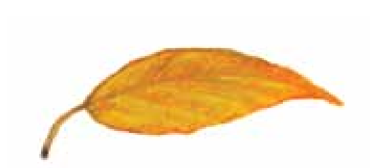
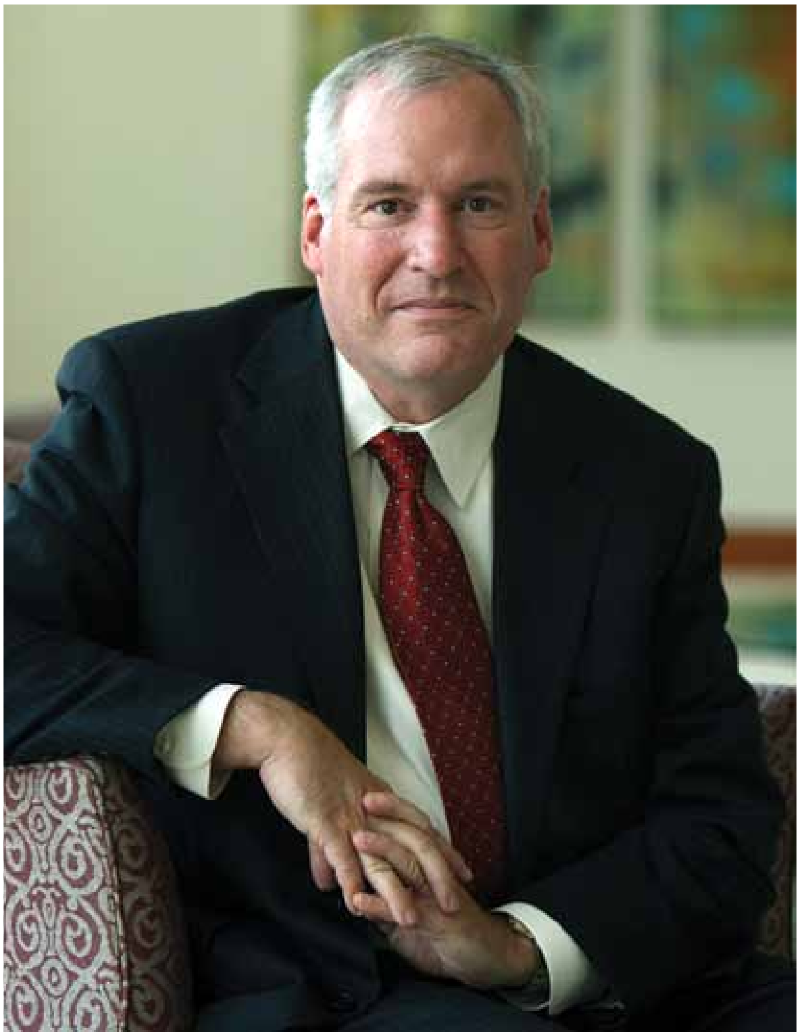
New England Transformed

Annual Report 2010
Federal Reserve Bank of Boston

Contents



Letter from the President



Transition and transformation are themes running through this Annual Report from the Federal Reserve Bank of Boston. The report's essay reflects on transformations in New England's economy over the last 35 years, from the viewpoint of my colleague Lynn Browne, who followed the economy's every move over that time and has just recently retired from the Bank. And page 7 offers a tribute to Paul Connolly, the Bank's First Vice President and Chief Operating Officer, whose retirement at the end of 2010 ushered in a transition in the Bank's senior leadership. We welcome Kenneth C. Montgomery as the Bank's new First Vice President and Chief Operating Officer. The Highlights section of this report notes some areas where the Bank's work is evolving and, most importantly, having an impact that is positive and transformative for New Englanders and the nation.

Transitioning from the after-effects of the financial crisis and an acute recession is obviously a major concern for all of us today. Nationally, the economy grew during 2010, but not enough to make much progress in reducing unemployment, which continues unacceptably high. For 2011, I have forecast GDP growth of 3.0 to 4.0 percent. This is certainly an improvement, but — soberingly — would still leave unemployment at year's end far above anyone's estimate of full employment.

Housing has traditionally been a key generator of growth during the early stages of a recovery, but housing has not provided any lift to the economy thus far, and, looking ahead, it seems likely that residential investment, consumer durables, and services related to housing will be much less robust than usual. Other sectors, including business fixed investment, which has been relatively strong, will need to pick up the slack. It is important not to lose sight of how much excess capacity remains in the economy. It will likely take several years to return to full employment. It is also likely that measures of core inflation will remain well below 2 percent over that period. Given this substantial excess capacity and low core inflation rate, it is appropriate that monetary policy has been deployed so as to encourage a more vigorous recovery.

I know that some observers are concerned about a flare-up in inflation. I believe that core inflation will remain low in the short run, and that in the longer term the Federal Reserve has the tools and the steadfast commitment to address inflationary pressures. Indeed, while monetary policy works with lags, it has been more than two years since the Fed's balance sheet expanded dramatically. Since that time, core inflation has remained quite low. As the economy makes further significant improvement, policy must become less accommodative. Getting this balance right will be one of the main policy challenges over the next several years. I am confident that the Federal Open Market Committee can meet this challenge.

New England, I would note, is recovering from the financial crisis and subsequent recession somewhat more quickly than the rest of the country. On the whole, our region enjoys relatively healthier residential and commercial real estate markets and better-capitalized financial institutions. We are fortunate in this regard, and it is likely that our quicker recovery will continue. As I talk to business people around the region, I hear growing confidence in the recovery. But I believe it is critical to our region's success that we New Englanders continue to find ways to do what we have done so well in the past: to collaborate, leverage our regional advantages, and promote the best ideas generated by our colleges and universities, medical and scientific facilities, technology entrepreneurs, and others. Taking these exceptional resources to the next level can lead to another of the transformations that have fuelled New England's growth over the decades.

Turning to the Bank itself, I am pleased to report that our work in 2010 was noteworthy on many fronts. In the monetary policy realm, we made significant contributions to the challenge of policymaking in a slow, post-crisis recovery, placing a balanced emphasis on both elements of the Federal Reserve's mandate — price stability and maximum sustainable employment. We not only produced excellent research and analysis, but we also worked hard to make sure that policymakers were aware of our findings. I am particularly pleased about the work we have done to help Massachusetts lawmakers see new possibilities for addressing the thorny issue of state-aid distribution. And we believe that we have played a positive role in helping public, private, and civic leaders in Springfield, Massachusetts, work more collaboratively to revitalize their community.

Our bank supervision staff had a demanding and productive year. They provided important policy contributions regarding supervisory oversight of systemically significant financial organizations, capital regulation, and supervisory engagement with non-depository financial institutions. As a result of the Dodd-Frank Act, staff have new supervisory responsibilities, additional opportunities to contribute to financial stability, and an expanded role in diversity and inclusion efforts. Apart from Dodd-Frank, the Bank's work for the U.S. Treasury and our activities on behalf of the entire Federal Reserve System grew as well. We expanded and enhanced the services we provide to the

U.S. Treasury with the goal of providing the most economic value to U.S. taxpayers. Our national responsibilities within the Federal Reserve System include financial management and Internet security. We fulfilled key objectives in both of these areas. These and other initiatives are described in more detail in the Bank Highlights section of this report.

We have a dedicated staff at the Bank, and I am grateful for their engagement and expertise. I am also most appreciative of the valuable service of our board of directors and our various advisory councils. The insights they share with us from all corners of New England truly make a difference in the work we do. In this regard, I especially want to thank two directors. James Smith, President and CEO of Webster Bank, N.A., completed his service on our board in 2010. During his term, Jim was an early supporter of our mortgage-relief and foreclosure-prevention efforts, and he brought a wealth of knowledge and perspective to board deliberations. Michael Wedge, former President and CEO of BJ's Wholesale Club, completed five years on our board in early 2011. Mike provided valued input and counsel, and his insights were always very helpful.

Sincerely,

Eric Rosengren

Paul M. Connolly

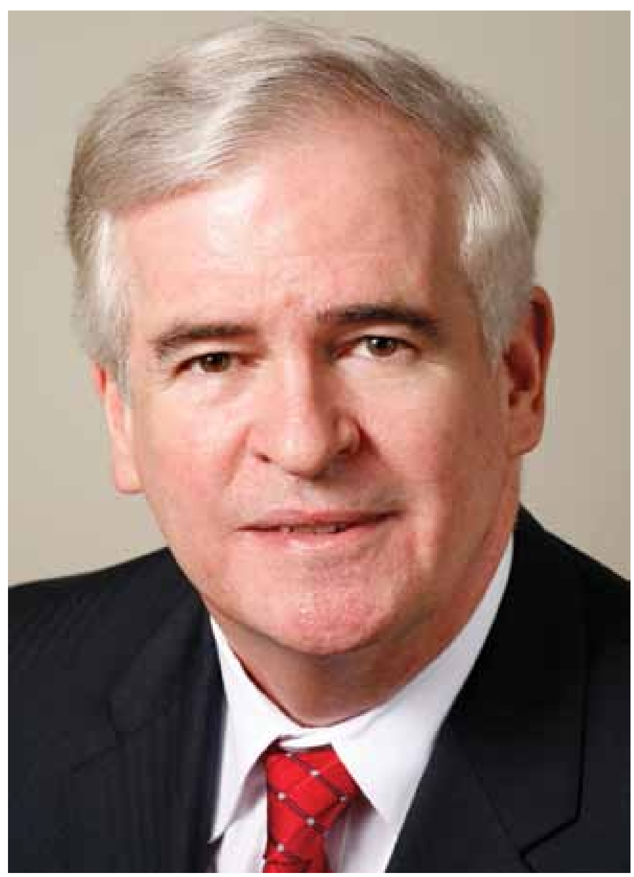
Distinguished Service to the Federal Reserve System

After more than three decades of public service at the Federal Reserve Bank of Boston, most recently as First Vice President and Chief Operating Officer, Paul M. Connolly retired from the Bank in December 2010.

When Paul, a Boston native, responded to a 1974 newspaper ad for a Boston Fed systems analyst, he embarked on a distinguished 36-year career at the Bank, one marked by "substantial contributions and accomplishments," according to Federal Reserve Board Chairman Ben Bernanke, who added, "the Boston Federal Reserve Bank is a strong, stable, and well-managed leader within the System today — an enviable position that is due in no small measure to your 16 years of service as the Bank's first Vice President and Chief Operating Officer."

Whether it was encouraging the Bank and the System to become more electronic, spurring the Bank to become a System-wide e-commerce leader, nudging the Bank to become more engaged with the outside world, leading the System's Y2K preparation efforts in the late 1990s, or directing the System's Retail Payments Products Office and the System's Financial Support Office, Paul, in his understated way, inspired colleagues to *always* strive for excellence.

The pursuit of excellence, Paul often emphasized, is important not only because it impacts the reputation of the Bank and the System, but also because success attracts opportunities. Thanks to Paul's emphasis on achieving excellence and his insistence on long-range strategic planning, the Bank is better positioned today to meet the rigorous demands of an ever-evolving global financial landscape.



Paul's commitment to public service was unwavering. While a board member of the Greater Boston Chamber of Commerce, Paul, citing Boston Fed research, argued that regional business leaders must make a greater effort to retain recent college graduates, who too often leave New England after graduation. Paul not only argued this persuasively, but he also worked to show how it might be done through internships and other approaches.

Paul never forgot his Dorchester roots. During the Bank's annual United Way Community Care Day, Paul drove from site to site, dropping off lunches and offering words of encouragement to Boston Fed volunteers. He also sat on the board of the neighborhood organization, College Bound Dorchester.

The Bank's officers, directors, and staff thank Paul for his distinguished leadership, insightful perspective on issues confronting the Bank, and his friendship. We wish him well.

NEW ENGLAND Transformed

Lynn E. Browne
Executive Vice President
and Economic Advisor

In April 1975, I joined the Federal Reserve Bank of Boston as an economist specializing in regional issues. New England and the nation were just reaching the bottom of a very severe recession, with signs of recovery not yet evident. The 1973-75 recession had been deeper in New England than the nation, and the region's recovery was expected to be slower. Worse, New England had seen its per capita income slip relative to the rest of the country and was viewed as an old region, with an industry mix heavily oriented to uncompetitive and declining industries.

Today, we still speak about New England being old, but now the focus of concern is the age of the population. We are less worried about our ability to compete for industries than our ability to attract and retain young people. New England, especially the Greater Boston area, has built a reputation for having reinvented its economy, and the region enjoys the highest per capita income of any part of the country. New England's globally renowned research universities and academic health centers have proven to be powerful engines of growth, fostering innovation and supporting sophisticated industrial clusters in life sciences and information technology and the nexus between the two. The region continues to face challenges, particularly in providing opportunities for those who do not possess advanced education and skills. But it has come a long way over the past four decades.

This essay discusses some of the changes that have occurred in New England over the past four decades, comparing the challenges we faced in the mid-1970s with those we face today.

New England in the 1970s

In 1975, New England's future did not look promising. Employment growth since 1950 had fallen well short of that nationally.[1] The recession of 1970-71 had been more severe in New England than the nation, and the region's recovery had lagged that of the nation. This scenario seemed to be replaying itself in the 1973-75 downturn.

New England in 1975 was still contending with the legacy of its early industrialization. Manufacturing had flourished in New England when most of the country was still dominated by farming. The region's early industrial start was the foundation for its prosperity. But industries that had been technological leaders in the 19th century struggled to compete in the 20th — first, against firms in other parts of the country and by the 1970s, increasingly against overseas competitors. Yet so dominant had the textile and shoe industries been in their heyday that even in the mid-1970s,

after years of decline, they were still sizable — albeit declining — employers. Newer, more vibrant manufacturing industries, notably electronics and aircraft engines, had emerged; but these were tied to defense spending, which was sharply curtailed as the Vietnam War wound down.

Adding to New England's woes was the oil embargo of 1973 and the resulting increase in oil prices. New England was much more dependent upon oil than the rest of the country, relying on oil for heating and electricity generation as well as for transportation. Elsewhere, natural gas and coal were more important fuel sources for non-transportation needs. Because of New England's dependence on oil, energy costs rose much more in the region than in the country as a whole.[2]

Anxieties about the future were particularly acute in Massachusetts and Rhode Island. Both states had been centers for the textile industry. Both states were severely affected by the closing of military bases in the early 1970s. Both states had developed reputations as hostile to business, and Massa-

chusetts had acquired the nickname "Taxachusetts" for its high tax burden.

Competition for manufacturing jobs from "Sunbelt" states in the South and West was a key concern, but competition within the region was also an issue. New Hampshire had been growing more rapidly than the rest of the region. While New Hampshire's success was commonly attributed to its low taxes and a pro-business attitude, many in Massachusetts thought that New Hampshire took advantage of its proximity to its larger neighbor and the more generous public services provided by Massachusetts.

Some things change; some things stay the same

The precarious state of New England's future in 1975 seemed to be summarized by the decline in its per capita income from 109 percent of the national average in 1970 to 103 percent in 1975.[3] Despite the challenges of the post World War II years, per capita income in New England had remained close to 10 percent above the national average. But now, New England was losing ground. And the southern states were making rapid gains. Would New England and the South trade places?[4] This was more than a purely economic issue.

In fact, the South's role in the nation has grown, while New England's shares of U.S. employment and population have declined — from 6 percent in 1970 to 5 percent today. But in terms of income, New England has performed extraordinarily well. Per capita income in New England in 2010 is 20 percent above the national average, the highest of any major region of the country. Some will note — correctly — that the cost of living is higher in New England than in much of the country; so per capita income overstates the region's economic well-being. But the high cost of living in New England was also a lament in 1975, when relative incomes were much lower.

What went right in New England? Among the developments contributing to New England's relative prosperity were

- rising educational attainment in the region;
- relatively strong economic growth in the late 1970s and 1980s; and
- slow population growth in the 1990s and 2000s.

The region's research universities have been important engines of growth, and new industrial clusters have emerged based on concentrations of advanced skills and knowledge sets.

Rising educational attainment

Educational attainment was higher in New England than the nation in 1970, but not strikingly so. Despite a concentration of prestigious colleges and universities in the region, the fraction of the adult population in New England with at least a bachelor's degree was only 12.1 percent compared with 10.7 percent nationwide.[5] Massachusetts and Connecticut had larger fractions of college-educated adults than the nation, but the college shares in Rhode Island and Maine were below average.

Over the next three and a half decades, New England's margin of superiority widened even as educational levels rose everywhere. As of 2008, 35 percent of adult New Englanders had college degrees, compared with a national share about 28 percent.[6] Of the six New England states, only Maine was below the national average. Furthermore, New England's college graduates were more likely than their counterparts nationally to have advanced degrees.

Since college graduates earn substantially more than high school graduates and since this college premium has increased since the 1970s, rising educational attainment might seem a sufficient explanation for New England's high relative income.[7] However, the timing does not match. The bulk of New England's income gains occurred in the 1980s, while its educational level has continued to increase relative to that elsewhere.

It is probably more accurate to say that New England enjoyed a burst of growth from the late 1970s to the late 1980s that boosted productivity and incomes. Subsequently, despite episodes of economic stress, New England was able to maintain its position because educational attainment continued to rise and labor force growth slowed.

Advances in educational attainment did more than impart skills to the workforce. Higher levels of education facilitated the emergence of new industrial clusters based on state-of-the-art technology and concentrations of highly educated workers. Among these were computers and related manufacturing industries in the 1970s; software and information services in the 1980s; and more recently, life sciences activities. Additionally, throughout this period, elements of New England's financial services industry have been on the forefront of both financial innovations and information management. All of these industry groups compete nationally and internationally; productivity and pay are high. But they are not immune from recession or competitive challenges. The transformation of New England has not made it recession-proof. And in times of falling labor demand, net outmigration has acted as a safety valve, supporting wages and income levels.

A short history

While not obvious at the time, 1975 was a turning point for New England. The region recovered strongly from the recession and enjoyed relatively vigorous growth for the following ten years. The economic challenges of the first part of the 1970s had overshadowed the emergence of a new set of firms and industries that came to be characterized as "high technology industries." The quintessential high tech industry was the minicomputer industry, which flourished in the Greater Boston area and southern New Hampshire. But much of the region saw growth in manufacturing firms employing large numbers of scientists and engineers.

The rise of high tech in New England has been chronicled in many places.[8] Technological advances at the region's universities, often sparked by defense-related research, and the entry into the labor force of highly educated baby boom workers were key drivers. Not only did the rise of high tech contribute directly to the region's prosperity, but it also changed New England's image in a fundamental way: a region once seen as stagnant came to be viewed as dynamic and innovative.

New England flourished. Governor Dukakis of Massachusetts ran for president in 1988 on the basis of the "Massachusetts Miracle" and the state's transformation into a national and global high tech leader. Per capita income in New England in that year was 120 percent of the national average.[9] The regional unemployment rate was 3 percent.[10]

Increasing prosperity drove up housing prices. In the Boston area, the median sales price of an existing single family home rose from about 20 percent above the national average in 1983 to double the national average in 1988.[11] Construction took off, not only for housing but also for office, industrial, and commercial buildings.

And then the boom imploded. Construction had surged ahead of more fundamental drivers of the New England economy. High tech had begun to struggle in the mid-1980s, as the minicomputer companies succumbed to competition from personal computers and as the Reagan defense build-up came to an end. Overall growth remained strong, however, as construction had taken over as an economic driver in its own right. But when construction began to falter, the underlying weakness in fundamentals was exposed. The faltering became a plunge, and a host of construction-related industries were dragged down. Housing prices fell. Commercial property values collapsed. Many New England banks, which had lent heavily against real estate, failed. Banking problems in turn affected credit availability and added to the challenges already facing New England businesses.

WITH VERY HIGH PAY LEVELS, THE SECURITIES INDUSTRY'S CONTRIBUTION TO EARNINGS IS MUCH LARGER THAN ITS CONTRIBUTION TO JOBS. PROFESSIONAL AND TECHNICAL SERVICES, ESPECIALLY COMPUTER SYSTEMS DESIGN; INFORMATION; AND EDUCATION AND HEALTH SERVICES ALL PERFORMED WELL.

While the recession of 1990-91 was relatively mild in the country as a whole, for New England it was a regional version of the Great Recession of 2007-2009. Wage and salary employment in the region fell 10 percent.[12] Declining housing prices caused foreclosures to soar, as homeowners who lost their jobs and could not make their mortgage payments could neither sell nor refinance. People moved out and migration into the region fell off.[13] This population outflow and the resulting slow growth in the regional labor force helped cushion the effect of the falloff in labor demand.

New England saw a gradual return to prosperity as the decade of the 1990s unfolded. Driving the recovery were a more diverse group of industries than the high tech manufacturing and services that had been so important in the 1970s and 1980s. Financial services, especially the securities industry, grew vigorously in southwestern Connecticut and Greater Boston. With very high pay levels, the securities industry's contribution to earnings is much larger than its contribution to jobs. Professional and technical services, especially computer systems design; information; and education and health services all performed well. Massachusetts, in particular, was on the forefront of both the dot.com and telecommunications booms.

By 2000, New England seemed to be on top again. The region's per capita income was 20 percent above the national average; the regional unemployment rate was 2.8 percent — the lowest in the country.[14] Housing prices in much of the region had recovered in nominal terms, and the rate of appreciation was beginning to accelerate. The manufacturing sector, however, remained severely challenged. In 2000, New England had only 1 million manufacturing jobs, compared with 1½ million twenty years earlier. Job losses were widespread and included sophisticated industries like computers and aircraft engines as well as lower-skill, lower-wage industries. Since the middle of the 19th century, the New England economy had been distinguished by the high fraction of its workforce in manufacturing. In 1980, 24 percent of employment in New England was in manufacturing, compared with 18 percent nationally. But in 2000, manufacturing's share of employment had fallen to roughly 12 percent in both the region and the nation.[15]

The 2001 recession hit Massachusetts hard. The rest of New England fared about the same as the nation. But cutbacks in spending on technology equipment and software after the Y2K date change, the bursting of the dot.com bubble, and the stock market decline all affected sectors important to Massachusetts. Once again, the combination of economic distress in Massachusetts and better circumstances elsewhere in the country triggered outmigration, cushioning the rise in unemployment. In contrast with the experience in the early 1990s, the regional housing market remained very strong. Homeowners could easily sell and move to regions of greater opportunity.

Recovery was slow. Education and health care, professional and technical services, the securities industry and real estate provided most of the jobs. Manufacturing employment continued to decline.

And then came the Great Recession. Although not quite as severe in New England as the nation, the recession showed the same general pattern in both. The experience of individual New England states varied considerably. For two years, Rhode Island had the second or third highest unemployment rate of any state, while unemployment rates in New Hampshire and Vermont were consistently lower than rates in most states. Notably, Massachusetts fared somewhat better than the nation, in contrast with the recessions of 1991 and 2001. Also in contrast with the experience in the two preceding recessions, outmigration from New England did not increase. Economic conditions in most of the country were no better than in New England; and in some states that had been favored destinations for New England residents, conditions were substantially worse. At the end of 2010, New England — like the nation — was seeing a slow recovery.

Where are we now?

Clearly, New England cannot be considered a declining region today. While its shares of U.S. population and employment have declined, New England has had the highest income of any part of the country for the past twenty-five years. For much of that time, the region's unemployment rate has been below the national average.

Nevertheless, New England faces significant challenges. Many observers of the New England economy are concerned about the region's slow population growth and advancing age. The median age in all six New England states is above the national average. By this measure, Maine and Vermont are the oldest and second-oldest states in the country, and New Hampshire ranks fourth.[16] The explanation is not that the fraction of older people in New England is so much higher than elsewhere. It is higher; but a bigger difference is the smaller fraction of the population in New England that is under 18 years of age. After the baby boom, birth rates fell more in New England than in the rest of the country — and they have remained low ever since.

Aging population

The aging of the New England population raises several concerns. Many worry that an older population will have health care and other service needs that will place a fiscal burden on state governments. Growing numbers of state and local government retirees will also strain state and local government budgets. Interestingly, there is little discussion of the implications of the region's relatively small population of children. In considering the demands for government services, it seems logical to consider both ends of the age spectrum. One would think that fewer children would translate into less pressure on school budgets. The *total* dependency ratio, that is the ratio of the number of people too old and too young to work to the number of people of working age, is actually lower in New England than in most of the country.[17]

Another concern is that the aging of the New England population will result in labor shortages that could crimp the region's future growth. The availability of highly educated labor is considered to be one of New England's key competitive advantages; and as noted above, the entry into the labor force of highly educated baby boomers trained in state-of-the-art computer and other technologies is thought to be one of the reasons for the flowering of high tech industries in the region in the 1970s. These baby boomers are now reaching retirement age, raising the prospect of future shortages of skilled workers, with negative implications for the region's competitive position.

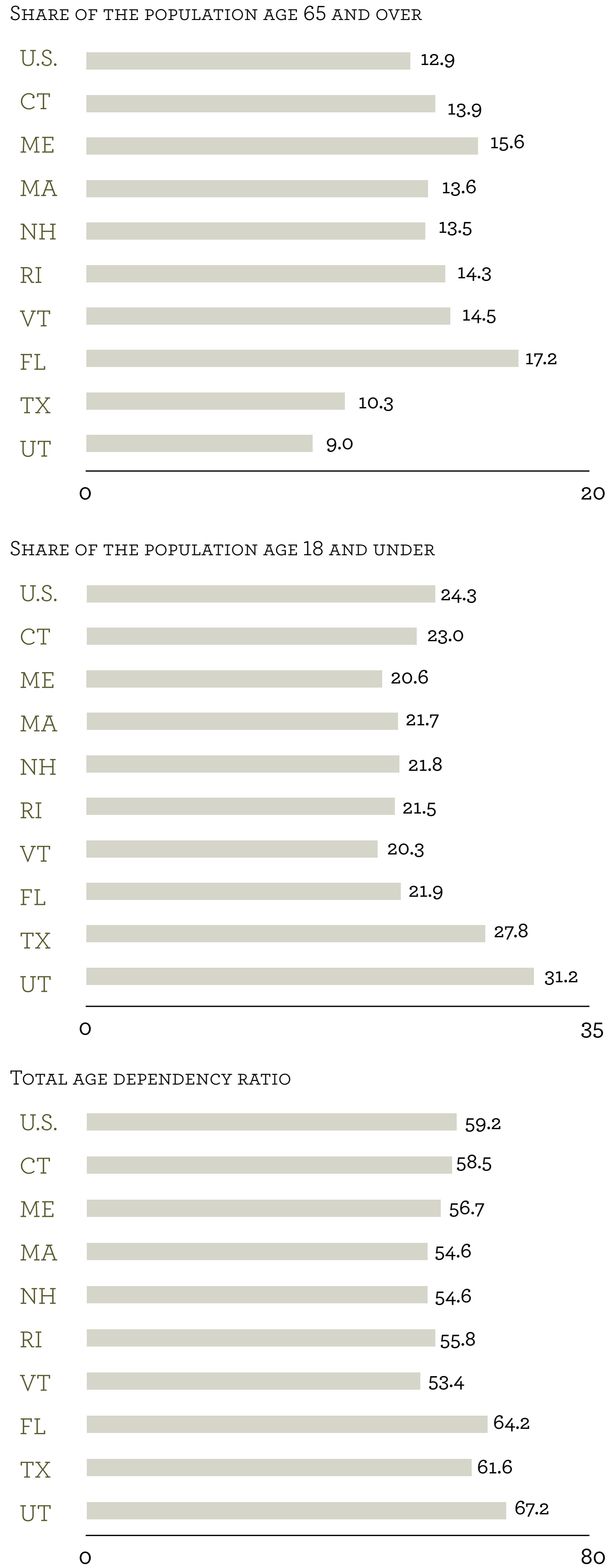
Over the past twenty years, however, New England has had to contend more with a shortage of jobs than a shortage of workers. There have been three severe recessions. Two of these, the recessions of 1991 and 2001, were deeper and longer in the region than the nation, contributing to net outmigration to the rest of the country. Given this history of weak labor demand and an unemployment rate in 2010 of over 8 percent, some New England workers might see the pending retirement of the baby boomers as a positive development — enhancing their own employment and earnings prospects.

Alicia Sasser Modestino of the Boston Fed recently examined in detail the potential for labor force shortages in New England. She found that the potential for shortages is greatest in the mid-skill range — in occupations requiring an associate's degree or equivalent, rather than at the upper end. These middle level skills are especially prevalent in health care and in office and administrative support occupations. The overall potential for shortages is most pronounced after 2020.

Although Modestino's projections suggest that the supply of higher skill workers may be adequate, at least in the aggregate, her analysis flags some worrisome developments. First, even in the recession year of 2009, vacancy rates for computer-related occupations, engineers, and scientists were quite high. And before the recession, vacancy rates were very high. While employment in high technology manufacturing and related services industries has fallen in recent years, high vacancy rates in key occupations raise the question of whether the competitive position of these industries has been adversely affected by shortages of specialized labor.

Perhaps of even greater concern are projections of future labor supply that show minimal increases in overall educational attainment. Minorities, especially Latinos, will be an increasing share of the labor force, both in New England and nationally. Because minorities have lower education levels than whites, this demographic shift is projected to limit increases in overall educational attainment — even al-

The Old, the Young, and Age Dependency Ratio New England and Selected States

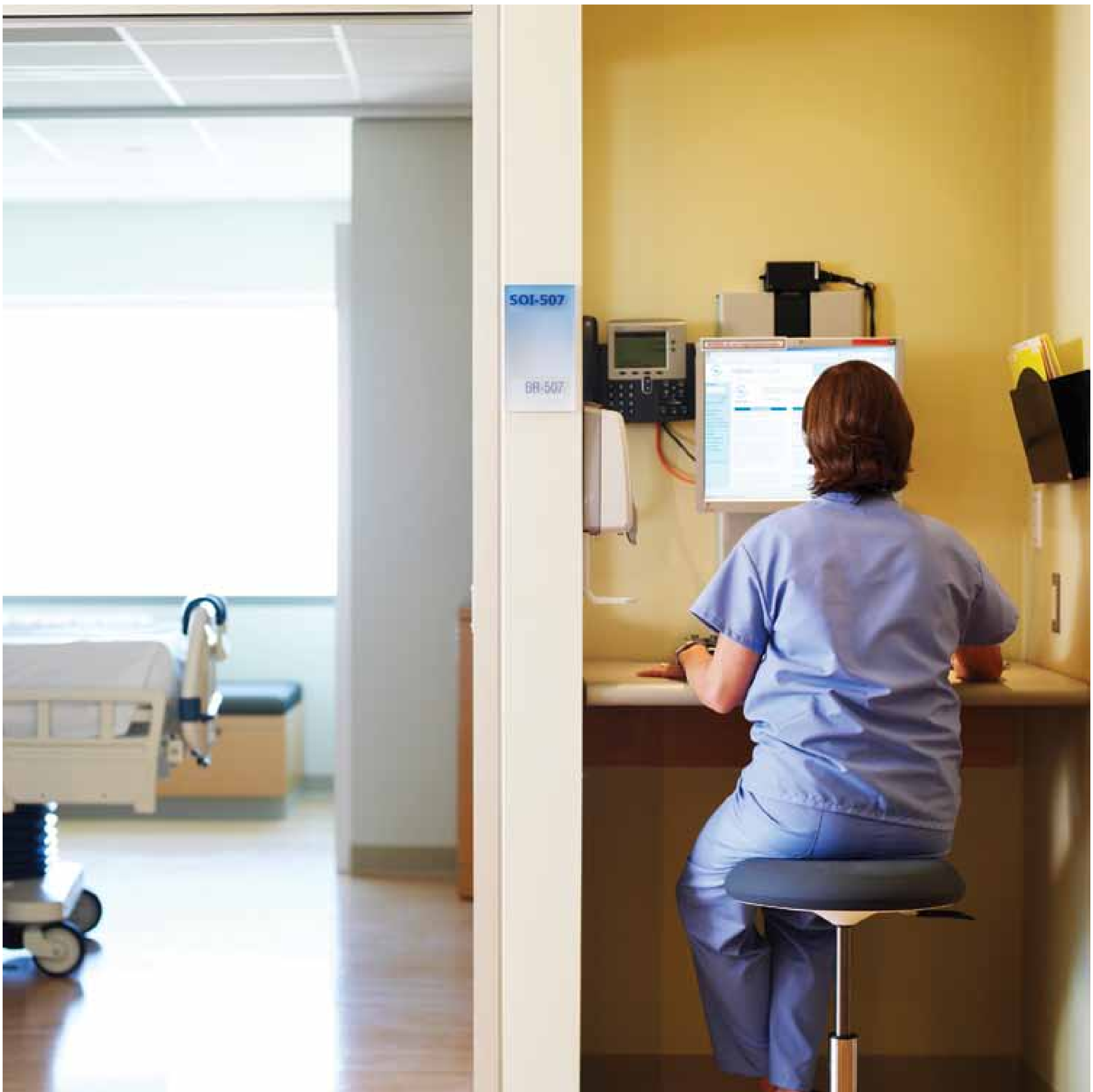


Source: U.S. Census Bureau, "Annual Estimates of the Resident Population by Sex and Age for States and for Puerto Rico, April 1, 2000 to July 1, 2009," June 2010, Table 16.

lowing for increasing educational gains among minority populations.[18] New England should maintain its educational advantage relative to the nation, but it seems unlikely to make much progress relative to its own past performance.

Why is this worrisome in the absence of projected shortages of high-skill workers? Because the supply of high-skill workers can create its own demand. The emergence of high technology industries in the mid-1970s was not a continuation of past trends. The entry into the labor force of the highly educated baby boomers played a key role in these industries' development. Further, concentrations of highly educated individuals from diverse fields can create a culture of innovation in which different perspectives, experiences, and expertise come together to generate new ideas that, in turn, lead to new opportunities. This networking is most often associated with Silicon Valley; but New England, especially the Boston area, has also benefited from this phenomenon.[19]

The region's research universities and, increasingly, their affiliated medical schools, have been important sources of innovative technologies that have formed the basis for new firms. These institutions are magnets for top students and researchers from across the country and around the world. Will these students and researchers choose to stay in New England? And if they choose to become entrepre-



THE REGION'S UNIVERSITIES AND, INCREASINGLY, THEIR AFFILIATED MEDICAL SCHOOLS, HAVE BEEN IMPORTANT SOURCES OF INNOVATIVE TECHNOLOGIES…THESE INSTITUTIONS ARE MAGNETS FOR TOP STUDENTS AND RESEARCHERS FROM ACROSS THE COUNTRY AND AROUND THE WORLD.

neurs, will they locate their businesses in the region? Research, again by Alicia Sasser Modestino, shows that New England's retention rate for non-native graduates is relatively low.[20] Moreover, foreign nationals, who compose a substantial fraction of the graduate-student population, face formidable hurdles when they seek to become permanent residents. However, a recent study of entrepreneurship at the Massachusetts Institute of Technology (MIT) indicates that MIT, the institution with the strongest reputation for generating new firms, remains an active source of new technology-based start-up businesses, many in close physical proximity to the universities.[21] Furthermore, other universities in the region are actively trying to emulate MIT in this regard.

Decline of manufacturing

While highly skilled workers have generally prospered in New England, workers without a college education have found their opportunities increasingly constrained.

The number of manufacturing jobs in New England has fallen by roughly half since the mid-1980s. For the past ten years, manufacturing employment nationally has also been falling rapidly. High productivity growth has contributed to the decline in manufacturing jobs. But in addition, manufacturers in both the nation and New England have lost ground to foreign competitors. In the past ten years, in industry after industry, employment has fallen sharply as imports have soared.

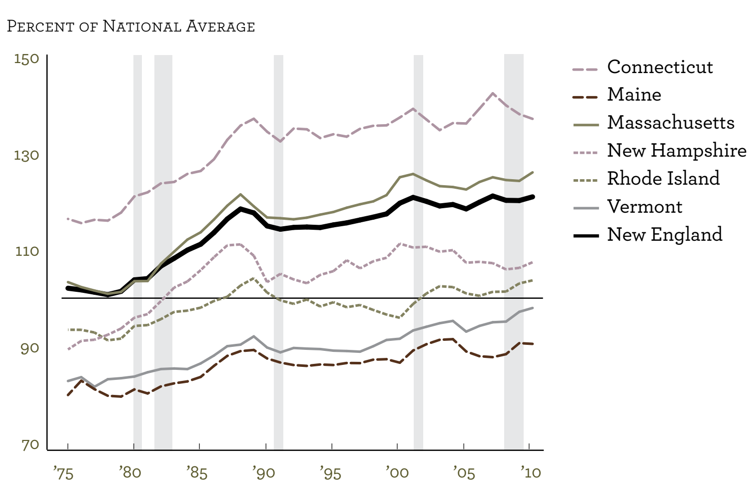
Historically, manufacturing production offered relatively high-wage jobs for people who lacked formal education. Construction, although a much smaller industry than manufacturing, was another option. However, with the Great Recession of 2007-2009, construction jobs plummeted. Men have been especially affected by the employment declines in both industries. And for many men who have lost their jobs in these industries, the alternatives are not promising. Opportunities to match the wages that they enjoyed in manufacturing and construction are few. Jobs paying comparably require more formal education.

More generally, educational attainment has not increased as much among men as among women. The ramifications of this situation are potentially far reaching. The lower levels of education among men, especially minority men, and the poor earnings prospects of men who lack college are thought to contribute to lower marriage rates.[22] Low marriage rates are, in turn, associated with more children born outside of marriage, more single-parent families, and higher rates of poverty.

Poverty rates in New England

Poverty rates in New England are lower than nationally by a considerable margin. All six New England states were below the national average in 2008, with New Hampshire having the lowest poverty rate of any state. But in some cities and towns poverty rates are high. Poverty rates are especially high, over 25 percent, in some of the region's former manufacturing centers — Hartford, Providence, Lawrence, and Springfield.[23] This geographic concentration of the poor creates negative spillovers that tend to be self-reinforcing — poor schools, higher crime rates, poorly maintained buildings and infrastructure. Communities with high concentrations of poverty face higher demands for public services, while at the same time local property tax and other resources are limited.

New England State Per Capita Income Relative to the National Average, 1975-2010



Source: Bureau of Economic Analysis, U.S. Department of Commerce.
Note: Shaded areas indicate recessions.

State governments have provided some relief through local aid, but their ability to help has been severely constrained in recent years by the Great Recession.

It could have been worse

Some challenges that seemed pressing in 1975 have either diminished or their consequences have been less dire than feared. The high cost of energy and New England's dependence on imported oil are a case in point. In 1975, the nation had just gone through an oil embargo that caused huge lines at gasoline stations and a sharp spike in oil prices. Because New England was much more dependent upon oil than the nation, many feared that higher oil prices would cripple the region's economy. But these fears have not been realized.

Conservation and increases in energy efficiency helped, as did the fact that New England industries were generally less energy intensive than industries nationally. Federal deregulation of natural gas prices led to increases in the supply of natural gas nationally and, eventually, in New England. Nuclear power plants that were under construction or in the planning stages in 1975 were completed and contributed importantly to the region's energy mix.

At times, over the next three decades, concerns about the adequacy of energy supplies, especially electricity, would intensify and lead to calls for aggressive action. But to date, ways have been found to meet New England's needs without draconian conservation measures, controversial new construction, or serious consequences for the region's economic growth. This is not to suggest that more should not be done to encourage conservation or to develop new energy alternatives. Rather, the point is simply that, to date, this has been a more manageable problem than was feared in 1975, and many of the energy issues confronting New England today, including how to address concerns about carbon emissions, are not unique to the region.[24]

Another problem that seems to have receded is New England's reputation as a high-tax region, hostile to business. This perception was attributable, in large measure, to Massachusetts. Each of the six New England states has a different political environment and a different strategy for encouraging economic development. But with half of the region's population and economic activity, Massachusetts' image tends to dominate. Moreover, some features of doing business in Massachusetts are mirrored in other states. All of the New England states are characterized by small municipal jurisdictions that wield considerable power. Environmental considerations and community character matter a lot in New England; so the process of securing building and other permits can be arduous. Political leaders in New England recognize the benefits of a streamlined approach, but local control is also much valued.

In 1975, many businesses leaders regarded Massachusetts as a pro-labor, anti-business state. Massachusetts had also embraced the Great Society with enthusiasm, expanding the social safety net and, in the process, increasing taxes.

To some extent, hostility to business was understandable, given a long history of disinvestment by the once dominant textile industry. However, with the emergence of the minicomputer and other high tech companies, a new group of business leaders came to the fore. These leaders aggressively pushed a more pro-business agenda, promising to create large numbers of high-paying jobs in return — and for a time, they delivered.

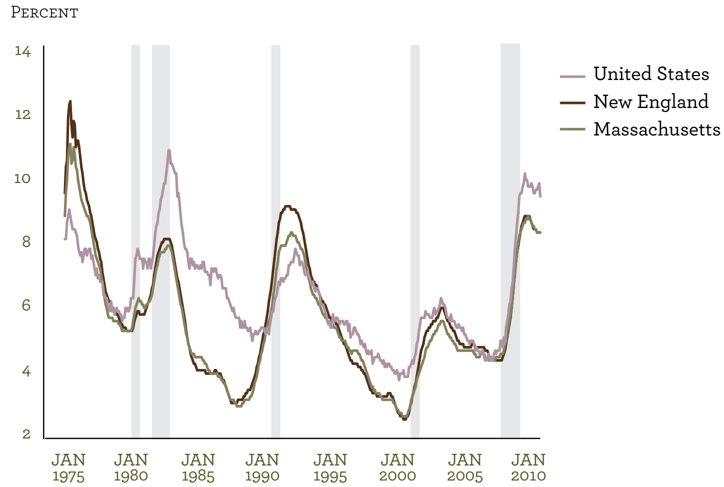
A key element of their agenda was lower taxes. There was also growing grassroots support for lower taxes, inspired in part by the example of California's Proposition 13. In 1980, Massachusetts voters passed a referendum limiting property taxes to 2 ½ percent of property values. Proposition 2 ½ redefined the tax situation in Massachusetts, exerting a restraining influence that remains to this day. At the same time, the Commonwealth began to promote itself as a business-friendly, technologically savvy place. Political leaders, as well as the public, embraced the dynamic, can-do image.

The recession of 1990-91 brought a hard end to the Massachusetts Miracle and threatened to revive old hostilities. Instead, however, political leaders of different stripes came together and made a number of tax and other changes intended to make the state more attractive to entrepreneurs and investors. Today, Massachusetts' tax burden compares favorably with that in most states.[25] However, while the reality has changed, Massachusetts may never be able to shed its catchy nickname as Taxachusetts.

Conclusions

New England is a different place today than it was back in 1975. Notably, New England has demonstrated an ability to prosper despite setbacks. Both in reality and in its image, New England has been transformed from a region dependent on older, traditional manufacturing industries to one that sustains itself through knowledge-intensive activities.

Monthly Unemployment Rate, 1975-2010
United States, New England, and Massachusetts



Source: Bureau of Labor Statistics and New England Economic Indicators.
Note: Shaded areas indicate recessions.

This transformation began with the simultaneous flowering of computer-based high technology industries and the entry into the labor force of young, energetic, highly educated baby boomers.

Now, the most pervasive concerns in the region center on the implications of the aging of the population. Some of the concern is based on the demand for services that an older population may impose. Some of the concern focuses on the possibility of labor shortages. Perhaps a bigger issue, however, is whether a projected leveling off in the region's educational attainment will adversely affect the region's capacity for innovation.

The loss of manufacturing jobs was a concern in 1975, and it is a concern today — but with a difference. Thirty-five years ago, the primary fear was competition from the Sunbelt states of the South and West. Today, both New England *and* the nation are challenged by aggressive and increasingly innovative global competitors. Energy, which seemed a critical problem for the region in the 1970s, remains a concern; but the dire consequences that seemed imminent have not materialized and New England's biggest challenges are, again, shared by the rest of the country.

As I look back over the past thirty-five years, I am struck, first, by New England's ability to adapt to changing circumstances and, second, by how quickly and unexpectedly circumstances can change.

Endnotes

1 Lynn E. Browne, "The Impact of Industry Mix on New England's Economic Growth since 1950," Federal Reserve Bank of Boston, *New England Economic Indicators*, April 1977.

2 Robert Eisenmenger and Richard Syron show the ratio of energy costs to manufacturers in New England to the cost to manufacturers in the rest of the United States rising from 1.5 in 1971 to 2.3 in 1974 in "The Energy Crisis and New England's Economy," *New England and the Energy Crisis*, Federal Reserve Bank of Boston, Proceedings of a Conference held in October 1975.

3 Calculated from data in the Bureau of Economic Analysis, Regional Economic Accounts at http://www.bea.gov/regional/spi/action.cfm as found on February 17, 2011.

4 See, for example, projections by the BEA's Regional Economic Analysis Division in "Regional and State Projections of Income, Employment and Population to the Year 2000," in the *Survey of Current Business*, November 1980. New England's per capita income falls to 98 percent of the national average by 2000, while per capita income in the Southwest rises to 98 percent. The Southeast remains the lowest income region.

5 Yolanda K. Kodrzycki, "New England's Educational Advantage: Past Successes and Future Prospects," *New England Economic Review*, January/February 2000, Table 1.

6 State educational attainment is from the U.S. Census Bureau, *Statistical Abstract of the United States*, 2011, Table 229, p. 151. New England figures are calculated by weighting state attainment by populations age 25 and above from U.S. Census Bureau, "Annual Estimates of the Resident Population by Sex and Age for States and for Puerto Rico: April 1, 2000 to July 1, 2008" as found at http://www.Census.gov/popest/states/asrh/SC-EST2008-02.htm.

7 See calculations of the change in the college premium since 1980 in Figure 6 in Alicia Sasser Modestino, "Mismatch in the Labor Market: Measuring the Supply of and Demand for Skilled Labor in New England," Federal Reserve Bank of Boston New England Public Policy Center, Research Report No. 10-2, 2010. Available at http://www.bos.frb.org/economic/neppc/researchreports/2010/rr1002.htm.

8 See, for example, Lynn Elaine Browne and Steven Sass, "The Transition from a Mill-based to a Knowledge-based Economy: New England, 1940-2000," *Engines of Enterprise: An Economic History of New England*, ed. Peter Temin. (Harvard University Press, 2000).

9 From BEA Regional Economic Accounts at http://www.bea.gov/regional/spi/action.cfm as found on February 17, 2011.

10 Federal Reserve Bank of Boston, *New England Economic Indicators*, First Quarter 1990, Historical Data, p. 26.

11 Data from National Association of Realtors as found in the Federal Reserve Bank of Boston, *New England Economic Indicators*, First Quarter 1990, Historical Data, p. 31.

12 The recession started earlier and lasted longer in New England. BEA wage and salary employment in New England (NAICS) fell 10 percent from 1989 to 1992. Data from the regional data base in HAVER Analytics as of February 17, 2011.

13 Figure 4 in Alicia Sasser, "Voting with Their Feet? Local Economic Conditions and Migration Patterns in New England." Federal Reserve Bank of Boston New England Public Policy Center, Working Paper No. 09-1, 2009. Available at http://www.bos.frb.org/economic/neppc/wp/2009/neppcwp0901.htm.

14 Per capita income from http://www.bea.gov/regional/spi.drill.cfm and unemployment rate from http://www.bls.gov/news.release/History/srgune_02232001.txt as of February 22, 2011.

15 Calculated from full and part-time employment data (SIC) in the BEA Regional Economic Accounts at http://www.bea.gov/regional/spi/action.cfm as found on February 18, 2011. These calculations refer to total employment, including self-employed. For wage and salary employment, manufacturing accounted for 26 percent of jobs in New England in 1980 and 14 percent in 2000; in the United States, manufacturing accounted for 21 percent of wage and salary jobs in 1980 and 13 percent in 2000.

16 U.S. Census Bureau, "Annual Estimates of the Resident Population by Sex and Age for States and for Puerto Rico: April 1, 2000 to July 1, 2009," Table 16 at http://www.census.gov/popest/states/asrh/SC-EST2009-02.html as found on February 17, 2011.

17 U.S. Census Bureau American FactFinder, GCT-T6-R. Age Dependency Ratio of the Total Population, Data Set: 2009 Estimates, http://factfinder.census.gov/servlet/GCTTable?format=U-40Se&geo_id=01000US&ds_name=PEP_2009_EST&_box_head_nbr=GCT-T6-R as found on February 22, 2011.

18 Modestino, "Mismatch," (2010), Table 7 and Stephen Coelen and Joseph B. Berger, New England 2020: *A Forecast of Educational Attainment and its Implications for the Workforce of New England States*, (commissioned by the Nellie Mae Foundation, June 2006).

19 See Robert Krim et al., *Innovate Boston: Shaping the Future from the Past: Four Amazing Centuries of Innovation.* Boston History and Innovation Collaborative, 2006. Available at http://www.bostonhistorycollaborative.org/pdf/InnovateBoston.pdf. Section II is particularly relevant.

20 Alicia Sasser, "The Future of the Skilled Labor Force in New England: The Supply of Recent College Graduates," Federal Reserve Bank of Boston New England Public Policy Center Series, Research Report No. 08-1 (2008) Table 8. Available

at http://www.bostonfed.org/economic/neppc/research reports/2008/rr0801.pdf on February 22, 2011.

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22 D'Vera Cohn and Richard Fry, "Women, Men and the New Economics of Marriage, Executive Summary," Pew Research Center, Social & Demographic Trends, January 19, 2010. Available at http://pewsocialtrends.org/2010/01/19/women-men-and-the-new-economics-of-marriage/ on December 10, 2010.

23 These are poverty rates for individuals. The U.S. rate in 2008 was 13.2 percent; New Hampshire's rate was 7.6 percent. U.S. Bureau of the Census, *The 2011 Statistical Abstract* as found at http://www.census.gov/compendia/statab/cats/income_expenditures_poverty_wealth.html on February 22, 2010.

24 In 2008, the six New England states and four Atlantic states signed the Regional Greenhouse Gas Initiative (RGGI), a regional version of cap and trade proposals that have been very contentious at the national level.

25 In 2008, state and local taxes as a percent of personal income were 10.5 percent in Massachusetts, compared with 11.3 percent nationally, and the Commonwealth ranked 38th among all states and the District of Columbia. In 1977-78, in contrast, state and local taxes were 13.7 percent of personal income in Massachusetts, compared with 11.2 percent nationally, and the state ranked third in its tax burden. Not all the New England states moved in the same direction, however. The tax burden has increased in Maine and Connecticut since the 1970s. New Hampshire remains very low. Source: Massachusetts Budget and Policy Center data in presentation by Michael J. Widmer, Massachusetts Taxpayer Foundation, to the Commonwealth Summit, January 29, 2011.

2010 Bank Highlights

2010 was a year of major internal and external milestones for the Federal Reserve Bank of Boston. Externally, the signing of the Dodd-Frank Wall Street Reform and Consumer Protection Act, in July, ushered in a new era of revised priorities and increased responsibilities for the Bank and the Federal Reserve System. Internally, Paul M. Connolly, the Bank's Chief Operating Officer for 16 years, retired at year end. His successor, Kenneth C. Montgomery, joined the Bank in late 2010 and was able to start off the new year at full speed. These changes occurred against a backdrop of continuing economic weakness, particularly in employment, well after the official end of the recession in June 2009. As 2011 began to unfold, the New England and national economies were beginning to show welcome signs of a more robust recovery.

Supervision, Regulation, and Credit.

In the early months of 2010, while the details of the regulatory reform legislation were still being debated, Bank supervisory staff continued to apply the lessons of the financial crisis, supporting the System's efforts to strengthen the supervision of the most complex banking organizations. With the enactment of Dodd-Frank in July, supervisory personnel moved ahead with renewed direction and vigor as the System's focus shifted to the challenges of implementing this historic legislation.

Boston Fed supervisory staff provided leadership for the development and implementation of a strengthened program for the supervision of complex banking organizations. The program more effectively integrated the multi-disciplinary perspectives of a broader range of expertise within the Federal Reserve. We also shared examination staff with other Federal Reserve districts, including specialized expertise for evaluating some of the largest banks in the System and assistance with the examination of troubled regional and community banks. At the System level, we provided leadership for initiatives to develop new approaches for reviewing bank capital adequacy and incentive compensation; helped implement a methodology for evaluating capital distribution requests and improved stress testing approaches; participated in an initiative to identify, monitor, and mitigate risks associated with money market mutual funds; and contributed to several additional initiatives, including the accounting treatment of financial instruments and small business finance.

Economic Research.

With the federal funds rate at or near zero, and the possibility that deflation — widespread falling prices — could occur, the year was a challenging one for the conduct of monetary policy. In both their regular research and their work to prepare the Bank's president for meetings of the Federal Open Market Committee, Bank economists focused on the challenges of conducting monetary policy in such an environment. Their work

included analyses of inflation dynamics, the effectiveness of alternative monetary policy tools, and the extent of downward nominal wage rigidity and its implications for inflation. In October, some 130 academic, business-sector, and central-banking economists gathered for the Bank's 55th economic conference to explore in depth the challenges associated with conducting monetary policy in an environment of near-zero inflation. Many of these economists had attended a Boston Fed conference on the same topic 11 years earlier; most seemed to agree that the challenges of conducting monetary policy when short term interest rates are near zero, as in 2010, were much greater in reality than they had considered would be the case in 1999.

While work to support monetary policy decision-making was a major research focus, the Bank's economists also addressed many other important topics, including the mortgage market and housing. Researchers published six papers on the dynamics of the mortgage market, the housing crash, and the effects of the Federal Reserve's first-ever purchases of mortgage-backed securities.

The Bank's four research centers — Center for Behavioral Economics, Consumer Payments Research Center, New England Public Policy Center, and Risk and Policy Analysis Unit — produced substantial, thought-provoking research. A paper by the Consumer Payments Research Center analyzed credit card fees, documenting the implicit monetary transfer to credit card users from non-card ("cash") users. This transfer occurs because cash users generally pay the same price as card users even though merchants must pay a fee to the card issuer when consumers use their card and card issuers in turn give rewards to consumers for using their card. A paper by the Risk and Policy Analysis Unit examined financing constraints for small businesses, finding empirical evidence that such constraints may indeed hamper job creation and contribute to unemployment.

Financial Services.

The Bank operates three payment and funds management programs on behalf of the U.S. Treasury:

- the Internet Payment Platform (IPP), an application enabling federal agencies to handle all purchase order and invoice processing electronically in a single web-based system;
- the Stored Value Card (SVC) program, a prepaid card for use by military personnel at bases in the United States and 11 other countries worldwide; and
- a Cash Management program that enables the Treasury to streamline its collection of the public's money from depository institutions.

The newest of these programs, the Cash Management program, moved ahead significantly in 2010 with the Treasury's approval of the design for a new account structure and software application that will enable more efficient consolidation of funds and improve the Treasury's ability to monitor funds flows. In addition, planning and technology changes were completed to position the IPP to offer greater efficiencies and transparency in government spending. Several technology upgrades were implemented with regard to the Stored Value Card program.

National Responsibilities.

On behalf of all Federal Reserve Banks, the Boston Fed is responsible for the coordination of Federal Reserve System financial management and Internet and directory services. Over the course of 2010, we implemented upgrades and enhancements in these areas. In financial management, we made significant progress on a multi-year strategic plan, partnering with other System business areas to eliminate redundant editing and processing functions, expand training offerings for Reserve Bank financial management staff, and enhance depository institutions' ability to track and manage their collateral in real time. In Internet security, we enhanced our capability for addressing emerging Internet threats and reduced our time-to-market for completing new business requests by 50 percent. We also developed new analytical capabilities and strengthened our information sharing with other federal entities.

Regional Outreach.

The Bank continued to look for ways to address the problems arising from increasing foreclosures. We facilitated meetings between mortgage servicers, on the one hand, and community leaders and counseling organizations, on the other, to address delays and deficiencies in the processing of loan modifications. We also continued our engagement in efforts to revitalize the city of Springfield, Massachusetts. In Springfield, we focused on sharing the findings of our research on how some cities have more successfully addressed the challenges of deindustrialization and increasing poverty; these findings stress the importance of sustained collaborative leadership. Springfield's public and private sector leaders have found value in this approach. In addition, with an eye to Springfield's difficult fiscal circumstances, the Bank's New England Public Policy Center examined how Massachusetts distributes unrestricted municipal aid. The Center's detailed analysis showed that the distribution of aid does not align well with the needs of Massachusetts cities and towns. The Bank developed an approach for distributing new state aid that provides a closer alignment. Bank staff have been sharing this analysis with state and local officials.

The implications of the aging of New England's population were the focus of two additional studies by the New England Public Policy Center in 2010. In June, the Center released a study examining the state pension programs of the six New England states, outlining possible reforms to make the plans more age-neutral and more conducive to work at older ages — reforms that might provide some relief to the financial pressures all plans face. In November, the Center released a study examining the future supply of skilled labor in New England, suggesting that pressure points are most likely to occur in "middle-skill" jobs.

Diversity and Volunteerism.

Diversity highlights included the hosting of a six-unit Diversity Speakers Series; the creation of Bank-wide and department-wide diversity profiles; nine "listening tour" focus-group sessions; the formation of a Diversity and Inclusion Council; and the formation of a Diversity Advisory Council. With the passage of the Dodd-Frank Act, the Diversity Office was renamed and assumed the broader responsibilities of the Office of Minority and Women Inclusion, including assessing vendor diversity policies, providing technical assistance to suppliers, and assessing progress on diversity and inclusion at regulated financial institutions. Our Volunteer Office enjoyed its first full year of operation, with a full range of new volunteer opportunities being made available and significantly expanded staff participation in volunteer activities.

Facilities.

The Bank made a number of changes in 2010 to upgrade and enhance our building facilities — for our own use, but, more important, to maintain the attractiveness and functionality of our facilities for the use of outside groups. In October, just in time for the 55th economic conference sponsored by the Bank, we opened a new meeting center capable of accommodating comfortably 150 to 175 people and incorporating state-of-the-art audiovisual services. The new center, named the Connolly Center in honor of retiring First Vice President Paul Connolly, was completed on a fast schedule in time to host the economic conference. We also completely redesigned the New England Economic Adventure, our on-site economic education facility featuring a gallery, theater, and learning center with interactive games, exhibits, and programs. The Adventure highlights New England's economic history and the relationship between economic growth and standard of living. The new investment game, featuring alternative energy, provides a look at 21st century concerns.

Bank in the Community

While many responsibilities of the Federal Reserve Bank of Boston are regional, national, and global in scope, the Bank also seeks to share its expertise with the communities throughout its district in a variety of outreach activities. Bank staff are also engaged in the local community, working and volunteering on many projects and initiatives.

- United Way of Massachusetts Bay
- Community Care Day
- Dress for Success
- South Boston Neighborhood House
- Cradles to Crayons
- Boston Earned Income Tax Credit Campaign
- Books and Kids Program
- Math and Kids Program
- Citizen Schools
- Operation Hope
- LifeSmarts – National Consumer League Program
- Massachusetts School Bank Association
- Boston Private Industry Council
- Excel High School Partnership
    - FinTech Scholars Program
    - Job Shadow Day
    - Boston After School Jobs Program
    - Boston Summer Jobs Program
        - WriteBoston
        - Classroom at the Workplace

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Craig Welch
Vice President for Housing
NH Community Loan Fund

Center three, left to right: Meredith Jones, Eloise Vitelli, Prabal Chakrabarti. Clockwise, left to right: Eric Rosengren, Andrea Pereira, Craig Welch, Michael Swack, Andrew Cortés.

Management's Report on Internal Control Over Financial Reporting

March 22, 2011

To the Board of Directors

The management of the Federal Reserve Bank of Boston (FRBB) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2010 and 2009, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (the Financial Statements). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System as set forth in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), and, as such, include some amounts that are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the FAM and include all disclosures necessary for such fair presentation.

The management of the FRBB is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of the Financial Statements in accordance with the FAM. Internal control contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal control are reported to management and appropriate corrective measures are implemented.

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

The management of the FRBB assessed its internal control over financial reporting reflected in the Financial Statements, based upon the criteria established in the *"Internal Control – Integrated Framework"* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that the FRBB maintained effective internal control over financial reporting as it relates to the Financial Statements.

Eric S. Rosengren,
President

Jon D. Colvin, CPA,
Chief Financial Officer

Independent Auditors' Report

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

We have audited the accompanying Statements of Condition of the Federal Reserve Bank of Boston ("FRB Boston") as of December 31, 2010 and 2009 and the related 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. We also have audited the internal control over financial reporting of the FRB Boston as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The FRB Boston's management is responsible for these Financial Statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these Financial Statements and an opinion on the FRB Boston's internal control over financial reporting 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 and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the Financial Statements included 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, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

As described in Note 4 to the Financial Statements, the FRB Boston has prepared these 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 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 Financial Statements present fairly, in all material respects, the financial position of the FRB Boston as of December 31, 2010 and 2009, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, the FRB Boston maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Deloitte & Touche LLP

Boston, Massachusetts
March 22, 2011

Abbreviations

ACH............................Automated clearinghouse
AMLF..........................Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ASC.............................Accounting Standards Codification
BEP.............................Benefit Equalization Retirement Plan
Bureau..........................Bureau of Consumer Financial Protection
Dodd-Frank Act ....The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
FAM............................*Financial Accounting Manual for Federal Reserve Banks*
FASB...........................Financial Accounting Standards Board
Fannie Mae..................Federal National Mortgage Association
Freddie Mac.................Federal Home Loan Mortgage Corporation
FOMC.........................Federal Open Market Committee
FRBA...........................Federal Reserve Bank of Atlanta
FRBNY........................Federal Reserve Bank of New York
GAAP...........................Accounting principles generally accepted in the United States of America
GSE.............................Government-sponsored enterprise
IMF..............................International Monetary Fund
MBS............................Mortgage-backed securities
OEB............................Office of Employee Benefits of the Federal Reserve System
OFR............................Office of Financial Research
SDR.............................Special drawing rights
SERP............................ Supplemental Executive Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA..........................System Open Market Account
STRIP..........................Separate Trading of Registered Interest and Principal of Securities
TAF..............................Term Auction Facility
TBA.............................To be announced
TDF.............................Term Deposit Facility
TIPS............................Treasury Inflation-Protected Securities
TSLF............................Term Securities Lending Facility
TOP.............................Term Securities Lending Facility Options Program

Statements of Condition

As of December 31, 2010 and December 31, 2009 (in millions)

	2010	2009
Assets		
Gold certificates	$ 369	$ 412
Special drawing rights certificates	196	196
Coin	47	64
Items in process of collection	10	19
Loans:		
Depository institutions	1	4,161
System Open Market Account:		
Treasury securities, net	27,001	15,461
Government-sponsored enterprise debt securities, net	3,871	3,211
Federal agency and government-sponsored enterprise mortgage-backed securities, net	25,425	17,628
Foreign currency denominated assets, net	960	1,012
Central bank liquidity swaps	3	411
Accrued interest receivable	360	243
Bank premises and equipment, net	149	143
Interdistrict settlement account	4,414	25,668
Other assets	33	27
Total assets	$ 62,839	$ 68,656
Liabilities and Capital		
Federal Reserve notes outstanding, net	$ 36,298	$ 32,169
System Open Market Account:		
Securities sold under agreements to repurchase	1,511	1,491
Other liabilities	–	12
Deposits:		
Depository institutions	22,935	32,934
Other deposits	6	9
Interest payable to depository institutions	2	2
Accrued benefit costs	83	86
Deferred credit items	71	56
Accrued interest on Federal Reserve notes	90	1
Other liabilities	9	8
Total liabilities	61,005	66,768
Capital paid-in	917	944
Surplus (including accumulated other comprehensive loss of $11 million and $20 million at December 31, 2010 and 2009, respectively)	917	944
Total capital	1,834	1,888
Total liabilities and capital	$ 62,839	$ 68,656

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

Statements of Income and Comprehensive Income

For the years ended December 31, 2010 and December 31, 2009 (in millions)

	2010	2009
Interest Income		
Loans:		
Depository institutions	$ 1	$ 34
Other	–	73
System Open Market Account:		
Securities purchased under agreements to resell	–	1
Treasury securities, net	622	546
Government-sponsored enterprise debt securities, net	82	45
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,055	423
Foreign currency denominated assets, net	8	12
Central bank liquidity swaps	–	96
Total interest income	1,768	1,230
Interest Expense		
System Open Market Account:		
Securities sold under agreements to repurchase	2	3
Deposits:		
Depository institutions	42	77
Total interest expense	44	80
Net interest income	1,724	1,150
Non-Interest Income		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	18	10
Foreign currency gains (losses), net	20	(7)
Compensation received for service costs provided	19	21
Reimbursable services to government agencies	30	29
Other income	17	21
Total non-interest income	104	74
Operating Expenses		
Salaries and benefits	112	110
Occupancy	25	23
Equipment	14	11
Assessments:		
Board of Governors operating expenses and currency costs	45	42
Bureau of Consumer Financial Protection and Office of Financial Research	1	–
Other	26	27
Total operating expenses	223	213
Net income prior to distribution	1,605	1,011
Change in funded status of benefit plans	9	(10)
Comprehensive income prior to distribution	$1,614	$1,001
Distribution of comprehensive income:		
Dividends paid to member banks	$ 55	$ 55
Transferred (from) to surplus and change in accumulated other comprehensive loss	(27)	100
Payments to Treasury as interest on Federal Reserve notes	1,586	846
Total distribution	$ 1,614	$ 1,001

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

Statements of Changes in Captial

For the years ended December 31, 2010 and December 31, 2009 (in millions, except share data)

	Capital paid-in	Surplus: Net income retained	Surplus: Accumulated other comprehensive loss	Surplus: Total surplus	Total capital
Balance at January 1, 2009 (16,885,449 shares)	$ 844	$ 854	$ (10)	$ 844	$ 1,688
Net change in capital stock issued (2,002,898 shares)	100	–	–	–	100
Transferred to surplus and change in accumulated other comprehensive loss	–	110	(10)	100	100
Balance at December 31, 2009 (18,888,347 shares)	$ 944	$ 964	$ (20)	$ 944	$ 1,888
Net change in capital stock redeemed (555,986 shares)	(27)	–	–	–	(27)
Transferred from surplus and change in accumulated other comprehensive loss	–	(36)	9	(27)	(27)
Balance at December 31, 2010 (18,332,361 shares)	$ 917	$ 928	$ (11)	$ 917	$ 1,834

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

1. STRUCTURE

The Federal Reserve Bank of Boston (Bank) is part of the Federal Reserve System (System) and is one of the 12 Federal Reserve Banks (Reserve Banks) created by Congress under the Federal Reserve Act of 1913 (Federal Reserve Act), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank serves the First Federal Reserve District, which includes the states of Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, and a portion of the state of Connecticut.

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

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

2. OPERATIONS AND SERVICES

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

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

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

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

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.

Major services provided by the Bank on behalf of the System and for which the costs were not reimbursed by the other Reserve Banks include Internet and Directory Services, Financial Support Office, and Centralized Accounting Technology Services. A portion of the Centralized Accounting Technology Service costs related to services provided to the System in support of the electronic access channel is redistributed to the Federal Reserve Bank of Chicago. The Bank's reimbursement for these services was $1 million and $2 million for the years ended December 31, 2010 and 2009, respectively, and is included in "Other Income" on the Statement of Income and Comprehensive Income.

3. FINANCIAL STABILITY ACTIVITIES

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

Large-Scale Asset Purchase Programs

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

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

GSE MBS in March 2010. The settlement of all Federal agency and GSE MBS transactions was completed by August 2010.

Central Bank Liquidity Swaps

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which could be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements. U.S. dollar liquidity swap arrangements were authorized with 14 foreign central banks to provide liquidity in U.S. dollars to overseas markets. The authorization for these swap arrangements expired on February 1, 2010. In May 2010, U.S. dollar liquidity swap arrangements were reestablished with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank; these arrangements will expire on August 1, 2011.

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

Lending to Depository Institutions

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

Lending to Primary Dealers

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

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

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 Bank 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.

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 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 Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost 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 Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, more appropriately reflects the timing of the transaction's effect on the quantity of reserves in the banking system. Although the application of fair value measurements to the securities holdings may result in values substantially greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities.

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

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

a. Consolidation

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 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 Bank at original cost. In 2009, the Treasury issued $3 billion in SDR certificates to the Reserve Banks, of which $81 million was allocated to the Bank. There were no SDR transactions in 2010.

c. Coin

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

d. Loans

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

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

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are 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 Bank 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 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 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 Statements of Income and Comprehensive Income.

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

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

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

In addition to outright purchases of Federal agency and GSE MBS that are held in the SOMA, the FRBNY 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 furthers the MBS purchase program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets more generally. The FRBNY accounts 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 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 (losses), net" in the 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.

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

The foreign central bank compensates the FRBNY based on the 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 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 Bank.

h. Interdistrict Settlement Account

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

i. Bank Premises, Equipment, and Software

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

j. Federal Reserve Notes

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

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize outstanding Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government. "Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of $4,714 million and $3,618 million 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.

k. Deposits

Depository Institutions

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as "Interest payable to depository institutions" on the Statements of Condition.

There were no deposits held by the Bank under the TDF at December 31, 2010.

Other

Other deposits include foreign central bank and foreign government deposits held at the FRBNY that are allocated to the Bank.

l. 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.

m. 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 Statements of Income and Comprehensive Income.

n. 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 Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

o. 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 Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued interest on Federal Reserve notes" in the Statements of Condition.

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

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

p. Income and Costs Related to Treasury Services

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

q. Compensation Received for Service Costs Provided

The Federal Reserve Bank of Atlanta (FRBA) has overall responsibility for managing the Reserve Banks' provision of check and ACH services to depository institutions and, as a result, recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. Similarly, the FRBNY manages the Reserve Banks' provision of Fedwire funds and securities services and recognizes total System revenue for these services on its Consolidated Statements of Income and Comprehensive Income. The FRBA and the FRBNY compensate the applicable Reserve Banks for the costs incurred to provide these services. The Bank reports this compensation as "Compensation received for service costs provided" in the Statements of Income and Comprehensive Income.

r. 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 Governors' 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 fixed 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.

s. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real property taxes were $6 million for each of the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

t. Restructuring Charges

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

Note 14 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY.

The Bank had no significant restructuring activities in 2010 and 2009.

u. Recently Issued Accounting Standards

In June 2009, FASB issued Statement of Financial Accounting Standards 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 Bank for the year beginning on January 1, 2010, and did not have a material effect on the Bank's 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 Bank on December 31, 2011, and is not expected to have a material effect on the Bank's 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	Total	Total
Primary, secondary, and seasonal credit	$ 1	$ 1	$ 109
TAF	$ –	$ –	$ 4,052
Loans to depository institutions	$ 1	$ 1	$ 4,161

Loans to Depository Institutions

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

Depository institutions that are eligible to borrow under the Bank's 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 the Bank. All TAF loan principal and accrued interest was fully repaid.

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

Allowance for loan loss

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

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 Bank's allocated share of SOMA balances was approximately 2.531 percent and 1.918 percent at December 31, 2010 and 2009, respectively.

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

2010	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 466	$ –	$ –	$ 466	$ 466
Notes	19,569	356	(19)	19,906	20,364
Bonds	5,815	828	(14)	6,629	7,333
Total Treasury securities	$ 25,850	$ 1,184	$ (33)	$ 27,001	$ 28,163
GSE debt securities	$ 3,732	$ 140	$ (1)	$ 3,871	$ 3,968
Federal agency and GSE MBS	$ 25,107	$ 357	$ (39)	$ 25,425	$ 25,965

2009	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost	Fair value
Bills	$ 353	$ –	$ –	$ 353	$ 353
Notes	10,902	126	(19)	11,009	11,185
Bonds	3,642	469	(12)	4,099	4,426
Total Treasury securities	$ 14,897	$ 595	$ (31)	$ 15,461	$ 15,964
GSE debt securities	$ 3,067	$ 144	$ –	$ 3,211	$ 3,212
Federal agency and GSE MBS	$ 17,426	$ 232	$ (30)	$ 17,628	$ 17,539

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		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Bills	$ 18,422	$ 18,422	$ 18,423	$ 18,423
Notes	786,575	804,703	573,877	583,040
Bonds	261,955	289,757	213,672	230,717
Total Treasury securities	$ 1,066,952	$ 1,112,882	$ 805,972	$ 832,180
GSE debt securities	$ 152,972	$ 156,780	$ 167,362	$ 167,444
Federal agency and GSE MBS	$ 1,004,695	$ 1,026,003	$ 918,927	$ 914,290

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

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

The following table provides additional information on the amortized cost and fair values of the Federal agency and GSE MBS portfolio at December 31, 2010 and 2009 (in millions):

Distribution of MBS holdings by coupon rate	2010		2009	
Allocated to the Bank:	Amortized cost	Fair value	Amortized cost	Fair value
3.5%	$ 9	$ 9	$ 7	$ 7
4.0%	4,243	4,262	3,263	3,179
4.5%	12,594	12,876	8,332	8,280
5.0%	5,856	6,011	3,749	3,768
5.5%	2,357	2,426	1,983	2,006
6.0%	327	339	244	248
6.5%	39	42	50	51
Total	$ 25,425	$ 25,965	$ 17,628	$ 17,539
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
Allocated to the Bank:				
Contract amount outstanding, end of year	$ –	$ –	$ 1,511	$ 1,491
Average daily amount outstanding, during the year	–	152	1,378	1,779
Maximum balance outstanding, during the year	–	3,356	1,705	3,755
Securities pledged (par value), end of year	–	–	1,104	1,494
SOMA:				
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)	$ 248	$ 628	$ 1,373	$ 11,124	$ 8,451	$ 4,026	$ 25,850
GSE debt securities (par value)	29	350	721	1,798	774	60	3,732
Federal agency and GSE MBS (par value)	–	–	–	1	1	25,106	25,108
Securities sold under agreements to repurchase (contract amount)	1,511	–	–	–	–	–	1,511
Total	$ 1,788	$ 978	$ 2,094	$ 12,923	$ 9,226	$ 29,192	$ 56,201

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 the weighted average life factors in prepayment assumptions, is approximately 4.2 years.

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

	Allocated to the Bank		SOMA	
	2010	2009	2010	2009
Treasury securities	$ 559	$ 393	$ 22,081	$ 20,502
GSE debt securities	41	22	1,610	1,108

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 Bank has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Bank's obligation to pay for the securities when delivered. The amount of other liabilities allocated to the Bank and held in the SOMA at December 31, was as follows (in millions):

	Allocated to the Bank		SOMA	
	2010	2009	2010	2009
Other liabilities	$ –	$ 12	$ –	$ 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, of which $18 million and $10 million, respectively, was allocated to the Bank. These net gains are reported as "Non-interest income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

7. FOREIGN CURRENCY DENOMINATED ASSETS

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

The Bank's allocated share of foreign currency denominated assets was approximately 3.683 percent and 4.006 percent at December 31, 2010 and 2009, respectively.

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

	2010	2009
Euro:		
Foreign currency deposits	$ 260	$ 296
Securities purchased under agreements to resell	91	104
Government debt instruments	170	198
Japanese yen:		
Foreign currency deposits	143	136
Government debt instruments	296	278
Total allocated to the Bank	$ 960	$ 1,012

At December 31, 2010 and 2009, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was $966 million and $1,021 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 a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

Total Reserve Bank foreign currency denominated assets were $26,049 million and $25,272 million at December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the fair value of the total Reserve Bank foreign currency denominated assets, including accrued interest, was $26,213 million and $25,480 million, respectively.

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2010, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total allocated to the Bank
Euro	$ 200	$ 110	$ 75	$ 136	$ 521
Japanese yen	151	20	90	178	$ 439
Total allocated to the Bank	$ 351	$ 130	$ 165	$ 314	$ 960

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 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 $209 million of outstanding commitments to purchase Euro-denominated government debt instruments, of which $8 million was allocated to the Bank. 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.

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 3.683 percent and 4.006 percent at December 31, 2010 and 2009, respectively.

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, of which $3 million and $411 million, respectively, was allocated to the Bank. 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. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2010	2009
Bank premises and equipment:		
Land and land improvements	$ 27	$ 27
Buildings	162	144
Building machinery and equipment	30	30
Construction in progress	1	6
Furniture and equipment	63	60
Subtotal	283	267
Accumulated depreciation	(134)	(124)
Bank premises and equipment, net	$ 149	$ 143
Depreciation expense, for the years ended December 31	$ 15	$ 14

The Bank leases space to outside tenants with remaining lease terms ranging from 1 to 10 years. Rental income from such leases was $13 million for each of the years ended December 31, 2010 and 2009, respectively, and is reported as a component of "Other income" in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2010 are as follows (in millions):

2011	$ 12
2012	12
2013	12
2014	12
2015	10
Thereafter	16
Total	$ 74

The Bank had capitalized software assets, net of amortization, of $6 million and $7 million at December 31, 2010 and 2009, respectively. Amortization expense was $3 million for each of the years ended December 31, 2010 and 2009. Capitalized software assets are reported as a component of “Other assets” in the Statements of Condition and the related amortization is reported as a component of “Operating expenses: Other” in the Statements of Income and Comprehensive Income.

10. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2010, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms of approximately 2 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 $2 million and $1 million for the years ended December 31, 2010 and 2009, respectively. Certain of the Bank’s leases have options to renew.

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

	Operating leases
2011	$ 559
2012	427
2013	–
2014	–
2015	–
Thereafter	–
Future minimum rental payments	$ 986

At December 31, 2010, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve Bank’s capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2010 or 2009.

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

11. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (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 Bank (SERP). In addition, under the Dodd-Frank Act, employees of the Bureau can elect to participate in the System Plan. There were no Bureau participants in the System Plan as of December 31, 2010.

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 consolidated financial statements. During the years ended December 31, 2010 and 2009, costs associated with the System Plan were not reimbursed by other participating employers.

The Bank's 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.

Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches employee contributions based on a specified formula. Effective April 1, 2009, the Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. For the first three months of the year ended December 31, 2009, the Bank 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 Bank's Thrift Plan contributions totaled $5 million and $4 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income.

12. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

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

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

	2010	2009
Accumulated postretirement benefit obligation at January 1	$ 75.4	$ 63.4
Service cost benefits earned during the period	2.0	1.7
Interest cost on accumulated benefit obligation	4.3	3.8
Net actuarial (gain)/loss	(3.4)	10.2
Contributions by plan participants	1.9	1.7
Benefits paid	(5.1)	(5.6)
Medicare Part D subsidies	0.2	0.2
Plan amendments	(3.9)	–
Accumulated postretirement benefit obligation at December 31	$ 71.4	$ 75.4

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

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

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

	2010	2009
Fair value of plan assets at January 1	$ –	$ –
Contributions by the employer	3.0	3.7
Contributions by plan participants	1.9	1.7
Benefits paid	(5.1)	(5.6)
Medicare Part D subsidies	0.2	0.2
Fair value of plan assets at December 31	$ –	$ –
Unfunded obligation and accrued postretirement benefit cost	$ 71.4	$ 75.4
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 4.1	$ 0.4
Net actuarial loss	(15.4)	(20.7)
Total accumulated other comprehensive loss	$ (11.3)	$ (20.3)

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

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

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

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

	one percentage point increase	one percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 1.0	$ (0.8)
Effect on accumulated postretirement benefit obligation	8.3	(7.0)

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

	2010	2009
Service cost-benefits earned during the period	$ 2.0	$ 1.7
Interest cost on accumulated benefit obligation	4.3	3.8
Amortization of prior service cost	(0.2)	(0.7)
Amortization of net actuarial loss	1.9	0.8
Total periodic expense	8.0	5.6
Curtailment gain	–	(0.1)
Net periodic postretirement benefit expense	$ 8.0	$ 5.5

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

Prior service cost	$ (0.8)
Net actuarial loss	1.1
Total	$ 0.3

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 Statements of Income and Comprehensive Income.

A curtailment gain associated with restructuring programs that are described in Note 14 was recognized in net income in the year ended December 31, 2009, related to employees who terminated employment during 2009.

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

Federal Medicare Part D subsidy receipts were $0.2 million and $0.3 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 $61 thousand.

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

	Without subsidy	With subsidy
2011	$ 4.0	$ 3.7
2012	4.2	3.9
2013	4.3	4.0
2014	4.4	4.1
2015	4.6	4.2
2016 - 2020	25.4	22.8
Total	$ 46.9	$ 42.7

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2010 and 2009 were $5.6 million and $5.9 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2010 and 2009 operating expenses were $0.1 million and $1.7 million, respectively, and are recorded as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount related to postretirement benefits other than retirement plans
Balance at January 1, 2009	$ (10.2)
Change in funded status of benefit plans:	
Net actuarial loss arising during the year	(10.2)
Amortization of prior service cost	(0.7)
Amortization of net actuarial loss	0.8
Change in funded status of benefit plans - other comprehensive loss	(10.1)
Balance at December 31, 2009	$ (20.3)
Change in funded status of benefit plans:	
Prior service costs arising during the year	3.9
Net actuarial gain arising during the year	3.4
Amortization of prior service cost	(0.2)
Amortization of net actuarial loss	1.9
Change in funded status of benefit plans - other comprehensive loss	9.0
Balance at December 31, 2010	$ (11.3)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 12.

14. BUSINESS RESTRUCTURING CHARGES

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

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

	2008 and prior restructuring plans
Information related to restructuring plans as of December 31, 2010:	
Total expected costs related to restructuring activity	$ 3.5
Expected completion date	2010
Reconciliation of liability balances:	
Balance at January 1, 2009	$ 0.6
Payments	(0.1)
Balance at December 31, 2009	$ 0.5
Contract termination costs	1.2
Payments	(0.6)
Balance at December 31, 2010	$ 1.1

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

15. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2010. Subsequent events were evaluated through March 22, 2011, which is the date that the Bank issued the financial statements.

External Auditor Independence

In 2010, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks and the consolidated financial statements of the limited liability companies (LLCs) that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the Federal Reserve Bank of New York. Fees for D&T's services are estimated to be $8.0 million, of which approximately $1.6 million were for the audits of the LLCs. To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of Reserve Banks, or in any other way impairing its audit independence. In 2010, the Bank did not engage D&T for any non-audit services.

Bank Mission

As part of the nation's central bank, the Federal Reserve Bank of Boston promotes sound growth and financial stability in New England and the nation.

The Bank contributes to local communities, the region, and the nation through its high-quality research, regulatory oversight, and financial services, and through its commitment to leadership and innovation.

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