100th Annual Report

2013

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

100th Annual Report

2013

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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Letter of Transmittal

Board of Governors of the Federal Reserve System
Washington, D.C.

May 2014

The Speaker of the House of Representatives:

Pursuant to the requirements of section 10 of the Federal Reserve Act, I am pleased to submit the 100th annual report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 2013.

Sincerely,

Janet L. Yellen
Chair

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1 Overview

The Federal Reserve, the central bank of the United States, is a federal system composed of a central governmental agency—the Board of Governors—and 12 regional Federal Reserve Banks.

The Board of Governors, located in Washington, D.C., consists of seven members appointed by the President of the United States and supported by a 2,648-person staff. Besides conducting research, analysis, and policymaking related to domestic and international financial and economic matters, the Board plays a major role in the supervision and regulation of U.S. financial institutions and activities, has broad oversight responsibility for the nation's payments system and the operations and activities of the Federal Reserve Banks, and plays an important role in promoting consumer protection, fair lending, and community development.

For More Background on Board Operations

For more information about the Federal Reserve Board and the Federal Reserve System, visit the Board's website at www.federalreserve.gov/aboutthefed/default.htm. An online version of this *Annual Report* is available at www.federalreserve.gov/pubs/alpha.htm.

About This Report

This report covers Board and System operations and activities during calendar-year 2013. The report includes the following sections:

- **Monetary policy and economic developments.** Section 2 provides adapted versions of the Board's semiannual monetary policy reports to Congress.
- **Federal Reserve operations.** Section 3 provides a summary of Board and System activities in the areas of supervision and regulation; section 4, in consumer and community affairs; and section 5, in Reserve Bank operations.
- **Dodd-Frank Act implementation and other requirements.** Section 6 summarizes the Board's efforts in 2013 to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as the Board's compliance with the Government Performance and Results Act of 1993.
- **Policy actions and litigation.** Section 7 and section 8 provide accounts of policy actions taken by the Board in 2013, including new or amended rules and regulations and other actions as well as the deliberations and decisions of the Federal Open Market Committee (FOMC); section 9 summarizes litigation involving the Board.[1]
- **Statistical tables.** Section 10 includes 14 statistical tables that provide updated historical data concerning Board and System operations and activities.
- **Federal Reserve System audits.** Section 11 provides detailed information on the several levels of audit and review conducted in regards to System operations and activities, including those provided by outside auditors and the Board's Office of Inspector General.
- **Federal Reserve System budgets.** Section 12 presents information on the 2013 budget performance of the Board and Reserve Banks, as well as their 2014 budgets, budgeting processes, and trends in their expenses and employment.
- **Federal Reserve System organization.** Section 13 provides listings of key officials at the Board and in the Federal Reserve System, including the Board of

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[1] For more information on the FOMC, see the Board's website at www.federalreserve.gov/monetarypolicy/fomc.htm.

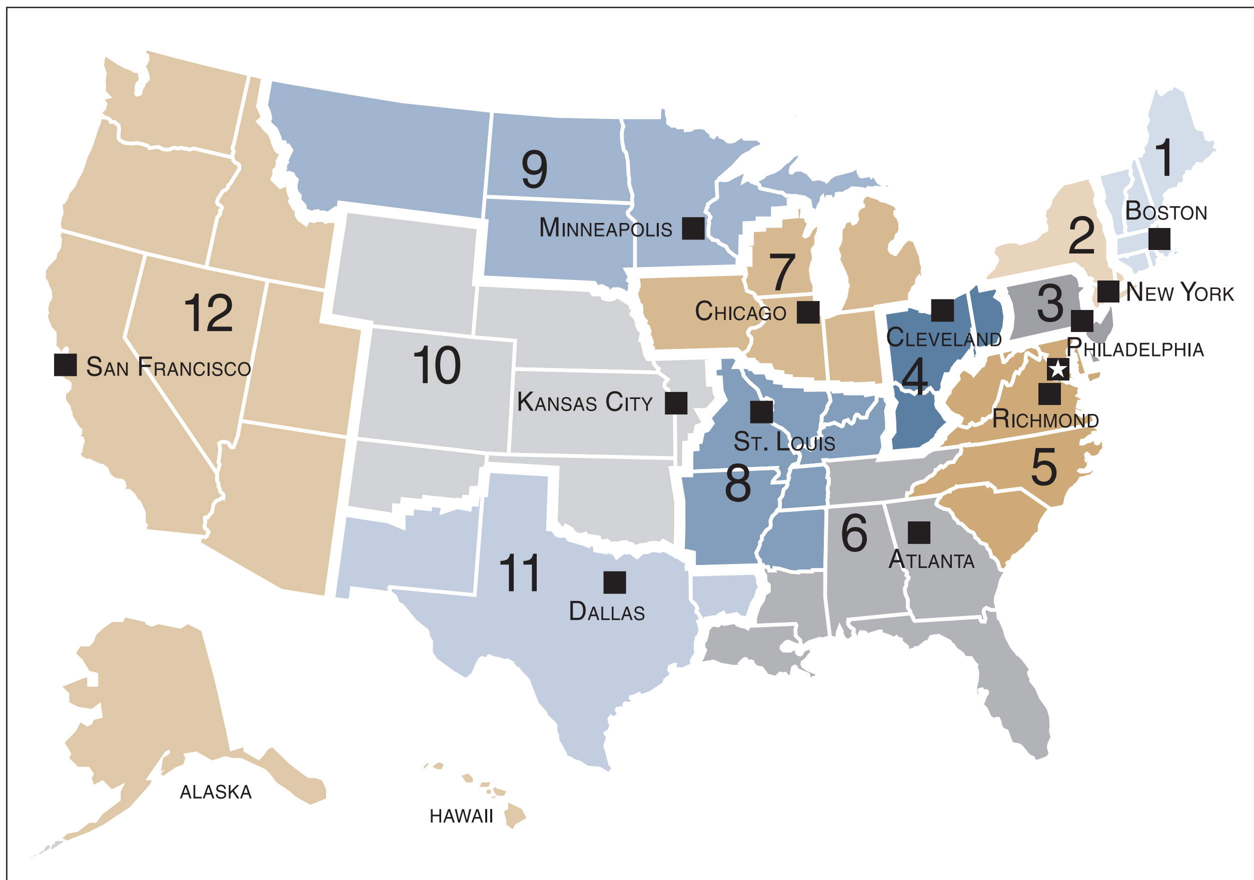
Governors, its officers, FOMC members, several System councils, and Federal Reserve Bank and Branch officers and directors.

About the Federal Reserve System

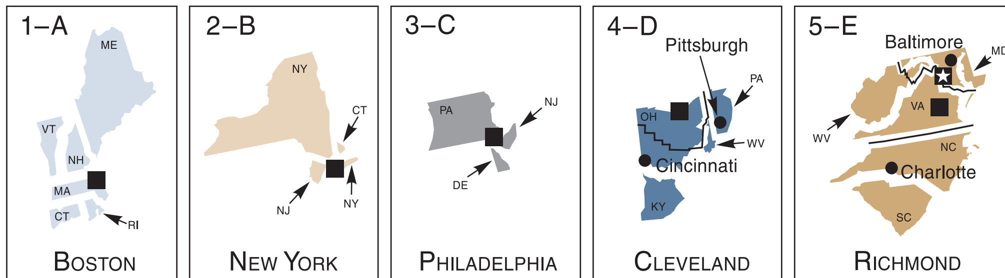
The Federal Reserve System, which serves as the nation's central bank, was created by an act of Congress on December 23, 1913. The System consists of a seven-member Board of Governors with headquarters in Washington, D.C., and the 12 Reserve Banks located in major cities throughout the United States.

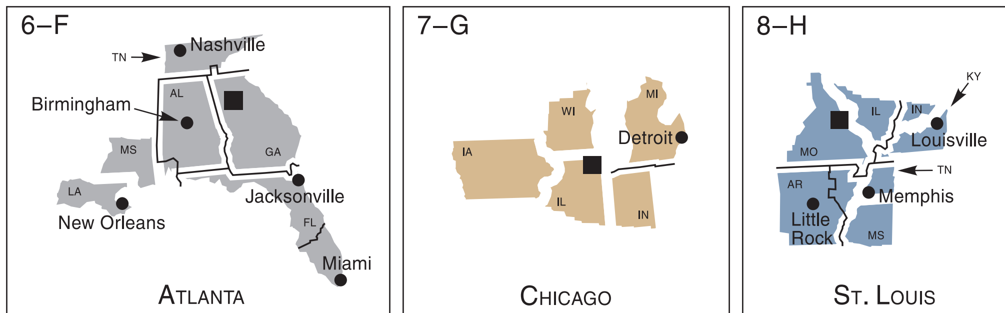
The Federal Reserve Banks are the operating arms of the central banking system, carrying out a variety of System functions, including operating a nationwide payment system; distributing the nation's currency and coin; under authority delegated by the Board of Governors, supervising and regulating a variety of financial institutions and activities; serving as fiscal agents of the U.S. Treasury; and providing a variety of financial services for the Treasury, other government agencies, and other fiscal principals.

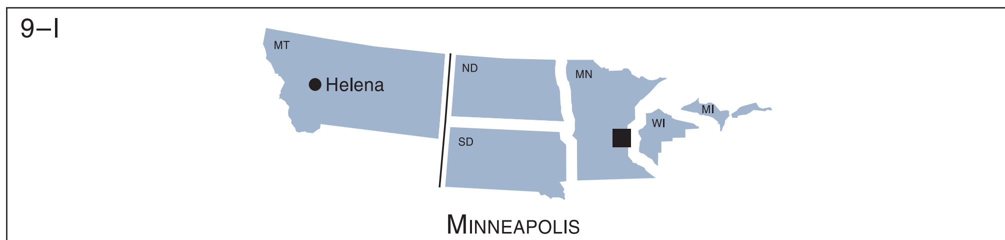
The following maps identify Federal Reserve Districts by their official number, city, and letter designation.

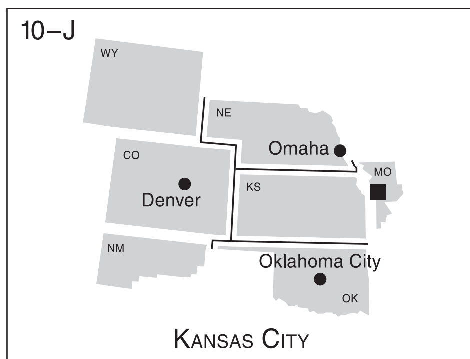


■ Federal Reserve Bank city
✪ Board of Governors of the Federal Reserve System, Washington, D.C.









■ Federal Reserve Bank city
● Federal Reserve Branch city
⛝ Board of Governors of the Federal Reserve System, Washington, D.C.
— Branch boundary

2 | Monetary Policy and Economic Developments

As required by section 2B of the Federal Reserve Act, the Federal Reserve Board submits written reports to Congress that contain discussions of "the conduct of monetary policy and economic developments and prospects for the future." The *Monetary Policy Report,* submitted semiannually to the Senate Committee on Banking, Housing, and Urban Affairs and to the House Committee on Banking and Financial Services, is delivered concurrently with testimony from the Federal Reserve Board Chair.

The following discussion is a review of U.S. monetary policy and economic developments in 2013, excerpted from the *Monetary Policy Report*s published in February 2014 and July 2013. Those complete reports, which include a copy of the Federal Open Market Committee's Statement on Longer-Run Goals and Monetary Policy Strategy, are available on the Board's website at www.federalreserve.gov/monetarypolicy/files/20140211_mprfullreport.pdf (February 2014) and www.federalreserve.gov/monetarypolicy/files/20130717_mprfullreport.pdf (July 2013).

Other materials in this annual report related to the conduct of monetary policy can be found in section 8, "Minutes of Federal Open Market Committee Meetings," and section 10, "Statistical Tables" (see tables 1–4).

Monetary Policy Report of February 2014

Summary

The labor market improved further during the second half of 2013 and into early 2014 as the economic recovery strengthened: Employment has increased at an average monthly pace of about 175,000 since June, and the unemployment rate fell from 7.5 percent in June to 6.6 percent in January. With these gains, payrolls have risen a cumulative 3¼ million and the unemployment rate has declined 1½ percentage points since August 2012, the month before the Federal Open Market Committee (FOMC) began its current asset purchase program. Nevertheless, even with these improvements, the unemployment rate remains well above levels that FOMC participants judge to be sustainable in the longer run.

Consumer price inflation remained low. The price index for personal consumption expenditures rose at an annual rate of only 1 percent in the second half of last year, noticeably below the FOMC's longer-run objective of 2 percent. However, some of the recent softness reflects factors that seem likely to prove transitory, and survey- and market-based measures of longer-term inflation expectations have remained in the ranges seen over the past several years.

Economic growth picked up in the second half of last year. Real gross domestic product is estimated to have increased at an annual rate of 3¾ percent, up from a 1¾ percent gain in the first half. Fiscal policy—which was unusually restrictive in 2013 as a whole—likely began to impose somewhat less restraint on the pace of expansion in the latter part of the year. Moreover, financial markets remained supportive of economic growth—as household net worth rose further, credit became more readily available, and interest rates remained relatively low—and economic conditions in the rest of the world improved overall despite recent turbulence in some emerging financial markets. As a result, growth in consumer spending, business investment, and exports all increased in the second half of last year.

On the whole, the U.S. financial system continued to strengthen. Capital and liquidity profiles at large bank holding companies improved further. In addition, the Federal Reserve and other agencies took further steps to enhance the resilience of the financial system, including strengthening capital regulations for large financial institutions and issuing a final rule implementing the Volcker rule, which restricts such firms' proprietary trading activities. Use of financial leverage was relatively restrained, and valuations in

most asset markets were broadly in line with historical norms. Overall, the vulnerability of the system to adverse shocks remained at a moderate level.

With the economic recovery continuing, most Committee members judged by the time of the December 2013 FOMC meeting that they had seen meaningful, sustainable improvement in economic and labor market conditions since the beginning of the current asset purchase program, even while recognizing that the unemployment rate remained elevated and that inflation was running noticeably below the Committee's 2 percent longer-run objective. Accordingly, the FOMC concluded that a highly accommodative policy stance remained appropriate, but that in light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee could begin to trim the pace of its asset purchases. Specifically, the Committee decided that, beginning in January, it would add to its holdings of longer-term securities at a pace of $75 billion per month rather than $85 billion per month as it had done previously. At its January meeting, the Committee continued to see improvements in economic conditions and the outlook and reduced the pace of its asset purchases by an additional $10 billion per month, to $65 billion. The FOMC indicated that if incoming information continues to broadly support the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings. Nonetheless, the Committee reiterated that asset purchases are not on a preset course, and that its decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases. The FOMC also noted that its sizable and still-increasing holdings of longer-term securities should maintain downward pressure on longer-term interest rates, support mortgage markets, and help make broader financial conditions more accommodative.

At the same time, to emphasize its commitment to provide a high level of monetary accommodation for as long as needed to support continued progress toward maximum employment and price stability, the Committee enhanced its forward guidance regarding the federal funds rate. Over the year prior to December 2013, the FOMC had reaffirmed its view that a highly accommodative stance of monetary policy would remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee indicated its intention to maintain the current low target range for the federal funds rate at least as long as the unemployment rate remained above 6½ percent, inflation between one and two years ahead was projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continued to be well anchored. At the December 2013 FOMC meeting, with the unemployment rate moving down toward the 6½ percent threshold, the Committee decided to provide additional information about how it expects its policies to evolve after the threshold is crossed. Specifically, the Committee indicated its anticipation that it will likely maintain the current federal funds rate target well past the time that the unemployment rate declines below 6½ percent, especially if projected inflation continues to run below its 2 percent goal.

At the time of the most recent FOMC meeting in late January, Committee participants saw the economic outlook as little changed from the time of their December meeting, when the most recent Summary of Economic Projections (SEP) was compiled. (The December SEP is included as Part 3 of the February 2014 *Monetary Policy Report* on pages 37–49; it is also included in section 8 of this annual report.) Participants viewed labor market indicators as showing further improvement on balance—notwithstanding recent mixed readings—and overall economic activity as consistent with growing underlying strength in the broader economy. Even taking into account the recent volatility in global financial markets, participants regarded the risks to the outlook for the economy and the labor market as having become more nearly balanced in recent months. FOMC participants expected that, with appropriate policy accommodation, economic activity would expand at a moderate pace, and that the unemployment rate would gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee recognized that inflation persistently below its 2 percent objective could pose risks to economic performance, and it is monitoring inflation developments carefully for evidence that inflation will move back toward its objective over the medium term.

Part 1: Recent Economic and Financial Developments

The labor market continued to improve over the second half of last year. Job gains have averaged about

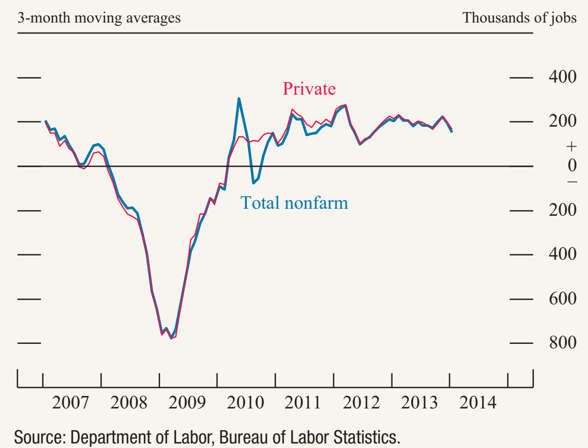
175,000 per month since June, and the unemployment rate fell from 7.5 percent in June 2013 to 6.6 percent in January of this year. Even so, the unemployment rate remains well above Federal Open Market Committee (FOMC) participants' estimates of the long-run sustainable rate. Inflation remained low, as the price index for personal consumption expenditures (PCE) increased at an annual rate of 1 percent from June to December—noticeably below the FOMC's longer-run goal of 2 percent. However, transitory influences appear to have been partly responsible for the low readings on inflation last year, and measures of inflation expectations remained steady and near longer-run averages. Growth in economic activity picked up in the second half of 2013. Real gross domestic product (GDP) is estimated to have risen at an annual rate of 3¾ percent, up from a 1¾ percent rate of increase in the first half. Fiscal policy—which was unusually restrictive in 2013 as a whole—likely started to exert somewhat less restraint on economic growth in the second half of the year. In addition, household net worth rose further as key asset prices continued to increase, credit became more available while interest rates remained low, and economic conditions in the rest of the world improved overall in spite of recent turbulence in emerging financial markets. Consumer spending, business investment, and exports all increased more rapidly in the latter part of last year. In contrast, the recovery in the housing sector appeared to pause in the second half of last year following increases in mortgage interest rates in the spring and summer.

Domestic Developments

The labor market continued to improve, . . .

The labor market continued to improve over the second half of 2013. Payroll employment has increased an average of about 175,000 per month since June, roughly similar to the average gain over the first half of last year (figure 1). In addition, the unemployment rate declined from 7.5 percent in June to 6.6 percent in January of this year (figure 2). A variety of alternative measures of labor force underutilization—which include, in addition to the unemployed, those classified as discouraged, other individuals who are out of work and classified as marginally attached to the labor force, and individuals who have a job but would like to work more hours—have also improved in the past several months. Since August 2012—the month before the Committee began its current asset purchase pro-

Figure 1. Net change in payroll employment



Source: Department of Labor, Bureau of Labor Statistics.

gram—total payroll employment has increased a cumulative 3¼ million, and the unemployment rate has declined 1½ percentage points.

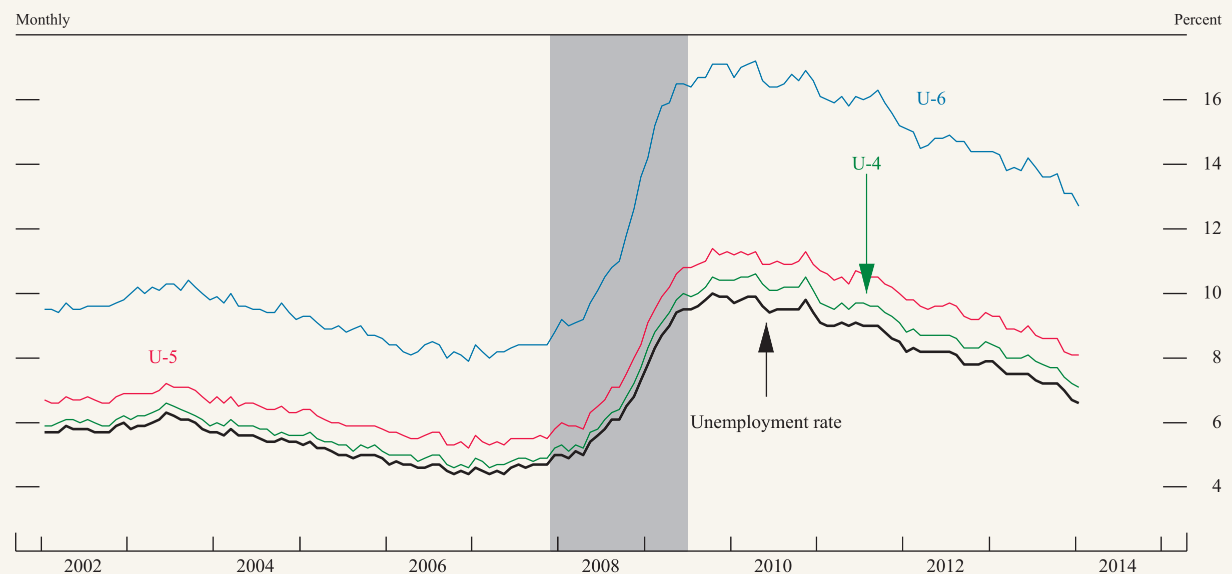
. . . although labor force participation remained weak, . . .

While the unemployment rate and total payroll employment have improved further, the labor force participation rate has continued to move lower on net. As a result, the employment-to-population ratio, a measure that combines the unemployment rate and the labor force participation rate, has changed little during the past year. Although much of the decline in participation likely reflects changing demographics—most notably the increasing share in the population of older people, who have lower-than-average participation rates—and would have occurred even if the labor market had been stronger, some of the weakness in participation is also likely due to workers' perceptions of relatively poor job opportunities.

. . . considerable slack in labor markets remains, . . .

Despite its recent declines, the unemployment rate remains well above FOMC participants' estimates of the long-run sustainable rate of unemployment and well above rates that prevailed prior to the recent recession. Moreover, beyond labor force participation, some other aspects of the labor market remain of concern. For example, the share of the unemployed who have been out of work longer than six months and the percentage of the workforce that is working part time but would like to work full time have declined only modestly over the recovery. In

Figure 2. Measures of labor underutilization



Note: U-4 measures total unemployed plus discouraged workers, as a percent of the labor force plus discouraged workers. Discouraged workers are a subset of marginally attached workers who are not currently looking for work because they believe no jobs are available for them. U-5 measures total unemployed plus all marginally attached to the labor force, as a percent of the labor force plus persons marginally attached to the labor force. Marginally attached workers are not in the labor force, want and are available for work, and have looked for a job in the past 12 months. U-6 measures total unemployed plus all marginally attached workers plus total employed part time for economic reasons, as a percent of the labor force plus all marginally attached workers. The shaded bar indicates a period of business recession as defined by the National Bureau of Economic Research.

Source: Department of Labor, Bureau of Labor Statistics.

addition, the quit rate—an indicator of workers' confidence in the availability of other jobs—remains low.

. . . and gains in compensation have been slow

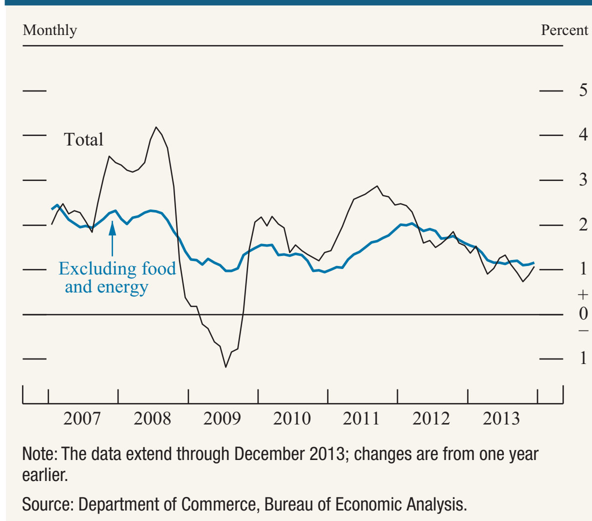
The relatively weak labor market has also been evident in the behavior of wages, as the modest gains in labor compensation seen earlier in the recovery continued last year. The 12-month change in the employment cost index for private industry workers, which measures both wages and the cost to employers of providing benefits, has remained close to 2 percent throughout most of the recovery. Similarly, average hourly earnings for all employees—the timeliest measure of wage developments—increased close to 2 percent over the 12 months ending in January, about the same pace as over the preceding year. Compensation per hour in the nonfarm business sector—a measure derived from the labor compensation data in the national income and product accounts (NIPA)—can be quite volatile even at annual frequencies, but, over the past three years, this measure has increased at an annual average pace of 2¼ percent, well below the average pace prior to the recent recession.

Productivity growth has also been relatively weak over the recovery. From the end of 2009 to the end of 2013, annual growth in output per hour in the nonfarm business sector averaged only 1¼ percent, considerably slower than the average rate before the recent recession. However, with the recent strengthening in the pace of economic activity, productivity growth rose to an annual rate of nearly 3½ percent over the second half of last year.

Inflation was low . . .

Inflation remained low in the second half of 2013, with the PCE price index increasing at an annual rate of only 1 percent from June to December, similar to the increase in the first half and noticeably below the FOMC's long-run objective of 2 percent (figure 3). Core PCE prices—or prices of PCE goods and services excluding food and energy—also increased at an annual rate of about 1 percent over the second half of 2013. Other measures of core consumer price inflation, such as the core consumer price index, were also low last year relative to norms prevailing in the years prior to the recent recession, though not as low as core PCE inflation.

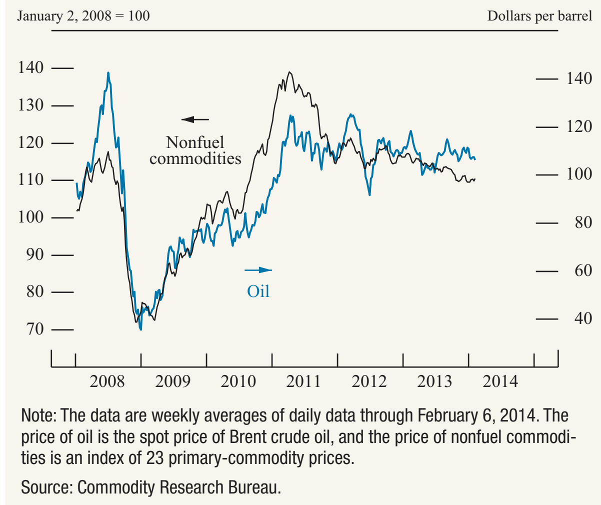
Figure 3. Change in the chain-type price index for personal consumption expenditures



Note: The data extend through December 2013; changes are from one year earlier.

Source: Department of Commerce, Bureau of Economic Analysis.

Figure 4. Prices of oil and nonfuel commodities



Note: The data are weekly averages of daily data through February 6, 2014. The price of oil is the spot price of Brent crude oil, and the price of nonfuel commodities is an index of 23 primary-commodity prices.

Source: Commodity Research Bureau.

Some of the recent softness in core PCE price inflation reflects factors that appear to have been transitory. In particular, after increasing at an average annual rate of 1¾ percent from the end of 2009 to the end of 2012, non-oil import prices fell 1¼ percent in 2013, pushed down by the effects of dollar appreciation and declining commodity prices during the first half of last year. These factors have abated since last summer, as the broad nominal value of the dollar has moved up only a little, on net, and the fall in overall nonfuel commodity prices has eased. In addition, during the final part of 2013, prices for a few industrial metals reversed part of their earlier declines, supported by a positive turnaround in Chinese demand.

Moreover, despite the relatively meager gains in wages, recent increases in the cost of labor needed to produce a unit of output (unit labor costs)—which reflects movements in both labor compensation and productivity and is a useful gauge of the influence of labor-related production costs on inflation—do not suggest an unusual amount of downward pressure on inflation. Unit labor costs increased at an annual rate of 1½ percent over the past two years, just a little below their average prior to the recent recession.

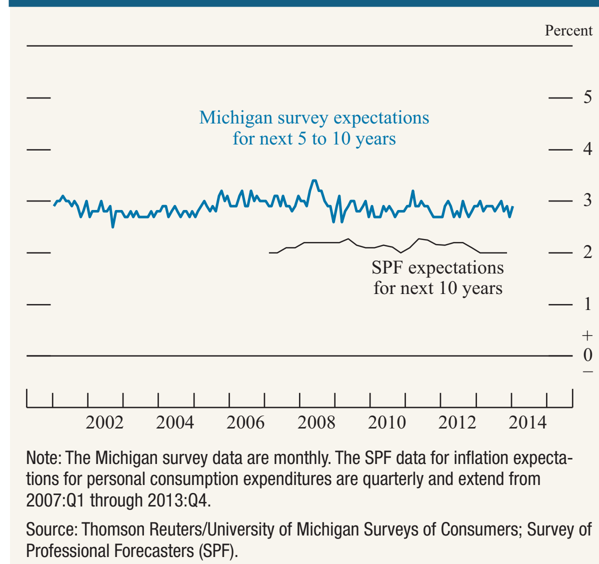
Consumer energy and food prices changed relatively little over the second half of 2013. The spot price of Brent crude oil, after peaking in late August at nearly $120 per barrel, has been relatively stable in recent months, trading at about $110 per barrel since mid-September, as a continued increase in North American crude oil production has helped buffer the effects of some supply disruptions elsewhere (figure 4). Meanwhile, strong harvests have put downward pressure on food commodity prices, and, as a result, consumer food prices—which reflect both commodity prices and processing costs—were little changed in the second half of last year.

. . . but inflation expectations changed little

The Federal Reserve monitors the public's expectations of inflation, in part because these expectations may influence wage- and price-setting behavior and thus actual inflation. Despite the weakness in recent inflation data, survey- and market-based measures of longer-term inflation expectations changed little, on net, over the second half of last year and have remained fairly stable in recent years. Median expected inflation over the next 5 to 10 years, as reported in the Thomson Reuters/University of Michigan Surveys of Consumers, was 2.9 percent in January, within the narrow range of the past decade (figure 5).[1] In the Survey of Professional Forecasters, conducted by the Federal Reserve Bank of Philadelphia, the median expectation for the annual rate of increase in the PCE price index over the next 10 years was 2 percent in the fourth quarter of 2013, similar to its level in recent years. Meanwhile, measures of medium- and longer-term inflation compensation derived from differences between yields on nominal and inflation-protected Treasury securities have remained within their respective ranges observed over the past several years.

1 The question in the Michigan survey asks about inflation generally but does not refer to any specific price index.

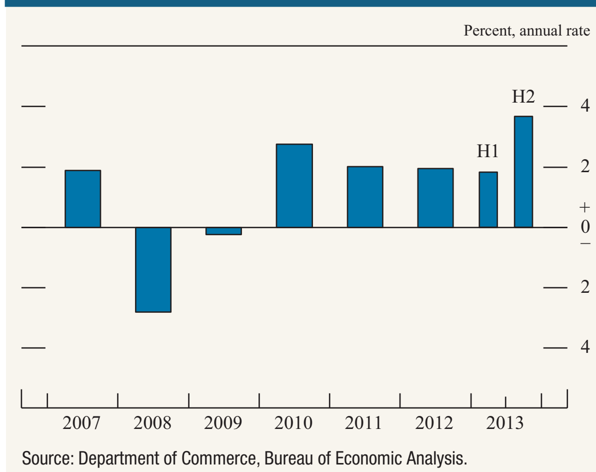
Figure 5. Median inflation expectations



Note: The Michigan survey data are monthly. The SPF data for inflation expectations for personal consumption expenditures are quarterly and extend from 2007:Q1 through 2013:Q4.

Source: Thomson Reuters/University of Michigan Surveys of Consumers; Survey of Professional Forecasters (SPF).

Figure 6. Change in real gross domestic product



Source: Department of Commerce, Bureau of Economic Analysis.

Growth in economic activity picked up

Real GDP is estimated to have increased at an annual rate of 3¾ percent over the second half of last year, up from a reported 1¾ percent pace in the first half (figure 6). Gross domestic income, or GDI, an alternative measure of economic output, increased a little more than 3 percent over the four quarters ending in the third quarter of last year (the most recent data available), 1 percentage point faster than the increase in GDP over this period.[2]

Some of the strength in GDP growth in the second half of 2013 reflected a pickup in the pace of inventory investment, a factor that cannot continue indefinitely. But other likely more persistent factors influencing demand shifted in a more favorable direction as well. In particular, restraint from fiscal policy likely started to diminish in the latter part of last year. In addition, further increases in the prices of corporate equities and housing boosted household net worth, while credit became more broadly available to households and businesses and interest rates remained low. Moreover, the boom in oil and gas production continued. Finally, economic conditions in the rest of the world improved overall, notwithstanding recent market turmoil in some emerging market economies (EMEs). As a result, consumer spending, business investment, and exports all increased more rapidly in the latter part of the year, more than offsetting a slowing in the pace of residential investment.

Fiscal policy was a notable headwind in 2013, . . .

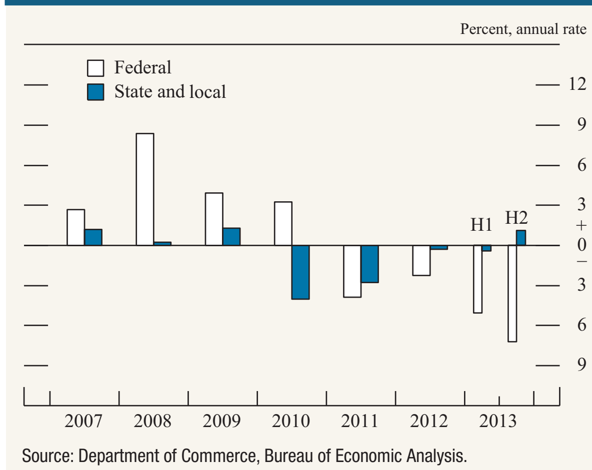
Relative to prior recoveries, fiscal policy in recent years has been unusually restrictive, and the drag on GDP growth in 2013 was particularly large. The expiration of the temporary payroll tax cut and tax increases for high-income households at the beginning of 2013 restrained consumer spending. Moreover, federal purchases were pushed down by the sequestration, budget caps on discretionary spending, and the drawdown in foreign military operations. As a result, real federal purchases, as measured in the NIPA, fell at an annual rate of more than 7 percent over the second half of the year (figure 7). Due to the government shutdown in October, which temporarily held down purchases in the fourth quarter, this decline was somewhat steeper than in the first half.[3]

The federal budget deficit declined as a share of GDP for the fourth consecutive year in fiscal year 2013, reaching about 4 percent of GDP. Although down from nearly 10 percent in fiscal 2009, the fiscal 2013 deficit is still 1½ percentage points higher than its 50-year average. Federal receipts rose in fiscal 2013 but still were only 16¾ percent of GDP; federal outlays, while falling, remained elevated at 20¾ percent of GDP in the past fiscal year. With the deficit still elevated, the debt-to-GDP ratio increased from

[2] Conceptually, GDI and GDP should be equal, but because they are measured with different source data, they can send different signals about growth in U.S. economic output.

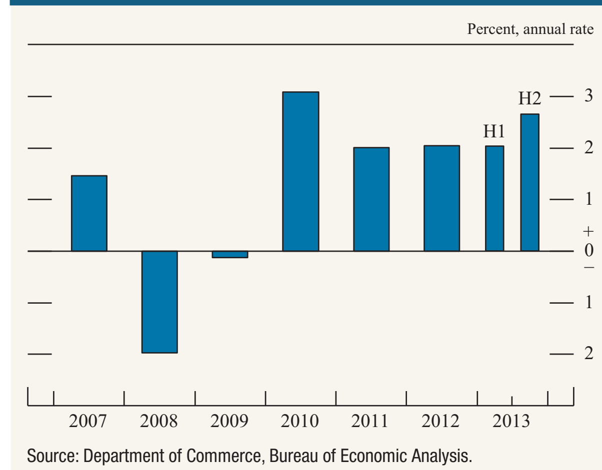
[3] Through a reduction in hours worked by federal employees, the shutdown is estimated to have directly reduced real GDP growth about ¼ percentage point at an annual rate in the fourth quarter. This influence is likely to be reversed in the first quarter of 2014.

Figure 7. Change in real government expenditures on consumption and investment



Source: Department of Commerce, Bureau of Economic Analysis.

Figure 8. Change in real personal consumption expenditures



Source: Department of Commerce, Bureau of Economic Analysis.

69 percent at the end of fiscal 2012 to 71 percent at the end of fiscal 2013.

. . . but fiscal drag appears to be easing

Although the expiration of emergency unemployment compensation at the beginning of this year will impose some fiscal restraint, fiscal policy is in the process of becoming less restrictive for GDP growth. Most importantly, the drag on growth in consumer spending from the tax increases at the beginning of 2013 has likely begun to wane. In addition, the Bipartisan Budget Act of 2013 will ease the limits on spending associated with the sequestration, and an increase in transfers from the Affordable Care Act should provide a boost to demand beginning this year. Also, fiscal conditions at the state and local levels of government have improved, and real purchases by such governments are estimated to have edged up in 2013 after several years of declines.

Consumer spending rose faster, supported by improvements in labor markets, . . .

After increasing at an annual rate of 2 percent in the first half of 2013, real PCE rose at a 2¾ percent rate over the second half (figure 8). Real disposable personal income—which had been pushed lower by the tax increases in the first quarter of 2013—moved up in the final three quarters of the year. Continued job gains helped improve the economic prospects of many households last year and boosted aggregate income growth. And the net rise in consumer sentiment in recent months suggests that greater optimism about the economy on the part of households should support consumer spending in early 2014.

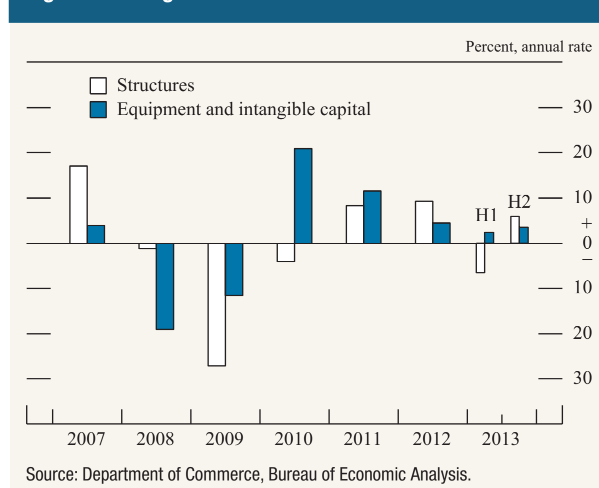
. . . as well as increases in household net worth and low interest rates

Consumer spending was also likely supported by a significant increase in household net worth in the second half of last year, as prices of corporate equities and housing continued to rise. (For further information, see the box "Recent Changes in Household Wealth" on pages 12–13 of the February 2014 *Monetary Policy Report*.) In addition, consumer credit for auto purchases (including loans to borrowers with subprime credit scores) and for education has remained broadly available. Moreover, interest rates for auto loans have stayed low. And spending on consumer durables—which is quite sensitive to interest rates—rose at an annual rate of nearly 7 percent in the second half of the year. Nevertheless, standards and terms for credit card debt have remained tight, and, partly as a result, credit card balances changed relatively little over the second half.

Business investment picked up . . .

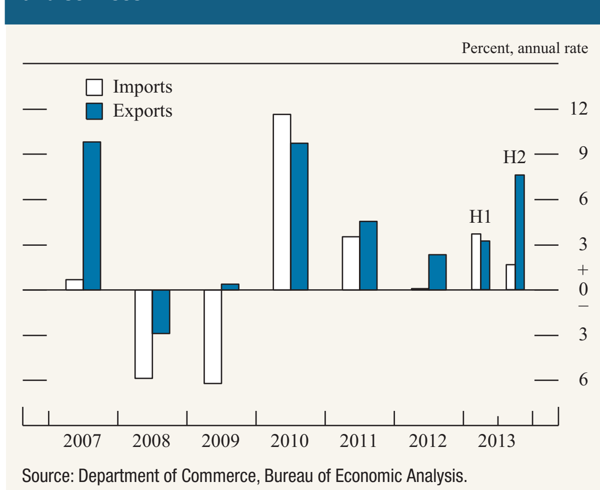
Business fixed investment (BFI) rose at an annual rate of 4¼ percent in the second half of 2013 after changing little in the first half. Investment in equipment and intangible capital rose at an annual rate of nearly 4 percent, while investment in nonresidential structures increased close to 6 percent (figure 9). On balance, national and regional surveys of purchasing managers suggest that orders for new equipment continued to increase at the turn of the year. However, still-high vacancy rates and relatively tight financing conditions likely continued to limit building investment; despite the recent increases, investment in buildings remains well below the peaks reached prior to the most recent recession.

Figure 9. Change in real business fixed investment



Source: Department of Commerce, Bureau of Economic Analysis.

Figure 10. Change in real imports and exports of goods and services



Source: Department of Commerce, Bureau of Economic Analysis.

The relatively modest rate of increase in the demand for business output has likely restrained BFI in recent quarters. In 2012 and the first half of 2013, business output increased at an annual rate of only 2½ percent. However, the acceleration in overall economic activity in the second half of 2013 may provide more impetus for business investment in the period ahead.

. . . as financing conditions for businesses were generally quite favorable

Moreover, the financial condition of nonfinancial firms remained strong in the second half of 2013, with profitability high and the default rate on nonfinancial corporate bonds close to zero. Interest rates on corporate bonds, while up since the spring, have stayed low relative to historical norms. And net issuance of nonfinancial corporate debt appears to have remained strong in the second half of the year. In addition, in recent quarters an increasing portion of the aggregate proceeds from the issuance of speculative-grade debt was reportedly intended for uses beyond the refinancing of existing debt.

Conditions in business loan markets also continued to improve. According to the Federal Reserve Board's January 2014 Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS), a modest net fraction of respondents indicated they had eased standards on commercial and industrial (C&I) loans over the second half of 2013.[4] In addition, according to the Federal Reserve Board's November 2013 Survey of Terms of Business Lending, loan rate spreads over banks' cost of funds have continued to decline. Financing conditions for small businesses also improved: Reductions in loan spreads have been most notable for the types of loans likely made to small businesses—that is, loans of $1 million or less or those originated by small domestic banks. Standards on commercial real estate (CRE) loans extended by banks also eased over the second half of last year, moving back toward longer-run norms, according to the SLOOS. Still, standards for construction and land development loans, a subset of CRE loans, likely remained relatively tight.

Exports strengthened

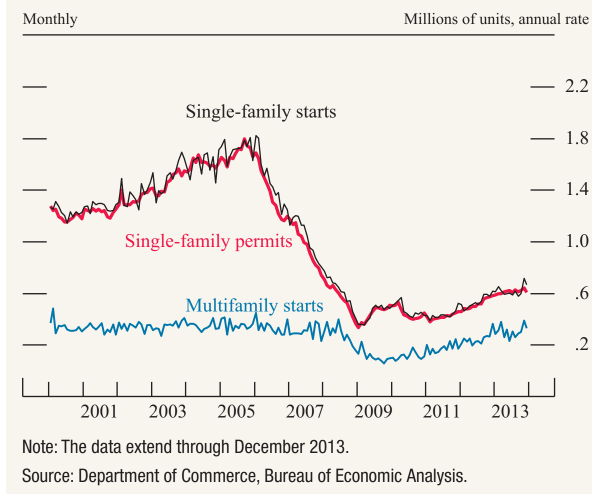
Export demand also provided significant support to domestic economic activity in the second half of 2013 (figure 10). Real exports of goods and services rose at an annual rate of 7½ percent, consistent with improving foreign GDP growth in the latter part of the year and buoyed by soaring sales both of petroleum products—associated with the boom in U.S. oil production—and of agricultural goods. Across the major destinations, the robust increase in exports was supported by higher shipments to Canada, China, and other Asian emerging economies.

The growth of real imports of goods and services stepped down to an annual rate of 1½ percent in the second half of last year. Among the major categories, imports of non-oil goods and services rose more moderately, while oil imports continued to decline.

Altogether, real net trade added an estimated ¾ percentage point to GDP growth over the second half of 2013, whereas in the first half it made a small negative contribution. Owing in part to the improvement

4 The SLOOS is available on the Board's website at www.federalreserve.gov/boarddocs/snloansurvey.

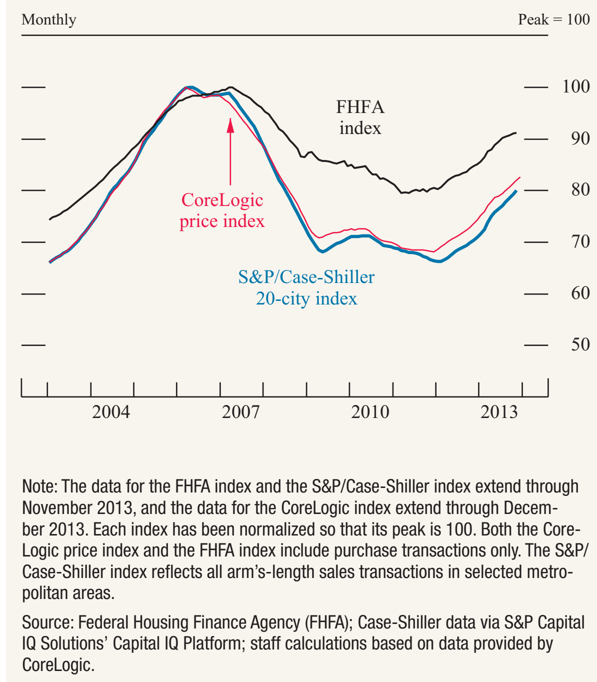
Figure 11. Private housing starts and permits



Note: The data extend through December 2013.

Source: Department of Commerce, Bureau of Economic Analysis.

Figure 12. Prices of existing single-family houses



Note: The data for the FHFA index and the S&P/Case-Shiller index extend through November 2013, and the data for the CoreLogic index extend through December 2013. Each index has been normalized so that its peak is 100. Both the CoreLogic price index and the FHFA index include purchase transactions only. The S&P/Case-Shiller index reflects all arm's-length sales transactions in selected metropolitan areas.

Source: Federal Housing Finance Agency (FHFA); Case-Shiller data via S&P Capital IQ Solutions' Capital IQ Platform; staff calculations based on data provided by CoreLogic.

in net petroleum trade, the nominal trade deficit shrank, on balance, over the second half of 2013. That decrease contributed to the narrowing of the current account deficit to 2¼ percent of GDP in the third quarter, a level generally not seen since the late 1990s.

The current account deficit continued to be financed by strong financial inflows in the third quarter of 2013, mostly in the form of purchases of Treasury and corporate securities by both foreign official and foreign private investors. Partial monthly data suggest that these trends likely continued in the fourth quarter. U.S. investors continued to finance direct investment projects abroad at a rapid pace in the third quarter. Although U.S. purchases of foreign securities edged down in the summer, consistent with stresses observed in emerging markets, they appear to have rebounded in the final part of the year.

The recovery in housing investment paused with the backup in interest rates . . .

After increasing at close to a 15 percent annual rate in 2012 and the first part of 2013, residential investment was little changed in the second half of last year. Mortgage interest rates increased about 1 percentage point, to around 4¼ percent, over May and June of last year and have remained near this level since then. Soon after the increase, mortgage refinancing dropped sharply, while home sales declined somewhat and the issuance of new single-family housing permits leveled off (figure 11). However, relative to historical norms, mortgage rates remain low, and housing is still quite affordable. Moreover, steady growth in jobs is likely continuing to support growth in housing demand, and, because new home construction is still well below levels consistent with population growth, the potential for further growth in the housing sector is considerable.

. . . and mortgage credit continued to be tight, . . .

Lending policies for home purchase remained quite tight overall, but there are some indications that mortgage credit is starting to become more widely available. A modest net fraction of SLOOS respondents reported having eased standards on prime residential loans during the second half of last year. And, in a sign that lending conditions for home refinance are becoming less restrictive, the credit scores of individuals refinancing mortgages at the end of last year were lower, on average, than scores for individuals refinancing earlier in the year. However, credit scores of individuals receiving mortgages for home purchases have yet to drop.

. . . but house prices continued to rise

Home prices continued to rise in the second half of the year, although somewhat less quickly than in the first half (figure 12). Over the 12 months ending in December, home prices increased 11 percent. Much of the recent gain in home prices has been concentrated in areas that saw the largest declines in prices during the recession and early recovery, as prices in these areas likely dropped below levels consistent

with the rents these homes could bring, spurring purchases by large and small investors who have converted some homes into rental properties.

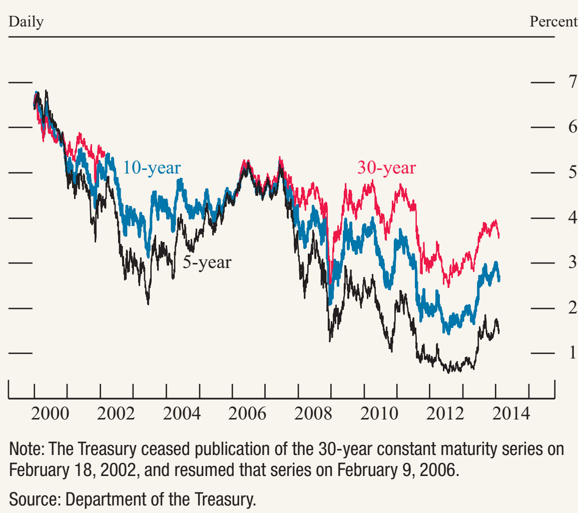
Financial Developments

The expected path for the federal funds rate through mid-2017 moved lower . . .

Market-based measures of the expected (or mean) future path of the federal funds rate through mid-2017 moved lower, on balance, over the second half of 2013 and early 2014, mostly reflecting FOMC communications that were broadly seen as indicating that a highly accommodative stance of monetary policy would be maintained for longer than had been expected. Measures of the expected policy path rose in the summer in conjunction with longer-term interest rates, as investors increasingly expected the Committee to start reducing the pace of asset purchases at the September FOMC meeting. However, those increases were more than retraced over the weeks surrounding the September meeting, in part because the decision to keep the pace of asset purchases unchanged and the accompanying communications by the Federal Reserve were viewed as more accommodative than investors had anticipated. Expectations for the path of the federal funds rate through mid-2016 have changed little, on net, since mid-October. Federal Reserve communications since last September, including the enhanced forward guidance included in the December and January FOMC statements, reportedly helped keep federal funds rate expectations near their earlier levels despite generally stronger-than-expected economic data and the modest reductions in the pace of Federal Reserve asset purchases announced at the December and January FOMC meetings.

The *modal* path of the federal funds rate—that is, the values for future federal funds rates that market participants see as most likely—derived from interest rate options also shifted down for horizons through 2017, suggesting that investors may now expect the target federal funds rate to lift off from its current range substantially later than they had expected at the end of June 2013. Similarly, the most recent Survey of Primary Dealers conducted by the Open Market Desk at the Federal Reserve Bank of New York just prior to the January FOMC meeting showed that dealers' expectations of the date of liftoff have moved out about two quarters since the middle of last year, to the fourth quarter of 2015.[5]

Figure 13. Yields on nominal Treasury securities



Note: The Treasury ceased publication of the 30-year constant maturity series on February 18, 2002, and resumed that series on February 9, 2006.

Source: Department of the Treasury.

. . . while yields on longer-term securities increased but remained low by historical standards

Despite the lower expected path of the federal funds rate, yields on longer-term Treasury securities and agency mortgage-backed securities (MBS) rose moderately over the second half of 2013 (figure 13). These increases likely reflected economic data that were generally better than investors expected, as well as market adjustments to rising expectations that the Committee would start reducing the pace of its asset purchases, a step that was taken at the December FOMC meeting. Subsequently, yields declined amid flight-to-safety flows in response to recent emerging market turbulence (see the box "Financial Stress and Vulnerabilities in the Emerging Market Economies" on pages 28–29 of the February 2014 *Monetary Policy Report*). On net, yields on 5-, 10-, and 30-year nominal Treasury securities have increased between about 10 and 20 basis points from their levels at the end of June 2013. Yields on 30-year agency MBS edged up, on balance, over the same period.

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5 The results of the Survey of Primary Dealers are available on the Federal Reserve Bank of New York's website at www.newyorkfed.org/markets/primarydealer_survey_questions.html.

Nonetheless, yields on longer-term securities continue to be low by historical standards. Those low levels reflect several factors, including subdued inflation expectations as well as market perceptions of a still-modest global economic outlook. In addition, term premiums—the extra return investors expect to obtain from holding longer-term securities as opposed to holding and rolling over a sequence of short-term securities for the same period—while above the historically low levels observed prior to the bond market selloff in the summer, remained within the low range they have occupied since the onset of the financial crisis, reflecting both the FOMC's large-scale asset purchases and strong demand for longer-term securities from global investors.

Indicators of Treasury market functioning were solid, on balance, over the second half of 2013 and early in 2014. For example, available data suggest that bid–asked spreads in the Treasury market stayed in line with recent averages. Moreover, Treasury auctions generally continued to be well received by investors. Liquidity conditions in the agency MBS market deteriorated somewhat for a time over the summer, amid heightened volatility, and a bit again toward year-end but have largely returned to normal levels since the turn of the year. Over the past seven months, the number of trades in the MBS market that failed to settle remained low, and implied financing rates in the "dollar roll" market—an indicator of the scarcity of agency MBS for settlement—have been stable.[6]

Short-term funding markets continued to function well, on balance, despite some strains during the debt ceiling standoff

In the fall of 2013, many short-term funding markets were adversely affected for a time by concerns about the possibility of a delay in raising the federal debt limit. The Treasury bill market experienced the largest effect as yields on bills maturing between mid-October and early November rose sharply, some bill auctions saw reduced demand, and liquidity in this market deteriorated, especially for certain securities that were seen as being at risk of delayed payment. Conditions in other short-term funding markets, such as the market for repurchase agreements (repos), were also strained for a time. However, these effects eased quickly after an agreement to raise the debt limit was reached in mid-October, and, overall, the debt ceiling standoff left no permanent imprint on short-term funding markets.

On balance, since the end of June 2013, conditions in both secured and unsecured short-term funding markets have changed little, with many money market rates remaining near the bottom of the ranges they have occupied since the federal funds rate first reached its zero lower bound. Unsecured offshore dollar funding markets generally did not exhibit any signs of stress. Rates on asset-backed commercial paper and unsecured financial commercial paper for the most part also stayed low. In the repo market, rates for general collateral Treasury repos also were low, consistent with reduced financing activities of dealers. These rates declined noticeably at year-end, leading to increased participation in the Federal Reserve's overnight reverse repurchase agreement operations (see Part 2 of this report). Overall, year-end pressures in short-term funding markets were modest and roughly in line with experiences during other years since the financial crisis.

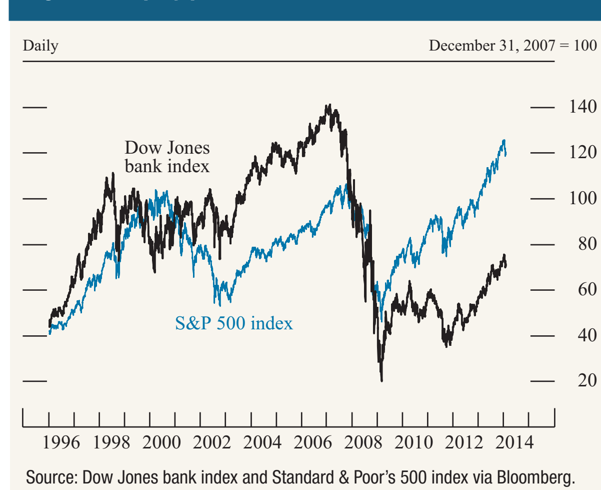
Broad equity price indexes increased further and risk spreads on corporate debt declined . . .

Boosted by improved market sentiment regarding the economic outlook and the FOMC's sustained highly accommodative monetary policy, broad measures of equity prices continued posting substantial gains through the end of 2013. Around the turn of the year, however, investor sentiment deteriorated amid resurfacing concerns about emerging financial markets, and equity prices retraced some of their earlier increases. As of early February, broad measures of equity prices were more than 10 percent higher, on net, than their levels in the middle of 2013 (figure 14). Consistent with the developments in equity markets, the spreads of yields on corporate bonds to yields on Treasury securities of comparable maturities have narrowed, on net, since the middle of 2013. Spreads on syndicated loans have also narrowed some, and issuance of leveraged loans, boosted by strong demand from collateralized loan obligations, was generally strong in the second half of 2013.

While some broad equity price indexes touched all-time highs in nominal terms since the middle of 2013 and valuation metrics in some sectors appear stretched, valuation measures for the overall market are now generally at levels not far above their historical average levels, suggesting that, in aggregate, investors are not excessively optimistic in their attitudes

[6] A dollar roll transaction consists of a purchase or sale of agency MBS with a simultaneous agreement to sell or purchase substantially similar securities on a specified future date. The Committee directs the Desk to engage in these transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS purchases.

Figure 14. Equity prices



Source: Dow Jones bank index and Standard & Poor's 500 index via Bloomberg.

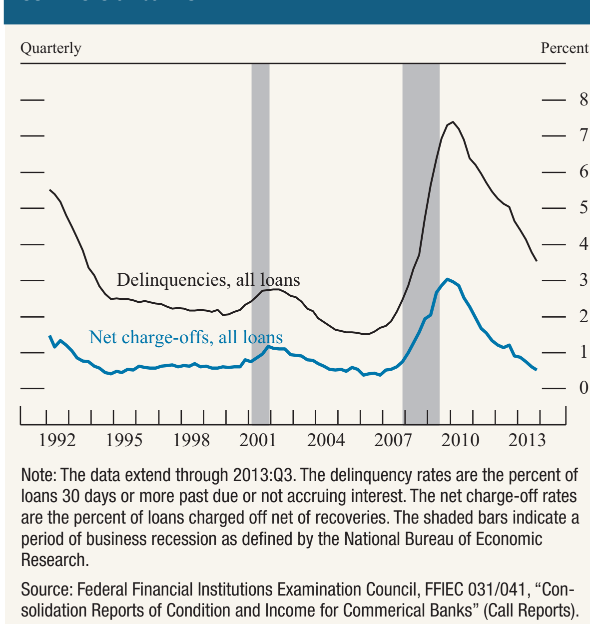
toward equities. Implied volatility for the S&P 500 index, as calculated from option prices, generally remained low over the period; it has risen since early January but remains below the recent high reached during the debt ceiling standoff in the fall.

. . . and market sentiment toward financial institutions continued to strengthen as their capital and liquidity profiles improved

Market sentiment toward the financial sector continued to strengthen in the second half of 2013, reportedly driven in large part by improvements in banks' capital and liquidity profiles, as well as further improvements in asset quality. On average, equity prices of large domestic banks and insurance companies performed roughly in line with broader equity indexes. The spreads on the credit default swap (CDS) contracts written on the debt of these firms generally narrowed. Among nonbank financial institutions, many hedge funds significantly underperformed benchmark indexes in the second half of 2013 and, according to responses to the Federal Reserve Board's December Senior Credit Officer Opinion Survey on Dealer Financing Terms, have reduced their use of leverage on net.[7] The industry as a whole continued to see strong inflows, however, bringing its assets under management to an all-time high by the end of 2013.

Standard measures of profitability of bank holding companies (BHCs) were little changed in the third quarter of 2013, as large reductions in income from mortgage originations and revenue from fixed-income trading, as well as a sharp increase in litigation expenses, were offset primarily by decreases in provisions for loan losses and in employee compensation. Asset quality continued to improve for BHCs, with delinquency rates declining across a range of asset classes and the industry's net charge-off rate now close to pre-crisis levels (figure 15). Net interest margins remained about unchanged over the same period. (For further discussion of the financial condition of BHCs, see the box "Developments Related to Financial Stability" on pages 24–25 of the February 2014 *Monetary Policy Report*.) Meanwhile, aggregate credit provided by commercial banks inched up in the second half of 2013 following the rise in longer-term interest rates. Strong growth in loan categories that are more likely to have floating interest rates or shorter maturities—including C&I, CRE, and auto loans—was partly offset by runoffs in assets that have longer duration and so are more sensitive to increases in interest rates—including residential mortgages and some securities.

Figure 15. Delinquency and charge-off rates for commercial banks



Note: The data extend through 2013:Q3. The delinquency rates are the percent of loans 30 days or more past due or not accruing interest. The net charge-off rates are the percent of loans charged off net of recoveries. The shaded bars indicate a period of business recession as defined by the National Bureau of Economic Research.

Source: Federal Financial Institutions Examination Council, FFIEC 031/041, "Consolidation Reports of Condition and Income for Commerical Banks" (Call Reports).

Financial conditions in the municipal bond market generally remained stable

Yields on 20-year general obligation municipal bonds rose since June 2013. However, the spreads of municipal bond yields over those of comparable-maturity Treasury securities generally fell over the same period, and CDS spreads on debt obligations of

7 The Senior Credit Officer Opinion Survey on Dealer Financing Terms is available on the Board's website at www.federalreserve.gov/econresdata/releases/scoos.htm.

individual states were generally little changed and remained at moderate levels.

Nevertheless, significant financial strains have been evident for some issuers. For example, the City of Detroit filed for bankruptcy in July 2013, making it the largest municipal bankruptcy filing in U.S. history. In addition, the prices of bonds issued by Puerto Rico continued to reflect the substantial financial pressures facing the territory and the spreads for five-year CDS contracts written on the debt issued by the territory soared. In early February, some of the territory's bonds were downgraded to below the investment grade.

M2 rose briskly

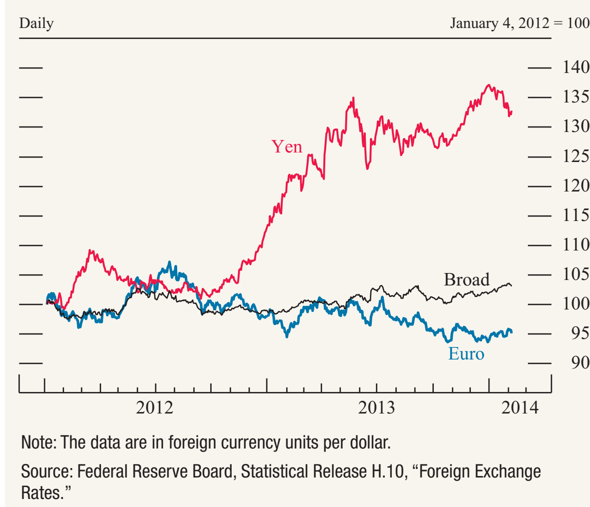
M2 has increased at an annual rate of about 7½ percent since June, faster than the pace registered in the first half of 2013. Flows into M2 picked up amid the selloff in fixed-income markets in the summer, which prompted large outflows from bond funds, as well as the uncertainty about the passage of debt limit legislation in the fall, which appeared to have led some institutional investors to shift from money fund shares to bank deposits. Following the resolution of the fiscal standoff, M2 growth slowed significantly as investors reallocated out of cash positions.

International Developments

Bond yields rose sharply in some emerging market economies, but were flat to down in most advanced foreign economies

Foreign long-term bond yields rose significantly from May of last year through most of the summer, as expectations of an imminent reduction in the pace of large-scale asset purchases by the Federal Reserve intensified. In many EMEs, yields stabilized after the September FOMC meeting. However, in a handful of vulnerable EMEs, sovereign yields continued to exhibit outsized increases—particularly in Brazil and Turkey—and, more recently, EME yields generally moved up as several EMEs experienced heightened financial stresses (see the box "Financial Stress and Vulnerabilities in the Emerging Market Economies" on pages 28–29 of the February 2014 *Monetary Policy Report*). Rates in the advanced foreign economies (AFEs) rose slightly on balance during the second half of 2013, with improved economic conditions generally supporting yields. In particular, bond yields increased in the United Kingdom as unemployment fell more quickly than anticipated. In the euro area, yields were little changed, as below-target inflation led the European Central Bank (ECB) to

Figure 16. U.S. dollar exchange rate against broad index and selected major currencies



Note: The data are in foreign currency units per dollar.

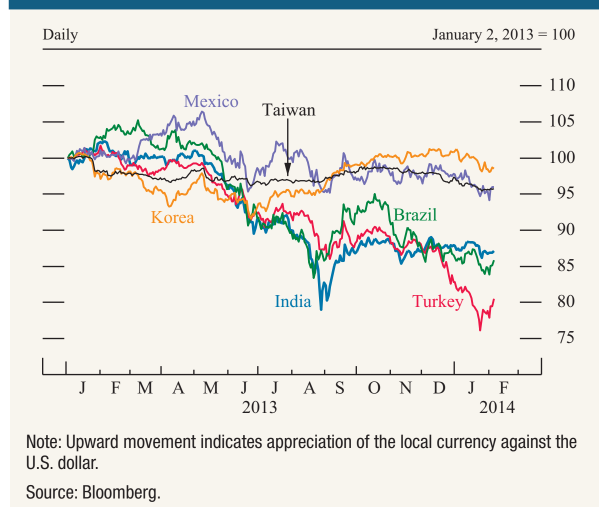
Source: Federal Reserve Board, Statistical Release H.10, "Foreign Exchange Rates."

cut its main refinancing rate a further 25 basis points in November. In contrast, Japanese government bond yields were down modestly, on net, since mid-July, in part as market participants anticipated that the Bank of Japan (BOJ) would expand the size of its asset purchase program. Over the past two weeks, however, AFE sovereign yields in general declined somewhat, as market participants pulled back from risky assets.

The dollar has appreciated a little on net

The broad nominal value of the dollar is up a little, on net, since last summer (figure 16). The dollar depreciated against both the euro and the British pound in the second half of the year, as macroeconomic conditions improved in Europe and as financial stresses and the associated flight to safety continued to abate. However, the dollar has appreciated sharply against the Japanese yen since October, in part reflecting anticipations of an expansion in the BOJ's asset purchase program, although it retraced somewhat in recent weeks amid the recent turbulence in emerging financial markets. The U.S. dollar also appreciated against the currencies of some vulnerable EMEs amid higher long-term yields in the United States, and, more recently, as market participants expressed concerns about developments in several economies (figure 17). EME-dedicated bond and equity funds experienced outflows over the second half of last year and into 2014, suggesting a reduced willingness by investors to maintain exposures to EMEs. In an attempt to curb the depreciation of their currencies, central banks in some EMEs, such as Brazil and Turkey, intervened in currency markets.

Figure 17. Exchange rates of selected emerging market currencies against the U.S. dollar



Note: Upward movement indicates appreciation of the local currency against the U.S. dollar.

Source: Bloomberg.

During the second half of 2013, equity indexes in the AFEs added considerably to earlier gains, likely reflecting the improved economic outlook. Over the year as a whole, equity markets in Japan outperformed other foreign indexes, increasing more than 50 percent. Since the end of last year, however, AFE equity indexes have reversed part of their earlier gains, with the decrease coinciding with heightened financial volatility in the EMEs. Equity markets in the EMEs, after underperforming those in the AFEs during the second half of last year, have also fallen more recently.

Activity in the advanced foreign economies continued to recover . . .

Indicators suggest that economic growth in the AFEs edged higher in the second half of 2013, supported by diminished fiscal drag and further easing of European financial stresses. The euro area continued to pull slowly out of recession in the third quarter, with some of the most vulnerable economies returning to positive growth, but unemployment remained at record levels. Real GDP growth in the United Kingdom picked up to a robust 3 percent pace in the second half of last year, driven in part by improving household and business sentiment, and Canadian growth rebounded in the third quarter after being restrained by floods that impeded economic activity in the second quarter. Japanese GDP growth stepped down in the third quarter from the rapid 4 percent pace registered in the first half, as exports dipped and household spending moderated, but data on manufacturing and exports suggest that growth rebounded toward year-end.

Amid stronger growth and rising import prices, Japanese inflation moved above 1 percent for the first time since 2008. In contrast, 12-month rates of inflation fell below 1 percent in some other AFEs, with much of this decline reflecting falling retail energy and food prices as well as continued economic slack. With inflation low and economic activity still sluggish, monetary policy in the AFEs remains very accommodative. In addition to the ECB's cut of its main refinancing rate in November, the Bank of England issued forward guidance in August that it intends to maintain a highly stimulative policy stance until economic slack has been substantially reduced, while the BOJ continued its aggressive program of asset purchases.

. . . while growth in the emerging market economies moved back up from its softness earlier last year

After slowing earlier last year, economic growth in the EMEs moved back up in the third quarter, reflecting a rebound of Mexican activity from its second-quarter contraction and a pickup in emerging Asia. Recent data suggest that activity in EMEs continued to strengthen in the fourth quarter.

In China, economic growth picked up in the second half of 2013, supported in part by relatively accommodative policies and rapid credit growth earlier in the year. Since the middle of last year, the pace of credit creation has slowed, interbank interest rates have trended up, and the interbank market has experienced bouts of volatility during which interest rates spiked. In mid-November, Chinese leaders unveiled an ambitious reform agenda that aims to enhance the role of markets in the economy, address worrisome imbalances, and improve the prospects for sustainable economic growth.

The step-up in Chinese growth, along with firmer activity in the advanced economies, generally helped support economic activity in other parts of Asia. In Mexico, growth appears to have rebounded in the second half of the year, supported by higher government spending and a pickup in U.S. manufacturing activity. In recent months, Mexico continued to make progress on the government's reform agenda, with its Congress approving fiscal, energy, and financial sector reforms. By contrast, in some EMEs, such as Brazil, India, and Indonesia, shifts in market expectations about the path of U.S. monetary policy appear to have resulted in tightened financial conditions, which weighed on growth over the second half of last year.

Inflation remained subdued in most EMEs, and their central banks generally kept policy rates on hold or, as in Chile, Mexico, and Thailand, cut them to further support growth. In contrast, inflation remained elevated in a few EMEs, such as Brazil, India, Indonesia, and Turkey, due to currency depreciation as well as country-specific factors, including supply bottlenecks and tight labor market conditions in some sectors. In response to higher inflation, central banks in these countries raised rates and, in some cases, intervened in foreign exchange markets to support their currencies.

Part 2: Monetary Policy

In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Federal Open Market Committee (FOMC) decided to modestly reduce the pace of its asset purchases at its December 2013 and January 2014 meetings. Nonetheless, with unemployment still well above its longer-run normal level and inflation below the Committee's 2 percent objective, the stance of monetary policy remains highly accommodative, with the Federal Reserve continuing to increase the size of its balance sheet, albeit at a reduced pace, and having enhanced its forward guidance with regard to the future path of the federal funds rate.

Through most of last year, the FOMC maintained the current pace of large-scale asset purchases while awaiting more evidence that progress toward its economic objectives would be sustained . . .

Since the onset of the financial crisis and ensuing deep recession, the unemployment rate has remained well above its normal levels and the inflation rate has tended to run at or below the FOMC's 2 percent objective despite the target range for the federal funds rate remaining at its effective lower bound. Accordingly, the strategy of the FOMC during the past several years has been to employ alternative methods of providing additional monetary accommodation and promoting the more rapid achievement of its mandated objectives of maximum employment and price stability. In particular, the FOMC has used large-scale asset purchases and forward guidance regarding the future path of the federal funds rate to put downward pressure on longer-term interest rates.

During most of the second half of 2013, with unemployment still elevated (though declining), and with inflation remaining noticeably below the Committee's 2 percent longer-run objective, the FOMC left in place the key parameters of its monetary policy stance while awaiting further evidence that progress toward its economic objectives would be sustained. Nonetheless, the Committee recognized the cumulative improvement in labor market conditions and therefore believed it important to begin the process of outlining the considerations that would ultimately govern the winding-down of the program of large-scale asset purchases. In his press conference following the June 2013 FOMC meeting, Chairman Bernanke indicated that, if the economy were to evolve broadly in line with the expectations that the Committee held at that time, the FOMC would moderate the pace of purchases later in 2013 and, if economic developments remained broadly consistent with the Committee's expectations, subsequently reduce them in further measured steps. However, the Chairman emphasized that the Committee's purchases were in no way predetermined, and that a decision about reducing the pace of purchases would depend on how economic conditions evolved.[8]

At each of its subsequent meetings prior to December 2013, the Committee judged that the outlook for the economy and the labor market had improved, on net, since the inception of the current asset purchase program, but that it was appropriate to await more evidence that the progress would be sustained before the Committee began adjusting the pace of its purchases. In addition, at the July meeting, the Committee recognized that inflation persistently below its 2 percent objective could pose risks to economic performance.[9] At the September FOMC meeting, Committee members also expressed concern about near-term fiscal uncertainties and the rapid tightening of financial conditions observed over the summer, which, if sustained, could have slowed improvements in the economy and the labor market.[10] The Committee therefore decided to await more evidence that progress toward its goals would be maintained before adjusting the pace of asset purchases and, in the

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[8] See Board of Governors of the Federal Reserve System (2013), "Transcript of Chairman Bernanke's Press Conference," June 19, www.federalreserve.gov/mediacenter/files/FOMCpresconf20130619.pdf.

[9] See Board of Governors of the Federal Reserve System (2013), "Federal Reserve Issues FOMC Statement," press release, July 31, www.federalreserve.gov/newsevents/press/monetary/20130731a.htm.

[10] See Board of Governors of the Federal Reserve System (2013), "Transcript of Chairman Bernanke's Press Conference," September 18, www.federalreserve.gov/mediacenter/files/FOMCpresconf20130918.pdf.

meantime, continued adding to its holdings of agency mortgage-backed securities (MBS) and longer-term Treasury securities at a pace of $40 billion and $45 billion per month, respectively.

. . . before modestly reducing the pace of asset purchases in light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions

By the time of the December 2013 meeting, most Committee members viewed the cumulative improvement in labor market conditions as meaningful and likely to be sustained. Participants also anticipated that inflation would move back toward 2 percent over time as the economic recovery strengthened and longer-run inflation expectations remained steady. Therefore, most members agreed that the Committee could appropriately begin to slow the pace of its asset purchases. Nonetheless, some members expressed concern about the potential for an unintended tightening of financial conditions if a reduction in the pace of asset purchases was misinterpreted as signaling that the Committee was likely to withdraw policy accommodation more quickly than had been anticipated. Many members therefore judged that the Committee should proceed cautiously in taking its first action to reduce the pace of asset purchases and should indicate that further reductions would be undertaken in measured steps. Members also stressed the need to underscore that the pace of asset purchases was not on a preset course and would remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the efficacy and costs of purchases.

Consistent with this approach, the Committee announced at the December meeting that it would reduce the pace of its purchases of agency MBS from $40 billion to $35 billion per month and reduce the pace of its purchases of longer-term Treasury securities from $45 billion to $40 billion per month. The Committee continued to see improvements in economic conditions and the labor market outlook at the January meeting and further reduced the pace of its asset purchases to $30 billion per month for agency MBS and $35 billion per month for longer-term Treasury securities.

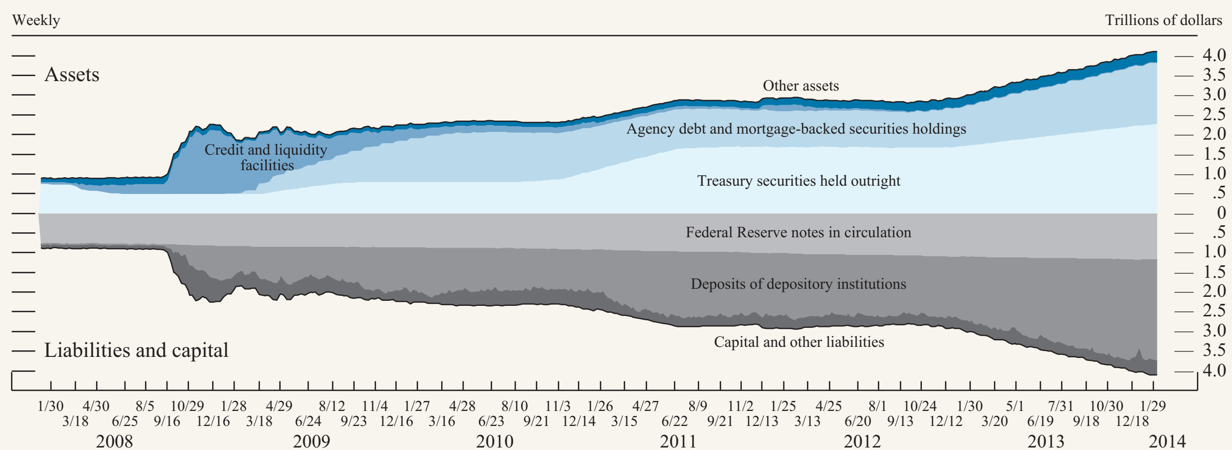
While deciding to modestly reduce its pace of purchases, the Committee emphasized that its holdings of longer-term securities were sizable and would still be increasing, which would promote a stronger economic recovery by maintaining downward pressure on longer-term interest rates, supporting mortgage markets, and helping to make broader financial conditions more accommodative. The Committee reiterated that it will continue its asset purchases and employ its other policy tools as appropriate until the outlook for the labor market has improved substantially in a context of price stability. The FOMC also maintained its practices of reinvesting principal payments it receives on agency debt and agency-guaranteed MBS in new agency MBS and of rolling over maturing Treasury securities at auction.

The Committee first kept in place and then reinforced its forward guidance on the path of the federal funds rate

With regard to the federal funds rate, the Committee continued to indicate through the second half of 2013 its expectation that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee stated that the current exceptionally low target range for the federal funds rate of 0 to ¼ percent will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. The Committee emphasized that these criteria are thresholds, not triggers, meaning that crossing a threshold will not lead automatically to an increase in the federal funds rate but will indicate only that it is appropriate for the Committee to consider whether the broader economic outlook justifies such an increase.

In December, with the unemployment rate having moved closer to the 6½ percent threshold, the FOMC decided to provide qualitative guidance to clarify its likely actions during the time after the unemployment threshold is crossed and, in particular, to emphasize its commitment to providing a high level of monetary accommodation for as long as needed to foster its objectives. Specifically, the Committee indicated that in determining how long to maintain a highly accommodative stance of monetary policy, it will consider not only the unemployment rate but also other indicators, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. Further, the Committee stated that, based on these factors, it continues to anticipate that it will likely be appropriate to

Figure 18. Federal Reserve assets and liabilities



Note: The data extend through February 7, 2014. Credit and liquidity facilities consists of primary, secondary, and seasonal credit; term auction credit; central bank liquidity swaps; support for Maiden Lane, Bear Stearns, and AIG; and other credit facilities, including the Primary Dealer Credit Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, and the Term Asset-Backed Securities Loan Facility. Other assets includes unamortized premiums and discounts on securities held outright. Other liabilities includes reverse repurchase agreements, the U.S. Treasury General Account, and the U.S. Treasury Supplementary Financing Account. The dates on the horizontal axis are those of regularly scheduled Federal Open Market Committee meetings.

Source: Federal Reserve Board, Statistical Release H.4.1, "Factors Affecting Reserve Balances," www.federalreserve.gov/releases/h41/.

maintain the current federal funds rate target well past the time that the unemployment rate declines to below 6½ percent, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal. The Committee continued to indicate that when it decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent.

The Committee's large-scale asset purchases led to a significant increase in the size of the Federal Reserve's balance sheet

As a result of the Committee's large-scale asset purchase program, Federal Reserve assets have increased significantly since the middle of last year (figure 18). The par value of the holdings of U.S. Treasury securities in the System Open Market Account (SOMA) increased $315 billion to $2.2 trillion, and the par value of its holdings of agency debt and MBS increased $308 billion, on net, to $1.5 trillion.[11] As of the end of January 2014, the SOMA's holdings of Treasury and agency securities constituted 55 percent and 39 percent, respectively, of the $4 trillion in total Federal Reserve assets. As a result of these purchases, the size of the overall Federal Reserve balance sheet increased briskly over the second half of the year; on the liability side of the balance sheet, the rise resulted in a further increase in reserve balances.

Reflecting the continued improvement in offshore U.S. dollar funding markets, the outstanding amount of dollars provided through the temporary U.S. dollar liquidity swap arrangements with foreign central banks decreased $1 billion, bringing the level close to zero. To reduce uncertainties among market participants as to whether and when these arrangements would be renewed, at the October FOMC meeting the Committee agreed to convert the existing temporary central bank liquidity swap arrangements to standing arrangements with no preset expiration dates, with the intention to review participation in these arrangements annually. These modifications to the liquidity swap arrangements were introduced to help support financial stability and confidence in global funding markets.

Interest income on the SOMA portfolio continued to support a substantial volume of remittances to the U.S. Treasury Department. Preliminary estimates suggest that in 2013 the Federal Reserve provided more than $77 billion of such distributions to the Treasury.[12]

[11] The difference between changes in the par value of SOMA holdings and the amount of purchases of securities since the middle of 2013 reflects, in part, lags in settlements.

[12] See Board of Governors of the Federal Reserve System (2014), "Reserve Bank Income and Expense Data and Transfers to the Treasury for 2013," press release, January 10, www.federalreserve.gov/newsevents/press/other/20140110a.htm.

The Federal Reserve continued to test tools that could potentially be used to manage reserves

As part of its ongoing program to ensure the readiness of tools to manage reserves, the Federal Reserve conducted a series of small-scale transactions with eligible counterparties. Since the end of June 2013, the Federal Reserve has conducted four operations for 28-day term deposits under the Term Deposit Facility. The offerings had a fixed-rate format, with individual operations totaling between about $12 billion and $13.5 billion in deposits. In addition, in August 2013, the Federal Reserve conducted six overnight reverse repurchase operations with auction sizes between $1 billion and $5 billion, using Treasury securities and agency MBS as collateral.

Moreover, in support of the Committee's longer-run plan for improvements in the implementation of monetary policy, at the July 2013 FOMC meeting, the Committee discussed the potential for establishing a fixed-rate, full-allotment overnight reverse repurchase agreement (ON RRP) facility as an additional tool for managing money market interest rates. At the September 2013 meeting, the Committee authorized the Open Market Desk to conduct a series of fixed-rate ON RRP operations involving U.S. government securities and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the purpose of assessing operational readiness. A number of meeting participants emphasized that their interest in these operations reflected an ongoing effort to improve the technical execution of policy and did not signal any change in the Committee's views about policy going forward.

From the operations' inception through early February, the fixed rate on the operations has been adjusted gradually within the authorized limits of 0 to 5 basis points set by the FOMC, and the daily counterparty allotment limit has been gradually raised from $500 million to $5 billion. All operations to date have proceeded smoothly. Participation in and usage of ON RRP operations has varied from day to day, in part reflecting changes in the spread between market rates on repurchase agreement transactions and the rate offered in the Federal Reserve's ON RRP operations, as well as quarter-end dynamics. In particular, take-up at these operations surged at year-end and only partly retraced over recent weeks, as rates in markets for Treasury repurchase agreements remained generally low against the backdrop of reduced supply of U.S. Treasury securities in collateral markets. The operations were reauthorized at the January FOMC meeting through January 30, 2015, to allow the Committee to obtain additional information about the potential usefulness of ON RRP operations to affect market interest rates when doing so becomes appropriate.

In addition, the Desk has been developing the capability to conduct agency MBS transactions over FedTrade, its proprietary trading platform. To test this capability, the Desk conducted an exercise consisting of a series of small-value purchase and sale operations of agency MBS via FedTrade, running from November 21, 2013, through January 14, 2014. The operations conducted as part of this exercise did not exceed $500 million in total and were not counted toward the monthly agency MBS purchases that the Desk was conducting at the direction of the FOMC.

Monetary Policy Report of July 2013

Summary

Thus far this year, labor market conditions have improved further, while consumer price inflation has run below the Federal Open Market Committee's (FOMC) longer-run objective of 2 percent. Gains in payroll employment since the start of the year have averaged about 200,000 jobs per month, and various measures of underutilization in labor markets have continued to trend down. Even so, the unemployment rate, at 7½ percent in June, was still well above levels prevailing prior to the recent recession and well above the levels that FOMC participants think can be sustained in the longer term consistent with price stability.

Consumer price inflation has slowed this year. Over the first five months of the year, the price index for personal consumption expenditures increased at an annual rate of only ½ percent, while the index excluding food and energy prices rose at a rate of 1 percent, both down from increases of about 1½ percent over 2012. This slowing appears to owe partly to transitory factors. Survey measures of longer-term inflation expectations have remained in the narrow ranges seen over the past several years, while market-based measures have declined so far this year, reversing their rise over the second half of 2012.

Meanwhile, real gross domestic product (GDP) continued to increase at a moderate pace in the first quarter of this year. Available indicators suggest that the growth of real GDP proceeded at a somewhat slower pace in the second quarter. Although federal fiscal policy is imposing a substantial drag on growth this year and export demand is still damped by subdued growth in foreign economies, some of the other headwinds that have weighed on the economic recovery have begun to dissipate. Against this backdrop, a sustained housing market recovery now appears to be under way, and consumption growth is estimated to have held up reasonably well despite the increase in taxes earlier this year.

Credit conditions generally have eased further, though they remain relatively tight for households with lower credit scores—and especially for such households seeking mortgage loans. However, beginning in May, longer-term interest rates rose significantly and asset price volatility increased as investors responded to somewhat better-than-expected economic data as well as Federal Reserve communications about monetary policy. Despite their recent moves, interest rates have generally remained low by historical standards, importantly due to the Federal Reserve's highly accommodative monetary policy stance.

With unemployment still well above normal levels and inflation quite low, and with the economic recovery anticipated to pick up only gradually, the FOMC has continued its highly accommodative monetary policy this year in order to support progress toward maximum employment and price stability.

The FOMC kept its target range for the federal funds rate at 0 to ¼ percent and anticipated that this exceptionally low range would be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. The Committee also stated that when it decides to begin to remove policy accommodation, it would take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent.

The FOMC also has continued its asset purchase program, purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee has reiterated that the purchase program will continue until the outlook for the labor market has improved substantially in a context of price stability. In addition, the FOMC has indicated that the size, pace, and composition of purchases will be adjusted in light of the Committee's assessment of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives. The Committee has noted that it is prepared to increase or reduce the pace of purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes.

At the June FOMC meeting, Committee participants generally thought it would be helpful to provide greater clarity about the Committee's approach to decisions about its asset purchase program and thereby reduce investors' uncertainty about how the Committee might react to future economic develop-

ments. In choosing to provide this clarification, the Committee made no changes to its approach to monetary policy. Against this backdrop, Chairman Bernanke, at his postmeeting press conference, described a possible path for asset purchases that the Committee would anticipate implementing if economic conditions evolved in a manner broadly consistent with the outcomes the Committee saw as most likely. The Chairman noted that such economic outcomes involved continued gains in labor markets, supported by moderate growth that picks up over the next several quarters, and inflation moving back toward its 2 percent objective over time. If the economy were to evolve broadly in line with the Committee's expectations, the FOMC would moderate the pace of purchases later this year and continue to reduce the pace of purchases in measured steps until purchases ended around the middle of next year, at which time the unemployment rate would likely be in the vicinity of 7 percent, with solid economic growth supporting further job gains and inflation moving back toward the FOMC's 2 percent target. In emphasizing that the Committee's policy was in no way predetermined, the Chairman noted that the pace of asset purchases could increase or decrease depending on the evolution of the outlook and its implications for further progress in the labor market. The Chairman also drew a strong distinction between the asset purchase program and the forward guidance regarding the target for the federal funds rate, noting that the Committee anticipates that there will be a considerable period between the end of asset purchases and the time when it becomes appropriate to increase the target for the federal funds rate.

In conjunction with the most recent FOMC meeting in June, Committee participants submitted individual economic projections under each participant's judgment of appropriate monetary policy. According to the Summary of Economic Projections (SEP), Committee participants saw the downside risks to the outlook for the economy and the labor market as having diminished since the fall. (The June SEP is included as Part 3 of the July 2013 *Monetary Policy Report* on pages 39–52; it is also included in section 8 of this annual report. Committee participants also projected that, with appropriate monetary policy accommodation, economic growth would pick up, the unemployment rate would gradually decline, and inflation would move up over the medium term from recent very low readings and subsequently move back toward the FOMC's 2 percent longer-run objective. Committee participants saw increases in the target for the federal funds rate as being quite far in the future, with most expecting the first increase to occur in 2015 or 2016.

Part 1: Recent Economic and Financial Developments

Real economic activity continued to increase at a moderate pace in the first quarter of 2013, though available indicators suggest that the pace of economic growth was somewhat slower in the second quarter. Federal fiscal policy is imposing a substantial drag on economic growth this year, and subdued growth in foreign economies continues to weigh on export demand. However, some other headwinds have diminished, and interest rates, despite recent increases, have generally remained low by historical standards, importantly due to the ongoing monetary accommodation provided by the Federal Open Market Committee (FOMC). A sustained housing market recovery appears to be under way, and, despite the increase in taxes earlier this year, consumption growth is estimated to have held up reasonably well, supported by higher equity and home prices, more-upbeat consumer sentiment, and the improving jobs situation. Payroll employment has continued to rise at a moderate pace, and various measures of underutilization in labor markets have improved further. But, at 7½ percent in June, the unemployment rate was still well above levels prevailing prior to the recent recession. Meanwhile, consumer price inflation has slowed further this year, in part because of falling energy and import prices and other factors that are expected to prove transitory, and it remains below the FOMC's longer-run objective of 2 percent. Survey measures of longer-term inflation expectations have remained in the fairly narrow ranges seen over the past several years.

Domestic Developments

Economic growth continued at a moderate pace early this year

Output appears to have risen further in the first half of 2013 despite the substantial drag on economic growth from federal fiscal policy this year and the restraint on export demand from subdued foreign growth. Real gross domestic product (GDP) increased at an estimated annual rate of 1¾ percent in the first quarter of the year, the same as the average pace in 2012, though available indicators point at present to a somewhat smaller gain in the second quarter. Economic activity so far this year has been supported by the continued expansion in demand by U.S. households and businesses, including what

appears to be a sustained recovery in the housing market. Private demand has been bolstered by the historically low interest rates and rising prices of houses and other assets, partly associated with the FOMC's continued policy accommodation.

In addition, some of the other headwinds that have held back the economy in recent years have dissipated further. Risks of heightened financial stresses in Europe appear to have diminished somewhat, consumer confidence has improved noticeably, and credit conditions in the United States generally have eased. Nonetheless, tight credit conditions for some households are still likely restraining residential investment and consumer spending, and uncertainty about the foreign outlook continues to represent a downside risk for U.S. financial markets and for sales abroad.

Conditions in the labor market have continued to improve . . .

The labor market has continued to improve gradually. Gains in payroll employment averaged about 200,000 jobs per month over the first half of 2013, slightly above the average increase in each of the previous two years. The combination of this year's output and employment increases imply that gains in labor productivity have remained slow. According to the latest published data, output per hour in the nonfarm business sector rose at an annual rate of only ½ percent in the first quarter of 2013, similar to its average pace in both 2011 and 2012.

Meanwhile, the unemployment rate declined to 7½ percent in the second quarter of this year from around 8¼ percent a year earlier. A variety of alternative, broader measures of labor force underutilization have also improved over the past year, roughly in line with the official unemployment rate.

While the unemployment rate and total payroll employment have improved further, the labor force participation rate has continued to decline, on balance. As a result, the employment–population ratio, a measure that combines the unemployment rate and labor force participation rate, has changed little so far this year. To an important extent, the decline in the participation rate likely reflects changing demographics—most notably the increasing share in the population of older persons, who have lower-than-average participation rates—that would have occurred regardless of the strength of the labor market. However, it is also likely that some of the decline in the participation rate reflects an increase in the number of workers who have stopped looking for work because of poor job prospects.[1]

. . . but considerable slack in labor markets remains . . .

Although labor market conditions have improved moderately so far this year, the job market remains weak overall. The unemployment rate and other measures of labor underutilization are still well above their pre-recession levels, despite payroll employment having now expanded by nearly 7 million jobs since its recent trough and the unemployment rate having fallen 2½ percentage points since its peak. Moreover, unemployment has been unusually concentrated among the long-term unemployed; in June, the fraction of the unemployed who had been out of work for more than six months remained greater than one-third, although this share has continued to edge down. In addition, last month, 8 million people, or 5 percent of the workforce, were working part time because they were unable to find full-time work due to economic conditions.

. . . and gains in compensation have been slow

Increases in hourly compensation continue to be restrained by the weak condition of the labor market. The 12-month change in the employment cost index for private industry workers, which measures both wages and the cost to employers of providing benefits, has remained close to 2 percent throughout most of the recovery. Compensation per hour in the nonfarm business sector—a measure derived from the labor compensation data in the national income and product accounts—rose 2 percent over the year ending in the first quarter of 2013. Similarly, average hourly earnings for all employees—the timeliest measure of wage developments—increased 2¼ percent in nominal terms over the 12 months ending in June. Even with relatively slow productivity gains, the change in unit labor costs faced by firms—an estimate of the extent to which nominal hourly compensation rises in excess of labor productivity—has remained subdued.

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[1] As was discussed in the box "Assessing Conditions in the Labor Market" in the February 2013 *Monetary Policy Report*, the unemployment rate typically provides a very good summary of labor market conditions; however, other indicators also provide important perspectives on the health of the labor market, with the most accurate assessment of labor market conditions obtained by combining the signals from many such indicators. For the box, see Board of Governors of the Federal Reserve System (2013), *Monetary Policy Report* (Washington: Board of Governors, February), www.federalreserve.gov/monetarypolicy/mpr_20130226_part1.htm.

Consumer price inflation has been especially low . . .

The price index for personal consumption expenditures (PCE) increased at an annual rate of just ½ percent over the first five months of the year, down from a rise of 1½ percent over 2012 and below the FOMC's long-run objective of 2 percent. The very low rate of inflation so far this year partly reflects declines in consumer energy prices, but price inflation for other consumer goods and services has also been subdued. Consumer food prices have remained largely unchanged so far this year, and consumer prices excluding food and energy increased at an annual rate of 1 percent in the first five months of this year after rising 1½ percent over 2012. With wages growing slowly and materials prices flat or moving downward, firms have generally not faced cost pressures that they might otherwise try to pass on.

. . . as some transitory factors weighed on prices . . .

In addition to the decline in energy prices, this year's especially low inflation reflects, in part, other special factors that are expected to be transitory. Notably, increases in both medical services prices and the nonmarket component of PCE prices have been unusually low. While the average rate of medical-price inflation as measured by the PCE index has been considerably lower during the past few years than it was earlier, the increase over the first five months of 2013—at below ½ percent—has been extraordinarily muted, largely reflecting the effects on medical services prices of cuts in Medicare reimbursements associated with federal budget sequestration. (In contrast, medical services prices in the consumer price index (CPI), which exclude most Medicare payments, have risen at an annual rate of nearly 2 percent so far this year.) Because medical services have a relatively large weight in PCE expenditures (as the PCE price index reflects payments by all payers, not just out-of-pocket expenses as in the CPI), price changes in this component of spending can have a sizable effect on top-line PCE inflation.

The nonmarket PCE price index covers spending components for which market prices are not observed, such as financial services rendered without explicit charge; as a result, the Bureau of Economic Analysis imputes prices for those items. Overall, this nonmarket index declined early this year before moving up again in recent months; however, these prices tend to be volatile and appear to contain little signal for future inflation.

. . . and as oil and other commodity prices declined . . .

Global oil prices have come down, on net, from their February peak of nearly $120 per barrel, though in recent weeks they have increased somewhat from their spring lows to almost $110 per barrel. Tensions in the Middle East have likely continued to put upward pressures on crude oil prices, but those pressures have been mitigated by concerns about the strength of oil demand in China and the rest of emerging Asia and by rising oil production in North America. Nonfuel commodity prices have eased since the beginning of the year, also reflecting slowing economic growth in emerging Asia. Notably, the price of iron ore, widely viewed as an indicator of Chinese demand for commodities, has fallen roughly 20 percent since early January. Along with falling commodity prices, prices of non-oil imported goods declined in the first half of 2013, also likely holding down domestic price increases this year.

. . . but longer-term inflation expectations remained in their historical range

The Federal Reserve monitors the public's expectations of inflation, in part because these expectations may influence wage- and price-setting behavior and thus actual inflation. Survey-based measures of longer-term inflation expectations have changed little, on net, so far this year. Median expected inflation over the next 5 to 10 years, as reported in the Thomson Reuters/University of Michigan Surveys of Consumers (Michigan survey), was 2.9 percent in early July, within the narrow range of the past decade.[2] In the Survey of Professional Forecasters, conducted by the Federal Reserve Bank of Philadelphia, the median expectation for the increase in the PCE price index over the next 10 years was 2 percent in the second quarter of this year, similar to its level in recent years.

Measures of medium- and longer-term inflation compensation derived from the differences between yields on nominal and inflation-protected Treasury securities have declined between ¼ and ½ percentage point so far this year. Nonetheless, these measures of inflation compensation also remain within their respective ranges observed over the past several years, as the recent declines reversed the rise over the second half of last year. In general, movements in inflation compensation can reflect not only market participants' expectations of future inflation but also

2 The question in the Michigan survey asks about inflation generally but does not refer to any specific price index.

changes in investor risk aversion and fluctuations in the relative liquidity of nominal versus inflation-protected securities; the recent declines in inflation compensation may have been amplified by a reduction in demand for Treasury inflation-protected securities amid increased volatility in fixed-income markets.

Fiscal consolidation has quickened, leading to stronger headwinds but smaller deficits

Fiscal policy at the federal level has tightened significantly this year. As discussed in the box "Economic Effects of Federal Fiscal Policy" (see pages 10–11 of the July 2013 *Monetary Policy Report*), fiscal policy changes—including the expiration of the payroll tax cut, the enactment of other tax increases, the effects of the budget caps on discretionary spending, the onset of the sequestration, and the declines in defense spending for overseas military operations—are estimated, collectively, to be exerting a substantial drag on economic activity this year. Even prior to the bulk of the spending cuts associated with the sequestration that started in March, total real federal purchases contracted at an annual rate of nearly 9 percent in the first quarter, reflecting primarily a significant decline in defense spending. The sequestration will induce further reductions in real federal expenditures over the next few quarters. For example, many federal agencies have announced plans to furlough workers, especially in the third quarter. However, considerable uncertainty continues to surround the timing of these effects.

These fiscal policy changes—along with the ongoing economic recovery and positive net payments to the Treasury by Fannie Mae and Freddie Mac—have resulted in a narrower federal deficit this year. Nominal outlays have declined substantially as a share of GDP since their peak during the previous recession, and tax receipts have moved up to about 17 percent of GDP, their highest level since the recession. As a result, the deficit in the federal unified budget fell to about $500 billion over the first nine months of the current fiscal year, almost $400 billion less than over the same period a year earlier. Accordingly, the Congressional Budget Office projects that the budget deficit for fiscal year 2013 as a whole will be 4 percent of GDP, markedly narrower than the deficit of 7 percent of GDP in fiscal 2012. In addition, the deficit is projected to narrow further over the next couple of years in light of ongoing policy actions and continued improvement in the economy. Despite the substantial decline in the deficit, federal debt held by the public has continued to rise and stood at 75 percent of nominal GDP in the first quarter of 2013.

At the state and local level as well, the strengthening economy has helped foster a gradual improvement in the budget situations of most jurisdictions. In the first quarter of 2013, state tax receipts came in 9 percent higher than a year earlier. (Some of the recent strength in receipts, though, likely reflects tax payments on income that was shifted into 2012 in anticipation of higher federal tax rates this year.) Consistent with improving sector finances, states and municipalities are no longer reducing their workforces; employment in the nonfederal government sector edged up over the first half of the year after contracting only slightly in 2012. However, construction expenditures by these governments have declined significantly further this year. In all, real government purchases at the state and local level decreased in the first quarter and have imposed a drag on the pace of economic growth so far this year.

The housing market recovery continued to gain traction . . .

Activity in the housing market has continued to strengthen, supported by low mortgage rates, sustained job gains, and improved sentiment on the part of potential buyers. In the Michigan survey, many households report that low interest rates and house prices make it a good time to buy a home; a growing percentage of respondents also expect that house price gains will continue. Reflecting the improving demand conditions, sales of both new and existing homes have continued to move up, on net, this year. Construction of new housing units has also trended up over the past year, contributing to solid rates of increase in real residential investment in the first half of 2013. Even so, the level of construction activity remains low by historical standards. The steep rise in mortgage interest rates since May could temper the pace of home sales and construction going forward, though the pace of purchase mortgage applications so far has shown no material signs of slowing, even as the pace of refinancing applications has tailed off sharply.

The strengthening in housing demand has occurred despite the fact that mortgage credit remains limited for borrowers without excellent credit scores or the ability to make sizable down payments. Responses to special questions in the Federal Reserve's April Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) suggested that some banks had actually tightened standards over the past year

on some loans that are eligible for purchase by the government-sponsored enterprises and loans guaranteed by the Federal Housing Administration, specifically those to borrowers with credit scores below 620 and with low down payments. Indeed, only about 10 percent of new prime mortgage originations made this spring were reported to be associated with FICO scores below 690, compared with a quarter of originations in 2005.

. . . as house prices rose further

House prices, as measured by several national indexes, have increased significantly further since the end of last year. In particular, the CoreLogic repeat-sales index rose about 7 percent (not at an annual rate) over the first five months of 2013 to reach its highest level since the third quarter of 2008. Some of the largest recent gains have occurred where the housing market has been most severely depressed. Recent increases notwithstanding, house prices remain far below the peaks reached before the recession, and the national price-to-rent ratio continues to be near its long-run average. Still, the increase in house prices has helped to materially reduce the number of "underwater" mortgages and made households somewhat less likely to default on their mortgages.

Mortgage interest rates increased but remained low by historical standards

Mortgage interest rates have increased significantly in the past couple of months from record lows reached earlier this year. However, rates are still low by historical standards, reflecting in part the Federal Reserve's ongoing purchases of mortgage-backed securities (MBS) and highly accommodative overall stance of monetary policy. The spread between rates on conforming mortgages and yields on agency-guaranteed MBS has decreased slightly since the end of 2012.

Low mortgage rates, along with rising house prices, continued to facilitate a significant pace of refinancing for most of the first half of 2013, which has helped households reduce monthly debt service payments. However, refinancing remained difficult for households without solid credit ratings and those with limited home equity. Moreover, as mortgage rates moved higher, refinancing activity began to decrease sharply in May.

Consumer spending has held up despite the drag from tax increases early this year

Real consumption expenditures rose at an annual rate of about 2 percent over the first five months of this year, about the same as in the previous two years. These increases have occurred despite higher taxes and have been supported by several factors. The gains this year in house prices and equity values have helped households recover some of the wealth lost during the recession; indeed, the ratio of household net wealth to income is estimated to have moved up sharply in the first quarter. In recent months, indicators of consumer sentiment have become more upbeat as well. Furthermore, in contrast to mortgage rates, interest rates on auto loans and credit cards have changed little, on balance, since the end of 2012. With interest rates low, the household debt service ratio—the ratio of required principal and interest payments on outstanding household debt to disposable personal income—remained near historical lows.

In addition, real disposable personal income has increased slightly, on balance, over the past year, as moderate gains in employment and wages have more than offset the implications for income of changes in tax policy.[3] And household purchasing power has been supported so far this year by low consumer price inflation. On balance, moderate increases in spending have outpaced disposable income growth, pushing the personal saving rate down to around 3 percent in recent months, close to the level that prevailed before the recession.

The financial conditions of households continued to improve slowly

Although mortgage debt continued to contract amid still-tight credit conditions for some borrowers, consumer credit expanded at an annual rate of about 6 percent in the first quarter of 2013. Student loans, the vast majority of which are guaranteed or originated by the federal government and subject to minimal underwriting criteria, are estimated to have

[3] The income data have been quite volatile in recent months, reflecting both direct and indirect effects of the changes in tax policy this year. Personal income is reported to have surged late last year and then fallen back sharply early this year, as many firms apparently shifted dividend and employee bonus payments into 2012 in anticipation of higher marginal tax rates for high-income households this year. In addition, the rise in the payroll tax rate and a surge in personal income taxes at the beginning of the year pushed down disposable personal income in the first quarter.

increased rapidly and now total nearly $1 trillion, making them the largest category of consumer indebtedness outside of mortgages. Auto loans are also estimated to have increased at a robust pace. Stable collateral values and favorable conditions in the asset-backed securities market may have contributed to easier standards for such loans. In contrast, revolving consumer credit (primarily credit card lending) was little changed in the first quarter, and standards and terms on credit card loans appeared to remain tight, especially for consumers with less-than-pristine credit histories. For instance, spreads of interest rates on credit card loans over reference interest rates remained historically wide. Consequently, credit card debt extended to consumers with prime credit scores remained well below its pre-crisis levels, while debt extended to those with subprime credit scores—that is, Equifax Risk Scores below 660—continued to trend down.

According to the most recent available data, indicators of distress for most types of household debt have declined since the end of 2012. For home mortgages, for example, the fraction of current mortgages becoming 30 or more days delinquent has now reached relatively low levels as a result of strict underwriting conditions for new mortgages as well as improved conditions in housing and labor markets. Measures of late-stage mortgage delinquency, such as the inventory of properties in foreclosure, also improved but remained elevated. Delinquency rates on student loans also remained high, likely reflecting in part the lack of underwriting on the federally backed loans that make up the bulk of the student loans outstanding.

The financial conditions of nonfinancial firms continued to be strong . . .

In the first quarter, the aggregate ratio of liquid to total assets for nonfinancial firms ticked up and remained near its highest level in 20 years, while the aggregate ratio of debt to assets was still well below its average over the same period. Strong balance sheets, in turn, have contributed to solid credit quality: Bond default rates, as of June, stayed low by historical standards, and the delinquency rate on commercial and industrial (C&I) loans continued to fall in the first quarter from already low levels. However, over the first half of the year, the volume of nonfinancial corporate bonds that were upgraded by Moody's Investors Service was less than the volume downgraded.

. . . and corporate bond and loan issuance remained robust

With corporate credit quality strong and interest rates near historically low levels through much of the first half of 2013, nonfinancial firms continued to raise funds, especially using longer-duration instruments. The pace of bond issuance by both investment- and speculative-grade nonfinancial firms remained extraordinarily brisk until interest rates rose significantly in May, while nonfinancial commercial paper (CP) outstanding was little changed. C&I loans outstanding at commercial banks in the United States continued to expand during the first half of 2013 but at a slower pace than in the second half of 2012, when firms reportedly ramped up their C&I borrowing in part to make larger-than-usual dividend and bonus payments in advance of anticipated year-end tax hikes. A relatively large fraction of respondents to the April SLOOS indicated that, over the preceding three months, they had eased standards and pricing terms for C&I loans to firms of all sizes. Meanwhile, issuance of leveraged loans extended by nonbank institutions in the syndicated loan market was very elevated, boosted by strong investor demand for these floating-rate instruments manifested through inflows to loan mutual funds and rapid growth of newly established collateralized loan obligations. More than two-thirds of the proceeds from such syndicated loan issuance, however, were reportedly used to repay existing debt.

Borrowing conditions for small businesses improved, though demand for credit remained subdued

Some indicators of borrowing conditions for small businesses have improved since the end of 2012. According to the surveys conducted by the National Federation of Independent Business (NFIB) during the first half of 2013, the fraction of small businesses that found credit more difficult to obtain than three months prior declined on net. Recent readings from the Federal Reserve's Survey of Terms of Business Lending indicate that the spreads charged by commercial banks on newly originated C&I loans with original amounts less than $1 million—a large share of which likely consist of loans to small businesses—continued to edge down, though they remained elevated.[4] However, demand for credit from small firms apparently remained subdued compared with

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[4] Data releases for the Survey of Terms of Business Lending are available on the Federal Reserve Board's website at www.federalreserve.gov/releases/e2/default.htm.

demand from large and middle-market firms. Relatively large fractions of respondents in recent NFIB surveys indicated that they did not have any borrowing needs, and the total dollar volume of business loans with original amounts of $1 million or less outstanding at U.S. commercial banks was little changed in the first quarter.

However, business spending on capital investment has been rising at only a modest pace

Despite the large amount of business borrowing, businesses' capital investment has been rising only modestly. Real spending on equipment and software (E&S) increased at an annual rate of 4 percent in the first quarter after having risen at a similar, below-average pace in 2012; these increases likely reflect the tepid growth in business output over the past year. Shipments and orders of nondefense capital goods and other forward-looking indicators of business spending are consistent with further moderate gains in E&S spending in the spring and summer of this year.

Business investment in structures has also been relatively low so far this year, even apart from a sharp drop-off in expenditures on wind-power facilities following a tax-related burst of construction late last year. The level of investment in drilling and mining structures has stayed elevated, supported by high oil prices and the continued exploitation of new drilling technologies. However, investment in nonresidential buildings continues to be restrained by high vacancy rates for existing properties, low commercial real estate (CRE) prices, and tight financing conditions for new construction. Indeed, banks' holdings of construction and land development loans have contracted every quarter since the first half of 2008.

Despite weak fundamentals, conditions in markets for CRE financing appeared to loosen somewhat. A moderate fraction of banks in the April SLOOS again reported having eased their lending standards on CRE loans, while a somewhat larger fraction continued to report some increase in demand for these loans. In addition, the pace of issuance of commercial mortgage-backed securities has stepped up, on balance, this year, but it remained well below its peak reached in 2007.

Foreign trade has been relatively weak

Export demand, which provided substantial support to domestic activity earlier in the recovery, has weakened since the middle of 2012, partly reflecting subdued foreign economic activity. Real exports of goods and services declined at an annual rate of 1 percent in the first quarter of 2013, though data for the first two months of the second quarter suggest that they rebounded. Exports to Japan have been particularly weak, but those to Canada continue to rise.

Real imports of goods and services edged down in the first quarter after falling substantially in the fourth quarter of 2012. Data for April and May suggest that imports recovered at a moderate pace in the second quarter. Although imports of non-oil goods and services rose, imports of oil declined further as U.S. oil production continued its climb of recent years.

Altogether, net exports were a neutral influence on the growth of real GDP in the first quarter of 2013, and partial data suggest that the same was the case in the second quarter.

The current account deficit remained at about 2½ percent of GDP in the first quarter of 2013, a level little changed since 2009. The current account deficit had narrowed substantially in late 2008 and early 2009 when U.S. imports dropped sharply, in part reflecting the steep decline in oil prices.

In the first quarter of 2013, the current account deficit continued to be financed by strong financial inflows, mostly from purchases of Treasury securities by both foreign official and foreign private investors. Consistent with continued improvement in market sentiment, U.S. investors made further strong purchases of foreign securities, especially equities.

National saving is very low

Net national saving—that is, the saving of U.S. households, businesses, and governments, net of depreciation charges—remains extremely low by historical standards. In the first quarter of 2013, net national saving was 1 percent of nominal GDP, up from figures that averaged around zero over the past few years. As discussed earlier, the near-term federal deficit has narrowed because of fiscal policy changes and the economic recovery, and further declines in the federal budget deficit over the next few years should boost national saving somewhat. With the economy still weak and demand for investable funds limited, the low level of national saving is not constraining growth or leading to higher interest rates. However, if low levels of national saving persist over the longer run, they will likely be associated with both low rates of capital formation and heavy bor-

rowing from abroad, limiting the rise in the standard of living for U.S. residents over time.

Financial Developments

The expected path for the federal funds rate in 2014 and 2015 steepened . . .

Market-based measures of the expected future path of the federal funds rate moved higher over the first half of the year, as investors responded to somewhat better-than-expected incoming economic data and to communications from Federal Reserve officials that were seen as suggesting a tighter stance of monetary policy than had been anticipated. The modal path of the federal funds rate—that is, the values for future federal funds rates that market participants see as most likely—derived from interest rate options shifted up considerably, especially around the June FOMC meeting, suggesting that investors may now expect the target funds rate to lift off from its current range significantly earlier than they expected at the end of 2012. However, a part of this increase may have reflected a rise in term premiums associated with increased uncertainty about the monetary policy outlook. According to a survey of primary dealers conducted shortly after the June FOMC meeting by the Open Market Desk at the Federal Reserve Bank of New York, dealers' expectations of the date of liftoff have moved up one quarter since the end of last year, to the second quarter of 2015.[5]

. . . while yields on longer-term securities increased significantly but remained low by historical standards

Reflecting the same factors, yields on longer-term Treasury securities and agency MBS are also substantially higher now than they were at the end of last year. The rise in longer-term yields appears to have been amplified by a pullback from duration risk as well as technical factors, including rapid changes in trading strategies and positions that had been predicated on the continuation of very low rates and volatility. On balance, yields on 5-, 10-, and 30-year nominal Treasury securities have increased between 65 and 85 basis points, on net, to 1½ percent, 2½ percent, and 3¾ percent, respectively, since the end of last year.

Yields on 30-year agency MBS increased more than those on Treasury securities, rising about 1¼ percentage points, on net, since the end of 2012, to about 3½ percent. Agency MBS yields also rose significantly more than the yields on comparable nominal Treasury securities after adjusting for the effects of higher interest rates on the likelihood that borrowers will prepay their mortgages (the option-adjusted spread), likely reflecting investors' reassessment of the outlook for the Federal Reserve's MBS purchases as well as subsequent market dynamics.

Nonetheless, yields on longer-term securities continue to be low by historical standards. Those low levels reflect several factors, including subdued inflation expectations as well as still-modest economic growth prospects in the United States and other major developed economies. In addition, despite their recent rise, term premiums—the extra return investors expect to obtain from holding longer-term securities as opposed to holding and rolling over a sequence of short-term securities for the same period—remain small, reflecting both the FOMC's ongoing large-scale asset purchase program and strong demand for longer-term securities from global investors.

Indicators of market functioning in both the Treasury and agency MBS markets were generally solid over the first half of the year. In particular, the Desk's outright purchases of Treasury securities and agency MBS did not appear to have a material adverse effect on liquidity in those markets. For example, available data suggest bid–asked spreads in Treasury and agency MBS markets continued to be in line with recent averages, though some widening has been observed of late amid increased market volatility. In the Treasury market, auctions generally continued to be well received by investors. In the agency MBS market, settlement fails remained low, and implied financing rates in the "dollar roll" market—an indicator of the scarcity of agency MBS for settlement—have drifted up over the past six months, indicating reduced settlement pressures.[6]

Short-term funding markets continued to function well

Conditions in short-term funding markets remained good, with many money market rates having edged down from already low levels since the end of 2012 to near the bottom of the ranges they have occupied

[5] The results of the survey of primary dealers are available on the Federal Reserve Bank of New York's website at www.newyorkfed.org/markets/primarydealer_survey_questions.html.

[6] Dollar roll transactions consist of a purchase or sale of agency MBS with the simultaneous agreement to sell or purchase substantially similar securities on a specified future date. The Committee directs the Desk to engage in these transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS purchases.

since the zero-lower-bound period began. In the market for repurchase agreements, bid–asked spreads and haircuts for most collateral types were reportedly little changed, while rates moved down slightly, on net, for general collateral finance repurchase agreements. Despite the high level of reserve balances and the substantially reduced volume of trading in the federal funds market since 2008, the effective federal funds rate has continued to be strongly correlated with these money market rates. Rates on asset-backed commercial paper (ABCP) also fell, and spreads on ABCP with European bank sponsors have generally converged back to those on ABCP with U.S. bank sponsors. Rates on unsecured financial CP for both U.S. and European issuers have remained low, even during the temporary flare-up of concerns about European financial stability surrounding the banking problems in Cyprus, while forward measures of funding spreads have continued to be narrow by historical standards.

Broad equity price indexes increased further . . .

Broad equity price indexes notched substantial gains and reached record levels in nominal terms, boosted by improved market sentiment regarding the economic outlook, the FOMC's sustained highly accommodative monetary policy, and stable expectations about medium-term earnings growth. Despite the increased volatility around the time of the June FOMC meeting, as of mid-July, broad measures of equity prices were 18 percent higher, on net, than their levels at the end of 2012. Nonetheless, the spread between the 12-month expected forward earnings–price ratio for the S&P 500 and a long-run real Treasury yield—a rough gauge of the equity risk premium—stayed very elevated by historical standards, suggesting that investors remain somewhat cautious in their attitudes toward equities. Outside of the period surrounding the June FOMC meeting, implied volatility for the S&P 500 index, as calculated from option prices, generally remained near the bottom end of the range it has occupied since the onset of the financial crisis.

. . . and market sentiment toward financial institutions continued to strengthen as credit quality improved

On average, the equity prices of domestic financial institutions have outperformed broader equity indexes since the end of last year. Improved investor sentiment toward the financial sector reportedly was driven by perceptions of reduced downside risk in the housing market as well as expectations of continued improvements in credit quality and of increased net interest margins as the yield curve steepened over the past few months. However, prices of real estate investment trust (REIT) shares underperformed, especially after interest rates started rising in May, partially reflecting a broader shift on the part of investors from income-oriented shares toward more cyclically sensitive issues. Shares of mortgage REITs were particularly affected by the sharp rise in Treasury and agency MBS yields.

Equity prices for large domestic banks have increased 24 percent since the end of 2012. However, they have yet to fully recover from the very depressed levels reached during the financial crisis. Standard measures of the profitability of bank holding companies (BHCs) edged down in the first quarter but remained in the upper end of their subdued post-crisis range. BHC profits were held down by modest noninterest income and a further narrowing of net interest margins. By contrast, profits were supported by additional reductions in noninterest expenses and decreases in provisioning for loan losses, as indicators of credit quality improved further in every major asset class. Banks' allowances for loan and lease losses continued to trend down as charge-offs of bad loans once again exceeded provisions in the first quarter.

Risk-based capital ratios (based on current Basel I definitions) of the 25 largest BHCs decreased in the first quarter because of the adoption of the new market risk capital rule, while risk-based capital ratios at smaller BHCs edged up.[7] Nonetheless, BHCs of all sizes remained well capitalized by historical standards as they prepare for the transition to stricter Basel III requirements (see the box "Developments Related to Financial Stability" on pages 26–27 of the July 2013 *Monetary Policy Report*). Aggregate credit provided by commercial banks continued to increase in the first half of 2013.

M2 rose at a more moderate rate, but balances remain elevated

M2 has increased at an annual rate of about 4¾ percent since the end of 2012, notably slower than the pace registered last year. However, holdings of M2 assets—including their largest component, liquid

[7] The new market risk capital rule requires banking organizations with significant trading activities to adjust their capital requirements to better account for the market risks of those activities. For more information on this change, see Board of Governors of the Federal Reserve System (2012), "Federal Reserve Board Approves Final Rule to Implement Changes to Market Risk Capital Rule," press release, June 7, www.federalreserve.gov/newsevents/press/bcreg/20120607b.htm.

deposits—remained elevated relative to what would have been expected based on historical relationships with nominal income and interest rates, likely due to investors' continued preference to hold safe and liquid assets. The monetary base—which is equal to the sum of currency and reserve balances—increased briskly over the first half of the year, driven mainly by the significant rise in reserve balances due to the Federal Reserve's asset purchases.

International Developments

Foreign bond yields have risen and asset prices have declined, on net, especially in emerging market economies

Foreign benchmark sovereign yields have moved somewhat higher, on net, since the beginning of the year. Rates moved lower in March and April, in part reflecting weak incoming data on activity; anticipation of the Bank of Japan's (BOJ) asset purchase program may have also contributed to declining Japanese government bond (JGB) yields early in the year. Since early May, however, as with U.S. Treasury securities, sovereign yields have risen worldwide, as investors responded to better-than-expected U.S. economic data and to Federal Reserve communications about monetary policy. Sovereign yields are up, on net, in Europe, Japan, and Canada and have increased substantially in Korea, Mexico, and other emerging market economies (EMEs).

Equity indexes in the major advanced foreign economies (AFEs) rose earlier in the year, especially in Japan, where stock prices continued to soar as Prime Minister Abe's ambitious stimulus program began to take shape. However, since mid-May, equity prices have declined on net. Corporate bond issuance eased somewhat in June as rates climbed higher, but year-to-date issuance totals are still strong relative to recent years. Since the start of the year, sovereign and corporate credit spreads have narrowed slightly. Financial stresses in Europe have remained well below their highs last year despite banking problems in Cyprus and political tensions in several other European countries.

The significantly higher interest rates in EMEs have been accompanied by sharp moves in other EME financial markets. Since mid-May, stock prices have declined and credit spreads have widened markedly. EME bond and equity funds have also experienced sizable outflows, as investors reassessed the economic outlook in these economies as well as the returns on EME assets relative to those in advanced economies.

The improved sentiment toward the U.S. economic outlook and anticipation of less-accommodative monetary policy have pushed the U.S. dollar higher against a broad set of currencies since the end of 2012. In particular, the dollar has appreciated sharply against the Japanese yen, on net, as the BOJ adopted a more accommodative monetary policy stance.

Activity in the advanced foreign economies remained subdued despite a pickup . . .

Activity in the AFEs improved to a still-muted pace in the first half of 2013, supported in part by stronger exports and the easing in financial stresses in Europe. The euro-area economy shrank further in the first quarter, but the pace of contraction moderated as consumption stabilized. In the United Kingdom, real GDP resumed growing, at a 1¼ percent pace, in the first quarter; retail sales and the purchasing managers index (PMI) suggest that growth firmed in the second quarter. First-quarter activity accelerated in Japan, reflecting a strong rebound of exports and a pickup in consumption. Canadian growth also firmed in the first quarter, and the labor market notched solid employment gains through the second quarter.

With activity weak and inflationary pressures low, several foreign central banks took additional steps to support their economies. (See the box "The Expansion of Central Bank Balance Sheets" on pages 30–31 of the July 2013 *Monetary Policy Report* for a broader overview of central bank actions.) The European Central Bank (ECB) and the Reserve Bank of Australia lowered their main policy rates, and the ECB stated after its July meeting that it will keep key policy rates low "for an extended period." The Bank of England extended its Funding for Lending Scheme until January 2015 and increased banks' incentives to lend to small and medium-sized businesses. In April, the BOJ announced a sharp rise in its purchases of JGBs and other assets, as well as an extension of the maturity of the JGBs that it purchases.

Authorities in some AFEs also eased fiscal policy in response to still-subdued activity. The Japanese parliament approved a fiscal stimulus package worth about 2 percent of GDP, with the bulk of the spending directed to infrastructure projects. European authorities postponed deadlines for several euro-area countries, including France and Spain, to reduce fiscal deficits below 3 percent of GDP.

. . . while growth slowed in the emerging market economies

Aggregate real GDP growth in the EMEs picked up in the fourth quarter of 2012 despite the weakness in Europe and the United States, led by a strong performance of the Chinese economy. However, EME growth slowed considerably in the first quarter, in part as a step-down in Chinese growth weighed on activity in the rest of emerging Asia and on the commodity-dependent economies of South America. Recent indicators of exports, industrial production, and PMIs suggest that EME activity remained subdued in the second quarter. Amid concerns about economic growth and lack of inflationary pressures, the central banks of several countries in Asia and Latin America further eased monetary policy over the first half of the year. However, more recently, concerns about reversal of capital inflows and currency depreciation pressures are giving EME central banks pause about further rate cuts, and a few have begun to raise rates.

In China, macroeconomic data for the second quarter indicate that growth continued to be modest by the standards of recent years. Although retail sales rose slightly faster in April and May than in the subdued first quarter, fixed investment increased at roughly its first-quarter pace.

Activity also cooled across Latin America. In Mexico, growth had already slowed in the second half of last year, weighed down by weaker U.S. manufacturing activity. Growth slowed further in the first quarter, as exports declined and domestic demand weakened. In response, the Bank of Mexico reduced its policy rate for the first time since mid-2009. Mexican activity appears to have remained subdued in the second quarter. Brazilian real GDP growth stepped down a little in the first quarter, extending the lackluster performance of the past two years. Indicators of economic activity for the second quarter, including industrial production and exports, have been mixed. Unlike many of its EME counterparts, Brazil's central bank raised its policy rate to combat rising inflation.

Part 2: Monetary Policy

With unemployment still well above normal levels and inflation below its longer-run objective, the Federal Open Market Committee (FOMC) has continued its highly accommodative monetary policy this year by maintaining its forward guidance with regard to the target for the federal funds rate and continuing its program of large-scale asset purchases.

To foster the attainment of maximum employment and price stability, the FOMC kept in place its forward guidance on the path of the federal funds rate . . .

With unemployment still elevated and declining only gradually, and inflation having moved further below the Committee's 2 percent longer-run objective, the FOMC has maintained its highly accommodative monetary policy stance this year. Because the target range for the federal funds rate remains at its effective lower bound, the Committee has been relying mainly on its forward guidance about the future path of the federal funds rate and on its program of large-scale asset purchases to make progress toward its mandated objectives.

With regard to the federal funds rate, the Committee has continued to indicate its expectation that the current exceptionally low target range of 0 to ¼ percent will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain its target range for the federal funds rate, the Committee has stated that it would also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. The FOMC also has reiterated that a highly accommodative stance of monetary policy would remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. Moreover, the Committee has indicated that when it decides to begin to remove policy accommodation, it would take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent.

. . . and maintained its policy of large-scale asset purchases . . .

To sustain downward pressure on longer-term interest rates, support mortgage markets, and help make broader financial conditions more accommodative, the FOMC has continued its large-scale asset purchases; the Committee also has maintained its practices of reinvesting principal payments it receives on agency debt and agency-guaranteed mortgage-backed securities (MBS) in new agency MBS and of

rolling over maturing Treasury securities at auction. Over the first half of this year, purchases of longer-term securities totaled $510 billion, with the Committee purchasing additional agency MBS at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee reconfirmed at each meeting during the first half of 2013 that it would continue purchasing Treasury and agency MBS until the outlook for the labor market has improved substantially in a context of price stability.

In determining the size, pace, and composition of its asset purchases, the Committee has taken account of the likely efficacy and costs of such purchases. As noted in the minutes of the March FOMC meeting, most participants saw asset purchases as having a meaningful effect in easing financial conditions—for example, keeping longer-term interest rates, including mortgage rates, lower than they would be otherwise—and so supporting economic growth.[8] FOMC participants generally judged that these benefits outweighed the likely costs and risks of additional purchases. However, the Committee has continued to monitor those costs and risks, including possible effects on financial stability, security market functioning, the smooth withdrawal of monetary accommodation when it eventually becomes appropriate, and the Federal Reserve's net income.[9]

. . . while providing additional information about potential adjustments to its asset purchases

During the first half of 2013, the FOMC took various steps to provide greater clarity regarding its thinking about possible adjustments in the pace of asset purchases and the eventual cessation of those purchases. In its statement after the March meeting, the Committee added that the size, pace, and composition of its asset purchases would reflect the extent of progress toward its economic objectives, in addition to the likely efficacy and costs of such purchases.[10] And in May, to highlight its willingness to adjust the flow of purchases in light of incoming information, the Committee noted that it was prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changed.[11]

At the June FOMC meeting, Committee participants generally thought it would be helpful to provide greater clarity about the Committee's approach to decisions about its asset purchase program and thereby reduce investors' uncertainty about how it might react to future economic developments. In choosing to provide this clarification, the Committee made no changes to its approach to monetary policy. Against this backdrop, Chairman Bernanke, at his postmeeting press conference, described a possible path for asset purchases that the Committee would anticipate implementing if economic conditions evolved in a manner broadly consistent with the outcomes the Committee saw as most likely.[12] The Chairman noted that such economic outcomes involved continued gains in labor markets, supported by moderate growth that picks up over the next several quarters, and inflation moving back toward its 2 percent objective over time. If the economy were to evolve broadly in line with the Committee's expectations, the FOMC would moderate the pace of purchases later this year and continue to reduce the pace of purchases in measured steps until purchases ended around the middle of next year, at which time the unemployment rate would likely be in the vicinity of 7 percent, with solid economic growth supporting further job gains and inflation moving back toward the FOMC's 2 percent target.

In emphasizing that the Committee's policy was in no way predetermined, the Chairman noted that if economic conditions improved faster than expected, the pace of asset purchases could be reduced somewhat more quickly. Conversely, if the outlook for the economy or the labor market became less favorable, inflation did not move over time toward the Committee's 2 percent longer-term objective, or financial conditions were judged to be inconsistent with further progress in the labor markets, reductions in the pace of purchases could be delayed or the pace increased for a time. The Chairman also drew a

8 See Board of Governors of the Federal Reserve System (2013), "Minutes of the Federal Open Market Committee, March 19–20, 2013," press release, April 10, www.federalreserve.gov/newsevents/press/monetary/20130410a.htm.

9 For further discussion of these issues, see the box "Efficacy and Costs of Large-Scale Asset Purchases" in Board of Governors of the Federal Reserve System (2013), *Monetary Policy Report* (Washington: Board of Governors, February), www.federalreserve.gov/monetarypolicy/mpr_20130226_part2.htm.

10 See Board of Governors of the Federal Reserve System (2013), "Federal Reserve Issues FOMC Statement," press release, March 20, www.federalreserve.gov/newsevents/press/monetary/20130320a.htm.

11 See Board of Governors of the Federal Reserve System (2013), "Federal Reserve Issues FOMC Statement," press release, May 1, www.federalreserve.gov/newsevents/press/monetary/20130501a.htm.

12 See Ben S. Bernanke (2013), "Transcript of Chairman Bernanke's Press Conference," June 19, www.federalreserve.gov/mediacenter/files/FOMCpresconf20130619.pdf.

strong distinction between the asset purchase program and the forward guidance regarding the target for the federal funds rate, noting that the Committee anticipates that there will be a considerable period between the end of asset purchases and the time when it becomes appropriate to increase the target for the federal funds rate.

The Committee's large-scale asset purchases led to a significant increase in the size of the Federal Reserve's balance sheet

As a result of the Committee's large-scale asset purchase program, Federal Reserve assets have increased significantly since the end of last year. The par value of the System Open Market Account's (SOMA) holdings of U.S. Treasury securities increased about $300 billion to $2 trillion, and the par value of its holdings of agency debt and MBS increased about $270 billion, on net, to $1.3 trillion.[13] These asset purchases accounted for nearly all of the increase in total assets of the Federal Reserve and were accompanied by a significant rise in reserve balances over the period. As of July 10, the SOMA's holdings of Treasury and agency securities constituted 56 percent and 36 percent, respectively, of the $3.5 trillion in total Federal Reserve assets. By contrast, balances of facilities established during the financial crisis declined further from already low levels.[14]

Interest income on the SOMA portfolio continued to support a substantial sum of remittances to the Treasury Department. In the first quarter, the Federal Reserve provided more than $15 billion of such distributions to the Treasury.[15] The Federal Reserve has also released detailed transactions data on open market operations and discount window operations with a two-year lag in compliance with the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010.

The Committee also reviewed the principles for policy normalization

During its May and June meetings, the FOMC reviewed the Federal Reserve's principles for the eventual normalization of the stance of monetary policy, which initially were published in the minutes of the Committee's June 2011 meeting.[16] The Committee's discussion included various aspects of those principles—the size and composition of the SOMA portfolio in the longer run, the use of a range of reserve-draining tools, the approach to sales of securities, the eventual framework for policy implementation, and the relationship between the principles and the economic thresholds in the Committee's forward guidance on the federal funds rate. Meeting participants, in general, continued to view the broad principles set out in 2011 as still applicable. Nonetheless, they agreed that many of the details of the eventual normalization process would likely differ from those specified two years ago, that the appropriate details would depend in part on economic and financial developments between now and the time when it becomes appropriate to begin normalizing monetary policy, and that the Committee would need to provide additional information about its intentions as that time approaches. Participants continued to think that the Federal Reserve should, in the long run, hold predominantly Treasury securities. Most, however, now anticipated that the Committee would not sell agency MBS as part of the normalization process, although some indicated that limited sales might be warranted in the longer run to reduce or eliminate residual holdings.

The Federal Reserve continued to test tools that could potentially be used to manage reserves

As part of the Federal Reserve's ongoing program to ensure the readiness of tools to manage reserves, the Federal Reserve conducted a series of small-scale transactions with eligible counterparties. During the first half of 2013, the Federal Reserve conducted four repurchase agreement (repo) operations and three reverse repurchase agreement (reverse repo) opera-

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[13] The difference between changes in the par value of SOMA holdings and the amount of purchases of securities since the end of 2012 reflects, in part, lags in settlements.

[14] The outstanding amount of dollars provided through the temporary U.S. dollar liquidity swap arrangements with foreign central banks decreased $7 billion to about $1 billion because of the improvement in offshore U.S. dollar funding markets. During the financial crisis, the Federal Reserve created several special lending facilities to support financial institutions and markets and strengthen economic activity. These facilities were closed by 2010; however, some loans made under the Term Asset-Backed Securities Loan Facility, which is closed to new lending, remain outstanding and will mature over the next two years. Other programs supported certain specific institutions in order to avert disorderly failures that could have resulted in severe dislocations and strains for the financial system as a whole and harmed the U.S. economy. While the loans made by the Federal Reserve under these programs have been repaid, the Federal Reserve will continue to receive cash flows generated from assets remaining in the portfolios established in connection with such support, principally the portfolio of Maiden Lane LLC.

[15] The *Quarterly Report on Federal Reserve Balance Sheet Developments* for the first quarter is available on the Federal Reserve Board's website at www.federalreserve.gov/monetarypolicy/quarterly-balance-sheet-developments-report.htm.

[16] See Board of Governors of the Federal Reserve System (2011), "Minutes of the Federal Open Market Committee, June 21–22, 2011," press release, July 12, www.federalreserve.gov/newsevents/press/monetary/20110712a.htm.

tions. Operation sizes ranged between $0.2 and $2.8 billion using all eligible collateral types. While the repo transactions were conducted only with primary dealers, two of the reverse repo operations were open to the expanded set of eligible counterparties, which include not only primary dealers, but also banks, government-sponsored enterprises, and money market funds.[17] In addition, the Federal Reserve Board conducted three operations for 28-day term deposits under the Term Deposit Facility (TDF). These operations included two competitive single-price TDF auctions totaling $3 billion in deposits and an offering with a fixed-rate, full-allotment format, which totaled $10 billion in deposits.

[17] To prepare for the potential need to conduct large-scale reverse repo transactions, the Federal Reserve Bank of New York is developing arrangements with an expanded set of counterparties with which it can conduct these transactions. These counterparties are in addition to the existing set of primary dealer counterparties with whom the Federal Reserve can already conduct reverse repos. The list of the expanded set of counterparties is available on the Federal Reserve Bank of New York's website at www.newyorkfed.org/markets/expanded_counterparties.html.

3 Supervision and Regulation

The Federal Reserve has supervisory and regulatory authority over a variety of financial institutions and activities with the goal of promoting a safe, sound, and stable financial system that supports the growth and stability of the U.S. economy. As described in this report, the Federal Reserve carries out its supervisory and regulatory responsibilities and supporting functions primarily by

- promoting the safety and soundness of individual financial institutions supervised by the Federal Reserve;
- developing supervisory policy (rulemakings, supervision and regulation letters (SR letters), policy statements, and guidance);
- identifying requirements and setting priorities for supervisory information technology initiatives;
- ensuring ongoing staff development to meet evolving supervisory responsibilities;
- regulating the U.S. banking and financial structure by acting on a variety of proposals; and
- enforcing other laws and regulations.

2013 Developments

During 2013, the U.S. banking system and financial markets continued to improve following their recovery from the financial crisis that started in mid-2007.

Performance of bank holding companies. An improvement in bank holding companies' (BHCs) performance was evident during 2013. U.S. BHCs, in aggregate, reported earnings approaching an all-time high—$139 billion for 2013, up from $117 billion for the year ending December 31, 2012. The proportion of unprofitable BHCs continues to decline, reaching 6 percent, down from 11 percent in 2012, but remains elevated compared to historical rates; unprofitable BHCs encompass roughly 1 percent of banking industry assets, in line with historical norms. Nonperforming assets continue to be a challenge to industry recovery, with the nonperforming asset ratio remaining elevated at 2.5 percent of loans and foreclosed assets, an improvement from 3.4 percent at year-end 2012. (Also see "Bank Holding Companies" later in this section.)

Performance of state member banks. The performance at state member banks in 2013 improved modestly compared to 2012. As a group, state member banks reported a profit of $18.2 billion for 2013, up from $17.8 billion for 2012 and near pre-crisis levels. However, profitability from a return on average assets (ROA) and return on equity (ROE) perspective still lags pre-crisis levels by nearly a quarter and one-third, respectively. Provisions (as a percent of revenue) have continued to decrease and are now 3.1 percent, down from a crisis high of 32.4 percent at year-end 2009. Further, 4.1 percent of all state member banks continued to report losses, down from 6.5 percent for year-end 2012. The nonperforming assets ratio remained elevated at 1.4 percent of loans and foreclosed assets, reflecting ongoing weaknesses in asset quality. Growth in problem loans continued to slow during 2013; however, loan types with the largest dollar weakness included nonresidential lending and residential mortgages. The risk-based capital ratios for state member banks were basically unchanged compared to the prior year in the aggregate, and the percent of state member banks deemed well capitalized under prompt corrective action standards remained high at 99 percent. In 2013, one state member bank with $45 million in assets failed. (Also see "State Member Banks" later in this section.)

Revised regulatory capital framework. In July 2013, the federal banking agencies issued rules that restructure the agencies' current regulatory capital rules. The capital requirements in the revised framework serve as the foundation for other key initiatives designed to strengthen financial stability, including the Board's capital plan rule, Dodd-Frank Act stress testing, and capital surcharges for systemically important financial institutions (SIFIs). (See box 1 for details.)

Box 1. Revised Regulatory Capital Framework

In July 2013, the federal banking agencies issued rules that restructure the agencies' current regulatory capital rules into a harmonized, comprehensive framework that addresses shortcomings in regulatory capital requirements that became apparent during the recent financial crisis. The capital requirements in the revised framework serve as the foundation for other key initiatives designed to strengthen financial stability, including the Board's capital plan rule, Dodd-Frank Act stress testing, and capital surcharges for systemically important financial institutions.

The revised framework applies to all banks, savings associations, bank holding companies that are not subject to the Board's small bank holding company policy statement, and certain savings and loan holding companies. The framework implements in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Act. More specifically, the new capital framework:

1. **Increases the quantity and quality of capital banking organizations must hold.** To help ensure that banking organizations maintain strong capital positions, the revised framework incorporates the Basel III definition of capital, new minimum ratios, and a capital conservation buffer. The framework emphasizes common equity tier 1 capital as the highest quality, most loss-absorbing form of capital. High amounts of loss-absorbing capital allow banking organizations to remain viable and continue lending to creditworthy borrowers in times of financial stress. The capital conservation buffer limits a banking organization's capital distributions and certain discretionary bonus payments if the organization does not hold a specified amount of common equity tier 1 capital in addition to the amount necessary to meet the minimum risk-based capital requirements. This buffer is designed to provide incentives for banking organizations to conserve capital during benign economic periods, so that they are prepared to withstand severe stress events and still remain above the minimum capital levels.
2. **Improves the methodology for calculating risk-weighted assets to enhance risk sensitivity.** The rule includes revisions to the methodologies for determining risk-weighted assets, such as for securitization exposures, past-due loans, and counterparty credit risk. In addition, the rule modifies the recognition of credit risk mitigation to include greater recognition of financial collateral and a wider range of eligible guarantors. The rule also eliminates references to and reliance on credit ratings in the calculation of risk-weighted assets, consistent with the requirements of the Dodd-Frank Act.
3. **Applies additional requirements to large, internationally active banking organizations to address the systemic risk these organizations may pose.** To address certain shortcomings identified during the financial crisis, the rule requires that large, internationally active banking organizations maintain higher levels of capital for exposures to large and unregulated financial institutions. The rule also includes higher counterparty credit risk capital requirements for over-the-counter derivatives and introduces a countercyclical capital buffer that allows regulators to expand the capital conservation buffer of these firms during periods of excessive credit growth. In addition, these firms are subject to a new minimum supplementary leverage ratio that takes into account off-balance sheet exposures.

Transition Arrangements

Banking organizations have a significant transition period to meet the new requirements. The phase-in period for smaller, less complex banking organizations will not begin until January 2015 while the phase-in period for larger institutions subject to the advanced approaches rule begins in January 2014. In addition, savings and loan holding companies with significant commercial or insurance underwriting activities will not be subject to the rule at this time. The Federal Reserve will take additional time to evaluate the appropriate regulatory capital framework for these entities.

The revised regulatory capital framework is available at www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

Proposed liquidity coverage ratio. In October 2013, the federal banking agencies jointly published a notice of proposed rulemaking (NPR) to implement, for the first time, quantitative liquidity requirements for internationally active U.S. banking organizations. (See box 2 for details.)

Capital planning and stress testing. Since the financial crisis, the Board has led a series of initiatives to strengthen the capital positions of the largest banking organizations. Two related initiatives are the Comprehensive Capital Analysis and Review (CCAR) and the Dodd-Frank Act stress tests. (Also

Box 2. Proposed Liquidity Coverage Ratio

In October 2013, the federal banking agencies jointly published an NPR to implement, for the first time, quantitative liquidity requirements for internationally active U.S. banking organizations. At the same time, the Federal Reserve also proposed a modified version of these requirements applicable to certain large, non-internationally active holding companies. The NPR would establish a liquidity coverage ratio based on the Basel Committee on Banking Supervision (BCBS)'s standard for internationally active firms. The proposed introduction of a quantitative minimum threshold for liquidity complements the more qualitative prudential liquidity standards that the Federal Reserve proposed in January and December 2012 under section 165 of the Dodd-Frank Act.

International Coordination

The recent financial crisis demonstrated significant weaknesses in both the liquidity positions and the liquidity risk-management practices of banking organizations. In response, the Federal Reserve worked with regulators around the globe to establish international liquidity standards. These standards include both principles for sound liquidity risk management and also quantitative standards for liquidity. The BCBS published two liquidity measures in December 2010 applicable to internationally active banking organizations: a liquidity coverage ratio (LCR) and a net stable funding ratio (NSFR). In January 2013, the BCBS updated key components of the LCR and has continued work on the development of the NSFR standard.

The U.S. LCR and Modified LCR

Under the proposed U.S. LCR framework, internationally active banking organizations would be required to hold an amount of unencumbered high-quality liquid assets (HQLA) to meet their obligations and other liquidity needs during a standardized 30-day stress scenario. Expressed as a coverage ratio:

$$\frac{\text{Unencumbered HQLA}}{\text{Net Cash Outflows over 30-Day Stress Scenario}} \geq 100\%$$

For large, non-internationally active firms, the Federal Reserve proposed a modified version of the LCR that incorporates a shorter, 21-day stress scenario. These firms are generally smaller in size, less complex in structure, and less reliant on riskier forms of market funding when compared to internationally active firms. They are also less likely to have as great a systemic impact in a stress event.

High Quality Liquid Assets

To ensure that the HQLA can generate the required liquidity in a period of stress, only assets that are highly liquid are eligible for the LCR numerator. Furthermore, the mix of the eligible assets is constrained by composition limits to ensure that the majority of the HQLA is of the very highest quality. For example, some eligible assets, such as U.S. Treasuries, may be included without any haircut being applied to their market value and can comprise any amount of the total HQLA. In contrast, the value of other eligible assets are subject to a haircut and they may only constitute a limited proportion of the total HQLA.

Net Cash Outflow Categories

The NPR sets forth various categories of cash outflows and eligible inflows that would be used in calculating the ratio denominator. Each category pertaining to a firm's balance sheet and off-balance sheet exposures would be prescribed an outflow rate, designed to reflect the 30-day stress scenario. These rates would be multiplied by the outstanding exposure for each category to arrive at the outflow amount. The outflow rates are reflective of the liquidity characteristics of the category. For example, stable, fully insured retail deposits would receive a relatively low outflow rate of 3 percent. By contrast, balances of certain unsecured wholesale deposits that are uninsured and provided by a financial entity would receive a 100 percent outflow rate. The proposal recognizes that certain types of wholesale deposits are placed at firms for operational purposes, and the outflow rates for operational deposits reflect their implied stability.

Highest Cumulative Net Cash Outflow

Total stressed net cash outflows would be calculated for each of the 30-days following the LCR calculation date. The LCR denominator for internationally active banking organizations would be the amount on the day within the 30-day stress period that has the highest cumulative net outflow.

Transition Arrangements

The NPR would require covered companies to comply with a minimum LCR of 80 percent beginning on January 1, 2015, increasing to 90 percent beginning on January 1, 2016, and then to 100 percent beginning on January 1, 2017. For more information see the Board's press release at www.federalreserve.gov/newsevents/press/bcreg/20131024a.htm.

Box 3. Recovery and Resolution Planning

The Federal Reserve, in collaboration with other U.S. agencies, has continued to work with large financial institutions to develop a range of recovery and resolution strategies in the event of their distress or failure.

Recovery Planning

The Federal Reserve has required that the largest and most globally active U.S. financial institutions develop recovery plans that describe a number of options and actions to be taken by management to maintain the financial institution as a going concern during instances of extreme stress. Eight domestic bank holding companies and two non-bank financial institutions that may pose elevated risk to U.S. financial stability currently submit recovery plans to the Federal Reserve.

Resolution Planning

Covered financial institutions are required by the Dodd-Frank Act to submit annual resolution plans for their orderly resolution under the Bankruptcy Code in the event of their material financial distress or failure. In 2011, the Federal Reserve and FDIC jointly issued rules implementing the resolution plan requirement for financial institutions that are subject to higher prudential standards. The final resolution plan rule is available at www.gpo.gov/fdsys/pkg/FR-2011-11-01/html/2011-27377.htm.

In a phased approach based on nonbank asset size, the first group of 11 financial institutions, including four foreign banking organizations with operations in the United States, submitted resolution plans on July 1, 2012, and again on October 1, 2013. The second group of four financial institutions submitted their first plans on July 1, 2013; the third group of 116 financial institutions submitted their first plans on December 31, 2013; and three non-bank financial firms will submit their first plans on July 1, 2014. The initial plan submissions identified and described the firms' critical operations, core business lines, material legal entities, interconnections and interdependencies, corporate governance structure and processes related to resolution, and impediments to resolution and the actions the financial institution will take to facilitate its orderly resolution. The second iteration plans submitted by the first group of firms addressed supplemental guidance from the Federal Reserve and FDIC.

- **Guidance for 2013 §165(d) Annual Resolution Plan Submissions by Domestic and Foreign-Based Covered Companies:** To further assist the Federal Reserve and FDIC in their review of annual resolution plans, the agencies provided additional guidance, clarification, and direction for the institutions required to submit their second iteration resolution plan on October 1, 2013. The guidance included additional clarity around certain assumptions and requested more-detailed information on, and analysis of, the firm's ability to overcome certain obstacles to rapid and orderly resolution under the Bankruptcy Code identified by the Federal Reserve and FDIC, including obstacles related to operational and global interconnectedness, access to financial market utilities, derivatives close-out, collateral management practices, and funding and liquidity. The guidance is available at www.federalreserve.gov/newsevents/press/bcreg/20130415c.htm.

Resolution plan submissions must include both a confidential and public portion. The public portion of each resolution plan is available on the Federal Reserve's website (www.federalreserve.gov/bankinforeg/resolution-plans.htm). The Federal Reserve and the FDIC may determine that a resolution plan is not credible or would not facilitate an orderly resolution of the institution under the Bankruptcy Code. The agencies continue to review and work with firms to develop their resolution plans.

In accordance with principles promulgated by the Financial Stability Board, the Federal Reserve participates with other U.S. and international supervisors in crisis management group meetings to enhance preparedness for the cross-border management and resolution of a failed global systemically important financial institution.

see "Capital Adequacy Standards" later in this section.)

Recovery and resolution planning. The Federal Reserve continues to work with other regulatory agencies to reduce the probability of failure of the largest, most complex financial firms and to minimize the losses to the financial system and the economy if such a firm should fail. (See box 3 for details.)

Easing regulatory burden on community banking organizations. The Subcommittee on Smaller Regional and Community Banking was established to ensure that the development of supervisory guidance is informed by an understanding of the unique characteristics of community and regional banks and consideration of the potential for excessive burden and adverse effects on lending. Since its establishment, the subcommittee has led a number of initiatives focused on reducing regulatory burden on

community-banking organizations and gaining additional perspective on community bank concerns. (See box 4 for details.)

Supervision

The Federal Reserve is the federal supervisor and regulator of all U.S. BHCs, including financial holding companies, and state-chartered commercial banks that are members of the Federal Reserve System. The Federal Reserve also has responsibility for supervising the operations of all Edge Act and agreement corporations, the international operations of state member banks and U.S. BHCs, and the U.S. operations of foreign banking organizations. Furthermore, through the Dodd-Frank Act, the Federal Reserve has been assigned responsibilities for nonbank financial firms and financial market utilities (FMUs) designated by the Financial Stability Oversight Council (FSOC) as systemically important. In addition, the Dodd-Frank Act transferred authority for consolidated supervision of more than 400 savings and loan holding companies (SLHCs) and their non-depository subsidiaries from the Office of Thrift Supervision (OTS) to the Federal Reserve.

In overseeing the institutions under its authority, the Federal Reserve seeks primarily to promote safety and soundness, including compliance with laws and regulations.

Safety and Soundness

The Federal Reserve uses a range of supervisory activities to promote the safety and soundness of financial institutions and maintain a comprehensive understanding and assessment of each firm. These activities include horizontal reviews, firm-specific examinations and inspections, continuous monitoring and surveillance activities, and implementation of enforcement or other supervisory actions as necessary. The Federal Reserve also provides training and technical assistance to foreign supervisors and minority-owned and de novo depository institutions.

Examinations and Inspections

The Federal Reserve conducts examinations of state member banks, FMUs, the U.S. branches and agencies of foreign banks, and Edge Act and agreement corporations. In a process distinct from examinations, it conducts inspections of holding companies and their nonbank subsidiaries. Whether an examination or an inspection is being conducted, the review of operations entails

- an evaluation of the adequacy of governance provided by the board and senior management, including an assessment of internal policies, procedures, controls, and operations;
- an assessment of the quality of the risk-management and internal control processes in place to identify, measure, monitor, and control risks;
- an assessment of the key financial factors of capital, asset quality, earnings, and liquidity; and
- a review for compliance with applicable laws and regulations.

Table 1 provides information on examinations and inspections conducted by the Federal Reserve during the past five years.

Consolidated Supervision

Consolidated supervision, a method of supervision that encompasses the parent company and its subsidiaries, allows the Federal Reserve to understand the organization's structure, activities, resources, risks, and financial and operational resilience. Working with other relevant supervisors and regulators, the Federal Reserve seeks to ensure that financial, operational, or other deficiencies are addressed before they pose a danger to the consolidated organization, its banking offices, or the broader economy.[1]

Large financial institutions increasingly operate and manage their integrated businesses across corporate boundaries. Financial trouble in one part of a financial institution can spread rapidly to other parts of the institution. Risks that cross legal entities or that are managed on a consolidated basis cannot be monitored properly through supervision that is directed at any one of the legal entity subsidiaries within the overall organization.

To strengthen its supervision of the largest, most complex financial institutions, the Federal Reserve created a centralized multidisciplinary body called the Large Institution Supervision Coordinating Committee (LISCC) to oversee the supervision and evaluate conditions of supervised firms. The committee also develops cross-firm perspectives and moni-

[1] "Banking offices" are defined as U.S. depository institution subsidiaries, as well as the U.S. branches and agencies of foreign banking organizations.

Box 4. Easing Regulatory Burden on Community Banking Organizations

A subcommittee of Board members was established in 2011 with a primary goal to ensure that the development of supervisory guidance is informed by an understanding of the unique characteristics of community and regional banks and consideration of the potential for excessive burden and adverse effects on lending. Since its establishment, the subcommittee has led a number of initiatives focused on reducing regulatory burden on community banking organizations and gaining additional perspective on community bank concerns. Key aspects of these initiatives include the following:

1. **Considering the impact of new and existing regulations on community banking organizations.** The subcommittee convenes regularly to review regulatory proposals, supervisory guidance, and examination practices to evaluate the effects of these components on community banks. The primary goal of these reviews is to ensure that regulatory directives relevant to community banking organizations remain commensurate with the size and complexity of these institutions.
2. **Enhancing communication with the community bank industry.** The Federal Reserve remains committed to fostering enhanced communication between banking supervisors and community bankers. Primary efforts to support this objective include the following:
   - **Establishing the Community Depository Institutions Advisory Council.** Established in 2010, this Council, comprised of individuals representing community banks, thrifts, and credit unions from each of the 12 Federal Reserve Districts, provides the Board of Governors with industry input on the economy, lending conditions, and other topics of interest to community banking organizations. The Council continues to meet with Board officials twice a year to communicate their views on both the banking industry and pertinent regulatory matters.
   - **Clarifying new regulations or proposals to help community banking organizations understand and identify items applicable to their organizations.** To support this objective, the subcommittee set forth a requirement that all new supervisory proposals and rules include a clear statement of applicability to community banking institutions. This requirement is intended to help community banks more readily identify aspects of supervisory directives applicable to their organizations. As an example, in July 2013, after the final Basel III capital rules were adopted, the Federal Reserve, in collaboration with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, issued a comprehensive guide to help community banking organizations understand the sections of the rule that were relevant to their operations (www.federalreserve.gov/bankinforeg/basel/files/capital_rule_community_bank_guide_20130709.pdf).

(continued on next page)

tors interconnectedness and common practices that could lead to systemic risk.

A new framework for the consolidated supervision of LISCC firms and other large financial institutions was issued in December 2012.[2] This framework strengthened traditional microprudential supervision and regulation to enhance the safety and soundness of individual firms and incorporates macroprudential considerations to reduce potential threats to the stability of the financial system. The framework has two primary objectives:

1. **Enhancing resiliency of a firm to lower the probability of its failure or inability to serve as a financial intermediary.** Each firm is expected to ensure that the consolidated organization (or the combined U.S. operations in the case of foreign banking organizations) and its core business lines can survive under a broad range of internal or external stresses. This requires financial resilience by maintaining sufficient capital and liquidity, and operational resilience by maintaining effective corporate governance, risk management, and recovery planning.
2. **Reducing the impact on the financial system and the broader economy in the event of a firm's failure or material weakness.** Each firm is expected to

[2] For more information about the supervisory framework, see the Board's press release and SR letter 12-17/CA 12-14 at www.federalreserve.gov/newsevents/press/bcreg/20121217a.htm.

Box 4. Easing Regulatory Burden on Community Banking Organizations—*continued*

2. *continued*

- **Disseminating supervisory publications with a focus on community banking organizations.** The Federal Reserve uses the following System publications to communicate with community banking organizations on emerging risks and important supervisory matters:

  —***Community Banking Connections®***—Throughout 2013, the publication continued to offer a number of articles focused on timely regulatory topics, including interest rate risk management, cyber security, and capital planning (http://communitybankingconnectionsqa.phil.frb.org/archives.cfm).

  —***FedLinks™***—Articles published throughout 2013 covered topics outlining supervisory expectations for a number of banking functions, including the internal control function, the allowance for loan and lease losses, and appraisal and evaluation programs (http://communitybankingconnectionsqa.phil.frb.org/fedlinks.cfm).

3. **Focusing on community bank research.** To support well-informed supervisory decisions relative to community banking organizations, the subcommittee established an informal working group of economists from the research and supervision functions in the Federal Reserve System. Findings from research produced by this group continue to help guide community bank policy development and implementation. As an example of research efforts encouraged by the subcommittee and undertaken by this group, in 2013, the Federal Reserve Bank of St. Louis, in collaboration with the Conference of State Bank Supervisors, hosted a Community Banking Research and Policy Conference focused on the role of community banks in the financial system. During the conference, participants discussed and identified issues most important to community bank vitality. Participants also explored a number of research topics relevant to the community-bank business model, including the effects of the Dodd-Frank Act on community banks, the relationship between community bank capital ratios and the likelihood of failure, and the characteristics of community banks that recovered from significant financial distress.

ensure the sustainability of its critical operations and banking offices under a broad range of internal or external stresses. This requires, among other things, effective resolution planning that addresses the complexity and the interconnectivity of the firm's operations.

The framework is designed to support a tailored supervisory approach that accounts for the unique risk characteristics of each firm, including the nature and degree of potential systemic risk inherent in a firm's activities and operations, and is being implemented in a multi-stage approach.

The Federal Reserve uses a range of supervisory activities to maintain a comprehensive understanding and assessment of each large financial institution:

- **Coordinated horizontal reviews.** These reviews involve examining several institutions simultaneously and encompass firm-specific supervision and the development of cross-firm perspectives. The Federal Reserve recognizes the priority of these reviews through the dedication of experienced staff with multidisciplinary skills. Examples include analysis of capital adequacy and planning through the Comprehensive Capital Analysis and Review (CCAR), as well as horizontal evaluations of resolution plans and incentive compensation practices.
- **Firm-specific examinations and/or inspections and continuous monitoring activities.** These activities are designed to maintain an understanding and assessment across the core areas of supervisory focus. These activities include review and assessment of changes in strategy, inherent risks, control processes, and key personnel, and follow-up on previously identified concerns (for example, areas subject to enforcement actions), or emerging vulnerabilities.
- **Interagency information sharing and coordination.** In developing and executing a detailed supervisory plan for each firm, the Federal Reserve generally relies to the fullest extent possible on the information and assessments provided by other relevant

Table 1. State member banks and bank holding companies, 2009–13					
Entity/item	2013	2012	2011	2010	2009
State member banks					
Total number	850	843	828	829	845
Total assets (billions of dollars)	2,060	2,005	1,891	1,697	1,690
Number of examinations	745	769	809	912	850
By Federal Reserve System	459	487	507	722	655
By state banking agency	286	282	302	190	195
Top-tier bank holding companies					
Large (assets of more than $1 billion)					
Total number	505	508	491	482	488
Total assets (billions of dollars)	16,269	16,112	16,443	15,986	15,744
Number of inspections	716	712	672	677	658
By Federal Reserve System[1]	695	691	642	654	640
On site	509	514	461	491	501
Off site	186	177	181	163	139
By state banking agency	21	21	30	23	18
Small (assets of $1 billion or less)					
Total number	4,036	4,124	4,251	4,362	4,486
Total assets (billions of dollars)	953	983	982	991	1,018
Number of inspections	3,131	3,329	3,306	3,340	3,264
By Federal Reserve System	2,962	3,150	3,160	3,199	3,109
On site	148	200	163	167	169
Off site	2,814	2,950	2,997	3,032	2,940
By state banking agency	169	179	146	141	155
Financial holding companies					
Domestic	420	408	417	430	479
Foreign	39	38	40	43	46

[1] For large bank holding companies subject to continuous, risk-focused supervision, includes multiple targeted reviews.

supervisors and functional regulators. The Federal Reserve actively participates in interagency information sharing and coordination, consistent with applicable laws, to promote comprehensive and effective supervision and limit unnecessary duplication of information requests. Supervisory agencies continue to enhance formal and informal discussions to jointly identify and address key vulnerabilities, and to coordinate supervisory strategies for large financial institutions.

- **Internal audit and control functions.** In certain instances, supervisors may be able to rely on a firm's internal audit or internal control functions in developing a comprehensive understanding and assessment.

The Federal Reserve uses a risk-focused approach to supervision, with activities directed toward identifying the areas of greatest risk to financial institutions and assessing the ability of institutions' management processes to identify, measure, monitor, and control those risks. For medium and small-sized financial institutions, the risk-focused consolidated supervision program provides that examination and inspection procedures are tailored to each organization's size, complexity, risk profile, and condition. The supervisory program for an institution, regardless of its asset size, entails both off-site and on-site work, including development of supervisory plans, pre-examination visits, detailed documentation, and preparation of examination reports tailored to the scope and findings of the examination.

State Member Banks

At the end of 2013, 2,003 banks (excluding nondepository trust companies and private banks) were members of the Federal Reserve System, of which 850 were state chartered. Federal Reserve System member banks operated 58,074 branches, and accounted for 34 percent of all commercial banks in the United States and for 71 percent of all commercial banking offices. State-chartered commercial banks that are members of the Federal Reserve, commonly referred to as state member banks, represented

approximately 14 percent of all insured U.S. commercial banks and held approximately 15 percent of all insured commercial bank assets in the United States.

Under section 10 of the Federal Deposit Insurance Act, as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994, the Federal Reserve must conduct a full-scope, on-site examination of state member banks at least once a year,[3] although certain well-capitalized, well-managed organizations with total assets of less than $500 million may be examined once every 18 months.[4] The Federal Reserve conducted 459 exams of state member banks in 2013.

Bank Holding Companies

At year-end 2013, a total of 5,095 U.S. BHCs were in operation, of which 4,541 were top-tier BHCs. These organizations controlled 4,930 insured commercial banks and held approximately 99 percent of all insured commercial bank assets in the United States.

Federal Reserve guidelines call for annual inspections of large BHCs and complex smaller companies. In judging the financial condition of the subsidiary banks owned by holding companies, Federal Reserve examiners consult examination reports prepared by the federal and state banking authorities that have primary responsibility for the supervision of those banks, thereby minimizing duplication of effort and reducing the supervisory burden on banking organizations.

Inspections of BHCs, including financial holding companies, are built around a rating system introduced in early January of 2005. The system reflects the shift in supervisory practices away from a historical analysis of financial condition toward a more dynamic, forward-looking assessment of risk-management practices and financial factors. Under the system, known as RFI but more fully termed RFI/C(D), holding companies are assigned a composite rating (C) that is based on assessments of three components: Risk Management (R), Financial Condition (F), and the potential Impact (I) of the parent company and its nondepository subsidiaries on the subsidiary depository institution. The fourth component, Depository Institution (D), is intended to mirror the primary supervisor's rating of the subsidiary depository institution.[5] Noncomplex BHCs with consolidated assets of $1 billion or less are subject to a special supervisory program that permits a more flexible approach.[6] In 2013, the Federal Reserve conducted 695 inspections of large BHCs and 2,962 inspections of small, noncomplex BHCs.

Financial Holding Companies

Under the Gramm-Leach-Bliley Act, BHCs that meet certain capital, managerial, and other requirements may elect to become financial holding companies and thereby engage in a wider range of financial activities, including full-scope securities underwriting, merchant banking, and insurance underwriting and sales. As of year-end 2013, 420 domestic BHCs and 39 foreign banking organizations had financial holding company status. Of the domestic financial holding companies, 23 had consolidated assets of $50 billion or more; 29, between $10 billion and $50 billion; 113, between $1 billion and $10 billion; and 255, less than $1 billion.

Savings and Loan Holding Companies

On July 21, 2011, responsibility for supervision and regulation of SLHCs transferred from the OTS to the Federal Reserve, pursuant to the Dodd-Frank Act. At year-end 2013, a total of 607 SLHCs were in operation, of which 331 were top tier SLHCs. These SLHCs control 344 thrift institutions and include 30 companies engaged primarily in nonbanking activities, such as insurance underwriting (15 SLHCs), securities brokerage (8 SLHCs), and commercial activities (7 SLHCs). Excluding SIFI SLHCs, the 25 largest SLHCs accounted for more than $1.3 trillion of total combined assets. Ten institutions in the top 25 and approximately 90 percent of all SLHCs engage primarily in depository activities. These firms hold approximately 13 percent ($364 billion) of the total combined assets of all SLHCs. The Office of

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3 The Office of the Comptroller of the Currency examines nationally chartered banks, and the Federal Deposit Insurance Corporation examines state-chartered banks that are not members of the Federal Reserve.

4 The Financial Services Regulatory Relief Act of 2006, which became effective in October 2006, authorized the federal banking agencies to raise the threshold from $250 million to $500 million, and final rules incorporating the change into existing regulations were issued on September 21, 2007.

5 Each of the first two components has four subcomponents: **Risk Management**—(1) Board and Senior Management Oversight; (2) Policies, Procedures, and Limits; (3) Risk Monitoring and Management Information Systems; and (4) Internal Controls. **Financial Condition**—(1) Capital, (2) Asset Quality, (3) Earnings, and (4) Liquidity.

6 The special supervisory program was implemented in 1997, most recently modified in 2013. See SR letter 13-21 for a discussion of the factors considered in determining whether a BHC is complex or noncomplex. (www.federalreserve.gov/bankinforeg/srletters/sr1321.htm).

the Comptroller of the Currency (OCC) is the primary regulator for most of the subsidiary savings associations of the firms engaged primarily in depository activities.

Board staff continues to work on operational, technical, and supervisory transition issues while engaging the industry, Reserve Banks, and other financial regulatory agencies. Approximately 95 percent of the SLHCs are now filing all required Federal Reserve regulatory reports. Other significant milestones have been achieved; however, several complex policy issues continue to be addressed by the Board, including those related to consolidated capital requirements, intermediate holding companies, adoption and application of a formal rating system, and the applicability of OTS policies and procedures to SLHCs.

Financial Market Utilities

FMUs manage or operate multilateral systems for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the FMU. Under the Federal Reserve Act, the Federal Reserve supervises FMUs that are chartered as member banks or Edge Act corporations and cooperates with other federal banking supervisors to supervise FMUs considered bank service providers under the Bank Service Company Act.

In July 2012, the FSOC voted to designate eight FMUs as systemically important under title VIII of the Dodd-Frank Act. As a result of these designations, the Federal Reserve assumed an expanded set of responsibilities related to these designated FMUs that include promoting uniform risk-management standards, playing an enhanced role in the supervision of designated FMUs, reducing systemic risk, and supporting the stability of the broader financial system. For designated FMUs subject to the Federal Reserve's supervision, the Board established risk-management standards and expectations that are articulated in Board Regulation HH (effective September 2012). Proposed revisions to these standards to take into account new international standards have been issued by the Board for public comment through March 2014. In addition to setting minimum risk-management standards, Regulation HH also establishes requirements for the advance notice of proposed material changes to the rules, procedures, or operations of a designated FMU for which the Federal Reserve is the supervisory agency under title VIII of the Dodd-Frank Act. Section 234.6 of Regulation HH (effective February 2014) establishes terms and conditions under which the Board may authorize a designated FMU access to Reserve Bank accounts and services.

The Federal Reserve's risk-based supervision program for FMUs is administered by the FMU Supervision Committee (FMU-SC). The FMU-SC is a multidisciplinary committee of senior supervision, payment policy, and legal staff at the Board of Governors and Reserve Banks who are responsible for, and knowledgeable about, supervisory issues for FMUs. The FMU-SC's primary objective is to provide senior level oversight, consistency, and direction to the Federal Reserve's supervisory process for FMUs. The FMU-SC coordinates with the LISCC on issues related to large financial institutions' roles in FMUs; the payment, clearing, and settlement activities of large financial institutions; and the FMU activities and implications for large financial institutions.

In an effort to promote greater financial market stability and mitigate systemic risk, the Board works closely with the U.S. Securities and Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission, both of which also have supervisory authority for certain FMUs. The Federal Reserve's work with these agencies under title VIII, including the sharing of appropriate information and participation in designated FMU examinations, aims to improve consistency in FMU supervision, promote robust FMU risk management, and improve the regulators' ability to monitor and mitigate systemic risk.

Designated Nonfinancial Companies

In 2013, the FSOC designated three nonbank financial companies for supervision by the Board: American International Group, Inc. (AIG); General Electric Capital Corporation, Inc. (GECC); and Prudential Financial, Inc. (Prudential). The Federal Reserve's supervisory approach for these firms as designated companies is consistent with the approach used for the largest financial holding companies but tailored to account for different material characteristics of each firm. The Dodd-Frank Act requires the Board to apply enhanced prudential standards and early remediation requirements to BHCs with at least $50 billion in consolidated assets and to the nonbank financial companies designated by the FSOC for supervision by the Board. The act authorizes the Board to tailor the application of these standards and requirements to different companies on an individual basis or by category.

International Activities

The Federal Reserve supervises the foreign branches and overseas investments of member banks, Edge Act and agreement corporations, and BHCs (including the investments by BHCs in export trading companies). In addition, it supervises the activities that foreign banking organizations conduct through entities in the United States, including branches, agencies, representative offices, and subsidiaries.

Foreign operations of U.S. banking organizations. In supervising the international operations of state member banks, Edge Act and agreement corporations, and BHCs, the Federal Reserve generally conducts its examinations or inspections at the U.S. head offices of these organizations, where the ultimate responsibility for the foreign offices resides. Examiners also visit the overseas offices of U.S. banking organizations to obtain financial and operating information and, in some instances, to test their adherence to safe and sound banking practices and compliance with rules and regulations. Examinations abroad are conducted with the cooperation of the supervisory authorities of the countries in which they take place; for national banks, the examinations are coordinated with the OCC.

At the end of 2013, 41 member banks were operating 488 branches in foreign countries and overseas areas of the United States; 24 national banks were operating 414 of these branches, and 17 state member banks were operating the remaining 54. In addition, 13 nonmember banks were operating 20 branches in foreign countries and overseas areas of the United States.

Edge Act and agreement corporations. Edge Act corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international business, especially exports. Agreement corporations are similar organizations, state or federally chartered, that enter into agreements with the Board to refrain from exercising any power that is not permissible for an Edge Act corporation. Sections 25 and 25A of the Federal Reserve Act grant Edge Act and agreement corporations permission to engage in international banking and foreign financial transactions. These corporations, most of which are subsidiaries of member banks, may (1) conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions and (2) make foreign investments that are broader than those permissible for member banks.

At year-end 2013, out of 48 banking organizations chartered as Edge Act or agreement corporations, 3 operated 7 Edge Act and agreement branches. These corporations are examined annually.

U.S. activities of foreign banks. Foreign banks continue to be significant participants in the U.S. banking system. As of fourth quarter 2013, 166 foreign banks from 50 countries operated 188 state-licensed branches and agencies, of which 6 were insured by the Federal Deposit Insurance Corporation (FDIC), and 48 OCC-licensed branches and agencies, of which 4 were insured by the FDIC. These foreign banks also owned 10 Edge Act and agreement corporations and 1 commercial lending company. In addition, they held a controlling interest in 50 U.S. commercial banks. Altogether, the U.S. offices of these foreign banks controlled approximately 20 percent of U.S. commercial banking assets. These 166 foreign banks also operated 87 representative offices; an additional 40 foreign banks operated in the United States through a representative office. The Federal Reserve—in coordination with appropriate state regulatory authorities—examines state-licensed, non-FDIC insured branches and agencies of foreign banks on-site at least once every 18 months.[7] In most cases, on-site examinations are conducted at least once every 12 months, but the period may be extended to 18 months if the branch or agency meets certain criteria. As part of the supervisory process, a review of the financial and operational profile of each organization is conducted to assess the organization's ability to support its U.S. operations and to determine what risks, if any, the organization poses to the banking system through its U.S. operations. The Federal Reserve conducted or participated with state and federal regulatory authorities in 411 examinations in 2013.

Compliance with Regulatory Requirements

The Federal Reserve examines institutions for compliance with a broad range of legal requirements, including anti-money-laundering (AML) and consumer protection laws and regulations, and other laws pertaining to certain banking and financial activities. Most compliance supervision is conducted under the oversight of the Board's Division of Bank-

7 The OCC examines federally licensed branches and agencies, and the FDIC examines state-licensed FDIC-insured branches in coordination with the appropriate state regulatory authority.

ing Supervision and Regulation, but consumer compliance supervision is conducted under the oversight of the Division of Consumer and Community Affairs. The two divisions coordinate their efforts with each other and also with the Board's Legal Division to ensure consistent and comprehensive Federal Reserve supervision for compliance with legal requirements.

Anti-Money-Laundering Examinations

The Treasury regulations implementing the Bank Secrecy Act (BSA) generally require banks and other types of financial institutions to file certain reports and maintain certain records that are useful in criminal, tax, or regulatory proceedings. The BSA and separate Board regulations require banking organizations supervised by the Board to file reports on suspicious activity related to possible violations of federal law, including money laundering, terrorism financing, and other financial crimes. In addition, BSA and Board regulations require that banks develop written BSA compliance programs and that the programs be formally approved by bank boards of directors. The Federal Reserve is responsible for examining institutions for compliance with applicable AML laws and regulations and conducts such examinations in accordance with the Federal Financial Institutions Examination Council's (FFIEC) *Bank Secrecy Act/Anti-Money Laundering Examination Manual*.[8]

Specialized Examinations

The Federal Reserve conducts specialized examinations of supervised financial institutions in the areas of information technology, fiduciary activities, transfer agent activities, and government and municipal securities dealing and brokering. The Federal Reserve also conducts specialized examinations of certain nonbank entities that extend credit subject to the Board's margin regulations.

Information Technology Activities

In recognition of the importance of information technology to safe and sound operations in the financial industry, the Federal Reserve reviews the information technology activities of supervised financial institutions, as well as certain independent data centers that provide information technology services to these organizations. All safety-and-soundness examinations include a risk-focused review of information technology risk-management activities. During 2013, the Federal Reserve continued as the lead supervisory agency for eight of the 15 large, multiregional data processing servicers recognized on an interagency basis and assumed leadership of two more of the large servicers.

Fiduciary Activities

The Federal Reserve has supervisory responsibility for state member banks and state member nondepository trust companies, which hold assets in various fiduciary and custodial capacities. On-site examinations of fiduciary and custodial activities are risk-focused and entail the review of an organization's compliance with laws, regulations, and general fiduciary principles, including effective management of conflicts of interest; management of legal, operational, and reputational risk exposures; and audit and control procedures. In 2013, Federal Reserve examiners conducted 107 fiduciary examinations, excluding transfer agent examinations, of state member banks.

Transfer Agents

As directed by the Securities Exchange Act of 1934, the Federal Reserve conducts specialized examinations of those state member banks and BHCs that are registered with the Board as transfer agents. Among other things, transfer agents countersign and monitor the issuance of securities, register the transfer of securities, and exchange or convert securities. On-site examinations focus on the effectiveness of an organization's operations and its compliance with relevant securities regulations. During 2013, the Federal Reserve conducted on-site transfer agent examinations at 14 of the 30 state member banks and BHCs that were registered as transfer agents.

Government and Municipal Securities Dealers and Brokers

The Federal Reserve is responsible for examining state member banks and foreign banks for compliance with the Government Securities Act of 1986 and with the Treasury regulations governing dealing and brokering in government securities. Fourteen state member banks and six state branches of foreign banks have notified the Board that they are government securities dealers or brokers not exempt from the Treasury's regulations. During 2013, the Federal Reserve conducted six examinations of broker–dealer activities in government securities at these organizations. These examinations are generally conducted

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[8] The FFIEC is an interagency body of financial regulatory agencies established to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: the Board of Governors of the Federal Reserve System, the FDIC, the National Credit Union Administration, the OCC, the Consumer Financial Protection Bureau, and the chair of the State Liaison Committee.

concurrently with the Federal Reserve's examination of the state member bank or branch.

The Federal Reserve is also responsible for ensuring that state member banks and BHCs that act as municipal securities dealers comply with the Securities Act Amendments of 1975. Municipal securities dealers are examined, pursuant to the Municipal Securities Rulemaking Board's rule G-16, at least once every two calendar years. Four of the 12 entities supervised by the Federal Reserve that dealt in municipal securities were examined during 2013.

Securities Credit Lenders

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchasing or carrying of securities. As part of its general examination program, the Federal Reserve examines the banks under its jurisdiction for compliance with Board Regulation U (Credit by Banks and Persons other than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock). The Federal Reserve may conduct specialized examinations of these lenders if they are not already subject to supervision by the Farm Credit Administration or the National Credit Union Administration (NCUA).

Enforcement Actions

The Federal Reserve has enforcement authority over the financial institutions it supervises and their affiliated parties. Enforcement actions may be taken to address unsafe and unsound practices or violations of any law or regulation. Formal enforcement actions include cease-and-desist orders, written agreements, prompt corrective action directives, removal and prohibition orders, and civil money penalties. In 2013, the Federal Reserve completed 50 formal enforcement actions. Civil money penalties totaling $250,030,130 were assessed. As directed by statute, all civil money penalties are remitted to either the Treasury or the Federal Emergency Management Agency. Enforcement orders and prompt corrective action directives, which are issued by the Board, and written agreements, which are executed by the Reserve Banks, are made public and are posted on the Board's website (www.federalreserve.gov/apps/enforcementactions/).

In 2013, the Reserve Banks completed 161 informal enforcement actions. Informal enforcement actions include memoranda of understanding (MOU), commitment letters, and board of directors' resolutions.

Surveillance and Off-Site Monitoring

The Federal Reserve uses automated screening systems to monitor the financial condition and performance of state member banks and BHCs in the period between on-site examinations. Such monitoring and analysis helps direct examination resources to institutions that have higher risk profiles. Screening systems also assist in the planning of examinations by identifying companies that are engaging in new or complex activities.

The primary off-site monitoring tool used by the Federal Reserve is the Supervision and Regulation Statistical Assessment of Bank Risk model (SR-SABR). Drawing mainly on the financial data that banks report on their Reports of Condition and Income (Call Reports), SR-SABR uses econometric techniques to identify banks that report financial characteristics weaker than those of other banks assigned similar supervisory ratings. To supplement the SR-SABR screening, the Federal Reserve also monitors various market data, including equity prices, debt spreads, agency ratings, and measures of expected default frequency, to gauge market perceptions of the risk in banking organizations. In addition, the Federal Reserve prepares quarterly Bank Holding Company Performance Reports (BHCPRs) for use in monitoring and inspecting supervised banking organizations. The BHCPRs, which are compiled from data provided by large BHCs in quarterly regulatory reports (FR Y-9C and FR Y-9LP), contain, for individual companies, financial statistics and comparisons with peer companies. BHCPRs are made available to the public on the National Information Center (NIC) website, which can be accessed at www.ffiec.gov.

Federal Reserve analysts use Performance Report Information and Surveillance Monitoring (PRISM), a querying tool, to access and display financial, surveillance, and examination data. In the analytical module, users can customize the presentation of institutional financial information drawn from Call Reports, Uniform Bank Performance Reports, FR Y-9 statements, BHCPRs, and other regulatory reports. In the surveillance module, users can generate reports summarizing the results of surveillance screening for banks and BHCs. During 2013, two major and two minor upgrades to the web-based PRISM application were completed.

The Federal Reserve works through the FFIEC Task Force on Surveillance Systems to coordinate surveil-

lance activities with the other federal banking agencies.

Training and Technical Assistance

The Federal Reserve provides training and technical assistance to foreign supervisors and minority-owned depository institutions.

International Training and Technical Assistance

In 2013, the Federal Reserve continued to provide technical assistance on bank supervisory matters to foreign central banks and supervisory authorities. Technical assistance involves visits by Federal Reserve staff members to foreign authorities as well as consultations with foreign supervisors who visit the Board or the Reserve Banks. The Federal Reserve, along with the OCC, the FDIC, and the Treasury, was an active participant in the Middle East and North Africa Financial Regulators' Training Initiative, which is part of the U.S. government's Middle East Partnership Initiative. The Federal Reserve also contributes to the regional training provision under the Asia Pacific Economic Cooperation Financial Regulators' Training Initiative.

In 2013, the Federal Reserve offered a number of training courses exclusively for foreign supervisory authorities, both in the United States and in a number of foreign jurisdictions. Federal Reserve staff also took part in technical assistance and training missions led by the International Monetary Fund, the World Bank, the Asian Development Bank, the Basel Committee on Banking Supervision, and the Financial Stability Institute.

The Federal Reserve is also an associate member of the Association of Supervisors of Banks of the Americas (ASBA), an umbrella group of bank supervisors from countries in the Western Hemisphere. The group, headquartered in Mexico,

- promotes communication and cooperation among bank supervisors in the region;
- coordinates training programs throughout the region with the help of national banking supervisors and international agencies; and
- aims to help members develop banking laws, regulations, and supervisory practices that conform to international best practices.

The Federal Reserve contributes significantly to ASBA's organizational management and to its training and technical assistance activities.

Efforts to Support Minority-Owned Depository Institutions

The Federal Reserve System implements its responsibilities under section 367 of the Dodd-Frank Act primarily through its Partnership for Progress (PFP) program. Established in 2008, this program promotes the viability of minority-owned institutions (MOIs) by facilitating activities designed to strengthen their business strategies, maximize their resources, and increase their awareness and understanding of regulatory topics. In addition, the Federal Reserve continues to maintain the PFP website, which supports MOIs by providing them with technical information and links to useful resources (www.fedpartnership.gov). Representatives from each of the 12 Reserve Bank districts, along with staff from the Board of Governors, continue to offer technical assistance tailored to MOIs by providing targeted supervisory guidance, identifying additional resources, and fostering mutually beneficial partnerships between MOIs and community organizations. As of year-end 2013, the Federal Reserve's MOI portfolio included 17 state member banks.

Throughout 2013, the Federal Reserve System continued to support MOIs through the following activities:

- issuing SR letter 13-15 "Federal Reserve Resources for Minority Depository Institutions" to reaffirm the Federal Reserve System's commitment to support minority depositories
- in collaboration with the FDIC and the Comptroller of the Currency, participating in a biannual interagency conference to help promote and preserve MOIs
- participating in the 86th National Bankers Association (NBA) Convention, with senior Board officials attending this event to explain the impact of Basel III capital rules on community banking organizations
- providing technical assistance to MOIs on a wide variety of topics, including topics focused on improving regulatory ratings, navigating the regulatory applications process, and refining capital-planning practices
- continuing to offer prescreening of MOI applications, to support early identification and resolution of factors that may cause processing delays
- partnering with the NBA, the National Urban League, and the Minority Council of the Indepen-

dent Community Bankers Association in outreach events

- in conjunction with the Division of Consumer and Community Affairs, conducting several joint outreach efforts to educate MOIs on supervisory topics
- participating in an interagency taskforce to consider and address supervisory challenges facing MOIs

Throughout 2013, PFP representatives hosted and participated in numerous banking workshops and seminars aimed at promoting and preserving MOIs, including the NBA's Legislative and Regulatory Conference and the National Urban League Convention. Further, program representatives continued to collaborate with community leaders, trade groups, the Small Business Administration, and other organizations to seek support for MOIs.

Business Continuity

In 2013, the Federal Reserve continued its efforts to strengthen the resilience of the U.S. financial system in the event of unexpected disruptions, including focused supervisory efforts to evaluate the resiliency of the banking institutions under its jurisdiction and their technology services providers. As a result of several events that presented major challenges to the financial system, including the continuing distributed denial of service (DDoS) attacks against U.S. financial institutions, in 2013 the Federal Reserve, in conjunction with the other FFIEC agencies, took steps to promote the continued resilience of the financial system. First, the FFIEC agencies reviewed supervisory lessons learned from Superstorm Sandy and developed specific action steps for addressing these supervisory concerns. Second, the FFIEC agencies created the Cybersecurity and Critical Infrastructure Working Group to assess the risks to banks and credit unions from the evolving cyber threat landscape. In addition, as a result of the lessons learned from Superstorm Sandy, the DDoS attacks, and other cyber security threats, the Federal Reserve led an FFIEC agency review of business resiliency for technology service providers. Finally, the Federal Reserve, together with other federal and state financial regulators, continued to participate in the Financial and Banking Information Infrastructure Committee, which supports improved coordination and communication among financial regulators, promotes the resiliency of the financial sector, and promotes public/private partnership.

Supervisory Policy

The Federal Reserve's supervisory policy function, carried out by the Board, is responsible for developing regulations and guidance for financial institutions under the Federal Reserve's supervision, as well as guidance for examiners. The Board (often in concert with the other federal banking agencies) issues rulemakings, public SR letters, and other policy statements and guidance in order to carry out its supervisory policies. Federal Reserve staff also take part in supervisory and regulatory forums, provide support for the work of the FFIEC, and participate in international policymaking forums, including the Basel Committee on Banking Supervision, the Financial Stability Board, and the Joint Forum.

Capital Adequacy Standards

In 2013, the Board issued several rulemakings and guidance documents related to capital adequacy standards, including joint rulemakings with the other federal banking agencies that would implement certain revisions to the Basel capital framework and that address certain provisions of the Dodd-Frank Act.

- In March, the Federal Reserve issued guidance to explain the availability on the Board's public website of examination guidance relating to implementation of the advanced approaches risk-based capital rule. A series of bulletins will be used to address technical and other matters on the implementation of the advanced approaches rule. This guidance only applies to a few large, internationally active banking organizations. Seven bulletins were published in 2013 and are available, with the associated guidance, at www.federalreserve.gov/bankinforeg/basel/basel-coordination-committee-bulletins.htm.
- In July, the Federal Reserve and the OCC published a final rule to amend the regulatory capital rules. The FDIC published an interim final rule that is consistent with the final rule adopted by the Board and the OCC. The final rule establishes an integrated regulatory capital framework that addresses shortcomings in regulatory capital requirements that became apparent during the recent financial crisis. For internationally active banking organizations, the final rule implements in the United States the Basel III regulatory capital reforms adopted by the Basel Committee on Banking Supervision. The final rule also makes changes required by the Dodd-Frank Act, including removal of references to and reliance on credit rat-

ings. The final rule is available at www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf.

- In July, the federal banking agencies issued a proposed rule to strengthen the leverage ratio standards for the largest, most systemically significant U.S. banking organizations. Under the proposed rule, U.S. top tier BHCs with more than $700 billion in consolidated total assets or $10 trillion in assets under custody (covered BHCs) would be required to maintain a tier 1 capital leverage buffer of more than 2 percent above the minimum supplementary leverage ratio requirement of 3 percent to avoid limitations on distributions and discretionary bonus payments. The subsidiary insured depository institutions of covered BHCs would be required to meet a 6 percent supplementary leverage ratio to be considered "well capitalized" for prompt corrective action purposes. The proposed rule would apply to the eight largest, most systemically significant U.S. banking organizations and would strengthen the leverage requirements for these firms in proportion to the stronger risk-based capital requirements in effect under the revised capital framework in order to maintain an effective complementary relationship between the two types of requirements. The proposed rule is available at www.gpo.gov/fdsys/pkg/FR-2013-08-20/pdf/2013-20143.pdf.
- In August, the Federal Reserve issued a paper, *Capital Planning at Large Bank Holding Companies: Supervisory Expectations and Range of Current Practice*. The paper is intended to promote better capital planning at BHCs generally, and to provide greater clarity on the standards against which those practices are evaluated as part of the CCAR exercise. In particular, the Federal Reserve emphasized that BHCs, when considering their capital needs, should focus on the specific risks they could face under potentially stressful conditions. The paper is available at www.federalreserve.gov/bankinforeg/bcreg20130819a1.pdf.
- In September, the Federal Reserve issued two interim final rules that clarify how companies should incorporate the revised regulatory capital framework, implementing the Basel III regulatory capital reforms, into their capital and business projections during the cycle of capital plan submissions and stress tests that began October 1, 2013 (current cycle). The interim final rule applicable to BHCs with $50 billion or more in total consolidated assets clarifies that these companies must incorporate the revised capital framework into their capital planning projections and into the required stress tests. The other interim final rule provides a one-year transition period for most banking organizations with between $10 billion and $50 billion in total consolidated assets. These companies will be required to calculate their stress test projections using the Board's current regulatory capital rules during the current cycle in order to allow time to adjust their internal systems to the revised capital framework. The interim final rules are available at www.gpo.gov/fdsys/pkg/FR-2013-09-30/pdf/2013-23618.pdf and www.gpo.gov/fdsys/pkg/FR-2013-09-30/pdf/2013-23619.pdf.
- In November, the federal banking agencies announced the availability of a revised regulatory capital estimation tool to help community banks and other interested parties evaluate the revised regulatory capital framework issued in July. The tool was developed to assist these banks in estimating the potential effects on their capital ratios of the agencies' recently revised regulatory capital framework. The announcement and the capital estimation tool are available at www.federalreserve.gov/newsevents/press/bcreg/20131119a.htm.
- In December, the Federal Reserve published a final rule that makes technical changes to the market risk capital rule to align it with the Basel III revised capital framework adopted by the agencies earlier this year. The market risk capital rule is used by banking organizations with significant trading activities to calculate regulatory capital requirements for market risk. The rule is available at www.federalreserve.gov/newsevents/press/bcreg/20131206a.htm.
- In December, the Federal Reserve issued guidance to large financial institutions that provides clarification on supervisory expectations when assessing a firm's capital adequacy in certain circumstances when the risk-based capital framework may not fully capture the residual risks of a transaction. For such transactions, a financial institution should be able to demonstrate that it reflects the residual risk in its internal assessment of capital adequacy and maintains sufficient capital to address such risk. The letter is available at www.federalreserve.gov/bankinforeg/srletters/sr1323.pdf.

In 2013, Board and Reserve Bank staff conducted in-depth supervisory analyses of a number of complex capital issuances and private capital investments to evaluate their qualification for inclusion in regulatory capital. For certain transactions, banking organizations were required to make changes necessary

for instruments to satisfy regulatory capital criteria, whereas other instruments were disallowed from inclusion in a banking organization's regulatory capital.

International Coordination on Supervisory Policies

As a member of the Basel Committee on Banking Supervision, the Federal Reserve actively participates in efforts to advance sound supervisory policies for internationally active banking organizations and enhance the strength and stability of the international banking system.

Basel Committee

During 2013, the Federal Reserve participated in ongoing international initiatives to track the progress of implementation of the Basel framework in member countries.

The Federal Reserve contributed to supervisory policy recommendations, reports, and papers issued for consultative purposes or finalized by the Basel Committee that were designed to improve the supervision of banking organizations' practices and to address specific issues that emerged during the financial crisis. The listing below includes key final and consultative papers from 2013.

Final papers:

- *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (issued in January and available at www.bis.org/publ/bcbs238.pdf).
- *Monitoring tools for intraday liquidity management* (issued in April and available at www.bis.org/publ/bcbs248.pdf).
- *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* (issued in July and available at www.bis.org/publ/bcbs255.pdf).
- *Margin requirements for non-centrally cleared derivatives* (issued in September and available at www.bis.org/publ/bcbs261.pdf).
- *Capital requirements for banks' equity investments in funds* (issued in December and available at www.bis.org/publ/bcbs266.pdf).

Consultative papers:

- *Supervisory framework for measuring and controlling large exposures* (issued in March and available at www.bis.org/publ/bcbs246.pdf).
- *Revised Basel III leverage ratio framework and disclosure requirements* (issued in June and available at www.bis.org/publ/bcbs251.pdf).
- *Capital treatment of bank exposures to central counterparties* (issued in June and available at www.bis.org/publ/bcbs253.pdf).
- *The non-internal model method for capitalising counterparty credit risk exposures* (issued in June and available at www.bis.org/publ/bcbs254.pdf).
- *Capital requirements for banks' equity investments in funds* (issued in July and available at www.bis.org/publ/bcbs257.pdf).
- *Liquidity coverage ratio disclosure standards* (issued in July and available at www.bis.org/publ/bcbs259.pdf).
- *Fundamental review of the trading book: A revised market risk framework* (issued in October and available at www.bis.org/publ/bcbs265.pdf).
- *Revisions to the securitisation framework* (issued in December and available at www.bis.org/publ/bcbs269.pdf).

Joint Forum

In 2013, the Federal Reserve continued its participation in the Joint Forum—an international group of supervisors of the banking, securities, and insurance industries established to address various cross-sector issues, including the regulation of financial conglomerates. The Joint Forum operates under the aegis of the Basel Committee, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. The Federal Reserve is also currently participating in a new initiative that will analyze how increased requirements for collateral have impacted firm behavior in the banking, securities, and insurance sectors. Final and consultative papers issued by the Joint Forum in 2013 include:

- *Mortgage insurance: market structure, underwriting cycle and policy implications* (issued in February and available at www.bis.org/publ/joint30.pdf).
- *Longevity risk transfer markets: market structure, growth drivers and impediments, and potential risks* (issued in December and available at www.bis.org/publ/joint34.pdf).

Financial Stability Board

In 2013, the Federal Reserve continued its active participation in the Financial Stability Board (FSB)—an international group that helps coordinate the work of

national financial authorities and international standard setting bodies, and develops and promotes the implementation of financial sector policies in the interest of financial stability. Through the FSB Standing Committee on Supervisory and Regulatory Cooperation, the FSB is engaged in several issues, including shadow banking, supervision of globally systemically important financial institutions, and the development of effective resolution regimes for large financial institutions. Guidance and consultative papers issued by the FSB in 2013 include:

- *Principles for an Effective Risk Appetite Framework* (issued in July and available at www.financialstabilityboard.org/publications/r_130717.pdf).
- *Information sharing for resolution purposes* (issued in August and available at www.financialstabilityboard.org/publications/r_130812b.pdf).
- *Application of the Key Attributes of Effective Resolution Regimes to Non-Bank Financial Institutions* (issued in August and available at www.financialstabilityboard.org/publications/r_130812a.pdf).
- *Assessment Methodology for the Key Attributes of Effective Resolution Regimes for Financial Institutions* (issued in August and available at www.financialstabilityboard.org/publications/r_130828.pdf).
- *Strengthening Oversight and Regulation of Shadow Banking – An Overview of Policy Recommendations* (issued in August and available at www.financialstabilityboard.org/publications/r_130829a.pdf).
- *Strengthening Oversight and Regulation of Shadow Banking – Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos* (issued in August and available at www.financialstabilityboard.org/publications/r_130829b.pdf).
- *Strengthening Oversight and Regulation of Shadow Banking – Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* (issued in August and available at www.financialstabilityboard.org/publications/r_130829c.pdf).

Accounting Policy

The Federal Reserve strongly endorses sound corporate governance and effective accounting and auditing practices for all regulated financial institutions. Accordingly, the Federal Reserve's accounting policy function is responsible for providing expertise in policy development and implementation efforts, both within and outside the Federal Reserve System, on issues affecting the banking industry in the areas of accounting, auditing, internal controls over financial reporting, financial disclosure, and supervisory financial reporting.

Federal Reserve staff regularly consult with key constituents in the accounting and auditing professions, including domestic and international standard-setters, accounting firms, accounting and financial sector trade groups, and other financial sector regulators to facilitate the Board's understanding of domestic and international practices; proposed accounting, auditing, and regulatory standards; and the interactions between accounting standards and regulatory reform efforts. The Federal Reserve also participates in various accounting, auditing, and regulatory forums in order to both formulate and communicate its views.

During 2013, Federal Reserve staff addressed numerous issues including loan accounting, troubled debt restructurings, other real estate accounting, accounting for credit losses, financial instrument accounting and reporting, securities financing transactions, deferred taxes, insurance contracts accounting, and external and internal audit processes.

The Federal Reserve shared its views with accounting and auditing standard-setters through informal discussions and public comment letters. Comment letters on Financial Accounting Standards Board proposals related to accounting for credit losses, recognition and measurement of financial assets and financial liabilities, accounting for leases, and accounting for insurance contracts were issued during the past year.

The Federal Reserve staff also participated in meetings of the Basel Committee's Accounting Experts Group (formerly known as the Accounting Task Force), which represents the Basel Committee at international meetings on accounting, auditing, and disclosure issues affecting global banking organizations. Working with international bank supervisors, Federal Reserve staff contributed to the development of numerous other comment letters that were submitted to standard setters through the Basel Committee. The issues addressed in the comment letters during 2013 included accounting for credit losses, classifica-

tion and measurement of financial instruments, and auditor's reporting model.

In 2013, the Federal Reserve issued supervisory guidance to financial institutions and supervisory staff on accounting matters, as appropriate, and participated in a number of supervisory-related activities. For example, Federal Reserve staff

- issued guidance on the internal audit function, troubled debt restructurings, and secured consumer debt discharged in Chapter 7 bankruptcy;[9]
- developed and participated in a number of domestic and international supervisory training programs and education sessions to educate supervisors and bankers about new and emerging accounting and reporting topics affecting financial institutions; and
- supported the efforts of the Reserve Banks in financial institution supervisory activities, through participation in examinations and provision of expert guidance on specific queries related to financial accounting, auditing, reporting, and disclosures.

The Federal Reserve System staff also provided their accounting and business expertise through participation in other supervisory activities during the past year. These activities included supporting Dodd-Frank Act initiatives related to stress testing of banks and resolution planning by banks, as well as, various Basel III issues.

Credit-Risk Management

The Federal Reserve works with the other federal banking agencies to develop guidance on the management of credit risk; to coordinate the assessment of regulated institutions' credit risk; and to ensure that institutions properly identify, measure, and manage credit risk.

Shared National Credit Program

In September, the Federal Reserve and the other banking agencies released summary results of the 2013 annual review of the Shared National Credit (SNC) Program. The agencies established the program in 1977 to promote an efficient and consistent review and classification of shared national credits. A SNC is any loan or formal loan commitment—and any asset, such as other real estate, stocks, notes, bonds, and debentures taken as debts previously contracted—extended to borrowers by a supervised institution, its subsidiaries, and affiliates. A SNC must have an original loan amount that aggregates to $20 million or more and either (1) is shared by three or more unaffiliated supervised institutions under a formal lending agreement or (2) a portion of which is sold to two or more unaffiliated supervised institutions, with the purchasing institutions assuming their pro rata share of the credit risk.

The 2013 SNC review was based on analyses prepared in the second quarter of 2013 using credit-related data provided by federally supervised institutions as of December 31, 2012, and March 31, 2013. The 2013 SNC portfolio totaled $3.01 trillion, with roughly 9,300 credit facilities to approximately 5,800 borrowers. From the previous period, the dollar volume of the portfolio commitment amount rose by $219 billion or 7.8 percent, and the number of credits increased by 590, or 6.8 percent.

The quality of 2012 originations slightly improved from 2011 originations as more transactions were reported as investment grade. However, the SNC examination noted weak underwriting standards in 24 percent of the loan transactions sampled. This percentage compares unfavorably to 2011, 2010, and 2009 percentages of 19 percent, 16 percent and 13 percent, respectively. Leveraged lending transactions are the primary driver of this deterioration. The most frequently cited underwriting deficiencies identified during the 2013 SNC Review were minimal or no loan covenants, liberal repayment terms, repayment dependent on refinancing, and inadequate collateral valuations. The weak underwriting structures are in part attributable to aggressive competition and market liquidity.

In conjunction with the March 21, 2013, issuance of the Interagency Guidance on Leveraged Lending, the 2013 SNC review included a review of 496 leveraged obligors, with $429 billion in commitments (approximately 53.6 percent of reviewed SNC commitments). The review identified a high level of risk associated with this subset of the portfolio. The leveraged loan criticized rate, at 42 percent, was substantially higher than that of non-leveraged loans, which carried a criticized rate of 3.1 percent.

Refinancing risk has declined in the SNC portfolio as only 15 percent of SNCs will mature over the next two years compared with 23 percent for the same time frame in the 2012 SNC Review. Poorly under-

[9] Final guidance documents are available at www.federalreserve.gov/bankinforeg/srletters/sr1301.pdf; www.federalreserve.gov/bankinforeg/srletters/sr1324.pdf; www.federalreserve.gov/bankinforeg/srletters/sr1317.pdf; and www.federalreserve.gov/reportforms/supplemental/SI_FRY9_201306.pdf.

written credits originated in 2006 and 2007 continued to adversely affect the SNC portfolio. During 2012 and into 2013, syndications continued to modify loan agreements to extend maturities. These transactions had the effect of relieving near-term refinancing risk, but may not improve borrowers' ability to repay their debts in the longer term.

For more information on the 2013 SNC review, visit the Board's website at www.federalreserve.gov/newsevents/press/bcreg/20131010a.htm.

Compliance Risk Management

The Federal Reserve works with international and domestic supervisors to develop guidance that promotes compliance with Bank Secrecy Act and Anti-Money-Laundering Compliance (BSA/AML) and counter terrorism laws.

Bank Secrecy Act and Anti-Money-Laundering Compliance

In 2013, the Federal Reserve continued to actively promote the development and maintenance of effective BSA/AML compliance risk-management programs, including developing supervisory strategies and providing guidance to the industry on trends in BSA/AML compliance. For example, the Federal Reserve supervisory staff participated in a number of industry conferences to continue to communicate regulatory expectations and policy interpretations for financial institutions.

The Federal Reserve is a member of the Treasury-led BSA Advisory Group, which includes representatives of regulatory agencies, law enforcement, and the financial services industry and covers all aspects of the BSA. The Federal Reserve also participated in several Treasury-led private/public sector dialogues with Latin American and Mexican financial institutions, regulators, and supervisors. The objective of these dialogues is to optimize correspondent relations between U.S. and country-specific financial sectors. In addition, the Federal Reserve participated in meetings during the year to discuss BSA/AML issues with delegations from Japan, Columbia, and Hong Kong regarding managing and reporting on AML risk, customer due diligence, and emerging payments. The Federal Reserve also participates in the FFIEC BSA/AML working group, a monthly forum for the discussion of pending BSA policy and regulatory matters. In addition to the FFIEC agencies, the BSA/AML working group includes the Financial Crimes Enforcement Network (FinCEN) and, on a quarterly basis, the SEC, the Commodity Futures Trading Commission, the Internal Revenue Service, and the Office of Foreign Assets Control (OFAC).

The FFIEC BSA/AML working group is responsible for updating the FFIEC *Bank Secrecy Act/Anti-Money Laundering Examination Manual*). The FFIEC developed this manual as part of its ongoing commitment to provide current and consistent interagency guidance on risk-based policies, procedures, and processes for financial institutions to comply with the BSA and safeguard their operations from money laundering and terrorist financing.

Throughout 2013, the Federal Reserve and other federal banking agencies continued to regularly share examination findings and enforcement proceedings with FinCEN as well as with OFAC under the interagency MOUs finalized in 2004 and 2006. The Federal Reserve also provided a speaker for and participated in OFAC's day-long Financial Institution Symposium.

In 2013, the Federal Reserve continued to participate in the U.S. Treasury's Interagency Task Force on Strengthening and Clarifying the BSA/AML Framework (Task Force), created in 2012, which includes representatives from the Department of Justice, OFAC, FinCEN, the federal banking agencies, the SEC, and the Commodity Futures Trading Commission. The primary focus of the Task Force is to review the BSA, its implementation, and its enforcement with respect to U.S. financial institutions that are subject to these requirements, and to develop recommendations for ensuring the continued effectiveness of the BSA and efficiency in agency efforts to monitor compliance.

International Coordination on Sanctions, Anti-Money-Laundering, and Counter-Terrorism Financing

The Federal Reserve participates in a number of international coordination initiatives related to sanctions, money laundering, and terrorism financing. For example, the Federal Reserve has a long-standing role in the U.S. delegation to the intergovernmental Financial Action Task Force (FATF) and its working groups, contributing a banking supervisory perspective to formulation of international standards. The Federal Reserve participated in developing the FATF guidance for the banking sector on identifying, assessing, and monitoring money laundering and the financing of terrorism on a risk-assessed basis. The Federal Reserve also participated in efforts by FATF to more fully understand effective AML supervision

and enforcement. In addition, the Federal Reserve has provided input and review of ongoing work to revise the FATF Recommendations to ensure that they continue to provide a comprehensive and current framework for combating money laundering and terrorist financing. Finally, the Federal Reserve continues to participate in a subcommittee of the Basel Committee that focuses on AML/counter-terrorism financing issues. With respect to that subcommittee, the Federal Reserve actively contributed to the development of a consultative paper on the sound management of risks related to money laundering and the financing of terrorism.

Incentive Compensation

To foster improved incentive compensation practices in the financial industry, the Federal Reserve along with the other federal banking agencies adopted interagency guidance oriented to the risk-taking incentives created by incentive compensation arrangements.[10] The guidance is principles-based, recognizing that the methods used to achieve appropriately risk-sensitive compensation arrangements likely will differ significantly across and within firms. The three principles at the core of the guidance are:

- Incentive compensation arrangements should balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risks.
- A banking organization's risk-management processes and internal controls should reinforce and support the development and maintenance of balanced incentive compensation arrangements, and incentive compensation should not hinder risk management and controls.
- Banking organizations should have strong and effective corporate governance of incentive compensation.

These principles and the guidance more generally are consistent with the Principles for Sound Compensation Practices issued in April 2009 by the Financial Stability Board and associated implementation standards.[11]

Through two Board-led horizontal reviews and with ongoing engagement with the largest firms and our supervisory teams, we have improved practice and design of incentive compensation arrangements at firms with greater than $50 billion in U.S. assets. This horizontal review was designed to assess the potential for incentive compensation arrangements to encourage imprudent risk-taking; the actions the large banking organizations have taken to correct deficiencies in incentive compensation design; and the adequacy of the firms' compensation-related risk management, controls, and corporate governance.[12]

The Dodd-Frank Act requires the reporting to regulators of incentive compensation arrangements and prohibits incentive compensation arrangements that provide excessive compensation or that could expose the firm to inappropriate risks. Banking organizations, broker–dealers, investment advisers, and certain other firms are covered under the act if they have $1 billion or more in total consolidated assets. To implement the act, seven financial regulatory agencies (Federal Reserve, OCC, FDIC, OTS, NCUA, SEC, FHFA) issued a joint proposed rule in April 2011. At the heart of the proposed rule are the three principles in the banking agencies' guidance. A very large number of comments were received from the public and these comments are being carefully considered in the drafting of the final rule.

Other Policymaking Initiatives

- In March, the Federal Reserve and the other federal banking agencies issued updated guidance on leveraged lending. The guidance outlines high-level principles related to safe-and-sound leveraged lending activities. It addresses pertinent risk-management issues surrounding leveraged loans that came to the forefront prior to and during the recent financial crisis and encourages companies to develop and maintain a definition of leveraged lending that can be applied across business lines. The guidance highlights the importance of developing and maintaining a sound leveraged lending policy and extending prudent risk-management practices equally to loans originated to hold and to those originated to distribute. The guidance is available at www.federalreserve.gov/bankinforeg/srletters/sr1303.htm.

[10] See "Guidance on Sound Incentive Compensation Policies," vol. 75 *Federal Register*, pp. 36395–36414, June 25, 2010.

[11] In July 2011, the Basel Committee on Banking Supervision published its Pillar 3 Disclosure Requirements for Remuneration. These disclosure requirements are designed to support effective market discipline with the goal of providing access to the quality of the compensation practices and the quality of support for a firm's strategy and risk posture. The Board plans to issue a notice of proposed rulemaking to implement the key elements of the Basel Committee's issuance.

[12] See "Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations," published in October 2011 by the Board of Governors of the Federal Reserve System.

- In August, the Board issued a final rule (Regulation TT, 12 CFR 246 et seq.) establishing an annual assessment for its supervision and regulation of large financial companies pursuant to section 318 of the Dodd-Frank Act, which directs the Board to collect assessments equal to the expenses it estimates are necessary or appropriate to supervise and regulate BHCs and SLHCs with $50 billion or more in total consolidated assets and nonbank financial companies designated by the FSOC for supervision by the Federal Reserve. The final rule became effective on October 25, 2013, and is available at www.gpo.gov/fdsys/pkg/FR-2013-08-23/pdf/2013-20306.pdf. The final rule provides that each calendar year is an assessment period and outlines how the Board determines which companies are charged, estimates the applicable expenses, determines each company's assessment, and bills for and collects the assessment. In 2013, the Board billed 72 companies for the 2012 assessment period. In accordance with Regulation TT and as required by law, the Board collected and transferred a total of $433,483,299 to the U.S. Treasury. As such, the Board does not recognize the assessments as revenue nor does the Board use the collections to fund Board expenses.
- In August, six federal agencies (the Federal Reserve, Department of Housing and Urban Development, the FDIC, the Federal Housing Finance Agency, the OCC, and the SEC) issued a revised proposed rule requiring sponsors of securitization transactions to retain risk in those transactions. The new proposal revises a proposed rule the agencies issued in 2011 to implement the risk retention requirement in the Dodd-Frank Act. The rule would provide asset-backed securities sponsors with several options to satisfy the risk retention requirements. The proposed rule is available at www.gpo.gov/fdsys/pkg/FR-2013-09-20/pdf/2013-21677.pdf.
- In October, the federal banking agencies issued securities classification guidance. The guidance outlines principles related to the proper classification of securities without relying on ratings issued by nationally recognized statistical rating organizations (external credit ratings). Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires each federal agency to remove references to, and requirements of reliance on, external credit ratings in any regulation issued by the agency that requires the assessment of the creditworthiness of a security or money market instrument. This guidance clarifies the classification standards for securities held by an institution and provides examples that demonstrate when a security is investment grade and when it is not investment grade. The guidance is available at www.federalreserve.gov/bankinforeg/srletters/sr1318.htm.
- In December, the Federal Reserve issued guidance on managing outsourcing risk. The guidance expands upon the existing interagency guidance on outsourcing of information technology services that was issued by the FFIEC in 2004. Specifically, it applies to service provider relationships where business functions or activities are outsourced. The guidance highlights potential risks arising from the use of service providers and describes elements of an appropriate service provider risk-management program. The guidance is available at www.federalreserve.gov/bankinforeg/srletters/sr1319.htm.
- In December, the Federal Reserve and the other federal financial institutions regulatory agencies issued a statement to clarify safety-and-soundness expectations and Community Reinvestment Act considerations for regulated mortgage lenders in light of the Consumer Financial Protection Bureau's Ability-to-Repay and Qualified Mortgage Standards Rule. The statement was intended to guide institutions as they assessed the implementation of the Bureau's Ability-to-Repay Rule. From a safety-and-soundness perspective, the Federal Reserve and the other agencies emphasized that an institution may originate both qualified and nonqualified residential mortgage loans (QM and non-QM, respectively) based on its business strategy and risk appetite. The agencies will not subject a residential mortgage loan to safety-and-soundness criticism solely because of the loan's status as a QM or non-QM loan. The statement also emphasized that, from a consumer protection perspective, the agencies do not anticipate that an institution's decision to originate only QMs, absent other factors, would adversely affect its CRA evaluations. The letter and guidance are available at www.federalreserve.gov/bankinforeg/srletters/SR1320.htm.
- In December, the Federal Reserve issued guidance to clarify that financial institutions with significant foreign exchange operations in the United States should apply the principles of the Supervisory Guidance for Managing Risks Associated with the Settlement of Foreign Exchange Transactions, which was published in February by the Basel

Committee on Banking Supervision. The Basel Committee's guidance discusses the importance of strong governance over foreign exchange settlement risks and calls for the use of payment versus payment settlement systems and bilateral netting when possible, along with the exchange of variation margin on transactions with financial institutions. The letter and guidance are available at www.federalreserve.gov/bankinforeg/srletters/sr1324.htm.

- In December, the Federal Reserve, the other federal banking agencies, and the SEC issued a statement regarding the treatment of certain collateralized debt obligations backed by trust preferred securities under the investment prohibitions of section 619 of the Dodd-Frank Act, otherwise known as the "Volcker rule." The letter and guidance are available at www.federalreserve.gov/bankinforeg/srletters/sr1325.htm.

Regulatory Reports

The Federal Reserve's supervisory policy function is also responsible for developing, coordinating, and implementing regulatory reporting requirements for various financial reporting forms filed by domestic and foreign financial institutions subject to Federal Reserve supervision. Federal Reserve staff members interact with other federal agencies and relevant state supervisors, including foreign bank supervisors as needed, to recommend and implement appropriate and timely revisions to the reporting forms and the attendant instructions.

Bank Holding Company Regulatory Reports

The Federal Reserve requires that U.S. holding companies (HCs) periodically submit reports that provide information about their financial condition and structure.[13] This information is essential to formulating and conducting bank regulation and supervision. It is also used in responding to requests by Congress and the public for information about HCs and their nonbank subsidiaries. Foreign banking organizations also are required to periodically submit reports to the Federal Reserve.

- FR Y-9 series reports—the FR Y-9C, FR Y-9LP, FR Y-9SP and FR Y-9ES—provide standardized financial statements for HCs on both a consolidated and a parent-only basis. The reports are used to detect emerging financial problems, to review performance and conduct pre-inspection analysis, to monitor and evaluate risk profiles and capital adequacy, to evaluate proposals for HC mergers and acquisitions, and to analyze a holding company's overall financial condition.
- Nonbank subsidiary reports—the FR Y-11, FR 2314, FR Y-7N, and FR 2886b—help the Federal Reserve determine the condition of HCs that are engaged in nonbank activities and also aid in monitoring the number, nature, and condition of the companies' nonbank subsidiaries.
- The FR Y-8 report provides information on transactions between an insured depository institution and its affiliates that are subject to section 23A of the Federal Reserve Act; it is used to monitor bank exposures to affiliates and to ensure banks' compliance with section 23A of the Federal Reserve Act.
- The FR Y-10 report provides data on changes in organization structure at domestic and foreign banking organizations.
- The FR Y-6 and FR Y-7 reports gather additional information on organization structure and shareholders from domestic banking organizations and foreign banking organizations, respectively; the information is used to monitor structure so as to determine compliance with provisions of the Bank Holding Company Act (BHC Act) and Regulation Y, and the Home Owners Loan Act (HOLA) and Regulation LL and to assess the ability of a foreign banking organization to continue as a source of strength to its U.S. operations.
- The FFIEC 101 report collects information about the components of reporting entities' regulatory capital, risk-weighted assets by type of credit-risk exposure under the Advanced Internal Ratings-Based Approach, and risk-weighted assets and operational losses under the Advanced Measurement Approach. The report is used to assess and monitor the levels and components of each reporting entity's risk-based capital requirements and the adequacy of the entity's capital under the Advanced Capital Adequacy Framework.
- The FFIEC 009 report collects detailed information on the distribution, by country, of claims on foreigners held by the reporting institution. The report is used to determine the degree of risk in the reporting institution's portfolios and the effect adverse developments in particular countries may have on the U.S. banking system.

During 2013, the Federal Reserve proposed to revise the FR Y-9C, FR Y-9SP and the FFIEC 101 reports

[13] HCs are defined as bank holding companies, savings and loan holding companies, and securities holding companies.

to implement the revised regulatory capital framework. The Federal Reserve would modify the FR Y-9C to split the current Schedule HC-R, Regulatory Capital, into two parts: Part I, which would collect information on regulatory capital components and ratios, and Part II, which would collect information on risk-weighted assets. The Federal Reserve would modify the FR Y-9SP to add a new Schedule SC-R, Regulatory Capital, to begin collecting information on regulatory capital components and ratios and risk-weighted assets from small covered SLHCs. The Federal Reserve (with the other FFIEC member banking agencies) would modify FFIEC 101 Schedule A, Advanced Risk-Based Capital, and nine other schedules to implement the revised advanced approaches capital rules.

Effective in December 2013, the FFIEC 009 report was revised to (1) increase the number of counterparty categories; (2) add additional information on the type of claim being reported; (3) provide details on a limited number of risk mitigants to help provide perspective to currently reported gross exposure numbers; (4) add more detailed reporting of credit derivatives; (5) add the United States as a country row to facilitate the analysis of domestic and foreign exposures and comply with enhancements to International Banking Statistics proposed by the Bank for International Settlements; and (6) effective March 2014, expand the entities that must report to include SLHCs.

Also effective in December 2013, the Federal Reserve reduced reporting burden by increasing the asset size thresholds for filing the annual FR Y-11/S, FR 2314/S, and FR Y-7N/S. In addition, the Federal Reserve eliminated the FR Y-11S and FR 2314S threshold requirement based on the percentage of consolidated assets of the top-tier organization.

Savings and Loan Holding Company Regulatory Reports

The majority of SLHCs became compliant with Federal Reserve regulatory reporting by the end of 2013. At this time, approximately 20 commercial and insurance SLHCs remain exempt from filing consolidated regulatory reports.

Commercial Bank Regulatory Reports

As the federal supervisor of state member banks, the Federal Reserve, along with the other banking agencies (through the FFIEC), requires banks to submit quarterly the Consolidated Reports of Condition and Income (Call Reports). Call Reports are the primary source of data for the supervision and regulation of banks and the ongoing assessment of the overall soundness of the nation's banking system. Call Report data provide the most current statistical data available for evaluating institutions' corporate applications, for identifying areas of focus for both on-site and off-site examinations, and for considering monetary and other public policy issues. Call Report data, which also serve as benchmarks for the financial information required by many other Federal Reserve regulatory financial reports, are widely used by state and local governments, state banking supervisors, the banking industry, securities analysts, and the academic community.

During 2013, the FFIEC proposed to revise the Call Report to implement the banking agencies' revised regulatory capital framework. The FFIEC would modify the Call Report to split the current Schedule RC-R, Regulatory Capital, into two parts: Part I, which would collect information on regulatory capital components and ratios, and Part II, which would collect information on risk-weighted assets. Also during 2013, the FFIEC proposed revisions to the following types of information on the Call Report: effective March 2014 (1) information about international remittance transfers; (2) information on trade names (other than an institution's legal title) used to identify physical offices and the addresses of any public-facing Internet websites (other than the institution's primary Internet website address) at which the institution accepts or solicits deposits from the public; (3) responses to a yes-no question asking whether the reporting institution offers any deposit account products (other than time deposits) primarily intended for consumers; (4) for institutions with $1 billion or more in total assets that offer one or more deposit account products (other than time deposits) primarily intended for consumers, information on the total balances of these consumer deposit account products; and effective March 2015 (5) for institutions with $1 billion or more in total assets that offer one or more deposit account products (other than time deposits) primarily intended for consumers, information on the amount of income earned from each of three categories of service charges on their consumer deposit account products.

Supervisory Information Technology

The Federal Reserve's supervisory information technology function, carried out by the Board's Division of Banking Supervision and Regulation and the Reserve Banks under the guidance of the Subcom-

mittee on Supervisory Administration and Technology, works to identify and set priorities for information technology initiatives within the supervision and regulation business line.

In 2013, the supervisory information technology function focused on

- **Large bank supervision**. Improved the supervision of large and regional financial institutions with new processes and linked workflows to enable continuous updates of information provided through examinations and ongoing monitoring activities.
- **Community and regional bank supervision**. Worked with community and regional bank examiners and other regulators to implement enhanced tools to support community and regional bank examinations.
- **Data management and analysis**. Implemented a Data Management Office to strengthen capabilities in the areas of data collection and data stewardship. Implemented new tools for the analysis of large volumes of data, especially in support of stress testing and risk analysis.
- **Collaboration**. (1) Enhanced information sharing among staff at the Board and Reserve Banks through new and enhanced collaboration tools; (2) implemented an electronic solution to support exam teams' ability to share documents, and (3) leveraged an Interagency Steering Group to improve methods for sharing work among state and federal regulators.
- **Modernization**. Implemented products to modernize business capabilities in the areas of loan review, examiner credentialing, and scheduling.
- **Information security**. Commenced several initiatives to improve overall information security and the efficiency of our information security practices.

National Information Center

The National Information Center (NIC) is the Federal Reserve's comprehensive repository for supervisory, financial, and banking structure data. It is also the main repository for many supervisory documents. The NIC includes (1) data on banking structure throughout the United States as well as foreign banking concerns; (2) the National Examination Data (NED), an application that enables supervisory personnel as well as federal and state banking authorities to access NIC data; (3) the Banking Organization National Desktop, an application that facilitates secure, real-time electronic information sharing and collaboration among federal and state banking regulators for the supervision of banking organizations; and (4) the Central Document and Text Repository (CDTR), an application that contains documents supporting the supervisory processes.

Within the NIC, the supporting systems continue to be modified over time to extend their usefulness and improve business workflow efficiency, especially for the sourcing transactional data systems. Throughout 2013, the NIC supervisory and structure databases continued to be modified to support Dodd-Frank Act changes and to facilitate the supervision of SLHCs. The capture and integration of the former OTS data and documents into several NIC databases were completed this year, which resulted in substantially more SLHC examination and enforcement action data being available. Additionally, SLHCs were added to the reporting panel for the Report of Changes in Organizational Structure (FR Y-10).

NIC staff are engaged with the Board's new Office of the Chief Data Officer established in 2013 to continue improving data management and data governance practices for the Board and FRS enterprise information. During 2013, a number of FRS management groups were modified to align with the Board's strategic planning initiatives.

Changes to the NIC public website continued to be implemented in response to the Dodd-Frank Act, including implementation of changes to allow access to the Banking Organization Systemic Risk Report (FR Y-15). Similarly the website was enhanced to provide access to the Risk-Based Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101). The data for these two series will be available in 2014.

Also in 2013, enhancements were made to the CDTR, which included the expansion of the application to accommodate additional text associated with new supervisory data collections and modifications to facilitate the sharing of information between the Federal Reserve System and the Consumer Financial Protection Bureau.

The NIC staff participated in a number of interagency technology-related initiatives as part of FFIEC task forces and interagency committees. These efforts support standardized data collections and cross-agency information sharing. Work in this area will continue to be important as the agencies work through the implementation of the remaining

Table 2. Training for banking supervision and regulation, 2013

Course sponsor or type	Number of enrollments		Instructional time (approximate training days)[1]	Number of course offerings
	Federal Reserve personnel	State and federal banking agency personnel		
Federal Reserve System	2,313	489	560	112
FFIEC	725	318	432	108
The Options Institute[2]	9	2	3	1
Rapid Response™	20,595	3,368	13	106

1 Training days are approximate. System courses were calculated using five days as an average, with FFIEC courses calculated using four days as an average.

2 The Options Institute, an educational arm of the Chicago Board Options Exchange, provides a three-day seminar on the use of options in risk management.

Dodd-Frank Act initiatives. One such technology-related initiative required Board staff to collaborate with the FDIC and OCC to review proposals on and award a contract for the enhancements to and the operations and maintenance of the FFIEC Central Data Repository (CDR), the data collection and validation system for the FFIEC commercial bank Consolidated Reports of Condition and Income (Call Reports: FFIEC 031 and FFIEC 041) and the Uniform Bank Performance Report.

The NIC also supports the interagency Shared National Credit (SNC) Program, the annual review of large syndicated loans. During 2013, the agencies continued to review and implement remaining business requirements to complete the SNC automation build out. This automation is focused on improving the efficiency of the annual SNC examination process and enhancing the supervisory insight derived from these exams.

Additionally, throughout 2013, NIC staff provided project management support for the maturation of data management practices associated with the CCAR, Capital Plan Review, and DFAST program initiatives and for the automation of the Capital Assessment and Stress Testing (FR Y-14) information collection.

Staff Development

The Federal Reserve's staff development program supports the ongoing development of about 3,200 professional supervisory staff, ensuring that they have the skills necessary to meet their evolving supervisory responsibilities. The Federal Reserve also provides course offerings to staff at state banking agencies. Training activities in 2013 are summarized in table 2.

Examiner Commissioning Program

The Federal Reserve System's commissioning program for assistant examiners is set forth in the Examiner Commissioning Program (SR letter 98-02).[14] Examiners choose from one of three specialty tracks—(1) safety and soundness, (2) consumer compliance, or (3) information technology. On average, individuals move through a combination of classroom offerings, self-paced learning, and on-the-job training over a period of three years. Achievement is measured by completing the required course content, demonstrating adequate on-the-job knowledge, and passing a professionally validated proficiency examination.

In 2013, 157 examiners passed the first proficiency exam and 142 passed the second proficiency exam (103 in safety and soundness and 39 in consumer compliance).

Currently, the Federal Reserve is undertaking a major initiative to modernize its Examiner Commissioning Program. As a result, the curriculum for examiners involved in community banking supervision and consumer compliance has been revised or is currently being revised.

Continuing Professional Development

Other formal and informal learning opportunities are available to examiners in the form of self-study materials, online learning, and classroom instruction. Schools, conferences, and programs covering a variety of regulatory topics are offered within the System, Board, and FFIEC. System programs are also available to state and federal banking agency personnel.

14 SR letter 98-02 is available at www.federalreserve.gov/boarddocs/srletters/1998/sr9802.htm.

Regulation

The Federal Reserve exercises important regulatory influence over entry into the U.S. banking system and the system structure through its administration of several federal statutes. The Federal Reserve is also responsible for imposing margin requirements on securities transactions. In carrying out its responsibilities, the Federal Reserve coordinates supervisory activities with the other federal banking agencies, state agencies, functional regulators (that is, regulators for insurance, securities, and commodities firms), and foreign bank regulatory agencies.

Regulation of the U.S. Banking Structure

The Federal Reserve administers six federal statutes that apply to BHCs, financial holding companies, member banks, SLHCs, and foreign banking organizations: the BHC Act, the Bank Merger Act, the Change in Bank Control Act, the Federal Reserve Act, section 10 of the Home Owners' Loan Act (HOLA (applies to SLHCs)), and the International Banking Act.

In administering these statutes, the Federal Reserve acts on a variety of applications that directly or indirectly affect the structure of the U.S. banking system at the local, regional, and national levels; the international operations of domestic banking organizations; or the U.S. banking operations of foreign banks. The applications concern BHC and SLHC formations and acquisitions, bank mergers, and other transactions involving banks and savings associations or nonbank firms. In 2013, the Federal Reserve acted on 994 applications filed under the six statutes. Many of these applications involved target banking organizations in less than satisfactory financial condition.

Bank Holding Company Act Applications

Under the BHC Act, a corporation or similar legal entity must obtain the Federal Reserve's approval before forming a BHC through the acquisition of one or more banks in the United States. Once formed, a BHC must receive Federal Reserve approval before acquiring or establishing additional banks. Also, BHCs generally may engage in only those nonbanking activities that the Board has previously determined to be closely related to banking under section 4(c)(8) of the BHC Act.[15] Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement.

When reviewing a BHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, financial stability factors, the convenience and needs of the community to be served, the potential public benefits, the competitive effects of the application, and the applicant's ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law. In the case of a foreign banking organization seeking to acquire control of a U.S. bank, the Federal Reserve also considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. In 2013, the Federal Reserve acted on 242 applications and notices filed by BHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities, including applications involving private equity firms.

A BHC may repurchase its own shares from its shareholders. When the company borrows money to buy the shares, the transaction increases the company's debt and decreases its equity. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital adequacy guidelines. In 2013, the Federal Reserve acted on 13 stock repurchase applications by BHCs.

The Federal Reserve also reviews elections submitted by BHCs seeking financial holding company status under the authority granted by the Gramm-Leach-Bliley Act. BHCs seeking financial holding company status must file a written declaration with the Federal Reserve. In 2013, 26 domestic financial holding company declarations were approved.

Bank Merger Act Applications

The Bank Merger Act requires that all applications involving the merger of insured depository institutions be acted on by the relevant federal banking agency. The Federal Reserve has primary jurisdiction if the institution surviving the merger is a state member bank. Before acting on a merger application, the Federal Reserve considers the financial and manage-

[15] Since 1996, the act has provided an expedited prior notice procedure for certain permissible nonbank activities and for acquisitions of small banks and nonbank entities. Since that time, the act has also permitted well-run BHCs that satisfy certain criteria to commence certain other nonbank activities on a de novo basis without first obtaining Federal Reserve approval.

rial resources of the applicant, the future prospects of the existing and combined organizations, the convenience and needs of the communities to be served, and the competitive effects of the proposed merger. The Federal Reserve also must consider the views of the U.S. Department of Justice regarding the competitive aspects of any proposed bank merger involving unaffiliated insured depository institutions. In 2013, the Federal Reserve approved 41 merger applications under the act.

Change in Bank Control Act Applications

The Change in Bank Control Act requires individuals and certain other parties that seek control of a U.S. bank, BHC, or SLHC to obtain approval from the relevant federal banking agency before completing the transaction. The Federal Reserve is responsible for reviewing changes in the control of state member banks, BHCs, and SLHCs. In its review, the Federal Reserve considers the financial position, competence, experience, and integrity of the acquiring person; the effect of the proposed change on the financial condition of the bank, BHC, or SLHC being acquired; the future prospects of the institution to be acquired; the effect of the proposed change on competition in any relevant market; the completeness of the information submitted by the acquiring person; and whether the proposed change would have an adverse effect on the Deposit Insurance Fund. A proposed transaction should not jeopardize the stability of the institution or the interests of depositors. During its review of a proposed transaction, the Federal Reserve may contact other regulatory or law enforcement agencies for information about relevant individuals. In 2013, the Federal Reserve approved 153 change in control notices and denied one notice.

Federal Reserve Act Applications

Under the Federal Reserve Act, a bank must seek Federal Reserve approval to become a member bank. A member bank may be required to seek Federal Reserve approval before expanding its operations domestically or internationally. State member banks must obtain Federal Reserve approval to establish domestic branches, and all member banks (including national banks) must obtain Federal Reserve approval to establish foreign branches. When reviewing applications for membership, the Federal Reserve considers, among other things, the bank's financial condition and its record of compliance with banking laws and regulations. When reviewing applications to establish domestic branches, the Federal Reserve considers, among other things, the scope and nature of the banking activities to be conducted. When reviewing applications for foreign branches, the Federal Reserve considers, among other things, the condition of the bank and the bank's experience in international banking. In 2013, the Federal Reserve acted on membership applications for 39 banks, and new and merger-related branch applications for 420 domestic branches and three foreign branches.

State member banks must also obtain Federal Reserve approval to establish financial subsidiaries. These subsidiaries may engage in activities that are financial in nature or incidental to financial activities, including securities-related and insurance agency-related activities. In 2013, no financial subsidiary applications were submitted.

Home Owners' Loan Act Applications

Under HOLA, a corporation or similar legal entity must obtain the Federal Reserve's approval before forming an SLHC through the acquisition of one or more savings associations in the United States. Once formed, an SLHC must receive Federal Reserve approval before acquiring or establishing additional savings associations. Also, SLHCs generally may engage in only those nonbanking activities that are specifically enumerated in HOLA or which the Board has previously determined to be closely related to banking under section 4(c)(8) of the BHC Act. Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement. In 2013, the Federal Reserve acted on 15 applications and notices filed by SLHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities.

Under HOLA, a savings association reorganizing to a mutual holding company (MHC) structure must receive Federal Reserve approval prior to its reorganization. In addition, an MHC must receive Federal Reserve approval before converting to stock form, and MHCs must receive Federal Reserve approval before waiving dividends declared by the MHC's subsidiary. In 2013, the Federal Reserve acted on no applications for MHC reorganizations. In 2013, the Federal Reserve acted on six applications filed by MHCs to convert to stock form, and six applications to waive dividends.

When reviewing an SLHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential

public benefits, the competitive effects of the application, and the applicant's ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law.

The Federal Reserve also reviews elections submitted by SLHCs seeking status as financial holding companies under the authority granted by the Dodd-Frank Act. SLHCs seeking financial holding company status must file a written declaration with the Federal Reserve. In 2013, no SLHC financial holding company declarations were approved.

Overseas Investment Applications by U.S. Banking Organizations

U.S. banking organizations may engage in a broad range of activities overseas. Many of the activities are conducted indirectly through Edge Act and agreement corporation subsidiaries. Although most foreign investments are made under general consent procedures that involve only after-the-fact notification to the Federal Reserve, large and other significant investments require prior approval. In 2013, the Federal Reserve approved 23 applications and notices for overseas investments by U.S. banking organizations, many of which represented investments through an Edge Act or agreement corporation.

International Banking Act Applications

The International Banking Act, as amended by the Foreign Bank Supervision Enhancement Act of 1991, requires foreign banks to obtain Federal Reserve approval before establishing branches, agencies, commercial lending company subsidiaries, or representative offices in the United States.

In reviewing applications, the Federal Reserve generally considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. It also considers whether the home-country supervisor has consented to the establishment of the U.S. office; the financial condition and resources of the foreign bank and its existing U.S. operations; the managerial resources of the foreign bank; whether the home-country supervisor shares information regarding the operations of the foreign bank with other supervisory authorities; whether the foreign bank has provided adequate assurances that information concerning its operations and activities will be made available to the Federal Reserve, if deemed necessary to determine and enforce compliance with applicable law; whether the foreign bank has adopted and implemented procedures to combat money laundering and whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering; and the record of the foreign bank with respect to compliance with U.S. law. In 2013, the Federal Reserve approved seven applications by foreign banks to establish branches, agencies, or representative offices in the United States.

Public Notice of Federal Reserve Decisions

Certain decisions by the Federal Reserve that involve an acquisition by a BHC, a bank merger, a change in control, or the establishment of a new U.S. banking presence by a foreign bank are made known to the public by an order or an announcement. Orders state the decision, the essential facts of the application or notice, and the basis for the decision; announcements state only the decision. All orders and announcements are made public immediately; they are subsequently reported in the Board's weekly H.2 statistical release. The H.2 release also contains announcements of applications and notices received by the Federal Reserve upon which action has not yet been taken. For each pending application and notice, the related H.2A release gives the deadline for comments. The Board's website provides information on orders and announcements (www.federalreserve.gov/newsevents/press/orders/2013orders.htm) as well as a guide for U.S. and foreign banking organizations that wish to submit applications (www.federalreserve.gov/bankinforeg/afi/afi.htm).

Enforcement of Other Laws and Regulations

The Federal Reserve's enforcement responsibilities also extend to the disclosure of financial information by state member banks and the use of credit to purchase and carry securities.

Financial Disclosures by State Member Banks

Under the Securities Exchange Act of 1934 and Federal Reserve's Regulation H, certain state member banks are required to make financial disclosures to the Federal Reserve using the same reporting forms (such as Form 10K- annual report and Schedule 14A -proxy statement) that are normally used by publicly held entities to submit information to the Securities Exchange Commission.[16] As most of the publicly

[16] Under Section 12(g) of the Securities Exchange Act, certain companies that have issued securities are subject to SEC registration and filing requirements that are similar to those imposed on public companies. Per Section 12(i) of the Securities Exchange Act, the powers of the SEC over banking entities that

held banking organizations are BHCs and the reporting threshold was recently raised, only three state member banks were required to submit data to the Federal Reserve in 2013. The information submitted by these three small state member banks is available to the public upon request and is primarily used for disclosure to the bank's shareholders and public investors.

Securities Credit

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchasing or carrying of securities. The Board's Regulation T limits the amount of credit that may be provided by securities brokers and dealers when the credit is used to purchase debt and equity securities. The Board's Regulation U limits the amount of credit that may be provided by lenders other than brokers and dealers when the credit is used to purchase or carry publicly held equity securities if the loan is secured by those or other publicly held equity securities. The Board's Regulation X applies these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Several regulatory agencies enforce the Board's securities credit regulations. The SEC, the Financial Industry Regulatory Authority, and the Chicago Board Options Exchange examine brokers and dealers for compliance with Regulation T. With respect to compliance with Regulation U, the federal banking agencies examine banks under their respective jurisdictions; the Farm Credit Administration and the NCUA examine lenders under their respective jurisdictions; and the Federal Reserve examines other Regulation U lenders.

fall under Section 12(g) are vested with the appropriate banking regulator. Specifically, state member banks with 2,000 or more shareholders and more than $10 million in total assets are required to register with, and submit data to, the Federal Reserve. These thresholds reflect the recent amendments by the Jumpstart Our Business Startups Act (JOBS Act).

4 Consumer and Community Affairs

The mission of the Division of Consumer and Community Affairs (DCCA) is to ensure that the voices and concerns of consumers and communities are represented at the central bank of the United States. DCCA has primary responsibility for carrying out the Board of Governor's consumer financial protection and community development programs. It also conducts consumer-focused supervision, research, and policy analysis, as well as implements statutory requirements and facilitates community development. These activities promote a fair and transparent consumer financial services market, including for traditionally underserved households and neighborhoods.

Throughout 2013, the division engaged in numerous consumer and community-related functions and policy activities in the following areas:

- **Consumer-focused supervision and examinations.** The division provided leadership for the Reserve Bank consumer compliance supervision and examination programs in state member banks and bank holding companies through policy development, examiner training, supervision oversight, fair lending, Unfair or Deceptive Acts or Practices (UDAP) and flood enforcement, analysis of bank and bank holding company applications in regard to consumer protection, and processing consumer complaints.
- **Consumer research and emerging-issues and policy analysis.** The division analyzed emerging issues in consumer financial services policies and practices in order to understand their implications for the economic and supervisory policies that are core to the central bank's functions, as well as to gain insight into consumer decisionmaking around financial services.
- **Community development activities.** The division continued to promote fair and informed access to financial markets for all consumers, particularly the needs of underserved populations, by engaging lenders, government officials, and community leaders. Throughout the year, DCCA convened programs to share information and research on effective community development policies and strategies.
- **Consumer laws and regulations.** The division continued to administer the Board's regulatory responsibilities with respect to certain entities and specific statutory provisions of the consumer financial services and fair lending laws. DCCA drafted and consulted with other agencies on regulations and official interpretations, as well as issued regulatory interpretations and compliance guidance for the industry, the Reserve Banks, other federal agencies, and congressional staff.

Supervision and Examinations

DCCA develops and supports supervisory policy and examination procedures for consumer protection laws and regulations, as well as the Community Reinvestment Act (CRA), as part of its supervision of the organizations for which it has authority, including holding companies, state member banks, and foreign banking organizations. The division also administers the Federal Reserve System's risk-focused program for assessing consumer compliance risk at the largest bank and financial holding companies in the System, with division staff ensuring that consumer compliance risk is effectively integrated into the consolidated supervision oversight of the holding company. The division oversees the efforts of the 12 Reserve Banks to ensure that compliance with consumer protection laws and regulations is fully evaluated and fairly enforced. Division staff provides guidance and expertise to the Reserve Banks on consumer protection laws and regulations, bank and bank holding company application analysis and processing, examination and enforcement techniques and policy matters, examiner training, and emerging issues. Staff review Reserve Bank supervisory reports, examination work products, and consumer complaint analyses and responses. Finally, staff members participate

in interagency activities that promote consistency in examination principles, standards, and processes.

Examinations are one of the Federal Reserve's methods of enforcing compliance with consumer protection laws and assessing the adequacy of consumer compliance risk-management systems within regulated entities. During 2013, the Reserve Banks completed 296 consumer compliance examinations of state member banks and 1 examination of a foreign banking organization.[1]

Bank Holding Company Consolidated Supervision Program

During 2013, staff in the Bank Holding Company (BHC) Consolidated Supervision Program had responsibility for reviewing more than 120 bank and financial holding companies to ensure consumer compliance risk was appropriately incorporated into the consolidated risk assessment for the organization. BHC Consolidated Supervision Program staff participated jointly with staff from the Board's Division of Banking Supervision and Regulation on numerous projects related to implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), including supervisory assessment fees, consolidated supervision, and thrift holding company integration. Also, as part of the consolidated supervision of BHCs, staff continued to monitor compliance with the provisions of the consent orders that were implemented in 2011 and 2012 at the 6 mortgage servicers and 10 BHCs for which the Federal Reserve has supervisory authority. Staff's oversight is designed to determine if the servicers and BHCs have corrected the noted deficiencies; that future abuses in the loan modification and foreclosure process are prevented; and that borrowers are compensated for financial injury they suffered because of errors, misrepresentations, or other deficiencies in the foreclosure process.

In January, the Federal Reserve issued guidance entitled "Supplemental Policy Statement on the Internal Audit Function and its Outsourcing,"[2] which addresses the characteristics, governance, and operational effectiveness of a financial institution's internal audit function. The guidance reflects changes over the past several years in banking regulations related to auditor independence and limitations placed on the external auditor. The Federal Reserve encourages financial institutions to enhance their internal audit practices and to adopt professional audit standards.

In April, the Federal Reserve issued guidance entitled "Extension of the Use of Indicative Ratings for Savings and Loan Holding Companies."[3] When the Federal Reserve assumed responsibility for supervision of savings and loan holding companies (SLHC) in July 2011, the Federal Reserve set forth the SLHC supervisory approach for the first supervisory cycle in SR letter 11-11/CA letter 11-5, "Supervision of Savings and Loan Holding Companies (SLHCs)." Under that approach, the Federal Reserve issues an indicative rating to each SLHC to indicate how the SLHC would be rated under the RFI rating system.[4] The current guidance clarifies that until finalization of a proposed rating system for SLHCs, the Federal Reserve will continue to assign indicative ratings to SLHCs.

In December, the Federal Reserve issued guidance entitled "Guidance on Managing Outsourcing Risk," which addresses the characteristics, governance, and operational effectiveness of a financial institution's service provider risk-management program for outsourced activities.[5] The guidance highlights the potential risks arising from the use of service providers and describes the elements of an appropriate service provider risk-management program.

Mortgage Servicing and Foreclosure: Remediating Borrowers through the Payment Agreement

In January 2013, the Payment Agreement replaced the Independent Foreclosure Review requirement of

1 Beginning with 2013, reporting of the number of examinations completed will reflect the period from January 1 to December 31. The Federal Reserve's 2012 Annual Report to Congress captured consumer compliance and CRA examinations from July 1, 2011, to June 30, 2012. For the period from July 1 to December 31, 2012, the Federal Reserve completed 136 consumer compliance examinations of state member banks and of 1 foreign banking organization, as well as 121 CRA examinations of state member banks.

2 For more information, see www.federalreserve.gov/bankinforeg/srletters/sr1301.htm.

3 For more information, see www.federalreserve.gov/bankinforeg/srletters/sr1308.htm.

4 The main components of the RFI rating system represent Risk Management (R), Financial Condition (F), and potential Impact (I) of the parent company and nondepository subsidiaries (collectively, nondepository entities) on the subsidiary depository institution(s).

5 For more information, see www.federalreserve.gov/bankinforeg/srletters/sr1319.htm.

the enforcement actions issued by federal banking regulators that included case-by-case file reviews and instead provides for cash payments to borrowers.[6] It resulted from an agreement reached among 13 separate mortgage servicers and the Federal Reserve Board and the Office of the Comptroller of the Currency (OCC). The participating servicers agreed to pay an estimated $3.6 billion to 4.2 million borrowers whose primary residence was in a foreclosure process in 2009 or 2010. The Payment Agreement also included an additional $5.7 billion dollars in other foreclosure prevention assistance, such as loan modifications and forgiveness of deficiency judgments. In late February, the Board and the OCC released amendments that memorialized the agreements in principle announced in January. For the participating servicers, fulfillment of the agreement will satisfy the foreclosure review requirements of the enforcement actions issued by the Board, the OCC, and the Office of Thrift Supervision in April and September 2011 and April 2012.

A paying agent, Rust Consulting, Inc. (Rust Consulting), was retained to administer payments to borrowers on behalf of the participating servicers. Beginning in April 2013, a letter with an enclosed check was sent to borrowers who had a foreclosure action initiated, pending, or completed in 2009 or 2010 with any of the participating servicers.[7] For checks that were returned undeliverable, Rust Consulting, at the direction of the regulators, is attempting to locate more current address information for the borrowers and will send a new check to the updated address. As of December 31, 2013, more than $3 billion has been distributed through 3.4 million checks. Receiving a payment under the agreement will not prevent borrowers from taking any action they may wish to pursue related to their foreclosure. Servicers are not permitted to ask borrowers to sign a waiver of any legal claims they may have against their servicer in connection with receiving payment.

In summer 2013, two additional mortgage servicers, GMAC Mortgage and EverBank, also reached agreements with the Board and the OCC that ended the Independent Foreclosure Review for those servicers. The amended consent orders that memorialized the agreements for GMAC Mortgage and EverBank were released in July and October 2013, respectively. In December, Rust Consulting mailed postcards to more than 232,000 borrowers whose mortgage loans were serviced by GMAC Mortgage, notifying them that they should expect to receive a payment, or a letter describing additional information needed to process their payment, by the end of January 2014.[8]

The Payment Agreement also required servicers to undertake well-structured loss-mitigation efforts focused on foreclosure prevention, with preference given to activities designed to keep borrowers in their homes through affordable, sustainable, and meaningful home-preservation actions within two years from the date the agreement in principle was reached. Under the Payment Agreement, servicers must not disfavor a specific geography within or among states, nor disfavor low- and/or moderate-income borrowers, and should not discriminate against any protected class. Servicers may fulfill their obligations through three specific consumer-relief activities set forth in the National Mortgage Settlement, including first-lien loan modifications, second-lien loan modifications, and short sales or deeds-in-lieu of foreclosure. Servicers were given the option, subject to non-objection from their regulator, to meet their foreclosure prevention assistance requirements by paying additional cash into the qualified settlement funds to be used for direct payments to consumers or by providing cash or other resource commitments to borrower counseling or education.

In addition to the foreclosure review requirements, the enforcement actions required servicers to submit acceptable written plans to address various mortgage loan servicing and foreclosure processing deficiencies. The Payment Agreement did not eliminate the other existing provisions of the April 2011 enforcement actions, which remain in full force and effect. Since the enforcement actions were issued, the banking organizations have been implementing the action plans that include enhanced controls, and improving systems and processes. Federal Reserve supervisory teams continue to monitor and evaluate the servicers' progress on implementing the action plans to address unsafe and unsound mortgage servicing and foreclosure practices as required by the enforcement actions.

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6 For more information, see www.federalreserve.gov/newsevents/press/bcreg/20130107a.htm.

7 For more information, see www.federalreserve.gov/newsevents/press/bcreg/20130409a.htm.

8 For more information, see www.federalreserve.gov/consumerinfo/independent-foreclosure-review-payment-agreement.htm.

Supervisory Matters

Risk-Focused Supervision

In November 2013, the Board revised its Community Bank Risk-Focused Consumer Compliance Supervision Program for state member banks with consolidated assets of $10 billion or less and their subsidiaries.[9] The new program became effective on January 1, 2014, and is designed to promote strong compliance risk-management practices and consumer protection at state member community banks. Under the updated program, consumer compliance examiners will base the examination intensity more explicitly on the individual financial institution's risk profile, including its consumer compliance culture and how effectively it identifies and manages consumer compliance risk. The new program is intended to enhance the efficacy of the Board's supervision program and reduce regulatory burden on many community banking organizations.

The program provides an enhanced risk-assessment process based on current information about a financial institution's products and services, as well as related legal and regulatory factors, the environment in which the institution operates, and its compliance risk-management practices. Based on the level of residual risk identified in the risk-assessment process, a customized work program will be developed that includes examination activities consistent with the size, complexity, and risk profile of the institution's products, services, and business lines.

The program also incorporates ongoing supervision, typically a supervisory contact close to the mid-cycle between consumer compliance examinations. However, in some cases when the institution's risk profile is high or it changes materially as a result of the addition of more complex or higher-risk strategies, more frequent contacts may be appropriate. Ongoing supervision is intended to identify and, if necessary, address significant changes in the institution's compliance risk-management program or in the level of consumer compliance risk present and ensure that supervisory information is up to date.

The program is complemented by a revised examination frequency policy, which will promote effective supervision through deployment of examiner resources commensurate with an institution's size, compliance rating, and CRA rating. The upper asset size threshold for the frequency category for smaller financial institutions was raised from $250 million to $350 million, and a new tier was added to the examination frequency schedule for banks with assets between $350 million and $1 billion. The examination frequency for these institutions is longer because these institutions tend to be less complex and pose more-limited compliance risk than larger institutions. The examination frequency schedule for financial institutions with assets over $1 billion and institutions with less than satisfactory compliance or CRA ratings remains the same. The Board expects that the new examination frequency policy will reduce burden on many community banks.

Flood Insurance

The National Flood Insurance Act imposes certain requirements on loans secured by buildings or mobile homes located in, or to be located in, areas determined to have special flood hazards. Under the Federal Reserve's Regulation H, which implements the act, state member banks are generally prohibited from making, extending, increasing, or renewing any such loan unless the building or mobile home, as well as any personal property securing the loan, are covered by flood insurance for the term of the loan. The law requires the Board and other federal financial institution regulatory agencies to impose civil money penalties when they find a pattern or practice of violations of the regulation. The civil money penalties are payable to the Federal Emergency Management Agency (FEMA) for deposit into the National Flood Mitigation Fund.

In 2012, the Biggert-Waters Flood Insurance Reform Act (Biggert-Waters Act) was signed into law, with certain provisions impacting regulations and guidance that the federal financial institution supervisory agencies have provided to lenders to assist them in complying with federal flood insurance statutes.

In March 2013, the Board and four other federal agencies responsible for implementing the Biggert-Waters Act issued guidance to inform financial institutions about these provisions.[10] The guidance identified and described several provisions of the Biggert-Waters Act that will become effective when the agencies publish implementing regulations. The guidance further discussed two lender-related provisions of the Biggert-Waters Act addressing force placement and civil money penalties, which became effective

[9] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1319.htm.

[10] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1302.htm.

immediately upon enactment. Among other things, the act raised the civil money penalty cap when a pattern or practice of flood violations exists. Specifically, the cap was raised from $385 per violation to $2,000 per violation. In addition, the overall calendar year cap on penalties was removed.

In 2013, the Federal Reserve issued eight formal consent orders and assessed $26,720 in civil money penalties against state member banks to address violations of the flood regulations. These statutorily mandated penalties were forwarded to the National Flood Mitigation Fund held by the Department of the Treasury for the benefit of FEMA.

Community Reinvestment Act

The Community Reinvestment Act (CRA) requires that the Federal Reserve and other federal banking and thrift agencies encourage financial institutions to help meet the credit needs of the local communities in which they do business, consistent with safe and sound operations. To carry out this mandate, the Federal Reserve

- examines state member banks to assess their compliance with the CRA;
- analyzes applications for mergers and acquisitions by state member banks' and bank holding companies' CRA performance in context with other supervisory information; and
- disseminates information about community development techniques to bankers and the public through Community Development offices at the Reserve Banks.

The Federal Reserve assesses and rates the CRA performance of state member banks in the course of examinations conducted by staff at the 12 Reserve Banks. During the 2013 reporting period, the Reserve Banks completed 248 CRA examinations of state member banks. Of those banks examined, 31 were rated "Outstanding," 212 were rated "Satisfactory," 4 were rated "Needs to Improve," and 1 was rated "Substantial Non-Compliance."

In November, the Board, OCC, and FDIC issued final revisions to their Interagency Questions and Answers Regarding Community Reinvestment.[11] The document provides additional guidance to financial institutions and the public on the agencies' CRA regulations.

[11] For more information, see www.federalreserve.gov/newsevents/press/bcreg/20131115a.htm.

The revisions focus primarily on community development. Community development activities are considered as part of the CRA performance tests for large institutions, intermediate small institutions, and wholesale and limited purpose institutions. Small institutions may use community development activity to receive consideration toward an outstanding CRA rating. Among other things, the revisions

- clarify how the agencies consider community development activities that benefit a broader statewide or regional area that includes an institution's assessment area;
- provide guidance related to CRA consideration of, and documentation associated with, investments in nationwide funds;
- clarify the consideration of certain community development services, such as service on a community development organization's board of directors;
- address the treatment of loans or investments to organizations that, in turn, invest those funds and use only a portion of the income from their investment to support a community development purpose; and
- clarify that community development lending performance is always a factor considered in a large institution's lending test rating.

Mergers and Acquisitions

During 2013, the Board considered and approved seven banking merger applications that were protested on CRA or fair lending grounds or that raised issues involving consumer compliance or the CRA.[12]

- An application by Trustmark Corporation, Jackson, Mississippi, to merge with BancTrust Financial Group, Inc. and acquire BancTrust's subsidiary bank, BankTrust (both in Mobile, Alabama) was approved in January.
- An application by FirstMerit Corporation, Akron, Ohio, to acquire Citizens Republic Bancorp, Inc., and thereby indirectly acquire Citizens Bank, both of Flint, Michigan, was approved in March.
- An application by Live Oak Bancshares, Inc., Wilmington, North Carolina, to engage in certain nonbanking activities through the acquisition of Government Loan Solutions, Inc., Cleveland, Ohio, was approved in August.

[12] Another protested application was withdrawn by the applicant. For more information on Orders on Banking Applications in 2013, go to http://federalreserve.gov/newsevents/press/orders/2013orders.htm.

- An application by Investors Bancorp, MHC, and Investors Bancorp, Inc., both of Short Hills, New Jersey, to acquire Roma Financial Corporation, MHC, Roma Financial Corporation, and Roma Bank, all of Robbinsville, New Jersey, and RomAsia Bank, South Brunswick Township, New Jersey, was approved in December.
- An application by Ameris Bancorp, Moultrie, Georgia, to acquire The Prosperity Banking Company, St. Augustine, Florida, was approved in December.
- An application by United Bankshares, Inc., Charleston, West Virginia, and its subsidiary, George Mason Bankshares, Inc., Fairfax, Virginia (collectively, "United"), to acquire Virginia Commerce Bancorp, Inc., Arlington, Virginia; and for United's subsidiary bank, United Bank, Fairfax, Virginia, to (1) merge with Virginia Commerce Bank, Arlington, Virginia, and (2) retain and operate branches at the locations of Virginia Commerce Bank's main office and branches was approved in December.
- An application by Investors Bancorp, MHC, and Investors Bancorp, Inc., both of Short Hills, New Jersey, to acquire Gateway Community Financial, MHC, Gateway Community Financial Corporation, and GCF Bank, all of Sewell, New Jersey, was approved in December.

Members of the public submitted comments on each of the above applications. Public comments raised various issues for staff to consider in their analyses of the supervisory and lending records of the applicants. Several commenters alleged that various institutions failed to make credit available to certain minority groups and to low- and moderate-income (LMI) individuals. Other commenters raised concerns over the greater incidence of higher-cost loans to minority and LMI borrowers at a higher cost than to other borrowers. Commenters also alleged that institutions failed to meet the needs of small businesses in LMI geographies. Several commenters raised CRA-related concerns about inadequate plans to meet communities' credit needs.

In evaluating the merits of these comments, the Board considered information provided by applicants and analyzed relevant lending data in markets of interest to the commenters. The Board also incorporated other information, including examination reports with on-site evaluations of compliance with fair lending and other consumer protection laws and regulations and conferred with other regulators for their supervisory views. The Board conducted analyses to understand the lending activities and practices of the applicant and target institutions. On several applications, the Board placed conditions on its approval that were related to consumer compliance.

The Board also considered 98 applications, with a range of topics from change in control notices, branching requests, and mergers and acquisitions, with outstanding issues involving compliance with consumer protection statutes and regulations, including fair lending laws and the CRA. Eighty-six of those applications were approved and 12 were withdrawn or suspended.

In April 2013, the Board issued guidance to the public on the process for state member banks in less-than-satisfactory condition to establish a de novo branch. The guidance aims to increase transparency in the applications process related to branching requirements. The policy indicates that institutions with 3-ratings (or worse) generally should not pursue expansionary proposals and should focus on remediating identified supervisory issues; however, the policy describes certain circumstances under which a state member bank may be permitted to branch on a de novo basis.

Fair Lending Enforcement

The Federal Reserve supervises 850 state member banks. Pursuant to provisions of the Dodd-Frank Act, effective on July 21, 2011, the Consumer Financial Protection Bureau (CFPB) supervises state member banks with assets of more than $10 billion for compliance with the Equal Credit Opportunity Act (ECOA), and the Board has supervisory authority for compliance with the Fair Housing Act. For the 829 state member banks with assets of $10 billion or less, the Board retains the authority to enforce both the ECOA and the Fair Housing Act.

Fair lending reviews are conducted regularly within the supervisory cycle. Additionally, examiners may conduct fair lending reviews outside of the usual supervisory cycle, if warranted by fair lending risk. When examiners find evidence of potential discrimination, they work closely with DCCA's Fair Lending Enforcement Section, which provides additional legal and statistical expertise and ensures that fair lending laws are enforced consistently and rigorously throughout the Federal Reserve System.

Pursuant to the ECOA, if the Board has reason to believe that a creditor has engaged in a pattern or practice of discrimination in violation of the ECOA, the matter will be referred to the U.S. Department of Justice (DOJ). The DOJ reviews the referral and determines whether further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement. Alternatively, the DOJ may decide to return the matter to the Board for administrative enforcement. When a matter is returned to the Board, staff ensures that the institution takes all appropriate corrective action.

During 2013, the Board referred the following six matters to the DOJ:

- One referral involved discrimination on the basis of national origin in violation of the ECOA and the FHA. For secondary market loans, the lender charged Hispanic borrowers higher prices than similarly situated non-Hispanic white borrowers. Legitimate pricing factors failed to explain the pricing disparities.
- One referral involved discrimination on the basis of national origin, in violation of the ECOA. The lender charged Hispanic borrowers higher interest rates than non-Hispanic borrowers for unsecured consumer loans. Legitimate pricing factors failed to explain the pricing disparities.
- One referral involved discrimination against potential borrowers based on the racial and ethnic composition of their neighborhood in violation of the ECOA and the FHA. Based on an analysis of the bank's delineated assessment area under the CRA, the location of its branches, its lending practices, and its marketing, the Board determined that the bank avoided lending in the minority neighborhoods of a major metropolitan area.
- One referral involved discrimination on the basis of receipt of public assistance in violation of the ECOA and discrimination on the basis of handicap status in violation of the FHA. Although the applicant provided the information necessary to verify disability income pursuant to all relevant requirements, the lender requested additional information, including a doctor's letter stating that income received from disability would last for at least three years.
- Two referrals involved discrimination on the basis of marital status, in violation of the ECOA. The banks improperly required spousal guarantees on commercial and agricultural loans, in violation of Regulation B.

If a fair lending violation does not constitute a pattern or practice, the Federal Reserve acts on its own to ensure that the violation is remedied by the bank. Most lenders readily agree to correct fair lending violations. In fact, lenders often take corrective action as soon as they become aware of a problem. Thus, the Federal Reserve generally uses informal supervisory tools (such as memoranda of understanding between banks' boards of directors and the Reserve Banks, or board resolutions) to ensure that violations are corrected. If necessary to protect consumers, however, the Board can bring public enforcement actions.

Guidance on Minimum Standards for Prioritization and Handling Borrower Files with Imminent Scheduled Foreclosure Sale

In April, the Board issued guidance on sound business practices for residential mortgage servicing that Federal Reserve-supervised financial institutions are expected to address in their collections, loss mitigation, and foreclosure processing functions.[13] The guidance confirms the minimum standards for the handling and prioritization of borrowers' files that are subject to an imminent (within 60 days) scheduled foreclosure sale. These minimum review criteria are intended to ensure a level of consistency across servicers, and are intended to be used to determine whether a scheduled foreclosure sale should be postponed, suspended, or cancelled because of critical defects in the borrower's file. The purpose of the guidance is to ensure that borrowers will not lose their homes without their files first receiving a preforeclosure sale review that, at a minimum, meets the standards listed in the Board's guidance.

Statement on Deposit Advance Products

In April 2013, the Board issued a statement to emphasize to state member banks the significant consumer risks associated with deposit advance products. State member banks are expected to consider the risks associated with deposit advance products, including potential consumer harm and the potential for elevated compliance risk, when designing and offering such products.[14]

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[13] For more information, see www.federalreserve.gov/bankinforeg/srletters/sr1309.htm.

[14] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1307.htm.

The statement notes that in designing and offering deposit advance products, state member banks must comply with all applicable federal laws and regulations, including but not limited to requirements under the Truth in Lending Act (TILA), the Electronic Fund Transfer Act (EFTA), the Truth in Savings Act, and ECOA. In addition to these laws, institutions must act in accordance with section 5 of the Federal Trade Commission (FTC) Act, which prohibits UDAP, and section 1036 of the Dodd-Frank Act, which prohibits unfair, deceptive, or abusive acts or practices. Depository institutions must also comply with state laws and regulations. The statement further sets forth the Board's expectation that Federal Reserve examiners will thoroughly review any deposit advance products offered by supervised institutions for compliance with section 5 of the FTC Act, as well as other applicable laws.

Financial Fraud Enforcement Task Force and Other Outreach

As an active member of the Financial Fraud Enforcement Task Force (FFETF), the Board coordinates with other agencies to facilitate consistent and effective enforcement of the fair lending laws.[15] The director of the Board's DCCA co-chairs the FFETF's Non-Discrimination Working Group with the assistant attorney general for DOJ's Civil Rights Division, the deputy general counsel of the U.S. Department of Housing and Urban Development, the assistant director of the CFPB's Office of Fair Lending and Equal Opportunity, and the Conference of State Bank Supervisors. In 2013, the Board and the Non-Discrimination Working Group sponsored a free interagency webinar that had more than 4,000 registrants, most of which were community banks.

In addition, the Federal Reserve participates in numerous meetings, conferences, and trainings sponsored by consumer advocates, industry representatives, and interagency groups. Fair Lending Enforcement staff meets regularly with consumer advocates, supervised institutions, and industry representatives to discuss fair lending matters and receive feedback. Through this outreach, the Board is able to address emerging fair lending issues and promote sound fair lending compliance.

Coordination with Other Federal Banking Agencies

The member agencies of the Federal Financial Institutions Examination Council (FFIEC) develop consistent examination principles, standards, procedures, and report formats.[16] In 2013, the FFIEC member organizations issued examination procedures for consumer protection regulations, as discussed below.[17]

Interagency Examination Procedures for Regulation X and Z

Procedures were revised to reflect a series of amendments to Regulations X (Real Estate Settlement Procedures Act) and Z (Truth in Lending Act) that were issued in 2013 by the CFPB.[18] The CFPB's rulemakings implement provisions of the Dodd-Frank Act that pertain to ability-to-repay and qualified mortgage (ATR/QM) standards, loan originator compensation and qualification, mortgage servicing, loans subject to the Home Ownership and Equity Protection Act, and escrows. The new requirements generally became effective on January 10, 2014. The Regulation Z procedures were also revised to incorporate interagency amendments regarding appraisals finalized in January 2013 and generally effective on January 18, 2014.

Interagency Examination Procedures for Regulation E

Procedures were revised to incorporate the CFPB's addition of remittance transfer provisions in a new Subpart B to Regulation E (Electronic Fund Transfer Act), and to reflect elimination of the requirement

[15] For more information about the FFETF, go to www.stopfraud.gov.

[16] FFIEC member agencies include the Board of Governors, the FDIC, the NCUA, the OCC, the State Liaison Committee (SLC), and the CFPB.

[17] In prior years, the Board included in this section the findings and rate of compliance with the consumer protection rules for which it had rulemaking authority as reported by the various federal agencies with supervisory authority for those regulations. This reporting responsibility transferred to the CFPB in July 2011. For more information see www.consumerfinance.gov/reports.

[18] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1326.htm and www.federalreserve.gov/bankinforeg/caletters/caltr1325.htm.

that a fee notice be posted on or at automated teller machines.[19]

Interagency Examination Procedures for the Garnishment of Accounts Containing Federal Benefit Payments Rule

Procedures were revised to reflect a final rule issued by the Department of the Treasury, the Social Security Administration, the Department of Veteran Affairs, the Railroad Retirement Board, and the Office of Personnel Management to implement statutory restrictions on garnishment of certain exempt federal benefit payments.[20] The rule establishes procedures that a financial institution must follow when it receives a garnishment order against an account holder who receives certain Federal benefit payments by direct deposit.

Interagency Guidance Regarding Social Media: Consumer Compliance Risk Management

In December, the FFIEC member agencies jointly issued guidance addressing the applicability of federal consumer protection and compliance laws, regulations, and policies to activities conducted via social media by financial institutions.[21] The use of social media to attract and interact with customers can impact a financial institution's risk profile, including risk of harm to consumers, compliance and legal risks, operational risks, and reputation risks. The guidance is intended to assist financial institutions in understanding potential risks associated with the use of social media, along with expectations for managing those risks. The guidance does not impose additional obligations on financial institutions, but instead highlights existing legal requirements that apply to social media forums.

Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults

In September, the FFIEC member agencies, Commodity Futures Trading Commission, Federal Trade Commission, and Securities and Exchange Commission issued guidance to clarify the applicability of privacy provisions of the Gramm-Leach-Bliley Act (GLBA) to reporting suspected financial exploitation of older adults.[22] The guidance clarifies for financial institutions that reporting suspected elder financial abuse to law enforcement, social service and other appropriate agencies does not, in general, violate the privacy provisions of the GLBA. The guidance does not impose additional requirements on financial institutions but, rather, informs individuals who may observe signs of possible financial exploitation of an older adult about GLBA exceptions that may permit sharing of nonpublic personal information with local, state, or federal agencies for the purpose of reporting suspected financial abuse of older adults.

Interagency Guidance on the Relationship between Ability to Repay (ATR)/Qualified Mortgage (QM) and Other Requirements

The CFPB's ATR/QM rule requires lenders to make reasonable, good faith determinations that consumers have the ability to repay mortgage loans before extending such loans. The rule provides lenders with a presumption of compliance with the ability-to-repay requirements for loans that meet the regulatory definition of a "qualified mortgage." At the same time, the rule permits lenders to make loans that do not qualify as QMs, referred to as "non-QM loans."

The Board and other federal banking regulators received inquiries regarding the relationship between the ATR/QM rule and other regulatory requirements, including those that pertain to fair lending and the Community Reinvestment Act. In particular, institutions raised concerns regarding whether a decision to offer only qualified mortgages would adversely impact their compliance with those other requirements. In October 2013, the FFIEC member agencies issued a statement clarifying that the agencies do not anticipate that a creditor's decision to offer only qualified mortgages would, absent other factors, elevate a supervised institution's fair lending risk. In December 2013, the Board, FDIC, NCUA, and OCC issued a statement clarifying that residential mortgage loans will not be subject to safety-and-soundness criticism based solely on their status as QMs or non-QMs. The agencies that conduct CRA evaluations (the Board, FDIC, and OCC) further clarified that they do not anticipate that institutions' decisions to originate only QMs, absent other factors, would adversely affect their CRA evaluations.[23]

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[19] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1317.htm.

[20] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1316.htm.

[21] For more information, see www.federalreserve.gov/bankinforeg/caletters/caltr1322.htm.

[22] For more information, see www.federalreserve.gov/newsevents/press/bcreg/20130924a.htm.

[23] For more information, see www.federalreserve.gov/newsevents/press/bcreg/20131213a.htm.

Coordination with the Consumer Financial Protection Bureau

During 2013, staff continued to work through the implementation of the Interagency Memorandum of Understanding on Supervision Coordination with the CFPB. The agreement is intended to establish arrangements for coordination and cooperation between the CFPB and the OCC, Federal Deposit Insurance Corporation (FDIC), National Credit Union Association (NCUA), and the Board of Governors. The agreement strives to minimize unnecessary regulatory burden, and avoid unnecessary duplication of effort and conflicting supervisory directives amongst the prudential regulators. The regulators work cooperatively to share exam schedules for covered institutions and covered activities to plan simultaneous exams, provide final drafts of examination reports for comment, and share supervisory information.

Examiner Training

Ensuring that financial institutions comply with laws that protect consumers and encourage community reinvestment is an important part of the bank examination and supervision process. As the complexity of both consumer financial transactions and the regulatory landscape has increased, training for consumer compliance examiners has become more important than ever before. The examiner staff development function is responsible for the ongoing development of the professional consumer compliance supervisory staff, and ensuring that these staff members have the skills necessary to meet their supervisory responsibilities now and in the future.

Consumer Compliance Examiner Training Curriculum

The consumer compliance examiner training curriculum consists of five courses focused on consumer protection laws, regulations, and examining concepts. In 2013, these courses were offered in 13 sessions, and training was delivered to a total of 242 System consumer compliance examiners and staff members and 8 state banking agency examiners.

When appropriate, courses are delivered via alternative methods, such as the Internet or other distance-learning technologies. For instance, several courses use a combination of instructional methods, including both classroom instruction focused on case studies and specially developed computer-based instruction that includes interactive self-check exercises.

Board and Reserve Bank staff regularly review the core curriculum for examiner training, updating subject matter and adding new elements as appropriate. During 2013, staff began migrating fundamentals content from a classroom-based training model to more online delivery, dedicating classroom time for examiners to apply their learning using case studies and reviewing loan files.

Outreach and Training: Dodd-Frank Act

In 2013, the CFPB promulgated new rules pursuant to the Dodd-Frank Act. Board and CFPB staff collaborated on examiner training and outreach to bankers. Specifically, training was provided to examiners using the Federal Reserve's Rapid Response webinar platform on the following topics: the Home Ownership and Equity Protection Act, qualified mortgage/ability-to-repay, appraisals, escrow, and servicing rules under Regulation Z.

The Board collaborated with the CFPB to provide outreach to bankers, using the Federal Reserve's Outlook Live platform to broadcast a free webinar on small creditor qualified mortgages (see box 1).

Ongoing Training Opportunities

In addition to providing core examiner training, the examiner staff development function emphasizes the importance of continuing life-long learning. Opportunities for continuing learning include special projects and assignments, self-study programs, rotational assignments, the opportunity to instruct at System schools, mentoring programs, and an annual consumer compliance examiner forum, where senior consumer compliance examiners receive information on emerging compliance issues and are able to share best practices from across the System.

In 2013, the System continued to offer Rapid Response sessions. Debuted in 2008, Rapid Response sessions offer examiners one-hour teleconference webinars on emerging issues or urgent training needs that result from the implementation of new laws, regulations or supervisory guidance as well as case studies. A total of 18 consumer compliance Rapid Response sessions were designed, developed, and presented to System staff during 2013.

Responding to Consumer Complaints and Inquiries

The Federal Reserve investigates complaints against state member banks and selected nonbank subsidiaries of bank holding companies (Federal Reserve

Box 1. Promoting Outreach, Communication, and Education to Support Financial Institutions and Advance Consumer Compliance

The Federal Reserve has worked to increase transparency and outreach in recent years in order to provide the public and the financial industry with a better understanding of its policies and decisions. Examples of fulfillment of this commitment include the Board's press conferences to communicate monetary policy decisions and various efforts to increase outreach to the financial industry.[1]

The Division of Consumer and Community Affairs (DCCA) contributes to increased transparency in the consumer compliance arena by providing guidance and clarification to bankers as they navigate an expanded supervisory environment and an array of new regulations. In recent years, new communication channels have been developed to increase outreach by and access to consumer compliance experts to provide insight on supervisory issues and policies. DCCA works with its banking supervision colleagues throughout the Federal Reserve System and at other agencies to support a variety of communication platforms, some of which leverage technology and foster two-way communication between regulators and banks on consumer compliance topics and emerging issues. Topics range from complying with the prohibition on unfair or deceptive acts or practices to understanding mortgage appraisal rules.

Consumer Compliance Outlook, a quarterly online publication sponsored by the Federal Reserve Bank of Philadelphia, features in-depth articles on emerging compliance issues and on important developments within the consumer compliance arena.[2] For example, recent articles have addressed topics such as new garnishment rules and the role of internal audit, and have also provided insights from (former) Governor Elizabeth Duke in commemoration of the newsletter's five-year anniversary. The publication reaches more than 15,000 subscribers. In addition, the Federal Reserve has launched Community Banking Connections, a website that serves as a "one-stop shop" for information on issues that affect community banks, as well as providing links to tools and resources that can help them.[3]

To address consumer compliance issues with officials of state member banks and other supervised institutions, the Federal Reserve Bank of San Francisco hosts a national webinar series called Outlook Live, which complements the *Consumer Compliance Outlook* publication.[4] Outlook Live webinars frequently feature staff from each of the federal banking regulators, so that institutions have the opportunity to hear perspectives of the Federal Reserve as well as the other agencies. For example, in 2013, Consumer Financial Protection Bureau (CFPB) staff presented an Outlook Live session that discussed provisions of the CFPB's new qualified mortgage rule applicable to small creditors. In another webinar, Board staff and representatives from six other agencies discussed emerging fair lending issues and hot topics from their agencies' vantage point. Each of these webinars regularly attracts thousands of registrants.

Further, the Board fosters improved communication and outreach with community bankers through its Community Depository Institutions Advisory Council.[5] The council's membership is drawn from smaller banks, credit unions, and savings associations, with representatives from each of the 12 Reserve Bank districts, providing the Board with a direct line of communication from community bankers about supervisory and regulatory issues that affect their institutions as well as about local economic trends. During recent meetings, council members have discussed with the Board potential impacts of new mortgage rules on community banks' product offerings and compliance functions.

These communication, outreach, and education mechanisms help provide valuable transparency in the implementation of consumer compliance supervision policies, advancing the goal of enabling strong consumer protection programs at financial institutions and providing consumers with the protections intended by such policies.

[1] For more information, see www.federalreserve.gov/mediacenter/media.htm.

[2] For more information, see www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/index.cfm.

[3] For more information, see www.communitybankingconnections.org/.

[4] For more information, see www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live/.

[5] For more information, see www.federalreserve.gov/aboutthefed/cdiac.htm.

regulated entities), and forwards complaints against other creditors and businesses to the appropriate enforcement agency. Each Reserve Bank investigates complaints against state member banks and selected nonbank subsidiaries in its District. The Federal Reserve also responds to consumer inquiries on a broad range of banking topics, including consumer protection questions.

In late 2007, the Federal Reserve established Federal Reserve Consumer Help (FRCH) to centralize the processing of consumer complaints and inquiries. In 2013, FRCH processed 41,220 cases—approximately 5 percent of cases were referred to the Federal Reserve from other agencies. Of these cases, more than half (27,720) were inquiries and the remainder (13,500) were complaints, with most cases received directly from consumers. Of the 13,500 complaints received, 2,529 were complaints against Federal Reserve regulated entities, and the remaining complaints were referred to the appropriate regulatory agencies and government offices for investigation. To minimize the time required to re-route complaints to these agencies, referrals were transmitted electronically.

Consumers can contact FRCH by telephone, fax, mail, e-mail, or online, but most FRCH consumer contacts in 2013 occurred by telephone (58 percent). Thirty-nine percent (15,875) of complaint and inquiry submissions were made electronically (via e-mail, online submissions, and fax), and the online form page received approximately 66,147 visits during the year.

Consumer Complaints

Complaints received against Federal Reserve regulated entities totaled 2,529 in 2013. Approximately 35 percent (892) of these complaints were closed without investigation pending the receipt of additional information from consumers. Nearly 9 percent of the total complaints remained open and under investigation at December 31, 2013. Of the remaining complaints (1,412), 69 percent (968) involved unregulated practices, and 31 percent (444) involved regulated practices. (Table 1 shows the breakdown of complaints about regulated practices by regulation or act; table 2 shows complaints by product type.)

Complaints about Regulated Practices

The majority of regulated practices complaints concerned checking accounts (30 percent), real estate[24] (19.4 percent), and credit cards (27.4 percent). The most common checking account complaints related to funds availability not as expected (31 percent); insufficient funds or overdraft charges and procedures (19 percent); disputed withdrawal of funds (9 percent); and disputed rates, terms, or fees (7 percent). The most common real estate complaints by problem code related to debt collection/foreclosure concerns (24 percent); flood insurance (14 percent); disputed rates, terms, and fees (14 percent); and payment errors or delays (9 percent). The most common

Table 1. Complaints against state member banks and selected nonbank subsidiaries of bank holding companies about regulated practices, by regulation/act, 2013

Regulation/act	Number
Total	**444**
Regulation AA (Unfair or Deceptive Acts or Practices)	10
Regulation B (Equal Credit Opportunity)	15
Regulation BB (Community Reinvestment)	2
Regulation C (Home Mortgage Disclosure)	1
Regulation CC (Expedited Funds Availability)	60
Regulation D (Reserve Requirements)	2
Regulation DD (Truth in Savings)	58
Regulation E (Electronic Funds Transfers)	46
Regulation H (National Flood Insurance Act / Insurance Sales)	14
Regulation P (Privacy of Consumer Financial Information)	13
Regulation V (Fair and Accurate Credit Transactions)	13
Regulation Z (Truth in Lending)	59
Check 21 Act	1
Fair Credit Reporting Act	86
Fair Debt Collection Practices Act	23
Fair Housing Act	17
HOPA (Homeowners Protection Act)	1
Real Estate Settlement Procedures Act	11
Protecting Tenants at Foreclosure Act	1
Servicemembers Civil Relief Act (SCRA)	11
Regulation AA (Unfair or Deceptive Acts or Practices)	7
Regulation B (Equal Credit Opportunity)	26
Regulation BB (Community Reinvestment)	2
Regulation C (Home Mortgage Disclosure)	0
Regulation CC (Expedited Funds Availability)	65
Regulation D (Reserve Requirements)	3
Regulation DD (Truth in Savings)	55
Regulation E (Electronic Funds Transfers)	67
Regulation G (Disclosure/Reporting of CRA-Related Agreements)	0
Regulation H (National Flood Insurance Act/Insurance Sales)	20
Regulation M (Consumer Lending)	0
Regulation P (Privacy of Consumer Financial Information)	17
Regulation Q (Payment of Interest)	1
Regulation V (Fair and Accurate Credit Transactions)	14
Regulation Z (Truth in Lending)	51
Fair Credit Reporting Act	49
Fair Debt Collection Practices Act	15
Fair Housing Act	14
Home Ownership Counseling	0
HOPA (Homeowners Protection Act)	2
Real Estate Settlement Procedures Act	31
Right to Financial Privacy Act	3
Protecting Tenants at Foreclosure Act	2
Servicemembers Civil Relief Act	3

[24] Real estate loans include adjustable-rate mortgages, residential construction loans, open-end home equity lines of credit, home improvement loans, home purchase loans, home refinance/closed-end loans, and reverse mortgages.

Table 2. Complaints against state member banks and selected nonbank subsidiaries of bank holding companies about regulated practices, by product type, 2013

Subject of complaint/product type	All complaints		Complaints involving violations	
	Number	Percent	Number	Percent
Total	**444**	**100**	**31**	**7**
Discrimination alleged				
Real estate loans	16	4	0	0
Credit cards	1	0.2	0	0
Other loans	2	1	0	0
Nondiscrimination complaints				
Checking accounts	136	30	13	3
Real estate loans	86	19.4	9	2
Credit cards	122	27.4	1	0.2
Other	81	18	8	1.8

credit card complaints related to inaccurate credit reporting (37 percent), bank debt-collection tactics (13 percent), and billing error resolutions (7 percent).

Nineteen regulated practices complaints alleging discrimination were received. Of these, six complaints (1 percent of total regulated complaints) alleged discrimination based on prohibited borrower traits or rights.[25] Two discrimination complaints were related to the race, color, national origin or ethnicity of the applicant or borrower. One discrimination complaint was related to either the age or handicap of the applicant or borrower. Of the complaints alleging discrimination based on a prohibited basis, there were no violations.

In 80 percent of investigated complaints against Federal Reserve regulated entities, evidence revealed that institutions correctly handled the situation. Of the remaining 20 percent of investigated complaints, 7 percent were deemed violations of law; 5 percent were identified errors which were corrected by the bank; and the remainder included matters involving litigation or factual disputes, withdrawn complaints, internally referred complaints, or information was provided to the consumer.

Complaints about Unregulated Practices

The Board continued to monitor complaints about banking practices not subject to existing regulations. In 2013, the Board received 968 complaints against Federal Reserve regulated entities that involved these unregulated practices. The majority of the complaints were related to real estate concerns (39 percent), credit cards (16 percent), checking account activity (14 percent), and commercial loans/leases (8 percent).

Complaint Referrals

The Federal Reserve forwarded 22 complaints to the Department of Housing and Urban Development (HUD) that alleged violations of the Fair Housing Act.[26] The Federal Reserve's investigation of these complaints revealed one instance of illegal credit discrimination.[27]

Consumer Inquiries

The Federal Reserve received 27,720 consumer inquiries in 2013, covering a wide range of topics. Consumers were typically directed to other resources, including other federal agencies or written materials, to address their inquiries.

Consumer Research and Emerging-Issues and Policy Analysis

Throughout 2013, DCCA analyzed emerging issues in consumer financial services policies and practices in order to understand their implications for the economic and supervisory policies that are core to the Federal Reserve's functions, as well as to gain insight into consumer financial decisionmaking.

[25] This includes alleged discrimination based on race, color, religion, national origin, sex, marital status, age, applicant income derived from public assistance programs, or applicant reliance on provisions of the Consumer Credit Protection Act.

[26] A memorandum of understanding between HUD and the federal bank regulatory agencies requires that complaints alleging a violation of the Fair Housing Act be forwarded to HUD.

[27] The complaint referred to HUD was received in 2012, and the violation determination and referral were completed in 2013.

Consumer Financial Services Research

In recent years, two notable forces have been converging in today's financial services landscape: 1) the increasing array of financial services—including banking services, shopping tools, and payment options—that has become available to consumers using cell phones and other mobile devices, and 2) the aging of the population. Collectively, these developments may ultimately have significant effects on the ways in which consumers conduct their financial lives. In 2013, DCCA explored the issues associated with each of these topics and conducted consumer surveys to gain insights and improve understanding of the dynamics in each area.

With respect to the use of mobile financial services, DCCA conducted its annual survey to revisit consumers' use of, and opinions about, mobile financial services. Since 2011, the survey has polled more than 2,200 individuals each year to learn whether and how they use mobile devices for banking and payments, and it was among the first to integrate questions about using mobile devices for shopping and comparing products along with questions about using mobile devices for banking and payments.

The findings of the surveys, conducted in the winter, are released each spring in the report *Consumers and Mobile Financial Services*. Results from the survey conducted in November 2012 were published in March 2013.[28] For the third annual survey, conducted in December 2013, results will be published in early 2014. Given the rapid pace of developments in the mobile financial services market, DCCA plans to continue conducting this annual survey of consumers' use of mobile financial services and producing a corresponding report summarizing the survey results.

Recognizing that in the aging U.S. population, about one in five individuals will be over the age of 65 by 2060 (up from one in seven today), DCCA conducted the Older Adults Survey to gather data around the financial experience of 1,800 adults over the age of 40. The combination of a major demographic shift with the aging of the baby boomers, who have longer life expectancies, and an increasingly complex financial marketplace raise questions about the financial stability of older adults in the years ahead. The survey found that many older adults carry debt late in life, potentially undermining their financial security. One-half of credit card users carry balances. Also, one in eight carries student loan debt for themselves or their children. Furthermore, owning a home outright by late middle-age is no longer the norm. Though not necessarily a sign of financial stress, substantial numbers of older adults carry debt secured by their homes, including six in ten of those in their 60s and nearly four in ten of those age 70 and older. Mortgage debt is of particular significance because homes are the largest component of net worth of many older adult households, and this debt may signal a lack of resources to help fund retirement or other expenses.

To explore these issues further, Policy Analysis staff convened a one-day event in July, held in conjunction with the release of a Board briefing paper, *Insights into the Financial Experiences of Older Adults*.[29] The forum aimed to identify future research areas for the field at large. Discussions focused on the financial circumstances of subgroups of older adults, housing needs and affordability, employment and retirement transitions, and the role of cognition in financial decisionmaking. Forum participants shared examples of policies, products, and services that may be promising ways to meet the financial needs and choices of aging consumers.

Emerging-Issues Analysis

The Policy Analysis function of DCCA provides key insights, information, and analysis on emerging financial services issues that affect the well-being of consumers and communities. To this end, staff follow and analyze trends, lead division-wide working groups, and organize expert roundtables to identify emerging risks and inform policy recommendations. In 2013, the team was actively engaged in issues and activities to promote household financial security and sustainable recovery from the financial crisis. Staff contributed analyses on a broad range of policy issues from recovery trends in local housing markets, to the implications of mobile banking, existing and emerging credit products, and challenges facing certain segments of consumers.

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28 See Board of Governors of the Federal Reserve System (2013), *Consumers and Mobile Financial Services 2013*, (Washington: Board of Governors, March), www.federalreserve.gov/econresdata/mobile-devices/files/consumers-and-mobile-financial-services-report-201303.pdf.

29 For more information, the briefing paper, video clips, and other materials from the forum, see www.federalreserve.gov/newsevents/conferences/financial-experiences-of-older-adults-agenda.htm.

Investors in Single-Family Housing: Changing the Profile of Communities

While many signs point to continued recovery in the housing sector nationally, the impact of the housing crisis and the extent of recovery vary greatly by market. Some communities are experiencing a surge in demand for foreclosed properties by private investors, including large institutional investors and hedge funds. Because of their ability to transact purchases quickly, buy large numbers of homes and then renovate them as rentals, investors have been able to help absorb excess inventory and stabilize communities. However, the prevalence of investor activity in some areas raises concerns about crowding out owner-occupants and the ability of firms to manage and maintain the properties they acquire. Meanwhile, other communities contend with large numbers of vacant and abandoned homes that have imposed significant costs on the surrounding neighborhoods—including decreased property values and, in some places, a rise in crime. They continue to struggle with a lack of investors or prospective owner-occupants to purchase excess vacant properties.

In late February, DCCA staff from both the Community Development and Policy Analysis teams, together with staff from the Federal Reserve Banks of Cleveland and Philadelphia, convened *Renters, Homeowners, and Investors: The Changing Profile of Communities*, a one-day event focused on current patterns of housing investment in neighborhoods and the various ways this activity is changing communities. More than 100 researchers, practitioners, investors and state and local officials attended to discuss effective approaches for stabilizing neighborhoods post-crisis.[30]

Throughout the year DCCA staff, together with colleagues from the Federal Reserve Banks, continued to closely monitor housing markets across the nation to better understand the direct and indirect effects of the crises on neighborhoods and their residents. Staff also contributed to the stabilization of neighborhoods by conducting applied research, convening key stakeholders, and highlighting community approaches that are working.

Race and Wealth: Examining the Trends

Without wealth, it is difficult for families to maintain their standard of living when there are setbacks—the unexpected house repair, lost job, or sudden illness of a family breadwinner—much less to invest for the future. During a financial crisis, the lack of sufficient wealth to overcome financial shocks can delay considerably a family's ability to recover. Minority families face particular challenges. Disparities in wealth between white and minority families have persisted for decades, in both strong and weak economies, and the most recent crisis was no exception. National survey data, including the Board's Survey of Consumer Finances, show minority families experienced larger declines in their net worth than white families, and in turn, have fewer assets to draw upon to rebuild wealth.

In November 2013, the DCCA policy analysis staff convened an external group of researchers and public policy experts to discuss race and wealth trends and to consider the implications of continued disparities in wealth, particularly in the recent economic crisis. Discussion focused on constraints on saving and rebuilding wealth due to higher unemployment rates and on fallout from the housing crisis—which erased homeownership gains and reduced home equity to a greater extent for black and Hispanic households. Staff will continue to monitor these trends and the effectiveness of alternative recovery strategies to assist minority families hard hit by the recession.

Community Development

The Federal Reserve System's Community Development function promotes economic growth and financial stability for low- and moderate-income (LMI) communities and individuals through a range of activities: convening stakeholders, conducting and sharing research, and identifying emerging issues (see box 2 for an example). As a decentralized function, the Community Affairs Officers (CAOs) at each of the 12 Reserve Banks design activities to respond to the specific needs of the communities they serve, with oversight from Board staff. The Board's Community Development staff promote and coordinate System-wide priorities, including the following five System Community Development strategic goals:

1. support programs and promote policies that improve the financial stability of LMI households
2. strengthen LMI communities by advancing comprehensive neighborhood revitalization and stabilization strategies

[30] For more information, presentations, video clips, and summaries of the discussions, see www.federalreserve.gov/newsevents/conferences/renters-homeowners-investors-agenda.htm.

Box 2. Resilience and Rebuilding for Low-Income Communities: Research to Inform Policy and Practice

"Resilient communities require more than decent housing, important as that is; they require an array of amenities that support the social fabric of the community and build the capabilities of community residents. The holistic approach has the power to transform neighborhoods and, as a result, the lives of their lower-income residents."
—Federal Reserve Chairman Ben S. Bernanke, April 12, 2013

Every two years, the Federal Reserve System hosts its signature community development research conference, convening a cross-discipline audience to generate and explore the latest research in community economic policy and to share models of success. The event is a unique forum that gathers a diverse group of community developers and practitioners, policymakers, philanthropists, researchers, financial services providers, government officials, and students.

In April, the System held its eighth conference, with the theme of improving resiliency and rebuilding in low-income households and neighborhoods.[1] Led by the Community Development Offices of the Board and the Federal Reserve Bank of Atlanta, the event attracted nearly 350 participants and was a catalyst for new ideas, approaches, and strategies for the community development industry and academic field. During the two-day program, featured panel discussions delved into the core issues critical to advance effective and sustainable development:

- ***People:*** Why did young households lose so much wealth during the housing crisis?
- ***Places:*** What are the linkages between the national poverty rate and the number of people living in concentrated poverty?
- ***Human capital and jobs:*** What insights can bring better understanding of the dynamics of labor market in low-income communities?
- ***Housing:*** What is the impact of initiatives aimed at addressing distressed housing markets in low-income communities, such as housing vouchers on rental prices, the effect of pre-purchase homeownership counseling on mortgage delinquency, and the neighborhood social impacts of home rehabilitation?
- ***Small business:*** What factors lead to small business resilience?
- ***Rural:*** What are the critical community and economic development issues in rural areas?
- ***Using data to test and tell:*** What data and research approaches help overcome the challenge of analyzing the complex development issues of low-income communities?
- ***Collaborating for the future:*** How can the interrelated sectors of education, public health, financial stability, and employment collaborate more effectively?

Additional highlights of the event were thought-provoking keynotes addresses by Ben Bernanke, Chairman of the Federal Reserve Board, and Sudhir Venkatesh, a professor of Sociology Columbia University and nationally recognized expert in the economics of underserved communities.[2]

[1] For more information, papers, and videos from the conference, see www.frbatlanta.org/news/conferences/13resilience_rebuilding.cfm.

[2] For transcripts of the keynote addresses, see www.federalreserve.gov/newsevents/speech/bernanke20130412a.htm and www.frbatlanta.org/news/multimedia/13resilience_rebuilding_venkatesh_transcript.cfm.

3. foster innovative strategies that assist LMI communities and individuals in launching, growing, and sustaining small businesses
4. advance innovation and efficiency in community development programs, funding, and infrastructure to promote scale, sustainability, and impact
5. strategically communicate key findings of the Community Development function and share emerging community development issues and trends that have national implications

Labor Markets and Human Capital

In 2013, DCCA community development staff, in conjunction with staff from a number of Reserve Banks, convened internal and external experts to explore changing aspects of the U.S. labor market

and the impact on workers. This initiative demonstrated that the increased use of "contingent" workers[31] was ripe for research, as the impact of this shift on workers is not clear-cut. In particular, DCCA staff sought to determine the experience and expectations of young workers entering the workforce in this new environment of workers increasingly acting as their own agents of employment, rather than primarily as employees of a particular firm. As a result, the Board surveyed more than 2,000 individuals between 18 and 30 about their education and training, experience as a paid employee, and self-employment activities. In 2014, the Board will use the data collected to develop a report for policymakers, researchers, and practitioners to further their work.

This body of work is a continuation of work, begun in fall 2011, that arose from concerns of the attenuating effects of long-term unemployment on the broader economic recovery and the particular issues facing low-income communities. A collection of regional perspectives on this issue was gathered during a series of forums held throughout the country with primarily intermediary organizations involved in the delivery of workforce development services and local employers. Insights into the complex factors creating long-term unemployment conditions, particularly in low-income communities, and promising workforce development strategies were published in December 2012, in "A Perspective from Main Street: Long-Term Unemployment and Workforce Development," which provides a summary of the key topics that emerged from the forums and examples of how those issues were reflected in different parts of the country and for different populations.[32]

Community Data Initiative

The Community Data Initiative (CDI) is a pilot effort to better understand current and emerging community economic conditions around the country, with a special focus on capturing issues impacting low-to-moderate income communities, using targeted polling. The Board and each of the 12 Reserve Banks participate in this collaborative research project to provide systematic and relevant community conditions and trend information on a consistent basis.

The Reserve Banks administer web-based polls and surveys of key stakeholders within their districts. The Board surveys affiliates and grantees of NeighborWorks® America, providing a menu of national benchmark findings for Reserve Bank comparisons. All information collected through the CDI is voluntary.

Community stakeholders often play a central role in the community and economic development of low-income locales. These stakeholders include such organizations as community development financial institutions, credit unions, community banks, non-profit service providers and faith-based organizations, public sector agencies, small business owners, and community colleges. Recognizing that information from such organizations can help explain local changes and can complement the results of other surveys, Federal Reserve System staff has engaged in several modes of systematically collecting such information at the community level. While the initiative is too new to yield definitive results, the Federal Reserve is exploring the most effective and efficient means to gather and interpret information from these community stakeholders.

This work parallels exploratory work happening outside the United States. Board staff presented an overview of the CDI project at the World Statistics Congress in 2013, prompting conversations with other central banks and external researchers about their own interests in better understanding emerging issues in their own communities.

Consumer Laws and Regulations

Throughout 2013, DCCA continued to administer the Board's regulatory responsibilities with respect to certain entities and specific statutory provisions of the consumer financial services and fair lending laws. DCCA also drafts regulations and issues regulatory interpretations and compliance guidance for the industry, the Reserve Banks, and other federal agencies.

Appraisal Requirements for "Higher-Risk Mortgage Loans"

In January 2013, the Board and five federal financial regulatory agencies issued a final rule to establish appraisal requirements for "higher-risk mortgage

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[31] See Department of Labor, "Contingent Workers," www.dol.gov/_sec/media/reports/dunlop/section5.htm.

[32] Board of Governors of the Federal Reserve System (2012), *A Perspective from Main Street: Long-Term Unemployment and Workforce Development* (Board of Governors: Washington, D.C., December), www.federalreserve.gov/communitydev/pdfs/Workforce_errata_final2.pdf.

loans."[33] The rule implements amendments to the TILA made by the Dodd-Frank Act.[34] Mortgage loans are covered by the rule if they are higher-priced secured by a consumer's home and have interest rates above certain thresholds.

For higher-priced mortgage loans, the rule requires creditors to use a licensed or certified appraiser who prepares a written appraisal report based on a physical visit of the interior of the property. The rule also requires creditors to disclose to applicants information about the purpose of the appraisal and provide consumers with a free copy of any appraisal report.

If the seller acquired the property for a lower price during the prior six months and the price difference exceeds certain thresholds, creditors will have to obtain a second appraisal at no cost to the consumer. This requirement for higher-priced home-purchase loans is intended to address fraudulent property flipping by seeking to ensure that the value of the property legitimately increased.

In response to public comments, the agencies published a supplemental proposal to request comment on possible exemptions for "streamlined" refinance programs and small-dollar loans, and to solicit views on the rule's applicability to loans secured by manufactured homes. A final rule was issued in December to exempt a subset of higher-priced mortgage loans from these appraisal requirements, with the intention of saving borrowers time and money while still ensuring that the loans are financially sound.[35] Under the supplemental rule, loans of $25,000 or less and certain "streamlined" refinancings are exempt from the Dodd-Frank Act's appraisal requirements for higher-risk loans, which took effect January 18, 2014.

The rule also contains special provisions for manufactured homes, which can present unique issues in determining the appropriate valuation method. To ensure that access to affordable housing options is not hindered while creditors make the necessary adjustments, the requirements for manufactured home loans will not become effective for 18 months. Starting on July 18, 2015, loans secured by an existing manufactured home and land will be subject to the Dodd-Frank Act's appraisal requirements. Loans secured by a new manufactured home and land will be exempt from the requirement that the appraiser visit the home's interior. For loans secured by manufactured homes without land, creditors will be allowed to use other valuation methods without an appraisal, such as using third-party valuation services or "book values."

[33] The five agencies issuing the rule are the CFPB, the FDIC, the Federal Housing Finance Agency (FHFA), NCUA, and OCC.

[34] See Board of Governors, CFPB, FDIC, FHFA, NCUA, and OCC (2013), "Agencies Issue Final Rule on Appraisals for Higher-Priced Mortgage Loans," joint press release, January 18, www.federalreserve.gov/newsevents/press/bcreg/20130118a.htm.

[35] See Board of Governors, CFPB, FDIC, FHFA, NCUA, and OCC (2013), "Agencies Issue Final Rule to Exempt Subset of Higher-Priced Mortgage Loans from Appraisal Requirements," joint press release, December 12, www.federalreserve.gov/newsevents/press/bcreg/20131212a.htm.

Proposed Flood Insurance Rule

In October, the Board and four other federal agencies issued a joint notice of proposed rulemaking to amend regulations pertaining to loans secured by property located in special flood hazard areas.[36] The proposed rule would implement certain provisions of the Biggert-Waters Act with respect to private flood insurance, the escrow of flood insurance payments, and the forced-placement of flood insurance.

The proposed rule would require that regulated lending institutions accept private flood insurance as defined in the Biggert-Waters Act to satisfy the mandatory purchase requirements. It also solicits comment on whether the agencies should adopt additional regulations on the acceptance of flood insurance policies issued by private insurers. In addition, the proposal would require regulated lending institutions to escrow payments and fees for flood insurance for any new or outstanding loans secured by residential improved real estate or a mobile home—not including business, agricultural, and commercial loans—unless the institutions qualify for the statutory exception. Finally, the proposal would clarify that regulated lending institutions have the authority to charge a borrower for the cost of force-placed flood insurance coverage beginning on the date on which the borrower's coverage lapsed or became insufficient and would stipulate the circumstances under which a lender must terminate force-placed flood insurance coverage and refund payments to a borrower.

The public comment period for the rule closed on December 10, 2013, other than for comments related to the Paperwork Reduction Act analysis, which were due by December 30, 2013.

[36] See Board of Governors, CFPB, FDIC, FHA, NCUA, and OCC (2013), "Agencies Request Comment on Proposed Flood Insurance Rule," joint release, October 11, www.federalreserve.gov/newsevents/press/bcreg/20131011a.htm.

5 Federal Reserve Banks

The Federal Reserve Banks provide payment services to depository and certain other institutions, distribute the nation's currency and coin to depository institutions, and serve as fiscal agents and depositories for the U.S. government and other entities. The Reserve Banks also contribute to setting national monetary policy and supervision of banks and other financial entities operating in the United States (discussed in sections 2 through 4 of this annual report).

Federal Reserve Priced Services

Federal Reserve Banks provide a range of payment and related services to depository and certain other institutions; these "priced services" include collecting checks, operating an automated clearinghouse (ACH) service, transferring funds and securities, and providing a multilateral settlement service.

The Federal Reserve Banks, working with the financial services industry, have made substantial progress in their effort to migrate to a more efficient electronic payment system by expanding the use of ACH payments and by converting from a paper-based check-clearing process to an electronic one. Over the past several years, the Reserve Banks have capitalized on efficiencies gained from increased electronic processing; the Reserve Banks bundle all-electronic payment services and offer information and risk-management services, which help depository institutions manage effectively both their payment operations and associated operational and credit risk.

The Reserve Banks have also been engaged in a number of multiyear technology initiatives that will modernize their priced-services processing platforms. In 2013, the Banks continued efforts to migrate the FedACH, Fedwire Funds, and Fedwire Securities services off a mainframe system and to a distributed computing environment.

In December 2013, the *Federal Register* published a notice of proposed changes to the Federal Reserve Policy on Payment System Risk (PSR) and conforming amendments to Regulation J (Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire).[1] The proposed changes relate to the Board's procedures for posting debit and credit entries to institutions' Federal Reserve accounts for ACH debit and commercial check transactions.

Under the current posting rules for commercial and government ACH transactions established in 1994, ACH debit transactions post at 11:00 a.m. eastern time (ET), and ACH credit transactions post at 8:30 a.m. ET.[2] The Board elected to delay the posting of ACH debit transactions to allow receiving institutions time to obtain funds after the opening of the Reserve Banks' Fedwire Funds Service, which at that time opened at 8:30 a.m. Since then, the Fedwire Funds Service opening has been moved earlier, and the service now opens at 9:00 p.m. the previous evening. Therefore, the Board deemed that continuing the practice of delaying the settlement of ACH debit transactions until 11:00 a.m. was no longer necessary and may retard efforts by institutions to expedite funds settlements.[3]

In addition, the Board's current posting rules for commercial check transactions reflect a presumption that banks generally handle checks in paper form and do not reflect banks' widespread use of electronic check-processing methods. As a consequence, the Board's posting rules align with the processing of less than one-tenth of 1 percent of checks that the Reserve Banks handle.[4] The Board believes that

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1 The comment period for the changes to the PSR policy and Regulation J ended on February 10, 2014.

2 All times are eastern time unless otherwise specified.

3 The Board initially requested comment in 2008 on moving the posting time of ACH debit transactions from 11:00 a.m. to 8:30 a.m. to coincide with the posting of ACH credit transactions but decided not to pursue the change because of economic conditions at the time and the additional costs and liquidity pressures that could be placed on some institutions.

4 Under the current posting rules, commercial check credits post according to one of two options: (1) all credits post at a single,

Call to Improve the Speed and Efficiency of the Payment System

The Federal Reserve Banks released a public consultation paper in 2013 that requested comments on gaps and opportunities in the payment system and potential desired outcomes, strategies, and tactics to shape the future of U.S. payments from end to end.[1] The paper also sought input on the Federal Reserve's role in implementing the strategies and tactics.

Themes explored in the consultation paper included the need for a near-real-time payment system, the need for contemporary features and process improvements in legacy payment systems, the cost and convenience of international payments, and the mitigation of threats to payment system security. Responses were due in December 2013, and the Reserve Banks received feedback from a range of interested parties, including individual financial institutions, businesses, payment networks and processors, software vendors, payment innovators, consultants, and consumers, as well as from trade groups.[2] The Reserve Banks are analyzing the responses and seeking clarifications as needed.

In concert with this analysis of responses, the Reserve Banks have engaged in a number of additional information-gathering efforts that are designed to inform the Reserve Banks' future plans. These efforts include

- researching end-user demand for specific payment attributes, including payment speed,
- conducting an assessment of alternatives for speeding U.S. retail payments, and
- identifying gaps and opportunities related to payment system security.[3]

The consultation paper responses and these additional information-gathering efforts will serve as important inputs to the Reserve Banks' collective thinking in regard to future improvement initiatives, which will be communicated in a paper expected to be published in 2014.

1 See *Payment System Improvement—Public Consultation Paper,* Federal Reserve Financial Services (http://fedpaymentsimprovement.org/wp-content/uploads/2013/09/Payment_System_Improvement-Public_Consultation_Paper.pdf). For an overview of the initiative, see In Pursuit of a Better Payment System (http://fedpaymentsimprovement.org/).

2 See *Consultation Paper Response Summary,* Federal Reserve Financial Services (http://fedpaymentsimprovement.org/wp-content/uploads/industry_feedback_summary.pdf).

3 See *End-User Payment Research Summary,* Federal Reserve Financial Services (http://fedpaymentsimprovement.org/wp-content/uploads/enduser_demand_summary.pdf).

settlement practices should reflect the speed of clearing as well as the timing of deposits and presentments, and that its posting rules should be updated to align with today's electronic check-processing environment. In order to reflect today's electronic check-processing environment, the Board proposed to post commercial check transactions—both credits and debits—at 8:30 a.m., 1:00 p.m., and 5:30 p.m., with the specific posting time depending on when the check was deposited with the Reserve Banks (for credits) or presented by the Reserve Banks (for debits).

Recovery of Direct and Indirect Costs

The Monetary Control Act of 1980 requires that the Federal Reserve establish fees for priced services so as to recover, over the long run, all direct and indirect costs actually incurred as well as the imputed costs that would have been incurred—including financing costs, taxes, and certain other expenses—and the return on equity (profit) that would have been earned if a private business firm had provided the services.[5] The imputed costs and imputed profit are collectively referred to as the *private-sector adjustment factor* (PSAF). Over the past 10 years, Reserve Banks have recovered 102.0 percent of their priced services costs, including the PSAF (see table 1).[6]

float-weighted posting time, or (2) fractional credits post between 11:00 a.m. and 6:00 p.m., depending on the institution's preference. Both crediting options are based on surveys of check presentment times and vary across time zones. Commercial check debits are posted on the next clock hour at least one hour after presentment beginning at 11:00 a.m. for paper checks and 1:00 p.m. local time for electronic checks, and ending at 3:00 p.m. local time.

5 Financial data reported throughout this section—including revenue, other income, costs, income before taxes, and net income—will reference the "Pro Forma Financial Statements for Federal Reserve Priced Services" at the end of this section.

6 Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans [Accounting Standards Codification (ASC) Topic 715 (ASC 715), *Compensation–Retirement Benefits*], which has resulted in the recognition of a $466.2 million reduction in equity related to the priced services' benefit plans through 2013. Including this reduction in equity, which represents a decline in economic value, results in cost recovery of 95.9 percent for the 10-year period. For details on how implementing ASC 715 affected the pro forma financial statements, refer to note 4 to the pro forma financial statements at the end of this section.

Table 1. Priced services cost recovery, 2004–13
Millions of dollars, except as noted

Year	Revenue from services[1]	Operating expenses and imputed costs[2]	Targeted return on equity[3]	Total costs	Cost recovery (percent)[4,5]
2004	914.6	842.6	112.4	955.0	95.8
2005	993.8	834.4	103.0	937.4	106.0
2006	1,029.7	874.8	72.0	946.8	108.8
2007	1,012.3	912.9	80.4	993.3	101.9
2008	873.8	820.4	66.5	886.9	98.5
2009	675.4	707.5	19.9	727.5	92.8
2010	574.7	532.8	13.1	545.9	105.3
2011	478.6	444.4	16.8	461.2	103.8
2012	449.8	423.0	8.9	432.0	104.1
2013	441.3	409.3	4.2	413.5	106.7
2004–13	7,443.9	6,802.2	497.2	7,299.4	102.0

Note: Here and elsewhere in this section, components may not sum to totals or yield percentages shown because of rounding.

1 For the 10-year period, includes revenue from services of $6,924.4 million and other income and expense (net) of $519.5 million.

2 For the 10-year period, includes operating expenses of $6,480.9 million, imputed costs of $34.8 million, and imputed income taxes of $286.5 million.

3 From 2009 to 2012, the PSAF was adjusted to reflect the actual clearing balance levels maintained; previously, the PSAF had been calculated based on a projection of clearing balance levels.

4 Revenue from services divided by total costs.

5 Revenue from services divided by total costs. For the 10-year period, cost recovery is 95.9 percent, including the effect of accumulated other comprehensive income (AOCI) reported by the priced services under ASC 715. For details on changes to the estimation of priced services accumulated other comprehensive income and their effect on the pro forma financial statements, refer to note 4 to the "Pro Forma Financial Statements for Federal Reserve Priced Services" at the end of this section.

In 2013, Reserve Banks recovered 106.7 percent of total priced services costs, including the PSAF.[7] The Banks' operating costs and imputed expenses totaled $409.3 million. Revenue from operations totaled $441.3 million and other income was $0.1 million, resulting in net income from priced services of $32.0 million.

Commercial Check-Collection Service

In 2013, Reserve Banks recovered 115.4 percent of the total costs of their commercial check-collection service, including the related PSAF. The Banks' operating expenses and imputed costs totaled $170.7 million. Revenue from operations totaled $198.8 million and other income totaled $0.1 million, resulting in net income of $28.2 million. In 2013, check-service revenue from operations decreased $21.2 million from 2012.[8] Reserve Banks handled 6.0 billion checks in 2013, a decrease of 9.6 percent from 2012 (see table 2). The decline in Reserve Bank check volume continues to be influenced by nationwide trends away from the use of checks.

By year-end 2013, 99.9 percent of check deposits processed by the Reserve Banks and 99.9 percent of checks presented by the Reserve Banks to paying banks were processed electronically. In addition, 98.7 percent of unpaid checks were returned electronically to a Reserve Bank and 96.8 percent were delivered electronically by the Reserve Bank to the bank of first deposit.

Commercial Automated Clearinghouse Service

The Automated Clearinghouse Service enables depository institutions and their customers to process large volumes of payments effectively through electronic, batch processes. In 2013, the Reserve Banks recovered 101.2 percent of the total costs of their commercial ACH services, including the related PSAF. Reserve Bank operating expenses and imputed costs totaled $116.3 million.

Revenue from ACH operations totaled $118.8 million, resulting in net income of $2.6 million. The Reserve Banks processed 11.1 billion commercial ACH transactions, an increase of 4.5 percent from 2012.

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7 *Total cost* is the sum of operating expenses, imputed costs (income taxes, interest on debt, interest on float, and sales taxes), and the targeted return on equity.

8 Section 17 of the Check Clearing for the 21st Century Act requires the Federal Reserve Board's *Annual Report* to include costs of and revenue from inter-District commercial check transportation. In 2008, the Reserve Banks discontinued the transportation of commercial checks between their check-processing offices. As a result, in 2013, there were no costs or imputed revenues associated with the transportation of commercial checks between Reserve Bank check-processing offices.

Table 2. Activity in Federal Reserve priced services, 2011–13
Thousands of items

Service	2013	2012	2011	Percent change	
				2012 to 2013	2011 to 2012
Commercial check	5,988,302	6,622,265	6,779,607	-9.6	-2.3
Commercial ACH	11,142,821	10,664,613	10,348,802	4.5	3.1
Fedwire funds transfer	137,219	134,409	129,734	2.2	3.6
National settlement	661	663	571	-0.4	16
Fedwire securities	6,535	6,441	7,271	1.3	-11.4

Note: Activity in commercial check is the total number of commercial checks collected, including processed and fine-sort items; in commercial ACH, the total number of commercial items processed; in Fedwire funds transfer and securities transfer, the number of transactions originated online and offline; and in national settlement, the number of settlement entries processed.

Fedwire Funds and National Settlement Services

In 2013, Reserve Banks recovered 98.6 percent of the costs of their Fedwire Funds and National Settlement Services, including the related PSAF. Reserve Bank operating expenses and imputed costs for these operations totaled $97.1 million in 2013. Revenue from these services totaled $96.7 million, resulting in a net loss of $0.3 million.

Fedwire Funds Service

The Fedwire Funds Service allows its participants to use their balances at Reserve Banks to transfer funds to other participants in the service. In 2013, the number of Fedwire funds transfers originated by depository institutions increased 2.2 percent from 2012, to approximately 137.2 million. The average daily value of Fedwire funds transfers in 2013 was $2.8 trillion, an increase of 19 percent from the previous year.

National Settlement Service

The National Settlement Service is a multilateral settlement system that allows participants in private-sector clearing arrangements to settle transactions using Federal Reserve balances. In 2013, the service processed settlement files for 17 local and national private-sector arrangements, one more than in 2012. The Reserve Banks processed slightly fewer than 10,200 files that contained around 725,000 settlement entries for these arrangements in 2013. Activity in 2013 represents an increase from the 663,000 settlement entries processed in 2012.

Fedwire Securities Service

In 2013, the Reserve Banks recovered 105.0 percent of the total costs of the priced-service component of their Fedwire Securities Service, including the related PSAF. The Banks' operating expenses and imputed costs for providing this service totaled $25.3 million in 2013. Revenue from the service totaled $26.8 million and there was no other income, resulting in a net income of $1.5 million.

The Fedwire Securities Service allows its participants to transfer electronically to other service participants certain securities issued by the U.S. Treasury, federal government agencies, government-sponsored enterprises, and certain international organizations.[9] In 2013, the number of non-Treasury securities transfers processed via the service increased 1.3 percent from 2012, to approximately 6.5 million.

Float

In 2013, the Reserve Banks had daily average credit float of $630.2 million, compared with daily average credit float of $767.1 million in 2012.[10]

Currency and Coin

The Federal Reserve Board is the issuing authority for the nation's currency (in the form of Federal Reserve notes). In 2013, the Board paid the U.S. Treasury Department's Bureau of Engraving and Printing (BEP) approximately $664.0 million for

[9] The expenses, revenues, volumes, and fees reported here are for transfers of securities issued by federal government agencies, government-sponsored enterprises, and certain international organizations. Reserve Banks provide Treasury securities services in their role as the U.S. Treasury's fiscal agent. These services are not considered priced services. For details, see "Treasury Securities Services" later in this section.

[10] Credit float occurs when the Reserve Banks present checks and other items to the paying bank prior to providing credit to the depositing bank (debit float occurs when the Reserve Banks credit the depositing bank before presenting checks and other items to the paying bank).

costs associated with the production of 6.4 billion Federal Reserve notes. The Federal Reserve Banks distribute and receive currency and coin through depository institutions in response to public demand. Together, the Federal Reserve Board and Reserve Banks work to maintain the integrity of and confidence in Federal Reserve notes.

In 2013, the Reserve Banks distributed 37.4 billion Federal Reserve notes into circulation, the same as in 2012, and received 35.8 billion Federal Reserve notes from circulation, a 0.6 percent increase from 2012.

The value of Federal Reserve notes in circulation increased nearly 6.4 percent in 2013, to $1,197.9 billion at year-end, largely because of international demand for $100 notes. In 2013, the Reserve Banks also distributed 68.3 billion coins into circulation, a 1.2 percent decrease from 2012, and received 56.8 billion coins from circulation, a 3.2 percent decrease from 2012.

Redesigned $100 Note

The Federal Reserve began supplying financial institutions with a redesigned $100 note on October 8, 2013. The redesigned $100 note incorporates new security features to deter counterfeiters and help businesses and consumers tell whether a note is genuine. The Federal Reserve, U.S. Department of the Treasury, the BEP, and the U.S. Secret Service partner to redesign Federal Reserve notes to stay ahead of counterfeiting threats. The redesigned $100 note includes two new security features: a blue 3-D security ribbon with images of bells and 100s, and a color-changing bell in an inkwell. The new features, and additional features retained from the previous design, such as a watermark, offer the public a simple way to visually authenticate the new $100 note.

Improvements to Efficiency and Risk Management

Advances in currency-processing equipment and sensor technology have increased productivity and improved note authentication and fitness measurement, thereby reducing the premature destruction of fit currency while maintaining the quality and integrity of currency in circulation. In 2013, Reserve Banks began implementing a new authentication sensor and fitness sensor, which will be fully deployed in 2014. The Reserve Banks also began working with equipment manufacturers to explore the next generation of equipment to process the high volume of notes received annually for authentication and fitness sorting.

Since 2009, policy changes and improvements to the Reserve Banks' high-speed, currency-processing equipment have increased productivity almost 20 percent and Reserve Banks have reduced staffing levels in cash services by approximately 8 percent. The Reserve Banks, in consultation with Board staff, are investigating additional opportunities to improve processing technology to further increase productivity and enhance risk management. In 2013, Reserve Banks began several field tests to evaluate the feasibility and effectiveness of new processes.

Other Improvements and Efforts

Reserve Banks continue to develop a new cash-automation platform that will replace legacy software applications, automate business concepts and processes, and employ technologies to meet the cash business's current and future needs more cost effectively. The new platform will also facilitate business continuity and contingency planning and enhance the support provided to Reserve Bank customers. In 2013, the Reserve Banks successfully implemented another major component of the new automation platform that will allow communication between various interfaces. The final automation platform is scheduled to be deployed to all cash offices in 2017.

During 2013, the Board, its quality consultants, and the BEP continued implementing components of a new quality system for the BEP. Specifically, the consultants turned over to BEP staff several key components of the new quality system, and completed work on a process-change procedure that allows staff to identify, submit, and evaluate opportunities for improvement in all areas of production. One suggestion has already resulted—in less than a year—in savings of about $2 million in ink costs. This program will continue to enable the BEP to more efficiently and effectively meet the Federal Reserve Board's print-order requirements and the future production of bank notes that are more technologically complex

Fiscal Agency and Government Depository Services

As fiscal agents and depositories for the federal government, the Federal Reserve Banks auction Treasury securities, process electronic and check payments for Treasury, collect funds owed to the federal govern-

ment, maintain Treasury's bank account, and develop, operate, and maintain a number of automated systems to support Treasury's mission. The Reserve Banks also provide certain fiscal agency and depository services to other entities; these services are primarily related to book-entry securities. Treasury and other entities fully reimbursed the Reserve Banks for the costs of providing fiscal agency and depository services.

In 2013, fiscal agency expenses amounted to $530 million, a 4.7 percent increase from 2012 (see table 3). These costs increased as a result of requests from Treasury's Bureau of the Fiscal Service (Fiscal Service). Support for Treasury programs accounted for 93.6 percent of the cost, and support for other entities accounted for 6.4 percent.

Treasury Securities Services

The Reserve Banks work closely with Treasury's Fiscal Service in support of the borrowing needs of the federal government. The Banks auction, issue, maintain, and redeem securities; provide customer service; and operate the automated systems supporting U.S. savings bonds and marketable Treasury securities (bills, notes, and bonds). Treasury securities services consist of retail securities programs (which primarily serve individual investors) and wholesale securities programs (which serve institutional customers).

Retail Securities Programs

Reserve Bank operating expenses for the retail securities programs were $55.3 million in 2013, an 8 percent decrease from $60.2 million in 2012. This cost decrease is largely explained by increased operational efficiencies that resulted in lower staffing levels, as well as by continued savings from a 2012 Reserve Bank initiative that uses image processing to handle savings bond redemptions. In 2013, the Reserve Banks further enhanced their customer service and support environment by centralizing core functions of Treasury's Retail E-Services initiative. Reserve Banks also continued their work on decommissioning the Legacy Treasury Direct (LTD) system—established in 1986 as an application for investors to hold Treasury marketable securities (bills, notes, bonds, and Treasury Inflation-Protected Securities, or TIPS)—in order to eliminate aging technology platforms.

Wholesale Securities Programs

The Reserve Banks support wholesale securities programs through the sale, issuance, safekeeping, and transfer of marketable Treasury securities for institutional investors. In 2013, Reserve Bank operating expenses in support of Treasury securities auctions were $26.7 million, compared with $30.6 million in 2012. The cost decrease is attributable to lower oper-

Table 3. Expenses of the Federal Reserve Banks for fiscal agency and depository services, 2011–13
Thousands of dollars

Agency and service	2013	2012	2011
Department of the Treasury			
Treasury securities services			
Treasury retail securities	55,334	60,208	79,346
Treasury securities safekeeping and transfer	14,397	14,131	11,187
Treasury auction	26,673	30,648	29,258
Computer infrastructure development and support	5,801	4,990	1,969
Other services	2,971	3,340	4,036
Total	105,176	113,317	125,796
Payment, collection, and cash-management services			
Payment services	151,715	141,534	125,196
Collection services	44,788	41,456	38,707
Cash-management services	66,519	58,975	53,832
Computer infrastructure development and support	75,565	70,075	67,014
Other services	9,360	9,075	9,536
Total	347,947	321,115	294,285
Other Treasury			
Total	42,826	37,011	36,233
Total, Treasury	495,949	471,443	456,314
Other federal agencies			
Total, other agencies	34,077	34,569	27,893
Total reimbursable expenses	530,026	506,012	484,207

ating costs after program assets were fully amortized. The Banks conducted 267 Treasury securities auctions, compared with 264 in 2012. Reserve Banks also completed work on the Floating Rate Note (FRN), a new type of marketable Treasury security with a floating rate interest payment. Treasury held its inaugural FRN auction in January 2014—the first new Treasury security issued since the introduction of TIPS almost two decades ago.

Operating expenses associated with Treasury securities safekeeping and transfer activities were $14.4 million in 2013, compared with $14.1 million in 2012.

Payment Services

The Reserve Banks work closely with Treasury's Fiscal Service and other government agencies to process payments to individuals and companies. For example, the Banks process federal payroll payments, Social Security and veterans' benefits, income tax refunds, vendor payments, and other types of payments.

Reserve Bank operating expenses for payments-related activity totaled $151.7 million in 2012, compared with $141.5 million in 2012. The increase in expenses is largely due to costs associated with the new Post Payment System (PPS) initiative, expanded Treasury requirements for the Do Not Pay (DNP) and Invoice Processing Platform (IPP) programs, which were partly offset by lower costs for the Go Direct initiative. Reserve Banks began a multiyear effort to modernize several of Treasury's post-payment processing systems into a single application under the PPS initiative. The resulting application will provide a centralized and standardized set of payment data, greatly enhancing operations while reducing costs and providing better data analytics capabilities. In 2013, program expenses for PPS were $3.8 million.

In support of Treasury's DNP initiative, the Reserve Banks continued to enhance the DNP Portal, which is a single point of access through which federal agencies can query multiple data sources before making federal payments. The Reserve Banks implemented a number of software releases, established advanced data analytics functionality for fraud analysis, and added a number of new agency participants. In 2013, expenses for DNP increased to $13.9 million, from $8.0 million in 2012, largely because of the need for additional staffing to support application development, maintenance, and new data source purchases.

The IPP is part of Treasury's all-electronic initiative—an electronic invoicing and payment information system that allows vendors to enter invoice data electronically, either through a web-based portal or electronic submission. The IPP accepts, processes, and presents data from agencies and supplier systems related to all stages of payment transactions (including purchase orders, invoices, and other payment information). In 2013, the Reserve Banks' IPP expenses increased 45.6 percent, to $17.3 million. This increase is primarily driven by the higher staffing levels required to support 11 new federal agencies and bureaus that began using the IPP platform.

The cost decreases associated with the Go Direct initiative partly offset Treasury's other payments-related expenses. In 2013, expenses for Go Direct decreased 18.7 percent, to $23.8 million, because the public outreach campaign ended and because of lower call-center support costs. These cost reductions resulted because Go Direct achieved Treasury's March 2013 goal of making 95 percent of federal benefit check payments via electronic disbursement methods. As of December 2013, 97.5 percent of all federal benefit recipients received their payments electronically.

Treasury's payments-related expenses also were offset by lower spending for the Stored Value Card (SVC) program. This program provides stored value cards that military personnel can use to purchase goods and services on military bases. In 2013, the SVC program's expenses decreased 6.6 percent from 2012, to $13.5 million, because of a decline in new card and kiosk orders.

Collection Services

The Reserve Banks also work closely with Treasury's Fiscal Service to collect funds owed the federal government, including various taxes, fees for goods and services, and delinquent debts. In 2013, Reserve Bank operating expenses related to collections services increased 8.0 percent to $44.8 million, largely as a result of the expanded functionality of the Pay.gov application.

The Reserve Banks operate Pay.gov, an application that allows the public to use the Internet to authorize and initiate payments to federal agencies. During the year, the Pay.gov program expanded to include 109 new agency programs, and it processed more than 116 million online payments totaling $110 billion, a 23 percent and a 17 percent increase, respectively, from 2012. Increases in operational support and

enhanced functionality resulted in expenses increasing 33 percent, to $15.5 million.

The Reserve Banks also began supporting Treasury's new electronic commerce (eCommerce) initiative to expand ways for agencies and the public to do business with Treasury—through online banking solutions, mobile technologies, and other payment methods. In 2013, initial program expenses for eCommerce were $156,000 and were included under Pay.gov's budget.

The Reserve Banks also continued to support the government's centralized delinquent debt-collection program. Specifically, the Banks developed and maintained software that facilitates the collection of delinquent debts owed to federal agencies and states by matching federal payments against delinquent debts, including past-due child support payments owed to custodial parents.

Treasury Cash-Management Services

The Reserve Banks maintain Treasury's operating cash account and provide collateral-management and collateral-monitoring services for those Treasury programs that have collateral requirements. The Reserve Banks also support Treasury's efforts to modernize its financial management processes by developing software, operating help desks, and managing projects on behalf of the Fiscal Service.

In 2013, Reserve Bank operating expenses related to Treasury cash-management services totaled $66.5 million, compared with $59.0 million in 2012.

During 2013, the Reserve Banks continued to support Treasury's efforts to improve centralized government accounting and reporting functions. In particular, the Reserve Banks collaborated with the Fiscal Service on several ongoing software development efforts, such as the Central Accounting Reporting System (CARS), which is intended to provide Treasury with a modernized system for the collection and dissemination of financial management and accounting information transmitted from and to federal program agencies. In 2013, expenses for CARS were $26.6 million, compared with $22.1 million in 2012.

Services Provided to Other Entities

When permitted by federal statute or when required by the Secretary of the Treasury, the Reserve Banks provide fiscal agency and depository services to other domestic and international entities.

Reserve Bank operating expenses for services provided to other entities were $34.1 million in 2013, compared with $34.6 million in 2012. Book-entry securities issuance and maintenance activities account for a significant amount of the work performed for other entities, with the majority performed for the Federal Home Loan Mortgage Association, the Federal National Mortgage Association, and the Government National Mortgage Association.

The Reserve Banks continue to process postal money orders primarily in image form, resulting in operational improvements, lower staffing levels, and lower costs to the U.S. Postal Service. In 2013, expenses for postal money orders were $3.4 million, compared with $4.0 million in 2012.

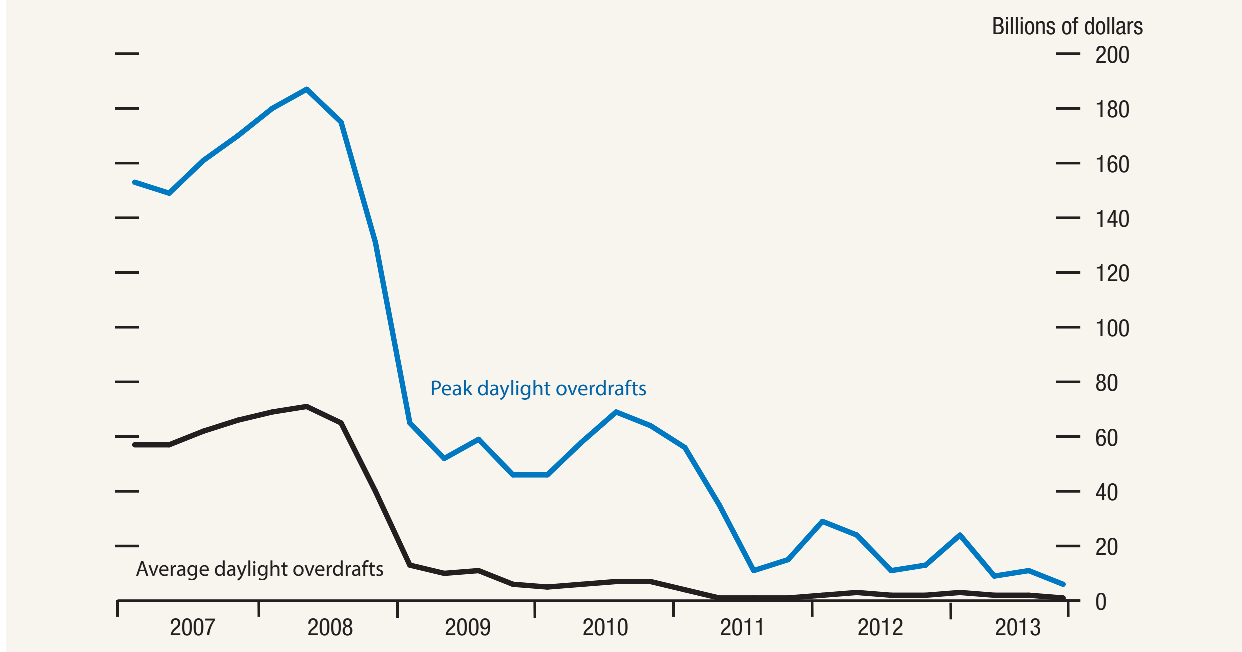
Use of Federal Reserve Intraday Credit

The Board's Payment System Risk (PSR) policy governs the use of Federal Reserve Bank intraday credit, also known as daylight overdrafts. A daylight overdraft occurs when an institution's account activity creates a negative balance in the institution's Federal Reserve account at any time in the operating day. Daylight overdrafts enable an institution to send payments more freely throughout the day than if it were limited strictly by its available intraday funds balance. The PSR policy recognizes explicitly the role of the central bank in providing intraday balances and credit to healthy institutions; under the policy, the Reserve Banks provide collateralized intraday credit at no cost.

Before the 2007–09 financial crisis, overnight balances were much lower and daylight overdrafts significantly higher than levels observed since late 2008. In 2007, for example, institutions held, on average, less than $20 billion in overnight balances, and total average daylight overdrafts were around $60 billion.

In contrast, institutions held historically high levels of overnight balances—on average more than $2 trillion—at the Reserve Banks in 2013, while daylight overdrafts remained historically low. Average daylight overdrafts across the System declined to $1.9 billion in 2013 from $2.1 billion in 2012, a decrease of about 10 percent (see figure 1). The aver-

Figure 1. Aggregate daylight overdrafts, 2007–13



age level of peak daylight overdrafts fell from almost $20 billion in 2012 to $12 billion in 2013; the average level of peak daylight overdrafts in 2013 was just a fraction of its level in 2008 (about 7 percent).

Daylight overdraft fees are also at historically low levels. In 2013, institutions paid about $40,000 in daylight overdraft fees; in contrast, fees totaled more than $50 million in 2008. The decrease in fees is largely attributable to the elevated level of reserve balances that began to accumulate in late 2008 and to the March 2011 policy revision that eliminated fees for collateralized daylight overdrafts.

FedLine Access to Reserve Bank Services

The Reserve Banks' FedLine access solutions provide depository institutions with a variety of alternatives for electronically accessing the Banks' payment and information services. These FedLine channels are designed to meet the individual connectivity, security, and contingency requirements of depository institution customers.

For the past few years, as a result of the declining number of depository institutions, Reserve Bank FedLine connections have decreased. At the same time, the number of employees within depository institutions who have credentials that establish them as trusted users increased, reflecting in part the expansion of electronic value-added services provided. Between 2007 and 2013, the total number of depository institutions in the U.S. declined 19.2 percent. The number of depository institutions with FedLine connections declined 8.8 percent, while the number of trusted users increased 10.5 percent over the same period.

The Reserve Banks continue to maintain their focus on security and resiliency by upgrading critical elements of the FedLine solutions. The next-generation VPN solution is a key component of the security model for the FedLine Advantage and FedLine Command access solutions, used by approximately 6,000 financial institutions. The solution was certified for general availability in July 2013, and the overall migration is scheduled for completion by September 2015.

The Bank's credential management strategy, known as FedLine User Authentication Enhancements, focused on eliminating the use of user IDs and passwords for authentication to any FedLine environment. The project was completed in November 2013, with more than 30,000 credentials migrated.

Information Technology

The Federal Reserve Banks continued to improve the efficiency, effectiveness, and security of information technology (IT) services and operations in 2013.

The Federal Reserve System's National IT reorganized to align functional responsibilities and improve service and support. Additional efforts were initiated to help System leaders articulate business needs through IT roadmaps and to identify additional opportunities to employ common technology services and solutions.

Major multiyear programs to consolidate the Federal Reserve's IT operations and networking services are nearing completion and are expected to improve the overall efficiency and quality of business operations. Two projects within the programs are finished, and the centralization of the remaining enterprise IT functions will be complete by the end of 2014.

Additionally, National IT continued to improve the Reserve Banks' information security posture, and the chief information security officer (CISO) continued efforts to ensure System preparedness for potential information security (IS) risk are coordinated to mitigate advanced persistent threats among the Federal Reserve Banks.[11] Under the direction of the CISO, management of the Federal Reserve's IS risk continues to mature, with priority given to IS strategy, performance objectives, and measures of success for National IT's IS operations. The Federal Reserve System continued its implementation of a new IS framework, known as System Assurance for the Federal Reserve, which is based on guidance from the National Institute of Standards and Technology and adapted to the Federal Reserve's environment.

Examinations of the Federal Reserve Banks

The Reserve Banks and several consolidated variable interest entities (VIEs) operated by the Federal Reserve System in response to the 2007–09 financial crisis are subject to several levels of audit and review.[12] The combined financial statements of the Reserve Banks —as well as the financial statements of each of the 12 Banks and those of the consolidated VIEs—are audited annually by an independent public accountant retained by the Board of Governors.[13] In addition, the Reserve Banks, including the consolidated VIEs, are subject to oversight by the Board of Governors, which performs its own reviews.

The Reserve Banks use the 1992 framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to assess their internal controls over financial reporting, including the safeguarding of assets. Within this framework, the management of each Reserve Bank annually provides an assertion letter to its board of directors that confirms adherence to COSO standards. Similarly, each consolidated VIE annually provides an assertion letter to the board of directors of the New York Reserve Bank.

The Federal Reserve Board engaged Deloitte & Touche LLP (D&T) to audit the 2013 combined and individual financial statements of the Reserve Banks and those of the consolidated VIEs.[14]

In 2013, D&T also conducted audits of the internal controls associated with financial reporting for each of the Reserve Banks. Fees for D&T's services totaled $7 million, of which $1 million was for the audits of the consolidated VIEs. To ensure auditor independence, the Board requires that D&T be independent in all matters relating to the audits. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2013, the Banks did not engage D&T for any non-audit services.[15]

[11] National IT supplies national infrastructure and business line technology services to the Federal Reserve Banks and provides guidance on the System's information technology architecture and business use of technology.

[12] The New York Reserve Bank is considered to be the controlling financial interest holder of each of the consolidated VIEs.

[13] See "Federal Reserve Banks Combined Financial Statements" in section 11 of this report. Each VIE reimburses the Board of Governors—from the entity's available net assets—for the fees related to the audit of its financial statements.

[14] In addition, D&T audited the Office of Employee Benefits of the Federal Reserve System (OEB), the Retirement Plan for Employees of the Federal Reserve System (System Plan), and the Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The System Plan and the Thrift Plan provide retirement benefits to employees of the Board, the Federal Reserve Banks, the OEB, and the Consumer Financial Protection Bureau.

[15] One Bank leases office space to D&T.

The Board's reviews of the Reserve Banks include a wide range of off-site and on-site oversight activities, conducted primarily by its Division of Reserve Bank Operations and Payment Systems. Division personnel monitor on an ongoing basis the activities of each Reserve Bank and consolidated VIE, FRIT, and the Office of Employee Benefits of the Federal Reserve System (OEB), and they conduct a comprehensive on-site review of each Reserve Bank, FRIT, and OEB at least once every three years.

The comprehensive on-site reviews include an assessment of the internal audit function's effectiveness and its conformance to the Institute of Internal Auditors' (IIA) *International Standards for the Professional Practice of Internal Auditing*, applicable policies and guidance, and the IIA's code of ethics.

The Board also reviews the System Open Market Account (SOMA) and foreign currency holdings to (1) determine whether the New York Reserve Bank, while conducting the related transactions, complies with the policies established by the Federal Open Market Committee (FOMC) and (2) assess SOMA-related IT project management and application development, vendor management, and system resiliency and contingency plans. In addition, D&T audits the year-end schedule of participated asset and liability accounts and the related schedule of participated income accounts. The FOMC is provided with the external audit reports and a report on the Board review.

Income and Expenses

Table 4 summarizes the income, expenses, and distributions of net earnings of the Reserve Banks for 2013 and 2012. Income in 2013 was $91,150 million, compared with $81,586 million in 2012.

Expenses totaled $10,980 million: $5,223 million in interest paid to depository institutions on reserve balances and term deposits; $3,765 million in operating expenses; $617 million in net periodic pension expense, $60 million in interest expense on securities sold under agreements to repurchase; $580 million in assessments for Board of Governors expenditure; $702 million for new currency costs; $563 million for Consumer Financial Protection Bureau costs; the expenses were reduced by $530 million in reimbursements for services provided to government agencies. Net deductions from current net income totaled $1,029 million, which includes $1,257 million in unrealized losses on foreign currency denominated assets revalued to reflect current market exchange rates; $181 million in net income associated with consolidated VIEs; and $51 million in realized gains on federal agency and government-sponsored enterprise mortgage-backed securities (GSE MBS). Dividends paid to member banks, set at 6 percent of paid-in capital by section 7(1) of the Federal Reserve Act, totaled $1,650 million.

Comprehensive net income before interest on Federal Reserve notes expense remitted to Treasury totaled $81,430 million in 2013 (net income of $79,141 million, increased by other comprehensive gain of $2,289 million). Earnings remittances to Treasury totaled $79,633 million in 2013. The remittances equal comprehensive income after the deduction of dividends paid and the amount necessary to equate the Reserve Banks' surplus to paid-in capital.

Section 10 of this report (Statistical Tables) provides more detailed information on the Reserve Banks and the VIEs. Table 9 is a statement of condition for each Reserve Bank; table 10 details the income and expenses of each Reserve Bank for 2013; table 11 shows a condensed statement for each Reserve Bank for the years 1914 through 2013; and table 13 gives the number and annual salaries of officers and employees for each Reserve Bank. A detailed account of the assessments and expenditures of the Board of Governors appears in the Board of Governors Financial Statements (see section 11, "Federal Reserve System Audits").

SOMA Holdings and Loans

The Reserve Banks' average net daily holdings of securities and loans during 2013 amounted to $3,341,859 million, an increase of $625,883 million from 2012 (see table 5).

SOMA Securities Holdings

The average daily holdings of Treasury securities increased by $318,726 million, to an average daily amount of $2,092,769 million. The average daily holdings of GSE debt securities decreased by $24,376 million, to an average daily amount of $69,872 million. The average daily holdings of federal agency and GSE MBS increased by $376,991 million, to an average daily amount of $1,249,810 million.

Table 4. Income, expenses, and distribution of net earnings of the Federal Reserve Banks, 2013 and 2012
Millions of dollars

Item	2013	2012[1]
Current income	91,150	81,586
Loan interest income	6	81
SOMA interest income	90,503	80,860
Other current income[2]	641	645
Net expenses	9,135	7,798
Operating expenses	3,765	3,646
Reimbursements	-530	-506
Net periodic pension expense	617	641
Interest paid on depository institutions deposits and term deposits	5,223	3,875
Interest expense on securities sold under agreements to repurchase	60	142
Current net income	82,015	73,788
Net additions to (deductions from) current net income	-1,029	18,380
Treasury securities gains, net	0	13,255
Federal agency and government-sponsored enterprise mortgage-backed securities	51	241
Foreign currency translation losses	-1,257	-1,116
Net income (loss) from consolidated VIEs	181	6,038
Other deductions[3]	-4	-38
Assessments by the Board of Governors	1,845	1,599
For Board expenditures	580	490
For currency costs	702	722
For Consumer Financial Protection Bureau costs[4]	563	385
For Office of Financial Research costs[4]	0	2
Net income before providing for remittances to Treasury	79,141	90,569
Earnings remittances to Treasury	79,633	88,418
Net income (loss)	-492	2,151
Other comprehensive gain (loss)	2,289	-53
Comprehensive income	1,797	2,098
Total distribution of net income	81,430	90,516
Dividends on capital stock	1,650	1,637
Transfer to surplus and change in accumulated other comprehensive income	147	461
Earnings remittances to Treasury	79,633	88,418

1 Certain amounts relating to 2012 have been reclassified to conform to the current-year presentation.

2 Includes income from priced services, compensation received for services provided, and securities lending fees.

3 Includes unrealized loss on Term Asset-Backed Securities Loan Facility loans.

4 The Board of Governors assesses the Reserve Banks to fund the operations of the Consumer Financial Protection Bureau and, for a two-year period beginning July 21, 2010, the Office of Financial Research.

The increases in average daily holdings of Treasury securities and federal agency and GSE MBS are due to the purchases through a large-scale asset purchase program and reinvestment of principal payments from other SOMA holdings in federal agency and GSE MBS. The average daily holdings of GSE debt securities decreased as a result of maturities.

There were no significant holdings of securities purchased under agreements to resell in 2013 or 2012. Average daily holdings of foreign currency denominated assets in 2013 were $23,941 million, compared with $25,488 million in 2012. The average daily balance of central bank liquidity swap drawings was $3,361 million in 2013 and $38,737 million in 2012. The average daily balance of securities sold under agreements to repurchase was $95,519 million, an increase of $3,734 million from 2012.

The average rates of interest earned on the Reserve Banks' holdings of Treasury securities decreased to 2.47 percent and the average rates on GSE debt securities increased to 3.10 percent in 2013. The average rate of interest earned on federal agency and GSE MBS decreased to 2.93 percent in 2013. The average interest rates for securities sold under agreements to repurchase decreased to 0.06 percent in 2013. The average rate of interest earned on foreign currency

Table 5. System Open Market Account (SOMA) holdings and loans of the Federal Reserve Banks, 2013 and 2012
Millions of dollars, except as noted

Item	Average daily assets (+)/liabilities (–)		Current income (+)/expense (–)		Average interest rate (percent)	
	2013	2012	2013	2012	2013	2012
U.S. Treasury securities[1]	2,092,769	1,774,043	51,591	46,416	2.47	2.62
Government-sponsored enterprise debt securities[1]	69,872	94,248	2,166	2,626	3.10	2.79
Federal agency and government-sponsored enterprise mortgage-backed securities[2]	1,249,810	872,819	36,628	31,429	2.93	3.60
Foreign currency denominated assets[3]	23,941	25,488	96	139	0.40	0.55
Central bank liquidity swaps[4]	3,361	38,737	22	241	0.65	0.62
Other SOMA investments[5]	63	66	*	9	0.03	…
Total SOMA assets	3,439,816	2,805,401	90,503	80,860	2.63	2.88
Securities sold under agreements to repurchase	-95,519	-91,785	-60	-142	0.06	0.15
Other SOMA liabilities[6]	-2,781	-2,209	…	…	…	…
Total SOMA liabilities	-98,300	-93,994	-60	-142	0.06	0.15
Total SOMA holdings	**3,341,516**	**2,711,407**	**90,443**	**80,718**	**2.71**	**2.98**
Primary, secondary, and seasonal credit	79	72	*	*	0.25	0.38
Total loans to depository institutions	79	72	*	*	0.25	0.38
Term Asset-Backed Securities Loan Facility (TALF)[7]	264	4,497	6	80	2.27	1.78
Total loans to others	264	4,497	6	80	2.27	1.78
Total loans	**343**	**4,569**	**6**	**80**	**1.75**	**1.75**
Total SOMA holding and loans	**3,341,859**	**2,715,976**	**90,449**	**80,798**	**2.71**	**2.97**

[1] Face value, net of unamortized premiums and discounts.
[2] Face value, which is the remaining principal balance of the securities, net of unamortized premiums and discounts. Does not include unsettled transactions.
[3] Includes accrued interest. Foreign currency denominated assets are revalued daily at market exchange rates.
[4] Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.
[5] Cash and short-term investments related to the federal agency and government-sponsored enterprise mortgage-backed securities portfolio.
[6] Represents the obligation to return cash margin posted by counterparties as collateral under commitments to purchase and sell federal agency and GSE MBS, as well as obligations that arise from the failure of a seller to deliver securities on the settlement date.
[7] Represents the remaining principal balance.
* Less than $500 thousand.
… Not applicable.

denominated assets decreased to 0.40 percent while the average rate of interest earned on central bank liquidity swaps increased to 0.65 percent in 2013.

Lending

In 2013, the average daily primary, secondary, and seasonal credit extended by the Reserve Banks to depository institutions increased by $7 million, to $79 million. The average rate of interest earned on primary, secondary, and seasonal credit decreased to 0.25 percent in 2013, from 0.38 percent in 2012. The average daily balance of Term Asset-Backed Securities Loan Facility (TALF) loans in 2013 was $264 million, a decrease of $4,233 million from 2012. The average rate of interest earned on TALF loans in 2013 was 2.27 percent.

Investments of the Consolidated VIEs

Certain lending facilities established during 2008 and 2009, under authority of section 13(3) of the Federal Reserve Act, involved creating and lending to the consolidated VIEs (see table 6). Consistent with generally accepted accounting principles, the assets and liabilities of these VIEs have been consolidated with the assets and liabilities of the New York Reserve Bank in the preparation of the statements of condition included in this report. The proceeds at the maturity or the liquidation of the consolidated VIEs' assets are used to repay the loans extended by the New York Reserve Bank.

Net portfolio assets of the consolidated VIEs decreased from $2,750 million in 2012 to $1,926 million in 2013. The sale of portfolio assets held by Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC during 2012 enabled the repayment in full, including accrued interest, of loans extended to those VIEs by the Federal Reserve Bank of New York. Funds advanced to those VIEs by other beneficial interests were also repaid in full.

Table 6. Key financial data for consolidated variable interest entities (VIEs), 2013 and 2012
Millions of dollars

Item	TALF LLC		Maiden Lane LLC		Maiden Lane II LLC		Maiden Lane III LLC		Total VIEs	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Net portfolio assets of the consolidated VIEs and the net position of the New York Reserve Bank (FRBNY) and subordinated interest holders										
Net portfolio assets[1]	109	856	1,732	1,811	63	61	22	22	1,926	2,750
Liabilities of consolidated VIEs	0	0	-157	-415	0	0	0	0	-157	-415
Net portfolio assets available[2]	109	856	1,575	1,396	63	61	22	22	1,769	2,335
Loans extended to the consolidated VIEs by the FRBNY[3]	0	0	0	0	0	0	0	0	0	0
Other beneficial interests[3, 4]	0	113	0	0	0	0	0	0	0	113
Total loans and other beneficial interests	0	113	0	0	0	0	0	0	0	113
Cumulative change in net assets since the inception of the program[5]										
Allocated to FRBNY	11	71	1,575	1,396	53	51	15	15	1,654	1,533
Allocated to other beneficial interests	98	672	0	0	10	10	7	7	115	689
Cumulative change in net assets	109	743	1,575	1,396	63	61	22	22	1,769	2,222
Summary of consolidated VIE net income, including a reconciliation of total consolidated VIE net income to the consolidated VIE net income										
Portfolio interest income[6]	0	1	2	34	4	52	*	1,023	6	1,110
Interest expense on loans extended by FRBNY[7]	0	0	0	-10	0	-11	0	-46	0	-67
Interest expense–other	0	-3	0	-45	0	-7	0	-98	0	-153
Portfolio holdings gains (losses)	-573	0	183	552	0	1,393	0	5,506	-390	7,451
Professional fees	-1	-1	-6	-12	-1	-1	*	-11	-8	-25
Net income (loss) of consolidated VIEs	-574	-3	179	519	3	1,426	*	6,374	-392	8,316
Less: Net income (loss) allocated to other beneficial interests	574	4	0	0	-1	238	*	2,103	573	2,345
Net income (loss) allocated to FRBNY	0	-7	179	519	2	1,188	*	4,271	181	5,971
Add: Interest expense on loans extended by FRBNY, eliminated in consolidation[7]	0	0	0	10	0	11	0	46	0	67
Net income (loss) recorded by FRBNY[8]	0	-7	179	529	2	1,199	0	4,317	181	6,038
Balances of loans extended to the consolidated VIEs by the FRBNY										
Balance at beginning of the year	0	0	0	4,859	0	6,792	0	9,826	0	21,477
Accrued and capitalized interest	0	0	0	10	0	11	0	46	0	67
Repayments	0	0	0	-4,869	0	-6,803	0	-9,872	0	-21,544
Balance at end of the year	0	0	0	0	0	0	0	0	0	0

1 TALF, Maiden Lane, Maiden Lane II, and Maiden Lane III holdings are recorded at fair value. Fair value reflects an estimate of the price that would be received upon selling an asset if the transaction were to be conducted in an orderly market on the measurement date.

2 Represents the net assets available for distribution to FRBNY and "other beneficiaries" of the consolidated VIEs.

3 Book value. Includes accrued interest.

4 The other beneficial interest holders are the U.S. Treasury for TALF LLC, JPMorgan Chase for Maiden Lane LLC, and AIG for Maiden Lane II LLC and Maiden Lane III LLC.

5 Represents the allocation of the change in net assets and liabilities of the consolidated VIEs that are available for distribution to FRBNY and the other beneficiaries of the consolidated VIEs. The differences between the fair value of the net assets available and the book value of the loans (including accrued interest) are indicative of gains or losses that would be incurred by the beneficiaries if the assets had been fully liquidated at prices equal to the fair value.

6 Interest income is recorded when earned and includes amortization of premiums, accretion of discounts, and paydown gains and losses.

7 Interest expense recorded by each consolidated VIE on the loans extended by FRBNY is eliminated when the VIEs are consolidated in FRBNY's financial statements and, as a result, the consolidated VIEs' net income (loss) recorded by FRBNY is increased by this amount.

8 In addition to the net income attributable to TALF LLC, FRBNY earned $3 million on TALF loans during the year ended December 31, 2013 (interest income of $6 million and a loss on the valuation of loans of $3 million). FRBNY earned $46 million on TALF loans during the year ended December 31, 2012 (interest income of $80 million and loss on the valuation of loans of $34 million).

* Less than $500 thousand.

Federal Reserve Bank Premises

Several Reserve Banks took action in 2013 to maintain and renovate their facilities. The multiyear renovation programs at the Boston, New York, Richmond, St. Louis, and San Francisco Reserve Banks' headquarters buildings continued. The New York Reserve Bank began anticipated renovations to the

33 Maiden Lane building, and the Chicago Federal Reserve Bank began construction of security enhancements to its building. The Cleveland and Atlanta Reserve Banks disposed of the buildings formerly used to house their Pittsburgh and Nashville Branches, respectively. The Dallas Reserve Bank secured leased office space for its San Antonio Branch and in 2014 will pursue the sale of the building that previously housed the Branch's operations.

For more information on the acquisition costs and net book value of the Federal Reserve Banks and Branches, see table 14 in the "Statistical Tables" section of this report.

Pro Forma Financial Statements for Federal Reserve Priced Services

Table 7: Pro forma balance sheet for Federal Reserve priced services, December 31, 2013 and 2012
Millions of dollars

Item	2013		2012	
Short-term assets (Note 2)				
Imputed reserve requirements on clearing balances	913.3		510.9	
Receivables	36.2		35.6	
Materials and supplies	0.9		0.9	
Prepaid expenses	6.6		9.4	
Items in process of collection	165.3		216.0	
Total short-term assets		1,122.5		772.8
Long-term assets (Note 3)				
Premises	144.2		171.2	
Furniture and equipment	32.5		33.8	
Leases, leasehold improvements, and long-term prepayments	95.0		78.6	
Prepaid pension costs	59.2		-	
Prepaid FDIC asset	-		20.3	
Deferred tax asset	291.8		287.5	
Total long-term assets		622.8		591.4
Total assets		1,745.3		1,364.1
Short-term liabilities				
Deferred-availability items	1,078.6		703.6	
Short-term debt	20.4		-	
Short-term payables	23.4		35.4	
Total short-term liabilities		1,122.5		738.9
Long-term liabilities				
Long-term debt	129.4		-	
Accrued benefit costs	406.1		549.8	
Total long-term liabilities		535.5		549.8
Total liabilities		1,658.0		1,288.7
Equity (including accumulated other comprehensive loss of $466.2 million and $643.0 million at December 31, 2013 and 2012, respectively)		87.3		75.4
Total liabilities and equity (Note 4)		1,745.3		1,364.1

Note: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

Table 8: Pro forma income statement for Federal Reserve priced services, 2013 and 2012
Millions of dollars

Item	2013		2012	
Revenue from services provided to depository institutions (Note 5)	441.2			449.3
Operating expenses (Note 6)	385.5			406.1
Income from operations	55.7			43.2
Imputed costs (Note 7)				
Interest on float	-0.7		-1.1	
Interest on debt	0.1		–	
Sales taxes	4.4		4.6	
FDIC Insurance	0.0	3.8	1.4	4.9
Income from operations after imputed costs		51.9		38.3
Other income and expenses (Note 8)				
Investment income	0.1		1.0	
Earnings credits	0.0	0.1	-0.5	0.5
Income before income taxes		52.0		38.8
Imputed income taxes (Note 7)		20.0		12.0
Net income		32.0		26.8
Memo: Targeted return on equity (Note 7)		4.2		8.9

Note: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

Table 9: Pro forma income statement for Federal Reserve priced services, by service, 2013
Millions of dollars

Item	Total	Commercial check collection	Commercial ACH	Fedwire funds	Fedwire securities
Revenue from services (Note 5)	441.2	198.8	118.8	96.7	26.8
Operating expenses (Note 6)[1]	385.5	151.8	113.5	96.2	24.1
Income from operations	55.7	47.0	5.4	0.5	2.8
Imputed costs (Note 7)	3.8	1.2	1.2	1.1	0.3
Income from operations after imputed costs	51.9	45.8	4.2	-0.6	2.5
Other income and expenses, net (Note 8)	0.1	0.1	0.0	0.0	0.0
Income before income taxes	52.0	45.8	4.2	-0.5	2.5
Imputed income taxes (Note 7)	20.0	17.6	1.6	-0.2	1.0
Net income	32.0	28.2	2.6	-0.3	1.5
Memo: Targeted return on equity (Note 7)	4.2	1.6	1.2	1.0	0.3
Cost recovery (percent) (Note 9)	106.7	115.4	101.2	98.6	105.0

Note: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

[1] Operating expenses include pension costs, Board expenses, and reimbursements for certain nonpriced services.

Notes to Pro Forma Financial Statements for Priced Services

(1) Discontinuation of Clearing Balance Program

Effective July 11, 2012, the Board discontinued the contractual clearing balance program in connection with its simplification of reserve requirements. Clearing balances were a primary component of the pro forma balance sheet used to compute the imputed costs in the PSAF. As a result of the Board discontinuing the clearing balance program, Reserve Bank priced services no longer impute related expenses or investment income.

(2) Short-Term Assets

Before the discontinuation of the clearing balance program in 2012, a portion of the clearing balances was used to finance short- and long-term assets. The remainder of these clearing balances and the deposit balances arising from float were assumed to be invested in a portfolio of investments, shown as imputed investments. In addition, priced services imputed a reserve requirement on clearing balances, which are comparable to compensating balances held at correspondent banks by respondent institutions, held at Reserve Banks by depository institutions. The Board's reserve requirement imposed on respondent balances could be held as vault cash or as balances maintained; thus, a portion of priced services clearing balances was shown as required reserves on the asset side of the balance sheet. There were no clearing balances or related reserve requirement balances on December 31, 2012 (see note 1).

Receivables are composed of fees due the Reserve Banks for providing priced services and the share of suspense- and difference-account balances related to priced services.

Items in process of collection are gross Federal Reserve cash items in process of collection (CIPC), stated on a basis comparable to that of a commercial bank. They reflect adjustments for intra-Reserve Bank items that would otherwise be double-counted on the combined Federal Reserve balance sheet and adjustments for items associated with nonpriced items (such as those collected for government agencies). Among the costs to be recovered under the Monetary Control Act is the cost of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

(3) Long-Term Assets

Long-term assets consist of long-term assets used solely in priced services and the priced-service portion of long-term assets shared with nonpriced services, including the net pension asset and deferred tax asset related to the priced services pension and postretirement benefits obligation. The tax rate associated with the deferred tax asset was 38.5 percent and 30.9 percent for 2013 and 2012, respectively.

Long-term assets also consist of an estimate of the assets of the Board of Governors used in the development of priced services.

(4) Liabilities and Equity

Under the matched-book capital structure for assets, short-term assets are financed with short-term payables and imputed short-term debt, if needed. Long-term assets are financed with long-term liabilities, imputed long-term debt, and

imputed equity, if needed. Equity is imputed at 5 percent of total assets and 10 percent of risk-weighted assets for 2013 and 2012, respectively, to satisfy the FDIC requirements for a well-capitalized institution.

Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standard Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (codified in FASB Accounting Standards Codification (ASC) Topic 715 (ASC 715), Compensation–Retirement Benefits), which requires an employer to record the funded status of its pension and other benefit plans on its balance sheet. To reflect the funded status of its benefit plans, the Reserve Banks recognized the deferred items related to these plans, which include prior service costs and actuarial gains or losses, on the balance sheet. This resulted in an adjustment to the pension and other benefit plans related to priced services and the recognition of an associated deferred tax asset with an offsetting adjustment, net of tax, to accumulated other comprehensive income (AOCI), which is included in equity.

The Reserve Bank priced services recognized a pension asset of $59.2 million and a pension liability, which is a component of accrued benefit costs, of $103.6 million in 2013 and 2012, respectively. The change in the funded status of the pension and other benefit plans resulted in a corresponding increase in accumulated other comprehensive loss of $176.8 million in 2013.

The method for estimating the priced services portion of the SFAS 158/ASC715 adjustments to the pension and other benefit liabilities, AOCI, and deferred tax asset was refined in 2012 and incorporates AOCI component changes from year-to-year since the adoption of SFAS 158 in 2006. This estimation change does not directly affect the income statement or cost recovery.

(5) Revenue

Revenue represents fees charged to depository institutions for priced services and is realized from each institution through direct charges to an institution's account or, until the elimination of the clearing balance program, charges against its accumulated earnings credits (see note 7).

After all accumulated earnings credits expired in 2013, institutions could no longer use earnings credits to pay for priced services.

(6) Operating Expenses

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services and the expenses of the Board of Governors related to the development of priced services. Board expenses were $4.0 million in 2013 and $4.1 million in 2012.

In accordance with SFAS No. 87, Employers' Accounting for Pensions (codified in ASC 715), the Reserve Bank priced services recognized qualified pension-plan operating expenses of $45.4 million in 2013 and $49.1 million in 2012. Operating expenses also include the nonqualified pension credit and expense of $(0.7) million in 2013 and $0.3 million in 2012. The implementation of SFAS No. 158 (ASC 715) does not change the systematic approach required by generally accepted accounting principles to recognize the expenses associated with the Reserve Banks' benefit plans in the income statement. As a result, these expenses do not include amounts

related to changes in the funded status of the Reserve Banks' benefit plans, which are reflected in AOCI (see note 4).

The income statement by service reflects revenue, operating expenses, imputed costs, other income and expenses, and cost recovery.

(7) Imputed Costs

Imputed costs consist of income taxes, return on equity, interest on debt, sales taxes, interest on float, and, in 2012, an FDIC assessment. Many imputed costs are derived from the PSAF model. The 2013 cost of short-term debt imputed in the PSAF model is based on nonfinancial commercial paper rates; the cost of imputed long-term debt is based on Aaa and Baa Moody's bond yields; and the effective tax rate is derived from U.S. publicly traded firm data, which serve as the proxy for the financial data of a representative private-sector firm. The after-tax rate of return on equity is based on the returns of the equity market as a whole.[16]

Interest is imputed on the debt assumed necessary to finance priced-service assets. These imputed costs are allocated among priced services according to the ratio of operating expenses, less shipping expenses, for each service to the total expenses, less the total shipping expenses, for all services.

Interest on float is derived from the value of float to be recovered for the check and ACH services, Fedwire Funds Service, and Fedwire Securities Services through per-item fees during the period.

Float income or cost is based on the actual float incurred for each priced service.

The following shows the daily average recovery of actual float by the Reserve Banks for 2013, in millions of dollars:

Total float	(630.2)
Unrecovered float	7.1
Float subject to recovery through per item fees	(637.3)

Unrecovered float includes float generated by services to government agencies and by other central bank services. Float that is created by account adjustments due to transaction errors and the observance of nonstandard holidays by some depository institutions was recovered from the depository institutions through charging institutions directly. Float subject to recovery is valued at the federal funds rate. Certain ACH funding requirements and check products generate credit float; this float has been subtracted from the cost base subject to recovery in 2013 and 2012.

(8) Other Income and Expenses

Before the contractual clearing balance program was discontinued, other income and expenses consisted of income on the imputed investment of the required portion of the clearing balances, earning at the average coupon-equivalent yield on three-month Treasury bills, and income from expired earnings credits. Earnings credits were granted to depository institutions on their clearing balances based on a discounted average coupon-equivalent yield on three-month Treasury bills, and the credits expired 52 weeks after they were granted. For 2013, other income and

[16] Details regarding the PSAF methodology change can be found at www.gpo.gov/fdsys/pkg/FR-2012-11-08/pdf/2012-26918.pdf.

expenses consists exclusively of income from expired earnings credits. Expired earnings credits in 2013 were immaterial.

(9) Cost Recovery

Annual cost recovery is the ratio of revenue, including other income, to the sum of operating expenses, imputed costs, imputed income taxes, and after-tax targeted return on equity.

6 Other Federal Reserve Operations

Regulatory Developments: Dodd-Frank Act Implementation

Throughout 2013, the Federal Reserve continued to work diligently to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) (Pub. L. No. 111-203), which gives the Federal Reserve important responsibilities to issue rules and supervise financial companies to enhance financial stability and preserve the safety and soundness of the banking system. The Board also continued to implement various international frameworks developed under the auspices of the Basel Committee on Banking Supervision (BCBS).

The Board has issued a variety of final rules to implement the provisions of the Dodd-Frank Act and BCBS international frameworks that are designed to promote the safety and soundness of the banking system and enhance consumer financial protection. The following is a summary of the key regulatory initiatives that were completed during 2013.

The Volcker Rule: Prohibitions against Proprietary Trading and Other Activities

Section 619 of the Dodd-Frank Act generally prohibits insured depository institutions (IDIs) and their affiliates (collectively, banking entities) from engaging in proprietary trading or from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund. These prohibitions and other provisions of section 619 are commonly known as the "Volcker rule."

On December 10, 2013, the Board—jointly with the Commodity Futures Trading Commission (CFTC), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Securities and Exchange Commission (SEC)—issued final rules to implement section 619. The final rules prohibit banking entities from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures, and options on these instruments for their own account. This prohibition is subject to exemptions for underwriting, market making-related activities, risk-mitigating hedging, activities of foreign banking entities solely outside the United States, and certain other activities.

The final rules also prohibit banking entities from acquiring or retaining an ownership interest in, or having certain relationships with, a hedge fund or private equity fund (covered fund), subject to exemptions for investments made in connection with organizing and offering a covered fund, including making and retaining *de minimis* investments in a covered fund, certain investments made on behalf of customers, activities of foreign banking entities solely outside the United States, and certain other activities.

The final rules require a banking entity to establish a compliance program designed to help ensure and monitor compliance with the prohibitions and restrictions of section 619 and the final rules. The compliance requirements vary based on the size of the banking entity and the size, scope, and complexity of activities conducted. The final rule requires banking entities with total assets greater than $10 billion and less than $50 billion to have a compliance program that includes six pillars (including written policies and procedures, internal controls, management framework and accountability, independent testing and audits, training, and recordkeeping). Banking entities with significant trading operations and banking entities with total assets of $50 billion or more will be required to establish a detailed compliance program, and their chief executive officers will be required to attest that the program is reasonably designed to achieve compliance with the final rule.

The final rules reduce the burden on smaller, less-complex institutions by limiting their compliance requirements. For a banking entity that has total assets of $10 billion or less that engages in some

activity regulated under the final rule, the compliance program may be limited to appropriate references in existing compliance policies, appropriate to the activities, size, scope and complexity of the banking entity. A banking entity that does not engage in covered activities or investments (other than trading in certain government obligations) will not need to establish a compliance program.

The Dodd-Frank Act directs the Board to adopt rules governing the conformance period for section 619 and requires banking entities to conform their activities and investments by July 21, 2014, unless extended by the Board. On December 10, 2013, the Board extended the conformance period until July 21, 2015, to ensure effective compliance with the rules.

Integrated Regulatory Capital Framework

On July 2, 2013, the Board adopted a final rule (Regulation Q) that revises its risk-based and leverage capital requirements to implement the Basel III regulatory capital reforms and integrate the Board's capital rules into a comprehensive regulatory framework. The final rule was published jointly with the OCC, and the FDIC published a substantively identical interim final rule.

Under the final rule, minimum requirements increase for both the quantity and quality of capital held by all depository institutions, bank holding companies (BHCs) with total consolidated assets of $500 million or more, and savings and loan holding companies (SLHCs) that are not substantially engaged in commercial or insurance underwriting activities (collectively, banking organizations). Consistent with the BCBS international standard, the rule includes a new minimum ratio of common equity tier 1 capital to risk-weighted assets of 4.5 percent, raises the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent, and includes a minimum leverage ratio of 4 percent for all banking organizations. In addition, the rule requires a banking organization to hold a capital conservation buffer of common equity tier 1 capital in an amount greater than 2.5 percent of total risk-weighted assets to avoid limitations on capital distributions and discretionary bonus payments to executive officers. The final rule also incorporates the new and revised minimum requirements into the agencies' prompt corrective action framework.

In addition, for advanced approaches banking organizations (generally, the largest, most complex banking organizations), the final rule includes a new 3 percent minimum supplementary leverage ratio based on the BCBS international leverage standard that takes into account off-balance-sheet exposures. The rule also introduces a countercyclical capital buffer applicable to advanced approaches banking organizations to augment the capital conservation buffer during periods of excessive credit growth.

The final rule enhances the quality of banking organizations' regulatory capital through the establishment of standards based on common equity tier 1 capital—the most loss-absorbing form of capital—and the implementation of strict eligibility criteria for regulatory capital instruments. The final rule also improves the methodology for calculating risk-weighted assets to enhance risk sensitivity.

The final rule also establishes transition periods designed to provide sufficient time for banking organizations to meet the new capital standards while supporting lending. Under the final rule, the phase-in period for smaller, less complex banking organizations and all covered SLHCs begins in January 2015. The phase-in period for larger banking organizations that are not SLHCs began in January 2014.

Consistent with section 939A of the Dodd-Frank Act, the final rule removes references to, and reliance on, credit ratings from the Board's capital rules.

On December 6, 2013, the Board issued a final rule that makes technical changes to the market risk capital rule to align it with the Basel III revised capital framework. Technical changes to the rule reflect modifications by the Organisation for Economic Co-operation and Development regarding country risk classifications. The final rule also clarifies criteria for determining whether underlying assets are delinquent for certain traded securitization positions. It clarifies disclosure deadlines and modifies the definition of a covered position.

Stress Testing Requirements: Basel III Application and Transition Period

On September 24, 2013, the Board issued two interim final rules to clarify how companies should incorporate the Basel III regulatory capital reforms into their capital and business projections for capital plan sub-

missions and their stress tests required under the Dodd-Frank Act.

The first interim final rule applies to BHCs with $50 billion or more in total consolidated assets. The rule clarifies that for the 2013–14 capital planning and stress-testing cycle, these companies must incorporate the revised capital framework into their capital planning projections and into the stress tests required under the Dodd-Frank Act using the transition paths established in the Basel III final rule. This rule also clarifies that for the 2013–14 cycle, capital adequacy at large banking organizations would continue to be assessed against a minimum 5 percent tier 1 common ratio calculated in the same manner as under previous stress tests and capital plan submissions, ensuring consistency with those previous exercises.

The second interim final rule provides a one-year transition period for most banking organizations with between $10 billion and $50 billion in total consolidated assets to incorporate the Basel III capital reforms into their stress tests. These companies conducted their first company-run stress test under the Board's rules implementing the Dodd-Frank Act during the fall of 2013. The interim final rule requires these companies to calculate their stress test projections in their 2013–14 stress tests using the Board's then-current regulatory capital rules to allow the firms time to adjust their internal systems to the revised capital framework.

Swaps Push-Out Provision Applicability to Uninsured U.S. Branches and Agencies of Foreign Banking Organizations

Section 716 of the Dodd-Frank Act, commonly referred to as the swaps push-out provision, prohibits the provision of certain kinds of federal assistance to IDIs and other institutions that engage in swaps activities, subject to certain exceptions. Under section 716, which became effective on July 16, 2013, the appropriate federal banking agency for an IDI is required to provide a transition period of up to 24 months for conformance with the requirements of section 716 if requested by an IDI.

The Board issued an interim final rule on June 5, 2013, and a final rule on December 24, 2013, clarifying the treatment of uninsured U.S. branches and agencies of foreign banks under section 716. The final rule provides that, for purposes of section 716, uninsured U.S. branches and agencies of foreign banks are treated as IDIs. The final rule also establishes the process for state member banks and uninsured state branches or agencies of foreign banks to apply to the Board for a transition period of up to 24 months.

Supervisory Assessment Fees

Section 318 of the Dodd-Frank Act directs the Board to collect assessments from BHCs and SLHCs with $50 billion or more in total consolidated assets and from nonbank financial companies designated by the Financial Stability Oversight Council (Council) equal to the expenses the Board estimates are necessary or appropriate to carry out its supervision and regulation of those companies.

The Board issued a proposed rule on April 15, 2013, and a final rule on August 16, 2013, establishing how the Board will determine which companies are charged, estimate the applicable expenses, determine each company's assessment fee, and bill for and collect assessments. Under the final rule, each calendar year is an assessment period. Payments for the 2012 assessment period, the first assessment period under the final rule, were due by December 15, 2013. Beginning with the 2013 assessment period, the Federal Reserve will notify each company of the amount of its assessment no later than June 30 of the year following the assessment period, with payment due by September 15. The Federal Reserve will transfer the assessments it collects to the U.S. Department of the Treasury.

Bank Secrecy Act Regulations

On December 3, 2013, the Board and the Financial Crimes Enforcement Network, a bureau of the Treasury, issued a final rule to amend the definitions of "funds transfer" and "transmittal of funds" under regulations implementing the Bank Secrecy Act (BSA). The final rule addresses an ambiguity regarding the amendments to the Electronic Funds Transfer Act made by the Dodd-Frank Act by affirming the scope of funds transfers and transmittals subject to the BSA prior to the enactment of the Dodd-Frank Act.

Requirements for Determining When a Nonbank Financial Company Is Predominantly Engaged in Financial Activities

The Dodd-Frank Act established the Council, which, among other authorities and duties, may subject a

nonbank financial company to supervision by the Board and consolidated prudential standards. The act defines a nonbank financial company to include a company (other than a BHC and certain other specified types of entities) that is predominantly engaged in financial activities. A company is considered to be predominantly engaged in financial activities if 85 percent or more of its revenues or assets are related to activities that are defined as financial in nature under the Bank Holding Company Act. The Dodd-Frank Act directs the Board to establish the requirements for determining if a company is predominantly engaged in financial activities.

On April 3, 2013, the Board issued a final rule that establishes the requirements for determining when a company is predominantly engaged in financial activities. Under the final rule, the computation of assets and revenues for purposes of determining if a company meets the statutory threshold would be based on the relevant company's annual financial revenues in, or financial assets at the end of, either of its two most recent fiscal years. The final rule lists in an appendix the activities that will be defined as financial for the purposes of determining whether a company is predominantly engaged in financial activities.

The Dodd-Frank Act requires the Board to define "significant nonbank financial company" and "significant bank holding company," and the final rule also defines these terms. Among the factors the Council must consider when determining whether to designate a nonbank financial company for consolidated supervision by the Board is the extent and nature of the company's transactions and relationships with other significant nonbank financial companies and significant BHCs. If designated, those nonbank financial companies would be required to disclose to the Federal Reserve, the Council, and the FDIC the nature and extent of the company's credit exposure to other significant nonbank financial companies and significant BHCs as well as the credit exposure of such significant entities to the company. Under the final rule, a firm will be considered significant if it has $50 billion or more in total consolidated assets or has been designated by the Council as systemically important.

Federal Reserve Accounts and Services for Financial Market Utilities

Title VIII of the Dodd-Frank Act establishes a supervisory framework for financial market utilities (FMUs) that are designated as systemically important by the Council. FMUs are multilateral systems that provide the essential infrastructure for transferring, clearing, and settling payments, securities, and other financial transactions among financial institutions or between financial institutions and the system. Among other things, the act permits the Board to authorize a Federal Reserve Bank to establish and maintain an account for a designated FMU and provide certain services, including wire transfers, settlement, and securities safekeeping, to the designated FMU. Title VIII also permits a Federal Reserve Bank to pay earnings on balances maintained by or on behalf of a designated FMU in the same manner and to the same extent as the Federal Reserve Bank may pay earnings to a depository institution under the Federal Reserve Act, subject to any applicable rules, orders, standards, or guidelines provided by the Board.

On December 5, 2013, the Board issued a final rule to amend Regulation HH that sets out standards, restrictions, and guidelines for the establishment and maintenance of an account at, and provision of financial services from, a Reserve Bank for a designated FMU. The terms and conditions for access to Reserve Bank accounts and services are intended to facilitate the use of Reserve Bank accounts and services by a designated FMU in order to reduce settlement risk and strengthen settlement processes while limiting the risk presented by the designated FMU to the Reserve Banks.

In addition, the final rule would authorize a Reserve Bank to pay interest on the balances maintained by a designated FMU in accordance with the statute and other terms and conditions as the Board may prescribe. The final rule provides that interest on balances paid to designated FMUs will be the rate paid on balances of depository institutions or another rate determined by the Board from time to time, not to exceed the general level of short-term interest rates.

Retail Foreign Exchange Futures and Options

On April 4, 2013, the Board issued a final rule that sets standards for institutions regulated by the Federal Reserve that engage in certain types of foreign exchange transactions with retail customers. The rule outlines requirements for disclosure, recordkeeping, business conduct, and documentation for retail foreign exchange transactions. Under the final rule, institutions engaging in such transactions are required to notify the Federal Reserve and to be well

capitalized. Such institutions are also required to collect margin for retail foreign exchange transactions.

Appraisals for Higher-Risk Mortgage Loans

On January 18, 2013, the Board—jointly with the Consumer Financial Protection Bureau, the FDIC, the Federal Housing Finance Agency, the National Credit Union Administration, and the OCC—issued a final rule to implement section 129H of the Truth in Lending Act, added by the Dodd-Frank Act, which requires a creditor to obtain an appraisal before issuing a "higher-risk mortgage." Under the act, mortgage loans are higher-risk if they are secured by a consumer's home and have interest rates above a certain threshold.

For higher-risk mortgage loans, the final rule requires creditors to use a licensed or certified appraiser who prepares a written appraisal report based on a physical inspection of the interior of the property. The final rule also requires creditors to disclose to applicants information about the purpose of the appraisal and provide consumers with a free copy of any appraisal report. Creditors are required to obtain an additional appraisal at no cost to the consumer for a home-purchase higher-risk mortgage loan if the seller acquired the property for a lower price during the past six months and the price difference exceeds certain thresholds. This requirement addresses fraudulent property flipping by seeking to ensure that the value of the property being used as collateral for the loan legitimately increased.

The rule exempts several types of loans, such as qualified mortgages, temporary bridge loans and construction loans, and loans for mobile homes, trailers, and boats that are dwellings. The rule also has exemptions from the second appraisal requirement to facilitate loans in rural areas and other transactions.

On December 12, 2013, the Board, together with the other agencies, issued a supplemental final rule that provides additional exemptions from the appraisal requirements for higher-risk mortgage loans. The rule provides that loans of $25,000 or less and certain "streamlined" refinancings are exempt from the appraisal requirements. In addition, the final rule contains special provisions for manufactured homes. These provisions are intended to save borrowers time and money while still ensuring that the loans are financially sound.

Key Regulatory Initiatives Proposed in 2013

A number of important regulatory developments are in the proposal stage. The following is a summary of additional regulatory initiatives that the Board proposed in 2013.

Liquidity Requirements for Large Financial Institutions

On October 24, 2013, the Board issued a proposed rule for comment that would strengthen the liquidity positions of large financial institutions. The proposal is based on an international standard agreed to by the BCBS and was published for comment jointly with the FDIC and OCC.

The proposal would require institutions subject to the rule to meet a minimum quantitative liquidity requirement in the form of a liquidity coverage ratio (LCR). Under the LCR, each institution would hold an amount of high-quality, liquid assets such as central bank reserves and government and corporate debt that is equal to or greater than its projected cash outflows less up to 75 percent of its projected cash inflows during a short-term stress period. The proposal defines various categories of liquid assets and also specifies how a firm's projected net cash outflows over the stress period would be calculated using common, standardized assumptions about the outflows and inflows associated with specific liabilities, assets, and off-balance-sheet obligations.

The LCR would apply to all internationally active BHCs and SLHCs—generally, those with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposure—and to nonbank financial companies designated by the Council. It would also apply to depository institutions with $10 billion or more in consolidated assets that are subsidiaries of BHCs or SLHCs subject to the rule. The proposal also would apply a less stringent, modified LCR to BHCs and SLHCs that are not internationally active but have more than $50 billion in total assets. BHCs and SLHCs with substantial insurance subsidiaries and nonbank financial companies supervised designated by the Council with substantial insurance operations are not covered by the proposal.

Supplementary Leverage Ratio for Large Financial Institutions

On July 9, 2013, the Board, together with the FDIC and the OCC, issued a proposed rule to strengthen

the leverage ratio standards for the largest, most systemically significant financial institutions. The Board proposed to establish a new leverage buffer for BHCs with more than $700 billion in consolidated total assets or $10 trillion in assets under custody (covered BHCs) above the minimum supplementary leverage ratio requirement in Regulation Q of 3 percent tier 1 capital to total leverage exposure. Under the proposal, a covered BHC that maintained a leverage buffer of tier 1 capital in an amount greater than 2 percent of its total leverage exposure would not be subject to limitations on discretionary bonus payments and capital distributions. In addition to the leverage buffer for covered BHCs, the proposed rule would establish under the prompt corrective action rules a "well capitalized" threshold of 6 percent for the supplementary leverage ratio for IDI subsidiaries of covered BHCs. The proposed rule would currently apply to the eight largest, most systemically significant U.S. BHCs and their IDI subsidiaries.

Credit-Risk Retention

Under section 941 of the Dodd-Frank Act, the Board—along with the OCC, the FDIC, and the SEC, and with respect to residential mortgages, the Federal Housing Finance Administration and the Secretary of Housing and Urban Development—must establish regulations to require securitizers (sponsors of securitization transactions) to hold at least 5 percent of the credit risk of the assets they securitize. On August 28, 2013, the Board and the other agencies issued a revised proposal to implement the requirements of section 941 (new proposal). The original proposal was released on March 29, 2011 (original proposal). The agencies issued the new proposal after considering the many comments received on the original proposal.

As required by the statute, the new proposal includes a variety of exemptions, including an exemption for mortgage-backed securities that are collateralized exclusively by residential mortgages that qualify as qualified residential mortgages (QRMs). The new proposal would define QRMs to have the same meaning as "qualified mortgages" as defined by the Consumer Financial Protection Bureau under the Truth in Lending Act, as amended by the Dodd-Frank Act. The new proposal also requests comment on an alternative definition of QRM that would include certain underwriting standards in addition to the qualified mortgage criteria.

As under the original proposal, the new proposal includes various options to allow securitizers to meet their risk-retention requirement, including standard risk retention based on holding a "vertical" interest in each tranche of the transaction, a "horizontal" interest in the residual tranche of the transaction, or a combination of the two. However, the new proposal would allow greater flexibility in combining vertical and horizontal risk retention and includes modifications to measuring risk retention. The original proposal generally measured compliance with the standard risk-retention requirement based on the par value of securities issued in a securitization transaction and included a provision intended to ensure the securitizer retained an economically meaningful risk retention interest. Under the new proposal, risk retention generally would be based on fair-value measurements, which the agencies believe should generally ensure meaningful risk retention.

Like the original proposal, the new proposal contains risk-retention options explicitly designed for specific asset classes, including commercial real estate transactions, securitizations through revolving master trusts, and asset-backed commercial paper securitizations. The provisions in the new proposal were modified in certain cases for these options in response to comments received on the original proposal. In addition, the new proposal includes an option that would allow lead arrangers in syndicated loans to satisfy risk retention by retaining risk with respect to that loan, with no further risk retention required with respect to the loan if it was securitized through a collateralized loan obligation transaction.

Similar to the original proposal, under the new proposal, securitizations of commercial loans, commercial mortgages, or automobile loans that meet underwriting standards that reflect low credit risk would not be subject to risk retention. Also similar to the original proposal, the rule would recognize the full guarantee on payments of principal and interest provided by Fannie Mae and Freddie Mac for their residential mortgage-backed securities as meeting the risk-retention requirements while Fannie Mae and Freddie Mac are in conservatorship or receivership and have capital support from the U.S. government.

Federal Reserve Emergency Lending Authority

Section 1101 of the Dodd-Frank Act made extensive amendments to the emergency lending provisions of section 13(3) of the Federal Reserve Act. The amendments generally prohibit the Federal Reserve from extending emergency credit to any single or specific company and instead require emergency credit to be extended only to participants in a program or facility

with broadbased eligibility. The amendments also require the Board to establish, by regulation, policies and procedures that impose additional limitations on extensions of emergency credit.

On December 23, 2013, the Board issued proposed amendments to Regulation A to implement the changes to section 13(3) made by the Dodd-Frank Act. As required by the act, the proposed amendments are designed to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system and not to aid a failing financial company. The proposed amendments would establish procedures to prohibit extensions of emergency credit to insolvent borrowers. In addition, they would establish that a program or facility that is structured to remove assets from the balance sheet of a single and specific company, or that is established for the purpose of assisting a single and specific company to avoid insolvency proceedings, would not be a program or facility with broadbased eligibility.

The proposed amendments also would require the security for emergency loans to be sufficient to protect taxpayers from losses and would require the lending Reserve Bank to assign, at the time the credit is initially extended, a lendable value to all collateral for the program or facility, consistent with sound risk-management practices, in determining whether the extension of credit is secured to the Reserve Bank's satisfaction. The proposed amendments would further implement additional requirements imposed by section 1101 of the DoddFrank Act, such as requirements relating to reporting and termination of emergency credit programs or facilities.

Flood Insurance

On October 11, 2012, the Board and four other federal regulatory agencies issued a proposed rule to implement certain provisions of the Biggert-Waters Flood Insurance Reform Act of 2012, which significantly revised federal flood insurance statutes. The proposed rule would require that regulated lending institutions accept private flood insurance to satisfy mandatory purchase requirements. In addition, the proposal would require regulated lending institutions to escrow payments and fees for flood insurance for any new or outstanding loans secured by residential improved real estate or a mobile home, not including business, agricultural, and commercial loans, unless the institutions qualify for a statutory exception.

The proposal includes new and revised sample notice forms and clauses concerning the availability of private flood insurance coverage and the escrow requirement. The proposal also would clarify that regulated lending institutions have the authority to charge a borrower for the cost of force-placed flood insurance coverage beginning on the date on which the borrower's coverage lapsed or became insufficient and would stipulate the circumstances under which a lender must terminate force-placed flood insurance coverage and refund payments to a borrower.

The Board of Governors and the Government Performance and Results Act

Overview

The Government Performance and Results Act (GPRA) of 1993 requires federal agencies, in consultation with Congress and outside stakeholders, to prepare a strategic plan covering a multiyear period. GPRA also requires each agency to submit an annual performance plan and an annual performance report. The GPRA Modernization Act of 2010 further refines those requirements to include quarterly performance reporting. Although the Board is not covered by GPRA, the Board follows the spirit of the act and, like other federal agencies, prepares an annual performance plan and an annual performance report.

Strategic Framework, Performance Plan, and Performance Report

The Board's 2012–15 *Strategic Framework* (framework) articulates the Board's mission within the context of resources required to meet Dodd-Frank Act mandates, close cross-disciplinary knowledge gaps, develop appropriate policy, and continue addressing the recovery of a fragile global economy. The framework sets forth major goals, outlines strategies for achieving those goals, and identifies key measures of performance toward achieving the strategic objectives.

The annual performance plan outlines the planned projects, initiatives, and activities that support the framework's long-term objectives and resources necessary to achieve those objectives. The annual performance report summarizes the Board's accomplishments that contributed toward achieving the strategic goals and objectives identified in the framework.

The framework, performance plan, and performance report are available on the Board's websites at www.federalreserve.gov/publications/gpra/files/2012-2015-strategic-framework.pdf, www.federalreserve.gov/publications/gpra/files/2013-gpra-performance-plan.pdf, and www.federalreserve.gov/publications/gpra/files/2012-gpra-performance-report.pdf.

7 Record of Policy Actions of the Board of Governors

Policy actions of the Board of Governors are presented pursuant to section 10 of the Federal Reserve Act. That section provides that the Board shall keep a record of all questions of policy determined by the Board and shall include in its annual report to Congress a full account of such actions. This section provides a summary of policy actions in 2013, as implemented through (1) rules and regulations, (2) policy statements and other actions, and (3) discount rates for depository institutions. Policy actions were approved by all Board members in office, unless indicated otherwise.[1] Information on the actions is also available from the "Reading Rooms" on the Board's Freedom of Information (FOI) Act web page or on request from the Board's FOI Office.

For information on Federal Open Market Committee policy actions relating to open market operations, see section 8, "Minutes of Federal Open Market Committee Meetings."

Rules and Regulations

Regulation H (Membership of State Banking Institutions in the FRS), Regulation Q (Capital Adequacy of Bank Holding Companies, Savings and Loan Holding Companies, and State Member Banks), and Regulation Y (Bank Holding Companies and Change in Bank Control)

On July 2, 2013, the Board approved a final rule (Docket No. R-1442), issued jointly with the Office of the Comptroller of the Currency, to implement in the United States the capital reforms popularly known as Basel III and certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).[2] Among other provisions, the final rule increases the minimum requirements for both the quality and quantity of banking organizations' capital by establishing a new minimum common equity tier 1 capital ratio and implementing a capital conservation buffer. The rule also includes (1) a number of macroprudential features that apply only to large, internationally active banking organizations and (2) other features to reduce the complexity and regulatory burden for smaller and community banks. The final rule is effective January 1, 2014, with later compliance dates for certain provisions. The phase-in period for smaller, less complex banking organizations begins in January 2015, and savings and loan holding companies that have significant commercial or insurance underwriting activities are not subject to the final rule.

> **Voting for this action:** Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

On December 3, 2013, the Board approved a final rule (Docket No. R-1459) making conforming changes to its market risk capital rule in order to align that rule with the Basel III revised capital framework adopted in July 2013.[3] The Board also approved a final rule (Docket No. R-1442) making minor modifications to the Basel III revised capital framework in order to clarify the criteria for subordinated debt instruments that may be counted as tier 2 capital.[4] The technical changes to the market risk rule are effective April 1, 2014, and the Basel III modifications are effective January 1, 2014.

> **Voting for this action:** Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

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1 Governor Duke resigned from the Board on August 31, 2013.

2 See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-10-11/html/2013-21653.htm.

3 See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-12-18/html/2013-29785.htm.

4 See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-12-20/html/2013-29883.htm.

Regulation M (Consumer Leasing) and Regulation Z (Truth in Lending)

On November 12, 2013, the Board approved final rules (Docket Nos. R-1469 and R-1470) to increase the dollar threshold for exempt consumer credit and lease transactions from $53,000 to $53,500, in accordance with the Dodd-Frank Act.[5] The final rules were published jointly with the Consumer Financial Protection Bureau (CFPB). The dollar threshold is adjusted to reflect the annual percentage increase in the consumer price index. Transactions at or below the threshold are subject to the protections of the regulations. Although the Dodd-Frank Act generally transferred rulemaking authority under the Consumer Leasing Act and the Truth in Lending Act to the CFPB, the Board retains authority to issue rules for certain motor vehicle dealers. The final rules are effective January 1, 2014.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

Regulation Y (Bank Holding Companies and Change in Bank Control) and Regulation YY (Enhanced Prudential Standards)

On September 24, 2013, the Board approved two interim final rules (Docket Nos. R-1463 and R-1464) to clarify how financial institutions should incorporate the recent Basel III regulatory capital reforms into their capital and business projections during the cycle of capital plan submissions and stress tests that begin October 1, 2013.[6] The planning horizon for this capital plan and stress test cycle runs from the October 1 start date through the fourth quarter of 2015 and thus overlaps with the implementation of the Basel III capital reforms. The first interim final rule, which applies to bank holding companies with $50 billion or more in total consolidated assets, clarifies that in this capital planning and stress test cycle, these companies must incorporate the revised capital framework into their capital planning projections and into the stress tests required under the Dodd-Frank Act using the transition paths established in the Basel III final rule. The second interim final rule provides a one-year transition period for most banking organizations with between $10 billion and $50 billion in total consolidated assets. These companies are conducting their first Dodd-Frank Act company-run stress tests and will be required to calculate their stress test projections using the Board's current regulatory capital rules so that the companies have time to adjust their internal systems to the revised Basel III capital framework. The interim final rules also include other clarifying provisions—such as when, for a given capital planning and stress test cycle, a company is required to use the Board's advanced approaches capital rules. The interim final rules are effective September 30, 2013.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

Note: On February 20, 2014, the Board approved a final rule (Docket Nos. R-1463 and 1464) to further clarify the Board's stress testing and capital planning requirements, including requirements for bank holding companies using the advanced approaches capital rules.[7]

Regulation Z (Truth in Lending)

On January 11, 2013, the Board approved a final rule (Docket No. R-1443) to establish appraisal requirements for "higher-priced mortgage loans," in accordance with the Dodd-Frank Act.[8] The Board issued the final rule jointly with the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), National Credit Union Administration (NCUA), Consumer Financial Protection Bureau (CFPB), and Federal Housing Finance Agency (FHFA). Under the act, a "higher-priced mortgage loan" is secured by a consumer's home and has an annual percentage rate that exceeds certain thresholds. The final rule requires creditors to obtain an appraisal by a licensed or certified appraiser, disclose to applicants information about the purpose of the appraisal, and provide a free copy of any appraisal report. Second appraisals are required in some circumstances to address fraudulent property flipping. The final rule also provides exemptions for certain types of loans, including qualified mortgages and loans for new manufactured homes,

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5 See *Federal Register* notices at www.gpo.gov/fdsys/pkg/FR-2013-11-25/html/2013-28194.htm and www.gpo.gov/fdsys/pkg/FR-2013-11-25/html/2013-28195.htm.

6 See *Federal Register* notices at www.gpo.gov/fdsys/pkg/FR-2013-09-30/html/2013-23618.htm and www.gpo.gov/fdsys/pkg/FR-2013-09-30/html/2013-23619.htm.

7 See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2014-03-11/html/2014-05053.htm.

8 See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-02-13/html/2013-01809.htm.

and exemptions to facilitate loans in rural areas. The final rule is effective January 18, 2014.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

On December 5, 2013, the Board approved a final rule (Docket No. R-1443) to establish additional exemptions from certain appraisal requirements for a subset of higher-priced mortgage loans.[9] The final rule, issued jointly with the FDIC, OCC, NCUA, CFPB, and FHFA, provides that loans of $25,000 or less and certain "streamlined" refinancings are exempt from specified appraisal requirements for higher-priced mortgages. Loans secured by an existing manufactured home and land will not be subject to the appraisal requirements for 18 months, and the rule includes other special provisions relating to loans for manufactured homes. The final rule is effective January 18, 2014, and the provisions on manufactured home loans are effective July 18, 2015.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

Regulation HH (Designated Financial Market Utilities)

On December 2, 2013, the Board approved a final rule (Docket No. R-1455) to set out the standards, restrictions, and guidelines for the establishment and maintenance of an account at, and for the provision of financial services from, a Reserve Bank for financial market utilities that are designated as systemically important by the Financial Stability Oversight Council.[10] In addition, the final rule would authorize a Reserve Bank to pay interest on these account balances, in accordance with the Dodd-Frank Act and other terms and conditions as the Board may prescribe. The final rule is effective February 18, 2014.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

[9] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-12-26/html/2013-30108.htm.

[10] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-12-20/html/2013-29711.htm.

Regulation KK (Margin and Capital Requirements for Covered Swap Entities)

On June 4, 2013, the Board approved an interim final rule (Docket No. R-1458) clarifying the treatment of uninsured U.S. branches and agencies of foreign banks under section 716 of the Dodd-Frank Act, commonly referred to as the swaps push-out provision.[11] Section 716 generally prohibits the provision of certain kinds of federal assistance, such as discount window lending and deposit insurance, to insured depository institutions and other institutions that engage in swaps activities, subject to specified exceptions. Insured depository institutions that are swaps entities are eligible for certain statutory exceptions and a transition period of up to 24 months to comply with the requirements of section 716. For purposes of section 716, the interim final rule provides that uninsured U.S. branches and agencies of foreign banks are treated as insured depository institutions. The interim final rule also establishes the process for state member banks and uninsured state branches or agencies of foreign banks to apply to the Board for a transition period of up to 24 months. The Board also requested comment on the interim final rule, which is effective June 10, 2013.

Voting for this action: Chairman Bernanke and Governors Duke, Tarullo, Raskin, Stein, and Powell. **Absent and not voting:** Vice Chair Yellen.

On December 20, 2013, the Board approved a final rule (Docket No. R-1458) adopting without change the interim final rule approved in June 2013.[12] The final rule is effective January 31, 2014.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Stein, and Powell. **Abstaining:** Governor Raskin.

Regulation NN (Retail Foreign Exchange Transactions)

On April 1, 2013, the Board approved a final rule (Docket No. R-1428) to establish standards for banking organizations regulated by the Federal Reserve that engage in certain types of foreign exchange transactions with retail customers.[13] Foreign

[11] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-06-10/html/2013-13670.htm.

[12] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2014-01-03/html/2013-31204.htm.

[13] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-04-09/html/2013-08163.htm.

exchange transactions covered by the rule include futures or options on futures, over-the-counter options on foreign currency, and so-called rolling spot transactions. The rule establishes requirements for risk disclosures to customers and business conduct, recordkeeping, and documentation requirements. Banking organizations that engage in covered transactions are also expected to notify the Federal Reserve and to be well capitalized. The final rule is issued in accordance with the Dodd-Frank Act and is effective May 13, 2013.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

Regulation PP (Definitions Relating to Title I of the Dodd-Frank Act)

On March 28, 2013, the Board approved a final rule (Docket No. R-1405) to establish the requirements for determining whether a company is "predominantly engaged in financial activities."[14] Under the Dodd-Frank Act, the Financial Stability Oversight Council may subject a nonbank financial company to supervision by the Board and to consolidated prudential standards. The act defines a nonbank financial company to include a company (other than a bank holding company and certain other specified types of entities) that is predominantly engaged in financial activities. Under the final rule, the computation of assets and revenues for purposes of determining if a company meets the statutory threshold would be based on the relevant company's annual financial revenues in, or financial assets at the end of, either of its two most recent fiscal years. The final rule lists in an appendix the activities that will be defined as financial for the purposes of determining whether a company is predominantly engaged in financial activities. As required by the Dodd-Frank Act, the final rule defines the terms "significant nonbank financial company" and "significant bank holding company." The rule specifies that such a company will be considered "significant" if it has $50 billion or more in total consolidated assets or has been designated by the Council as systemically important. The final rule is effective May 6, 2013.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

[14] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-04-05/html/2013-07688.htm.

Regulation TT (Supervision and Regulation Assessments of Fees)

On August 14, 2013, the Board approved a final rule (Docket No. R-1457) to establish annual assessment fees to implement section 318 of the Dodd-Frank Act.[15] Under section 318, the Board is directed to collect assessments equal to the expenses it estimates are necessary or appropriate to supervise and regulate bank holding companies and savings and loan holding companies with $50 billion or more in total consolidated assets and nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve. The final rule describes how the Board estimates applicable expenses and determines each company's assessment fee, as well as the process for billing and collecting the fees. The final rule is effective October 25, 2013.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

Regulation VV (Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds)

On December 10, 2013, the Board approved a final rule (Docket No. R-1432), developed jointly with the FDIC, OCC, CFTC, and SEC, to implement section 619 of the Dodd-Frank Act, the so-called Volcker rule.[16] Under the final rule, insured depository institutions and their affiliates (banking entities) are (1) prohibited from short-term proprietary trading in certain instruments for their own account, (2) limited in their investments in and relationships with hedge funds and private equity funds (covered funds), and (3) subject to certain compliance requirements that include establishing a detailed compliance program if the entities engage in significant covered activities or investments. In addition, the final rule implements the statute and provides exemptions for certain activities, such as market making, underwriting, hedging, and acquiring or retaining an ownership interest as part of organizing and offering a covered fund. The final rule also limits compliance and other

[15] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-08-23/html/2013-20306.htm.

[16] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2014-01-31/html/2013-31511.htm.

requirements for smaller, less-complex banking entities. The final rule is effective April 1, 2014. The Board also approved an order extending the conformance period for banking entities subject to the final rule for an additional year until July 21, 2015.[17]

Voting for these actions: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

Note: On January 14, 2014, the Board approved an interim final rule (Docket No. R-1480) that is a companion rule to the December 2013 final rule.[18] The interim final rule would permit banking entities to retain investments in certain pooled investment vehicles that invested their offering proceeds primarily in certain securities issued by community banking organizations of the type grandfathered under section 171 of the Dodd-Frank Act. The interim final rule was developed jointly and also approved by the FDIC, OCC, CFTC, and SEC.

Bank Secrecy Act Regulations

On July 18, 2013, the Board approved a final rule (RIN 1506-AB20), issued jointly with the Department of the Treasury's Financial Crimes Enforcement Network, amending the definitions of "funds transfer" and "transmittal of funds" in the regulations implementing the Bank Secrecy Act.[19] The final rule maintains the current scope of funds transfers and transmittals of funds subject to the act in light of Dodd-Frank Act amendments to the Electronic Fund Transfer Act. The rule is effective January 3, 2014.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

Policy Statements and Other Actions

Term Asset-Backed Securities Loan Facility

On January 15, 2013, the Board approved eliminating the Department of the Treasury's (Treasury) remaining obligation to cover potential losses from the Term Asset-Backed Securities Loan Facility (TALF) using funds from the Troubled Asset Relief Program.[20] The Board and Treasury agreed that the credit protection was no longer necessary because the accumulated fees collected through the TALF program exceeded the amount of TALF loans outstanding. The TALF program closed in June 2010, and most loans have been repaid or matured. The Treasury's original $20 billion in credit protection for the TALF was reduced to $4.3 billion in June 2010 and to $1.4 billion in June 2012.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

Leveraged Lending

On March 7, 2013, the Board approved final guidance (Docket No. OP-1438), issued jointly with the FDIC and OCC, on leveraged lending.[21] The guidance, which applies to all financial institutions supervised by these agencies that engage in leveraged lending activities, covers transactions with borrowers whose degree of financial leverage significantly exceeds industry norms. The guidance outlines high-level principles for safe and sound leveraged lending, including underwriting, monitoring, and reporting practices for these loans, and replaces existing guidance issued in April 2001. The guidance is effective on March 22, 2013 (the compliance date is May 21, 2013).

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Duke, Tarullo, Raskin, Stein, and Powell.

Community Reinvestment Act

On September 30, 2013, the Board approved final new and revised Interagency Questions and Answers Regarding Community Reinvestment (Docket No. OP-1456), issued jointly with the FDIC and OCC, to provide additional guidance to financial institutions and the public regarding the agencies' Community Reinvestment Act regulations.[22] The questions and answers clarify several community development mat-

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[17] See press release at www.federalreserve.gov/newsevents/press/bcreg/20131210b.htm.

[18] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2014-01-31/html/2014-02019.htm.

[19] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-12-04/html/2013-28951.htm.

[20] See press release at www.federalreserve.gov/newsevents/press/monetary/20130115b.htm.

[21] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-03-22/html/2013-06567.htm.

[22] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-11-20/html/2013-27738.htm.

ters, including how the agencies consider community development activities that benefit a broader statewide or regional area that includes an institution's assessment area and how they consider certain community development services. The questions and answers are effective November 20, 2013.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

Stress Testing Scenarios

On November 5, 2013, the Board approved a final policy statement (Docket No. OP-1452) describing its processes for developing the scenarios to be used in the annual supervisory and company-run stress tests required under the Board's Dodd-Frank Act stress test rules and capital plan rule.[23] The policy statement is effective January 1, 2014.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

Social Media and Financial Institutions

On November 12, 2013, the Board approved final guidance (Docket No. FFIEC-2013-0002) to help financial institutions understand and manage potential consumer compliance, legal, reputational, and operational risks associated with their use of social media.[24] The guidance also provides considerations that financial institutions may find useful when conducting risk assessments and developing and evaluating policies and procedures related to social media. The Federal Financial Institutions Examination Council, on behalf of its member agencies, issued the guidance on December 11, 2013. The guidance is effective immediately.

Voting for this action: Chairman Bernanke, Vice Chair Yellen, and Governors Tarullo, Raskin, Stein, and Powell.

[23] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-11-29/html/2013-27009.htm.

[24] See *Federal Register* notice at www.gpo.gov/fdsys/pkg/FR-2013-12-17/html/2013-30004.htm.

Discount Rates for Depository Institutions in 2013

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks must establish rates on discount window loans to depository institutions at least every 14 days, subject to review and determination by the Board of Governors.

Primary, Secondary, and Seasonal Credit

Primary credit, the Federal Reserve's main lending program for depository institutions, is extended at the primary credit rate, which is set above the usual level of short-term market interest rates. It is made available, with minimal administration and for very short terms, as a backup source of liquidity to depository institutions that, in the judgment of the lending Federal Reserve Bank, are in generally sound financial condition. Throughout 2013, the primary credit rate was ¾ percent.

Secondary credit is available in appropriate circumstances to depository institutions that do not qualify for primary credit. The secondary credit rate is set at a spread above the primary credit rate. Throughout 2013, the spread was set at 50 basis points resulting in a secondary credit rate of 1¼ percent. Seasonal credit is available to smaller depository institutions to meet liquidity needs that arise from regular swings in their loans and deposits. The rate on seasonal credit is calculated every two weeks as an average of selected money-market yields, typically resulting in a rate close to the federal funds rate target. At year-end, the seasonal credit rate was 0.15 percent.[25]

Votes on Changes to Discount Rates for Depository Institutions

About every two weeks during 2013, the Board approved proposals by the 12 Reserve Banks to maintain the formulas for computing the secondary and seasonal credit rates. In 2013, the Board did not approve any changes in the primary credit rate.

[25] For current and historical discount rates, see www.frbdiscountwindow.org/.

8 Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the Annual Report of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to Congress a full account of such actions.

The minutes of the meetings contain the votes on the policy decisions made at those meetings, as well as a summary of the information and discussions that led to the decisions. In addition, four times a year, starting with the October 2007 Committee meeting, a Summary of Economic Projections is published as an addendum to the minutes. The descriptions of economic and financial conditions in the minutes and the Summary of Economic Projections are based solely on the information that was available to the Committee at the time of the meetings.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the minutes. When members dissent from a decision, they are identified in the minutes and a summary of the reasons for their dissent is provided.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under instructions from the Federal Open Market Committee that take the form of an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Federal Reserve Bank of New York operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. Changes in the instruments during the year are reported in the minutes for the individual meetings.[1]

[1] As of January 1, 2013, the Federal Reserve Bank of New York was operating under the Domestic Policy Directive approved at the December 11–12, 2012, Committee meeting. The other policy instruments (the Authorization for Domestic Open Market Operations, the Authorization for Foreign Currency Operations, the Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations) in effect as of January 1, 2013, were approved at the January 24–25, 2012, meeting.

Meeting Held on January 29–30, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, January 29, 2013, at 2:00 p.m., and continued on Wednesday, January 30, 2013, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Charles L. Evans

Esther L. George

Jerome H. Powell

Sarah Bloom Raskin

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, James J. McAndrews, Stephen A. Meyer, David Reifschneider, Daniel G. Sullivan, Christopher J. Waller, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Nellie Liang[1]
Director, Office of Financial Stability Policy and Research, Board of Governors

Jon W. Faust
Special Advisor to the Board, Office of Board Members, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Mark E. Van Der Weide
Deputy Director, Division of Banking Supervision and Regulation, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Joyce K. Zickler
Senior Adviser, Division of Monetary Affairs, Board of Governors

Eric M. Engen, Thomas Laubach, and David E. Lebow
Associate Directors, Division of Research and Statistics, Board of Governors

Beth Anne Wilson
Deputy Associate Director, Division of International Finance, Board of Governors

Karen M. Pence and Stacey Tevlin
Assistant Directors, Division of Research and Statistics, Board of Governors

Jeremy B. Rudd
Adviser, Division of Research and Statistics, Board of Governors

[1] Attended Tuesday's session only.

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Andrew Figura
Group Manager, Division of Research and Statistics, Board of Governors

John C. Driscoll and Jennifer E. Roush
Senior Economists, Division of Monetary Affairs, Board of Governors

Ruth Judson
Senior Economist, Division of International Finance, Board of Governors

Jonathan D. Rose
Economist, Division of Monetary Affairs, Board of Governors

Sarah G. Green
First Vice President, Federal Reserve Bank of Richmond

David Altig, Jeff Fuhrer, Loretta J. Mester, Glenn D. Rudebusch, and Mark S. Sniderman
Executive Vice Presidents, Federal Reserve Banks of Atlanta, Boston, Philadelphia, San Francisco, and Cleveland, respectively

Ron Feldman and Lorie K. Logan
Senior Vice Presidents, Federal Reserve Banks of Minneapolis and New York, respectively

Evan F. Koenig and Steven M. Friedman
Vice Presidents, Federal Reserve Banks of Dallas and New York, respectively

Matthew D. Raskin
Markets Officer, Federal Reserve Bank of New York

Robert L. Hetzel
Senior Economist, Federal Reserve Bank of Richmond

Annual Organizational Matters[2]

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for a term beginning January 29, 2013, had been received and that these individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William C. Dudley
President of the Federal Reserve Bank of New York, with

Christine Cumming
First Vice President of the Federal Reserve Bank of New York, as alternate.

Eric Rosengren
President of the Federal Reserve Bank of Boston, with

Charles I. Plosser
President of the Federal Reserve Bank of Philadelphia, as alternate.

Charles L. Evans
President of the Federal Reserve Bank of Chicago, with

Sandra Pianalto
President of the Federal Reserve Bank of Cleveland, as alternate.

James Bullard
President of the Federal Reserve Bank of St. Louis, with

Richard W. Fisher
President of the Federal Reserve Bank of Dallas, as alternate.

Esther L. George
President of the Federal Reserve Bank of Kansas City, with

Narayana Kocherlakota
President of the Federal Reserve Bank of Minneapolis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were selected to serve until the selection of their successors at the first regularly scheduled meeting of the Committee in 2014:

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

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2 Versions of the current Committee documents are available at http://www.federalreserve.gov/monetarypolicy/rules_authorizations.htm.

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Richard M. Ashton
Assistant General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors

Troy Davig

Michael P. Leahy

James J. McAndrews

Stephen A. Meyer

David Reifschneider

Daniel G. Sullivan

Geoffrey Tootell

Christopher J. Waller

William Wascher
Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account.

By unanimous vote, Simon Potter was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

> Secretary's note: Advice subsequently was received that the selection of Mr. Potter as Manager was satisfactory to the Federal Reserve Bank of New York.

By unanimous vote, the Authorization for Domestic Open Market Operations was approved with two amendments. The first broadened the actions that the Open Market Desk may take, at the Chairman's instruction during an intermeeting period, to include transactions to address temporary disruptions of an operational or highly unusual nature in U.S. dollar funding markets. For example, if secured funding rates were to increase to high levels in the wake of a natural disaster, the risk of a broader, more systemic disruption to the functioning of asset markets could result. In this case, the prospect that repurchase operations could potentially alleviate some of the market strains might warrant immediate action. Consistent with Committee practice, the Chairman, if feasible, would consult with the Committee before making any such instruction. The second amendment harmonized the language referring to the Committee's longer-run objectives with that in the Committee's Statement on Longer-Run Goals and Monetary Policy Strategy. The Guidelines for the Conduct of System Open Market Operations in Federal-Agency Issues remained suspended.

Authorization for Domestic Open Market Operations (Amended Effective on January 29, 2013)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

   A. To buy or sell U.S. government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. government and federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; and

   B. To buy or sell in the open market U.S. government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the System Open Market Account under agreements to resell or repurchase such securities or obligations (including such transactions as are commonly referred to as repo and reverse repo transactions) in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive

bidding, after applying reasonable limitations on the volume of agreements with individual counterparties.

2. The Federal Open Market Committee authorizes the Federal Reserve Bank of New York to undertake transactions of the type described in paragraphs 1.A and 1.B from time to time for the purpose of testing operational readiness. The aggregate par value of such transactions of the type described in paragraph 1.A shall not exceed $5 billion per calendar year. The outstanding amount of such transactions of the type described in paragraph 1.B shall not exceed $5 billion at any given time. These transactions shall be conducted with prior notice to the Committee.

3. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to use agents in agency MBS-related transactions.

4. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. government securities and securities that are direct obligations of any agency of the United States, held in the System Open Market Account, to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids that could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York. The Federal Reserve Bank of New York may lend securities on longer than an overnight basis to accommodate weekend, holiday, and similar trading conventions.

5. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments or other authorized services for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to section 15 of the Federal Reserve Act, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York:

   A. For the System Open Market Account, to sell U.S. government securities and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to such accounts on the bases set forth in paragraph 1.A under agreements providing for the resale by such accounts of those securities in 65 business days or less on terms comparable to those available on such transactions in the market;

   B. For the New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph l.B, repurchase agreements in U.S. government securities and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and to arrange corresponding sale and repurchase agreements between its own account and such foreign, international, and fiscal agency accounts maintained at the Bank; and

   C. For the New York Bank account, when appropriate, to buy U.S. government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States from such foreign and international accounts maintained at the Bank under agreements providing for the repurchase by such accounts of those securities on the same business day.

   Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

6. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to (i) adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate and to take actions that result in material changes in the composition

and size of the assets in the System Open Market Account other than those anticipated by the Committee at its most recent meeting or (ii) undertake transactions of the type described in paragraphs 1.A and 1.B in order to appropriately address temporary disruptions of an operational or highly unusual nature in U.S. dollar funding markets. Any such adjustment as described in clause (i) shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives to foster maximum employment and price stability, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any instruction under this paragraph.

The Committee voted unanimously to amend the Authorization for Foreign Currency Operations and the Procedural Instructions with Respect to Foreign Currency Operations, and to reaffirm the Foreign Currency Directive in the form shown below. The approval of these documents included approval of the System's warehousing agreement with the U.S. Treasury. The Authorization for Foreign Currency Operations and the Procedural Instructions with Respect to Foreign Currency Operations were amended to include the authority to conduct small-value operations against the full range of foreign transactions that the Desk is authorized to conduct. This change was made to allow for prudent testing of operational readiness, and is similar in purpose to the amendment that the Committee approved in June 2012 to the Authorization for Domestic Open Market Operations.

Authorization for Foreign Currency Operations (Amended Effective on January 29, 2013)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for the System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

    A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

    Australian dollars
    Brazilian reais
    Canadian dollars
    Danish kroner
    euro
    Japanese yen
    Korean won
    Mexican pesos
    New Zealand dollars
    Norwegian kroner
    Pounds sterling
    Singapore dollars
    Swedish kronor
    Swiss francs

    B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

    C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

    D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies, excluding changes in dollar value due to foreign exchange rate movements and interest accruals. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt,

minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Canada	2,000
Bank of Mexico	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1.A above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). Such investments may include buying or selling outright obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof; buying such securities under agreements for repurchase of such securities; selling such securities under agreements for the resale of such securities; and holding various time and other deposit accounts at foreign institutions. In addition, when appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, the Vice Chairman's alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to the Manager's responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

   A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the

division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

10. The Federal Open Market Committee authorizes the Federal Reserve Bank of New York to undertake transactions of the type described in paragraphs 1, 2, and 5, and foreign exchange and investment transactions that it may be otherwise authorized to undertake from time to time for the purpose of testing operational readiness. The aggregate amount of such transactions shall not exceed $2.5 billion per calendar year. These transactions shall be conducted with prior notice to the Committee.

Procedural Instructions with Respect to Foreign Currency Operations (Amended Effective on January 29, 2013)

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee, unless otherwise directed by the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

   A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

   B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with re-payment of swap drawings.

   C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

   D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

   A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

   B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

4. The Federal Open Market Committee authorizes the Federal Reserve Bank of New York to undertake transactions of the type described in paragraphs 1, 2, and 5 of the Foreign Authorization and foreign exchange and investment transactions that it may be otherwise authorized to undertake from time to time for the purpose of testing operational readiness. The aggregate amount of such transactions shall not exceed $2.5 billion per calendar year. These transactions shall be conducted with prior notice to the Committee.

Foreign Currency Directive (Reaffirmed January 29, 2013)

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with IMF Article IV, Section 1.

2. To achieve this end the System shall:

    A. Undertake spot and forward purchases and sales of foreign exchange.

    B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

    C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

    A. To adjust System balances in light of probable future needs for currencies.

    B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

    C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

    A. In close and continuous consultation and cooperation with the United States Treasury;

    B. In cooperation, as appropriate, with foreign monetary authorities; and

    C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under IMF Article IV.

All participants but one supported making only minor wording changes to the Statement on Longer-Run Goals and Monetary Policy Strategy. Mr. Tarullo abstained because he did not think the statement had advanced the cause of achieving or communicating greater consensus in the policy views of the Committee.

Statement on Longer-Run Goals and Monetary Policy Strategy (Amended Effective on January 29, 2013)

> "The Federal Open Market Committee (FOMC) is firmly committed to fulfilling its statutory mandate from the Congress of promoting maximum employment, stable prices, and moderate long-term interest rates. The Committee seeks to explain its monetary policy decisions to the public as clearly as possible. Such clarity facilitates well-informed decisionmaking by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability, which are essential in a democratic society.
>
> Inflation, employment, and long-term interest rates fluctuate over time in response to economic and financial disturbances. Moreover, monetary policy actions tend to influence economic activity and prices with a lag. Therefore, the Committee's policy decisions reflect its longer-run goals, its medium-term outlook, and its assessments of the balance of risks, including risks to the financial system that could impede the attainment of the Committee's goals.
>
> The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the

Federal Reserve's statutory mandate. Communicating this inflation goal clearly to the public helps keep longer-term inflation expectations firmly anchored, thereby fostering price stability and moderate long-term interest rates and enhancing the Committee's ability to promote maximum employment in the face of significant economic disturbances.

The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market. These factors may change over time and may not be directly measurable. Consequently, it would not be appropriate to specify a fixed goal for employment; rather, the Committee's policy decisions must be informed by assessments of the maximum level of employment, recognizing that such assessments are necessarily uncertain and subject to revision. The Committee considers a wide range of indicators in making these assessments. Information about Committee participants' estimates of the longer-run normal rates of output growth and unemployment is published four times per year in the FOMC's Summary of Economic Projections. For example, in the most recent projections, FOMC participants' estimates of the longer-run normal rate of unemployment had a central tendency of 5.2 percent to 6.0 percent, unchanged from one year ago but substantially higher than the corresponding interval several years earlier.

In setting monetary policy, the Committee seeks to mitigate deviations of inflation from its longer-run goal and deviations of employment from the Committee's assessments of its maximum level. These objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it follows a balanced approach in promoting them, taking into account the magnitude of the deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate.

The Committee intends to reaffirm these principles and to make adjustments as appropriate at its annual organizational meeting each January."

By unanimous vote, the Policy on External Communications of Committee Participants and the Policy on External Communications of Federal Reserve System Staff were amended to clarify the precise beginning and end of the communication blackout period surrounding regular meetings of the Federal Open Market Committee (FOMC).

By unanimous vote, the Rules of Procedure were amended to change the quorum requirements to state that a meeting of the FOMC could not be convened without a representative of a Reserve Bank.

By unanimous vote, the Committee reaffirmed its Program for Security of FOMC Information.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets as well as the System open market operations during the period since the FOMC met on December 11–12, 2012. By unanimous vote, the Committee ratified the Open Market Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

Staff Review of the Economic Situation

The information reviewed at the January 29–30 meeting indicated that the expansion in overall economic activity slowed in the fourth quarter of last year, reflecting weather-related disruptions and other transitory factors, but private domestic final demand grew at a solid rate. Employment continued to increase at a moderate pace, and the unemployment rate, though still high, was lower at the end of the fourth quarter than in the preceding quarter. Consumer price inflation was subdued, and measures of longer-run inflation expectations remained stable.

Private nonfarm employment expanded in December at about the same rate as in the fourth quarter as a whole, while government employment decreased. The unemployment rate was 7.8 percent in December, below its average in the third quarter, while the labor force participation rate was the same as its third-quarter average. The rate of long-duration unemployment and the share of workers employed part time for economic reasons edged down in December, but both measures were still elevated. The rate of private-sector hiring, along with indicators of job openings and firms' hiring plans, was generally

muted but remained consistent with continued moderate increases in employment in the coming months.

Manufacturing production increased briskly in November and December after declining in October when activity was disrupted by Hurricane Sandy. As a result, factory output expanded only slightly in the fourth quarter as a whole, and the rate of manufacturing capacity utilization was only a little higher in December than in the third quarter. The production of motor vehicles and parts increased considerably in the fourth quarter, but factory output outside of the motor vehicle sector declined somewhat. Automakers' schedules indicated that the pace of motor vehicle assemblies in the first quarter would be roughly the same as in the fourth quarter. Broader indicators of manufacturing production, such as the diffusion indexes of new orders from the national and regional manufacturing surveys, were at levels consistent with only modest increases in factory output in the near term.

Increases in real personal consumption expenditures picked up somewhat in the fourth quarter, boosted importantly by higher spending on motor vehicles. After being roughly flat in the third quarter, households' real disposable income rose considerably, in part reflecting an acceleration of income payments in anticipation of increases in individual income tax rates after the turn of the year. In December and January, consumer sentiment was more downbeat than in the previous several months.

Conditions in the housing sector continued to improve, but construction activity remained at a relatively low level, restrained by tight underwriting standards for mortgage loans and the substantial inventory of foreclosed and distressed properties. Starts of both new single-family homes and multifamily units advanced in the fourth quarter, and permits also rose, which pointed to additional gains in construction in the coming months. Home prices increased further in November. In the fourth quarter, sales of both new and existing homes were higher than in the previous quarter.

Real business expenditures on equipment and software rose briskly in the fourth quarter after declining moderately in the preceding quarter. Although nominal new orders for nondefense capital goods excluding aircraft also increased markedly last quarter, the level of orders remained below shipments. Moreover, other recent forward-looking indicators, such as surveys of business conditions and capital spending plans, suggested that outlays for business equipment would rise only modestly in the coming months. Real business spending for nonresidential construction declined somewhat in the fourth quarter and remained at a relatively low level. A reduction in the accumulation of nonfarm business inventories subtracted a considerable amount from the change in real gross domestic product (GDP) in the fourth quarter.

Real federal government purchases decreased substantially in the fourth quarter, primarily because of a sharp decline in defense spending that followed a marked increase in the previous quarter. Real state and local government purchases decreased slightly in the fourth quarter.

The U.S. international trade deficit widened substantially in November, as imports rose more quickly than exports. The rise in imports was fairly broad-based, led by strong increases in consumer goods, while the increase in exports mainly reflected higher sales of capital goods and automotive products. Exports to Europe posted another significant decline in November. Based on data for October and November and an estimate of the trade data for December, the advance release of the national income and product accounts showed that real net exports of goods and services made a small negative arithmetic contribution to the change in U.S. real GDP in the fourth quarter, with exports declining more than imports.

Overall U.S. consumer prices increased more slowly in the fourth quarter than in the previous quarter. Consumer energy prices declined in November and December, and survey data indicated that retail gasoline prices fell further in the first few weeks of January. Consumer food prices continued to rise at a faster pace in November and December than in the third quarter, likely reflecting the ongoing effects of last summer's drought. In the fourth quarter, the rise in consumer prices excluding food and energy slowed. Near-term inflation expectations from the Thomson Reuters/University of Michigan Surveys of Consumers rose a little in December and early January; longer-term inflation expectations were unchanged.

Available measures of labor compensation indicated that recent gains in nominal wages remained relatively slow. Increases in average hourly earnings for all employees picked up a little in the fourth quarter but continued to be fairly subdued.

Economic growth in the advanced foreign economies appeared to remain weak in the fourth quarter. In the euro area, industrial production and retail sales were below their third-quarter levels through November, and real GDP contracted in the United Kingdom. In Japan, indicators of production and exports remained weak; however, household consumption showed some improvement, and the new government introduced a large fiscal stimulus program and called for aggressive monetary easing to end deflation. In emerging market economies, real GDP growth is estimated to have picked up in China in the fourth quarter, consistent with other Chinese indicators that pointed to an improvement in activity. Production and exports rebounded at year-end in a number of other emerging Asian economies as well. Inflation generally remained well contained in both advanced foreign economies and emerging market economies.

Staff Review of the Financial Situation

U.S. financial market conditions improved on net between the December and January FOMC meetings, largely in response to the partial resolution of the issues associated with the so-called fiscal cliff, a positive start to the corporate earnings reporting season, and some favorable policy developments in Europe.

The expected path of the federal funds rate based on market quotes moved up on balance over the intermeeting period, likely reflecting a somewhat more positive assessment of the economic outlook. Results from the Desk's survey of primary dealers conducted prior to the January meeting showed that dealers continued to view the third quarter of 2015 as the most likely time of the first increase in the target federal funds rate. In addition, the median dealer continued to see the first quarter of 2014 as the most likely time for the Committee's asset purchases to conclude, although fewer dealers than in December expected those purchases to continue beyond 2014.

Treasury coupon yields increased over the intermeeting period, including a notable rise just after year-end when passage of the American Taxpayer Relief Act of 2012 apparently lessened concerns about the risk of substantially higher fiscal drag on growth in the near term. More-positive investor sentiment regarding the outlook for global economic growth, along with some optimism about a federal debt ceiling deal, may also have contributed to the increase in yields. Measures of inflation compensation derived from nominal and inflation-protected Treasury securities rose slightly over the intermeeting period.

Conditions in short-term dollar funding markets were generally little changed on balance; year-end funding pressures were modest overall and roughly in line with market expectations. The outstanding amount of unsecured commercial paper issued by European financial institutions increased noticeably.

Indicators of the condition of domestic financial institutions generally improved over the intermeeting period. A broad index of bank stock prices rose, and the median spread on credit default swaps of the largest banking organizations moved lower.

Broad U.S. equity price indexes increased on net over the intermeeting period, buoyed by many of the same factors that contributed to the rise in Treasury yields. In addition, the fourth-quarter earnings reporting season started off well, as earnings and revenue results were above analysts' expectations for a higher-than-average number of firms. Option-implied volatility for the S&P 500 index over the near term dipped to its lowest level since early 2007. The option-implied price of insurance against downside risk on the index at longer horizons remained elevated.

Yields on speculative-grade corporate bonds decreased over the intermeeting period, and yields on investment-grade corporate bonds were up a bit. Risk spreads on speculative-grade bonds narrowed substantially, and spreads on investment-grade bonds decreased as well.

Net debt financing by nonfinancial firms increased in the fourth quarter. Outstanding volumes of corporate bonds, commercial and industrial loans, and nonfinancial commercial paper all expanded. The pace of gross public issuance of equity by nonfinancial firms remained solid in the fourth quarter, but it was subdued in January, likely because of seasonal factors.

Conditions in the commercial real estate sector continued to be strained amid elevated vacancy and delinquency rates. However, issuance of commercial mortgage-backed securities strengthened during the fourth quarter, and spreads on those securities narrowed over the intermeeting period.

Conforming home mortgage rates edged up, on net, after touching new lows during the intermeeting

period. Yields on residential mortgage-backed securities (MBS) rose by more, leaving the spread between the primary mortgage rate and MBS yields narrower. Mortgage refinancing originations in December and January stayed near their highest levels since the housing market began to recover. The share of existing mortgages that were seriously delinquent edged down in October and November but remained high.

Consumer credit expanded briskly again in October and November. Nonrevolving credit continued to increase at a robust pace because of growth in student and auto loans, while revolving credit moved roughly sideways. Issuance of consumer asset-backed securities remained strong in the fourth quarter.

Growth of bank credit in the fourth quarter slowed to about half its pace compared with earlier in the year, as loan growth declined. According to the January Senior Loan Officer Opinion Survey on Bank Lending Practices, domestic banks continued to ease somewhat their lending standards and some loan terms, on balance; they also experienced an increase in demand, on net, in most major loan categories in the fourth quarter.

M2 and its largest component, liquid deposits, expanded robustly in December. Initial data suggested that the expiration of unlimited deposit insurance on noninterest-bearing transaction accounts at year-end had only a limited effect on bank deposits through early January. The monetary base expanded at a strong rate in December, reflecting growth in both currency and reserve balances.

Foreign financial conditions improved over the intermeeting period as markets responded favorably to the passage of fiscal policy legislation in the United States and to further progress in addressing euro-area strains. On net, global equity prices rose and euro-area peripheral spreads narrowed. As global risk sentiment improved, the dollar depreciated against the euro and most emerging market currencies. Against the yen, however, the dollar appreciated substantially. The yen's depreciation appeared to occur in part in response to statements from Japan's new prime minister, who urged the Bank of Japan to ease policy more aggressively. At its January meeting, the Bank of Japan restated its monetary policy framework, replacing its inflation goal of 1 percent with an inflation target of 2 percent, and announced it would commence a program of asset purchases in January 2014 with no predetermined limit on the maximum amount ultimately purchased. Yields on long-term Japanese sovereign bonds rose a few basis points on net over the intermeeting period, but yields on other foreign benchmark sovereign bonds increased more, reflecting both the improvement in global sentiment and reduced expectations for additional monetary accommodation, as the European Central Bank and the Bank of England kept their policy rates on hold and appeared to signal less likelihood of further easing.

Staff Economic Outlook

In the economic forecast prepared by the staff for the January meeting of the FOMC, the near-term projection for real GDP growth was revised up, in large part because the fiscal policy legislation enacted in early January was slightly less restrictive than the staff had assumed. The staff's medium-term forecast for real GDP growth was essentially unchanged. With fiscal policy still anticipated to be tighter this year than last year, the staff expected that increases in real GDP would only moderately exceed the growth rate of potential output. In 2014 and 2015, real GDP was projected to accelerate gradually, supported by an eventual lessening of fiscal policy restraint, increases in consumer and business sentiment, further improvements in credit availability and financial conditions, and accommodative monetary policy. The expansion in economic activity was expected to slowly reduce the slack in labor and product markets over the projection period, and progress in reducing the unemployment rate was anticipated to be gradual.

The staff's forecast for inflation was little changed from that prepared for the December FOMC meeting. The staff continued to project that inflation would be subdued through 2015. That forecast is based on the expectation that crude oil prices will trend down slowly from their current levels, the boost to retail food prices from last summer's drought will be temporary and relatively small, longer-run inflation expectations will remain stable, and significant resource slack will persist over the forecast period.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation, meeting participants indicated that they viewed the information received during the intermeeting period as suggesting that, apart from some temporary factors that had led to a pause in overall output growth in recent months, the economy remained on a moderate

growth path. In particular, participants saw the economic outlook as little changed or modestly improved relative to the December meeting. Most participants judged that there had been some reduction in downside risks facing the economy: Strains in global financial markets had eased somewhat, and U.S. fiscal policymakers had come to a partial resolution of the so-called fiscal cliff. Supported by a highly accommodative stance of monetary policy, the housing sector was strengthening, and the unemployment rate appeared likely to continue its gradual decline. Nearly all participants anticipated that inflation over the medium-term would run at or below the Committee's 2 percent objective.

In their discussion of the household sector, participants noted various factors influencing consumer spending. Some participants stated that low interest rates appeared to be contributing to strong sales of autos or, more generally, of consumer durables. It was also noted that continued deleveraging by households was improving their financial positions, which would likely support increased spending. Holiday shopping reportedly was relatively solid, and, reflecting the improvement in the housing market, demand for home furnishings and construction materials was up. However, some participants were concerned that the recent increase in the payroll tax could have a significant negative effect on spending, particularly on the part of lower-income consumers.

Participants remarked on the ongoing recovery in the housing market, pointing variously to rising house prices, growth in residential construction and sales, and the lower inventory of homes for sale. A number of participants thought it likely that higher home values and low mortgage rates were helping support other sectors of the economy as well, and a couple saw the housing market as having the potential to cause overall growth to be stronger than expected this year. Nonetheless, it was noted that mortgage credit remained tight and the fraction of homeowners with mortgage balances exceeding the value of their homes remained high.

In general, participants indicated that, relative to the recent past, more business contacts reported an improvement in confidence and some cautious optimism about the economic outlook. Anecdotal reports suggested that uncertainty about the evolution of the economy and government policy continued to restrain firms' hiring and capital spending decisions, but the passage of fiscal legislation in early January helped resolve some of the uncertainty about federal tax policy. Moreover, it was noted that businesses were in a good position to expand once they came to view the economic environment as more favorable. Survey data from one District indicated that more than half of the respondents expected to increase employment this year, with many citing expected sales growth as the reason. Reports from a number of industries across the country also suggested a more positive assessment of future prospects, particularly in the automotive, energy, and technology sectors. However, reports from the nonautomotive manufacturing sector were less positive. In agriculture, record payouts from crop insurance following last year's drought supported farm incomes, and land prices continued to rise. Reports on business conditions in the commercial real estate sector were more mixed but, on the whole, somewhat improved. The strength of exports reportedly varied, with indications of higher demand from Mexico but some relatively pessimistic readings from firms about business conditions in Europe. Participants generally welcomed an apparent pickup in economic growth in parts of Asia and saw reduced risk that the Chinese economy would slow abruptly, but it was noted that no economy was currently in a position to lead global growth higher.

The passage of legislation in early January resolved some of the uncertainties surrounding the federal fiscal outlook, but near-term uncertainties remained, including the prospect of automatic budget cuts. Participants generally agreed that fiscal negotiations could develop in a way that would result in significantly greater drag on economic growth than in their baseline outlook. One participant noted positive news about the fiscal position of the states; in some cases, revenues had risen sufficiently to enable increases in state government spending and employment.

In their comments on labor market developments, participants viewed the decline in the unemployment rate from the third quarter to the fourth and the continued moderate gains in payroll employment as consistent with a gradually improving job market. However, the unemployment rate remained well above estimates of its longer-run normal level, and other indicators, such as the share of long-term unemployed and the number of people working part time for economic reasons, suggested that the recovery in the labor market was far from complete. One participant reported that firms in his District continued to have difficulty finding workers with suitable skills, suggesting that labor market mismatch was a factor

deterring job growth. A few others, however, pointed to evidence that weak aggregate demand was the primary factor restraining job growth, citing data and analyses in support of the view that there was still a substantial margin of slack in the labor market. For example, a couple of participants noted evidence suggesting that a shift in the relationship between the unemployment rate and the level of job vacancies in recent years was unlikely to persist as the economy recovered and unemployment benefits returned to customary levels. Similarly, one participant cited empirical analysis showing that employment growth was lower in the states where a greater share of small businesses identified lack of demand as their most important business problem. Several participants expressed concern that continuation of only slow job growth and persistently high long-duration unemployment could lead to permanent damage to the labor market.

Participants generally saw recent price developments as consistent with their projections that inflation would remain at or below the Committee's 2 percent objective over the medium run. There was little evidence of wage or cost pressures outside of isolated sectors, and measures of inflation expectations remained stable. However, a few participants expressed concerns that the current highly accommodative stance of monetary policy posed upside risks to inflation in the medium or longer term.

Participants also touched on the implications for monetary policy of changes in estimates of the economy's potential output. A number of participants thought that the growth of potential output had been reduced in recent years, possibly in part because restrictive financial conditions and weak economic activity in the aftermath of the financial crisis had reduced investment, business formation, and the pace of adoption of new technologies. Many of these participants worried that, should the economy continue to operate below potential for too long, reduced investment and underutilization of labor could further undermine the growth of potential output over time. A couple of participants noted that uncertainties concerning both the level of, and the source of shifts in, potential output made it difficult to base decisions about monetary policy on real-time measures of the output gap.

Participants noted that financial conditions appeared to have been supported by the recent fiscal agreement, a perceived reduction in the risk that the debt ceiling would not be raised in a timely manner, accommodative monetary policy, and actions taken by European authorities. With regard to Europe, participants continued to see downside risks to growth emanating from that region, given its unresolved imbalances and weak economic outlook. Several participants mentioned that domestic credit conditions appeared to have improved: Automobile loans were expanding rapidly and it was reported that competition to make commercial and industrial loans was robust. Although mortgage availability was still limited, a couple of participants indicated that they expected increased competition to bring about some lessening of the restraints on mortgage credit. In general, after having been depressed for some time, investor appetite for risk had increased. A few participants commented that the Committee's accommodative policies were intended in part to promote a more balanced approach to risk-taking, but several others expressed concern about the potential for excessive risk-taking and adverse consequences for financial stability. Some participants mentioned the potential for a sharp increase in longer-term interest rates to adversely affect financial stability and indicated their interest in further work on this topic.

The Committee again discussed the possible benefits and costs of additional asset purchases. Most participants commented that the Committee's asset purchases had been effective in easing financial conditions and helping stimulate economic activity, and many pointed, in particular, to the support that low longer-term interest rates had provided to housing or consumer durable purchases. In addition, the Committee's highly accommodative policy was seen as helping keep inflation over the medium term closer to its longer-run goal of 2 percent than would otherwise have been the case. Policy was also aimed at improving the labor market outlook. In this regard, several participants stressed the economic and social costs of high unemployment, as well as the potential for negative effects on the economy's longer-term path of a prolonged period of underutilization of resources. However, many participants also expressed some concerns about potential costs and risks arising from further asset purchases. Several participants discussed the possible complications that additional purchases could cause for the eventual withdrawal of policy accommodation, a few mentioned the prospect of inflationary risks, and some noted that further asset purchases could foster market behavior that could undermine financial stability. Several participants noted that a very large portfolio of long-duration assets would, under certain circumstances, expose the Federal Reserve to significant capital

losses when these holdings were unwound, but others pointed to offsetting factors and one noted that losses would not impede the effective operation of monetary policy. A few also raised concerns about the potential effects of further asset purchases on the functioning of particular financial markets, although a couple of other participants noted that there had been little evidence to date of such effects. In light of this discussion, the staff was asked for additional analysis ahead of future meetings to support the Committee's ongoing assessment of the asset purchase program.

Several participants emphasized that the Committee should be prepared to vary the pace of asset purchases, either in response to changes in the economic outlook or as its evaluation of the efficacy and costs of such purchases evolved. For example, one participant argued that purchases should vary incrementally from meeting to meeting in response to incoming information about the economy. A number of participants stated that an ongoing evaluation of the efficacy, costs, and risks of asset purchases might well lead the Committee to taper or end its purchases before it judged that a substantial improvement in the outlook for the labor market had occurred. Several others argued that the potential costs of reducing or ending asset purchases too soon were also significant, or that asset purchases should continue until a substantial improvement in the labor market outlook had occurred. A few participants noted examples of past instances in which policymakers had prematurely removed accommodation, with adverse effects on economic growth, employment, and price stability; they also stressed the importance of communicating the Committee's commitment to maintaining a highly accommodative stance of policy as long as warranted by economic conditions. In this regard, a number of participants discussed the possibility of providing monetary accommodation by holding securities for a longer period than envisioned in the Committee's exit principles, either as a supplement to, or a replacement for, asset purchases.

Participants also discussed the economic thresholds in the Committee's forward guidance on the path of the federal funds rate. On the whole, participants judged that financial markets had adapted to the shift from date-based communication to guidance based on economic thresholds without difficulty, although a few participants stated that communications challenges remained. For example, one participant commented that some market participants appeared to have incorrectly interpreted the thresholds as triggers that, when reached, would necessarily lead to an immediate rise in the federal funds rate. A couple of participants noted that this policy tool would be more effective if the Committee were able to communicate a consensus expectation for the path of the federal funds rate after a threshold was crossed. One participant also indicated a preference for lowering the threshold for the unemployment rate as a means of providing additional accommodation.

Committee Policy Action

Committee members saw the information received over the intermeeting period as suggesting that growth in economic activity had paused in recent months, in large part because of weather-related disruptions and other transitory factors. Employment had continued to expand at a moderate pace, but the unemployment rate remained elevated. However, members generally expected that, with appropriately accommodative monetary policy, economic growth would proceed at a moderate pace and the unemployment rate would gradually decline toward levels they judged to be consistent with the Committee's dual mandate. Although members saw strains in global financial markets as having eased somewhat, they continued to see an increase in such strains as well as slower global growth and a greater-than-expected fiscal tightening in the United States as downside risks to the economy. Members generally continued to anticipate that, with longer-term inflation expectations stable and slack in resource utilization remaining, inflation over the medium term would run at or below the Committee's longer-run objective of 2 percent.

In their discussion of monetary policy for the period ahead, members saw the economic outlook as relatively little changed since the previous meeting. Accordingly, all but one member judged that maintaining the highly accommodative stance of monetary policy was warranted in order to foster a stronger economic recovery in a context of price stability. The Committee agreed that it would be appropriate to continue purchases of MBS at a pace of $40 billion per month and purchases of longer-term Treasury securities at a pace of $45 billion per month, as well as to maintain the Committee's reinvestment policies. The Committee also retained its forward guidance about the federal funds rate, including the thresholds on the unemployment and inflation rates. Some members remarked favorably on the move away from providing calendar dates in the forward guidance and toward highlighting the eco-

nomic conditionality of future monetary policy. One member dissented from the Committee's policy decision, expressing concern that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in long-term inflation expectations.

In the statement to be released following the meeting, the Committee made relatively small modifications to the language of its December statement, including to acknowledge both the pause in economic growth during the fourth quarter and some easing of the strains in global financial markets. In light of the importance of ongoing U.S. fiscal concerns, members discussed whether to include a reference to unresolved fiscal issues, but decided to refrain. Similarly, one member raised a question about whether the statement language adequately captured the importance of the Committee's assessment of the likely efficacy and costs in its asset purchase decisions, but the Committee decided to maintain the current language pending a review, planned for the March meeting, of its asset purchases.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency MBS transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

> "Information received since the Federal Open Market Committee met in December suggests that growth in economic activity paused in recent months, in large part because of weather-related disruptions and other transitory factors. Employment has continued to expand at a moderate pace but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has shown further improvement. Inflation has been running somewhat below the Committee's longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. Longer-term inflation expectations have remained stable.
>
> Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. Although strains in global financial markets have eased somewhat, the Committee continues to see downside risks to the economic outlook. The Committee also anticipates that inflation over the medium term likely will run at or below its 2 percent objective.
>
> To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee will continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed

securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

The Committee will closely monitor incoming information on economic and financial developments in coming months. If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until such improvement is achieved in a context of price stability. In determining the size, pace, and composition of its asset purchases, the Committee will, as always, take appropriate account of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Charles L. Evans, Jerome H. Powell, Sarah Bloom Raskin, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Esther L. George.

Ms. George dissented out of concern that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in inflation expectations. In her view, the potential costs and risks posed by the Committee's asset purchases outweighed their uncertain benefits. Although she noted that monetary policy needed to remain supportive of the economy, Ms. George believed that policy had become too accommodative and that possible unintended side effects of ongoing asset purchases, posing risks to financial stability and complicating future monetary policy, argued against continuing on the Committee's current path.

Discussion of Communications Regarding Economic Projections

As a follow-up to the FOMC's discussion in October about providing more information on the Committee's collective judgment regarding the economic outlook and appropriate monetary policy, the staff presented several options for enhancing the Summary of Economic Projections (SEP). Most of the options involved displaying the information currently collected from participants in new ways by using different summary statistics or aggregations. In the ensuing discussion, participants expressed a range of views on the advantages and disadvantages of implementing changes to the SEP. For example, they generally judged that the addition of the median of participants' projections could be useful to better illustrate the central outlook of the Committee. Many participants also expressed interest in exploring the potential for using the SEP to convey information about issues related to the Committee's future asset purchases and the Federal Reserve's balance sheet. However, the discussion highlighted the complexity involved in providing this information, in part because participants' quantitative assessments of the likely evolution of the Federal Reserve's asset holdings under appropriate policy may not adequately convey the nature of the conditionality and the broader cost–benefit considerations guiding the Committee's actions in this area. At the end of the discussion, the Chairman asked the subcommittee on communications to explore potential approaches to providing more information about participants' indi-

vidual views of appropriate balance sheet policy and its conditionality.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, March 19–20, 2013. The meeting adjourned at 1:45 p.m. on January 30, 2013.

Notation Vote

By notation vote completed on January 2, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on December 11–12, 2012.

William B. English
Secretary

Meeting Held on March 19–20, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 19, 2013, at 10:00 a.m., and continued on Wednesday, March 20, 2013, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Charles L. Evans

Esther L. George

Jerome H. Powell

Sarah Bloom Raskin

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, Stephen A. Meyer, David Reifschneider, Christopher J. Waller, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Michael S. Gibson
Director, Division of Banking Supervision and Regulation, Board of Governors

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Seth B. Carpenter
Senior Associate Director, Division of Monetary Affairs, Board of Governors

Ellen M. Meade
Senior Adviser, Division of Monetary Affairs, Board of Governors

Eric M. Engen, Thomas Laubach, David E. Lebow, and Michael G. Palumbo
Associate Directors, Division of Research and Statistics, Board of Governors

William F. Bassett
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Stacey Tevlin
Assistant Director, Division of Research and Statistics, Board of Governors

Min Wei
Assistant Director, Division of Monetary Affairs, Board of Governors

Jeremy B. Rudd
Adviser, Division of Research and Statistics, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Gregory L. Stefani
First Vice President, Federal Reserve Bank of Cleveland

David Altig, Loretta J. Mester, Glenn D. Rudebusch, and Mark S. Sniderman
Executive Vice Presidents, Federal Reserve Banks of Atlanta, Philadelphia, San Francisco, and Cleveland, respectively

Spencer Krane, Lorie K. Logan, Kevin Stiroh, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of Chicago, New York, New York, and Minneapolis, respectively

Evan F. Koenig, Jonathan P. McCarthy, Giovanni Olivei, and Julie Ann Remache[1]
Vice Presidents, Federal Reserve Banks of Dallas, New York, Boston, and New York, respectively

Robert L. Hetzel
Senior Economist, Federal Reserve Bank of Richmond

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets as well as the System open market operations during the period since the Federal Open Market Committee (FOMC) met on January 29–30, 2013. The Manager also reported on developments in foreign money markets and implications for the assets that the Federal Reserve holds in its foreign currency portfolio. By unanimous vote, the Committee ratified the Open Market Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

Staff Review of the Economic Situation

The information reviewed at the March 19–20 meeting suggested that economic activity was expanding at a moderate rate in the first quarter of this year after the slowdown late last year. Private-sector employment increased at a fairly solid pace, on balance, and the unemployment rate, though still elevated, was slightly lower in February than in the fourth quarter of last year. Consumer price inflation, excluding some temporary fluctuations in energy prices, was subdued, while measures of longer-run inflation expectations remained stable.

Private nonfarm employment increased at a modest rate in January but expanded more briskly in February, while government employment continued to decrease. The unemployment rate was 7.7 percent in February, slightly less than its fourth-quarter average; the labor force participation rate was also a bit below its fourth-quarter average. The rate of long-duration unemployment and the share of workers employed part time for economic reasons were little changed, on net, and both measures remained high. Initial claims for unemployment insurance trended down somewhat over the intermeeting period. The rate of private-sector hiring, along with indicators of job openings and firms' hiring plans, were generally subdued and were consistent with continued moderate increases in employment in the coming months.

Manufacturing production increased strongly in February after declining in January, and the rate of manufacturing capacity utilization in February was a little higher than in the fourth quarter. The production of motor vehicles and parts rose considerably in February, and there were also widespread increases in factory output in other sectors. Automakers' schedules, however, indicated that the pace of motor vehicle assemblies in the coming months would be a bit below that in February. Broader indicators of manufacturing production, such as the diffusion indexes of new orders from the national and regional manufacturing surveys, were at levels that pointed to moderate increases in factory production in the near term.

Real personal consumption expenditures rose modestly in January. In February, nominal retail sales, excluding those at motor vehicle and parts outlets, increased at a strong rate, while light motor vehicle sales edged up. Some key factors that tend to influence household spending were mixed: Households' real disposable incomes declined in January, reflecting in part the increases in both payroll and income taxes that went into effect at the beginning of the year and the previous pulling forward of taxable income from 2013 into 2012; in contrast, household net worth likely rose in recent months as a result of

[1] Attended Tuesday's session only.

higher equity values and home prices. Consumer sentiment in the Thomson Reuters/University of Michigan Surveys of Consumers rose somewhat in February, but it declined in early March and remained relatively downbeat.

Conditions in the housing sector improved further, but construction activity was still at a relatively low level and continued to be restrained by tight credit standards for mortgages. Both starts and permits of new single-family homes increased, on net, over January and February. Starts of multifamily units declined, on balance, but permits rose, consistent with additional gains in construction in coming months. Sales of both new and existing homes advanced in January, and home prices increased further.

Real business expenditures on equipment and software appeared to slow somewhat early this year after rising at a brisk rate in the fourth quarter. Nominal shipments for nondefense capital goods excluding aircraft decreased in January, but nominal orders increased to a level above that of shipments, pointing to higher shipments in the near term. Other forward-looking indicators, such as surveys of business conditions and capital spending plans, also suggested that outlays for business equipment would rise in the coming months. Nominal business spending for nonresidential construction declined in January. Business inventories in most industries appeared to be generally aligned with sales in recent months.

Real federal government purchases appeared to decrease further in January and February, as defense spending continued to contract on balance. Real state and local government purchases looked to have declined as nonfederal government payrolls decreased in January and February and nominal construction expenditures fell in January.

The U.S. international trade deficit narrowed in December but widened in January. Imports rose in January, largely reflecting a rebound in the value of oil imports, and exports decreased, driven by a decline in the value of exports of petroleum products. Exports of capital goods increased; the other major categories of exports remained about unchanged.

Indexes of overall U.S. consumer prices were little changed in January but the consumer price index moved up briskly in February, largely reflecting a sharp rise in gasoline prices. Consumer food prices were flat in January and only edged up in February. Consumer prices excluding food and energy increased moderately in January and February. Near-term inflation expectations from the Michigan survey were unchanged in February and early March; longer-term inflation expectations in the survey were also little changed and remained within the narrow range that they have occupied for some time.

Measures of labor compensation indicated that gains in nominal wages remained relatively slow, only slightly above the rate of price inflation. Compensation per hour in the nonfarm business sector rose modestly over 2012, and, with small increases in productivity, unit labor costs also advanced only modestly. Gains in the employment cost index were even slower than for the measure of compensation per hour last year. In January and February, increases in average hourly earnings for all employees continued to be subdued.

Economic growth weakened in a number of the advanced foreign economies in the fourth quarter of 2012. In the euro area, real gross domestic product (GDP) contracted for a fifth consecutive quarter. Recent data for European economies, including retail sales and purchasing managers indexes, suggest that the rate of economic contraction may have diminished since the beginning of the year. In emerging market economies (EMEs), an increase in exports contributed to a pickup in the pace of economic growth in the fourth quarter, including for China. More-recent indicators suggest that economic activity in China has slowed some. Inflation remained generally contained in both advanced foreign economies and EMEs.

Staff Review of the Financial Situation

Generally favorable U.S. economic data releases, along with communications from Federal Reserve policymakers regarding the outlook for the economy and monetary policy, appeared to contribute to improved sentiment in domestic financial markets over the intermeeting period despite some renewed concerns about economic and financial conditions in Europe.

The expected path for the federal funds rate implied by market quotes moved down over the intermeeting period, likely reflecting policymakers' communications that reinforced market expectations of continued monetary policy accommodation. Results from the Desk's survey of primary dealers conducted prior to the March meeting showed that dealers continued

to view the third quarter of 2015 as the most likely time of the first increase in the target federal funds rate. In addition, the median dealer continued to see the first quarter of 2014 as the most probable time for the Federal Reserve's asset purchases to end, and most dealers anticipated that the pace of purchases would be adjusted down before ending.

Yields on nominal Treasury securities were modestly lower, on net, over the intermeeting period. In late February, these yields declined notably following the inconclusive election outcomes in Italy but mostly retraced this decline as economic data releases in subsequent weeks exceeded expectations. Measures of inflation compensation derived from nominal and inflation-protected Treasury securities edged down over the period.

Conditions in domestic and offshore dollar funding markets were generally little changed, on balance, during the intermeeting period. The outstanding amount of unsecured commercial paper (CP) issued by financial institutions with European parents increased slightly on net, and CP issued by institutions with U.S. parents remained stable.

In the March Senior Credit Officer Opinion Survey on Dealer Financing Terms, respondents reported that leveraged investors seemed to have become somewhat more willing to take positions in risky assets since December.

Market reaction to the results of the Dodd-Frank Act annual stress tests and of the Comprehensive Capital Analysis and Review was limited. Overall, a broad index of U.S. bank equity prices rose, on net, over the intermeeting period, and credit default swap spreads for most large domestic banks edged down on balance.

Broad equity price indexes increased over the intermeeting period, bolstered by favorable incoming economic data. Option-implied volatility for the S&P 500 index over the near term rose slightly but remained low, at levels last seen in early 2007. Fourth-quarter earnings per share for S&P 500 firms were estimated to have increased modestly from the previous quarter.

Yields on investment- and speculative-grade corporate bonds rose a bit over the intermeeting period, leaving risk spreads a little wider. Corporate bond issuance by nonfinancial firms remained fairly robust in February; commercial and industrial (C&I) loans and nonfinancial CP also continued to expand. After picking up in January, gross public issuance of equity by nonfinancial firms remained strong in February, and issuance of collateralized loan obligations reached a post-financial-crisis high.

Conditions in the commercial real estate (CRE) sector improved somewhat. Commercial mortgage debt increased in the fourth quarter after having decreased in each quarter since the beginning of 2009, and commercial mortgage-backed security (CMBS) issuance continued to be robust over the intermeeting period. Nonetheless, delinquency rates on loans underlying existing CMBS remained near historically high levels in February, and CRE prices flattened out in the fourth quarter after several quarters of increases.

Both conforming home mortgage rates and yields on agency mortgage-backed securities (MBS) rose, on net, during the intermeeting period, and the spread between the primary mortgage rate and MBS yields narrowed a bit. Despite the increase in mortgage rates since the start of the year, mortgage refinancing originations declined only slightly.

Consumer credit sustained its moderate expansion in December and January. Nonrevolving credit continued to increase at a solid pace because of growth in student and auto loans, while revolving credit was roughly flat. Issuance of consumer asset-backed securities remained strong.

Driven largely by continued growth in C&I loans, total bank credit expanded in January and February at roughly its fourth-quarter pace. The February Survey of Terms of Business Lending indicated some easing in loan pricing.

The level of M2 was about unchanged, on net, over January and February. In contrast, the monetary base expanded briskly from January through mid-March, driven mainly by the increase in reserve balances resulting from the Federal Reserve's purchases of Treasury securities and agency MBS.

Financial market concerns regarding the euro area rose over the intermeeting period amid weaker-than-expected economic data releases and political uncertainties generated by the inconclusive election results in Italy. Adding to the concerns was the proposal in Cyprus to tax insured, along with uninsured, deposits as part of the country's effort to secure an aid package from the euro area and the International Mon-

etary Fund. Ten-year sovereign yields in most peripheral euro-area countries rose relative to German bond yields, with spreads for Italian sovereign debt increasing noticeably; euro-area banking-sector share prices fell sharply. With economic data for the euro area, the United Kingdom, and Canada coming in weaker than anticipated, yields on bunds, gilts, and long-term Canadian government securities fell. In addition, market-based measures of expected overnight interest rates also declined in those countries, and the dollar appreciated against the euro, sterling, and the Canadian dollar. Expectations intensified that the Bank of Japan would pursue aggressive monetary easing after the new governor of the Bank of Japan was installed; over the intermeeting period, the yen depreciated further, 10-year Japanese government bond yields declined to near record lows, and the Nikkei stock price index rose substantially. Movements in the currencies of EMEs against the dollar were generally small. Although inflows into emerging market mutual funds continued, they slowed notably in recent weeks, and EME equity indexes were, on average, slightly lower. Some EME central banks cut interest rates, citing concerns about economic growth.

The staff also reported on potential risks to financial stability, including those associated with the current low interest rate environment. Some observers have suggested that a lengthy period of low long-term rates could encourage excessive risk-taking that could have adverse consequences for financial stability at some point in the future. The staff surveyed a wide range of asset markets and financial institutions for signs of excess valuations, leverage, or risk-taking that could pose systemic risks. Low interest rates likely have supported gains in asset prices and encouraged the flow of credit to households and businesses, but these changes to date do not appear to have been accompanied by significant financial imbalances. However, trends in a few specific markets bore watching, and the staff will continue to monitor for signs of developments that could pose risks to financial stability.

Staff Economic Outlook

In the economic forecast prepared by the staff for the March FOMC meeting, real GDP growth was revised down somewhat in the near term, largely reflecting the federal spending sequestration that went into effect on March 1 and the resulting drag from reduced government purchases. The staff's medium-term forecast for real GDP growth was little changed, on balance, as the effects of somewhat more fiscal policy restraint and a higher assumed path for the foreign exchange value of the dollar were essentially offset by a brighter outlook for domestic energy production and a higher projection for household wealth, which reflected upward revisions to the projected paths for both equity prices and home prices. On balance, with fiscal policy expected to be tighter in 2013 than in 2012, the staff expected that increases in real GDP this year would only modestly exceed the growth rate of potential output. Fiscal policy restraint on economic growth was assumed to ease over time, and real GDP was projected to accelerate gradually in 2014 and 2015, supported by increases in consumer and business sentiment, further improvements in credit availability and financial conditions, and accommodative monetary policy. The expansion in economic activity was anticipated to slowly reduce the slack in labor and product markets over the projection period, and progress in reducing the unemployment rate was expected to be gradual.

The staff's forecast for inflation was little changed from the projection prepared for the January FOMC meeting. With crude oil prices anticipated to trend down slowly from their current levels, long-run inflation expectations assumed to remain stable, and significant resource slack persisting over the forecast period, the staff continued to project that inflation would be subdued through 2015.

The staff viewed the uncertainty around its forecast for economic activity as similar to the average level over the past 20 years. However, the risks were viewed as skewed to the downside, reflecting in part the concerns about the situation in Europe and the possibility of a more severe tightening in U.S. fiscal policy than currently anticipated. The staff saw the uncertainty around its projection for inflation as about average, and it viewed the risks to the inflation outlook as roughly balanced.

Participants' Views on Current Conditions and Economic Outlook

In conjunction with this FOMC meeting, meeting participants—the 7 members of the Board of Governors and the presidents of the 12 Federal Reserve Banks, all of whom participate in the deliberations of the FOMC—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2015 and over the longer run, under each participant's judgment of appropriate monetary

policy. The longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. These economic projections and policy assessments are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

Meeting participants generally indicated that they viewed the economic data received during the intermeeting period as somewhat more positive than had been expected, but that fiscal policy appeared to have become more restrictive, leaving the outlook for the economy little changed on balance since the January meeting. Participants judged that the economy had returned to moderate growth following a pause late last year, and a few noted that the downside risks may have diminished. Conditions in labor markets had shown signs of improvement, although the unemployment rate remained elevated. Spending by households and businesses was continuing to expand, perhaps reflecting some increased optimism. Participants noted that the housing market, in particular, had firmed somewhat further. Accommodative monetary policy was likely providing important support to these developments.

In contrast, participants thought that fiscal policy was exerting significant near-term restraint on the economy. Participants generally anticipated that growth would proceed at a moderate pace and that the unemployment rate would decline gradually toward levels consistent with the Committee's mandate. Inflation had been running below the Committee's 2 percent objective for some time, and nearly all of the participants anticipated that it would run at or below 2 percent over the medium term.

In their discussion of the household sector, most participants noted that the data on spending were somewhat encouraging, particularly with regard to spending on automobiles, other consumer durables, and housing. Several participants stated that the moderate acceleration in spending might in part reflect pent-up demand following years of deleveraging and was importantly supported by the stance of monetary policy, which has reduced the cost of financing purchases and improved credit availability to some degree. A couple of participants noted that the increase in the payroll tax appeared to have not yet had a material effect on household spending; however, another suggested that the payroll tax increase, along with higher gasoline prices, may be one reason why spending by lower-income households appeared to be depressed, as those changes disproportionately cut into the disposable income of those households. A couple of other participants thought that overall consumer spending was likely still held back, at least in part, by ongoing concerns about future income and employment prospects. Both fiscal restraint and the high level of student debt were mentioned as risks to aggregate household spending over the forecast period.

Participants generally saw conditions in the housing market as having improved further over the intermeeting period. Rising house prices were strengthening household balance sheets by raising wealth and by increasing the ability of some homeowners to refinance their mortgages at lower rates. Such a dynamic was seen as potentially leading to a virtuous cycle that could help support household spending and financial market conditions over time. Reports from homebuilders in many parts of the country were encouraging. One participant pointed to ongoing changes in a range of factors—including demographics, credit conditions, business models, and consumer preferences—that were likely shifting both supply and demand in the housing sector and concluded that the outlook for the sector was quite uncertain and potentially subject to rapid changes.

Many participants reported that their business contacts were seeing some further improvement in the economic outlook. Firms reported increased planning for capital expenditures, supported by low interest rates and substantial cash holdings. Investment spending on productivity-enhancing technology was strong, as was pipeline construction in the energy sector. A few participants indicated that their contacts saw the level of uncertainty about the economic outlook as having declined recently, a development that could lead to increased investment expenditures.

Most participants remarked on the federal spending sequester and its potential effects on the economy; they judged that recent tax and spending changes were already restraining aggregate demand or would do so over the course of the year. A couple of participants, however, suggested that they had cut their estimates of the effect of recent federal austerity measures or had never considered the effects to be substantial.

Recent readings on private employment and the unemployment rate indicated some improvement in labor market conditions. Nonetheless, participants

generally saw the unemployment rate as still elevated and were not yet confident that the recent progress toward the Committee's employment objective would be sustained. The need to use a range of indicators to gauge labor market conditions was noted. One participant highlighted that hiring rates and quit rates remained somewhat low. Another participant discussed evidence that the labor market may have become less dynamic over time, with the result that recent payroll gains might be more meaningful than would first appear. Inference about the labor force participation rate was complicated by its long-run downward trend. One participant cited research indicating that long-term unemployment, which is currently especially high, could lead to persistently lower income and wealth for those affected, even after they found jobs. More broadly, firms reportedly remained cautious about hiring, which some participants attributed in part to restrictive fiscal policy combined with growing regulatory burden. This caution appeared to have resulted in jobs remaining vacant for substantially longer than would normally be the case, given the unemployment rate.

Recent price developments were consistent with subdued inflation pressures and inflation remaining at or below the Committee's 2 percent objective over the medium run. Participants saw little near-term inflationary pressure, with a few noting that the appreciation of the dollar was holding down import costs or that the recent increases in gasoline prices did not appear to have passed through more broadly to prices of other goods. Pointing to inflation that had been running below their objective for some time, some participants saw downside risks to inflation, especially if economic activity did not pick up as projected. But a few participants noted that the risk remained that inflationary pressures could rise as the expansion continued, especially if monetary policy remained highly accommodative for too long.

Participants discussed their assessments of risks to financial stability, particularly in light of the Committee's highly accommodative stance of monetary policy. Many participants noted that in the current low-interest rate environment, investors in some financial markets were taking on additional risk—either credit risk or interest rate risk—in an effort to boost returns. As a result, vigilance on the part of policymakers and regulators was warranted, especially in light of episodic strains in European markets. A couple of participants noted that U.S. banks had expanded their capital positions and were generally in sound financial condition. Meeting participants generally agreed that there was an ongoing need to evaluate the possible interactions between monetary policy decisions and financial stability, with some noting that adverse shocks to financial stability can affect progress toward the Committee's dual mandate.

Review of Efficacy and Costs of Asset Purchases

The staff provided presentations covering the efficacy of the Federal Reserve's asset purchases, the effects of the purchases on security market functioning, the ways in which asset purchases might amplify or reduce risks to financial stability, and the fiscal implications of purchases. In their discussion of this topic, meeting participants generally judged the macroeconomic benefits of the current purchase program to outweigh the likely costs and risks, but they agreed that an ongoing assessment of the benefits and costs was necessary. Pointing to academic and Federal Reserve staff research, most participants saw asset purchases as having a meaningful effect in easing financial conditions and so supporting economic growth. Some expressed the view that these effects had likely been stronger during the Federal Reserve's initial large-scale asset purchases because that program also helped support market functioning during the financial crisis. Other participants, however, saw little evidence that the efficacy of asset purchases had declined over time, and a couple of these suggested that the effectiveness of purchases might even have increased more recently, as the easing of credit constraints allowed more borrowers to take advantage of lower interest rates. One participant emphasized the role of recent asset purchases in keeping inflation from declining further below the Committee's longer-run goal. A few participants felt that MBS purchases provided more support to the economy than purchases of longer-term Treasury securities because they stimulated the housing sector directly; however, a few preferred to focus any purchases in the Treasury market to avoid allocating credit to a specific sector of the economy. It was noted that, in addition to the standard channels through which monetary policy affects the economy, asset purchases could help signal the Committee's commitment to accommodative monetary policy, thereby making the forward guidance about the federal funds rate more effective. However, a few participants were not convinced of the benefits of asset purchases, stating that the effects on financial markets appeared to be short lived or that they saw little evidence of a significant macroeconomic effect. One participant suggested

that the signaling effect of asset purchases may have been reduced by the adoption of threshold-based forward guidance. In general, reflecting the limited experience with large-scale asset purchases, participants recognized that estimates of the economic effects were necessarily imprecise and covered a wide range.

Participants generally agreed that asset purchases also have potential costs and risks. In particular, participants pointed to possible risks to the stability of the financial system, the functioning of particular financial markets, the smooth withdrawal of monetary accommodation when it eventually becomes appropriate, and the Federal Reserve's net income. Their views on the practical importance of these risks varied, as did their prescriptions for mitigating them. Asset purchases were seen by some as having a potential to contribute to imbalances in financial markets and asset prices, which could undermine financial stability over time. Moreover, to the extent that asset purchases push down longer-term interest rates, they potentially expose financial markets to a rapid rise in those rates in the future, which could impose significant losses on some investors and intermediaries. Several participants suggested that enhanced supervision could serve to limit, at least to some extent, the increased risk-taking associated with a lengthy period of low long-term interest rates, and that effective policy communication or balance sheet management by the Committee could reduce the probability of excessively rapid increases in longer-term rates. It was also noted that the accommodative stance of policy could be supporting financial stability by returning the economy to a stable footing sooner than would otherwise be the case and perhaps by allowing borrowers to secure longer-term financing and thereby reduce funding risks; by contrast, curtailing asset purchases could slow the recovery and so extend the period of very low interest rates. Nevertheless, a number of participants remained concerned about the potential for financial stability risks to build. One consequence of asset purchases has been the increase in the Federal Reserve's net income and its remittances to the Treasury, but those values were projected to decline, perhaps even to zero for a time, as the Committee eventually withdraws policy accommodation. Some participants were concerned that a substantial decline in remittances might lead to an adverse public reaction or potentially undermine Federal Reserve credibility or effectiveness. The possibility of such outcomes was seen as necessitating clear communications about the outlook for Federal Reserve net income. Several participants stated that such risks should not inhibit the Committee from pursuing its mandated objectives for inflation and employment. In any case, it was indicated that the fiscal benefits of a stronger economy would be much greater than any short-term fluctuations in remittances, and moreover, a couple of participants noted that cumulative remittances to the Treasury would likely be higher than would have been the case without any asset purchases. Some participants also were concerned that additional asset purchases could complicate the eventual firming of policy—for example, by impairing the Committee's control over the federal funds rate. A few participants raised the possibility of an undesirable rise in inflation. However, others expressed confidence in the Committee's exit tools and its resolve to keep inflation near its longer-run goal. Another exit-related concern was a possible adverse effect on market functioning from MBS sales during the normalization of the Federal Reserve's balance sheet. Although the Committee's asset purchases have had little apparent effect on securities market functioning to date, some participants felt that future asset sales could prove more challenging. In this regard, several participants noted that a decision by the Committee to hold its MBS to maturity instead of selling them would essentially eliminate this risk. A decision not to sell MBS, or to sell MBS only very slowly, would also mitigate some of the financial stability risks that could be associated with such sales as well as damp the decline in remittances to the Treasury at that time. Such a decision was also seen by some as a potential source of additional near-term policy accommodation. Overall, most meeting participants thought the risks and costs of additional asset purchases remained manageable, but also that continued close attention to these issues was warranted. A few participants noted that curtailing the purchase program was the most direct way to mitigate the costs and risks.

In light of their discussion of the benefits and costs of asset purchases, participants discussed their views on the appropriate course for the current asset purchase program. A few participants noted that they already viewed the costs as likely outweighing the benefits and so would like to bring the program to a close relatively soon. A few others saw the risks as increasing fairly quickly with the size of the Federal Reserve's balance sheet and judged that the pace of purchases would likely need to be reduced before long. Many participants, including some of those who were focused on the increasing risks, expressed the view that continued solid improvement in the outlook for the labor market could prompt the Com-

mittee to slow the pace of purchases beginning at some point over the next several meetings, while a few participants suggested that economic conditions would likely justify continuing the program at its current pace at least until late in the year. A range of views was expressed regarding the economic and labor market conditions that would call for an adjustment in the pace of purchases. Many participants emphasized that any decision to reduce the pace of purchases should reflect both an improvement in their overall outlook for labor market conditions, as implied by a wide range of available indicators, and their confidence in the sustainability of that improvement. A couple of these participants noted that if progress toward the Committee's economic goals were not maintained, the pace of purchases might appropriately be increased. A number of participants suggested that the Committee could change the mix of its policy tools if necessary to increase or maintain overall accommodation, including potentially adjusting its forward guidance or its balance sheet policies.

Committee Policy Action

Committee members saw the information received over the intermeeting period as suggesting that moderate economic growth had resumed following a pause late last year. Labor market conditions had shown signs of improvement, but the unemployment rate remained elevated. Household spending and business fixed investment had advanced, and the housing sector had strengthened further, but fiscal policy had become somewhat more restrictive. The Committee expected that, with appropriate monetary policy accommodation, economic growth would proceed at a moderate pace and result in a gradual decline in the unemployment rate toward levels that the Committee judges consistent with its dual mandate. Members generally continued to anticipate that, with longer-term inflation expectations stable and slack in resource utilization remaining, inflation over the medium term would likely run at or below the Committee's 2 percent objective.

In their discussion of monetary policy for the period ahead, members saw the economic outlook as little changed since the previous meeting, and, consequently, all but one member judged that a highly accommodative stance of monetary policy was warranted in order to foster a stronger economic recovery in a context of price stability. The Committee agreed that it would be appropriate to continue purchases of MBS at a pace of $40 billion per month and purchases of longer-term Treasury securities at a pace of $45 billion per month, as well as to maintain the Committee's reinvestment policies. The Committee also retained its forward guidance about the federal funds rate, including the thresholds on the unemployment and inflation rates. One member dissented from the Committee's policy decision, expressing concern that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in inflation expectations.

Members stressed that any changes to the purchase program should be conditional on continuing assessments both of labor market and inflation developments and of the efficacy and costs of asset purchases. In light of the current review of benefits and costs, one member judged that the pace of purchases should ideally be slowed immediately. A few members felt that the risks and costs of purchases, along with the improved outlook since last fall, would likely make a reduction in the pace of purchases appropriate around midyear, with purchases ending later this year. Several others thought that if the outlook for labor market conditions improved as anticipated, it would probably be appropriate to slow purchases later in the year and to stop them by year-end. Two members indicated that purchases might well continue at the current pace at least through the end of the year. It was also noted that were the outlook to deteriorate, the pace of purchases could be increased. In light of this discussion, the Committee included language in the statement to be released following the meeting in part to make explicit that the size, pace, and composition of its asset purchases were conditional not only on the likely efficacy and costs of those purchases, but also on the extent of progress toward the Committee's economic objectives.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such condi-

tions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

"Information received since the Federal Open Market Committee met in January suggests a return to moderate economic growth following a pause late last year. Labor market conditions have shown signs of improvement in recent months but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has strengthened further, but fiscal policy has become somewhat more restrictive. Inflation has been running somewhat below the Committee's longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. Longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee continues to see downside risks to the economic outlook. The Committee also anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

The Committee will closely monitor incoming information on economic and financial developments in coming months. The Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. In determining the size, pace, and composition of its asset purchases, the Committee will continue to take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market

conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Charles L. Evans, Jerome H. Powell, Sarah Bloom Raskin, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Esther L. George.

Ms. George dissented because she continued to view monetary policy as too accommodative and therefore as posing risks to the achievement of the Committee's economic objectives in the long run. In particular, the current stance of policy could lead to financial imbalances, a mispricing of risk, and, over time, higher long-term inflation expectations. In her view, the Committee's asset purchases were providing relatively small benefits, and, given the risks that they posed as well as the improvement in the outlook for the labor market, she thought they should be wound down.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, April 30–May 1, 2013. The meeting adjourned at 11:30 a.m. on March 20, 2013.

Notation Vote

By notation vote completed on February 19, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on January 29–30, 2013.

William B. English
Secretary

Addendum: Summary of Economic Projections

In conjunction with the March 19–20, 2013, Federal Open Market Committee (FOMC) meeting, meeting participants—the 7 members of the Board of Governors and the 12 presidents of the Federal Reserve Banks, all of whom participate in the deliberations of the FOMC—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2015 and over the longer run. Each participant's assessment was based on information available at the time of the meeting plus his or her judgment of appropriate monetary policy and assumptions about the factors likely to affect economic outcomes. The longer-run projections represent each participant's judgment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the Federal Reserve's objectives of maximum employment and stable prices.

Overall, the assessments submitted in March indicated that FOMC participants projected that, under appropriate monetary policy, the pace of economic recovery would gradually pick up over the 2013–15 period and inflation would remain subdued (table 1 and figure 1). Participants anticipated that the growth rate of real gross domestic product (GDP) would increase somewhat over the forecast period to a pace that generally exceeded their estimates of the longer-run sustainable rate of growth. Participants expected the unemployment rate to decline gradually through 2015. Nearly all participants projected that inflation, as measured by the annual change in the price index for personal consumption expenditures (PCE), would remain somewhat below the longer-run goal in 2013 and then rise toward 2 percent over the forecast period.

As shown in figure 2, most participants judged that highly accommodative monetary policy was likely to be warranted over the next few years to support stable prices and continued progress toward maximum employment. In particular, 14 participants thought that it would be appropriate for the first increase in the target federal funds rate to occur during 2015 or later. Most participants also judged that it would be appropriate to continue purchasing agency mortgage-backed securities (MBS) and longer-term Treasury securities into the second half of 2013.

Many participants continued to judge the uncertainty associated with the outlook for real activity and the unemployment rate to be unusually high compared with the norm of the past 20 years. In con-

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, March 2013
Percent

Variable	Central tendency[1]				Range[2]			
	2013	2014	2015	Longer run	2013	2014	2015	Longer run
Change in real GDP	2.3 to 2.8	2.9 to 3.4	2.9 to 3.7	2.3 to 2.5	2.0 to 3.0	2.6 to 3.8	2.5 to 3.8	2.0 to 3.0
December projection	2.3 to 3.0	3.0 to 3.5	3.0 to 3.7	2.3 to 2.5	2.0 to 3.2	2.8 to 4.0	2.5 to 4.2	2.2 to 3.0
Unemployment rate	7.3 to 7.5	6.7 to 7.0	6.0 to 6.5	5.2 to 6.0	6.9 to 7.6	6.1 to 7.1	5.7 to 6.5	5.0 to 6.0
December projection	7.4 to 7.7	6.8 to 7.3	6.0 to 6.6	5.2 to 6.0	6.9 to 7.8	6.1 to 7.4	5.7 to 6.8	5.0 to 6.0
PCE inflation	1.3 to 1.7	1.5 to 2.0	1.7 to 2.0	2.0	1.3 to 2.0	1.4 to 2.1	1.6 to 2.6	2.0
December projection	1.3 to 2.0	1.5 to 2.0	1.7 to 2.0	2.0	1.3 to 2.0	1.4 to 2.2	1.5 to 2.2	2.0
Core PCE inflation[3]	1.5 to 1.6	1.7 to 2.0	1.8 to 2.1		1.5 to 2.0	1.5 to 2.1	1.7 to 2.6	
December projection	1.6 to 1.9	1.6 to 2.0	1.8 to 2.0		1.5 to 2.0	1.5 to 2.0	1.7 to 2.2	

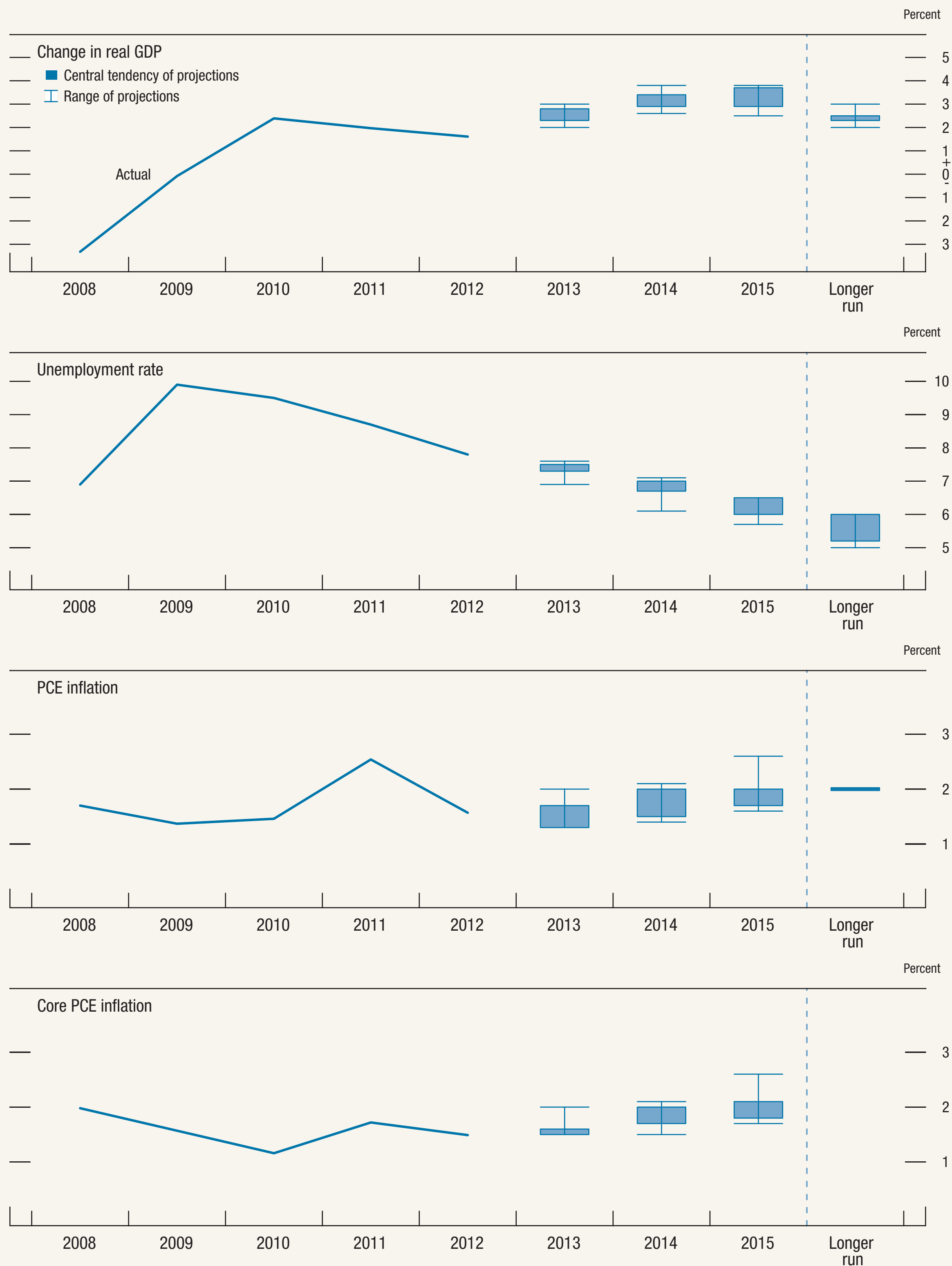
Note: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The December projections were made in conjunction with the meeting of the Federal Open Market Committee on December 11–12, 2012.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

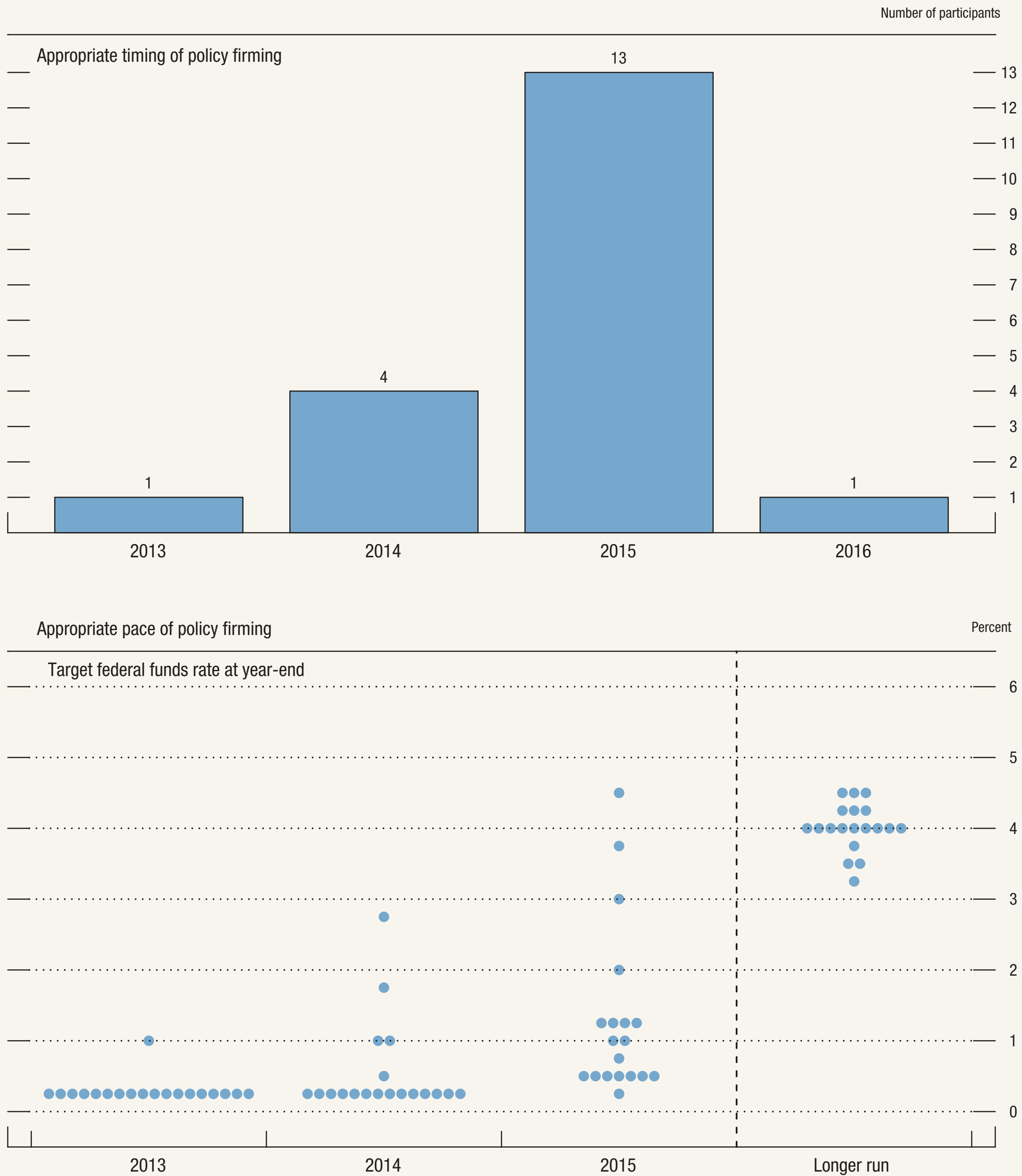
3 Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2013–15 and over the longer run



Note: Definitions of variables are in the general note to table 1. The data for the actual values of the variables are annual.

Figure 2. Overview of FOMC participants' assessments of appropriate monetary policy



Note: In the upper panel, the height of each bar denotes the number of FOMC participants who judge that, under appropriate monetary policy, the first increase in the target federal funds rate from its current range of 0 to ¼ percent will occur in the specified calendar year. In December 2012, the numbers of FOMC participants who judged that the first increase in the target federal funds rate would occur in 2013, 2014, 2015, and 2016 were, respectively, 2, 3, 13, and 1. In the lower panel, each shaded circle indicates the value (rounded to the nearest ¼ percentage point) of an individual participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run.

trast to December, however, more participants viewed the risks to those outlooks as broadly balanced than saw the risks as skewed toward adverse outcomes. A majority of participants indicated that the uncertainty surrounding their projections for PCE inflation was broadly similar to historical norms, and nearly all considered the risks to inflation to be either broadly balanced or weighted to the downside.

The Outlook for Economic Activity

Participants projected that, conditional on their individual assumptions about appropriate monetary policy, the economy would grow at a somewhat faster pace in 2013 than it had in 2012. They also generally judged that growth would strengthen further in 2014 and 2015, in most cases to a rate above what participants saw as the longer-run rate of output growth. Most participants noted that the high degree of monetary policy accommodation assumed in their projections would help promote the economic recovery over the forecast period and expected that continued improvement in the housing sector would add more broadly to private demand; however, they also judged that increased fiscal restraint in the United States would hold back the pace of economic expansion, especially in 2013, and pointed to the situation in Europe as an ongoing downside risk.

The central tendency of participants' projections for the change in real GDP was 2.3 to 2.8 percent for 2013, 2.9 to 3.4 percent for 2014, and 2.9 to 3.7 percent for 2015; these projections were little changed, to slightly below, the ones in December. When participants compared their own March forecast with the one they made in December, many mentioned that stronger-than-anticipated incoming data on private economic activity had nearly offset the effects of greater-than-expected fiscal restraint likely to be put in place this year. The central tendency for the longer-run rate of increase of real GDP was 2.3 to 2.5 percent, unchanged from December.

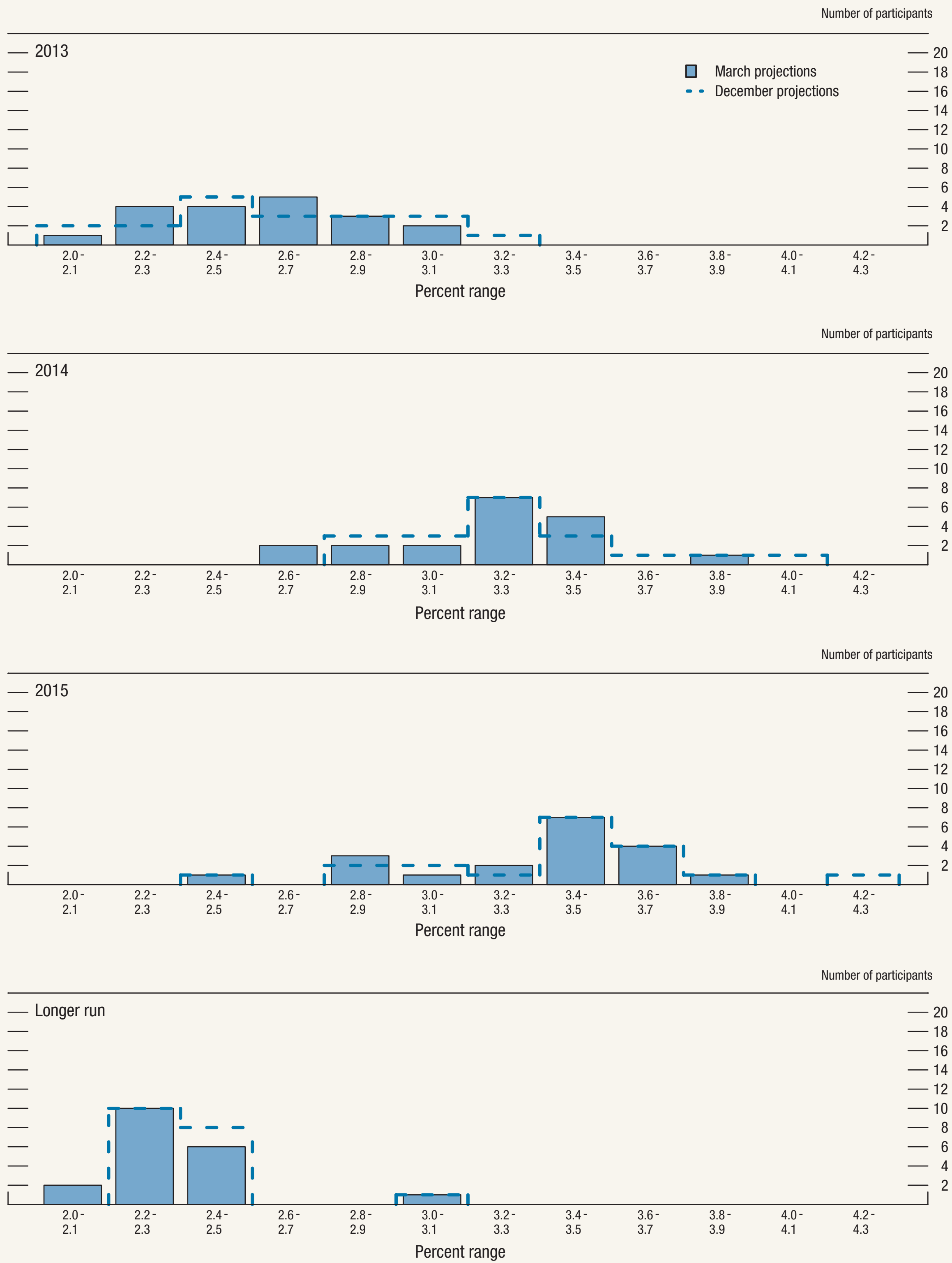
Participants anticipated a gradual decline in the unemployment rate over the forecast period; even so, they generally thought that the unemployment rate at the end of 2015 would remain well above their individual estimates of its longer-run normal level. The central tendencies of participants' forecasts for the unemployment rate were 7.3 to 7.5 percent at the end of 2013 and 6.7 to 7.0 percent at the end of 2014. These projections are slightly lower than in December, with a few participants attributing their revisions to the more favorable data from the labor market or small changes in their estimated rate of potential output growth. However, the central tendency of the forecasts for the end of 2015, at 6.0 to 6.5 percent, changed little. The central tendency of participants' estimates of the longer-run normal rate of unemployment that would prevail under appropriate monetary policy and in the absence of further shocks to the economy was 5.2 to 6.0 percent, the same as in December. Most participants projected that the unemployment rate would converge to their estimates of its longer-run normal rate in five or six years, while some judged that less time would be needed.

As shown in figures 3.A and 3.B, participants' views regarding the likely outcomes for real GDP growth and the unemployment rate over the next three years and over the longer run remained diverse, reflecting their individual assessments of appropriate monetary policy and its economic effects, the likely rate of improvement in the housing sector and domestic spending more generally, the domestic implications of foreign economic developments, the extent of structural dislocations to the labor market and the economy's productive potential, and a number of other factors. The dispersion of participants' projections of real GDP growth was little changed relative to December, with a small reduction in the upper end of the distribution in all three years of the forecast period and a slight overall downward shift in 2014. The distributions of the unemployment rate projections in each year narrowed a few tenths, reflecting decreases in the high ends of the ranges. The dispersion of estimates for the longer-run rate of output growth stayed fairly narrow, with all but four within the central tendency of 2.3 to 2.5 percent; two participants, however, dropped their estimates to below 2.2 percent. The range of participants' estimates of the longer-run rate of unemployment, at 5.0 to 6.0 percent, was unchanged relative to December.

The Outlook for Inflation

Participants' broad outlook for inflation under appropriate monetary policy suggested that both headline and core inflation would remain subdued over the 2013–15 period, with nearly all participants judging that inflation would be equal to or below the FOMC's longer-run objective of 2 percent in each year. Specifically, the central tendency of participants' projections for overall inflation in 2013, as measured by the growth in the PCE price index, narrowed to 1.3 to 1.7 percent, while the central tendencies for 2014 and 2015 were unchanged at 1.5 to

Figure 3.A. Distribution of participants' projections for the change in real GDP, 2013–15 and over the longer run



Note: Definitions of variables are in the general note to table 1.

Figure 3.B. Distribution of participants' projections for the unemployment rate, 2013–15 and over the longer run

Note: Definitions of variables are in the general note to table 1.

2.0 percent and 1.7 to 2.0 percent, respectively. The central tendency of the forecasts for core inflation in 2013 also narrowed, to 1.5 to 1.6 percent, but, unlike overall inflation, edged up slightly in 2014 and 2015; nevertheless, the central tendencies remained near or below 2 percent in both years. In discussing factors likely to keep inflation near the Committee's inflation objective of 2 percent, several participants cited the role of stable inflation expectations and existing resource slack that was expected to diminish only gradually.

Figures 3.C and 3.D provide information on the diversity of participants' views about the outlook for inflation. The ranges of participants' projections for overall inflation in 2013 and 2014 were almost unchanged compared with the corresponding distributions for December. The ranges for core inflation were also little changed, but, in 2013, many of the projections shifted toward the lower end of the range. The distributions for core and overall inflation in 2015 remained concentrated near the Committee's longer-run objective, and all participants continued to project that overall inflation would converge to the 2 percent goal over the longer run.

Appropriate Monetary Policy

As indicated in figure 2, most participants judged that exceptionally low levels of the federal funds rate would remain appropriate for a couple more years. In particular, 13 participants thought that the first increase in the target federal funds rate would not be warranted until sometime in 2015, and one judged that policy firming would likely not be appropriate until 2016 (upper panel). Five participants judged that an earlier increase in the federal funds rate, in 2013 or 2014, would be most consistent with the Committee's statutory mandate.

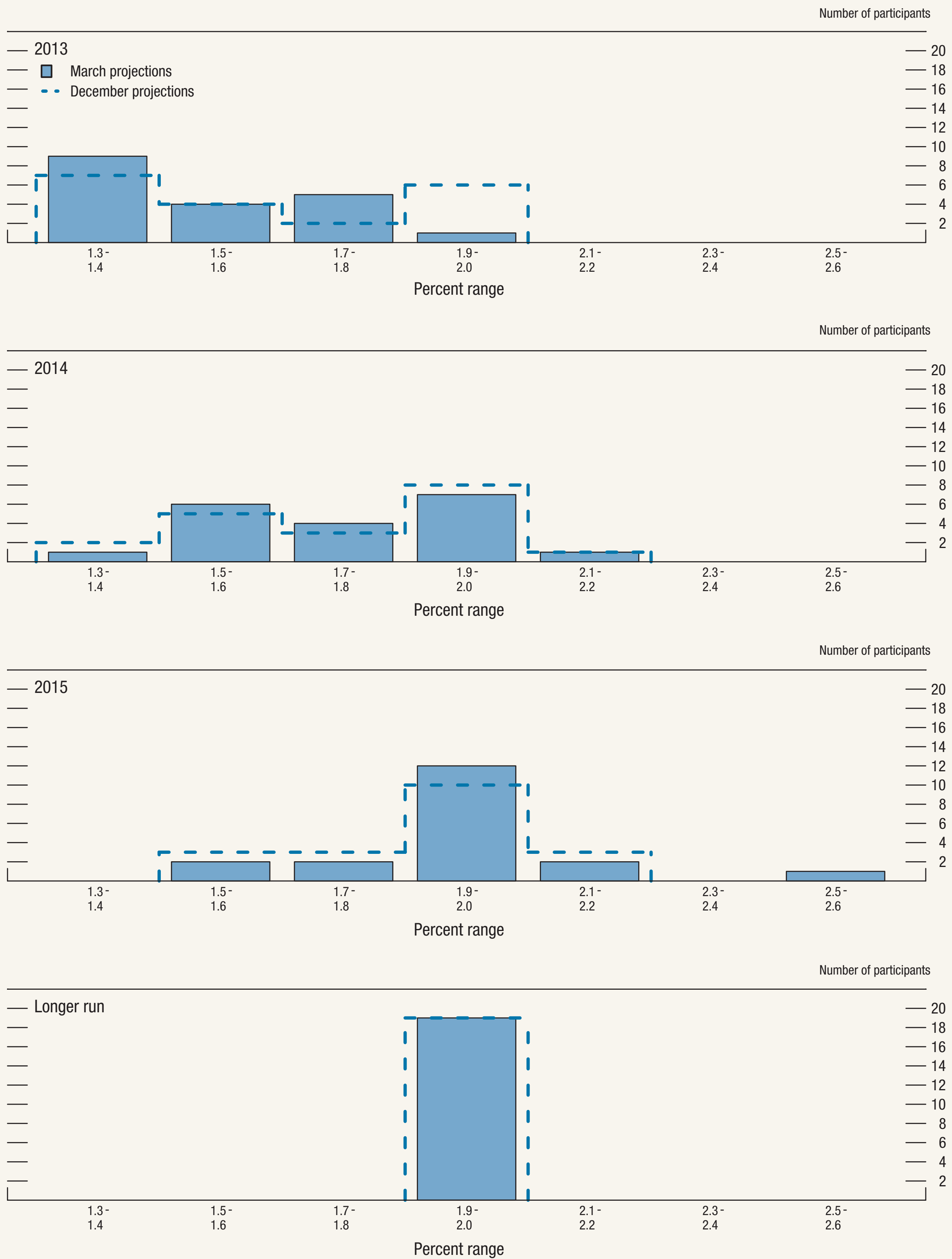
All of the participants who judged that raising the federal funds rate target would first be appropriate in 2015 also projected that the unemployment rate would first decline below 6½ percent during that year and that inflation would remain near or below 2 percent. In addition, those participants, as well as the participant who saw liftoff in 2016 as appropriate, also projected that a sizable gap between the unemployment rate and the longer-run normal level of the unemployment rate would persist until 2015 or later. The majority of the five participants who judged that policy firming should begin in 2013 or 2014 indicated that the Committee would need to act relatively soon in order to keep inflation near the FOMC's longer-run objective of 2 percent and to prevent a rise in inflation expectations.

Figure 3.E provides the distribution of participants' judgments regarding the appropriate level of the target federal funds rate at the end of each calendar year from 2013 to 2015 and over the longer run. As previously noted, most participants judged that economic conditions would warrant maintaining the current low level of the federal funds rate until 2015. Among the five participants who saw the federal funds rate leaving the effective lower bound earlier, their projections for the federal funds rate at the end of 2014 range from ½ to 2¾ percent. Views on the appropriate level of the federal funds rate at the end of 2015 varied, with 15 participants seeing the appropriate level of the federal funds rate as 1¼ percent or lower and the others seeing the appropriate level as 2 percent or higher. On balance, participants' projections for the appropriate federal funds rate at the end of 2015 shifted down a bit from those in their December forecasts.

Nearly all participants saw the appropriate target for the federal funds rate at the end of 2015 as still well below their assessment of its expected longer-run value. Estimates of the longer-run target federal funds rate ranged from 3¼ to 4½ percent, reflecting the Committee's inflation objective of 2 percent and participants' individual judgments about the longer-run level of the real federal funds rate.

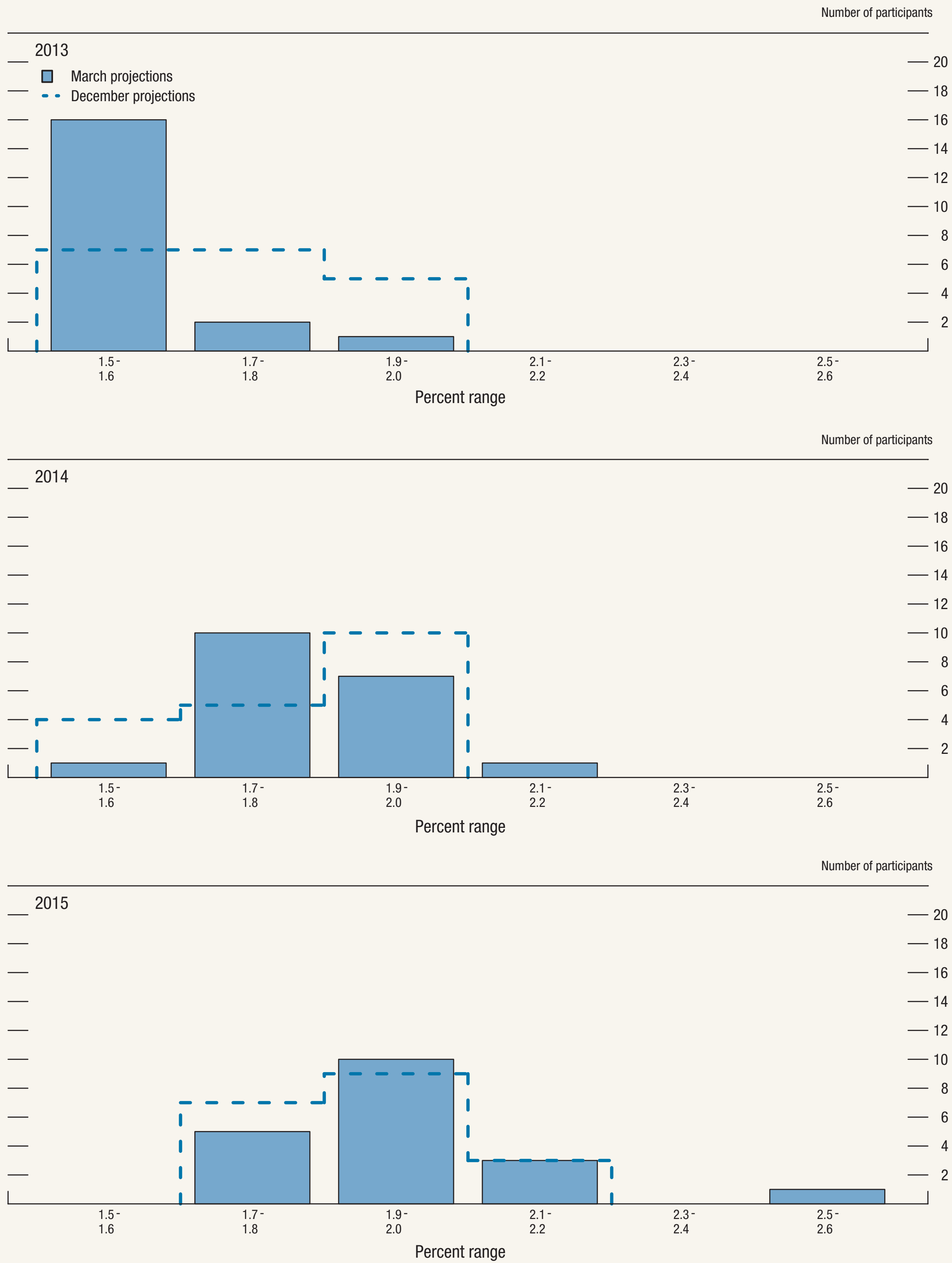
Participants also described their views regarding the appropriate path of the Federal Reserve's balance sheet. All but a few participants thought that, given the current economic outlook, it would be appropriate for the Committee to continue purchasing MBS and longer-term Treasury securities at about the current pace at least through midyear. A number of these participants anticipated that the pace would be tapered down around midyear. A few others thought that it would be appropriate for the Committee to purchase securities at the current pace through the third quarter of 2013 before beginning to adjust the pace and a few saw the current rate of purchases continuing at least through the end of 2013, with two participants specifying that some purchases would likely extend into 2014. Several participants emphasized that the asset purchase program was effective in supporting the economic expansion, that the benefits continued to exceed the costs, and that additional purchases would be necessary to achieve a substantial improvement in the outlook for the labor market. In contrast, a couple of participants indicated that the

Figure 3.C. Distribution of participants' projections for PCE inflation, 2013–15 and over the longer run



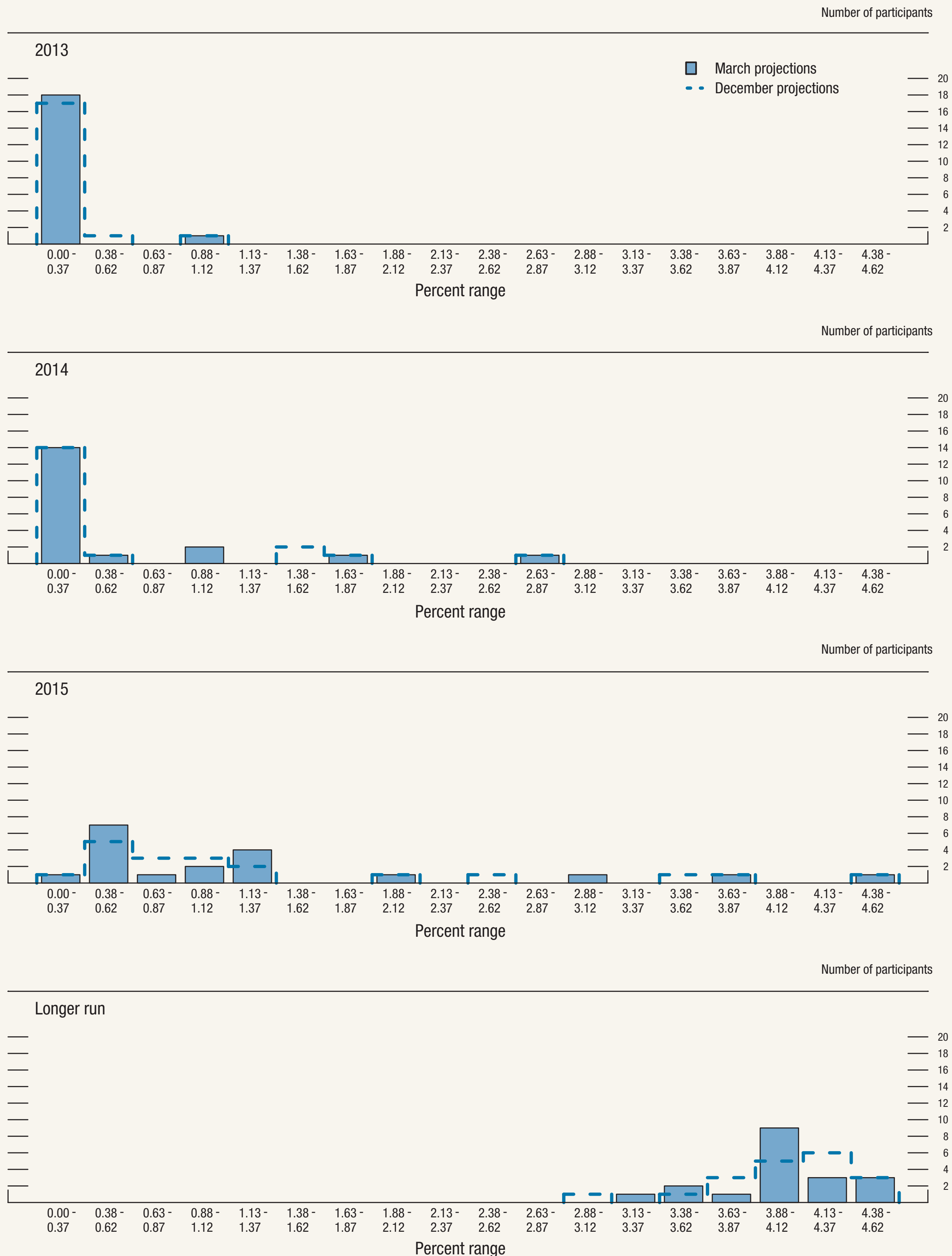
Note: Definitions of variables are in the general note to table 1.

Figure 3.D. Distribution of participants' projections for core PCE inflation, 2013–15



Note: Definitions of variables are in the general note to table 1.

Figure 3.E. Distribution of participants' projections for the target federal funds rate, 2013–15 and over the longer run



Note: The target federal funds rate is measured as the level of the target rate at the end of the calendar year or in the longer run.

Committee could best foster its dual objectives and limit the potential costs of the program by beginning to taper its purchases before midyear or by ending purchases altogether.

Key factors informing participants' views of the economic outlook and the appropriate setting for monetary policy included their judgments regarding labor market conditions that would be consistent with maximum employment, the extent to which employment currently deviated from maximum employment, the extent to which projected inflation over the medium term deviated from the Committee's longer-term objective of 2 percent, and participants' projections of the likely time horizon necessary to return employment and inflation to mandate-consistent levels. Participants generally discussed their forecasts for the time of the first increase in the federal funds rate in the context of the thresholds adopted by the Committee in December 2012. A couple of participants noted that their assessments of the appropriate path for the federal funds rate took into account the likelihood that the neutral level of the federal funds rate was currently somewhat below its historical norm. It was also noted that, because the appropriate stance of monetary policy is conditional on the path of real activity and inflation over time, assessments of the appropriate future path of the federal funds rate and the balance sheet could change if economic conditions were to evolve in an unexpected manner.

Uncertainty and Risks

A majority of the participants continued to judge that the levels of uncertainty about their projections for real GDP growth and unemployment remained higher than was the norm during the previous 20 years; however, the number of participants with this view was noticeably smaller than in December (figure 4).[2] The main factor cited as contributing to the elevated uncertainty about economic outcomes was the challenge associated with forecasting the path of the U.S. economic recovery following a financial crisis and recession that differed markedly from recent historical experience. Several participants also noted the difficulties involved in predicting fiscal policy in the United States and the potential for European developments to threaten U.S. financial stability, though a few participants noted a decline in the likely severity of those risks as a reason for changing their assessments of uncertainty from "higher" to "broadly similar" to the norm.

[2] Table 2 provides estimates of the forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1993 through 2012. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in the economic forecasts and explains the approach used to assess the uncertainty and risks attending the participants' projections.

Table 2. Average historical projection error ranges
Percentage points

Variable	2013	2014	2015
Change in real GDP[1]	±1.3	±1.7	±1.8
Unemployment rate[1]	±0.6	±1.2	±1.7
Total consumer prices[2]	±0.9	±1.0	±1.1

Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1993 through 2012 that were released in the spring by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 Definitions of variables are in the general note to table 1.

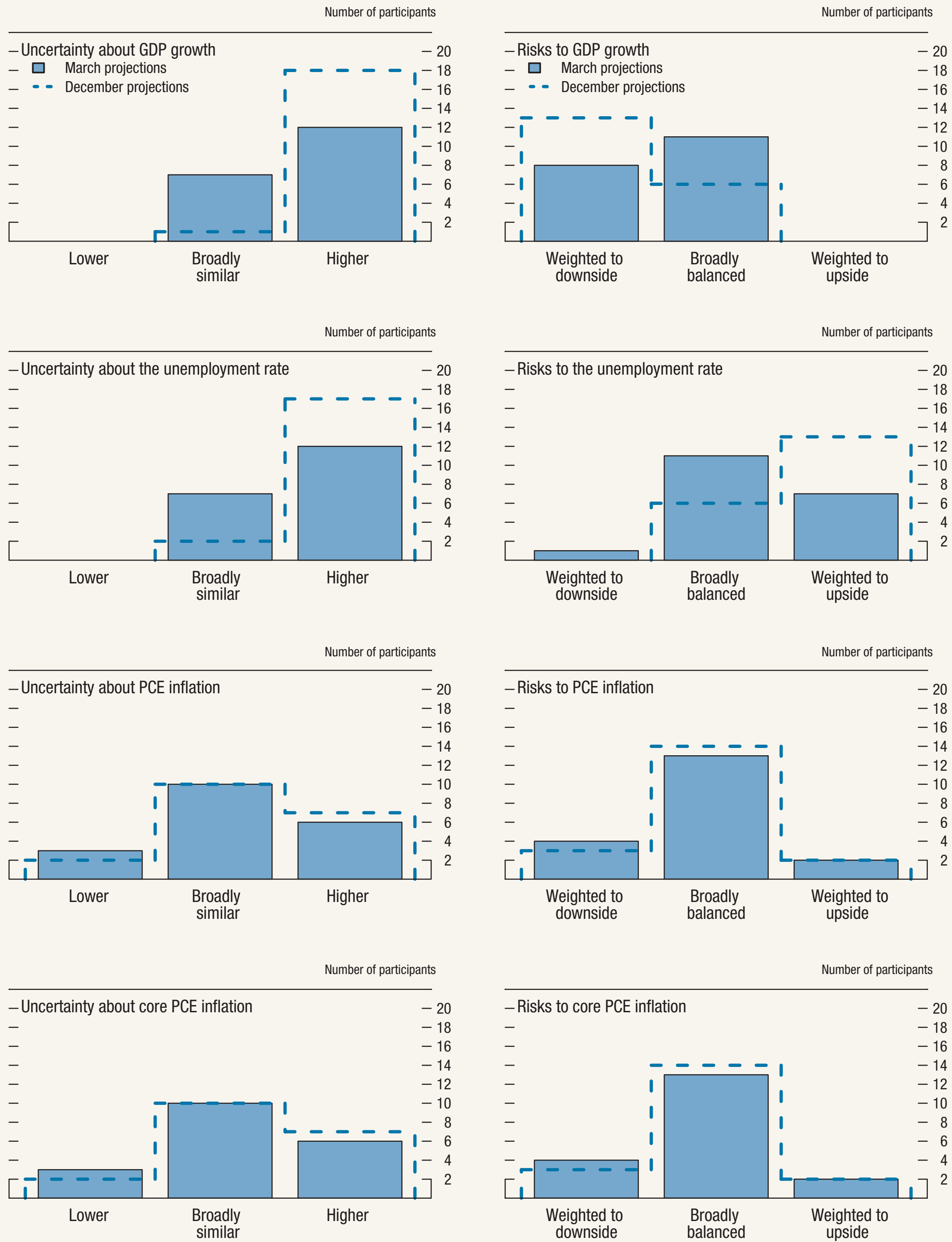
2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

A majority of participants, somewhat more than in December, reported that they saw the risks to their forecasts of real GDP growth and unemployment as broadly balanced, with the remainder generally indicating that they saw the risks to their forecasts for real GDP growth as weighted to the downside and for unemployment as weighted to the upside. Some participants who changed their assessment to "broadly balanced" indicated that, while U.S. fiscal policy had become more restrictive this year, the future path of that policy had become less uncertain than it was in December.

Participants reported little change in their assessments of the level of uncertainty and the balance of risks around their forecasts for overall PCE inflation and core inflation. Thirteen participants judged the levels of uncertainty associated with their forecasts for those inflation measures to be broadly similar to, or lower than, historical norms; the same number assessed the risks to those projections to be broadly balanced. Several participants highlighted the likely role played by the Committee's adoption of a 2 percent inflation goal or its commitment to maintaining accommodative monetary policy as contributing to the recent stability of longer-term inflation expectations. Four participants saw the risks to their inflation forecast as tilted to the downside, reflecting, for example, risks of disinflation that could arise from

adverse shocks to the economy that policy would have limited scope to offset in the current environment. Conversely, a couple of the participants saw the risks to inflation as weighted to the upside in light of the current highly accommodative stance of monetary policy and their concerns about the Committee's ability to shift to a less accommodative policy stance when it becomes appropriate to do so.

Figure 4. Uncertainty and risks in economic projections



Note: For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty." Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world, and the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by the Federal Reserve Board's staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 1.7 to 4.3 percent in the current year, 1.3 to 4.7 percent in the second year, and 1.2 to 4.8 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 to 2.9 percent in the current year, 1.0 to 3.0 percent in the second year, and 0.9 to 3.1 percent in the third year.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past, as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

As with real activity and inflation, the outlook for the future path of the federal funds rate is subject to considerable uncertainty. This uncertainty arises primarily because each participant's assessment of the appropriate stance of monetary policy depends importantly on the evolution of real activity and inflation over time. If economic conditions evolve in an unexpected manner, then assessments of the appropriate setting of the federal funds rate would change from that point forward.

Meeting Held on April 30–May 1, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, April 30, 2013, at 2:00 p.m. and continued on Wednesday, May 1, 2013, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Charles L. Evans

Esther L. George

Jerome H. Powell

Sarah Bloom Raskin

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, Stephen A. Meyer, David Reifschneider, Daniel G. Sullivan, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Michael S. Gibson
Director, Division of Banking Supervision and Regulation, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Andreas Lehnert
Deputy Director, Office of Financial Stability Policy and Research, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Seth B. Carpenter
Senior Associate Director, Division of Monetary Affairs, Board of Governors

Joyce K. Zickler
Senior Adviser, Division of Monetary Affairs, Board of Governors

Michael T. Kiley and Thomas Laubach
Associate Directors, Division of Research and Statistics, Board of Governors

David Bowman
Deputy Associate Director, Division of International Finance, Board of Governors

Steven A. Sharpe and John J. Stevens
Assistant Directors, Division of Research and Statistics, Board of Governors

Min Wei
Assistant Director, Division of Monetary Affairs, Board of Governors

Stefania D'Amico
Senior Economist, Division of Monetary Affairs, Board of Governors

Randall A. Williams
Records Project Manager, Division of Monetary Affairs, Board of Governors

Kenneth C. Montgomery
First Vice President, Federal Reserve Bank of Boston

David Altig, Jeff Fuhrer, and Loretta J. Mester
Executive Vice Presidents, Federal Reserve Banks of Atlanta, Boston, and Philadelphia, respectively

Lorie K. Logan and Mark E. Schweitzer
Senior Vice Presidents, Federal Reserve Banks of New York and Cleveland, respectively

Fred Furlong
Group Vice President, Federal Reserve Bank of San Francisco

Evan F. Koenig and David C. Wheelock
Vice Presidents, Federal Reserve Banks of Dallas and St. Louis, respectively

Robert L. Hetzel and Andrea Tambalotti
Senior Economists, Federal Reserve Banks of Richmond and New York, respectively

Jonathan Heathcote
Senior Research Economist, Federal Reserve Bank of Minneapolis

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on developments in domestic and foreign financial markets as well as the System open market operations during the period since the Federal Open Market Committee (FOMC) met on March 19–20, 2013. By unanimous vote, the Committee ratified the Open Market Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

By unanimous vote, the Committee agreed to extend the reciprocal currency (swap) arrangements with the Bank of Canada and the Banco de México for an additional year beginning in mid-December 2013; these arrangements are associated with the Federal Reserve's participation in the North American Framework Agreement of 1994. The arrangement with the Bank of Canada allows for cumulative drawings of up to $2 billion equivalent, and the arrangement with the Banco de México allows for cumulative drawings of up to $3 billion equivalent. The vote to renew the System's participation in these swap arrangements was taken at this meeting because a provision in the Framework Agreement requires each party to provide six months' prior notice of an intention to terminate its participation.

Staff Review of the Economic Situation

The information reviewed at the April 30–May 1 meeting indicated that economic activity expanded at a moderate pace in the first quarter. In March, the unemployment rate edged down further, although it continued to be elevated, and employment growth slowed. Consumer price inflation was relatively low, while measures of longer-run inflation expectations remained stable.

After faster gains in January and February, private nonfarm employment increased at a subdued rate in March, and government employment declined slightly. The unemployment rate was 7.6 percent in March, a little below its average in the fourth quarter of last year. The labor force participation rate also edged down to below its fourth-quarter average. The rate of long-duration unemployment and the share of workers employed part time for economic reasons declined somewhat in March, but these measures remained well above their pre-recession levels. Indicators of near-term labor market conditions were consistent with projections of moderate increases in employment in the coming months: Measures of job openings generally moved up, but the rate of gross private-sector hiring and indicators of firms' hiring plans were subdued, on balance, and initial claims for unemployment insurance trended up a little over the intermeeting period.

Manufacturing production decreased slightly in March but expanded at a brisk rate in the first quarter as a whole, supported in part by a recovery in output following Hurricane Sandy, and the rate of manufacturing capacity utilization in March was somewhat higher than in the fourth quarter. The production of motor vehicles and parts rose solidly in March, but factory output outside of the motor vehicle sector declined. Automakers' schedules indicated that the pace of motor vehicle assemblies in the coming months would be a bit below that in March. Broad indicators of manufacturing production, such as the diffusion indexes of new orders from the national and regional manufacturing surveys, were at levels that pointed to small increases in factory output in the near term.

Real personal consumption expenditures (PCE) expanded at a solid pace in March and in the first

quarter as a whole. Some factors that tend to influence household spending were generally positive in recent months. For example, real disposable income increased in February and March, supported in part by recent declines in retail gasoline prices that raised household purchasing power and offset to some extent the effects of this year's higher payroll and income taxes. In addition, household net worth likely rose in recent months as a result of higher equity values and home prices. In contrast, consumer sentiment in the Thomson Reuters/University of Michigan Surveys of Consumers was roughly flat, on balance, in March and April and remained relatively downbeat.

Conditions in the housing sector continued to improve, as real expenditures for residential investment expanded briskly in the first quarter, although from a low level. Total combined starts of new single-family homes and multifamily units increased in March to a level well above that at the beginning of the year. Home prices continued to rise through February, and sales of new homes rose in March, but sales of existing homes decreased a little.

Growth in real business expenditures on equipment and software slowed in the first quarter. Nominal shipments of nondefense capital goods excluding aircraft continued to rise gradually in February and March, but new orders were slightly below the level of shipments, pointing to modest gains in shipments in the near term. Other forward-looking indicators, such as surveys of business conditions and capital spending plans, also suggested that outlays for business equipment would rise at a subdued pace in the coming months. Real business spending for nonresidential construction declined a little in the first quarter. Real inventory investment increased in the first quarter, and business inventories in most industries appeared to be broadly aligned with sales in recent months.

Real federal government purchases declined markedly in the first quarter, led by a significant decrease in defense spending, which may have partially reflected the anticipated effects of the federal spending sequestration. Real state and local government purchases also decreased somewhat in the first quarter, as state and local construction expenditures continued to decline.

The advance release of first-quarter data for the national income and product accounts showed that real net exports of goods and services also subtracted moderately from real gross domestic product (GDP) growth, as real imports outpaced real exports.

Overall consumer prices, as measured by the price index for PCE, edged down in March and rose just 1 percent from a year earlier. Consumer energy prices declined in March, and retail gasoline prices fell further in the first few weeks of April. Consumer food prices only edged up in March. Consumer prices excluding food and energy were flat in March, and their increase from 12 months earlier was similar to that for total consumer prices. Near-term inflation expectations from the Thomson Reuters/University of Michigan Surveys of Consumers were slightly lower in April, and longer-term inflation expectations in the survey were little changed and remained within the narrow range that they have occupied for several years.

Measures of labor compensation indicated that gains in nominal wages remained subdued. Increases in the employment cost index were modest over the year ending in the first quarter. Average hourly earnings for all employees were unchanged in March, and hourly earnings gains in the first quarter as a whole were muted.

Economic growth in foreign economies overall in the first quarter of 2013 showed only a small improvement from that registered in the second half of 2012. Real GDP growth picked up in the United Kingdom, and recent indicators suggested that the pace of contraction moderated in the euro area. In contrast, economic growth in China slowed abruptly after surging late last year. Foreign inflation appeared to increase a little in the first quarter, partly as a result of higher food prices in several emerging market economies, but remained quite moderate.

Staff Review of the Financial Situation

Financial conditions improved a little, on balance, over the intermeeting period. Yields of longer-term Treasury securities and foreign benchmark sovereign bonds declined appreciably, reflecting the somewhat negative tone of U.S. and foreign economic data releases as well as policy actions by the Bank of Japan that were more accommodative than the markets had expected. Equity prices rose modestly, on net, supported in part by solid quarterly earnings reports.

The expected path of the federal funds rate implied by market quotes shifted down moderately over the

intermeeting period. However, the Desk's survey of primary dealers, conducted prior to the April 30–May 1 meeting, indicated that the dealers continued to view the third quarter of 2015 as the most likely time for the initial increase in the target federal funds rate. The median dealer anticipated that the FOMC would maintain its current pace of asset purchases through December 2013 and saw the second quarter of 2014 as the most probable time for the end of asset purchases, implying a slight upward revision to the projected total size of the Federal Reserve's asset purchase program.

Over the intermeeting period, near-term measures of inflation compensation derived from yields on nominal and inflation-protected Treasury securities moved lower amid somewhat disappointing economic data and declines in energy and other commodity prices; forward measures of inflation compensation changed little at longer horizons. Yields on agency mortgage-backed securities (MBS) decreased about in line with those on nominal Treasury securities of comparable duration.

Conditions in domestic dollar funding markets were generally little changed, and offshore dollar funding markets reacted only modestly to the elevated uncertainty surrounding the negotiations, early in the intermeeting period, to resolve the banking crisis in Cyprus.

Some indicators of the condition of domestic financial institutions weakened slightly. Share prices for the largest domestic banking organizations declined somewhat, on balance, and bank credit default swap spreads edged a bit higher, on average, across the larger firms in the sector.

Broad equity price indexes increased, on net, over the intermeeting period, likely reflecting solid quarterly earnings reports, stable medium-term earnings expectations, and lower interest rates. Option-implied volatility for the S&P 500 index over the near term remained in a range that was low by historical standards.

Yields on corporate bonds fell roughly in line with those on Treasury securities of comparable maturity, generally leaving their spreads little changed. The rate of corporate bond issuance by nonfinancial firms remained robust in March and April. Consistent with recent trends, some companies reportedly retired a notable portion of their outstanding commercial paper and issued longer-term bonds in comparable amounts. Syndicated leveraged loans were issued at a record pace in the first quarter, supported by strong demand for this type of asset, particularly from nonbank institutions. Gross public issuance of equity by nonfinancial firms was solid over the same period.

Conditions in some segments of the commercial real estate (CRE) sector continued to improve in recent months. Outstanding CRE loans held by commercial banks edged up in the past two quarters following a prolonged period of decline, and commercial mortgage-backed security issuance was strong in the first quarter. According to the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) conducted in April, the fraction of banks that eased standards on CRE loans over the past three months increased to a relatively high level, while demand for these loans strengthened further. CRE prices continued to move up slowly, and price indexes for various market segments reached levels last seen in late 2008.

Rates on conforming home mortgage loans declined over the intermeeting period, and the spread between the primary mortgage rate and MBS yields remained well below its peak during the second half of 2012. The estimated pace of mortgage refinancing originations continued to be high, supported by historically low mortgage rates. However, purchase mortgage applications stayed at low levels. Overall delinquencies trended lower for both prime and subprime mortgages, primarily reflecting the very tight underwriting standards imposed over the past several years.

Consumer credit continued to expand in January and February, mostly driven by sizable increases in nonrevolving credit. Growth was particularly strong in auto loans as well as in student loans extended through the Department of Education's Direct Loan Program. In contrast, total revolving credit was about flat amid continued tight underwriting standards and terms on credit card loans. Issuance of consumer asset-backed securities—in particular, those backed by subprime auto loans—remained robust in recent months.

Total bank credit expanded moderately during the first quarter of 2013. Gains continued to be concentrated in commercial and industrial (C&I) loans, which increased especially strongly at domestic banks. In the April SLOOS, relatively large net fractions of these banks reported having eased standards and reduced spreads on C&I loans to firms of all sizes.

M2 grew at a faster pace in March and April than earlier in the year, possibly boosted by the higher level of annual tax payments and refunds relative to recent years. Meanwhile, the monetary base expanded briskly over those two months, driven mainly by the increase in reserve balances resulting from the Federal Reserve's asset purchases.

Early in the intermeeting period, prices of a range of risky assets abroad fell in reaction to reports of the "bail-in" of depositors at banks in Cyprus and the imposition of an extended bank holiday in that country, but outside of Cyprus those movements generally proved temporary. Euro-area equity indexes, which fell as stresses in Cyprus intensified, ended the period up slightly. By contrast, stock prices in Japan rose sharply, as the Bank of Japan surprised investors with the scale of its new monetary policy program aimed at raising inflation to 2 percent. Yields on longer-term Japanese government bonds displayed considerable volatility in the days following the announcement, although they were little changed, on net, over the intermeeting period. Outside of Japan, foreign benchmark sovereign yields fell over the intermeeting period, with market commentary citing weak U.S. and foreign macroeconomic data releases, increased expectations for further monetary accommodation by some foreign central banks, and the announcement by the Bank of Japan.

After appreciating, on balance, since early this year, the dollar depreciated against most currencies, although it continued to appreciate against the yen. Emerging market stock prices changed little, on net, and emerging market equity mutual funds experienced modest outflows.

Staff Economic Outlook

In the economic forecast prepared by the staff for the April 30–May 1 FOMC meeting, the projection for real GDP growth was little revised from that prepared for the March meeting. With fiscal policy expected to be tighter this year than last year, the staff still anticipated that the pace of expansion in real GDP would only somewhat exceed the growth rate of potential output in 2013. The staff also continued to project that real GDP would accelerate gradually in 2014 and 2015, supported by an eventual easing in the effects of fiscal policy restraint on economic growth, increases in consumer and business sentiment, further improvements in credit availability and financial conditions, and accommodative monetary policy. The expansion in economic activity was anticipated to slowly reduce the slack in labor and product markets over the projection period, and the unemployment rate was expected to decline gradually.

The staff's forecast for inflation was also little revised from the projection prepared for the March FOMC meeting. With longer-run inflation expectations assumed to remain stable, energy prices expected to continue to trend down, and significant resource slack persisting over the forecast period, the staff continued to project that inflation would remain subdued through 2015.

The staff viewed the uncertainty around its forecast for economic activity as similar to the average level over the past 20 years. However, the risks to this outlook were viewed as skewed to the downside, reflecting in part concerns about the situation in Europe. Although the staff saw the outlook for inflation as uncertain, the risks were viewed as balanced and not unusually high.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation, meeting participants generally indicated that they viewed the information received during the intermeeting period as suggesting that the economy was expanding at a moderate pace despite some softness in recent economic data. Conditions in the labor market showed some continued improvement, although the unemployment rate remained elevated. Spending by consumers continued to expand, supported by better credit conditions, rising equity and housing prices, and lower energy prices; and the housing sector improved further. However, growth in business investment spending slowed somewhat, and fiscal policy appeared to be exerting significant near-term restraint on the economy. Perhaps reflecting more subdued growth abroad, especially in Europe and China, net exports weakened in the first quarter.

Participants generally saw the economic outlook as little changed since they met in March. However, economic data releases over the intermeeting period were mixed, raising some concern that the recovery might be slowing after a solid start earlier this year, thereby repeating the pattern observed in recent years. Various views on this prospect were offered, from those participants who put more emphasis on the underlying momentum of the economy, noting the strengthening in private domestic final demand,

to those who stressed the growing fiscal restraint or the other headwinds still facing the economy. Participants continued to anticipate that, with appropriate monetary policy, growth would proceed at a moderate pace over the medium run and that the unemployment rate would decline gradually toward levels consistent with the Committee's mandate. A number of participants noted that the balance of risks to growth remained to the downside, although a couple suggested that such risks had diminished appreciably since last fall. A few participants warned that, in light of ongoing fiscal restraint and a weak global outlook, economic data could remain soft for the next few months, regardless of the underlying strength of the economy.

Consumer spending was reported to be strong in a number of areas of the country and, more broadly, appeared to be supported by rising equity and house prices, improved household balance sheets, and easier credit conditions. However, concerns were expressed that this rate of growth in consumer expenditures might not be sustainable without the support of a notable pickup in business investment and hiring. Other factors that might affect spending also were mentioned. For example, the losses in income and wealth experienced during the crisis might lead households to be more cautious in their spending and to save at a higher rate; wealth gains in recent years appeared concentrated among higher-net-worth individuals, who may have a lower propensity to spend out of additional wealth; and retailers reported weakness in spending by lower-income households, who had been more affected by the increase in payroll taxes.

Participants saw the housing market as having strengthened further during the intermeeting period and pointed variously to rising house prices, growth in home sales, a lower inventory of houses for sale, a reduction in the average time houses stayed on the market, and encouraging reports from homebuilders. More all-cash or investor purchases were being reported, and the pace of home purchases overall appeared to be constrained less by a lack of demand than by a lack of homes for sale, in part reflecting fewer newly foreclosed houses coming onto the market. The rate of new delinquencies on mortgages declined nearly to pre-crisis levels, and the pipeline of properties in the foreclosure process was being slowly worked down, in part through modifications and short sales. Over time, the supply of homes for sale was expected to increase as new construction picked up and sellers saw more attractive opportunities to put their houses on the market. The improvement in the housing sector was also seen as contributing to a pickup in activity in related industries.

With some exceptions, business contacts were reporting continued caution about expanding investment or payrolls. Reports included some weakening in manufacturing activity, due in part to reduced demand from abroad, and farm exports in one District were projected to be flat following strong growth in previous years. However, the CRE sector showed some signs of recovery, and survey results indicated that the terms of CRE lending were easing and loan demand increasing.

The federal spending sequestration and recent tax increases were viewed as restraining aggregate demand. Participants differed somewhat in their assessments of the magnitude of these effects on the economy, with views ranging from an estimate of substantial fiscal drag to one of less restraint than previously expected. A few participants mentioned the sequestration's impact on hiring and spending by the defense industry or government contractors, but one participant noted that a decline in expected future tax liabilities of the private sector associated with lower federal spending might provide a partial offset to the economic effects of the budget cuts.

Participants generally saw signs of improvement in labor market conditions despite the weaker-than-expected March payroll employment figure. Employment growth in earlier months had been solid, and more-recent improvements included the further decline in the unemployment rate in March and the gradual progress being made in some other labor market indicators. However, several participants cautioned that the drop in the unemployment rate in the latest month was also accompanied by another reduction in the labor force participation rate; the decline in labor force participation over recent quarters could indicate that the reduction in overall labor market slack had been substantially smaller than suggested by the change in the unemployment rate over that period. One participant commented that assessing the shortfall of employment from its maximum level required taking account of not only the gap between the unemployment rate and its corresponding natural rate, but also the gap between the labor force participation rate and its longer-term trend—a trend which was admittedly subject to considerable uncertainty. A few participants mentioned that job growth may have been restrained to an extent by businesses postponing hiring because of uncertainties

over the implementation of health-care legislation or because they were unable to find certain types of skilled workers.

Both headline and core PCE inflation in the first quarter came in below the Committee's longer-run goal of 2 percent, but these recent lower readings appeared to be due, in part, to temporary factors; other measures of inflation as well as inflation expectations had remained more stable. Accordingly, participants generally continued to expect that inflation would move closer to the 2 percent objective over the medium run. Nonetheless, a number of participants expressed concern that inflation was below the Committee's target and stressed that future price developments bore careful watching. Most of the recent reports from business contacts revealed little upward pressure on prices or wages. A couple of participants expressed the view that an additional monetary policy response might be warranted should inflation fall further. It was also pointed out that, even absent further disinflation, continued low inflation might pose a threat to the economic recovery by, for example, raising debt burdens. One participant focused instead on the upside risks to inflation over the longer term resulting from highly accommodative monetary policy.

Financial conditions appeared to have eased further over the intermeeting period: Longer-term interest rates declined significantly, banks loosened their C&I lending terms and standards on balance, and competition to make commercial and auto loans was strong. Businesses were reportedly still borrowing to refinance, but they had begun to take out more new loans as well. While the Committee's accommodative policy continued to provide support to financial conditions, events abroad also influenced U.S. markets over the intermeeting period. In particular, the Bank of Japan announced a new monetary policy program that was considerably more expansionary than markets had expected. Financial conditions in Europe improved somewhat over the period, but some participants still saw the situation in Europe as posing downside risks to U.S. growth. At this meeting, a few participants expressed concern that conditions in certain U.S. financial markets were becoming too buoyant, pointing to the elevated issuance of bonds by lower-credit-quality firms or of bonds with fewer restrictions on collateral and payment terms (so-called covenant-lite bonds). One participant cautioned that the emergence of financial imbalances could prove difficult for regulators to identify and address, and that it would be appropriate to adjust monetary policy to help guard against risks to financial stability.

In discussing the effects of the Committee's asset purchases, several participants pointed to the improvement in interest-sensitive sectors, such as consumer durables and housing, over the recent period as evidence that the purchases were having positive results for the economy. The effects on a range of asset prices of the Bank of Japan's recent announcement were cited as added evidence that large-scale asset purchases were effective in easing financial conditions and thereby helping stimulate economic activity. In evaluating the prospects for benefits from asset purchases, however, one participant viewed uncertainty about U.S. fiscal and regulatory policies as interfering with the transmission of monetary policy and as preventing asset purchases from having a meaningful effect on the real economy.

Participants also touched on the conditions under which it might be appropriate to change the pace of asset purchases. Most observed that the outlook for the labor market had shown progress since the program was started in September, but many of these participants indicated that continued progress, more confidence in the outlook, or diminished downside risks would be required before slowing the pace of purchases would become appropriate. A number of participants expressed willingness to adjust the flow of purchases downward as early as the June meeting if the economic information received by that time showed evidence of sufficiently strong and sustained growth; however, views differed about what evidence would be necessary and the likelihood of that outcome. One participant preferred to begin decreasing the rate of purchases immediately, while another participant preferred to add more monetary accommodation at the current meeting and mentioned that the Committee had several other tools it could potentially use to do so. Most participants emphasized that it was important for the Committee to be prepared to adjust the pace of its purchases up or down as needed to align the degree of policy accommodation with changes in the outlook for the labor market and inflation as well as the extent of progress toward the Committee's economic objectives. Regarding the composition of purchases, one participant expressed the view that, in light of the substantial improvement in the housing market and to avoid further credit

allocation across sectors of the economy, the Committee should start to shift any asset purchases away from MBS and toward Treasury securities.

Committee Policy Action

Committee members saw the information received over the intermeeting period as suggesting that economic activity had been expanding at a moderate pace. Labor market conditions had shown some improvement in recent months, on balance, but the unemployment rate remained elevated. Household spending and business fixed investment advanced, and the housing sector had strengthened further, but fiscal policy was restraining economic growth. The Committee expected that, with appropriate monetary policy accommodation, economic growth would proceed at a moderate pace and result in a gradual decline in the unemployment rate toward levels that the Committee judged consistent with its dual mandate. Members generally continued to anticipate that, with longer-term inflation expectations stable and persisting slack in resource utilization, inflation over the medium term would likely run at or below the Committee's 2 percent objective.

In their discussion of monetary policy for the period ahead, all but one member judged that a highly accommodative stance of monetary policy was warranted in order to foster a stronger economic recovery in a context of price stability. The Committee agreed to continue purchases of MBS at a pace of $40 billion per month and purchases of longer-term Treasury securities at a pace of $45 billion per month, as well as to maintain the Committee's reinvestment policies. The Committee also retained its forward guidance about the federal funds rate, including the thresholds on the unemployment and inflation rates. One member dissented from the Committee's policy decision, expressing concern that the continued high level of monetary accommodation increased the risks of future economic and financial imbalances and, over time, could cause an increase in inflation expectations.

A few members expressed concerns that investor expectations of the cumulative size of the asset purchase program appeared to have increased somewhat since it was launched last September despite a notable decline in the unemployment rate and other improvements in the labor market since then. In contrast, a few other members focused on evidence that market expectations about the total size of the program had changed little, on net, since the program was launched or had responded appropriately to incoming information. Members generally agreed on the need for the Committee to communicate clearly that the pace and ultimate size of its asset purchases would depend on the Committee's continued assessment of the outlook for the labor market and inflation in addition to its judgments regarding the efficacy and costs of additional purchases and the extent of progress toward its economic objectives. To highlight its willingness to adjust the flow of purchases in light of incoming information, the Committee included language in the statement to be released following the meeting that said the Committee was prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

"Information received since the Federal Open Market Committee met in March suggests that economic activity has been expanding at a moderate pace. Labor market conditions have shown some improvement in recent months, on balance, but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has strengthened further, but fiscal policy is restraining economic growth. Inflation has been running somewhat below the Committee's longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. Longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee continues to see downside risks to the economic outlook. The Committee also anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

The Committee will closely monitor incoming information on economic and financial developments in coming months. The Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes. In determining the size, pace, and composition of its asset purchases, the Committee will continue to take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Charles L. Evans, Jerome H. Powell, Sarah Bloom Raskin, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Esther L. George.

Ms. George dissented because she continued to view monetary policy as overly accommodative and therefore as posing risks to the long-term sustainable

growth of the economy. She expressed concern that the stance of policy might be fostering imbalances and excessive risk-taking in some financial markets and institutions, and she cited the potential for the Committee's ongoing asset purchases to complicate the future conduct of policy, raise uncertainty, and affect future inflation expectations. Accordingly, Ms. George preferred to signal a near-term tapering of asset purchases, which would begin to move policy toward a more appropriate stance.

Review of Exit Strategy Principles

After the policy vote, participants began a review of the exit strategy principles that were published in the minutes of the Committee's June 2011 meeting. Those principles, which the Committee issued to clarify how it intended to normalize the stance and conduct of monetary policy when doing so eventually became appropriate, included broad principles along with some details about the timing and sequence of specific steps the Committee expected to take. The participants' discussion touched on various aspects of the exit strategy principles and policy normalization more generally, including the size and composition of the SOMA portfolio in the longer run, the use of a range of reserve-draining tools, the approach to sales of securities, the eventual framework for policy implementation, and the relationship between the principles and the economic thresholds in the Committee's forward guidance on the federal funds rate. The broad principles adopted almost two years ago appeared generally still valid, but developments since then—including the change in the size and composition of SOMA asset holdings—suggested a need for greater flexibility regarding the details of implementing policy normalization, particularly because those details would appropriately depend at least in part upon future economic and financial developments. Also, because normalization still appeared to be well in the future, the Committee might wish to wait and acquire additional experience to inform its plans. In particular, the process of normalizing policy could yield information about the most effective framework for implementing monetary policy in the longer run, and thus about the appropriate size of the SOMA portfolio and level of reserve balances. In addition, several participants raised the possibility that the federal funds rate might not, in the future, be the best indicator of the general level of short-term interest rates, and supported further staff study of potential alternative approaches to implementing monetary policy in the longer term and of possible new tools to improve control over short-term interest rates.

Views differed regarding whether the best course at this point would be to simply acknowledge that certain components of the June 2011 principles had been overtaken by events or rather to formally revise the principles. Acknowledging that the principles need to be updated would help avoid possible confusion regarding the Committee's intentions; waiting to update the principles would allow the Committee to obtain additional information before revising them. It was also mentioned that the public's understanding of the likely exit process might not be improved if the Committee issued only a set of broad principles without providing detailed information on the steps anticipated for normalization. However, issuing revised principles relatively soon could give the public additional confidence that the Committee had the tools and a plan for eventually normalizing the conduct of policy. Moreover, one participant stressed that the Committee's ability to provide forward guidance about the normalization process was a key monetary policy tool, and revised principles would permit use of that tool to help adjust the stance of policy. Participants emphasized that their review of the June 2011 exit strategy principles did not suggest any change in their views about the economic conditions that would eventually warrant beginning the process of normalizing the stance of monetary policy. At the conclusion of the discussion, the Chairman directed the staff to undertake additional preparatory work on this issue for Committee consideration in the future.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, June 18–19, 2013. The meeting adjourned at 1:05 p.m. on May 1, 2013.

Notation Vote

By notation vote completed on April 9, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on March 19–20, 2013.

William B. English
Secretary

Meeting Held on June 18–19, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, June 18, 2013, at 1:30 p.m. and continued on Wednesday, June 19, 2013, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Charles L. Evans

Esther L. George

Jerome H. Powell

Sarah Bloom Raskin

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Gregory L. Stefani
First Vice President, Federal Reserve Bank of Cleveland

William B. English
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, James J. McAndrews, Stephen A. Meyer, David Reifschneider, Geoffrey Tootell, Christopher J. Waller, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Matthew J. Eichner
Deputy Director, Division of Research and Statistics, Board of Governors

Maryann F. Hunter
Deputy Director, Division of Banking Supervision and Regulation, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Ellen E. Meade and Joyce K. Zickler
Senior Advisers, Division of Monetary Affairs, Board of Governors

Daniel M. Covitz, Eric M. Engen, and Thomas Laubach
Associate Directors, Division of Research and Statistics, Board of Governors

Sean D. Campbell and Joshua Gallin
Deputy Associate Directors, Division of Research and Statistics, Board of Governors

Jane E. Ihrig and David López-Salido
Deputy Associate Directors, Division of Monetary Affairs, Board of Governors

Joseph W. Gruber
Assistant Director, Division of International Finance, Board of Governors

Jeremy B. Rudd
Adviser, Division of Research and Statistics, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Deborah J. Lindner
Group Manager, Division of Research and Statistics, Board of Governors

Patrice Robitaille
Senior Economist, Division of International Finance, Board of Governors

Seung J. Lee
Economist, Division of Monetary Affairs, Board of Governors

Peter M. Garavuso
Records Management Analyst, Division of Monetary Affairs, Board of Governors

James M. Lyon
First Vice President, Federal Reserve Bank of Minneapolis

David Altig and Loretta J. Mester
Executive Vice Presidents, Federal Reserve Banks of Atlanta and Philadelphia, respectively

Lorie K. Logan, David Marshall, Mark E. Schweitzer, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of New York, Chicago, Cleveland, and Minneapolis, respectively

Evan F. Koenig
Vice President, Federal Reserve Bank of Dallas

Andreas L. Hornstein
Senior Advisor, Federal Reserve Bank of Richmond

John Fernald
Senior Research Adviser, Federal Reserve Bank of San Francisco

Discussion of Guidelines for Policy Normalization

In light of the changes in the System Open Market Account (SOMA) portfolio over the past two years, the Committee again discussed its strategy for the eventual normalization of the stance of monetary policy and the size and composition of the Federal Reserve's balance sheet that was released in the minutes of the Committee's June 2011 meeting. Although most participants saw this review as prudent longer-range planning, some felt that the discussion was premature. Meeting participants, in general, continued to view the broad principles set out in 2011 as still applicable. Nonetheless, they agreed that many of the details of the eventual normalization process would likely differ from those specified two years ago, that the appropriate details would depend in part on economic and financial developments between now and the time when it becomes appropriate to begin normalizing monetary policy, and that the Committee would need to provide additional information about its intentions as that time approaches. Participants continued to think that the Federal Reserve should, in the long run, hold predominantly Treasury securities. Most, however, now anticipated that the Committee would not sell agency mortgage-backed securities (MBS) as part of the normalization process, although some indicated that limited sales might be warranted in the longer run to reduce or eliminate residual holdings. A couple of participants stated that they preferred that the Committee make no decision about sales of MBS until closer to the start of the normalization process. Participants agreed that the Committee's focus continued to be on providing appropriate monetary accommodation to promote a stronger recovery in the context of price stability and so judged that additional discussion regarding policy normalization should be deferred.

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the SOMA reported on developments in domestic and foreign financial markets as well as the System open market operations during the period since the Federal Open Market Committee (FOMC) met on April 30–May 1, 2013. The review included a report that the System's purchases of longer-term assets did not appear to have had an adverse effect on the functioning of the markets for Treasury securities or agency MBS, and that the Open Market Desk's operations in both sectors had proceeded smoothly. By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

Staff Review of the Economic Situation

The information reviewed for the June 18–19 meeting suggested that economic activity continued to increase at a moderate rate in the second quarter. Private-sector employment expanded further in

recent months, and the unemployment rate in April and May was below its first-quarter average, although it continued to be elevated. Consumer price inflation was subdued, partly reflecting transitory influences. However, measures of longer-run inflation expectations remained stable.

Private nonfarm employment rose moderately in April and May, while total government employment continued to decline somewhat. The unemployment rate was 7.6 percent in May, little changed from its level in April. The labor force participation rate edged up in May, but was still slightly below its first-quarter average, and the employment-to-population ratio increased a bit in recent months. The rate of long-duration unemployment declined slightly, while the share of workers employed part time for economic reasons was little changed; both of these measures remained well above their pre-recession levels. Forward-looking indicators of near-term labor market activity were mixed but generally pointed to some further improvement in labor market conditions in the coming months: Household expectations of the labor market situation improved; initial claims for unemployment insurance were little changed, on net, over the intermeeting period; and firms' hiring plans edged up. However, measures of job openings and the rate of gross private-sector hiring were about flat, on balance, in recent months and remained near their levels of a year ago.

Manufacturing production increased slightly in May after declining in the previous two months, and the rate of manufacturing capacity utilization in May was lower than in the first quarter. Automakers' schedules indicated that the pace of motor vehicle assemblies would hold roughly steady in the coming months, and broader indicators of manufacturing production, such as the readings on new orders from national and regional manufacturing surveys, were generally at subdued levels that pointed to only modest increases in factory output in the near term.

Real personal consumption expenditures (PCE) rose in April. In May, nominal retail sales, excluding those at motor vehicle and parts outlets, increased briskly, while light motor vehicle sales moved up solidly. Some key factors that tend to support growth in household spending were positive in recent months. After decreasing in the first quarter when payroll and income taxes increased, households' real disposable income rose in April, in part reflecting a small decline in consumer prices. Households' net worth likely increased in recent months, as equity values and home prices rose further. Moreover, consumer sentiment in the Thomson Reuters/University of Michigan Surveys of Consumers improved notably, on balance, in May and early June and was at its most upbeat level since the onset of the recession.

Conditions in the housing sector generally improved further, but construction activity was still at a relatively low level, and demand continued to be restrained by tight credit standards for mortgage loans. Starts of new single-family homes declined, on net, in April and May, but permits rose, suggesting gains in construction in the coming months. Starts of new multifamily units decreased in April but increased in May. Home prices continued to rise rapidly through April, while sales of both new and existing homes advanced.

Real business expenditures on equipment and software appeared to slow somewhat going into the second quarter after expanding modestly earlier in the year. Nominal shipments of nondefense capital goods excluding aircraft decreased in April, but nominal new orders for these capital goods increased and were slightly above the level of shipments, pointing to modest gains in shipments in the near term. Other forward-looking indicators, such as surveys of business conditions and capital spending plans, also suggested that outlays for business equipment would continue to rise at only a modest pace in the coming months. Nominal business spending for nonresidential construction increased in April after it had declined in the first quarter. Business inventories in most industries appeared to be broadly aligned with sales in recent months.

Real federal government purchases appeared to be declining less rapidly going into the second quarter than they had during the first quarter, as decreases in defense spending slowed, on balance, in April and May. The ongoing declines in real state and local government purchases appeared to moderate over recent months; the payrolls of these governments expanded in April and May, but state and local construction expenditures continued to decline noticeably.

The U.S. international trade deficit narrowed in March but widened in April, leaving the level of the trade deficit in April similar to its average in the first quarter. Both imports and exports fell in March but largely recovered in April, although oil imports remained below their first-quarter average. Exports

of consumer goods and automotive products reached new highs in April, but exports of agricultural products declined.

Overall U.S. consumer prices, as measured by the PCE price index, edged down in April, while the consumer price index (CPI) rose somewhat in May. Both the CPI and the PCE price index increased at a subdued rate over the most recent 12-month period for each series. After declining in the previous two months, consumer energy prices rose a little in May, and retail gasoline prices, measured on a seasonally adjusted basis, were up further in the first couple of weeks in June. Consumer food prices edged down in May after rising modestly in April. Partly reflecting some transitory factors, such as a one-time reduction in Medicare prices associated with the federal government spending sequestration, consumer prices excluding food and energy only edged up in April but rose slightly more in May. Near-term inflation expectations from the Michigan survey were little changed in May and early June; longer-term inflation expectations in the survey also were essentially flat and remained within the narrow range that they have occupied for a number of years.

Measures of labor compensation indicated that gains in nominal wages remained modest. Compensation per hour in the nonfarm business sector increased moderately over the year ending in the first quarter, and, with a small rise in productivity, unit labor costs advanced only a little. Gains in average hourly earnings for all employees were muted, on balance, in April and May.

Foreign economic growth remained sluggish so far this year. A slower pace of expansion in many emerging market economies (EMEs), including China, since the beginning of the year offset an increase in the average rate of economic growth in the advanced foreign economies. In Japan, where recent policy measures appeared to have boosted household confidence, economic growth picked up noticeably early in the year. Recent indicators of Canadian economic activity also strengthened. However, indicators for the euro-area economies remained weak. A decline in commodity prices and continued lackluster economic growth contributed to a decline in foreign inflation.

Staff Review of the Financial Situation

Financial markets were volatile during the intermeeting period as investors reacted to incoming economic data and Federal Reserve communications. Information about the U.S. economy was somewhat better, on balance, than investors had anticipated, apparently giving them greater confidence in the economic outlook. Federal Reserve communications over the period reportedly were interpreted by market participants as pointing to a less accommodative stance of future monetary policy than they previously had expected.

Market-based indicators suggested that investors revised up their expectations about the path of the federal funds rate in coming years. Forward rates two to three years ahead derived from overnight index swaps shifted up 25 to 40 basis points over the intermeeting period, likely reflecting both an increase in the expected path for the federal funds rate and an increase in term premiums. In contrast to the readings from financial market quotes, which suggested that investors had come to expect the FOMC to increase its target for the federal funds rate sooner than they previously had anticipated, the results from the Desk's survey of primary dealers conducted prior to the June meeting showed little material change, on balance, in the dealers' expectations of the most likely timing of the first increase in the federal funds rate target.

Nominal yields on Treasury securities rose sharply over the intermeeting period amid some better-than-expected U.S. economic data and Federal Reserve communications that were interpreted by market participants as signaling a possible earlier-than-expected reduction in the pace of purchases under the FOMC's flow-based asset purchase program. Nominal yields on 5- to 30-year Treasury securities increased about 35 to 55 basis points. Yields on agency MBS rose more than those on comparable-maturity Treasury securities, leaving option-adjusted spreads to Treasury securities notably wider. The rise in longer-term Treasury yields appeared to reflect both an increase in term premiums and a rise in expected future short-term rates. The rise in term premiums, in turn, likely reflected in part a reassessment of the pace and ultimate size of the Federal Reserve's asset purchase program, as well as increased uncertainty about the future path of monetary policy.

Measures of inflation compensation derived from yields on nominal and inflation-protected Treasury securities fell notably but ended the intermeeting period within their ranges over the past few years. Investor perceptions of a somewhat less accommodative tone of Federal Reserve communications, as well

as the softer-than-expected reading for the April CPI, likely contributed to the decline in inflation compensation.

Conditions in domestic and offshore dollar funding markets were generally little changed, on balance, over the intermeeting period. In secured funding markets, rates on Treasury general collateral repurchase agreements decreased, on net, in large part because of the seasonal decline in the supply of Treasury securities.

Market sentiment toward large domestic banking organizations appeared to improve somewhat over the intermeeting period, likely related in part to further reductions in nonperforming loans and growing confidence in the economic outlook. Equity prices for large domestic banks outperformed broad equity indexes over the intermeeting period, as did the equity prices for most other types of financial institutions. In contrast, equity prices for agency mortgage real estate investment trusts declined, reflecting the rise in longer-term interest rates, the underperformance of agency MBS, and weaker-than-expected earnings reports.

Responses to the June Senior Credit Officer Opinion Survey on Dealer Financing Terms generally suggested little change over the past three months in the credit terms applicable to important classes of counterparties and in the use of financial leverage by most classes of counterparties covered by the survey. However, about one-fourth of dealers reported an increase in the use of leverage by hedge funds.

Corporate bond yields rose significantly over the intermeeting period, and their spreads relative to comparable-maturity Treasury yields edged higher on net. Credit flows to nonfinancial businesses remained strong in May, especially through bond issuance. Gross issuance of speculative-grade corporate bonds was particularly elevated early in the intermeeting period, but such issuance slowed after mid-May in response to the rise in interest rates and in market volatility. Meanwhile, the issuance of syndicated leveraged loans remained robust in April and May, supported by strong investor demand for floating-rate corporate debt instruments.

House prices continued to rise in recent months, with national home price indexes up between 5 and 12 percent over the 12-month period ending in April. As a result, the number of mortgages with negative equity was estimated to have decreased substantially. Primary mortgage rates increased with yields on MBS over the intermeeting period, and the spread between primary mortgage rates and MBS yields remained near the low end of its range over recent years. Consumer credit continued to expand at a solid pace because of the ongoing expansion in auto and student loans; credit card debt remained about flat. Issuance of consumer asset-backed securities increased strongly again in May.

Growth in total bank credit moderated in April and May compared with the first quarter, as core loans slowed and securities declined slightly. Growth in commercial and industrial loans at large banks decreased noticeably in recent months, reportedly reflecting both increased paydowns and reduced originations. In contrast, increases in commercial real estate loans picked up, especially at large banks.

The M2 monetary aggregate expanded at an annual rate of about 5 percent from April through mid-June. The monetary base grew at an annual rate exceeding 40 percent over the same period, driven mainly by the increase in reserve balances that resulted from the Federal Reserve's asset purchases.

Over the intermeeting period, yields on 10-year sovereign debt of the advanced foreign economies followed the yields on comparable-maturity U.S. Treasury securities higher, and volatility in sovereign bond markets rose, particularly in Japan. Japanese equity markets also displayed substantial volatility; equity prices fell sharply late in the period and erased the gains that had been registered since early April, when the Bank of Japan announced that it would expand its asset purchases in order to nearly double the size of its balance sheet. European equity indexes were little changed, on net, over the period, and euro-area financial conditions remained relatively stable. Spreads of yields on Italian and Spanish government debt over yields on German bunds increased only a few basis points, while comparable spreads for Greek sovereign debt declined notably. The foreign exchange value of the dollar was little changed, on average, relative to the currencies of the advanced foreign economies, but appreciated against EME currencies amid weak incoming data on economic activity and monetary policy easing in some EMEs, along with rising U.S. Treasury yields. Emerging market mutual funds experienced sharp outflows in recent weeks, while EME stock prices declined and EME credit spreads widened on net.

The staff reported on potential risks to financial stability, including the stability of banking firms, nonbank financial intermediaries, and asset markets. Most market-based measures of the health of the banking sector—such as banks' stock prices, credit default swap spreads, and equity correlations—pointed to an improvement in the stability of the banking sector, in part because of rising levels of liquidity and capital as well as diminished concerns about downside risks. However, a number of indicators pointed to a modest increase in risk-taking and leverage that was largely being intermediated through the shadow banking system. Signs of upward pressures on the valuations of some risky assets were also noted. Overall, the risks to financial stability were viewed as roughly unchanged since March.

Staff Economic Outlook

In the economic forecast prepared by the staff for the June FOMC meeting, the projection for near-term growth of real gross domestic product (GDP) was little changed from the one prepared for the previous meeting. However, the staff's medium-term projection for real GDP was revised up somewhat. The staff raised its projected paths for equity and home prices, which pushed up expected consumer spending over the medium term, and boosted its outlook for domestic oil production, which reduced oil imports in the forecast. These positive factors were partly offset in the staff's medium-term GDP projection by higher projected paths for both longer-term interest rates and the foreign exchange value of the dollar. Nevertheless, with fiscal policy expected to restrain economic growth this year, the staff still anticipated that the pace of expansion in real GDP would only moderately exceed the growth rate of potential output. The staff also continued to forecast that real GDP would accelerate gradually in 2014 and 2015, supported by accommodative monetary policy, an eventual easing in the effects of fiscal policy restraint on economic growth, increases in consumer and business sentiment, and further improvements in credit availability and financial conditions. The expansion in economic activity was anticipated to slowly reduce the slack in labor and product markets over the projection period, and the unemployment rate was expected to decline gradually. In addition, although the staff did not change its view of the longer-run level of the natural rate of unemployment, it judged that the natural rate was on a more pronounced downward trajectory back toward its longer-run level than previously assumed; as a result, the staff's projection for the unemployment rate over the next two years was revised down a little, relative to its previous forecast.

The staff's forecast for inflation in the near term was also revised down a little from the projection prepared for the previous FOMC meeting, reflecting in part some of the recent softer-than-expected readings on consumer prices. Nonetheless, the staff expected that much of the recent softness in inflation would be transitory, and thus did not materially change its medium-term projection. The staff projected that inflation would pick up in the second half of this year, but given the assumption of stable longer-run inflation expectations and only modest changes in commodity and import prices as well as forecasts of gradually diminishing resource slack over the projection period, inflation was projected to still be relatively subdued through 2015.

The staff viewed the uncertainty around the forecast for economic activity as normal relative to the experience of the past 20 years. However, the risks were still viewed as skewed to the downside, in part because of concerns about the situation in Europe and the ability of the U.S. economy to weather potential adverse shocks. Although the staff saw the outlook for inflation as uncertain, the risks were viewed as balanced and not unusually high.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, meeting participants—the 7 members of the Board of Governors and the presidents of the 12 Federal Reserve Banks, all of whom participate in the deliberations of the FOMC—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2015 and over the longer run, under each participant's judgment of appropriate monetary policy.[1] The longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. These economic projections and policy assessments are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

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[1] Although President Pianalto was unable to attend the June 18–19, 2013, FOMC meeting, she submitted economic projections. First Vice President Gregory L. Stefani represented the Federal Reserve Bank of Cleveland at the meeting.

In their discussion of the economic situation, meeting participants generally indicated that the information received during the intermeeting period continued to suggest that the economy was expanding at a moderate pace. A number of participants mentioned that they were encouraged by the apparent resilience of private spending so far this year despite considerable downward pressure from lower government spending and higher taxes. In particular, consumer spending rose at a moderate rate, and the housing sector continued to strengthen. Business investment advanced, although only modestly, and slower economic activity abroad restrained domestic production. Overall conditions in the labor market improved further in recent months, although the unemployment rate remained elevated. Inflation continued to run below the Committee's longer-run objective, but longer-term inflation expectations remained stable.

Most participants anticipated that growth of real GDP would pick up somewhat in the second half of 2013. Growth of economic activity was projected to strengthen further during 2014 and 2015, supported by accommodative monetary policy; waning fiscal restraint; and ongoing improvements in household and business balance sheets, credit availability, and labor market conditions. Accordingly, the unemployment rate was projected to gradually decline toward levels consistent with the Committee's dual mandate. Many participants saw the downside risks to the medium-run outlook for the economy and the labor market as having diminished somewhat in recent months, or expressed greater confidence that stronger economic activity was in train. However, some participants noted that they remained uncertain about the projected pickup in growth of economic activity in coming quarters, and thus about the prospects for further improvement in labor market conditions, given that, in recent years, forecasts of a sustained pickup in growth had not been realized.

Participants noted that consumer spending continued to increase at a moderate rate in recent months despite tax increases and only modest gains in wages. Among the factors viewed as supporting consumption were improvements in household balance sheets and in the job market, as well as low interest rates. In addition, consumer sentiment improved over the intermeeting period, which some participants attributed to rising house prices and gains in the stock market. It was noted that the mutually reinforcing dynamic of rising confidence, declining risk premiums, improving credit availability, increasing spending, and greater hiring was an important factor in the projected pickup in economic activity but also that this favorable dynamic could be vulnerable to an adverse shock. A few participants expressed some concern about the outlook for consumer spending, citing the weakness in labor income and households' cautious attitudes toward using debt.

Housing markets continued to strengthen, with participants variously reporting increases in house prices, sales, and building permits; low inventories of homes on the market; and rising demand for construction supplies. The improvement in the housing sector was seen as supporting the broader economy through related spending and employment, with rising real estate values boosting household wealth, confidence, and access to credit. Participants generally were optimistic that the recovery in housing activity would be sustained, although a couple of participants were concerned that the run-up in mortgage rates in recent weeks might begin to crimp demand. However, the recent increase in mortgage purchase applications was seen as suggesting that the demand for housing was being driven by factors beyond low mortgage rates.

Reports on business spending were mixed. A number of participants continued to hear that businesses were limiting their capital spending to projects intended to enhance productivity and that they remained reluctant to invest to expand capacity, or to step up hiring. Uncertainties about regulatory issues and fiscal policies as well as weak economic activity abroad were cited as factors weighing on business decisionmaking. Some businesses, particularly smaller firms, were again reported to be concerned about the implications of new health-care regulations for their labor costs. Nonetheless, a few participants reported that their business contacts expressed somewhat greater confidence in the economic outlook or reported plans to expand capacity. A pickup in bank lending to small businesses was also reported. Although the manufacturing sector slowed considerably during the spring, contacts in several Districts reported that activity turned up more recently. Reports on activity in the airline, trucking, and warehousing industries were uneven. Agriculture remained robust, supported in part by strong demand from emerging market economies. However, prospects for farm income were less positive as a result of the wet weather in the Midwest and expectations of lower prices for corn. The outlook for the energy sector remained positive.

While the federal sequestration and the tax increases that became effective earlier in the year were expected to be a substantial drag on economic activity this year, the magnitude and timing of the effects remained unclear. Several participants commented that the direct effects of the cutbacks in federal spending, to date, did not appear as great as had been expected, but that they anticipated that fiscal policy would continue to restrain economic growth in coming quarters. In particular, one pointed out that the furloughs scheduled for the second half of the year were likely to reduce household income and spending. A report on the favorable fiscal condition of one state was indicative of the improvement in the budget situation at state and local governments.

Participants generally agreed that labor market conditions had continued to improve, on balance, in recent months; many saw the cumulative decline in the unemployment rate and gains in nonfarm payrolls over the past nine months as considerable. Reflecting these developments, participants' forecasts for the unemployment rate at this meeting were lower than those prepared for the September 2012 meeting. Among the encouraging aspects of labor market developments since then were the step-up in average monthly gains in private employment, the breadth of job gains across industries, the decline in layoffs, and a rise in voluntary quits in some industries. However, some participants discussed a number of indicators that suggested that the improvement in broad labor market conditions was less than might be implied by the decline in the unemployment rate alone. Some pointed out that the rate of hiring still fell short of the pace that they saw as consistent with more-noticeable progress in labor market conditions, that a portion of the improvement in payroll employment since the September meeting was due to data revisions, or that there were no signs of an increase in wage pressures. Others expressed concern about the still-elevated level of long-duration joblessness and the weakness in labor force participation. Most participants still saw slack remaining in the labor market, although they differed on the extent to which the progress to date had reduced that slack and how confident they were about future labor market improvement.

Inflation was low in the months prior to the meeting, with the trends in all broad measures remaining below the Committee's 2 percent longer-run objective. Several transitory factors, including a one-time reduction in Medicare costs, contributed to the recent very low inflation readings. In addition, energy prices declined, and nonfuel commodity prices were soft. Over the past year, both core and overall consumer price inflation trended lower; participants cited various alternative measures of consumer price inflation, including the trimmed mean PCE and CPI as well as the sticky price CPI, that suggested that the slowing was broad based. Market-based measures of inflation expectations decreased over the intermeeting period but remained within their ranges over the past few years. Most participants expected inflation to begin to move up over the coming year as economic activity strengthened, but many anticipated that it would remain below the Committee's 2 percent objective for some time. One participant expressed concern about the risk of a more rapid rise in inflation over the medium term, given the highly accommodative stance of monetary policy. In contrast, many others worried about the low level of inflation, and a number indicated that they would be watching closely for signs that the shift down in inflation might persist or that inflation expectations were persistently moving lower.

In their discussion of financial market developments over the intermeeting period, participants weighed the extent to which the rise in market interest rates and increase in volatility reflected a reassessment of market participants' expectations for monetary policy and the extent to which it reflected growing confidence about the economic outlook. It was noted that corporate credit spreads had not widened substantially and that the stock market had posted further gains, suggesting that the higher rates reflected, at least in part, increasing confidence that moderate economic growth would be sustained. Several participants worried that higher mortgage rates and bond yields could slow the recovery in the housing market and restrain business expansion. However, some others commented that any adverse effects of the increase in rates on financial conditions more broadly appeared to be limited.

A number of participants offered views on risks to financial stability. A couple of participants expressed concerns that some financial institutions might not be well positioned to weather a rapid run-up in interest rates. Two others emphasized the importance of bolstering the resilience of money market funds against disorderly outflows. And a few stated their view that a prolonged period of low interest rates would encourage investors to take on excessive credit or interest rate risk and would distort some asset prices. However, others suggested that the recent rise in rates might have reduced such incentives. While

market volatility had increased of late, it was noted that the rise in measured volatility, while noticeable, occurred from a low level, and that a broad index of financial stress remained below average. One participant felt that the Committee should explore ways to calibrate the magnitude of the risks to financial stability so that those considerations could be more fully incorporated into deliberations on monetary policy.

Participants discussed how best to communicate the Committee's approach to decisions about its asset purchase program and how to reduce uncertainty about how the Committee might adjust its purchases in response to economic developments. Importantly, participants wanted to emphasize that the pace, composition, and extent of asset purchases would continue to be dependent on the Committee's assessment of the implications of incoming information for the economic outlook, as well as the cumulative progress toward the Committee's economic objectives since the institution of the program last September. The discussion centered on the possibility of providing a rough description of the path for asset purchases that the Committee would anticipate implementing if economic conditions evolved in a manner broadly consistent with the outcomes the Committee saw as most likely. Several participants pointed to the challenge of making it clear that policymakers necessarily weigh a broad range of economic variables and longer-run economic trends in assessing the outlook. As an alternative, some suggested providing forward guidance about asset purchases based on numerical values for one or more economic variables, broadly akin to the Committee's guidance regarding its target for the federal funds rate, arguing that such guidance would be more effective in reducing uncertainty and communicating the conditionality of policy. However, participants also noted possible disadvantages of such an approach, including that such forward guidance might inappropriately constrain the Committee's decisionmaking, or that it might prove difficult to communicate to investors and the general public.

Since the September meeting, some participants had become more confident of sustained improvement in the outlook for the labor market and so thought that a downward adjustment in asset purchases had or would likely soon become appropriate; they saw a need to clearly communicate an intention to lower the pace of purchases before long. However, to some other participants, this approach appeared likely to limit the Committee's flexibility in adjusting asset purchases in response to changes in economic conditions, which they viewed as a key element in the design of the purchase program. Others were concerned that stating an intention to slow the pace of asset purchases, even if the intention were conditional on the economy developing about in line with the Committee's expectations, might be misinterpreted as signaling an end to the addition of policy accommodation or even be seen as the initial step toward exit from the Committee's highly accommodative policy stance. It was suggested that any statement about asset purchases make clear that decisions concerning the pace of purchases are distinct from decisions concerning the federal funds rate.

Participants generally agreed that the Committee should provide additional clarity about its asset purchase program relatively soon. A number thought that the postmeeting statement might be the appropriate vehicle for providing additional information on the Committee's thinking. However, some saw potential difficulties in being able to convey succinctly the desired information in the postmeeting statement. Others noted the need to ensure that any new statement language intended to provide more information about the asset purchase program be clearly integrated with communication about the Committee's other policy tools. At the conclusion of the discussion, most participants thought that the Chairman, during his postmeeting press conference, should describe a likely path for asset purchases in coming quarters that was conditional on economic outcomes broadly in line with the Committee's expectations. In addition, he would make clear that decisions about asset purchases and other policy tools would continue to be dependent on the Committee's ongoing assessment of the economic outlook. He would also draw the distinction between the asset purchase program and the forward guidance regarding the target for the federal funds rate, noting that the Committee anticipates that there will be a considerable time between the end of asset purchases and the time when it becomes appropriate to increase the target for the federal funds rate.

Committee Policy Action

Committee members viewed the information received over the intermeeting period as suggesting that economic activity had expanded at a moderate pace. Labor market conditions showed further improvement in recent months, on balance, but the unemployment rate remained elevated. Household spending and business fixed investment advanced, and the

housing sector strengthened further, but fiscal policy was restraining economic growth. The Committee expected that, with appropriate policy accommodation, economic growth would proceed at a moderate pace and result in a gradual decline in the unemployment rate toward levels consistent with its dual mandate. With economic activity and employment continuing to grow at a moderate pace despite tighter fiscal policy, and with global financial conditions less strained, members generally saw the downside risks to the outlook for the economy and the labor market as having diminished since the fall. Inflation was running below the Committee's longer-run objective, partly reflecting transitory influences, but longer-run inflation expectations were stable, and the Committee anticipated that inflation over the medium term would move closer to its 2 percent objective.

In their discussion of monetary policy for the period ahead, all members but one judged that the outlook for economic activity and inflation warranted the continuation of the Committee's current highly accommodative stance of monetary policy in order to foster a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability. In the view of one member, the improvement in the outlook for the labor market warranted a more deliberate statement from the Committee that asset purchases would be reduced in the very near future. At the conclusion of its discussion, the Committee decided to continue adding policy accommodation by purchasing additional MBS at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month and to maintain its existing reinvestment policies. In addition, the Committee reaffirmed its intention to keep the target federal funds rate at 0 to ¼ percent and retained its forward guidance that it anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

Regarding the outlook for policy, members agreed that monetary policy in coming quarters would depend on the evolution of the economic outlook and progress toward the Committee's longer-run objectives of maximum employment and inflation of 2 percent. While recognizing the improvement in a number of indicators of economic activity and labor market conditions since the fall, many members indicated that further improvement in the outlook for the labor market would be required before it would be appropriate to slow the pace of asset purchases. Some added that they would, as well, need to see more evidence that the projected acceleration in economic activity would occur, before reducing the pace of asset purchases. For one member, such a decision would also depend importantly on evidence that inflation was moving back toward the Committee's 2 percent objective; that member urged the Committee to modify its postmeeting statement to say explicitly that the Committee will act to move inflation back toward its goal. A couple of other members also worried that the downside risks to inflation had increased, with one of them suggesting that the statement more explicitly reflect this increased risk. However, several members judged that a reduction in asset purchases would likely soon be warranted, in light of the cumulative decline in unemployment since the September meeting and ongoing increases in private payrolls, which had increased their confidence in the outlook for sustained improvement in labor market conditions. Two of these members also indicated that the Committee should begin curtailing its purchases relatively soon in order to prevent the potential negative consequences of the program from exceeding its anticipated benefits. Another member pointed out that if the program were ended because of concerns about such consequences, the Committee would need to explore other options for providing appropriate monetary accommodation. Many members indicated that decisions about the pace and composition of asset purchases were distinct from decisions about the appropriate level of the federal funds rate, which would continue to be guided by the thresholds in the Committee's statement. In general, members continued to anticipate that maintaining the current exceptionally low level of the federal funds rate was likely to remain appropriate for a considerable period after asset purchases are concluded.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve

markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

"Information received since the Federal Open Market Committee met in May suggests that economic activity has been expanding at a moderate pace. Labor market conditions have shown further improvement in recent months, on balance, but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has strengthened further, but fiscal policy is restraining economic growth. Partly reflecting transitory influences, inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will proceed at a moderate pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished since the fall. The Committee also anticipates that inflation over the medium term likely will run at or below its 2 percent objective.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

The Committee will closely monitor incoming information on economic and financial developments in coming months. The Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes. In determining the size, pace, and composition of its asset purchases, the Committee will continue to take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives.

To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent

longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, Elizabeth Duke, Charles L. Evans, Jerome H. Powell, Sarah Bloom Raskin, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: James Bullard and Esther L. George.

Mr. Bullard dissented because he believed that, in light of recent low readings on inflation, the Committee should signal more strongly its willingness to defend its goal of 2 percent inflation. He pointed out that inflation had trended down since the beginning of 2012 and was now well below target. Going forward, he viewed it as particularly important for the Committee to monitor price developments closely and to adapt its policy in response to incoming economic information.

Ms. George dissented because she viewed the ongoing improvement in labor market conditions and in the outlook as warranting a deliberate statement from the Committee at this meeting that the pace of its asset purchases would be reduced in the very near future. She continued to have concerns about maintaining aggressive monetary stimulus in the face of a growing economy and pointed to the potential for financial imbalances to emerge as a result of the high level of monetary accommodation.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, July 30–31, 2013. The meeting adjourned at 11:25 a.m. on June 19, 2013.

Notation Vote

By notation vote completed on May 21, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on April 30–May 1, 2013.

William B. English
Secretary

Addendum: Summary of Economic Projections

In conjunction with the June 18–19, 2013, Federal Open Market Committee (FOMC) meeting, meeting participants—the 7 members of the Board of Governors and the 12 presidents of the Federal Reserve Banks, all of whom participate in the deliberations of the FOMC—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2015 and over the longer run.[2] Each participant's assessment was based on information available at the time of the meeting plus his or her judgment of appropriate monetary policy and assumptions about the factors likely to affect economic outcomes. The longer-run projections represent each participant's judgment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the Federal Reserve's objectives of maximum employment and stable prices.

Overall, FOMC participants projected that, under appropriate monetary policy, the pace of economic recovery would gradually pick up over the 2013–15 period, and inflation would move up from recent very low readings but remain subdued (table 1 and figure 1). Almost all of the participants projected that inflation, as measured by the annual change in the price index for personal consumption expenditures (PCE), would be running at or a little below the Committee's 2 percent objective in 2015.

As shown in figure 2, most participants judged that highly accommodative monetary policy was likely to be warranted over the next few years to support continued progress toward maximum employment and a gradual return toward 2 percent inflation. Moreover, all participants but one judged that it would be appropriate to continue purchasing both agency mortgage-backed securities (MBS) and longer-term Treasury securities at least until later this year.

A majority of participants saw the uncertainty associated with their outlook for economic growth and the unemployment rate as similar to that of the past 20 years. An equal number of participants also indicated that the risks to the outlook for real gross

[2] Although President Pianalto was unable to attend the June 18–19, 2013, FOMC meeting, she submitted economic projections.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, June 2013
Percent

Variable	Central tendency[1]				Range[2]			
	2013	2014	2015	Longer run	2013	2014	2015	Longer run
Change in real GDP	2.3 to 2.6	3.0 to 3.5	2.9 to 3.6	2.3 to 2.5	2.0 to 2.6	2.2 to 3.6	2.3 to 3.8	2.0 to 3.0
March projection	2.3 to 2.8	2.9 to 3.4	2.9 to 3.7	2.3 to 2.5	2.0 to 3.0	2.6 to 3.8	2.5 to 3.8	2.0 to 3.0
Unemployment rate	7.2 to 7.3	6.5 to 6.8	5.8 to 6.2	5.2 to 6.0	6.9 to 7.5	6.2 to 6.9	5.7 to 6.4	5.0 to 6.0
March projection	7.3 to 7.5	6.7 to 7.0	6.0 to 6.5	5.2 to 6.0	6.9 to 7.6	6.1 to 7.1	5.7 to 6.5	5.0 to 6.0
PCE inflation	0.8 to 1.2	1.4 to 2.0	1.6 to 2.0	2.0	0.8 to 1.5	1.4 to 2.0	1.6 to 2.3	2.0
March projection	1.3 to 1.7	1.5 to 2.0	1.7 to 2.0	2.0	1.3 to 2.0	1.4 to 2.1	1.6 to 2.6	2.0
Core PCE inflation[3]	1.2 to 1.3	1.5 to 1.8	1.7 to 2.0		1.1 to 1.5	1.5 to 2.0	1.7 to 2.3	
March projection	1.5 to 1.6	1.7 to 2.0	1.8 to 2.1		1.5 to 2.0	1.5 to 2.1	1.7 to 2.6	

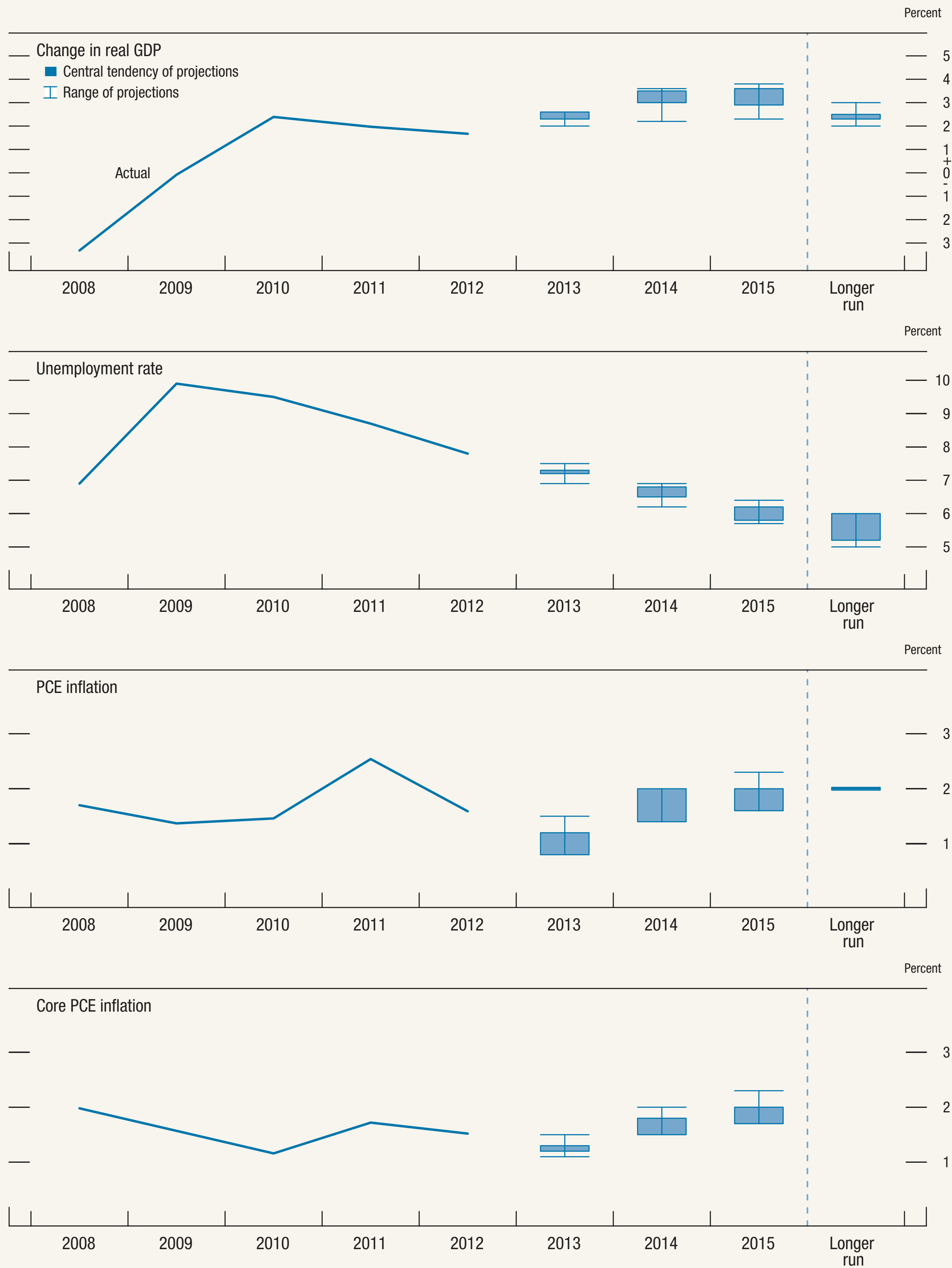
Note: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The March projections were made in conjunction with the meeting of the Federal Open Market Committee on March 19–20, 2013.

[1] The central tendency excludes the three highest and three lowest projections for each variable in each year.

[2] The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

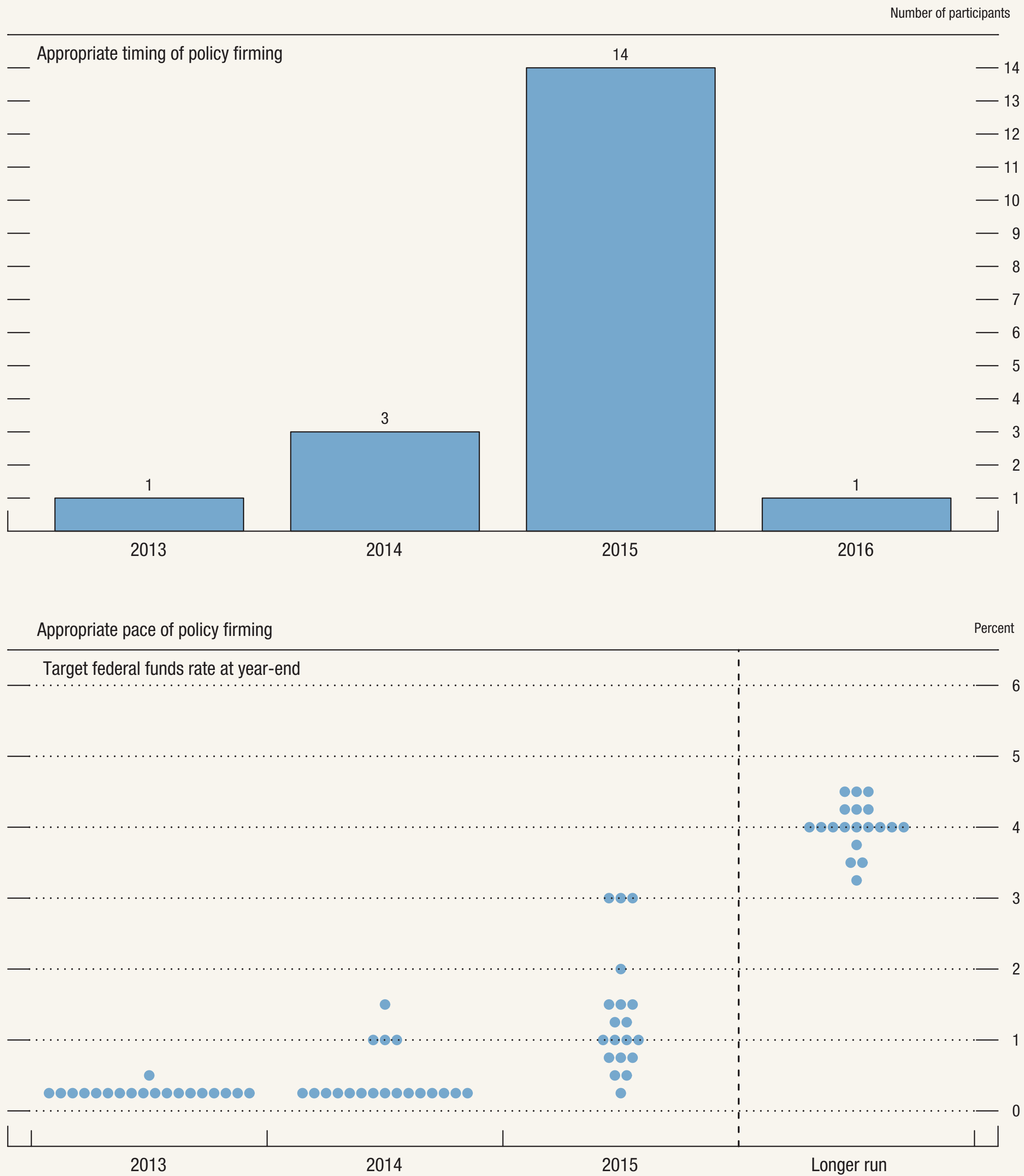
[3] Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2013–15 and over the longer run



Note: Definitions of variables are in the general note to table 1. The data for the actual values of the variables are annual.

Figure 2. Overview of FOMC participants' assessments of appropriate monetary policy



Note: In the upper panel, the height of each bar denotes the number of FOMC participants who judge that, under appropriate monetary policy, the first increase in the target federal funds rate from its current range of 0 to ¼ percent will occur in the specified calendar year. In March 2013, the numbers of FOMC participants who judged that the first increase in the target federal funds rate would occur in 2013, 2014, 2015, and 2016 were, respectively, 1, 4, 13, and 1. In the lower panel, each shaded circle indicates the value (rounded to the nearest ¼ percentage point) of an individual participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run.

domestic product (GDP) growth and the unemployment rate were broadly balanced. Some participants, however, continued to see downside risks to growth and upside risks to unemployment. A majority of participants indicated that the uncertainty surrounding their projections for PCE inflation was similar to historical norms, and nearly all considered the risks to inflation to be either broadly balanced or weighted to the downside.

The Outlook for Economic Activity

Participants projected that, conditional on their individual assumptions about appropriate monetary policy, the economy would grow at a faster pace in 2013 than it had in 2012. They also generally judged that growth would strengthen further in 2014 and 2015, in most cases to a rate above their estimates of the longer-run rate of output growth. Most participants noted that the high degree of monetary policy accommodation assumed in their projections, continued improvement in the housing sector and the accompanying rise in household net worth, and the absence of further fiscal tightening should result in a pickup in growth; however, they pointed to the foreign economic outlook as an ongoing downside risk.

The central tendency of participants' projections for real GDP growth was 2.3 to 2.6 percent for 2013, 3.0 to 3.5 percent for 2014, and 2.9 to 3.6 percent for 2015. Most participants noted that their projections were little changed since March, with the downward revisions to growth in 2013 reflecting the somewhat slower-than-anticipated growth in the first half. The central tendency for the longer-run rate of growth of real GDP was 2.3 to 2.5 percent, unchanged from March.

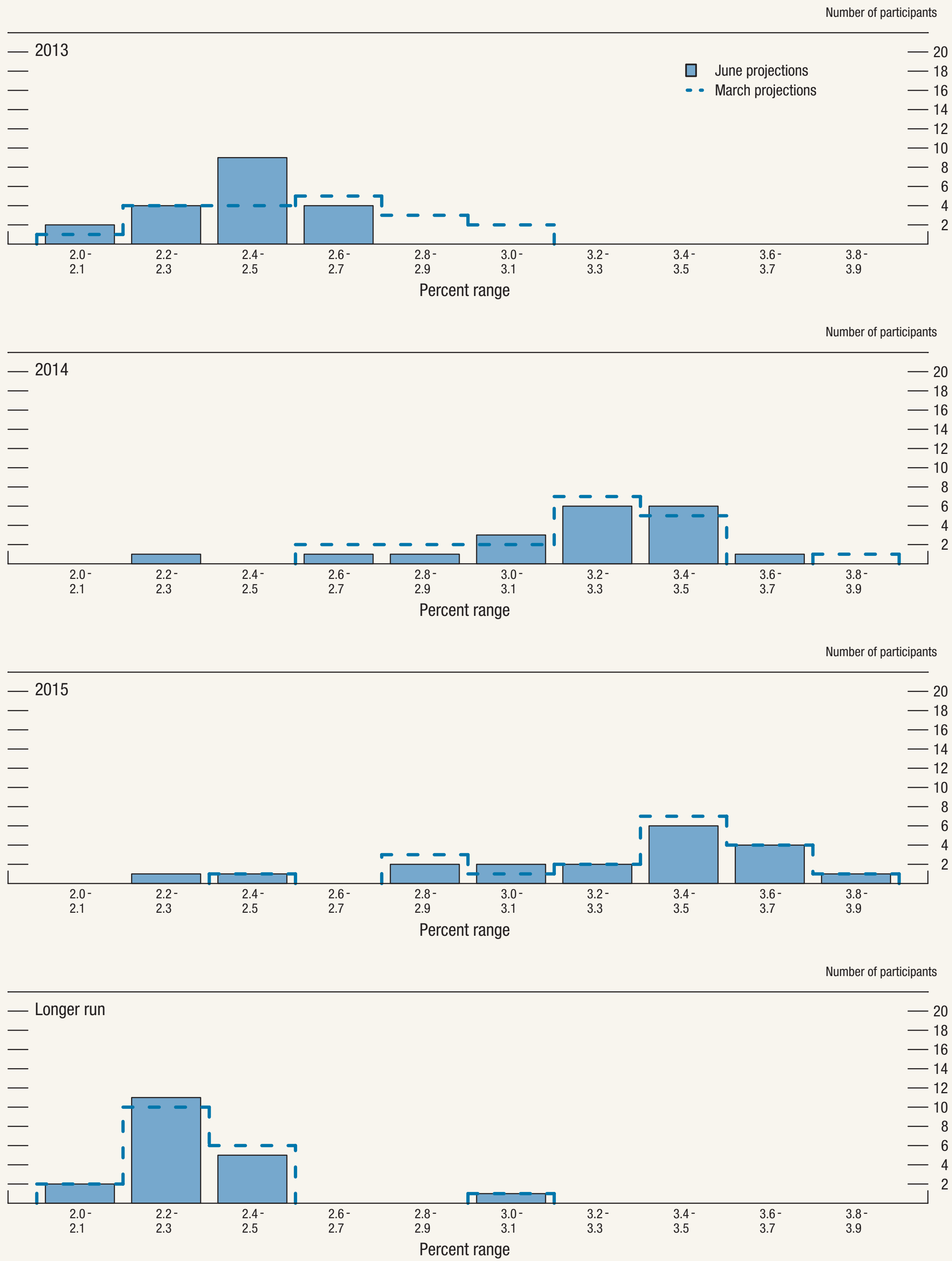
Participants anticipated a gradual decline in the unemployment rate over the forecast period; a large majority projected that the unemployment rate would not reach their estimates of its longer-run level before 2016. The central tendencies of participants' forecasts for the unemployment rate were 7.2 to 7.3 percent at the end of 2013, 6.5 to 6.8 percent at the end of 2014, and 5.8 to 6.2 percent at the end of 2015. These projections were slightly lower than in March, with participants reacting to recent data indicating that the unemployment rate had declined by a little more than they had previously expected. The central tendency of participants' estimates of the longer-run normal rate of unemployment that would prevail under appropriate monetary policy and in the absence of further shocks to the economy was 5.2 to 6.0 percent, the same as in March. Most participants projected that the unemployment rate would converge to their estimates of its longer-run normal rate in five or six years, while some judged that less time would be needed.

As shown in figures 3.A and 3.B, the distributions of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate were relatively narrow for 2013. Their projections for economic activity were more diverse for 2014 and 2015, reflecting their individual assessments of appropriate monetary policy and its economic effects, the likely rate of improvement in the housing sector and households' balance sheets, the domestic implications of foreign economic developments, the prospective path for U.S. fiscal policy, the extent of structural dislocations to the labor market, and a number of other factors. The dispersion of participants' projections for 2015 and for the longer run was little changed relative to March; there was some reduction in the upper ends of the distributions in 2013 and 2014 for both real GDP growth and the unemployment rate.

The Outlook for Inflation

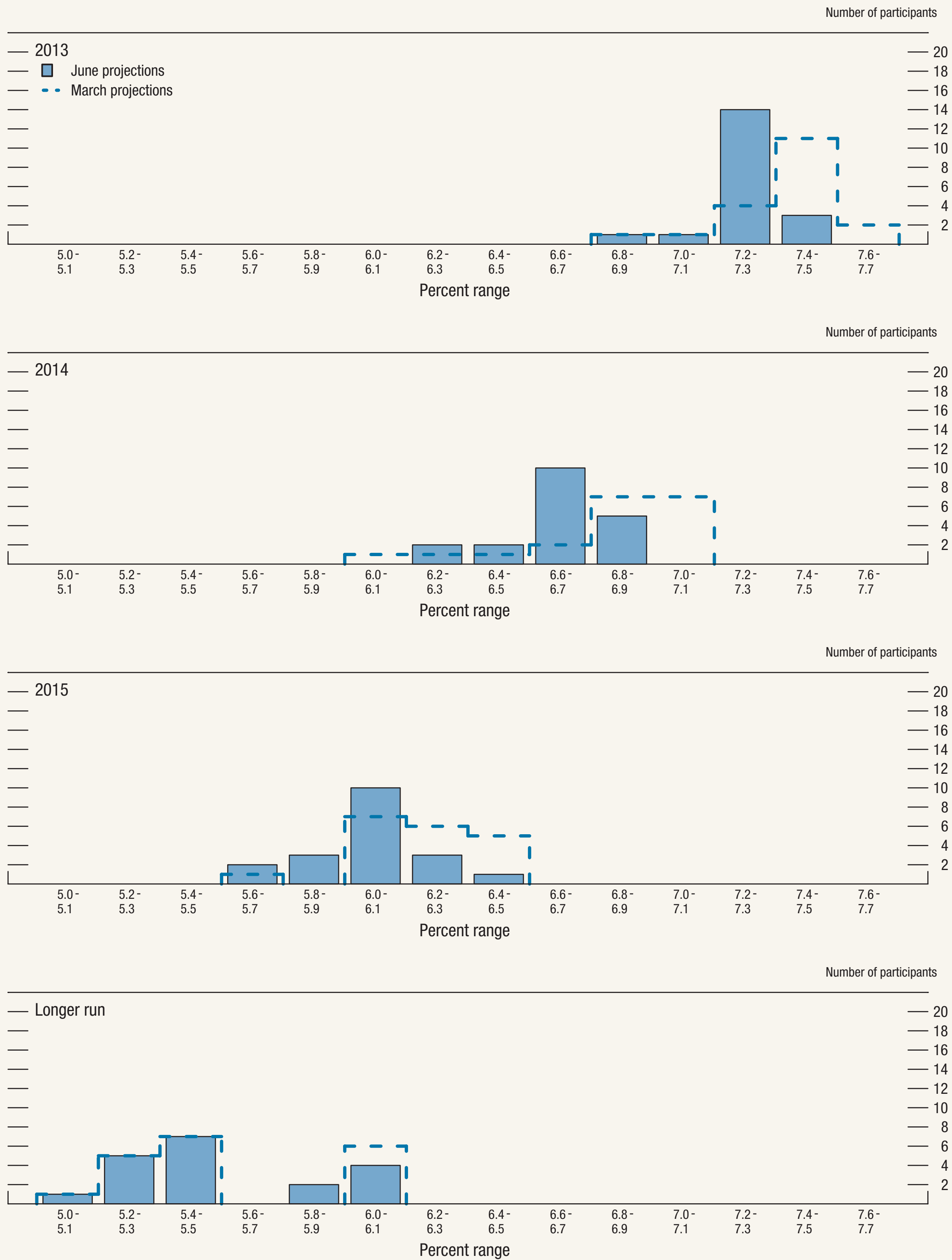
All participants marked down their projections for both PCE and core PCE inflation in 2013, reflecting the low readings on inflation so far this year. Participants generally judged that the recent slowing in inflation partly reflected transitory factors, and their projections for inflation under appropriate monetary policy over the period 2014–15 were only a little lower than in March. Participants projected that both headline and core inflation would move up but remain subdued, with nearly all projecting that inflation would be equal to, or somewhat below, the FOMC's longer-run objective of 2 percent in each year. Specifically, the central tendency of participants' projections for overall inflation, as measured by the growth in the PCE price index, moved down to 0.8 to 1.2 percent in 2013 and was 1.4 to 2.0 percent in 2014 and 1.6 to 2.0 percent in 2015. The central tendency of the forecasts for core inflation shifted down slightly in 2013 and 2014, to 1.2 to 1.3 percent and 1.5 to 1.8 percent, respectively; the central tendency in 2015 was little changed and broadly similar to that of headline inflation. In discussing factors likely to return inflation to near the Committee's inflation objective of 2 percent, several participants noted that the reversal of transitory factors currently holding down inflation would cause inflation to move up a little in the near term. In addition, many participants viewed the combination of

Figure 3.A. Distribution of participants' projections for the change in real GDP, 2013–15 and over the longer run



Note: Definitions of variables are in the general note to table 1.

Figure 3.B. Distribution of participants' projections for the unemployment rate, 2013–15 and over the longer run



Note: Definitions of variables are in the general note to table 1.

stable inflation expectations and diminishing resource slack as likely to lead to a gradual pickup in inflation toward the Committee's longer-run objective.

Figures 3.C and 3.D provide information on the diversity of participants' views about the outlook for inflation. The range of participants' projections for overall and core inflation in 2013 shifted down, while those ranges narrowed in 2014–15. The distributions for core and overall inflation in 2015 remained concentrated near the Committee's longer-run objective, and all participants continued to project that overall inflation would converge to the FOMC's 2 percent goal over the longer run.

Appropriate Monetary Policy

As indicated in figure 2, most participants judged that exceptionally low levels of the federal funds rate would remain appropriate for a couple of years. In particular, 14 participants thought that the first increase in the target federal funds rate would not be warranted until sometime in 2015, and one judged that policy firming would likely not be appropriate until 2016. Four participants judged that an increase in the federal funds rate in 2013 or 2014 would be appropriate.

All of the participants who judged that raising the federal funds rate target would become appropriate in 2015 also projected that the unemployment rate would decline below 6½ percent during that year and that inflation would remain near or below 2 percent. In addition, most of those participants also projected that a sizable gap between the unemployment rate and the longer-run normal level of the unemployment rate would persist until 2015 or later. Three of the four participants who judged that policy firming should begin in 2013 or 2014 indicated that, in their judgment, the Committee would need to act relatively soon in order to keep inflation near the FOMC's longer-run objective of 2 percent and to keep longer-run inflation expectations well anchored.

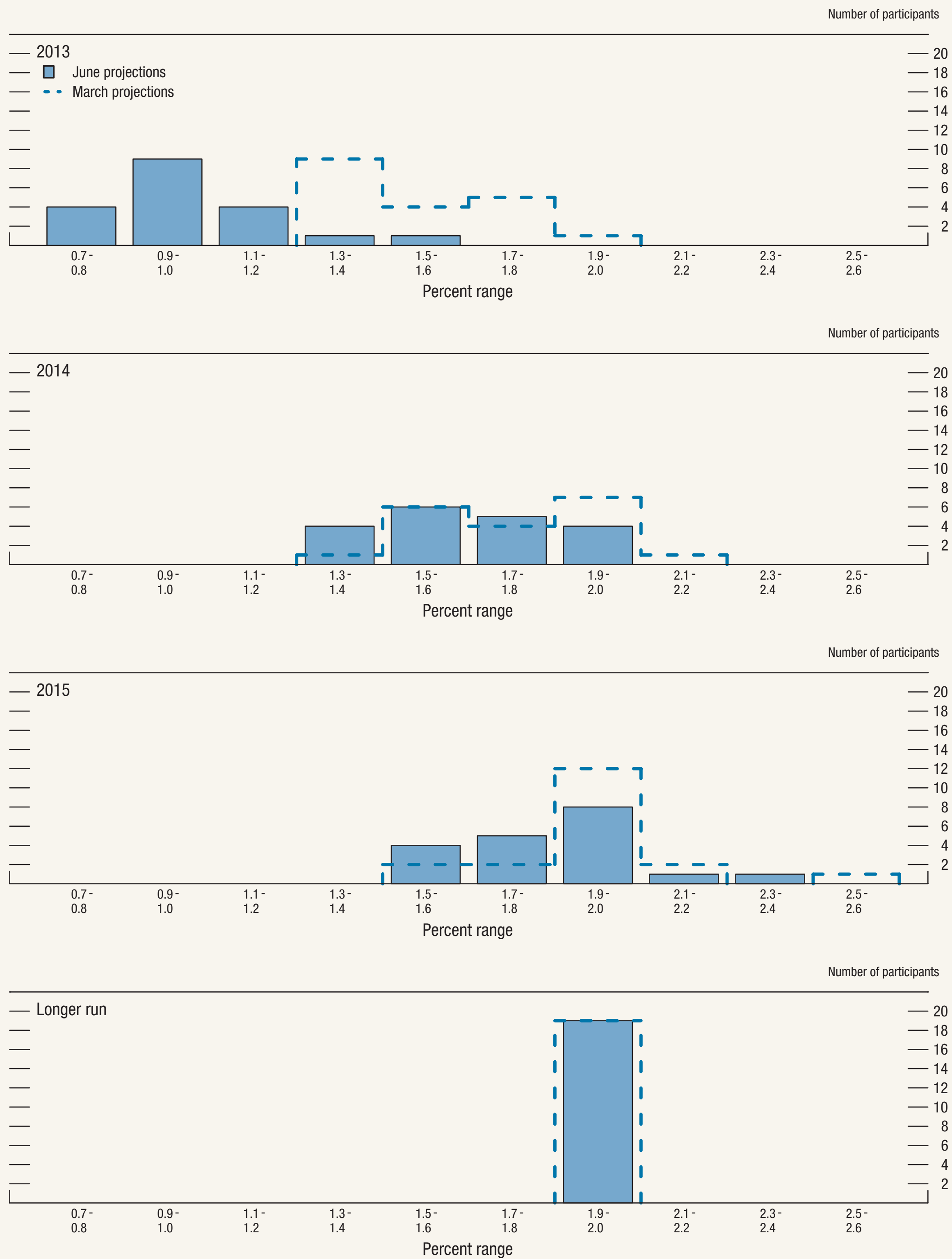
Figure 3.E provides the distribution of participants' judgments regarding the appropriate level of the target federal funds rate at the end of each calendar year from 2013 to 2015 and over the longer run. As previously noted, most participants judged that economic conditions would warrant maintaining the current low level of the federal funds rate at least until 2015. Among the four participants who saw the federal funds rate leaving the effective lower bound earlier, their projections for the federal funds rate at the end of 2014 ranged from 1 to 1½ percent; however, the median for all participants remained at the effective lower bound. Views on the appropriate level of the federal funds rate at the end of 2015 varied, with the range of participants' projections a bit narrower than in the March Summary of Economic Projections and the median value unchanged at 1 percent.

All participants saw the appropriate target for the federal funds rate at the end of 2015 as still well below their assessments of its expected longer-run value. Estimates of the longer-run target federal funds rate ranged from 3¼ to 4½ percent, reflecting the Committee's inflation objective of 2 percent and participants' individual judgments about the appropriate longer-run level of the real federal funds rate in the absence of further shocks to the economy.

Participants also described their views regarding the appropriate path of the Federal Reserve's balance sheet. Given their respective economic outlooks, all participants but one judged that it would be appropriate to continue purchasing both agency MBS and longer-term Treasury securities. About half of these participants indicated that it likely would be appropriate to end asset purchases late this year. Many other participants anticipated that it likely would be appropriate to continue purchases into 2014. Several participants emphasized that the asset purchase program was effective in supporting the economic expansion, that the benefits continued to exceed the costs, or that continuing purchases would be necessary to achieve a substantial improvement in the outlook for the labor market. A few participants, however, indicated that the Committee could best foster its dual objectives and limit the potential costs of the program by slowing, or stopping, its purchases at the June meeting.

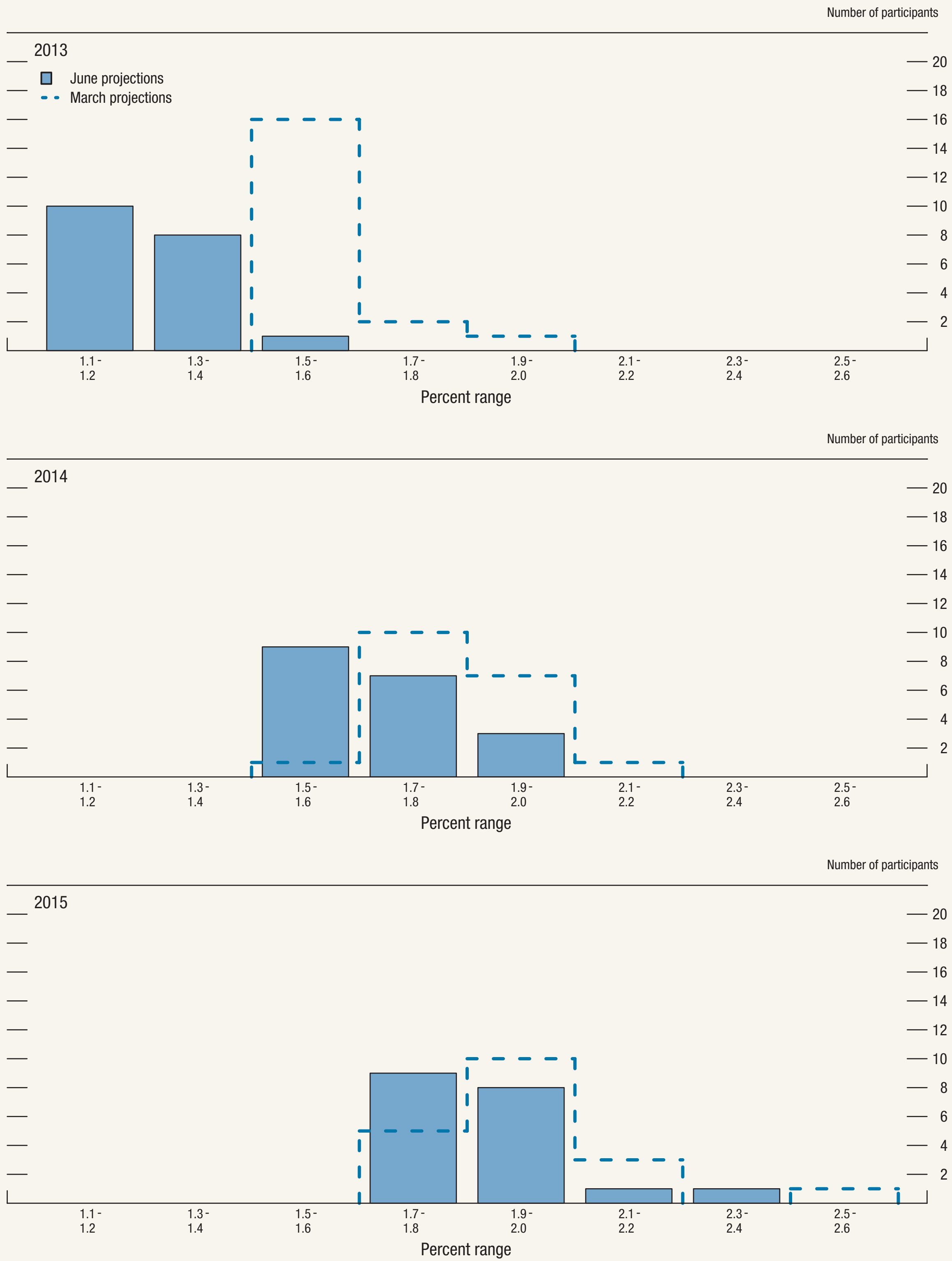
Key factors informing participants' views of the appropriate path for monetary policy included their judgments regarding the values of the unemployment rate and other labor market indicators that would be consistent with maximum employment; the extent to which the economy fell short of maximum employment and the extent to which inflation was running below the Committee's longer-term objective of 2 percent; and the implications of alternative policy paths for the likely extent of progress, over the medium-term, in returning employment and inflation to mandate-consistent levels. A couple of participants noted that persistent headwinds and somewhat slower productivity growth since the end of the reces-

Figure 3.C. Distribution of participants' projections for PCE inflation, 2013–15 and over the longer run



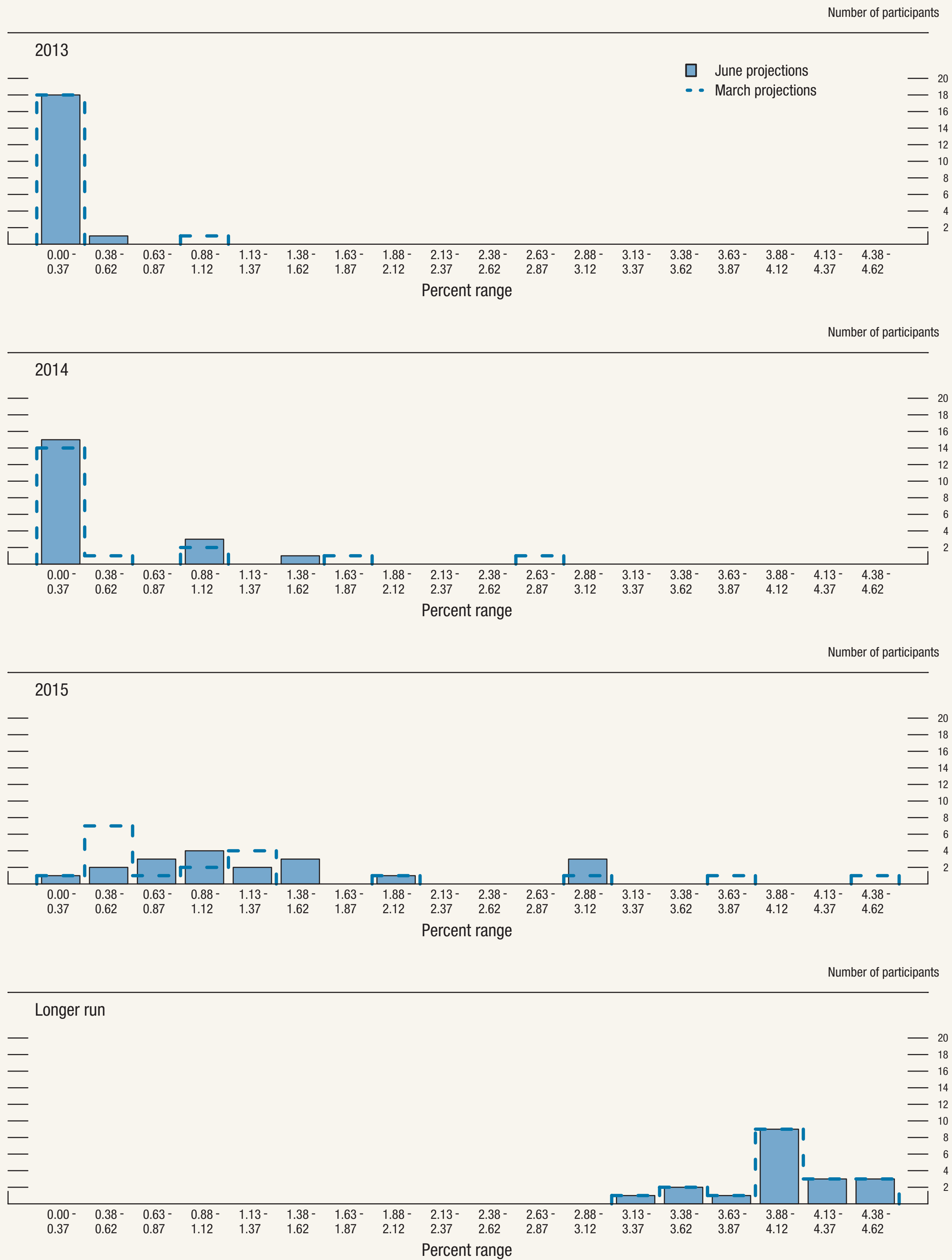
Note: Definitions of variables are in the general note to table 1.

Figure 3.D. Distribution of participants' projections for core PCE inflation, 2013–15



Note: Definitions of variables are in the general note to table 1.

Figure 3.E. Distribution of participants' projections for the target federal funds rate, 2013–15 and over the longer run



Note: The target federal funds rate is measured as the level of the target rate at the end of the calendar year or in the longer run.

sion made their assessments of the longer-run normal level of the federal funds rate, and thus of the appropriate path for the federal funds rate, lower than would otherwise be the case.

Uncertainty and Risks

A majority of participants reported that they saw the levels of uncertainty about their projections for real GDP growth and unemployment as broadly similar to the norm during the previous 20 years, with the remainder generally indicating that they saw higher uncertainty about these economic outcomes (figure 4).[3] In March, a similar number of participants had seen the level of uncertainty about real GDP growth and the unemployment rate as above average. A majority of participants continued to judge that the risks to their forecasts of real GDP growth and unemployment were broadly balanced, with the remainder generally indicating that they saw the risks to their forecasts for real GDP growth as weighted to the downside and for unemployment as weighted to the upside. The main factors cited as contributing to the uncertainty and balance of risks about economic outcomes were the limits on the ability of monetary policy to offset the effects of adverse shocks when short-term interest rates are near their effective lower bound, as well as challenges with forecasting the path of fiscal policy and economic and financial developments abroad.

Participants reported little change in their assessments of the level of uncertainty and the balance of risks around their forecasts for overall PCE inflation and core inflation. Fourteen participants judged the levels of uncertainty associated with their forecasts for those inflation measures to be broadly similar to, or lower than, historical norms; the same number saw the risks to those projections as broadly balanced. A few participants highlighted the likely role played by the Committee's adoption of a 2 percent inflation goal or its commitment to maintaining accommodative monetary policy as contributing to the recent stability of longer-term inflation expectations and, hence, the relatively low level of uncertainty. Four participants saw the risks to their inflation forecasts as tilted to the downside, reflecting, for example, risks of disinflation that could arise from adverse shocks to the economy that policy would have limited scope to offset in the current environment. Conversely, one participant saw the risks to inflation as weighted to the upside, citing the present highly accommodative stance of monetary policy and concerns about the Committee's ability to shift to a less accommodative policy stance when it becomes appropriate to do so.

Table 2. Average historical projection error ranges
Percentage points

Variable	2013	2014	2015
Change in real GDP[1]	±1.0	±1.6	±1.8
Unemployment rate[1]	±0.4	±1.2	±1.8
Total consumer prices[2]	±0.8	±1.0	±1.0

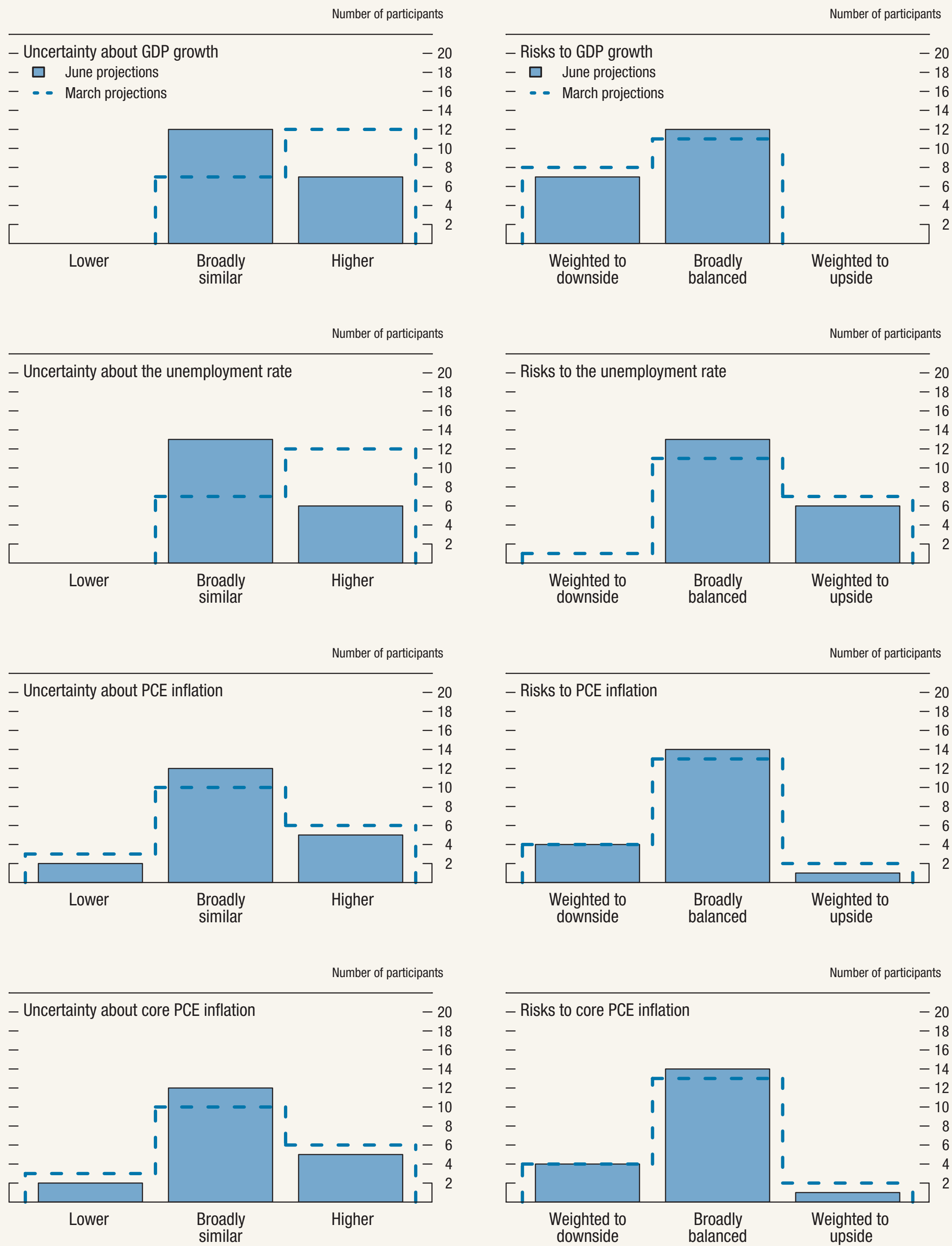
Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1993 through 2012 that were released in the summer by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 Definitions of variables are in the general note to table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

3 Table 2 provides estimates of the forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1993 through 2012. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in the economic forecasts and explains the approach used to assess the uncertainty and risks attending the participants' projections.

Figure 4. Uncertainty and risks in economic projections



Note: For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty." Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world, and the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by the Federal Reserve Board's staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.0 to 4.0 percent in the current year, 1.4 to 4.6 percent in the second year, and 1.2 to 4.8 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.2 to 2.8 percent in the current year and 1.0 to 3.0 percent in the second and third years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past, as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

As with real activity and inflation, the outlook for the future path of the federal funds rate is subject to considerable uncertainty. This uncertainty arises primarily because each participant's assessment of the appropriate stance of monetary policy depends importantly on the evolution of real activity and inflation over time. If economic conditions evolve in an unexpected manner, then assessments of the appropriate setting of the federal funds rate would change from that point forward.

Meeting Held on July 30–31, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, July 30, 2013, at 2:00 p.m. and continued on Wednesday, July 31, 2013, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Elizabeth Duke

Charles L. Evans

Esther L. George

Jerome H. Powell

Sarah Bloom Raskin

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, Stephen A. Meyer, Daniel G. Sullivan, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Maryann F. Hunter
Deputy Director, Division of Banking Supervision and Regulation, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Joyce K. Zickler
Senior Adviser, Division of Monetary Affairs, Board of Governors

Michael T. Kiley, Thomas Laubach, and David E. Lebow
Associate Directors, Division of Research and Statistics, Board of Governors

Joshua Gallin
Deputy Associate Director, Division of Research and Statistics, Board of Governors

Edward Nelson
Assistant Director, Division of Monetary Affairs, Board of Governors

Stacey Tevlin
Assistant Director, Division of Research and Statistics, Board of Governors

Laura Lipscomb
Section Chief, Division of Monetary Affairs, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Marie Gooding
First Vice President, Federal Reserve Bank of Atlanta

David Altig, Jeff Fuhrer, and Loretta J. Mester
Executive Vice Presidents, Federal Reserve Banks of Atlanta, Boston, and Philadelphia, respectively

Lorie K. Logan
Senior Vice President, Federal Reserve Bank of New York

Todd E. Clark, William Gavin, Evan F. Koenig, Paolo A. Pesenti, Julie Ann Remache,[1] and Mark Spiegel
Vice Presidents, Federal Reserve Banks of Cleveland, St. Louis, Dallas, New York, New York, and San Francisco, respectively

Robert L. Hetzel and Samuel Schulhofer-Wohl
Senior Economists, Federal Reserve Banks of Richmond and Minneapolis, respectively

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets as well as the System open market operations during the period since the Federal Open Market Committee (FOMC) met on June 18–19, 2013. By unanimous vote, the Committee ratified the Open Market Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

In support of the Committee's longer-run planning for improvements in the implementation of monetary policy, the Desk report also included a briefing on the potential for establishing a fixed-rate, full-allotment overnight reverse repurchase agreement facility as an additional tool for managing money market interest rates. The presentation suggested that such a facility would allow the Committee to offer an overnight, risk-free instrument directly to a relatively wide range of market participants, perhaps complementing the payment of interest on excess reserves held by banks and thereby improving the Committee's ability to keep short-term market rates at levels that it deems appropriate to achieve its macroeconomic objectives. The staff also identified several key issues that would require consideration in the design of such a facility, including the choice of the appropriate facility interest rate and possible additions to the range of eligible counterparties. In general, meeting participants indicated that they thought such a facility could prove helpful; they asked the staff to undertake further work to examine how it might operate and how it might affect short-term funding markets. A number of them emphasized that their interest in having the staff conduct additional research reflected an ongoing effort to improve the technical execution of policy and did not signal any change in the Committee's views about policy going forward.

[1] Attended Tuesday's session only.

Staff Review of the Economic Situation

The information reviewed for the July 30–31 meeting indicated that economic activity expanded at a modest pace in the first half of the year. Private-sector employment increased further in June, but the unemployment rate was still elevated. Consumer price inflation slowed markedly in the second quarter, likely restrained in part by some transitory factors, but measures of longer-term inflation expectations remained stable. The Bureau of Economic Analysis (BEA) released its advance estimate for second-quarter real gross domestic product (GDP), along with revised data for earlier periods, during the second day of the FOMC meeting. The staff's assessment of economic activity and inflation in the first half of 2013, based on information available before the meeting began, was broadly consistent with the new information from the BEA.

Private nonfarm employment rose at a solid pace in June, as in recent months, while total government employment decreased further. The unemployment rate was 7.6 percent in June, little changed from its level in the prior few months. The labor force participation rate rose slightly, as did the employment-to-population ratio. The rate of long-duration unemployment decreased somewhat, but the share of workers employed part time for economic reasons moved up; both of these measures remained relatively high. Forward-looking indicators of labor market activity in the near term were mixed: Although household expectations for the labor market situation generally improved and firms' hiring plans moved up, initial claims for unemployment insurance were essentially flat over the intermeeting period, and measures of job openings and the rate of gross private-sector hiring were little changed.

Manufacturing production expanded in June, and the rate of manufacturing capacity utilization edged up. Auto production and sales were near pre-recession levels, and automakers' schedules indicated that the rate of motor vehicle assemblies would continue at a similar pace in the coming months. Broader indicators of manufacturing production, such as the readings on new orders from the national and regional manufacturing surveys, were generally consistent with further modest gains in factory output in the near term.

Real personal consumption expenditures (PCE) increased more slowly in the second quarter than in the first. However, some key factors that tend to support household spending were more positive in recent months; in particular, gains in equity values and home prices boosted household net worth, and consumer sentiment in the Thomson Reuters/University of Michigan Surveys of Consumers rose in July to its highest level since the onset of the recession.

Conditions in the housing sector generally improved further, as real expenditures for residential investment continued to expand briskly in the second quarter. However, construction activity was still at a low level, with demand restrained in part by tight credit standards for mortgage loans. Starts of new single-family homes were essentially flat in June, but the level of permit issuance was consistent with gains in construction in subsequent months. In the multifamily sector, where activity is more variable, starts and permits both decreased. Home prices continued to rise strongly through May, and sales of both new and existing homes increased, on balance, in May and June. The recent rise in mortgage rates did not yet appear to have had an adverse effect on housing activity.

Growth in real private investment in equipment and intellectual property products was greater in the second quarter than in the first quarter.[2] Nominal new orders for nondefense capital goods excluding aircraft continued to trend up in May and June and were running above the level of shipments. Other recent forward-looking indicators, such as surveys of business conditions and capital spending plans, were mixed and pointed to modest gains in business equipment spending in the near term. Real business expenditures for nonresidential construction increased in the second quarter after falling in the first quarter. Business inventories in most industries appeared to be broadly aligned with sales in recent months.

Real federal government purchases contracted less in the second quarter than in the first quarter as reductions in defense spending slowed. Real state and local government purchases were little changed in the second quarter; the payrolls of these governments expanded somewhat, but state and local construction expenditures continued to decrease.

The U.S. international trade deficit widened in May as exports fell slightly and imports rose. The decline in exports was led by a sizable drop in consumer goods, while most other categories of exports showed modest gains. Imports increased in a wide range of categories, with particular strength in oil, consumer goods, and automotive products.

Overall U.S. consumer prices, as measured by the PCE price index, were unchanged from the first quarter to the second and were about 1 percent higher than a year earlier. Consumer energy prices declined significantly in the second quarter, although retail gasoline prices, measured on a seasonally adjusted basis, moved up in June and July. The PCE price index for items excluding food and energy rose at a subdued rate in the second quarter and was around 1¼ percent higher than a year earlier. Near-term inflation expectations from the Michigan survey were little changed in June and July, as were longer-term inflation expectations, which remained within the narrow range seen in recent years. Measures of labor compensation indicated that gains in nominal wages and employee benefits remained modest.

Foreign economic growth appeared to remain subdued in comparison with longer-run trends. Nonetheless, there were some signs of improvement in the advanced foreign economies. Production and business confidence turned up in Japan, real GDP growth picked up to a moderate pace in the second quarter in the United Kingdom, and recent indicators suggested that the euro-area recession might be nearing an end. In contrast, Chinese real GDP growth moderated in the first half of this year compared with 2012, and indicators for other emerging market economies (EMEs) also pointed to less-robust growth. Foreign inflation generally remained well contained. Monetary policy stayed highly accommodative in the advanced foreign economies, but some

[2] With the most recent revision to the national accounts, the BEA introduced intellectual property products as a new category of investment that included software; research and development; and entertainment, literary, and artistic originals.

EME central banks tightened policy in reaction to capital outflows and to concerns about inflationary pressures from currency depreciation.

Staff Review of the Financial Situation

Financial markets were volatile at times during the intermeeting period as investors reacted to Federal Reserve communications and to incoming economic data and as market dynamics appeared to amplify some asset price moves. Broad equity price indexes ended the period higher, and longer-term interest rates rose significantly. Sizable increases in rates occurred following the June FOMC meeting, as investors reportedly saw Committee communications as suggesting a less accommodative stance of monetary policy than had been expected going forward; however, a portion of the increases was reversed as subsequent policy communications lowered these concerns. U.S. economic data, particularly the June employment report, also contributed to the rise in yields over the period.

On balance, yields on intermediate- and longer-term Treasury securities rose about 30 to 45 basis points since the June FOMC meeting, with staff models attributing most of the increase to a rise in term premiums and the remainder to an upward revision in the expected path of short-term rates. The federal funds rate path implied by financial market quotes steepened slightly, on net, but the results from the Desk's July survey of primary dealers showed little change in dealers' views of the most likely timing of the first increase in the federal funds rate target. Market-based measures of inflation compensation were about unchanged.

Over the period, rates on primary mortgages and yields on agency mortgage-backed securities (MBS) rose about in line with the 10-year Treasury yield. The option-adjusted spread for production-coupon MBS widened somewhat, possibly reflecting a downward revision in investors' expectations for Federal Reserve MBS purchases, an increase in uncertainty about longer-term interest rates, and convexity-related MBS selling.

Spreads between yields on 10-year nonfinancial corporate bonds and yields on Treasury securities narrowed somewhat on net. Early in the period, yields on corporate bonds increased, and bond mutual funds and bond exchange-traded funds experienced large net redemptions in June; the rate of redemptions then slowed in July.

Market sentiment toward large domestic banking organizations appeared to improve somewhat over the intermeeting period, as the largest banks reported second-quarter earnings that were above analysts' expectations. Stock prices of large domestic banks outperformed broader equity indexes, and credit default swap spreads for the largest bank holding companies moved about in line with trends in broad credit indexes.

Municipal bond yields rose sharply over the intermeeting period, increasing somewhat more than yields on Treasury securities. In June, gross issuance of long-term municipal bonds remained solid and was split roughly evenly between refunding and new-capital issuance. The City of Detroit's bankruptcy filing reportedly had only a limited effect on the market for municipal securities as it had been widely anticipated by market participants.

Credit flows to nonfinancial businesses showed mixed changes. Reflecting the reduced incentive to refinance as longer-term interest rates rose, the pace of gross issuance of investment- and speculative-grade corporate bonds dropped in June and July, compared with the elevated pace earlier this year. In contrast, gross issuance of equity by nonfinancial firms maintained its recent strength in June. Leveraged loan issuance also continued to be strong amid demand for floating-rate instruments by investors. Financing conditions for commercial real estate continued to recover slowly. In response to the July Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS), banks generally indicated that they had eased standards on both commercial and industrial (C&I) and commercial real estate loans over the past three months. For C&I loans, standards were currently reported to be somewhat easy compared with longer-term norms, while for commercial real estate loans, standards remained somewhat tighter than longer-term norms. Banks reported somewhat stronger demand for most types of loans.

Financing conditions in the household sector improved further in recent months. Mortgage purchase applications declined modestly through July even as refinancing applications fell off sharply with the rise in mortgage rates. The outstanding amounts of student and auto loans continued to expand at a robust pace in May. Credit card debt remained about flat on a year-over-year basis. In the July SLOOS, banks reported that they had eased standards on most categories of loans to households in the second quarter, but that standards on all types of mortgages,

and especially on subprime mortgage loans and home equity lines of credit, remained tight when judged against longer-run norms.

Increases in total bank credit slowed in the second quarter, as the book value of securities holdings fell slightly and C&I loan balances at large banks increased only modestly in April and May. M2 grew at an annual rate of about 7 percent in June and July, supported by flows into liquid deposits and retail money market funds. Both of these components of M2 may have been boosted recently by the sizable redemptions from bond mutual funds. The monetary base continued to expand rapidly in June and July, driven mainly by the increase in reserve balances resulting from the Federal Reserve's asset purchases.

Ten-year sovereign yields in the United Kingdom and Germany rose with U.S. yields early in the intermeeting period but fell back somewhat after statements by the European Central Bank and the Bank of England were both interpreted by market participants as signaling that their policy rates would be kept low for a considerable time. On net, the U.K. 10-year sovereign yield increased, though by less than the comparable yield in the United States, while the yield on German bunds was little changed. Peripheral euro-area sovereign spreads over German bunds were also little changed on net. Japanese government bond yields were relatively stable over the period, after experiencing substantial volatility in May. The staff's broad nominal dollar index moved up as the dollar appreciated against the currencies of the advanced foreign economies, consistent with the larger increase in U.S. interest rates. The dollar was mixed against the EME currencies. Foreign equity prices generally increased, although equity prices in China declined amid investor concerns regarding further signs that the economy was slowing and over volatility in Chinese interbank funding markets. Outflows from EME equity and bond funds, which had been particularly rapid in June, moderated in July.

Staff Economic Outlook

The data received since the forecast was prepared for the previous FOMC meeting suggested that real GDP growth was weaker, on net, in the first half of the year than had been anticipated.[3] Nevertheless, the staff still expected that real GDP would accelerate in the second half of the year. Part of this projected increase in the rate of real GDP growth reflected the staff's expectation that the drag on economic growth from fiscal policy would be smaller in the second half as the pace of reductions in federal government purchases slowed and as the restraint on growth in consumer spending stemming from the higher taxes put in place at the beginning of the year diminished. For the year as a whole, the staff anticipated that the rate of growth of real GDP would only slightly exceed that of potential output. The staff's projection for real GDP growth over the medium term was essentially unrevised, as higher equity prices were seen as offsetting the restrictive effects of the increase in longer-term interest rates. The staff continued to forecast that the rate of real GDP growth would strengthen in 2014 and 2015, supported by a further easing in the effects of fiscal policy restraint on economic growth, increases in consumer and business confidence, additional improvements in credit availability, and accommodative monetary policy. The expansion in economic activity was anticipated to lead to a slow reduction in the slack in labor and product markets over the projection period, and the unemployment rate was expected to decline gradually.

The staff's forecast for inflation was little changed from the projection prepared for the previous FOMC meeting. The staff continued to judge that much of the recent softness in consumer price inflation would be transitory and that inflation would pick up somewhat in the second half of this year. With longer-run inflation expectations assumed to remain stable, changes in commodity and import prices expected to be modest, and significant resource slack persisting over the forecast period, inflation was forecast to be subdued through 2015.

The staff continued to see numerous risks around the forecast. Among the downside risks for economic activity were the uncertain effects and future course of fiscal policy, the possibility of adverse developments in foreign economies, and concerns about the ability of the U.S. economy to weather potential future adverse shocks. The most salient risk for the inflation outlook was that the recent softness in inflation would not abate as anticipated.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation, meeting participants noted that incoming information on economic activity was mixed. Household spending

[3] The staff's forecast for the July FOMC meeting was prepared before the BEA released its estimate for real GDP in the second quarter and the revisions for earlier periods.

and business fixed investment continued to advance, and the housing sector was strengthening. Private domestic final demand continued to increase in the face of tighter federal fiscal policy this year, but several participants pointed to evidence suggesting that fiscal policy had restrained spending in the first half of the year more than they previously thought. Perhaps partly for that reason, a number of participants indicated that growth in economic activity during the first half of this year was somewhat below their earlier expectations. In addition, subpar economic activity abroad was a negative factor for export growth. Conditions in the labor market improved further as private payrolls rose at a solid pace in June, but the unemployment rate remained elevated. Inflation continued to run below the Committee's longer-run objective.

Participants generally continued to anticipate that the growth of real GDP would pick up somewhat in the second half of 2013 and strengthen further thereafter. Factors cited as likely to support a pickup in economic activity included highly accommodative monetary policy, improving credit availability, receding effects of fiscal restraint, continued strength in housing and auto sales, and improvements in household and business balance sheets. A number of participants indicated, however, that they were somewhat less confident about a near-term pickup in economic growth than they had been in June; factors cited in this regard included recent increases in mortgage rates, higher oil prices, slow growth in key U.S. export markets, and the possibility that fiscal restraint might not lessen.

Consumer spending continued to advance, but spending on items other than motor vehicles was relatively soft. Recent high readings on consumer confidence and boosts to household wealth from increased equity and real estate prices suggested that consumer spending would gather momentum in the second half of the year. However, a few participants expressed concern that higher household wealth might not translate into greater consumer spending, cautioning that household income growth remained slow, that households might not treat the additions to wealth arising from recent equity price increases as lasting, or that households' scope to extract housing equity for the purpose of increasing their expenditures was less than in the past.

The housing sector continued to pick up, as indicated by increases in house prices, low inventories of homes for sale, and strong demand for construction. While recent mortgage rate increases might serve to restrain housing activity, several participants expressed confidence that the housing recovery would be resilient in the face of the higher rates, variously citing pent-up housing demand, banks' increasing willingness to make mortgage loans, strong consumer confidence, still-low real interest rates, and expectations of continuing rises in house prices. Nonetheless, refinancing activity was down sharply, and the incoming data would need to be watched carefully for signs of a greater-than-anticipated effect of higher mortgage rates on housing activity more broadly.

In the business sector, the outlook still appeared to be mixed. Manufacturing activity was reported to have picked up in a number of Districts, and activity in the energy sector remained at a high level. Although a step-up in business investment was likely to be a necessary element of the projected pickup in economic growth, reports from businesses ranged from those contacts who expressed heightened optimism to those who suggested that little acceleration was likely in the second half of the year.

Participants reported further signs that the tightening in federal fiscal policy restrained economic activity in the first half of the year: Cuts in government purchases and grants reportedly had been a factor contributing to slower growth in sales and equipment orders in some parts of the country, and consumer spending seemed to have been held back by tax increases. Moreover, uncertainty about the effects of the federal spending sequestration and related furloughs clouded the outlook. It was noted, however, that fiscal restriction by state and local governments seemed to be easing.

The June employment report showed continued solid gains in payrolls. Nonetheless, the unemployment rate remained elevated, and the continuing low readings on the participation rate and the employment-to-population ratio, together with a high incidence of workers being employed part time for economic reasons, were generally seen as indicating that overall labor market conditions remained weak. It was noted that employment growth had been stronger than would have been expected given the recent pace of output growth, reflecting weak gains in productivity. Some participants pointed out that once productivity growth picked up, faster economic growth would be required to support further increases in employment along the lines seen of late. However, one participant thought that sluggish productivity performance was

likely to persist, implying that the recent pace of output growth would be sufficient to maintain employment gains near current rates.

Recent readings on inflation were below the Committee's longer-run objective of 2 percent, in part reflecting transitory factors, and participants expressed a range of views about how soon inflation would return to 2 percent. A few participants, who felt that the recent low inflation rates were unlikely to persist or that the low PCE inflation readings might be marked up in future data revisions, suggested that, as transitory factors receded and the pace of recovery improved, inflation could be expected to return to 2 percent reasonably quickly. A number of others, however, viewed the low inflation readings as largely reflecting persistently deficient aggregate demand, implying that inflation could remain below 2 percent for a protracted period and further supporting the case for highly accommodative monetary policy.

Both domestic and foreign asset markets were volatile at times during the intermeeting period, reacting to policy communications and data releases. In discussing the increases in U.S. longer-term interest rates that occurred in the wake of the June FOMC meeting and the associated press conference, meeting participants pointed to heightened financial market uncertainty about the path of monetary policy and a shift of market expectations toward less policy accommodation. A few participants suggested that this shift occurred in part because Committee participants' economic projections, released following the June meeting, generally showed a somewhat more favorable outlook than those of private forecasters, or because the June policy statement and press conference were seen as indicating relatively little concern about inflation readings, which had been low and declining. Moreover, investors may have perceived that Committee communications about the possibility of slowing the pace of asset purchases also implied a higher probability of an earlier firming of the federal funds rate. Subsequent Federal Reserve communications, which emphasized that decisions about the two policy tools were distinct and underscored that a highly accommodative stance of monetary policy would remain appropriate for a considerable period after purchases are completed, were seen as having helped clarify the Committee's policy strategy. A number of participants mentioned that, by the end of the intermeeting period, market expectations of the future course of monetary policy, both with regard to asset purchases and with regard to the path of the federal funds rate, appeared well aligned with their own expectations. Nonetheless, some participants felt that, as a result of recent financial market developments, overall financial market conditions had tightened significantly, importantly reflecting larger term premiums, and they expressed concern that the higher level of longer-term interest rates could be a significant factor holding back spending and economic growth. Several others, however, judged that the rise in rates was likely to exert relatively little restraint, or that the increase in equity prices and easing in bank lending standards would largely offset the effects of the rise in longer-term interest rates. Some participants also stated that financial developments during the intermeeting period might have helped put the financial system on a more sustainable footing, insofar as those developments were associated with an unwinding of unsustainable speculative positions or an increase in term premiums from extraordinarily low levels.

In looking ahead, meeting participants commented on several considerations pertaining to the course of monetary policy. First, almost all participants confirmed that they were broadly comfortable with the characterization of the contingent outlook for asset purchases that was presented in the June postmeeting press conference and in the July monetary policy testimony. Under that outlook, if economic conditions improved broadly as expected, the Committee would moderate the pace of its securities purchases later this year. And if economic conditions continued to develop broadly as anticipated, the Committee would reduce the pace of purchases in measured steps and conclude the purchase program around the middle of 2014. At that point, if the economy evolved along the lines anticipated, the recovery would have gained further momentum, unemployment would be in the vicinity of 7 percent, and inflation would be moving toward the Committee's 2 percent objective. While participants viewed the future path of purchases as contingent on economic and financial developments, one participant indicated discomfort with the contingent plan on the grounds that the references to specific dates could be misinterpreted by the public as suggesting that the purchase program would be wound down on a more-or-less preset schedule rather than in a manner dependent on the state of the economy. Generally, however, participants were satisfied that investors had come to understand the data-dependent nature of the Committee's thinking about asset purchases. A few participants, while comfortable with the plan, stressed the need to avoid putting too much emphasis on the 7 percent value for the unemployment rate, which they saw only as illustra-

tive of conditions that could obtain at the time when the asset purchases are completed.

Second, participants considered whether it would be desirable to include in the Committee's policy statement additional information regarding the Committee's contingent outlook for asset purchases. Most participants saw the provision of such information, which would reaffirm the contingent outlook presented following the June meeting, as potentially useful; however, many also saw possible difficulties, such as the challenge of conveying the desired information succinctly and with adequate nuance, and the associated risk of again raising uncertainty about the Committee's policy intentions. A few participants saw other forms of communication as better suited for this purpose. Several participants favored including such additional information in the policy statement to be released following the current meeting; several others indicated that providing such information would be most useful when the time came for the Committee to begin reducing the pace of its securities purchases, reasoning that earlier inclusion might trigger an unintended tightening of financial conditions.

Finally, the potential for clarifying or strengthening the Committee's forward guidance for the federal funds rate was discussed. In general, there was support for maintaining the current numerical thresholds in the forward guidance. A few participants expressed concern that a decision to lower the unemployment threshold could potentially lead the public to view the unemployment threshold as a policy variable that could not only be moved down but also up, thereby calling into question the credibility of the thresholds and undermining their effectiveness. Nonetheless, several participants were willing to contemplate lowering the unemployment threshold if additional accommodation were to become necessary or if the Committee wanted to adjust the mix of policy tools used to provide the appropriate level of accommodation. A number of participants also remarked on the possible usefulness of providing additional information on the Committee's intentions regarding adjustments to the federal funds rate after the 6½ percent unemployment rate threshold was reached, in order to strengthen or clarify the Committee's forward guidance. One participant suggested that the Committee could announce an additional, lower set of thresholds for inflation and unemployment; another indicated that the Committee could provide guidance stating that it would not raise its target for the federal funds rate if the inflation rate was expected to run below a given level at a specific horizon. The latter enhancement to the forward guidance might be seen as reinforcing the message that the Committee was willing to defend its longer-term inflation goal from below as well as from above.

Committee Policy Action

Committee members viewed the information received over the intermeeting period as suggesting that economic activity expanded at a modest pace during the first half of the year. Labor market conditions showed further improvement in recent months, on balance, but the unemployment rate remained elevated. Household spending and business fixed investment advanced, and the housing sector was strengthening, but mortgage rates had risen somewhat and fiscal policy was restraining economic growth. The Committee expected that, with appropriate policy accommodation, economic growth would pick up from its recent pace, resulting in a gradual decline in the unemployment rate toward levels consistent with the Committee's dual mandate. With economic activity and employment continuing to grow despite tighter fiscal policy, and with global financial conditions less strained overall, members generally continued to see the downside risks to the outlook for the economy and the labor market as having diminished since last fall. Inflation was running below the Committee's longer-run objective, partly reflecting transitory influences, but longer-run inflation expectations were stable, and the Committee anticipated that inflation would move back toward its 2 percent objective over the medium term. Members recognized, however, that inflation persistently below the Committee's 2 percent objective could pose risks to economic performance.

In their discussion of monetary policy for the period ahead, members judged that a highly accommodative stance of monetary policy was warranted in order to foster a stronger economic recovery and sustained improvement in labor market conditions in a context of price stability. In considering the likely path for the Committee's asset purchases, members discussed the degree of improvement in the labor market outlook since the purchase program began last fall. The unemployment rate had declined considerably since then, and recent gains in payroll employment had been solid. However, other measures of labor utilization—including the labor force participation rate and the numbers of discouraged workers and those working part time for economic reasons—suggested more modest improvement, and other indicators of labor

demand, such as rates of hiring and quits, remained low. While a range of views were expressed regarding the cumulative improvement in the labor market since last fall, almost all Committee members agreed that a change in the purchase program was not yet appropriate. However, in the view of the one member who dissented from the policy statement, the improvement in the labor market was an important reason for calling for a more explicit statement from the Committee that asset purchases would be reduced in the near future. A few members emphasized the importance of being patient and evaluating additional information on the economy before deciding on any changes to the pace of asset purchases. At the same time, a few others pointed to the contingent plan that had been articulated on behalf of the Committee the previous month, and suggested that it might soon be time to slow somewhat the pace of purchases as outlined in that plan. At the conclusion of its discussion, the Committee decided to continue adding policy accommodation by purchasing additional MBS at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month and to maintain its existing reinvestment policies. In addition, the Committee reaffirmed its intention to keep the target federal funds rate at 0 to ¼ percent and retained its forward guidance that it anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

Members also discussed the wording of the policy statement to be issued following the meeting. In addition to updating its description of the state of the economy, the Committee decided to underline its concern about recent shortfalls of inflation from its longer-run goal by including in the statement an indication that it recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, while also noting that it continues to anticipate that inflation will move back toward its objective over the medium term. The Committee also considered whether to add more information concerning the contingent outlook for asset purchases to the policy statement, but judged that doing so might prompt an unwarranted shift in market expectations regarding asset purchases. The Committee decided to indicate in the statement that it "reaffirmed its view"—rather than simply "expects"—that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

> "Information received since the Federal Open Market Committee met in June suggests that economic activity expanded at a modest pace during the first half of the year. Labor market conditions have shown further improvement in recent months, on balance, but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the

housing sector has been strengthening, but mortgage rates have risen somewhat and fiscal policy is restraining economic growth. Partly reflecting transitory influences, inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will pick up from its recent pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished since the fall. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, but it anticipates that inflation will move back toward its objective over the medium term.

To support a stronger economic recovery and to help ensure that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

The Committee will closely monitor incoming information on economic and financial developments in coming months. The Committee will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. The Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labor market or inflation changes. In determining the size, pace, and composition of its asset purchases, the Committee will continue to take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Elizabeth Duke, Charles L. Evans, Jerome H. Powell, Sarah Bloom Raskin, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Esther L. George.

Ms. George dissented because she favored including in the policy statement a more explicit signal that the pace of the Committee's asset purchases would be reduced in the near term. She expressed concerns about the open-ended approach to asset purchases and viewed providing such a signal as important at this time, in light of the ongoing improvement in labor market conditions as well as the potential costs and uncertain benefits of large-scale asset purchases.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, September 17–18, 2013. The meeting adjourned at 12:30 p.m. on July 31, 2013.

Notation Vote

By notation vote completed on July 9, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on June 18–19, 2013.

William B. English
Secretary

Meeting Held on September 17–18, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, September 17, 2013, at 1:00 p.m. and continued on Wednesday, September 18, 2013, at 8:30 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Charles L. Evans

Esther L. George

Jerome H. Powell

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, Stephen A. Meyer, Geoffrey Tootell, Christopher J. Waller, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Michael S. Gibson
Director, Division of Banking Supervision and Regulation, Board of Governors

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Ellen E. Meade and Joyce K. Zickler
Senior Advisers, Division of Monetary Affairs, Board of Governors

Eric M. Engen, Michael T. Kiley, Thomas Laubach, David E. Lebow, and Michael G. Palumbo
Associate Directors, Division of Research and Statistics, Board of Governors

Fabio M. Natalucci
Associate Director, Division of Monetary Affairs, Board of Governors

Joshua Gallin
Deputy Associate Director, Division of Research and Statistics, Board of Governors

Jeremy B. Rudd
Adviser, Division of Research and Statistics, Board of Governors

Christopher J. Gust and Elizabeth Klee
Section Chiefs, Division of Monetary Affairs, Board of Governors

Gordon Werkema
First Vice President, Federal Reserve Bank of Chicago

David Altig, Loretta J. Mester, and Harvey Rosenblum[1]
Executive Vice Presidents, Federal Reserve Banks of Atlanta, Philadelphia, and Dallas, respectively

Joyce Hansen, Evan F. Koenig, Spencer Krane, Lorie K. Logan, Mark E. Schweitzer, John A. Weinberg, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of New York, Dallas, Chicago, New York, Cleveland, Richmond, and Minneapolis, respectively

Chris Burke and Jonathan P. McCarthy
Vice Presidents, Federal Reserve Bank of New York

Eric T. Swanson
Senior Research Advisor, Federal Reserve Bank of San Francisco

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets as well as the System open market operations during the period since the Federal Open Market Committee (FOMC) met on July 30–31, 2013. The review included a report that the System's purchases of longer-term assets did not appear to have had an adverse effect on the functioning of the markets for Treasury securities or agency mortgage-backed securities (MBS), and that the Open Market Desk's operations in both sectors had proceeded smoothly. By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

In support of the Committee's longer-run planning for improvements in the implementation of monetary policy, the staff presented an update on the potential for establishing a fixed-rate, full-allotment overnight reverse repurchase agreement (RRP) facility. The presentation summarized initial discussions with financial market firms about how such a facility might affect money market interest rates and intermediation flows, what the relationship might be between the facility rate and other money market rates, and how the different types of firms might view the facility. Overall, the inquiries suggested that the facility could be an effective additional tool for managing money market interest rates and helping to support a floor on those rates. Meeting participants discussed the potential role for an overnight RRP facility, the possible effects on the functioning of the federal funds market or the structure of money markets, and the usefulness of expanding the Desk's test operations in RRPs. Meeting participants generally supported a proposal to authorize the Desk to conduct a limited exercise in order to provide some insight into the potential usage of an overnight RRP facility as well as additional experience with operational aspects of such a facility. One participant, however, preferred that further analysis be undertaken before proceeding with the exercise. A number of meeting participants emphasized that their interest in these operations reflected an ongoing effort to improve the technical execution of policy and did not signal any change in the Committee's views about policy going forward. Following the discussion, the Committee unanimously approved the following resolution:

> "The Federal Open Market Committee (FOMC) authorizes the Federal Reserve Bank of New York to conduct a series of fixed-rate, overnight reverse repurchase operations involving U.S. Government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the purpose of assessing operational readiness. The reverse repurchase operations authorized by this resolution shall be (i) offered at a fixed rate that may vary from zero to five basis points, (ii) offered at up to a capped allotment per counterparty of $1 billion per day and (iii) for an overnight term, or such longer term as is warranted to accommodate weekend, holiday, and similar trading conventions. The System Open Market Account Manager will inform the FOMC in advance of the terms of the planned operations. These operations may be announced when authorized by the Chairman, may begin when authorized by the Chairman on or after September 23, 2013, and shall be authorized through the FOMC meeting that ends on January 29, 2014."

Staff Review of the Economic Situation

The information reviewed for the September 17–18 meeting suggested that economic activity continued to increase at a moderate rate. Private-sector employment rose further in July and August, but the unemployment rate was still elevated. Total consumer price inflation picked up in recent months but continued to be modest, and measures of longer-run inflation expectations remained stable.

[1] Attended introductory remarks at Tuesday's session only.

Private nonfarm employment continued to expand in July and August, but at a somewhat slower pace than in the first half of the year, while total government employment edged down on balance. The unemployment rate declined further to 7.3 percent in August. The labor force participation rate also decreased, leaving the employment-to-population ratio essentially unchanged in recent months. Other indicators of labor market activity also were mixed. Measures of firms' hiring plans moved up, initial claims for unemployment insurance declined, and the share of workers employed part time for economic reasons decreased a little. However, household expectations of the labor market situation deteriorated somewhat, rates of job openings and gross private-sector hiring were little changed, on net, and the rate of long-duration unemployment rose slightly.

Manufacturing production increased in August after a decline in July, and the rate of manufacturing capacity utilization was unchanged, on balance, over those two months. Automakers' schedules indicated that the pace of motor vehicle assemblies would remain roughly flat in the coming months, but broader indicators of manufacturing production, such as the readings on new orders from the national and regional manufacturing surveys, pointed to moderate increases in factory output in the near term.

Real personal consumption expenditures (PCE) were flat in July. In August, nominal retail sales, excluding those at motor vehicle and parts outlets, edged up, while sales of light motor vehicles rose notably. Recent information on key factors that influence consumer spending were mixed: Households' net worth likely expanded further as home prices posted additional gains through July, but real disposable incomes increased only a little in July and consumer sentiment in the Thomson Reuters/University of Michigan Surveys of Consumers moved lower in August and early September.

Improvements in housing-sector activity appeared to slow, possibly reflecting the rise in mortgage rates since the spring. Starts and permits of new single-family homes moved down in July, but the level of permit issuance was still somewhat above that for starts and pointed to moderate increases in construction in subsequent months. In the multifamily sector, both starts and permits rose in July but construction remained around the same level as early in the year. Sales of existing homes increased, but new home sales declined.

Growth in real private expenditures for business equipment and intellectual property products appeared to be subdued going into the third quarter. Nominal shipments of nondefense capital goods excluding aircraft declined again in July. However, nominal new orders for these capital goods continued to be above the level of shipments, pointing to increases in shipments in subsequent months, and other forward-looking indicators, such as surveys of business conditions, were consistent with moderate gains in spending for business equipment in the near term. Nominal business expenditures for nonresidential construction increased in July but were still at a low level. Recent book-value data for inventory-sales ratios, along with readings on inventories from national and regional manufacturing surveys, did not point to significant inventory imbalances.

Reductions in real federal government purchases appeared to persist: Defense spending continued to decrease in July and August, while federal employment edged down further. Real state and local government purchases looked to be about flat—the payrolls of these governments expanded slightly, on balance, in July and August, and state and local construction expenditures seemed to be leveling off.

The U.S. international trade deficit narrowed substantially in June before widening in July to a level near its second-quarter average. Exports expanded in June, with particular strength in industrial supplies and capital goods, before stepping down somewhat in July. Imports fell in June but then largely recovered in July, driven by swings in imports of oil and consumer goods.

Total U.S. inflation, as measured by the PCE price index through July and by the consumer price index through August, was about 1½ percent over the preceding 12-month period for each series. Consumer food prices only edged up in July and August, while energy prices were little changed, on net, over those two months, and retail gasoline prices moved down in the first half of September. Core consumer price inflation, which excludes food and energy, was modest in July and August. Both near-term and longer-term inflation expectations from the Michigan survey were little changed in August and early September.

Measures of labor compensation indicated that increases in nominal wages were still subdued. Both compensation per hour and unit labor costs in the nonfarm business sector rose modestly over the year

ending in the second quarter, as there were only slight gains in productivity. In July and August, increases in average hourly earnings for all employees were fairly slow on balance.

Average foreign economic growth remained muted in the first half of the year, although there were some notable divergences across countries. Growth in real gross domestic product (GDP) picked up in the second quarter in the United Kingdom and remained strong in Japan, recent data suggested that the euro-area economy was coming out of recession, and economic indicators were positive for China and several other emerging market economies (EMEs) in Asia. However, real GDP fell in the second quarter in Mexico and decelerated notably in India. Foreign inflation was generally subdued. Monetary policy remained highly accommodative in the advanced economies, but some EME central banks moved toward tighter monetary policy in the face of capital outflows and depreciation pressures. An exception was the Bank of Mexico, which cut its policy rate in response to economic weakness.

Staff Review of the Financial Situation

Longer-term interest rates rose over the intermeeting period, while equity prices were fairly volatile but ended the period modestly higher. The move in interest rates appeared to be importantly influenced by shifting expectations about monetary policy.

The path of the federal funds rate implied by financial market quotes steepened notably during the period, in part reflecting some increase in uncertainty about the outlook for monetary policy as indicated by option-implied measures of uncertainty about the future path of the policy rate. In contrast to market-based quotes, the results from the Desk's September survey of primary dealers showed little change in the projected path of the policy rate relative to that in the July survey. However, the survey also suggested that primary dealers marked up somewhat the odds that the FOMC would begin to cut the pace of asset purchases at its September meeting, a result generally in line with other surveys of market participants.

Five- and 10-year Treasury yields increased about 25 basis points over the intermeeting period. Yields on corporate bonds, agency MBS, and Treasury inflation-protected securities rose about in line with those on nominal Treasury securities.

Conditions in short-term dollar funding markets were generally stable during the period since the July FOMC meeting. Responses to the September Senior Credit Officer Opinion Survey on Dealer Financing Terms suggested little change over the preceding three months in the credit terms applicable to most classes of counterparties covered by the survey. A moderate net fraction of respondents reported a decline in the use of financial leverage by hedge funds, and a more substantial net fraction reported a decrease in financial leverage used by real estate investment trusts. In response to special questions in the survey, dealers indicated that, during the period of heightened volatility beginning in May and extending into early July, liquidity and functioning had deteriorated in a number of fixed-income markets.

Stock prices for financial-sector firms underperformed the broad equity market somewhat over the intermeeting period. However, spreads on credit default swaps (CDS) for the largest bank holding companies remained stable at levels near the bottom of their range over the past few years.

Credit flows to nonfinancial businesses remained solid in the face of higher longer-term interest rates. Relative to the typical summer lull, gross issuance of corporate bonds and leveraged loans was robust in August; commercial and industrial (C&I) loans on banks' books continued to expand moderately, on average, in July and August. Commercial real estate (CRE) loans at banks accelerated over the summer, and issuance of commercial mortgage-backed securities remained strong despite slightly wider spreads on those securities.

Recent information about household credit was mixed. Mortgage rates increased further over the intermeeting period, and credit standards for mortgage loans remained tight. Nonetheless, applications for new mortgages declined only modestly, apparently supported by improvements in labor market conditions and some pent-up demand. Higher mortgage rates weighed more heavily on applications to refinance existing mortgages, which decreased significantly. The pace of home price appreciation moderated a bit in July, although it was still strong. In non-

mortgage credit, automobile loans and student loans both continued to expand rapidly, while balances on revolving consumer credit stayed about flat. Issuance of consumer asset-backed securities remained robust in July and August.

In the municipal bond market, despite the ongoing bankruptcy proceedings for Detroit and greater scrutiny of Puerto Rico's fiscal problems, broader market sentiment was reportedly supported by the lessening in budget pressures for many other state and local governments. Gross issuance of long-term municipal bonds was solid in August, and yield ratios on general-obligation municipal bonds over comparable Treasury securities were about unchanged, on balance, over the intermeeting period.

Bank credit declined in July and August amid the general rise in longer-term interest rates. While banks' holdings of assets with longer duration, such as residential mortgages, decreased, growth in C&I, CRE, and automobile loans—which are more likely to have floating interest rates or relatively short maturities, and therefore less duration risk—tended to hold up in recent months.

M2 increased significantly in July and August, as the selloff in fixed-income markets that began in May, along with the associated outflows from bond funds, likely continued to support reallocations into liquid M2 assets. The monetary base continued to expand rapidly, primarily reflecting the rise in reserve balances resulting from the Federal Reserve's asset purchases.

Against a backdrop of higher interest rates in the advanced economies and slowing economic growth in the EMEs, several EME currencies came under downward pressure in August; yields and CDS premiums on EME sovereign debt increased, particularly for those economies experiencing sharp currency depreciations; and investors continued to decrease their holdings in EME mutual funds. In response, some EME authorities took actions to support their currencies, including tightening monetary policy, modifying capital controls, and purchasing their currencies in foreign exchange markets. On net over the period, the dollar ended little changed on a trade-weighted basis against a broad set of currencies, but it appreciated notably against the currencies of India, Indonesia, and Turkey. Equity prices in Germany increased substantially and sovereign yields in the United Kingdom and Germany continued to rise as data on economic activity in Europe generally improved over the period, while yield spreads of Spanish and Italian sovereign securities relative to German government debt declined a bit further.

The staff reported on potential risks to financial stability, including those highlighted by the rise in yields and volatility on longer-term fixed-income securities since the spring. The increase in yields appeared to reduce investors' appetite for taking duration risk, but if a significant volume of bond investors moved to sell at a future time, issues surrounding dealer capacity and willingness to make markets in volatile conditions could again amplify price movements. On balance, the vulnerability of the financial system appeared moderate, as loss-absorbing capital had increased and the reliance on short-term funding and the exposure of financial institutions to nonfinancial credit risk had decreased. Nonetheless, a number of potential shocks could prove challenging to markets and institutions, including a failure to raise the U.S. federal debt limit, financial instability in EMEs, and geopolitical events in the Middle East.

Staff Economic Outlook

In the economic forecast prepared by the staff for the September FOMC meeting, the projection for real GDP growth in the second half of this year was revised down a little from the one prepared for the previous meeting. The staff's forecast for real GDP over the medium term also was revised down somewhat, reflecting higher projected paths for both longer-term interest rates and the foreign exchange value of the dollar, along with slightly lower projected paths for equity and home prices. The staff still anticipated that the pace of expansion in real GDP this year would only moderately exceed the growth rate of potential output but continued to forecast that real GDP would accelerate in 2014 and 2015, supported by an eventual easing in the effects of fiscal policy restraint on economic growth, increases in consumer and business sentiment, further improvements in credit availability and financial conditions, and accommodative monetary policy. In 2016, real GDP growth was projected to begin to edge down toward the growth rate of potential output. Over the projection period, the expansion in economic activity was anticipated to slowly reduce the slack in labor and product markets, and the unemployment rate was expected to decline gradually.

The staff's forecast for inflation was little changed from the projection prepared for the previous FOMC meeting. In the near term, the staff continued to

project that inflation would be modest in the second half of this year but higher than the readings posted in the first half. Over the medium term, with longer-run inflation expectations assumed to remain stable, changes in commodity and import prices expected to be modest, and resource slack persisting over most of the projection period, inflation was forecast to be subdued through 2016.

The staff viewed the uncertainty around the forecast for economic activity as similar to its normal level over the past 20 years. However, the risks were viewed as skewed to the downside, reflecting concerns about the economic effects of the recent tightening in U.S. financial market conditions, the resolution of federal fiscal policy issues in the coming months, the economic and financial stresses in the EMEs, and the ability of the U.S. economy to weather potential future adverse shocks. The staff did not see the uncertainty around its outlook for inflation as unusually high, and the risks were viewed as balanced.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, meeting participants—5 members of the Board of Governors and the presidents of the 12 Federal Reserve Banks, all of whom participated in the deliberations—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2016 and over the longer run, under each participant's judgment of appropriate monetary policy. The longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. These economic projections and policy assessments are described in the Summary of Economic Projections (SEP), which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, meeting participants regarded the information received during the intermeeting period as indicating that economic activity had continued to expand at a moderate pace, albeit somewhat more slowly than earlier anticipated, and they generally indicated that the broad contours of the outlook further out had not changed materially since their July meeting. Participants continued to project the rate of growth of economic activity to strengthen over coming years, supported by highly accommodative monetary policy and the gradual abatement of the headwinds that have been slowing the pace of economic recovery, such as household-sector deleveraging, tight credit conditions for some households and businesses, and fiscal restraint. Accordingly, the unemployment rate was projected to continue to decline over time toward levels judged to be consistent with the Committee's dual mandate. While downside risks to the outlook for the economy and the labor market were generally viewed as having diminished, on balance, since last fall, a number of significant risks remained, including those related to the potential economic effects of the sizable increases in interest rates since the spring, ongoing fiscal drag, and the possible fallout from near-term fiscal debates. Inflation continued to run below the Committee's longer-run objective, apart from fluctuations that largely reflected changes in energy prices, and participants generally saw it as moving back gradually to 2 percent in the medium term.

In the household sector, consumer spending continued to advance, but incoming data on retail sales were somewhat weaker than expected. Auto sales, however, remained strong, supported in part by steady interest rates on auto loans, which, unlike mortgage rates, did not rise substantially in recent months. Despite the continued improvement in household balance sheets, a number of factors were mentioned as possible restraints on spending, including declines in consumer confidence, concerns about job security and availability, and the lingering effects of this year's payroll tax increase. While the housing sector continued to strengthen, supported by improving fundamentals and gains in house prices, the increases in mortgage rates since the spring were seen as a potential risk. The extent to which the higher mortgage rates had materially affected that sector remained unclear, with the exception of the sharp decline in refinancing activity. But it was noted that recent softness in housing starts and home sales might well reflect some restraint from those higher rates.

Business contacts in selected parts of the country were reported to be cautiously optimistic, consistent with encouraging responses to a number of business surveys. Nonetheless, uncertainties regarding the outlook for the economy and fiscal and regulatory policies were reportedly continuing to weigh on business decisionmaking, with firms focused on improving their balance sheets and enhancing productivity and still quite cautious about expanding their workforces.

Reports on manufacturing activity pointed to some rebound, with production related to autos the most notable area of strength, and activity in the energy sector continued to expand at a steady pace. In the agricultural sector, farmland values increased further, even though farm income was reported to be declining. Some business contacts indicated that wage and price pressures were subdued; however, in one District, contacts pointed to rising wage pressures and labor shortages.

Participants discussed the extent to which the ongoing tightening in fiscal policy was likely to further restrain economic activity in the second half of this year, with one participant noting that the effects of the federal sequestration appeared to be less pronounced than previously anticipated. However, a number of others pointed to heightened uncertainty about the course of federal fiscal policy over coming months, including the potential for a government shutdown or strains related to the debt ceiling debate, which posed downside risks to the economic outlook.

In discussing labor market developments, a number of participants indicated that gains in payrolls in the July and August employment reports were disappointing, but one participant also noted that seasonal adjustment tended to be challenging during the summer months. Taking a range of data into account, participants generally agreed that labor market conditions had improved meaningfully since the start of the asset purchase program in September 2012. Participants discussed how to reconcile the notable decline in the unemployment rate over the past year with the only moderate pace of expansion in real GDP. One possible explanation was that, to the extent the decline in the unemployment rate was primarily driven by a fall in the labor force participation rate and low productivity growth, such a decline might overstate the degree of improvement in broader labor market conditions. Indeed, the continued low readings on the employment-to-population ratio were supportive of this explanation, suggesting that overall labor market conditions had not improved as much as the unemployment rate would indicate. An alternative explanation for the significant improvement in the labor market performance despite the moderate growth in real GDP over the past year was that growth had been understated somewhat; notably, some research suggested that real gross domestic income, which expanded at a somewhat faster pace than real GDP, may provide better information about overall economic activity. Despite recent declines in the unemployment rate, one participant noted the risk that the longer the duration of elevated unemployment, the more likely it was that the labor market and economy would experience some lasting structural damage. While judging the extent of structural damage continued to be quite difficult, one piece of evidence consistent with this view was the apparent decline in the job-finding rate of the long-term unemployed.

Despite the reversal of some transitory factors that had contributed to the earlier softness in inflation, recent readings continued to be below the Committee's longer-run objective of 2 percent. However, participants generally expected inflation to pick up over the coming year as the pace of economic growth accelerated and slack in resource utilization diminished further, although to a rate still below the Committee's longer-run objective.

Participants discussed financial market developments, including their views on the extent to which the rise in longer-term interest rates since May reflected growing confidence about the economic outlook or a perception by financial markets that monetary policy would be less accommodative going forward than had been previously anticipated. Several participants judged that overall financial conditions had tightened notably over the past few months, as seen most importantly in the rise in mortgage rates. While acknowledging that it was too early to assess the effects of such an increase, they expressed concerns that tighter financial conditions might weigh on the recovery in the housing sector. A few others observed that the increase in longer-term yields in recent months had not seemed to leave a meaningful imprint on other asset prices, suggesting that the effects on the economy were likely to be relatively muted. While recognizing the potentially significant impact of higher mortgage rates on the housing market, these same participants pointed to higher equity prices, the further gradual loosening of terms in bank lending, and the continued availability of credit at inexpensive terms in corporate debt markets as signs that financial conditions more generally had not tightened materially. In any case, however, the assessment of the adverse effects of the increase in longer-term rates on financial conditions and ultimately on economic activity would depend importantly upon the extent to which rates stabilized at current levels or instead continued to rise.

Participants also touched on the implications for financial stability resulting from the increase in interest rates, focusing on the effects on securities held by

banking and other nonbank institutions, the unwinding of leveraged trades, and the liquidity and functioning of a number of fixed-income markets. One participant noted that, notwithstanding the recent rise in interest rates, net interest margins remained under pressure at community and regional banks, and as a result many of these banks continued to add to risk exposures. Another participant raised the possibility that financial stability risks might arise from recent adverse developments in municipal bond markets. It was also noted that financial conditions in a number of EMEs had tightened as a result of some depreciation of their currencies, an increase in yields and borrowing costs, and some capital outflows as measured by withdrawals from bond funds. More broadly, a couple of participants noted the complexities related to the interaction between the stance of monetary policy and the vulnerabilities in the financial system.

In their discussion of the path for monetary policy, participants debated the advantages and disadvantages of reducing the pace of the Committee's asset purchases at this meeting, focusing importantly on whether the conditions presented to the public in June for reducing the pace of asset purchases had yet been met. In general, those who preferred to maintain for now the pace of purchases viewed incoming data as having been on the disappointing side and, despite clear improvements in labor market conditions since the purchase program's inception in September 2012, were not yet adequately confident of continued progress. Many of these participants had revised down their forecasts for economic activity or pointed to near-term risks and uncertainties. For example, questions were raised about the effects on the housing sector and on the broader economy of the tightening in financial conditions in recent months, as well as about the considerable risks surrounding fiscal policy. Moreover, the announcement of a reduction in asset purchases at this meeting might trigger an additional, unwarranted tightening of financial conditions, perhaps because markets would read such an announcement as signaling the Committee's willingness, notwithstanding mixed recent data, to take an initial step toward exit from its highly accommodative policy. As a result of such concerns, a number of participants thought that risk-management considerations called for a cautious approach and that, in light of the ambiguous cast of recent readings on the economy, it would be prudent to await further evidence of progress before reducing the pace of asset purchases. Consistent with the framework discussed by the Chairman during the June press conference, asset purchases were contingent on the Committee's ongoing assessment of the economic outlook and were not on a preset course; this approach implied a need to adapt and to adjust asset purchases in response to changes in economic conditions in order to preserve the Committee's credibility. With many outside observers expecting a decision to reduce purchases at this meeting, some participants emphasized a need to clearly communicate the rationale behind any decision not to do so, in order to avoid conveying a message of pessimism regarding the economic outlook or to reinforce the distinction between decisions concerning the pace of purchases and those concerning the federal funds rate. One participant suggested that postponing the reduction in the pace of asset purchases would also allow time for the Committee to further discuss and to implement a clarification or strengthening of its forward guidance for the federal funds rate, which could temper the risk that a future downward adjustment in asset purchases would cause an undesirable tightening of financial conditions.

The participants who spoke in favor of moderating the pace of securities purchases at this meeting also cited the incoming data, but viewed those data as broadly consistent with the Committee's outlook for the labor market at the time of the June FOMC meeting when the contingent expectation that the pace of asset purchases would be reduced later in the year was first presented to the public. Moreover, they highlighted what they saw as meaningful cumulative progress in labor market conditions since the purchase program began. Those participants generally were satisfied that investors had come to understand the data-dependent nature of the Committee's thinking about asset purchases, and, because they judged that the conditions laid out in June had been met, they believed that the credibility of the Committee would best be served by announcing a downward adjustment in asset purchases at this meeting. With the markets apparently viewing a cut in purchases as the most likely outcome, it was noted that the postponement of such an announcement to later in the year or beyond could have significant implications for the effectiveness of Committee communications. In particular, concerns were expressed that a delay could potentially undermine the credibility or predictability of monetary policy by, for example, increasing uncertainty about the Committee's reaction function and about its commitment to the forward guidance for the federal funds rate, with the result of an increase in volatility in financial markets. Moreover, maintaining the pace of purchases could

be perceived as a sign that the FOMC had turned more pessimistic about the economic outlook. Finally, it was noted that if the Committee did not pare back its purchases in these circumstances, it might be difficult to explain a cut in coming months, absent clearly stronger data on the economy and a swift resolution of federal fiscal uncertainties. Most of the participants leaning toward a downward adjustment in the pace of asset purchases also indicated that they favored a relatively small reduction to signal the Committee's intention to proceed cautiously.

With regard to adjustments in the pace of asset purchases, whether at this or a future meeting, a few participants expressed a preference for not cutting MBS purchases but reducing purchases only of Treasury securities initially, with the intent of continuing to support the recovery in the housing sector. However, the appeal of including both types of securities in any reduction was also mentioned. In addition, in an effort to reduce uncertainty about how the Committee might adjust its purchases in response to economic developments and to alleviate some of the related communications issues, one participant suggested an approach that would mechanically link the reduction in asset purchases to numerical values for the unemployment rate, with the goal of ending the program when the unemployment rate reached a stated level.

Participants also discussed the potential for clarifying or strengthening the Committee's forward guidance for the federal funds rate. To the extent that financial markets have at times interpreted the Committee's communications regarding the asset purchase program as also signaling information about the federal funds rate target, participants thought it might be important to reiterate the distinction between the two, and a clarification or strengthening of the forward guidance might help to reinforce this message. In part toward this end, participants mentioned several possible steps that might be considered, including stating that the Committee would not raise its target for the federal funds rate if the inflation rate was expected to run below a given level or providing additional information on the Committee's intentions regarding the federal funds rate after the 6½ percent unemployment threshold was reached. One participant stressed that the Committee could use the full range of its tools, including forward guidance, to further improve the alignment of the medium-term outlook for employment and inflation with its longer-term goals. In light of the importance of credibility for the effectiveness of the forward guidance for the federal funds rate, participants noted the possible implications of uncertainties related to the Federal Reserve leadership transition in considering the appropriate timing of any enhancements to the guidance.

In discussing the projections for the target federal funds rate at the end of 2016 as reported in the SEP, some participants highlighted the importance of communicating to the public the reasons why the policy rates that were projected by most, but not all, participants appeared to remain at low levels even as the unemployment rate and inflation by then were expected to be close to their longer-run values. In particular, if economic headwinds died away only slowly, as a number of participants expected, the achievement of the Committee's employment and price stability objectives would likely require keeping the federal funds rate below its longer-run equilibrium value for some time even as economic conditions improved. In light of the potential difficulties in succinctly conveying this information in the Committee's policy statement, the Chairman's postmeeting press conference and the minutes were mentioned as more appropriate vehicles for providing this information. A couple of participants also remarked that they viewed their projections of a low federal funds rate in 2016 as reflecting a commitment to support the economy by maintaining a more accommodative policy for longer.

Committee Policy Action

Committee members saw the information received over the intermeeting period as suggesting that economic activity was expanding at a moderate pace. Some indicators of labor market conditions showed further improvement in recent months, but the unemployment rate remained elevated. Household spending and business fixed investment advanced, and the housing sector was strengthening, but mortgage rates had risen further and fiscal policy was restraining growth. The Committee expected that, with appropriate policy accommodation, economic growth would pick up from its recent pace, resulting in a gradual decline in the unemployment rate toward levels consistent with the Committee's dual mandate. Members generally continued to see the downside risks to the outlook for the economy and the labor market as having diminished, on net, since last fall, but indicated that the tightening of financial conditions observed in recent months, if sustained, could slow the pace of improvement in the economy and

labor market. Apart from fluctuations due to changes in energy prices, inflation was running below the Committee's longer-run objective, but longer-term inflation expectations were stable, and the Committee anticipated that inflation would move back toward its objective over the medium term. Members recognized, however, that inflation persistently below the Committee's 2 percent objective could pose risks to economic performance.

In their discussion of monetary policy for the period ahead, members reviewed the degree of improvement in economic activity and labor market conditions since the asset purchase program began a year ago and judged that, taking into account the extent of federal fiscal retrenchment, the improvement was consistent with growing underlying strength in the broader economy. However, all members but one judged that it would be appropriate for the Committee to await more evidence that progress would be sustained before adjusting the pace of asset purchases. In the view of one member, the progress to date in labor markets and in broader economic conditions amply supported a reduction in purchases. During the exchange of views on whether to trim the flow of asset purchases at this meeting, a number of members emphasized the contingent and data-dependent nature of the Committee's purchase program. In light of the mixed data recently, including inflation readings that remained below the Committee's longer-run objective, and the concerns over near-term fiscal uncertainties, some members indicated that they preferred to await more evidence that their expectation of continuing improvement would be realized. But with financial markets appearing to expect a reduction in purchases at this meeting, concerns were raised about the effectiveness of FOMC communications if the Committee did not take that step. For several members, the various considerations made the decision to maintain an unchanged pace of asset purchases at this meeting a relatively close call. At the conclusion of the discussion, the Committee decided to continue adding policy accommodation by purchasing additional MBS at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month and to maintain its existing reinvestment policies. In addition, the Committee reaffirmed its intention to keep the target federal funds rate at 0 to ¼ percent and retained its forward guidance that it anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

Members also discussed the wording of the policy statement to be issued following the meeting. In addition to updating its description of the state of the economy, the Committee decided to underline its concern about the tightening of financial conditions observed in recent months. It also acknowledged the improvement in economic activity and labor market conditions since its asset purchase program began, while emphasizing that it was prepared to be patient and await more evidence that progress would be sustained before adjusting downward the pace of purchases. The Committee also adopted language to the effect that, in judging when to moderate the pace of asset purchases at its coming meetings, it would assess whether incoming information continued to support its expectation of ongoing improvement in labor market conditions and of inflation moving back toward its longer-run objective. Finally, the Committee reiterated the contingent nature of the outlook for asset purchases, indicating that asset purchases were not on a preset course and that the Committee's decisions about their pace would continue to depend on its economic outlook as well as its assessment of the likely efficacy and costs of such purchases.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal

Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

"Information received since the Federal Open Market Committee met in July suggests that economic activity has been expanding at a moderate pace. Some indicators of labor market conditions have shown further improvement in recent months, but the unemployment rate remains elevated. Household spending and business fixed investment advanced, and the housing sector has been strengthening, but mortgage rates have risen further and fiscal policy is restraining economic growth. Apart from fluctuations due to changes in energy prices, inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will pick up from its recent pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished, on net, since last fall, but the tightening of financial conditions observed in recent months, if sustained, could slow the pace of improvement in the economy and labor market. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, but it anticipates that inflation will move back toward its objective over the medium term.

Taking into account the extent of federal fiscal retrenchment, the Committee sees the improvement in economic activity and labor market conditions since it began its asset purchase program a year ago as consistent with growing underlying strength in the broader economy. However, the Committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases. Accordingly, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.

The Committee will closely monitor incoming information on economic and financial developments in coming months and will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. In judging when to moderate the pace of asset purchases, the Committee will, at its coming meetings, assess whether incoming information continues to support the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective. Asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's economic outlook as well as its assessment of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly

accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Charles L. Evans, Jerome H. Powell, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Esther L. George.

Ms. George dissented because she saw recent information on the economy as sufficiently positive to warrant a reduction in the pace of the Committee's asset purchases at this meeting. In her view, waiting for more evidence of progress discounted the cumulative improvement in the economy as well as the potential costs of ongoing purchases. Accordingly, not only would a reduction be appropriate in light of the ongoing improvement in labor market conditions, but it also would support the credibility and predictability of monetary policy because it would be seen as following through on the Committee's earlier communications about the outlook for the asset purchase program.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, October 29–30, 2013. The meeting adjourned at 11:15 a.m. on September 18, 2013.

Notation Vote

By notation vote completed on August 20, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on July 30–31, 2013.

William B. English
Secretary

Addendum: Summary of Economic Projections

In conjunction with the September 17–18, 2013, Federal Open Market Committee (FOMC) meeting, meeting participants—5 members of the Board of Governors and the 12 presidents of the Federal Reserve Banks, all of whom participated in the deliberations—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2016 and over the longer run. Each participant's assessment was based on information available at the time of the meeting plus his or her judgment of appropriate monetary policy and assumptions about the factors likely to affect economic outcomes. The longer-run projections represent each participant's judgment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the Federal Reserve's objectives of maximum employment and stable prices.

Overall, FOMC participants expected, under appropriate monetary policy, a pickup in economic growth, with the unemployment rate declining gradually (table 1 and figure 1). Almost all of the participants projected that inflation, as measured by the annual change in the price index for personal consumption expenditures (PCE), would rise to a level at or somewhat below the Committee's 2 percent objective in 2016.

Most participants judged that highly accommodative monetary policy was likely to remain warranted over the next few years to support continued progress toward maximum employment and a return to 2 percent inflation. As shown in figure 2, a large majority of participants judged not only that it would be appropriate to wait until 2015 or later before beginning to increase the federal funds rate, but also that it would then be appropriate to raise the federal funds rate target relatively gradually. Most participants viewed their economic projections as broadly consistent with a slowing in the pace of the Committee's purchases of longer-term securities this year and the completion of the program in mid-2014.

Most participants saw the uncertainty associated with their outlook for economic growth, the unemployment rate, and inflation as similar to that of the past 20 years. In addition, most participants considered the risks to the outlook for the unemployment rate and inflation as broadly balanced. A slim majority of the participants also judged that the risks to the outlook for real gross domestic product (GDP) growth were broadly balanced, while nearly as many

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, September 2013
Percent

Variable	Central tendency[1]					Range[2]				
	2013	2014	2015	2016	Longer run	2013	2014	2015	2016	Longer run
Change in real GDP	2.0 to 2.3	2.9 to 3.1	3.0 to 3.5	2.5 to 3.3	2.2 to 2.5	1.8 to 2.4	2.2 to 3.3	2.2 to 3.7	2.2 to 3.5	2.1 to 2.5
June projection	2.3 to 2.6	3.0 to 3.5	2.9 to 3.6	n.a.	2.3 to 2.5	2.0 to 2.6	2.2 to 3.6	2.3 to 3.8	n.a.	2.0 to 3.0
Unemployment rate	7.1 to 7.3	6.4 to 6.8	5.9 to 6.2	5.4 to 5.9	5.2 to 5.8	6.9 to 7.3	6.2 to 6.9	5.3 to 6.3	5.2 to 6.0	5.2 to 6.0
June projection	7.2 to 7.3	6.5 to 6.8	5.8 to 6.2	n.a.	5.2 to 6.0	6.9 to 7.5	6.2 to 6.9	5.7 to 6.4	n.a.	5.0 to 6.0
PCE inflation	1.1 to 1.2	1.3 to 1.8	1.6 to 2.0	1.7 to 2.0	2.0	1.0 to 1.3	1.2 to 2.0	1.4 to 2.3	1.5 to 2.3	2.0
June projection	0.8 to 1.2	1.4 to 2.0	1.6 to 2.0	n.a.	2.0	0.8 to 1.5	1.4 to 2.0	1.6 to 2.3	n.a.	2.0
Core PCE inflation[3]	1.2 to 1.3	1.5 to 1.7	1.7 to 2.0	1.9 to 2.0		1.2 to 1.4	1.4 to 2.0	1.6 to 2.3	1.7 to 2.3	
June projection	1.2 to 1.3	1.5 to 1.8	1.7 to 2.0	n.a.		1.1 to 1.5	1.5 to 2.0	1.7 to 2.3	n.a.	

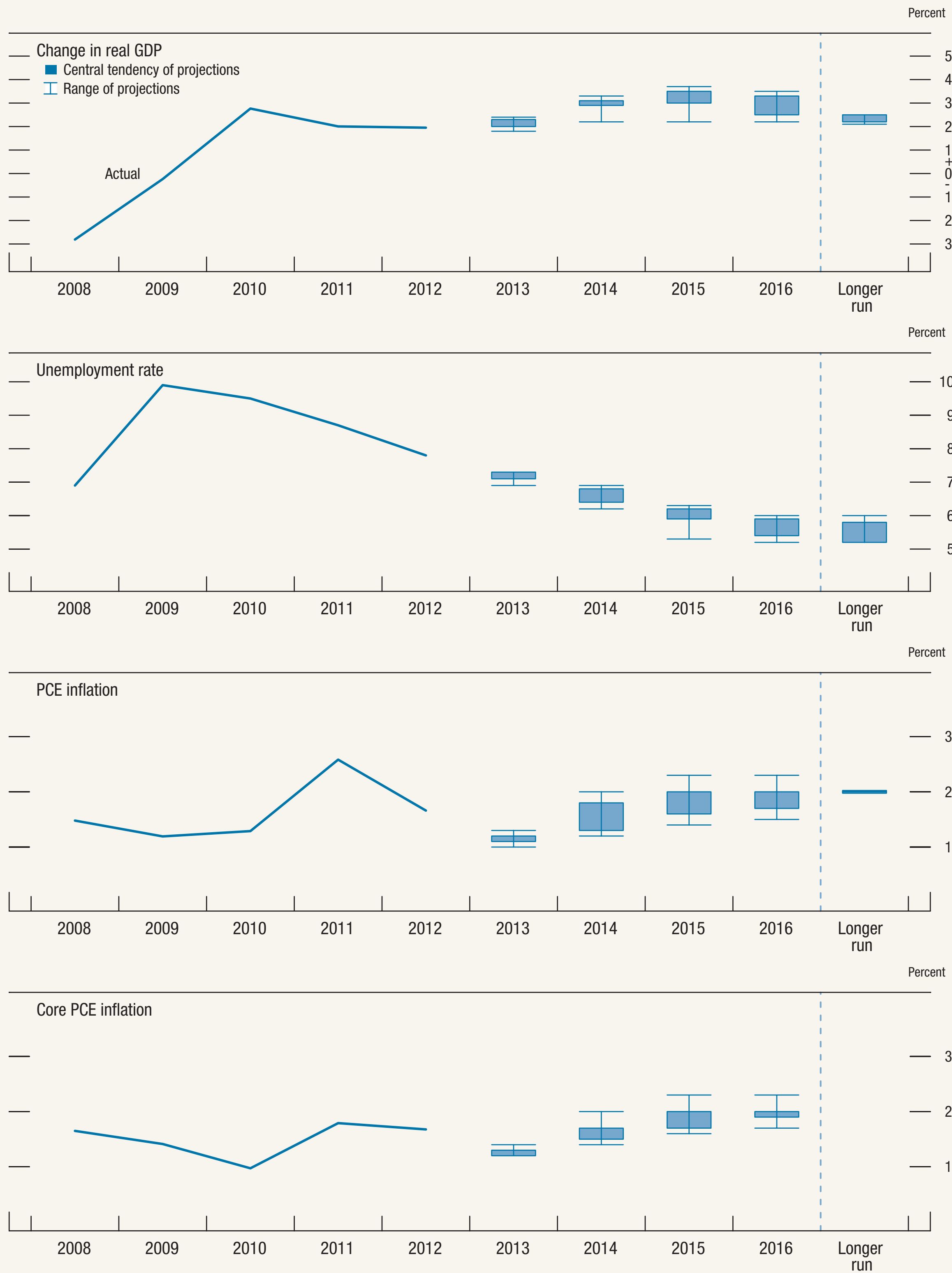
Note: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The June projections were made in conjunction with the meeting of the Federal Open Market Committee on June 18–19, 2013.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

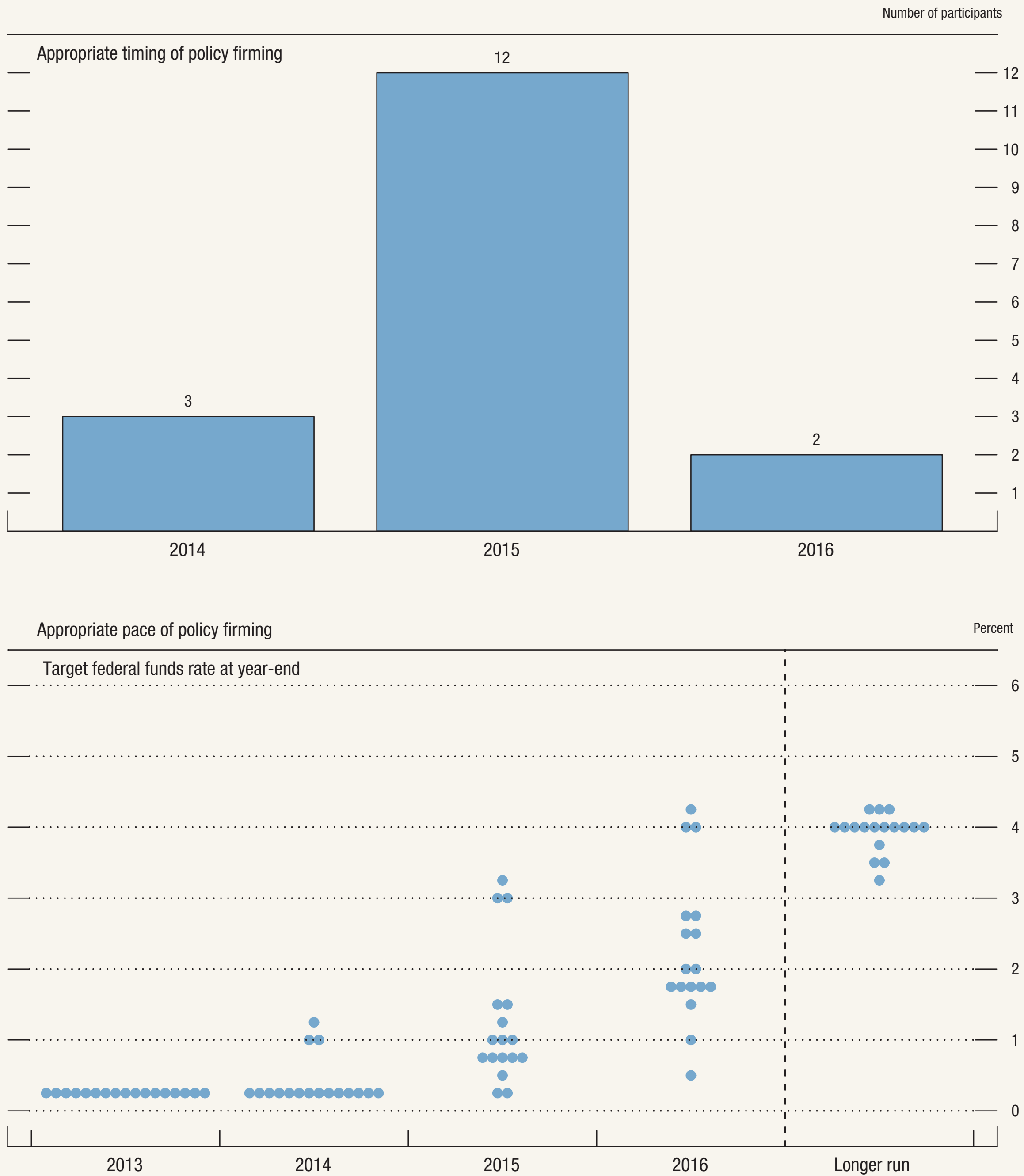
3 Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2013–16 and over the longer run



Note: Definitions of variables are in the general note to table 1. The data for the actual values of the variables are annual.

Figure 2. Overview of FOMC participants' assessments of appropriate monetary policy



Note: In the upper panel, the height of each bar denotes the number of FOMC participants who judge that, under appropriate monetary policy, the first increase in the target federal funds rate from its current range of 0 to ¼ percent will occur in the specified calendar year. In June 2013, the numbers of FOMC participants who judged that the first increase in the target federal funds rate would occur in 2013, 2014, 2015, and 2016 were, respectively, 1, 3, 14, and 1. In the lower panel, each shaded circle indicates the value (rounded to the nearest ¼ percentage point) of an individual participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run.

indicated that the risks were weighted to the downside.

The Outlook for Economic Activity

Participants generally projected that, conditional on their individual assumptions about appropriate monetary policy, real GDP growth would be similar in 2013 to its rate in 2012 and would increase in the 2014–16 period to a pace above what participants saw as the longer-run rate of output growth. Many participants pointed to diminishing restraint from fiscal policy, pent-up demand for consumer and producer durables, or rising household net worth as contributing to the pickup in growth. In addition, a number of participants noted continued improvement in the housing sector, supported by rising employment and income and by improved credit availability.

The central tendencies of participants' projections for real GDP growth were 2.0 to 2.3 percent in 2013, 2.9 to 3.1 percent in 2014, 3.0 to 3.5 percent in 2015, and 2.5 to 3.3 percent in 2016. In general, participants' projections for growth in 2013, 2014, and, to a lesser extent, 2015 were below those collected in June. Most participants attributed the downward revisions to their projections in 2013 and 2014 in part to weaker-than-expected incoming data, while some participants pointed to tighter financial conditions. The central tendency for the longer-run rate of growth of real GDP was 2.2 to 2.5 percent, little changed from June.

Participants anticipated a gradual decline in the unemployment rate over the projection period. The central tendencies of participants' forecasts for the unemployment rate in the fourth quarter of each year were 7.1 to 7.3 percent in 2013, 6.4 to 6.8 percent in 2014, 5.9 to 6.2 percent in 2015, and 5.4 to 5.9 percent in 2016. These projections were little changed from June. The central tendency of participants' estimates of the longer-run normal rate of unemployment that would prevail under appropriate monetary policy and in the absence of further shocks to the economy was 5.2 to 5.8 percent. A majority of participants projected that the unemployment rate would be near or slightly above their individual estimates of its longer-run level at the end of 2016.

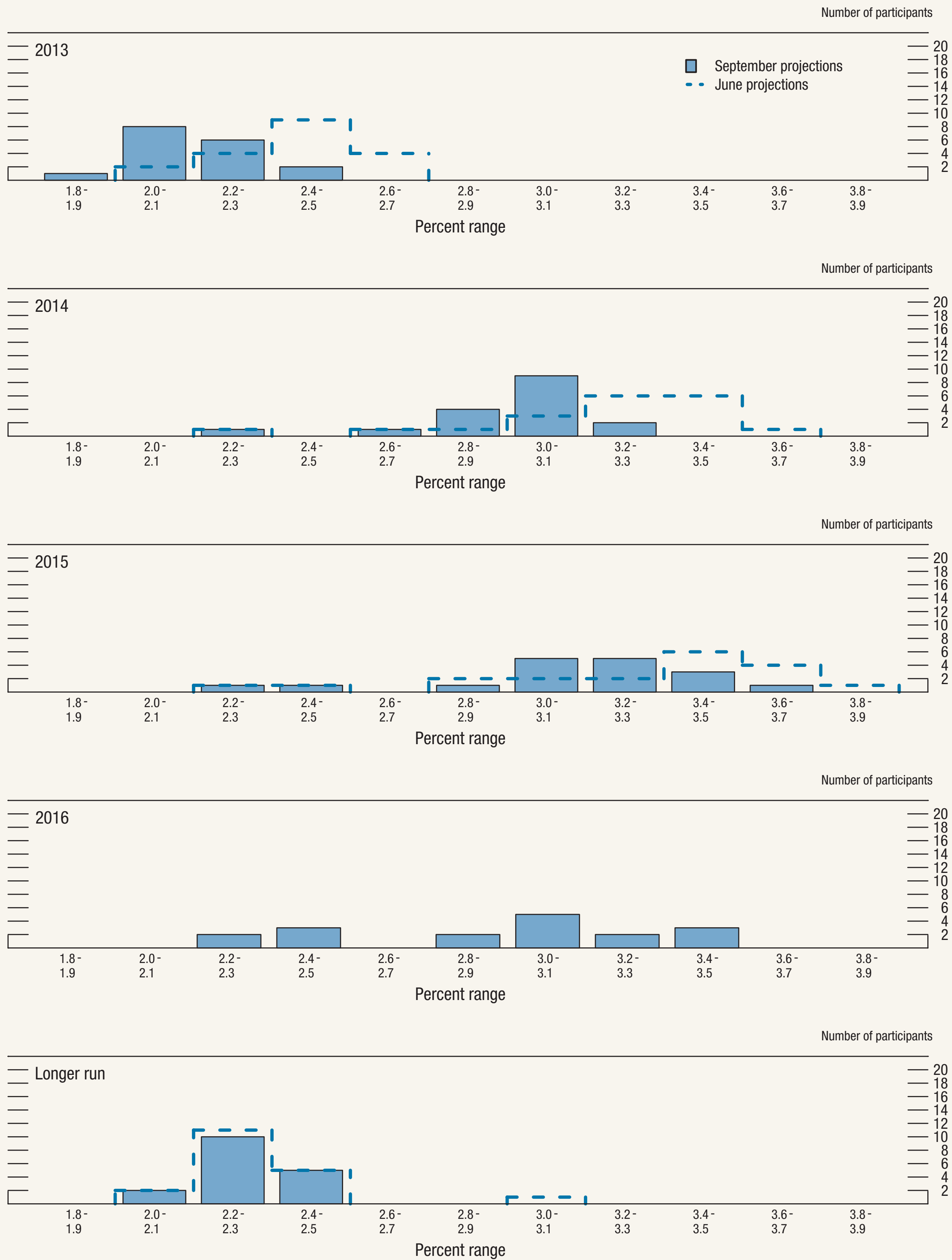
Figures 3.A and 3.B show that participants' views regarding the likely outcomes for real GDP growth and the unemployment rate in 2014 and 2015 remained dispersed. This diversity reflected their individual assessments of the likely rate of improvement in the housing sector and in household balance sheets, the domestic implications of foreign economic developments, the prospective path for U.S. fiscal policy, the likely evolution of financial conditions, and a number of other factors. Relative to June, the dispersions of participants' projections for GDP growth in 2014 and 2015 narrowed to some extent, while the dispersions of projections for the unemployment rate in those years generally widened a bit.

The Outlook for Inflation

Participants' views on the broad outlook for inflation under the assumption of appropriate monetary policy were little changed from June. Although most participants revised up slightly their projection for PCE inflation in 2013, a number of participants revised down a bit their forecasts for 2014. All participants anticipated that both headline and core inflation would rise gradually over the next few years, and almost all participants expected inflation to be at or somewhat below the Committee's 2 percent objective in 2016. Specifically, the central tendencies for PCE inflation were 1.1 to 1.2 percent in 2013, 1.3 to 1.8 percent in 2014, 1.6 to 2.0 percent in 2015, and 1.7 to 2.0 percent in 2016. The central tendencies of the forecasts for core inflation were little changed from June and broadly similar to those for the headline measure over the projection period. A number of participants viewed the combination of stable inflation expectations and diminishing resource slack as important factors leading to a gradual pickup in inflation toward the Committee's longer-run objective.

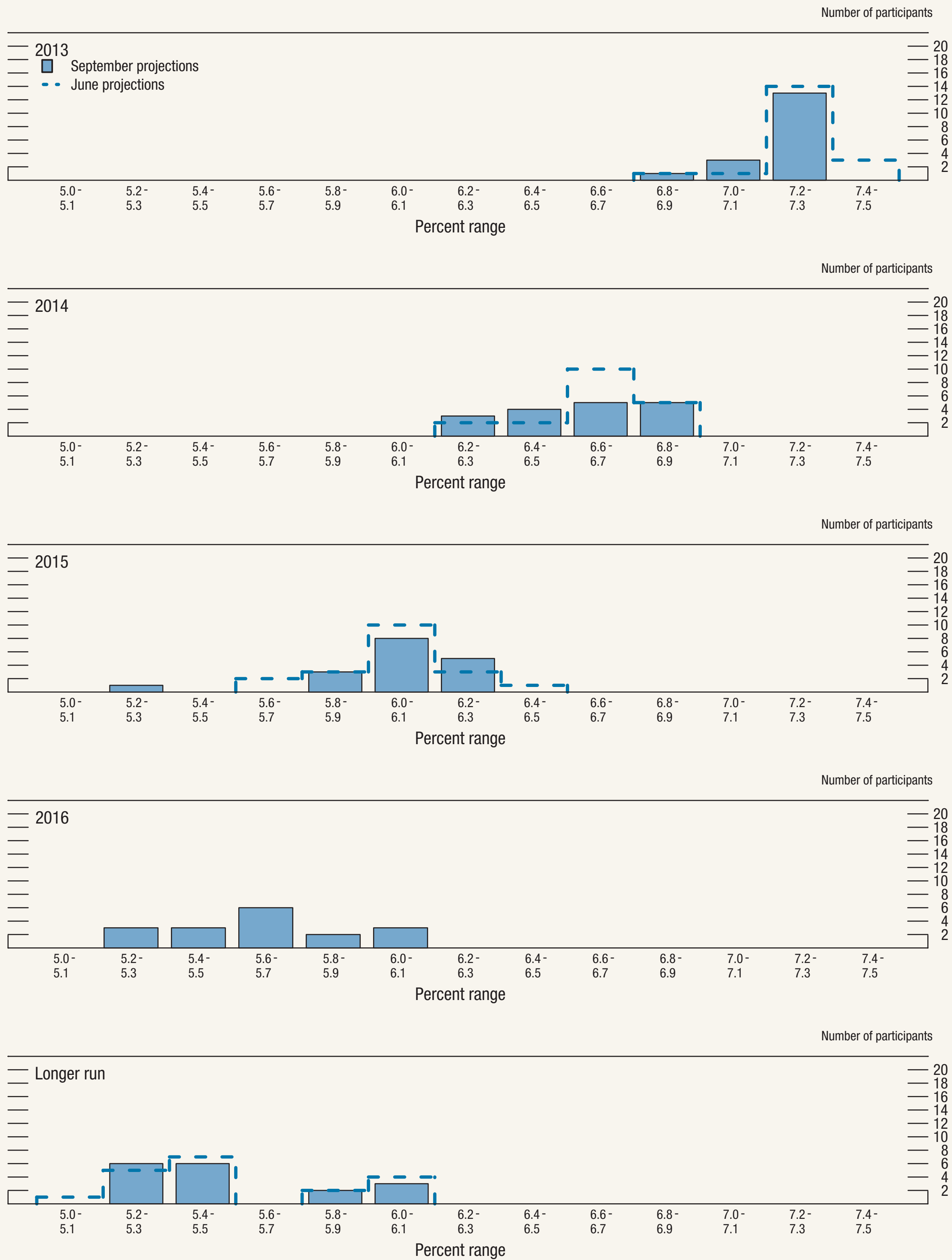
Figures 3.C and 3.D provide information on the diversity of participants' views about the outlook for inflation. The ranges of participants' projections for overall inflation in 2014 and 2015 widened slightly from June and were 1.2 to 2.0 percent in 2014 and 1.4 to 2.3 percent in 2015. In 2016, the forecasts for PCE inflation were concentrated near the Committee's longer-run objective, though one participant expected inflation to be noticeably above the Committee's objective and another expected it to be ½ percentage point below. Similar to the projections for headline inflation, the projections for core inflation became more concentrated near the 2 percent objective in 2016 than in earlier years; however, the dispersion of the projections for core inflation in each year was lower than for headline inflation.

Figure 3.A. Distribution of participants' projections for the change in real GDP, 2013–16 and over the longer run



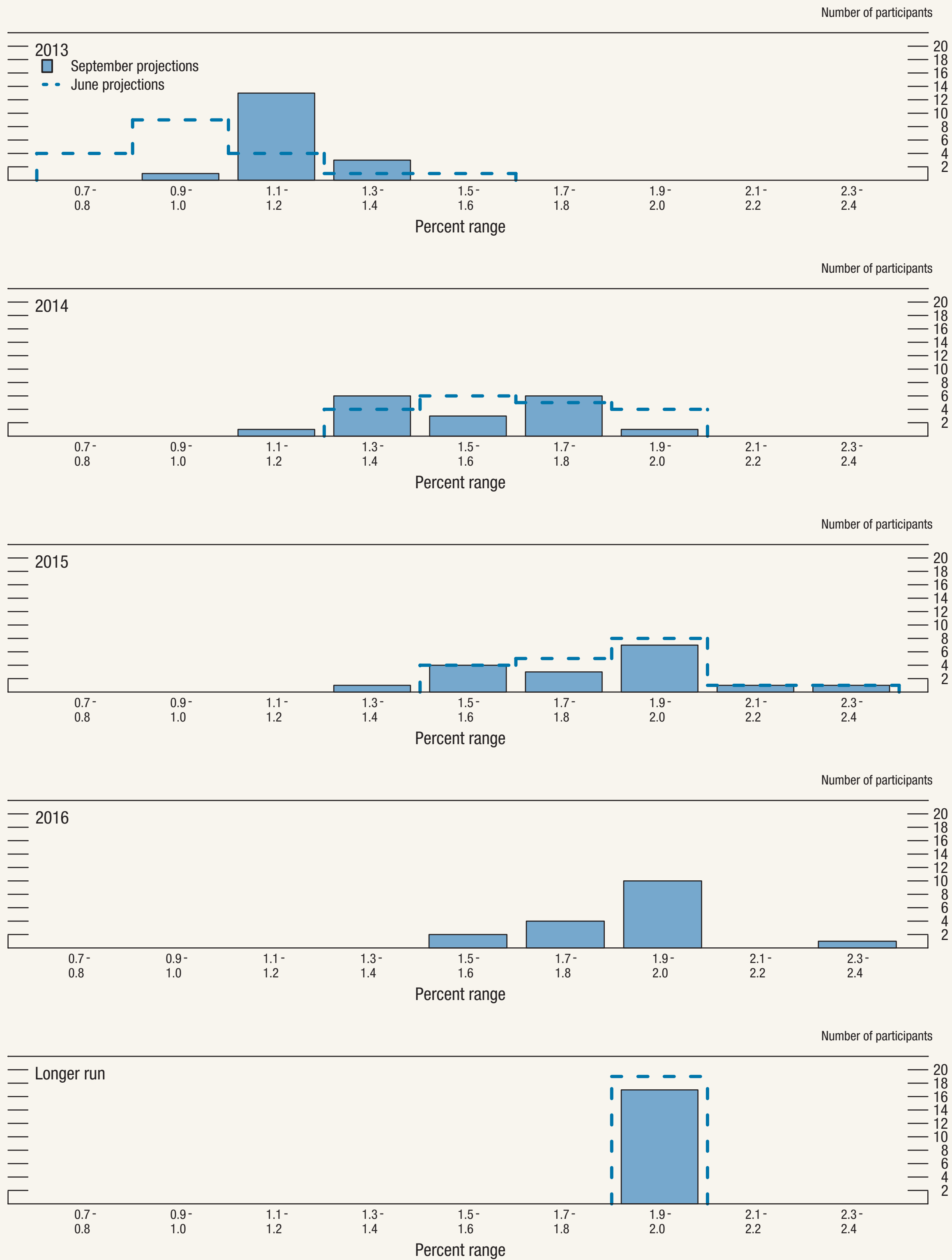
Note: Definitions of variables are in the general note to table 1.

Figure 3.B. Distribution of participants' projections for the unemployment rate, 2013–16 and over the longer run



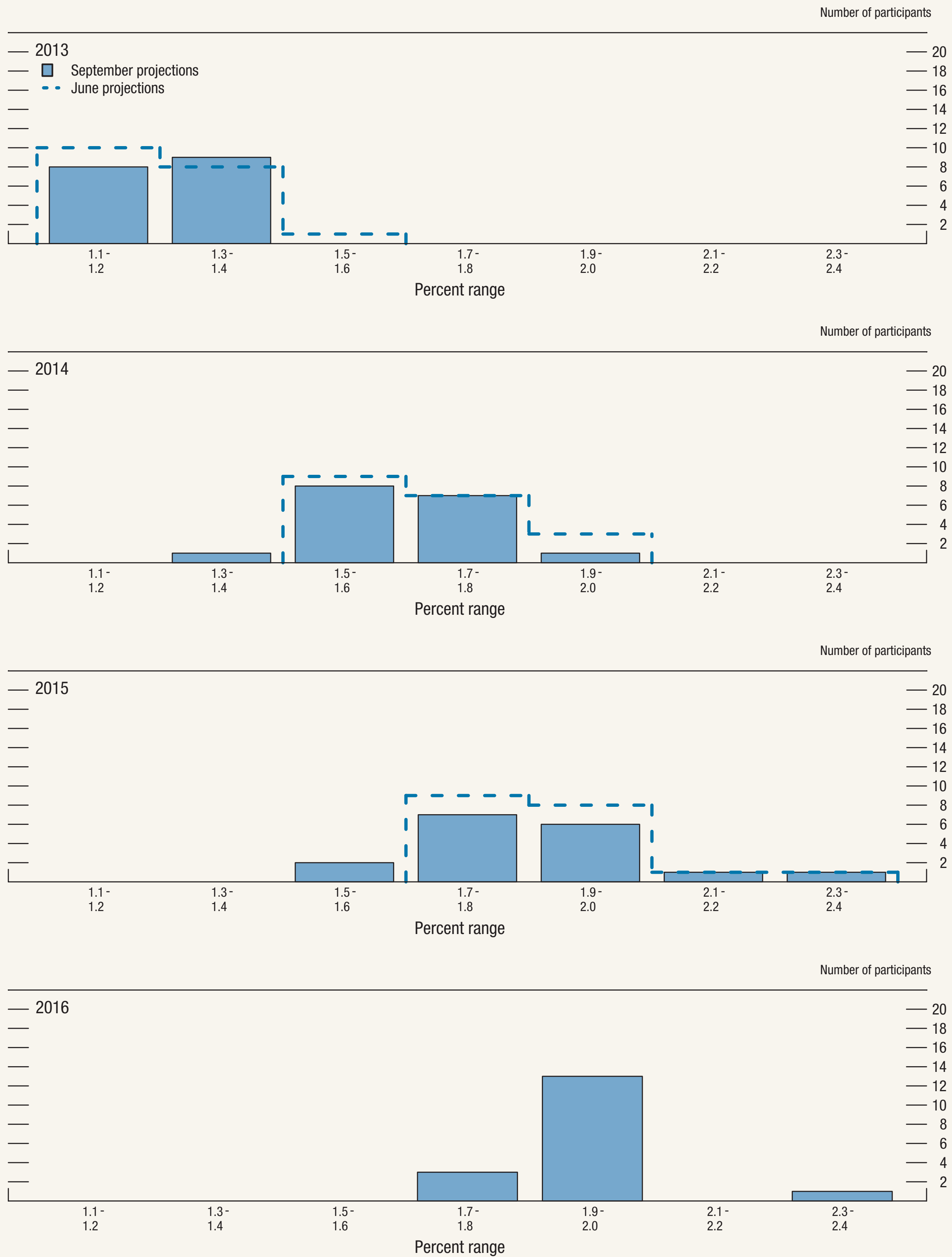
Note: Definitions of variables are in the general note to table 1.

Figure 3.C. Distribution of participants' projections for PCE inflation, 2013–16 and over the longer run



Note: Definitions of variables are in the general note to table 1.

Figure 3.D. Distribution of participants' projections for core PCE inflation, 2013–16



Note: Definitions of variables are in the general note to table 1.

Appropriate Monetary Policy

As indicated in figure 2, most participants judged that exceptionally low levels of the federal funds rate would remain appropriate for the next few years. In particular, 12 participants thought that the first increase in the target federal funds rate would not be warranted until sometime in 2015, and two judged that policy firming would likely not be appropriate until 2016. Three participants judged that an increase in the federal funds rate in 2014 would be appropriate.

All participants projected that the unemployment rate would be below the Committee's 6½ percent threshold at the end of the year in which they viewed the initial increase in the federal funds rate to be appropriate, and all but one judged that inflation would be at or below the Committee's longer-run objective. Almost all participants projected that the unemployment rate would still be above their view of its longer-run level at the end of the year in which they saw the federal funds rate increasing from the effective lower bound.

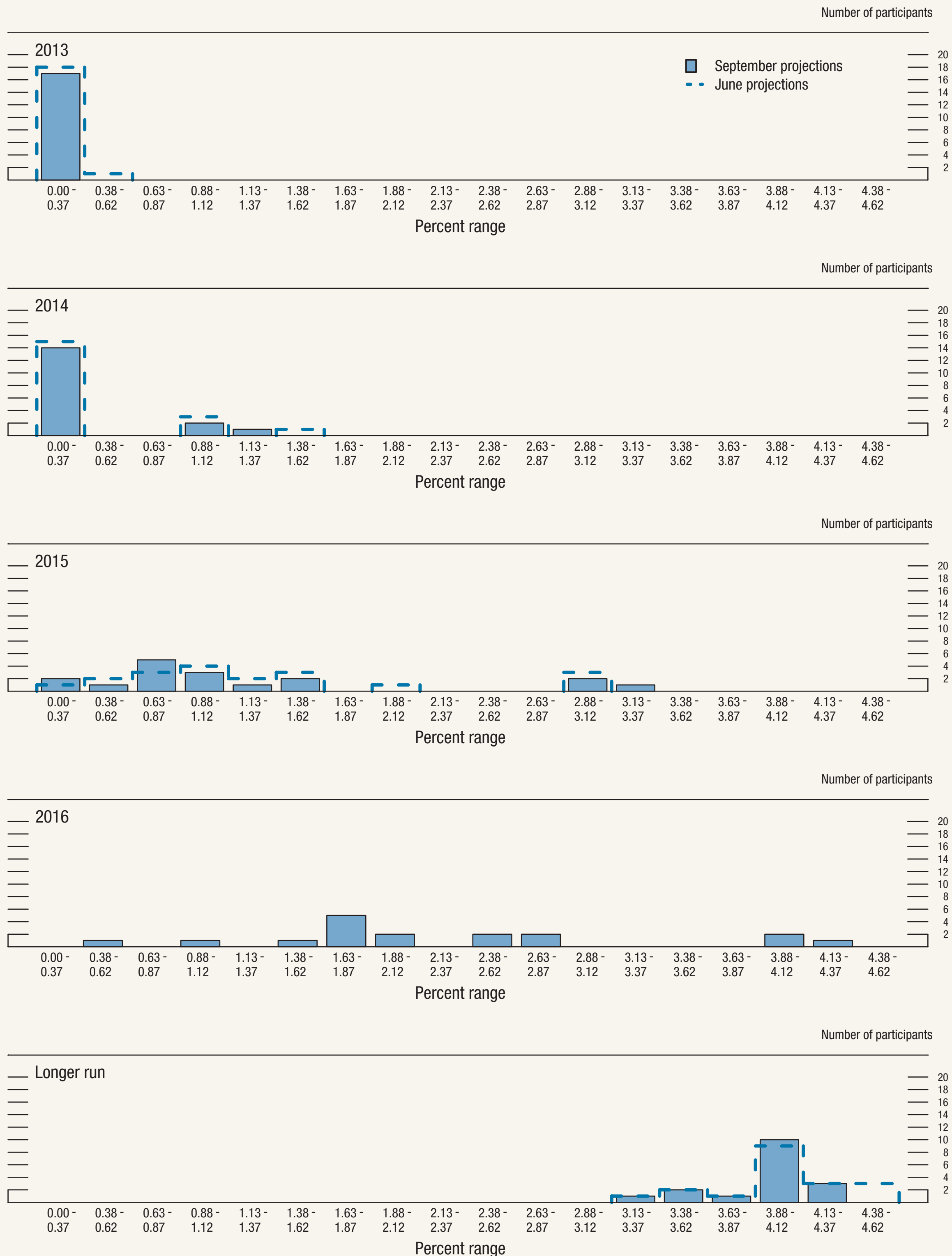
Figure 3.E provides the distribution of participants' judgments regarding the appropriate level of the target federal funds rate at the end of each calendar year from 2013 to 2016 and over the longer run. As noted above, most participants judged that economic conditions would warrant maintaining the current low level of the federal funds rate until 2015. Among the three participants who saw the federal funds rate leaving the effective lower bound earlier, projections for the federal funds rate at the end of 2014 ranged from 1 to 1¼ percent. These three participants viewed the appropriate level of the federal funds rate as 3 percent or higher at the end of 2015, while the remainder of participants saw the appropriate level of the funds rate as 1½ percent or lower. On balance, the dispersion of participants' projections for the appropriate federal funds rate at the end of 2015 widened a bit from June, while the median value of the rate was unchanged.

All of the participants who saw the first tightening in either 2015 or 2016 judged that the appropriate level of the federal funds rate at the end of 2016 would still be below their individual assessment of its expected longer-run value. In contrast, the three participants who saw the first tightening in 2014 believed that the appropriate level of the federal funds rate at the end of 2016 would be at their assessment of its longer-run level, which they viewed as either at or just above 4 percent. Among all participants, estimates of the longer-run target federal funds rate ranged from 3¼ to about 4¼ percent, reflecting the Committee's inflation objective of 2 percent and participants' individual judgments about the appropriate longer-run level of the real federal funds rate in the absence of further shocks to the economy.

Participants also described their views regarding the appropriate path of the Federal Reserve's balance sheet. Conditional on their respective economic outlooks, most participants judged that it would likely be appropriate to begin to reduce the pace of the Committee's purchases of longer-term securities this year and to conclude purchases in the middle of 2014. A couple of participants thought it appropriate for the first reduction in the pace of asset purchases to occur later, and another specified that purchases likely would continue past midyear 2014; in contrast, a couple of participants thought that the program should be ended considerably sooner than the middle of next year.

Participants' views of the appropriate path for monetary policy were informed by their judgments on the state of the economy, including the values of the unemployment rate and other labor market indicators that would be consistent with maximum employment, the extent to which the economy was currently falling short of maximum employment, the prospects for inflation to reach the Committee's longer-term objective of 2 percent, and the balance of risks around the outlook. Some participants also mentioned the usefulness of examining the implications of alternative policy strategies for returning employment and inflation to mandate-consistent levels over the medium term.

Figure 3.E. Distribution of participants' projections for the target federal funds rate, 2013–16 and over the longer run



Note: The target federal funds rate is measured as the level of the target rate at the end of the calendar year or in the longer run.

Uncertainty and Risks

Most participants judged that the levels of uncertainty about their projections for real GDP growth and unemployment were broadly similar to the norm during the previous 20 years, although four participants continued to see them as higher (figure 4).[2] The number of participants who viewed the risks around their GDP projections as weighted to the downside was nearly equal to the number who viewed them as broadly balanced. Most participants saw the risks around their unemployment projections as broadly balanced. The main factors cited as contributing to the uncertainty and balance of risks around economic outcomes were the limits on the ability of monetary policy at the zero lower bound to respond to adverse shocks, as well as challenges associated with forecasting the path of fiscal policy and developments abroad. In addition, some participants pointed to the tightening in financial conditions in recent months and the possibility of heightened volatility in financial markets, while others pointed to risks associated with structural changes affecting productivity growth and labor markets.

Participants reported little change in their assessments of the level of uncertainty and the balance of risks around their forecasts for overall PCE inflation and core inflation. Eleven participants judged the levels of uncertainty associated with their forecasts for those inflation measures to be broadly similar to historical norms; the same number saw the risks to those projections as broadly balanced. Five participants saw the risks to their inflation forecasts as tilted to the downside, reflecting, for example, the possibility that the current low levels of inflation could persist and become embedded in inflation expectations. Conversely, a couple of participants cited upside risks to inflation stemming from the current highly accommodative stance of monetary policy or concerns about the Committee's ability to shift to a less accommodative policy stance when it becomes appropriate to do so.

Table 2. Average historical projection error ranges
Percentage points

Variable	2013	2014	2015	2016
Change in real GDP[1]	±0.9	±1.5	±1.8	±1.9
Unemployment rate[1]	±0.3	±1.0	±1.6	±1.9
Total consumer prices[2]	±0.8	±1.0	±1.1	±1.1

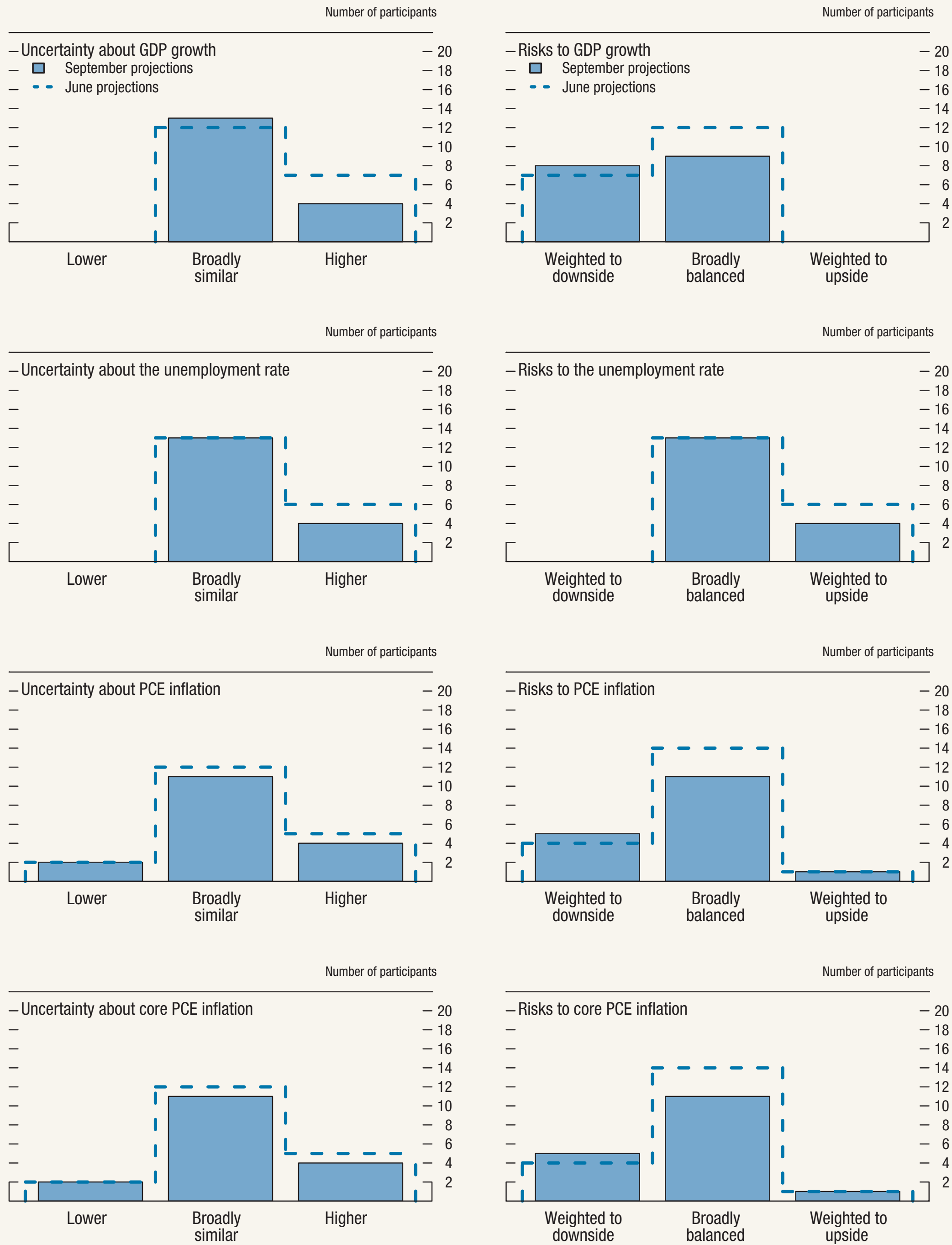
Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1993 through 2012 that were released in the fall by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information may be found in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 Definitions of variables are in the general note to table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

2 Table 2 provides estimates of the forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1993 through 2012. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in the economic forecasts and explains the approach used to assess the uncertainty and risks attending the participants' projections.

Figure 4. Uncertainty and risks in economic projections



Note: For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty." Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world, and the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by the Federal Reserve Board's staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.1 to 3.9 percent in the current year, 1.5 to 4.5 percent in the second year, 1.2 to 4.8 percent in the third year, and 1.1 to 4.9 percent in the fourth year. The corresponding 70 percent confidence intervals for overall inflation would be 1.2 to 2.8 percent in the current year, 1.0 to 3.0 percent in the second year, and 0.9 to 3.1 percent in the third and fourth years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past, as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

As with real activity and inflation, the outlook for the future path of the federal funds rate is subject to considerable uncertainty. This uncertainty arises primarily because each participant's assessment of the appropriate stance of monetary policy depends importantly on the evolution of real activity and inflation over time. If economic conditions evolve in an unexpected manner, then assessments of the appropriate setting of the federal funds rate would change from that point forward.

Meeting Held on October 29–30, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, October 29, 2013, at 1:00 p.m. and continued on Wednesday, October 30, 2013, at 9:00 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Charles L. Evans

Esther L. George

Jerome H. Powell

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Michael P. Leahy, Stephen A. Meyer, Daniel G. Sullivan, Christopher J. Waller, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Michael S. Gibson
Director, Division of Banking Supervision and Regulation, Board of Governors

James A. Clouse
Deputy Director, Division of Monetary Affairs, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Trevor A. Reeve
Senior Associate Director, Division of International Finance, Board of Governors

Ellen E. Meade and Joyce K. Zickler
Senior Advisers, Division of Monetary Affairs, Board of Governors

Eric M. Engen, Michael T. Kiley, Thomas Laubach, and David E. Lebow
Associate Directors, Division of Research and Statistics, Board of Governors

Marnie Gillis DeBoer
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Rochelle M. Edge
Assistant Director, Office of Financial Stability Policy and Research, Board of Governors

Eric Engstrom
Section Chief, Division of Research and Statistics, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Mark A. Carlson
Senior Economist, Division of Monetary Affairs, Board of Governors

Robert J. Tetlow
Senior Economist, Division of Research and Statistics, Board of Governors

Blake Prichard
First Vice President, Federal Reserve Bank of Philadelphia

David Altig, Glenn D. Rudebusch, and Mark S. Sniderman
Executive Vice Presidents, Federal Reserve Banks of Atlanta, San Francisco, and Cleveland, respectively

Craig S. Hakkio, Evan F. Koenig, Lorie K. Logan, and Kei-Mu Yi
Senior Vice Presidents, Federal Reserve Banks of Kansas City, Dallas, New York, and Minneapolis, respectively

Anna Nordstrom and Giovanni Olivei
Vice Presidents, Federal Reserve Banks of New York and Boston, respectively

Argia M. Sbordone
Assistant Vice President, Federal Reserve Bank of New York

Andreas L. Hornstein
Senior Advisor, Federal Reserve Bank of Richmond

Satyajit Chatterjee
Senior Economic Advisor, Federal Reserve Bank of Philadelphia

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets as well as System open market operations, including the progress of the overnight reverse repurchase agreement operational exercise, during the period since the Federal Open Market Committee (FOMC) met on September 17–18, 2013. By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

The Committee considered a proposal to convert the existing temporary central bank liquidity swap arrangements to standing arrangements with no preset expiration dates. The Manager described the proposed arrangements, noting that the Committee would still be asked to review participation in the arrangements annually. A couple of participants expressed reservations about the proposal, citing opposition to swap lines with foreign central banks in general or questioning the governance implications of these standing arrangements in particular. Following the discussion, the Committee unanimously approved the following resolution:

> "The Federal Open Market Committee directs the Federal Reserve Bank of New York to convert the existing temporary dollar liquidity swap arrangements with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank to standing facilities, with the modifications approved by the Committee. In addition, the Federal Open Market Committee directs the Federal Reserve Bank of New York to convert the existing temporary foreign currency liquidity swap arrangements with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, and the Swiss National Bank to standing facilities, also with the modifications approved by the Committee.
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> Drawings on the dollar and foreign currency liquidity swap lines will be approved by the Chairman in consultation with the Foreign Currency Subcommittee. The Foreign Currency Subcommittee will consult with the Federal Open Market Committee prior to the initial drawing on the dollar or foreign currency liquidity swap lines if possible under the circumstances then prevailing; authority to approve subsequent drawings of a more routine character for either the dollar or foreign currency liquidity swap lines may be delegated to the Manager, in consultation with the Chairman.
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> The Chairman may change the rates and fees on the swap arrangements by mutual agreement with the foreign central banks and in consultation with the Foreign Currency Subcommittee. The Chairman shall keep the Federal Open Market Committee informed of any changes in rates or fees, and the rates and fees shall be consistent with principles discussed with and guidance provided by the Committee."

Staff Review of the Economic Situation

In general, the data available at the time of the October 29–30 meeting suggested that economic activity continued to rise at a moderate pace; the set of information reviewed for this meeting, however, was reduced somewhat by delays in selected statistical

releases associated with the partial shutdown of the federal government earlier in the month. In the labor market, total payroll employment increased further in September, but the unemployment rate was still high. Consumer price inflation continued to be modest, and measures of longer-run inflation expectations remained stable.

Private nonfarm employment rose in September but at a slower pace than in the previous month, while total government employment increased at a solid rate. The unemployment rate edged down to 7.2 percent in September; both the labor force participation rate and the employment-to-population ratio were unchanged. Other recent indicators of labor market activity were mixed. Measures of firms' hiring plans improved, the rate of job openings increased slightly, and the rate of long-duration unemployment declined a little. However, household expectations of the labor market situation deteriorated somewhat, the rate of gross private-sector hiring remained flat, and the share of workers employed part time for economic reasons was essentially unchanged and continued to be elevated. In addition, initial claims for unemployment insurance rose in the first few weeks of October, likely reflecting, in part, some spillover effects from the government shutdown.

Manufacturing production expanded modestly in September, but output was flat outside of the motor vehicle sector and the rate of total manufacturing capacity utilization was unchanged. Automakers' schedules indicated that the pace of light motor vehicle assemblies would be slightly lower in the coming months, but broader indicators of manufacturing production, such as the readings on new orders from the national and regional manufacturing surveys, pointed to further gains in factory output in the near term.

Real personal consumption expenditures (PCE) rose moderately in August. In September, nominal retail sales, excluding those at motor vehicle and parts outlets, increased significantly, while sales of light motor vehicles declined. Recent readings on key factors that influence consumer spending were somewhat mixed: Households' net worth likely expanded further as both equity values and home prices rose in recent months, and real disposable incomes increased solidly in August, but measures of consumer sentiment declined in September and October.

The recovery in the housing sector appeared to continue, although recent data in this sector were limited. Starts and permits of new single-family homes increased in August, but starts and permits of multifamily units declined. After falling significantly in July, sales of new homes increased in August, but existing home sales decreased, on balance, in August and September, and pending home sales also contracted.

Growth in real private expenditures for business equipment and intellectual property products appeared to be tepid in the third quarter. Nominal shipments of nondefense capital goods excluding aircraft rose modestly, on balance, in August and September after declining in July. However, nominal new orders for these capital goods continued to be above the level of shipments, pointing to increases in shipments in subsequent months, and other forward-looking indicators, such as surveys of business conditions, were consistent with some gains in business equipment spending in the near term. Nominal business expenditures for nonresidential construction were essentially unchanged in August. Recent book-value data for inventory-to-sales ratios, along with readings on inventories from national and regional manufacturing surveys, did not point to notable inventory imbalances.

Real federal government purchases likely declined as federal employment edged down further in September and many federal employees were temporarily furloughed during the partial government shutdown in October. Real state and local government purchases, however, appeared to increase; the payrolls of these governments expanded briskly in September, and nominal state and local construction expenditures rose in August.

The U.S. international trade deficit remained about unchanged in August, as both exports and imports were flat.

Available measures of total U.S. consumer prices—the PCE price index for August and the consumer price index for September—increased modestly, as did the core measures, which exclude prices of food and energy. Both near- and longer-term inflation expectations from the Thomson Reuters/University of Michigan Surveys of Consumers were little changed, on balance, in September and October. Nominal average hourly earnings for all employees increased slowly in September.

Foreign economic growth appeared to improve in the third quarter following a sluggish first half, largely

reflecting stronger growth estimated for China and a rebound in Mexico from contraction in the previous quarter. Growth also picked up in the third quarter in the United Kingdom, and available indicators suggested an increase in growth in Canada and continued mild recovery in the euro area. Economic activity in Japan appeared to have decelerated somewhat from its first-half pace but continued to expand, and inflation measured on a 12-month basis turned positive in the middle of this year. Inflation elsewhere generally remained subdued. Monetary policy stayed highly accommodative in advanced foreign economies. In addition, the Bank of Mexico continued to ease monetary policy, citing concerns about the strength of the economy, but central banks in certain other emerging market economies, including Brazil and India, tightened policy and intervened in currency markets in response to concerns about the potential effect of currency depreciation on inflation.

Staff Review of the Financial Situation

On balance over the intermeeting period, longer-term interest rates declined and equity prices rose, largely in response to expectations for more-accommodative monetary policy. In addition, financial markets were affected for a time by uncertainties about raising the federal debt limit and resolving the government shutdown.

Financial market views about the outlook for monetary policy shifted notably following the September FOMC meeting, as the outcome and communications from that meeting were seen as more accommodative than expected. Investors pushed out their anticipated timing of both the first reduction in the pace of FOMC asset purchases and the first hike in the target federal funds rate. The path of the federal funds rate implied by financial market quotes shifted down over the period, as did the path based on the results from the Desk's survey of primary dealers. The Desk's survey also indicated that the dealers had revised up their expectations of the total size of the Committee's asset purchase program. Concerns about the fiscal situation and somewhat weaker-than-expected economic data releases also contributed to the change in expectations about the timing of monetary policy actions.

Five- and 10-year yields on both nominal and inflation-protected Treasury securities declined 30 basis points or more over the intermeeting period. The reduction in longer-term Treasury yields was also reflected in other longer-term rates, such as those on agency mortgage-backed securities (MBS) and corporate securities.

Short-term funding markets were adversely affected for a time by concerns about potential delays in raising the federal debt limit. The Treasury bill market was particularly affected as yields on bills maturing between mid-October and early November rose sharply and some bill auctions saw reduced demand. Conditions in other short-term markets, such as the market for repurchase agreements, were also strained. However, these effects eased quickly after an agreement to raise the debt limit was reached in mid-October.

Credit flows to nonfinancial businesses appeared to slow somewhat during the fiscal standoff amid increased market volatility; however, access to credit generally remained ample for large firms. Gross issuance of nonfinancial corporate bonds and commercial paper, which had been particularly strong in September, slowed a bit in October. In September, leveraged loan issuance was also robust. Commercial and industrial (C&I) loans at banks continued to advance, on balance, in the third quarter at about the pace posted in the previous quarter, and commercial real estate (CRE) loans at banks rose moderately. In response to the October Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS), banks generally indicated that they had eased standards on C&I and CRE loans over the past three months.

Developments affecting financing for the household sector were generally favorable. House prices posted further gains in August. Mortgage rates declined over the intermeeting period, although they were still above their early-May lows. Mortgage refinancing applications were down dramatically compared with May, but purchase applications were only a bit below their earlier level. Some large banks responding to the October SLOOS reported having eased standards on home-purchase loans to prime borrowers on net. In nonmortgage credit, automobile loans and student loans continued to expand at a robust pace, while balances on revolving consumer credit were again about flat.

In the municipal bond market, issuance of bonds for new capital projects remained solid. Yields on 20-year general obligation municipal bonds decreased about in line with other longer-term market rates over the intermeeting period.

Bank credit declined slightly during the third quarter. Growth of core loans slowed, primarily because of a sizable decline in outstanding balances of residential mortgages on banks' books. Third-quarter earnings reports for large banks generally met or exceeded analysts' modest expectations.

M2 grew moderately in September. Preliminary data indicated that growth in M2 picked up temporarily in early October amid uncertainty about the passage of debt limit legislation; deposits increased sharply as institutional investors appeared to shift from money fund shares to bank deposits, and as money funds increased their bank deposits in anticipation of possible redemptions. These inflows to deposits were estimated to have reversed shortly after the debt limit agreement was reached.

Foreign stock prices rose, foreign yields and yield spreads declined, and the dollar depreciated against most other currencies. A large portion of these asset price changes occurred immediately following the September FOMC announcement. In addition, yields and the value of the dollar fell further after the debt ceiling agreement was reached and in response to the U.S. labor market report. Mutual fund flows to emerging markets stabilized, following large outflows earlier this year.

Staff Economic Outlook

In the economic projection prepared by the staff for the October FOMC meeting, the forecast for growth in real gross domestic product (GDP) in the near term was revised down somewhat from the one prepared for the previous meeting, primarily reflecting the effects of the federal government shutdown and some data on consumer spending that were softer than anticipated. In contrast, the staff's medium-term forecast for real GDP was revised up slightly, mostly reflecting lower projected paths for the foreign exchange value of the dollar and longer-term interest rates, along with somewhat higher projected paths for equity prices and home values. The staff anticipated that the pace of expansion in real GDP this year would be about the same as the growth rate of potential output but continued to project that real GDP would accelerate in 2014 and 2015, supported by an easing in the effects of fiscal policy restraint on economic growth, increases in consumer and business sentiment, further improvements in credit availability and financial conditions, and accommodative monetary policy. Real GDP growth was projected to begin to slow a little in 2016 but to remain above potential output growth. The expansion in economic activity was anticipated to slowly reduce resource slack over the projection period, and the unemployment rate was expected to decline gradually.

The staff's forecast for inflation was little changed from the projection prepared for the previous FOMC meeting. The staff continued to expect that inflation would be modest in the second half of this year, but higher than its level in the first half. Over the medium term, with longer-run inflation expectations assumed to remain stable, changes in commodity and import prices expected to be relatively small, and slack in labor and product markets persisting over most of the projection period, inflation was projected to run somewhat below the FOMC's longer-run inflation objective of 2 percent through 2016.

The staff continued to see a number of risks around the forecast. The downside risks to economic activity included the uncertain effects and future course of fiscal policy, concerns about the outlook for consumer spending growth, and the potential effects on residential construction of the increase in mortgage rates since the spring. With regard to inflation, the staff saw risks both to the downside, that the low rates of core consumer price inflation posted earlier this year could be more persistent than anticipated, and to the upside, that unanticipated increases in energy or other commodity prices could emerge.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and the outlook, meeting participants generally indicated that the broad contours of their medium-term economic projections had not changed materially since the September meeting. Although the incoming data suggested that growth in the second half of 2013 might prove somewhat weaker than many of them had previously anticipated, participants broadly continued to project the pace of economic activity to pick up. The acceleration over the medium term was expected to be bolstered by the gradual abatement of headwinds that have been slowing the pace of economic recovery—such as household-sector deleveraging, tight credit conditions for some households and businesses, and fiscal restraint—as well as improved prospects for global growth. While downside risks to the outlook for the economy and the labor market were generally viewed as having diminished, on balance, since last fall, several significant risks remained,

including the uncertain effects of ongoing fiscal drag and of the continuing fiscal debate.

Consumer spending appeared to have slowed somewhat in the third quarter. A number of participants noted that their outlook for stronger economic activity was contingent on a pickup in growth of consumer spending and reviewed the factors that might contribute to such a development, including low interest rates, easing of debt burdens, continued gains in employment, lower gasoline prices, higher real incomes, and higher household wealth boosted by rising home prices and equity values. Nonetheless, consumer sentiment remained unusually low, posing a downside risk to the forecast, and uncertainty surrounding prospective fiscal deliberations could weigh further on consumer confidence. A few participants commented that a pickup in the growth rates of economic activity or real disposable income could require improvements in productivity growth. However, it was noted that slower growth in productivity might have become the norm.

Business contacts generally reported continued moderate growth in sales, but remained cautious about expanding payrolls and capital expenditures. Manufacturing activity in parts of the country was reported to have picked up, and auto sales remained strong. Reports from several Districts indicated that commercial real estate and housing-related business activity continued to advance. In the agricultural sector, crop yields were healthy, farmland values were up, and lower crop prices were increasing the affordability of livestock feed. Wage and cost pressures remained limited, but business contacts in some Districts mentioned that selected labor markets were tight or expressed concerns about a shortage of skilled workers. Reports from the retail sector were mixed, with remarks about higher luxury sales and expectations for reduced hiring of seasonal workers over the upcoming holiday season. Uncertainty about future fiscal policy and the regulatory environment, including changes in health care, were mentioned as weighing on business planning.

Participants generally saw the direct economic effects of the partial shutdown of the federal government as temporary and limited, but a number of them expressed concern about the possible economic effects of repeated fiscal impasses on business and consumer confidence. More broadly, fiscal policy, which has been exerting significant restraint on economic growth, was expected to become somewhat less restrictive over the forecast period. Nonetheless, it was noted that the stance of fiscal policy was likely to remain one of the most important headwinds restraining growth over the medium term.

Although a number of participants indicated that the September employment report was somewhat disappointing, they judged that the labor market continued to improve, albeit slowly. The limited pace of gains in wages and payrolls, as well as the number of employees working part time for economic reasons, were mentioned as evidence of substantial remaining slack in the labor market. The drop in the unemployment rate over the past year, while welcome and significant, could overstate the degree of improvement in labor market conditions, in part because of the decline in the labor force participation rate. However, a few participants offered reasons why recent readings on the unemployment rate might provide an accurate assessment, on balance, of the extent of improvement in the labor market. For instance, if the decline in labor force participation reflected decisions to retire, it was unlikely to be reversed, because retirees were unlikely to return to the labor force. Furthermore, a secular decline in labor market dynamism, or turnover, might have contributed to a reduction in the size of normal monthly payroll gains. Finally, revised data showed that the historical relationship between real GDP growth and changes in the unemployment rate had remained broadly in place in recent years, suggesting that the unemployment rate continued to provide a reasonably accurate signal about the strength of the labor market and the degree of slack in the economy.

Available information suggested that inflation remained subdued and below the Committee's longer-run objective of 2 percent. Similarly, longer-run inflation expectations remained stable and, by some measures, below 2 percent.

Financial conditions eased notably over the intermeeting period, with declines in longer-term interest rates and increases in equity values. Financial quotes suggested that markets moved out the date at which they expected to see the Committee first increase the federal funds rate target. It was noted that interest rate volatility was substantially lower than at the time of the September meeting, and a couple of participants pointed to signs suggesting that reaching-for-yield behavior might be increasing again. Nevertheless, term premiums appeared to only partially retrace their rise of earlier in the year, and longer-term interest rates remained well above their levels in the spring. A few participants expressed concerns

about the eventual economic impact of the change in financial conditions since the spring; in particular, increases in mortgage rates and home prices had reduced the affordability of housing, and the higher rates were at least partly responsible for some slowing in that sector. One participant stated that the extended period of near-zero interest rates continued to create challenges for the banking industry, as net interest margins remained under pressure.

Policy Planning

After an introductory briefing by the staff, meeting participants had a wide-ranging discussion of topics related to the path of monetary policy over the medium term, including strategic and communication issues associated with the Committee's asset purchase program as well as possibilities for clarifying or strengthening its forward guidance for the federal funds rate. In this context, participants discussed the financial market response to the Committee's decisions at its June and September meetings and, more generally, the complexities associated with communications about the Committee's current policy tools. A number of participants noted that recent movements in interest rates and other indicators suggested that financial markets viewed the Committee's tools—asset purchases and forward guidance regarding the federal funds rate—as closely linked. One possible explanation for this view was an inference on the part of investors that a change in asset purchases reflected a change in the Committee's outlook for the economy, which would be associated with adjustments in both the purchase program and the expected path of policy rates; another was a perspective that a change in asset purchases would be read as providing information about the willingness of the Committee to pursue its economic objectives with both tools. A couple of participants observed that the decision at the September FOMC meeting might have strengthened the credibility of monetary policy, as suggested by the downward shift in the expected path of short-term interest rates that had brought the path more closely into alignment with the Committee's forward guidance. Participants broadly endorsed making the Committee's communications as simple, clear, and consistent as possible, and discussed ways of doing so. With regard to the asset purchase program, one suggestion was to repeat a set of principles in public communications; for example, participants could emphasize that the program was data dependent, that any reduction in the pace of purchases would depend on both the cumulative progress in labor markets since the start of the program as well as the outlook for future gains, and that a continuing assessment of the efficacy and costs of asset purchases might lead the Committee to decide at some point to change the mix of its policy tools while maintaining a high degree of accommodation. Another suggestion for enhancing communications was to use the Summary of Economic Projections to provide more information about participants' views.

During this general discussion of policy strategy and tactics, participants reviewed issues specific to the Committee's asset purchase program. They generally expected that the data would prove consistent with the Committee's outlook for ongoing improvement in labor market conditions and would thus warrant trimming the pace of purchases in coming months. However, participants also considered scenarios under which it might, at some stage, be appropriate to begin to wind down the program before an unambiguous further improvement in the outlook was apparent. A couple of participants thought it premature to focus on this latter eventuality, observing that the purchase program had been effective and that more time was needed to assess the outlook for the labor market and inflation; moreover, international comparisons suggested that the Federal Reserve's balance sheet retained ample capacity relative to the scale of the U.S. economy. Nonetheless, some participants noted that, if the Committee were going to contemplate cutting purchases in the future based on criteria other than improvement in the labor market outlook, such as concerns about the efficacy or costs of further asset purchases, it would need to communicate effectively about those other criteria. In those circumstances, it might well be appropriate to offset the effects of reduced purchases by undertaking alternative actions to provide accommodation at the same time.

Participants generally expressed reservations about the possibility of introducing a simple mechanical rule that would adjust the pace of asset purchases automatically based on a single variable such as the unemployment rate or payroll employment. While some were open to considering such a rule, others viewed that approach as unlikely to reliably produce appropriate policy outcomes. As an alternative, some participants mentioned that it might be preferable to adopt an even simpler plan and announce a total size of remaining purchases or a timetable for winding down the program. A calendar-based step-down would run counter to the data-dependent, state-contingent nature of the current asset purchase program, but it would be easier to communicate and

might help the public separate the Committee's purchase program from its policy for the federal funds rate and the overall stance of policy. With regard to future reductions in asset purchases, participants discussed how those might be split across asset classes. A number of participants believed that making roughly equal adjustments to purchases of Treasury securities and MBS would be appropriate and relatively straightforward to communicate to the public. However, some others indicated that they could back trimming the pace of Treasury purchases more rapidly than those of MBS, perhaps to signal an intention to support mortgage markets, and one participant thought that trimming MBS first would reduce the potential for distortions in credit allocation.

As part of the planning discussion, participants also examined several possibilities for clarifying or strengthening the forward guidance for the federal funds rate, including by providing additional information about the likely path of the rate either after one of the economic thresholds in the current guidance was reached or after the funds rate target was eventually raised from its current, exceptionally low level. A couple of participants favored simply reducing the 6½ percent unemployment rate threshold, but others noted that such a change might raise concerns about the durability of the Committee's commitment to the thresholds. Participants also weighed the merits of stating that, even after the unemployment rate dropped below 6½ percent, the target for the federal funds rate would not be raised so long as the inflation rate was projected to run below a given level. In general, the benefits of adding this kind of quantitative floor for inflation were viewed as uncertain and likely to be rather modest, and communicating it could present challenges, but a few participants remained favorably inclined toward it. Several participants concluded that providing additional qualitative information on the Committee's intentions regarding the federal funds rate after the unemployment threshold was reached could be more helpful. Such guidance could indicate the range of information that the Committee would consider in evaluating when it would be appropriate to raise the federal funds rate. Alternatively, the policy statement could indicate that even after the first increase in the federal funds rate target, the Committee anticipated keeping the rate below its longer-run equilibrium value for some time, as economic headwinds were likely to diminish only slowly. Other factors besides those headwinds were also mentioned as possibly providing a rationale for maintaining a low trajectory for the federal funds rate, including following through on a commitment to support the economy by maintaining more-accommodative policy for longer. These or other modifications to the forward guidance for the federal funds rate could be implemented in the future, either to improve clarity or to add to policy accommodation, perhaps in conjunction with a reduction in the pace of asset purchases as part of a rebalancing of the Committee's tools.

Participants also discussed a range of possible actions that could be considered if the Committee wished to signal its intention to keep short-term rates low or reinforce the forward guidance on the federal funds rate. For example, most participants thought that a reduction by the Board of Governors in the interest rate paid on excess reserves could be worth considering at some stage, although the benefits of such a step were generally seen as likely to be small except possibly as a signal of policy intentions. By contrast, participants expressed a range of concerns about using open market operations aimed at affecting the expected path of short-term interest rates, such as a standing purchase facility for shorter-term Treasury securities or the provision of term funding through repurchase agreements. Among the concerns voiced was that such operations would inhibit price discovery and remove valuable sources of market information; in addition, such operations might be difficult to explain to the public, complicate the Committee's communications, and appear inconsistent with the economic thresholds for the federal funds rate. Nevertheless, a number of participants noted that such operations were worthy of further study or saw them as potentially helpful in some circumstances.

At the end of the discussion, participants agreed that it would be helpful to continue reviewing these issues of longer-run policy strategy at upcoming meetings. No decisions on the substance were taken, and participants generally noted the usefulness of planning for various contingencies.

Committee Policy Action

Committee members saw the information received over the intermeeting period as suggesting that economic activity was continuing to expand at a moderate pace. Although indicators of labor market conditions had shown some further improvement, the unemployment rate remained elevated. Household spending and business fixed investment advanced, but the recovery in the housing sector slowed somewhat in recent months, and fiscal policy was restrain-

ing economic growth. The Committee expected that, with appropriate policy accommodation, economic growth would pick up from its recent pace, resulting in a gradual decline in the unemployment rate toward levels consistent with the Committee's dual mandate. Members generally continued to see the downside risks to the outlook for the economy and the labor market as having diminished, on net, since last fall. Inflation was running below the Committee's longer-run objective, but longer-term inflation expectations were stable, and the Committee anticipated that inflation would move back toward its objective over the medium term. Members recognized, however, that inflation persistently below the Committee's 2 percent objective could pose risks to economic performance.

In their discussion of monetary policy for the period ahead, members generally noted that there had been little change in the economic outlook since the September meeting, and all members but one again judged that it would be appropriate for the Committee to await more evidence that progress toward its economic objectives would be sustained before adjusting the pace of asset purchases. In the view of one member, the cumulative improvement in the economy indicated that the continued easing of monetary policy at the current pace was no longer necessary. Many members stressed the data-dependent nature of the current asset purchase program, and some pointed out that, if economic conditions warranted, the Committee could decide to slow the pace of purchases at one of its next few meetings. A couple of members also commented that it would be important to continue laying the groundwork for such a reduction in pace through public statements and speeches, while emphasizing that the overall stance of monetary policy would remain highly accommodative as needed to meet the Committee's objectives.

At the conclusion of the discussion, the Committee decided to continue adding policy accommodation by purchasing additional MBS at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month and to maintain its existing reinvestment policies. In addition, the Committee reaffirmed its intention to keep the target federal funds rate at 0 to ¼ percent and retained its forward guidance that it anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored.

Members also discussed the wording of the policy statement to be issued following the meeting. In addition to updating its description of the state of the economy, the Committee considered whether to note that the effects of the temporary government shutdown had made economic conditions more difficult to assess, but judged that this might overemphasize the role of the shutdown in the Committee's policy deliberations. Members noted the improvement in financial conditions since the time of the September meeting and agreed that it was appropriate to drop the reference, which was included in the September statement, to the tightening of financial conditions seen over the summer. Members also discussed whether to add to the forward guidance in the policy statement an indication that the headwinds restraining the economic recovery were likely to abate only gradually, with the federal funds rate target anticipated to remain below its longer-run normal value for a considerable time. While there was some support for adding this language at some stage, a range of concerns were expressed about including it at this meeting. In particular, given its complexity, many members felt that it would be difficult to communicate this point succinctly in the statement. In addition, there was not complete consensus within the Committee that headwinds were the only explanation for the low expected future path of policy rates.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. The Desk is directed to continue purchasing longer-term Treasury securities at a pace of about $45 billion per month and to continue purchasing agency mortgage-backed securities at a pace of about $40 billion per month. The

Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

"Information received since the Federal Open Market Committee met in September generally suggests that economic activity has continued to expand at a moderate pace. Indicators of labor market conditions have shown some further improvement, but the unemployment rate remains elevated. Available data suggest that household spending and business fixed investment advanced, while the recovery in the housing sector slowed somewhat in recent months. Fiscal policy is restraining economic growth. Apart from fluctuations due to changes in energy prices, inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will pick up from its recent pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished, on net, since last fall. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, but it anticipates that inflation will move back toward its objective over the medium term.

Taking into account the extent of federal fiscal retrenchment over the past year, the Committee sees the improvement in economic activity and labor market conditions since it began its asset purchase program as consistent with growing underlying strength in the broader economy. However, the Committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases. Accordingly, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.

The Committee will closely monitor incoming information on economic and financial developments in coming months and will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. In judging when to moderate the pace of asset purchases, the Committee will, at its coming meetings, assess whether incoming information continues to support the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective. Asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's economic outlook as well as its assessment of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly accommodative stance of monetary policy will

remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. In particular, the Committee decided to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that this exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Charles L. Evans, Jerome H. Powell, Eric Rosengren, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Esther L. George.

Ms. George dissented because she did not see the continued aggressive easing of monetary policy as warranted in the face of both actual and forecasted improvements in the economy. In her view, the cumulative progress in labor markets justified taking steps toward slowing the pace of the Committee's asset purchases. Moreover, market expectations for the size of the purchase program had continued to escalate despite that progress, increasing her concerns about communications challenges and the potential costs associated with asset purchases.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, December 17–18, 2013. The meeting adjourned at 12:05 p.m. on October 30, 2013.

Notation Vote

By notation vote completed on October 8, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on September 17–18, 2013.

Videoconference meeting of October 16

On October 16, 2013, the Committee met by videoconference to discuss issues associated with contingencies in the event that the Treasury was temporarily unable to meet its obligations because the statutory federal debt limit was not raised. The meeting covered issues similar to those discussed at the Committee's videoconference meeting of August 1, 2011. The staff provided an update on legislative developments bearing on the debt ceiling and the funding of the federal government, recent conditions in financial markets, technical aspects of the processing of federal payments, potential implications for bank supervision and regulatory policies, and possible actions that the Federal Reserve could take if disruptions to market functioning posed a threat to the Federal Reserve's economic objectives. Meeting participants saw no legal or operational need in the event of delayed payments on Treasury securities to make changes to the conduct or procedures employed in currently authorized Desk operations, such as open market operations, large-scale asset purchases, or securities lending, or to the operation of the discount window. They also generally agreed that the Federal Reserve would continue to employ prevailing market values of securities in all its transactions and operations, under the usual terms. With respect to potential additional actions, participants noted that the appropriate responses would depend importantly on the actual conditions observed in financial markets. Under certain circumstances, the Desk might act to facilitate the smooth transmission of monetary policy through money markets and to address disruptions in market functioning and liquidity. Supervisory policy would take into account and make appropriate allowance for unusual market conditions. The need to maintain the traditional separation of the Federal Reserve's actions from the Treasury's debt management decisions was noted. Participants agreed that while the Federal Reserve should take whatever steps it could, the risks posed to the financial system and to the broader economy by a delay in payments on Treasury securities would be potentially catastrophic, and thus such a situation should be avoided at all costs.

William B. English
Secretary

Meeting Held on December 17–18, 2013

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 17, 2013, at 1:00 p.m. and continued on Wednesday, December 18, 2013, at 8:30 a.m.

Present

Ben Bernanke
Chairman

William C. Dudley
Vice Chairman

James Bullard

Charles L. Evans

Esther L. George

Jerome H. Powell

Eric Rosengren

Jeremy C. Stein

Daniel K. Tarullo

Janet L. Yellen

Christine Cumming, Richard W. Fisher, Narayana Kocherlakota, Sandra Pianalto, and Charles I. Plosser
Alternate Members of the Federal Open Market Committee

Jeffrey M. Lacker, Dennis P. Lockhart, and John C. Williams
Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

William B. English
Secretary and Economist

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors, Troy Davig, Michael P. Leahy, Stephen A. Meyer, and William Wascher
Associate Economists

Simon Potter
Manager, System Open Market Account

Michael S. Gibson
Director, Division of Banking Supervision and Regulation, Board of Governors

Nellie Liang
Director, Office of Financial Stability Policy and Research, Board of Governors

James A. Clouse and William Nelson
Deputy Directors, Division of Monetary Affairs, Board of Governors

Jon W. Faust
Special Adviser to the Board, Office of Board Members, Board of Governors

Linda Robertson
Assistant to the Board, Office of Board Members, Board of Governors

Trevor A. Reeve
Senior Associate Director, Division of International Finance, Board of Governors

Ellen E. Meade and Joyce K. Zickler
Senior Advisers, Division of Monetary Affairs, Board of Governors

Eric M. Engen, Thomas Laubach, David E. Lebow, and Michael G. Palumbo
Associate Directors, Division of Research and Statistics, Board of Governors

Gretchen C. Weinbach
Associate Director, Division of Monetary Affairs, Board of Governors

Marnie Gillis DeBoer
Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Diana Hancock
Deputy Associate Director, Division of Research and Statistics, Board of Governors

Stacey Tevlin
Assistant Director, Division of Research and Statistics, Board of Governors

Eric Engstrom
Section Chief, Division of Research and Statistics, Board of Governors

David H. Small
Project Manager, Division of Monetary Affairs, Board of Governors

Peter M. Garavuso
Records Management Analyst, Division of Monetary Affairs, Board of Governors

John F. Moore
First Vice President, Federal Reserve Bank of San Francisco

David Altig, Jeff Fuhrer, Loretta J. Mester, and Mark S. Sniderman
Executive Vice Presidents, Federal Reserve Banks of Atlanta, Boston, Philadelphia, and Cleveland, respectively

Evan F. Koenig, Lorie K. Logan, and Samuel Schulhofer-Wohl
Senior Vice Presidents, Federal Reserve Banks of Dallas, New York, and Minneapolis, respectively

David Andolfatto, James P. Bergin, Jonas D. M. Fisher, Sylvain Leduc, and Paolo A. Pesenti
Vice Presidents, Federal Reserve Banks of St. Louis, New York, Chicago, San Francisco, and New York, respectively

Robert L. Hetzel
Senior Economist, Federal Reserve Bank of Richmond

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets as well as System open market operations during the period since the Federal Open Market Committee (FOMC) met on October 29–30, 2013. The staff also presented an update on the ongoing testing of overnight reverse repurchase agreement (ON RRP) operations that the Committee approved at its September meeting and that is scheduled to end on January 29, 2014. All operations to date had proceeded smoothly. Participation in ON RRP operations varied somewhat from day to day, in part reflecting changes in the spread between market rates on repurchase agreement transactions and the rate offered in the Federal Reserve's ON RRP operations. The staff reported that they saw potential benefits to extending the exercise and in January would likely recommend a continuation along with possible adjustments to program parameters that could provide additional insights into the demand for a potential facility and its efficacy in putting a floor on money market rates.

Following the Manager's report, the Committee considered a proposal to increase the caps on individual allocations in the ON RRP test operations from $1 billion to $3 billion per counterparty. The proposed increase in caps was intended to test the Desk's ability to manage somewhat larger operational flows and to provide additional information about the potential usefulness of ON RRP operations to affect market interest rates when doing so becomes appropriate. Participants generally supported the proposal, with one participant emphasizing the usefulness of extending the end date of the program beyond the end of January. However, some participants questioned the extent to which the proposed limited increase in the caps would provide additional insights about the operational aspects of the ON RRP program or the potential market effects of ON RRP operations. A few participants suggested that it would be useful to evaluate the potential role of an ON RRP facility in the context of the Committee's plans for monetary policy implementation over the medium and longer term.

Following the discussion, the Committee unanimously approved the following resolution:

> "The Federal Open Market Committee authorizes an increase in the maximum allotment cap for the series of fixed-rate, overnight reverse repurchase operations approved on September 17, 2013, to $3 billion per counterparty per day from its previous level of $1 billion per counterparty per day. All other aspects of the resolution remain unchanged."

By unanimous vote, the Committee ratified the Desk's domestic transactions over the intermeeting period. There were no intervention operations in foreign currencies for the System's account over the intermeeting period.

The staff presented a short briefing summarizing a survey that was conducted over the intermeeting period regarding participants' views of the marginal costs and marginal efficacy of asset purchases. Most participants judged the marginal costs of asset purchases as unlikely to be sufficient, relative to their marginal benefits, to justify ending the purchases

now or relatively soon; a few participants identified some possible costs as being more substantial, indicating that the costs could justify ending purchases now or relatively soon even if the Committee's macroeconomic goals for the purchase program had not yet been achieved. Participants were most concerned about the marginal cost of additional asset purchases arising from risks to financial stability, pointing out that a highly accommodative stance of monetary policy could provide an incentive for excessive risk-taking in the financial sector. It was noted that the risks to financial stability could be somewhat larger in the case of asset purchases than in the case of interest rate policy because purchases work in part by affecting term premiums and policymakers have less experience with term premium effects than with more conventional interest rate policy. Participants also expressed some concern that additional asset purchases increase the likelihood that the Federal Reserve might at some point suffer capital losses. But it was pointed out that the Federal Reserve's asset purchases would almost certainly provide significant net income to the Treasury over the life of the program, especially when the effects of the program on the broader economy were taken into account, and that potential reputational risks to the Federal Reserve arising from any future capital losses could be mitigated by communicating that point to the public. Further, participants noted that ongoing asset purchases could increase the difficulty of managing exit from the current highly accommodative policy stance when the time came. Many participants, however, expressed confidence in the tools at the Federal Reserve's disposal for managing its balance sheet and for normalizing the stance of policy at the appropriate time. Regarding the marginal efficacy of the purchase program, most participants viewed the program as continuing to support accommodative financial conditions, with a number of them pointing to the importance of purchases in serving to enhance the credibility of the Committee's forward guidance about the target federal funds rate. A majority of participants judged that the marginal efficacy of purchases was likely declining as purchases continue, although some noted the difficulty inherent in making such an assessment. A couple of participants thought that the marginal efficacy of the program was not declining, as evidenced by the substantial effects in financial markets in recent months of news about the likely path of purchases.

Staff Review of the Economic Situation

The information reviewed for the December 17–18 meeting indicated that economic activity was expanding at a moderate pace. Total payroll employment increased further, and the unemployment rate declined but remained elevated. Consumer price inflation continued to run below the Committee's objective, although measures of longer-run inflation expectations remained stable.

Total nonfarm payroll employment rose in October and November at a faster monthly pace than in the previous two quarters. The unemployment rate declined, on net, from 7.2 percent in September to 7.0 percent in November. The labor force participation rate also decreased, on balance, and the employment-to-population ratio in November was the same as in September. The share of workers employed part time for economic reasons declined slightly while the rate of long-duration unemployment was little changed, but both measures were still high. Other indicators were generally consistent with gradually improving conditions in the labor market. The rate of job openings edged up in recent months, the share of small businesses reporting that they had hard-to-fill positions increased, and the four-week moving average of initial claims for unemployment insurance trended down, on net, over the intermeeting period, although the rate of gross private-sector hiring was still somewhat low. Measures of firms' hiring plans remained higher than a year earlier, and household expectations of the labor market situation improved in early December.

Manufacturing production accelerated briskly in October and November after increasing at a subdued pace in the third quarter, and the gains were broad based across industries. Automakers' schedules indicated that the pace of light motor vehicle assemblies would rise in December, and broader indicators of manufacturing production, such as the readings on new orders from the national and regional manufacturing surveys, were consistent with a further expansion in factory output in the coming months.

Real personal consumption expenditures (PCE) increased modestly in the third quarter but rose at a faster pace in September and October. The components of the nominal retail sales data used by the Bureau of Economic Analysis to construct its estimate of PCE increased at a strong pace in November, and light motor vehicle sales moved up significantly. Moreover, recent information for key factors that support household spending was consistent with further solid gains in PCE in the coming months. Households' net worth likely expanded as equity values and home prices increased further in recent months; real disposable income rose, on net, in September and October; and consumer sentiment in the Thomson Reuters/University of Michigan Surveys of Consumers improved significantly in early December.

The pace of activity in the housing sector appeared to continue to slow somewhat, likely reflecting the higher level of mortgage rates since the spring. Starts for both new single-family homes and multifamily units increased, on balance, from August to November, but permits—which are typically a better indicator of the underlying pace of construction—rose more gradually than starts over the same period. Sales of existing homes and pending home sales decreased further in October, although new home sales rose in October after falling markedly in the third quarter.

Growth in real private expenditures for business equipment and intellectual property products was subdued in the third quarter. In October, nominal shipments of nondefense capital goods excluding aircraft edged down. However, nominal new orders for these capital goods remained above the level of shipments, pointing to increases in shipments in subsequent months, and other forward-looking indicators, such as surveys of business conditions, were generally consistent with moderate gains in business equipment spending in the near term. Real business spending for nonresidential structures rose substantially in the third quarter, but nominal expenditures for new business buildings declined slightly in October. Real nonfarm inventory investment increased noticeably in the third quarter, but recent book-value data for inventory-to-sales ratios, along with readings on inventories from national and regional manufacturing surveys, did not point to significant inventory imbalances in most industries.

Real federal government purchases declined somewhat in the third quarter but appeared likely to decrease more substantially in the fourth quarter, reflecting the effect of the temporary partial government shutdown in October and further cuts in defense spending in October and November. Real state and local government purchases rose markedly in the third quarter. Moreover, the payrolls of these governments continued to expand, on net, in October and November, and nominal state and local construction expenditures increased in October.

The U.S. international trade deficit narrowed in October as exports rose more than imports. The gains in exports were fairly widespread across categories and were led by sales of consumer goods, industrial supplies, and agricultural products. The higher value of imports reflected increases in services, consumer goods, and petroleum products that more than offset lower purchases of computers, semiconductors, and automotive products.

Total U.S. consumer price inflation, as measured by the PCE price index, was less than 1 percent over the 12 months ending in October, in part because consumer energy prices declined over the same 12-month period. In addition, core PCE price inflation—which excludes consumer energy and food prices—was only a little above 1 percent, partly reflecting subdued increases in medical services prices and recent declines in the prices of many nonfuel imported goods. In November, the consumer price index (CPI) was flat, and core CPI prices rose slightly faster than in the preceding few months. Both near-term and longer-term inflation expectations from the Michigan survey were little changed, on net, in November and early December.

Measures of labor compensation indicated that increases in nominal wages continued to be modest. Compensation per hour in the nonfarm business sector rose moderately over the year ending in the third quarter, and unit labor costs moved up at a similar pace as gains in productivity were small. The employment cost index expanded a little more slowly than the compensation per hour measure over the same yearlong period. The increase in nominal average hourly earnings for all employees over the 12 months ending in November was also modest.

Foreign economic activity strengthened in the third quarter, as the euro area continued to recover from its recent recession, economic growth picked up in China after slowing in the first half of the year, and the Mexican economy rebounded from a second-quarter contraction. Inflation slowed recently in many advanced foreign economies, partly as a result

of a deceleration in prices for energy and other commodities. Monetary policy remained very accommodative in most advanced economies, but central banks in some emerging market economies recently tightened policy further to contain inflation and support the foreign exchange value of their currencies.

Staff Review of the Financial Situation

Financial market developments over the intermeeting period appeared to be driven largely by incoming data on employment and economic activity that exceeded investor expectations as well as by Federal Reserve communications.

Investors appeared to read the economic data releases over the intermeeting period as better than had been expected and therefore as raising the odds that the FOMC might decide to reduce the pace of asset purchases at its December meeting. Survey evidence suggested that market participants now saw roughly similar probabilities of the first reduction in the pace of asset purchases occurring at the December, January, or March meeting. Market expectations regarding the timing of liftoff of the federal funds rate seemed to be little changed over the period. In part, a variety of Federal Reserve communications were seen as strengthening the Committee's forward guidance for the federal funds rate and contributing to the stability of expectations for the near-term path of the federal funds rate in the face of an improved economic outlook.

On net, judging by financial market quotes on interest rate futures, the expected federal funds rate path through the end of 2015 moved only slightly since the October FOMC meeting. The expected federal funds rate path at longer horizons rose somewhat, and the Treasury yield curve steepened, with the 2-year Treasury yield about unchanged but the 5- and 10-year yields higher by 21 and 34 basis points, respectively. The measure of 5-year inflation compensation based on Treasury inflation-protected securities dipped 5 basis points, while the 5-year forward measure increased 7 basis points. The 30-year current-coupon yield on agency mortgage-backed securities increased a bit more than the 10-year Treasury yield.

Stock prices were about unchanged, on net, over the intermeeting period, even though some broad equity price indexes temporarily touched all-time nominal highs. Corporate risk spreads narrowed somewhat.

Business finance flows were robust over the intermeeting period. Gross equity issuance by the nonfinancial corporate sector in October and November reached levels not seen in a decade. Gross bond issuance by nonfinancial corporations picked up again after a dip related to the fiscal standoff in October. Similarly, institutional issuance of leveraged loans rose in October and November, and collateralized loan obligation issuance remained strong.

Financing conditions in commercial real estate (CRE) markets were consistent with increased confidence. Year-to-date issuance of commercial mortgage-backed securities (CMBS) remained strong, but far below levels seen before the financial crisis. Responses to the December 2013 Senior Credit Officer Opinion Survey on Dealer Financing Terms (SCOOS) suggested that demand for funding for CMBS picked up since September. CRE loans on banks' books expanded in October and November at an increasing pace.

Automobile loans continued to expand in October, and available data suggested that this trend was sustained in November. Automobile asset-backed securities (ABS) issuance accelerated in November, and issuance of paper backed by subprime automobile loans stayed strong. In contrast, credit card balances moved sideways, and ABS issuance in that sector stayed flat.

In the residential mortgage market, several large lenders were reported to have eased their underwriting standards slightly, but data suggested that mortgage lenders generally continued to be reluctant to lend to borrowers with less-than-pristine credit scores. Mortgage rates rose over the intermeeting period to levels about 100 basis points above their early-May lows. On balance, refinancing applications were down substantially since May while purchase applications declined much less. House prices rose significantly in October, but some indicators suggested that the pace of house price gains continued to decelerate relative to earlier in the year.

Responses to the December SCOOS generally showed little change in dealer-intermediated financing since September. Credit terms for most classes of counterparties were little changed. One-third of respondents reported a decline in the use of financial leverage by trading real estate investment trusts, whereas the use of financial leverage by other classes

of counterparties was basically unchanged. In response to special questions in the survey, dealers indicated that the current use of repurchase agreements or other forms of short-term funding for longer-duration assets was roughly in line with or somewhat below the levels seen early in 2013.

Bank credit rose slightly in October and November, as growth in commercial and industrial loans, CRE loans, and consumer loans was partially offset by declines in the outstanding balances of closed-end residential mortgages on banks' books. Stock prices for large and regional domestic banking firms outperformed the broad equity market over the intermeeting period amid better-than-expected economic data and the settlement of mortgage-related litigation by some large banking organizations. Spreads on credit default swaps for the largest bank holding companies also moved lower, on net.

M2 contracted in November, likely reflecting in part portfolio reallocations by investors that had temporarily placed funds in bank deposits as a safe haven during the recent federal debt limit impasse. Meanwhile, the monetary base continued to expand rapidly, primarily reflecting the increase in reserve balances resulting from the Federal Reserve's asset purchases.

The foreign exchange value of the dollar appreciated following the October FOMC meeting and the October employment report and ended the intermeeting period higher on balance. A shift in market expectations toward easier monetary policy abroad may have also boosted the exchange value of the dollar, most notably against the Japanese yen, and equity prices in Japan rose substantially further during the period. By contrast, equity prices declined in many emerging market economies; in some cases, those declines were large and accompanied by sizable decreases in currency values and sovereign bond prices. European equity prices were also lower over the period. Long-term benchmark sovereign yields in the United Kingdom and Canada increased, in line with, but somewhat less than, the rise in yields on comparable U.S. Treasury securities. Yields on German sovereign bonds, which reacted to a policy rate cut by the European Central Bank and the release of data showing lower-than-expected euro-area inflation, were only slightly higher on net.

The staff's periodic report on potential risks to financial stability concluded that the vulnerability of the financial system to adverse shocks remained at moderate levels overall. Relatively strong capital profiles of large domestic banking firms, low levels and moderate growth of aggregate credit in the nonfinancial sectors, and some reduction in reliance on short-term wholesale funding across the financial sector were seen as factors supporting financial stability in the current environment. Valuations in most asset markets seemed broadly in line with historical norms. However, the staff report noted that the complexity and interconnectedness of large financial institutions, along with some apparent increases in investor appetite for higher-yielding assets and associated pressures on underwriting standards remained potential sources of risk to the financial system.

Staff Economic Outlook

In the economic projection prepared by the staff for the December FOMC meeting, the forecast for growth in real gross domestic product (GDP) in the second half of this year was revised up a little from the one prepared for the previous meeting, as the recent information on private domestic final demand—particularly consumer spending—was somewhat better, on balance, than the staff had anticipated. The staff's medium-term forecast for real GDP growth was also revised up slightly, reflecting a small reduction in fiscal restraint from the recent federal budget agreement, which the staff assumed would be enacted; a lower anticipated trajectory for longer-term interest rates; and higher paths for equity values and home prices. Those factors, in total, more than offset a higher path for the foreign exchange value of the dollar. The staff continued to project that real GDP would expand more quickly over the next few years than it has this year and would rise significantly faster than the growth rate of potential output. This acceleration in economic activity was expected to be supported by an easing in the effects of fiscal policy restraint on economic growth, increases in consumer and business sentiment, continued improvements in credit availability and financial conditions, a further easing of the economic stresses in Europe, and still-accommodative monetary policy. The expansion in economic activity was anticipated to slowly reduce resource slack over the projection period, and the unemployment rate was expected to decline gradually to the staff's estimate of its longer-run natural rate.

The staff's forecast for inflation was quite similar to the projection prepared for the previous FOMC meeting. The near-term forecast for inflation was revised down slightly to reflect some recent softer-

than-expected data. The staff continued to forecast that inflation would be modest, on net, through early next year but higher than its low level in the first half of this year. The staff's projection for inflation over the medium term was essentially unchanged. With longer-run inflation expectations assumed to remain stable, changes in commodity and import prices expected to be measured, and slack in labor and product markets persisting over most of the projection period, inflation was projected to be subdued through 2016.

The staff viewed the uncertainty around the projection for economic activity as similar to its average over the past 20 years. Nonetheless, the risks to the forecast for real GDP growth were viewed as tilted to the downside, reflecting concerns that the extent of supply-side damage to the economy since the recession could prove greater than assumed; that the tightening in mortgage rates since last spring could exert greater restraint on the housing recovery than had been projected; that economic and financial stresses in emerging market economies and the euro area could intensify; and that, with the target federal funds rate already near its lower bound, the U.S. economy was not well positioned to weather future adverse shocks. However, the staff viewed the risks around the projection for the unemployment rate as roughly balanced, with the risk of a higher unemployment rate resulting from adverse developments roughly countered by the possibility that the unemployment rate could continue to fall more than expected, as it had in recent years. The staff did not see the uncertainty around its outlook for inflation as unusually high, and the risks to that outlook were viewed as broadly balanced.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, the meeting participants—5 members of the Board of Governors and the presidents of the 12 Federal Reserve Banks, all of whom participated in the deliberations—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2016 and over the longer run, under each participant's judgment of appropriate monetary policy. The longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. These economic projections and policy assessments are described in the Summary of Economic Projections (SEP), which is attached as an addendum to these minutes.

In their discussion of the economic situation and the outlook, meeting participants viewed the information received over the intermeeting period as suggesting that the economy was expanding at a moderate pace. They generally indicated that the broad contours of their outlook for real activity, the labor market, and inflation had not changed materially since their October meeting, but most expressed greater confidence in the outlook and saw the risks associated with their forecasts of real GDP growth and the unemployment rate as more nearly balanced than earlier in the year. Almost all participants continued to project that the rate of growth of economic activity would strengthen in coming years, and all anticipated that the unemployment rate would gradually decline toward levels consistent with their current assessments of its longer-run normal value. The projected improvement in economic activity was expected to be supported by highly accommodative monetary policy, diminished fiscal policy restraint, and a pickup in global economic growth, as well as a further easing of credit conditions and continued improvements in household balance sheets. Inflation remained below the Committee's longer-run objective over the intermeeting period. Nevertheless, participants still anticipated that with longer-run inflation expectations stable and economic activity picking up, inflation would move back toward its objective over the medium run. But they noted that inflation persistently below the Committee's objective would pose risks to economic performance and so saw a need to monitor inflation developments carefully.

Consumer spending appeared to be strengthening, with solid gains in retail sales in recent months and a rebound in motor vehicle sales in November. On balance, retail contacts reportedly were fairly optimistic about holiday sales. Participants cited a number of factors that likely contributed to the recent pickup in spending, including the waning effects of the payroll tax increase that had trimmed disposable income earlier in the year, the drop in energy costs, and the recent improvement in consumer sentiment. More broadly, spending was being supported by gains in household wealth associated with rising house prices and equity values, the still-low level of interest rates, and the progress that households have made in reducing debt and strengthening their balance sheets. These favorable trends were generally anticipated to continue and to be accompanied by stronger real dis-

posable income as labor market conditions improve and inflation remains low.

Activity in the housing sector slowed in recent months. Some participants noted that the increase in mortgage interest rates since the spring was having a greater effect on that sector than they had anticipated earlier. Despite the recent softening, participants discussed a number of factors that should support a continued recovery in housing going forward. These included expectations that mortgage interest rates would remain relatively favorable, that rising home values would boost household wealth and further reduce the number of borrowers with underwater mortgages, that consumer incomes and confidence would continue to rise as employment expanded, and that a pickup in household formation would support the demand for housing.

Business investment appeared to be advancing at a moderate rate. A number of the fundamental determinants of business investment were positive: Business balance sheets remained in good shape, cash flow was ample, and input costs were subdued. Business contacts in a number of Districts were reportedly somewhat more confident about the outlook than they had been earlier in the fall, but a couple of participants reported that their contacts continued to focus on investments intended to reduce costs and were still cautious regarding investment to expand capacity, or that concerns about health care costs were holding back hiring. In the manufacturing sector, production appeared to be increasing at a solid rate according to both national and most of the regional surveys of activity, and the available indexes of future activity continued to suggest optimism among firms. Renewed export demand and a buildup in auto inventories, which may be reversed in 2014, were cited as contributing to the recent gains in production. Participants heard positive reports from their contacts in the technology, rail, freight, and airline industries, and activity in the energy sector remained strong. In agriculture, record yields were reported for corn and soybeans, but farm income was being reduced by lower crop prices. Measures of farmland values were still rising, but anecdotal reports suggested softening in some areas.

Fiscal policy continued to restrain economic growth. However, participants generally judged that the extent of the restraint may have begun to diminish as the effects of the payroll tax increases earlier in the year seem to have waned, and the drag on real activity from restrictive fiscal policies was expected to decline further going forward. Moreover, a number of participants observed that the prospect that the Congress would shortly reach an accord on the budget seemed to be reducing uncertainty and lowering the risks that might be associated with a disruptive political impasse.

Committee participants generally viewed the increases in nonfarm payroll employment of more than 200,000 per month in October and November and the decline in the unemployment rate to 7 percent as encouraging signs of ongoing improvement in labor market conditions. Several cited other indicators of progress in the labor market, such as the decline in new claims for unemployment insurance, the uptrend in quits, or the rise in the number of small businesses reporting job openings that were hard to fill. Participants exchanged views on the extent to which the decrease in labor force participation over recent years represented cyclical weakness in the labor market that was not adequately captured by the unemployment rate. Some participants cited research that found that demographic and other structural factors, particularly rising retirements by older workers, accounted for much of the recent decline in participation. However, several others continued to see important elements of cyclical weakness in the low labor force participation rate and cited other indicators of considerable slack in the labor market, including the still-high levels of long-duration unemployment and of workers employed part time for economic reasons and the still-depressed ratio of employment to population for workers ages 25 to 54. In addition, although a couple of participants had heard reports of labor shortages, particularly for workers with specialized skills, most measures of wages had not accelerated. A few participants noted the risk that the persistent weakness in labor force participation and low rates of productivity growth might indicate lasting structural economic damage from the financial crisis and ensuing recession.

Inflation continued to run noticeably below the Committee's longer-run objective of 2 percent, but participants anticipated that it would move back toward 2 percent over time as the economic recovery strengthened and longer-run inflation expectations remained steady. Several participants suggested that some of the factors that had held down inflation recently, such as the slowing in price increases for medical care and banking services, were likely to prove transitory. Some participants suggested that inflation, while low, was unlikely to slow further,

pointing to core, trimmed mean, or sticky-price inflation measures as indicative of fairly steady underlying price trends; most measures of wage gains were also steady. Nonetheless, many participants expressed concern about the deceleration in consumer prices over the past year, and a couple pointed out that a number of other advanced economies were also experiencing very low inflation. Among the costs of very low or declining inflation that were cited were its effects in raising real interest rates and debt burdens. A few participants raised the possibility that recent declines in inflation might suggest that the economic recovery was not as strong as some thought.

Domestic financial markets were influenced importantly over the intermeeting period by Federal Reserve communications and by economic data that were generally better than market participants expected. These factors apparently led market participants to raise the odds they assigned to a reduction in the pace of asset purchases at the December meeting, and to leave roughly unchanged their expectations for the timing of the first increase in the target federal funds rate. A number of participants noted that current market expectations were reasonably well aligned with the Committee's recent policy communications.

Participants also reviewed indicators of financial vulnerabilities that could pose risks to financial stability and the broader economy. These indicators generally suggested that such risks were moderate, in part because of the reduction in leverage and maturity transformation that has occurred in the financial sector since the onset of the financial crisis. In their discussion of potential risks, several participants commented on the rise in forward price-to-earnings ratios for some small-cap stocks, the increased level of equity repurchases, or the rise in margin credit. One pointed to the increase in issuance of leveraged loans this year and the apparent decline in the average quality of such loans. A couple of participants offered views on the role of financial stability in monetary policy decisionmaking more broadly. One proposed that the Committee analyze more explicitly the potential consequences of specific risks to the financial system for its dual-mandate objectives and take account of the possible effects of monetary policy on such risks in its assessment of appropriate policy. Another suggested that the importance of financial stability considerations in the Committee's deliberations would likely increase over time as progress is made toward the Committee's objectives, and that such considerations should be incorporated into forward guidance for the federal funds rate and asset purchases.

In their discussion of the appropriate path for monetary policy, participants considered whether the cumulative improvement in labor market conditions since the asset purchase program began in September 2012 and the associated improvement in the outlook for the labor market warranted a reduction in the pace of asset purchases. The most recent data showed that increases in nonfarm payroll employment had averaged around 190,000 per month for the past 15 months, and the unemployment rate had fallen more quickly over that period than most participants had expected. Moreover, participants generally anticipated that the improvement in labor market conditions would continue, and most had become more confident in that outlook. Against this backdrop, most participants saw a reduction in the pace of purchases as appropriate at this meeting and consistent with the Committee's previous policy communications. Many commented that progress to date had been meaningful, and some expressed the view that the criterion of substantial improvement in the outlook for the labor market was likely to be met in the coming year if the economy evolved as expected. However, several participants stressed that the unemployment rate remained elevated, that a range of other indicators had shown less progress toward levels consistent with a full recovery in the labor market, and that the projected pickup in economic growth was not assured. Some participants also questioned whether slowing the pace of purchases at a time when inflation was running well below the Committee's longer-run objective was appropriate. For some, the considerable slack remaining in the labor market and shortfall of inflation from the Committee's longer-run objective warranted continuing asset purchases at the current pace for a time in order to wait for additional information confirming sustained progress toward the Committee's objectives or to promote faster progress toward those objectives. Among those inclined to begin to reduce the pace of asset purchases at this meeting, many favored a modest initial reduction accompanied by guidance indicating that decisions regarding future reductions would depend on economic and financial developments as well as the efficacy and costs of purchases. Some other participants preferred a larger reduction in purchases at this meeting and future reductions that would bring the program to a close relatively quickly. A few proposed that the Committee lay out, either at this meeting or subsequently, a more deterministic path for winding down the program or that

it announce a fixed amount of additional purchases and an expected completion date, thereby reducing uncertainty about the trajectory of the purchase program.

Participants also considered the potential for clarifying or strengthening the Committee's forward guidance for the federal funds rate. In general, participants who favored amending the forward guidance saw a need to more fully communicate how, if the unemployment rate threshold was reached first, the Committee would likely set monetary policy after that threshold was crossed. A number of participants pointed out that the federal funds rate paths underlying the economic forecasts that they prepared for this meeting, as well as expectations for the funds rate path priced into financial markets, were consistent with the view that the Committee would not raise the federal funds rate until well after the time that the threshold was crossed. A few participants discussed the potential advantages and disadvantages of using medians of the projections of the federal funds rate from the SEP as a means of communicating the likely path of short-term interest rates. Some worried that, if the Committee began to reduce asset purchases, market expectations might shift, and they wanted to reinforce the forward guidance to mitigate the risks of an undesired tightening of financial conditions that could have adverse effects on the economy. In light of their concern that inflation might continue to run well below the Committee's longer-run objective, several participants saw the need to clearly convey that inflation remains an important consideration in adjusting the target funds rate. Participants debated the advantages and disadvantages of lowering the unemployment rate threshold provided in the forward guidance. In the view of the few participants who advocated such a change, a lower threshold would be a clear signal of the Committee's intentions and was an appropriate adjustment in light of recent labor market and inflation trends. In contrast, a few others expressed concern that any change in the threshold might be confusing and could undermine the credibility of the Committee's forward guidance. Most were inclined to retain the current thresholds for the unemployment and inflation rates and to instead provide qualitative guidance regarding the Committee's likely behavior after a threshold was crossed.

Committee Policy Action

Committee members viewed the information received over the intermeeting period as indicating that the economy was expanding at a moderate pace. Labor market conditions had improved in recent months, with monthly gains in payroll employment of more than 200,000 in October and November. The unemployment rate had declined but remained elevated. Household spending and business fixed investment advanced, while the recovery in the housing market slowed somewhat in recent months. Fiscal policy was restraining economic growth, although the extent of the restraint may have begun to diminish. The Committee expected that, with appropriate policy accommodation, economic growth would strengthen and the unemployment rate would gradually decline toward levels consistent with its dual mandate. Moreover, members judged that the risks to the outlook for the economy and the labor market had become more nearly balanced, reflecting in part an easing of fiscal policy concerns and an improvement in the prospects for global economic growth. Inflation was running below the Committee's longer-run objective, and this was seen as posing possible risks to economic performance. Members anticipated that inflation would, over time, return to the Committee's 2 percent objective, supported by stable inflation expectations and stronger economic activity. However, in light of their concerns about the persistence of low inflation, many members saw a need for the Committee to monitor inflation developments carefully for evidence that inflation was moving back toward its longer-run objective.

In their discussion of monetary policy in the period ahead, most members agreed that the cumulative improvement in labor market conditions and the likelihood that the improvement would be sustained indicated that the Committee could appropriately begin to slow the pace of its asset purchases at this meeting. However, members also weighed a number of considerations regarding such an action, including their degree of confidence in prospects for sustained above-potential economic growth, continued improvement in labor market conditions, and a return of inflation to its mandate-consistent level over time. Some also expressed concern about the potential for an unintended tightening of financial conditions if a reduction in the pace of asset purchases was misinterpreted as signaling that the Committee was likely to withdraw policy accommodation more quickly than had been anticipated. As a consequence, many members judged that the Committee should proceed cautiously in taking its first action to reduce the pace of asset purchases and should indicate that further reductions would be undertaken in measured steps. Members also stressed the need to

underscore that the pace of asset purchases was not on a preset course and would remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the efficacy and costs of purchases. Consistent with this approach, the Committee agreed that, beginning in January, it would add to its holdings of agency mortgage-backed securities at a pace of $35 billion per month rather than $40 billion per month, and add to its holdings of longer-term Treasury securities at a pace of $40 billion per month rather than $45 billion per month. While deciding to modestly reduce its pace of purchases, the Committee emphasized that its holdings of longer-term securities were sizable and would still be increasing, which would promote a stronger economic recovery by maintaining downward pressure on longer-term interest rates, supporting mortgage markets, and helping to make broader financial conditions more accommodative. The Committee also reiterated that it will continue its asset purchases, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. In the view of one member, a reduction in the pace of purchases was premature and, before taking such a step, the Committee should wait for more convincing evidence that economic growth was rising faster than its potential and that inflation would return to the Committee's 2 percent objective.

In their discussion of forward guidance about the target federal funds rate, a few members suggested that lowering the unemployment threshold to 6 percent could effectively convey the Committee's intention to keep the target federal funds rate low for an extended period. However, most members wanted to make no change to the threshold and instead preferred to provide qualitative guidance to clarify that a range of labor market indicators would be used when assessing the appropriate stance of policy once the threshold had been crossed. A number of members thought that the forward guidance should emphasize the importance of inflation as a factor in their decisions. Accordingly, almost all members agreed to add language indicating the Committee's anticipation, based on its current assessment of additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments, that it would be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6½ percent, especially if projected inflation continues to run below the Committee's longer-run objective. It was noted that this language might appear calendar-based rather than conditional on economic and financial developments, and one member objected to having forward guidance that might be seen as relatively inflexible in response to changes in members' views about the appropriate path of the target federal funds rate. However, those concerns generally were seen as outweighed by the benefit of avoiding tying the Committee's decision too closely to the unemployment rate alone, while still being clear about the Committee's intention to provide the monetary accommodation needed to support a return to maximum employment and stable prices.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "Consistent with its statutory mandate, the Federal Open Market Committee seeks monetary and financial conditions that will foster maximum employment and price stability. In particular, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to undertake open market operations as necessary to maintain such conditions. Beginning in January, the Desk is directed to purchase longer-term Treasury securities at a pace of about $40 billion per month and to purchase agency mortgage-backed securities at a pace of about $35 billion per month. The Committee also directs the Desk to engage in dollar roll and coupon swap transactions as necessary to facilitate settlement of the Federal Reserve's agency mortgage-backed securities transactions. The Committee directs the Desk to maintain its policy of rolling over maturing Treasury securities into new issues and its policy of reinvesting principal payments on all agency debt and agency mortgage-backed securities in agency mortgage-backed securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:00 p.m.:

"Information received since the Federal Open Market Committee met in October indicates that economic activity is expanding at a moderate pace. Labor market conditions have shown further improvement; the unemployment rate has declined but remains elevated. Household spending and business fixed investment advanced, while the recovery in the housing sector slowed somewhat in recent months. Fiscal policy is restraining economic growth, although the extent of restraint may be diminishing. Inflation has been running below the Committee's longer-run objective, but longer-term inflation expectations have remained stable.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee expects that, with appropriate policy accommodation, economic growth will pick up from its recent pace and the unemployment rate will gradually decline toward levels the Committee judges consistent with its dual mandate. The Committee sees the risks to the outlook for the economy and the labor market as having become more nearly balanced. The Committee recognizes that inflation persistently below its 2 percent objective could pose risks to economic performance, and it is monitoring inflation developments carefully for evidence that inflation will move back toward its objective over the medium term.

Taking into account the extent of federal fiscal retrenchment since the inception of its current asset purchase program, the Committee sees the improvement in economic activity and labor market conditions over that period as consistent with growing underlying strength in the broader economy. In light of the cumulative progress toward maximum employment and the improvement in the outlook for labor market conditions, the Committee decided to modestly reduce the pace of its asset purchases. Beginning in January, the Committee will add to its holdings of agency mortgage-backed securities at a pace of $35 billion per month rather than $40 billion per month, and will add to its holdings of longer-term Treasury securities at a pace of $40 billion per month rather than $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. The Committee's sizable and still-increasing holdings of longer-term securities should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative, which in turn should promote a stronger economic recovery and help to ensure that inflation, over time, is at the rate most consistent with the Committee's dual mandate.

The Committee will closely monitor incoming information on economic and financial developments in coming months and will continue its purchases of Treasury and agency mortgage-backed securities, and employ its other policy tools as appropriate, until the outlook for the labor market has improved substantially in a context of price stability. If incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings. However, asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases.

To support continued progress toward maximum employment and price stability, the Committee today reaffirmed its view that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens. The Committee also reaffirmed its expectation that the current exceptionally low target range for the federal funds rate of 0 to ¼ percent will be appropriate at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored. In determining how long to maintain a highly accommodative stance of monetary policy, the Committee will also consider other information, including additional measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial

developments. The Committee now anticipates, based on its assessment of these factors, that it likely will be appropriate to maintain the current target range for the federal funds rate well past the time that the unemployment rate declines below 6½ percent, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal. When the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent."

Voting for this action: Ben Bernanke, William C. Dudley, James Bullard, Charles L. Evans, Esther L. George, Jerome H. Powell, Jeremy C. Stein, Daniel K. Tarullo, and Janet L. Yellen.

Voting against this action: Eric Rosengren.

Mr. Rosengren dissented because he viewed the decision to slow the pace of asset purchases at this meeting as premature. In his view, with the unemployment rate still elevated and the inflation rate well below the Committee's longer-run objective of 2 percent, changes in the asset purchase program should be postponed until incoming data more clearly indicate that economic growth is likely to be sustained above its potential rate. He saw the costs of delaying action at this meeting as likely to be small relative to the gains from promoting a faster return of both elements of the Committee's dual mandate to their longer-run objectives.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, January 28–29, 2014. The meeting adjourned at 11:00 a.m. on December 18, 2013.

Notation Vote

By notation vote completed on November 19, 2013, the Committee unanimously approved the minutes of the FOMC meeting held on October 29–30, 2013.

William B. English
Secretary

Addendum: Summary of Economic Projections

In conjunction with the December 17–18, 2013, Federal Open Market Committee (FOMC) meeting, meeting participants—5 members of the Board of Governors and the 12 presidents of the Federal Reserve Banks, all of whom participated in the deliberations—submitted their assessments of real output growth, the unemployment rate, inflation, and the target federal funds rate for each year from 2013 through 2016 and over the longer run. Each participant's assessment was based on information available at the time of the meeting plus his or her judgment of appropriate monetary policy and assumptions about the factors likely to affect economic outcomes. The longer-run projections represent each participant's judgment of the value to which each variable would be expected to converge, over time, under appropriate monetary policy and in the absence of further shocks to the economy. "Appropriate monetary policy" is defined as the future path of policy that each participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her individual interpretation of the Federal Reserve's objectives of maximum employment and stable prices.

Overall, FOMC participants expected, under appropriate monetary policy, that economic growth would pick up, on average, over the next three years, with the unemployment rate declining gradually (table 1 and figure 1). Almost all of the participants projected that inflation, as measured by the annual change in the price index for personal consumption expenditures (PCE), would rise to a level at or slightly below the Committee's 2 percent objective in 2016.

Most participants expected that highly accommodative monetary policy would remain warranted over the next few years to foster progress toward the Federal Reserve's longer-run objectives. As shown in figure 2, a large majority of participants projected not only that it would be appropriate to wait until 2015 or later before beginning to increase the federal funds rate, but also that it would then be appropriate to raise the target federal funds rate relatively gradually. Most participants viewed their economic projections as broadly consistent with a slowing in the pace of the Committee's purchases of longer-term securities in early 2014 and the completion of the program in the second half of the year.

Most participants saw the uncertainty associated with their outlook for economic growth, the unemployment rate, and inflation as similar to that of the past 20 years. In addition, most participants considered the risks to the outlook for real gross domestic product (GDP), the unemployment rate, and inflation to be broadly balanced, although a few saw the risks to their inflation forecasts as tilted to the downside.

Table 1. Economic projections of Federal Reserve Board members and Federal Reserve Bank presidents, December 2013
Percent

Variable	Central tendency[1]					Range[2]				
	2013	2014	2015	2016	Longer run	2013	2014	2015	2016	Longer run
Change in real GDP	2.2 to 2.3	2.8 to 3.2	3.0 to 3.4	2.5 to 3.2	2.2 to 2.4	2.2 to 2.4	2.2 to 3.3	2.2 to 3.6	2.1 to 3.5	1.8 to 2.5
September projection	2.0 to 2.3	2.9 to 3.1	3.0 to 3.5	2.5 to 3.3	2.2 to 2.5	1.8 to 2.4	2.2 to 3.3	2.2 to 3.7	2.2 to 3.5	2.1 to 2.5
Unemployment rate	7.0 to 7.1	6.3 to 6.6	5.8 to 6.1	5.3 to 5.8	5.2 to 5.8	7.0 to 7.1	6.2 to 6.7	5.5 to 6.2	5.0 to 6.0	5.2 to 6.0
September projection	7.1 to 7.3	6.4 to 6.8	5.9 to 6.2	5.4 to 5.9	5.2 to 5.8	6.9 to 7.3	6.2 to 6.9	5.3 to 6.3	5.2 to 6.0	5.2 to 6.0
PCE inflation	0.9 to 1.0	1.4 to 1.6	1.5 to 2.0	1.7 to 2.0	2.0	0.9 to 1.2	1.3 to 1.8	1.4 to 2.3	1.6 to 2.2	2.0
September projection	1.1 to 1.2	1.3 to 1.8	1.6 to 2.0	1.7 to 2.0	2.0	1.0 to 1.3	1.2 to 2.0	1.4 to 2.3	1.5 to 2.3	2.0
Core PCE inflation[3]	1.1 to 1.2	1.4 to 1.6	1.6 to 2.0	1.8 to 2.0		1.1 to 1.2	1.3 to 1.8	1.5 to 2.3	1.6 to 2.2	
September projection	1.2 to 1.3	1.5 to 1.7	1.7 to 2.0	1.9 to 2.0		1.2 to 1.4	1.4 to 2.0	1.6 to 2.3	1.7 to 2.3	

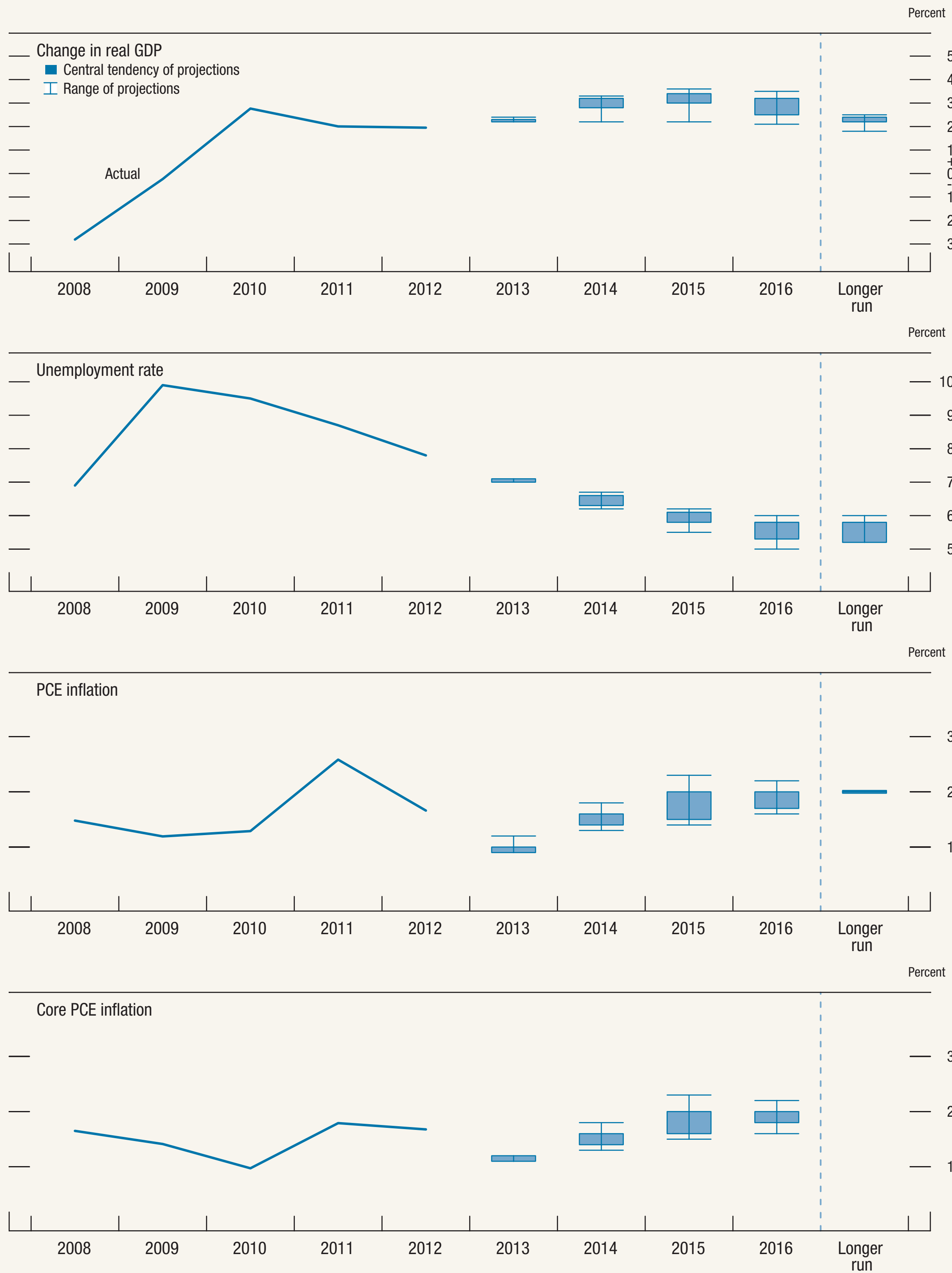
Note: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The September projections were made in conjunction with the meeting of the Federal Open Market Committee on September 17–18, 2013.

1 The central tendency excludes the three highest and three lowest projections for each variable in each year.

2 The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

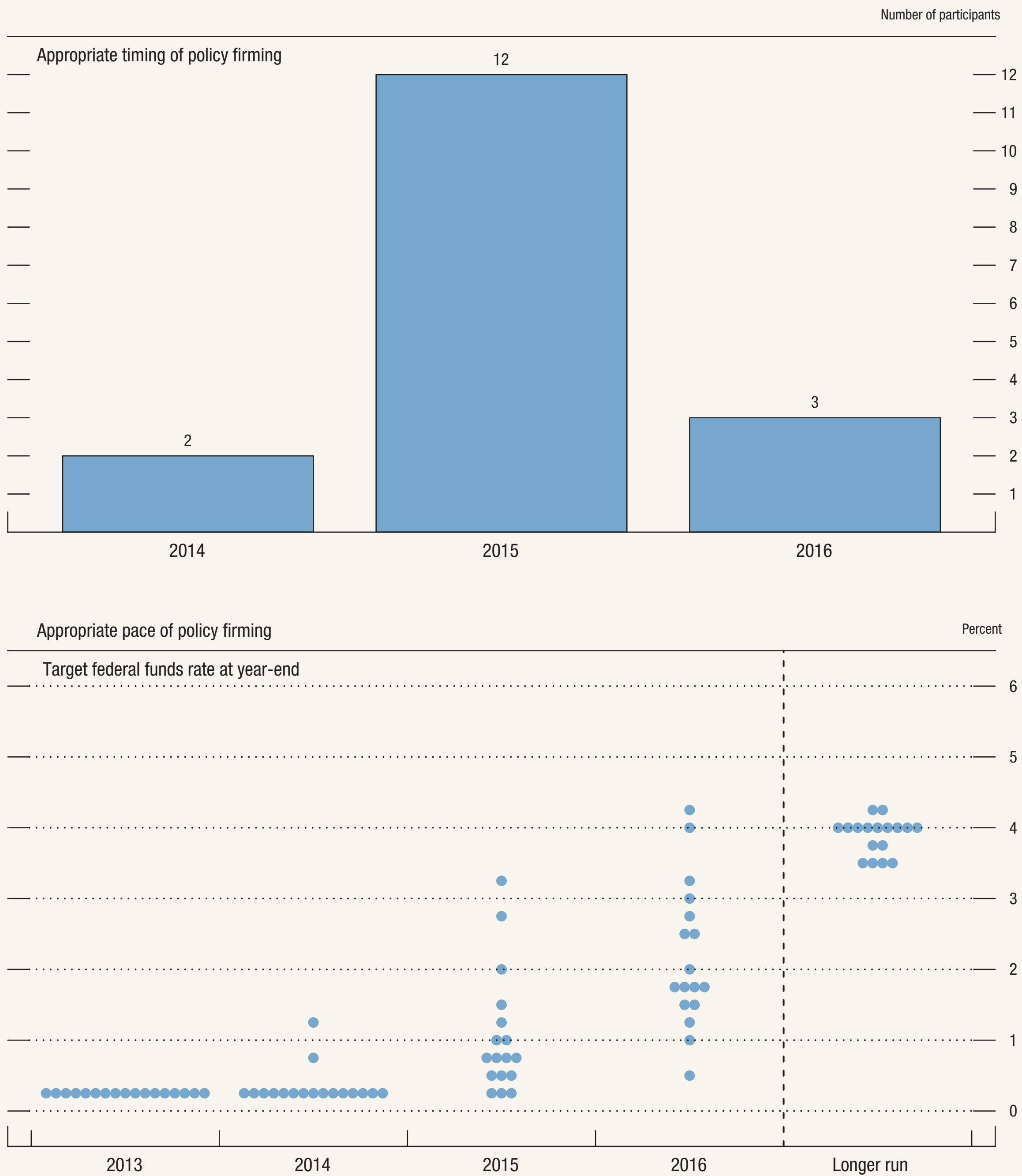
3 Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2013–16 and over the longer run



Note: Definitions of variables are in the general note to table 1. The data for the actual values of the variables are annual.

Figure 2. Overview of FOMC participants' assessments of appropriate monetary policy



Note: In the upper panel, the height of each bar denotes the number of FOMC participants who judge that, under appropriate monetary policy, the first increase in the target federal funds rate from its current range of 0 to ¼ percent will occur in the specified calendar year. In September 2013, the numbers of FOMC participants who judged that the first increase in the target federal funds rate would occur in 2014, 2015, and 2016 were, respectively, 3, 12, and 2. In the lower panel, each shaded circle indicates the value (rounded to the nearest ¼ percentage point) of an individual participant's judgment of the appropriate level of the target federal funds rate at the end of the specified calendar year or over the longer run.

The Outlook for Economic Activity

Participants generally projected that, conditional on their individual assumptions about appropriate monetary policy, real GDP growth would accelerate in 2014 from its rate in 2013 and would pick up further in 2015. Subsequently, in 2016, real GDP growth would begin to converge back to a pace that participants saw as the longer-run rate of output growth. Participants pointed to a number of factors contributing to the pickup in growth in the near term, including diminishing restraint from fiscal policy, pent-up demand for consumer and producer durables, rising household net worth, stronger growth abroad, and accommodative monetary policy. A number of participants noted that growth in residential investment had slowed some recently as a result of higher mortgage rates, but they expected growth to strengthen beginning in 2014. Several participants also noted a slowdown in the growth of business investment but saw growth picking up over the forecast horizon, reflecting an expected acceleration in sales.

The central tendencies of participants' projections for real GDP growth were 2.2 to 2.3 percent in 2013, 2.8 to 3.2 percent in 2014, 3.0 to 3.4 percent in 2015, and 2.5 to 3.2 percent in 2016. The central tendency for the longer-run rate of growth of real GDP was 2.2 to 2.4 percent. These projections were little changed from September.

Participants anticipated a gradual decline in the unemployment rate over the projection period. The central tendencies of participants' forecasts for the unemployment rate in the fourth quarter of each year were 7.0 to 7.1 percent in 2013, 6.3 to 6.6 percent in 2014, 5.8 to 6.1 percent in 2015, and 5.3 to 5.8 percent in 2016. Nearly all participants made a modest downward revision to their projected path for the unemployment rate, reflecting its recent larger-than-expected decline; however, the central tendency of participants' estimates of the longer-run normal rate of unemployment that would prevail under appropriate monetary policy and in the absence of further shocks to the economy was unchanged at 5.2 to 5.8 percent. A majority of participants projected that the unemployment rate would be near or slightly above their individual estimates of its longer-run level at the end of 2016.

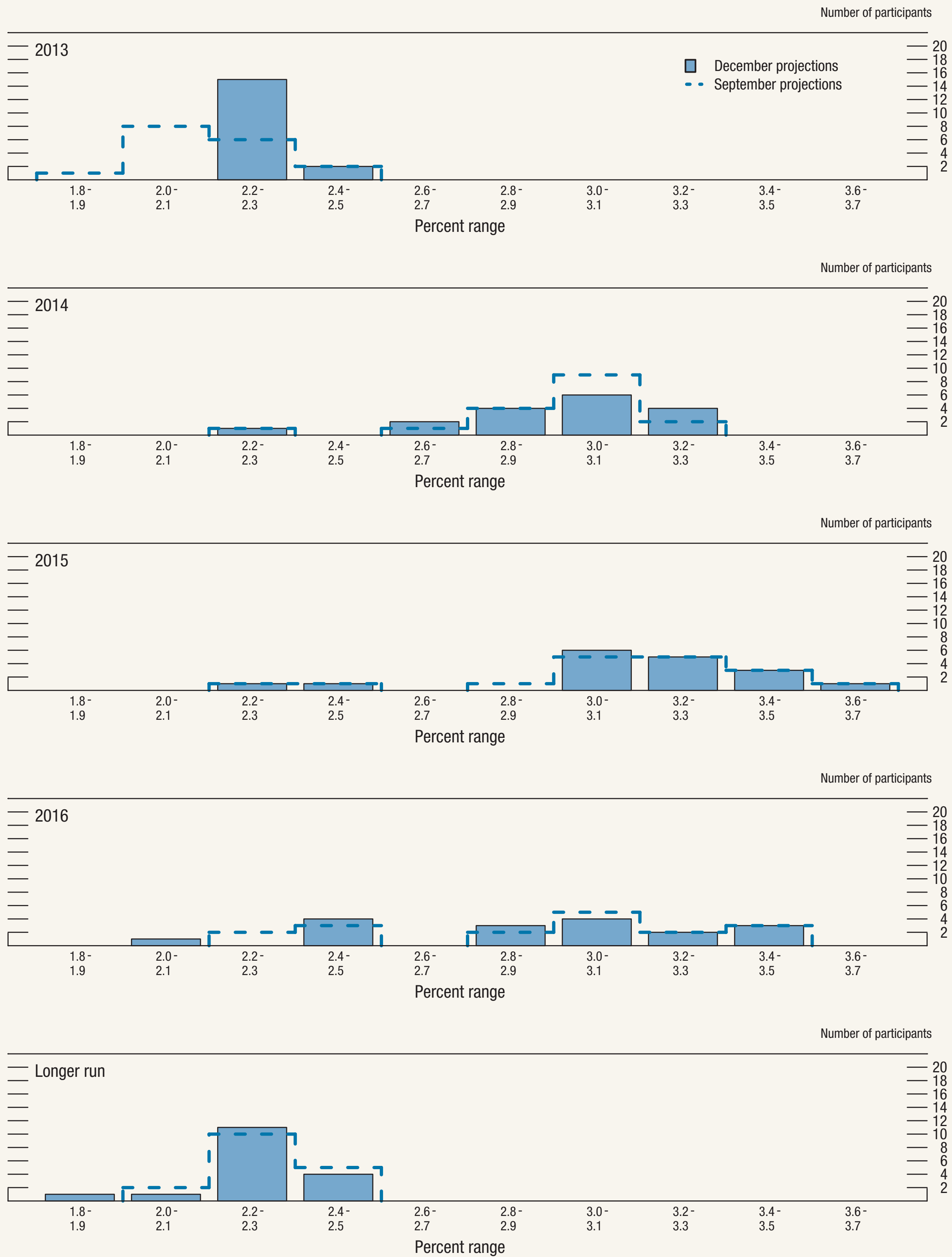
Figures 3.A and 3.B show that participants' views regarding the likely outcomes for real GDP growth and the unemployment rate remained dispersed. The diversity evidently reflected their individual assessments of the likely rate at which the restraint from fiscal policy will diminish and demand for consumer and producer durables will recover, the anticipated path for foreign economic activity, the trajectory for growth in household net worth, and the appropriate path of monetary policy. Relative to September, the dispersions of participants' projections for GDP growth in 2014 and beyond were about unchanged, while dispersions of the projections for the unemployment rate narrowed some through 2015.

The Outlook for Inflation

Participants' views on the broad outlook for inflation under the assumption of appropriate monetary policy were marked down a bit in 2013 and 2014 from those in their September projections, but the central tendencies for 2015 and beyond were similar. All participants anticipated that, on average, both headline and core inflation would rise gradually over the next few years, and a large majority of participants expected headline inflation to be at or slightly below the Committee's 2 percent objective in 2016. Specifically, the central tendencies for PCE inflation were 0.9 to 1.0 percent in 2013, 1.4 to 1.6 percent in 2014, 1.5 to 2.0 percent in 2015, and 1.7 to 2.0 percent in 2016. The central tendencies of the forecasts for core inflation were slightly lower over the projection period than in September and broadly similar to those for the headline measure. A number of participants viewed the combination of stable inflation expectations and diminishing resource slack as likely to contribute to a gradual rise of inflation back toward the Committee's longer-run objective.

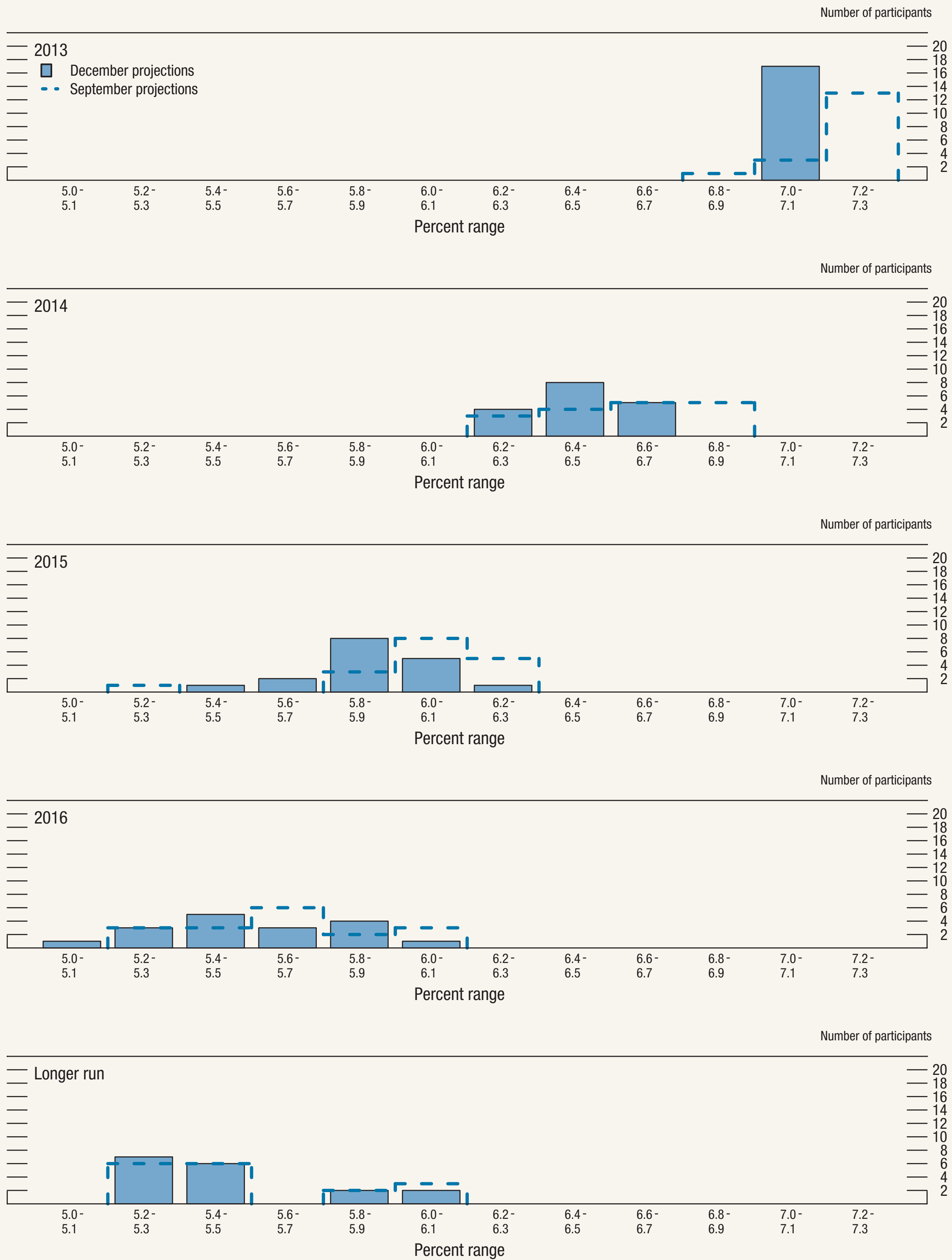
Figures 3.C and 3.D provide information on the diversity of participants' views about the outlook for inflation. Relative to September, the ranges of participants' projections for overall inflation narrowed some in 2013 and 2014 but remained relatively unchanged thereafter. In 2016, the forecasts for PCE inflation were concentrated near the Committee's longer-run objective, though one participant expected inflation to be ¼ percentage point above the Committee's objective and another three expected it to be almost ½ percentage point below. Similar to the projections for headline inflation, the projections for core inflation also were concentrated near 2 percent in 2016.

Figure 3.A. Distribution of participants' projections for the change in real GDP, 2013–16 and over the longer run



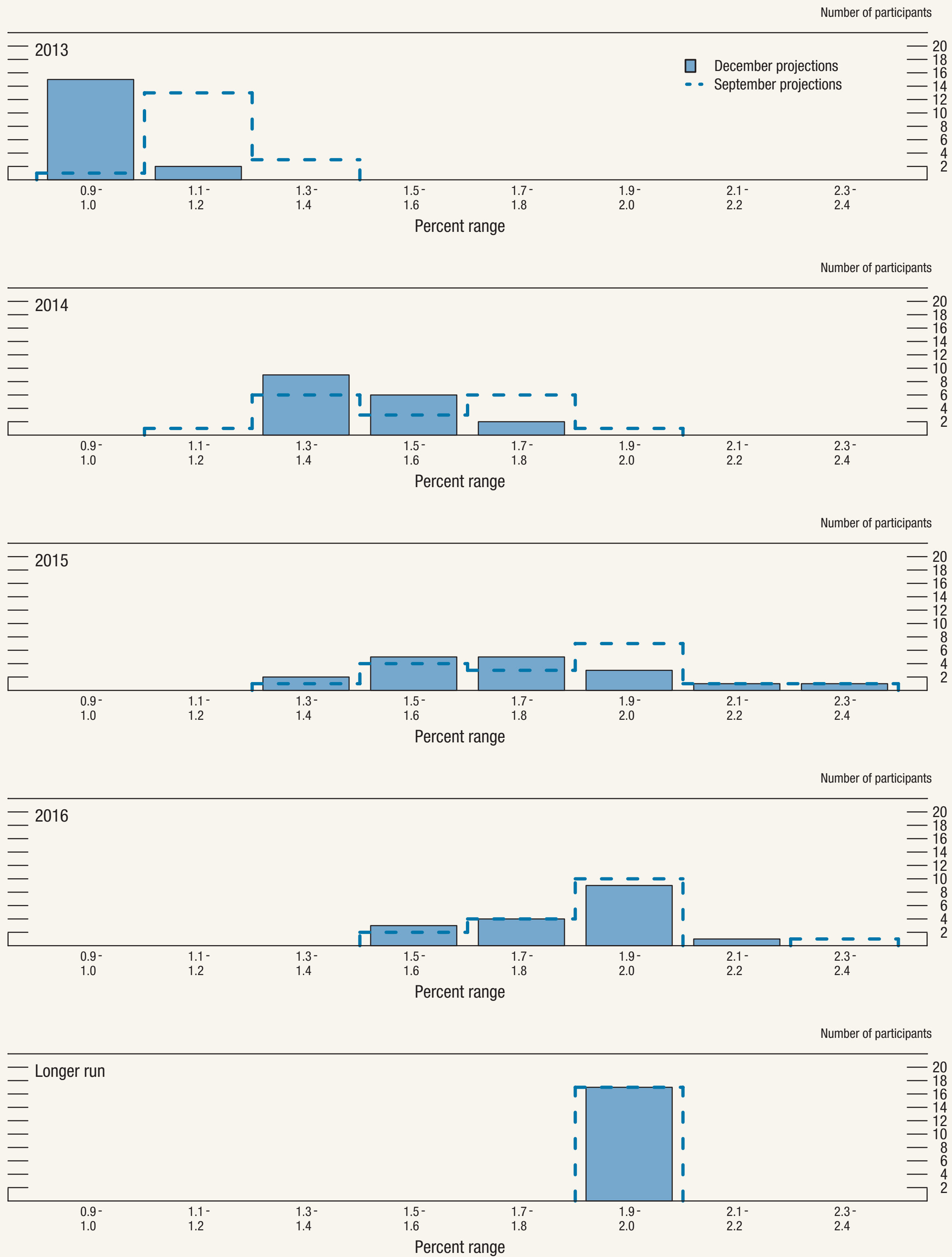
Note: Definitions of variables are in the general note to table 1.

Figure 3.B. Distribution of participants' projections for the unemployment rate, 2013–16 and over the longer run



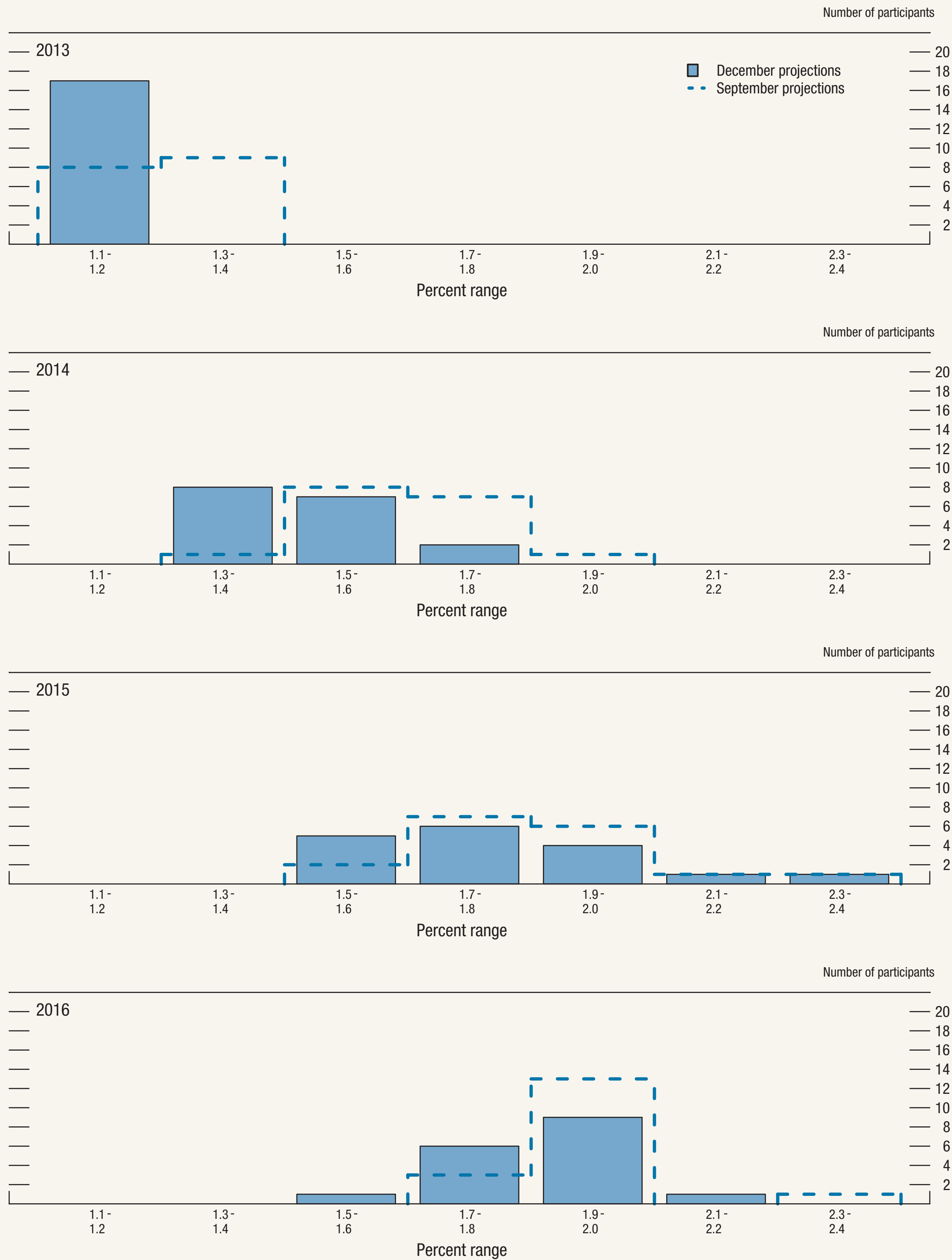
Note: Definitions of variables are in the general note to table 1.

Figure 3.C. Distribution of participants' projections for PCE inflation, 2013–16 and over the longer run



Note: Definitions of variables are in the general note to table 1.

Figure 3.D. Distribution of participants' projections for core PCE inflation, 2013–16



Note: Definitions of variables are in the general note to table 1.

Appropriate Monetary Policy

As indicated in figure 2, most participants judged that exceptionally low levels of the federal funds rate would remain appropriate for the next few years. In particular, 12 participants thought that the first increase in the target federal funds rate would not be warranted until sometime in 2015, and 3 judged that policy firming would likely not be appropriate until 2016. Only 2 participants judged that an increase in the federal funds rate in 2014 would be appropriate.

All participants projected that the unemployment rate would be below the Committee's 6½ percent threshold at the end of the year in which they viewed the initial increase in the federal funds rate to be appropriate, and all but one judged that inflation would be at or below the Committee's longer-run objective. Almost all participants projected that the unemployment rate would remain above their view of its longer-run normal level at the end of the year in which they saw the federal funds rate increasing from the effective lower bound.

Figure 3.E provides the distribution of participants' judgments regarding the appropriate level of the target federal funds rate at the end of each calendar year from 2013 to 2016 and over the longer run. As noted above, most participants judged that economic conditions would warrant maintaining the current low level of the federal funds rate until 2015. The two participants who saw the federal funds rate leaving the effective lower bound earlier submitted projections for the federal funds rate at the end of 2014 of ¾ percent and 1¼ percent. These two participants' views of the appropriate level of the federal funds rate at the end of 2015 were 2¾ percent and 3¼ percent, while the remainder of participants saw the appropriate level of the funds rate at that time to be 2 percent or lower. On balance, while the dispersion of projections for the value of the federal funds rate in each year changed little since September, the median value of the rate at the end of 2015 and 2016 decreased ¼ percentage point.

As in September, all of the participants who saw the first tightening in either 2015 or 2016 judged that the appropriate level of the federal funds rate at the end of 2016 would still be below their individual assessments of its expected longer-run value. In contrast, the two participants who saw the first tightening in 2014 believed that the appropriate level of the federal funds rate at the end of 2016 would be at their assessment of its longer-run level, which they judged to be either at or just above 4 percent. Among all participants, estimates of the longer-run target federal funds rate ranged from 3½ to about 4¼ percent, reflecting the Committee's inflation objective of 2 percent and participants' individual judgments about the appropriate longer-run level of the real federal funds rate in the absence of further shocks to the economy.

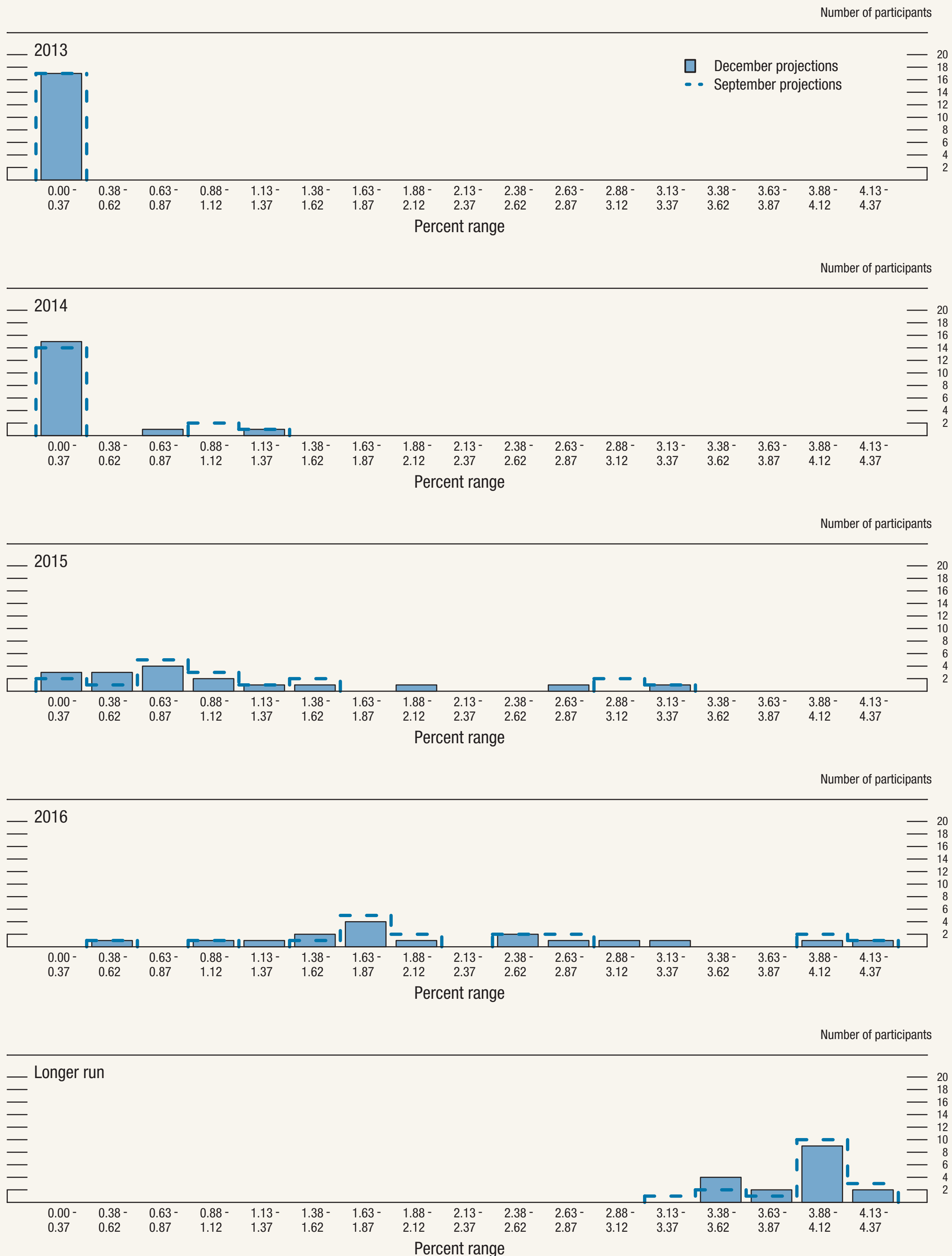
Participants also described their views regarding the appropriate path of the Federal Reserve's balance sheet. Conditional on their respective economic outlooks, most participants judged that it would likely be appropriate to begin to reduce the pace of the Committee's purchases of longer-term securities in the first quarter of 2014 and to conclude purchases in the second half of the year. A number of participants thought it would be appropriate to end the asset purchase program earlier; in contrast, one participant thought a more accommodative path for asset purchases would be appropriate.

Participants' views of the appropriate path for monetary policy were informed by their judgments on the state of the economy, including the values of the unemployment rate and other labor market indicators that would be consistent with maximum employment, the extent to which the economy was currently falling short of maximum employment, the prospects for inflation to reach the Committee's longer-term objective of 2 percent, and the balance of risks around the outlook. A few participants also mentioned using various monetary policy rules to guide their thinking on the appropriate path for the federal funds rate.

Uncertainty and Risks

Nearly all participants judged that the levels of uncertainty about their projections for real GDP growth and unemployment were broadly similar to the norm during the previous 20 years, although three participants continued to see them as higher

Figure 3.E. Distribution of participants' projections for the target federal funds rate, 2013–16 and over the longer run



Note: The target federal funds rate is measured as the level of the target rate at the end of the calendar year or in the longer run.

(figure 4).[1] More participants than in September judged the risks to real GDP growth and the unemployment rate to be broadly balanced. A range of factors was cited as contributing to this change in view, including an improved outlook for global financial and economic conditions, a moderation in geopolitical risks, an upgraded assessment of the prospects for consumption growth, and reduced odds of a fiscal impasse.

Participants reported little change in their assessments of the level of uncertainty and the balance of risks around their forecasts for overall PCE inflation and core inflation. Most participants judged the levels of uncertainty associated with their forecasts for the two inflation measures to be broadly similar to historical norms and the risks to those projections as broadly balanced. Four participants saw the risks to their inflation forecasts as tilted to the downside, reflecting, for example, the possibility that the current low levels of inflation could prove more persistent than anticipated. Conversely, one participant cited upside risks to inflation stemming from uncertainty about the timing and efficacy of the Committee's withdrawal of accommodation.

Table 2. Average historical projection error ranges

Percentage points

Variable	2013	2014	2015	2016
Change in real GDP[1]	±0.5	±1.4	±1.8	±1.8
Unemployment rate[1]	±0.1	±0.7	±1.4	±1.8
Total consumer prices[2]	±0.3	±0.9	±1.0	±1.0

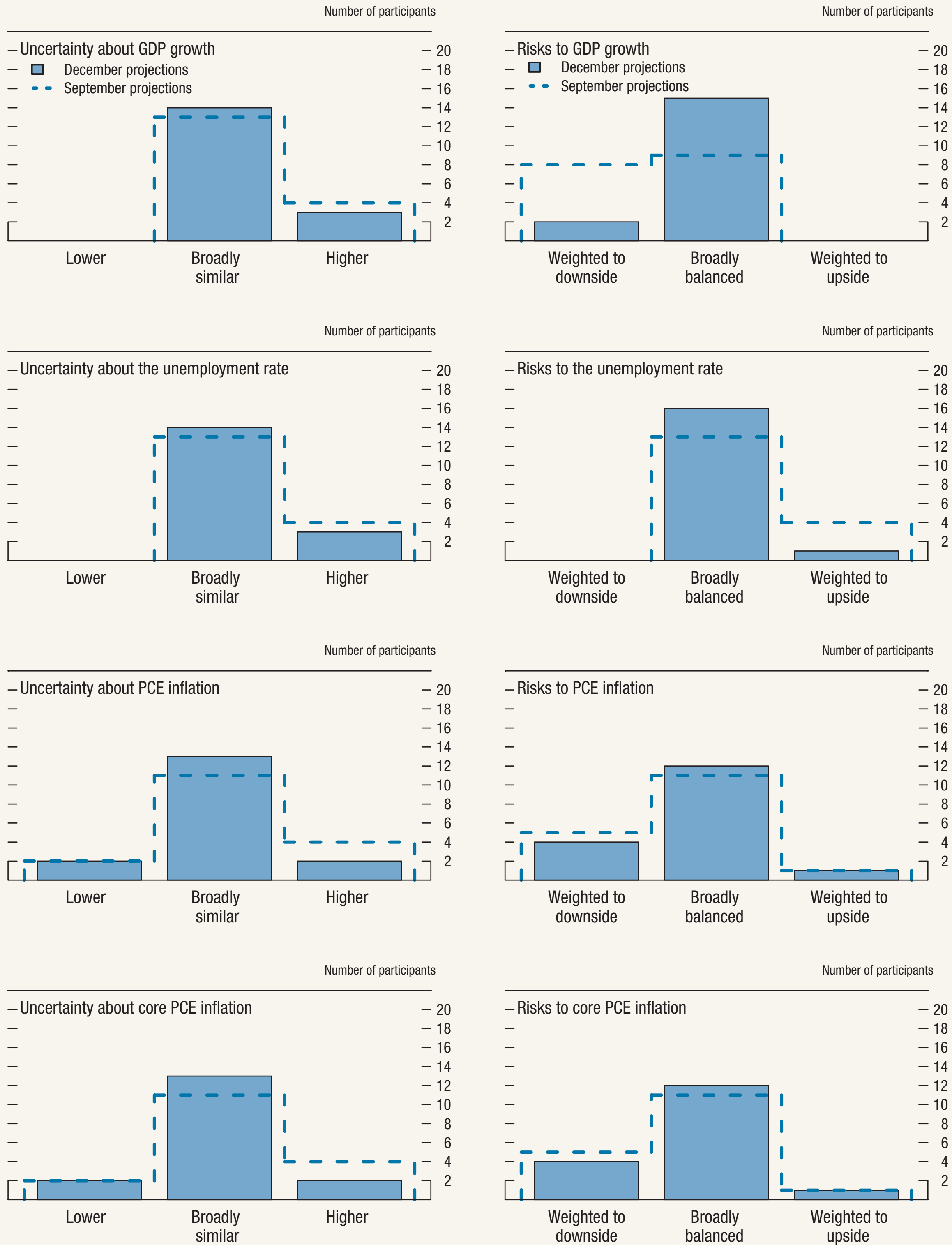
Note: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1993 through 2012 that were released in the winter by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information may be found in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1 Definitions of variables are in the general note to table 1.

2 Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

1 Table 2 provides estimates of the forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1993 through 2012. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in the economic forecasts and explains the approach used to assess the uncertainty and risks attending the participants' projections.

Figure 4. Uncertainty and risks in economic projections



Note: For definitions of uncertainty and risks in economic projections, see the box "Forecast Uncertainty." Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world, and the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by the Federal Reserve Board's staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.5 to 3.5 percent in the current year, 1.6 to 4.4 percent in the second year, and 1.2 to 4.8 percent in the third and fourth years. The corresponding 70 percent confidence intervals for overall inflation would be 1.7 to 2.3 percent in the current year, 1.1 to 2.9 percent in the second year, and 1.0 to 3.0 percent in the third and fourth years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past, as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

As with real activity and inflation, the outlook for the future path of the federal funds rate is subject to considerable uncertainty. This uncertainty arises primarily because each participant's assessment of the appropriate stance of monetary policy depends importantly on the evolution of real activity and inflation over time. If economic conditions evolve in an unexpected manner, then assessments of the appropriate setting of the federal funds rate would change from that point forward.

9 Litigation

During 2013, the Board of Governors was a party in 14 lawsuits or appeals filed that year and was a party in 15 other cases pending from previous years, for a total of 29 cases. In 2012, the Board had been a party in a total of 26 cases. As of December 31, 2013, 15 cases were pending.

American Bankers Association, et al., v. Board of Governors, No. 13-cv-02050 (D. District of Columbia, filed December 24, 2013), was a challenge to a portion of the so-called "Volcker rule" issued by the Board and other regulators. On February 12, 2014, the plaintiffs voluntarily dismissed the action.

American Bankers Association, et al., v. Board of Governors, No. 13-1310 (D.C. Circuit, filed December 23, 2013), is a challenge to a portion of the so-called "Volcker rule" issued by the Board and other regulators. On February 12, 2014, the parties stipulated to a dismissal of the petition for review.

Blair v. Bernanke, No. CJ-2013-3525, No. 14-CV-00022 (N.D. Oklahoma, filed November 25, 2013), is a third-party, pro-se complaint originally filed in Oklahoma state court alleging that the Board violated the plaintiff's constitutional rights through its regulation of direct deposit payments.

Richter v. Board of Governors, No. 13-cv-015107 (D.D.C., filed October 1, 2013), was a Freedom of Information Act case. On February 14, 2014, the district court granted the Board's motion for summary judgment.

WMI Liquidating Trust v. Board of Governors, No. 13-cv-01706 (W.D. Washington, filed September 20, 2013), is an action for a declaratory judgment regarding golden parachute payments.

NACS et al. v. Board of Governors, No. 13-5720 (D.C. Circuit, notice of appeal filed August 21, 2013), is an appeal from district court ruling invalidating Board regulations issued pursuant to section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to debit card interchange fees.

State National Bank of Big Spring v. Bernanke, No. 13-5247 (D.C. Circuit, notice of appeal filed August 2, 2013), is an appeal of a district court ruling dismissing plaintiffs' challenge to the constitutionality of the Consumer Financial Protection Bureau and the Financial Stability Oversight Council.

Law Office La Ley con John H. Ruiz v. John Doe Borrowers, et al., No. 13-cv-22783 (S.D. Fla., removed from state court on August 2, 2013), was an action to foreclose on attorneys' charging liens. On October 3, 2013, the district court granted in part and denied in part the Board's motion to dismiss, and remanded the matter to the state court.

Ferrer v. Bernanke, No. 13-29975 (S.D. Florida, filed July 29, 2013), is an action alleging that plaintiffs received improper relief under the Board's and the Office of the Comptroller of the Currency's financial remediation orders regarding deficient mortgage servicing and foreclosure practices.

Law Offices La Ley con John H. Ruiz v. John Doe Borrowers, et al., No. 13-cv-22476 (S.D. Florida, removed from state court July 11, 2013), was an action seeking injunction and declaration that plaintiffs' attorneys' charging liens are valid and enjoining disbursal of funds to individuals under a Board enforcement order. On October 3, 2013, the district court granted in part and denied in part the Board's motion to dismiss, and remanded the matter to the state court.

Law Offices La Ley con John H. Ruiz v. Rust Consulting, No. 13-cv-22119 (S.D. Florida, removed from state court June 13, 2013), was an action seeking injunction preventing disbursement of funds to individuals under Board enforcement order. The district court dismissed the action on July 12, 2013.

Goldstein, Trustee v. Board of Governors, No. 13-MC-00445-RC (D.D.C., motion to compel filed May 1, 2013), was a motion to compel production of bank examination material. On January 17, 2014, the plaintiff voluntarily dismissed the action.

Ball v. Board of Governors, No. 13-cv-00603 (D. District of Columbia, filed April 30, 2013), is a Freedom of Information Act case.

Taylor v. Bernanke, et al., No. 13-cv-1013 (E.D. New York, filed February 26, 2013), was an action for an order requiring agencies to issue final rules under 12 U.S.C. 1851 (the "Volcker rule"). On September 9, 2013, the district court granted the government's motion to dismiss the action.

Conover v. Board of Governors, No. 12-cv-6480 (N.D. California, filed December 20, 2012), was a Freedom of Information Act case. On April 2, 2013, the district court granted the Board's motion to dismiss.

Crisman v. Board of Governors et al., No. 12-cv-1871 (D. District of Columbia, filed November 19, 2012), is a Freedom of Information Act case.

Wise v. Federal Reserve Board, No. 12-cv-1636 (D. District of Columbia, filed October 2, 2012), is a claim under the Federal Tort Claims Act.

McKinley v. Board of Governors, No 12-cv-1175 (D. District of Columbia, filed July 18, 2012), was a Freedom of Information Act case. On March 7, 2013, the plaintiff voluntarily dismissed the action with prejudice.

Judicial Watch v. Board of Governors and Federal Open Market Committee, No. 12-cv-1114 (D. District of Columbia, filed July 6, 2012), was a Freedom of Information Act case. On February 12, 2013, the plaintiff voluntarily dismissed the action with prejudice.

Marcusse v. United States Department of Justice, et al., No. 12-cv-1025 (D. District of Columbia, filed June 22, 2012), was a Freedom of Information Act case. On August 12, 2013, the district court granted the Board's motion for summary judgment and dismissed the action as to the Board.

Gelb v. Board of Governors, No. 12-cv-4880 (S.D. New York, filed June 21, 2012), was a Freedom of Information Act case. On July 17, 2013, the district court granted the Board's motion to dismiss the action as to the Board.

Mashak v. Federal Reserve Bank System, et al., No. 12-cv-1333 (D. Minnesota, filed June 1, 2012), was a challenge regarding mortgage foreclosure. On February 14, 2013, the district court dismissed the action.

DeNaples v. Board of Governors et al., No. 12-1198 (D.C. Circuit, filed April 19, 2012), was a petition for review of cease-and-desist orders issued by the Board and the Office of the Comptroller of the Currency. On January 29, 2013, the Court of Appeals vacated the orders and remanded to the agencies for additional action.

Freedom Watch v. Board of Governors, No. 12-cv-314 (D. District of Columbia, filed February 27, 2012), was a Freedom of Information Act case. On February 27, 2013, the district court granted the government's motion to dismiss.

Estate of Deleon v. Board of Governors, No. 11-cv-1538 (N.D. New York, filed December 30, 2011), was a complaint involving alleged failure to address a consumer complaint at a regulated bank. On February 14, 2013, the district court dismissed the case.

Haller v. U.S. Department of Housing and Urban Development et al., No 11-cv-881 MRB-KLL (S.D. Ohio, filed December 16, 2011), was an action arising out of a mortgage foreclosure. On March 4, 2013, the district court granted the Board's motion to dismiss.

CitiMortgage, Inc. v. Kokolis, No. 11-cv-2933-RBH (D. South Carolina, filed in state court August 5, 2011; notice of removal filed October 27, 2011), is a third-party complaint against the Board and the United States Department of the Treasury by the defendant in a mortgage foreclosure action. The district court dismissed the action on May 30, 2012, and the plaintiff's appeal to the Fourth Circuit Court of Appeals (No. 12-1917) is pending.

First Citizens Bank and Trust Co. v. Spirakis, No. 11-cv-2895-RBH (D. South Carolina, filed in state court August 5, 2011; notice of removal filed October 24, 2011), was a third-party complaint against the Board and the United States Department of the Treasury by the defendant in a mortgage foreclosure action. The district court dismissed the action on May 30, 2012, and the Fourth Circuit affirmed the dismissal (No. 12-1914) on March 15, 2013.

Artis v. Greenspan, No. 01-cv-0400 (D. District of Columbia, filed February 22, 2001), is an employment discrimination action.

10 Statistical Tables

Table 1. Federal Reserve open market transactions, 2013

Millions of dollars

Type of security and transaction	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
U.S. Treasury securities[1]													
Outright transactions[2]													
Treasury bills													
Gross purchases	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
For new bills	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	0	0	0	0	0	0	0	0	0	0	0	0	0
Others within 1 year													
Gross purchases	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	2	3	1	2	3	2	2	2	2	1	2	1	21
1 to 5 years													
Gross purchases	5,468	6,048	4,113	10,342	9,433	12,844	7,487	9,513	8,353	8,297	7,808	7,770	97,476
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
5 to 10 years													
Gross purchases	25,841	24,553	21,398	20,714	21,591	22,987	22,499	21,800	22,698	21,990	22,370	22,806	271,247
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Exchanges	0	0	0	0	0	0	0	0	0	0	0	0	0
More than 10 years													
Gross purchases	12,888	14,092	15,544	14,600	13,753	12,606	15,469	14,510	12,607	14,940	15,572	14,755	171,336
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Maturity shifts	0	0	0	0	0	0	0	0	0	0	0	0	0
Discount notes	0	0	0	0	0	0	0	0	0	0	0	0	0
All maturities													
Gross purchases	44,197	44,693	41,055	45,656	44,777	48,437	45,455	45,823	43,658	45,227	45,750	45,331	540,059
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	2	3	1	2	3	2	2	2	2	1	2	1	21
Net change in U.S. Treasury securities	44,195	44,690	41,054	45,654	44,774	48,435	45,453	45,821	43,656	45,226	45,748	45,330	540,038
Federal agency obligations													
Outright transactions[2]													
Gross purchases	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross sales	0	0	0	0	0	0	0	0	0	0	0	0	0
Redemptions	1,672	1,523	1,165	370	1,163	1,710	2,659	808	5,061	1,572	708	1,151	19,562
Net change in federal agency obligations	-1,672	-1,523	-1,165	-370	-1,163	-1,710	-2,659	-808	-5,061	-1,572	-708	-1,151	-19,562
Mortgage-backed securities[3]													
Net settlements[2]													
Net change in mortgage-backed securities	39,166	50,107	55,011	50,570	43,455	43,162	38,831	44,400	50,724	51,603	46,167	50,304	563,500

(continued on next page)

Table 1.—*continued*

Type of security and transaction	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
Temporary transactions													
Repurchase agreements[4]													
Gross purchases	820	0	0	0	0	1,220	0	0	0	0	0	0	2,040
Gross sales	820	0	0	0	0	1,220	0	0	0	0	0	0	2,040
Reverse repurchase agreements[4]													
Gross purchases	2,000,002	1,725,868	1,962,784	2,094,496	2,001,001	1,811,382	1,970,863	2,074,490	1,930,370	2,401,905	2,028,922	2,727,351	24,729,434
Gross sales	1,982,135	1,733,111	1,971,677	2,091,924	1,997,642	1,812,509	1,966,796	2,078,416	1,992,763	2,369,383	2,032,210	2,915,105	24,943,670
Net change in temporary transactions	17,868	-7,243	-8,894	2,573	3,359	-1,128	4,068	-3,927	-62,393	32,522	-3,287	-187,754	-214,235
Total net change in System Open Market Account	**99,557**	**86,032**	**86,006**	**98,427**	**90,425**	**88,759**	**85,694**	**85,487**	**26,927**	**127,779**	**87,919**	**-93,271**	**869,741**

Note: Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Components may not sum to totals because of rounding.

1 Transactions exclude changes in compensation for the effects of inflation on the principal of inflation-indexed securities. Transactions include the rollover of inflation compensation into new securities.

2 Excludes the effect of temporary transactions—repurchase agreements and reverse repurchase agreements.

3 Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Monthly net change in the remaining principal balance of the securities, reported at face value.

4 Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.

Table 2. Federal Reserve Bank holdings of U.S. Treasury and federal agency securities, December 31, 2011–13
Millions of dollars

Description	December 31			Change	
	2013	2012	2011	2012 to 2013	2011 to 2012
U.S. Treasury securities					
Held outright[1]	**2,208,775**	**1,666,145**	**1,663,446**	**542,630**	**2,699**
By remaining maturity					
Bills					
1–90 days	0	0	18,423	0	-18,423
91 days to 1 year	0	0	0	0	0
Notes and bonds					
1 year or less	474	21	114,829	453	-114,808
More than 1 year through 5 years	763,329	378,476	649,698	384,853	-271,222
More than 5 years through 10 years	864,700	862,410	649,913	2,290	212,497
More than 10 years	580,272	425,238	230,583	155,034	194,655
By type					
Bills	0	0	18,423	0	-18,423
Notes	1,467,427	1,110,398	1,286,344	357,029	-175,946
Bonds	741,348	555,747	358,679	185,601	197,068
Federal agency securities					
Held outright[1]	**57,221**	**76,783**	**103,994**	**-19,562**	**-27,211**
By remaining maturity					
Discount notes					
1–90 days	0	0	0	0	0
91 days to 1 year	0	0	0	0	0
Coupons					
1 year or less	18,544	19,562	27,211	-1,018	-7,649
More than 1 year through 5 years	36,268	52,830	60,603	-16,562	-7,773
More than 5 years though 10 years	62	2,044	13,833	-1,982	-11,789
More than 10 years	2,347	2,347	2,347	0	0
By type					
Discount notes	0	0	0	0	0
Coupons	57,221	76,783	103,994	-19,562	-27,211
By issuer					
Federal Home Loan Mortgage Corporation	24,986	32,261	45,126	-7,275	-12,865
Federal National Mortgage Association	25,555	31,906	39,707	-6,351	-7,801
Federal Home Loan Banks	6,680	12,616	19,161	-5,936	-6,545
Mortgage-backed securities[2]					
Held outright[1]	**1,490,162**	**926,662**	**837,683**	**563,500**	**88,979**
By remaining maturity					
1 year or less	0	2	0	-2	2
More than 1 year through 5 years	5	1	13	4	-12
More than 5 years though 10 years	2,549	2,365	34	184	2,331
More than 10 years	1,487,608	924,294	837,636	563,314	86,658
By issuer					
Federal Home Loan Mortgage Corporation	426,311	292,155	289,537	134,156	2,618
Federal National Mortgage Association	774,689	503,696	460,910	270,993	42,786
Government National Mortgage Association	289,162	130,811	87,237	158,351	43,574
Temporary transactions					
Repurchase agreements[3]	**0**	**0**	**0**	**0**	**0**
Reverse repurchase agreements[3]	**315,924**	**107,188**	**99,900**	**208,736**	**7,288**
Foreign official and international accounts	118,169	107,188	99,900	10,981	7,288
Dealers	197,755	0	0	197,755	0

Note: Components may not sum to totals because of rounding.

[1] Excludes the effect of temporary transactions—repurchase agreements and reverse repurchase agreements.

[2] Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae.

[3] Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.

Table 3. Federal Reserve Bank interest rates on loans to depository institutions, December 31, 2013
Percent

Reserve Bank	Primary credit	Secondary credit	Seasonal credit
All banks	0.75	1.25	0.15

Note: For details on rate changes over the course of 2013, see the section on discount rates in "Record of Policy Actions of the Board of Governors." *Primary credit* is available for very short terms as a backup source of liquidity to depository institutions that are in generally sound financial condition in the judgment of the lending Federal Reserve Bank. *Secondary credit* is available in appropriate circumstances to depository institutions that do not qualify for primary credit. *Seasonal credit* is available to help relatively small depository institutions meet regular seasonal needs for funds that arise from a clear pattern of intra-yearly movements in their deposits and loans. The discount rate on seasonal credit takes into account rates charged by market sources of funds and is reestablished on the first business day of each two-week reserve maintenance period.

Table 4. Reserve requirements of depository institutions, December 31, 2013

Type of deposit	Requirements	
	Percentage of deposits	Effective date
Net transaction accounts[1]		
$0 million–$13.3 million[2]	0	12/24/2013
More than $13.3 million–$89.0 million[3]	3	12/24/2013
More than $89.0 million	10	12/24/2013
Nonpersonal time deposits	0	12/27/1990
Eurocurrency liabilities	0	12/27/1990

Note: Required reserves must be held in the form of vault cash and, if vault cash is insufficient, also in the form of a deposit with a Federal Reserve Bank. An institution must hold that deposit directly with a Reserve Bank or with another institution in a pass-through relationship. Reserve requirements are imposed on commercial banks, savings banks, savings and loan associations, credit unions, U.S. branches and agencies of foreign banks, Edge corporations, and agreement corporations.

1 Total transaction accounts consist of demand deposits, automatic transfer service (ATS) accounts, NOW accounts, share draft accounts, telephone or preauthorized transfer accounts, ineligible acceptances, and affiliate-issued obligations maturing in seven days or less. Net transaction accounts are total transaction accounts less amounts due from other depository institutions and less cash items in the process of collection.

For a more detailed description of these deposit types, see Form FR 2900.

2 The amount of net transaction accounts subject to a reserve requirement ratio of 0 percent (the "exemption amount") is adjusted each year by statute. The exemption amount is adjusted upward by 80 percent of the previous year's (June 30 to June 30) rate of increase in total reservable liabilities at all depository institutions. No adjustment is made in the event of a decrease in such liabilities.

3 The amount of net transaction accounts subject to a reserve requirement ratio of 3 percent is the "low reserve tranche." By statute, the upper limit of the low reserve tranche is adjusted each year by 80 percent of the previous year's (June 30 to June 30) rate of increase or decrease in net transaction accounts held by all depository institutions.

Table 5. Banking offices and banks affiliated with bank holding companies in the United States, December 31, 2012 and 2013

Type of office	Total	Commercial banks[1]					State-chartered savings banks
		Total	Member			Nonmember	
			Total	National	State		
All banking offices							
Banks							
Number, Dec. 31, 2012	**6,359**	**6,062**	**2,051**	**1,222**	**829**	**4,011**	**297**
Changes during 2013							
New banks	19	15	6	3	3	9	4
Banks converted into branches	-192	-182	-59	-38	-21	-123	-10
Ceased banking operations[2]	-53	-53	-18	-16	-2	-35	0
Other[3]	0	0	-1	-27	26	1	0
Net change	-226	-220	-72	-78	6	-148	-6
Number, Dec. 31, 2013	**6,133**	**5,842**	**1,979**	**1,144**	**835**	**3,863**	**291**
Branches and additional offices							
Number, Dec. 31, 2012	**84,716**	**82,081**	**58,668**	**44,251**	**14,417**	**23,413**	**2,635**
Changes during 2013							
New branches	1,422	1,324	923	763	160	401	98
Banks converted to branches	192	183	58	32	26	125	9
Discontinued[2]	-2,194	-2,160	-1,544	-1,174	-370	-616	-34
Other[3]	0	-2	-31	60	-91	29	2
Net change	-580	-655	-594	-319	-275	-61	75
Number, Dec. 31, 2013	**84,136**	**81,426**	**58,074**	**43,932**	**14,142**	**23,352**	**2,710**
Banks affiliated with bank holding companies							
Banks							
Number, Dec. 31, 2012	**5,181**	**5,054**	**1,800**	**1,066**	**734**	**3,254**	**127**
Changes during 2013							
BHC-affiliated new banks	50	40	13	9	4	27	10
Banks converted into branches	-165	-156	-52	-32	-20	-104	-9
Ceased banking operations[2]	-51	-51	-16	-15	-1	-35	0
Other[3]	0	0	-2	-26	24	2	0
Net change	-166	-167	-57	-64	7	-110	1
Number, Dec. 31, 2013	**5,015**	**4,887**	**1,743**	**1,002**	**741**	**3,144**	**128**

Note: Includes banks, banking offices, and bank holding companies in U.S. territories and possessions (affiliated insular areas).

1 For purposes of this table, banks are entities that are defined as banks in the Bank Holding Company Act, as amended, which is implemented by Federal Reserve Regulation Y. Generally, a bank is any institution that accepts demand deposits and is engaged in the business of making commercial loans or any institution that is defined as an insured bank in section 3(h) of the FDIC Act.

2 Institutions that no longer meet the Regulation Y definition of a bank.

3 Interclass changes and sales of branches.

Table 6A. Reserves of depository institutions, Federal Reserve Bank credit, and related items, year-end 1984–2013 and month-end 2013

Millions of dollars

Period	Factors supplying reserve funds								
	Federal Reserve Bank credit outstanding						Gold stock	Special drawing rights certificate account	Treasury currency outstanding[5]
	Securities held outright[1]	Repurchase agreements[2]	Loans and other credit extensions[3]	Float	Other Federal Reserve assets[4]	Total[4]			
1984	167,612	2,015	3,577	833	12,347	186,384	11,096	4,618	16,418
1985	186,025	5,223	3,060	988	15,302	210,598	11,090	4,718	17,075
1986	205,454	16,005	1,565	1,261	17,475	241,760	11,084	5,018	17,567
1987	226,459	4,961	3,815	811	15,837	251,883	11,078	5,018	18,177
1988	240,628	6,861	2,170	1,286	18,803	269,748	11,060	5,018	18,799
1989	233,300	2,117	481	1,093	39,631	276,622	11,059	8,518	19,628
1990	241,431	18,354	190	2,222	39,897	302,091	11,058	10,018	20,402
1991	272,531	15,898	218	731	34,567	323,945	11,059	10,018	21,014
1992	300,423	8,094	675	3,253	30,020	342,464	11,056	8,018	21,447
1993	336,654	13,212	94	909	33,035	383,904	11,053	8,018	22,095
1994	368,156	10,590	223	-716	33,634	411,887	11,051	8,018	22,994
1995	380,831	13,862	135	107	33,303	428,239	11,050	10,168	24,003
1996	393,132	21,583	85	4,296	32,896	451,992	11,048	9,718	24,966
1997	431,420	23,840	2,035	719	31,452	489,466	11,047	9,200	25,543
1998	452,478	30,376	17	1,636	36,966	521,475	11,046	9,200	26,270
1999	478,144	140,640	233	-237	35,321	654,100	11,048	6,200	28,013
2000	511,833	43,375	110	901	36,467	592,686	11,046	2,200	31,643
2001	551,685	50,250	34	-23	37,658	639,604	11,045	2,200	33,017
2002	629,416	39,500	40	418	39,083	708,457	11,043	2,200	34,597
2003	666,665	43,750	62	-319	40,847	751,005	11,043	2,200	35,468
2004	717,819	33,000	43	925	42,219	794,007	11,045	2,200	36,434
2005	744,215	46,750	72	885	39,611	831,532	11,043	2,200	36,540
2006	778,915	40,750	67	-333	39,895	859,294	11,041	2,200	38,206
2007	740,611	46,500	72,636	-19	41,799	901,528	11,041	2,200	38,681
2008	495,629	80,000	1,605,848	-1,494	43,553	2,223,537	11,041	2,200	38,674
2009	1,844,838	0	281,095	-2,097	92,811	2,216,647	11,041	5,200	42,691
2010	2,161,094	0	138,311	-1,421	110,255	2,408,240	11,041	5,200	43,542
2011	2,605,124	0	144,098	-631	152,568	2,901,159	11,041	5,200	44,198
2012[r]	2,669,589	0	11,867	-486	218,296	2,899,266	11,041	5,200	44,751
2013	3,756,158	0	2,177	-962	246,947	4,004,320	11,041	5,200	45,539
Jan	2,750,982	0	8,127	-698	227,534	2,985,945	11,041	5,200	44,847
Feb	2,844,074	0	10,746	-640	225,524	3,079,704	11,041	5,200	44,912
Mar	2,939,417	0	10,333	-591	236,702	3,185,861	11,041	5,200	44,971
Apr	3,036,415	0	10,892	-1,033	245,475	3,291,749	11,041	5,200	45,029
May	3,124,081	0	3,989	-705	242,495	3,369,859	11,041	5,200	45,084
Jun	3,213,905	0	3,842	-714	250,282	3,467,315	11,041	5,200	45,147
Jul	3,295,892	0	3,641	-816	253,952	3,552,669	11,041	5,200	45,225
Aug	3,385,572	0	2,350	-541	243,337	3,630,718	11,041	5,200	45,266
Sep	3,475,024	0	2,483	-566	246,094	3,723,035	11,041	5,200	45,334
Oct	3,570,525	0	2,202	61	250,965	3,823,753	11,041	5,200	45,418
Nov	3,661,905	0	2,150	-857	244,125	3,907,323	11,041	5,200	45,483
Dec	3,756,158	0	2,177	-962	246,947	4,004,320	11,041	5,200	45,539

Note: Components may not sum to totals because of rounding.

[1] Includes U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities. U.S. Treasury securities and federal agency debt securities include securities lent to dealers, which are fully collateralized by U.S. Treasury securities, federal agency securities, and other highly rated debt securities.

[2] Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and agency mortgage-backed securities.

[3] Refer to "Table 6B. Loans and other credit extensions, by type, year-end 1984–2013 and month-end 2013" for detail.

[4] As of 2013, unamortized discounts on securities held outright are included as a component of Other Federal Reserve assets. Previously, they were included in Other Federal Reserve liabilities and capital.

[5] Includes currency and coin (other than gold) issued directly by the U.S. Treasury. The largest components are fractional and dollar coins. For details refer to "U.S. Currency and Coin Outstanding and in Circulation," *Treasury Bulletin*.

Table 6A.—*continued*

Period	Factors absorbing reserve funds										Reserve balances with Federal Reserve Banks
	Currency in circulation	Reverse repurchase agreements[6]	Treasury cash holdings[7]	Deposits with Federal Reserve Banks, other than reserve balances					Required clearing balances[8]	Other Federal Reserve liabilities and capital[4,9]	
				Term deposits	Treasury general account	Treasury supplementary financing account	Foreign	Other			
1984	183,796	0	513	...	5,316	...	253	867	1,126	5,952	20,693
1985	197,488	0	550	...	9,351	...	480	1,041	1,490	5,940	27,141
1986	211,995	0	447	...	7,588	...	287	917	1,812	6,088	46,295
1987	230,205	0	454	...	5,313	...	244	1,027	1,687	7,129	40,097
1988	247,649	0	395	...	8,656	...	347	548	1,605	7,683	37,742
1989	260,456	0	450	...	6,217	...	589	1,298	1,618	8,486	36,713
1990	286,963	0	561	...	8,960	...	369	528	1,960	8,147	36,081
1991	307,756	0	636	...	17,697	...	968	1,869	3,946	8,113	25,051
1992	334,701	0	508	...	7,492	...	206	653	5,897	7,984	25,544
1993	365,271	0	377	...	14,809	...	386	636	6,332	9,292	27,967
1994	403,843	0	335	...	7,161	...	250	1,143	4,196	11,959	25,061
1995	424,244	0	270	...	5,979	...	386	2,113	5,167	12,342	22,960
1996	450,648	0	249	...	7,742	...	167	1,178	6,601	13,829	17,310
1997	482,327	0	225	...	5,444	...	457	1,171	6,684	15,500	23,447
1998	517,484	0	85	...	6,086	...	167	1,869	6,780	16,354	19,164
1999	628,359	0	109	...	28,402	...	71	1,644	7,481	17,256	16,039
2000	593,694	0	450	...	5,149	...	216	2,478	6,332	17,962	11,295
2001	643,301	0	425	...	6,645	...	61	1,356	8,525	17,083	8,469
2002	687,518	21,091	367	...	4,420	...	136	1,266	10,534	18,977	11,988
2003	724,187	25,652	321	...	5,723	...	162	995	11,829	19,793	11,054
2004	754,877	30,783	270	...	5,912	...	80	1,285	9,963	26,378	14,137
2005	794,014	30,505	202	...	4,573	...	83	2,144	8,651	30,466	10,678
2006	820,176	29,615	252	...	4,708	...	98	972	6,842	36,231	11,847
2007	828,938	43,985	259	...	16,120	...	96	1,830	6,614	41,622	13,986
2008	889,898	88,352	259	...	106,123	259,325	1,365	21,221	4,387	48,921	855,599
2009	928,249	77,732	239	...	186,632	5,001	2,411	35,262	3,020	63,219	973,814
2010	982,750	59,703	177	0	140,773	199,964	3,337	13,631	2,374	99,602	965,712
2011	1,075,820	99,900	128	0	85,737	0	125	64,909	2,480	72,766	1,559,731
2012[r]	1,169,159	107,188	150	0	92,720	0	6,427	27,476	...	66,093	1,491,044
2013	1,241,274	315,924	234	0	162,399	0	7,970	26,181	...	63,049	2,249,070
Jan	1,156,245	89,321	190	3,036	120,247	0	7,595	8,266	...	62,925	1,599,208
Feb	1,171,363	96,563	218	0	81,750	0	8,635	22,620	...	64,565	1,695,144
Mar	1,176,943	105,457	231	3,045	79,152	0	9,183	20,463	...	65,291	1,787,307
Apr	1,181,856	97,384	186	0	213,863	0	9,950	12,062	...	66,611	1,771,108
May	1,190,468	94,025	152	10,496	34,681	0	11,208	22,082	...	63,120	2,004,952
Jun	1,193,796	95,153	121	0	134,858	0	10,022	19,777	...	61,713	2,013,263
Jul	1,197,437	91,085	144	11,913	109,693	0	10,481	9,630	...	62,908	2,120,843
Aug	1,208,308	95,012	140	0	26,135	0	10,381	21,163	...	63,708	2,267,378
Sep	1,207,063	157,405	167	11,662	88,386	0	8,938	24,346	...	65,900	2,220,743
Oct	1,218,421	124,883	206	0	83,001	0	8,654	9,382	...	63,497	2,377,369
Nov	1,227,586	128,170	224	13,532	33,433	0	8,735	8,643	...	63,525	2,485,200
Dec	1,241,274	315,924	234	0	162,399	0	7,970	26,181	...	63,049	2,249,070

6 Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and agency mortgage-backed securities.

7 Coin and paper currency held by the Treasury.

8 Required clearing balances were discontinued in July 2012.

9 In 2010, includes funds from American International Group, Inc. asset dispositions, held as agent.

... Not applicable.

r Revised.

Table 6B. Loans and other credit extensions, by type, year-end 1984–2013 and month-end 2013
Millions of dollars

Period	Total loans and other credit extensions	Term auction credit	Other loans					Net portfolio holdings of						Preferred interests in AIA/ALICO LLCs[10]	Central bank liquidity swaps[11]
			Primary, secondary, and seasonal credit[1]	Primary dealer and other broker-dealer credit[2]	AMLF[3]	TALF[4]	AIG[5]	CPFF LLC[6]	MMIFF LLC[7]	Maiden Lane LLC[8]	Maiden Lane II LLC[8]	Maiden Lane III LLC[8]	TALF LLC[9]		
1984	3,577	…	3,577	…	…	…	…	…	…	…	…	…	…	…	…
1985	3,060	…	3,060	…	…	…	…	…	…	…	…	…	…	…	…
1986	1,565	…	1,565	…	…	…	…	…	…	…	…	…	…	…	…
1987	3,815	…	3,815	…	…	…	…	…	…	…	…	…	…	…	…
1988	2,170	…	2,170	…	…	…	…	…	…	…	…	…	…	…	…
1989	481	…	481	…	…	…	…	…	…	…	…	…	…	…	…
1990	190	…	190	…	…	…	…	…	…	…	…	…	…	…	…
1991	218	…	218	…	…	…	…	…	…	…	…	…	…	…	…
1992	675	…	675	…	…	…	…	…	…	…	…	…	…	…	…
1993	94	…	94	…	…	…	…	…	…	…	…	…	…	…	…
1994	223	…	223	…	…	…	…	…	…	…	…	…	…	…	…
1995	135	…	135	…	…	…	…	…	…	…	…	…	…	…	…
1996	85	…	85	…	…	…	…	…	…	…	…	…	…	…	…
1997	2,035	…	2,035	…	…	…	…	…	…	…	…	…	…	…	…
1998	17	…	17	…	…	…	…	…	…	…	…	…	…	…	…
1999	233	…	233	…	…	…	…	…	…	…	…	…	…	…	…
2000	110	…	110	…	…	…	…	…	…	…	…	…	…	…	…
2001	34	…	34	…	…	…	…	…	…	…	…	…	…	…	…
2002	40	…	40	…	…	…	…	…	…	…	…	…	…	…	…
2003	62	…	62	…	…	…	…	…	…	…	…	…	…	…	…
2004	43	…	43	…	…	…	…	…	…	…	…	…	…	…	…
2005	72	…	72	…	…	…	…	…	…	…	…	…	…	…	…
2006	67	…	67	…	…	…	…	…	…	…	…	…	…	…	…
2007	72,636	40,000	8,636	…	…	…	…	…	…	…	…	…	…	…	24,000
2008	1,605,848	450,219	93,791	37,404	23,765	…	38,914	334,102	0	27,023	20,117	26,785	…	…	553,728
2009	281,095	75,918	20,700	0	0	47,532	22,184	14,064	…	26,701	15,659	22,661	298	25,106	10,272
2010	138,311	0	221	…	…	24,703	19,953	…	…	26,967	16,198	23,143	665	26,385	75
2011	144,098	0	196	…	…	9,013	…	…	…	7,232	9,280	17,744	811	…	99,823
2012	11,867	0	70	…	…	556	…	…	…	1,413	61	22	856	…	8,889
2013	2,177	0	74	…	…	97	…	…	…	1,541	63	22	109	…	272

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Table 6B.—*continued*

Period	Total loans and other credit extensions	Term auction credit	Other loans					Net portfolio holdings of						Preferred interests in AIA/ALICO LLCs[10]	Central bank liquidity swaps[11]
			Primary, secondary, and seasonal credit[1]	Primary dealer and other broker-dealer credit[2]	AMLF[3]	TALF[4]	AIG[5]	CPFF LLC[6]	MMIFF LLC[7]	Maiden Lane LLC[8]	Maiden Lane II LLC[8]	Maiden Lane III LLC[8]	TALF LLC[9]		
2013, month-end															
Jan	8,127	0	47	…	…	547	…	…	…	1,401	61	22	857	…	5,192
Feb	10,746	0	25	…	…	388	…	…	…	1,400	61	22	507	…	8,343
Mar	10,333	0	9	…	…	382	…	…	…	1,402	64	22	399	…	8,056
Apr	10,892	0	33	…	…	377	…	…	…	1,427	64	22	393	…	8,576
May	3,989	0	50	…	…	271	…	…	…	1,424	64	22	388	…	1,771
Jun	3,842	0	120	…	…	258	…	…	…	1,419	64	22	281	…	1,679
Jul	3,641	0	135	…	…	185	…	…	…	1,488	64	22	268	…	1,479
Aug	2,350	0	158	…	…	102	…	…	…	1,492	64	22	195	…	317
Sep	2,483	0	177	…	…	101	…	…	…	1,497	64	22	112	…	511
Oct	2,202	0	120	…	…	100	…	…	…	1,515	64	22	111	…	272
Nov	2,150	0	68	…	…	98	…	…	…	1,517	63	22	110	…	272
Dec	2,177	0	74	…	…	97	…	…	…	1,541	63	22	109	…	272

Note: Components may not sum to totals because of rounding.

1 Prior to 2003, category was “Adjustment, extended, and seasonal credit.”

2 Includes credit extended through the Primary Dealer Credit Facility (PDCF) and credit extended to certain other broker-dealers. The PDCF was dissolved in February 2010.

3 Includes credit extended through the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF). The AMLF was dissolved in February 2010.

4 Includes credit extended by the Federal Reserve Bank of New York (FRBNY) to eligible borrowers through the Term Asset-Backed Securities Loan Facility (TALF), net of unamortized deferred administrative fees. The TALF was discontinued in June 2010.

5 Credit extended to American International Group, Inc. (AIG) includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring. Excludes credit extended to consolidated LLCs. Upon the closing of the AIG recapitalization plan in January 2011, the credit extended to AIG by the FRBNY under the revolving credit facility was repaid in full.

6 Net portfolio holdings of Commercial Paper Funding Facility (CPFF) LLC. The CPFF was discontinued in February 2010.

7 Net portfolio holdings of Money Market Investor Funding Facility (MMIFF) LLC. The MMIFF was discontinued in October 2009.

8 Net portfolio holdings at fair value.

9 Net portfolio holdings of TALF LLC, a limited liability company formed to purchase and manage any asset-backed securities that might be surrendered by a TALF borrower or otherwise claimed by the FRBNY in connection with its enforcement rights to the TALF collateral.

10 Preferred interests in AIA Aurora LLC and ALICO Holdings LLC at book value. After the closing of the AIG recapitalization plan, the Federal Reserve was paid in full for its preferred interests in the special purpose vehicles AIA Aurora LLC and ALICO Holdings LLC.

11 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

… Not applicable.

Table 6C. Reserves of depository institutions, Federal Reserve Bank credit, and related items, year-end 1918–1983
Millions of dollars

Period	Factors supplying reserve funds									
	Federal Reserve Bank credit outstanding							Gold stock[6]	Special drawing rights certificate account	Treasury currency outstanding[7]
	Securities held outright[1]	Repurchase agreements[2]	Loans	Float[3]	All other[4]	Other Federal Reserve assets[5]	Total			
1918	239	0	1,766	199	294	0	2,498	2,873	…	1,795
1919	300	0	2,215	201	575	0	3,292	2,707	…	1,707
1920	287	0	2,687	119	262	0	3,355	2,639	…	1,709
1921	234	0	1,144	40	146	0	1,563	3,373	…	1,842
1922	436	0	618	78	273	0	1,405	3,642	…	1,958
1923	80	54	723	27	355	0	1,238	3,957	…	2,009
1924	536	4	320	52	390	0	1,302	4,212	…	2,025
1925	367	8	643	63	378	0	1,459	4,112	…	1,977
1926	312	3	637	45	384	0	1,381	4,205	…	1,991
1927	560	57	582	63	393	0	1,655	4,092	…	2,006
1928	197	31	1,056	24	500	0	1,809	3,854	…	2,012
1929	488	23	632	34	405	0	1,583	3,997	…	2,022
1930	686	43	251	21	372	0	1,373	4,306	…	2,027
1931	775	42	638	20	378	0	1,853	4,173	…	2,035
1932	1,851	4	235	14	41	0	2,145	4,226	…	2,204
1933	2,435	2	98	15	137	0	2,688	4,036	…	2,303
1934	2,430	0	7	5	21	0	2,463	8,238	…	2,511
1935	2,430	1	5	12	38	0	2,486	10,125	…	2,476
1936	2,430	0	3	39	28	0	2,500	11,258	…	2,532
1937	2,564	0	10	19	19	0	2,612	12,760	…	2,637
1938	2,564	0	4	17	16	0	2,601	14,512	…	2,798
1939	2,484	0	7	91	11	0	2,593	17,644	…	2,963
1940	2,184	0	3	80	8	0	2,274	21,995	…	3,087
1941	2,254	0	3	94	10	0	2,361	22,737	…	3,247
1942	6,189	0	6	471	14	0	6,679	22,726	…	3,648
1943	11,543	0	5	681	10	0	12,239	21,938	…	4,094
1944	18,846	0	80	815	4	0	19,745	20,619	…	4,131
1945	24,262	0	249	578	2	0	25,091	20,065	…	4,339
1946	23,350	0	163	580	1	0	24,093	20,529	…	4,562
1947	22,559	0	85	535	1	0	23,181	22,754	…	4,562
1948	23,333	0	223	541	1	0	24,097	24,244	…	4,589
1949	18,885	0	78	534	2	0	19,499	24,427	…	4,598
1950	20,725	53	67	1,368	3	0	22,216	22,706	…	4,636
1951	23,605	196	19	1,184	5	0	25,009	22,695	…	4,709
1952	24,034	663	156	967	4	0	25,825	23,187	…	4,812
1953	25,318	598	28	935	2	0	26,880	22,030	…	4,894
1954	24,888	44	143	808	1	0	25,885	21,713	…	4,985
1955	24,391	394	108	1,585	29	0	26,507	21,690	…	5,008
1956	24,610	305	50	1,665	70	0	26,699	21,949	…	5,066
1957	23,719	519	55	1,424	66	0	25,784	22,781	…	5,146
1958	26,252	95	64	1,296	49	0	27,755	20,534	…	5,234
1959	26,607	41	458	1,590	75	0	28,771	19,456	…	5,311
1960	26,984	400	33	1,847	74	0	29,338	17,767	…	5,398
1961	28,722	159	130	2,300	51	0	31,362	16,889	…	5,585
1962	30,478	342	38	2,903	110	0	33,871	15,978	…	5,567
1963	33,582	11	63	2,600	162	0	36,418	15,513	…	5,578
1964	36,506	538	186	2,606	94	0	39,930	15,388	…	5,405
1965	40,478	290	137	2,248	187	0	43,340	13,733	…	5,575
1966	43,655	661	173	2,495	193	0	47,177	13,159	…	6,317
1967	48,980	170	141	2,576	164	0	52,031	11,982	…	6,784
1968	52,937	0	186	3,443	58	0	56,624	10,367	…	6,795

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Table 6C.—*continued*

Period	Factors supplying reserve funds									
	Federal Reserve Bank credit outstanding							Gold stock[6]	Special drawing rights certificate account	Treasury currency outstanding[7]
	Securities held outright[1]	Repurchase agreements[2]	Loans	Float[3]	All other[4]	Other Federal Reserve assets[5]	Total			
1969	57,154	0	183	3,440	64	2,743	63,584	10,367	...	6,852
1970	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	13,083
1980	128,038	2,554	1,809	4,467	776	8,739	146,383	11,160	2,518	13,427
1981	136,863	3,485	1,601	1,762	195	9,230	153,136	11,151	3,318	13,687
1982	144,544	4,293	717	2,735	1,480	9,890	163,659	11,148	4,618	13,786
1983	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732

Note: For a description of figures and discussion of their significance, see *Banking and Monetary Statistics*, 1941–1970 (Board of Governors of the Federal Reserve System, 1976), pp. 507–23. Components may not sum to totals because of rounding.

1 In 1969 and thereafter, includes securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale–purchase transactions. On September 29, 1971, and thereafter, includes federal agency issues bought outright.

2 On December 1, 1966, and thereafter, includes federal agency obligations held under repurchase agreements.

3 In 1960 and thereafter, figures reflect a minor change in concept; refer to *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

4 Principally acceptances and, until August 21, 1959, industrial loans, the authority for which expired on that date.

5 For the period before April 16, 1969, includes the total of Federal Reserve capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets, and is reported as "Other Federal Reserve accounts;" thereafter, "Other Federal Reserve assets'' and "Other Federal Reserve liabilities and capital'' are shown separately.

6 Before January 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

7 Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details refer to "U.S. Currency and Coin Outstanding and in Circulation,'' *Treasury Bulletin*.

Table 6C. Reserves of depository institutions, Federal Reserve Bank credit, and related items, year-end 1918–1983—*continued*
Millions of dollars

Period	Factors absorbing reserve funds								Member bank reserves[9]			
	Currency in circulation	Treasury cash holdings[8]	Deposits with Federal Reserve Banks, other than reserve balances			Other Federal Reserve accounts[5]	Required clearing balances	Other Federal Reserve liabilities and capital[5]	With Federal Reserve Banks	Currency and coin[10]	Required[11]	Excess[11,12]
			Treasury	Foreign	Other							
1918	4,951	288	51	96	25	118	0	0	1,636	…	1,585	51
1919	5,091	385	31	73	28	208	0	0	1,890	…	1,822	68
1920	5,325	218	57	5	18	298	0	0	1,781	…	…	…
1921	4,403	214	96	12	15	285	0	0	1,753	…	1,654	99
1922	4,530	225	11	3	26	276	0	0	1,934	…	…	…
1923	4,757	213	38	4	19	275	0	0	1,898	…	1,884	14
1924	4,760	211	51	19	20	258	0	0	2,220	…	2,161	59
1925	4,817	203	16	8	21	272	0	0	2,212	…	2,256	-44
1926	4,808	201	17	46	19	293	0	0	2,194	…	2,250	-56
1927	4,716	208	18	5	21	301	0	0	2,487	…	2,424	63
1928	4,686	202	23	6	21	348	0	0	2,389	…	2,430	-41
1929	4,578	216	29	6	24	393	0	0	2,355	…	2,428	-73
1930	4,603	211	19	6	22	375	0	0	2,471	…	2,375	96
1931	5,360	222	54	79	31	354	0	0	1,961	…	1,994	-33
1932	5,388	272	8	19	24	355	0	0	2,509	…	1,933	576
1933	5,519	284	3	4	128	360	0	0	2,729	…	1,870	859
1934	5,536	3,029	121	20	169	241	0	0	4,096	…	2,282	1,814
1935	5,882	2,566	544	29	226	253	0	0	5,587	…	2,743	2,844
1936	6,543	2,376	244	99	160	261	0	0	6,606	…	4,622	1,984
1937	6,550	3,619	142	172	235	263	0	0	7,027	…	5,815	1,212
1938	6,856	2,706	923	199	242	260	0	0	8,724	…	5,519	3,205
1939	7,598	2,409	634	397	256	251	0	0	11,653	…	6,444	5,209
1940	8,732	2,213	368	1,133	599	284	0	0	14,026	…	7,411	6,615
1941	11,160	2,215	867	774	586	291	0	0	12,450	…	9,365	3,085
1942	15,410	2,193	799	793	485	256	0	0	13,117	…	11,129	1,988
1943	20,449	2,303	579	1,360	356	339	0	0	12,886	…	11,650	1,236
1944	25,307	2,375	440	1,204	394	402	0	0	14,373	…	12,748	1,625
1945	28,515	2,287	977	862	446	495	0	0	15,915	…	14,457	1,458
1946	28,952	2,272	393	508	314	607	0	0	16,139	…	15,577	562
1947	28,868	1,336	870	392	569	563	0	0	17,899	…	16,400	1,499
1948	28,224	1,325	1123	642	547	590	0	0	20,479	…	19,277	1,202
1949	27,600	1,312	821	767	750	706	0	0	16,568	…	15,550	1,018
1950	27,741	1,293	668	895	565	714	0	0	17,681	…	16,509	1,172
1951	29,206	1,270	247	526	363	746	0	0	20,056	…	19,667	389
1952	30,433	1,270	389	550	455	777	0	0	19,950	…	20,520	-570
1953	30,781	761	346	423	493	839	0	0	20,160	…	19,397	763
1954	30,509	796	563	490	441	907	0	0	18,876	…	18,618	258
1955	31,158	767	394	402	554	925	0	0	19,005	…	18,903	102
1956	31,790	775	441	322	426	901	0	0	19,059	…	19,089	-30
1957	31,834	761	481	356	246	998	0	0	19,034	…	19,091	-57
1958	32,193	683	358	272	391	1,122	0	0	18,504	…	18,574	-70
1959	32,591	391	504	345	694	841	0	0	18,174	310	18,619	-135
1960	32,869	377	485	217	533	941	0	0	17,081	2,544	18,988	637
1961	33,918	422	465	279	320	1,044	0	0	17,387	2,823	20,114	96
1962	35,338	380	597	247	393	1,007	0	0	17,454	3,262	20,071	645
1963	37,692	361	880	171	291	1,065	0	0	17,049	4,099	20,677	471
1964	39,619	612	820	229	321	1,036	0	0	18,086	4,151	21,663	574
1965	42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	-238
1966	44,663	1,176	416	174	588	-147	0	0	19,779	4,310	24,321	-232
1967	47,226	1,344	1,123	135	653	-773	0	0	21,092	4,631	25,905	-182

(continued on next page)

Table 6C.—*continued*

Period	Factors absorbing reserve funds								Member bank reserves[9]			
	Currency in circulation	Treasury cash holdings[8]	Deposits with Federal Reserve Banks, other than reserve balances			Other Federal Reserve accounts[5]	Required clearing balances	Other Federal Reserve liabilities and capital[5]	With Federal Reserve Banks	Currency and coin[10]	Required[11]	Excess[11,12]
			Treasury	Foreign	Other							
1968	50,961	695	703	216	747	-1,353	0	0	21,818	4,921	27,439	-700
1969	53,950	596	1,312	134	807	0	0	1,919	22,085	5,187	28,173	-901
1970	57,093	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	-460
1971	61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
1972	66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98
1973	72,497	317	2,542	251	1,149[13]	0	0	2,669	27,060	6,781	35,268	-1,360
1974	79,743	185	3,113	418	1,275[13]	0	0	2,935	25,843	7,370	37,011	-3,798
1975	86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	-1,103[14]
1976	93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	-1,535
1977	103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	-1,265
1978	114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	-893
1979	125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	-2,835
1980	136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
1981	144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	-1,442
1982	154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
1983	171,935	479	3,661	191	851	0	1013	5,392	20,413	17,821	39,179	-945

[8] Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Reserve Bank.

[9] In November 1979 and thereafter, includes reserves of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks. On November 13, 1980, and thereafter, includes reserves of all depository institutions.

[10] Between December 1, 1959, and November 23, 1960, part was allowed as reserves; thereafter, all was allowed.

[11] Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call date was December 29). Since September 12, 1968, the amount has been based on close-of-business figures for the reserve period two weeks before the report date.

[12] For the week ending November 15, 1972, and thereafter, includes $450 million of reserve deficiencies on which Federal Reserve Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective November 9, 1972. Allowable deficiencies are as follows (beginning with first statement week of quarter, in millions): 1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; 1974—Q1, $67; Q2, $58. The transition period ended with the second quarter of 1974.

[13] For the period before July 1973, includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with Federal Reserve Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System program of credit restraint. As of December 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at Federal Reserve Banks that are associated with marginal reserves is no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States and (2) Eurodollar liabilities.

[14] Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy, effective November 19, 1975.

... Not applicable.

Table 7. Principal assets and liabilities of insured commercial banks, by class of bank, June 30, 2013 and 2012

Millions of dollars, except as noted

Item	Total	Member banks			Nonmember banks
		Total	National	State	
2013					
Assets					
Loans and investments	9,172,541	7,391,014	6,030,022	1,360,992	1,781,527
Loans, gross	6,504,679	5,140,529	4,246,189	894,340	1,364,150
Net	6,503,501	5,139,891	4,245,753	894,138	1,363,610
Investments	2,667,862	2,250,485	1,783,833	466,652	417,377
U.S. Treasury and federal agency securities	358,895	270,712	196,611	74,101	88,183
Other	2,308,967	1,979,773	1,587,222	392,551	329,194
Cash assets, total	1,156,918	1,002,496	784,998	217,498	154,422
Liabilities					
Deposits, total	8,526,007	6,910,665	5,660,131	1,250,534	1,615,342
Interbank	165,606	142,523	117,971	24,552	23,083
Other transactions	1,319,528	1,061,576	763,172	298,404	257,952
Other nontransactions	7,040,874	5,706,567	4,778,989	927,578	1,334,307
Equity capital	1,473,092	1,227,059	1,012,790	214,269	246,033
Number of banks	5,938	2,012	1,193	819	3,926
2012					
Assets					
Loans and investments	8,943,041	7,239,395	5,926,675	1,312,720	1,703,646
Loans, gross	6,291,336	4,994,716	4,137,450	857,266	1,296,620
Net	6,289,913	4,994,026	4,136,998	857,028	1,295,887
Investments	2,651,706	2,244,679	1,789,225	455,454	407,027
U.S. Treasury and federal agency securities	380,004	299,723	234,048	65,675	80,281
Other	2,271,703	1,944,957	1,555,178	389,779	326,746
Cash assets, total	917,467	758,048	572,540	185,508	159,419
Liabilities					
Deposits, total	7,979,043	6,433,954	5,241,953	1,192,001	1,545,089
Interbank	165,317	142,602	122,121	20,481	22,715
Other transactions	1,189,735	950,745	687,651	263,094	238,990
Other nontransactions	6,623,992	5,340,608	4,432,181	908,427	1,283,384
Equity capital	1,445,286	1,207,939	995,035	212,904	237,347
Number of banks	6,187	2,097	1,284	813	4,090

Note: Includes U.S.-insured commercial banks located in the United States but not U.S.-insured commercial banks operating in U.S. territories or possessions. Data are domestic assets and liabilities (except for those components reported on a consolidated basis only). Components may not sum to totals because of rounding. Data for 2012 have been revised.

Table 8. Initial margin requirements under Regulations T, U, and X
Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only[1]
1934, Oct. 1	25–45	...	...
1936, Feb. 1	25–55	...	...
1936, Apr. 1	55	...	...
1937, Nov. 1	40	...	50
1945, Feb. 5	50	...	50
1945, July 5	75	...	75
1946, Jan. 21	100	...	100
1947, Feb. 1	75	...	75
1949, Mar. 3	50	...	50
1951, Jan. 17	75	...	75
1953, Feb. 20	50	...	50
1955, Jan. 4	60	...	60
1955, Apr. 23	70	...	70
1958, Jan. 16	50	...	50
1958, Aug. 5	70	...	70
1958, Oct. 16	90	...	90
1960, July 28	70	...	70
1962, July 10	50	...	50
1963, Nov. 6	70	...	70
1968, Mar. 11	70	50	70
1968, June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50

Note: These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit that may be extended for the purpose of purchasing or carrying margin securities (as defined in the regulations) when the loan is collateralized by such securities. The margin requirement, expressed as a percentage, is the difference between the market value of the securities being purchased or carried (100 percent) and the maximum loan value of the collateral as prescribed by the Board. Regulation T was adopted effective October 1, 1934; Regulation U, effective May 1, 1936; and Regulation X, effective November 1, 1971. The former Regulation G, which was adopted effective March 11, 1968, was merged into Regulation U, effective April 1, 1998.

[1] From October 1, 1934, to October 31, 1937, the requirement was the margin "customarily required" by the brokers and dealers.

... Not applicable.

Table 9A. Statement of condition of the Federal Reserve Banks, by Bank, December 31, 2013 and 2012
Millions of dollars

Item	Total		Boston		New York		Philadelphia		Cleveland		Richmond	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Assets												
Gold certificates	11,037	11,037	391	408	3,925	3,824	397	437	512	515	856	890
Special drawing rights certificates	5,200	5,200	196	196	1,818	1,818	210	210	237	237	412	412
Coin	1,955	2,108	35	38	82	90	123	141	130	145	335	373
Loans and securities												
Primary, secondary, and seasonal loans	74	70	0	2	10	18	0	2	0	0	1	0
Term Asset-Backed Securities Loan Facility[1]	98	560	...	...	98	560	...	...	...	...	...	...
Treasury securities, bought outright[2]	2,208,775	1,666,145	57,757	40,467	1,224,856	934,131	63,998	55,079	56,410	42,361	137,343	118,582
Government-sponsored enterprise debt securities, bought outright[2]	57,221	76,783	1,496	1,865	31,731	43,048	1,658	2,538	1,461	1,952	3,558	5,465
Federal agency and government-sponsored enterprise mortgage-backed securities, bought outright[3]	1,490,162	926,662	38,966	22,507	826,356	519,536	43,176	30,633	38,057	23,560	92,659	65,952
Unamortized premiums on securities held outright[4]	208,610	170,962	5,455	4,153	115,682	95,852	6,043	5,651	5,329	4,346	12,972	12,168
Unamortized discounts on securities held outright[4]	-12,352	-1,564	-323	-37	-6,850	-877	-357	-50	-316	-40	-768	-112
Total loans and securities	3,952,588	2,839,618	103,351	68,958	2,191,883	1,592,268	114,518	93,853	100,941	72,179	245,765	202,055
Accrued interest receivable - System Open Market Account	23,493	19,031	616	463	13,007	10,645	685	635	605	489	1,474	1,369
Net portfolio holdings of consolidated variable interest entities[5]	1,926	2,750	...	...	1,926	2,750	...	...	...	...	...	...
Foreign currency denominated assets[6]	23,724	24,873	1,166	872	7,583	8,023	1,835	2,157	1,851	1,839	4,982	5,145
Central bank liquidity swaps[7]	272	8,889	13	312	87	2,867	21	771	21	657	57	1,839
Other assets												
Items in process of collection	165	216	0	0	0	0	0	0	0	8	0	0
Bank premises	2,290	2,318	123	119	432	431	73	71	111	115	228	230
All other assets[8]	1,499	1,096	64	56	581	251	43	45	42	47	247	226
Interdistrict settlement account	0	0	6,796	31,984	166,886	-110,116	-19,721	-16,451	4,138	3,671	-32,634	-28,388
Total assets	**4,024,149**	**2,917,136**	**112,751**	**103,406**	**2,388,210**	**1,512,851**	**98,184**	**81,869**	**108,588**	**79,902**	**221,722**	**184,151**
Liabilities												
Federal Reserve notes outstanding	1,400,977	1,354,878	45,182	47,464	513,592	478,110	41,983	47,566	58,552	60,564	104,492	103,121
Less: Notes held by Federal Reserve Bank	203,057	228,217	9,988	6,244	38,515	93,101	5,920	4,304	5,080	8,060	8,774	11,462
Federal Reserve notes outstanding, net	1,197,920	1,126,661	35,194	41,220	475,077	385,008	36,063	43,262	53,472	52,504	95,718	91,659

(continued on next page)

Table 9A.—*continued*

Item	Total		Boston		New York		Philadelphia		Cleveland		Richmond	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Securities sold under agreements to repurchase[9]	315,924	107,188	8,261	2,603	175,193	60,096	9,154	3,543	8,068	2,725	19,645	7,629
Deposits												
Depository institutions	2,249,070	1,491,045	66,567	56,666	1,518,974	917,383	48,568	30,547	42,425	20,154	94,182	72,657
Treasury, general account	162,399	92,720	…	…	162,399	92,720	…	…	…	…	…	…
Foreign, official accounts	7,970	6,427	2	1	7,943	6,399	3	3	3	3	8	8
Other[10]	26,180	27,476	8	8	26,020	27,345	17	14	0	0	105	68
Total deposits	2,445,619	1,617,668	66,577	56,675	1,715,336	1,043,847	48,588	30,564	42,428	20,157	94,295	72,733
Other liabilities												
Accrued remittances to Treasury[11]	4,791	1,407	87	31	3,328	831	84	29	84	17	192	51
Deferred credit items	1,127	702	0	0	0	0	0	0	3	3	0	0
Consolidated variable interest entities[12]	274	1,218	…	…	274	1,218	…	…	…	…	…	…
All other liabilities[13]	3,480	7,572	130	187	1,312	4,361	159	239	157	228	400	587
Total liabilities	**3,969,135**	**2,862,416**	**110,249**	**100,716**	**2,370,520**	**1,495,361**	**94,048**	**77,637**	**104,212**	**75,634**	**210,250**	**172,659**
Capital accounts												
Capital paid in	27,507	27,360	1,251	1,345	8,845	8,745	2,068	2,116	2,188	2,134	5,736	5,746
Surplus (including accumulated other comprehensive loss)	27,507	27,360	1,251	1,345	8,845	8,745	2,068	2,116	2,188	2,134	5,736	5,746
Total liabilities and capital accounts	**4,024,149**	**2,917,136**	**112,751**	**103,406**	**2,388,210**	**1,512,851**	**98,184**	**81,869**	**108,588**	**79,902**	**221,722**	**184,151**

Note: Components may not sum to totals because of rounding.

1 Measured at fair value. Amounts include $1 million and $4 million in unrealized gains as of December 31, 2013 and 2012, respectively.

2 Par value. Includes securities loaned—fully collateralized by U.S. Treasury securities, other investment-grade securities, and collateral eligible for tri-party repurchase agreements pledged with Federal Reserve Banks.

3 The par amount shown is the remaining principal balance of the securities.

4 Reflects the premium or discount, which is the difference between the purchase price and the face value of the securities that has not been amortized. For U.S. Treasury and Federal agency debt securities, amortization is on a straight-line basis. For mortgage-backed securities, amortization is on an effective-interest basis.

5 The FRBNY is the primary beneficiary of TALF LLC, Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC and, as a result, the accounts and results of operations of these entities are included in the combined financial statements of the Federal Reserve Banks. For additional details, see section 5, "Table 6. Key financial data for consolidated variable interest entities."

6 Valued daily at market exchange rates.

7 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

8 Includes furniture and equipment and depository institution overdrafts.

9 Contract amount of agreements.

10 Includes deposits of government-sponsored enterprises, the Consumer Financial Protection Bureau, and international organizations. These deposits are primarily held by the FRBNY.

11 Represents the estimated weekly remittances to U.S. Treasury as interest on Federal Reserve notes or, in those cases where the Reserve Bank's net earnings are not sufficient to equate surplus to capital paid-in, the deferred asset for interest on Federal Reserve notes. The amounts on this line are calculated in accordance with Board of Governors policy, which requires the Federal Reserve Banks to remit residual earnings to the U.S. Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and the amount necessary to equate surplus with capital paid-in.

12 The other beneficial interest holder related to the TALF LLC is the U.S. Treasury; to Maiden Lane LLC, it is JPMorgan Chase; and to Maiden Lane II and Maiden Lane III LLCs, it is AIG.

13 Includes accrued benefit costs and cash collateral posted by counterparties under commitments to purchase and sell federal agency and GSE MBS.

… Not applicable.

Table 9A. Statement of condition of the Federal Reserve Banks, by Bank, December 31, 2013 and 2012—*continued*
Millions of dollars

Item	Atlanta		Chicago		St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Assets														
Gold certificates	1,421	1,337	792	839	310	313	190	192	309	315	728	725	1,206	1,242
Special drawing rights certificates	654	654	424	424	150	150	90	90	153	153	282	282	574	574
Coin	238	209	285	311	19	35	48	51	152	165	178	196	332	354
Loans and securities														
Primary, secondary, and seasonal loans	6	4	18	9	3	0	27	32	9	3	0	0	0	0
Term Asset-Backed Securities Loan Facility[1]	……	…	…	…	…	…	…	…	…	…	…	…	…	…
Treasury securities, bought outright[2]	146,726	100,457	119,354	92,430	35,540	26,048	20,960	15,147	41,788	33,473	85,772	64,738	218,271	143,229
Government-sponsored enterprise debt securities, bought outright[2]	3,801	4,629	3,092	4,260	921	1,201	543	698	1,083	1,543	2,222	2,983	5,655	6,601
Federal agency and government-sponsored enterprise mortgage-backed securities, bought outright[3]	98,989	55,871	80,523	51,407	23,977	14,487	14,140	8,424	28,192	18,617	57,867	36,006	147,258	79,660
Unamortized premiums on securities held outright[4]	13,858	10,308	11,273	9,485	3,355	2,673	1,980	1,555	3,947	3,434	8,101	6,643	20,614	14,697
Unamortized discounts on securities held outright[4]	-821	-93	-668	-87	-198	-24	-117	-15	-233	-31	-479	-61	-1,220	-135
Total loans and securities	262,559	171,176	213,592	157,504	63,598	44,385	37,533	25,841	74,786	57,039	153,483	110,309	390,578	244,052
Accrued interest receivable - System Open Market Account	1,560	1,147	1,267	1,053	377	297	222	173	444	381	910	737	2,325	1,643
Net portfolio holdings of consolidated variable interest entities[5]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Foreign currency denominated assets[6]	1,352	1,422	677	663	198	203	99	101	240	247	376	398	3,365	3,800
Central bank liquidity swaps[7]	15	508	8	237	2	73	1	36	3	89	4	142	39	1,358
Other assets														
Items in process of collection	165	208	0	0	0	1	0	0	0	0	0	0	0	0
Bank premises	211	215	203	203	127	131	99	103	247	252	231	239	204	209
All other assets[8]	95	108	61	58	84	56	72	59	42	38	60	63	109	89
Interdistrict settlement account	-44,679	36,287	-53,946	-856	-19,511	958	-14,795	2,869	-22,792	-4,827	-31,534	5,662	61,793	79,207
Total assets	**223,591**	**213,271**	**163,363**	**160,436**	**45,354**	**46,602**	**23,559**	**29,515**	**53,584**	**53,852**	**124,718**	**118,753**	**460,525**	**332,528**
Liabilities														
Federal Reserve notes outstanding	170,140	175,865	89,177	95,089	34,459	37,318	21,614	22,352	36,847	36,361	120,857	95,624	164,081	155,444
Less: Notes held by Federal Reserve Bank	18,059	26,016	13,399	12,410	3,161	3,780	9,275	3,123	10,308	6,603	53,146	28,068	27,431	25,047
Federal Reserve notes outstanding, net	152,081	149,849	75,778	82,679	31,298	33,538	12,339	19,229	26,539	29,758	67,711	67,556	136,650	130,397

(continued on next page)

Table 9A.—*continued*

Item	Atlanta		Chicago		St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Securities sold under agreements to repurchase[9]	20,986	6,463	17,071	5,946	5,083	1,676	2,998	974	5,977	2,153	12,268	4,165	31,219	9,214
Deposits														
Depository institutions	45,828	52,776	68,547	69,746	8,325	10,739	7,723	8,790	20,315	21,194	43,500	45,805	284,115	184,588
Treasury, general account	…	…	…	…	…	…	…	…	…	…	…	…	…	…
Foreign, official accounts	2	2	1	1	0	0	0	0	0	0	1	1	6	6
Other[10]	10	8	13	26	0	0	0	0	1	2	3	6	3	1
Total deposits	45,840	52,786	68,561	69,773	8,325	10,739	7,723	8,790	20,316	21,196	43,504	45,812	284,124	184,595
Other liabilities														
Acrued remittances to Treasury[11]	231	90	186	89	62	27	44	11	66	39	137	75	292	118
Deferred credit items	1,009	553	0	0	0	0	118	147	0	0	0	0	0	0
Consolidated variable interest entities[12]	…	…	…	…	…	…	…	…	…	…	…	…	…	…
All other liabilities[13]	280	412	249	389	124	166	105	134	106	152	178	277	278	442
Total liabilities	**220,427**	**210,153**	**161,845**	**158,876**	**44,892**	**46,146**	**23,327**	**29,285**	**53,004**	**53,298**	**123,798**	**117,885**	**452,563**	**324,766**
Capital accounts														
Capital paid in	1,582	1,559	759	780	231	228	116	115	290	277	460	434	3,981	3,881
Surplus (including accumulated other comprehensive loss)	1,582	1,559	759	780	231	228	116	115	290	277	460	434	3,981	3,881
Total liabilities and capital accounts	**223,591**	**213,271**	**163,363**	**160,436**	**45,354**	**46,602**	**23,559**	**29,515**	**53,584**	**53,852**	**124,718**	**118,753**	**460,525**	**332,528**

Note: Components may not sum to totals because of rounding.

1 Measured at fair value. Amounts include $1 million and $4 million in unrealized gains as of December 31, 2013 and 2012, respectively.

2 Par value. Includes securities loaned—fully collateralized by U.S. Treasury securities, other investment-grade securities, and collateral eligible for tri-party repurchase agreements pledged with Federal Reserve Banks.

3 The par amount shown is the remaining principal balance of the securities.

4 Reflects the premium or discount, which is the difference between the purchase price and the face value of the securities that has not been amortized. For U.S. Treasury and Federal agency debt securities, amortization is on a straight-line basis. For mortgage-backed securities, amortization is on an effective-interest basis.

5 The FRBNY is the primary beneficiary of TALF LLC, Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC and, as a result, the accounts and results of operations of these entities are included in the combined financial statements of the Federal Reserve Banks. For additional details, see section 5, "Table 6. Key financial data for consolidated variable interest entities."

6 Valued daily at market exchange rates.

7 Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

8 Includes furniture and equipment and depository institution overdrafts.

9 Contract amount of agreements.

10 Includes deposits of government-sponsored enterprises, the Consumer Financial Protection Bureau, and international organizations. These deposits are primarily held by the FRBNY.

11 Represents the estimated weekly remittances to U.S. Treasury as interest on Federal Reserve notes or, in those cases where the Reserve Bank's net earnings are not sufficient to equate surplus to capital paid-in, the deferred asset for interest on Federal Reserve notes. The amounts on this line are calculated in accordance with Board of Governors policy, which requires the Federal Reserve Banks to remit residual earnings to the U.S. Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and the amount necessary to equate surplus with capital paid-in.

12 The other beneficial interest holder related to the TALF LLC is the U.S. Treasury; to Maiden Lane LLC, it is JPMorgan Chase; and to Maiden Lane II and Maiden Lane III LLCs, it is AIG.

13 Includes accrued benefit costs and cash collateral posted by counterparties under commitments to purchase and sell federal agency and GSE MBS.

… Not applicable.

Table 9B. Statement of condition of the Federal Reserve Banks, December 31, 2013 and 2012
Supplemental information—collateral held against Federal Reserve notes: Federal Reserve agents' accounts
Millions of dollars

Item	2013	2012
Federal Reserve notes outstanding	1,400,977	1,354,877
Less: Notes held by Federal Reserve Banks not subject to collateralization	203,057	228,216
Collateralized Federal Reserve notes	**1,197,920**	**1,126,661**
Collateral for Federal Reserve notes		
Gold certificates	11,037	11,037
Special drawing rights certificates	5,200	5,200
U.S. Treasury securities[1]	1,181,683	1,110,424
Total collateral	**1,197,920**	**1,126,661**

[1] Face value. Includes compensation to adjust for the effect of inflation on the original face value of inflation-indexed securities.

Table 10. Income and expenses of the Federal Reserve Banks, by Bank, 2013

Thousands of dollars

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Current income													
Interest income													
Primary, secondary, and seasonal loans	194	3	8	8	3	8	20	32	20	32	25	12	23
Term Asset-Backed Securities Loan Facility	5,820	...	5,820	...	...	...	...	...	...	...	...	...	...
Total loan interest income	6,014	3	5,828	8	3	8	20	32	20	32	25	12	23
Treasury securities	51,590,721	1,324,218	28,690,734	1,549,286	1,316,045	3,327,905	3,345,243	2,806,982	824,023	484,241	991,670	2,003,698	4,926,676
Government-sponsored enterprise debt securities	2,166,447	55,397	1,205,500	65,521	55,252	140,766	139,782	118,036	34,552	20,290	41,776	84,144	205,431
Federal agency and government-sponsored enterprise mortgage-backed securities	36,628,566	940,868	20,367,668	1,098,442	934,413	2,359,400	2,377,359	1,992,374	585,213	343,952	703,632	1,422,584	3,502,661
Foreign currency denominated assets	95,996	4,589	30,711	7,511	7,451	20,131	5,471	2,721	799	401	970	1,524	13,717
Central bank liquidity swaps[1]	21,717	1,004	6,955	1,722	1,676	4,547	1,238	611	180	90	219	345	3,130
Total SOMA interest income	90,503,447	2,326,076	50,301,568	2,722,482	2,314,837	5,852,749	5,869,093	4,920,724	1,444,767	848,974	1,738,267	3,512,295	8,651,615
Total interest income	90,509,461	2,326,079	50,307,396	2,722,490	2,314,840	5,852,757	5,869,113	4,920,756	1,444,787	849,006	1,738,292	3,512,307	8,651,638
Priced services	441,203	...	89,595	...	...	...	273,919	77,689	...	...	...	...	...
Compensation received for services provided[2]	174,294	14,460	2,530	4,342	5,373	20,095	683	21,941	3,089	54,413	31,547	7,524	8,297
Securities lending fees	10,161	260	5,654	307	259	659	656	553	162	95	196	395	965
Other income	14,834	320	9,255	378	320	825	806	681	200	132	246	487	1,184
Total other income	640,492	15,040	107,034	5,027	5,952	21,579	276,064	100,864	3,451	54,640	31,989	8,406	10,446
Total current income	**91,149,953**	**2,341,119**	**50,414,430**	**2,727,517**	**2,320,792**	**5,874,336**	**6,145,177**	**5,021,620**	**1,448,238**	**903,646**	**1,770,281**	**3,520,713**	**8,662,084**
Net expenses													
Personnel													
Salaries and other personnel expenses	2,021,610	116,018	485,013	90,901	85,768	309,462	151,251	153,786	107,714	102,096	128,280	106,999	184,322
Retirement and other benefits	663,857	32,511	151,969	34,275	32,860	96,864	55,592	52,392	33,548	33,738	37,618	40,046	62,444
Administrative													
Fees	186,689	4,099	48,684	9,009	4,928	72,511	18,128	7,405	8,758	3,288	2,458	2,039	5,382
Travel	87,798	3,641	11,446	3,580	5,388	13,281	8,588	10,085	5,483	3,701	6,860	5,071	10,674
Postage and other shipping costs	14,099	288	893	319	1,347	687	2,637	365	762	384	1,021	2,553	2,843
Communications	47,471	966	6,233	595	730	28,862	1,851	2,040	1,040	1,291	1,190	1,389	1,284
Materials and supplies	66,467	3,542	22,520	6,515	2,709	7,198	4,672	4,803	2,390	1,608	3,187	3,530	3,793
Building													
Taxes on real estate	48,443	6,175	14,269	1,879	1,102	2,864	3,229	3,465	739	3,621	3,412	3,608	4,080
Property depreciation	132,304	11,693	26,883	6,463	6,793	14,373	9,191	15,483	7,878	4,312	8,159	9,769	11,307
Utilities	38,703	4,169	10,127	1,545	1,520	4,208	3,165	2,172	1,822	1,889	2,137	2,847	3,102
Rent	35,837	199	7,562	910	973	22,437	522	927	1,125	250	502	167	263
Other building	59,044	4,988	11,016	5,081	3,150	5,841	4,823	6,840	2,276	2,634	2,300	6,741	3,354
Equipment/software													
Purchases	30,680	1,807	4,804	1,100	999	8,794	1,933	2,171	1,315	1,510	1,924	1,947	2,376
Rentals	3,386	301	1,272	183	237	248	314	664	18	68	14	42	25
Depreciation	69,888	3,914	6,439	3,315	1,693	36,641	3,021	2,829	2,024	1,353	2,389	2,616	3,654
Repairs and maintenance	64,786	5,527	5,517	2,837	2,100	25,483	5,221	3,535	1,650	1,445	2,401	3,063	6,007
Software	182,073	5,247	34,345	9,896	6,605	70,858	14,347	3,913	4,582	6,434	6,340	9,430	10,076

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Table 10.—*continued*

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Other expenses													
Compensation paid for service costs incurred[2]	174,294	…	36,899	…	…	…	125,501	11,894	…	…	…	…	…
Other expenses	78,369	16,436	84,988	24,425	6,644	-314,839	31,463	59,243	80,963	24,110	16,091	22,966	25,882
Recoveries	-159,790	-16,665	-21,102	-5,232	-4,935	-51,197	-12,236	-9,900	-5,930	-2,246	-8,552	-15,530	-6,265
Expenses capitalized[3]	-80,541	-6,141	-30,016	-2,779	-5,104	5,137	-423	-2,480	-4,726	-10,486	-10,671	-1,671	-11,182
Total operating expenses before pension expense and reimbursements	**3,765,467**	**198,715**	**919,761**	**194,817**	**155,507**	**359,713**	**432,790**	**331,632**	**253,431**	**181,000**	**207,060**	**207,622**	**323,421**
Net periodic pension expense[4]	616,286	-268	618,944	-37	-183	820	-187	-882	-86	-345	-742	273	-1,021
Reimbursements	-530,055	-38,427	-120,184	-38,501	-27,235	-48,487	-22,223	-6,127	-122,239	-34,484	-33,468	-24,604	-14,076
Operating Expenses	**3,851,698**	**160,020**	**1,418,521**	**156,279**	**128,089**	**312,046**	**410,380**	**324,623**	**131,106**	**146,171**	**172,850**	**183,291**	**308,324**
Interest expense on securities sold under agreements to repurchase	60,201	1,516	33,575	1,871	1,534	4,023	3,808	3,298	954	559	1,175	2,339	5,549
Interest on reserves[5]	5,211,912	82,253	3,712,634	98,956	51,443	214,826	114,022	168,129	27,382	19,351	47,516	114,405	560,995
Interest on term deposits[6]	10,845	24	7,400	614	0	247	707	525	4	111	162	67	984
Net expenses	9,134,656	243,813	5,172,130	257,720	181,066	531,142	528,917	496,575	159,446	166,192	221,703	300,102	875,852
Current net income	82,015,297	2,097,306	45,242,300	2,469,797	2,139,726	5,343,194	5,616,260	4,525,045	1,288,792	737,454	1,548,578	3,220,611	7,786,232
Additions to (+) and deductions from (-) current net income													
Profit on sales of federal agency and government-sponsored enterprise mortgage-backed securities	50,954	1,397	28,044	1,335	1,305	2,857	3,598	2,703	836	497	923	1,978	5,481
Foreign currency translation gains (losses)	-1,256,960	-60,198	-402,109	-98,276	-97,594	-263,625	-71,631	-35,639	-10,462	-5,252	-12,699	-19,959	-179,516
Net income from consolidated variable interest entities[7]	181,149	…	181,149	…	…	…	…	…	…	…	…	…	…
Other additions	653	21	5	1	2	6	598	7	2	1	2	3	5
Other deductions	-5,537	-1	-3,639	59	-1,759	-216	-54	-39	-9	-4	0	139	-13
Net deductions to (-) current net income	-1,029,741	-58,781	-196,550	-96,881	-98,046	-260,978	-67,489	-32,968	-9,633	-4,758	-11,774	-17,839	-174,043
Cost of unreimbursed Treasury services	9	…	9	…	…	…	…	…	…	…	…	…	…
Assessments by Board													
Board expenditures[8]	580,000	27,934	185,239	44,711	45,553	121,717	33,374	16,233	4,867	2,446	5,908	9,467	82,552
Cost of currency	701,522	34,109	138,873	35,901	41,991	62,923	107,591	64,837	23,237	15,201	22,089	54,932	99,838
Consumer Financial Protection Bureau[9]	563,200	26,966	179,558	43,280	44,357	117,808	32,547	15,686	4,743	2,384	5,751	9,303	80,819
Assessments by the Board of Governors	1,844,722	89,009	503,670	123,892	131,901	302,448	173,512	96,756	32,847	20,031	33,748	73,702	263,209
Net income before providing for remittances to Treasury	79,140,825	1,949,516	44,542,089	2,249,024	1,909,779	4,779,768	5,375,259	4,395,321	1,246,312	712,665	1,503,056	3,129,070	7,348,980
Earnings remittances to Treasury	79,633,271	1,981,758	45,940,958	2,189,384	1,749,365	4,495,626	5,286,388	4,406,921	1,245,055	721,260	1,485,464	3,105,049	7,026,043
Net income (loss)	-492,446	-32,242	-1,398,869	59,640	160,414	284,142	88,871	-11,600	1,257	-8,595	17,592	24,021	322,937
Other comprehensive income (loss)	2,288,811	16,763	2,024,343	19,205	22,884	51,493	29,116	36,783	15,747	17,300	11,988	29,031	14,157

(continued on next page)

Table 10.—*continued*

Item	Total	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
Comprehensive income	1,796,365	-15,479	625,474	78,845	183,298	335,635	117,987	25,183	17,004	8,705	29,580	53,052	337,094
Distribution of comprehensive income													
Dividends on capital stock	1,649,277	78,102	525,884	126,774	129,908	345,446	94,989	45,858	13,877	6,992	16,902	27,207	237,338
Transferred to/from surplus and change in accumulated other comprehensive income	147,088	-93,581	99,576	-47,932	53,388	-9,812	22,996	-20,672	3,128	1,718	12,675	25,850	99,755
Earnings remittances to Treasury	79,633,271	1,981,758	45,940,958	2,189,384	1,749,365	4,495,626	5,286,388	4,406,921	1,245,055	721,260	1,485,464	3,105,049	7,026,043
Total distribution of net income	**81,429,636**	**1,966,279**	**46,566,418**	**2,268,226**	**1,932,661**	**4,831,260**	**5,404,373**	**4,432,107**	**1,262,060**	**729,970**	**1,515,041**	**3,158,106**	**7,363,136**

Note: Components may not sum to totals because of rounding.

1 Represents interest income recognized on swap agreements with foreign central banks.

2 The Federal Reserve Bank of Atlanta (FRBA) has overall responsibility for managing the Reserve Banks' provision of check and automated clearinghouse (ACH) services and recognizes total System revenue for these services. The Federal Reserve Bank of New York (FRBNY) has overall responsibility for managing the Reserve Banks' provision of Fedwire funds transfer and securities transfer services, and recognizes the total System revenue for these services. The Federal Reserve Bank of Chicago (FRBC) has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions, and recognizes the total System revenue for these services. The FRBA, the FRBNY, and the FRBC compensate the other Reserve Banks for the costs incurred in providing these services.

3 Includes expenses for labor and materials capitalized and depreciated or amortized as charges to activities in the periods benefited.

4 Reflects the effect of the Financial Accounting Standards Board's Codification Topic (ASC 715) Compensation-Retirement Benefits. Net pension expense for the System Retirement Plan of $625,019 thousand is recorded on behalf of the System in the books of the FRBNY. The Retirement Benefit Equalization Plan and the Supplemental Employee Retirement Plan are recorded by each Federal Reserve Bank.

5 In October 2008, the Reserve Banks began to pay interest to depository institutions on qualifying balances held at the Federal Reserve Banks.

6 In April 2010, the Reserve Banks began to pay interest on term deposits under the Term Deposit Facility.

7 Represents the portion of the consolidated variable interest entities' net income recorded by the FRBNY. The amount includes interest income, interest expenses, realized and unrealized gains and losses, and professional fees.

8 For additional details, see "Board of Governors Financial Statements" in section 11.

9 The Board of Governors assesses the Reserve Banks to fund the operations of the Consumer Financial Protection Bureau and Office of Financial Research. These assessments are allocated to each Reserve Bank based on each Reserve Bank's capital and surplus balances as of the most recent quarter.

… Not applicable.

Table 11. Income and expenses of the Federal Reserve Banks, 1914–2013
Thousands of dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)[1]	Assessments by the Board of Governors			Other compre-hensive income (loss)	Dividends paid	Distributions to the U.S. Treasury		Trans-ferred to/ from sur-plus[4]	Transferred to/from surplus and change in accumulated other compre-hensive income[5]
				Board expenditures	Costs of currency	Consumer Financial Protection Bureau and Office of Financial Research[2]			Statutory transfers[3]	Interest on Federal Reserve notes		
All banks												
1914–15	2,173	2,018	6	302	…	…	…	217	…	…	…	…
1916	5,218	2,082	-193	192	…	…	…	1,743	…	…	…	…
1917	16,128	4,922	-1,387	238	…	…	…	6,804	1,134	…	…	1,134
1918	67,584	10,577	-3,909	383	…	…	…	5,541	…	…	…	48,334
1919	102,381	18,745	-4,673	595	…	…	…	5,012	2,704	…	…	70,652
1920	181,297	27,549	-3,744	710	…	…	…	5,654	60,725	…	…	82,916
1921	122,866	33,722	-6,315	741	…	…	…	6,120	59,974	…	…	15,993
1922	50,499	28,837	-4,442	723	…	…	…	6,307	10,851	…	…	-660
1923	50,709	29,062	-8,233	703	…	…	…	6,553	3,613	…	…	2,546
1924	38,340	27,768	-6,191	663	…	…	…	6,682	114	…	…	-3,078
1925	41,801	26,819	-4,823	709	…	…	…	6,916	59	…	…	2,474
1926	47,600	24,914	-3,638	722	1,714	…	…	7,329	818	…	…	8,464
1927	43,024	24,894	-2,457	779	1,845	…	…	7,755	250	…	…	5,044
1928	64,053	25,401	-5,026	698	806	…	…	8,458	2,585	…	…	21,079
1929	70,955	25,810	-4,862	782	3,099	…	…	9,584	4,283	…	…	22,536
1930	36,424	25,358	-93	810	2,176	…	…	10,269	17	…	…	-2,298
1931	29,701	24,843	311	719	1,479	…	…	10,030	…	…	…	-7,058
1932	50,019	24,457	-1,413	729	1,106	…	…	9,282	2,011	…	…	11,021
1933	49,487	25,918	-12,307	800	2,505	…	…	8,874	…	…	…	-917
1934	48,903	26,844	-4,430	1,372	1,026	…	…	8,782	…	…	-60	6,510
1935	42,752	28,695	-1,737	1,406	1,477	…	…	8,505	298	…	28	607
1936	37,901	26,016	486	1,680	2,178	…	…	7,830	227	…	103	353
1937	41,233	25,295	-1,631	1,748	1,757	…	…	7,941	177	…	67	2,616
1938	36,261	25,557	2,232	1,725	1,630	…	…	8,019	120	…	-419	1,862
1939	38,501	25,669	2,390	1,621	1,356	…	…	8,110	25	…	-426	4,534
1940	43,538	25,951	11,488	1,704	1,511	…	…	8,215	82	…	-54	17,617
1941	41,380	28,536	721	1,840	2,588	…	…	8,430	141	…	-4	571
1942	52,663	32,051	-1,568	1,746	4,826	…	…	8,669	198	…	50	3,554
1943	69,306	35,794	23,768	2,416	5,336	…	…	8,911	245	…	135	40,327
1944	104,392	39,659	3,222	2,296	7,220	…	…	9,500	327	…	201	48,410
1945	142,210	41,666	-830	2,341	4,710	…	…	10,183	248	…	262	81,970
1946	150,385	50,493	-626	2,260	4,482	…	…	10,962	67	…	28	81,467
1947	158,656	58,191	1,973	2,640	4,562	…	…	11,523	36	75,284	87	8,366
1948	304,161	64,280	-34,318	3,244	5,186	…	…	11,920	…	166,690	…	18,523
1949	316,537	67,931	-12,122	3,243	6,304	…	…	12,329	…	193,146	…	21,462
1950	275,839	69,822	36,294	3,434	7,316	…	…	13,083	…	196,629	…	21,849
1951	394,656	83,793	-2,128	4,095	7,581	…	…	13,865	…	254,874	…	28,321
1952	456,060	92,051	1,584	4,122	8,521	…	…	14,682	…	291,935	…	46,334
1953	513,037	98,493	-1,059	4,100	10,922	…	…	15,558	…	342,568	…	40,337
1954	438,486	99,068	-134	4,175	6,490	…	…	16,442	…	276,289	…	35,888
1955	412,488	101,159	-265	4,194	4,707	…	…	17,712	…	251,741	…	32,710
1956	595,649	110,240	-23	5,340	5,603	…	…	18,905	…	401,556	…	53,983
1957	763,348	117,932	-7,141	7,508	6,374	…	…	20,081	…	542,708	…	61,604
1958	742,068	125,831	124	5,917	5,973	…	…	21,197	…	524,059	…	59,215
1959	886,226	131,848	98,247	6,471	6,384	…	…	22,722	…	910,650	…	-93,601
1960	1,103,385	139,894	13,875	6,534	7,455	…	…	23,948	…	896,816	…	42,613
1961	941,648	148,254	3,482	6,265	6,756	…	…	25,570	…	687,393	…	70,892

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Table 11.—*continued*

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)[1]	Assessments by the Board of Governors			Other comprehensive income (loss)	Dividends paid	Distributions to the U.S. Treasury		Transferred to/ from surplus[4]	Transferred to/from surplus and change in accumulated other comprehensive income[5]
				Board expenditures	Costs of currency	Consumer Financial Protection Bureau and Office of Financial Research[2]			Statutory transfers[3]	Interest on Federal Reserve notes		
1962	1,048,508	161,451	-56	6,655	8,030	…	…	27,412	…	799,366	…	45,538
1963	1,151,120	169,638	615	7,573	10,063	…	…	28,912	…	879,685	…	55,864
1964	1,343,747	171,511	726	8,655	17,230	…	…	30,782	…	1,582,119	…	-465,823
1965	1,559,484	172,111	1,022	8,576	23,603	…	…	32,352	…	1,296,810	…	27,054
1966	1,908,500	178,212	996	9,022	20,167	…	…	33,696	…	1,649,455	…	18,944
1967	2,190,404	190,561	2,094	10,770	18,790	…	…	35,027	…	1,907,498	…	29,851
1968	2,764,446	207,678	8,520	14,198	20,474	…	…	36,959	…	2,463,629	…	30,027
1969	3,373,361	237,828	-558	15,020	22,126	…	…	39,237	…	3,019,161	…	39,432
1970	3,877,218	276,572	11,442	21,228	23,574	…	…	41,137	…	3,493,571	…	32,580
1971	3,723,370	319,608	94,266	32,634	24,943	…	…	43,488	…	3,356,560	…	40,403
1972	3,792,335	347,917	-49,616	35,234	31,455	…	…	46,184	…	3,231,268	…	50,661
1973	5,016,769	416,879	-80,653	44,412	33,826	…	…	49,140	…	4,340,680	…	51,178
1974	6,280,091	476,235	-78,487	41,117	30,190	…	…	52,580	…	5,549,999	…	51,483
1975	6,257,937	514,359	-202,370	33,577	37,130	…	…	54,610	…	5,382,064	…	33,828
1976	6,623,220	558,129	7,311	41,828	48,819	…	…	57,351	…	5,870,463	…	53,940
1977	6,891,317	568,851	-177,033	47,366	55,008	…	…	60,182	…	5,937,148	…	45,728
1978	8,455,309	592,558	-633,123	53,322	60,059	…	…	63,280	…	7,005,779	…	47,268
1979	10,310,148	625,168	-151,148	50,530	68,391	…	…	67,194	…	9,278,576	…	69,141
1980	12,802,319	718,033	-115,386	62,231	73,124	…	…	70,355	…	11,706,370	…	56,821
1981	15,508,350	814,190	-372,879	63,163	82,924	…	…	74,574	…	14,023,723	…	76,897
1982	16,517,385	926,034	-68,833	61,813	98,441	…	…	79,352	…	15,204,591	…	78,320
1983	16,068,362	1,023,678	-400,366	71,551	152,135	…	…	85,152	…	14,228,816	…	106,663
1984	18,068,821	1,102,444	-412,943	82,116	162,606	…	…	92,620	…	16,054,095	…	161,996
1985	18,131,983	1,127,744	1,301,624	77,378	173,739	…	…	103,029	…	17,796,464	…	155,253
1986	17,464,528	1,156,868	1,975,893	97,338	180,780	…	…	109,588	…	17,803,895	…	91,954
1987	17,633,012	1,146,911	1,796,594	81,870	170,675	…	…	117,499	…	17,738,880	…	173,771
1988	19,526,431	1,205,960	-516,910	84,411	164,245	…	…	125,616	…	17,364,319	…	64,971
1989	22,249,276	1,332,161	1,254,613	89,580	175,044	…	…	129,885	…	21,646,417	…	130,802
1990	23,476,604	1,349,726	2,099,328	103,752	193,007	…	…	140,758	…	23,608,398	…	180,292
1991	22,553,002	1,429,322	405,729	109,631	261,316	…	…	152,553	…	20,777,552	…	228,356
1992	20,235,028	1,474,531	-987,788	128,955	295,401	…	…	171,763	…	16,774,477	…	402,114
1993	18,914,251	1,657,800	-230,268	140,466	355,947	…	…	195,422	…	15,986,765	…	347,583
1994	20,910,742	1,795,328	2,363,862	146,866	368,187	…	…	212,090	…	20,470,011	…	282,122
1995	25,395,148	1,818,416	857,788	161,348	370,203	…	…	230,527	…	23,389,367	…	283,075
1996	25,164,303	1,947,861	-1,676,716	162,642	402,517	…	…	255,884	5,517,716	14,565,624	…	635,343
1997	26,917,213	1,976,453	-2,611,570	174,407	364,454	…	…	299,652	20,658,972	0	…	831,705
1998	28,149,477	1,833,436	1,906,037	178,009	408,544	…	…	343,014	17,785,942	8,774,994	…	731,575
1999	29,346,836	1,852,162	-533,557	213,790	484,959	…	…	373,579	…	25,409,736	…	479,053
2000	33,963,992	1,971,688	-1,500,027	188,067	435,838	…	…	409,614	…	25,343,892	…	4,114,865
2001	31,870,721	2,084,708	-1,117,435	295,056	338,537	…	…	428,183	…	27,089,222	…	517,580
2002	26,760,113	2,227,078	2,149,328	205,111	429,568	…	…	483,596	…	24,495,490	…	1,068,598
2003	23,792,725	2,462,658	2,481,127	297,020	508,144	…	…	517,705	…	22,021,528	…	466,796
2004	23,539,942	2,238,705	917,870	272,331	503,784	…	…	582,402	…	18,078,003	…	2,782,587
2005	30,729,357	2,889,544	-3,576,903	265,742	477,087	…	…	780,863	…	21,467,545	…	1,271,672
2006	38,410,427	3,263,844	-158,846	301,014	491,962	…	…	871,255	…	29,051,678	…	4,271,828
2007	42,576,025	3,510,206	198,417	296,125	576,306	…	324,481	992,353	…	34,598,401	…	3,125,533
2008	41,045,582	4,870,374	3,340,628	352,291	500,372	…	-3,158,808	1,189,626	…	31,688,688	…	2,626,053
2009	54,463,121	5,978,795	4,820,204	386,400	502,044	…	1,006,813	1,428,202	…	47,430,237	…	4,564,460
2010	79,300,937	6,270,420	9,745,562	422,200	622,846	42,286	45,881	1,582,785	…	79,268,124	…	883,724

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Table 11.—*continued*

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (-)[1]	Assessments by the Board of Governors			Other compre-hensive income (loss)	Dividends paid	Distributions to the U.S. Treasury		Trans-ferred to/ from sur-plus[4]	Transferred to/from surplus and change in accumulated other compre-hensive income[5]
				Board expenditures	Costs of currency	Consumer Financial Protection Bureau and Office of Financial Research[2]			Statutory transfers[3]	Interest on Federal Reserve notes		
2011	85,241,366	7,316,643	2,015,991	472,300	648,798	281,712	-1,161,848	1,577,284	...	75,423,597	...	375,175
2012	81,586,102	7,798,353	18,380,835	490,001	722,301	387,279	-52,611	1,637,934	...	88,417,936	...	460,528
2013	91,149,953	9,134,656	-1,029,750	580,000	701,522	563,200	2,288,811	1,649,277	...	79,633,271	...	147,088
Total, 1914–2013	**1,186,252,728**	**98,226,703**	**41,513,683**	**7,704,117**	**13,106,200**	**1,274,477**	**-707,281**	**18,796,238**	**44,113,958**	**1,010,388,214**	**-4**	**33,449,236[6]**
Aggregate for each Bank, 1914–2013												
Boston	51,279,178	4,828,708	478,994	328,411	735,103	56,441	9,877	821,871	2,579,504	40,972,606	135	1,445,269
New York	470,670,121	28,610,232[7]	27,102,475	2,039,651	3,670,015	398,835	-885,309	5,118,391	17,307,161	428,467,738	-433	11,275,692
Philadelphia	40,938,788	4,190,761	1,041,786	486,608	603,615	104,641	9,399	1,367,477	1,312,118	31,690,268	291	2,234,192
Cleveland	57,608,370	4,561,484	949,026	564,875	737,571	98,504	24,387	1,389,004	2,827,043	45,907,225	-10	2,496,089
Richmond	94,883,564	8,270,922	2,944,213	1,377,610	1,112,656	265,534	46,940	3,737,994	3,083,928	73,209,366	-72	6,816,783
Atlanta	81,548,299	11,349,617	1,905,852	544,630	1,281,413	72,931	7,813	1,255,535	2,713,230	64,342,341	5	1,902,259
Chicago	118,307,330	9,352,194	1,973,116	624,229	1,403,432	35,186	18,086	1,252,321	4,593,811	101,859,121	12	1,178,226
St. Louis	35,161,474	3,580,587	460,097	142,188	464,173	10,663	17,560	297,824	1,833,837	28,954,917	-27	354,974
Minneapolis	19,033,550	3,612,262	441,992	190,391	252,993	10,674	7,895	419,247	416,227	14,307,193	65	274,396
Kansas City	38,929,972	4,895,786	621,802	176,201	479,300	12,704	-2,122	345,634	1,249,703	31,978,396	-9	411,931
Dallas	51,198,780	5,146,967	1,142,028	264,248	730,078	20,312	27,038	502,867	1,510,802	43,564,602	55	627,916
San Francisco	126,693,302	9,827,187	2,452,312	965,077	1,635,850	188,054	11,154	2,288,074	4,686,594	105,134,440	-17	4,431,511
Total	**1,186,252,728**	**98,226,703**	**41,513,683**	**7,704,117**	**13,106,200**	**1,274,477**	**-707,281**	**18,796,238**	**44,113,958**	**1,010,388,214**	**-4**	**33,449,236**

Note: Components may not sum to totals because of rounding.

[1] For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

[2] Starting in 2010, as required under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Board of Governors began assessing the Reserve Banks to fund the operations of the Consumer Financial Protection Bureau and Office of Financial Research. These assessments are allocated to the Reserve Banks based on each Reserve Bank's capital and surplus balances as of the most recent quarter.

[3] Represents transfers made as a franchise tax from 1917 through 1932; transfers made under section 13b of the Federal Reserve Act from 1935 through 1947; and transfers made under section 7 of the Federal Reserve Act for 1996 and 1997.

[4] Transfers are made under section 13b of the Federal Reserve Act.

[5] Transfers are made under section 7 of the Federal Reserve Act. Beginning in 2006, accumulated other comprehensive income is reported as a component of surplus.

[6] The $33,449,236 thousand transferred to surplus was reduced by direct charges of $500 thousand for charge-off on Bank premises (1927); $139,300 thousand for contributions to capital of the Federal Deposit Insurance Corporation (1934); $4 thousand net upon elimination of section 13b surplus (1958); and $106,000 thousand (1996), $107,000 thousand (1997), and $3,752,000 thousand (2000) transferred to the Treasury as statutorily required; and $1,848,716 thousand related to the implementation of SFAS No. 158 (2006) and was increased by a transfer of $11,131 thousand from reserves for contingencies (1955), leaving a balance of $27,506,847 thousand on December 31, 2013.

[7] This amount is reduced by $5,856,187 thousand for expenses of the System Retirement Plan. See note 4, "Table 10. Income and expenses of the Federal Reserve Banks, by Bank, 2013."

... Not applicable.

Table 12. Operations in principal departments of the Federal Reserve Banks, 2010–13

Operation	2013	2012	2011	2010
Millions of pieces				
Currency processed	33,254	31,703	32,249	32,143
Currency destroyed	5,564	4,614	4,813	5,948
Coin received	56,806	58,669	59,550	62,345
Checks handled				
U.S. government checks[1]	83	121	159	185
Postal money orders	101	108	113	121
Commercial	5,987	6,622	6,780	7,712
Securities transfers[2]	19	18	19	20
Funds transfers[3]	134	132	127	125
Automated clearinghouse transactions				
Commercial	11,143	10,665	10,349	10,233
Government	1,467	1,382	1,305	1,222
Millions of dollars				
Currency processed	639,164	581,382	576,442	569,249
Currency destroyed	206,998	105,464	81,943	120,049
Coin received	5,481	5,700	5,907	6,014
Checks handled				
U.S. government checks[1]	154,584	199,251	241,817	292,261
Postal money orders	22,262	21,927	22,220	23,210
Commercial	7,960,028	8,125,424	7,943,524	8,811,010
Securities transfers[2]	295,186,170	284,401,670	291,823,993	320,123,901
Funds transfers[3]	713,310,354	599,200,625	663,837,575	608,325,851
Automated clearinghouse transactions				
Commercial	19,689,431	19,293,857	17,801,549	16,941,077
Government	4,714,428	4,609,914	4,534,707	4,426,808

[1] Includes government checks handled electronically (electronic checks).
[2] Data on securities transfers do not include reversals.
[3] Data on funds transfers do not include non-value transfers.

Table 13. Number and annual salaries of officers and employees of the Federal Reserve Banks, December 31, 2013

Federal Reserve Bank (including branches)	President[1]	Other officers[1]		Employees			Total	
	Annual salary (dollars)[2]	Number	Annual salaries (dollars)[2]	Number		Annual salaries (dollars)[2]	Number	Annual salaries (dollars)[2]
				Full-time	Part-time			
Boston	350,400	71	14,671,048	937	29	88,352,943	1,038	103,374,391
New York	410,780	514	115,252,921	2,546	35	282,839,031	3,096	398,502,732
Philadelphia	350,400	66	11,536,765	823	16	67,149,811	906	79,036,976
Cleveland	347,400	54	9,668,100	839	23	66,771,202	917	76,786,702
Richmond	347,400	79	13,853,652	1,387	25	112,557,675	1,492	126,758,727
Atlanta	314,400	78	14,991,480	1,486	16	118,308,887	1,581	133,614,767
Chicago	350,400	111	20,615,543	1,324	44	120,412,103	1,480	141,378,047
St. Louis	281,300	88	15,772,000	910	34	71,690,841	1,033	87,744,141
Minneapolis	313,500	55	9,920,225	988	51	75,243,412	1,095	85,477,137
Kansas City	323,200	79	13,884,200	1,319	14	92,281,391	1,413	106,488,791
Dallas	350,400	70	11,812,352	1,085	9	78,959,645	1,165	91,122,396
San Francisco	367,500	87	18,403,012	1,521	18	142,695,287	1,627	161,465,799
Federal Reserve Information Technology	…	67	12,374,436	1,092	4	115,136,914	1,163	127,511,350
Office of Employee Benefits	…	14	3,178,250	38	0	3,949,040	52	7,127,290
Total	**4,107,080**	**1,433**	**285,933,984**	**16,295**	**318**	**1,436,348,182**	**18,058**	**1,726,389,246**

Note: Components may not sum to totals because of rounding.

1 No president or other officer, except for an officer who received a promotion with a significant increase in responsibility, received a salary increase in 2011, 2012, or 2013, due to the Board's application of the pay freeze to Reserve Bank officers.

2 Annualized salary liability (excluding outside agency costs) based on salaries in effect on December 31, 2013.

… Not applicable.

Table 14. Acquisition costs and net book value of the premises of the Federal Reserve Banks and Branches, December 31, 2013
Thousands of dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate[3]
	Land	Buildings (including vaults)[1]	Building machinery and equipment	Total[2]		
Boston	27,293	184,197	31,605	243,095	122,983	…
New York	67,570	508,520	109,422	685,512	432,479	…
Philadelphia	8,146	113,616	25,487	147,249	72,553	…
Cleveland	4,219	128,346	25,647	158,212	92,697	…
Cincinnati	3,075	28,639	17,604	49,318	17,983	…
Richmond	31,749	161,501	56,577	249,827	152,555	…
Baltimore	7,917	39,807	13,746	61,470	34,245	…
Charlotte	7,884	45,049	13,957	66,890	41,239	…
Atlanta	22,995	158,265	20,140	201,400	149,016	…
Birmingham	5,347	13,056	1,465	19,868	10,338	…
Jacksonville	1,779	23,625	4,974	30,378	16,484	…
New Orleans	3,785	13,796	6,332	23,913	11,591	…
Miami	4,254	30,087	7,470	41,811	24,448	…
Chicago	5,403	219,708	28,302	253,413	122,634	…
Detroit	12,329	74,283	11,554	98,166	80,412	…
St. Louis	9,377	140,755	15,899	166,031	116,709	…
Memphis	2,472	15,680	5,188	23,340	9,967	…
Minneapolis	15,522	109,423	17,518	142,463	90,767	…
Helena	2,890	10,335	1,548	14,773	8,654	…
Kansas City	38,585	200,331	27,129	266,045	232,426	…
Denver	3,694	9,873	5,902	19,469	8,435	…
Omaha	3,559	7,692	1,925	13,176	5,992	…
Dallas	37,461	124,081	32,298	193,840	115,142	…
El Paso	262	3,821	2,050	6,133	945	…
Houston	25,119	104,059	9,209	138,387	111,335	7,204
San Antonio	826	8,401	2,969	12,196	3,656	…
San Francisco	20,988	122,479	29,882	173,349	90,028	…
Los Angeles	6,306	75,494	20,244	102,044	51,659	…
Salt Lake City	1,294	5,407	1,610	8,311	2,745	…
Seattle	13,101	49,970	6,744	69,815	59,790	
Total	**395,201**	**2,730,296**	**554,397**	**3,679,894**	**2,289,907**	**7,204**

[1] Includes expenditures for construction at some offices, pending allocation to appropriate accounts.
[2] Excludes charge-offs of $17,699 thousand before 1952.
[3] Includes real estate held pending sale.
… Not applicable.

11 Federal Reserve System Audits

The Board of Governors, the Federal Reserve Banks, and the Federal Reserve System as a whole are all subject to several levels of audit and review.

The Board's financial statements and internal controls over financial reporting are audited annually by an independent outside auditor retained by the Board's Office of Inspector General (OIG). The outside auditor also tests the Board's compliance with certain laws and regulations affecting those statements.

The Reserve Banks' financial statements are audited annually by an independent outside auditor retained by the Board of Governors. In addition, the Reserve Banks are subject to annual examination by the Board. As discussed in section 5, "Federal Reserve Banks," the Board's examination includes a wide range of ongoing oversight activities conducted on site and off site by staff of the Board's Division of Reserve Bank Operations and Payment Systems.

In addition, the OIG conducts audits, investigations, and other reviews relating to the Board's programs and operations as well as to Board functions delegated to the Reserve Banks. Certain aspects of Federal Reserve operations are also subject to review by the Government Accountability Office.

Board of Governors Financial Statements

The financial statements of the Board of Governors for 2013 and 2012 were audited by Deloitte & Touche LLP, independent auditors.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

March 12, 2014

Management's Report on Internal Control over Financial Reporting

To the Committee on Board Affairs:

The management of the Board of Governors of the Federal Reserve System ("the Board") is responsible for the preparation and fair presentation of the balance sheet as of December 31, 2013, and for the related statement of operations and statement of cash flows for the year then ended (the "Financial Statements"). The Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include some amounts which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with generally accepted accounting principles and include all disclosures necessary for such presentation.

The Board's management is also responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Committee on Board Affairs regarding the preparation of the Financial Statements in accordance with accounting principles generally accepted in the United States of America. The Board's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Board; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of Financial Statements in accordance with generally accepted accounting principles, and that the Board's receipts and expenditures are being made only in accordance with authorizations by its management; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Board's assets that could have a material effect on the Financial Statements.

Internal control, no matter how well designed and operated, can only provide reasonable assurance of achieving the Board's control objectives with respect to the preparation of reliable Financial Statements. The likelihood of achievement of such objectives is affected by limitations inherent to internal control, including the possibility of human error. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that specific controls may become inadequate because of changes in conditions or that the degree of compliance with policies or procedures may deteriorate.

The Board's management assessed its internal control over financial reporting with regards to the Financial Statements based upon the criteria established in the *Internal Control—Integrated Framework* (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, we believe that the Board has maintained effective internal control over financial reporting as it relates to its Financial Statements.

Donald V. Hammond
Chief Operating Officer

William L. Mitchell
Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Board of Governors of the Federal Reserve System:

We have audited the accompanying financial statements of the Board of Governors of the Federal Reserve System (the "Board"), which are comprised of the balance sheets as of December 31, 2013 and 2012, and the related statements of operations, and cash flows for the years then ended, and the related notes to the financial statements. We also have audited the Board's internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management's Responsibility

The Board's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The Board's management is also responsible for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assertion.

Auditors' Responsibility

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

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Board's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting involves obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

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

Definition of Internal Control Over Financial Reporting

The Board's internal control over financial reporting is a process designed by, or under the supervision of, the Board's principal executive and principal financial officers, or persons performing similar functions, and effected by the Board's Committee on Board Affairs, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Board's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Board; (2) provide

reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Board are being made only in accordance with authorizations of management and governors of the Board; and (3) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the Board's assets that could have a material effect on the financial statements.

Inherent Limitations of Internal Control Over Financial Reporting

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the Board maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Report on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated March 12, 2014 on our tests of the Board's compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Deloitte & Touche LLP

March 12, 2014
Washington, DC

Board of Governors of the Federal Reserve System Balance Sheets

	As of December 31,	
	2013	2012
Assets		
Current assets:		
Cash	$ 90,851,317	$ 53,965,151
Accounts receivable – net	7,911,011	2,437,241
Prepaid expenses and other assets	4,621,633	4,518,080
Total current assets	103,383,961	60,920,472
Noncurrent assets:		
Property, equipment, and software – net	195,347,206	186,703,851
Other assets	1,959,389	1,081,446
Total noncurrent assets	197,306,595	187,785,297
Total	$300,690,556	$248,705,769
Liabilities and cumulative results of operations		
Current liabilities:		
Accounts payable and accrued liabilities	$ 22,376,801	$ 16,181,003
Accrued payroll and related taxes	25,105,590	20,907,437
Accrued annual leave	31,288,437	29,218,663
Capital lease payable	465,219	456,896
Unearned revenues and other liabilities	2,509,202	617,787
Total current liabilities	81,745,249	67,381,786
Long-term liabilities:		
Capital lease payable	603,897	1,069,116
Retirement benefit obligation	30,129,567	33,740,310
Postretirement benefit obligation	11,294,443	13,249,648
Postemployment benefit obligation	8,490,921	10,695,165
Other liabilities	22,060,853	21,261,795
Total long-term liabilities	72,579,681	80,016,034
Total liabilities	154,324,930	147,397,820
Cumulative results of operations:		
Fund balance	153,616,578	119,140,439
Accumulated other comprehensive income (loss)	(7,250,952)	(17,832,490)
Total cumulative results of operations	146,365,626	101,307,949
Total	$300,690,556	$248,705,769

See notes to financial statements.

Board of Governors of the Federal Reserve System Statements of Operations

	For the years ended December 31,	
	2013	2012
Board operating revenues:		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$580,000,000	$490,000,000
Other revenues	14,888,833	9,793,604
Total operating revenues	594,888,833	499,793,604
Board operating expenses:		
Salaries	322,740,797	299,889,043
Retirement, insurance, and benefits	73,336,663	70,232,938
Contractual services and professional fees	63,094,846	50,873,548
Depreciation, amortization, and net gains or losses on disposals	24,694,987	21,969,729
Travel	14,726,855	15,068,161
Postage, supplies, and non-capital furniture and equipment	10,955,269	11,256,753
Utilities	9,330,903	9,016,693
Software	11,592,703	10,967,296
Rentals of space	14,790,457	14,120,215
Repairs and maintenance	5,866,831	5,696,326
Printing and binding	1,899,711	2,126,056
Other expenses	7,382,672	7,887,650
Total operating expenses	560,412,694	519,104,408
Net income (loss)	34,476,139	(19,310,804)
Currency costs:		
Assessments levied or to be levied on Federal Reserve Banks for currency costs	705,030,765	721,074,064
Expenses for costs related to currency	705,030,765	721,074,064
Currency assessments over (under) expenses	–	–
Bureau of Consumer Financial Protection (Bureau):		
Assessments levied on the Federal Reserve Banks for the Bureau	563,200,000	385,200,000
Transfers to the Bureau	563,200,000	385,200,000
Bureau assessments over (under) transfers	–	–
Office of Financial Research (Office):		
Assessments levied on the Federal Reserve Banks for the Office	–	2,078,298
Transfers to the Office	–	2,078,298
Office assessments over (under) transfers	–	–
Total net income (loss)	34,476,139	(19,310,804)
Other comprehensive income:		
Amortization of prior service (credit) cost	605,684	584,890
Amortization of net actuarial (gain) loss	1,218,367	1,659,956
Net actuarial gain (loss) arising during the year	8,757,487	(2,983,794)
Total other comprehensive income (loss)	10,581,538	(738,948)
Comprehensive income (loss)	45,057,677	(20,049,752)
Cumulative results of operations – beginning of year	101,307,949	121,357,701
Cumulative results of operations – end of year	$146,365,626	$101,307,949

See notes to financial statements.

Board of Governors of the Federal Reserve System Statements of Cash Flows

	For the years ended December 31,	
	2013	2012
Cash flows from operating activities:		
Net income (loss)	$ 34,476,139	$(19,310,804)
Adjustments to reconcile results of operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	22,804,365	21,901,984
Net loss (gain) on disposal of property and equipment	1,890,621	67,745
Other additional non-cash adjustments to results of operations	119,355	492,739
(Increase) decrease in assets:		
Accounts receivable, prepaid expenses and other assets	(6,455,266)	1,211,886
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	4,260,385	(6,317,712)
Accrued payroll and related taxes	4,198,153	2,290,903
Accrued annual leave	2,069,774	1,936,913
Unearned revenues and other liabilities	1,891,415	(255,081)
Net retirement benefit obligation	4,694,408	6,363,414
Net postretirement benefit obligation	321,182	602,805
Net postemployment benefit obligation	(2,204,244)	(449,979)
Other long-term liabilities	(523,133)	437,509
Net cash provided by (used in) operating activities	67,543,154	8,972,322
Cash flows from investing activities:		
Capital expenditures	(30,200,771)	(28,057,137)
Net cash provided by (used in) investing activities	(30,200,771)	(28,057,137)
Cash flows from financing activities:		
Capital lease payments	(456,217)	(542,160)
Net cash provided by (used in) financing activities	(456,217)	(542,160)
Net increase (decrease) in cash	36,886,166	(19,626,975)
Cash balance – beginning of year	53,965,151	73,592,126
Cash balance – end of year	$ 90,851,317	$ 53,965,151

See notes to financial statements.

Board of Governors of the Federal Reserve System Notes to Financial Statements as of and for the Years Ended December 31, 2013 and 2012

(1) Structure

The Federal Reserve System (the System) was established by Congress in 1913 and consists of the Board of Governors (the Board), the Federal Open Market Committee, the twelve regional Federal Reserve Banks (Reserve Banks), the Federal Advisory Council, and the private commercial banks that are members of the System. The Board, unlike the Reserve Banks, was established as a federal government agency and is located in Washington, D.C.

The Board is required by the Federal Reserve Act (the Act) to report its operations to the Speaker of the House of Representatives. The Act also requires the Board, each year, to order a financial audit of each Reserve Bank and to publish each week a statement of the financial condition of each Reserve Bank and a combined statement for all of the Reserve Banks. Accordingly, the Board believes that the best financial disclosure consistent with law is achieved by issuing separate financial statements for the Board and for the Reserve Banks. Therefore, the accompanying financial statements include only the results of operations and activities of the Board. Combined financial statements for the Reserve Banks are included in the Board's annual report to the Speaker of the House of Representatives and weekly statements are available on the Board's public website.

The Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010 (Dodd-Frank Act) established the Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System and designated the Board's Office of Inspector General (OIG) as the OIG for the Bureau. As required by the Dodd-Frank Act, the Board transferred certain responsibilities to the Bureau. The Dodd-Frank Act requires the Board to fund the Bureau from the combined earnings of the System. The Dodd-Frank Act also created the Financial Stability Oversight Council (FSOC), of which the Chairman of the Board is a member, as well as the Office of Financial Research (Office) within the U.S. Department of Treasury (Treasury) to provide support to the FSOC and the member agencies. The Dodd-Frank Act required that the Board provide funding for the FSOC and the Office until July 2012. 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 or the System; the Board has also determined that neither the FSOC nor the Office should be consolidated in the Board's financial statements. Accordingly, the Board's financial statements do not include financial data of the Bureau, the FSOC, or the Office other than the funding that the Board is required by the Dodd-Frank Act to provide.

(2) Operations and Services

The Board's responsibilities require thorough analysis of domestic and international financial and economic developments. The Board carries out those responsibilities in conjunction with the Reserve Banks and the Federal Open Market Committee. The Board also exercises general oversight of the operations of the Reserve Banks and exercises broad responsibility in the nation's payments system. Policy regarding open market operations is established by the Federal Open Market Committee. However, the Board has sole authority over changes in reserve requirements, and it must approve any change in the discount rate initiated by a Reserve Bank. The Board also plays a major role in the supervision and regulation of the

U.S. banking system. It has supervisory responsibilities for state-chartered banks that are members of the System, bank holding companies, savings and loan holding companies, foreign activities of member banks, U.S. activities of foreign banks, and any systemically important nonbank financial companies that are designated as such by the FSOC. Although the Dodd-Frank Act gave the Bureau general rule-writing responsibility for Federal consumer financial laws, the Board retains rule-writing responsibility under the Community Reinvestment Act and other specific statutory provisions. The Board also enforces the requirements of Federal consumer financial laws for state member banks with assets of $10 billion or less. In addition, the Board enforces certain other consumer laws at all state member banks, regardless of size.

(3) Significant Accounting Policies

Basis of Accounting — The Board prepares its financial statements in accordance with accounting principles generally accepted in the United States (GAAP).

Revenues — The Federal Reserve Act authorizes the Board to levy an assessment on the Reserve Banks to fund its operations. The Board allocates the assessment to each Reserve Bank based on the Reserve Bank's capital and surplus balances.

Assessments to Fund the Bureau and the Office — The Board assesses the Reserve Banks for the funds transferred to the Bureau and the Office based on each Reserve Bank's capital and surplus balances. These assessments and transfers are reported separately from the Board's operating activities in the Board's Statements of Operations.

Assessments for Supervision and Regulation (S&R) — The Dodd-Frank Act directs the Board to collect assessments, fees, or other charges equal to the total expenses the Board estimates are necessary or appropriate to carry out the supervisory and regulatory responsibilities of the Board for bank holding companies and savings and loan holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated for Board supervision by the FSOC. More comprehensive information about these assessments is available on the Board's public website. As a collecting entity, the Board does not recognize the S&R assessments as revenue nor does the Board use the collections to fund Board expenses; the funds are transferred to the Treasury. The Board collected and transferred $433,483,299 during 2013.

Civil Money Penalties — The Board has enforcement authority over the financial institutions it supervises and their affiliated parties, including the authority to assess civil money penalties. As directed by statute, all civil money penalties that are assessed and collected by the Board are remitted to either the Treasury or the Federal Emergency Management Agency (FEMA). As a collecting entity, the Board does not recognize civil money penalties as revenue nor does the Board use the civil money penalty to fund Board expenses. Civil money penalties whose collection is contingent upon fulfillment of certain conditions in the enforcement action are not recorded in the Board's financial records. Checks for civil money penalties made payable to the National Flood Insurance Program are forwarded to FEMA and are not recorded in the Board's financial records.

Currency Costs — The Board issues the nation's currency (in the form of Federal Reserve notes), and the Reserve Banks distribute currency through depository institutions. The Board incurs expenses and assesses the Reserve Banks for the expenses related to producing, issuing, and retiring Federal Reserve notes as well

as providing educational services. The assessment is allocated 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. These expenses and assessments are reported separately from the Board's operating activities in the Board's Statements of Operations.

Accounts Receivable and Allowance for Doubtful Accounts — Accounts receivable are recorded when amounts are earned but not yet received and are shown net of the allowance for doubtful accounts. Accounts receivable considered uncollectible are charged against the allowance account in the year they are deemed uncollectible. The allowance for doubtful accounts is adjusted monthly, based upon a review of outstanding receivables. The allowance for doubtful accounts is $122,000 and $30,000 as of December 31, 2013 and 2012, respectively.

Property, Equipment, and Software — The Board's property, equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets, which range from three to ten years for furniture and equipment, ten to fifty years for building equipment and structures, and two to five years for software. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation or amortization are removed and any gain or loss is recognized. Construction in process includes costs incurred for short-term and long-term projects that have not been placed into service; the majority of the balance represents long-term building enhancement projects.

Art Collections — The Board has collections of works of art, historical treasures, and similar assets. These collections are maintained and held for public exhibition in furtherance of public service. Proceeds from any sales of collections are used to acquire other items for collections. The cost of collections purchased by the Board is charged to expense in the year purchased and donated collection items are not recorded. The value of the Board's collections has not been determined.

Deferred Rent — Leases for certain space contain scheduled rent increases over the term of the lease. Rent abatements, lease incentives, and scheduled rent increases must be considered in determining the annual rent expense to be recognized. The deferred rent represents the difference between the actual lease payments and the rent expense recognized. Lease incentives impact deferred rent and are non-cash transactions.

Estimates — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Standards — In February 2013, the Financial Accounting Standards Board (FASB) issued ASU 2013-02, *Comprehensive Income* (Topic 220): *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* related to reporting of significant reclassification adjustments from accumulated other comprehensive income. This update improves the transparency of changes in other comprehensive income and items reclassified out of accumulated other comprehensive income in the financial statements. The required disclosures

in ASU 2013-02 are effective for the Board for the year ended December 31, 2013, and are reflected in the Board's 2013 financial statements and Note 9.

(4) Property, Equipment, and Software

The following is a summary of the components of the Board's property, equipment, and software, at cost, less accumulated depreciation and amortization as of December 31, 2013 and 2012:

	As of December 31,	
	2013	2012
Land	$ 18,640,314	$ 18,640,314
Buildings and improvements	217,293,649	205,006,985
Construction in process	15,436,635	14,362,523
Furniture and equipment	62,655,420	74,519,266
Software in use	33,690,483	29,147,933
Software in process	1,641,886	2,422,381
Vehicles	1,205,025	960,745
Other intangible assets	0	496,675
Subtotal	350,563,412	345,556,822
Less accumulated depreciation and amortization	(155,216,206)	(158,852,971)
Property, equipment, and software – net	$ 195,347,206	$ 186,703,851

The Board retired $28,331,000 and $5,972,000 of long-term assets during 2013 and 2012, respectively.

(5) Leases

Capital Leases — The Board entered into capital leases for copier equipment in 2008 and 2009 that terminated in March 2012. The Board subsequently entered into new capital leases in 2012. Under the new commitments, the capital lease term extends through 2016. Furniture and equipment includes capitalized leases of $1,853,000 as of 2013 and 2012. Accumulated depreciation includes $801,000 and $337,000 related to assets under capital leases as of 2013 and 2012, respectively. The depreciation expense for the leased equipment is $464,000 and $471,000 for 2013 and 2012, respectively.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2013, are as follows:

Years Ended December 31,	Amount
2014	$ 711,659
2015	711,659
2016	192,799
Total minimum lease payments	1,616,117
Less amount representing maintenance	(523,816)
Net minimum lease payments	1,092,301
Less amount representing interest	(23,185)
Present value of net minimum lease payments	1,069,116
Less current maturities of capital lease payments	(465,219)
Long-term capital lease obligations	$ 603,897

Operating Leases — The Board has entered into several operating leases to secure office, training, data center, and warehouse space. Minimum annual payments under the multi-year operating leases having an initial or remaining noncancelable lease term in excess of one year at December 31, 2013, are as follows:

Years Ended December 31,	
2014	$ 15,315,273
2015	24,172,153
2016	26,260,510
2017	27,067,576
After 2017	138,751,173
	$231,566,685

Rental expenses under the multi-year operating leases were $13,978,000 and $13,553,000 for the years ended December 31, 2013 and 2012, respectively. The Board entered into four operating leases in 2013, which are reflected in the schedule above. The Board entered into a new operating lease in early 2014. The estimated future minimum lease payments associated with the new lease total $1,068,000 over a ten year period, which is not reflected in the schedule above.

The Board leases and subleases space, primarily to other governmental agencies. The revenues collected for these leases from governmental agencies were $508,000 and $480,000 in 2013 and 2012.

Deferred Rent — Other long-term liabilities include deferred rent of $21,783,000 and $20,924,000 as of the years ended December 31, 2013 and 2012, respectively. The Board recorded non-cash lease incentives of $1,322,000 and $563,000 for the years ended December 31, 2013 and 2012, respectively.

(6) Retirement Benefits

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (the System Plan). The System Plan provides retirement benefits to employees of the Board, the Reserve Banks, the Office of Employee Benefits of the Federal Reserve System (OEB), and certain employees of the Bureau. The Federal Reserve Bank of New York (FRBNY), on behalf of the System, recognizes the net assets and costs associated with the System Plan in its financial statements. Costs associated with the System Plan were not redistributed to the Board during the years ended December 31, 2013 and 2012.

Employees of the Board who became employed prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who became employed after 1983 are covered by a non-contributory defined benefits program under the System Plan. FRBNY, on behalf of the System, funded $900 million and $780 million during the years ended December 31, 2013 and 2012, respectively. The Board was not assessed a contribution for 2013 or 2012.

Board employees covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan due to limitations imposed by the Inter-

nal Revenue Code. Activity for the BEP as of December 31, 2013 and 2012, is summarized in the following tables:

	2013	2012
Change in projected benefit obligation:		
Benefit obligation – beginning of year	$ 15,152,833	$ 14,147,186
Service cost	1,361,346	2,100,366
Interest cost	656,007	867,002
Plan participants' contributions	–	–
Actuarial (gain) loss	(4,473,905)	(1,928,409)
Gross benefits paid	(22,389)	(33,312)
Benefit obligation – end of year	$ 12,673,892	$ 15,152,833
Accumulated benefit obligation – end of year	$ 1,699,943	$ 3,149,276
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	5.26 %	4.25 %
Rate of compensation increase	4.50 %	4.50 %
Change in plan assets:		
Fair value of plan assets – beginning of year	$ –	$ –
Employer contributions	22,389	33,312
Plan participants' contributions	–	–
Gross benefits paid	(22,389)	(33,312)
Fair value of plan assets – end of year	$ –	$ –
Funded status:		
Reconciliation of funded status – end of year:		
Fair value of plan assets	$ –	$ –
Benefit obligation (current)	55,061	97,085
Benefit obligation (noncurrent)	12,618,831	15,055,748
Funded status	(12,673,892)	(15,152,833)
Amount recognized – end of year	$(12,673,892)	$(15,152,833)
Amounts recognized in the balance sheets consist of:		
Asset	$ –	$ –
Liability – current	(55,061)	(97,085)
Liability – noncurrent	(12,618,831)	(15,055,748)
Net amount recognized	$(12,673,892)	$(15,152,833)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ (1,534,296)	$ 2,939,609
Prior service cost (credit)	521,188	620,967
Net amount recognized	$ (1,013,108)	$ 3,560,576

Expected cash flows:	
Expected employer contributions – 2014	$ 55,061
Expected benefit payments:*	
2014	$ 55,061
2015	$ 60,238
2016	$ 78,421
2017	$ 99,944
2018	$110,329
2019–2023	$971,366

* Expected benefit payments to be made by the Board.

	2013	2012
Components of net periodic benefit cost:		
Service cost	$ 1,361,346	$ 2,100,366
Interest cost	656,007	867,002
Expected return on plan assets	–	–
Amortization:		
Actuarial (gain) loss	–	667,775
Prior service (credit) cost	99,779	78,985
Net periodic benefit cost (credit)	$ 2,117,132	$ 3,714,128
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	4.25 %	4.50 %
Rate of compensation increase	4.50 %	5.00 %
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year actuarial (gain) loss	$(4,473,905)	$(1,928,409)
Amortization of prior service credit (cost)	(99,779)	(78,985)
Amortization of actuarial gain (loss)	–	(667,775)
Total recognized in other comprehensive (income) loss	$(4,573,684)	$(2,675,169)
Total recognized in net periodic benefit cost and other comprehensive income	$(2,456,552)	$ 1,038,959

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2014 are shown below:

Net actuarial (gain) loss	$(25,667)
Prior service (credit) cost	99,578
Total	$ 73,911

The Board also provides another non-qualified plan for officers of the Board. The retirement benefits covered under the Pension Enhancement Plan (PEP) increase the pension benefit calculation from 1.8% above the Social Security integration

level to 2.0%. Activity for the PEP as of December 31, 2013 and 2012, is summarized in the following tables:

	2013	2012
Change in projected benefit obligation:		
Benefit obligation – beginning of year	$ 18,440,730	$ 13,250,209
Service cost	795,619	684,473
Interest cost	821,785	750,474
Plan participants' contributions	–	–
Actuarial (gain) loss	(2,312,328)	3,856,673
Gross benefits paid	(152,139)	(101,099)
Benefit obligation – end of year	$ 17,593,667	$ 18,440,730
Accumulated benefit obligation – end of year	$ 14,172,160	$ 14,766,590
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	5.06 %	4.00 %
Rate of compensation increase	4 .50 %	4.50 %
Change in plan assets:		
Fair value of plan assets – beginning of year	$ –	$ –
Employer contributions	152,139	101,099
Plan participants' contributions	–	–
Gross benefits paid	(152,139)	(101,099)
Fair value of plan assets – end of year	$ –	$ –
Funded status:		
Reconciliation of funded status – end of year:		
Fair value of plan assets	$ –	$ –
Benefit obligation – current	240,788	97,867
Benefit obligation – noncurrent	17,352,879	18,342,863
Funded status	(17,593,667)	(18,440,730)
Amount recognized – end of year	$(17,593,667)	$(18,440,730)
Amounts recognized in the balance sheets consist of:		
Asset	$ –	$ –
Liability – current	(240,788)	(97,867)
Liability – noncurrent	(17,352,879)	(18,342,863)
Net amount recognized	$(17,593,667)	$(18,440,730)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 5,314,468	$ 8,514,540
Prior service cost (credit)	1,649,093	2,180,488
Net amount recognized	$ 6,963,561	$ 10,695,028

Expected cash flows:	
Expected employer contributions – 2014	$ 240,788
Expected benefit payments:*	
2014	$ 240,788
2015	$ 318,244
2016	$ 399,161
2017	$ 483,738
2018	$ 576,898
2019–2023	$4,398,804

* Expected benefit payments to be made by the Board.

	2013	2012
Components of net periodic benefit cost:		
Service cost	$ 795,619	$ 684,473
Interest cost	821,785	750,474
Expected return on plan assets	–	–
Amortization:		
Actuarial (gain) loss	887,744	758,925
Prior service (credit) cost	531,395	531,395
Net periodic benefit cost (credit)	$ 3,036,543	$2,725,267
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	4.00 %	4.50 %
Rate of compensation increase	4.50 %	5.00 %
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year actuarial (gain) loss	$(2,312,328)	$3,856,673
Amortization of prior service credit (cost)	(531,395)	(531,395)
Amortization of actuarial gain (loss)	(887,744)	(758,925)
Total recognized in other comprehensive (income) loss	$(3,731,467)	$2,566,353
Total recognized in net periodic benefit cost and other comprehensive income	$ (694,924)	$5,291,620

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2014 are shown below:

Net actuarial (gain) loss	$387,019
Prior service (credit) cost	531,395
Total	$918,414

The total accumulated retirement benefit obligation includes a liability for a supplemental retirement agreement and a benefits equalization plan under the Federal Reserve System's Thrift Plan. The total obligation as of December 31, 2013 and 2012 is summarized in the following table:

	2013	2012
Retirement benefit obligation:		
Benefit obligation – BEP	$12,673,892	$15,152,833
Benefit obligation – PEP	17,593,667	18,440,730
Additional benefit obligations	157,857	146,747
Total accumulated retirement benefit obligation	$30,425,416	$33,740,310

A relatively small number of Board employees participate in the Civil Service Retirement System or the Federal Employees' Retirement System. These defined benefit plans are administered by the U.S. Office of Personnel Management, which determines the required employer contribution levels. The Board's contributions to these plans totaled $778,000 and $586,000 in 2013 and 2012, respectively. The Board has no liability for future payments to retirees under these programs and is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan or Roth 401(k). Board contributions to members' accounts were $20,288,000 and $19,211,000 in 2013 and 2012, respectively.

(7) Postretirement Benefits

The Board provides certain life insurance programs for its active employees and retirees. Activity as of December 31, 2013 and 2012, is summarized in the following tables:

	2013	2012
Change in benefit obligation:		
Benefit obligation – beginning of year	$ 13,249,648	$ 11,799,079
Service cost	219,222	210,030
Interest cost	533,435	534,224
Plan participants' contributions	–	–
Actuarial (gain) loss	(1,971,254)	1,055,530
Gross benefits paid	(337,740)	(349,215)
Benefit obligation – end of year	$ 11,693,311	$ 13,249,648
Weighted-average assumptions used to determine benefit obligation as of December 31 – discount rate	4 .97 %	4.00 %
Change in plan assets:		
Fair value of plan assets – beginning of year	$ –	$ –
Employer contributions	337,740	349,215
Gross benefits paid	(337,740)	(349,215)
Fair value of plan assets – end of year	$ –	$ –
Funded status:		
Reconciliation of funded status – end of year:		
Fair value of plan assets	$ –	$ –
Benefit obligation – current	398,868	345,021
Benefit obligation – noncurrent	11,294,443	12,904,627
Funded status	(11,693,311)	(13,249,648)
Amount recognized – end of year	$(11,693,311)	$(13,249,648)
Amounts recognized in the balance sheets consist of:		
Asset	$ –	$ –
Liability – current	(398,868)	(345,021)
Liability – noncurrent	(11,294,443)	(12,904,627)
Net amount recognized	$(11,693,311)	$(13,249,648)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 1,500,562	$ 3,802,439
Prior service cost (credit)	(200,064)	(225,554)
Net amount recognized	$ 1,300,498	$ 3,576,885

Expected cash flows:	
Expected employer contributions – 2014	$ 398,868
Expected benefit payments:*	
2014	$ 398,868
2015	$ 426,704
2016	$ 458,916
2017	$ 489,011
2018	$ 504,713
2019–2023	$2,989,203

* Expected benefit payments to be made by the Board.

	2012	2011
Components of net periodic benefit cost:		
Service cost	$ 219,222	$ 210,030
Interest cost	533,435	534,224
Expected return on plan assets	–	–
Amortization:		
Actuarial (gain) loss	330,623	233,256
Prior service (credit) cost	(25,490)	(25,490)
Net periodic benefit cost (credit)	$ 1,057,790	$ 952,020
Weighted-average assumptions used to determine net periodic benefit cost – discount rate	4.00 %	4.50 %
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year actuarial (gain) loss	$(1,971,254)	$1,055,530
Amortization of prior service credit (cost)	25,490	25,490
Amortization of actuarial gain (loss)	(330,623)	(233,256)
Total recognized in other comprehensive (income) loss	$(2,276,387)	$ 847,764
Total recognized in net periodic benefit cost and other comprehensive income	$(1,218,597)	$1,799,784

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2014 are shown below:

Net actuarial (gain) loss	$ 46,594
Prior service (credit) cost	(25,490)
Total	$ 21,104

(8) Postemployment Benefits

The Board provides certain postemployment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. Postemployment costs were actuarially determined using a December 31 measurement date and discount rates of 3.43% and 2.50% as of December 31, 2013 and 2012, respectively. The net periodic postemployment benefit cost (credit) recognized by the Board as of December 31, 2013 and 2012, was ($217,000) and $518,000, respectively.

(9) Accumulated Other Comprehensive Income (Loss)

A reconciliation of beginning and ending balances of accumulated other comprehensive income (loss) for the years ended December 31, 2013 and 2012, is as follows:

	Amount Related to Defined Benefit Retirement Plans	Amount Related to Postretirement Benefits Other Than Pensions	Total Accumulated Other Comprehensive Income (Loss)
Balance – January 1, 2012	$(14,364,420)	$(2,729,122)	$(17,093,542)
Change in accumulated other comprehensive income (loss):			
Net actuarial gain (loss) arising during the year[a]	(1,928,264)	(1,055,530)	(2,983,794)
Other comprehensive income before reclassifications	(1,928,264)	(1,055,530)	(2,983,794)
Amortization of prior service (credit) costs[a][b]	610,380	(25,490)	584,890
Amortization of net actuarial (gain) loss[a][b]	1,426,700	233,256	1,659,956
Amounts reclassified from accumulated other comprehensive income	2,037,080	207,766	2,244,846
Change in accumulated other comprehensive income (loss)	108,816	(847,764)	(738,948)
Balance – December 31, 2012	(14,255,604)	(3,576,886)	(17,832,490)
Change in accumulated other comprehensive income (loss):			
Net actuarial gain (loss) arising during the year[a]	6,786,233	1,971,254	8,757,487
Other comprehensive income before reclassifications	6,786,233	1,971,254	8,757,487
Amortization of prior service (credit) costs[a][b]	631,174	(25,490)	605,684
Amortization of net actuarial (gain) loss[a][b]	887,744	330,623	1,218,367
Amounts reclassified from accumulated other comprehensive income	1,518,918	305,133	1,824,051
Change in accumulated other comprehensive income (loss)	8,305,151	2,276,387	10,581,538
Balance – December 31, 2013	$ (5,950,453)	$(1,300,499)	$ (7,250,952)

[a] These components of accumulated other comprehensive income are included in the computation of net periodic pension cost (see Notes 6 and 7 for additional details).

[b] These components of accumulated other comprehensive income are reflected in the "Retirement, insurance, and benefits" line on the Statements of Operations.

(10) Reserve Banks

The Board performs certain functions for the Reserve Banks in conjunction with its responsibilities for the System, and the Reserve Banks provide certain administrative functions for the Board. The Board assesses the Reserve Banks for its operating expenses, to include expenses related to its currency responsibilities, as well as for the funding the Board is required to provide to the Bureau and the Office.

Activity related to the Board and Reserve Banks is summarized in the following table:

	2013	2012
For the years ended December 31:		
Assessments levied or to be levied on Reserve Banks for:		
Currency expenses	$ 705,030,765	$ 721,074,064
Board operations	580,000,000	490,000,000
Transfers of funds to the Bureau	563,200,000	385,200,000
Transfers of funds to the Office	–	2,078,298
Total assessments levied or to be levied on Reserve Banks	$1,848,230,765	$1,598,352,362
Board expenses charged to the Reserve Banks for data processing and office space	$ 417,324	$ 423,209
Reserve Bank expenses charged to the Board:		
Data processing and communication	$ 861,671	$ 1,313,902
Office space	1,289,714	–
Contingency site	1,262,616	1,191,220
Total Reserve Bank expenses charged to the Board	$ 3,414,001	$ 2,505,122
Net transactions with Reserve Banks	$1,845,234,088	$1,596,270,449
As of the years ended December 31:		
Accounts receivable due from the Reserve Banks	$ 5,496,852	$ 751,614
Accounts payable due to the Reserve Banks	$ 1,000,923	$ 334,665

The Board contracted for audit services on behalf of entities that are included in the combined financial statements of the Reserve Banks. The entities reimburse the Board for the cost of the audit services. The Board accrued liabilities of $47,000 and $185,000 in audit services and recorded net receivables of $47,000 and $170,000 from the entities as of December 31, 2013 and 2012, respectively.

The OEB administers certain System benefit programs on behalf of the Board and the Reserve Banks, and costs associated with the OEB's activities are assessed to the Board and Reserve Banks. The Board was assessed $2,402,000 and $2,530,000 for the years ended December 31, 2013 and 2012, respectively.

(11) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the Council), and currently performs certain management functions for the Council. The five agencies that are represented on the Council are the Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and the Bureau.

The Board's financial statements do not include financial data for the Council. Activity related to the Board and Council is summarized in the following table:

	2013	2012
For the years ended December 31:		
Council expenses charged to the Board:		
Assessments for operating expenses	$ 141,111	$ 137,466
Assessments for examiner education	988,233	1,043,917
Central Data Repository	1,049,787	1,111,793
Home Mortgage Disclosure Act/Community Reinvestment Act	717,177	753,464
Uniform Bank Performance Report	134,977	132,294
Total Council expenses charged to the Board	$3,031,285	$3,178,934
Board expenses charged to the Council:		
Data processing related services	$4,233,290	$4,392,625
Administrative services	223,000	261,000
Total Board expenses charged to the Council	$4,456,290	$4,653,625
As of the years ended December 31:		
Accounts receivable due from the Council	$ 442,749	$ 545,770
Accounts payable due to the Council	$ 326,875	$ 211,061

(12) The Bureau of Consumer Financial Protection

Beginning July 2011, section 1017 of the Dodd-Frank Act requires the Board to fund the Bureau from the combined earnings of the System, in an amount determined by the Director of the Bureau to be reasonably necessary to carry out the authorities of the Bureau under Federal consumer financial law, taking into account such other sums made available to the Bureau from the preceding year (or quarter of such year). The Dodd-Frank Act limits the amount to be transferred each fiscal year to a fixed percentage of the System's total operating expenses. The Board received and processed funding requests for the Bureau totaling $563,200,000 and $385,200,000 during calendar years 2013 and 2012, respectively. The Bureau transferred to the Board funding for the operations of the OIG of $10 million and $3 million in 2013 and 2012, respectively. Beginning in 2014, the Bureau's funding share of OIG operations will be adjusted based on actual OIG expenses and work allocation from the previous year. The Board accrued a liability of $1.84 million as of December 31, 2013, which will be applied to subsequent Bureau transfers.

As part of the transfer of responsibilities from the Board to the Bureau, certain Board staff were transferred to the Bureau during 2011. The Board continued to administer certain non-retirement benefits for all transferred Board employees through July 20, 2012.

(13) The Office of Financial Research

Section 155(c) of the Dodd-Frank Act requires the Board to provide an amount sufficient to cover the expenses of the Office for the two-year period following the date of the enactment (July 21, 2010). The expenses of the FSOC are included in the expenses of the Office. The Board received and processed funding requests for the Office totaling $42,000,000 during 2012. At the end of the two-year period in 2012, the Office returned $39,921,702 to the Board which was returned to the Reserve Banks.

(14) Currency

The Bureau of Engraving and Printing (BEP) is the sole supplier for currency printing and also provides currency retirement services. The Board provides or contracts for other services associated with currency, such as shipping, education, and quality assurance. The currency costs incurred by the Board for the years ended December 31, 2013 and 2012, are reflected in the following table:

	2013	2012
Expenses related to BEP services:		
Printing	$660,957,789	$687,704,624
Retirement	3,081,392	3,132,105
Subtotal related to BEP services	$664,039,181	$690,836,729
Other currency expenses:		
Shipping	$ 20,732,476	$ 17,179,610
Research and development	5,393,220	5,316,005
Quality assurance services	11,284,687	7,259,900
Education services	3,581,201	481,820
Subtotal other currency expenses	$ 40,991,584	$ 30,237,335
Total currency expenses	$705,030,765	$721,074,064

(15) Commitments and Contingencies

Commitments — The Board has entered into an agreement with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, through the Council, to fund a portion of the enhancements and maintenance fees for a central data repository project that requires maintenance through 2019 with two one-year option periods. The estimated Board expense to support this effort is $5 to $6 million.

Litigation and Contingent Liabilities — The Board is subject to contingent liabilities which arise from litigation cases and various business contracts. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available to management, it is management's opinion that the expected outcome of these matters, in the aggregate, will not have a material adverse effect on the financial statements.

(16) Subsequent Events

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2013. Subsequent events were evaluated through March 12, 2014, which is the date the financial statements were available to be issued.

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Governors of the Federal Reserve System:

We have audited, in accordance with auditing standards generally accepted in the United States of America, auditing standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Board of Governors of the Federal Reserve System (the "Board") as of and for the years ended December 31, 2013 and 2012, and the related notes to the financial statements. We have also audited, in accordance with attestation standards established by the American Institute of Certified Public Accountants and in accordance with the auditing standards of the PCAOB, the Board's internal control over financial reporting as of December 31, 2013, based on the criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. We have issued our report on the aforementioned audits dated March 12, 2014.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Board's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Board's compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

March 12, 2014
Washington, DC

Federal Reserve Banks Combined Financial Statements

The combined financial statements of the Federal Reserve Banks were audited by Deloitte & Touche LLP, independent auditors, for the years ended December 31, 2013 and 2012.

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 financial statements of the Federal Reserve Banks (the "Reserve Banks"), which are comprised of the combined statements of condition as of December 31, 2013 and 2012, and the related combined statements of income and comprehensive income, and changes in capital for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles established by the Board of Governors of the Federal Reserve System (the "Board") as described in Note 3 to the combined financial statements; this includes determining that the basis of accounting established by the Board is an acceptable basis for the preparation of the combined financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fair presentation of the combined financial statements of the Federal Reserve Banks' in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Federal Reserve Banks' internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

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

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Reserve Banks as of December 31, 2013 and 2012, and the results of their operations for the years then ended in accordance with the basis of accounting described in Note 3 to the combined financial statements.

Basis of Accounting

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

Deloitte & Touche LLP

March 14, 2014
Washington, DC

Federal Reserve Banks

Abbreviations

ABS	Asset-backed securities
ACH	Automated clearinghouse
AIG	American International Group, Inc.
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
FAM	*Financial Accounting Manual for Federal Reserve Banks*
FASB	Financial Accounting Standards Board
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
FOMC	Federal Open Market Committee
FRBA	Federal Reserve Bank of Atlanta
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
JPMC	JPMorgan Chase & Co.
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
OFR	Office of Financial Research
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
STRIPS	Separate Trading of Registered Interest and Principal of Securities
TALF	Term Asset-Backed Securities Loan Facility
TBA	To be announced

TDF	Term Deposit Facility
TRS	Total return swap
VIE	Variable interest entity

Federal Reserve Banks Combined Statements of Condition as of December 31, 2013 and December 31, 2012
(in millions)

	2013	2012
Assets		
Gold certificates	$ 11,037	$ 11,037
Special drawing rights certificates	5,200	5,200
Coin	1,955	2,108
Loans:		
Depository institutions	74	70
Term Asset-Backed Securities Loan Facility (measured at fair value)	98	560
System Open Market Account:		
Treasury securities, net (of which $17,153 and $9,139 is lent as of December 31, 2013 and 2012, respectively)	2,359,434	1,809,188
Government-sponsored enterprise debt securities, net (of which $1,099 and $697 is lent as of December 31, 2013 and 2012, respectively)	59,122	79,479
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,533,860	950,321
Foreign currency denominated assets, net	23,724	24,873
Central bank liquidity swaps	272	8,889
Accrued interest receivable	23,493	19,031
Other investments	2	23
Investments held by consolidated variable interest entities (of which $1,774 and $2,266 is measured at fair value as of December 31, 2013 and 2012, respectively)	1,926	2,750
Bank premises and equipment, net	2,653	2,676
Items in process of collection	165	216
Other assets	1,134	713
Total assets	$4,024,149	$2,917,134
Liabilities and capital		
Federal Reserve notes outstanding, net	$1,197,920	$1,126,661
System Open Market Account:		
Securities sold under agreements to repurchase	315,924	107,188
Other liabilities	1,331	3,177
Consolidated variable interest entities:		
Beneficial interest in consolidated variable interest entities (measured at fair value)	116	803
Other liabilities (of which $73 and $71 is measured at fair value as of December 31, 2013 and 2012, respectively)	158	415
Deposits:		
Depository institutions	2,249,070	1,491,045
Treasury, general account	162,399	92,720
Other deposits	34,150	33,903
Interest payable to depository institutions	99	199
Accrued benefit costs	1,823	3,964
Deferred credit items	1,127	702
Accrued remittances to Treasury	4,791	1,407
Other liabilities	227	230
Total liabilities	3,969,135	2,862,414
Capital paid-in	27,507	27,360
Surplus (including accumulated other comprehensive loss of $2,556 and $4,845 at December 31, 2013 and 2012, respectively)	27,507	27,360
Total capital	55,014	54,720
Total liabilities and capital	$4,024,149	$2,917,134

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, 2013 and December 31, 2012
(in millions)

	2013	2012
Interest income		
Loans:		
Term Asset-Backed Securities Loan Facility	$ 6	$ 80
System Open Market Account:		
Treasury securities, net	51,591	46,416
Government-sponsored enterprise debt securities, net	2,166	2,626
Federal agency and government-sponsored enterprise mortgage-backed securities, net	36,628	31,429
Foreign currency denominated assets, net	96	139
Central bank liquidity swaps	22	241
Other investments	–	9
Investments held by consolidated variable interest entities	6	1,110
Total interest income	90,515	82,050
Interest expense		
System Open Market Account:		
Securities sold under agreements to repurchase	60	142
Beneficial interest in consolidated variable interest entities	–	153
Deposits:		
Depository institutions	5,212	3,871
Term Deposit Facility	11	4
Total interest expense	5,283	4,170
Net interest income	85,232	77,880
Non-interest income		
System Open Market Account:		
Treasury securities gains, net	–	13,255
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	51	241
Foreign currency translation losses, net	(1,257)	(1,116)
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities gains, net	183	7,451
Beneficial interest in consolidated variable interest entities gains (losses), net	1	(2,345)
Income from services	441	449
Reimbursable services to government agencies	530	506
Other	76	35
Total non-interest income	25	18,476
Operating expenses		
Salaries and benefits	3,225	3,084
Occupancy	314	314
Equipment	169	193
Other	563	597
Assessments:		
Board of Governors operating expenses and currency costs	1,282	1,212
Bureau of Consumer Financial Protection	563	385
Office of Financial Research	–	2
Total operating expenses	6,116	5,787
Net income before providing for remittances to Treasury	79,141	90,569
Earnings remittances to Treasury	79,633	88,418
Net (loss) income	(492)	2,151
Change in prior service costs related to benefit plans	97	171
Change in actuarial gains (losses) related to benefit plans	2,192	(224)
Total other comprehensive income (loss)	2,289	(53)
Comprehensive income	$ 1,797	$ 2,098

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, 2013 and December 31, 2012
(in millions, except share data)

	Capital paid-in	Surplus			Total capital
		Net income retained	Accumulated other comprehensive loss	Total surplus	
Balance at December 31, 2011 (537,984,621 shares)	$26,899	$31,691	$(4,792)	$26,899	$53,798
Net change in capital stock issued (9,210,524 shares)	461	–	–	–	461
Comprehensive income:					
Net income	–	2,151	–	2,151	2,151
Other comprehensive loss	–	–	(53)	(53)	(53)
Dividends on capital stock	–	(1,637)	–	(1,637)	(1,637)
Net change in capital	461	514	(53)	461	922
Balance at December 31, 2012 (547,195,145 shares)	$27,360	$32,205	$(4,845)	$27,360	$54,720
Net change in capital stock issued (2,941,791 shares)	147	–	–	–	147
Comprehensive income:					
Net loss	–	(492)	–	(492)	(492)
Other comprehensive income	–	–	2,289	2,289	2,289
Dividends on capital stock	–	(1,650)	–	(1,650)	(1,650)
Net change in capital	147	(2,142)	2,289	147	294
Balance at December 31, 2013 (550,136,936 shares)	$27,507	$30,063	$(2,556)	$27,507	$55,014

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

(1) Structure

The 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, U.S. offices of foreign banking organizations, and designated financial market utilities pursuant to authority delegated by the Board of Governors. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

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

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

To counter disorderly conditions in foreign exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities, the FOMC has authorized and directed the FRBNYto execute spot and forward foreign exchange transactions in 14 foreign currencies, to hold balances in those currencies, and to invest such foreign currency holdings, while maintaining adequate liquidity. The FOMC has also authorized the FRBNY to maintain reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico in the maximum amounts of $2 billion and $3 billion, respectively, and to warehouse foreign currencies for the Treasury and the Exchange Stabilization Fund in the maximum amount of $5 billion.

Because of the global character of bank funding markets, the System has at times coordinated with other central banks to provide liquidity. The FOMC authorized and directed the FRBNY to establish temporary U.S. dollar liquidity swap lines with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. In addition, as a contingency measure, the FOMC authorized and directed the FRBNY to establish temporary foreign currency liquidity swap arrangements with these five central banks to allow for the System to access liquidity, if necessary, in any of the foreign central banks' currencies. On October 31, 2013, the Federal Reserve and these five central banks agreed to convert their existing temporary liquidity swap arrangements to standing agreements which will remain in effect until further notice.

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

(3) Significant Accounting Policies

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* (FAM), which is issued by the Board of Governors. The Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the FAM. The 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, adjusted for credit impairment, if any, and the recording of all 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 ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities. Accounting for these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, better reflects the timing of the transaction's effect on the quantity of reserves in the banking system. The cost bases of Treasury securities, GSE debt securities, and foreign government debt instruments are adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP.

In addition, the 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 combined financial statements. Other than those described above, there are no significant differences between the policies outlined in the FAM and GAAP.

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

In 2013, the description of certain line items presented in the Combined Statements of Income and Comprehensive Income and the Combined Statements of Condition have been revised to better reflect the nature of these items. Amounts related to these line items were not changed from the prior year, only the nomenclature for the line item was revised, as further noted below:

- The line item, "Accrued interest on Federal Reserve notes," has been revised in the Combined Statements of Condition to "Accrued remittances to Treasury."
- The line item, "Net income before interest on Federal Reserve notes expense remitted to Treasury," has been revised in the Combined Statements of Income and Comprehensive Income to "Net income before providing for remittances to Treasury."

- The line item, “Interest on Federal Reserve notes expense remitted to Treasury,” has been revised in the Combined Statements of Income and Comprehensive Income to “Earnings remittances to Treasury.”

Certain amounts relating to the prior year have been reclassified in the Combined Statements of Condition to conform to the current year presentation. The amount reported as “System Open Market Account: Accrued interest receivable” for the year ended December 31, 2012 ($19,031 million) was previously reported as a component of “System Open Market Account: Foreign currency denominated assets, net” ($99 million) and “Accrued interest receivable” ($18,932 million).

Certain immaterial amounts relating to the prior year have been reclassified in the Combined Statements of Income and Comprehensive Income to conform to the current year presentation. $34 million previously reported for the year ended December 31, 2012 as “Non-interest income: Term Asset-Back Securities Loan Facility, unrealized losses” have been reclassified to “Non-interest income: Other,” and $25 million previously reported as “Operating expenses: Professional fees related to consolidated variable interest entities” have been reclassified to “Operating expenses: Other.”

Significant accounts and 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 Maiden Lane LLC (ML), Maiden Lane II LLC (ML II), Maiden Lane III LLC (ML III), 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. See Note 6 for additional information on the VIEs. The combined financial statements of the Reserve Banks also include accounts and results of operations of Maiden and Nassau LLC, a Delaware limited liability company (LLC) wholly-owned by the Bank, which was formed to own and operate the 33 Maiden Lane building, which was purchased on February 28, 2012.

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 or if there is an event that requires consideration.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the Bureau of Consumer Financial Protection (Bureau) as an independent bureau within the System that has supervisory authority over some institutions previously supervised by the Reserve Banks in connection with those institutions’ compliance with consumer protection statutes. Section 1017 of the Dodd-Frank Act provides that the financial statements of the Bureau are not to be consolidated with those of the Board of Governors or the

System. The Board of Governors funds the Bureau through assessments on the Reserve Banks as required by the Dodd-Frank Act. Section 152 of the Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury and required the Board of Governors to fund the OFR for the two-year period ended July 21, 2012. 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' comibined financial statements.

b. Gold and Special Drawing Rights Certificates

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

Special drawing rights (SDR) are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange-stabilization operations. At the time SDR certificate transactions occur, the Board of Governors allocates the SDR certificates among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding calendar year. SDR certificates are recorded by the Banks at original cost. There were no SDR certificate transactions during the years ended December 31, 2013 and 2012.

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 has elected the fair value option for all Term Asset-Backed Securities Loan Facility (TALF) loans in accordance with ASC 825. Recording all TALF loans at fair value, rather than at the remaining principal amount outstanding, 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 6. Unrealized losses on TALF loans that are recorded at fair value are reported as a component of "Non-interest income: Other" 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 "Interest Income: Term Asset-Backed Securities Loan Facility" in the Combined Statements of Income and Comprehensive Income.

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 are due in accordance with the contractual terms of the loan agreement. Impaired loans are evaluated to determine whether an allowance for loan loss is required. The 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.

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

"System Open Market Account: Securities purchased under agreements to resell" and the related accrued interest receivable is reported as a component of "System Open Market Account: Accrued interest receivable" in the Combined Statements of Condition.

The FRBNY may engage in sales of securities under agreements to repurchase (reverse repurchase transactions) with primary dealers and with the set of expanded counterparties which includes banks, savings associations, GSEs, and domestic money market funds. These reverse repurchase transactions, when arranged as open market operations, are settled through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international account holders as part of a service offering. Reverse repurchase agreements are collateralized by a pledge of an amount of Treasury securities, GSE debt securities, 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, typically overnight, to facilitate the effective functioning of the domestic securities markets. The amortized cost basis of securities lent continues to be reported as "Treasury securities, net" and "Government-sponsored enterprise debt securities, net," as appropriate, in the Combined Statements of Condition. Securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNYcharges 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.

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 included in 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 or accreted over the term of the security to stated maturity, and the amortization of premiums and accretion of discounts are accelerated when principal payments are received. Gains and losses resulting from sales of securities are determined by specific issue based on average cost. Treasury securities, GSE debt securities, and federal agency and GSE MBS are reported net of premiums and discounts in the 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. During the years ended December 31, 2013 and 2012, the FRBNY executed dollar rolls primarily to facilitate settlement of outstanding purchases of federal agency and GSE MBS. The FRBNY accounts for dollar rolls as purchases or sales on a settlement-date basis. In addition, TBA MBS transactions may be paired off or assigned prior to settlement. Net gains resulting from these MBS transactions are reported as "Non-interest 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. Foreign currency translation gains and losses that result from the daily revaluation of foreign currency denominated assets are reported as "Non-interest income: System Open Market Account: Foreign currency translation losses, 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 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.

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 translation 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 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 consist primarily of cash and cash equivalents, short-term investments with maturities of greater than three months and less than one year, commercial mortgage loans, and swap contracts. 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:

- 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 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 asset-backed securities (ABS) investments and has elected the fair value option for all eligible assets in accordance with ASC 825.

i. Bank Premises, Equipment, and Software

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

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

j. Federal Reserve Notes

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

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize outstanding Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that 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 Reserve Banks' Federal Reserve notes outstanding, reduced by the Reserve Banks' currency holdings of $203 billion and $228 billion at December 31, 2013 and 2012, respectively.

At December 31, 2013 and 2012, all Federal Reserve notes outstanding, reduced by the Reserve Banks' currency holdings, were fully collateralized. At December 31, 2013, all gold certificates, all special drawing rights certificates, and $1,182 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2013, no investments denominated in foreign currencies were pledged as collateral.

k. Beneficial Interest in Consolidated Variable Interest Entities

ML and TALF LLC have outstanding financial interests, and ML II and ML III have outstanding senior and subordinated financial interests. 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.

l. Deposits

Depository Institutions

Depository institutions' deposits represent the reserve and service-related balances in the accounts that depository institutions hold at the Reserve Banks. The interest rates paid on required reserve balances and excess balances are determined by the Board of Governors, based on an FOMC-established target range for the federal funds rate. Interest payable is reported as a component of "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 a component of "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, 2013 and 2012.

Treasury

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

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.

m. 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 represents 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 fluctuate significantly.

n. Capital Paid-in

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

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

o. 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 9, 10, and 11.

p. Remittances to Treasury

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. Currently, remittances to Treasury are made on a weekly basis. This amount is reported as "Earnings remittances to Treasury" in the Combined Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued remittances to Treasury" in the Combined Statements of Condition. See Note 13 for additional information on remittances to Treasury.

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

q. 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 depositary of the United States Government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2013 and 2012, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

r. 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. The Board of Governors also assesses each Reserve Bank for expenses related to producing, issuing, and retiring Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

The Dodd-Frank Act requires that, after the transfer date of July 21, 2011, the Board of Governors fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the System as reported in the Board of Governors' 2009 annual report, which totaled $4.98 billion. The fixed percentage of total operating expenses of the System for the years ended December 31, 2013 and 2012 was 12 percent ($597.6 million) and 11 percent ($547.8 million), respectively. 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 assessed the Reserve Banks to fund the operations of the OFR for the two-year period ended July 21, 2012, following enactment of the Dodd-Frank Act; thereafter, the OFR is funded by fees assessed on bank holding companies and nonbank financial companies that meet the criteria specified in the Dodd-Frank Act.

s. 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 VIEs, 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 Banks' assumptions developed using the best information available in the circumstances (unobservable inputs). The three levels established by ASC 820 are described as follows:

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

t. 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 $48 million and $47 million for the years ended December 31, 2013 and 2012, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Combined Statements of Income and Comprehensive Income.

u. 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 12 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 7. 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 9. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 10.

v. Recently Issued Accounting Standards

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-11, *Balance Sheet* (Topic 210): *Disclosures about Offsetting Assets and Liabilities*. This update requires 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. In January 2013, the FASB issued ASU 2013-01, *Balance Sheet* (Topic 210): *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. This update clarifies that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815. These updates are effective for the Reserve Banks for the year ended December 31, 2013, and the required disclosures are included in Note 6.

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 deferred the requirements of ASU 2011-05, which required an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective net income line items. Subsequently, in February 2013, the FASB issued ASU 2013-02, *Comprehensive Income* (Topic 220): *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* which established an effective date for the requirements of ASU 2011-05 related to reporting of significant reclassification adjustments from accumulated other comprehensive income. This update

improves the transparency of changes in other comprehensive income and items reclassified out of accumulated other comprehensive income in the combined financial statements. These presentation requirements of ASU 2011-05 and required disclosures in ASU 2013-02 are effective for the Reserve Banks for the year ending December 31, 2013, and are reflected in the Bank's 2013 combined financial statements and Note 11.

In April 2013, the FASB issued ASU 2013-07, *Presentation of Financial Statements* (Topic 205): *Liquidation Basis of Accounting*. This update clarifies when entities in liquidation should apply the liquidation basis of accounting and provides guidance on financial statement presentation. This update is effective for an entity that determines liquidation is imminent during annual reporting periods beginning after December 15, 2013. During 2012, ML II and ML III sold their remaining portfolio assets; however, the financial statement presentations for ML II and ML III were not modified to the liquidation basis as the standard does not apply to entities whose liquidation follows a plan for liquidation that was specified in the entity's governing documents at inception.

In June 2013, the FASB issued ASU 2013-08, *Financial Services – Investment Companies* (Topic 946): *Amendments to the Scope, Measurement, and Disclosure Requirements*. This update changes the assessment of whether an entity is an investment company by developing a new two-tiered approach for that assessment, which requires an entity to possess certain fundamental characteristics while allowing judgment in assessing other typical characteristics. This update, which is applicable to ML II and ML III, is effective for the Bank for the year ending December 31, 2014 and is not expected to have a material effect on the Reserve Banks' combined financial statements.

(4) Loans

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 usingthe applicable interest rate established at least every 14 days by the Reserve Banks' board of directors, subject to review and determination by the Board of Governors. Primary and secondary loans are extended on a short-term basis, typically overnight, whereas seasonal loans may be extended for a period of up to nine months.

Primary, secondary, and seasonal loans are collateralized to the satisfaction of 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; 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. 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.

The remaining maturity distribution of loans to depository institutions outstanding as of December 31, 2013, and 2012, was as follows (in millions):

	Within 15 days	16 days to 90 days	Total
December 31, 2013	$69	$5	$74
December 31, 2012	$67	$3	$70

At December 31, 2013 and 2012, the Reserve Banks did not have any loans that were impaired, restructured, past due, or on non-accrual status, and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2013 and 2012.

TALF

The TALF assisted financial markets in accommodating the credit needs of consumers and businesses of all sizes by facilitating the issuance of ABS collateralized by a variety of consumer and business loans. Each TALF loan had an original maturity of three years, 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 had an original maturity of five years if the borrower so elected. The loans 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.

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 LLC, established for the purpose of purchasing such assets. As of December 31, 2013, 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 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 proved insufficient for the asset purchases that TALF LLC has committed to make under the put agreement, the Treasury originally committed to lend up to $20 billion, and on March 25, 2009, the Treasury funded $100 million. In addition to the Treasury's commitment, the FRBNY originally committed to lend up to $180 billion to TALF LLC if it needed the funding to purchase assets pursuant to the put agreement and provided that the Treasury had fully funded its commitment. Subsequently, the Treasury and FRBNY commitments to lend to TALF LLC were eliminated, because the cash equivalents and short-term investments held by TALF LLC exceeded the remaining amount of TALF loans outstanding, and the credit protection from the Treasury was no longer deemed necessary. The TALF remains a joint Treasury-Federal Reserve program, and the Treasury and Federal Reserve will continue to consult on the administration of the program.

TALF LLC has repaid in full the outstanding principal and accrued interest on the initial funding previously provided by the Treasury. The Board of Governors has also authorized TALF LLC to begin distributions from the accumulated fees and income earned by TALF LLC since inception to the Treasury and the FRBNY in the amount by which such accumulated fees and income exceeds the current out-

standing TALF loan balance plus funds reserved for future expenses of TALF LLC. Treasury receives 90 percent of the distributions and the FRBNY receives 10 percent.

As of December 31, 2013, TALF loans were classified within Level 2 of the valuation hierarchy. TALF loans were transferred from Level 3 to Level 2 because they were valued at December 31, 2013 using model-based techniques for which all significant inputs were considered observable (Level 2). Previously, TALF loans were valued using significant unobservable inputs (level 3).

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

	2013	2012
Level 2	$98	$ -
Level 3	-	560
Total fair value	$98	$560

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, 2013 and 2012 (in millions):

	TALF loans
Fair value at December 31, 2011	$ 9,059
Loan repayments and prepayments	(8,465)
Total realized and unrealized (losses)	(34)
Fair value at December 31, 2012	$ 560
Gross transfer out[1]	(560)
Fair value at December 31, 2013	$ -

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

The fair value of TALF loans reported in the Combined Statements of Condition as of December 31, 2013 and 2012, includes $1 million and $3 million in unrealized gains, respectively. The FRBNY attributes substantially all changes in fair value of loans to changes in instrument-specific credit spreads.

Eligible collateral includes U.S. dollar-denominated ABS that are backed by student loans, insurance premium financial loans, or commercial mortgage loans. The

following table presents the collateral concentration and remaining maturity distribution measured at fair value as of December 31, 2013 and 2012 (in millions):

Collateral type[1]	Time to maturity			
	Within 90 days	91 days to 1 year	Over 1 year to 5 years	Total
December 31, 2013:				
Student loan	$ -	$14	$ 33	$ 47
CMBS	-	51	-	51
Total	$ -	$65	$ 33	$ 98
December 31, 2012:				
Student loan	$ -	$ -	$382	$382
CMBS	3	-	129	132
Other[2]	46	-	-	46
Total	$49	$ -	$511	$560

1 All credit ratings are AAA unless otherwise indicated.
2 Includes insurance premium financial loans.

The aggregate remaining principal amount outstanding on TALF loans as of December 31, 2013 and 2012, was $97 million and $556 million, respectively.

At December 31, 2013 and 2012, no TALF loans were over 90 days past due or on nonaccrual status.

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 TALF LLC is presented in Note 6. The following table presents the components of TALF earnings recorded by the FRBNY for the years ended December 31 (in millions):

	2013	2012
Interest income	$ 6	$ 80
Unrealized gains (losses)	(3)	(34)
Subtotal – TALF loans	$ 3	$ 46
Allocated share of TALF LLC	-	(7)
Total TALF	$ 3	$ 39

(5) System Open Market Account

a. Domestic Securities Holdings

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

During the years ended December 31, 2013 and 2012, the FRBNY continued the purchase of Treasury securities and federal agency and GSE MBS under the large-scale asset purchase programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would reinvest principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In June 2012, the FOMC announced that it would continue the existing policy of reinvesting principal payments from the SOMA portfolio holdings of GSE debt securities and federal agency and GSE MBS in federal agency and GSE MBS. In September 2012, the FOMC announced that the Federal Reserve would purchase additional federal agency and GSE MBS at a pace of $40 billion per month. In December 2012, the FOMC announced that

the Federal Reserve would purchase longer-term Treasury securities initially at a pace of $45 billion per month after its program to extend the average maturity of its holdings of Treasury securities was completed at the end of 2012. In December 2012, the FOMC announced that the Federal Reserve would continue the policy of rolling over maturing Treasury securities into new issues at auction.

During the year ended December 31, 2012, the FRBNY also continued the purchase and sale of SOMA portfolio holdings under the maturity extension programs authorized by the FOMC. In September 2011, the FOMC announced that the Federal Reserve would extend the average maturity of the SOMA portfolio holdings of securities by purchasing $400 billion par value of Treasury securities with maturities of six to thirty years and selling or redeeming an equal par amount of Treasury securities with remaining maturities of three years or less by the end of June 2012. In June 2012, the FOMC announced that the Federal Reserve would continue through the end of 2012 its program to extend the average maturity of securities by purchasing $267 billion par value of Treasury securities with maturities of six to thirty years and selling or redeeming an equal par amount of Treasury securities with maturities of three and a quarter years or less by the end of 2012.

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):

	2013			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Notes	$1,467,427	$ 33,385	$ (5,697)	$1,495,115
Bonds	741,348	128,541	(5,570)	864,319
Total Treasury securities	$2,208,775	$161,926	$(11,267)	$2,359,434
GSE debt securities	$ 57,221	$ 1,903	$ (2)	$ 59,122
Federal agency and GSE MBS	$1,490,162	$ 44,781	$ (1,083)	$1,533,860

	2012			
	Par	Unamortized premiums	Unaccreted discounts	Total amortized cost
Notes	$1,110,398	$ 32,532	$(711)	$1,142,219
Bonds	555,747	111,360	(138)	666,969
Total Treasury securities	$1,666,145	$143,892	$(849)	$1,809,188
GSE debt securities	$ 76,783	$ 2,703	$ (7)	$ 79,479
Federal agency and GSE MBS	$ 926,662	$ 24,367	$(708)	$ 950,321

The FRBNY enters into transactions for the purchase of securities under agreements to resell and transactions to sell securities under agreements to repurchase as part of its monetary policy activities. In addition, transactions to sell securities under to repurchase agreements are entered into as part of a service offering to foreign official and international account holders.

There were no material transactions related to securities purchased under agreements to resell during the years ended December 31, 2013 and 2012. Financial

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

	2013	2012
Contract amount outstanding, end of year	$315,924	$107,188
Average daily amount outstanding, during the year	99,681	91,898
Maximum balance outstanding, during the year	315,924	122,541
Securities pledged (par value), end of year	310,452	93,547
Securities pledged (market value), end of year	314,901	107,188

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, 2013 and 2012 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
December 31, 2013:							
Treasury securities (par value)	$ -	$ 298	$ 176	$763,329	$864,700	$ 580,272	$2,208,775
GSE debt securities (par value)	2,310	7,568	8,666	36,268	62	2,347	57,221
Federal agency and GSE MBS (par value)[1]	-	-	-	5	2,549	1,487,608	1,490,162
Securities sold under agreements to repurchase (contract amount)	315,924	-	-	-	-	-	315,924
December 31, 2012:							
Treasury securities (par value)	$ -	$ 5	$ 16	$378,476	$862,410	$ 425,238	$1,666,145
GSE debt securities (par value)	1,565	2,795	15,202	52,830	2,044	2,347	76,783
Federal agency and GSE MBS (par value)[1]	-	-	2	1	2,365	924,294	926,662
Securities sold under agreements to repurchase (contract amount)	107,188	-	-	-	-	-	107,188

[1] The par amount shown for federal agency and GSE MBS is the remaining principal balance of the securities.

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities, which differs from the stated maturity primarily because it factors in scheduled payments and prepayment assumptions, was approximately 6.5 and 3.3 years as of December 31, 2013 and 2012, respectively.

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):

	2013	2012
Treasury securities (amortized costs)	$17,153	$9,139
Treasury securities (par value)	15,447	8,460
GSE debt securities (amortized cost)	1,099	697
GSE debt securities (par value)	1,055	676

The FRBNY enters into commitments to buy and sell Treasury securities and records the related securities on a settlement-date basis. As of December 31, 2013, there were no outstanding commitments.

The FRBNY enters into commitments to buy and sell federal agency and GSE MBS and records the related securities on a settlement-date basis. As of December 31, 2013, the total purchase price of the federal agency and GSE MBS under outstanding purchase commitments was $59,350 million, of which $479 million was related to dollar rolls. As of December 31, 2013, there were no outstanding sales commitments for federal agency and GSE MBS. These commitments, which had contractual settlement dates extending through February 2014, are for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to varying degrees of off-balance-sheet market risk and counterparty credit risk that result from their future settlement. The FRBNY requires the posting of cash collateral for commitments as part of the risk management practices used to mitigate the counterparty credit risk.

Other investments consist of cash and short-term investments related to the federal agency and GSE MBS portfolio. 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 obligation to pay for the securities when delivered. The amount of other investments and other liabilities held in the SOMA at December 31 was as follows (in millions):

	2013	2012
Other investments	$ 2	$ 23
Other liabilities:		
Cash margin	$1,320	$3,092
Obligations from MBS transaction fails	11	85
Total other liabilities	$1,331	$3,177

Accrued interest receivable on domestic securities holdings was $23,405 million and $18,924 million as of December 31, 2013 and 2012, respectively. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Combined Statements of Condition.

Information about transactions related to Treasury securities, GSE debt securities, and federal agency and GSE MBS during the years ended December 31, 2013 and 2012, is summarized as follows (in millions):

	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Balance December 31, 2011	$ 18,423	$1,311,917	$419,937	$1,750,277	$107,828	$ 848,258
Purchases[1]	118,886	397,999	263,991	780,876	-	431,487
Sales[1]	-	(507,420)	(11,727)	(519,147)	-	-
Realized gains, net[2]	-	12,003	1,252	13,255	-	-
Principal payments and maturities	(137,314)	(67,462)	-	(204,776)	(27,211)	(324,181)
Amortization of premiums and accretion of discounts, net	5	(5,461)	(7,531)	(12,987)	(1,138)	(5,243)
Inflation adjustment on inflation-indexed securities	-	643	1,047	1,690	-	-
Balance December 31, 2012	$ -	$1,142,219	$666,969	$1,809,188	$ 79,479	$ 950,321
Purchases[1]	-	358,656	206,208	564,864	-	864,538
Sales[1]	-	-	-	-	-	-
Realized gains, net[2]	-	-	-	-	-	-
Principal payments and maturities	-	(21)	-	(21)	(19,562)	(273,991)
Amortization of premiums and accretion of discounts, net	-	(6,024)	(9,503)	(15,527)	(795)	(7,008)
Inflation adjustment on inflation-indexed securities	-	285	645	930	-	-
Balance December 31, 2013	$ -	$1,495,115	$864,319	$2,359,434	$ 59,122	$1,533,860
Year ended December 31, 2012						
Supplemental information – par value of transactions:						
Purchases[3]	$ 118,892	$ 383,106	$205,115	$ 707,113	$ -	$ 413,160
Sales[3]	-	(492,234)	(9,094)	(501,328)	-	-
Year ended December 31, 2013						
Supplemental information – par value of transactions:						
Purchases[3]	$ -	$ 356,766	$184,956	$ 541,722	$ -	$ 837,490
Sales[3]	-	-	-	-	-	-

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

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

3 Includes inflation compensation.

b. Foreign Currency Denominated Assets

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

The FRBNY holds foreign currency deposits with foreign central banks and the Bank for International Settlements and invests in foreign government debt instruments of Germany, France, and Japan. These foreign government debt instruments are 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.

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

	2013	2012
Euro:		
Foreign currency deposits	$ 7,530	$ 8,925
Securities purchased under agreements to resell	2,549	659
German government debt instruments	2,397	2,133
French government debt instruments	2,397	2,421
Japanese yen:		
Foreign currency deposits	2,926	3,553
Japanese government debt instruments	5,925	7,182
Total	$23,724	$24,873

Accrued interest receivable on foreign currency denominated assets was $88 million and $99 million as of December 31, 2013 and 2012, respectively. These amounts are reported as a component of "System Open Market Account: Accrued interest receivable" in the Combined Statements of Condition.

The remaining maturity distribution of foreign currency denominated investments at December 31, 2013 and 2012, 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
December 31, 2013:					
Euro	$ 7,037	$1,803	$2,161	$3,872	$14,873
Japanese yen	3,116	380	1,870	3,485	8,851
Total	$10,153	$2,183	$4,031	$7,357	$23,724
December 31, 2012:					
Euro	$ 6,593	$1,726	$2,151	$3,668	$14,138
Japanese yen	3,801	490	2,138	4,306	10,735
Total	$10,394	$2,216	$4,289	$7,974	$24,873

There were no foreign exchange contracts related to open market operations outstanding as of December 31, 2013.

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, 2013, there were no outstanding commitments to purchase foreign government debt instruments During 2013, there were purchases, sales, and maturities of foreign government debt instruments of $3,539 million, $0, and $3,431 million, respectively.

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.

At December 31, 2013 and 2012, there was no balance outstanding under the authorized warehousing facility.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2013 and 2012.

Foreign currency working balances held and foreign exchange contracts executed by the Bank to facilitate its international payments and currency transactions it made on behalf of foreign central banks and U.S. official institution customers were not material as of December 31, 2013 and 2012.

c. 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, 2013 and 2012, was $272 million and $8,889 million, respectively.

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

	2013			2012		
	Within 15 days	16 days to 90 days	Total	Within 15 days	16 days to 90 days	Total
Euro	$113	$159	$272	$1,741	$7,147	$8,888
Japanese yen	-	-	-	1	-	1
Total	$113	$159	$272	$1,742	$7,147	$8,889

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2013 and 2012.

d. Fair Value of SOMA Assets

The fair value amounts below are presented solely for informational purposes. Although the fair value of SOMA security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities.

The fair value of the Treasury securities, GSE debt securities, federal agency and GSE MBS, and foreign government debt instruments in the SOMA's holdings is subject to market risk, arising from movements in market variables such as interest rates and credit risk. The fair value of federal agency and GSE MBS is also affected by the expected rate of prepayments of mortgage loans underlying the securities. The fair value of foreign government debt instruments is also affected by currency risk. Based on evaluations performed as of December 31, 2013, there are no credit impairments of SOMA securities holdings.

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

	2013			2012		
	Amortized cost	Fair value	Cumulative unrealized gains (losses)	Amortized cost	Fair value	Cumulative unrealized gains (losses)
Treasury securities:						
Notes	$1,495,115	$1,499,000	$ 3,885	$1,142,219	$1,213,177	$ 70,958
Bonds	864,319	842,336	(21,983)	666,969	761,138	94,169
Total Treasury securities	$2,359,434	$2,341,336	$(18,098)	$1,809,188	$1,974,315	$165,127
GSE debt securities	59,122	62,236	3,114	79,479	85,004	5,525
Federal agency and GSE MBS	1,533,860	1,495,572	(38,288)	950,321	993,990	43,669
Total domestic SOMA portfolio securities holdings	$3,952,416	$3,899,144	$(53,272)	$2,838,988	$3,053,309	$214,321
Memorandum – Commitments for:						
Purchases of Treasury securities	$ -	$ -	$ -	$ -	$ -	$ -
Purchases of Federal agency and GSE MBS	59,350	59,129	(221)	118,215	118,397	182
Sales of Federal agency and GSE MBS	-	-	-	-	-	-

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

At December 31, 2013 and 2012, the fair value of foreign currency denominated investments, was $23,802 million and $25,042 million, respectively. The fair value of government debt instruments was determined using pricing services that provide market consensus prices based on indicative quotes from various market participants. The fair value of foreign currency deposits and securities purchased under agreements to resell was determined by reference to market interest rates.

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

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	2013		2012	
	Amortized cost	Fair value	Amortized cost	Fair value
2.0%	$ 14,191	$ 13,529	$ 845	$ 846
2.5%	123,832	118,458	37,562	37,766
3.0%	521,809	484,275	160,613	161,757
3.5%	349,689	338,357	179,587	184,752
4.0%	230,256	231,113	137,758	145,955
4.5%	185,825	195,481	262,485	282,182
5.0%	83,290	87,968	125,107	132,213
5.5%	21,496	22,718	39,970	41,819
6.0%	3,051	3,225	5,642	5,888
6.5%	421	448	752	812
Total	$1,533,860	$1,495,572	$950,321	$993,990

Because SOMA securities are recorded at amortized cost, the change in the cumulative unrealized gains (losses) is not reported in the Combined Statements of Income and Comprehensive Income. The following table presents the realized gains and the change in the cumulative unrealized gains (losses), presented as "Fair value changes unrealized losses," of the domestic securities holdings during the years ended December 31, 2013 and 2012 (in millions):

	2013		2012	
	Total portfolio holdings realized gains[1]	Fair value changes unrealized losses	Total portfolio holdings realized gains[1]	Fair value changes unrealized losses
Treasury securities	$ -	$(183,225)	$13,255	$(1,142)
GSE debt securities	-	(2,411)	-	(885)
Federal agency and GSE MBS	51	(81,957)	241	(3,568)
Total	$51	$(267,593)	$13,496	$(5,595)

1 Total portfolio holdings realized gains are reported in "Non-interest income (loss): System Open Market Account" in the Combined Statements of Income and Comprehensive Income.

The amount of change in unrealized gains position, net, related to foreign currency denominated assets was a decrease of $90 million and an increase of $3 million for the years ended December 31, 2013 and 2012, respectively.

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

(6) 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, accrued interest, and other receivables at December 31 were as follows (in millions):

	2013	2012
ML	$1,732	$1,811
ML II	63	61
ML III	22	22
TALF LLC	109	856
Total	$1,926	$2,750

The FRBNY's approximate maximum exposure to loss at December 31, 2013 and 2012, was $1,089 million and $829 million, respectively. These estimates incorporate potential losses associated with assets recorded on the FRBNY's balance sheet, net of the fair value of subordinated interests (beneficial interest in consolidated VIEs).

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

	2013	2012
Assets:		
Short-term investments	$ 530	$ 690
Commercial mortgage loans	507	466
Swap contracts	158	408
Non-agency RMBS	8	2
Other investments[1]	2	66
Subtotal	$1,205	$1,632
Cash, cash equivalents, accrued interest receivable, and other receivables	721	1,118
Total investments held by consolidated VIEs	$1,926	$2,750
Liabilities:		
Beneficial interest in consolidated VIEs	$ 116	$ 803
Other liabilities[2]	$ 158	$ 415

[1] Investments with a fair value of $1 million as of December 31, 2012 were recategorized from "Federal agency and GSE MBS" to "Other investments" to conform to the current year presentation.

[2] The amount reported as "Consolidated variable interest entities: Other liabilities" in the Combined Statements of Condition includes $82 million and $341 million related to cash collateral received on swap contracts at December 31, 2013 and 2012, respectively. The amount also includes accrued interest and accrued other expenses.

Total realized and unrealized gains (losses) for the year ended December 31, 2013, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/ unrealized gains (losses)
Commercial mortgage loans[1]	$ 28	$ 176	$204
Swap contracts	83	(136)	(53)
Non-agency RMBS	10	1	11
Residential mortgage loans[1]	(1)	1	-
CDOs	2	(2)	-
Other investments	9	12	21
Total	$131	$ 52	$183

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

Total realized and unrealized gains (losses) for the year ended December 31, 2012, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/ unrealized gains (losses)
Short-term investments	$ -	$ 2	$ 2
Commercial mortgage loans[1]	(101)	394	293
Swap contracts	75	(165)	(90)
Non-agency RMBS	(334)	2,038	1,704
Residential mortgage loans[1]	(326)	322	(4)
CDOs	1,110	4,439	5,549
Other investments[2]	11	(14)	(3)
Total	$ 435	$7,016	$7,451

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

2 Investments with realized gains of $12 million, unrealized losses of $13 million, and total realized/unrealized losses of $1 million as of December 31, 2012 were recategorized from "Federal agency and GSE MBS" to "Other investments" to conform to the current year presentation.

The net income (loss) attributable to ML, ML II, ML III, and TALF LLC for the year ended December 31, 2013, was as follows (in millions):

	ML	ML II	ML III	TALF LLC	Total
Interest income:					
Portfolio interest income	$ 2	$ 4	$ -	$ -	$ 6
Less: Interest expense	-	-	-	-	-
Net interest income	2	4	-	-	6
Non-interest income:					
Portfolio holdings gains, net	183	-	-	-	183
Realized losses on beneficial interest in consolidated VIEs	-	-	-	(573)[1]	(573)
Unrealized gains (losses) on beneficial interest in consolidated VIEs	-	(1)	-	574[1]	573
Net non-interest income (loss)	183	(1)	-	1	183
Total net interest income and non-interest income	185	3	-	1	189
Less: Professional fees	6	1	-	1	8
Net income attributable to consolidated VIEs	$179	$ 2	$ -	$ -[2]	$ 181

1 The TALF LLC's realized and unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2013.

1 Additional information regarding TALF-related income recorded by the FRBNY is presented in Note 4.

The net income (loss) attributable to ML, ML II, ML III, and TALF for the year ended December 31, 2012, was as follows (in millions):

	ML	ML II	ML III	TALF LLC	Total
Interest income:					
Portfolio interest income	$ 34	$ 52	$ 1,023	$ 1	$ 1,110
Less: Interest expense	45	7	97	4	153
Net interest income (loss)	(11)	45	926	(3)	957
Non-interest income:					
Portfolio holdings gains, net	553	1,392	5,506	-	7,451
Realized losses on beneficial interest in consolidated VIEs	-	(453)	(2,905)	-[1]	(3,358)
Unrealized gains (losses) on beneficial interest in consolidated VIEs	-	216	801	(4)[1]	1,013
Net non-interest income (loss)	553	1,155	3,402	(4)	5,106
Total net interest income and non-interest income (loss)	542	1,200	4,328	(7)	6,063
Less: Professional fees	13	1	11	–	25
Net income (loss) attributable to consolidated VIEs	$529	$1,199	$ 4,317	$(7)[2]	$ 6,038

[1] The TALF LLC's realized and unrealized loss on beneficial interest represents Treasury's financial interest in the net income of TALF LLC for the year ended December 31, 2012.

[2] Additional information regarding TALF-related income recorded by the FRBNY is presented in Note 4.

Following is a summary of the consolidated VIEs' subordinated financial interest for the years ended December 31, 2013 and 2012 (in millions):

	ML subordinated loan	ML II deferred purchase price	ML III equity contribution	TALF financial interest	Total
Fair value, December 31, 2011	$ 1,385	$ 1,332	$ 6,350	$ 778	$ 9,845
Interest accrued and capitalized	45	7	97	4	153
Realized (gain)/loss	-	453	2,905	-	3,358
Unrealized (gain)/loss	-	(216)	(801)	4	(1,013)
Payments[1]	(1,430)	(1,566)	(8,544)	-	(11,540)
Fair value, December 31, 2012	$ -	$ 10	$ 7	$ 786	$ 803
Interest accrued and capitalized	$ -	$ -	$ -	$ -	$ -
Realized (gain)/loss	-	-	-	573	573
Unrealized (gain)/loss	-	1	-	(574)	(573)
Payments[1]	-	-	-	(687)	(687)
Fair value, at December 31, 2013	$ -	$ 11	$ 7	$ 98	$ 116

[1] For ML includes payments of $1,150 million of principal and $280 million of interest. For ML II includes payments of $1,000 million of principal, $113 million of interest, and $453 million of variable deferred purchase price. For ML III includes payments of $5,000 million of principal, $639 million of interest, and $2,905 million of excess amounts. For TALF LLC includes payments of $100 million of principal, $13 million of interest, and $574 million of contingent interest.

b. Maiden Lane LLC

To facilitate the merger of The Bear Stearns Companies, Inc. (Bear Stearns) and JPMorgan Chase & Co. (JPMC), the FRBNY extended credit to ML in June 2008. ML is a Delaware LLC formed by the FRBNY to acquire certain assets of Bear Stearns and to manage those assets. The assets acquired by ML were valued at $29.9 billion as of March 14, 2008, the date that the FRBNYcommitted to the transaction, and largely consisted of federal agency and GSE MBS, non-agency residential mortgage-back 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. On June 14, 2012, the remaining outstanding balance of the senior loan from the FRBNY to ML was repaid in full, with interest. On November 15, 2012, the remaining outstanding balance of the subordinated loan from JPMC was repaid in full, with interest. The FRBNY will continue to sell the remaining assets from the ML portfolio as market conditions warrant and if the sales represent good value for the public. In accordance with the ML agreements, proceeds from future asset sales will be distributed to the FRBNY as contingent interest after all derivative instruments in ML have been terminated and paid or sold from the portfolio.

The following is a description of the significant holdings at December 31, 2013, and the associated risk for each holding:

i. Debt Securities

ML has investments in short-term instruments with maturities of greater than three months and less than one year when acquired. As of December 31, 2013, ML's short-term instruments consisted of approximately $530 million in U.S. Treasury bills.

ii. Commercial Mortgage Loans

Commercial mortgage loans are subject to a high degree of credit risk because of exposure to financial loss resulting from failure by a counterparty to meet its contractual obligations. 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 mortgage loans at December 31, 2013, was as follows (in millions):

	Unpaid principal balance	Fair value	Fair value as a percentage of unpaid principal balance
Commercial mortgage loans:			
Performing loans	$ 28	$ 28	99.6%
Non-performing/non-accrual loans[1]	512	479	93.5%
Total	$540	$507	93.8%

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

Commercial mortgage loans held by ML are composed of different levels of subordination with respect to the underlying properties, and relative to each other. Senior mortgage loans are secured property loans evidenced by a first mortgage that is senior to any subordinate or mezzanine financing. Subordinate mortgage interests, sometimes known as B Notes, are loans evidenced by a junior note or a junior participation in a mortgage loan. Mezzanine loans are loans made to the direct or indirect owner of the property-owning entity. Mezzanine loans are not secured by a mortgage on the property but rather by a pledge of the mezzanine borrower's direct or indirect ownership interest in the property-owning entity. As of December 31, 2013, ML had unpaid principal balances of approximately $12 million in senior mortgage loans and $528 million in mezzanine loans.

As of December 31, 2013, the property types of commercial mortgage loans were concentrated in the office sector with one sponsor representing all of the total unpaid principal balance.

iii. Derivative Instruments

Derivative contracts are instruments, such as swap contracts, that derive their value from underlying assets, indexes, reference rates, or a combination of these factors. The ML portfolio is composed of derivative financial instruments included in a total return swap (TRS) agreement with JPMC. ML and JPMC entered into the TRS with reference obligations representing credit default swaps (CDS) primarily on commercial mortgage-backed securities (CMBS) and RMBS, with various market participants, including JPMC.

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 only nets the collateral received from JPMC from the bilateral MTM posting for the reference obligations for which JPMC is the counterparty.

The values of ML's cash equivalents, purchased by the re-hypothecation of cash collateral associated with the TRS, were $149 million and $477 million, for the years ended December 31, 2013 and 2012, respectively. In addition, ML has pledged $124 million and $231 million of US Treasury notes to JPMC as of December 31, 2013 and 2012, respectively.

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

Market Risk

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

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. ML remains exposed to credit risk for counterparties, other than JPMC, related to the swaps that underlie the TRS.

ML has entered into an International Swaps and Derivatives Association, Inc. master netting agreement with JPMC in connection with the TRS. This agreement provides ML with the right to liquidate securities held as collateral and to offset receivables and payables with JPMC in the event of default. This agreement also establishes the method for determining the net amount of receivables and payables that ML is entitled to receive from or owes to each counterparty to the swaps that underlie the TRS based upon the relevant fair value of the CDS.

For the derivative balances reported in the Combined Statements of Condition, ML offsets its asset and liability positions held with the same counterparty. In addition, ML offsets the cash collateral held with JPMC against any net liabilities of JPMC with ML under the TRS. As of December 31, 2013 and 2012, there were no amounts subject to an enforceable master netting agreement that were not offset in the Combined Statements of Condition.

The following table summarizes the fair value and notional amounts of derivative instruments by contract type on a gross basis as of December 31, 2013 and 2012, which is reported as a component of "Investments held by consolidated variable interest entities" in the Combined Statements of Condition (in millions, except contract data):

	2013			2012		
	Gross derivative assets	Gross derivative liabilities	Notional amounts[3]	Gross derivative assets	Gross derivative liabilities	Notional amounts[3]
Credit derivatives:						
CDS[1,2]	$ 345	$(193)	$899	$ 816	$(343)	$1,755
Amounts offset in the Combined Statements of Condition Counterparty netting	(120)	120		(272)	272	
Cash collateral	(67)	-		(136)	-	
Net amounts in the Combined Statements of Condition	$ 158	$ (73)		$ 408	$ (71)	

1 CDS fair values as of December 31, 2013 for assets and liabilities include interest receivables of $15 million and payables of $2 million. CDS fair values as of December 31, 2012 for assets and liabilities includes interest receivables of $15 million and payables of $9 million.

2 There were 269 and 470 CDS contracts outstanding as of December 31, 2013 and 2012, respectively.

3 Represents 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, 2013.

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

Credit ratings of the reference obligation	Maximum potential payout/notional							
	2013						2012	
	Years to maturity					Fair value	Total	Fair value
	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset/ (liability)		Asset/ (liability)
Investment grade (AAA to BBB-)	$ –	$ –	$ –	$ 13	$ 13	$ (3)	$ 52	$ (5)
Non-investment grade (BB+ or lower)	–	–	–	293	293	(188)	438	(329)
Total credit protection sold	$ –	$ –	$ –	$306	$306	$(191)	$490	$(334)

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

Credit ratings of the reference obligation	Maximum potential recovery/notional							
	2013						2012	
	Years to maturity					Fair value	Total	Fair value
	1 year or less	After 1 year through 3 years	After 3 years through 5 years	After 5 years	Total	Asset/ (liability)		Asset/ (liability)
Investment grade (AAA to BBB-)	$ –	$ –	$ 5	$ 51	$ 56	$ 2	$ 150	$ 27
Non-investment grade (BB+ or lower)	–	–	9	528	537	327	1,115	774
Total credit protection bought	$ –	$ –	$14	$579	$593	$329	$1,265	$801

Currency Risk

Currency risk is the risk of financial loss resulting from exposure to changes in exchange rates between two currencies. Under the terms of the TRS, JPMC may post cash collateral in the form of either U.S. dollar or Euro denominated currencies to cover the net MTM variation in the swap portfolio. Starting in December 2012, JPMC began posting collateral in Euro currency. This risk is mitigated by daily variation margin updates that capture the movement in the value of the swap portfolio in addition to any movement in exchange rates on the swap collateral. Swap collateral received that is denominated in a foreign currency is translated into U.S. dollar amounts using the prevailing exchange rate as of the date of the combined financial statements. There is no gain or loss associated with this foreign denominated collateral as the asset and liability positions associated with it are offsetting.

c. Maiden Lane II LLC

The FRBNY extended credit to ML II, a Delaware LLC formed to purchase non-agency RMBS from the reinvestment pool of the securities lending portfolios of several regulated U.S. insurance subsidiaries of American International Group, Inc. (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.

On February 28, 2012, the FRBNY announced the sale of the remaining securities in the ML II portfolio. On March 1, 2012, the loan from the FRBNY to ML II was repaid in full with interest, in accordance with the terms of the facility. On March 15, 2012, the remaining portion of the fixed deferred purchase price plus interest owed to the AIG subsidiaries was repaid in full. Concurrently, distributions were made to the Bank and the AIG subsidiaries in the form of contingent interest and variable deferred purchase price for the amounts of $2.3 billion and $0.5 billion, respectively.

On March 19, 2012, ML II was dissolved and the FRBNY began the wind up process in accordance with and as required by Delaware law and the agreements governing ML II. Winding up requires ML II to pay or make reasonable provision to pay all claims and obligations. Any remaining proceeds will be divided between the Bank, which is entitled to receive five-sixths, and the AIG subsidiaries, which are entitled to receive one-sixth. While its affairs are being wound up, the ML II is retaining certain assets to meet trailing expenses and other obligations as required by law. Dissolution costs are not expected to be material.

d. Maiden Lane III LLC

The FRBNY extended credit to ML III, a Delaware LLC formed to purchase ABS CDOs from certain third-party counterparties of AIG Financial Products Corp. ML III borrowed approximately $24.3 billion from the FRBNY, and AIG provided an equity contribution of $5.0 billion to ML III. The proceeds were used to purchase ABS CDOs with a fair value of $29.6 billion. On April 3, 2012, the FRBNY revised ML III's investment objective to allow for asset sales and began conducting such sales shortly thereafter. On June 14, 2012, the FRBNY announced that its loan to ML III had been repaid in full, with interest. On July 16, 2012, the FRBY announced that net proceeds from additional sales of securities in ML III enabled the full repayment of AIG's equity contribution plus accrued interest and provided residual profits to the FRBNY and AIG. During 2012, distributions were made to the Bank and AIG in the form of contingent interest and excess amounts in the amounts of $5.9 billion and $2.9 billion, respectively. On August 23, 2012, the FRBNY announced that all remaining securities in ML III were sold.

On September 10, 2012, ML III was dissolved and the FRBNY began the wind up process in accordance with and as required by Delaware law and the agreements governing ML III. Winding up requires ML III to pay or make reasonable provision to pay all claims and obligations. Any remaining proceeds will be divided between the FRBNY, which is entitled to receive two-thirds, and AIG (or its assignee), which is entitled to receive one-third, in accordance with the agreement. While its affairs are being wound up, ML III is retaining certain assets to meet trailing expenses and other obligations as required by law. Dissolution costs are not expected to be material.

e. TALF LLC

Cash receipts resulting from the put option fees paid to TALF LLC 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) fed-

eral 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. Proceeds from the Treasury's loan were also invested in these short-term investments and cash equivalents until the outstanding principal on the loan was repaid in full as described below.

On January 15, 2013, the Treasury and FRBNY eliminated the Treasury's and FRBNY's funding commitments to TALF LLC. These commitments were no longer deemed necessary because the cash equivalents and short-term investments held by TALF LLC exceeded the amount of TALF loans then outstanding. In addition, the agreement related to distribution of proceeds was amended to limit funding of the cash collateral account to an amount equal to the outstanding principal plus accrued interest of all TALF loans as of the payment determination date; all accumulated funding in excess of that amount would then be distributed according to the distribution priorities described in the agreements governing TALF LLC.

Pursuant to this agreement on February 6, 2013, TALF LLC repaid in full the outstanding principal and accrued interest on the Treasury loan. During the year ended December 31, 2013, additional distributions were made to the Treasury and FRBNY as contingent interest in the amounts of $573 million and $64 million, respectively.

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 mortgage loans 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 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 measure of fair value. In such cases or when market quotations are unavailable, the investment manager determines fair value by applying proprietary valuation models that use collateral performance scenarios and pricing metrics derived from the reported performance of the universe of investments 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, investments are classified within Level 3 of the valuation hierarchy. These valuations also incorporate pricing metrics derived from the reported performance of the universe of similar investments 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, performance data (i.e. prepayment rates, default rates, and loss severity), valuation estimates for underlying property collateral, projected cash flows, and other relevant contractual features. Because there is lack of observable pricing, some securities and investment loans that are carried at fair value are classified within Level 3.

For the CDS agreements, all of which are categorized as Level 3 assets and liabilities, there are various valuation methodologies. In each case, the fair value of the instrument underlying the swap is a significant input used to derive the fair value of the swap. When there are broker or dealer prices available for the underlying instruments, the fair value of the swap is derived based on those prices. When the instrument underlying the swap is a market index (i.e. CMBS index), the closing market index price, which can also be expressed as a credit spread, is used to determine the fair value of the swap. In the remaining cases, the fair value of the underlying instrument is principally based on inputs and assumptions not observable in the market (i.e. discount rates, prepayment rates, default rates, and recovery rates).

ML Inputs for Level 3 Assets and Liabilities

The following table presents the valuation techniques and ranges of significant unobservable inputs generally used to determine the fair values of ML's Level 3 assets and liabilities as of December 31, 2013 (in millions, except for input values):

Investment	Fair value	Principal valuation technique	Unobservable inputs	Range of input values	Weighted average[3]
Commercial mortgage loans	$507	Discounted cash flows	Discount rate	4%–13%	12%
			Property capitalization rate	7%	7%
			Net operating income growth rate	3%–5%	4%
CDS[1]	$152	Discounted cash flows	Credit spreads[2]	2,259 bps–8,870 bps	6,299 bps
			Discount rate	5%–25%	15%
			Constant prepayment rate	0%–17%	3%
			Constant default rate	0%–30%	6%
			Loss severity	40%–95%	54%

1 Swap assets and liabilities are presented net for the purposes of this table.

2 Implied spread on closing market prices for index positions.

3 Weighted averages are calculated based on the fair value of the respective instruments.

The following table presents the valuation techniques and ranges of significant unobservable inputs generally used to determine the fair values of ML's Level 3 assets and liabilities as of December 31, 2012 (in millions, except for input values):

Investment	Fair value	Principal valuation technique	Unobservable inputs	Range of input values	Weighted average[3]
Commercial mortgage loans	$466	Discounted cash flows	Discount rate	6%–20%	14%
			Property capitalization rate	6%–10%	7%
			Net operating income growth rate	3%–7%	3%
CDS[1]	$473	Discounted cash flows	Credit spreads[2]	100 bps–6,451 bps	4,995 bps
			Discount rate	0%–47%	15%
			Constant prepayment rate	0%–20%	1%
			Constant default rate	0%–34%	7%
			Loss severity	40%–80%	49%

1 Swap assets and liabilities are presented net for the purposes of this table.

2 Implied spread on closing market prices for index positions.

3 Weighted averages are calculated based on the fair value of the respective instruments.

Sensitivity of ML Level 3 Fair Value Measurements to Changes in Unobservable Inputs

The following provides a general description of the impact of a change in an unobservable input on the fair value measurement and the interrelationship of unobservable inputs.

I. Mortgage Loans

In general, an increase in isolation in either the discount rate or the property capitalization rate, which is the ratio between the net operating income produced by an asset and its current fair value, would result in a decrease in the fair value measurement; while an increase in net operating income growth rate, in isolation would result in an increase in the fair value measurement. For each of the relationships described above, the inverse would also generally apply.

II. Derivatives

For CDS with reference obligations on CMBS, an increase in credit spreads would generally result in a higher fair value measurement for protection buyers and a lower fair value measurement for protection sellers. The inverse would also generally apply to this relationship given a decrease in credit spreads.

For CDS with reference obligations on RMBS or other ABS assets, changes in the discount rate, constant prepayment rate, constant default rate, and loss severity would have an uncertain effect on the overall fair value measurement. This is because, in general, changes in these inputs could potentially affect other inputs used in determining the fair value measurement. For example, a change in the assumptions used for the constant default rate will generally be accompanied by a corresponding change in the assumption used for the loss severity and an inverse change in the assumption used for constant prepayment rates. Additionally, changes in the fair value measurement based on variations in the inputs used generally cannot be extrapolated because the relationship between each input is not perfectly correlated.

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

	2013				
	Level 1[1]	Level 2[1]	Level 3	Netting[2]	Total fair value
Assets:					
Cash equivalents [3]	$ 569	$ -	$ -	$ -	$ 569
Short-term investments	530	-	-	-	530
Commercial mortgage loans	-	-	507	-	507
Swap contracts	-	-	345	(187)	158
Non-agency RMBS	-	2	6	-	8
Other investments	-	-	2	-	2
Total assets	$1,099	$ 2	$860	$(187)	$1,774
Liabilities:					
Beneficial interest in consolidated VIEs	$ -	$116	$ -	$ -	$ 116
Swap contracts	-	-	193	(120)	73
Total liabilities	$ -	$116	$193	$(120)	$ 189

1 There were no transfers between Level 1 and Level 2 during the year ended December 31, 2013.

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

3 Cash equivalents consist primarily of money market funds.

	2012				
	Level 1[1]	Level 2[1]	Level 3	Netting[2]	Total fair value
Assets:					
Cash equivalents[3]	$ 634	$ -	$ -	$ -	$ 634
Short-term investments	454	236	-	-	690
Commercial mortgage loans	-	-	466	-	466
Swap contracts	-	-	816	(408)	408
Non-agency RMBS	-	2	-	-	2
Other investments[4]	-	11	55	-	66
Total assets	$1,088	$249	$1,337	$(408)	$2,266
Liabilities:					
Beneficial interest in consolidated VIEs	$ -	$803	$ -	$ -	$ 803
Swap contracts	-	-	343	(272)	71
Total liabilities	$ -	$803	$ 343	$(272)	$ 874

1 There were no significant transfers between Level 1 and Level 2 during the year ended December 31, 2012.

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

3 Cash equivalents consist primarily of money market funds and repurchase agreements.

4 Investments with a fair value of $1 million that were classified as a Level 2 instrument as of December 31, 2012 were recategorized from “Federal agency and GSE MBS” to “Other investments” to conform to the current year presentation.

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, 2013 (in millions). Unrealized gains and losses related to those assets still held at December 31, 2013 are reported as a component of "Investments held by consolidated variable interest entities, net" in the Combined Statements of Condition.

	2013						Change in unrealized gains (losses) related to financial instruments held at December 31, 2013
	Fair value December 31, 2012	Purchases, sales, issuances, and settlements, net	Net realized/ unrealized gains (losses)	Gross transfers in[1,2]	Gross transfers out[1,2]	Fair value December 31, 2013	
Assets:							
Commercial mortgage loans	$466	$(163)	$204	$ -	$ -	$507	$183
Non-agency RMBS	-	4	-	2	-	6	-
CDOs	-	-	-	-	-	-	(2)
Other investments	55	(73)	18	2	-	2	(2)
Total assets	$521	$(232)	$222	$4	$ -	$515	$179
Net swap contracts[3]	$473	$(268)	$ (53)	$ -	$ -	$152	$ (53)

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

[2] Non-agency RMBS and other investments, with December 31, 2012 fair values of $2 and $2, respectively, were transferred from Level 2 to Level 3 because they are valued at December 31, 2013 based on non-observable inputs (Level 3). These investments were valued in the prior year based on quoted prices for identical or similar assets in non-active markets or model-based techniques for which all significant inputs were observable (Level 2).

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

The following table presents the gross components of purchases, sales, issuances, and settlements, net, shown for the year ended December 31, 2013 (in millions):

	2013				
	Purchases	Sales	Issuances	Settlements[2]	Purchases, sales, issuances, and settlements, net
Assets:					
Commercial mortgage loans	$ -	$ (88)	-	(75)	(163)
Non-agency RMBS	4	-	-	-	(4)
CDOs	3	(5)	$ -	$ 2	$ -
Other investments	-	(74)	-	1	(73)
Total assets	$7	$(167)	$ -	$ (72)	$(232)
Net swap contracts[1]	$ -	$(153)	$ -	$(115)	$(268)

[1] Level 3 swap assets and liabilities are presented net for the purpose of this table.

[2] Includes paydowns.

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, 2012 (in millions). Unrealized gains and losses related to those assets still held at December 31, 2012 are reported as a component of "Investments held by consolidated variable interest entities, net" in the Combined Statements of Condition.

	2012						Change in unrealized gains (losses) related to financial instruments held at December 31, 2012
	Fair value December 31, 2011	Purchases, sales, and settlements, net	Net realized/ unrealized gains (losses)	Gross transfers in[1,2]	Gross transfers out[1,2]	Fair value December 31, 2012	
Assets:							
Commercial mortgage loans	$ 1,397	(1,187)	$ 256	$ -	$ -	$466	$135
Non-agency RMBS	5,410	(6,347)	937	-	-	-	-
Residential mortgage loans	378	(374)	(4)	-	-	-	(1)
CDOs	17,687	$(23,196)	5,509	-	-	-	(2)
Other investments	108	(65)	2	10	-	55	-
Total assets	$24,980	$(31,169)	$6,700	$10	$ -	$521	$132
Net swap contracts[3]	$ 839	$ (276)	$ (90)	$ -	$ -	$473	$ (93)
Liabilities:							
Beneficial interest in consolidated VIEs	$ 9,845	$ (1,385)	$ -	$ -	$(8,460)	$ -	$ -

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

2 Beneficial interest in consolidated VIEs, with a December 31, 2011, fair value of $8,460 million, were transferred from Level 3 to Level 2 because they are valued at December 31, 2012, based on model-based techniques for which all significant inputs are observable (Level 2). These investments were valued in the prior year on non-observable model based inputs (Level 3). There were also certain other investments for which valuation inputs became less observable during the year ended December 31, 2012, which resulted in $10 million in transfers from Level 2 to Level 3. There were no other transfers between Level 2 and Level 3 during the current year.

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

The following table presents the gross components of purchases, sales, issuances, and settlements, net, shown for the year ended December 31, 2012 (in millions):

	2012				
	Purchases	Sales	Issuances	Settlements[2]	Purchases, sales, issuances, and settlements, net
Assets:					
Commercial mortgage loans	$ -	$ (1,119)	$ -	$ (68)	$ (1,187)
Non-agency RMBS	-	(6,221)	-	(126)	(6,347)
Residential mortgage loans	-	(370)	-	(4)	(374)
CDOs	-	(22,206)	-	(990)	$(23,196)
Other investments	-	(66)	-	1	(65)
Total assets	$ -	$(29,982)	$ -	$(1,187)	$(31,169)
Net swap contracts[1]	$ -	$ (147)	$ -	$ (129)	$ (276)
Liabilities:					
Beneficial interest in consolidated VIEs	$45[2]	$ -	$ -	$(1,430)	$ (1,385)

1 Level 3 swap assets and liabilities are presented net for the purpose of this table.

2 Includes paydowns.

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 "Operating Expenses: Other" in the Combined Statements of Income and Comprehensive Income.

(7) Bank Premises, Equipment, and Software

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

	2013	2012
Bank premises and equipment:		
Land and land improvements	$ 395	$ 394
Buildings	2,693	2,659
Building machinery and equipment	554	520
Construction in progress	37	27
Furniture and equipment	1,006	1,024
Subtotal	4,685	4,624
Accumulated depreciation	(2,032)	(1,948)
Bank premises and equipment, net	$ 2,653	$ 2,676
Depreciation expense, for the years ended December 31	$ 202	$ 218

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

	2013	2012
Leased premises and equipment under capital leases	$ 27	$ 33
Accumulated depreciation	(18)	(20)
Leased premises and equipment under capital leases, net	$ 9	$ 13
Depreciation expense related to leased premises and equipment under capital leases	$ 6	$ 7

The Reserve Banks lease space to outside tenants with remaining lease terms ranging from 1 to 11 years. Rental income from such leases was $35 million and $37 million for the years ended December 31, 2013 and 2012, 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, 2013, are as follows (in millions):

2014	$ 33
2015	29
2016	23
2017	18
2018	14
Thereafter	36
Total	$153

The Reserve Banks had capitalized software assets, net of amortization, of $356 million and $213 million at December 31, 2013 and 2012, respectively. Amortization expense was $73 million and $64 million for the years ended December 31, 2013 and 2012, respectively. Capitalized software assets are reported as a component of "Other assets" in the Combined Statements of Condition and the related amortization is reported as a component of "Operating expenses: Other" in the Combined Statements of Income and Comprehensive Income.

As a result of the Federal Reserve Bank of Cleveland's (FRBC) restructuring plan discussed in Note 12, the FRBC sold its Pittburgh facility during the third quarter of 2013. This sale resulted in a $1.9 million loss, of which $0.2 million is reflected in "Operating expense: Occupancy" and $1.7 million is reflected in "Operating expense: Other" in the 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 was reported at fair value as a component of "Other Assets" in the Statements of Condition. In April 2012, the FRBSF completed the donation of the building to the United States General Services Administration (GSA). Under the donation agreement, the FRBSF must continue to maintain the building for up to fifteen months from the time GSA takes ownership. The FRBSF recorded an additional impairment of $3.4 million during the year ended December 31, 2012, to reflect the final disposition of this building, which was recorded as a component of "Operating expenses: Other" in the Statements of Income and Comprehensive Income.

(8) Commitments and Contingencies

In 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, 2013, the Reserve Banks were obligated under noncancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 9 years. These leases provide for increased lease payments based upon increases in real estate taxes, operating costs, or selected price indexes.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and mainte-

nance when included in rent), net of sublease rentals, was $17 million and $16 million for the years ended December 31, 2013 and 2012, respectively.

Future minimum lease payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2013, are as follows (in millions):

2014	$ 5
2015	5
2016	2
2017	2
2018	2
Thereafter	4
Future minimum rental payments	$20

At December 31, 2013, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2022 with a remaining fixed commitment of $240 million. Purchases of $37 million and $28 million were made against these commitments during 2013 and 2012, 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):

2014	$23
2015	27
2016	26
2017	26
2018	26

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.

Other Commitments

In support of financial market stability activities, the FRBNY entered into commitments to provide financial assistance to financial institutions. The FRBNY had remaining unfunded contractual commitments related to commercial mortgage loans in ML of $40 and $55 million at December 31, 2013 and 2012, respectively.

(9) 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 participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). Under the Dodd-Frank Act, newly hired Bureau employees are eligible to participate in the System Plan. In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP) and certain Reserve Bank officers

participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP).

The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2013 and 2012, certain costs associated with the System Plan were reimbursed by the Bureau.

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

	2013	2012
Estimated actuarial present value of projected benefit obligation at January 1	$11,468	$10,198
Service cost-benefits earned during the period	407	349
Interest cost on projected benefit obligation	472	473
Actuarial (gain) loss	(1,527)	833
Contributions by plan participants	5	4
Special termination benefits	6	9
Benefits paid	(355)	(334)
Plan amendments	-	(64)
Estimated actuarial present value of projected benefit obligation at December 31	$10,476	$11,468

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

	2013	2012
Estimated plan assets at January 1 (of which $9,440 and $7,977 is measured at fair value as of January 1, 2013 and 2012, respectively)	$ 9,566	$ 8,048
Actual return on plan assets	683	1,066
Contributions by the employer	909	782
Contributions by plan participants	5	4
Benefits paid	(355)	(334)
Estimated plan assets at December 31 (of which $10,687 and $9,440 is measured at fair value as of December 31, 2013 and 2012, respectively)	$10,808	$ 9,566
Funded status and accrued pension benefit costs	$ 332	$(1,902)
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (456)	$ (559)
Net actuarial loss	(1,928)	(3,784)
Total accumulated other comprehensive loss	$ (2,384)	$(4,343)

The FRBNY, on behalf of the System, funded $900 million and $780 million during the years ended December 31, 2013 and 2012, respectively. The Bureau is required by the Dodd-Frank Act to fund the System plan for each Bureau employee based on an established formula. During the years ended December 2013 and 2012, the Bureau funded contributions of $9 million and $2 million, respectively.

Accrued pension benefit costs are reported as a component of “Other assets” and “Accrued benefit costs” respectively, 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 $9,308 million and $10,035 million at December 31, 2013 and 2012, respectively.

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

	2013	2012
Discount rate	4.92%	4.00%
Rate of compensation increase	4.50%	4.50%

Net periodic benefit expenses for the years ended December 31, 2013 and 2012, 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:

	2013	2012
Discount rate	4.00%	4.50%
Expected asset return	6.50%	7.25%
Rate of compensation increase	4.50%	5.00%

Beginning in 2013, the System Plan discount rate assumption setting convention changed from rounding the rate to the nearest 25 basis points to using an unrounded rate.

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

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

	2013	2012
Service cost-benefits earned during the period	$ 407	$ 349
Interest cost on projected benefit obligation	472	473
Amortization of prior service cost	103	116
Amortization of net loss	284	292
Expected return on plan assets	(638)	(599)
Net periodic pension benefit expense	628	631
Special termination benefits	6	9
Bureau of Consumer Financial Protection contributions	(9)	(2)
Total periodic pension benefit expense	$ 625	$ 638

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2014 are shown below:

Prior service cost	$100
Net actuarial loss	87
Total	$187

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

2014	$ 406
2015	429
2016	455
2017	483
2018	512
2018–2023	2,982
Total	$5,267

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. At December 31, 2013, the System Plan's assets were held in nine investment vehicles: three actively-managed long-duration fixed income portfolios, a passively-managed long-duration fixed income portfolio, an indexed U.S. equity fund, an indexed non-U.S. developed-markets equity fund, an indexed emerging-markets equity fund, a private equity limited partnership, 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 three actively-managed 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 U.S. Treasury STRIPS Index. This custom benchmark was selected as a proxy to match the liabilities of the Plan and the guidelines for these portfolios are designed to limit portfolio deviations from the benchmark. The passively-managed long-duration fixed-income portfolio is invested in two commingled funds and is benchmarked to 55 percent Barclays Long Credit Index and 45 percent Barclays 20+ STRIPS Index. The indexed U.S. equity fund is intended to track the overall U.S. equity market across market capitalizations and is benchmarked to the Dow Jones U.S. Total Stock Market Index. The indexed non-U.S. developed-markets equity fund is intended to track the Morgan Stanley Capital International (MSCI) World ex-US Investible Markets Index (IMI), which includes stocks from 23 markets deemed by MSCI to be "developed markets." The indexed emerging-markets equity fund is intended to track the MSCI Emerging Markets IMI Index, which includes stocks from 21 markets deemed by MSCI to be "emerging markets." The three indexed equity funds include stocks from across the market capitalization spectrum (i.e., large-, mid- and small-cap stocks). The private equity limited partnership invests globally across various private equity strategies. Finally, the money market fund, which invests in short term Treasury and Agency debt and repurchase agreements backed by Treasury and Agency debt, 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 the passively-managed long-duration fixed income portfolio) or the investment guidelines (for the remaining investments). 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	
		2013	2012
U.S. equities	30.0%	29.7%	34.9%
International equities	18.0%	18.3%	13.6%
Emerging market equities	2.0%	1.9%	0.0%
Fixed income	50.0%	49.4%	50.4%
Cash and cash equivalents	0.0%	0.7%	1.1%
Total	100.0%	100.0%	100.0%

In June 2013, the Committee on Investment Performance (the "Committee") approved a change in the allocation and benchmarks for the Plan's public equity portfolio. The new benchmark is the MSCI All Country World Investible Markets Index. This benchmark change will reduce the Plan's holdings in U.S. equities, increase the Plan's holdings of developed markets international equities, and add an investment in emerging market equities when it is fully implemented in mid-2014. The Committee approved a phased six-month implementation period for these changes, commencing in September 2013 for developed market equities and November 2013 for emerging market equities. The policy weight percentages shown above reflect the target allocation as of December 2013 based on this implementation strategy.

Employer contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System Plan's anticipated funding level for 2014 is $480 million. In 2014, the Bank plans to make monthly contributions of $40 million and will reevaluate the monthly contributions upon completion of the 2014 actuarial valuation. The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2013 and 2012, and for the years then ended, were not material.

Determination of Fair Value

The System Plan's publicly available 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	2013			
	Level 1[1]	Level 2[1]	Level 3	Total
Short-term investments[2]	$14	$ 126	$ -	$ 140
Treasury and Federal agency securities	38	1,565	-	1,603
Corporate bonds	-	1,773	-	1,773
Other fixed income securities	-	362	-	362
Commingled funds	-	6,795	-	6,795
Private Equity	-	-	14	14
Total	$52	$10,621	$14	$10,687

[1] There were no transfers between Level 1 and Level 2 during the year.
[2] Short-term investments includes cash equivalents of $78 million.

Description	2012			
	Level 1[1]	Level 2[1]	Level 3	Total
Short-term investments	$ 23	$ 25	$ -	$ 48
Treasury and Federal agency securities	141	1,746	-	1,887
Corporate bonds	-	1,947	-	1,947
Other fixed income securities	-	352	-	352
Commingled funds	-	5,206	-	5,206
Total	$164	$9,276	$ -	$9,440

[1] U.S. Treasury STRIPs with a fair value of $1,737 million were transferred from Level 1 to Level 2 because they were valued based on quoted prices in non-active markets (Level 2). There were no other 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 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.

At December 31, 2013 and 2012, a portion of short-term investments was available for futures trading. There were $8 million and $7 million of Treasury securities pledged as collateral for the years ended December 31, 2013 and 2012, 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 six percent of employee contributions from the date of hire and provides an automatic employer contribution of one percent of eligible pay. The Reserve Banks' Thrift Plan contributions totaled $108 million and $102 million for the years ended December 31, 2013 and 2012, respectively, and are reported as a component of "Operating expenses: Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

(10) 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 and life insurance benefits during retirement.

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

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

	2013	2012
Accumulated postretirement benefit obligation at January 1	$1,755	$1,506
Service cost benefits earned during the period	75	59
Interest cost on accumulated benefit obligation	67	69
Net actuarial loss (gain)	(290)	181
Curtailment loss (gain)	-	-
Special termination benefits loss	1	1
Contributions by plan participants	24	22
Benefits paid	(93)	(87)
Medicare Part D subsidies	5	5
Plan amendments	(6)	(1)
Accumulated postretirement benefit obligation at December 31	$1,538	$1,755

At December 31, 2013 and 2012, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 4.79 percent and 3.75 percent, respectively.

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due. Beginning in 2013, the System Plan discount rate assumption setting convention changed from rounding the rate to the nearest 25 basis points to using an unrounded rate.

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):

	2013	2012
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	64	60
Contributions by plan participants	24	22
Benefits paid	(93)	(87)
Medicare Part D subsidies	5	5
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$1,538	$1,755
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 29	$ 36
Net actuarial loss	(201)	(538)
Total accumulated other comprehensive loss	$ (172)	$ (502)

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:

	2013	2012
Health-care cost trend rate assumed for next year	7.00%	7.00%
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	2019	2018

Assumed health-care cost trend rates have a significant effect on the amounts reported for health-care plans. A one percentage point change in assumed health-care cost trend rates would have the following effects for the year ended December 31, 2013 (in millions):

	One percentage point increase	One percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 25	$ (20)
Effect on accumulated postretirement benefit obligation	184	(157)

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

	2013	2012
Service cost-benefits earned during the period	$ 75	$ 59
Interest cost on accumulated benefit obligation	67	69
Amortization of prior service cost	(11)	(10)
Amortization of net actuarial loss	46	31
Total periodic expense	$177	$149
Curtailment (gain)	-	-
Special termination benefits loss	1	1
Net periodic postretirement benefit expense	$178	$150

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2014 are shown below:

Prior service cost	$(10)
Net actuarial loss	9
Total	$ (1)

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2013 and 2012, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 3.75 percent and 4.5 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 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 gainin the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were $4.0 million and $4.3 million in the years ended December 31, 2013 and 2012, respectively. Expected receipts in 2014, related to benefits paid in the years ended December 31, 2013 and 2012, are $3.5 million.

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

	Without subsidy	With subsidy
2014	$ 77	$ 72
2015	$ 81	$ 75
2016	$ 85	$ 79
2017	$ 89	$ 83
2018	$ 94	$ 87
2019–2023	$544	$498
Total	$970	$894

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a January 1 measurement date and include the cost of providing disability; medical, dental, and vision insurance; and survivor income benefits. The accrued postemployment benefit costs recognized by the Reserve Banks at December 31, 2013 and 2012, were $148 million and $164 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 2013 and 2012 operating expenses were $7 million and $25 million, respectively, and are recorded as a component of "Operating expenses: Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

(11) Accumulated Other Comprehensive Income and Other Comprehensive Income

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

	2013			2012		
	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than retirement plans	Total accumulated other comprehensive loss	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than retirement plans	Total accumulated other comprehensive loss
Balance at January 1	$(4,343)	$(502)	$(4,845)	$(4,449)	$(343)	$(4,792)
Change in funded status of benefit plans:						
Prior service costs arising during the year	-	5	5	64	1	65
Amortization of prior service cost	103[1]	(11)[2]	92	116[1]	(10)[2]	106
Change in prior service costs related to benefit plans	103	(6)	97	180	(9)	171
Net actuarial gain (loss) arising during the year	1,572	290	1,862	(366)	(181)	(547)
Amortization of net actuarial loss	284[1]	46[2]	330	292[1]	31[2]	323
Change in actuarial gain (losses) related to benefit plans	1,856	336	2,192	(74)	(150)	(224)
Change in funded status of benefit plans – other comprehensive income (loss)	1,959	330	2,289	106	(159)	(53)
Balance at December 31	$(2,384)	$(172)	$(2,556)	$(4,343)	$(502)	$(4,845)

[1] Reclassification is reported as a component of "Operating Expenses: Net periodic pension expense" in the Combined Statements of Income and Comprehensive Income.

[2] Reclassification is reported as a component of "Operating Expenses: Salaries and benefits" in the Combined Statements of Income and Comprehensive Income.

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 9 and 10.

(12) Business Restructuring Charges

The Reserve Banks had no material business restructuring charges in 2013 or 2012.

In 2011, the U.S. Treasury announced a restructuring initiative to consolidate the Treasury Retail Securities operations. As a result of this initiative, Treasury Retail Securities operations performed by the 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 Federal Reserve Bank of Atlanta (FRBA).

In years prior to 2011, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated paper and electronic check processing at the FRBA.

Restructuring costs associated with certain Bank assets, including software, buildings, leasehold improvements, furniture, and equipment, are discussed in Note 7.

(13) Distribution of Comprehensive Income

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

	2013	2012
Dividends on capital stock	$ 1,650	$ 1,637
Transfer to surplus – amount required to equate surplus with capital paid-in	147	461
Earnings on remittances to Treasury	79,633	88,418
Total distribution	$81,430	$90,516

(14) Subsequent Events

There were no subsequent events that require adjustments to or disclosures in the combined financial statements as of December 31, 2013. Subsequent events were evaluated through March 14, 2014, which is the date that the combined financial statements were available to be issued.

Office of Inspector General Activities

The Office of Inspector General (OIG) for the Federal Reserve Board, which is also the OIG for the Consumer Financial Protection Bureau (CFPB), operates in accordance with the Inspector General Act of 1978, as amended. The OIG conducts activities and makes recommendations to promote economy and efficiency; enhance policies and procedures; and prevent and detect waste, fraud, and abuse in Board programs and operations, including functions that the Board has delegated to the Federal Reserve Banks. Accordingly, the OIG plans and conducts audits, inspections, evaluations, investigations, and other reviews relating to Board and Board-delegated programs and operations. It also retains an independent public accounting firm to annually audit the Board's and the Federal Financial Institutions Examination Council's financial statements. In addition, the OIG keeps the Congress and the Board of Governors fully informed about serious abuses and deficiencies.

During 2013, the OIG issued 25 audit, inspection, and evaluation reports (table 1) and conducted a number of follow-up reviews to evaluate action taken on prior recommendations. Due to the sensitive nature of some of the material, certain reports were only issued internally to the Board, as indicated. OIG investigative work resulted in 3 arrests, 20 indictments, 11 convictions, and 2 suspensions/terminations, as well as $438,286,403 in criminal fines and restitution. Eighteen investigations were opened and six investigations were closed during the year. The OIG also issued two *Semiannual Reports to Congress* and performed approximately 50 reviews of legislation and regulations related to the operations of the Board, the CFPB, and/or the OIG.

For more information and to obtain copies of OIG reports, visit the OIG website at www.federalreserve.gov/oig/. Specific details about the OIG's body of work also may be found in the OIG's *Work Plan* and *Semiannual Report to Congress*.

Table 1. OIG audit, inspection, and evaluation reports issued in 2013

Report title	Month issued
No Changes Recommended to Freedom of Information Act Exemption Included in the Amended Federal Reserve Act	January
Federal Financial Institutions Examination Council Financial Statements as of and for the Years Ended December 31, 2012 and 2011, and Independent Auditors' Reports	March
Board of Governors of the Federal Reserve System Financial Statements as of and for the Years Ended December 31, 2012 and 2011, and Independent Auditors' Reports	March
Review of the Failure of Bank of Whitman	March
Status of the Transfer of Office of Thrift Supervision Functions	March
Security Control Review of the Consumer Financial Protection Bureau's Consumer Response System (internal report)	March
CFPB Contract Solicitation and Selection Processes Facilitate FAR Compliance, but Opportunities Exist to Strengthen Internal Controls	March
Audit Observations on the Board's Planning and Contracting Process for the Martin Building Construction, Renovation, and Relocation of Staff	March
Controls over the Board's Purchase Card Program Can Be Strengthened	March
Board Should Enhance Compliance with Small Entity Compliance Guide Requirements Contained in the Small Business Regulatory Enforcement Fairness Act of 1996	July
Security Control Review of the Board's National Examination Database System (internal report)	July
Security Control Review of a Third-party Commercial Data Exchange Service Used by the Board's Division of Banking Supervision and Regulation (internal report)	August
Opportunities Exist to Enhance the CFPB's Policies, Procedures, and Monitoring Activities for Conferences	August
Board Should Strengthen Controls over the Handling of the Federal Open Market Committee Meeting Minutes	August
The Board Can Benefit from Implementing an Agency-Wide Process for Maintaining and Monitoring Administrative Internal Control	September
Status of the Transfer of Office of Thrift Supervision Functions	September
Opportunities Exist for the CFPB to Strengthen Compliance with Its Purchase Card Policies and Procedures	September
The Board Should Improve Procedures for Preparing for and Responding to Emergency Events	September
The CFPB Should Strengthen Internal Controls for Its Government Travel Card Program to Ensure Program Integrity	September
Observations and Matters for Consideration Regarding the CFPB's Annual Budget Process	October
Response to a Congressional Request Regarding the CFPB's Compliance with Federal Requirements for Addressing Climate Change	October
Response to a Congressional Request Regarding the Board's Compliance with Federal Requirements for Addressing Climate Change	October
2013 Audit of the Board's Information Security Program	November
2013 Audit of the CFPB's Information Security Program	December
The CFPB Should Reassess Its Approach to Integrating Enforcement Attorneys Into Examinations and Enhance Associated Safeguards	December

Government Accountability Office Reviews

The Federal Banking Agency Audit Act (Pub. L. No. 95–320) authorizes the Government Accountability Office (GAO) to audit certain aspects of Federal Reserve System operations. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) directs GAO to conduct additional audits with respect to these operations. In 2013, the GAO completed 16 projects that involved the Federal Reserve (table 1). Twenty-one projects were ongoing as of December 31, 2013 (table 2). Some of the major projects that GAO has undertaken include parts II and III of a study of the Independent Foreclosure Review process; a review of the process of enacting regulations pursuant to Dodd-Frank Act requirements; a report on the diversity of employees at economic institutions as well as at federal financial regulators; and a review of virtual currencies.

Table 1. Reports completed during 2013

Report title	Report number	Month issued (2013)
State Small Business Credit Initiative: Opportunities Exist to Enhance Performance Measurement and Evaluation	GAO-14-97	December
Small Business Lending Fund: Treasury Should Ensure Evaluation Includes Methods to Isolate Program Impact	GAO-14-135	December
Dodd-Frank Regulations: Agencies Conducted Regulatory Analyses and Coordinated but Could Benefit from Additional Guidance on Major Rules	GAO-14-67	December
Government Support for Bank Holding Companies: Statutory Changes to Limit Future Support Are Not Yet Fully Implemented	GAO-14-18	November
U.S. Currency: Coin Inventory Management Needs Better Performance Information	GAO-14-110	November
Troubled Asset Relief Program: Status of Treasury's Investments in General Motors and Ally Financial	GAO-14-6	October
Financial Company Bankruptcies: Need to Further Consider Proposals' Impact on Systemic Risk	GAO-13-622	July
Federal Housing Administration: Improving Disposition and Oversight Practices May Increase Returns on Foreclosed Property Sales	GAO-13-542	June
Diversity Management: Trends and Practices in the Financial Services Industry and Agencies after the Recent Financial Crisis	GAO-13-238	May
Federal Reserve Banks: Areas for Improvement in Information System Controls	GAO-13-419R	May
Automated Teller Machines: Some Consumer Fees Have Increased	GAO-13-266	April
Foreclosure Review: Lessons Learned Could Enhance Continuing Reviews and Activities under Amended Consent Orders	GAO-13-277	March
Iran: U.S. and International Sanctions Have Adversely Affected the Iranian Economy	GAO-13-326	February
Financial Regulatory Reform: Financial Crises Losses and Potential Impacts of the Dodd-Frank Act	GAO-13-180	January
Financial Regulatory Reform: Regulators Have Faced Challenges Finalizing Key Reforms and Unaddressed Areas Pose Potential Risks	GAO-13-195	January
Financial Institutions: Causes and Consequences of Recent Bank Failures	GAO-13-71	January

Table 2. Projects active at year-end 2013

Subject of project	Month initiated	Status
College credit, debit and prepaid card agreement	November 2012	Closed 02/13/2014
Annual audit of Treasury financial statements	February 2013	Open
International financial regulatory reform	March 2013	Open
Data breach response policies and procedures	March 2013	Closed 01/08/2014
College credit cards	April 2013	Closed 02/25/2014
TARP: Making Homes Affordable Programs	April 2013	Closed 02/06/2014
Regulatory actions and banking-related financial crises lessons learned	May 2013	Open
Impact of Servicemembers Civil Service Relief Act (SCRA) protections	May 2013	Closed 01/28/2014
Costs and revenues of Puerto Rico statehood	May 2013	Open
Foreclosure review and amended consent orders	May 2013	Open
Treasury floating rate notes	June 2013	Open
CFPB's data collection and information security	August 2013	Open
Small Business Administration's Office of Advocacy	August 2013	Open
Potential reforms of single-family housing finance	August 2013	Open
Financial Stability Oversight Council (FSOC) designations	November 2013	Open
Student loan repayment programs	November 2013	Open
Student loan debt of older Americans	November 2013	Open
Capital reform requirements	December 2013	Open
Virtual currency	December 2013	Open
Perceived government support for the largest bank holding companies	December 2013	Open
Effect of low interest rates on seniors	December 2013	Open

12 Federal Reserve System Budgets

The Federal Reserve Board of Governors and the Federal Reserve Banks prepare annual budgets as part of their efforts to ensure appropriate stewardship and accountability. This section presents information on the 2013 budget performance of the Board and Reserve Banks, as well as their 2014 budgets, budgeting processes, and trends in expenses and employment. This section also presents information on the costs of new currency.

Before 2013, information about the budgeted expenses of the Board and Reserve Banks was presented in a separate report titled *Annual Report: Budget Review*. Copies of that report are available at www.federalreserve.gov/publications/budget-review/default.htm.

System Budgets Overview

Tables 1 and 2 summarize the Federal Reserve Board of Governors' and Federal Reserve Banks' 2013 budgeted and actual and 2014 budgeted operating expenses and employment.

2013 Budget Performance

In carrying out its responsibilities in 2013, the Federal Reserve System incurred $3.9 billion in net expenses. Total spending of $4,850.3 million was offset by $973.6 million in revenue from priced services, claims for reimbursement, and other income. Total 2013 expenses were $222.4 million, or 4.4 percent, less than the amount budgeted for 2013.

Table 1. Total operating expenses of the Federal Reserve System, net of receipts and claims for reimbursement, 2013–14
Millions of dollars

Item	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Board	586.9	553.7	-33.2	-5.7	611.1	57.4	10.4
Reserve Banks[1]	3,688.2	3,591.6	-96.6	-2.6	3,795.7	204.1	5.7
Currency	797.6	705.0	-92.6	-11.6	826.7	121.7	17.3
Total System operating expenses[2]	5,072.7	4,850.3	-222.4	-4.4	5,233.5	383.2	7.9
Revenue from priced services	423.9	441.3	17.4	4.1	423.6	-17.8	-4.0
Claims for reimbursement[3]	539.4	530.1	-9.4	-1.7	569.1	39.1	7.4
Other income[4]	2.2	2.2	0.0	2.0	2.7	0.5	21.4
Revenue and claims for reimbursement[5]	965.5	973.6	8.1	0.8	995.4	21.8	2.2
Total System operating expenses, net of revenue and claims for reimbursement	**4,107.2**	**3,876.7**	**-230.5**	**-5.6**	**4,238.1**	**361.4**	**9.3**

Note: Here and in subsequent tables, components may not sum to totals and may not yield percentages shown because of rounding.

1 Excludes assessments for the Board of Governors' operating expenses.

2 Includes total operating expenses of the Office of Inspector General (OIG), the Federal Reserve Information Technology (FRIT) support function, and the System's Office of Employee Benefits (OEB). Excludes operating expenses of the Consumer Financial Protection Bureau (CFPB).

3 Reimbursable claims include the expenses of fiscal agency and depository services provided to the U.S. Treasury, other government agencies, and other fiscal principals.

4 Fees that depository institutions pay for the settlement component of the Fedwire Securities Service transactions for Treasury securities transfers.

5 Excludes annual assessments for the supervision of large financial companies pursuant to Regulation TT, which are not recognized as revenue or used to fund Board expenses. (See section 3 ("Supervision and Regulation") of this annual report for more information.)

Table 2. Employment in the Federal Reserve System, 2013–14

Item	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Board[1]	2,655	2,648	-7	-0.3	2,740	92	3.5
Reserve Banks[2]	18,656	18,744	88	0.5	18,979	236	1.3
Total System employment	**21,311**	**21,392**	**81**	**0.4**	**21,719**	**328**	**1.5**

Note: Employment numbers presented include authorized position counts for the Board and average number of personnel (ANP) for the Reserve Banks. ANP is the average number of employees expressed in terms of full-time positions for the period.

[1] Budget represents authorized position count at the beginning of the year and actual represents authorized position count at year-end. The Board total also includes authorized position count for the OIG. In January, the Board approved an increase of 11 authorized positions to support the Board's oversight responsibilities related to financial market utilities as well as a technical editor to work on increased reporting requirements related to the Dodd-Frank Act.

[2] Includes employment of the FRIT support function and the OEB.

Substantially all employees of the Board and Reserve Banks participate in the defined benefit retirement plan for employees of the Federal Reserve System (System Plan). The Federal Reserve Bank of New York recognizes the costs associated with the System Plan. In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan, certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks (SERP), and Board officers participate in the Pension Enhancement Plan.

Expenses related to Board participants in the Benefit Equalization Retirement Plan and Pension Enhancement Plan are included in the Board's budget and are reflected in table 1. Expenses related to System participants in the System Plan and the Reserve Bank participants in the Benefit Equalization Plan and SERP are not included in the Reserve Bank budgets and, as a result, are not reflected in table 1. The 2013 actual retirement plan expenses recorded by the Board and the Reserve Banks were $5.2 million and $616.5 million, respectively.

2014 Operating Expense Budget

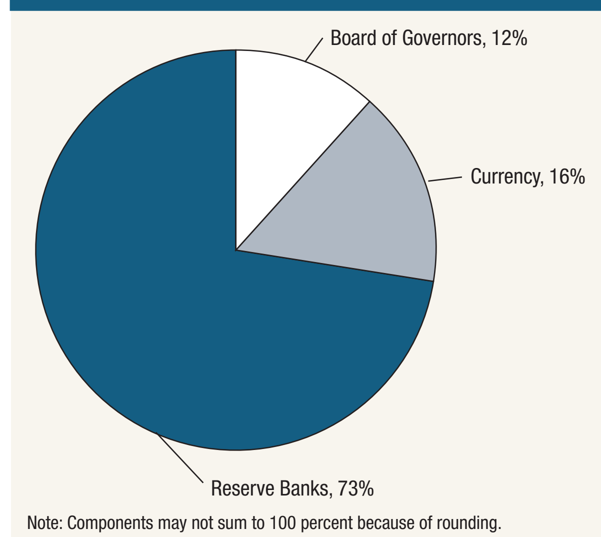
Budgeted 2014 operating expenses, net of revenue and reimbursements, are $361.4 million, or 9.3 percent, higher than 2013 actual expenses. The Reserve Bank budgets comprise almost three-quarters of the System budget (figure 1). Budgeted 2014 revenue from priced services is 4.0 percent lower than 2013 revenue, primarily because of continued declines in check volume as customers shift to other payment methods. Claims for reimbursements are expected to increase 7.4 percent in 2014, reflecting increased activity in new or expanded Treasury services.

Trends in Expenses and Employment

From the actual 2005 level to the budgeted 2014 amount, the total expenses of the Federal Reserve System have increased an average of 5.0 percent per year (figure 2). Over the same period, nondefense discretionary spending by the federal government has increased an average of 3.1 percent per year (figure 3). Over the 2005–14 period, Federal Reserve System employment declined through 2010 and subsequently increased due to requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act and responses to the financial crisis (figure 4).

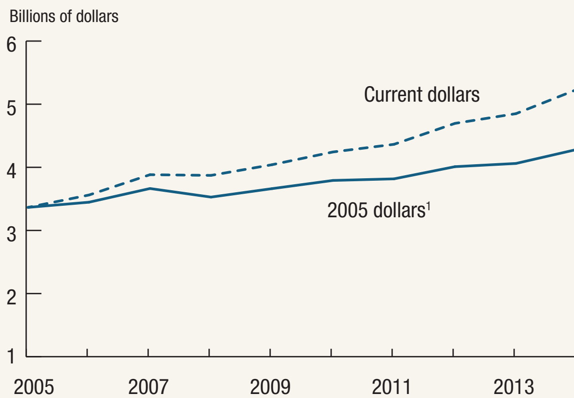
Operating expenses include additional resources and staffing needed to respond to the financial crisis and

Figure 1. Distribution of budgeted expenses of the Federal Reserve System, 2014



Note: Components may not sum to 100 percent because of rounding.

Figure 2. Total expenses of the Federal Reserve System, 2005–14

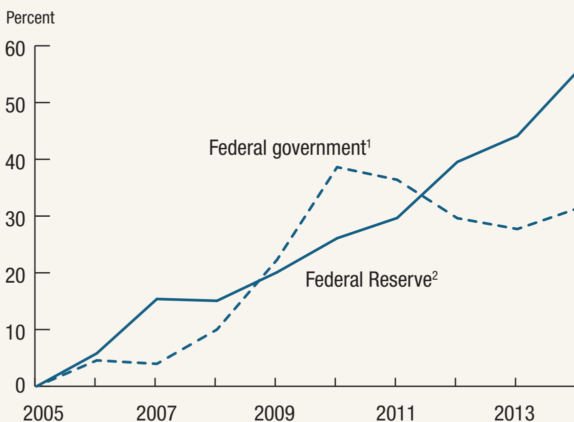


Note: For 2014, budgeted. Includes expenses of the Office of Inspector General (OIG).

1. Calculated with the GDP price deflator.

to implement requirements under the Dodd-Frank Act. More recently, growth in the number of supervised state member banks resulted in increased resource demands. Expenses in the cash area have increased as a result of the multiyear cash-processing modernization project. Expenses for services provided to Treasury have grown to meet that agency's evolving needs, including the automation of collection and payment services and continuing initiatives such as the Do Not Pay project, the Internet Channel, and other projects. These increases have been partially offset by substantial expense and staffing decreases related to the continued decline of paper check volume and efficiencies associated with the electronic check-processing function, cash operations, and support functions.

Figure 3. Cumulative change in Federal Reserve System expenses and federal government expenses, 2005–14

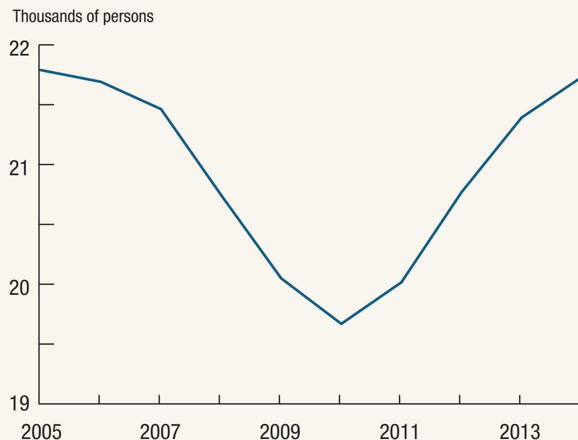


Note: For 2014, budgeted. Federal government expenses are reported on a fiscal-year basis beginning October 1; the Federal Reserve System expenses are reported on a calendar-year basis.

1. Discretionary spending less expenditures on defense. Source: *Budget of the United States Government, Fiscal Year 2014: Historical Tables,* Table 8.1. Outlays by Budget Enforcement Act Category, 1962–2018.

2. Includes expenses of the OIG.

Figure 4. Employment in the Federal Reserve System, 2005–14



Note: For 2014, budgeted. Employment numbers presented include position counts for the Board and average number of personnel (ANP) for the Reserve Banks.

2014 Capital Budgets

The capital budgets for the Board and Reserve Banks total $133.0 million and $475.4 million, respectively.[1] As in previous years, the 2014 capital budgets include funding for projects that support the strategic direction outlined by the Board and each Reserve Bank. These strategic goals focus on investments that continue to improve operational efficiencies, enhance services to Bank customers, and ensure a safe and productive work environment.

Board of Governors Budgets

The Board's budget is grounded in the direction set by its *Strategic Framework 2012–15* (www.federalreserve.gov/publications/gpra/files/2012-2015-

[1] The capital budget reported for the Board includes the amount budgeted for the Office of Inspector General (OIG). The capital budget reported for the Reserve Banks includes the amounts budgeted for the Federal Reserve Information Technology (FRIT) support function and the Office of Employee Benefits (OEB).

Table 3. Operating expenses of the Board of Governors, by division, office, or special account, 2013–14
Millions of dollars

Division, office, or special account	2013 budget[1]	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Board Members	26.9	25.4	-1.5	-5.7	26.5	1.1	4.4
Secretary	9.4	9.2	-0.2	-1.8	9.7	0.4	4.6
Research and Statistics	64.3	59.3	-5.0	-7.8	61.7	2.4	4.1
International Finance	25.1	23.8	-1.3	-5.2	27.0	3.2	13.6
Monetary Affairs	30.9	29.5	-1.4	-4.4	32.3	2.7	9.2
Office of Financial Stability Policy and Research	4.9	5.2	0.3	5.5	7.0	1.8	35.2
Bank Supervision and Regulation	102.6	99.2	-3.4	-3.4	106.5	7.3	7.4
Consumer and Community Affairs	24.1	22.7	-1.4	-5.8	24.5	1.8	8.1
Legal	22.7	20.9	-1.9	-8.1	24.3	3.4	16.4
Chief Operating Officer	3.0	4.2	1.2	40.7	10.2	6.0	141.0
Financial Management	9.5	9.3	-0.2	-2.2	10.3	1.0	10.3
Reserve Bank Operations and Payment Systems	33.9	33.8	-0.1	-0.4	34.7	1.0	2.8
Information Technology	81.6	79.6	-2.0	-2.4	93.5	13.8	17.4
Management	110.8	105.8	-5.0	-4.5	111.7	5.9	5.5
Data processing income	-36.5	-37.0	-0.5	1.4	-36.7	0.3	-0.7
Residual retirement	14.7	9.2	-5.5	-37.4	9.9	0.7	7.3
Special projects	17.9	13.5	-4.4	-24.5	13.6	0.1	0.9
Savings and reallocations	-1.9	0.0	1.9	-100.0	0.0	0.0	0.0
Extraordinary items	16.0	14.4	-1.6	-10.3	17.8	3.4	24.0
Total, Board operations	**559.9**	**527.9**	**-32.0**	**-5.7**	**584.2**	**56.3**	**10.7**
Office of Inspector General	26.9	25.8	-1.1	-4.1	26.9	1.1	4.3

[1] 2013 budget figures do not reflect internal transfers between divisions during the year.

strategic-framework.pdf).[2] The budget is structured by division, office, or special account.

The Board's budget process is as follows:

- The Board establishes a base budget to support current operations.
- Each division identifies new initiatives and offsetting savings required to achieve its objectives for the next budget cycle.
- The chief operating officer, the chief financial officer, and the executive committee of the Board evaluate each new initiative and proposed savings in the context of the Board's strategic framework.
- New initiatives that do not correspond to the themes set forth in the strategic framework require savings offsets.
- Staff submits the proposed budget to the Committee on Board Affairs (CBA) for review.
- The administrative governor of the CBA submits the budget to the full Board for review and final action.
- Expenses are monitored throughout the year. Variances are analyzed and reported.

The Board's Office of Inspector General (OIG), in keeping with its statutory independence, prepares its proposed budget apart from the Board's budget. The OIG presents its budget directly to the Board for approval; thus, information on the OIG's budget is also provided in the discussion that follows.

Tables 3 and 4 summarize the Board's 2013 budgeted and actual expenditures, as well as its 2014 budgeted expenditures by division, office, or special account and by account classification, respectively. Table 5 summarizes the Board's budgeted and actual authorized position count for 2013 and 2014. Each table also includes a line item for the OIG.

[2] The document identified and framed six overarching themes for the Board to address over the four-year planning horizon, along with recommended resource investments in terms of personnel and facilities.

Table 4. Operating expenses of the Board of Governors, by account classification, 2013–14
Millions of dollars

Account classification	2013 budget[1]	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Personnel services							
Salaries	314.3	307.2	-7.1	-2.3	328.0	20.8	6.8
Retirement/thrift plans	43.3	40.2	-3.1	-7.1	42.2	2.0	4.9
Employee insurance	28.9	26.3	-2.6	-9.0	28.6	2.3	8.6
Subtotal, personnel services	386.5	373.7	-12.8	-3.3	398.7	25.0	6.7
Goods and services							
Postage and shipping	0.7	0.3	-0.4	-62.9	0.5	0.3	107.7
Travel	14.2	13.7	-0.5	-3.2	15.1	1.4	9.8
Telecommunications	7.4	6.0	-1.5	-19.6	7.9	2.0	32.9
Printing and binding	2.4	1.5	-1.0	-39.6	2.2	0.7	49.0
Publications	0.6	0.5	-0.2	-25.0	0.6	0.2	42.2
Stationery and supplies	1.6	1.4	-0.2	-15.0	2.3	1.0	70.6
Software	12.1	11.4	-0.7	-5.7	17.1	5.7	49.9
Furniture and equipment	9.7	7.7	-2.0	-20.2	14.3	6.5	84.4
Rentals	12.8	12.4	-0.4	-3.0	16.2	3.7	30.1
Books and subscriptions	1.1	1.0	-0.1	-8.2	1.3	0.3	28.7
Utilities	3.9	3.3	-0.6	-14.9	3.6	0.3	8.7
Repairs and alterations bldg.	3.0	2.5	-0.6	-18.3	3.0	0.6	22.4
Repairs and maintenance F&E	2.9	3.4	0.5	17.2	3.3	-0.1	-3.2
Contingency processing center	1.3	1.3	0.0	-3.1	1.3	0.1	5.6
Contractual professional services	71.8	62.2	-9.6	-13.3	64.5	2.2	3.6
Interest expense	*	*	0.0	0.0	*	*	-50.0
Tuition	4.9	3.9	-1.0	-20.2	5.1	1.2	29.9
Subsidies and contributions	0.8	0.7	-0.1	-10.0	0.8	0.1	9.7
Depreciation/amortization	24.1	23.8	-0.4	-1.5	27.7	4.0	16.7
All other[2]	-1.8	-2.6	-0.8	44.4	-1.3	1.3	-50.0
Subtotal, goods and services	173.5	154.2	-19.3	-11.1	185.5	31.2	20.2
Total, Board operations	**559.9**	**527.9**	**-32.0**	**-5.7**	**584.2**	**56.3**	**10.7**
Office of Inspector General							
Personnel services	16.9	19.0	2.0	12.1	18.3	-0.7	-3.8
Goods and services	10.0	6.9	-3.1	-31.2	8.7	1.8	26.0
Total, OIG operations	**26.9**	**25.8**	**-1.1**	**-4.1**	**26.9**	**1.1**	**4.3**

[1] 2013 budget figures do not reflect internal transfers between divisions during the year.
[2] All other includes, among other items, income from outside agencies for data processing services, rental income, and transportation subsidy benefits for employees.
* Less than $500 thousand.

2013 Budget Performance

Board of Governors

Total expenses for Board operations were $527.9 million, which is $32.0 million, or 5.7 percent, less than the approved 2013 budget of $559.9 million. The Board's 2013 single-year capital spending was also less than budgeted by $0.45 million, or 4.1 percent, and all multiyear capital projects remained within their total project budgets.

The 2013 underrun is primarily driven by lower-than-planned personnel and contractual professional services expenses. Personnel services were $12.8 million less than the operating plan because divisions and offices took longer than expected to fill vacancies

Table 5. Positions authorized by the Board of Governors, by division, office, or special account

Division, office, or special account	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget[1]	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Board Members	115	116	1	0.9	117	1	0.9
Secretary	53	53	0	0.0	53	0	0.0
Research and Statistics	353	327	-26	-7.4	336	9	2.8
International Finance	136	136	0	0.0	145	9	6.6
Monetary Affairs	144	141	-3	-2.1	151	10	7.1
Office of Financial Stability Policy and Research	34	34	0	0.0	37	3	8.8
Bank Supervision and Regulation	412	412	0	0.0	423	11	2.7
Consumer and Community Affairs	103	103	0	0.0	103	0	0.0
Legal	105	105	0	0.0	110	5	4.8
Chief Operating Officer	16	42	26	162.5	59	17	40.5
Financial Management	67	69	2	3.0	69	0	0.0
Reserve Bank Operations and Payment Systems	156	156	0	0.0	168	12	7.7
Information Technology	397	399	2	0.5	409	10	2.5
Management	449	440	-9	-2.0	440	0	0.0
Total, Board operations[2]	**2,540**	**2,533**	**-7**	**-0.3**	**2,620**	**87**	**3.4**
Office of Inspector General	115	115	0	0.0	120	5	4.3

[1] In January, the Board approved an increase of 11 authorized positions to support the Board's oversight responsibilities related to financial market utilities as well as a technical editor to work on increased reporting requirements related to the Dodd-Frank Act.

[2] Budget represents authorized position count at the beginning of the year and actual represents authorized position count at year-end.

and the actuarial assumptions, demographics, and discount rates for the Board's non-qualified retirement plans changed. Contractual professional services were $9.6 million less than budgeted because divisions and offices engaged fewer consultants than expected for projects related to automation, organizational skills, and executive searches.

Office of Inspector General

Total expenses for OIG operations were $25.8 million, or $1.1 million less than the approved operating budget. Personnel services were $2.0 million more than budgeted, largely because hiring was earlier than anticipated. Goods and services were $3.1 million less than budgeted.

2014 Operating Expense Budget

Board of Governors

The 2014 budget for Board operations is $584.2 million, which is $56.3 million, or 10.7 percent, higher than 2013 actual expenses. The operating budget includes amounts to fund the Board's ongoing operations and to support the strategic themes identified in the Board's *Strategic Framework 2012–15*. This is the second budget since the Board approved the framework in June 2012.

For 2014, authorized positions for Board operations total 2,620, an increase of 87 positions, or 3.4 percent, from 2013. The positions are aligned with the strategic framework themes and will primarily support the Board's financial stability and supervisory mandate under the Dodd-Frank Act and implementation of a data governance program. The 2014 Board budget reflects a merit increase of 3.0 percent for staff.

Office of Inspector General

The 2014 budget for OIG operations is $26.9 million, which is $1.1 million, or 4.3 percent, higher than 2013 actual expenses. This includes an increase of 5 positions, for a total of 120 positions. A reduction to the 2014 goods and services budget offsets the personnel cost associated with these additional positions.

Risks in the 2014 Budget

When the Board approved the strategic framework, the governors considered the resources necessary to implement the strategic themes, as well as budgetary

Table 6. Capital Outlays of the Board of Governors, by capital type, 2013–14
Millions of dollars

Item	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget[1]	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Single-year capital outlays	11.1	10.5	-0.6	-5.4	5.1	-5.4	-51.4
Multiyear capital outlays	56.5	19.0	-37.5	-66.4	127.9	108.9	573.2
Total capital outlays[2]	**67.6**	**29.5**	**-38.1**	**-56.4**	**133.0**	**103.5**	**350.8**

[1] In January, the Board approved additional capital funding of $0.62 million in the Board's single-year capital budget and $13.72 million in the Board's multiyear capital budget for initiatives not included in the approved 2014 budget.

[2] Capital, as shown in this report, includes the Board and OIG capital budgets and expenditures. The amount reported for multiyear capital outlays budget and actual represents the expected expenditure and amount spent for the budgeted year.

growth targets to manage costs. The 2014 budget aligns with the guidelines contained in the framework and places the Board on a trajectory to meet the cost-reduction targets described in the framework.

The 2014 budget remains largely consistent with risks identified in previous years. In particular, the Board's ability to attract, retain, and engage qualified staff and continue to meet the demands of the increased work requirements remains a top priority.

Over the next few years, significant investments in the Board data environment will be required. As part of the framework, the Board approved its two largest capital projects in recent years—the renovation of the Martin Building and the relocation of the data center (discussed further under "2014 Capital Budget"). Although the Board has retained consultants to assist in these efforts and has capable staff who have experience dealing with complex projects, both initiatives continue to require careful monitoring given the size of their budgets, the initiatives' critical importance, and the continued public focus on Board operations. Past budget cycles have included purchases for additional data in support of supervisory activities and additional infrastructure investments (separate from costs already budgeted for the data center relocation). As noted in the framework, establishing an infrastructure to share data and improve opportunities for data integration is necessary to expand the Board's research and analytical capabilities and provide staff with the new tools necessary to obtain, interpret, and analyze large volumes of data required by the new supervisory tools. As the initiatives put forward as part of the 2014 budget process indicate, funding the new infrastructure will place upward pressure on the operating budget.

2014 Capital Budget

Table 6 summarizes the Board's and the OIG's budgeted and actual capital outlays for 2013 and 2014.

Board of Governors

The Board's 2014 capital budget totals $5.1 million for single-year capital and $127.9 million for multiyear capital projects. The budget increase for multiyear capital projects over 2013 actuals is primarily due to the data center relocation and Martin Building renovation. Efforts are currently under way to relocate the Board's data center to space identified within a branch of the Federal Reserve Bank of Richmond. The expected cost over the life of the project is $83.4 million, which includes funding for space build-out along with software and hardware acquisitions needed to support a network infrastructure that can handle the increase in demand for data. Total expected cost for the Martin Building renovation over the life of the project—which will overhaul the building's infrastructure as well as provide additional space for meetings and conferences—is $244.0 million.

Office of Inspector General

The 2014 OIG capital budget totals $0.07 million for single-year capital and $3.2 million for the life of the multiyear capital projects. The increase of $1.0 million in multiyear capital projects over 2013 actuals is due to build out for the regional offices.

Federal Reserve Banks Budgets

Each Reserve Bank establishes major operating goals for the coming year, devises strategies for attaining

Table 7. Operating expenses of the Federal Reserve Banks, by district, 2013–14
Millions of dollars

District	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Boston	207.2	198.7	-8.5	-4.1	220.1	21.4	10.8
New York	896.8	883.1	-13.7	-1.5	908.9	25.8	2.9
Philadelphia	199.0	194.8	-4.2	-2.1	202.6	7.9	4.0
Cleveland	158.4	155.6	-2.8	-1.8	176.2	20.6	13.3
Richmond	372.7	359.9	-12.8	-3.4	361.0	1.0	0.3
Atlanta	318.7	307.3	-11.4	-3.6	319.0	11.7	3.8
Chicago	326.1	319.8	-6.4	-1.9	340.7	20.9	6.5
St. Louis	258.0	253.4	-4.6	-1.8	285.8	32.4	12.8
Minneapolis	189.6	181.0	-8.6	-4.5	199.8	18.8	10.4
Kansas City	214.5	207.1	-7.5	-3.5	222.4	15.3	7.4
Dallas	214.5	207.5	-7.0	-3.3	212.2	4.8	2.3
San Francisco	332.8	323.4	-9.3	-2.8	347.0	23.5	7.3
Total Reserve Bank operating expenses	**3,688.2**	**3,591.6**	**-96.6**	**-2.6**	**3,795.7**	**204.1**	**5.7**

Note: Includes expenses budgeted by the FRIT support function and the OEB, and reflects all redistributions for support and allocation for overhead. Excludes capital outlays and assessments for Board expenses, currency costs, and expenses of the CFPB.

those goals, estimates required resources, and monitors results. The Reserve Banks' budgets are structured by operational area, with attributable support and overhead charged to each area. In addition to the budget approval process, the Reserve Banks must submit proposals for major capital acquisitions and capitalized projects to the Board for further review and approval.

The Reserve Bank budget process is as follows:

- Reserve Banks receive budget guidance regarding major functional areas for the upcoming budget year.
- The Reserve Banks develop budgets that incorporate this guidance, which are reviewed by senior leadership in the Reserve Banks for alignment with Reserve Bank and System priorities.
- The Reserve Banks submit preliminary budget information to the Board for review, including documentation to support the budget request.
- Board staff analyzes the Banks' budgets, both individually and in the context of System initiatives and other Banks' plans.
- The Board's Committee on Federal Reserve Bank Affairs (BAC) reviews the Bank budgets.
- The Reserve Banks make any requested or needed changes and the BAC chair submits the revised budgets to Board members for review and final action.
- Throughout the year, Reserve Bank and Board staffs monitor actual performance and compare it with approved budgets and forecasts.

Tables 7, 8, and 9 summarize the Reserve Banks' 2013 budgeted and actual expenses, 2014 budgeted expenses, and 2013 and 2014 employment by Reserve Bank, operating area, and account classification, respectively.[3] In addition, table 10 shows the Reserve Banks' budgeted and actual employment for 2013 and 2014.

2013 Budget Performance

Total 2013 operating expenses for the Reserve Banks were $3,591.6 million, which is $96.6 million, or 2.6 percent, less than the approved 2013 budget of $3,688.2 million, while the average number of personnel (ANP) increased by 88, largely because of application development work.

The 2013 budget underrun is primarily driven by lower-than-planned expenses for services to financial institutions and the public, supervision, Treasury ser-

[3] Additional information about the operating expenses of each of the Reserve Banks can be found in section 10 ("Statistical Tables") of this annual report (see "Table 10. Income and expenses of the Federal Reserve Banks, by Bank").

Table 8. Operating expenses of the Federal Reserve Banks, by operating area, 2013–14
Millions of dollars

Operating area	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Monetary and economic policy	602.3	596.5	-5.9	-1.0	614.1	17.6	3.0
Services to the U.S. Treasury and other government agencies	522.7	500.5	-22.2	-4.2	550.2	49.6	9.9
Services to financial institutions and the public	1,033.1	1,003.4	-29.7	-2.9	1,048.5	45.2	4.5
Supervision and regulation	1,146.3	1,118.8	-27.5	-2.4	1,189.4	70.6	6.3
Fee-based services to financial institutions[1]	383.8	372.4	-11.3	-3.0	393.4	21.0	5.6
Total Reserve Bank operating expenses	**3,688.2**	**3,591.6**	**-96.6**	**-2.6**	**3,795.7**	**204.1**	**5.7**

1 Operating expenses for fee-based services to financial institutions exclude pension costs, Board-related expenses, and reimbursements for certain non-priced services.

vices, and fee-based services to financial institutions (priced services). Expenses related to the CashForward initiative, which are a component of the expenses for services to financial institutions and the public, were $17.8 million lower than budget.[4] In the supervision function, efficiency initiatives and delays in hiring new staff led to lower overall expenses (-$27.5 million). The underrun in Treasury services is due to program changes primarily for the Do Not Pay program (-$5.1 million), volume reductions in Treasury Retail Securities (-$5.3 million), and the timing of other initiatives.[5] Priced services expenses reflect continued check volume declines.

Total 2013 actual employment of 18,744 ANP represents an increase of 88 ANP, or 0.5 percent, from 2013 budgeted levels of 18,656 ANP. The higher-than-budgeted ANP reflects increased application development support primarily for updates to cash technology and supervision projects. Additional information technology (IT) ANP growth was the result of higher-than-anticipated server and storage demand and an increase in network services support. Treasury's Go Direct initiative added temporary staff

4 The CashForward initiative will replace legacy software applications, automate business processes, and employ technologies to meet current and future needs for the cash function. Phase 1 was completed in 2010, and Phase 2 was completed in July 2012. The project's planned completion date is scheduled for 2017.

5 The Do Not Pay program was established to reduce the number of improper payments made through major programs administered by the federal government.

Table 9. Operating expenses of the Federal Reserve Banks, by account classification, 2013–14
Millions of dollars

Account classification	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Personnel[1]	2,681.8	2,672.0	-9.8	-0.4	2,787.4	115.4	4.3
Building	319.9	315.5	-4.4	-1.4	320.3	4.8	1.5
Equipment	193.1	169.1	-24.1	-12.5	197.3	28.3	16.7
Software Costs	188.6	183.1	-5.5	-2.9	211.9	28.8	15.7
Travel	95.6	88.1	-7.5	-7.8	96.2	8.1	9.1
Materials and Supplies	71.7	66.6	-5.0	-7.0	70.1	3.5	5.2
Communications	48.5	47.5	-1.0	-2.0	49.2	1.7	3.7
Shipping	16.1	14.5	-1.6	-9.7	15.5	1.0	6.8
All other[2]	72.8	35.1	-37.8	-51.9	47.6	12.6	35.9
Total Reserve Bank operating expenses	**3,688.2**	**3,591.6**	**-96.6**	**-2.6**	**3,795.7**	**204.1**	**5.7**

1 Personnel expense includes salaries, other personnel expense, and retirement and other employment benefit expenses.
2 Includes outside fees, recoveries, and the transfer of expenses for capitalizable software development efforts.

Table 10. Employment at the Federal Reserve Banks, by District, and at FRIT and OEB, 2013–14

District	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Boston	1,080	1,037	-42	-3.9	1,097	59	5.7
New York	3,326	3,277	-49	-1.5	3,247	-30	-0.9
Philadelphia	944	915	-30	-3.1	946	31	3.3
Cleveland	908	931	23	2.5	968	37	4.0
Richmond	1,541	1,549	8	0.5	1,586	37	2.4
Atlanta	1,630	1,623	-7	-0.4	1,627	5	0.3
Chicago	1,490	1,483	-7	-0.5	1,512	28	1.9
St. Louis	1,066	1,086	20	1.9	1,145	59	5.4
Minneapolis	1,147	1,131	-16	-1.4	1,133	3	0.3
Kansas City	1,430	1,443	13	0.9	1,512	69	4.8
Dallas	1,239	1,301	63	5.1	1,217	-84	-6.4
San Francisco	1,599	1,646	47	2.9	1,671	25	1.5
Total, all Districts	**17,400**	**17,422**	**22**	**0.1**	**17,662**	**240**	**1.4**
Federal Reserve Information Technology (FRIT)	1,202	1,272	70	5.8	1,265	-7	-0.5
Office of Employee Benefits (OEB)	53	50	-3	-6.1	52	2	4.5
Total	**18,656**	**18,744**	**88**	**0.5**	**18,979**	**236**	**1.3**

to manage higher call volumes related to the March 1, 2013, deadline to have all federal benefit payments issued electronically. Partially offsetting these increases are hiring delays in the supervision and monetary policy functions and for the Treasury's Invoice Processing Platform (IPP).[6] Other refinements include reductions in savings bond operations due to lower-than-expected volumes.

2014 Operating Expense Budget

The 2014 operating budgets of the Reserve Banks total $3,795.7 million, which is $204.1 million, or 5.7 percent, higher than 2013 actual expenses. The largest increase is in the supervision function, which is adding resources to support expanded supervisory responsibilities for large financial institutions and continued state member bank growth. The supervision function also is adding additional ANP to improve its analytical capabilities.

Budgeted expenses for services to the Treasury, which are fully reimbursable, are increasing to meet greater demand from the Treasury and because of the amortization of capitalized software projects. Expenses are expected to grow significantly because of Treasury's efforts to modernize its revenue collection and payment management methods, including the Internet Channel (Pay.gov), IPP, and the Post Payment System (PPS) ($13.1 million).[7] The budget includes $11.2 million for the new eCommerce initiative for payments to government agencies. Treasury Web Application Infrastructure (TWAI) expenses will also increase as the number of applications hosted in the infrastructure expands ($11.0 million). In addition, the Reserve Banks will provide increased support for the Do Not Pay ($5.6 million) and the Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS) ($2.2 million) programs.[8]

Increases in services to financial institutions and the public include continuing development work on the CashForward projects, cash-processing machine upgrades, and increased video surveillance support. Priced services increases are driven by the Fedwire, FedACH, and FedLine modernization programs and enhancements.[9] Several Banks are increasing analyti-

6 IPP is a secure, web-based system that manages the government's invoicing processes.

7 The Internet Channel application is a secure government-wide collection portal that was developed to meet Treasury's commitment to electronic collections processing using Internet technologies. PPS will streamline post-payment processes and eliminate redundant functionality by consolidating several existing applications into a single, centralized system.

8 The GTAS will replace current reporting systems in a single data collection system that will be used by all government agencies as the primary means of reporting trial balance data to the Office of Management and Budget.

9 The Fedwire modernization initiative involves the transition of the Fedwire Funds and Fedwire Securities applications from the legacy mainframe environment to a distributed platform. The FedACH program involves the transition of the FedACH Service platform from the mainframe to a distributed platform.

cal capabilities and enhancing resiliency in their monetary policy functions by adding ANP and investing in IT solutions. Partially offsetting these increases is reduced check operations expense resulting from the 2013 completion and implementation of the new check processing platform.

Total 2014 budgeted employment for the Reserve Banks, Federal Reserve Information Technology (FRIT), and the Office of Employee Benefits (OEB) is 18,979 ANP, an increase of 236 ANP, or 1.3 percent, from 2013 employment levels that is primarily driven by supervision and IT. The supervision function is adding 109 ANP due to expanding responsibilities and growth in the number and size of institutions supervised. IT ANP is increasing by 204 for large development projects and information security initiatives. These staff increases are partially offset by a decrease of temporary staff hired in 2013 for Go Direct and by efficiencies found in support areas.

Budgeted Reserve Bank personnel expenses for 2014 total $2,787.4 million, an increase of $115.4 million, or 4.3 percent, over 2013 expenses. The increase reflects expenses associated with additional staff and budgeted salary adjustments, including merit increases, equity adjustments, promotions, and funding for variable pay. The 2014 Reserve Bank budgets reflect merit increases of 3.0 percent, totaling $48.8 million for officers, senior professionals, and staff.[10] Equity adjustments and promotions total $10.0 million for officers and senior professionals and $19.1 million for staff. Funding for variable pay programs for officers, senior professionals, and staff totals $156.9 million.

Risks in the 2014 Budget

Risks to the budget remain largely consistent with those identified last year. In particular, the most significant risks in the 2014 budget are related to staffing. Banks are concerned about their ability to hire and retain staff, particularly in locations where the employment market is improving. A number of Reserve Banks have aggressive hiring plans, and some Banks may experience difficulty meeting schedules for hiring staff with specialized skills and experience, particularly in supervision and IT. The primary risks in the supervision function relate to changes that may be needed in supervisory programs to implement key Federal Reserve responsibilities under the Dodd-Frank Act where the final rules have not yet been adopted. The Treasury continues to refine its future vision for collections, payments, and cash management systems, including those provided by the Reserve Banks. The effect on Treasury-directed Reserve Bank initiatives is currently unknown.

2014 Capital Budget

Table 11 shows the Reserve Banks' budgeted and actual capital outlays for 2013 and 2014.

The 2014 capital budgets submitted by the Reserve Banks, FRIT, and OEB total $475.4 million. The increase in the 2014 capital budget is $170.6 million, or 56.0 percent, above the 2013 actual levels, largely reflecting capital shifts for ongoing multiyear programs from 2013 to 2014. The few major new initiatives in the 2014 capital budget support monetary policy functions, optimize work space, and accommodate an increasing demand for video conferencing.

In support of the Reserve Bank strategies, the 2014 budgets include three categories of capital initiatives: Reserve Bank automation/IT projects, building and infrastructure, and Treasury initiatives.

Automation/IT

The Reserve Banks, FRIT, and OEB included $225.5 million in funding for major IT initiatives and Reserve Bank automation projects. Multiyear projects currently under way to migrate major applications off the mainframe account for $33.5 million of the 2014 capital budget.[11] The Reserve Bank consolidated network project and increased demand for storage capacity account for an additional $67.6 million. Cash services automation initiatives include $37.9 million for the CashForward project and $9.6 million for cash sensor upgrades. Other automation initiatives include development of analytical and

FedLine provides financial institutions with direct access to Federal Reserve System services.

[10] Congress enacted legislation prohibiting statutory pay adjustments for most federal civilian employees for the period from January 2011 through December 31, 2013. Although not required to do so under the legislation, the Reserve Banks complied with the spirit of the civilian pay freeze enacted by Congress and interpreted in subsequent Office of Personnel Management guidance, which permitted increases for staff (but not officers) under performance-based compensation systems such as those used by the Reserve Banks. As a result of the expiration of the salary freeze, Reserve Banks resumed provision of merit increases and equity adjustments for officers and senior professionals effective January 1, 2014.

[11] The Reserve Bank migration strategy involves moving a majority of applications from the mainframe to alternate processing environments. Projects included in the 2014 budget include the migration of the Fedwire, FedACH, accounting, and statistics and reserves systems.

Table 11. Capital Outlays of the Federal Reserve Banks, by District, and of FRIT and OEB, 2013–14
Millions of dollars

District	2013 budget	2013 actual	Variance 2013 budget to 2013 actual		2014 budget	Variance 2014 budget to 2013 actual	
			Amount	Percent		Amount	Percent
Boston	49.7	28.1	-21.6	-43.4	41.9	13.8	49.1
New York	122.5	72.8	-49.7	-40.6	115.0	42.2	57.9
Philadelphia	18.8	11.9	-6.9	-36.9	21.2	9.3	78.6
Cleveland	15.6	9.3	-6.3	-40.6	22.0	12.7	137.4
Richmond	32.1	19.1	-13.0	-40.5	15.7	-3.4	-17.7
Atlanta	21.9	10.9	-11.0	-50.4	16.7	5.9	54.0
Chicago	49.9	22.0	-27.9	-56.0	38.1	16.2	73.7
St. Louis	8.2	10.7	2.5	30.6	13.5	2.8	26.3
Minneapolis	15.6	17.4	1.8	11.4	13.5	-3.9	-22.2
Kansas City	8.5	10.9	2.4	27.7	15.6	4.7	43.7
Dallas	15.5	7.1	-8.4	-54.0	18.1	11.0	153.6
San Francisco	53.1	33.3	-19.8	-37.4	65.1	31.8	95.7
Total, all Districts	**411.4**	**253.3**	**-158.1**	**-38.4**	**396.5**	**143.2**	**56.5**
Federal Reserve Information Technology (FRIT)	80.5	51.4	-29.1	-36.1	78.4	27.0	52.5
Office of Employee Benefits (OEB)	0.2	0.0	-0.2	-100.0	0.5	0.5	0.0
Total	**492.1**	**304.8**	**-187.4**	**-38.1**	**475.4**	**170.6**	**56.0**

operational tools supporting monetary policy, data security projects, and scheduled software and equipment upgrades.

Building and Infrastructure

Building and infrastructure projects account for $190.8 million of the proposed capital budget. Renovations to achieve more-efficient use of existing building space are proposed for the Federal Reserve Banks of New York, Cleveland, and Richmond. The Federal Reserve Banks of Boston and San Francisco will undertake space-renovation programs. The Federal Reserve Bank of Chicago continues its building security project, and the Federal Reserve Bank of Boston will modernize its elevators. The remaining outlays in this category fund programs necessary to maintain the safety and soundness of the Reserve Bank facilities.

Treasury

The capital budgets also include $59.1 million for Treasury initiatives, including support for TWAI, PPS, IPP, Treasury Retail Electronic Services, and the Internet Channel.

Currency Budget

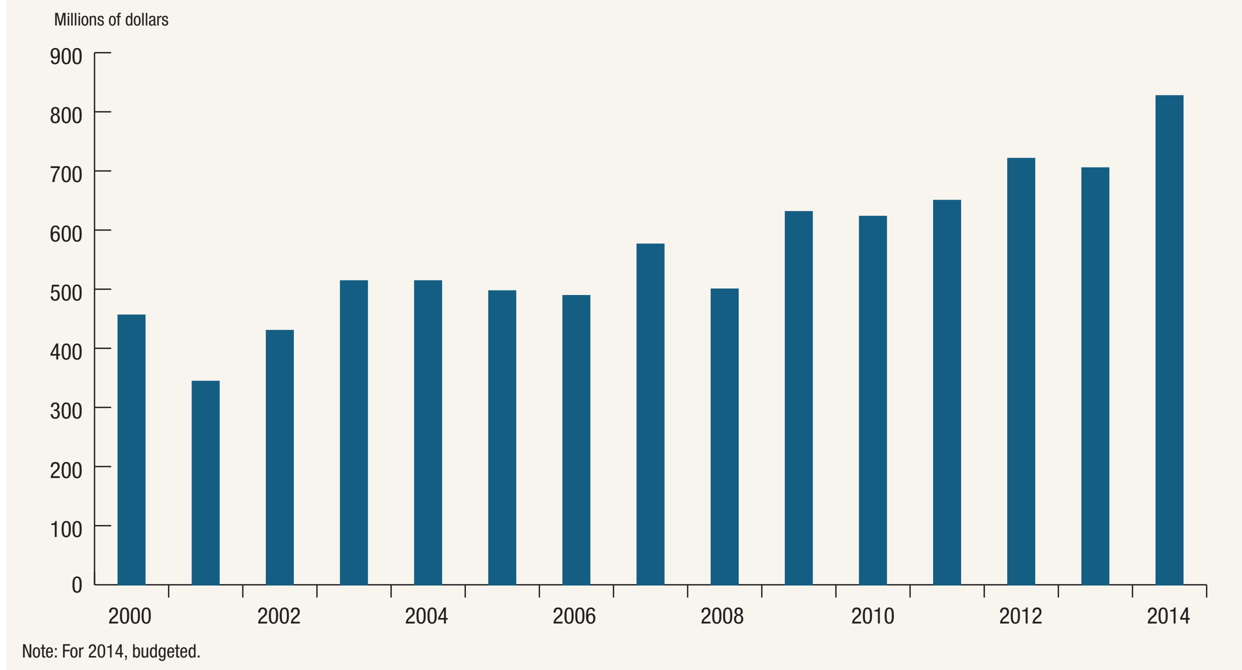
Board staff monitors payments of currency to and receipts of currency from circulation and the number of unfit notes destroyed at the Reserve Banks. Staff estimates the number of notes the Board will order from the Bureau of Engraving and Printing (BEP) to meet demand based on monthly monitoring, forecasts of growth rates for payments of currency to circulation and receipts of currency from circulation, operational factors, and other policy considerations. The Board of Governors reimburses the BEP for all costs related to the production of currency.[12] Historically, more than 90 percent of the notes that the Board orders each year replace unfit currency that Reserve Banks receive from circulation.

The annual currency budget process is as follows:

- Each August, based on Board staff's assessment of currency demand, the director of the Division of Reserve Bank Operations and Payment Systems submits a fiscal year (FY) print order for currency to the director of the BEP.
- Each December, Board staff estimates expenses for the currency budget, including printing expenses

[12] The BEP does not receive federal appropriations; all operations of the BEP are financed by a revolving fund that is reimbursed through product sales, virtually all of which are sales of Federal Reserve notes to the Board to fulfill its annual print order. Customer billings are the BEP's only means of recovering costs of operations and generating funds necessary for capital investment. Section 16 of the Federal Reserve Act requires all costs incurred for the issuing of notes shall be paid for by the Board and included in its assessments to Reserve Banks.

Figure 5. Federal Reserve costs for new currency, 2000–2014



Note: For 2014, budgeted.

(based on estimated production costs provided by the BEP); certain other BEP costs; and expenses for the currency education program, currency transportation, and counterfeit-deterrence research.

- The BAC reviews the proposed currency budget.
- The BAC chair submits the proposed currency budget to the Board for final action.

2013 Budget Performance

The Board's total 2013 actual expenses for new currency were $705.0 million, which represents a decrease of $92.6 million, or 11.6 percent, from the 2013 budget. The decrease is primarily due to lower-than-budgeted expenses for printing new notes and transporting new and fit notes, and for the currency education program. Because of uncertainty about whether the Board would issue the new-design $100 note in 2013, approximately 1.5 billion series-1996 (old-design) $100 notes were included in the budget to ensure that Reserve Banks would have sufficient quantities to meet demand during FY 2013.[13] By April, it was clear that the BEP could produce the quantity of new-design $100 notes the Board needed to begin issuing them in 2013, which it did starting on October 8. Because the full quantity of old-design $100 notes in the FY 2013 print order was no longer needed, the Board reduced its order for old-design $100 notes by approximately 1.0 billion notes, reducing estimated expenses by nearly $26.3 million. The remainder of the budget underrun is attributable primarily to the production of fewer notes in the fourth quarter than estimated in the 2013 budget.[14]

2014 Budget

The 2014 new currency budget of $826.7 million is 17.3 percent higher than 2013 expenditures (figure 5). Printing costs for Federal Reserve notes make up about 90 percent of the new currency budget. Expenses for currency transportation, the currency reader program, the currency quality assurance (CQA) program and counterfeit-deterrence research, and the currency education program (CEP) constitute the remaining 10 percent (table 12).

[13] The BEP experienced unexpected production problems that caused the Board to delay issuance, originally scheduled for February 2011.

[14] Because the BEP operates on a fiscal year that begins on October 1 and ends September 30, the Board estimates its calendar-year budget for new currency by eliminating the cost of notes that the BEP will produce in the first quarter of its fiscal year and estimating the costs of notes that the Board projects the BEP will produce in the fourth quarter of the calendar year.

Table 12. Federal Reserve budget for new currency, 2013 and 2014
Thousands of dollars, except as noted

Item	2013 actual	2014 budgeted	Variance 2014 budget to 2013 actual	
			Amount	Percent
BEP-related expenses				
Printing Federal Reserve notes	660,958	745,387	84,429	12.8
Currency reader	0	19,384	19,384	…
Other	3,081	3,225	144	4.7
Board expenses				
Currency transportation	20,732	33,222	12,490	60.2
Currency quality assurance and counterfeit deterrence	16,678	21,091	4,413	26.5
Currency education program	3,581	4,357	776	21.7
Total cost of new currency	**705,030**	**826,666**	**121,636**	**17.3**

… Not applicable.
BEP Bureau of Engraving and Printing.

Printing of Federal Reserve Notes

The 2014 currency budget includes $745.4 million to reimburse the BEP for expenses related to printing new currency. The budget reflects the variable costs to produce approximately 6.1 billion notes, as well as fixed costs at the BEP attributable to expenses associated with depreciation of a new information technology platform, payments to other government agencies, and staffing to support the CQA program. The average cost per thousand notes remained largely unchanged from 2013 to 2014.

Currency Reader Program

The 2014 budget also includes $19.4 million to fund the first year of a multiyear program to distribute currency readers to qualified individuals who are blind or visually impaired at no cost to the user. The BEP will implement a currency reader program to comply with a court order requiring the Treasury Department to provide meaningful access to individuals who are blind or visually impaired in denominating U.S. currency. During 2014, the BEP expects to award a contract to procure currency readers and to distribute the readers by mid-2014 through an interagency agreement with the Library of Congress' book reader program, which is managed by the National Library Service.

Other Reimbursements to the Bureau of Engraving and Printing

The 2014 budget includes $3.2 million to reimburse the BEP for expenses incurred by its Destruction Standards and Compliance Division of the Office of Compliance and Mutilated Currency Division of the Office of Financial Management. The Office of Compliance develops Reserve Bank standards for cancellation and destruction of unfit currency and for note accountability, and reviews Reserve Banks' cash operations for compliance with its standards. As a public service, the Mutilated Currency Division processes claims for the redemption of damaged or mutilated currency.

Currency Transportation

The 2014 currency transportation budget is $33.2 million. This amount includes the costs of shipping new currency from the BEP to Reserve Banks, intra-System shipments of fit and unprocessed currency, and returning currency pallets from Reserve Banks to the BEP. The Board estimates that the number of notes transported in 2014 will be approximately the same as in 2013. The budget increase is primarily attributable to a planned 6.0 percent increase in contracted rates with armored carriers to transport currency.

Currency Quality Assurance

The 2014 budget for the CQA program is $13.9 million. The budget will allow the CQA consultants to continue facilitating the implementation of the new quality system at the BEP; support the research, technology, and product development required for the next design family of Federal Reserve notes; and continue providing temporary resources to the BEP to sustain critical programs that have been implemented for the quality system.

Counterfeit Deterrence

The 2014 budget for counterfeit-deterrence research is $7.2 million. The budget includes $5.1 million for

membership in the Central Bank Counterfeit Deterrence Group (CBCDG). The CBCDG operates under the auspices of the G-10 central bank governors to combat digital counterfeiting and includes 33 central banks.

Currency Education Program

The 2014 CEP budget is $4.4 million. The CEP is designed to protect and maintain confidence in U.S. currency worldwide by providing information on all circulating designs of Federal Reserve notes to the global public. The program works to ensure that users of U.S. currency know what genuine Federal Reserve notes look like, are aware of the security features in each denomination, and know how to use those security features to distinguish between genuine and counterfeit notes.

The 2014 budget reflects continued activity associated with educating the global public about the new-design $100 note. This includes work that was postponed because of the shutdown of the U.S. government in October 2013. Spending for 2014 is expected to decrease after the second quarter of 2014 because educational efforts will shift to post-issuance levels. Major expense drivers for the 2014 budget include the fulfillment of educational materials in more than 20 languages, international outreach to businesses and retailers in more than 25 countries, and hosting and developing the NewMoney.gov educational website.

13 Federal Reserve System Organization

Congress designed the Federal Reserve System to give it a broad perspective on the economy and on economic activity in all parts of the nation. As such, the System is composed of a central, governmental agency—the Board of Governors—in Washington, D.C., and 12 regional Federal Reserve Banks. This section lists key officials across the System, including the Board of Governors, its officers, Federal Open Market Committee members, several System councils, and Federal Reserve Bank and Branch directors and officers.

Board of Governors

Members

The Board of Governors of the Federal Reserve System is composed of seven members, who are nominated by the President and confirmed by the Senate. The Chairman and the Vice Chairman of the Board are also named by the President from among the members and are confirmed by the Senate. For a full listing of Board members from 1914 through the present, visit www.federalreserve.gov/aboutthefed/bios/board/boardmembership.htm.

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Marietta Murphy
Deputy Associate Director

Kassandra Arana Quimby
Deputy Associate Director

Sheryl Lynn Warren
Deputy Associate Director

Rajasekhar R. Yelisetty
Deputy Associate Director

Theresa C. Palya
Assistant Director

Virginia M. Wall
Assistant Director

Edgar Wang
Assistant Director

Charles B. Young II
Assistant Director

Tillena G. Clark
Adviser

Can Xuan Nguyen
Adviser

Office of Inspector General

Mark Bialek
Inspector General

James A. Ogden
Deputy Inspector General

Jacqueline M. Becker
Associate Inspector General

Elise M. Ennis
Associate Inspector General

Melissa M. Heist
Associate Inspector General

Andrew Patchan Jr.
Associate Inspector General

Lawrence K. Valett
Associate Inspector General

Federal Open Market Committee

The Federal Open Market Committee is made up of the seven members of the Board of Governors; the president of the Federal Reserve Bank of New York; and four of the remaining 11 Federal Reserve Bank presidents, who serve one-year terms on a rotating basis. During 2013, the Federal Open Market Committee held eight regularly scheduled meetings (see section 8, "Minutes of Federal Open Market Committee Meetings").

Members

Ben S. Bernanke
Chairman, Board of Governors

William C. Dudley
Vice Chairman, President, Federal Reserve Bank of New York

James Bullard
President, Federal Reserve Bank of St. Louis

Elizabeth Duke
Member, Board of Governors (*through August 2013*)

Charles L. Evans
President, Federal Reserve Bank of Chicago

Esther L. George
President, Federal Reserve Bank of Kansas City

Jerome H. Powell
Member, Board of Governors

Sarah Bloom Raskin
Member, Board of Governors

Eric Rosengren
President, Federal Reserve Bank of Boston

Jeremy C. Stein
Member, Board of Governors

Daniel K. Tarullo
Member, Board of Governors

Janet L. Yellen
Member, Board of Governors

Alternate Members

Christine M. Cumming
First Vice President, Federal Reserve Bank of New York

Richard W. Fisher
President, Federal Reserve Bank of Dallas

Narayana Kocherlakota
President, Federal Reserve Bank of Minneapolis

Sandra Pianalto
President, Federal Reserve Bank of Cleveland

Charles I. Plosser
President, Federal Reserve Bank of Philadelphia

Officers

William B. English
Secretary and Economist

Deborah J. Danker
Deputy Secretary

Matthew M. Luecke
Assistant Secretary

David W. Skidmore
Assistant Secretary

Michelle A. Smith
Assistant Secretary

Scott G. Alvarez
General Counsel

Thomas C. Baxter
Deputy General Counsel

Richard M. Ashton
Assistant General Counsel

Steven B. Kamin
Economist

David W. Wilcox
Economist

Thomas A. Connors
Associate Economist

Troy Davig
Associate Economist

Michael P. Leahy
Associate Economist

James J. McAndrews
Associate Economist

Stephen A. Meyer
Associate Economist

David Reifschneider
Associate Economist (*through September 2013*)

Daniel G. Sullivan
Associate Economist

Geoffrey Tootell
Associate Economist

Christopher J. Waller
Associate Economist

William Wascher
Associate Economist

Simon Potter
Manager, System Open Market Account

Board of Governors Advisory Councils

The Federal Reserve System uses advisory committees in carrying out its varied responsibilities. Three of these committees advise the Board of Governors directly: the Federal Advisory Council, the Consumer Advisory Council, and the Community Depository Institutions Advisory Council. These councils, whose members are drawn from each of the 12 Federal Reserve Districts, meet two to four times a year. The individual Reserve Banks have advisory committees as well, including thrift institutions advisory committees, small business committees, and agricultural advisory committees. Moreover, officials from all Reserve Banks meet periodically in various committees. To learn more, visit www.federalreserve.gov/aboutthefed/advisorydefault.htm.

Federal Advisory Council

The Federal Advisory Council—a statutory body established under the Federal Reserve Act—consults with and advises the Board of Governors on all matters within the Board's jurisdiction. It is composed of one representative from each Federal Reserve District, chosen by the Reserve Bank in that District. The Federal Reserve Act requires the council to meet in Washington, D.C., at least four times a year. Three members of the council serve as its president, vice president, and secretary. In 2013, it met on February 7–8, May 16–17, September 19–20, and December 5–6. The council met with the Board on February 8, May 17, September 20, and December 6, 2013.

Members

District 1
Joseph L. Hooley
Chairman, President, and Chief Executive Officer, State Street Corporation, Boston, MA

District 2
James P. Gorman
Chairman and Chief Executive Officer, Morgan Stanley, New York, NY

District 3
Bharat B. Masrani
President and Chief Executive Officer, TD Bank, Cherry Hill, NJ

District 4
James E. Rohr
Chairman and Chief Executive Officer, The PNC Financial Services Group, Inc., Pittsburgh, PA

District 5
Kelly S. King
Chairman and Chief Executive Officer, BB&T Corporation,Winston-Salem, NC

District 6
Daryl G. Byrd
President and Chief Executive Officer, IBERIABANK Corporation, Lafayette, LA

District 7
David W. Nelms
Chairman and Chief Executive Officer, Discover Financial Services, Riverwoods, IL

District 8
D. Bryan Jordan
Chairman, President, and Chief Executive Officer, First Horizon National Corporation, Memphis, TN

District 9
Patrick J. Donovan
President and CEO, Bremer Financial Corporation, St. Paul, MN

District 10
Jonathan M. Kemper
Chairman and CEO, Commerce Bank, N.A. (Kansas City), Kansas City, MO

District 11
Richard W. Evans Jr.
Chairman and Chief Executive Officer, Cullen/Frost Bankers Inc., San Antonio, TX (*resigned August 1, 2013*)
Ralph W. Babb Jr.
Chairman and CEO, Comerica Inc. and Comerica Bank, Dallas, TX

District 12
J. Michael Shepherd
Chairman and Chief Executive Officer, Bank of the West and BancWest Corporation, San Francisco, CA

Officers

James E. Rohr
President

D. Bryan Jordan
Vice President

James E. Annable
Secretary

Community Depository Institutions Advisory Council

The Community Depository Advisory Council advises the Board of Governors on the economy, leading conditions, and other issues. Members are selected from representatives of banks, thrift institutions, and credit unions serving on local advisory councils at the 12 Federal Reserve Banks. One member of each of the Reserve Bank councils serves on the Community Depository Institutions Advisory Council, which meets twice a year with the Federal Reserve Board in Washington.

Members

Charles H. Majors
Executive Chairman, American National Bank and Trust, Danville, VA

Drake Mills
President and Chief Executive Officer, Community Trust Bank, Ruston, LA

Glenn D. Barks
President and Chief Executive Officer, First Community Credit Union, Chesterfield, MO

Claire W. Tucker
President and Chief Executive Officer, CapStar Bank, Nashville, TN

Michael J. Castellana
President and Chief Executive Officer, SEFCU, Albany, NY

Dennis D. Cirucci
President and Chief Executive Officer, Alliance Bank, Broomall, PA

John B. Dicus
Chairman, President, and Chief Executive Officer, Capitol Federal Savings Bank, Topeka, KS

John V. Evans Jr.
Chief Executive Officer, D.L. Evans Bank, Burley, ID

Chandler J. Howard
President and Chief Executive Officer, Liberty Bank, Middletown, CT

Terry Lobdell
President, Community First Bank of Glendive, Glendive, MT (*resigned August 2013*)

Brian L. Johnson
Chief Executive Officer, Choice Financial Group, Grand Forks, ND

Eddie Steiner
President and Chief Executive Officer, The Commercial and Savings Bank of Millersburg, Ohio, Millersburg, OH

Officers

Charles H. Majors
President

Drake Mills
Vice President

Model Validation Council

The Model Validation Council was established in 2012 by the Board of Governors to provide expert and independent advice on its process to rigorously assess the models used in stress tests of banking institutions. The Dodd-Frank Wall Street Reform and Consumer Protection Act required the Federal Reserve to conduct annual stress tests of large bank holding companies and systemically important, nonbank financial institutions supervised by the Board. The Model Validation Council provides input on the Board's efforts to assess the effectiveness of the models used in the stress tests. The council is intended to improve the quality of the Federal Reserve's model assessment program and to strengthen the confidence in the integrity and independence of the program.

Members

Mark Flannery, *Chair*
Professor, University of Florida

Peter Christoffersen
Professor, University of Toronto

Philippe Jorion
Professor, University of California at Irvine

Chester Spatt
Professor, Carnegie Mellon University

Allan Timmermann
Professor, University of California at San Diego

Nancy Wallace
Professor, University of California at Berkeley

Federal Reserve Banks and Branches

To carry out the day-to-day operations of the Federal Reserve System, the nation has been divided into 12 Federal Reserve Districts, each with a Reserve Bank. The majority of Reserve Banks also have at least one Branch. As required by the Federal Reserve Act of 1913, each of the Reserve Banks is supervised by a board of directors who are familiar with economic and credit conditions in the District. Similarly, each of the 24 Reserve Bank Branches has a board of directors who are familiar with conditions in the area encompassed by the Branch.

Reserve Bank and Branch Directors

Each Federal Reserve Bank has a nine-member board with three different classes of directors: three Class A directors, who are nominated and elected by the member banks in that District to represent the stockholding banks; three Class B directors, who are nominated and elected by the member banks to represent the public; and three Class C directors, who are appointed by the Board of Governors to represent the public. Class B and Class C directors are selected with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers. For the election of Class A and Class B directors, the member banks of each Federal Reserve District are classified into three groups. Each group, which is comprised of banks with similar capitalization, elects one Class A director and one Class B director. Directors are elected or appointed to three-year terms on a rotating basis so, barring any unexpected resignations, one position becomes available for each class of director each year. Each year, the Board of Governors designates one Class C director to serve as chair, and another Class C director to serve as deputy chair, of each Reserve Bank board.

Pursuant to the Federal Reserve Act, Class B and Class C directors may not be officers, directors, or employees of any bank, and Class C directors may not hold stock in any bank. In order to give full and meaningful effect to these restrictions, as well as the requirement that Class B and Class C directors be selected with consideration for sectors of the economy beyond banking, it is the Board's policy that Class B and Class C directors may not be affiliated with, and Class C directors may not hold stock in, certain other institutions that are also subject to the System's supervision.

Each Federal Reserve Bank Branch also has a board with either five or seven directors. A majority of the Branch directors are appointed by the Federal Reserve Bank, with the remaining directors appointed by the Board of Governors. Branch directors appointed by the Reserve Bank are subject to the same eligibility requirements as Class A or Class B directors. Board-appointed Branch directors must meet the same requirements as Class B directors.

For more information on Reserve Bank and Branch directors, see www.federalreserve.gov/aboutthefed/directors/about.htm.

The directors of the Banks and Branches are listed below. For each director, the class of directorship, the director's principal business, and the expiration date of the director's term are shown.

District 1–Boston

Class A

Richard E. Holbrook, 2013
Chairman and Chief Executive Officer, Eastern Bank, Boston, MA

Kathryn G. Underwood, 2014
President and Chief Executive Officer, Ledyard National Bank, Hanover, NH

Peter L. Judkins, 2015
President and Chief Executive Officer, Franklin Savings Bank, Farmington, ME

Class B

John F. Fish, 2013
Chairman and Chief Executive Officer, Suffolk Construction Company, Inc., Boston, MA

Gary L. Gottlieb, 2014
President and Chief Executive Officer, Partners HealthCare System, Inc., Boston, MA

Roger S. Berkowitz, 2015
President and Chief Executive Officer, Legal Sea Foods, LLC, Boston, MA

Class C

Kirk A. Sykes, 2013
President, New Boston's Urban Strategy America Fund, Boston, MA

William D. Nordhaus, 2014
Sterling Professor of Economics, Yale University, New Haven, CT

Catherine D'Amato, 2015
President and Chief Executive Officer, The Greater Boston Food Bank, Boston, MA

District 2–New York

Class A

Gerald H. Lipkin, 2013
Chairman, President, and Chief Executive Officer, Valley National Bank, Wayne, NJ

Paul P. Mello, 2014
President and Chief Executive Officer, Solvay Bank, Solvay, NY

Richard L. Carrión, 2015
Chairman, President, and Chief Executive Officer, Popular, Inc., San Juan, PR

Class B

Alphonso O'Neil-White, 2013
President and Chief Executive Officer, HealthNow New York Inc., Buffalo, NY

Terry J. Lundgren, 2014
Chairman, President, and Chief Executive Officer, Macy's, Inc., New York, NY

Glenn H. Hutchins, 2015
Co-Founder, Silver Lake, New York, NY

Class C

Kathryn S. Wylde, 2013
President and Chief Executive Officer, Partnership for New York City, New York, NY

Emily K. Rafferty, 2014
President, The Metropolitan Museum of Art, New York, NY

Sara Horowitz, 2015
Executive Director, Freelancers Union, Brooklyn, NY

District 3–Philadelphia

Class A

R. Scott Smith, 2013
Retired Chairman and Chief Executive Officer, Fulton Financial Corporation, Lancaster, PA

Frederick C. "Ted" Peters II, 2014
Chairman and Chief Executive Officer, Bryn Mawr Trust Company, Bryn Mawr, PA

David R. Hunsicker, 2015
Chairman, President, and Chief Executive Officer, New Tripoli Bank, New Tripoli, PA

Class B

Keith S. Campbell, 2013
Chairman, Mannington Mills, Inc., Salem, NJ

Patrick Harker, 2014
President, University of Delaware, Newark, DE

Rosemary Turner, 2015
President, UPS–North California District, Oakland, CA

Class C

Jeremy Nowak, 2013
President, J. Nowak and Associates, LLC, Philadelphia, PA

Michael Angelakis, 2014
Vice Chair and Chief Financial Officer, Comcast Corporation, Philadelphia, PA

James E. Nevels, 2015
Founder and Chairman, The Swarthmore Group, Philadelphia, PA

District 4–Cleveland

Class A

Paul G. Greig, 2013
Chairman, President, and Chief Executive Officer, FirstMerit Corporation, Akron, OH

Todd A. Mason, 2014
President and Chief Executive Officer, First National Bank of Pandora, Pandora, OH

Claude E. Davis, 2015
President and Chief Executive Officer, First Financial Bancorp, Cincinnati, OH

Class B

Harold (Hal) Keller, 2013
President, Ohio Capital Corporation for Housing, Columbus, OH

Tilmon F. Brown, 2014
President and Chief Executive Officer, New Horizons Baking Company, Norwalk, OH

Susan Tomasky, 2015
Energy Consultant and Former President, AEP Transmission, Columbus, OH

Class C

Christopher M. Connor, 2013
Chairman and Chief Executive Officer, The Sherwin-Williams Company, Cleveland, OH

John P. Surma, 2014
Executive Chairman, United States Steel Corporation, Pittsburgh, PA

Richard K. Smucker, 2015
Chief Executive Officer, The J.M. Smucker Company, Orrville, OH

Cincinnati Branch

Appointed by the Federal Reserve Bank

Austin W. Keyser, 2013
Midwest Senior Field Representative, AFL-CIO, Columbus, OH

Gregory B. Kenny, 2014
President and Chief Executive Officer, General Cable Corporation, Highland Heights, KY

Amos L. Otis, 2014
Founder, President, and Chief Executive Officer, SoBran, Inc., Dayton, OH

Donald E. Bloomer, 2015
President and Chief Executive Officer, Citizens National Bank, Somerset, KY

Appointed by the Board of Governors

Peter S. Strange, 2013
Chairman, Messer, Inc., Cincinnati, OH

Deborah A. Feldman, 2014
President and Chief Executive Officer, The Children's Medical Center of Dayton, Dayton, OH

Charles H. Brown, 2015
Vice President and Secretary, Toyota Motor Engineering and Manufacturing, N.A., Erlanger, KY

Pittsburgh Branch

Appointed by the Federal Reserve Bank

Todd D. Brice, 2013
President and Chief Executive Officer, S&T Bancorp, Inc., Indiana, PA

Petra Mitchell, 2014
President, Catalyst Connection, Pittsburgh, PA

Grant Oliphant, 2015
President and Chief Executive Officer, The Pittsburgh Foundation, Pittsburgh, PA

Sean McDonald, 2015
President and Chief Executive Officer, Precision Therapeutics, Inc., Pittsburgh, PA

Appointed by the Board of Governors

Glenn R. Mahone, 2013
Partner and Attorney at Law, Reed Smith LLP, Pittsburgh, PA

Charles L. Hammel III , 2014
President, PITT OHIO, Pittsburgh, PA

Dawne S. Hickton, 2015
Vice Chair, President, and Chief Executive Officer, RTI International Metals, Inc., Pittsburgh, PA

District 5–Richmond

Class A

Alan L. Brill, 2013
President and Chief Executive Officer, Capon Valley Bank, Wardensville, WV

Edward L. Willingham IV, 2014
President, First Citizens BancShares, Inc., and First Citizens Bank, Raleigh, NC

Brad E. Schwartz, 2015
Chief Executive Officer, Monarch Bank and Monarch Financial Holdings, Inc., Chesapeake, VA

Class B

Patrick C. Graney III, 2013
Chairman, OneStop, Charleston, WV

Marshall O. Larsen, 2014
Retired Chairman, President, and Chief Executive Officer, Goodrich Corporation, Charlotte, NC

Wilbur E. Johnson, 2015
Managing Partner, Young Clement Rivers, LLP, Charleston, SC

Class C

Margaret G. Lewis, 2013
President, HCA Capital Division, Richmond, VA

Linda D. Rabbitt, 2014
Chairman and Chief Executive Officer, Rand Construction Corporation, Washington, DC

Russell C. Lindner, 2015
Chairman and Chief Executive Officer, The Forge Company, Washington, DC

Baltimore Branch

Appointed by the Federal Reserve Bank

William B. Grant, 2013
Chairman, President, and Chief Executive Officer, First United Corporation and First United Bank & Trust, Oakland, MD

Richard Bernstein, 2014
President and Chief Executive Officer, LWRC International, LLC, Cambridge, MD

Anita G. Newcomb, 2015
President and Managing Director, A. G. Newcomb & Co., Columbia, MD

Christopher J. Estes, 2015
President and Chief Executive Officer, National Housing Conference, Washington, DC

Appointed by the Board of Governors

Samuel L. Ross, 2013
Chief Executive Officer, Bon Secours Baltimore Health System, Baltimore, MD

Jenny G. Morgan, 2014
President and Chief Executive Officer, basys, inc., Linthicum, MD

Stephen R. Sleigh, 2015
Fund Director, IAM National Pension Fund, Washington, DC

Charlotte Branch

Appointed by the Federal Reserve Bank

Robert R. Hill Jr., 2013
President and Chief Executive Officer, SCBT Financial Corporation, Columbia, SC

Paul E. Szurek, 2014
Chief Financial Officer, Biltmore Farms, LLC, Asheville, NC

Lucia Z. Griffith, 2015
Chief Executive Officer and Principal, METRO Landmarks, Charlotte, NC

John S. Kreighbaum, 2015
President and Chief Executive Officer, Carolina Premier Bank and Premara Financial, Inc., Charlotte, NC

Appointed by the Board of Governors

Elizabeth A. Fleming, 2013
President, Converse College, Spartanburg, SC

Claude Z. Demby, 2014
Chief Executive Officer, Noël Group, LLC, Zebulon, NC

David J. Zimmerman, 2015
President, Southern Shows, Inc., Charlotte, NC

District 6–Atlanta

Class A

T. Anthony Humphries, 2013
President and Chief Executive Officer, NobleBank & Trust, Anniston, AL

William H. Rogers Jr., 2014
Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, GA

Gerard R. Host, 2015
President and Chief Executive Officer, Trustmark Corporation, Jackson, MS

Class B

José S. Suquet, 2013
Chairman, President, and Chief Executive Officer, Pan-American Life Insurance Group, New Orleans, LA

Renée Lewis Glover, 2014
Former President and Chief Executive Officer, Atlanta Housing Authority, Atlanta, GA

Clarence Otis Jr., 2015
Chairman and Chief Executive Officer, Darden Restaurants, Inc., Orlando, FL

Class C

Carol B. Tomé, 2013
Chief Financial Officer and Executive Vice President, The Home Depot, Atlanta, GA

Thomas I. Barkin, 2014
Director, McKinsey & Company, Atlanta, GA

Thomas A. Fanning, 2015
Chairman, President, and Chief Executive Officer, Southern Company, Atlanta, GA

Birmingham Branch

Appointed by the Federal Reserve Bank

C. Richard Moore Jr., 2013
Chairman, President, and Chief Executive Officer, Peoples Southern Bank, Clanton, AL

Macke B. Mauldin, 2014
President, Bank Independent, Sheffield, AL

John A. Langloh, 2015
President and Chief Executive Officer, United Way of Central Alabama, Birmingham, AL

James K. Lyons, 2015
Director and Chief Executive Officer, Alabama State Port Authority, Mobile, AL

Appointed by the Board of Governors

Brandon W. Bishop, 2013
Business Manager and Financial Secretary, International Union of Operating Engineers - Local 312, Birmingham, AL

Thomas R. Stanton, 2014
Chairman and Chief Executive Officer, ADTRAN, Inc., Huntsville, AL

Pamela B. Hudson, 2015
Chief Executive Officer, Crestwood Medical Center, Huntsville, AL

Jacksonville Branch

Appointed by the Federal Reserve Bank

Michael J. Grebe, 2013
Chairman and Chief Executive Officer, Interline Brands, Inc., Jacksonville, FL

Hugh F. Dailey, 2014
President and Chief Executive Officer, Community Bank & Trust of Florida, Ocala, FL

Oscar J. Horton, 2015
President and Chief Executive Officer, Sun State International Trucks, LLC, Tampa, FL

D. Kevin Jones, 2015
President and Chief Executive Officer, MIDFLORIDA Credit Union, Lakeland, FL

Appointed by the Board of Governors

Carolyn M. Fennell, 2013
Director of Public Affairs, Greater Orlando Aviation Authority, Orlando International Airport, Orlando, FL

Lynda L. Weatherman, 2014
President and Chief Executive Officer, Economic Development Commission of Florida's Space Coast, Rockledge, FL

Leerie T. Jenkins Jr., 2015
Chairman, Reynolds, Smith and Hills, Inc., Jacksonville, FL

Miami Branch

Appointed by the Federal Reserve Bank

Gary L. Tice, 2013
Chairman and Chief Executive Officer, First National Bank of the Gulf Coast, Naples, FL

Carol C. Lang, 2014
President, HealthLink Enterprises, Inc., Miami Beach, FL

Facundo L. Bacardi, 2014
Chairman, Barcardi Limited, Coral Gables, FL

Millar Wilson, 2015
President and Chief Executive Officer, Mercantil Commercebank, Coral Gables, FL

Appointed by the Board of Governors

Michael J. Jackson, 2013
Chairman and Chief Executive Officer, AutoNation, Inc., Fort Lauderdale, FL

Thomas W. Hurley, 2014
Chairman and Chief Executive Officer, Becker Holding Corporation, Vero Beach, FL

Alberto Dosal, 2015
Chairman and Chief Executive Officer, Dosal Capital, LLC, Miami, FL

Nashville Branch

Appointed by the Federal Reserve Bank

William Y. Carroll Jr., 2013
President and Chief Executive Officer, SmartBank, Pigeon Forge, TN

Dan W. Hogan, 2014
Chief Operating Officer, CapStar Bank, Nashville, TN

Jennifer S. Banner, 2015
Chief Executive Officer, Schaad Companies, LLC, Knoxville, TN

Kent M. Adams, 2015
President and Chief Executive Officer, Caterpillar Financial Services Corporation, Nashville, TN
Vice President, Caterpillar, Inc., Peoria, IL

Appointed by the Board of Governors

Kathleen Calligan, 2013
Chief Executive Officer, Better Business Bureau Middle Tennessee, Nashville, TN

Scott McWilliams, 2014
Executive Chairman, OHL, Brentwood, TN

William J. Krueger, 2015
Senior Vice President, Manufacturing, Process Engineering, Purchasing, Supply Chain Management and Total Customer Satisfaction, Nissan Americas, Franklin, TN

New Orleans Branch

Appointed by the Federal Reserve Bank

Elizabeth A. Ardoin, 2013
Senior Executive Vice President – Director of Communications, IBERIABANK, Lafayette, LA

Carl J. Chaney, 2014
President and Chief Executive Officer, Hancock Holding Company, New Orleans, LA

Phillip R. May, 2015
President and Chief Executive Officer, Entergy Louisiana, LLC and Entergy Gulf States Louisiana, L.L.C., Jefferson, LA

Vacancy, 2015

Appointed by the Board of Governors

Terrie P. Sterling, 2013
Executive Vice President and Chief Operating Officer, Our Lady of the Lake Regional Medical Center, Baton Rouge, LA

T. Lee Robinson Jr., 2014
President, OHC, Inc., Mobile, AL

Kevin P. Reilly, Jr., 2015
President and Chairman of the Board, Lamar Advertising Company, Baton Rouge, LA

District 7–Chicago

Class A

Mark C. Hewitt, 2013
President and Chief Executive Officer, Clear Lake Bank & Trust Company, Clear Lake, IA

Frederick H. Waddell, 2014
Chairman and Chief Executive Officer, Northern Trust Corporation and The Northern Trust Company, Chicago, IL

William M. Farrow, 2015
President and Chief Executive Officer, Urban Partnership Bank, Chicago, IL

Class B

Jorge Ramirez, 2013

President, Chicago Federation of Labor, Chicago, IL

Nelda J. Connors, 2014
Chairwoman and Chief Executive Officer, Pine Grove Holdings, LLC, Chicago, IL

Terry Mazany, 2015
President and Chief Executive Officer, The Chicago Community Trust, Chicago, IL

Class C

Vacancy, 2013

Jeffrey A. Joerres, 2014
Chairman and Chief Executive Officer, ManpowerGroup, Milwaukee, WI

Greg Brown, 2015
Chairman and Chief Executive Officer, Motorola Solutions, Inc., Schaumburg, IL

Detroit Branch

Appointed by the Federal Reserve Bank

Nancy M. Schlichting, 2013
Chief Executive Officer, Henry Ford Health System, Detroit, MI

Susan M. Collins, 2014
Joan and Sanford Weill Dean of Public Policy, University of Michigan, Ann Arbor, MI

Fernando Ruiz, 2014
Corporate Vice President and Treasurer, The Dow Chemical Company, Midland, MI

Sheilah P. Clay, 2015
President and Chief Executive Officer, Neighborhood Service Organization, Detroit, MI

Appointed by the Board of Governors

Carl T. Camden, 2013
President and Chief Executive Officer, Kelly Services, Inc., Troy, MI

Michael E. Bannister, 2014
Retired Chairman and Chief Executive Officer, Ford Motor Credit Company, Dearborn, MI

Lou Anna K. Simon, 2015
President, Michigan State University, East Lansing, MI

District 8–St. Louis

Class A

Robert G. Jones, 2013
President and Chief Executive Officer, Old National Bancorp, Evansville, IN

Susan S. Stephenson, 2014
Co-Chairman and President, Independent Bank, Memphis, TN

William E. Chappel, 2015
President and Chief Executive Officer, The First National Bank, Vandalia, IL

Class B

Cal McCastlain, 2013
Partner, Dover Dixon Horne PLLC, Little Rock, AR

Gregory M. Duckett, 2014
Senior Vice President and Corporate Counsel, Baptist Memorial Health Care Corporation, Memphis, TN

Sonja Yates Hubbard, 2015
Chief Executive Officer, E-Z Mart Stores, Inc., Texarkana, TX

Class C

Sharon D. Fiehler, 2013
Executive Vice President and Chief Administrative Officer, Peabody Energy, St. Louis, MO

Ward M. Klein, 2014
Chief Executive Officer, Energizer Holdings, Inc., St. Louis, MO

George Paz, 2015
Chairman, President, and Chief Executive Officer, Express Scripts, St. Louis, MO

Little Rock Branch

Appointed by the Federal Reserve Bank

Michael A. Cook, 2013
Senior Vice President and Assistant Treasurer, Wal-Mart Stores, Inc., Bentonville, AR

Vacancy, 2014

Mary Ann Greenwood, 2014
Chairman and Investment Advisor, Greenwood Gearhart Inc., Fayetteville, AR

Ronald B. Jackson, 2015
Chairman and Chief Executive Officer, Simmons First Bank, Russellville, AR

Appointed by the Board of Governors

Kaleybra Mitchell Morehead, 2013, *Vice President for College Affairs/Advancement*, Southeast Arkansas College, Pine Bluff, AR

Ray C. Dillon, 2014
President and Chief Executive Officer, Deltic Timber Corporation, El Dorado, AR

Robert Martinez, 2015
Owner, Rancho La Esperanza, DeQueen, AR

Louisville Branch

Appointed by the Federal Reserve Bank

David P. Heintzman, 2013
Chairman and Chief Executive Officer, Stock Yards Bank & Trust Company, Louisville, KY

Malcolm Bryant, 2014
President, The Malcolm Bryant Corporation, Owensboro, KY

Kevin Shurn, 2014
President and Owner, Superior Maintenance Co., Elizabethtown, KY

Jon A. Lawson, 2015
President, Chief Executive Officer, and Chairman, Bank of Ohio County, Beaver Dam, KY

Appointed by the Board of Governors

Gary A. Ransdell, 2013
President, Western Kentucky University, Bowling Green, KY

Gerald R. Martin, 2014
Managing Member, River Hill Capital, LLC, Louisville, KY

Susan E. Parsons, 2015
Chief Financial Officer, Secretary, and Treasurer, Koch Enterprises, Inc., Evansville, IN

Memphis Branch

Appointed by the Federal Reserve Bank

Mark P. Fowler, 2013
Vice Chairman, Liberty Bank of Arkansas, Jonesboro, AR

Clyde Warren Nunn, 2014
Chairman and President, Security Bancorp of Tennessee, Inc., Halls, TN

R. Molitor Ford, Jr., 2014
Vice Chairman and Chief Executive Officer, Commercial Bank and Trust Company, Memphis, TN

Lisa McDaniel Hawkins, 2015
President, Room to Room, Tupelo, MS

Appointed by the Board of Governors

Charles S. Blatteis, 2013
Managing Member, Blatteis Law Firm, PLLC, Memphis, TN

Lawrence C. Long, 2014
Partner, St. Rest Planting Co., Indianola, MS

Charlie E. Thomas III, 2015
Regional Director of External & Legislative Affairs, AT&T Tennessee, Memphis, TN

District 9–Minneapolis

Class A

Julie Causey, 2013
Chairman, Western Bank, St. Paul, MN

Kenneth A. Palmer, 2014
Chairman, President, and Chief Executive Officer, Range Financial Corporation & Range Bank, NA, Marquette, MI

Randy L. Newman, 2015
Chairman and Chief Executive Officer, Alerus Financial, NA and Alerus Financial Corp., Grand Forks, ND

Class B

Lawrence R. Simkins, 2013
President and Chief Executive Officer, The Washington Companies, Missoula, MT

Howard A. Dahl, 2014
President and Chief Executive Officer, Amity Technology LLC, Fargo, ND

Christine Hamilton, 2015
Managing Partner, Christiansen Land and Cattle, Ltd, Kimball, SD

Class C

Mary K. Brainerd, 2013
President and Chief Executive Officer, HealthPartners, Minneapolis, MN

MayKao Y. Hang, 2014
President and Chief Executive Officer, Amherst H. Wilder Foundation, St. Paul, MN

Randall J. Hogan, 2015
Chairman and Chief Executive Officer, Pentair, Minneapolis, MN

Helena Branch

Appointed by the Federal Reserve Bank

Thomas R. Swenson, 2013
President and Chief Executive Officer, Bank of Montana and Bancorp of Montana Holding Company, Missoula, MT

Duana Kurokawa, 2014
President, Western Bank of Wolf Point, Wolf Point, MT

Barbara Stiffarm, 2015
Executive Director, Opportunity Link, Inc., Havre, MT

Appointed by the Board of Governors

David B. Solberg, 2014
Owner, Seven Blackfoot Ranch Company, Billings, MT

Marsha Goetting, 2015
Professor and Extension Family Economics Specialist, Montana State University, Bozeman, MT

District 10–Kansas City

Class A

Max T. Wake, 2013
President, Jones National Bank & Trust Co., Seward, NE

Vacancy, 2014

David W. Brownback, 2015
President and Chief Executive Officer, Citizens State Bank & Trust Company, Ellsworth, KS

Class B

Len C. Rodman, 2013
Chairman, President, and Chief Executive Officer, Black & Veatch, Overland Park, KS

Richard K. Ratcliffe, 2014
Chairman, Ratcliffe's Inc., Weatherford, OK

John T. Stout Jr., 2015
Chief Executive Officer, Plaza Belmont Management Group LLC, Shawnee Mission, KS

Class C

Rose Washington, 2013
Executive Director, Tulsa Economic Development Corporation, Tulsa, OK

Barbara Mowry, 2014
Chief Executive Officer, GoreCreek Advisors, Greenwood Village, CO

Steve Maestas, 2015
Managing Partner, NAI Maestas and Ward, Albuquerque, NM

Denver Branch

Appointed by the Federal Reserve Bank

Mark A. Zaback, 2013
President and Chief Executive Officer, Jonah Bank of Wyoming, Casper, WY

Brian R. Wilkinson, 2014
President, Steele Street Bank & Trust, Denver, CO

Anne Haines Yatskowitz, 2015
President and Chief Executive Officer, ACCION New Mexico–Arizona–Colorado, Albuquerque, NM

Lilly Marks, 2015
Vice President for Health Affairs and Executive Vice Chancellor, University of Colorado and Anschutz Medical Campus, Aurora, CO

Appointed by the Board of Governors

Margaret M. Kelly, 2013
Chief Executive Officer, RE/MAX, LLC, Denver, CO

Larissa L. Herda, 2014
Chair, Chief Executive Officer, and President, tw telecom inc., Littleton, CO

Richard L. Lewis, 2015
President and Chief Executive Officer, RTL Networks Inc., Denver, CO

Oklahoma City Branch

Appointed by the Federal Reserve Bank

Douglas E. Tippens, 2013
President and Chief Executive Officer, Bank of Commerce, Yukon, OK

Paula D. Bryant-Ellis, 2013
Chief Operating Officer, BOK Financial Mortgage Group, Tulsa, OK

Linda Capps, 2014
Vice Chairman, Citizen Potawatomi Nation, Shawnee, OK

Michael C. Coffman, 2015
President and Chief Executive Officer, Panhandle Oil and Gas, Inc., Oklahoma City, OK

Appointed by the Board of Governors

K. Vasudevan, 2013
Chairman and Founder, Service & Technology Corporation, Bartlesville, OK

James D. Dunn, 2014
Chair, Mill Creek Lumber & Supply Co., Tulsa, OK

Peter B. Delaney, 2015
Chairman, Chief Executive Officer, and President, OGE Energy Corporation, Oklahoma City, OK

Omaha Branch

Appointed by the Federal Reserve Bank

JoAnn M. Martin, 2013
Chair, President, and Chief Executive Officer, Ameritas Life Insurance Corp., Lincoln, NE

Jeff W. Krejci, 2014
President and Vice Chairman, First State Bank Nebraska, Lincoln, NE

James L. Thom, 2015
Vice President, T-L Irrigation Co., Hastings, NE

Brian D. Esch, 2015
President and Chief Executive Officer, McCook National Bank, McCook, NE

Appointed by the Board of Governors

Anne Hindery, 2013
Chief Executive Officer, Nonprofit Association of the Midlands, Omaha, NE

James C. Farrell, 2014
President and Chief Executive Officer, Farmers National Company, Omaha, NE

G. Richard Russell, 2015
President and Chief Executive Officer, Millard Lumber Inc., Omaha, NE

District 11–Dallas

Class A

Joe Kim King, 2013
Chief Executive Officer and Chairman of the Board, Texas Country Bancshares, Inc., Brady, TX

George F. Jones Jr., 2014
Chief Executive Officer, Texas Capital Bank, Dallas, TX

Allan James “Jimmy” Rasmussen, 2015
President and Chief Executive Officer, HomeTown Bank, N.A., Galveston, TX

Class B

Elton M. Hyder, 2013
President, The EMH Corporation, Fort Worth, TX

Jorge A. Bermudez, 2014
President and Chief Executive Officer, Byebrook Group, College Station, TX

Ann B. Stern, 2015
President and Chief Executive Officer, Houston Endowment, Inc., Houston, TX

Class C

Herbert D. Kelleher, 2013
Founder and Chairman Emeritus, Southwest Airlines, Dallas, TX

Renu Khator, 2014
Chancellor/President, University of Houston, Houston, TX

Myron E. Ullman III, 2015
Chief Executive Officer, J.C. Penney Company, Inc., Plano, TX

El Paso Branch

Appointed by the Federal Reserve Bank

Larry L. Patton, 2013
President and Chief Executive Officer, WestStar Bank, El Paso, TX

Laura M. Conniff, 2014
Qualifying Broker, Mathers Realty, Inc., Las Cruces, NM

Jerry Pacheco, 2014
President, Global Perspectives Integrated, Inc., Santa Teresa, NM

Robert Nachtmann, 2015
Dean and Professor of Finance, The University of Texas at El Paso, El Paso, TX

Appointed by the Board of Governors

Cindy J. Ramos-Davidson, 2013
President and Chief Executive Officer, El Paso Hispanic Chamber of Commerce, El Paso, TX

Robert E. McKnight Jr., 2014
Partner, McKnight Ranch Company, Fort Davis, TX

Renard U. Johnson, 2015
President and Chief Executive Officer, Management & Engineering Technologies International Inc. (METI), El Paso, TX

Houston Branch

Appointed by the Federal Reserve Bank

Gerald B. Smith, 2013
Chairman and Chief Executive Officer, Smith, Graham & Company Investment Advisors, L.P., Houston, TX

Vacancy, 2014

Kirk S. Hachigian, 2014
Principal, SkyKarr Capital LLC, Houston, TX

Paul B. Murphy Jr., 2015
President and Chief Executive Officer, Cadence Bank, Houston, TX

Appointed by the Board of Governors

Greg L. Armstrong, 2013
Chairman and Chief Executive Officer, Plains All American Pipeline, L.P., Houston, TX

Paul W. Hobby, 2014
Chairman and Founding Partner, Genesis Park, LP, Houston, TX

Ellen Ochoa, 2015
Director, NASA Johnson Space Center, Houston, TX

San Antonio Branch

Appointed by the Federal Reserve Bank

Josue Robles Jr., 2013
President and Chief Executive Officer, USAA, San Antonio, TX

Ygnacio D. Garza, 2014
Partner, Long Chilton LLP, Brownsville, TX

Janie Barrera, 2014
President and Chief Executive Officer, Accion Texas, Inc., San Antonio, TX

Manoj Saxena, 2015
General Manager, IBM Software Group, IBM, Austin, TX

Appointed by the Board of Governors

Curtis V. Anastasio, 2013
President and Chief Executive Officer, NuStar Energy L.P., San Antonio, TX

Thomas E. Dobson, 2014
Chairman and Chief Executive Officer, Whataburger Restaurants, L.P., San Antonio, TX

Catherine M. Burzik, 2015
Former President and Chief Executive Officer, Kinetic Concepts, Inc., San Antonio, TX

District 12–San Francisco

Class A

Betsy Lawer, 2013
Vice Chair and President, First National Bank Alaska, Anchorage, AK

Megan F. Clubb, 2014
President and Chief Executive Officer, Baker Boyer National Bank, Walla Walla, WA

Peter S. Ho, 2015
Chairman, President, and Chief Executive Officer, Bank of Hawaii and Bank of Hawaii Corporation, Honolulu, HI

Class B

Nicole C. Taylor, 2013
President and Chief Executive Officer, Thrive Foundation for Youth, Menlo Park, CA

Richard A. Galanti, 2014
Executive Vice President and Chief Financial Officer, Costco Wholesale Corporation, Issaquah, WA

Steven E. Bochner, 2015
Partner, Wilson, Sonsini, Goodrich, & Rosati, P.C., Palo Alto, CA

Class C

Patricia E. Yarrington, 2013
Vice President and Chief Financial Officer, Chevron Corporation, San Ramon, CA

Roy A. Vallee, 2014
Retired Executive Chairman and Chief Executive Officer, Avnet, Inc., Phoenix, AZ

Alexander R. Mehran, 2015
President and Chief Executive Officer, Sunset Development Company, San Ramon, CA

Los Angeles Branch

Appointed by the Federal Reserve Bank

David I. Rainer, 2013
Chairman, President, and Chief Executive Officer, California United Bank, Encino, CA

Peggy Tsiang Cherng, 2014
Co-Chair of the Board and Co-Chief Executive Officer, Panda Restaurant Group, Inc., Rosemead, CA

John C. Molina, 2015
Chief Financial Officer, Molina Healthcare, Inc., Long Beach, CA

James A. Hughes, 2015
Chief Executive Officer, First Solar, Inc., Tempe, AZ

Appointed by the Board of Governors

Grace Evans Cherashore, 2013
President and Chief Executive Officer, Evans Hotels, San Diego, CA

Keith E. Smith, 2014
President and Chief Executive Officer, Boyd Gaming Corporation, Las Vegas, NV

Vacancy, 2015

Portland Branch

Appointed by the Federal Reserve Bank

Roger W. Hinshaw, 2013
President, Oregon and SW Washington and Commercial Market Executive for Oregon and Inland Northwest, Bank of America Oregon, N.A., Portland, OR

Robert C. Hale, 2014
Chief Executive Officer, Hale Companies, Hermiston, OR

Tamara L. Lundgren, 2014
President and Chief Executive Officer, Schnitzer Steel Industries, Inc., Portland, OR

S. Randolph Compton, 2015
President, Chief Executive Officer, and Co-Chairperson of the Board, Pioneer Trust Bank, N.A., Salem, OR

Appointed by the Board of Governors

Joseph E. Robertson Jr., M.D., 2013, *President*, Oregon Health & Science University, Portland, OR

Roderick C. Wendt, 2014
Chief Executive Officer, JELD-WEN, inc., Klamath Falls, OR

Román D. Hernández, 2015
Shareholder, Schwabe, Williamson & Wyatt, P.C., Portland, OR

Salt Lake City Branch

Appointed by the Federal Reserve Bank

Albert T. Wada, 2013
Chairman, Wada Farms, Inc., Pingree, ID

Josh England, 2014
President and Chief Financial Officer, C.R. England, Inc., Salt Lake City, UT

Damon G. Miller, 2014
Utah Market President, U.S. Bank, Salt Lake City, UT

Susan D. Mooney Johnson, 2015
President, Futura Industries, Clearfield, UT

Appointed by the Board of Governors

Scott L. Hymas, 2013
Chief Executive Officer, RC Willey, Salt Lake City, UT

Patrick F. Keenan, 2014
Chief Financial Officer, Rio Tinto Kennecott Utah Copper, South Jordan, UT

Bradley J. Wiskirchen, 2015
Chief Executive Officer, Keynetics, Inc., Boise, ID

Seattle Branch

Appointed by the Federal Reserve Bank

Nicole W. Piasecki, 2013
Vice President and General Manager, Propulsion Systems Division, Boeing Commercial Airplanes, Everett, WA

Scott L. Morris, 2014
Chairman, President, and Chief Executive Officer, Avista Corporation, Spokane, WA

Patrick G. Yalung, 2014
Regional President, Washington, Wells Fargo Bank, N.A., Seattle, WA

Greg C. Leeds, 2015
President and Chief Executive Officer, Wizards of the Coast, Hasbro, Inc., Renton, WA

Appointed by the Board of Governors

Martha Choe, 2013
Chief Administrative Officer, The Bill & Melinda Gates Foundation, Seattle, WA

Ada M. Healey, 2014
Vice President, Real Estate, Vulcan Inc., Seattle, WA

Mary O. McWilliams, 2015
Executive Director, Puget Sound Health Alliance, Seattle, WA

Reserve Bank and Branch Leadership

Each year, the Board of Governors designates one Class C director to serve as chair, and one Class C director to serve as deputy chair, of each Reserve Bank board. Each Reserve Bank also has a president and first vice president, who are appointed by the board of directors of the Bank, subject to approval by the Board of Governors. The chair of a Branch board is selected from among the Branch's Board-appointed directors.

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William D. Nordhaus, *Deputy Chair*

Eric S. Rosengren, *President*

Kenneth C. Montgomery, *First Vice President*

New York

Emily K. Rafferty, *Chair*

Kathryn S. Wylde, *Deputy Chair*

William C. Dudley, *President*

Christine M. Cumming, *First Vice President*

Additional office at East Rutherford, NJ

Philadelphia

Jeremy Nowak, *Chair*

James E. Nevels, *Deputy Chair*

Charles I. Plosser, *President*

D. Blake Prichard, *First Vice President*

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Herbert D. Kelleher, *Chair*

Myron E. Ullman III, *Deputy Chair*

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Blake Hastings, *Officer in Charge*

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Patricia E. Yarrington, *Chair*

Roy A. Vallee, *Deputy Chair*

John C. Williams, *President*

John F. Moore, *First Vice President*

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Steven H. Walker, *Officer in Charge*

Salt Lake City

Scott L. Hymas, *Chair*

Robin A. Rockwood, *Officer in Charge*

Seattle

Ada M. Healey, *Chair*

Mark A. Gould, *Officer in Charge*

Leadership Conferences

Conference of Chairs

The chairs of the Federal Reserve Banks are organized into the Conference of Chairs, which meets to consider matters of common interest and to consult with and advise the Board of Governors. Such meetings, also attended by the deputy chairs, were held in Washington, D.C., on May 21 and 22 and November 5 and 6, 2013. The conference's executive committee members for 2013 and 2014 are listed below.

Conference of Chairs Executive Committee–2013

Herbert D. Kelleher, *Chair*,
Federal Reserve Bank of Dallas

Mary K. Brainerd, *Vice Chair*,
Federal Reserve Bank of Minneapolis

Ward M. Klein, *Member*,
Federal Reserve Bank of St. Louis

Conference of Chairs Executive Committee–2014

Jeffrey A. Joerres, *Chair*,
Federal Reserve Bank of Chicago

Sharon D. Fiehler, *Vice Chair*,
Federal Reserve Bank of St. Louis

Emily K. Rafferty, *Member*,
Federal Reserve Bank of New York

Conference of Presidents

The presidents of the Federal Reserve Banks are organized into the Conference of Presidents, which meets periodically to identify, define, and deliberate issues of strategic significance to the Federal Reserve System; to consider matters of common interest; and to consult with and advise the Board of Governors. Conference officers for 2013 are listed below.

Conference of Presidents–2013

Charles I. Plosser, *Chair*,
Federal Reserve Bank of Philadelphia

Dennis P. Lockhart, *Vice Chair*,
Federal Reserve Bank of Atlanta

Frank J. Doto, *Secretary*,
Federal Reserve Bank of Philadelphia

Maria Smith,
Assistant Secretary,
Federal Reserve Bank of Atlanta

Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet periodically for the consideration of operations and other matters. Conference officers for 2013 are listed below.[1]

Conference of First Vice Presidents–2013

Blake Prichard, *Chair*,
Federal Reserve Bank of Philadelphia

Kenneth Montgomery, *Vice Chair*,
Federal Reserve Bank of Boston

Thomas Lombardo, *Secretary*,
Federal Reserve Bank of Philadelphia

Jeanne MacNevin,
Assistant Secretary,
Federal Reserve Bank of Boston

[1] On December 3, 2013, the Conference elected Kenneth Montgomery as chair for 2014–15 and Gregory Stefani, first vice president of the Federal Reserve Bank of Cleveland, as vice chair. The Conference also elected Jeanne MacNevin as secretary for 2014–15 and Terri Bialowas, Federal Reserve Bank of Cleveland, as assistant secretary.

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