

***The Federal Reserve
Banks***

*Combined Financial Statements as of and for the Years
Ended December 31, 2011 and 2010 and
Independent Auditors' Report*

THE FEDERAL RESERVE BANKS

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying Combined Statements of Condition of the Federal Reserve Banks (the "Reserve Banks") as of December 31, 2011 and 2010, and the related Combined Statements of Income and Comprehensive Income, and of Changes in Capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. These Combined Financial Statements are the responsibility of the Division of Reserve Bank Operations and Payment System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

In our opinion, such Combined Financial Statements present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 2011 and 2010, and the combined results of their operations for the years then ended, on the basis of accounting described in Note 4.

Deloitte & Touche LLP

March 20, 2012

FEDERAL RESERVE BANKS

Abbreviations:

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

RMBS	Residential mortgage-backed securities
SBA	Small Business Administration
SDR	Special drawing rights
SERP	Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SOMA	System Open Market Account
STRIP	Separate Trading of Registered Interest and Principal of Securities
TAF	Term Auction Facility
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TBA	To be announced
TCE	Transitional Credit Extension
TDF	Term Deposit Facility
TRS	Total return swap agreement
TOP	Term Securities Lending Facility Options Program
TSLF	Term Securities Lending Facility
VIE	Variable interest entity

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CONDITION
As of December 31, 2011 and December 31, 2010
(in millions)

	2011	2010
<u>ASSETS</u>		
Gold certificates	\$ 11,037	\$ 11,037
Special drawing rights certificates	5,200	5,200
Coin	2,306	2,180
Loans:		
Depository institutions	196	221
Term Asset-Backed Securities Loan Facility (measured at fair value)	9,059	24,853
American International Group, Inc., net	-	20,603
System Open Market Account:		
Treasury securities, net	1,750,277	1,066,952
Government-sponsored enterprise debt securities, net	107,828	152,972
Federal agency and government-sponsored enterprise mortgage-backed securities, net	848,258	1,004,695
Foreign currency denominated assets, net	25,950	26,049
Central bank liquidity swaps	99,823	75
Investments held by consolidated variable interest entities (of which \$35,593 and \$68,469 is measured at fair value as of December 31, 2011 and 2010, respectively)	35,693	68,666
Preferred interests	-	26,385
Accrued interest receivable	19,710	14,231
Bank premises and equipment, net	2,549	2,613
Items in process of collection	273	374
Other assets	711	738
Total assets	<u>\$ 2,918,870</u>	<u>\$ 2,427,844</u>
<u>LIABILITIES AND CAPITAL</u>		
Federal Reserve notes outstanding, net	\$ 1,034,052	\$ 941,561
System Open Market Account:		
Securities sold under agreements to repurchase	99,900	59,703
Other liabilities	1,368	-
Consolidated variable interest entities:		
Beneficial interest in consolidated variable interest entities (measured at fair value)	9,845	10,051
Other liabilities (of which \$106 and \$203 is measured at fair value as of December 31, 2011 and 2010, respectively)	690	921
Deposits:		
Depository institutions	1,562,253	968,052
Treasury, general account	85,737	140,773
Treasury, supplementary financing account	-	199,964
Other deposits	65,034	16,967
Funds from American International Group, Inc. asset dispositions, held as agent	-	26,896
Interest payable to depository institutions	178	113
Accrued benefit costs	3,952	2,597
Deferred credit items	904	1,794
Accrued interest on Federal Reserve notes	900	5,124
Other liabilities	259	280
Total liabilities	<u>2,865,072</u>	<u>2,374,796</u>
Capital paid-in	26,899	26,524
Surplus (including accumulated other comprehensive loss of \$4,792 and \$3,630 at December 31, 2011 and 2010, respectively)	26,899	26,524
Total capital	<u>53,798</u>	<u>53,048</u>
Total liabilities and capital	<u>\$ 2,918,870</u>	<u>\$ 2,427,844</u>

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

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
For the years ended December 31, 2011 and December 31, 2010
(in millions)

	2011	2010
<u>INTEREST INCOME</u>		
Loans:		
Depository institutions	\$ -	\$ 50
Term Asset-Backed Securities Loan Facility	265	750
American International Group, Inc., net	409	2,728
System Open Market Account:		
Treasury securities, net	42,257	26,373
Government-sponsored enterprise debt securities, net	3,053	3,510
Federal agency and government-sponsored enterprise mortgage-backed securities, net	38,281	44,839
Foreign currency denominated assets, net	249	223
Central bank liquidity swaps	34	12
Investments held by consolidated variable interest entities	3,429	4,440
Total interest income	87,977	82,925
<u>INTEREST EXPENSE</u>		
System Open Market Account:		
Securities sold under agreements to repurchase	44	94
Beneficial interest in consolidated variable interest entities	285	277
Deposits:		
Depository institutions	3,765	2,680
Term Deposit Facility	6	4
Total interest expense	4,100	3,055
Net interest income	83,877	79,870
<u>NON-INTEREST INCOME</u>		
Term Asset-Backed Securities Loan Facility, unrealized losses	(84)	(436)
System Open Market Account:		
Treasury securities gains, net	2,258	-
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	10	782
Foreign currency gains, net	152	554
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities (losses) gains, net	(3,920)	8,180
Beneficial interest in consolidated variable interest entities gains (losses), net	491	(4,679)
Dividends on preferred interests	47	1,279
Income from services	477	567
Reimbursable services to government agencies	485	457
Other	134	187
Total non-interest income	50	6,891
<u>OPERATING EXPENSES</u>		
Salaries and benefits	2,811	2,722
Occupancy	312	297
Equipment	188	180
Assessments:		
Board of Governors operating expenses and currency costs	1,121	1,045
Bureau of Consumer Financial Protection	242	33
Office of Financial Research	40	10
Professional fees related to consolidated variable interest entities	71	104
Other	604	681
Total operating expenses	5,389	5,072
Net income prior to distribution	78,538	81,689
Change in prior service costs related to benefit plans	46	110
Change in actuarial losses related to benefit plans	(1,208)	(64)
Comprehensive income prior to distribution	\$ 77,376	\$ 81,735
Distribution of comprehensive income:		
Dividends paid to member banks	\$ 1,577	\$ 1,583
Transferred to surplus and change in accumulated other comprehensive loss	375	884
Payments to Treasury as interest on Federal Reserve notes	75,424	79,268
Total distribution	\$ 77,376	\$ 81,735

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

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CHANGES IN CAPITAL
For the years ended December 31, 2011 and December 31, 2010
(in millions, except share data)

	<u>Surplus</u>				
	<u>Capital paid-in</u>	<u>Net income retained</u>	<u>Accumulated other comprehensive loss</u>	<u>Total surplus</u>	<u>Total capital</u>
Balance at January 1, 2010 (512,806,659 shares)	\$ 25,640	\$ 29,316	\$ (3,676)	\$ 25,640	\$ 51,280
Net change in capital stock issued (17,674,477 shares)	884	-	-	-	884
Transferred to surplus and change in accumulated other comprehensive income	-	838	46	884	884
Balance at December 31, 2010 (530,481,136 shares)	\$ 26,524	\$ 30,154	\$ (3,630)	\$ 26,524	\$ 53,048
Net change in capital stock issued (7,503,485 shares)	375	-	-	-	375
Transferred to surplus and change in accumulated other comprehensive loss	-	1,537	(1,162)	375	375
Balance at December 31, 2011 (537,984,621 shares)	<u>\$ 26,899</u>	<u>\$ 31,691</u>	<u>\$ (4,792)</u>	<u>\$ 26,899</u>	<u>\$ 53,798</u>

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

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

1. STRUCTURE

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

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

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

2. OPERATIONS AND SERVICES

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

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

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

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NOTES TO COMBINED FINANCIAL STATEMENTS

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

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes the FRBNY to conduct operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities. Specifically, the FOMC authorizes and directs the FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, 14 foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of \$2 billion and \$3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund.

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

3. FINANCIAL STABILITY ACTIVITIES

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

Large-Scale Asset Purchase Programs and Reinvestment of Principal Payments

On March 18, 2009, the FOMC authorized and directed the FRBNY to purchase \$300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The FRBNY began the purchases of these Treasury securities in March 2009 and completed them in October 2009. On August 10, 2010, the FOMC announced that the Federal Reserve would maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in longer-term Treasury securities. On November 3, 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional \$600 billion and completed these purchases in June 2011. On June 22, 2011, the FOMC announced that the Federal Reserve would maintain its existing policy of reinvesting principal payments from all domestic securities in Treasury securities. On September 21, 2011, the FOMC announced that the Federal Reserve intends to purchase, by the end of June 2012, \$400 billion par value of Treasury securities with remaining maturities of 6 years to 30 years and to sell an equal amount of Treasury securities with remaining maturities of 3 years or less, of which \$133 billion has been purchased and \$134 billion sold as of December 31, 2011. In addition, the FOMC announced that it will maintain its existing policy of rolling over maturing Treasury securities at auction and, rather than reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in Treasury securities, such payments will be reinvested in federal agency and GSE MBS.

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

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2010. As discussed above, on September 21, 2011, the FOMC announced that the Federal Reserve will begin to reinvest principal payments from its holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS.

Central Bank Liquidity Swaps

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which could be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements.

In May 2010, U.S. dollar liquidity swap arrangements were re-authorized with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank through January 2011. Subsequently, these arrangements were extended through February 1, 2013. There is no specified limit to the amount that may be drawn by the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank under these swap arrangements; the Bank of Canada may draw up to \$30 billion under the swap arrangement with the FRBNY. In addition to the central bank liquidity swap arrangements, the FOMC has authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico, as discussed in Note 2.

Foreign currency liquidity swap arrangements were authorized with 4 foreign central banks and provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. The authorization for these swap arrangements expired on February 1, 2010. In November 2011, as a contingency measure, the FOMC agreed to establish temporary bilateral liquidity swap arrangements with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank so that liquidity can be provided in any of their currencies if necessary. The swap lines are authorized until February 1, 2013.

Lending to Depository Institutions

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

Lending to Primary Dealers

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

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

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

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

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Other Lending Facilities

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

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

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

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

The TALF loans were extended on a nonrecourse basis. If the borrower does not repay the loan, the FRBNY will enforce its rights in the collateral and may sell the collateral to TALF LLC, a Delaware limited liability company, established on February 4, 2009, for the purpose of purchasing such assets. As of December 31, 2011, the FRBNY has not enforced its rights to the collateral because there have been no defaults.

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

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Treasury. Any residual cash flows will be shared between the FRBNY, which will receive 10 percent, and the Treasury, which will receive 90 percent.

Support for Specific Institutions

The Bear Stearns Companies, Inc.

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

The FRBNY extended a senior loan of approximately \$28.8 billion and JPMC extended a subordinated loan of \$1.15 billion to finance the acquisition of the assets. The loans are collateralized by all of the assets of ML through a pledge to the collateral agent. The FRBNY is the sole and managing member and the controlling party of ML and will remain as such as long as the FRBNY retains an economic interest in ML. The interest rate on the senior loan is the primary credit rate in effect from time to time. The interest rate on the JPMC subordinated loan is the primary credit rate plus 450 basis points. JPMC bears losses associated with the portfolio through its subordinated loan plus accrued interest on the loan. Once the principal and interest are paid, residual gains, if any, will be allocated to the FRBNY. The two-year accumulation period that followed the closing date for ML ended on June 26, 2010. Consistent with the terms of the ML transaction, the distributions of the proceeds realized on the asset portfolio held by ML, after payment of certain fees and expenses, now occur on a monthly basis unless otherwise directed by the Federal Reserve.

American International Group, Inc.

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

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

Concurrent with the November 2008 restructuring of its financial support to AIG, the FRBNY established two limited liability companies (LLCs). The FRBNY extended credit to Maiden Lane II LLC (ML II), a Delaware

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

On March 30, 2011, the Federal Reserve announced that the FRBNY, through its investment manager, BlackRock Solutions, would dispose of the securities in the ML II portfolio individually and in segments through a competitive sales process over time as market conditions warrant. During the year ended December 31, 2011, a total of nine bid list auctions were conducted and assets with a total current face amount of \$9.96 billion were sold. Subsequent to December 31, 2011, the Federal Reserve sold the remaining securities in the ML II portfolio through a competitive bidding process, as discussed in Note 17.

The FRBNY also extended credit to Maiden Lane III LLC (ML III), a Delaware limited liability company formed to purchase ABS collateralized debt obligations (CDOs) from certain third-party counterparties of AIG Financial Products Corp. (AIGFP). In connection with the acquisitions, the third-party counterparties agreed to terminate their related credit default swap (CDS) contracts with AIGFP. ML III borrowed approximately \$24.3 billion from the FRBNY, and AIG provided an equity contribution of \$5 billion to ML III. The proceeds were used to purchase ABS CDOs with a fair value of \$29.6 billion. The counterparties received \$26.8 billion net of principal, interest received, and finance charges paid. ML III also made a payment to AIGFP of \$2.5 billion, representing the return of excess collateral previously posted by AIGFP with the counterparties. The FRBNY is the managing member and the controlling party of ML III and will remain as the controlling party as long as the FRBNY retains an economic interest in ML III. Net proceeds received by ML III will first be applied to repay the FRBNY's senior loan plus interest at one-month Libor plus 100 basis points. After the FRBNY is paid in full, the equity investor is entitled to receive its pro rata share of the equity contribution plus interest at the one-month Libor plus 300 basis points. After ML III has paid the FRBNY's senior loan and the equity contribution in full, the FRBNY will be entitled to receive 67 percent of any additional net proceeds received by ML III as a contingent interest on the senior loan and the equity investor will be entitled to receive its pro rata share of 33 percent of any net proceeds received by ML III as contingent distributions on its equity interest. The FRBNY's senior loan is collateralized by all of the assets of ML III through a pledge to the collateral agent.

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

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

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(AIA LLC) and \$9 billion for the ALICO Holdings LLC (ALICO LLC), which represented a percentage of the fair market value of AIA and ALICO, respectively.

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

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

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

4. SIGNIFICANT ACCOUNTING POLICIES

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

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

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Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP.

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

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

a. Consolidation

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

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

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

b. Gold and Special Drawing Rights Certificates

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

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SDR certificates are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. SDRs are recorded by the Bank at original cost. There were no SDR transactions during the years ended December 31, 2011 and 2010.

c. Coin

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

d. Loans

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

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

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

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

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

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a triparty arrangement. In a triparty arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging, and provide cash and securities custodial services for and on behalf of the FRBNY and counterparty. The collateral pledged must exceed the principal amount of the transaction by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including Treasury Inflation-Protected Securities and Separate Trading of Registered Interest and Principal of Securities (STRIP) Treasury securities); direct obligations of several federal and GSE-related agencies, including Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac); and pass-through MBS of Fannie Mae, Freddie Mac, and Government National Mortgage Association. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction.

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and, beginning August 2010, with selected money market funds. The list of eligible counterparties was subsequently expanded to include GSEs, effective in May 2011, and bank and savings institutions, effective in July 2011. These reverse repurchase transactions may be executed through a triparty arrangement as an open market operation, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, and federal agency and GSE MBS that are held in the SOMA. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts as “System Open Market Account: Securities sold under agreements to repurchase” and the related accrued interest payable is reported as a component of “Other liabilities” in the Combined Statements of Condition.

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. The amortized cost basis of securities lent continue to be reported in “Treasury securities, net” or “Government-sponsored enterprise debt securities, net,” as appropriate, in the Combined Statements of Condition. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of “Non-interest income: Other” in the Combined Statements of Income and Comprehensive Income.

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

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

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

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell “to be announced” (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. In 2010, the FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. During the year-ended December 31, 2010, the FRBNY’s participation in the dollar roll and coupon swap markets furthered the MBS purchase program goals of providing support to the mortgage and housing markets and of fostering improved conditions in financial markets more generally. During the year-ended December 31, 2011, the FRBNY executed dollar rolls primarily to facilitate settlement. The FRBNY accounts for outstanding commitments under dollar roll and coupon swaps as purchases or sales on a settlement-date basis. Net gains resulting from dollar roll and coupon swap transactions are reported as “Non-interest income: System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net” in the Combined Statements of Income and Comprehensive Income.

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

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

Warehousing is an arrangement under which the FOMC has approved the exchange, at the request of the Treasury, of U.S. dollars for foreign currencies held by the Treasury over a limited period. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury for financing purchases of foreign currencies and related international operations. Warehousing agreements are 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 the Reserve Banks’ aggregate capital and surplus at the preceding December 31.

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

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

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

Foreign currency liquidity swaps

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

h. Investments Held by Consolidated Variable Interest Entities

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

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- ML's investments in debt securities are accounted for in accordance with FASB ASC Topic 320 (ASC 320) *Investments – Debt and Equity Securities* and ML elected the fair value option for all eligible assets and liabilities in accordance with ASC 825. Other financial instruments, including swap contracts and other derivatives instruments in ML, are recorded at fair value in accordance with FASB ASC Topic 815 (ASC 815) *Derivatives and Hedging*.
- ML II and ML III qualify as nonregistered investment companies under the provisions of FASB ASC Topic 946 (ASC 946) *Financial Services – Investment Companies* and, therefore, all investments are recorded at fair value in accordance with ASC 946.
- TALF LLC follows the guidance in ASC 320 when accounting for any acquired ABS investments, and has elected the fair value option for all eligible assets in accordance with ASC 825.

i. Preferred Interests

The FRBNY presents its preferred interests in AIA LLC and ALICO LLC at cost consistent with ASC 320. The 5 percent cumulative dividends accrued by the FRBNY on the preferred interests are reported as “Non-interest income: Dividends on preferred interests” in the Combined Statements of Income and Comprehensive Income. On a quarterly basis, the accrued dividends were capitalized and increased the recorded cost of the FRBNY's preferred interests in AIA LLC and ALICO LLC

j. Bank Premises, Equipment, and Software

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

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

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

k. Federal Reserve Notes

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

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

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to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government.

“Federal Reserve notes outstanding, net” in the Combined Statements of Condition represents the Bank’s Federal Reserve notes outstanding, reduced by the Reserve Banks’ currency holdings of \$172 billion and \$180 billion at December 31, 2011 and 2010, respectively.

At December 31, 2011 and 2010, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2011, all gold certificates, all special drawing right certificates, and \$1,018 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2011, no investments denominated in foreign currencies were pledged as collateral.

I. Beneficial Interest in Consolidated Variable Interest Entities

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

m. Deposits

Depository Institutions

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

The Term Deposit Facility (TDF) consists of deposits with specific maturities held by eligible institutions at the Reserve Banks. The Reserve Banks pay interest on these deposits at interest rates determined by auction. Interest payable is reported as “Interest payable to depository institutions” in the Combined Statements of Condition. There were no deposits held by the Reserve Banks under the TDF at December 31, 2011 and 2010.

Treasury

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

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

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Other

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

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

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

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

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

p. *Capital Paid-in*

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

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

q. *Surplus*

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

r. *Interest on Federal Reserve Notes*

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

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

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s. *Income and Costs Related to Treasury Services*

When directed by the Secretary of the Treasury, the Reserve Banks are required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2011 and 2010, the Reserve Banks were reimbursed for all services provided to the Treasury as its fiscal agent.

t. *Assessments*

The Board of Governors assesses the Reserve Banks to fund its operations, the operations of the Bureau and, for a two-year period following the July 21, 2010 effective date of the Dodd-Frank Act, the OFR. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year for the Board of Governors' operations and as of the most recent quarter for the Bureau and OFR operations. The Board of Governors also assesses each Reserve Bank for the expenses incurred by the Treasury to produce and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

During the period prior to the Bureau transfer date of July 21, 2011, there was no limit on the funding provided to the Bureau and assessed to the Reserve Banks; the Board of Governors was required to provide the amount estimated by the Secretary of the Treasury needed to carry out the authorities granted to the Bureau under the Dodd-Frank Act and other federal law. The Dodd-Frank Act requires that, after the transfer date, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governors' 2009 annual report, which totaled \$4.98 billion. The fixed percentage of total 2009 operating expenses of the System is 10 percent (\$498.0 million) for 2011, 11 percent (\$547.8 million) for 2012, and 12 percent (\$597.6 million) for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd-Frank Act. The Reserve Banks' assessment for Bureau funding is reported as "Assessments: Bureau of Consumer Financial Protection" in the Combined Statements of Income and Comprehensive Income.

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

u. *Fair Value*

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

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

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

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

v. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Reserve Banks’ real property taxes were \$42 million and \$41 million for the years ended December 31, 2011 and 2010, respectively, and are reported as a component of “Operating expenses: Occupancy” in the Combined Statements of Income and Comprehensive Income.

w. Restructuring Charges

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

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

x. Recently Issued Accounting Standards

In January 2010, the FASB issued Accounting Standards Update (ASU) 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. New requirements for disclosure of information about transfers among the hierarchy’s classifications and the level of disaggregation of classes of assets were effective for the Reserve Banks for the year beginning on January 1, 2010, and the required disclosures are included where applicable in Note 5, Note 9, and Note 13. Other required disclosures include the gross presentation of purchases, sales, issuances, and settlements in the reconciliation for Level 3 fair value measurements, which were effective for the Reserve Banks for the year beginning on January 1, 2011 and are included in Note 9.

In July 2010, the FASB issued ASU 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which requires additional disclosures about the allowance for credit losses and the credit quality of loan portfolios. The additional disclosures include a rollforward of the allowance for credit losses on a disaggregated basis and more information, by type of receivable, on credit quality indicators, including the amount of certain past-due receivables and troubled debt restructurings and significant purchases and sales. The adoption of this update is effective for the Reserve Banks for the year ended December 31, 2011, and did not have a material effect on the Reserve Banks’ combined financial statements.

In April 2011, the FASB issued ASU 2011-02, *Receivables (Topic 310): A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which clarifies accounting for troubled debt

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restructurings, specifically clarifying creditor concessions and financial difficulties experienced by borrowers. This update is effective for the Reserve Banks for the year ending December 31, 2012, and is not expected to have a material effect on the Reserve Banks' combined financial statements.

In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements*, which reconsidered the effective control for repurchase agreements. This update prescribes when the Reserve Banks may or may not recognize a sale upon the transfer of financial assets subject to repurchase agreements. This determination is based, in part, on whether the Reserve Banks have maintained effective control over the transferred financial assets. This update is effective for the Reserve Banks for the year ending December 31, 2012, and is not expected to have a material effect on the Reserve Banks' combined financial statements.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. This update will result in common fair value measurement and disclosure requirements for GAAP and International Financial Reporting Standards. In addition, this update requires additional disclosures for fair value measurements categorized as Level 3, including quantitative information about the unobservable inputs and assumptions used in the fair value measurement, a description of the valuation policies and procedures, and a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs. In addition, disclosure of the amounts and reasons for all transfers in and out of Level 1 and Level 2 will be required. This update is effective for the Bank for the year ending December 31, 2012, and is not expected to have a material effect on the Reserve Banks' combined financial statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, which requires a reporting entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update eliminates the option to present the components of other comprehensive income as part of the statement of shareholders' equity. The update is intended to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items by presenting the components reported in other comprehensive income. The Reserve Banks have adopted the update in this ASU effective for the year ended December 31, 2011, and the required presentation is reflected in the Reserve Banks' combined financial statements.

In December 2011, the FASB issued ASU 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. This update will require a reporting entity to present enhanced disclosures for financial instruments and derivative instruments that are offset or subject to master netting agreements or similar such agreements. This update is effective for the Reserve Banks for the year ending December 31, 2013, and is not expected to have a material effect on the Reserve Banks' combined financial statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. This update indefinitely defers the requirements of ASU 2011-05 related to presentation of reclassification adjustments.

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5. LOANS

The remaining maturity distribution of loans outstanding at December 31, 2011, and total loans outstanding at December 31, 2010, was as follows (in millions):

	2011				2010	
	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total	Total
Loans to depository institutions	\$ 189	\$ 7	\$ -	\$ -	\$ 196	\$ 221
TALF loans, fair value	-	1	4,373	4,685	9,059	24,853
AI loan, net	-	-	-	-	-	20,603

Loans to Depository Institutions

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

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

TALF

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

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

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

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volatilities of market-risk factors. Other methodologies employed or assumptions made in determining fair value could result in an amount that differs significantly from the amount reported.

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

	2011	2010
Level 3 total fair value	\$ 9,059	\$ 24,853

The following table presents a reconciliation of TALF loans measured at fair value using significant unobservable inputs (Level 3) during the years ended December 31, 2011 and 2010 (in millions):

	TALF Loans
Fair value at January 1, 2010	\$ 48,183
Net loans originated	9,484
Loan repayments and prepayments	(32,378)
Total realized and unrealized losses	(436)
Fair value at December 31, 2010	\$ 24,853
Loan repayments and prepayments	(15,710)
Total realized and unrealized gains (losses)	(84)
Fair value at December 31, 2011	\$ 9,059

The fair value of TALF loans reported in the Combined Statements of Condition as of December 31, 2011 and 2010, includes \$37 million and \$121 million in unrealized gains, respectively. FRBNY attributes substantially all changes in fair value of nonrecourse loans to changes in instrument-specific credit spreads.

Eligible collateral includes U.S. dollar-denominated ABS that are backed by auto loans, student loans, credit card loans, equipment loans, floorplan loans, insurance premium financial loans, loans guaranteed by the SBA, residential mortgage servicing advances, or commercial mortgage loans. The following table presents the collateral concentration and maturity distribution for the remaining outstanding TALF loans, measured at fair value, as of December 31, 2011 (in millions):

Collateral type ¹	Time to maturity			Total
	16 - 90 days	91 days to 1 year	Over 1 year to 4 years	
Student Loan	\$ -	\$ 23	\$ 1,937	\$ 1,960
Credit Card	-	2,326	80	2,406
CMBS	-	578	1,454	2,032
Floorplan	-	533	430	963
Auto	1	374	36	411
SBAs	-	113	221	334
Other ²	-	426	527	953
Total	\$ 1	\$ 4,373	\$ 4,685	\$ 9,059

¹ All credit ratings are AAA unless otherwise indicated.

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

The aggregate remaining principal amount outstanding on TALF loans as of December 31, 2011 and 2010, was \$9,013 million and \$24,703 million, respectively.

At December 31, 2011 and 2010, no TALF loans were over 90 days past due or on nonaccrual status.

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

	2011	2010
Interest income	\$ 265	\$ 750
Administrative fee income	-	13
Unrealized losses	(84)	(436)
Total income on TALF loans	<u>\$ 181</u>	<u>\$ 327</u>
Allocated share of TALF LLC	(48)	71
Earnings of TALF	<u>\$ 133</u>	<u>\$ 398</u>

AIG Loan, Net

As a result of the closing of the AIG recapitalization plan on January 14, 2011, AIG repaid the FRBNY in full for all outstanding draws under the revolving line of credit and the related accrued interest, capitalized interest, and capitalized commitment fees. The remaining amount of the unamortized deferred commitment fees were recognized and the allowance for loan restructuring as of the closing of the recapitalization was fully accreted into interest income at that date.

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

Loan components	2011	2010
Line of credit drawn	\$ -	\$ 14,621
Capitalized interest	-	4,663
Capitalized commitment fees	-	1,700
AIG loan, gross	<u>\$ -</u>	<u>\$ 20,984</u>
Unamortized deferred commitment fees	-	(335)
Allowance for loan restructuring, net	-	(46)
AIG loan, net	<u>\$ -</u>	<u>\$ 20,603</u>

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

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

	2011	2010
Allowance for loan restructuring January 1	\$ (46)	\$ (1,488)
Adjustments to the allowance	46	1,442
Allowance for loan restructuring December 31	<u>\$ -</u>	<u>\$ (46)</u>

The allowance for loan restructuring represented the economic effect of the reduction of the interest rate on loans the FRBNY made to AIG prior to April 17, 2009, as part of the loan restructuring that occurred on that date. The restructuring charges were recovered over the remaining term of the related loan as adjustments to the allowance, which resulted from periodic evaluations and are reported as a component of "Interest income:

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American International Group, Inc., net” in the Combined Statements of Income and Comprehensive Income. The average balance of the loans to AIG under the revolving line of credit, net of the allowance for restructuring, during the years ended December 31, 2011 and 2010, was \$711 million and \$22,874 million, respectively.

Allowance for Loan Loss

At December 31, 2011 and 2010, the Reserve Banks did not have any impaired loans and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2011 and 2010.

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

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

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

	2011				
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost	Fair value
Bills	\$ 18,423	\$ -	\$ -	\$ 18,423	\$ 18,423
Notes	1,286,344	26,806	(1,233)	1,311,917	1,389,429
Bonds	358,679	61,347	(89)	419,937	508,694
Total Treasury securities	<u>\$ 1,663,446</u>	<u>\$ 88,153</u>	<u>\$ (1,322)</u>	<u>\$ 1,750,277</u>	<u>\$ 1,916,546</u>
GSE debt securities	<u>\$ 103,994</u>	<u>\$ 3,847</u>	<u>\$ (13)</u>	<u>\$ 107,828</u>	<u>\$ 114,238</u>
Federal agency and GSE MBS	<u>\$ 837,683</u>	<u>\$ 11,617</u>	<u>\$ (1,042)</u>	<u>\$ 848,258</u>	<u>\$ 895,495</u>
	2010				
	Par	Unamortized premiums	Unaccrued discounts	Total amortized cost	Fair value
Bills	\$ 18,423	\$ -	\$ (1)	\$ 18,422	\$ 18,422
Notes	773,284	14,056	(765)	786,575	804,703
Bonds	229,786	32,739	(570)	261,955	289,757
Total Treasury securities	<u>\$ 1,021,493</u>	<u>\$ 46,795</u>	<u>\$ (1,336)</u>	<u>\$ 1,066,952</u>	<u>\$ 1,112,882</u>
GSE debt securities	<u>\$ 147,460</u>	<u>\$ 5,532</u>	<u>\$ (20)</u>	<u>\$ 152,972</u>	<u>\$ 156,780</u>
Federal agency and GSE MBS	<u>\$ 992,141</u>	<u>\$ 14,106</u>	<u>\$ (1,552)</u>	<u>\$ 1,004,695</u>	<u>\$ 1,026,003</u>

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

The fair value of the fixed-rate Treasury securities, GSE debt securities, and federal agency and GSE MBS in the SOMA’s holdings is subject to market risk, arising from movements in market variables, such as interest rates

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and securities prices. The fair value of federal agency and GSE MBS is also affected by the expected rate of prepayments of mortgage loans underlying the securities.

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

Distribution of MBS holdings by coupon rate	2011		2010	
	Amortized cost	Fair value	Amortized cost	Fair value
3.0%	\$ 1,313	\$ 1,336	\$ -	\$ -
3.5%	19,415	19,660	341	352
4.0%	161,481	169,763	167,675	168,403
4.5%	406,465	431,171	497,672	508,798
5.0%	182,497	192,664	231,420	237,545
5.5%	66,795	70,064	93,119	95,873
6.0%	9,152	9,616	12,910	13,376
6.5%	1,140	1,221	1,558	1,656
Total	\$ 848,258	\$ 895,495	\$ 1,004,695	\$ 1,026,003

There were no transactions related to securities purchased under agreements to resell during the years ended December 31, 2011 and 2010. Financial information related to securities sold under agreements to repurchase for the years ended December 31 was as follows (in millions):

	2011	2010
Contract amount outstanding, end of year	\$ 99,900	\$ 59,703
Average daily amount outstanding, during the year	72,227	58,476
Maximum balance outstanding, during the year	124,512	77,732
Treasury securities pledged (par value), end of year	86,089	43,642
Treasury securities pledged (market value), end of year	99,900	59,703

The contract amounts for securities sold under agreements to repurchase approximate fair value. FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed to temporarily drain reserve balances from the banking system and as part of a service offering to foreign official and international account holders.

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase at December 31, 2011, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	\$ 16,246	\$ 27,107	\$ 89,899	\$ 649,698	\$ 649,913	\$ 230,583	\$ 1,663,446
GSE debt securities (par value)	2,496	5,020	19,695	60,603	13,833	2,347	103,994
Federal agency and GSE MBS (par value) ¹	-	-	-	13	34	837,636	837,683
Securities sold under agreements to repurchase (contract amount)	99,900	-	-	-	-	-	99,900

¹ The par amount shown for Federal agency and GSE MBS is the remaining principal balance of the underlying mortgages.

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Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2011, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, is approximately 2.4 years.

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

	Amortized cost		Par value	
	2011	2010	2011	2010
Treasury securities	\$ 15,121	\$ 22,627	\$ 13,978	\$ 22,081
GSE debt securities	1,276	1,686	1,216	1,610

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of Treasury securities under outstanding commitments was \$3,200 million. These commitments had contractual settlement dates extending through January 3, 2012. As of December 31, 2011, the fair value of Treasury securities under outstanding purchase commitments was \$3,208 million.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2011, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was \$41,503 million, of which \$513 million was related to dollar roll transactions. As of December 31, 2011, the total sales price of the federal agency and GSE MBS under outstanding sales commitments was \$4,430 million, all of which was related to dollar roll transactions. These commitments, which had contractual settlement dates extending through February 2012, are for the purchase and sale of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. As of December 31, 2011, the fair value of federal agency and GSE MBS purchases and sales, net under outstanding commitments was \$41,873 million and \$4,473 million, respectively. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

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

	2011	2010
Cash margin	\$ 1,271	\$ -
Obligations from MBS transaction fails	97	-
Total	\$ 1,368	\$ -

During the years ended December 31, 2011 and 2010, the Reserve Banks recorded net gains from federal agency and GSE MBS transactions of \$10 million and \$782 million, respectively. These net gains are reported as "Non-interest income: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Combined Statements of Income and Comprehensive Income.

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Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the year ended December 31, 2011, is summarized as follows (in millions):

	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance at December 31, 2010	\$ 18,422	\$ 786,575	\$ 261,955	\$ 1,066,952	\$ 152,972	\$ 1,004,695
Purchases ¹	239,487	731,252	161,876	1,132,615	-	42,145
Sales ¹	-	(137,733)	-	(137,733)	-	-
Realized gains, net ²	-	2,258	-	2,258	-	-
Principal payments and maturities	(239,494)	(67,273)	-	(306,767)	(43,466)	(195,413)
Amortization of premiums and discounts	8	(4,445)	(4,985)	(9,422)	(1,678)	(3,169)
Inflation adjustment of inflation-indexed securities	-	1,283	1,091	2,374	-	-
Balance at December 31, 2011	<u>\$ 18,423</u>	<u>\$ 1,311,917</u>	<u>\$ 419,937</u>	<u>\$ 1,750,277</u>	<u>\$ 107,828</u>	<u>\$ 848,258</u>

Supplemental information - par value of transactions:

Purchases	\$ 239,494	\$ 713,878	\$ 127,802	\$ 1,081,174	\$ -	\$ 40,955
Sales	-	(134,829)	-	(134,829)	-	-

¹ Purchases and sales are reported on a settlement-date basis and include payments and receipts related to principal, premiums, discounts, and inflation compensation included in the basis of inflation-indexed securities. The amount reported as sales also includes realized gains, net.

² Adjustment for realized gains, net is required because these amounts do not affect the reported amount of the related securities. Excludes realized gains and losses that result from net settled MBS TBA transactions.

7. FOREIGN CURRENCY DENOMINATED ASSETS

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

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

	2011	2010
Euro:		
Foreign currency deposits	\$ 9,367	\$ 7,057
Securities purchased under agreements to resell	-	2,467
German government debt instruments	1,885	1,849
French government debt instruments	2,635	2,754
Japanese yen:		
Foreign currency deposits	3,985	3,883
Japanese government debt instruments	8,078	8,039
Total	<u>\$ 25,950</u>	<u>\$ 26,049</u>

At December 31, 2011 and 2010, the fair value of foreign currency denominated assets, including accrued interest, was \$26,116 million and \$26,213 million, respectively. The fair value of government debt instruments was

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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 Treasury securities, GSE debt securities, and federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value is presented solely for informational purposes.

The remaining maturity distribution of foreign currency denominated assets at December 31, 2011, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total
Euro	\$ 5,352	\$ 2,933	\$ 2,115	\$ 3,487	\$ 13,887
Japanese yen	4,180	662	3,143	4,078	12,063
Total	<u>\$ 9,532</u>	<u>\$ 3,595</u>	<u>\$ 5,258</u>	<u>\$ 7,565</u>	<u>\$ 25,950</u>

At December 31, 2011 and 2010, the authorized warehousing facility was \$5 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2011 and 2010.

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2011.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2011, there were \$216 million of outstanding commitments to purchase Euro-denominated government debt instruments. These securities settled on January 4, 2012, and replaced Euro-denominated government debt instruments held in the SOMA that matured on that date. As of December 31, 2011, the fair value of Euro-denominated government debt instruments under outstanding commitments was \$216 million.

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

Foreign currency working balances held and foreign exchange contracts executed by the FRBNY to facilitate its international payments and currency transactions it made on behalf of foreign central banks and U.S. official institution customers were not material as of December 31, 2011 and 2010.

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2011 and 2010, was \$99,823 million and \$75 million, respectively.

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The remaining maturity distribution of U.S. dollar liquidity swaps at December 31, 2011, and total U.S. dollar liquidity swaps outstanding at December 31, 2010, was as follows (in millions):

	2011			2010
	Within 15 days	16 days to 90 days	Total	Total
Euro	\$ 34,357	\$ 51,080	\$ 85,437	\$ 75
Japanese yen	9,035	4,956	13,991	-
Swiss franc	320	75	395	-
Total	\$ 43,712	\$ 56,111	\$ 99,823	\$ 75

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2011 and 2010.

9. INVESTMENTS HELD BY CONSOLIDATED VARIABLE INTEREST ENTITIES

a. Summary Information for Consolidated Variable Interest Entities

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

	2011	2010
ML	\$ 7,805	\$ 27,961
ML II	9,257	16,457
ML III	17,820	23,583
TALF LLC	811	665
Total	\$ 35,693	\$ 68,666

The FRBNY's approximate maximum exposure to loss at December 31, 2011 and 2010, was \$24,606 million and \$55,434 million, respectively. These estimates incorporate potential losses associated with assets recorded on the FRBNY's Statement of Condition, net of the fair value of subordinated interests (beneficial interest in consolidated VIEs).

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

	<u>2011</u>	<u>2010</u>
Assets:		
CDOs	\$ 17,854	\$ 23,112
Non-agency RMBS	10,903	18,360
Federal agency and GSE MBS	440	16,842
Commercial mortgage loans	2,861	5,130
Swap contracts	657	851
Residential mortgage loans	378	603
Other investments	1,358	587
Subtotal	<u>\$ 34,451</u>	<u>\$ 65,485</u>
Cash, cash equivalents, and accrued interest receivable	1,242	3,181
Total investments held by consolidated VIEs	<u>\$ 35,693</u>	<u>\$ 68,666</u>
Liabilities:		
Beneficial interest in consolidated VIEs	<u>\$ 9,845</u>	<u>\$ 10,051</u>
Other liabilities ¹	<u>\$ 690</u>	<u>\$ 921</u>

¹ The amount reported as "Consolidated variable interest entities: Other liabilities" in the Combined Statements of Condition includes \$554 million and \$695 million related to cash collateral received on swap contracts at December 31, 2011 and 2010, respectively. The amount also includes accrued interest and accrued other expenses.

Total realized and unrealized gains (losses), net for the year ended December 31, 2011, were as follows (in millions):

	<u>Total portfolio holdings realized gains (losses)</u>	<u>Fair value changes unrealized gains (losses)</u>	<u>Total portfolio holdings realized/unrealized gains (losses)</u>
CDOs	\$ (60)	\$ (3,278)	\$ (3,338)
Non-agency RMBS	227	(1,084)	(857)
Federal agency and GSE MBS	1,221	(895)	326
Commercial mortgage loans ¹	(368)	407	39
Residential mortgage loans ¹	(312)	263	(49)
Swap contracts	(258)	225	(33)
Other investments	29	3	32
Other assets	(51)	11	(40)
Total	<u>\$ 428</u>	<u>\$ (4,348)</u>	<u>\$ (3,920)</u>

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

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

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

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

The net income (loss) attributable to ML, ML II, ML III, and TALF LLC for the year ended December 31, 2011, was as follows (in millions):

	ML	ML II	ML III	TALF LLC	Total
Interest income:					
Portfolio interest income	\$ 808	\$ 609	\$ 2,012	\$ -	\$ 3,429
Less: Interest expense	<u>70</u>	<u>36</u>	<u>175</u>	<u>4</u>	<u>285</u>
Net interest income	738	573	1,837	(4)	3,144
Non-interest income:					
Portfolio holdings gains (losses)	434	(991)	(3,363)	-	(3,920)
Unrealized gains (losses) on beneficial interest in consolidated VIEs	<u>(114)</u>	<u>91</u>	<u>558</u>	<u>(44)</u> ¹	<u>491</u>
Net non-interest income (loss)	<u>320</u>	<u>(900)</u>	<u>(2,805)</u>	<u>(44)</u>	<u>(3,429)</u>
Total net interest income and non-interest income	1,058	(327)	(968)	(48)	(285)
Less: Professional fees	<u>43</u>	<u>8</u>	<u>20</u>	<u>-</u>	<u>71</u>
Net income (loss) attributable to consolidated VIEs	<u>\$ 1,015</u>	<u>\$ (335)</u>	<u>\$ (988)</u>	<u>\$ (48)</u> ²	<u>\$ (356)</u>

¹ The TALF LLC's unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2011.

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

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

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	\$ 1,133	\$ 794	\$ 2,299	\$ 213	\$ 1	\$ 4,440
Less: Interest expense	66	34	173	-	4	277
Net interest income	1,067	760	2,126	213	(3)	4,163
Non-interest income:						
Portfolio holdings gains	2,571	2,467	3,141	1	-	8,180
Unrealized gains (losses) on beneficial interest in consolidated VIEs	(1,135)	(1,353)	(2,266)	-	75 ¹	(4,679)
Net non-interest income	1,436	1,114	875	1	75	3,501
Total net interest income and non-interest income	2,503	1,874	3,001	214	72	7,664
Less: Professional fees	69	10	22	2	1	104
Net income (loss) attributable to consolidated VIEs	\$ 2,434	\$ 1,864	\$ 2,979	\$ 212	\$ 71 ²	\$ 7,560

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

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

Following is a summary of the consolidated VIEs' subordinated financial interest for the years ended December 31, 2011 and 2010 (in millions):

	ML subordinated loan	ML II deferred purchase price	ML III equity contribution	TALF financial interest	Total
Fair value, January 1, 2010	\$ -	\$ -	\$ 4,294	\$ 801	\$ 5,095
Interest accrued and capitalized	66	34	173	4	277
Unrealized (gain) / loss	1,135	1,353	2,266	(75)	4,679
Fair value, December 31, 2010	\$ 1,201	\$ 1,387	\$ 6,733	\$ 730	\$ 10,051
Interest accrued and capitalized	70	36	175	4	285
Unrealized (gain) / loss	114	(91)	(558)	44	(491)
Fair value, at December 31, 2011	\$ 1,385	\$ 1,332	\$ 6,350	\$ 778	\$ 9,845

b. Maiden Lane LLC

ML's investment portfolio consists primarily of federal agency and GSE MBS, non-agency RMBS, commercial and residential mortgage loans, and derivatives and associated hedges. Following is a description of the significant holdings at December 31, 2011, and the associated credit risk for each holding:

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i. Debt Securities

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

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

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

As of December 31, 2011, approximately 37.9 percent and 12.5 percent of the properties collateralizing the non-agency RMBS held by ML were located in California and Florida, respectively, based on the total unpaid principal balance of the underlying loans.

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

At December 31, 2011, the ratings breakdown of the \$3,313 million of debt securities, which are recorded at fair value in the ML portfolio as a percentage of aggregate fair value of all securities in the portfolio was as follows:

Security type: ²	Ratings ^{1,4}						Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower ⁵	Government / agency	
Federal agency and GSE MBS	-	-	-	-	-	13.3%	13.3%
Non-agency RMBS	0.3%	0.6%	0.7%	0.6%	44.2%	-	46.4%
Other ³	2.6%	1.9%	1.2%	6.1%	6.8%	21.8%	40.3%
Total	2.9%	2.4%	1.9%	6.7%	51.0%	35.1%	100.0%

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

² This table excludes ML's commercial and residential mortgage loans, swaps, and other derivative contracts.

³ Includes \$702 million of short-term investments and \$380 million of CDOs.

⁴ Rows and columns may not total due to rounding.

⁵ BB+ and lower includes debt securities that were not rated by a nationally recognized statistical rating organization as of December 31, 2011.

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ii. Commercial and Residential Mortgage Loans

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

The performance profile for the commercial and residential mortgage loans at December 31, 2011, was as follows (in millions):

	<u>Unpaid principal balance</u>	<u>Fair value</u>	<u>Fair value as a percentage of unpaid principal balance</u>
Performing loans:			
Commercial	\$ 3,705	\$ 2,790	75.3%
Residential	618	335	54.2%
Subtotal	<u>4,323</u>	<u>3,125</u>	72.3%
Non-performing / Non-accrual loans ¹			
Commercial	126	71	56.3%
Residential	119	43	36.1%
Subtotal	<u>245</u>	<u>114</u>	46.5%
Total			
Commercial	3,831	2,861	74.7%
Residential	737	378	51.3%
Total loans	<u>\$ 4,568</u>	<u>\$ 3,239</u>	70.9%

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

The following table summarizes the state in which residential mortgage loans are collateralized and the property types of the commercial mortgage loans held in the ML portfolio at December 31, 2011:

	<u>Concentration of unpaid principal balances</u>	
	<u>Residential</u>	<u>Commercial ²</u>
By State:		
California	37.6%	
Florida	7.5%	
Other ¹	54.9%	
Total	<u>100.0%</u>	
By Property:		
Hospitality		74.7%
Office		18.0%
Other ¹		7.3%
Total		<u>100.0%</u>

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

² One borrower represents approximately 43 percent of total unpaid principal balance of the commercial mortgage loan portfolio.

Commercial mortgage loans held by ML are composed of different levels of subordination with respect to the underlying properties, and relative to each other. Senior mortgage loans are secured property loans evidenced by a first mortgage that is senior to any subordinate or mezzanine financing. Subordinate

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mortgage interests, sometimes known as B Notes, are loans evidenced by a junior note or a junior participation in a mortgage loan. Mezzanine loans are loans made to the direct or indirect owner of the property-owning entity. Mezzanine loans are not secured by a mortgage on the property but rather by a pledge of the mezzanine borrower's direct or indirect ownership interest in the property-owning entity.

The following table summarizes commercial mortgage loans held by ML at December 31, 2011 (in millions):

Loan type	Unpaid principal balances	Concentration of unpaid principal balances
Senior mortgage loan	\$ 2,695	70.3%
Subordinate mortgage interests	74	2.0%
Mezzanine loans	1,062	27.7%
Total	<u>\$ 3,831</u>	<u>100.0%</u>

As discussed in Note 17, subsequent to December 31, 2011, the total unpaid principal balance was reduced by \$1.6 billion due to the sale of commercial mortgage loans held by ML.

iii. Derivative Instruments

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

ML enters into additional derivative contracts consisting of futures and IRS to economically hedge its exposure to interest rates. For 2011, there were 144 trades executed as IRS. All derivatives are recorded at fair value in accordance with ASC 815. None of the derivatives held by ML are designated as hedging instruments for accounting purposes.

On an ongoing basis, ML pledges collateral for credit or liquidity related shortfalls based on 20 percent of the notional amount of sold CDS protection and 10 percent of the present value of future premiums on purchased CDS protection. Failure to post this collateral constitutes a TRS event of default. Separately, ML and JPMC engage in bilateral posting of collateral to cover the net mark-to-market (MTM) variations in the swap portfolio. ML nets the collateral received from JPMC from the bilateral MTM posting only to the extent that the reference obligations indicate JPMC as the original counterparty to Bear Stearns on March 14, 2008. The values of ML's cash equivalents, purchased by the re-hypothecation of cash collateral associated with the TRS, was \$0.8 billion for each of the years ended December 31, 2011 and December 31, 2010. In addition, ML has pledged \$0.6 billion and \$1.0 billion of federal agency and GSE MBS and U.S. Treasury notes to JPMC as of December 31, 2011 and 2010, respectively.

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

Market Risk

CDS are agreements that provide protection for the buyer against the loss of principal and, in some cases, interest on a bond or loan in case of a default by the issuer. The nature of a credit event is established by

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the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency, or failure to meet payment obligations when due. The buyer of the CDS pays a premium in return for payment protection upon the occurrence, if any, of a credit event. Upon the occurrence of a triggering credit event, the maximum potential amount of future payments the seller could be required to make under a CDS is equal to the notional amount of the contract. Such future payments could be reduced or offset by amounts recovered under recourse or by collateral provisions outlined in the contract, including seizure and liquidation of collateral pledged by the buyer. ML's derivatives portfolio consists of purchased credit protection and sold credit protection with differing underlying referenced names that do not necessarily offset.

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

Futures contracts are agreements to buy and sell financial instruments for a set price on a future date. Initial margin deposits are made upon entering into futures contracts in the form of cash or securities. During the period that a futures contract is open, changes in the value of the contract are recorded as unrealized gains or losses by revaluing the contracts daily to reflect the market value of the contract at the end of each day's trading. Variation margin payments are paid or received, depending upon whether unrealized gains or losses result. When the contract is closed, ML will record a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and ML's cost basis in the contract. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates, and the underlying hedged assets. ML is also at risk of not being able to enter into a closing transaction for the futures contract because of an illiquid secondary market. ML had no pledged cash collateral related to future contracts as of December 31, 2011, and \$18 million of cash collateral as of December 31, 2010.

Credit Risk

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

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The following table summarizes the notional amounts of derivative contracts outstanding as of December 31, 2011 and 2010 (in millions):

	Notional amounts ¹	
	2011	2010
Interest rate contracts:		
IRS ²	\$ -	\$ 4,130
Futures and options on futures ³	-	-
Credit derivatives:		
CDS ⁴	3,940	5,856
Total	<u>\$ 3,940</u>	<u>\$ 9,986</u>

¹ These amounts represent the sum of gross long and gross short notional derivative contracts. The change in notional amounts is representative of the volume of activity for the year ended December 31, 2011.

² There were no IRS contracts outstanding as of December 31, 2011, and 39 IRS contracts outstanding as of December 31, 2010.

³ Futures and options relate to contract equivalents and not gross notional amounts. The reported notional amount of futures and options as of December 31, 2010 has been corrected. The previously reported 2010 futures and options were reported at \$18 million. The revised 2010 futures and options are reported at \$18 thousand.

⁴ There were 979 and 1,361 CDS contracts outstanding as of December 2011 and 2010, respectively.

The following table summarizes the fair value of derivative instruments by contract type on a gross basis as of December 31, 2011 and 2010, which is reported as a component of "Investments held by consolidated variable interest entities" in the Combined Statements of Condition (in millions):

	2011		2010	
	Gross derivative assets	Gross derivative liabilities	Gross derivative assets	Gross derivative liabilities
Interest rate contracts:				
IRS	\$ -	\$ -	\$ 9	\$ 229
Futures and options on futures	-	-	4	2
Credit derivatives:				
CDS ¹	1,630	791	2,317	1,347
Counterparty netting	(685)	(685)	(1,375)	(1,374)
Cash collateral	(288)	-	(100)	-
Total	<u>\$ 657</u>	<u>\$ 106</u>	<u>\$ 855</u>	<u>\$ 204</u>

¹ CDS fair values as of December 31, 2011 for assets and liabilities include interest receivables of \$22 million and payables of \$13 million. CDS fair values as of December 31, 2010 for assets and liabilities includes interest receivables of \$39 million and payables of \$28 million.

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

	Maximum potential payout / notional							
	2011						2010	
	Years to maturity					Fair value	Fair value	
Credit ratings of the reference obligation	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset / (liability)	Total	Asset / (liability)
Investment grade (AAA to BBB-)	\$ -	\$ -	\$ -	\$ 92	\$ 92	\$ (14)	\$ 120	\$ (23)
Non-investment grade	150	100	-	904	1,154	(763)	1,824	(1,284)
Total credit protection sold	<u>\$ 150</u>	<u>\$ 100</u>	<u>\$ -</u>	<u>\$ 996</u>	<u>\$ 1,246</u>	<u>\$ (777)</u>	<u>\$ 1,944</u>	<u>\$ (1,307)</u>

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

	Maximum potential recovery / notional							
	2011						2010	
	Years to maturity					Fair value	Fair value	
Credit ratings of the reference obligation	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset / (liability)	Total	Asset / (liability)
Investment grade (AAA to BBB-)	\$ 5	\$ -	\$ 7	\$ 158	\$ 170	\$ 46	\$ 263	\$ 76
Non-investment grade	351	100	22	2,052	2,525	1,562	3,648	2,190
Total credit protection bought	<u>\$ 356</u>	<u>\$ 100</u>	<u>\$ 29</u>	<u>\$ 2,210</u>	<u>\$ 2,695</u>	<u>\$ 1,608</u>	<u>\$ 3,911</u>	<u>\$ 2,266</u>

Other Assets

Other assets are primarily composed of other real estate owned of approximately \$12 million.

c. Maiden Lane II LLC

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

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

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

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

At December 31, 2011, the type and rating composition of the ML II's \$9,105 million non-agency RMBS portfolio, recorded at fair value, as a percentage of aggregate fair value, were as follows:

Asset Type:	Rating ^{1,3}					
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower	Total
Alt-A ARM	-	1.1%	1.1%	0.2%	21.6%	23.9%
Subprime	3.9%	3.2%	1.6%	1.0%	49.5%	59.2%
Option ARM	-	-	-	-	5.9%	5.9%
Other ²	-	0.8%	1.6%	-	8.7%	11.0%
Total	3.9%	5.0%	4.3%	1.2%	85.7%	100.0%

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

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

³ Rows and columns may not total due to rounding.

At December 31, 2011, approximately 29 percent and 13 percent of the properties collateralizing the non-agency RMBS held by ML II were located in California and Florida, respectively, based on the geographical location data available for the underlying loans by aggregate unpaid principal balance.

d. Maiden Lane III LLC

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

ML III's investment in CMBS and RMBS contain varying levels of credit, interest rate, liquidity, and concentration risk. Credit-related risk arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the securities are issued. The rate of delinquencies and defaults on residential and commercial mortgage loans and the aggregate amount of the resulting losses will be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower. Adverse developments in the RMBS and CMBS markets could have a considerable effect on ML III because of its investment concentration in CDOs backed by CMBS and RMBS.

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At December 31, 2011, the investment type/vintage and rating composition of ML III's \$17,735 million portfolio, recorded at fair value, as a percentage of aggregate fair value of all securities in the portfolio was as follows:

	Rating ^{1,2,3}					Not rated ⁴	Total
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower		
ABS CDOs:							
High-Grade ABS CDOs	-	-	-	-	60.7%	2.7%	63.4%
Pre-2005	-	-	-	-	20.5%	0.8%	21.3%
2005	-	-	-	-	28.3%	1.9%	30.2%
2006	-	-	-	-	5.4%	-	5.4%
2007	-	-	-	-	6.4%	-	6.4%
Mezzanine ABS CDOs	-	-	-	-	8.0%	0.2%	8.2%
Pre-2005	-	-	-	-	4.5%	0.2%	4.7%
2005	-	-	-	-	3.0%	-	3.0%
2006	-	-	-	-	-	-	-
2007	-	-	-	-	0.6%	-	0.6%
Commercial Real-Estate CDOs	-	-	-	-	27.0%	-	27.0%
Pre-2005	-	-	-	-	3.5%	-	3.5%
2005	-	-	-	-	-	-	-
2006	-	-	-	-	-	-	-
2007	-	-	-	-	23.4%	-	23.4%
RMBS, CMBS, & Other:	0.1%	0.1%	0.1%	0.1%	1.0%	-	1.5%
Pre-2005	-	-	-	-	0.1%	-	0.2%
2005	0.1%	0.1%	0.1%	0.1%	0.8%	-	1.2%
2006	-	-	-	-	0.1%	-	0.1%
2007	-	-	-	-	-	-	-
Total Investments	0.1%	0.1%	0.1%	0.1%	96.7%	2.9%	100.0%

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

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

³ Rows and columns may not total due to rounding.

⁴ Not rated by a nationally recognized statistical rating organization as of December 31, 2011.

e. TALF LLC

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

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f. Fair Value Measurement

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

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

i. Determination of Fair Value

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

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

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

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

ii. Valuation Methodologies for Level 3 Assets and Liabilities

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

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

	2011				
	Level 1	Level 2	Level 3	Netting ¹	Total fair value
Assets:					
CDOs	\$ -	\$ 167	\$ 17,687	\$ -	\$ 17,854
Non-agency RMBS	-	5,493	5,410	-	10,903
Federal agency and GSE MBS	-	440	-	-	440
Commercial mortgage loans	-	1,464	1,397	-	2,861
Cash equivalents	1,171	-	-	-	1,171
Swap contracts	-	-	1,630	(973)	657
Residential mortgage loans	-	-	378	-	378
Other investments	1,095	126	108	-	1,329
Total assets	\$ 2,266	\$ 7,690	\$ 26,610	\$ (973)	\$ 35,593
Liabilities:					
Beneficial interest in consolidated VIEs	\$ -	\$ -	\$ 9,845	\$ -	\$ 9,845
Swap contracts	-	-	791	(685)	106
Total liabilities	\$ -	\$ -	\$ 10,636	\$ (685)	\$ 9,951

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

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

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

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The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2011 (in millions). Unrealized gains and losses related to those assets still held at December 31, 2011, are reported as a component of “Investments held by consolidated variable interest entities gains/(losses), net” in the Combined Statements of Income and Comprehensive Income.

2011							
	Fair value December 31, 2010	Purchases, sales, and settlements, net	Net realized/unrealized gains (losses)	Gross transfers in ^{1,2,3}	Gross transfers out ^{1,2,3}	Fair value December 31, 2011	Change in unrealized gains (losses) related to financial instruments held at December 31, 2011
Assets:							
CDOs	\$ 22,811	\$ (1,889)	\$ (3,351)	\$ 116	\$ -	\$ 17,687	\$ (3,297)
Non-agency RMBS	6,809	(2,891)	(483)	4,066	(2,091)	5,410	(725)
Commercial mortgage loans	1,931	(626)	92	-	-	1,397	65
Residential mortgage loans	603	(175)	(50)	-	-	378	263
Federal agency and GSE MBS	30	(28)	(2)	-	-	-	-
Other investments	79	(29)	(2)	94	(34)	108	(9)
Total assets	<u>\$ 32,263</u>	<u>\$ (5,638)</u>	<u>\$ (3,796)</u>	<u>\$ 4,276</u>	<u>\$ (2,125)</u>	<u>\$ 24,980</u>	<u>\$ (3,703)</u>
Net swap contracts ⁴	<u>\$ 970</u>	<u>\$ (235)</u>	<u>\$ 104</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 839</u>	<u>\$ 83</u>
Liabilities:							
Beneficial interest in consolidated VIEs	<u>\$ 10,051</u>	<u>\$ 285</u> ⁵	<u>\$ (491)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,845</u>	<u>\$ 491</u>

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

² There were no significant transfers between Level 1 and Level 2 during the year ended December 31, 2011.

³ Non-agency RMBS, with a December 31, 2010, fair value of \$2,091 million, were transferred from Level 3 to Level 2 because they are valued at December 31, 2011, based on quoted prices in non-active markets (Level 2). These investments were valued in the prior year on non-observable model based inputs (Level 3). There were also non-agency RMBS, CDOs, and other investments for which valuation inputs became less observable during the year ended December 31, 2011, which resulted in \$4,066 million, \$116 million, and \$94 million, respectively, in transfers from Level 2 to Level 3. There were no other significant transfers between Level 2 and Level 3 during the current year.

⁴ Level 3 derivative assets and liabilities are presented net for purposes of this table.

⁵ Includes \$285 million in capitalized interest.

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The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2010 (in millions). Unrealized gains and losses related to those assets still held at December 31, 2010, are reported as a component of “Investments held by consolidated variable interest entities gains/(losses), net” in the Combined Statements of Income and Comprehensive Income.

	2010					Fair value December 31, 2010	Change in unrealized gains (losses) related to financial instruments held at December 31, 2010
	Fair value December 31, 2009	Purchases, sales, and settlements, net	Net realized/unrealized gains (losses)	Gross transfers in ^{1,2,3,4}	Gross transfers out ^{1,2,3,4}		
Assets:							
CDOs ⁷	\$ 22,200	\$ (2,474)	\$ 3,096	\$ -	\$ (11)	\$ 22,811	\$ 3,043
Non-agency RMBS ⁷	8,300	(1,046)	1,144	2,791	(4,380)	6,809	1,044
Commercial mortgage loans	4,025	(335)	681	-	(2,440)	1,931	542
Residential mortgage loans	583	(91)	111	-	-	603	197
Federal agency and GSE MBS	24	(34)	2	62	(24)	30	2
Other investments	23	(39)	65	30	-	79	11
Total assets	<u>\$ 35,155</u>	<u>\$ (4,019)</u>	<u>\$ 5,099</u>	<u>\$ 2,883</u>	<u>\$ (6,855)</u>	<u>\$ 32,263</u>	<u>\$ 4,839</u>
Net swap contracts ⁵	\$ 1,456	\$ (325)	\$ (161)	\$ -	\$ -	\$ 970	\$ (137)
Liabilities:							
Beneficial interest in consolidated VIEs	\$ 5,095	\$ 277 ⁶	\$ 4,679	\$ -	\$ -	\$ 10,051	\$ 4,679

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

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

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

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

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

⁶ Includes \$277 million in capitalized interest.

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

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The following tables present the gross components of purchases, sales, and settlements, net, shown above for the years ended December 31, 2011 and 2010 (in millions):

	2011			
	Purchases	Sales	Settlements ²	Purchases, sales, and settlements, net
Assets:				
CDOs	\$ -	\$ (6)	\$ (1,883)	\$ (1,889)
Non-agency RMBS	-	(1,978)	(913)	(2,891)
Commercial mortgage loans	-	(557)	(69)	(626)
Residential mortgage loans	-	(97)	(78)	(175)
Federal agency and GSE MBS	-	(17)	(11)	(28)
Other investments	2	(21)	(10)	(29)
Total assets	<u>\$ 2</u>	<u>\$ (2,676)</u>	<u>\$ (2,964)</u>	<u>\$ (5,638)</u>
Net swap contracts	<u>\$ -</u>	<u>\$ (48)</u>	<u>\$ (187)</u>	<u>\$ (235)</u>
Liabilities:				
Beneficial interest in consolidated VIEs	<u>\$ 285</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 285</u>
2010 ¹				
	Purchases	Sales	Settlements ²	Purchases, sales, and settlements, net
Assets:				
CDOs	\$ -	\$ (184)	\$ (2,290)	\$ (2,474)
Non-agency RMBS	-	(8)	(1,038)	(1,046)
Commercial mortgage loans	-	(269)	(66)	(335)
Residential mortgage loans	-	-	(91)	(91)
Federal agency and GSE MBS	-	-	(34)	(34)
Other investments	16	(1)	(54)	(39)
Total assets	<u>\$ 16</u>	<u>\$ (462)</u>	<u>\$ (3,573)</u>	<u>\$ (4,019)</u>
Net swap contracts	<u>\$ -</u>	<u>\$ (19)</u>	<u>\$ (306)</u>	<u>\$ (325)</u>
Liabilities:				
Beneficial interest in consolidated VIEs	<u>\$ 277</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 277</u>

¹ The Bank chose to include the gross presentation of purchases, sales, and settlements in the reconciliation for Level 3 fair value measurements as of December 31, 2010, though not specifically required, so as to provide a more consistent presentation to the format seen for the Level 3 fair value measurements as of December 31, 2011.

² Includes paydowns.

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g. Professional Fees

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

10. NON-CONSOLIDATED VARIABLE INTEREST ENTITIES

In December 2009, the FRBNY received preferred interests in two VIEs, AIA LLC and ALICO LLC. As a result of the closing of the AIG recapitalization plan on January 14, 2011, AIG paid FRBNY in full for its preferred interests in AIA LLC and ALICO LLC, including accrued dividends. The FRBNY did not previously consolidate these VIEs because it did not have a controlling financial interest. The recorded value of the FRBNY's preferred interests, including capitalized dividends, was \$16,866 million for AIA LLC and \$9,499 million for ALICO LLC at December 31, 2010. The FRBNY's preferred interests and capitalized dividends are reported as "Preferred interests" and dividends receivable are reported as a component of "Other Assets" in the Combined Statements of Condition.

11. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	<u>2011</u>	<u>2010</u>
Bank premises and equipment:		
Land and land improvements	\$ 350	\$ 350
Buildings	2,494	2,436
Building machinery and equipment	514	511
Construction in progress	27	31
Furniture and equipment	1,042	1,034
Subtotal	<u>4,427</u>	<u>4,362</u>
Accumulated depreciation	<u>(1,878)</u>	<u>(1,749)</u>
Bank premises and equipment, net	<u>\$ 2,549</u>	<u>\$ 2,613</u>
Depreciation expense, for the years ended December 31	<u>\$ 213</u>	<u>\$ 204</u>

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

	<u>2011</u>	<u>2010</u>
Leased premises and equipment under capital leases	\$ 24	\$ 18
Accumulated depreciation	<u>(13)</u>	<u>(8)</u>
Leased premises and equipment under capital leases, net	<u>\$ 11</u>	<u>\$ 10</u>
Depreciation expense related to leased premises and equipment under capital leases	<u>\$ 5</u>	<u>\$ 3</u>

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The Reserve Banks lease space to outside tenants with remaining lease terms ranging from 1 to 13 years. Rental income from such leases was \$32 million and \$34 million for the years ended December 31, 2011 and 2010, respectively, and is reported as a component of “Non-interest income: Other” in the Combined Statements of Income and Comprehensive Income. Future minimum lease payments that the Reserve Banks will receive under noncancelable lease agreements in existence at December 31, 2011, are as follows (in millions):

2012	\$	26
2013		23
2014		25
2015		21
2016		16
Thereafter		31
Total	<u>\$</u>	<u>142</u>

The Reserve Banks had capitalized software assets, net of amortization, of \$165 million and \$146 million at December 31, 2011 and 2010, respectively. Amortization expense was \$54 million for each of the years ended December 31, 2011 and 2010. Capitalized software assets are reported as a component of “Other assets” in the Combined Statements of Condition and the related amortization is reported as a component of “Operating expenses: Other” in the Combined Statements of Income and Comprehensive Income.

The Federal Reserve Bank of Cleveland recorded asset impairment losses of \$12 million for the year ended December 31, 2011. Losses were determined using fair values based on quoted fair values or other valuation techniques. A \$10 million loss, related to building and land, and building machinery and equipment, is reported as a component of “Operating expenses: Other” and a \$2 million loss, related to building and land improvements, is reported as a component of “Operating expenses: Occupancy” in the Combined Statements of Income and Comprehensive Income.

The Federal Reserve Bank of Atlanta (FRBA) recorded asset impairment losses of \$1 million for the year ended December 31, 2011. Losses were determined using fair values based on quoted fair values or other valuation techniques and are reported as a component of “Operating expenses: Equipment” in the Combined Statements of Income and Comprehensive Income.

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

12. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2011, the Reserve Banks were obligated under noncancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 12 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was \$29 million and \$30 million for the years ended December 31, 2011 and 2010, respectively.

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Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2011, are as follows (in millions):

2012	\$	13
2013		13
2014		12
2015		11
2016		11
Thereafter		74
Future minimum rental payments ¹	<u>\$</u>	<u>134</u>

¹ On February 28, 2012, the FRBNY completed the purchase of the building located at 33 Maiden Lane, New York, NY for \$207.5 million. The FRBNY was previously leasing space in the building, and future minimum rental payments for the leased space reported in the table above were \$108 million.

At December 31, 2011, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2022 with a remaining fixed commitment of \$298 million. Purchases of \$25 million and \$54 million were made against these commitments during 2011 and 2010, respectively. These commitments are for maintenance of currency processing machines and have variable and/or fixed components. The variable portion of the commitments is for additional services above the fixed contractual service limits. The fixed payments for the next five years under these commitments are as follows (in millions):

2012	\$	3
2013		56
2014		28
2015		25
2016		25

At December 31, 2011, the Federal Reserve Bank of Richmond had commitments of approximately \$8 million for the construction and acquisition of an air handling unit at its Richmond building. Expected fixed payments were \$4 million for each of the years ended December 31, 2012 and 2013.

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

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Other Commitments

In support of financial market stability activities, the Reserve Bank entered into commitments to provide financial assistance to financial institutions. The contractual amounts shown below are the Reserve Banks' maximum exposures to loss in the event that the commitments are fully funded and there is a default by the borrower or total loss in value of pledged collateral. Total commitments at December 31, 2011 and 2010, were as follows (in millions):

	2011		2010	
	Contractual	Unfunded	Contractual	Unfunded
Secured revolving line of credit (AIG)	\$ -	\$ -	\$ 24,512	\$ 9,891
Commercial loan commitments (ML)	61	61	72	72
Additional loan commitments (ML) ¹	18	18	9	9
Total	<u>\$ 79</u>	<u>\$ 79</u>	<u>\$ 24,593</u>	<u>\$ 9,972</u>

¹ In 2011, there is additional restricted cash totaling \$18 million that may be required to be advanced by ML for property level expenses or improvements.

The contractual amount of the commitment related to the AIG secured revolving line of credit represents the maximum commitment at December 31, 2010, to lend to AIG and the unfunded amount represents the maximum commitment reduced by draws outstanding. As a result of the closing of the AIG recapitalization plan on January 14, 2011, the revolving line of credit was paid in full, including interest and fees, and FRBNY's commitment to lend any further funds was terminated.

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

13. RETIREMENT AND THRIFT PLANS

Retirement Plans

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

The System Plan provides retirement benefits to employees of the Reserve Banks, Board of Governors, OEB, and certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its combined financial statements. During the year ended December 31, 2011, certain costs associated with the System Plan were reimbursed by the Bureau. During the year ended December 31, 2010, costs associated with the System Plan were not reimbursed by other participating employers.

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

	<u>2011</u>	<u>2010</u>
Estimated actuarial present value of projected benefit obligation at January 1	\$ 8,258	\$ 7,364
Service cost-benefits earned during the period	258	223
Interest cost on projected benefit obligation	461	450
Actuarial loss	1,427	508
Contributions by plan participants	6	9
Special termination benefits	10	11
Benefits paid	(315)	(307)
Plan amendments	93	-
Estimated actuarial present value of projected benefit obligation at December 31	<u>\$ 10,198</u>	<u>\$ 8,258</u>

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

	<u>2011</u>	<u>2010</u>
Estimated plan assets at January 1 (of which \$6,998 and \$6,252 is measured at fair value as of January 1, 2011 and 2010, respectively)	\$ 7,273	\$ 6,281
Actual return on plan assets	649	710
Contributions by the employer	435	580
Contributions by plan participants	6	9
Benefits paid	(315)	(307)
Estimated plan assets at December 31 (of which \$7,977 and \$6,998 is measured at fair value as of January 1, 2011 and 2010, respectively)	<u>\$ 8,048</u>	<u>\$ 7,273</u>
Funded status and accrued pension benefit costs	<u>\$ (2,150)</u>	<u>\$ (985)</u>
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ (739)	\$ (771)
Net actuarial loss	(3,710)	(2,589)
Total accumulated other comprehensive loss	<u>\$ (4,449)</u>	<u>\$ (3,360)</u>

During the year ended December 31, 2011, the Bureau funded \$14.4 million for its employees who transferred into the System Plan. All other employer contributions during the years ended December 31, 2011 and 2010 were funded by FRBNY on behalf of the System.

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

The accumulated benefit obligation for the System Plan, which differs from the estimated actuarial present value of projected benefit obligation because it is based on current rather than future compensation levels, was \$8,803 million and \$7,136 million at December 31, 2011 and 2010, respectively.

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

	<u>2011</u>	<u>2010</u>
Discount rate	4.50%	5.50%
Rate of compensation increase	5.00%	5.00%

Net periodic benefit expenses for the years ended December 31, 2011 and 2010, were actuarially determined using a January 1 measurement date. The weighted-average assumptions used in developing net periodic benefit expenses for the System Plan for the years were as follows:

	<u>2011</u>	<u>2010</u>
Discount rate	5.50%	6.00%
Expected asset return	7.25%	7.75%
Rate of compensation increase	5.00%	5.00%

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the System Plan's benefits when due. The expected long-term rate of return on assets is an estimate that is based on a combination of factors, including the System Plan's asset allocation strategy and historical returns; surveys of expected rates of return for other entities' plans; a projected return for equities and fixed income investments based on real interest rates, inflation expectations, and equity risk premiums; and surveys of expected returns in equity and fixed income markets.

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

	<u>2011</u>	<u>2010</u>
Service cost - benefits earned during the period	\$ 258	\$ 223
Interest cost on accumulated benefit obligation	461	450
Amortization of prior service cost	110	112
Amortization of net loss	187	188
Expected return on plan assets	(531)	(491)
Net periodic pension benefit expense	<u>485</u>	<u>482</u>
Special termination benefits	10	11
Total periodic pension benefit expense	<u>\$ 495</u>	<u>\$ 493</u>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2012 are shown below:

Prior service cost	\$ 116
Net actuarial loss	<u>287</u>
Total	<u>\$ 403</u>

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

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

	Expected Benefit Payments
2012	\$ 351
2013	375
2014	398
2015	422
2016	446
2017-2021	2,616
Total	\$ 4,608

The System's Committee on Investment Performance (CIP) is responsible for establishing investment policies, selecting investment managers, and monitoring the investment managers' compliance with its policies. The CIP is supported by staff in the OEB in carrying out these responsibilities. At December 31, 2011, the System Plan's assets were held in five investment vehicles: two actively managed long-duration fixed income portfolios, an indexed U.S. equity fund, an indexed non-U.S. developed-markets equity fund, and a money market fund.

The diversification of the Plan's investments is designed to limit concentration of risk and the risk of loss related to an individual asset class. The two long-duration fixed income portfolios are separate accounts benchmarked to a custom benchmark of 55 percent Barclays Long Credit Index and 45 percent Citigroup 15+ years Treasury STRIP Index, which was selected as a proxy for the liabilities of the Plan. Although these portfolios are both actively managed, the guidelines are designed to limit portfolio deviations from the benchmark. The indexed U.S. equity fund is intended to track the overall U.S. equity market across market capitalizations. The indexed non-U.S. developed markets equity fund is intended to track the Morgan Stanley Capital International (MSCI) Emerging Markets Index, Europe, Australia, Far East plus Canada Index, which includes stocks from 23 markets deemed by MSCI to be "developed markets." Finally, the money market fund, which invests in high-quality money market securities, is the repository for cash balances and adheres to a constant dollar methodology.

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

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

	Policy Weight	Actual Asset Allocations	
		2011	2010
U.S. equities	40.0%	39.0%	45.4%
International equities	15.0%	13.8%	12.6%
Fixed income	45.0%	46.6%	41.7%
Cash	0.0%	0.6%	0.3%
Total	100.0%	100.0%	100.0%

Employer contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System Plan's actuarial funding method is expected to produce a recommended annual funding range between \$750 and \$800 million. In 2012, the System plans to make monthly contributions of \$65 million and will reevaluate the monthly contributions upon completion of the 2012

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actuarial valuation. The Reserve Banks' projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2011 and 2010, and for the years then ended, were not material.

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

Determination of Fair Value

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

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

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

Description	2011			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ 31	\$ 29	\$ -	\$ 60
Treasury and Federal agency securities	1,685	14	-	1,699
Other fixed income securities	-	1,962	-	1,962
Commingled funds	-	4,256	-	4,256
Total	<u>\$ 1,716</u>	<u>\$ 6,261</u>	<u>\$ -</u>	<u>\$ 7,977</u>

There were no transfers between Level 1 and Level 2 during the year.

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

There were no transfers between Level 1 and Level 2 during the year.

The System Plan enters into futures contracts, traded on regulated exchanges, to manage certain risks and to maintain appropriate market exposure in meeting the investment objectives of the System Plan. The System Plan bears the market risk that arises from any unfavorable changes in the value of the securities or indexes underlying these futures contracts. The use of futures contracts involves, to varying degrees, elements of

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market risk in excess of the amount recorded in the Combined Statements of Condition. The guidelines established by the CIP further reduce risk by limiting the net futures positions, for most fund managers, to 15 percent of the market value of the advisor's portfolio. No limit has been established on the futures positions of the liability-driven investments because the fund manager only executes Treasury futures.

At December 31, 2011 and 2010, a portion of short-term investments was available for futures trading. There were \$6 million and \$1 million of Treasury securities pledged as collateral for the years ended December 31, 2011 and 2010, respectively.

Thrift Plan

Employees of the Reserve Banks participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Reserve Banks match 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. The Reserve Banks' Thrift Plan contributions totaled \$96 million and \$94 million for the years ended December 31, 2011 and 2010, respectively, and are reported as a component of "Operating expenses: Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

14. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

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

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

	2011	2010
Accumulated postretirement benefit obligation at January 1	\$ 1,358	\$ 1,324
Service cost benefits earned during the period	49	47
Interest cost on accumulated benefit obligation	72	76
Net actuarial loss (gain)	114	(9)
Curtailment gain	(7)	-
Special termination benefits loss	1	1
Contributions by plan participants	21	18
Benefits paid	(86)	(88)
Medicare Part D subsidies	5	5
Plan amendments	(21)	(16)
Accumulated postretirement benefit obligation at December 31	<u>\$ 1,506</u>	<u>\$ 1,358</u>

At December 31, 2011 and 2010, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 4.50 percent and 5.25 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.

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

	<u>2011</u>	<u>2010</u>
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	60	65
Contributions by plan participants	21	18
Benefits paid	(86)	(88)
Medicare Part D subsidies	5	5
Fair value of plan assets at December 31	<u>\$ -</u>	<u>\$ -</u>
Unfunded obligation and accrued postretirement benefit cost	<u>\$ 1,506</u>	<u>\$ 1,358</u>

Amounts included in accumulated other comprehensive loss are shown below:

Prior service cost	\$ 45	\$ 31
Net actuarial (loss)	(388)	(301)
Total accumulated other comprehensive loss	<u>\$ (343)</u>	<u>\$ (270)</u>

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

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

	<u>2011</u>	<u>2010</u>
Health-care cost trend rate assumed for next year	7.50%	8.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2017

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A 1 percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2011 (in millions):

	<u>1 percentage point increase</u>	<u>1 percentage point decrease</u>
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 19	\$ (15)
Effect on accumulated postretirement benefit obligation	182	(154)

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

	<u>2011</u>	<u>2010</u>
Service cost-benefits earned during the period	\$ 49	\$ 47
Interest cost on accumulated benefit obligation	72	76
Amortization of prior service cost	(7)	(18)
Amortization of net actuarial loss	21	28
Total periodic expense	<u>135</u>	<u>133</u>
Special termination benefits loss	1	1
Net periodic postretirement benefit expense	<u>\$ 136</u>	<u>\$ 134</u>

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2012 are shown below:

Prior service cost	\$ (10)
Net actuarial loss	<u>30</u>
Total	<u>\$ 20</u>

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2011 and 2010, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.25 percent and 5.75 percent, respectively.

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

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

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

Federal Medicare Part D subsidy receipts were \$4.2 million and \$4.3 million in the years ended December 31, 2011 and 2010, respectively. Expected receipts in 2012, related to benefits paid in the years ended December 31, 2011 and 2010, were \$2.5 million and \$1.0 million, respectively.

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

	<u>Without subsidy</u>	<u>With subsidy</u>
2012	\$ 77	\$ 72
2013	81	75
2014	84	78
2015	88	81
2016	92	84
2017 - 2021	<u>522</u>	<u>470</u>
Total	<u>\$ 944</u>	<u>\$ 860</u>

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2011 and 2010, were \$157 million and \$146 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Combined Statements of Condition. Net periodic postemployment benefit expense included in operating expenses was \$27 million and \$11 million for 2011 and 2010, respectively, and is recorded as a component of "Operating expenses: Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

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15. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than retirement plans	Total accumulated other comprehensive income (loss)
Balance at January 1, 2010	\$ (3,371)	\$ (305)	\$ (3,676)
Change in funded status of benefit plans:			
Prior service costs arising during the year	-	16	16
Amortization of prior service cost	112	(18)	94
Change in prior service costs related to benefit plans	112	(2)	110
Net actuarial (loss) gain arising during the year	(289)	9	(280)
Amortization of net actuarial loss	188	28	216
Change in actuarial (loss) gain related to benefit plans	(101)	37	(64)
Change in funded status of benefit plans - other comprehensive income	11	35	46
Balance at December 31, 2010	<u>\$ (3,360)</u>	<u>\$ (270)</u>	<u>\$ (3,630)</u>
Change in funded status of benefit plans:			
Prior service costs arising during the year	(78)	22	(56)
Amortization of prior service cost	110	(8)	102
Change in prior service costs related to benefit plans	32	14	46
Net actuarial (loss) arising during the year	(1,308)	(108)	(1,416)
Amortization of net actuarial loss	187	21	208
Change in actuarial (losses) related to benefit plans	(1,121)	(87)	(1,208)
Change in funded status of benefit plans - other comprehensive (loss)	(1,089)	(73)	(1,162)
Balance at December 31, 2011	<u>\$ (4,449)</u>	<u>\$ (343)</u>	<u>\$ (4,792)</u>

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

16. BUSINESS RESTRUCTURING CHARGES

Before 2010, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites; one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing.

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

In 2011, the U.S. Treasury announced a restructuring initiative to consolidate the Treasury Retail Securities (TRS) operations. As a result of this initiative, TRS operations performed by the Federal Reserve Bank of Cleveland (FRBC) were consolidated into the Federal Reserve Bank of Minneapolis. Additional announcements in 2011 included the consolidation of paper check processing, performed by the FRBC, into the FRBA.

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

	2011 restructuring plans	2010 restructuring plans	2009 and prior restructuring plans	Total
<i>Information related to restructuring plans as of</i>				
<i>December 31, 2011:</i>				
Total expected costs related to restructuring activity	\$ 11	\$ 3	\$ 47	\$ 61
Expected completion date	2012	2011	2012	
<i>Reconciliation of liability balances:</i>				
Balance at January 1, 2010	\$ -	\$ -	\$ 19	\$ 19
Employee separation costs	-	3	-	3
Contract termination costs	-	-	1	1
Adjustments	-	-	(2)	(2)
Payments	-	-	(11)	(11)
Balance at December 31, 2010	\$ -	\$ 3	\$ 7	\$ 10
Employee separation costs	11	1	-	12
Adjustments	(1)	-	(2)	(3)
Payments	(4)	(2)	(2)	(8)
Balance at December 31, 2011	<u>\$ 6</u>	<u>\$ 2</u>	<u>\$ 3</u>	<u>\$ 11</u>

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

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

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

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

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17. SUBSEQUENT EVENTS

Subsequent to December 31, 2011, the FRBNY, through a series of three competitive bidding processes, sold the remaining ML II portfolio assets with a total unpaid principal balance of \$19.2 billion. The sales proceeds received exceeded the fair value of the assets as of December 31, 2011 by \$1.2 billion. Proceeds from these sales were used to fully repay the FRBNY's senior loan plus accrued interest and the fixed deferred purchase price plus accrued interest, and will provide residual income that will be distributed in accordance with the ML II agreements.

Also subsequent to December 31, 2011, the FRBNY, through a series of competitive bidding processes, sold or entered into an agreement to sell ML's interest in a senior commercial mortgage loan and has sold the majority of ML's mezzanine loan participation interests, with an aggregated unpaid principal balance of \$1.6 billion as of December 31, 2011.

On February 28, 2012, the FRBNY completed the purchase of the building located at 33 Maiden Lane, New York, NY for \$207.5 million. The FRBNY was previously leasing space in the building, as discussed in Note 12.

There were no other subsequent events that require adjustments to or disclosures in the combined financial statements as of December 31, 2011. Subsequent events were evaluated through March 20, 2012, which is the date that the combined financial statements were issued.