (4,019)</u>	<u>\$ 5,099</u>	<u>\$ (3,972)</u>	<u>\$ 32,263</u>	<u>\$ 4,839</u>
Net swap contracts ⁵	\$ 1,456	\$ (325)	\$ (161)	\$ -	\$ 970	\$ (137)
Liabilities:						
Beneficial interest in consolidated VIEs	<u>\$ (5,095)</u>	<u>\$ (277)</u> ⁶	<u>\$ (4,679)</u>	<u>\$ -</u>	<u>\$ (10,051)</u>	<u>\$ (4,679)</u>

¹ The amount of transfers is based on the fair values of the transferred assets at the beginning of the reporting period.

² There were no significant transfers between Level 1 and Level 2 during the year-ended December 31, 2010.

³ Commercial mortgage loans, with a December 31, 2009 fair value of \$2,440 million, were transferred from Level 3 to Level 2 because they are valued at December 31, 2010 based on quoted prices for identical or similar instruments in non-active markets (Level 2). These investments were valued in the prior year based on non-observable inputs (Level 3).

⁴ Non-agency RMBS, with a December 31, 2009 fair value of \$3,830 million, were transferred from Level 3 to Level 2 because they are valued at December 31, 2010 based on quoted prices in non-active markets (Level 2). These investments were valued in the prior year on non-observable model based inputs (Level 3). There were also certain non-agency RMBS for which valuation inputs became less observable during the year ended December 31, 2010 which resulted in \$2,647 million in transfers from Level 2 to Level 3. There were no other significant transfers between Level 2 and Level 3 during the year.

⁵ Level 3 derivative assets and liabilities are presented net for purposes of this table.

⁶ Includes \$277 million in capitalized interest.

⁷ Investments with a fair value of \$209 million as of December 31, 2009 were reclassified from CDOs to Non-agency RMBS.

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	2009					Change in unrealized gains (losses) related to financial instruments held at December 31, 2009
	Fair value January 1	Net purchases, sales, and settlements	Total realized/unrealized gains (losses)	Net transfers in or out	Fair value December 31	
Assets:						
CDOs	\$ 26,802	\$ (3,123)	\$ (1,267)	\$ (3)	\$ 22,409	\$ (1,265)
Non-agency RMBS	12,510	(1,481)	(499)	(2,439)	8,091	(533)
Commercial mortgage loans	5,553	(305)	(1,223)	-	4,025	(1,177)
Residential mortgage loans	937	(86)	(268)	-	583	(219)
Federal agency and GSE MBS	895	(248)	-	(623)	24	-
Other investments	348	(263)	30	(92)	23	29
Total assets	<u>\$ 47,045</u>	<u>\$ (5,506)</u>	<u>\$ (3,227)</u>	<u>\$ (3,157)</u>	<u>\$ 35,155</u>	<u>\$ (3,165)</u>
Net swap contracts ¹	\$ 2,454	\$ (906)	\$ 94	\$ (186)	\$ 1,456	\$ 212
Liabilities:						
Beneficial interest in consolidated VIEs	<u>\$ (2,824)</u>	<u>\$ (368)</u> ²	<u>\$ (1,903)</u>	<u>\$ -</u>	<u>\$ (5,095)</u>	<u>\$ (1,903)</u>

¹ Level 3 derivative assets and liabilities are presented net for purposes of this table.

² Includes \$268 million in capitalized interest.

h. Professional Fees

The consolidated VIEs have recorded costs for professional services provided, among others, by several nationally recognized institutions that serve as investment managers, administrators, and custodians for the VIEs' assets. The fees charged by the investment managers, custodians, administrators, auditors, attorneys, and other service providers, are recorded in "Professional fees related to consolidated variable interest entities" in the Combined Statements of Income and Comprehensive Income.

10. NON-CONSOLIDATED VARIABLE INTEREST ENTITIES

In December 2009, the FRBNY received preferred interests in two VIEs, AIA LLC and ALICO LLC. The FRBNY does not consolidate these VIEs because it does not have a controlling financial interest. The FRBNY's maximum exposure to any potential losses of the VIEs, should any occur, is limited to the recorded value of the FRBNY's investment in the preferred interests and dividends receivable from the VIEs. The following table shows financial information as of December 31, 2010 (in millions):

	2010		
	AIA LLC	ALICO LLC	Total non-consolidated VIEs
Total assets	\$ 31,223	\$ 17,417	\$ 48,640
Total liabilities	-	898	898
Maximum exposure to loss	16,886	9,499	26,385

The recorded value of the FRBNY's preferred interests, including capitalized dividends, was \$16,886 million and \$16,068 million for AIA LLC and \$9,499 million and \$9,038 million for ALICO LLC at December 31, 2010 and 2009, respectively. The FRBNY's preferred interests and capitalized dividends are reported as "Preferred interests" and dividends receivable are reported as a component of "Other Assets" in the Combined Statements of Condition.

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The fair value of FRBNY's preferred interests in AIA LLC and ALICO LLC was not materially different from the amounts reported as "Preferred interests" in the Combined Statements of Condition as of December 31, 2010 and 2009.

As a result of the closing of the AIG recapitalization plan on January 14, 2011, the FRBNY was paid in full for its preferred interests in AIA LLC and ALICO LLC, including accrued dividends.

11. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	<u>2010</u>	<u>2009</u>
Bank premises and equipment:		
Land and land improvements	\$ 350	\$ 344
Buildings	2,436	2,378
Building machinery and equipment	511	492
Construction in progress	31	43
Furniture and equipment	<u>1,034</u>	<u>1,010</u>
Subtotal	4,362	4,267
Accumulated depreciation	<u>(1,749)</u>	<u>(1,643)</u>
Bank premises and equipment, net	<u>\$ 2,613</u>	<u>\$ 2,624</u>
Depreciation expense, for the years ended December 31	<u>\$ 204</u>	<u>\$ 202</u>

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

	<u>2010</u>	<u>2009</u>
Leased premises and equipment under capital leases	\$ 18	\$ 10
Accumulated depreciation	<u>(8)</u>	<u>(6)</u>
Leased premises and equipment under capital leases, net	<u>\$ 10</u>	<u>\$ 4</u>
Depreciation expense related to leased premises and equipment under capital leases	<u>\$ 3</u>	<u>\$ 2</u>

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The Reserve Banks lease space to outside tenants with remaining lease terms ranging from one to fourteen years. Rental income from such leases was \$34 million and \$32 million for the years ended December 31, 2010 and 2009, respectively, and is reported as a component of “Other income” in the Combined Statements of Income and Comprehensive Income. Future minimum lease payments that the Reserve Banks will receive under noncancelable lease agreements in existence at December 31, 2010 are as follows (in millions):

2011	\$	28
2012		24
2013		24
2014		24
2015		19
Thereafter		41
Total	<u>\$</u>	<u>160</u>

The Reserve Banks had capitalized software assets, net of amortization, of \$146 million and \$134 million at December 31, 2010 and 2009, respectively. Amortization expense was \$54 million and \$52 million for the years ended December 31, 2010 and 2009, respectively. Capitalized software assets are reported as a component of “Other assets” in the Combined Statements of Condition and the related amortization is reported as a component of “Operating expenses: Other” in the Combined Statements of Income and Comprehensive Income.

In 2008, after relocating operations to a new facility, the Federal Reserve Bank of San Francisco (FRBSF) classified its former Seattle branch office building as held for sale, and the building is reported at fair value as a component of “Other Assets” in the Combined Statements of Condition. During the year ended December 31, 2010, the FRBSF recorded an adjustment of \$6.7 million to the fair value of the building and reported the charge as a component of “Operating expenses: Other” in the Combined Statements of Income and Comprehensive Income. The fair value of the building as of December 31, 2010 was based on appraised valuation.

The FRBSF disclosed a subsequent event in its 2009 financial statements, related to the termination of a contract for software development. The FRBSF has determined that a portion of the software development program will not be used, and in 2010 reduced the carrying value of the asset by \$20.2 million. The adjustment to the asset value is reported as a component of “Operating expenses: Other” in the Combined Statements of Income and Comprehensive Income. The FRBSF expects the remaining asset value will be recovered through use in other continuing software development programs.

12. COMMITMENTS AND CONTINGENCIES

Conducting its operations, the Reserve Banks enter into contractual commitments, normally with fixed expiration dates or termination provisions, at specific rates and for specific purposes.

At December 31, 2010, the Reserve Banks were obligated under noncancelable leases for premises and equipment with remaining terms ranging from one to approximately thirteen years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$30 million and \$27 million for the years ended December 31, 2010 and 2009, respectively.

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Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2010, are as follows (in millions):

	<u>Operating leases</u>
2011	\$ 13
2012	12
2013	12
2014	11
2015	11
Thereafter	<u>85</u>
Future minimum rental payments	<u>\$ 144</u>

At December 31, 2010, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2021 with a remaining fixed commitment of \$178 million. Purchases of \$54 million and \$28 million were made against these commitments during 2010 and 2009, respectively. These commitments are for maintenance of currency processing machines and have variable and/or fixed components. The variable portion of the commitments is for additional services above the fixed contractual service limits. The fixed payments for the next five years under these commitments are as follows (in millions):

2011	\$ 2
2012	26
2013	45
2014	27
2015	25

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

Other Commitments

In support of financial market stability activities, the Reserve Banks entered into commitments to provide financial assistance to financial institutions. The contractual amounts shown below are the Reserve Banks' maximum exposures to loss in the event that the commitments are fully funded and there is a default by the borrower or total loss in value of pledged collateral. Total commitments at December 31, 2010 and 2009 were as follows (in millions):

	<u>2010</u>		<u>2009</u>	
	Contractual amount	Unfunded amount	Contractual amount	Unfunded amount
Secured revolving line of credit (AIG)	\$ 24,512	\$ 9,891	\$ 35,000	\$ 17,100
Commercial loan commitments (ML)	72	72	157	157
Additional loan commitments (ML) ¹	9	9	-	-
Total	<u>\$ 24,593</u>	<u>\$ 9,972</u>	<u>\$ 35,157</u>	<u>\$ 17,257</u>

¹ In 2010, there is additional restricted cash totaling \$9 million that may be required to be advanced by ML for property level expenses or improvements.

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The contractual amount of the commitment related to the AIG secured revolving line of credit represents the maximum commitment at December 31, 2010, to lend to AIG and the unfunded amount represents the maximum commitment reduced by draws outstanding. The amount of the FRBNY's commitment to lend to AIG was reduced during the year ended December 31, 2009 as a result of the debt restructurings described in Note 3, Note 4, and Note 5. The FRBNY's commitment was further reduced during the year ended December 31, 2010, as a result of AIG asset sales. Collateral to secure the FRBNY's loan to AIG includes equity interests of various AIG subsidiaries. The FRBNY did not incur any losses related to the unfunded commitment as of December 31, 2010.

As a result of the closing of the AIG recapitalization plan on January 14, 2011, the revolving line of credit was paid in full, including interest and fees, and FRBNY's commitment to lend any further funds was terminated.

The undrawn portion of the FRBNY's commercial loan commitments relates to commercial mortgage loan commitments acquired by ML.

13. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Reserve Banks currently offer three defined benefit retirement plans to their employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP) and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP). Under the Dodd-Frank Act, employees of the Bureau can elect to participate in the System Plan. As of December 31, 2010, there were no Bureau participants in the System Plan.

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, Board of Governors, and OEB and in the future will provide retirement benefits to certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its combined financial statements. During the years ended December 31, 2010 and 2009, costs associated with the System Plan were not reimbursed by other participating employers.

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

	2010	2009
Estimated actuarial present value of projected benefit obligation at January 1	\$ 7,364	\$ 7,031
Service cost-benefits earned during the period	223	204
Interest cost on projected benefit obligation	450	427
Actuarial loss (gain)	508	(28)
Contributions by plan participants	9	3
Special termination benefits	11	9
Benefits paid	(307)	(291)
Plan amendments	-	9
Estimated actuarial present value of projected benefit obligation at December 31	\$ 8,258	\$ 7,364

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Following is a reconciliation showing the beginning and ending balance of the System Plan assets, the funded status, and the accrued pension benefit costs (in millions):

	2010	2009
Estimated plan assets at January 1 (of which \$6,252 and \$5,037 is measured at fair value as of January 1, 2010 and 2009, respectively)	\$ 6,281	\$ 5,053
Actual return on plan assets	710	1,016
Contributions by the employer	580	500
Contributions by plan participants	9	3
Benefits paid	(307)	(291)
Estimated plan assets at December 31 (of which \$6,998 and \$6,252 is measured at fair value as of December 31, 2010 and 2009, respectively)	\$ 7,273	\$ 6,281
Funded status and accrued pension benefit costs	\$ (985)	\$ (1,083)
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ (771)	\$ (883)
Net actuarial loss	(2,589)	(2,488)
Total accumulated other comprehensive loss	\$ (3,360)	\$ (3,371)

Accrued pension benefit costs are reported as a component of "Accrued benefit costs" in the Combined Statements of Condition.

The accumulated benefit obligation for the System Plan, which differs from the estimated actuarial present value of projected benefit obligation because it is based on current rather than future compensation levels, was \$7,136 million and \$6,430 million at December 31, 2010 and 2009, respectively.

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

	2010	2009
Discount rate	5.50%	6.00%
Rate of compensation increase	5.00%	5.00%

Net periodic benefit expenses for the years ended December 31, 2010 and 2009, were actuarially determined using a January 1 measurement date. The weighted-average assumptions used in developing net periodic benefit expenses for the System Plan for the years were as follows:

	2010	2009
Discount rate	6.00%	6.00%
Expected asset return	7.75%	7.75%
Rate of compensation increase	5.00%	5.00%

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the System Plan's benefits when due. The expected long-term rate of return on assets is an estimate that is based on a combination of factors, including the System Plan's asset allocation strategy and historical

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returns; surveys of expected rates of return for other entities' plans; a projected return for equities and fixed income investments based on real interest rates, inflation expectations, and equity risk premiums; and surveys of expected returns in equity and fixed income markets.

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

	2010	2009
Service cost-benefits earned during the period	\$ 223	\$ 204
Interest cost on accumulated benefit obligation	450	427
Amortization of prior service cost	112	116
Amortization of net loss	188	285
Expected return on plan assets	(491)	(389)
Net periodic pension benefit expense	482	643
Special termination benefits	11	9
Total periodic pension benefit expense	<u>\$ 493</u>	<u>\$ 652</u>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2011 are shown below:

Prior service cost	\$ 110
Net actuarial loss	182
Total	<u>\$ 292</u>

The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 16.

Following is a summary of expected benefit payments, excluding enhanced retirement benefits (in millions):

	Expected benefit payments
2011	\$ 326
2012	347
2013	370
2014	394
2015	417
2016-2019	2,454
Total	<u>\$ 4,308</u>

The System's Committee on Investment Performance (CIP) is responsible for establishing investment policies, selecting investment managers, and monitoring the investment managers' compliance with its policies. The CIP is supported by staff in the OEB in carrying out these responsibilities. At December 31, 2010, the System Plan's assets were held in seven investment vehicles: a liability-linked account, two actively managed long-duration fixed income portfolios, an indexed U.S. investment-grade bond fund, an indexed U.S. equity fund, an indexed non-U.S. developed-markets fund, and a money market fund.

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The diversification of the Plan's investments is designed to limit concentration of risk and the risk of loss related to an individual asset class. The liability-linked account, funded in 2008, seeks to defease a portion of the System Plan's liability related to retired lives using a Treasury securities portfolio. The policy governing this account calls for cash-matching the first two years of a portion of retiree benefits payments and immunizing the remaining obligation. The two long-duration fixed income portfolios are separate accounts benchmarked to the Barclays Long Government/Credit Index, which was selected as a proxy for the liabilities of the Plan. While these portfolios are both actively managed, the guidelines are designed to limit portfolio deviations from the benchmark. The indexed U.S. investment-grade bond fund tracks the Barclays U.S. Aggregate Index, which is a broader fixed income index than the Barclays Long Government/Credit Index, but has a shorter duration and average maturity. The indexed U.S. equity fund is intended to track the overall U.S. equity market across market capitalizations. The indexed non-U.S. developed markets equity fund is intended to track the Morgan Stanley Capital International (MSCI) Emerging Markets Index, Europe, Australia, Far East plus Canada Index, which includes stocks from 23 markets deemed by MSCI to be "developed markets". Finally, the money market fund, which invests in high-quality money market securities, is the repository for cash balances and adheres to a constant dollar methodology.

Permitted and prohibited investments, including the use of derivatives, are defined in either the trust agreement (for commingled index vehicles) or the investment guidelines (for the three separate accounts). The CIP reviews the trust agreement and approves all investment guidelines as part of the selection of each investment to ensure that the trust agreement is consistent with the CIP's investment objectives for the System Plan's assets.

The System Plan's policy weight and actual asset allocations at December 31, by asset category, are as follows:

	Policy Weight	Actual Asset Allocations	
		2010	2009
U.S. equities	42.8%	45.4%	53.0%
International equities	12.2%	12.6%	12.9%
Fixed income	45.0%	41.7%	33.8%
Cash	0.0%	0.3%	0.3%
Total	100.0%	100.0%	100.0%

Employer contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System Plan's actuarial funding method is expected to produce a recommended annual funding range between \$350 and \$400 million. In 2011, the System will make monthly contributions of \$35 million and will reevaluate the monthly contributions upon completion of the 2011 actuarial valuation. The Reserve Banks' projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2010 and 2009, and for the years then ended, were not material.

The System Plan's investments are reported at fair value as required by ASC 820. ASC 820 establishes a three-level fair value hierarchy that distinguishes between market participant assumptions developed using market data obtained from independent sources (observable inputs) and the Reserve Banks' assumptions about market participant assumptions developed using the best information available in the circumstances (unobservable inputs).

Determination of Fair Value

The System Plan's investments are valued on the basis of the last available bid prices or current market quotations provided by dealers, or pricing services. To determine the value of a particular investment, pricing services may use information on transactions in such investments; quotations from dealers; pricing metrics; market transactions in comparable investments; relationships observed in the market between investments; and calculated yield measures based on valuation methodologies commonly employed in the market for such investments.

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Because of the uncertainty inherent in determining the fair value of investments that do not have a readily available fair value, the fair value of these investments may differ significantly from the values that would have been reported if a readily available fair value had existed for these investments and may differ materially from the values that may ultimately be realized.

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

Description	2010			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ -	\$ 30	\$ -	\$ 30
Treasury and Federal agency securities	1,065	39	-	1,104
GSE debt securities	-	-	-	-
Other fixed income securities	-	644	-	644
Common stocks	-	-	-	-
Commingled funds	-	5,220	-	5,220
Total	<u>\$ 1,065</u>	<u>\$ 5,933</u>	<u>\$ -</u>	<u>\$ 6,998</u>

Description	2009			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ -	\$ 24	\$ -	\$ 24
Treasury and Federal agency securities	677	38	-	715
GSE debt securities	-	156	-	156
Other fixed income securities	-	128	-	128
Common stocks	883	-	-	883
Commingled funds	-	4,346	-	4,346
Total	<u>\$ 1,560</u>	<u>\$ 4,692</u>	<u>\$ -</u>	<u>\$ 6,252</u>

The System Plan enters into futures contracts, traded on regulated exchanges, to manage certain risks and to maintain appropriate market exposure in meeting the investment objectives of the System Plan. The System Plan bears the market risk that arises from any unfavorable changes in the value of the securities or indexes underlying these futures contracts. The use of futures contracts involves, to varying degrees, elements of market risk in excess of the amount recorded in the Statements of Condition. The guidelines established by the CIP further reduce risk by limiting the net futures positions, for most fund managers, to 15 percent of the market value of the advisor's portfolio. No limit has been established on the futures positions of the liability-driven investments because the fund manager only executes Treasury futures.

At December 31, 2010 and 2009, a portion of short-term investments was available for futures trading. There were \$1 million of Treasury securities pledged as collateral for each of the years ended December 31, 2010 and 2009.

Thrift Plan

Employees of the Reserve Banks participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Reserve Banks match employee contributions based on a specified formula. Effective April 1, 2009, the Reserve Banks match 100 percent of the first 6 percent of employee contributions from the date of hire and provide an automatic employer contribution of 1 percent of eligible

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pay. For the first three months of the year ended December 31, 2009, the Reserve Banks matched 80 percent of the first 6 percent of employee contributions for employees with less than five years of service and 100 percent of the first 6 percent of employee contributions for employees with five or more years of service. The Reserve Banks' Thrift Plan contributions totaled \$94 million and \$82 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

14. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

The Reserve Banks funds benefits payable under the medical and life insurance plans as due and, accordingly, have no plan assets.

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

	2010	2009
Accumulated postretirement benefit obligation at January 1	\$ 1,324	\$ 1,221
Service cost benefits earned during the period	47	40
Interest cost on accumulated benefit obligation	76	74
Net actuarial loss (gain)	(9)	54
Special termination benefits loss	1	1
Contributions by plan participants	18	16
Benefits paid	(88)	(79)
Medicare Part D subsidies	5	5
Plan amendments	(16)	(8)
Accumulated postretirement benefit obligation at December 31	\$ 1,358	\$ 1,324

At December 31, 2010 and 2009, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.25 percent and 5.75 percent, respectively.

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due.

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

	<u>2010</u>	<u>2009</u>
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	65	58
Contributions by plan participants	18	16
Benefits paid	(88)	(79)
Medicare Part D subsidies	<u>5</u>	<u>5</u>
Fair value of plan assets at December 31	<u>\$ -</u>	<u>\$ -</u>
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 1,358</u>	<u>\$ 1,324</u>

Amounts included in accumulated other comprehensive loss are shown below:

Prior service cost	\$ 31	\$ 33
Net actuarial (loss)	<u>(301)</u>	<u>(338)</u>
Total accumulated other comprehensive loss	<u>\$ (270)</u>	<u>\$ (305)</u>

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs" in the Combined Statements of Condition.

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

	<u>2010</u>	<u>2009</u>
Health care cost trend rate assumed for next year	8.00%	7.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2015

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2010 (in millions):

	<u>1 percentage point increase</u>	<u>1 percentage point decrease</u>
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 17	\$ (14)
Effect on accumulated postretirement benefit obligation	\$ 140	\$ (120)

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

	<u>2010</u>	<u>2009</u>
Service cost-benefits earned during the period	\$ 47	\$ 40
Interest cost on accumulated benefit obligation	76	74
Amortization of prior service cost	(18)	(20)
Amortization of net actuarial loss	<u>28</u>	<u>29</u>
Total periodic expense	133	123
Curtailment (gain)	-	(4)
Special termination benefits loss	<u>1</u>	<u>1</u>
Net periodic postretirement benefit expense	<u>\$ 134</u>	<u>\$ 120</u>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2011 are shown below:

Prior service cost	\$ (8)
Net actuarial loss	<u>21</u>
Total	<u>\$ 13</u>

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2010 and 2009, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 6.00 percent, respectively.

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

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

Federal Medicare Part D subsidy receipts were \$4.3 million and \$6.4 million in the years ended December 31, 2010 and 2009, respectively. Expected receipts in 2011, related to benefits paid in the years ended December 31, 2010 and 2009, are \$1 million.

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

	<u>Without subsidy</u>	<u>With subsidy</u>
2011	\$ 75	\$ 70
2012	79	73
2013	83	77
2014	87	80
2015	92	83
2016 - 2020	<u>523</u>	<u>469</u>
Total	<u>\$ 939</u>	<u>\$ 852</u>

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Reserve Banks at December 31, 2010 and 2009, were \$146 million and \$153 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Combined Statements of Condition. Net periodic postemployment benefit expense included in 2010 and 2009 operating expenses were \$11 million and \$56 million, respectively, and are recorded as a component of "Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

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15. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than retirement plans	Total accumulated other comprehensive income (loss)
Balance at January 1, 2009	\$ (4,418)	\$ (265)	\$ (4,683)
Change in funded status of benefit plans:			
Prior service costs arising during the year	(10)	9	(1)
Net actuarial gain (loss) arising during the year	656	(54)	602
Amortization of prior service cost	116	(20)	96
Amortization of net actuarial loss	285	29	314
Amortization of deferred curtailment gain	-	(4)	(4)
Change in funded status of benefit plans - other comprehensive income (loss)	<u>1,047</u>	<u>(40)</u>	<u>1,007</u>
Balance at December 31, 2009	<u>\$ (3,371)</u>	<u>\$ (305)</u>	<u>\$ (3,676)</u>
Change in funded status of benefit plans:			
Prior service costs arising during the year	-	16	16
Net actuarial gain (loss) arising during the year	(289)	9	(280)
Amortization of prior service cost	112	(18)	94
Amortization of net actuarial loss	<u>188</u>	<u>28</u>	<u>216</u>
Change in funded status of benefit plans - other comprehensive income	<u>11</u>	<u>35</u>	<u>46</u>
Balance at December 31, 2010	<u>\$ (3,360)</u>	<u>\$ (270)</u>	<u>\$ (3,630)</u>

Additional detail regarding the classification of accumulated other comprehensive loss is included in Notes 13 and 14.

16. BUSINESS RESTRUCTURING CHARGES

In 2010, the Reserve Banks announced the consolidation of some of their currency processing operations. As a result of this initiative, currency processing operations performed by two Reserve Bank Branch offices will be consolidated.

In 2009, the Reserve Banks continued their check restructuring initiatives to align check processing infrastructure and operations with declining check processing volumes. Additional announcements in 2009 included restructuring plans associated with discontinuing check print sites.

Restructuring plans announced prior to 2009 included the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites; one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing. Additional announcements in

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2008 included restructuring plans associated with the closure of a check processing contingency center and the consolidation of check adjustments sites.

Following is a summary of financial information related to the restructuring plans (in millions):

	2010 restructuring plans	2009 restructuring plans	2008 and prior restructuring plans	Total
<i>Information related to restructuring plans as of December 31, 2010:</i>				
Total expected costs related to restructuring activity	\$ 4	\$ 4	\$ 53	\$ 61
Estimated future costs related to restructuring activity	1	-	-	1
Expected completion date	2011	2010	2010	
<i>Reconciliation of liability balances:</i>				
Balance at January 1, 2009	\$ -	\$ -	\$ 40	\$ 40
Employee separation costs	-	4	-	4
Adjustments	-	-	(2)	(2)
Payments	-	-	(23)	(23)
Balance at December 31, 2009	<u>\$ -</u>	<u>\$ 4</u>	<u>\$ 15</u>	<u>\$ 19</u>
Employee separation costs	3	-	-	3
Contract termination costs	-	-	1	1
Adjustments	-	(1)	(1)	(2)
Payments	-	(2)	(9)	(11)
Balance at December 31, 2010	<u><u>\$ 3</u></u>	<u><u>\$ 1</u></u>	<u><u>\$ 6</u></u>	<u><u>\$ 10</u></u>

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period to termination. Restructuring costs related to employee separations are reported as a component of "Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

Contract termination costs include the charges resulting from terminating existing lease and other contracts and are shown as a component of "Operating expenses: Other" in the Combined Statements of Income and Comprehensive Income.

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

Restructuring costs associated with the impairment of certain Bank assets, including software and buildings, are discussed in Note 11.

17. SUBSEQUENT EVENTS

The closing of the AIG recapitalization plan, which occurred on January 14, 2011, is discussed in Note 3. On February 11, 2011, Treasury announced the consolidation of the Treasury Retail Securities operations and, as a result, the related operations currently performed at the Federal Reserve Bank of Cleveland will be

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consolidated at the Federal Reserve Bank of Minneapolis. Treasury plans to complete the consolidation by the end of 2011, and the Federal Reserve Bank of Cleveland is evaluating the consolidation efforts and has not yet determined the effects on the 2011 financial statements. There were no other subsequent events that require adjustments to or disclosures in the combined financial statements as of December 31, 2010. Subsequent events were evaluated through March 22, 2011, which is the date that the Board issued the combined financial statements.