Inside:
Saving tips for children
FOMC who's who
President Hoenig: Too big has failed

Recessions 101
When is a downturn a recession?
FE A T U R E S

E-BANKING EVOLVES:
Shifting consumer attitudes lead to growing acceptance
Anne Skinner hardly ever has to include trips to the bank on her to-do list, opting instead to bank online. A small majority still favors in-person banking, but new technologies are coming.

TUG-OF-WATER:
Markets may be a solution as urban, ag and recreational users vie for their share
Water transfers can be as simple as an individual seller, or large-scale, involving two or more states.

PRESIDENTS, GOVERNORS AND THE FOMC:
Regional Bank leaders provide long-term stability
Actions of the Federal Open Market Committee have made headlines during the current financial turmoil, but who is on this committee and what do they do?

2008 ANNUAL REPORT
Listing of officers, directors, advisory council and roundtable groups, and financial reports for the Federal Reserve Bank of Kansas City. An explanation of the Kansas City Fed’s divisions and a look back at ’08 also are included.

IN EVERY ISSUE
1 PRESIDENT’S MESSAGE
28 ABOUT ... REGIONAL ECONOMICS
32 COMMON CENTS
34 NOTES

RECESSIONS 101:
When is a downturn a recession?
Learn about how economists define when we’re in a recession, what that means and how the current economic crisis compares with previous ones.
Too big has failed

Two years ago, we started seeing a problem in a specialized area of financial markets that many people had never heard of, known as the subprime mortgage market. At that time, most policymakers thought the problems would be self-contained and have limited impact on the broader economy. Today, we know differently. We are in the midst of a very serious financial crisis, and our economy is under significant stress.

Over the past year, the federal government and financial policy makers have enacted numerous programs and committed trillions of dollars of public funds to address the crisis. And still the problems remain. We have yet to restore confidence and transparency to the financial markets, leaving lenders and investors wary of making new commitments.

The outcome so far, while disappointing, is perhaps not surprising.

We have been slow to face up to the fundamental problems in our financial system and reluctant to take decisive action with respect to failing institutions. We are slowly beginning to deal with the overhang of problem assets and management weaknesses in some of our largest firms that this crisis is revealing. We have been quick to provide liquidity and public capital, but we have not defined a consistent plan and not addressed basic shortcomings and, in some cases, the insolvent position of these institutions.

We understandably would prefer not to “nationalize” these businesses, but in reacting as we are, we nevertheless are drifting into a situation where institutions are being nationalized piecemeal with no resolution of the crisis.

With conditions deteriorating around us, I will offer my views on how we might yet deal with the current state of affairs. I’ll start with a brief overview of the policy actions we have been pursuing, but I will also provide perspective on the actions we have taken and the outcomes we have experienced in previous financial crises. Finally, I will suggest what lessons we might take from these previous crises and apply to working our way out of the current crisis.

In suggesting alternative solutions, I acknowledge it is no simple matter to solve. People say “it can’t be done” when speaking of allowing large institutions to fail. But I don’t think that those who managed the Reconstruction Finance Corporation, the Resolution Trust Corporation, the Swedish financial crisis or any other financial crisis were handed a blueprint that carried a guarantee of success. I don’t accept that we have lost our ability to solve a new problem, especially when it looks like a familiar problem.

Current policy actions and problems

Much has been written about how we got into our current situation, most notably the breakdowns in our mortgage finance system, weak or neglected risk management practices, and highly leveraged and interconnected firms
and financial markets. Because this has been well-documented, today I will focus on the policy responses we have tried so far and where they appear to be falling short.

A wide range of policy steps has been taken to support financial institutions and improve the flow of credit to businesses and households. In the interest of time, I will go over the list quickly.

As a means of providing liquidity to the financial system and the economy, the Federal Reserve has reduced the targeted federal funds rate in a series of steps from 5.25 percent at mid-year 2007 to the present 0 to 25 basis-point range. In addition, the Federal Reserve has instituted a wide range of new lending programs and, through its emergency lending powers, has extended this lending beyond depository institutions.

The Treasury Department, the Federal Reserve and other regulators have also arranged bailouts and mergers for large struggling or insolvent institutions, including Fannie Mae and Freddie Mac, Bear Stearns, WaMu, Wachovia, AIG, Countrywide, and Merrill Lynch. But other firms, such as Lehman Brothers, have been allowed to fail.

The Treasury has invested public funds, buying preferred stock in more than 400 financial institutions through the TARP program. TARP money has also been used to fund government guarantees of more than $400 billion of securities held by major financial institutions, such as CitiGroup and Bank of America. In addition, the Federal Reserve and the Treasury Department have committed more than $170 billion to bail out the troubled insurance company AIG.

Other actions have included increased deposit insurance limits and guarantees for bank debt instruments and money market mutual funds.

The most recent step is the Treasury’s financial stability plan, which provides for a new round of TARP spending and controls, assistance for struggling homeowners, and a plan for a government/private sector partnership to buy up bad assets held by financial institutions and others.

The sequence of these actions, unfortunately, has added to market uncertainty. Investors are understandably watching to see which institutions will receive public money and survive as wards of the state.

Any financial crisis leaves a stream of losses embedded among the various participants, and these losses must ultimately be borne by someone. To start the resolution process, management responsible for the problems must be replaced and the losses identified and taken. Until these kinds of actions are taken, there is little chance to restore market confidence and get credit markets flowing. It is not a question of avoiding these losses, but one of how soon we will take them and get on to the process of recovery. Economist Allan Meltzer may have expressed this point best when he said that “capitalism without failure is like religion without sin.”

What might we learn from previous financial crises?

Many of the policy actions I just described provide support to the largest financial institutions, those that are frequently referred to as “too big to fail.” A rationale for such actions is that the failure of a large institution would have a systemic impact on the economy. It is emphasized that markets have become more complex, and institutions—both bank and nonbank entities—are now larger and connected more closely through a complicated
set of relationships. Often, they point to the negative impact on the economy caused by last year's failure of Lehman Brothers.

History, however, may show us another experience. When examining previous financial crises, in other countries as well as in the United States, large institutions have been allowed to fail. Banking authorities have been successful in placing new and more responsible managers and directors in charge and then reprivatizing them. There is also evidence suggesting that countries that have tried to avoid taking such steps have been much slower to recover, and the ultimate cost to taxpayers has been larger.

There are several examples that illustrate these points and show what has worked in previous crises and what hasn't. A comparison that many are starting to draw now is with what happened in Japan and Sweden.

Japan took a very gradual and delayed approach in addressing the problems in its banks. A series of limited steps spread out over a number of years were taken to slowly remove bad assets from the banks, and Japan put off efforts to address an even more fundamental problem—a critical shortage of capital in these banks. As a result, the banks were left in the position of having to focus on past problems with little resources available to help finance any economic recovery.

In contrast, Sweden took decisive steps to identify losses in its major financial institutions and insisted that solvent institutions restore capital and clean up their balance sheets. The Swedish government did provide loans to solvent institutions, but only if they also raised private capital.

Sweden dealt firmly with insolvent institutions, including operating two of the largest banks under governmental oversight with the goal of bringing in private capital within a reasonable amount of time. To deal with the bad assets in these banks, Sweden created well-capitalized asset management corporations or what we might call “bad banks.” This step allowed the problem assets to be dealt with separately and systematically, while other banking operations continued under a transparent and focused framework.

The end result of this approach was to restore confidence in the Swedish banking system in a timely manner and limit the amount of taxpayer losses. Sweden, which experienced a real estate decline more severe than that in the United States, was able to resolve its banking problems at a long term net cost of less than 2 percent of GDP.

We can also learn a great deal from how the United States has dealt with previous crises. There has been a lot written attempting to draw parallels with the Great Depression. The main way that we dealt with struggling banks at that time was through the Reconstruction Finance Corporation.

Without going into great detail about the RFC, I will note the four principles that Jesse Jones, the head of the RFC, employed in restructing banks. The first step was to write down a bank’s bad assets to realistic economic values. Next, the RFC would judge the character and capacity of bank management and make any needed and appropriate changes. The third step was to inject equity in the form of preferred stock, but this step did not occur until realistic asset values and capable management were in place. The final step was receiving the dividends and eventually recovering the par value of the stock as a bank returned to profitability and full private ownership.

At one point in 1933, the RFC held capital in more than 40 percent of all banks, representing one-third of total bank capital according to some estimates, but because of the
four principles of Jesse Jones, this was all carried out without any net cost to the government or to taxpayers.

If we compare the TARP program to the RFC, TARP began without a clear set of principles and has proceeded with what seems to be an ad hoc and less-than-transparent approach in the case of banks judged “too big to fail.” In both the RFC and Swedish experiences, triage was first used to set priorities and determine what institutions should be addressed immediately. TARP treated the largest institutions as one. As we move forward from here, therefore, we would be wise to have a systematic set of principles and a detailed plan to guide us.

Another example we need to be aware of relates to the thrift problems of the 1980s. Because the thrift insurance fund was inadequate to avoid the losses embedded in thrift balance sheets, an attempt was made to cover over the losses with net worth certificates and expanded powers that were supposed to allow thrifts to grow out of their problems. A notable fraction of the thrift industry was insolvent, but continued to operate as so-called “zombie” or “living dead” thrifts. As you may recall, this attempt to postpone closing insolvent thrifts did not end well, but instead added greatly to the eventual losses and led to greater real estate problems.

A final example—our approach to large bank problems in the 1980s and early 1990s—shows that we have taken some steps to deal with banking organizations that are considered “too big to fail” or very important on a regional level.

The most prominent example is Continental Illinois’ failure in 1984. Continental was the seventh-largest bank in the country, the largest domestic commercial and industrial lender, and the bank that popularized the phrase “too big to fail.” Questions about Continental’s soundness led to a run by large foreign depositors in May of 1984.

But looking back, Continental actually was allowed to fail. Although the FDIC put together an open bank assistance plan and injected capital in the form of preferred stock, it also brought in new management at the top level, and shareholders, who were the bank’s owners, lost their entire investment. The FDIC also separated the problem assets from the bank, which left a clean bank to be restructured and eventually sold. To liquidate the bad assets, the FDIC hired specialists to oversee the different categories of loans and entered into a service agreement with Continental that provided incentive compensation for its staff to help with the liquidation process.

A lesson to be drawn from Continental is that even large banks can be dealt with in a manner that imposes market discipline on management and stockholders, while controlling taxpayer losses. The FDIC’s asset disposition model in Continental, which used incentive fees and contracts with outside specialists, also proved to be an effective and workable model. This model was employed again in the failure of Bank of New England in 1991, the failures of nearly all of the large banking organizations in Texas in the 1980s, and also for the Resolution Trust Corporation, which was set up to liquidate failed thrifts.

**Resolving the current crisis**

Turning to the current crisis, there are several lessons we can draw from these past experiences.

- First, the losses in the financial system won’t go away—they will only fester and increase while impeding our chances for a recovery.
Second, we must take a consistent, timely, and specific approach to major institutions and their problems if we are to reduce market uncertainty and bring in private investors and market funding.

Third, if institutions—no matter what their size—have lost market confidence and can’t survive on their own, we must be willing to write down their losses, bring in capable management, sell off and reorganize misaligned activities and businesses, and begin the process of restoring them to private ownership.

How can we do this today in an era where we have to deal with systemic issues rising not only from very large banks, but also from many other segments of the marketplace? I would be the first to acknowledge that some things have changed in our financial markets, but financial crises continue to occur for the same reasons as always—over-optimism, excessive debt and leverage ratios, and misguided incentives and perspectives—and our solutions must continue to address these basic problems.

The process we use for failing banks—albeit far from perfect in dealing with “too big to fail” banks—provides some first insight into the principles we should establish in dealing with financial institutions of any type.

Our bank resolution framework focuses on timely action to protect depositors and other claimants, while limiting spillover effects to the economy. Insured depositors at failed banks typically gain full and immediate access to their funds, while uninsured depositors often receive quick, partial payouts based on expected recoveries.

To provide for a continuation of essential banking services, the FDIC may choose from a variety of options, including purchase and assumption transactions, deposit transfers or payouts, bridge banks, conservatorships, and open bank assistance. These options focus on transferring important banking functions over to sound banking organizations with capable management, while putting shareholders at failed banks first in line to absorb losses.

Other important features in resolving failing banks include an established priority for handling claimants, prompt corrective action, and least-cost resolution provisions to protect the deposit insurance fund and, ultimately, taxpayers and to also bring as much market discipline to the process as possible.

I would argue for constructing a defined resolution program for “too big to fail” banks and bank holding companies, and nonbank financial institutions. It is especially necessary in cases where the normal bankruptcy process may be too slow or disruptive to financial market activities and relationships. The program and resolution process should be implemented on a consistent, transparent and equitable basis whether we are resolving small banks, large banks or other complex financial entities.

How should we structure this resolution process? While a number of details would need to be worked out, let me provide a broad outline of how it might be done.

First, public authorities would be directed to declare any financial institution insolvent whenever its capital level falls too low to support its ongoing operations and the claims against it, or whenever the market loses confidence in the firm and refuses to provide funding and capital. This directive should be clearly stated and consistently adhered to for all financial institutions that are part of the intermediation process or payments system. We must also recognize up front that the FDIC’s resources and other financial industry support funds may not always be sufficient for this task and that Treasury money may also be needed.

Next, public authorities should use
receivership, conservatorship or “bridge bank” powers to take over the failing institution and continue its operations under new management. Following what we have done with banks, a receiver would then take out all or a portion of the bad assets, and either sell the remaining operations to one or more sound financial institutions or arrange for the operations to continue on a bridge basis under new management and professional oversight. In the case of larger institutions with complex operations, such bridge operations would need to continue until a plan can be carried out for cleaning up and restructuring the firm and then reprivatizing it.

Shareholders would be forced to bear the full risk of the positions they have taken and suffer the resulting losses. The newly restructured institution would continue the essential services and operations of the failing firm.

All existing obligations would be addressed and dealt with according to whatever priority is set up for handling claims. This could go so far as providing 100 percent guarantees to all liabilities, or, alternatively, it could include resolving short-term claims expeditiously and, in the case of uninsured claims, giving access to maturing funds with the potential for haircuts depending on expected recoveries, any collateral protection and likely market impact.

There is legitimate concern for addressing these issues when institutions have significant foreign operations. However, if all liabilities are guaranteed, for example, and the institution is in receivership, such international complexities could be addressed satisfactorily.

One other point in resolving “too big to fail” institutions is that public authorities should take care not to worsen our exposure to such institutions going forward. In fact, for failed institutions that have proven to be too big or too complex to manage well, steps must be taken to break up their operations and sell them off in more manageable pieces. We must also look for other ways to limit the creation and growth of firms that might be considered “too big to fail.”

In this regard, our recent experience with ad hoc solutions to large failing firms has led to even more concentrated financial markets as only the largest institutions are likely to have the available resources for the type of hasty takeovers that have occurred. Another drawback is that these organizations do not have the time for necessary “due diligence” assessments and, as we have seen, may encounter serious acquisition problems. Under a more orderly resolution process, public authorities would have the time to be more selective and bring in a wider group of bidders, and they would be able to offer all or portions of institutions that have been restored to sound conditions.

**Concluding thoughts**

While hardly painless and with much complexity itself, this approach to addressing “too big to fail” strikes me as constructive and as having a proven track record. Moreover, the current path is beset by ad hoc decision making and the potential for much political interference, including efforts to force problem institutions to lend if they accept public funds; operate under other imposed controls; and limit management pay, bonuses and severance.

If an institution’s management has failed the test of the marketplace, these managers should be replaced. They should not be given public funds and then micro-managed, as we are now doing under TARP, with a set of political strings attached.

Many are now beginning to criticize the idea of public authorities taking over large institutions on the grounds that we would be
“nationalizing” our financial system. I believe that this is a misnomer, as we are taking a temporary step that is aimed at cleaning up a limited number of failed institutions and returning them to private ownership as soon as possible. This is something that the banking agencies have done many times before with smaller institutions and, in selected cases, with very large institutions. In many ways, it is also similar to what is typically done in a bankruptcy court, but with an emphasis on ensuring a continuity of services. In contrast, what we have been doing so far is every bit a process that results in a protracted nationalization of “too big to fail” institutions.

The issue that we should be most concerned about is what approach will produce consistent and equitable outcomes and will get us back on the path to recovery in the quickest manner and at reasonable cost. While it may take us some time to clean up and reprivatize a large institution in today’s environment—and I do not intend to underestimate the difficulties that would be encountered—the alternative of leaving an institution to continue its operations with a failed management team in place is certain to be more costly and far less likely to produce a desirable outcome.

In a similar fashion, some are now claiming that public authorities do not have the expertise and capacity to take over and run a “too big to fail” institution. They contend that such takeovers would destroy a firm’s inherent value, give talented employees a reason to leave, cause further financial panic and require many years for the restructuring process. We should ask, though, why would anyone assume we are better off leaving an institution under the control of failing managers, dealing with the large volume of “toxic” assets they created and coping with a raft of politically imposed controls that would be placed on their operations?

In contrast, a firm resolution process could be placed under the oversight of independent regulatory agencies whenever possible and ideally would be funded through a combination of Treasury and financial industry funds.

Furthermore, the experience of the banking agencies in dealing with significant failures indicates that financial regulators are capable of bringing in qualified management and specialized expertise to restore failing institutions to sound health. This rebuilding process thus provides a means of restoring value to an institution, while creating the type of stable environment necessary to maintain and attract talented employees. Regulatory agencies also have a proven track record in handling large volumes of problem assets—a record that helps to ensure that resolutions are handled in a way that best protects public funds.

Finally, I would argue that creating a framework that can handle the failure of institutions of any size will restore an important element of market discipline to our financial system, limit moral hazard concerns, and assure the fairness of treatment from the smallest to the largest organizations that is the hallmark of our economic system.

THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY

President Hoenig gave this speech in Omaha, Neb., on March 6.
With a packed work schedule and an active social life, Anne Skinner is constantly on the lookout for ways to save time when it comes to her weekly to-do list.

“Not having to adjust my schedule to meet the bank’s hours is a real plus,” says Skinner, a college career counselor at Rockhurst University in Kansas City, Mo. “I don’t have to balance my checkbook because I just check what I spend online and I get instant feedback.”

Even if she broke out a pencil and calculator to balance her checkbook, she might not have anything to record. Skinner uses her debit card or online billing services to pay for almost everything. She has also applied for a loan online and uses cash and checks only occasionally.

“About 95 percent of my banking is probably electronic or online,” she says. “The only time I go into a bank is to cash a random check every once in a while.”

Skinner is representative of a rapidly growing number of consumers—usually young and educated—who have turned to the electronic world to serve their financial needs.
While roughly half of consumers still conduct their bank business face-to-face at physical offices, surveys show that electronic banking services have become much more popular, says Eric Robbins, a policy economist at the Federal Reserve Bank of Kansas City. He recently examined consumers’ attitudes and adoption of e-banking with Jeanne Hogarth and Casey Bell of the Federal Reserve Board of Governors’ Consumer and Community Affairs staff.

“Looking at the entire population, slightly more than 50 percent prefer in-person contact at brick-and-mortar locations,” Robbins says. “But those who use online banking are much more likely to prefer electronic banking services over face-to-face interaction.”

Robbins found that shifting consumer attitudes of e-banking services have led to greater acceptance of the new technology over the last several years. The group’s research is based on two national surveys: the Survey of Consumer Finances, which is conducted every three years by the Federal Reserve and the Internal Revenue Service, and the Surveys of Consumers, conducted by the University of Michigan.

“The biggest factors that influence consumer attitudes about e-banking are the perception of security, the perception of convenience and consumer knowledge and familiarity,” Robbins says.

**Changing attitudes**

At F&M Bank, employees like to say that the institution, which has nine branches in the Tulsa, Okla., area, is high-tech without losing its focus on the “high-touch” service many customers prefer.

Asa Adamson, senior executive vice president/cashier, remembers the early days of online banking and the challenges of providing a secure electronic banking environment.

“The encryption technology was pretty crude,” Adamson says. “While some customers were eager to use online banking, there were many who weren’t interested, so we went several years before we offered it. We kept our ear to the ground and monitored our customers until we saw that offering online products would impact their decision of where to bank.”

The bank outsources its retail and wholesale online banking products to a third-party vendor, and customers appear to be happy with the level of service and products provided.

“It’s too expensive for a community bank to be a pioneer in many of the online products being offered,” Adamson says. “We simply don’t have the resources. But we are close behind what the large banks are offering. While our system isn’t proprietary, it allows us to remain competitive.”

Adamson notes that even with the improvements in technology, many customers are still concerned about security. Industrywide, those concerns are among the largest barriers to e-banking adoption. Robbins found that more than half of the U.S. consumers surveyed reported that they are concerned about the safety of their money and the security of their personal information when it comes to e-banking.

Publicity surrounding recent data breaches doesn’t help ease those worries, Robbins says. Banks must also battle spam e-mails, phishing attempts and computer viruses in their effort to reassure customers that electronic banking is safe.

“Adoption of e-banking is still positive, but improving confidence in the security and privacy of these technologies could result in even more people moving to e-banking,” Robbins said.

Guaranty Bank & Trust in Denver, which has 34 branches around the Denver area, is among the institutions putting a premium on security when it comes to electronic transactions. The bank has instituted a multifactor authentication system that asks customers several questions to verify their identity as they access their online accounts.

“It’s vitally important that customers feel
Based on demographic information collected in the Survey of Consumer Finances and the University of Michigan’s Surveys of Consumers, Kansas City Fed economist Eric Robbins and his Federal Reserve System colleagues have developed a profile of consumers who are likely to adopt e-banking services.

The Michigan Surveys of Consumers show that higher income households are more likely to have a bank account and thus are more likely to use e-banking products such as online banking, debit cards and account transfers. However, Robbins says the growth in the number of low- and moderate-income (LMI) households using electronic banking services is notable.

For example, the percentage of LMI households using preauthorized bill payment has doubled from 1999 to 2006. Likewise, online banking among the lowest-income consumers grew from 17 percent to 30 percent over the same period.

E-banking adoption also is tied closely to age. In general, the younger the consumer, the more likely they are to use ATMs, debit cards and online banking.

But older consumers are catching on quickly. From 1999 to 2006, the number of older consumers using ATMs and preauthorized bill payment doubled; the number using phone banking tripled; and the percentage of older online bankers increased tenfold.

In addition, education appears to be a significant factor in the usage of e-banking services, the researchers found. E-banking levels are rising across all education levels, but there is a sizeable gap between less-educated consumers and those with the most education.

“That gap may be more of a function of who has Internet access,” Robbins says. “The populations with less education are less likely to have computers or high-speed connections, so it makes sense that they are less likely to use online banking services and other electronic products.”
their transactions are safe and their privacy is being guarded,” said Nancy Smith, senior vice president at Guaranty.

**Convenience, familiarity**

Another issue that has affected the acceptance of e-banking is consumers’ perception of convenience. Since 1999, the Michigan Surveys of Consumers have shown that a growing proportion of consumers feel e-banking helps them better manage their finances. In addition, consumers are less concerned with not being able to interact with people while conducting transactions.

“Financial institutions that want to increase the adoption of e-banking can help show how these products make banking easier,” Robbins says. “For example, setting up preauthorized payments can help consumers pay their bills on time and avoid late fees.”

Similarly, improving consumer knowledge and familiarity with e-banking services can increase adoption of such products, he says.

“Increasing familiarity of e-banking appears to provide the opportunity for the largest boost to consumer adoption,” Robbins says. “The data we reviewed indicate that if consumers become more familiar with e-banking and have greater access to the technology, overall adoption could increase significantly.”

**Looking to the future**

While e-banking products such as online bill payment, debit cards and direct deposit have continued to gain widespread acceptance, consumers and banks are already focusing on emerging technologies such as mobile payments.

Not surprisingly, surveys show that it’s the youngest group of consumers—those born after 1980—that is most receptive to using cell phones or PDAs to pay for things and carry out bank transactions.

As with other e-banking services, there are also concerns among consumers about the security of mobile payments. Robbins says a common worry is that losing a cell phone equipped for mobile payments would be similar to losing a wallet.

“There is a barrier of familiarity with mobile payments,” Robbins says. “Right now, many people say they are unlikely to use it. There are also infrastructure issues as to how mobile payments would work. There is a need to develop a common platform for the technology.”

F&M Bank’s Adamson says the lack of a common platform is one reason why his bank has decided to wait and see how the mobile payments arena evolves before stepping in.

“There’s a real lack of standardization,” Adamson says. “What works well with one cell phone provider doesn’t work with another.

“The very competent computer and PDA users are the most confident users of our electronic products. A lot of people are still getting PCs for the first time and would be more reluctant.”

Skinner, who is in her late 20s, says the idea of using mobile payments is intriguing, but she, too, is concerned about security.

“For me, I would be concerned about my phone getting stolen or lost, or accidentally buying something,” she says. “But 10 years ago, I wouldn’t have thought I’d use online banking as much as I do now.”

**BY BILL MEDLEY, SENIOR WRITER**

**FURTHER RESOURCES**

“**U.S. HOUSEHOLDS’ ACCESS TO AND USE OF ELECTRONIC BANKING 1989-2007**”  
By Eric Robbins, Jeanne M. Hogarth and Casey J. Bell

“**LOCATION, LOCATION, LOCATION: HAS ELECTRONIC BANKING AFFECTED THE IMPORTANCE OF BANK LOCATION?”**  
By Eric Robbins  
KansasCityFed.org/TEN

**COMMENTS/QUESTIONS** are welcome and should be sent to teneditors@kc.frb.org.
Tug-of-Water

Markets may be a solution as urban, ag and recreational users vie for their share
Admittedly, his initial asking price of $50,000 for a 10-acre plot north of Santa Fe with a ditch fed by the Rio Chamas River was too low—especially, he soon realized, for water with transferrable usage rights. These aspects, not to mention the state’s dry terrain, make his water worth top dollar. Benson has since raised his asking price to $1 million and is waiting for the right buyer. He’s already turned down a company wanting the land for a trailer park and an investment company wanting just the water rights.

“I have been told the land with river frontage is worth a lot more than the other acres,” Benson says, adding he plans to have the land and water rights appraised.

As droughts parch the region, and urban, agricultural and recreational uses increase demand, the need for efficient water distribution has led to an increase of water markets, or the buying and selling of water rights.

Water markets are a way to efficiently transfer water to its highest economic use. Markets bring producers and consumers together to agree on prices, quantities and other terms. The transfer can be as simple as an individual owner, like Benson, selling water rights he doesn’t need, or coordinated through a large-scale water market, such as the Colorado-Big Thompson Project that provides supplemental water to almost a million people.

Some see transfers as an efficient way to improve water allocation, while others worry about negative long-term effects on rural America, say Jason Henderson, an economist and Branch executive, and Maria Akers, an assistant economist, both at the Federal Reserve Bank of Kansas City’s Omaha Branch. Akers and Henderson recently researched water markets in the Tenth Federal Reserve District, which includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico.

“During the past decade, usage in the
District has outpaced resources and, as a result, there has been somewhat of a tug-of-war over water,” Henderson says.

Water markets compensate current water rights holders, often farmers, for the monetary loss from reduced water use. However, the markets struggle to account for the public benefits of water use or the spillover effects reduced water use can have on business and household spending in communities. The uncertain economic effects of water transfers on rural communities have limited the implementation of water markets. Information on the economic effects of water reallocation in the District) has lost roughly 6 percent of its water—an amount that would cover 200 million acres of land a foot deep.

Recent advances in irrigation technology have heightened conservation while stricter quality standards have slowed rising water withdrawals. But other areas of water use—such as thermoelectric power generation (water is used as a coolant), hydroelectric use (water powers turbines) and recreational activities—are factors in the long list of growing water demands.

• Agriculture: In 2000, agriculture accounted for 85 percent of consumed water.

and improved methods of estimating the economic losses of transferring water outside rural communities are badly needed, Henderson and Akers say.

As for Benson, he says, “I am really lost with this land and water rights and have no idea what to do with them.”

Benson knows one thing for sure: “Every year I see the rivers go lower and lower … New Mexico is a desert state and any water is extremely valuable.”

Drought and demand

Historically, agriculture has been the largest user of water in the District. By the mid-1900s, industries also were significant water users, and today urban populations are ratcheting up overall water demand to unprecedented levels. Meanwhile, severe drought during the past few years has strained water supplies from streams, reservoirs and underground aquifers, Akers says. For example, at the peak of the drought in 2004, many reservoirs in Wyoming were only half full and some were below 10 percent capacity. The High Plains aquifer (encompassing about 174,000 square miles beneath nearly every state Irrigators in the District were drawing 37 million acre-feet of water per year, which is nearly double the amount in 1950.

• Industry: Withdrawals peaked in the early 1980s. Industrial use is high in the District where manufacturing is concentrated in industries that heavily rely on water, including food, pulp and paper, chemicals, petroleum and coal, metals, and ethanol.

• Municipalities: The largest surge in demand is from rising household and commercial use in urban areas. During the past 20 years, water for public services has boosted overall water use in the District by 28 percent. Public service water use increased 40 percent in metro counties and just 11 percent in rural counties.

• Population growth: Through 2030, District population levels are predicted to rise about 17 percent, with the largest District gains of 35 percent expected in Colorado. Districtwide per capita use would need to decline 15 percent to accommodate expected growth; Colorado would have to cut its per capita use 25 percent.

“These factors have raised tensions
in reallocating water rights,” Akers says. “Some type of workable solution is clearly needed.”

**Water markets**

In most of the western states, water use rights are governed by prior appropriation laws, or “first in time, first in right,” which gives senior water rights to the party first using the water in a beneficial way. Others cannot use the water until the most senior water user’s need, as defined by the water rights, is met. In some cases, water rights can be lost by nonuse.

The Colorado-Big Thompson Project allocates water from the Colorado River on the western slope of the Continental Divide to the eastern slope of the Rocky Mountains, providing supplemental water to 30 cities and helping to irrigate about 700,000 acres of farmland. The distribution system is made up of reservoirs, tunnels, canals and transmission lines that span hundreds of miles; water is released as needed.

Within the boundaries of the project, water is traded through annual leasing programs. Brian Werner, spokesperson for the Northern Colorado Water Conservancy District, the public agency that oversees the Colorado-Big Thompson Project, describes it as “the best example of a free market water system” because of its strategically planned water distribution.

The project’s goal is to provide water to all users without drying up agricultural land. For the past several years, the organization has been working on water storage, with a system expected in 2010 or so.

The project was completed in 1957, when 98 percent of its water went to agriculture and just 2 percent went to industries and municipalities, supplying water to about 150,000 people. Today, about one-third of the water goes to industries and municipalities, serving about 775,000 people, Werner says.

Though water transfers from agriculture are affecting farmland, the land is still in production. However, the water has become more valuable than the land.

“The farmers’ cash crop is the water supply,” says Werner, unless they plan to farm in the long term. Selling water rights is a short-term gain for farmers.

The shift from agricultural...
use toward urban use is not unique to northeastern Colorado. During the past decade, the number of water transfers from agriculture to urban use in western states rose steadily, while agricultural to agricultural transfers declined. With this reallocation, of course, comes both benefits and drawbacks.

One benefit of water markets is water rights holders are compensated for their direct economic loss. However, water markets can have a negative impact on rural communities, Henderson says. Many farmers sell water rights because it makes good business sense, not necessarily because they are experiencing financial hardship. This can economically hurt rural communities in the long run. Spillover effects include a drop in farm-related business activity and declines in land values and property tax incomes.

While there is no compensation for the reduced spending by businesses and households, this spillover effect could be offset by subsidies, water taxes and water-use regulations, among others.

Those in favor of water markets say a free-market approach is a more efficient way to distribute a resource that is often subsidized or out-right squandered. Another benefit to water markets is the flexible, transparent way to value water as its supply and demand change.

In Nebraska, there is some reluctance when it comes to transferring water rights, and, for the most part, farmers and ranchers haven’t been tempted to sell, says Jay Rempe, vice president of state governmental relations at the Nebraska Farm Bureau, which works in many capacities to improve farm income and quality of life.

“The fear is agriculture wouldn’t be able to compete,” says Rempe, meaning municipalities and other interests would outbid agricultural users, moving water away from that sector at its detriment.

Currently in Nebraska, agriculture is
the largest user of water. Others include hydroelectric power plants, environmental and recreational interests, and urban users, mostly in the eastern part of the state where Omaha and Lincoln are located.

“For efficiency purposes, there’s a lot of interest” in water transfer, Rempe says. “We don’t have a very efficient system right now. We have been blessed with natural resources. If we need more water, we’re always able to just drill a well.”

But this may not always be the case. Water transfers could be part of a solution, along with a better understanding of water use, he says.

“I think there are efficiency issues, even within agriculture,” Rempe says. “We’ve got to figure out a way to move water around.”

**Workable solution**

Within states and across their borders, agreements don’t always eliminate water disputes, however. In Nebraska, there is a debate over reducing agricultural use in favor of endangered species in the Platte River Basin. Also in Nebraska, recreational users of the Niobrara River are at odds with agricultural users. And across the state line, Kansas and Nebraska have disagreed over compliance with the water allocations of the Republican River Compact during the past decade.

“The conflict between Kansas and Nebraska over water from the Republican River Basin shows the potential economic impact of water reductions,” Henderson says.

Kansas proposes Nebraska retire 515,000 acres from irrigated production while Nebraska proposes reducing its irrigation water by one-third. Either plan has the same result: an economic loss of about $60 million, plus spillover, for a total loss of $75 million. For every dollar of direct loss, there is a 25-cent indirect loss. This means farm incomes would be directly affected, leading to less spending on Main Street.

The overall economic impact of a proposed reallocation is often a hurdle in addressing water conflicts. Measuring the full economic impact of water transfers is determined by the impact on the farm economy and the links between farm and nonfarm activity in the region.

“Water has shaped the economic fortunes of many rural communities,” Henderson says, adding water reallocation in the Great Plains typically is viewed as a threat to local economies. Effects include the reduction of crop yields and a shift toward lower revenue crops, which in turn means less household revenue and less spending in the community.

“The challenge with implementing any of these is measuring precisely the indirect effects and identifying the appropriate level of payment, tax or regulation that would offset impacts,” Henderson says. “It’s all about striking a balance between water users, water rights owners and public interest.”

For Rodney Benson in New Mexico, selling his water rights is certainly beneficial—he isn’t a farmer and wouldn’t raise crops like the wheat, alfalfa and soybeans his father-in-law once grew there. The land and water could be more useful to someone else, and Benson would be compensated for the transfer.

It’s this type of exchange that may help to better allocate resources.

“Although water markets aren’t perfect,” Henderson says, “their implementation is a step in solving water reallocation conflicts.”

---

**BY BRYE STEEVES, SENIOR WRITER**

---

**FURTHER RESOURCES**

“CAN MARKETS IMPROVE WATER ALLOCATION IN RURAL AMERICA?”
By Jason Henderson and Maria Akers
KansasCityFed.org/TEN

**COMMENTS/QUESTIONS** are welcome and should be sent to teneditors@kc.frb.org.
When the official declaration was made in December, the U.S. economy had already been in a recession for one year. No one was surprised by the National Bureau of Economic Research’s announcement, and many probably wondered what took so long to make it.

Although determining a recession is important to businesses, retailers and consumers, the NBER’s goal isn’t to make a quick call, but to correctly pinpoint when the economy enters a recession. This takes many months of data, especially now that our modern-day economy has become more stable in the past 25 years or so, says Troy Davig, an economist and assistant vice president at the Kansas City Fed.

“Although the difference between booms and busts has declined, then detecting whether the economy has shifted gears is more challenging,” Davig says. “People certainly feel the effect of a downturn, but it takes time to officially identify it.”

The economy generally behaves differently during a recession, which is marked by sharply rising unemployment that leads to a loss of income. In turn, the loss of income reduces demand for goods and services, and places even more jobs at risk.

To stem job losses during a recession,
policymakers want to know quickly when the economy may be deteriorating so they can formulate a policy response—such as the Federal Reserve’s reduction of the federal funds rate to nearly zero in late ’08 and provision of liquidity for the financial system. Additionally, the government sent out stimulus checks to consumers in mid-2008 and implemented another stimulus package earlier this year.

“Putting a recovery plan in place requires a timely and accurate signal as to whether the economy may be entering a recession,” Davig says, “but determining this is easier said than done.”

**What is a recession, how is it determined?**

The economy fluctuates for a variety of reasons, such as boom in new technologies or disruptions in financial markets. Occasionally, the economy enters a period when the amount of new goods and services produced in the United States, known as the real gross domestic product (GDP), declines. Periods of decline are recessions; periods of growth are expansions. Today, recessions are unusual and much shorter than expansions.

“It is commonly accepted that an economy has entered a recession after at least two consecutive quarters of negative GDP,” Davig says. “This rule of thumb is useful, but also a little simplistic. The 2001 recession, for example, did not fit this formula.”

In the United States, the NBER keeps track of when recessions begin and end. A committee analyzes several monthly indicators and makes an announcement after a sufficient amount of data is available, which creates the time lag between when a recession begins and when it is officially declared.

There are additional ways to get a snapshot of the current economic situation. The Fed’s Beige Book, for example, is anecdotal information collected from a sample of businesses by each of the 12 Federal Reserve branches.
Has the recession reached rural America?

Rural economies have weathered this recession much better than metro economies, says Jason Henderson, economist and Branch executive at the Kansas City Fed’s Omaha Branch.

Fallout from the housing and financial markets crises has been less severe while a summer surge in commodity prices boosted farm and energy activity.

The global downturn hasn’t left rural economies unscathed, though. Weaker commodity prices threaten farm incomes while demand from Main Street has lessened.

Economic forecasts indicate a modest recovery in the second half of ’09, hinging on fiscal and monetary policies’ ability to boost demand in the world economy.

For more information, read “Recession catches rural America” by Jason Henderson and Maria Akers at KansasCityFed.org/TEN.

Banks and is published eight times a year. GDP may be the best overall indicator of economic performance, Davig says, though its quarterly availability is a limiting factor.

To obtain a timely read on the economy, it may be useful to look at an indicator such as the Chicago Fed National Activity Index, Davig says. This index is available every month and covers a broad array of economic data, providing a good snapshot of current economic conditions.

Now vs. then

In the United States, recessions have become rarer in recent decades.

• From the end of the Civil War in 1865 until the end of World War I in 1918, the economy was in recession about half the time.
• From the end of WWI to WWII in 1939, the U.S. economy was in recession about one-third of the time.
• From the end of the Korean War in 1953 until 1984, the economy was in recession about 20 percent of the time.
• Since 1984, the economy has been in recession only 7 percent of the time, with a recession occurring roughly once every 12 years.

Recessions also have become shorter on average. Prior to WWII, recessions averaged 22 months. Since then, recessions average 10 months.

The two most recent recessions, in 1990 and 2001, were relatively mild and short by historical standards. The 1981-82 recession, however, lasted longer than average and led to a peak unemployment rate of 10.8 percent. The 1973-75 recession also lasted longer than average and led to a peak unemployment rate of 9 percent.

Today, media reports note the current recession is the most severe in recent decades, and some liken it to the Great Depression of 1929-33. Then, roughly 9,000 banks failed and the unemployment rate peaked at 25 percent. In contrast, the unemployment rate was just above 8 percent in early ’09. One major difference since the Great Depression...
is the inception of FDIC insurance to secure deposits and avoid bank runs, resulting in just a fraction of bank failures today.

“We’ve learned a lot on how to conduct monetary policy, making an outcome like the Great Depression very unlikely,” Davig says. “That said, this recession is the longest we’ve had since the Great Depression.”

Current economic climate

The current downturn is longer than average because of the ongoing housing bust and resulting credit crisis. This, along with soaring summer gas prices and mounting job losses, has caused a dramatic drop in consumer spending. These factors were apparent in 2007 in some of the anecdotes in the Beige Book and also in the Chicago Fed National Activity Index, Davig says.

However, real GDP expanded throughout the first half of 2008 despite the ongoing housing and credit crises. The sustained decline in GDP began in the third quarter of 2008, and many believe the economy won’t begin a recovery until late in 2009 or 2010.

The government can help make the recession less painful, but the recovery will have to be driven by a rebound in demand and private firms’ willingness to hire more workers.

“This recession is unlikely to be much worse than those in the 1970s and early 1980s, though longer than more recent downturns,” Davig says. “But it will eventually end—recessions always end.”

BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

“TRACKING THE BUSINESS CYCLE IN THE GREAT MODERATION”

By Troy Davig
THE BEIGE BOOK
THE CHICAGO FED NATIONAL ACTIVITY INDEX
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.
The Federal Reserve has taken numerous unprecedented steps over the past several months to calm the nation’s financial turmoil. Among the most notable was the Federal Open Market Committee’s mid-December cut of the fed funds rate to almost zero.

It was an historic move that raised several issues, many related to policy and what steps the Fed might take with no additional rate cuts possible. Aside from policy issues, it also raised important questions about the FOMC and specifically the role of the regional Federal Reserve Bank presidents, who serve on the committee.

The FOMC issues directives to the Fed’s open market desk to engage in trades that move interest rates toward the FOMC’s prescribed target. With that target now set effectively at zero for what appears to be an extended period, the FOMC has essentially no further authority to take additional steps. Any additional actions outside of interest rate moves will have to instead be made solely by the Board.

Regional Bank leaders provide long-term stability
of Governors of the Federal Reserve System, political appointees who may or may not rely on the regional Bank presidents as advisors.

In its online blog “Real Time Economics” only days after the rate cut, The Wall Street Journal asked “Does Fed Policy Marginalize Regional Bank Presidents?”

Some might logically follow up with another question: “Does it matter?”

Structure, creation of the FOMC

The FOMC, created by the Banking Act of 1935, is designed to reflect the unique structure of the Federal Reserve. The seven members of the Federal Reserve Board of Governors hold voting positions on the FOMC. Meanwhile, each of the regional Federal Reserve Bank presidents attends each FOMC meeting and participates in the deliberations. However, only five Federal Reserve Bank presidents vote. Those slots are filled by the New York Fed president with the other four positions rotating among the presidents of the 11 other Reserve Banks on an established schedule.

Initially, there was not agreement about the structure. In debate about the creation of the FOMC, the initial proposal called for the creation of a committee of three governors and two Reserve Bank presidents. It is perhaps not surprising that the legislation was drafted primarily by Federal Reserve Board staff and done without consultation of the Reserve Banks.

Federal Reserve Chairman Marriner Eccles took things a step farther, testifying before a House committee that he favored an even lesser role for the Reserve Bank presidents. Eccles supported making the Board alone responsible for open market operations with a committee of five Reserve Bank presidents serving only in an advisory role.

The ensuing debate is discussed by Allan Meltzer in his book, “A History of the Federal Reserve Vol. 1.” In it, Meltzer notes the fact that the legislation was essentially authored by Board staff which “raised concern about the shift in power that the bill proposed. Repeatedly Eccles was asked about the dangers of consolidating power over discount rates, reserve requirements, and open market operations in a single agency, appointed by the president and subject to political control. Congressmen expressed concern about the potential for inflation and the use of monetary expansion by the executive branch to influence elections. And the old issue of regional autonomy remained. Eccles responded that ‘monetary policy is a national matter, and it cannot be dealt with regionally without having such situations as we have had in the past.’”

Critics said that the legislation would effectively end the public-private compromise that had been at the Federal Reserve System’s core since its creation in 1913. After debating the issue with the powerful Sen. Carter Glass in front of Glass’ Senate subcommittee, Eccles finally relented on his contention about the FOMC and agreed to accept an American Bankers Association proposal that would include five Reserve Bank presidents in setting monetary policy. Although the final bill gave the Board of Governors increased power and influence in other areas of the Federal Reserve, among Glass’ key accomplishments was getting the Reserve Bank presidents a role in setting monetary policy.

The significance of that development has only grown over time. While the governors may have wanted to keep monetary policy solely within their realm of authority, the reality has been that the Reserve Bank presidents—and not the governors—have provided institutional stability to the FOMC. The governorships, meanwhile, seem to have become much more vulnerable to change than officials in 1935 would have expected.

The governors

The Board of Governors is considered a government agency. The governors are nominated by the president and confirmed
The Federal Reserve’s Federal Open Market Committee (FOMC) is made up of the Board of Governors, who are political appointees, and the 12 presidents of the regional Reserve Banks, who are appointed by their Reserve Bank’s board to serve as the Bank’s chief executive officer. The FOMC meets eight times a year to set monetary policy. The governors hold voting positions while five presidents vote on a rotating basis with the exception of the New York Reserve Bank president, who always votes. All members participate in deliberations.

Members of the Federal Reserve Board of Governors

Ben Bernanke
Chairman

Donald Kohn
Vice Chairman

Kevin Warsh

Elizabeth Duke

Daniel Tarullo

Federal Reserve Bank Presidents

Eric Rosengren
Boston

William Dudley
New York

Charles Plosser
Philadelphia

Sandra Pianalto
Cleveland

Jeffrey Lacker
Richmond

Dennis Lockhart
Atlanta

Charles Evans
Chicago

James Bullard
St. Louis

Gary Stern
Minneapolis

Thomas Hoenig
Kansas City

Richard Fisher
Dallas

Janet Yellen
San Francisco
by the Senate. For the FOMC, the governors are expected to bring the government, or public, component to the Federal Reserve’s unique blend of interests. With the expectation that they will have broader interests in accountability, the governors hold a 7-5 voting majority on the FOMC.

Of the five individuals currently serving as Federal Reserve governors, Vice Chairman Donald Kohn has the longest tenure at approximately 6.75 years. He is followed by Chairman Bernanke, with approximately 6.25 years of service spread over two appointments. Kevin Warsh has slightly more than three years of service. Elizabeth Duke was appointed in August, and Daniel Tarullo, who was appointed in January, is the most recent to join the Board.

Two governor positions remain unfilled. As it currently stands, there has not been an FOMC meeting with seven governors participating since March 2005. In the vast majority of meetings since that date, only five governors have taken part.

### The regional bank presidents

The presidents of the regional Reserve Banks are the other component of the FOMC. The presidents are selected by the boards of directors at their respective Reserve Banks and confirmed by the Board of Governors of the Federal Reserve System.

Although the presidents were initially considered the “private” component of the FOMC’s public-private structure, that description is no longer appropriate. Of the nine local directors who select the president, six are elected by bankers within the respective Federal Reserve District while three directors are appointed by the Board of Governors. There is very much a “public” component to the regional Bank president positions. Reserve Bank presidents participate in numerous public events and they gain significant insight on business and banking conditions through regular contacts with individuals from throughout their respective Districts.

Of the 12 Federal Reserve Bank presidents, nine have held their posts for less than five years, and three of those have been Bank presidents for less than two years. The two longest-serving FOMC members are Kansas City Fed President Tom Hoenig, with more than 17 years of experience, and Minneapolis Fed President Gary Stern, who has held that position for more than 24 years.

### Historic perspective

The Federal Reserve governorships were created to provide stability to the nation’s central bank in much the way that the justices serve the Supreme Court. Although governors do not have lifetime appointments, their terms are established in a way that is designed to greatly reduce the potential for political influence: Except in rare occasions, they may serve only one term, and, at 14 years, the term is designed to extend through multiple presidents. Ideally, even a two-term president would be able to appoint only four governors.

However, in practice, that has not been the case. At the time President George W. Bush left office, all five of the then-current Federal Reserve governors were his appointees. Two governor seats not filled by Bush were vacant, meaning that Bush could have, assuming Senate approval, appointed all seven positions to the Board of Governors.

That multiple appointments would be made by one president—especially a two-term president—is not at all unexpected or unique in Fed history. Virtually all Fed governors leave office well before the end of their term. The rules restricting the length of time a Federal Reserve governor can serve almost never come into consideration.

Looking at the 15 Fed governors appointed since former Chairman Alan Greenspan’s appointment on Aug. 11, 1987, and excluding current governors, the average time spent in office was 5.6 years. Removing Greenspan’s 18.5-year tenure from the equation lowers the average to 4.6 years per governor.

These relatively brief tenures in office are not a recent development. The 39 Fed
governors appointed since 1965 averaged 5.8 years in office. Removing Greenspan’s exceptionally long tenure cuts the average number to 5.5 years.

Prior to 1965, Governors generally served much longer in office, although even then a full term was a rarity. The 63 Governors serving between the creation of the FOMC in 1935 through Randall Kroszner’s departure in January held office for an average of 7.9 years. The longest tenure as a governor belongs to M.S. Szymczak, who served from June 1933 through May 1961. Also notable is Paul Volcker’s four years at the helm of the New York Fed before he became Fed chairman.

Interestingly, Congress has twice extended the term of office for Federal Reserve governors, but the moves had little actual impact on how long the governors stayed in office. Terms were 10 years prior to the Banking Act of 1933, which extended them to 12. The Banking Act of 1935 instituted the current 14-year terms.

Of the 82 individuals who have held appointed positions as members of the Board of Governors since the Fed’s beginning in 1914, only nine have served 14 years or more. Interestingly four of those nine had their initial appointment prior to the institution of 14-year terms.

The most recent governor to complete a full term was Greenspan, who finished an unexpired term before serving his own full 14-year term.

The tenures of the Reserve Bank presidents, meanwhile, have consistently been longer than those of the governors. Excluding those who held office on an interim basis and the current Federal Reserve Bank presidents, there have been 22 Federal Reserve Bank presidents serving from the time of Greenspan’s 1987 appointment through the most recently retired leader at each Bank. Their average time in office is 11.6 years, or a little more than twice the tenure of the average governor.

The average since ’87, however, could arguably be considered to actually be a little longer. Gary Stern, who became president of the Minneapolis Fed in March 1985, was in office when Greenspan became chairman and thus is not included in the tally because he is currently a Bank president. Including Stern, the average rises to 12.1 years. The figure also does not include Tom Hoenig, who has more than 17 years at the helm of the Kansas City Fed. Including both Stern and Hoenig raises the average to 12.3 years. Conversely, since Greenspan’s appointment, the former long-time chairman is the only Fed governor who remained in office for more than nine years.

Going back further in Fed history to presidents serving at the time of the FOMC’s creation in 1935 through the most recently retired president at each Bank shows that the 83 presidents, excluding interims and those who died in office, served an average of 10.5 years each.

The future

Relatively brief tenures on the FOMC will continue in the years to come.

Under mandatory retirement rules, Minneapolis Fed President Gary Stern will have to leave office before Nov. 3, 2009, and the Minneapolis Fed’s Board of Directors will
select a replacement. Even if President Obama filled the current vacancies on the Board of Governors immediately, the 19-member FOMC in December 2009 will include only five members with more than five years of experience.

A breakdown:
- Five members with less than one year of experience including three governors and New York Fed President William Dudley, who is the permanent vice chairman of the FOMC;
- Another nine members with between one and five years of experience;
- Four members with five to eight years of experience;
- One member with 18 years of experience.

On average, they will have less than four years of experience. That is assuming none of the other current governors or presidents quit over the next year. Based on history, that seems unlikely. Taking away Hoenig, they will average a little more than three years of experience.

Looking further ahead to 2011 when Hoenig will face mandatory retirement, the longest-serving FOMC member will be San Francisco Fed President Janet Yellen, with 10 years of experience including her time as a Fed governor. After Yellen would come Cleveland Fed President Sandy Pianalto with just more than eight years of experience, followed by Fed Chairman Ben Bernanke and Vice Chairman Don Kohn with eight years each. Eleven members would still have less than five years of experience. Because of Hoenig’s lengthy tenure, the average improves comparatively little over two years’ time to 5.1 years of service, again assuming no one retires before that time, which, based on history, seems extremely unlikely.

**Under the political influence?**

The regional Bank presidents are clearly doing more than contributing their regional perspective to FOMC’s policy deliberations. Aside from Greenspan, whose length of service is unlikely to be repeated, it has been the presidents who have brought the institutional stability to the FOMC. With their longer terms of service, they bring experience to the table. And with the likelihood they will remain in office longer, some might argue they could also bring a greater regard for the long-term consequences of their actions, as they will still be involved in policy deliberations in the future.

The creators of the FOMC, like the framers of the Federal Reserve Act before them, recognized the importance of checks and balances in creating the body responsible for the nation’s monetary policy. The primary concern of Sen. Glass, who was a key author of the Federal Reserve Act while a congressman two decades earlier, was the consolidation of power within the government. Monetary policy, Glass and others recognized, could not be solely in the hands of individuals who might be vulnerable to immediate political considerations and not as concerned about the long-term ramifications of their actions.

Although the 14-year terms of governors were designed to provide sufficient insulation, the number of years served by most governors has made them more like conventional political appointees than the Fed’s creators ever intended. That does not mean they are politically vulnerable, only that the potential exists.

Media accounts, such as The Wall Street Journal blog, suggest that the regional Reserve Bank presidents have been marginalized in the current environment. It may be a few years, until the current crisis is well behind us, before it is clear how much it mattered.

**Further Resources**

To learn more about the Federal Reserve System’s FOMC, and to read minutes from its meetings, visit KansasCityFed.org/TEN.

**Comments/Questions** are welcome and should be sent to teneditors@kc.frb.org.
hen Chad Wilkerson recently traveled to the small town of Altus to speak to the Southwestern Oklahoma Development Authority Board, he faced what’s becoming his new norm. The audience that day grew larger than typical when area businesspeople heard a Federal Reserve economist was speaking, and, as has often been the case recently given the economy, the question-and-answer session was lengthy and filled with pointed questions. What struck Wilkerson most: “After the speech, several people came up to me to say how much they appreciated being able to put a face on the Fed. They thanked me for our willingness to come out and talk with them about the national and regional economies at a time when we know we’ll be asked very hard questions.”

Wilkerson gets tough questions a lot these days. It’s a part of his role as the Kansas City Fed’s Oklahoma City Branch executive. This means maintaining two-way communication with the public to increase understanding of the economy, as well as listening to people and learning from what they say.

“As one of 12 regional Federal Reserve Banks, our charge is to know what’s happening in this part of the world, in the seven states that make up the Tenth Federal Reserve District,” says Alan Barkema, a senior vice president, who co-founded the Rural Center and created in 2005 the Regional, Public and Community Affairs Division.

For decades, the Kansas City Fed has focused on learning about its region. More recently, though, these efforts have expanded to develop an even better understanding of the District’s unique economic makeup and its
role in the world, says Barkema, who oversees the Division. The Kansas City Fed’s long tradition of regional economics comes from the makeup of the Tenth District—western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico—and its diversity. Industries in the District include tourism, agriculture, oil and gas, telecommunications, ranching, mining and more.

Blending new ideas with long-time practices, the regional economics department works toward its mission in a number of ways:

• Dedicating six economists plus their staff specifically to regional research and analysis;
• Maintaining a fixed presence in the District’s headquarters and three Branch offices (Kansas City and Denver, Oklahoma City and Omaha) with programs extending throughout the District;
• Developing working relationships within the business and industrial sectors of the region, as well as with the Boards of Directors for each office.

“This approach allows us to increase our range and make big investments in the study of regional economics,” Barkema says. “We’re more likely to spot what’s happening today, and what may happen tomorrow, in our District and how that can affect both Main Street and Wall Street.”

Exploration, documentation

Because a physical presence throughout the District is vital to understanding the region, the Kansas City Fed in 2006 moved regional economists out to the Branch offices for a closer look. These Branch executives also conduct research, give public presentations and media interviews, involve themselves with area businesses and community groups, and work with their Branch’s Board of Directors. In addition to Wilkerson in Oklahoma City, Jason Henderson is the Branch executive in Omaha and Mark Snead is the Branch executive in Denver.

The research focus of the Branch executives, along with other economists and staff, covers a wide breadth. For example, Kansas City economists Alison Felix and Kelly Edmiston specialize in public finance and community development, respectively. Wilkerson’s specialty is labor and manufacturing, while Omaha economist Brian Briggeman and Henderson specialize in agriculture and rural communities, and Snead in industry structure and forecasting.

“Not only is our region diverse, its economy is more important than ever before in the world,” says Henderson, citing oil and gas demand, agricultural commodities, global food consumption and green energy issues such as crop-based ethanol production and wind energy. “We track all of this.”

Economists frequently give speeches around the District about current economic conditions and their research papers. Recently published research focuses on foreclosures, farmland values, minority workers, defining industries and state tax portfolios. These papers appear in the Kansas City Fed’s quarterly Economic Review.

The Kansas City Fed also produces a publication dedicated to rural issues called
The Main Street Economist. This is a bimonthly electronic newsletter that reviews major economic challenges and opportunities emerging in the District. Recent Main Street topics include energy prices, food prices and rural home price trends.

Regularly published analyses include:

• The Survey of Agricultural Credit Conditions: a quarterly summary of farm financial conditions, including farmland values, interest rates on farm loans, credit supply and demand, and farm commodity prices. Results also help trace longer term trends. About one-third, or 360, of the District’s agricultural banks are surveyed. The survey is put together by the Omaha Branch.


The survey synopsis includes changes in production, shipments, and prices of raw materials and finished products. Results also help trace longer term trends. Participants are manufacturing plants selected according to geographic distribution, industry mix and size. It is put together by the Oklahoma City Branch.

• The Summary of Commentary on Current Economic Conditions: (known as the Beige Book) a compilation from each of the 12 Federal Reserve Districts published eight times a year. Each Reserve Bank interviews a sample of businesses representing primary industries in its District. The results are summarized by District and industry.

Building relationships

Each of the four offices of the Kansas City Fed has a board of directors who are either elected or appointed to three-year terms. Directors come from every state in the District and represent a variety of sectors, including banking, higher education, real estate and other industries. There are nine Kansas City directors and seven directors for each Branch.

Their role is twofold: Directors help the Fed fulfill its role in the economy while connecting it to the communities in the District. Their insights assist Kansas City Fed President Tom Hoenig,
who is a member of the Federal Open Market Committee—the group that sets the nation’s monetary policy. Additionally, directors are linked directly to the people and industries in the region.

“We listen to them very carefully,” Henderson says.

Wilkerson adds, “At every Branch board meeting, directors share several pieces of information that affect how I think about the economy.”

Other meetings with community leaders also prove beneficial in these capacities. For example, the Kansas City Fed hosts two annual regional roundtables at one of its four offices. Speakers and participants come from universities, state governments, banking or sectors specific to rural America, such as the cattle industry or farming. Photos of roundtable participants are on Pages 56-57.

• Regional Economic Roundtable:
  These annual meetings began in 1992. An economist from each state in the District reviews his or her state’s activities from the past year and offers future insights; pertinent issues also are highlighted. A variety of sectors are discussed, including: housing, manufacturing, agriculture, construction, energy, banking, employment, retail, ethanol and exports.
  “President Hoenig uses these insights, and those of others, in preparation for setting monetary policy,” Wilkerson says.

• Food and Agriculture Roundtable:
  These annual meetings started in 2000—a time when the Kansas City Fed recognized there was a lot of change in the industry, Henderson says.

  Participants come from ranching, cattle, hog, grain, seed, bio fuels, dairy and financing sectors. Many give presentations specific to their business, while other attendees participate in open discussion.

  Henderson, who facilitates this roundtable, says the meeting helps shape his yearly research agenda.

  “Agriculture has a boom and bust nature,” Henderson says. “Hearing from those with their fingers on the industry’s pulse is vital to understanding how our District’s agricultural and rural communities are affected by national or global trends.”

  Cultivating these relationships is just another way to better understand the region’s economy, Barkema says.

  “We’ve always recognized the importance of knowing our District,” Barkema says. “The regional economy does not always mirror the national economy, though they affect each other. Every day we’re learning more about how the economy of the Tenth Federal Reserve District works and fits into the global economy.”

BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

THE MAIN STREET ECONOMIST
SURVEY OF AGRICULTURAL CREDIT CONDITIONS
THE MANUFACTURING SURVEY
THE BEIGE BOOK
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.
Financial responsibility begins in childhood

When a student once commented during my economics class that you could always visit the ATM to get as much money as you wanted, I knew it was time for a personal finance lesson. But how do you discuss account debits and credits in terms that a child can understand? How do you compete with consumerism to teach young people to make good financial decisions? What about explaining the current economic situation? These are some of the questions I have faced as a parent and an educator, and some of the topics I’d like to discuss as columnist for TEN. Our “Common Cents” topic for this quarter is the importance of saving money.

In my 30 years of teaching elementary students, I developed a few tricks of the trade for relaying complex information in a language that children can understand. Children probably aren’t interested in day trading, so make financial lessons relevant to their everyday lives. Help the child visualize financial concepts in his or her own frame of reference. If there’s something they can’t live without, how can they earn money and save it to make the purchase? A child may not be able to define “opportunity cost” or “compound interest,” but sharing children’s books may help them understand basic financial concepts. For children 8 years old and younger, I recommend reading “Alexander, Who Used to Be Rich Last Sunday,” which will give them examples they can relate to.

To convince children to save rather than spend is a challenge in itself! I suggest discussing the concept of setting savings goals with children 6 and older. A short-term goal should be introduced first as
The Kansas City Fed is committed to promoting economic and financial literacy and greater knowledge of the Federal Reserve's role by providing resources for teachers, students and the public to better understand important economic concepts and issues.

**Teacher Resources**
We offer resources and programs for teachers and educators throughout the region to promote economic and financial education.

**Student Resources**
Looking for activities, games or other information about economics or the Federal Reserve? Find links to materials and other programs.

**Other Resources**
Find resources about the Federal Reserve, economics, personal finance and bank tours.

**Academic Competitions**
Consider participating in a Fed sponsored economic competition. The Federal Reserve Bank of Kansas City supports academic competitions for high school students on the subjects of monetary policy, economics and personal finance. Awards and recognition are available for teachers, students and their schools.

**For teacher tips and materials**
including information on in-service training, and to order publications for all ages, visit KansasCityFed.org/TEN.
Notes from around the Tenth District

Denver Branch executive named

Mark C. Snead has been appointed assistant vice president and Branch executive of the Denver Branch of the Federal Reserve Bank of Kansas City as of March 2.

In this position, Snead leads staff and activities there; conducts regional economic research; works with the Denver Branch board of directors; and expands relationships with area banking, business and community leaders. Each Branch office of the Kansas City Fed—Denver, Oklahoma City and Omaha—has such a position.

Snead comes from Oklahoma State University, where he had been the founding director of the Center for Applied Economic Research since 2004. Previously, he had been a research economist on the Oklahoma State Econometric Model in the university’s Department of Economics and Legal Studies in 2000.

Snead earned his bachelor’s degree in economics from the University of Georgia, his master’s degree in economics and finance from the Georgia Institute of Technology, and a doctorate in economics from Oklahoma State University.

Read about the Kansas City Fed’s regional economic efforts on Page 28.

K.C. Fed hosts Reserve Bank of India officers

The Kansas City Fed’s Supervision and Risk Management Division recently hosted two officers from the Reserve Bank of India (RBI).

The four-week visit was designed to give Gopalan Jayasree, deputy general manager in the Department of Banking Supervision in the RBI’s Bangalore office, and Prasant Kumar Seth, assistant general manager in banking supervision at the Mumbai office, a first-hand look at how the Fed regulates and supervises banks. They also attended an on-site examination of the Bank of Versailles in Missouri.

During discussions with various Kansas City Fed staff, the two discovered several similarities between the two central banks, such as the splitting of the country into regions overseen by regional offices, as well as many differences. The size of India’s banks tends to be larger, and the RBI supervises all banks, whereas the United States has several federal regulators.
Traveling currency exhibit available

The Kansas City Fed is offering its traveling exhibit of historic U.S. currency to banks and depository institutions in the Tenth Federal Reserve District for temporary display.

The exhibit features currency from the Colonial period through today. It focuses on historically significant items, such as State Bank notes, and also includes silver and gold coins, Confederate notes, and Demand notes, which are often called “greenbacks.”

There is no charge to host the exhibit, but institutions must have at least $5,000 in liability insurance and must pay shipping costs to transport the display to its next location. It ships in two cases, each weighing about 130 pounds. The exhibit is circular and needs a space of at least 6- by 6-feet to stand.

To reserve the exhibit, contact the Kansas City Fed at (800) 333-1010 ext. 2554.

The following banks in the Tenth Federal Reserve District are celebrating one, five, 10, 20 or more years as Federal Reserve members in April, May or June.

<table>
<thead>
<tr>
<th>Bank Name</th>
<th>City</th>
<th>State</th>
<th>Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sundance State Bank</td>
<td>Sundance</td>
<td>Wyo.</td>
<td>78</td>
</tr>
<tr>
<td>First Nebraska Bank</td>
<td>Valley</td>
<td>Neb.</td>
<td>75</td>
</tr>
<tr>
<td>First State Bank</td>
<td>Ness City</td>
<td>Kan.</td>
<td>75</td>
</tr>
<tr>
<td>Bank of Hartington</td>
<td>Hartington</td>
<td>Neb.</td>
<td>73</td>
</tr>
<tr>
<td>Bankwest of Kansas</td>
<td>Goodland</td>
<td>Kan.</td>
<td>70</td>
</tr>
<tr>
<td>First State B&amp;TC</td>
<td>Larned</td>
<td>Kan.</td>
<td>67</td>
</tr>
<tr>
<td>First State Bank of Hotchkiss</td>
<td>Hotchkiss</td>
<td>Colo.</td>
<td>67</td>
</tr>
<tr>
<td>First State Bank in Temple</td>
<td>Temple</td>
<td>Okla.</td>
<td>66</td>
</tr>
<tr>
<td>Citizens-Farmers Bank Cole Camp</td>
<td>Cole Camp</td>
<td>Mo.</td>
<td>64</td>
</tr>
<tr>
<td>Bank of Commerce</td>
<td>Rawlins</td>
<td>Wyo.</td>
<td>31</td>
</tr>
<tr>
<td>Citizens Bank of Edmond</td>
<td>Edmond</td>
<td>Okla.</td>
<td>28</td>
</tr>
<tr>
<td>Bank of Jackson Hole</td>
<td>Jackson</td>
<td>Wyo.</td>
<td>27</td>
</tr>
<tr>
<td>Bankers Bank</td>
<td>Oklahoma City</td>
<td>Okla.</td>
<td>23</td>
</tr>
<tr>
<td>Castle Rock Bank</td>
<td>Castle Rock</td>
<td>Colo.</td>
<td>23</td>
</tr>
<tr>
<td>Adrian Bank</td>
<td>Adrian</td>
<td>Mo.</td>
<td>10</td>
</tr>
<tr>
<td>American Bank of Baxter Springs</td>
<td>Baxter Springs</td>
<td>Kan.</td>
<td>10</td>
</tr>
<tr>
<td>Bank of Kramlin</td>
<td>Kremlin</td>
<td>Okla.</td>
<td>10</td>
</tr>
<tr>
<td>First Westroads Bank</td>
<td>Omaha</td>
<td>Neb.</td>
<td>5</td>
</tr>
<tr>
<td>Valley State Bank</td>
<td>Syracuse</td>
<td>Kan.</td>
<td>5</td>
</tr>
<tr>
<td>Metcalf Bank</td>
<td>Lee’s Summit</td>
<td>Mo.</td>
<td>1</td>
</tr>
<tr>
<td>Prime Bank</td>
<td>Edmond</td>
<td>Okla.</td>
<td>1</td>
</tr>
</tbody>
</table>

Comments/Questions are welcome and should be sent to teneditors@kc.frb.org.
The Federal Reserve Bank of Kansas City and its Branches in Denver, Oklahoma City and Omaha has three broad focus areas: contributing to monetary policy that promotes stability and growth; providing supervisory and regulatory oversight to financial institutions; and promoting safe and efficient financial services.

This annual report includes information on the leadership and divisions of the Kansas City Fed and its Branches, as well as financial reports for 2008.

2008 Overview ............................................................................................................... 38 – 45
Management Committee .......................................................................................... 47
Boards of Directors ................................................................................................. 49 – 52
Advisory Councils ................................................................................................. 53 – 55
Roundtable Participants ....................................................................................... 56 – 57
Work of the Kansas City Fed ............................................................................... 58
Tenth District Officers ............................................................................................ 59

Financial Report
Letters to the Boards ............................................................................................. 61 – 63
Financial Statements ............................................................................................. 64 – 66
Financial Notes ........................................................................................................ 67 – 92
Volume of Principal Operations .......................................................................... 93
Statement of Auditor Independence ........................................................................ 93
As the regional headquarters for the nation’s central bank, the Federal Reserve Bank of Kansas City and its Branches in Denver, Oklahoma City and Omaha serve the Tenth Federal Reserve District. Although many parts of the Kansas City Fed’s mission are related specifically to the financial system, such as its regulatory and supervisory responsibilities or its work in financial services, the Kansas City Fed is also responsible for linking the communities of our seven states to the policy deliberations and work of the nation’s central bank. The Kansas City Fed accomplishes this in many ways.

CONSUMERS
The Kansas City Fed, in partnership with the Minneapolis Fed, operates the national call center for Federal Reserve Consumer Help. In 2008, nearly 40,000 consumers either made an inquiry or filed a complaint through the FRCH website or toll-free line (888-851-1920). Thousands of others used the service to gain access to a wide range of resources about banking, finance and the Federal Reserve.

For more information, visit FederalReserveConsumerHelp.gov.

BANKERS
The Kansas City Fed offers numerous programs for bankers.

In 2008, more than 400 bankers took part in one of 11 Regulatory Update Seminars held throughout the District where Fed officials
discussed current regulatory and supervisory issues. Perhaps more importantly, it provided the Kansas City Fed a direct opportunity to learn from bankers what concerns they have.

To help directors of local banks better serve both their institutions and local communities, the Kansas City Fed also offers a wide range of free training resources including an online course and a six-hour on-site training course. The courses are based on the Kansas City Fed’s book “Basics for Bank Directors,” which also is free. For more information, visit KansasCityFed.org and click “Banking Supervision.”

COMMUNITIES

Numerous public events were held throughout the District, including the latest edition of the long-running Economic Forums series. For nearly 60 years, the Kansas City Fed has hosted programs throughout the District where Fed economists and officials talk about what the central bank is seeing in the economy, but, just as important, the forums are also an opportunity to learn from local business leaders what they are seeing. More than 1,200 attendees took part in forums held in locations such as Norfolk, Neb.; Laramie, Wyo.; and Albuquerque, N.M., in 2008. In addition, economists and officials, including Kansas City Fed President Tom Hoenig, spoke to thousands of District residents at numerous individual gatherings throughout the year, ranging from large chamber of commerce luncheons to more intimate gatherings with local service clubs.

For more information on the Economic Forums and events in the District, visit KansasCityFed.org and click “News and Events.”
One of the Kansas City Fed’s more concentrated efforts has related to the issue of home foreclosures. In 2008, the Kansas City Fed hosted numerous events throughout the District and worked closely with partner organizations on a series of initiatives and programs that provided troubled borrowers an opportunity to either gain assistance through available resources or meet with loan services to seek options with the goal of making them able to stay in their homes. In one recent Kansas City event alone, more than 700 homeowners received some type of assistance.

The Kansas City Fed also established a Web-based Foreclosure Resource center to help address challenges in mortgage markets. For homeowners and homebuyers, the centers provide contact information for agencies that can help those in financial trouble or provide counsel for those who want to buy their first home. For community leaders and local municipalities, the center offers information on preserving and protecting the neighborhoods where foreclosures have occurred. The center also provides access to Federal Reserve research and notices of upcoming events. For more information, visit KansasCityFed.org and click “Community Development.”

STUDENTS OF ALL AGES

The Kansas City Fed is committed to financial literacy and economic education. These efforts take many forms from free lesson plans and on-site training for teachers to educational conferences, designed for educators of all grade levels. For more information, visit KansasCityFed.org and click “Education Resources.”

In addition to the work with teachers, in 2008 the Kansas City Fed’s staff gave more than 50 presentations and workshops throughout the District to encourage financial literacy, including Jump$tart Your Money Week in Oklahoma, Money Smart
in Nebraska and Financial Fitness Week in Kansas City. Other events included the Financial Education in Oklahoma conference and a financial literacy summit in Denver.

The Kansas City Fed’s headquarters at 1 Memorial Drive also features the 3,000-square-foot Money Museum, featuring a number of interactive educational displays. From the facility’s June 2008 opening to year-end, nearly 11,000 guests learned more about the economy and the Federal Reserve through tours. During their visit, they also had the opportunity to see the more than 400-piece coin collection, on loan from the Truman Presidential Library and watch operations inside the region’s largest cash vault. Tours also are available at the Denver Branch, and the public is welcome to visit offices in Oklahoma City and Omaha.

For more information, go to KansasCityFed.org/MoneyMuseum, or visit KansasCityFed.org for branch information.
Federal Reserve Chairman Ben Bernanke helps commemorate the Kansas City Fed’s new building.

Architect Henry Cobb, President Tom Hoenig, Deputy Board Chairman Paul DeBruce and Builder Terry Dunn cut the ribbon during grand opening events.

“Confidence restored” is a chronicle of the Kansas City Fed’s history.

Chairman of the Kansas City Fed Board of Directors Lu Córdova speaks at the grand opening ceremonies.

Kansas City Fed commemorates grand opening in June.

Federal Reserve Chairman Ben Bernanke helps commemorate the Kansas City Fed’s new building.
In the Federal Reserve Bank of Kansas City's historical timeline, 2008 is a big notch.

Years of planning and preparation culminated with the completion of the Kansas City Fed's new headquarters building. That winter, staff moved from 925 Grand Blvd., where operations had taken place since 1921, to 1 Memorial Drive. In June, regional bankers, community leaders, educators and the public were invited to help commemorate the building's official opening. Special guests included Federal Reserve Chairman Ben Bernanke, as well as former and current members of the Boards of Directors, who are pictured at a reception on Pages 49 - 52.

ARTIST TUCK LANGLAND describes the features of the Spirits of Commerce and Industry using two miniature models. The larger-than-life, three-dimensional statues flank the building’s front entrance.

STATE BANKING COMMISSIONERS Jeff Vogel, Wyoming; Tom Thull, Kansas; Eric McClure, Missouri; Kansas City Fed Senior Vice President Esther George; President Tom Hoenig; Fed Chairman Ben Bernanke; Richard Fulkerson, Colorado; and John Munn, Nebraska, attend a meeting during the grand opening events.

THE FED RECOGNIZES ITS SITE’S FORMER OCCUPANT, ST. MARY’S HOSPITAL, by dedicating the chapel bell and a plaque to the hospital’s Sisters. The hospital closed in 2001.

THREE TAPESTRIES BY NEW MEXICO ARTIST REBECCA BLUESTONE are part of the Kansas City Fed’s regional art collection.
FORMER CHAIRMEN OF THE KANSAS CITY FED’S Board of Directors Fred Lyons, Terry Dunn, Lu Córdova (current), Richard Bard, Jo Marie Dancik, Bob Funk, Drue Jennings, Irvine Hockaday, seated, President Tom Hoenig, former President Roger Guffey and Former Chairman Harold Andersen.

AREA TEACHERS ATTEND AN OPEN HOUSE at the Kansas City Fed, which provided free materials to assist with their financial education lessons.

KANSAS CITY PUBLIC TELEVISION (KCPT) partnered with the Kansas City Fed to produce “10J: The History of the Federal Reserve Bank of Kansas City.” Crews filmed locally as well as in Denver, Oklahoma City, Omaha and elsewhere around the District to fully represent the area.
THE NEW BUILDING is 600,000 square feet and 14 stories tall. About 75 firms were involved in the construction; more than 60 are based within the Tenth District.

THE MONEY MUSEUM includes a window into the cash vault, which is the region’s largest with 540,000 cubic feet of storage capacity. Guided and self-guided tours are free and available 8:30 a.m. - 4:30 p.m. weekdays. The variety of exhibits appeals to all ages.

VISITORS STUDY THE TRUMAN COIN COLLECTION in the Fed’s Money Museum, which includes nearly 500 coins total from every presidential administration.
Management Committee

From left) Ms. George, Mr. Barkema, Mr. Hoenig, Mr. Dubbert, Mr. Rasdall, Mr. McBride, Ms. Pacheco, Mr. Sellon

Thomas M. Hoenig
President and
Chief Executive Officer

Richard K. Rasdall, Jr.
First Vice President and
Chief Operating Officer

Alan D. Barkema
Senior Vice President

Kelly J. Dubbert
Senior Vice President and
Chief Information Officer

Esther L. George
Senior Vice President

Stephen E. McBride
Senior Vice President

Barbara S. Pacheco
Senior Vice President

Gordon H. Sellon, Jr.
Senior Vice President and
Director of Research
The Board of Directors of a Federal Reserve Bank is filled through a unique blend of appointed and elected positions. The nine-member panel is divided evenly among three classifications. All directors serve staggered three-year terms.

**CLASS A**

The three Class A directors represent commercial banks that are members of the Federal Reserve System. These directors are bankers who are nominated and elected by member banks within the Tenth Federal Reserve District. This District includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico.

Under the Class A category, a director will be elected by a specific group of member banks classified as either 1, 2 or 3. This classification is based on the total amount of capital and surplus for each commercial bank, with Group 1 banks being the largest. Each group within the class elects one director.

For example, Robert C. Fricke, president and chief executive officer of the Farmers & Merchants Bank of Ashland, Neb., is a Class A director, who was elected by, and represents, Group 3 member banks.

**CLASS B**

The three Class B directors represent the public. Class B directors may not be an officer, director or employee of a bank or a bank holding company. However, these directors are also elected by member banks under the same categories as Class A directors. For example, Dan L. Dillingham, chief executive officer of Dillingham Insurance of Enid, Okla., is a Class B director elected by Group 2 member banks.

**CLASS C**

The three Class C directors also represent the public. These directors, however, are appointed by the Board of Governors of the Federal Reserve System.

Like a Class B director, a Class C director may not be an officer, director or employee of a bank or a bank holding company. These directors may not own stock in a bank or a bank holding company. From the Class C directors, the Board of Governors selects one person as chairman and another as deputy chairman.

**SERVING ON THE BOARD**

Federal Reserve Bank of Kansas City

Reserve Bank directors meet monthly to oversee the Bank’s operations and policies and to confer on economic and banking developments. The directors also provide information on economic conditions within the District as a part of the Bank president’s preparation for Federal Open Market Committee meetings. Among directors’ responsibilities is establishing the Kansas City Fed’s discount rate, which is subject to review and determination by the Federal Reserve Board. The directors and their classifications are on Page 49.

**SERVING THE BRANCHES**

Denver, Oklahoma City and Omaha

Each Branch of the Federal Reserve Bank of Kansas City also has its own seven-member Board of Directors. Four of these directors are appointed by the Federal Reserve Bank of Kansas City while three are appointed by the Board of Governors. Branch directors serve three-year terms and provide their respective Branch Executives with insight on regional economic conditions as well as offer advice and counsel. Branch directors are on Pages 50-52.
Boards of Directors

Kansas City

(From left) Mr. Smalley, Mr. Moore, Mr. Fricke, Ms. Córdova, Mr. DeBruce, Mr. Dillingham, Mr. Nunnink, Mr. Schifferdecker

Lu M. Córdova, Board Chairman;
Chief Executive Officer, Corlund Industries;
President and General Manager, Almacen Storage Group
Boulder, Colorado (Class C)

Paul DeBruce, Board Deputy Chairman;
Chief Executive Officer, Chair/Founder
DeBruce Grain Inc.
Kansas City, Missouri (Class C)

Dan L. Dillingham
Chief Executive Officer
Dillingham Insurance
Enid, Oklahoma (Class B, Group 2)

Robert C. Fricke
President and Chief Executive Officer
Farmers & Merchants National Bank
Ashland, Nebraska (Class A, Group 3)

Terry L. Moore
President
Omaha Federation of Labor
Omaha, Nebraska (Class C)

Kevin K. Nunnink
Chairman
Integra Realty Resources
Westwood, Kansas (Class B, Group 1)

Mark W. Schifferdecker
President and Chief Executive Officer
Girard National Bank
Girard, Kansas (Class A, Group 2)

Rick L. Smalley
Chief Executive Officer
Dickinson Financial Corporation
Kansas City, Missouri (Class A, Group 1)

Federal Advisory Council Representative
David C. Boyles (not pictured)
Chairman, Columbine Capital Corp.;
Director, Columbine Capital Corp. & Collegiate Peaks Bank
Buena Vista, Colorado
Board of Directors

Denver

(From left) Mr. Stanford, Ms. Mowry, Mr. Brown, Ms. Schloss, Mr. Alexander, Ms. Leavesley, Mr. Pearson

Kristy A. Schloss, Board Chairman;
President and Chief Executive Officer
Schloss Engineered Equipment
Aurora, Colorado

Bruce K. Alexander
President and Chief Executive Officer
Vectra Bank Colorado
Denver, Colorado

Charles H. Brown III
President
C.H. Brown Co.
Wheatland, Wyoming

Diane Leavesley
President
Mercy Loan Fund
Denver, Colorado

Barbara Mowry
President, Chief Executive Officer and
Board Member
Silver Creek Systems
Westminster, Colorado

John D. Pearson
Real Estate Broker and Owner
Pearson Real Estate Company Inc.
Buffalo, Wyoming

Michael R. Stanford
President and Chief Executive Officer
First State Bancorporation
Albuquerque, New Mexico

2008 • Annual Report
Richard K. Ratcliffe, Board Chairman;
Chairman
Ratcliffe’s Inc.
Weatherford, Oklahoma

Steven C. Agee
President
Agee Energy, L.L.C.
Oklahoma City, Oklahoma

Terry M. Almon
President
Oklahoma Community Capital Corporation
Broken Arrow, Oklahoma

Steve Burrage (not pictured)
Chairman
FirstBank
Antlers, Oklahoma

James D. Dunn
Chair
Mill Creek Lumber & Supply Co.
Tulsa, Oklahoma

Barry H. Golsen (not pictured)
Board Vice Chairman, President and
Chief Operating Officer
LSB Industries Inc.
Oklahoma City, Oklahoma

Fred M. Ramos
President
RGF Inc.
Oklahoma City, Oklahoma

Douglas E. Tippens (not pictured)
President and Chief Executive Officer
Canadian State Bank
Yukon, Oklahoma
Charles R. Hermes, Board Chairman
President
Dutton-Lainson Company
Hastings, Nebraska

Todd S. Adams
Chief Executive Officer
Adams Bank and Trust
Ogallala, Nebraska

Rodrigo Lopez (not pictured)
President and Chief Executive Officer
AmeriSphere Multifamily Finance, L.L.C.
Omaha, Nebraska

JoAnn M. Martin
President and Chief Executive Officer
Ameritas Life Insurance Corp.
Lincoln, Nebraska

Mark A. Sutko
President and Chief Executive Officer
Platte Valley State Bank
Kearney, Nebraska

James A. Timmerman
Chief Financial Officer
Timmerman & Sons Feeding Co.
Springfield, Nebraska

Lyn Wallin Ziegenbein (not pictured)
Executive Director
Peter Kiewit Foundation
Omaha, Nebraska
Deborah Bass  
President and Chief Executive Officer  
Bass & Associates, Inc.  
Omaha, Nebraska

Larissa Herda  
Chairman, Chief Executive Officer and President  
tw telecom inc.  
Littleton, Colorado

Garry Kemp  
Secretary-Business Manager and Executive Officer  
Greater Kansas City Building & Construction Trades Council, AFL-CIO  
Independence, Missouri

Terry McClain  
Senior Vice President and Chief Financial Officer  
Valmont Industries, Inc.  
Omaha, Nebraska

Bradford S. Mead  
Attorney at Law  
Mead & Mead  
Jackson, Wyoming

Xavier Neira (not pictured)  
Vice President of Special Projects  
Rooney Holdings, Inc.  
Oklahoma City, Oklahoma

Russell Perry (not pictured)  
President  
Perry Publishing and Broadcasting Company  
Oklahoma City, Oklahoma

Tom B. Price  
President  
UFCW District Local Two  
Kansas City, Missouri

John Stout  
Chief Executive Officer  
Plaza Belmont Management Group L.L.C.  
Shawnee Mission, Kansas

Charles T. Sunderland  
Chairman and Chief Executive Officer  
Ash Grove Cement Company  
Overland Park, Kansas
Community Development Advisory Council

(From left) Ms. Meyer, Ms. Tinney, Mr. Jensen, Ms. Dobreff, Mr. Yost, Ms. Noonan, Ms. Capps, Mr. Padilla

Linda Capps
Vice Chairman
Citizen Potawatomi Nation
Shawnee, Oklahoma

Erica Dobreff
President
Kansas City Equity Fund
Kansas City, Missouri

Bernard Franklin (not pictured)
President
Penn Valley Community College
Kansas City, Missouri

Robert Jensen
Chief Operating Officer
Wyoming Business Council
Cheyenne, Wyoming

Carol Meyer
Southwest Regional Representative
Kansas Department of Commerce
Garden City, Kansas

Agnes Noonan
Executive Director
WESST Corporation
Albuquerque, New Mexico

Daniel Padilla
Regional Branch Director
First National Bank
Omaha, Nebraska

Linda Tinney
Vice President
U.S. Bank
Denver, Colorado

Jeffrey Yost
President and Chief Executive Officer
Nebraska Community Foundation
Lincoln, Nebraska
Advisory Council on Payments

(From left) Mr. Champion, Mr. DeBroeck, Mr. Copeland, Mr. Fosler, Mr. Connealy, Mr. Oatman, Mr. Davidson, Mr. Frank

Kansas City
Tim Connealy
Executive Vice President and
Chief Operating Officer
Bank Midwest
Kansas City, Missouri

Lloyd Davidson
President
First Bank Kansas
Salina, Kansas

Steve Hipp (not pictured)
Executive Vice President
INTRUST Bank, N.A.
Wichita, Kansas

Michael DeBroeck
Senior Vice President
(in place of Mr. Hipp)

Denver
Mark Frank
Senior Vice President
CoBiz Bank, N.A.
Denver, Colorado

James A. Reuter (not pictured)
President
FirstBankData Corporation
Lakewood, Colorado

Oklahoma City
Scott Copeland
Executive Vice President
BancFirst
Oklahoma City, Oklahoma

C.H. Wyatt, Jr. (not pictured)
Vice Chair and
President
Rose Rock Bank
El Reno, Oklahoma

Omaha
Craig E. Champion
Senior Vice President
TierOne Bank
Lincoln, Nebraska

Alan L. Fosler
Senior Vice President and
Cashier
Union Bank and Trust Company
Lincoln, Nebraska

Russell A. Oatman
Senior Vice President
First National Bank of Omaha
Omaha, Nebraska

2008 • Annual Report 55
R o u n d t a b l e s

Food and Agriculture Roundtable

Front row, from left: Mr. Cooper, Mr. Adams, Mr. R. Farrell, Mr. Horan, Mr. McCauley, Mr. Kollar, Mr. J. Farrell, Mr. Timmerman, Senior Vice President Alan Barkema. Back row, from left: Branch Executive Jason Henderson, Mr. Black, Mr. West, Mr. Swedberg, Mr. Brooks, Mr. Devine, Mr. Gottschalk, Mr. Lapp, Mr. Detrick, Mr. Reynolds.

Jerry Adams
Adams Land & Cattle Company Inc.
Broken Bow, Nebraska

Bryan Black
National Pork Producers Council
Urbandale, Iowa

Bill Brooks
Downes-O’Neill/e-Dairy Inc.
Dearborn, Missouri

Ed Cooper
Wells Fargo Bank, N.A.
Chicago, Illinois

Terry Detrick
American Farmers & Ranchers
Oklahoma City, Oklahoma

Don Devine
Harris Ranch
Coalinga, California

Jim Farrell
Farmers National Company
Omaha, Nebraska

Ron Farrell
Farrell Growth Group
Kansas City, Missouri

Andrew Gottschalk
R.J. O’Brien & Associates
Greenwood Village, Colorado

William Horan
Horan Brothers Agricultural Enterprises
Rockwell City, Iowa

Ken Kollar
MetLife
Overland Park, Kansas

William Lapp
Advanced Economic Solutions
Omaha, Nebraska

Ken McCauley
National Corn Growers Association
Chesterfield, Missouri

Tom Reynolds
John Deere
Lenexa, Kansas

Joe Swedberg
Hormel Foods Corporation
Austin, Minnesota

Jim Timmerman
Timmerman & Sons Feeding Co.
Springfield, Nebraska

Thomas West
Pioneer Hi-Bred International Inc.
Johnston, Iowa
Regional Economic Roundtable

(From left) Senior Vice President Alan Barkema, Mr. Liu, Mr. Thompson, Ms. Reynis, Mr. Snead, Ms. Franklin, Mr. Crader, Mr. Wobbekind, Branch Executive Chad Wilkerson

Dean Crader
Research Analyst at the Economic & Policy Analysis Research Center
University of Missouri – Columbia
Columbia, Missouri

Debra Franklin
Regional Labor Force Analyst at the Center for Economic Development and Business Research
Wichita State University
Wichita, Kansas

Wenlin Liu
Senior Economist at the Division of Economic Analysis
State of Wyoming
Cheyenne, Wyoming

Lee Reynis
Director of the Bureau of Business and Economic Research
University of New Mexico
Albuquerque, New Mexico

Mark Snead
Director of the Center for Applied Economic Research
Oklahoma State University
Stillwater, Oklahoma

Eric Thompson
Director of the Bureau of Business Research
University of Nebraska – Lincoln
Lincoln, Nebraska

Rich Wobbekind
Director of the Business Research Division and Associate Dean
University of Colorado – Boulder
Boulder, Colorado
The Work of the Federal Reserve Bank of Kansas City

Employees are involved in a wide range of duties at the Kansas City Fed and its Branches in Denver, Oklahoma City and Omaha.

Administrative Services
Administrative Services performs a variety of services to keep the internal operations of the Federal Reserve Bank of Kansas City running smoothly on a daily basis. Functions include maintaining the Kansas City Fed’s facilities; providing a safe and secure environment; developing and implementing human resources strategies to meet the evolving needs of the Fed’s workforce and environment; developing the budget; and providing accurate financial accounting and reporting. Additionally, the division performs services on behalf of the Federal Reserve System, such as providing human resources information systems and billing users of Federal Reserve System services. Facilities Management, Protection, Business Continuity, Human Resources, Accounting, Financial Management, Human Resources Technology Center, and the National Billing Operations Site are included in this division, which employs 307 people.

Audit
Audit serves as an independent and objective evaluator of the Tenth Federal Reserve District’s performance. This division reports on the soundness of the Kansas City Fed’s operations to the Board of Directors, senior management and the Board of Governors. This division employs 23 people.

Legal
The Legal Department serves as the Kansas City Fed’s counsel. It provides advice to management and the Board of Directors; represents the Kansas City Fed in administrative and judicial proceedings; helps the Kansas City Fed comply with applicable law; counsels employees concerning the Kansas City Fed’s Code of Conduct; and helps educate employees on legal issues. This division employs six people.

Information Technology
The Information Technology Division consists of three functions: information technology services and support to local and select System business areas; technical support for System check processing services; and technology project management for the U.S. Treasury. This division employs about 262 people.

Financial Services
Financial Services works to provide financial institutions across the U.S. with services and support to assist them in carrying out their daily business. Through Cash Services, Wholesale Operations, Check Services, the Customer Contact Center and Regional Sales Departments, the division distributes coin and currency; provides secure and quick transfers of funds and securities between banks; processes paper and electronic checks; provides customer support and access to payments networks; manages customer relationships; and provides service to consumers nationwide who have questions or complaints about their financial institution. This division employs 251 people.

Economic Research
This division conducts research on macroeconomics and monetary policy; banking and financial markets; the payments system; and other issues of importance to the Kansas City Fed and the Federal Reserve System. Through publications and presentations, staff members communicate the results of this research to policymakers, other researchers and the general public. This division employs 45 people.

Regional, Public and Community Affairs
The division’s two primary responsibilities are research and communications. The division’s economists track developments in the District’s economy and present their findings to senior management as part of the Fed’s monetary policy deliberations. Through publications, media relations, electronic communication and programs, Public Affairs works to explain the Fed’s purpose and functions. Community Affairs promotes economic development through fair and impartial access to credit throughout the District. This division employs 56 people.

Supervision and Risk Management
Supervision and Risk Management is responsible for regulating bank holding companies and state-chartered member banks in the Tenth District. Staff members conduct examinations of these institutions to ensure a safe and sound banking system. In addition, the division works to make sure consumers are treated fairly in their dealings with banks and reviews applications by banking organizations seeking to acquire another institution, open a branch, change ownership or conduct other activities. The division also makes advances to depository institutions through the discount window and studies financial industry trends. This division employs 272 people.
Tenth District Officers

Kansas City
Thomas M. Hoenig
President and Chief Executive Officer
Richard K. Rasdall, Jr.
First Vice President and Chief Operating Officer
Alan D. Barkema
Senior Vice President
Kelly J. Dubbert
Senior Vice President and Chief Information Officer
Esther L. George
Senior Vice President
Barbara S. Pacheco
Senior Vice President
Stephen E. McBride
Senior Vice President
Gordon H. Sellon, Jr.
Senior Vice President and Director of Research
Charles L. Bacon, Jr.
Senior Vice President, General Counsel, and Secretary
Craig S. Hakko
Senior Vice President and Special Advisor on Economic Policy
Josias A. Aleman
Vice President and General Auditor
Larry D. Bailey
Vice President
Todd E. Clark
Vice President and Economist
Denise I. Connor
Vice President
Anita F. Costanza
Vice President
Kristi A. Coy
Vice President
Steven D. Evans
Vice President
Janel K. Frisch
Vice President and Chief Financial Officer
Mark C. Horan
Vice President
George A. Kahn
Vice President and Economist
Korie S. Miller
Vice President
Kevin L. Moore
Vice President
Dawn B. Morhaus
Vice President
Charles S. Morris
Vice President
Karen A. Pennell
Vice President
Diane M. Raley
Vice President and Public Information Officer
Linda S. Schroeder
Vice President
Veronica R. Sellers
Vice President and Associate General Counsel
Donna J. Ward
Vice President
Stuart E. Weiner
Vice President, Economist, and Director of Payments System Research
Susan E. ZGrab>
Vice President
Stanley R. Beatty
Assistant Vice President
Harriet I. Chern
Assistant Vice President
Michael R. Childs
Assistant Vice President
Kelley D. Courtright
Assistant Vice President
Kevin J. Craig
Assistant Vice President
Tanya L. Cvetan
Assistant Vice President
Troy A. Davig
Assistant Vice President and Economist
Justin M. Dean
Assistant General Counsel
Dennis V. Denney
Assistant Vice President
Linda K. Edwards
Assistant Vice President
Tammy Edwards
Assistant Vice President
C. Alan Garner
Assistant Vice President and Economist
Lori D. Haley
Assistant Vice President
Robert L. Hampton
Assistant Vice President
Ann L. Hoelting
Assistant Vice President
Kristofer K. Hogan
Assistant Vice President
Megan L. Hruda
Assistant Vice President and Assistant General Counsel
James H. Hunter
Assistant Vice President and Assistant Secretary
Lowell C. Jones
Assistant Vice President
William R. Keeton
Assistant Vice President and Economist
W. Todd Mackey
Assistant Vice President
D. Michael Manies
Assistant Vice President
Renu A. Mehra
Assistant Vice President
Randall L. Mueller
Assistant Vice President
Todd A. Offenbacker
Assistant Vice President
Annette K. Owens
Assistant Vice President
Wayne M. Powell
Assistant Vice President
Amy M. Seck
Assistant Vice President
Michael R. Steckline
Assistant Vice President
Stephanie L. Strateneier
Assistant Vice President
Leesa Guyton Thompson
Assistant Vice President
Wilmer R. Ullmann
Associate General Counsel and Ethics Officer
Mark A. Watson
Assistant Vice President
Kathryn A. Webster
Assistant Vice President
James Wilkinson
Assistant Vice President and Economist
Jonathan L. Willis
Assistant Vice President and Economist
Ginger K. Wise
Assistant Vice President
Kristina J. Young
Assistant Vice President
Catherine A. Zeigler
Assistant Vice President
Denver
Pamela L. Weinstein
Vice President
Debbie L. Meyers
Assistant Vice President
Dennis J. Stansbury
Assistant Vice President
Oklahoma City
Chad R. Wilkinson
Vice President, Branch Executive and Economist
Robert W. Toler
Assistant Vice President
Omaha
Jason R. Henderson
Vice President, Branch Executive and Economist
D. Rick Lay
Assistant Vice President
To the Board of Directors

The management of the Federal Reserve Bank of Kansas City (the “Bank”) is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statements of Income and Comprehensive Income, and Statement of Changes in Capital as of December 31, 2008 (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 and as set forth in the Financial Accounting Manual for the Federal Reserve Banks (“Manual”), and as such, include amounts, some of which 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 Manual and include all disclosures necessary for such fair presentation.

The management of the Bank is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. 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 Manual. 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 Bank 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 Bank maintained effective internal control over financial reporting as it relates to the Financial Statements.

Thomas M. Hoenig, President

Richard K. Rasdall, Jr., First Vice President

Janel K. Frisch, Vice President, Chief Financial Officer
REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying statements of condition of the Federal Reserve Bank of Kansas City (the “Bank”) as of December 31, 2008 and 2007 and the related statements of income and comprehensive income and 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 Bank as of December 31, 2008, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Bank’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 Bank’s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the 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 Bank’s internal control over financial reporting is a process designed by, or under the supervision of, the Bank’s principal executive and principal financial officers, or persons performing similar functions, and effected by the Bank’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 Bank’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 Bank; (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 Bank are being made only in accordance with authorizations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or
timely detection of unauthorized acquisition, use, or disposition of the Bank’s assets that could have a material effect on 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 Bank 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, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2008 and 2007, 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 Bank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

April 2, 2009
The accompanying notes are an integral part of these financial statements.

FEDERAL RESERVE BANK OF KANSAS CITY

STATEMENTS OF CONDITION (in millions)

As of December 31, 2008 and 2007

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gold certificates</td>
<td>$349</td>
<td>$335</td>
</tr>
<tr>
<td>Special drawing rights certificates</td>
<td>66</td>
<td>66</td>
</tr>
<tr>
<td>Coin</td>
<td>114</td>
<td>72</td>
</tr>
<tr>
<td>Items in process of collection</td>
<td>14</td>
<td>215</td>
</tr>
<tr>
<td>Loans to depository institutions</td>
<td>7,310</td>
<td>7</td>
</tr>
<tr>
<td>System Open Market Account:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities purchased under agreements to resell</td>
<td>2,937</td>
<td>1,505</td>
</tr>
<tr>
<td>U.S. government, Federal agency, and government-sponsored enterprise securities, net</td>
<td>18,439</td>
<td>24,137</td>
</tr>
<tr>
<td>Investments denominated in foreign currencies</td>
<td>261</td>
<td>264</td>
</tr>
<tr>
<td>Central bank liquidity swaps</td>
<td>5,825</td>
<td>280</td>
</tr>
<tr>
<td>Interdistrict settlement account</td>
<td>5,080</td>
<td>5,239</td>
</tr>
<tr>
<td>Bank premises and equipment, net</td>
<td>304</td>
<td>298</td>
</tr>
<tr>
<td>Accrued interest receivable</td>
<td>218</td>
<td>206</td>
</tr>
<tr>
<td>Other assets</td>
<td>16</td>
<td>19</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$40,933</strong></td>
<td><strong>$32,643</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES AND CAPITAL</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal Reserve notes outstanding, net</td>
<td>$26,332</td>
<td>$30,104</td>
</tr>
<tr>
<td>System Open Market Account:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities sold under agreements to repurchase</td>
<td>3,244</td>
<td>1,424</td>
</tr>
<tr>
<td>Deposits:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depository institutions</td>
<td>10,769</td>
<td>449</td>
</tr>
<tr>
<td>Other deposits</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Deferred credit items</td>
<td>102</td>
<td>157</td>
</tr>
<tr>
<td>Interest on Federal Reserve notes due to U.S. Treasury</td>
<td>7</td>
<td>43</td>
</tr>
<tr>
<td>Accrued benefit costs</td>
<td>50</td>
<td>45</td>
</tr>
<tr>
<td>Other liabilities</td>
<td>11</td>
<td>31</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>40,517</strong></td>
<td><strong>32,255</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital:</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital paid-in</td>
<td>208</td>
<td>194</td>
</tr>
<tr>
<td>Surplus (including accumulated other comprehensive loss of $8 million and $2 million at December 31, 2008 and 2007, respectively)</td>
<td>208</td>
<td>194</td>
</tr>
<tr>
<td><strong>Total capital</strong></td>
<td><strong>416</strong></td>
<td><strong>388</strong></td>
</tr>
<tr>
<td><strong>Total liabilities and capital</strong></td>
<td><strong>$40,933</strong></td>
<td><strong>$32,643</strong></td>
</tr>
</tbody>
</table>
STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (in millions)
For the years ended December 31, 2008 and 2007

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Interest income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans to depository institutions</td>
<td>$ 36</td>
<td>$ 1</td>
</tr>
<tr>
<td>System Open Market Account:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities purchased under agreements to resell</td>
<td>67</td>
<td>45</td>
</tr>
<tr>
<td>U.S. government, Federal agency, and government-sponsored enterprise securities</td>
<td>900</td>
<td>1,218</td>
</tr>
<tr>
<td>Investments denominated in foreign currencies</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Central bank liquidity swaps</td>
<td>38</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total interest income</strong></td>
<td>1,048</td>
<td>1,271</td>
</tr>
<tr>
<td><strong>Interest expense:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System Open Market Account:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities sold under agreements to repurchase</td>
<td>26</td>
<td>53</td>
</tr>
<tr>
<td>Depository institutions deposits</td>
<td>9</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total interest expense</strong></td>
<td>35</td>
<td>53</td>
</tr>
<tr>
<td><strong>Net interest income</strong></td>
<td>1,013</td>
<td>1,218</td>
</tr>
<tr>
<td><strong>Non-interest income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System Open Market Account:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. government, Federal agency, and government-sponsored enterprise securities gains, net</td>
<td>128</td>
<td>-</td>
</tr>
<tr>
<td>Foreign currency gains, net</td>
<td>14</td>
<td>21</td>
</tr>
<tr>
<td>Compensation received for services provided</td>
<td>66</td>
<td>81</td>
</tr>
<tr>
<td>Reimbursable services to government agencies</td>
<td>10</td>
<td>11</td>
</tr>
<tr>
<td>Other income</td>
<td>30</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total non-interest income</strong></td>
<td>248</td>
<td>116</td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and other benefits</td>
<td>120</td>
<td>124</td>
</tr>
<tr>
<td>Occupancy expense</td>
<td>15</td>
<td>7</td>
</tr>
<tr>
<td>Equipment expense</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>Assessments by the Board of Governors</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>Other expenses</td>
<td>34</td>
<td>47</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>207</td>
<td>215</td>
</tr>
<tr>
<td><strong>Net income prior to distribution</strong></td>
<td>1,054</td>
<td>1,119</td>
</tr>
<tr>
<td>Change in funded status of benefit plans</td>
<td>(6)</td>
<td>4</td>
</tr>
<tr>
<td><strong>Comprehensive income prior to distribution</strong></td>
<td>$ 1,048</td>
<td>$ 1,123</td>
</tr>
<tr>
<td><strong>Distribution of comprehensive income:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends paid to member banks</td>
<td>$ 12</td>
<td>$ 11</td>
</tr>
<tr>
<td>Transferred to surplus and change in accumulated other comprehensive loss</td>
<td>14</td>
<td>18</td>
</tr>
<tr>
<td>Payments to U.S. Treasury as interest on Federal Reserve notes</td>
<td>1,022</td>
<td>1,094</td>
</tr>
<tr>
<td><strong>Total distribution</strong></td>
<td>$ 1,048</td>
<td>$ 1,123</td>
</tr>
</tbody>
</table>
FEDERAL RESERVE BANK OF KANSAS CITY
STATEMENTS OF CHANGES IN CAPITAL [in millions, except share data]
For the years ended December 31, 2008 and 2007

<table>
<thead>
<tr>
<th></th>
<th>Capital Paid-In</th>
<th>Net Income Retained</th>
<th>Accumulated Other Comprehensive Loss</th>
<th>Total Surplus</th>
<th>Total Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance at January 1, 2007</strong> (3.5 million shares)</td>
<td>$176</td>
<td>$182</td>
<td>$(6)</td>
<td>$176</td>
<td>$352</td>
</tr>
<tr>
<td>Net change in capital stock issued (0.4 million shares)</td>
<td>18</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Transferred to surplus and change in accumulated other comprehensive loss</td>
<td>-</td>
<td>14</td>
<td>4</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td><strong>Balance at December 31, 2007</strong> (3.9 million shares)</td>
<td>$194</td>
<td>$196</td>
<td>$(2)</td>
<td>$194</td>
<td>$388</td>
</tr>
<tr>
<td>Net change in capital stock issued (0.3 million shares)</td>
<td>14</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Transferred to surplus and change in accumulated other comprehensive loss</td>
<td>-</td>
<td>20</td>
<td>(6)</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td><strong>Balance at December 31, 2008</strong> (4.2 million shares)</td>
<td>$208</td>
<td>$216</td>
<td>$(8)</td>
<td>$208</td>
<td>$416</td>
</tr>
</tbody>
</table>
1. STRUCTURE

The Federal Reserve Bank of Kansas City (“Bank”) is part of the Federal Reserve System (“System”) and is one of the twelve 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 Tenth Federal Reserve District, which includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, and portions of Missouri and New Mexico.

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 in the System. 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.

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. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse (“ACH”) operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government’s bank; provision of short-term loans to depository institutions; provision of loans to individuals, partnerships, and corporations in unusual and exigent circumstances; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of 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 FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY to execute transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of securities of the U.S. government, Federal agencies, and government-sponsored enterprises (“GSEs”), the purchase of these securities
under agreements to resell, the sale of these securities under agreements to repurchase, and the lending of these securities. The FRBNY executes these transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account ("SOMA").

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System’s central bank responsibilities. The FRBNY is authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, fourteen foreign currencies and to invest such foreign currency holdings, ensuring adequate liquidity is maintained. The FRBNY is also authorized and directed by the FOMC to maintain reciprocal currency arrangements with fourteen central banks and to "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund (“ESF”) through the Reserve Banks.

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 providing the service and the other 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 reimburse the other Reserve Banks for services provided to them.

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 the Customer Relations and Support Office/Customer Contact Center, Human Resources Technology Center, and Billing Operations Site.

3. RECENT FINANCIAL STABILITY ACTIVITIES

The Federal Reserve has implemented a number of programs designed to support the liquidity of financial institutions and to foster improved conditions in financial markets. These new programs, which are set forth below, have resulted in significant changes to the Bank’s financial statements.

Expanded Open Market Operations and Support for Mortgage Related Securities

The Single-Tranche Open Market Operation Program, created on March 7, 2008, allows primary dealers to initiate a series of term repurchase transactions that are expected to accumulate up to $100 billion in total. Under the provisions of the program, these transactions are conducted as 28-day term repurchase agreements for which primary dealers pledge U.S. Treasury and agency securities and agency Mortgage-Backed Securities ("MBS") as collateral. The FRBNY can elect to increase the size of the term repurchase program if conditions warrant. The repurchase transactions are reported as “System Open Market Account: Securities purchased under agreements to resell” in the Statements of Condition.
The GSE and Agency Securities and MBS Purchase Program was announced on November 25, 2008. The primary goal of the program is to provide support to the mortgage and housing markets and to foster improved conditions in financial markets. Under this program, the FRBNY will purchase the direct obligations of housing-related GSEs and MBS backed by the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”), and the Government National Mortgage Association (“Ginnie Mae”). Purchases of the direct obligations of housing-related GSEs began in November 2008 and purchases of GSE and agency MBS began in January 2009. There were no purchases of GSE and agency MBS during the period ended December 31, 2008. The program was initially authorized to purchase up to $100 billion in GSE direct obligations and up to $500 billion in GSE and agency MBS. In March 2009, the FOMC authorized FRBNY to purchase up to an additional $750 billion of GSE and agency MBS and up to an additional $100 billion of GSE direct obligations.

The FRBNY holds the resulting securities and agreements in the SOMA portfolio and the activities of both programs are allocated to the other Reserve Banks.

**Central Bank Liquidity Swaps**

The FOMC authorized the FRBNY to establish temporary reciprocal currency swap arrangements (central bank liquidity swaps) with the European Central Bank and the Swiss National Bank on December 12, 2007, to help provide liquidity in U.S. dollars to overseas markets. Subsequently, the FOMC authorized reciprocal currency swap arrangements with additional foreign central banks. Such arrangements are now authorized with the following central banks: the Reserve Bank of Australia, the Banco Central do Brasil, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, Sveriges Riksbank, and the Swiss National Bank. The activity related to the program is allocated to the other Reserve Banks. The maximum amount of borrowing permissible under the swap arrangements varies by central bank. The central bank liquidity swap arrangements are authorized through October 30, 2009.

**Lending to Depository Institutions**

The temporary Term Auction Facility (“TAF”) program was created on December 12, 2007. The goal of the TAF is to help promote the efficient dissemination of liquidity, which is achieved by the Reserve Banks injecting term funds through a broader range of counterparties and against a broader range of collateral than open market operations. Under the TAF program, Reserve Banks auction term funds to depository institutions against a wide variety of collateral. All depository institutions that are judged to be in generally sound financial condition by their Reserve Bank and that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All advances must be fully collateralized. The loans are reported as “Loans to depository institutions” in the Statements of Condition.

**Lending to Primary Dealers**

The Term Securities Lending Facility (“TSLF”) was created on March 11, 2008, to promote the liquidity in the financing markets for U.S. Treasuries and other collateral. Under the TSLF, the FRBNY will lend up to an aggregate amount of $200 billion of U.S. Treasury securities to primary dealers secured for a term of 28 days. Securities loans are collateralized by a pledge of other securities,
including federal agency debt, federal agency residential mortgage-backed securities, and non-agency
AAA/Aaa-rated private-label residential mortgage-backed securities, and are awarded to primary
dealers through a competitive single-price auction. The TSLF is authorized through October 30,
2009. The fees related to these securities lending transactions are reported as a component of “Non-
interest income: Other income” in the Statements of Income and Comprehensive Income.

The Term Securities Lending Facility Options Program (“TOP”) created on July 30, 2008, offers
primary dealers the option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible
collateral. The options are awarded through a competitive auction. The program is intended to enhance
the effectiveness of the TSLF by ensuring additional securities liquidity during periods of heightened
collateral market pressures, such as around quarter-end dates. TOP auction dates are determined by
the FRBNY, and the program authorization ends concurrently with the TSLF.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (“AMLF”),
created on September 19, 2008, is a lending facility that provides funding to U.S. depository institutions
and bank holding companies to finance the purchase of high-quality asset-backed commercial paper
(“ABCP”) from money market mutual funds under certain conditions. The program is intended to
assist money market mutual funds that hold such paper to meet the demands for investor redemptions
and to foster liquidity in the ABCP market and money markets more generally. The Federal Reserve
Bank of Boston (“FRBB”) administers the AMLF and is authorized to extend these loans to eligible
borrowers on behalf of the other Reserve Banks. All loans extended under the AMLF are recorded
as assets by the FRBB and, if the borrowing institution settles to a depository account in the Tenth
Federal Reserve District, the funds are credited to the institution’s depository account and settled
between the Banks through the interdistrict settlement account. The credit risk related to the AMLF
is assumed by the FRBB. The FRBB is authorized to finance the purchase of commercial paper
through October 30, 2009.

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
which is issued by the Board of Governors. All of 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.

Differences exist between the accounting principles and practices in the FAM and generally accepted
accounting principles in the United States (“GAAP”), primarily due to the unique nature of the
Bank’s powers and responsibilities as part of the nation’s central bank. The primary difference is
the presentation of all SOMA securities holdings at amortized cost rather than using the fair value
presentation required by GAAP. U.S. government, Federal agency, and GSE securities, and investments
denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date
basis, and are adjusted for amortization of premiums or accretion of discounts on a straight-line basis.
Amortized cost more appropriately reflects the Bank’s securities holdings given the System’s unique responsibility to conduct monetary policy. Although the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would 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 prior to 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 any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Bank has elected not to present a Statement of Cash Flows 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. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. Unique accounts and significant accounting policies are explained below.

a. Gold and Special Drawing Rights Certificates

The Secretary of the U.S. Treasury is authorized to issue gold and special drawing rights (“SDR”) certificates to the Reserve Banks.

Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. 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 a 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 in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund (the “Fund”) to its members in proportion to each member’s quota in the Fund 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 U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks’ SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the
direction of the U.S. 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. There were no SDR transactions in 2008 or 2007.

b. Loans to Depository Institutions

Loans are reported at their outstanding principal balances net of commitment fees. Interest income is recognized on an accrual basis. Loan commitment fees are generally deferred and amortized on a straight-line basis over the commitment period, which is not materially different from the interest method.

Outstanding loans are evaluated to determine whether an allowance for loan losses is required. The Bank has developed procedures for assessing the adequacy of the allowance for loan losses that reflect the assessment of credit risk considering all available information. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers.

Loans are considered to be impaired when it is probable that the Bank will not receive principal and interest due in accordance with the contractual terms of the loan agreement. The amount of the impairment is the difference between the recorded amount of the loan and the amount expected to be collected, after consideration of the fair value of the collateral. Recognition of interest income is discontinued for any loans that are considered to be impaired. Cash payments made by borrowers on impaired loans are applied to principal until the balance is reduced to zero; subsequent payments are recorded as recoveries of amounts previously charged off and then to interest income.

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

The FRBNY may engage in tri-party purchases of securities under agreements to resell (“tri-party agreements”). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities; pass-through mortgage securities of Fannie Mae, Freddie Mac, and Ginnie Mae; STRIP securities of the U.S. government; and “stripped” securities of other government agencies. The tri-party agreements are accounted for as financing transactions and the associated interest income is accrued over the life of the agreement.

Securities sold under agreements to repurchase 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 in the Statements of Condition and the related accrued interest payable is reported as a component of “Other liabilities.”

U.S. government securities held in the SOMA are lent to U.S. government securities dealers to facilitate the effective functioning of the domestic securities market. Overnight securities lending transactions are fully collateralized by other U.S. government securities. Term securities lending transactions are fully collateralized with investment-grade debt securities, collateral eligible for tri-party repurchase
agreements arranged by the Open Market Trading Desk, or both. The collateral taken in both overnight and term securities lending transactions is in excess of the fair value of the securities loaned. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of “Other 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.

d. U.S. Government, Federal Agency, and Government-Sponsored Enterprise Securities; Investments Denominated in Foreign Currencies; and Warehousing Agreements

Interest income on U.S. government, Federal agency, and GSE securities and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. 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 investments denominated in foreign currencies are reported as “Foreign currency (losses) gains, net” in the Statements of Income and Comprehensive Income.

Activity related to U.S. government, Federal agency, and GSE securities, 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. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies, 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 agrees to exchange, at the request of the U.S. Treasury, U.S. dollars for foreign currencies held by the U.S. Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the U.S. Treasury and ESF 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.

e. Central Bank Liquidity Swaps

At the initiation of each central bank liquidity swap transaction, the foreign central bank transfers a specified amount of its currency to 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. The foreign currency amounts that the FRBNY acquires are reported as “Central bank liquidity swaps” on the Statements
of Condition. Because the swap transaction will be unwound at the same exchange rate that was 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 pays interest to the FRBNY based on the foreign currency amounts held by the FRBNY. The FRBNY recognizes interest income during the term of the swap agreement and reports the interest income as a component of “Interest income: Central bank liquidity swaps” in the Statements of Income and Comprehensive Income.

Activity related to these swap transactions, including the related interest income, 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. Similar to other investments denominated in foreign currencies, the foreign currency holdings associated with these central bank liquidity swaps are revalued at current foreign currency market exchange rates and allocated to the other Reserve Banks. Because the swap arrangement will be unwound at the same exchange rate that was used in the initial transaction, the obligation to return the foreign currency is also revalued at current foreign currency market exchange rates and is recorded in a currency exchange valuation account by the FRBNY. This revaluation method eliminates the effects of the changes in the market exchange rate. As of December 31, 2008, the FRBNY began allocating this currency exchange valuation account to the Bank and, as a result, the reported amount of central bank liquidity swaps reflects the Bank’s allocated portion at the contract exchange rate.

f. 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.

g. 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 two to fifty 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 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 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.

h. Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the chairman of the board of directors of each Reserve Bank and their designees) to the Reserve Banks upon deposit with such agents of specified classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be at least equal to the sum of the notes applied for by such Reserve Bank.

Assets eligible to be pledged as collateral security include all of the Bank’s assets. The collateral value is equal to the book value of the collateral tendered with the exception of securities, for which the collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the 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. At December 31, 2008 and 2007, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

“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 $3,536 million and $3,212 million at December 31, 2008 and 2007, respectively.

i. Items in Process of Collection and Deferred Credit Items

“Items in process of collection” in the Statements of Condition 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, and 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.
j. **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 reflect 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.

k. **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. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks will be required to call on member banks for additional capital.

Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to other postretirement benefit plans that, under accounting standards, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

l. **Interest on Federal Reserve Notes**

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. 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 U.S. Treasury as interest on Federal Reserve notes” in the Statements of Income and Comprehensive Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

In the event of losses or an increase in capital paid-in at a Reserve Bank, payments to the U.S. Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in.

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 U.S. Treasury in the following year.
m. Interest on Depository Institutions Deposits

Beginning October 9, 2008, the Reserve Banks began paying interest to depository institutions on qualifying balances held at the Banks. Authorization for payment of interest on these balances was granted by Title II of the Financial Services Regulatory Relief Act of 2006, which had an effective date of 2011. Section 128 of the Emergency Economic Stabilization Act of 2008, enacted on October 3, 2008, made that authority immediately effective. The interest rates paid on required reserve balances and excess balances are based on an FOMC-established target range for the effective federal funds rate.

n. Income and Costs Related to U.S. Treasury Services

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury has appropriations to pay for these services. During the years ended December 31, 2008 and 2007, the Bank was reimbursed for all services provided to the Department of the Treasury as its fiscal agent.

o. Compensation Received for Services 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. The FRBNY manages the Reserve Banks’ provision of Fedwire funds and securities transfer services, and recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. Similarly, the Federal Reserve Bank of Chicago (“FRBC”) has overall responsibility for managing the Reserve Banks’ provision of electronic access services to depository institutions and, as a result, recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. The FRBA, FRBNY, and FRBC compensate the other Reserve Banks for the costs incurred to provide these services. The Bank reports this compensation as “Compensation received for services provided” in the Statements of Income and Comprehensive Income.

p. Assessments by the Board of Governors

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank’s capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred for the U.S. Treasury to prepare 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.

q. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property and, in some states, sales taxes on construction-related materials. The Bank’s real property taxes were $4 million and $201 thousand for the years ended December 31, 2008 and 2007, respectively, and are reported as a component of “Occupancy expense.”
r. 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. The costs associated with the impairment of certain Bank assets are discussed in Note 9. 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.

s. Recently Issued Accounting Standards

In September 2006, FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”), which established a single authoritative definition of fair value and a framework for measuring fair value, and expands the required disclosures for assets and liabilities measured at fair value. SFAS 157 was effective for fiscal years beginning after November 15, 2007, with early adoption permitted. The Bank adopted SFAS 157 effective January 1, 2008. The provisions of this standard have no material effect on the Bank’s financial statements.

In February 2007, FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities,” including an amendment of FASB Statement No. 115 (“SFAS 159”), which provides companies with an irrevocable option to elect fair value as the measurement for selected financial assets, financial liabilities, unrecognized firm commitments, and written loan commitments that are not subject to fair value under other accounting standards. There is a one-time election available to apply this standard to existing financial instruments as of January 1, 2008; otherwise, the fair value option will be available for financial instruments on their initial transaction date. SFAS 159 reduces the accounting complexity for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently, and it eliminates the operational complexities of applying hedge accounting. The Bank adopted SFAS 159 effective January 1, 2008. The provisions of this standard have no material effect on the Bank’s financial statements.

In February 2008, FASB issued FASB Staff Position (“FSP”) FAS 140-3, “Accounting for Transfers of Financial Assets and Repurchase Financing Transactions.” FSP FAS 140-3 requires that an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of, the initial transfer be evaluated together as a linked transaction under SFAS 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities”, unless certain criteria are met. FSP FAS 140-3 is effective for the Bank’s financial statements for the year beginning on January 1, 2009 and earlier adoption is not permitted. The provisions of this standard will not have a material effect on the Bank’s financial statements.
5. LOANS

The loan amounts outstanding to depository institutions at December 31 were as follows (in millions):

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary, secondary, and seasonal credit</td>
<td>$4,570</td>
<td>$7</td>
</tr>
<tr>
<td>TAF</td>
<td>$2,740</td>
<td>-</td>
</tr>
<tr>
<td>Total loans to depository institutions</td>
<td>$7,310</td>
<td>$7</td>
</tr>
</tbody>
</table>

**Loans to Depository Institutions**

The Bank offers primary, secondary, and seasonal credit to eligible borrowers. Each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every fourteen days by the board of directors of the Bank, subject to review and determination by the Board of Governors. Primary and secondary credits are extended on a short-term basis, typically overnight, whereas seasonal credit may be extended for a period 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, U.S. Treasury securities, Federal agency securities, GSE obligations, foreign sovereign debt obligations, municipal or corporate obligations, 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 deemed appropriate by the Bank, which is typically fair value or face value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank’s primary credit program are also eligible to participate in the temporary TAF program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans are extended on a short-term basis, with terms of either 28 or 84 days. All advances under the TAF must be fully collateralized. Assets eligible to collateralize TAF loans include the complete list noted above for loans to depository institutions. Similar to the process used for primary, secondary, and seasonal credit, a lending value is assigned to each asset accepted as collateral for TAF loans.

Loans to depository institutions are monitored on a daily basis 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 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.
The maturity distribution of loans outstanding at December 31, 2008, was as follows (in millions):

<table>
<thead>
<tr>
<th></th>
<th>Primary, secondary, and seasonal credit</th>
<th>TAF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 15 days</td>
<td>$4,526</td>
<td>$1,230</td>
</tr>
<tr>
<td>16 days to 90 days</td>
<td>44</td>
<td>1,510</td>
</tr>
<tr>
<td>91 days to 1 year</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Over 1 year to 5 years</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Over 5 years to 10 years</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Over 10 years</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total loans</td>
<td>$4,570</td>
<td>$2,740</td>
</tr>
</tbody>
</table>

Allowance for Loan Losses

At December 31, 2008 and 2007, no loans were considered to be impaired and the Bank determined that no allowance for loan losses was required.

6. U.S. Government, Federal Agency, and Government-Sponsored Enterprise 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 3.672 percent and 3.237 percent at December 31, 2008 and 2007, respectively.

The Bank’s allocated share of U.S. government, Federal agency, and GSE securities, net, held in the SOMA at December 31 was as follows (in millions):

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bills</td>
<td>$676</td>
<td>$7,375</td>
</tr>
<tr>
<td>Notes</td>
<td>12,292</td>
<td>13,006</td>
</tr>
<tr>
<td>Bonds</td>
<td>4,506</td>
<td>3,593</td>
</tr>
<tr>
<td>Federal agency and GSE securities</td>
<td>724</td>
<td>-</td>
</tr>
<tr>
<td>Total par value</td>
<td>18,198</td>
<td>23,974</td>
</tr>
<tr>
<td>Unamortized premiums</td>
<td>296</td>
<td>259</td>
</tr>
<tr>
<td>Unaccreted discounts</td>
<td>(55)</td>
<td>(96)</td>
</tr>
<tr>
<td>Total allocated to the Bank</td>
<td>$18,439</td>
<td>$24,137</td>
</tr>
</tbody>
</table>
At December 31, 2008 and 2007, the fair value of the U.S. government, Federal agency, and GSE securities allocated to the Bank, excluding accrued interest, was $20,798 million and $25,157 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government, Federal agency, and GSE securities, net, held in the SOMA was $502,189 million and $745,629 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the fair value of the U.S. government, Federal agency, and GSE securities held in the SOMA, excluding accrued interest, was $566,427 million and $777,141 million, respectively, as determined by reference to quoted prices for identical securities.

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 central bank, to meet their financial obligations and responsibilities and do not represent a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31, 2008 and 2007, were as follows (in millions):

<table>
<thead>
<tr>
<th>Securities purchased under agreements to resell</th>
<th>Securities sold under agreements to repurchase</th>
</tr>
</thead>
<tbody>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Allocated to the Bank:</td>
<td></td>
</tr>
<tr>
<td>Contract amount outstanding, end of year</td>
<td>$2,937</td>
</tr>
<tr>
<td>Weighted average amount outstanding, during the year</td>
<td>3,563</td>
</tr>
<tr>
<td>Maximum month-end balance outstanding, during the year</td>
<td>4,369</td>
</tr>
<tr>
<td>Securities pledged, end of year</td>
<td>2,897</td>
</tr>
<tr>
<td>System total:</td>
<td></td>
</tr>
<tr>
<td>Contract amount outstanding, end of year</td>
<td>$80,000</td>
</tr>
<tr>
<td>Weighted average amount outstanding, during the year</td>
<td>97,037</td>
</tr>
<tr>
<td>Maximum month-end balance outstanding, during the year</td>
<td>119,000</td>
</tr>
<tr>
<td>Securities pledged, end of year</td>
<td></td>
</tr>
</tbody>
</table>
The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value.

The maturity distribution of U.S. government, Federal agency, and GSE securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2008, was as follows (in millions):

<table>
<thead>
<tr>
<th>Subtotal:</th>
<th>U.S. government, Federal agency, and GSE securities (Par value)</th>
<th>Securities purchased under agreements to resell (Contract amount)</th>
<th>Securities sold under agreements to repurchase (Contract amount)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 15 days</td>
<td>$703</td>
<td>$720</td>
<td>$1,468</td>
</tr>
<tr>
<td>16 days to 90 days</td>
<td>770</td>
<td>890</td>
<td>1,469</td>
</tr>
<tr>
<td>91 days to 1 year</td>
<td>2,325</td>
<td>2,361</td>
<td></td>
</tr>
<tr>
<td>Over 1 year to 5 years</td>
<td>6,364</td>
<td>6,781</td>
<td></td>
</tr>
<tr>
<td>Over 5 years to 10 years</td>
<td>3,573</td>
<td>3,707</td>
<td></td>
</tr>
<tr>
<td>Over 10 years</td>
<td>3,739</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total allocated to the Bank</td>
<td>$17,474</td>
<td>$18,198</td>
<td>$2,937</td>
</tr>
</tbody>
</table>

At December 31, 2008 and 2007, U.S. government securities with par values of $180,765 million and $16,649 million, respectively, were loaned from the SOMA, of which $6,637 million and $539 million, respectively, were allocated to the Bank.

### 7. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. These investments are guaranteed as to principal and interest by the issuing foreign governments.

The Bank’s allocated share of investments denominated in foreign currencies was approximately 1.052 percent and 1.151 percent at December 31, 2008 and 2007, respectively.

The Bank’s allocated share of investments denominated in foreign currencies, including accrued interest, valued at foreign currency market exchange rates at December 31, was as follows (in millions):

<table>
<thead>
<tr>
<th>Foreign currency</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency deposits</td>
<td>$59</td>
<td>$83</td>
</tr>
<tr>
<td>Securities purchased under agreements to resell</td>
<td>43</td>
<td>29</td>
</tr>
<tr>
<td>Government debt instruments</td>
<td>48</td>
<td>54</td>
</tr>
<tr>
<td>Japanese yen:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign currency deposits</td>
<td>37</td>
<td>32</td>
</tr>
<tr>
<td>Government debt instruments</td>
<td>74</td>
<td>66</td>
</tr>
<tr>
<td>Total allocated to the Bank</td>
<td>$261</td>
<td>$264</td>
</tr>
</tbody>
</table>
At December 31, 2008 and 2007, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was $263 million for each year. 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 U.S. government, Federal agency, and GSE securities discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were $24,804 million and $22,914 million at December 31, 2008 and 2007, respectively. At December 31, 2008 and 2007, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was $25,021 million and $22,892 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2008, was as follows (in millions):

<table>
<thead>
<tr>
<th></th>
<th>Euro</th>
<th>Japanese yen</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 15 days</td>
<td>$ 80</td>
<td>$ 37</td>
<td>$ 117</td>
</tr>
<tr>
<td>16 days to 90 days</td>
<td>12</td>
<td>6</td>
<td>18</td>
</tr>
<tr>
<td>91 days to 1 year</td>
<td>19</td>
<td>21</td>
<td>40</td>
</tr>
<tr>
<td>Over 1 year to 5 years</td>
<td>39</td>
<td>47</td>
<td>86</td>
</tr>
<tr>
<td>Total allocated to the Bank</td>
<td>$ 150</td>
<td>$ 111</td>
<td>$ 261</td>
</tr>
</tbody>
</table>

At December 31, 2008 and 2007, the authorized warehousing facility was $5 billion, with no balance outstanding.

In connection with its foreign currency activities, the FRBNY may enter into transactions that contain varying degrees of off-balance-sheet market risk that result from their future settlement and counter-party credit risk. The FRBNY controls these risks by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

8. CENTRAL BANK LIQUIDITY SWAPS

Central bank liquidity swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank whereby the parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time. At the end of that period of time, the currencies are returned at the original contractual exchange rate and the foreign central bank pays interest to the Federal Reserve at an agreed-upon rate. These arrangements give the authorized foreign central bank temporary access to U.S. dollars. Drawings under the swap arrangements are initiated by the foreign central bank and must be agreed to by the Federal Reserve.

The Bank’s allocated share of central bank liquidity swaps was approximately 1.052 percent and 1.151 percent at December 31, 2008 and 2007, respectively.
At December 31, 2008 and 2007, the total System amount of foreign currency held under central bank liquidity swaps was $553,728 million and $24,353 million, respectively, of which $5,825 million and $280 million, respectively, was allocated to the Bank.

The maturity distribution of central bank liquidity swaps that were allocated to the Bank at December 31 was as follows (in millions):

<table>
<thead>
<tr>
<th>Currency</th>
<th>2008 within 15 days</th>
<th>2008 16 days to 90 days</th>
<th>2008 Total</th>
<th>2007 16 days to 90 days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian dollar</td>
<td>$105</td>
<td>$135</td>
<td>$240</td>
<td>$-</td>
</tr>
<tr>
<td>Danish krone</td>
<td>-</td>
<td>158</td>
<td>158</td>
<td>-</td>
</tr>
<tr>
<td>Euro</td>
<td>1,588</td>
<td>1,477</td>
<td>3,065</td>
<td>233</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>504</td>
<td>787</td>
<td>1,291</td>
<td>-</td>
</tr>
<tr>
<td>Korean won</td>
<td>-</td>
<td>109</td>
<td>109</td>
<td>-</td>
</tr>
<tr>
<td>Norwegian krone</td>
<td>23</td>
<td>63</td>
<td>86</td>
<td>-</td>
</tr>
<tr>
<td>Swedish krona</td>
<td>105</td>
<td>158</td>
<td>263</td>
<td>-</td>
</tr>
<tr>
<td>Swiss franc</td>
<td>202</td>
<td>63</td>
<td>265</td>
<td>47</td>
</tr>
<tr>
<td>U.K. pound</td>
<td>1</td>
<td>347</td>
<td>348</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$2,528</td>
<td>$3,297</td>
<td>$5,825</td>
<td>$280</td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank premises and equipment:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$45</td>
<td>$45</td>
</tr>
<tr>
<td>Buildings</td>
<td>215</td>
<td>16</td>
</tr>
<tr>
<td>Building machinery and equipment</td>
<td>34</td>
<td>6</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>-</td>
<td>217</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>64</td>
<td>71</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>358</td>
<td>355</td>
</tr>
<tr>
<td>Accumulated depreciation</td>
<td>(54)</td>
<td>(57)</td>
</tr>
<tr>
<td><strong>Bank premises and equipment, net</strong></td>
<td>$304</td>
<td>$298</td>
</tr>
<tr>
<td><strong>Depreciation expense, for the years ended December 31</strong></td>
<td>$12</td>
<td>$5</td>
</tr>
</tbody>
</table>

The Bank leases space to outside tenants with remaining lease terms ranging from one to three years. Rental income from such leases was not material for the years ended December 31, 2008 and 2007. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2008, were not material.

The Bank has capitalized software assets, net of amortization, of $6 million for each of the years ended December 31, 2008 and 2007. Amortization expense was $1 million for each of the years ended December 31, 2008 and 2007. Capitalized software assets are reported as a component of “Other assets” and the related amortization is reported as a component of “Other expenses.”

Assets impaired as a result of the Bank’s restructuring plan, as discussed in Note 14, include check equipment. Asset impairment losses of $2 million for the period ended December 31, 2007, were determined using fair values based on quoted fair values or other valuation techniques and are reported as a component of “Other expenses.” The Bank had no impairment losses in 2008.

10. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2008, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from two to approximately three 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 $5 million for the years ended December 31, 2008 and 2007, respectively. Certain of the Bank’s leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2008 were not material.

At December 31, 2008, there were no material unrecorded unconditional purchase commitments or long-term 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 pro rata share of losses in excess of one 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, 2008 or 2007.
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 Bank’s employees participate in the Retirement Plan for Employees of the Federal Reserve System (“System Plan”). Employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (“BEP”) and certain Reserve Bank officers participate in the Supplemental Employee Retirement Plan (“SERP”).

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are 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, 2008 and 2007, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank may also 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. For the years ended December 31, 2008 and 2007, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service. The Bank’s Thrift Plan contributions totaled $4 million for each of the years ended December 31, 2008 and 2007, and are reported as a component of “Salaries and other benefits” in the Statements of Income and Comprehensive Income. Beginning in 2009, the Bank will match 100 percent of the first 6 percent of employee contributions from the date of hire and provide an automatic employer contribution of 1 percent of eligible pay.
12. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Pensions

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):

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated postretirement benefit obligation at January 1</td>
<td>$36.5</td>
<td>$38.6</td>
</tr>
<tr>
<td>Service cost-benefits earned during the period</td>
<td>1.3</td>
<td>1.5</td>
</tr>
<tr>
<td>Interest cost on accumulated benefit obligation</td>
<td>2.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Net actuarial loss (gain)</td>
<td>4.5</td>
<td>(2.6)</td>
</tr>
<tr>
<td>Curtailment gain</td>
<td>(0.2)</td>
<td>(1.1)</td>
</tr>
<tr>
<td>Contributions by plan participants</td>
<td>1.1</td>
<td>0.9</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(3.7)</td>
<td>(3.3)</td>
</tr>
<tr>
<td>Medicare Part D subsidies</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Accumulated postretirement benefit obligation at December 31</td>
<td>$42.0</td>
<td>$36.5</td>
</tr>
</tbody>
</table>

At December 31, 2008 and 2007, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 6.00 percent and 6.25 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):

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of plan assets at January 1</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Contributions by the employer</td>
<td>2.4</td>
<td>2.2</td>
</tr>
<tr>
<td>Contributions by plan participants</td>
<td>1.1</td>
<td>0.9</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(3.7)</td>
<td>(3.3)</td>
</tr>
<tr>
<td>Medicare Part D subsidies</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Fair value of plan assets at December 31</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td>Unfunded obligation and accrued postretirement benefit cost</td>
<td>$ 42.0</td>
<td>$ 36.5</td>
</tr>
</tbody>
</table>

Amounts included in accumulated other comprehensive loss are shown below:

- Prior service cost: $ 2.7 in 2008, $ 3.7 in 2007
- Net actuarial loss: $(11.2) in 2008, $(7.2) in 2007
- Deferred curtailment gain: 0.4 in 2008, 1.3 in 2007
- Total accumulated other comprehensive loss: $ (8.1) in 2008, $ (2.2) in 2007

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:

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health care cost trend rate assumed for next year</td>
<td>7.50%</td>
<td>8.00%</td>
</tr>
<tr>
<td>Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)</td>
<td>5.00%</td>
<td>5.00%</td>
</tr>
<tr>
<td>Year that the rate reaches the ultimate trend rate</td>
<td>2014</td>
<td>2013</td>
</tr>
</tbody>
</table>
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, 2008 (in millions):

<table>
<thead>
<tr>
<th>Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs</th>
<th>One Percentage Point Increase</th>
<th>One Percentage Point Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effect on accumulated postretirement benefit obligation</td>
<td>$ -</td>
<td>$ (0.1)</td>
</tr>
<tr>
<td>Service cost-benefits earned during the period</td>
<td>$ 1.3</td>
<td>$ 1.5</td>
</tr>
<tr>
<td>Interest cost on accumulated benefit obligation</td>
<td>2.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Amortization of prior service cost</td>
<td>(1.2)</td>
<td>(1.4)</td>
</tr>
<tr>
<td>Amortization of net actuarial loss</td>
<td>0.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Total periodic expense</td>
<td>2.9</td>
<td>3.6</td>
</tr>
<tr>
<td>Curtailment gain</td>
<td>(0.9)</td>
<td>-</td>
</tr>
<tr>
<td>Net periodic postretirement benefit expense</td>
<td>$ 2.0</td>
<td>$ 3.6</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service cost-benefits earned during the period</td>
<td>$ 1.3</td>
</tr>
<tr>
<td>Interest cost on accumulated benefit obligation</td>
<td>2.3</td>
</tr>
<tr>
<td>Amortization of prior service cost</td>
<td>(1.2)</td>
</tr>
<tr>
<td>Amortization of net actuarial loss</td>
<td>0.5</td>
</tr>
<tr>
<td>Total periodic expense</td>
<td>2.9</td>
</tr>
<tr>
<td>Curtailment gain</td>
<td>(0.9)</td>
</tr>
<tr>
<td>Net periodic postretirement benefit expense</td>
<td>$ 2.0</td>
</tr>
</tbody>
</table>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2009 are shown below:

<table>
<thead>
<tr>
<th>Prior service cost</th>
<th>$ (1.2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net actuarial loss</td>
<td>0.6</td>
</tr>
<tr>
<td>Total</td>
<td>$ (0.6)</td>
</tr>
</tbody>
</table>
Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2008 and 2007, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 6.25 percent and 5.75 percent, respectively.

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

The curtailment gain associated with restructuring programs announced in 2006 and 2007 and described in Note 14 was recognized when the related employees terminated employment in 2008. Additionally, a deferred curtailment gain was recorded in 2008 as a component of accumulated other comprehensive loss; the gain will be recognized in net income in future years when the related employees terminate employment.

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 for each of the years ended December 31, 2008 and 2007. Expected receipts in 2009, related to benefits paid in the years ended December 31, 2008 and 2007 are $0.1 million.

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

<table>
<thead>
<tr>
<th></th>
<th>Without subsidy</th>
<th>With subsidy</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$3.3</td>
<td>$3.0</td>
</tr>
<tr>
<td>2010</td>
<td>3.5</td>
<td>3.3</td>
</tr>
<tr>
<td>2011</td>
<td>3.8</td>
<td>3.5</td>
</tr>
<tr>
<td>2012</td>
<td>3.9</td>
<td>3.5</td>
</tr>
<tr>
<td>2013</td>
<td>4.1</td>
<td>3.7</td>
</tr>
<tr>
<td>2014 - 2018</td>
<td>22.8</td>
<td>20.1</td>
</tr>
<tr>
<td>Total</td>
<td>$41.4</td>
<td>$37.1</td>
</tr>
</tbody>
</table>
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, 2008 and 2007, were $5 million and $6 million, respectively. This cost is included as a component of “Accrued benefit costs” in the Statements of Condition. Net periodic postemployment benefit (credit) expense included in 2008 and 2007 operating expenses were $(1) million and $1 million, respectively, and are recorded as a component of “Salaries and other 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):

<table>
<thead>
<tr>
<th>Amount related to postretirement benefits other than pensions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at January 1, 2007</td>
</tr>
<tr>
<td>Change in funded status of benefit plans:</td>
</tr>
<tr>
<td>Prior service costs arising during the year</td>
</tr>
<tr>
<td>Net actuarial gain arising during the year</td>
</tr>
<tr>
<td>Deferred curtailment gain</td>
</tr>
<tr>
<td>Amortization of prior service cost</td>
</tr>
<tr>
<td>Amortization of net actuarial loss</td>
</tr>
<tr>
<td>Change in funded status of benefit plans - other comprehensive income</td>
</tr>
<tr>
<td>Balance at December 31, 2007</td>
</tr>
<tr>
<td>Change in funded status of benefit plans:</td>
</tr>
<tr>
<td>Net actuarial loss arising during the year</td>
</tr>
<tr>
<td>Amortization of prior service cost</td>
</tr>
<tr>
<td>Amortization of net actuarial loss</td>
</tr>
<tr>
<td>Amortization of deferred curtailment loss</td>
</tr>
<tr>
<td>Change in funded status of benefit plans - other comprehensive loss</td>
</tr>
<tr>
<td>Balance at December 31, 2008</td>
</tr>
</tbody>
</table>

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

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes. The Bank incurred various restructuring charges prior to 2007 related to the consolidation of check and cash operations and staff reductions in other functions of the bank.

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

<table>
<thead>
<tr>
<th>Information related to restructuring plans as of December 31, 2008:</th>
<th>2006 and Prior restructuring plans</th>
<th>2007 Restructuring plans</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expected costs related to restructuring activity</td>
<td>$6</td>
<td>$3</td>
<td>$9</td>
</tr>
<tr>
<td>Expected completion date</td>
<td>2008</td>
<td>2010</td>
<td></td>
</tr>
</tbody>
</table>

Reconciliation of liability balances:

<table>
<thead>
<tr>
<th></th>
<th>2006 and Prior restructuring plans</th>
<th>2007 Restructuring plans</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at January 1, 2007</td>
<td>$3</td>
<td>$-</td>
<td>$3</td>
</tr>
<tr>
<td>Employee separation costs</td>
<td>-</td>
<td>$3</td>
<td>3</td>
</tr>
<tr>
<td>Balance at December 31, 2007</td>
<td>$3</td>
<td>$3</td>
<td>$6</td>
</tr>
<tr>
<td>Payments</td>
<td>(3)</td>
<td>(1)</td>
<td>(4)</td>
</tr>
<tr>
<td>Balance at December 31, 2008</td>
<td>$-</td>
<td>$2</td>
<td>$2</td>
</tr>
</tbody>
</table>

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

Restructuring costs associated with the impairment of Bank assets, such as check equipment, are discussed in Note 9. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 11.

15. SUBSEQUENT EVENTS

In February 2009, the System announced the extension through October 30, 2009, of liquidity programs that were previously scheduled to expire on April 30, 2009. The extension pertains to the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility and the Term Securities Lending Facility. In addition, the temporary reciprocal currency arrangements (swap lines) between the Federal Reserve and other central banks were extended to October 30, 2009.
In 2008, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks. Fees for D&T’s services are estimated to be $10.2 million. Approximately $2.7 million of the estimated total fees were for the audits of the limited liability companies (LLCs) that are associated with recent Federal Reserve actions to address the financial crisis, and are consolidated in the financial statements of the Federal Reserve Bank of New York. Each LLC will reimburse the Board of Governors for the fees related to the audit of its financial statements from the entity’s available net assets. 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 2008, the Bank did not engage D&T for any non-audit services.

**Volume of Principal Operations (Unaudited)**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and Discounts, Daily Average</td>
<td>$2,060,367,000</td>
<td>$18,305,000</td>
</tr>
<tr>
<td>Number of Institutions Borrowing</td>
<td>104</td>
<td>61</td>
</tr>
<tr>
<td>Commercial Checks - Paper</td>
<td>$300,496,000,000</td>
<td>$906,509,000,000</td>
</tr>
<tr>
<td>Commercial Checks Processed</td>
<td>230,094,000</td>
<td>664,832,000</td>
</tr>
<tr>
<td>Commercial Checks - Check 21</td>
<td>$1,264,807,000,000</td>
<td>$805,538,000,000</td>
</tr>
<tr>
<td>Commercial Checks Received</td>
<td>866,634,000</td>
<td>426,733,000</td>
</tr>
<tr>
<td>Currency Receipts and Payments</td>
<td>$42,981,823,000</td>
<td>$42,394,167,000</td>
</tr>
<tr>
<td>Pieces</td>
<td>2,823,340,000</td>
<td>2,724,237,000</td>
</tr>
<tr>
<td>Coin Receipts and Payments</td>
<td>$212,154,000</td>
<td>$207,145,000</td>
</tr>
<tr>
<td>Bags</td>
<td>270,000</td>
<td>246,000</td>
</tr>
</tbody>
</table>

*Numbers are not included in our audited financial statements.
The Federal Reserve System

Congress created the Federal Reserve in 1913 to bring financial stability after a number of banking panics. It is the nation’s third central bank. The first, established in 1791, and the second, created in 1816, were each operational for 20 years. In both cases, its charter failed to be renewed and the banks closed.

With the Federal Reserve Act, Congress sought to create a central bank the public would be more likely to support by making it “decentralized” with more local control. This new structure was designed to overcome one of the primary weaknesses of the previous central banks: public distrust of an institution that many felt could potentially be under the control of either government or special interests. The new central bank is a network of 12 regional Federal Reserve Banks, located throughout the country and under the leadership of local boards of directors, with oversight from the Board of Governors in Washington, D.C., a government agency.

The Federal Reserve is considered to be independent within government and broadly insulated from political pressures. While members of the Board of Governors are nominated by the president of the United States and confirmed by the Senate, the Federal Reserve’s regional structure, including local boards of directors and advisory councils, ensures that views from a broad spectrum of the public nationwide contribute to the central bank’s deliberations.

President Woodrow Wilson signed the Federal Reserve Act on Dec. 23, 1913, and the 12 regional Federal Reserve Banks opened on Nov. 16, 1914.

The Federal Reserve Bank of Kansas City

The Federal Reserve Bank of Kansas City and its Branches in Denver, Oklahoma City and Omaha serve the Tenth Federal Reserve District, which encompasses western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico. As a part of the Federal Reserve System, the Bank participates in setting national monetary policy, supervising and regulating numerous commercial banks and bank holding companies, and providing check processing and other services to depository institutions.