

AUDITOR INDEPENDENCE

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2007 was Deloitte & Touche LLP (D&T). Fees for these services totaled \$ 4.7 million. To ensure auditor independence, the Board of Governors 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 2007, the Bank did not engage D&T for any material advisory services.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

March 20, 2008

To the Board of Directors of the Federal Reserve Bank of Chicago

The management of the Federal Reserve Bank of Chicago ("FRBC") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statements of Income and Comprehensive Income, and Statement of Changes in Capital as of December 31st, 2007 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and as such, include amounts, some of which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the Manual and include all disclosures necessary for such fair presentation.

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

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

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

Federal Reserve Bank of Chicago



Charles Evans
President



Gordon Werkema
First Vice President



Jeffrey Marcus
Vice President and Controller

REPORT OF INDEPENDENT AUDITORS



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

We have audited the accompanying statement of condition of the Federal Reserve Bank of Chicago (“FRB Chicago”) as of December 31, 2007 and the related statements of income and comprehensive income and changes in capital for the year then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of FRB Chicago as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRB Chicago’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on FRB Chicago’s internal control over financial reporting based on our audit. The financial statements of FRB Chicago for the year ended December 31, 2006 were audited by other auditors whose report, dated March 12, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

FRB Chicago’s internal control over financial reporting is a process designed by, or under the supervision of, FRB Chicago’s principal executive and principal financial officers, or persons performing similar functions, and effected by FRB Chicago’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. FRB Chicago’s internal control over financial reporting includes those policies and procedures that (1) pertain to

(continued on page 28)

(continued from page 27)

the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of FRB Chicago; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System, and that receipts and expenditures of FRB Chicago are being made only in accordance with authorizations of management and directors of FRB Chicago; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of FRB Chicago's assets that could have a material effect on the financial statements.

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

As described in Note 3 to the financial statements, FRB Chicago has prepared these financial statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the *Financial Accounting Manual for Federal Reserve Banks*, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such financial statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 3.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FRB Chicago as of December 31, 2007, and the results of its operations for the year then ended, on the basis of accounting described in Note 3. Also, in our opinion, FRB Chicago maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Deloitte & Touche LLP

March 20, 2008

REPORT OF INDEPENDENT AUDITORS



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

We have audited the accompanying statement of condition of the Federal Reserve Bank of Chicago (the "Bank") as of December 31, 2006, and the related statements of income and changes in capital for the year then ended, which have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 3, these financial statements were prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These principles, policies, and practices, which were designed to meet the specialized accounting and reporting needs of the Federal Reserve System, are set forth in the *Financial Accounting Manual for Federal Reserve Banks* which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2006, and the results of its operations for the year then ended, on the basis of accounting described in Note 3.

A large, handwritten signature in black ink, appearing to read 'PricewaterhouseCoopers'. The signature is written in a cursive, flowing style.

March 12, 2007

2007 FINANCIAL STATEMENTS

STATEMENTS OF CONDITION (in millions)	As of December 31,	2007	2006
Assets			
Gold certificates		\$ 903	\$ 947
Special drawing rights certificates		212	212
Coin		137	100
Items in process of collection		155	241
Loans to depository institutions		2,339	24
Securities purchased under agreements to resell		3,900	–
U.S. government securities, net		62,541	71,952
Investments denominated in foreign currencies		2,648	1,357
Accrued interest receivable		534	617
Interdistrict settlement account		6,133	–
Bank premises and equipment, net		233	241
Other assets		25	29
Total Assets		\$ 79,760	\$ 75,720
Liabilities and Capital			
Liabilities:			
Federal Reserve notes outstanding, net		\$ 72,705	\$ 65,616
Securities sold under agreements to repurchase		3,689	2,719
Deposits:			
Depository institutions		910	1,395
Other deposits		3	3
Deferred credit items		517	277
Interest on Federal Reserve notes due to U.S. Treasury		160	104
Interdistrict settlement account		–	3,742
Accrued benefit costs		119	122
Other liabilities		29	26
Total Liabilities		78,132	74,004
Capital:			
Capital paid-in		814	858
Surplus (including accumulated other comprehensive loss of \$27 million and \$41 million at December 31, 2007 and 2006, respectively)		814	858
Total Capital		1,628	1,716
Total Liabilities and Capital		\$ 79,760	\$ 75,720

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

2007 FINANCIAL STATEMENTS

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (in millions) For the years ended December 31,	2007	2006
Interest Income:		
Interest on U.S. government securities	\$ 3,336	\$ 3,217
Interest on securities purchased under agreements to resell	121	–
Interest on investments denominated in foreign currencies	33	24
Interest on loans to depository institutions	2	3
Total Interest Income	3,492	3,244
Interest Expense:		
Interest expense on securities sold under agreements to repurchase	145	123
Net Interest Income	3,347	3,121
Other Operating Income:		
Income from services	59	55
Compensation received for services provided	82	59
Reimbursable services to government agencies	5	5
Foreign currency gains, net	102	78
Other income	12	11
Total Other Operating Income	260	208
Operating Expenses:		
Salaries and other benefits	161	142
Occupancy expense	24	24
Equipment expense	13	13
Compensation paid for services costs incurred	9	–
Assessments by Board of Governors	73	71
Other expenses	119	94
Total Operating Expenses	399	344
Net Income Prior to Distribution	3,208	2,985
Change in funded status of benefit plans	14	–
Comprehensive Income Prior to Distribution	\$ 3,222	\$ 2,985
Distribution of Comprehensive Income:		
Dividends paid to member banks	\$ 53	\$ 52
Transferred (from) to surplus and change in accumulated other comprehensive loss	(44)	23
Payments to U.S. Treasury as interest on Federal Reserve notes	3,213	2,910
Total Distribution	\$ 3,222	\$ 2,985

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

2007 FINANCIAL STATEMENTS

STATEMENTS OF CHANGES IN CAPITAL (in millions)

For the years ended December 31, 2007 and December 31, 2006

	Capital Paid-In	Net Income Retained	Surplus		Total Capital
			Accumulated Other Comprehensive Loss	Total Surplus	
Balance at January 1, 2006 (18 million shares)	\$ 876	\$ 876	\$ -	\$ 876	\$ 1,752
Net change in capital stock redeemed (364 thousand shares)	(18)	-	-	-	(18)
Transferred to surplus	-	23	-	23	23
Adjustment to initially apply SFAS No. 158	-	-	(41)	(41)	(41)
Balance at December 31, 2006 (17 million shares)	\$ 858	\$ 899	\$ (41)	\$ 858	\$ 1,716
Net change in capital stock redeemed (1 million shares)	(44)	-	-	-	(44)
Transferred (from) to surplus and change in accumulated other comprehensive loss	-	(58)	14	(44)	(44)
Balance at December 31, 2007 (16 million shares)	\$ 814	\$ 841	\$ (27)	\$ 814	\$ 1,628

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

NOTES TO FINANCIAL STATEMENTS

1. STRUCTURE

The Federal Reserve Bank of Chicago ("Bank") is part of the Federal Reserve System ("System") and one of the twelve Reserve Banks ("Reserve Banks") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act"), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank and its branch in Detroit, Michigan serve the Seventh Federal Reserve District, which includes Iowa, and portions of Michigan, Illinois, Wisconsin and Indiana.

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

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

2. OPERATIONS AND SERVICES

The Reserve Banks perform a variety of services and operations. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other enti-

ties; serving as the federal government's bank; provision of short-term loans to depository institutions; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in the conduct of monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY for its execution of transactions. The FRBNY is authorized and directed by the FOMC to conduct operations in domestic markets, including the direct purchase and sale of U.S. government securities, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. The FRBNY executes these open market transactions at the direction of the FOMC and holds the resulting securities and agreements in the portfolio known as the System Open Market Account ("SOMA").

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. The FRBNY is authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange ("FX") and securities contracts for, nine foreign currencies and to invest such foreign currency holdings ensuring adequate liquidity is maintained. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements ("FX swaps") with four central banks and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks. In connection with its foreign currency activities, the FRBNY may enter into transactions that contain varying degrees of off-balance-sheet market risk that results from their future settlement and counter-party credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

Although the Reserve Banks are separate legal entities, in the interests of greater efficiency and effectiveness they collaborate in the delivery of certain operations and services.

The 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 Bank providing the service and the other eleven 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 billed for services provided to them by another Reserve Bank.

Major services provided on behalf of the System by the Bank, for which the costs were not redistributed to the other Reserve Banks, include national business development and customer support.

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, which differ significantly from those of the private sector. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* ("Financial Accounting Manual"), which is issued by the Board of Governors. All of the Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual and the financial statements have been prepared in accordance with the Financial Accounting Manual.

Differences exist between the accounting principles and practices in the Financial Accounting Manual and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all securities holdings at amortized cost, rather than using the fair value presentation required by GAAP. U.S. government securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. While the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank

earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Bank has elected not to present a Statement of Cash Flows because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities. A Statement of Cash Flows, therefore, would not provide additional meaningful information. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

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

a. Gold and Special Drawing Rights Certificates

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

Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the U.S. Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold of the U.S. Treasury. The U.S. Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the U.S. Treasury. At such time, the U.S. Treasury's account is charged, and the Reserve Banks' gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at \$42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund ("Fund") to its members in proportion to each

member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2007 or 2006.

b. Loans to Depository Institutions

Depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in regulations issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Bank. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. The Bank offers three discount window programs to depository institutions: primary credit, secondary credit, and seasonal credit, each with its own interest rate. Interest is accrued using the applicable discount rate established at least every fourteen days by the board of directors of the Reserve Bank, subject to review and determination by the Board of Governors.

In addition, depository institutions that are eligible to borrow under the Reserve Bank's primary credit program are also eligible to participate in the temporary Term Auction Facility ("TAF") program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. All advances under the TAF must be fully collateralized.

Outstanding loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established.

c. U.S. Government Securities and Investments Denominated in Foreign Currencies

Interest income on U.S. government securities and investments denominated in foreign currencies comprising the

SOMA is accrued on a straight-line basis. Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains (losses), net" in the Statements of Income and Comprehensive Income.

Activity related to U.S. government securities, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies 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.

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

The FRBNY may engage in tri-party purchases of securities under agreements to resell ("tri-party agreements"). Tri-party agreements are conducted with two commercial custodial banks that manage the clearing and settlement of collateral. Collateral is held in excess of the contract amount. Acceptable collateral under tri-party agreements primarily includes U.S. government securities, pass-through mortgage securities of the Government National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association, STRIP securities of the U.S. Government, and "stripped" securities of other government agencies. The tri-party agreements are accounted for as financing transactions, with the associated interest income accrued over the life of the agreement.

Securities sold under agreements to repurchase are accounted for as financing transactions and the associated interest expense is recognized over the life of the transaction. These transactions are reported in the Statements of Condition at their contractual amounts and the related accrued interest payable is reported as a component of "Other liabilities."

U.S. government securities held in the SOMA are lent to U.S. government securities dealers in order to facilitate the effective functioning of the domestic securities market. Securities-lending transactions are fully collateralized by other U.S. government securities and the collateral taken is in

excess of the market value of the securities loaned. The FRBNY charges the dealer a fee for borrowing securities and the fees are reported as a component of "Other income."

Activity related to 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. On February 15, 2007 the FRBNY began allocating to the other Reserve Banks the activity related to securities purchased under agreements to resell.

e. FX Swap Arrangements and Warehousing Agreements

FX swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, whereby the parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to the foreign currencies it may need to support its international operations and give the authorized foreign central bank temporary access to dollars. Drawings under the FX swap arrangements can be initiated by either party and must be agreed to by the other party. The FX swap arrangements are structured so that the party initiating the transaction bears the exchange rate risk upon maturity. Foreign currencies received pursuant to these agreements are reported as a component of "Investments denominated in foreign currencies" in the Statements of Condition.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the U.S. Treasury, U.S. dollars for foreign currencies held by the U.S. Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the U.S. Treasury and ESF for financing purchases of foreign currencies and related international operations.

FX swap arrangements and warehousing agreements are revalued daily at current market exchange rates. Activity related to these agreements, with the exception of the unrealized gains and losses resulting from the daily revaluation, 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. Unrealized gains and losses resulting from the daily revaluation are recorded by FRBNY and not allocated to the other Reserve Banks.

f. Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the

assets, which range from two to fifty years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

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

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

g. Interdistrict Settlement Account

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

h. Federal Reserve Notes

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

Assets eligible to be pledged as collateral security include all of the Bank's assets. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, for which the collateral value is equal to the

par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government. At December 31, 2007, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

“Federal Reserve notes outstanding, net” in the Statements of Condition represents the Bank’s Federal Reserve notes outstanding, reduced by the Bank’s currency holdings of \$13,560 million and \$14,202 million at December 31, 2007 and 2006, respectively.

i. Items in Process of Collection and Deferred Credit Items

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

j. Capital Paid-in

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

By law, each Reserve Bank is required to pay each member bank an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. To reflect the Federal Reserve Act requirement that annual dividends are deducted from net earnings, dividends are pre-

sented as a distribution of comprehensive income in the Statements of Income and Comprehensive Income.

k. Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital.

Accumulated other comprehensive income is reported as a component of surplus in the Statements of Condition and the Statements of Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to defined benefit pension plans and other postretirement benefit plans that, under accounting standards, are included in other comprehensive income but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 9 and 10.

The Bank initially applied the provisions of SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Statements of Condition, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard required applying the provisions as of the end of the year of initial implementation, and the effect as of December 31, 2006 is recorded as “Adjustment to initially apply SFAS No. 158” in the Statements of Changes in Capital.

l. Interest on Federal Reserve Notes

The Board of Governors requires the Reserve Banks to transfer excess earnings to the U.S. Treasury as interest on Federal Reserve notes, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as “Payments to U.S. Treasury as interest on Federal Reserve notes” in the Statements of Income and Comprehensive Income and is reported as a liability, or as an asset if overpaid during the year, in the Statements of Condition. Weekly payments to the U.S. Treasury may vary significantly.

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

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

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

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services. During the years ended December 31, 2006 and 2007, the Bank was reimbursed for all services provided to the Department of Treasury.

n. Compensation Received for Services Provided and Compensation Paid for Services Costs Incurred

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

The Bank has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions, and as a result, recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. In 2007, the Bank compensated the other Reserve Banks for the costs incurred to provide these services. Compensation paid by the Bank for electronic access services is reported as "Compensation paid for services costs incurred" in the Statements of Income and Comprehensive Income.

o. Assessments by the Board of Governors

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred for the U.S. Treasury to prepare and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

p. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank's real prop-

erty taxes were \$2 million and \$4 million for the years ended December 31, 2007 and 2006, respectively, and are reported as a component of "Occupancy expense."

q. Restructuring Charges

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

Note 11 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain of the Bank's assets are discussed in Note 6. 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. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 9.

r. Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ("SFAS No. 157"). SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and expands on required disclosures about fair value measurement. SFAS No. 157 is generally effective for the Bank on January 1, 2008, though the effective date of some provisions is January 1, 2009. The provisions of SFAS No. 157 will be applied prospectively and are not expected to have a material effect on the Bank's financial statements.

4. U.S. GOVERNMENT SECURITIES, SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL, SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE, AND SECURITIES LENDING

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 8.388 percent and 9.182 percent at December 31, 2007 and 2006, respectively.

The Bank's allocated share of U.S. Government securities, net, held in the SOMA at December 31, was as follows (in millions):

	2007	2006
Par value:		
U.S. government:		
Bills	\$ 19,110	\$ 25,436
Notes	33,700	36,945
Bonds	9,310	9,139
Total par value	62,120	71,520
Unamortized premiums	670	800
Unaccreted discounts	(249)	(368)
Total allocated to the Bank	\$ 62,541	\$ 71,952

At December 31, 2007 and 2006, the fair value of the U.S. government securities allocated to the Bank, excluding accrued interest, was \$65,184 million and \$73,079 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government securities, net, held in the SOMA was \$745,629 million and \$783,619 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the fair value of the U.S. government securities held in the SOMA, excluding accrued interest, was \$777,141 million and \$795,900 million, respectively, as determined by reference to quoted prices for identical securities.

Although the fair value of security holdings can be substantially greater or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as central bank, to meet their financial obligations and responsibilities, and should not be misunderstood as representing a risk to the Reserve Banks, their shareholders, or the public. The fair value is presented solely for informational purposes.

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

	Securities purchased under agreements to resell	Securities sold under agreements to repurchase
Allocated to the Bank:		
Contract amount outstanding, end of year	\$ 3,900	\$ 3,689
Weighted average amount outstanding, during the year	2,942	2,923
Maximum month-end balance outstanding, during the year	4,320	3,689
Securities pledged, end of year	-	3,695
System total:		
Contract amount outstanding, end of year	\$ 46,500	\$ 43,985
Weighted average amount outstanding, during the year	35,073	34,846
Maximum month-end balance outstanding, during the year	51,500	43,985
Securities pledged, end of year	-	44,048

At December 31, 2006, the total contract amount of securities sold under agreements to repurchase was \$29,615 million, of which \$2,719 million was allocated to the Bank. The total par value of SOMA securities that were pledged for securities sold under agreements to repurchase at December 31, 2006 was \$29,676 million, of which \$2,725 million was allocated to the Bank.

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value.

The maturity distribution of U.S. government securities bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2007, was as follows (in millions):

	U.S. Government Securities (Par value)	Securities Purchased Under Agreements to Resell (Contract amount)	Securities Sold Under Agreements to Repurchase (Contract amount)
Within 15 days	\$ 2,289	\$ 3,900	\$ 3,689
16 days to 90 days	12,559	-	-
91 days to 1 year	12,772	-	-
Over 1 year to 5 years	20,178	-	-
Over 5 years to 10 years	6,873	-	-
Over 10 years	7,449	-	-
Total allocated to the Bank	\$ 61,120	\$ 3,900	\$ 3,689

At December 31, 2007 and 2006, U.S. government securities with par values of \$16,649 million and \$6,855 million, respectively, were loaned from the SOMA, of which \$1,396 million and \$629 million, respectively, were allocated to the Bank.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities purchased under agreements to resell. These investments are guaranteed as to principal and interest by the issuing foreign governments.

The Bank's allocated share of investments denominated in foreign currencies was approximately 5.599 percent and 6.626 percent at December 31, 2007 and 2006, respectively.

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

	2007	2006
<i>Euro:</i>		
Foreign currency deposits	\$ 1,539	\$ 413
Securities purchased under agreements to resell	143	147
Government debt instruments	261	270
<i>Japanese Yen:</i>		
Foreign currency deposits	157	172
Government debt instruments	320	355
<i>Swiss Franc:</i>		
Foreign currency deposits	228	-
Total allocated to the Bank	\$ 2,648	\$ 1,357

At December 31, 2007, the total amount of foreign currency deposits held under FX contracts was \$24,381 million of which \$1,365 million was allocated to the Bank. At December 31, 2006, there were no open foreign exchange contracts.

At December 31, 2007 and 2006, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was \$2,647 million and \$1,354 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the U.S. government securities discussed in Note 4, unrealized gains or losses have no effect on the ability of a Reserve Bank, as central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were \$47,295 million and \$20,482 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was \$47,274 million and \$20,434 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2007, was as follows (in millions):

	European Euro	Japanese Yen	Swiss Franc	Total
Within 15 days	\$ 280	\$ 167	\$ -	\$ 447
16 days to 90 days	1,294	23	228	\$ 1,545
91 days to 1 year	154	113	-	\$ 267
Over 1 year to 5 years	215	174	-	\$ 389
Total allocated to the Bank	\$ 1,943	\$ 477	\$ 228	\$ 2,648

At December 31, 2007 and 2006, the authorized warehousing facility was \$5,000 million, with no balance outstanding.

6. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2007	2006
Bank premises and equipment:		
Land	\$ 14	\$ 14
Buildings	238	231
Building machinery and equipment	31	31
Construction in progress	4	7
Furniture and equipment	62	65
Subtotal	349	348
Accumulated depreciation	(116)	(107)
Bank premises and equipment, net	\$ 233	\$ 241
Depreciation expense, for the year ended December 31	\$ 16	\$ 16

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

	2007	2006
Leased premises and equipment under capital leases	\$ 622	\$ 622
Accumulated depreciation	(596)	(492)
Leased premises and equipment under capital leases, net	\$ 26	\$ 130

Depreciation expense related to leased premises and equipment under capital leases was \$104 thousand for the year ended December 31, 2007.

The Bank leases space to outside tenants with remaining lease terms ranging from 1 to 13 years. Rental income from such leases was \$5 million and \$6 million for the years ended December 31, 2007 and 2006, respectively, and is reported as a component of "Other income." Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2007, are as follows (in millions):

2008	\$ 5
2009	5
2010	5
2011	5
2012	4
Thereafter	20
Total	\$ 44

The Bank has capitalized software assets, net of amortization, of \$2 million and \$4 million at December 31, 2007

and 2006, respectively. Amortization expense was \$2 million for each of the years ended December 31, 2007 and 2006. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses."

Assets impaired as a result of the Bank's restructuring plan, as discussed in Note 11, include check equipment, leasehold improvements, furniture and software. Asset impairment losses of \$9.7 million for the period ending December 31, 2007 were determined using fair values based on quoted market values or other valuation techniques and are reported as a component of "Other expenses." The Bank had no impairment losses in 2006.

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2007, the Bank was obligated under non-cancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 5 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance and maintenance when included in rent), net of sublease rentals, was \$2 million and \$3 million for the years ended December 31, 2007 and 2006, respectively.

Future minimum rental payments under noncancelable operating leases and capital leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2007 are as follows (in thousands):

	Operating	Capital
2008	\$ 524	\$ 22
2009	413	-
2010	415	-
2011	319	-
2012	10	-
Thereafter	-	-
Future minimum rental payments	\$ 1,681	22
Present value of net minimum lease payments		\$ 22

At December 31, 2007, there were no material unrecorded unconditional purchase commitments or long-term obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of one percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio of a Reserve

Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2007 or 2006.

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

8. RETIREMENT AND THRIFT PLANS

Retirement Plans

The Bank currently offers three defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). Employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP") and certain Reserve Bank officers participate in the Supplemental Employee Retirement Plan ("SERP").

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. The FRBNY, on behalf of the System, recognizes the net asset and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2007 and 2006, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled \$5 million for each of the years ended December 31, 2007 and 2006, and are reported as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income. The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2007 and 2006, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service.

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits other than Pensions

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

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

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

	2007	2006
Accumulated postretirement benefit obligation at January 1	\$ 110.9	\$ 98.6
Service cost-benefits earned during the period	2.5	1.7
Interest cost on accumulated benefit obligation	6.6	5.4
Net actuarial (gain) loss	(7.2)	11.4
Curtailment gain	(3.9)	-
Special termination benefits loss	3.2	-
Contributions by plan participants	1.6	1.6
Benefits paid	(8.6)	(8.3)
Medicare Part D subsidies	0.5	0.5
Accumulated postretirement benefit obligation at December 31	\$ 105.6	\$ 110.9

At December 31, 2007 and 2006, the weighted-average discount rate assumptions used in developing the post-retirement benefit obligation were 6.25 percent and 5.75 percent, respectively.

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

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

	2007	2006
Fair value of plan assets at January 1	\$ -	\$ -
Contributions by the employer	6.5	6.2
Contributions by plan participants	1.6	1.6
Benefits paid, net of Medicare Part D subsidies	(8.1)	(7.8)
Fair value of plan assets at December 31	\$ -	\$ -
Unfunded obligation and accrued postretirement benefit cost	\$ 105.6	\$ 110.9
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	\$ 5.6	\$ 9.4
Deferred curtailment gain	1.6	-
Net actuarial loss	(33.3)	(50.2)
Total accumulated other comprehensive loss	\$ (26.1)	\$ (40.8)

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

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

	2007	2006
Health care cost trend rate assumed for next year	8.00%	9.00%
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	2013	2012

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, 2007 (in millions):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 1.3	\$ (1.1)
Effect on accumulated postretirement benefit obligation	11.9	(10.0)

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

	2007	2006
Service cost-benefits earned during the period	\$ 2.5	\$ 1.7
Interest cost on accumulated benefit obligation	6.6	5.4
Amortization of prior service cost	(2.3)	(2.5)
Amortization of net actuarial loss	5.9	3.2
Total periodic expense	12.7	7.8
Special termination benefits loss	3.2	-
Net periodic postretirement benefit expense	\$ 15.9	\$ 7.8

Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2008 are shown below:

Prior service cost	\$ (1.8)
Net actuarial gain	3.2
Total	\$ 1.4

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2007 and 2006, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 5.50 percent, respectively.

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

The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 11. A deferred curtailment gain was recorded in 2007 as a component of accumulated other comprehensive loss; the gain will be recognized in net income in future years when the related employees terminate employment.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a prescription drug benefit under Medicare ("Medicare Part D") and a federal subsidy to sponsors of retiree health care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. The benefits provided under the Bank's plan to certain participants are at least actuarially equivalent to the Medicare Part D prescription drug benefit. The estimated effects of the subsidy, retroactive to January 1, 2004, are reflected in actuarial gain in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

There were no receipts of federal Medicare Part D subsidies in the year ended December 31, 2006. Receipts in the year ending December 31, 2007, related to benefits paid in the years ended December 31, 2006 and 2007 were \$0.5 million and \$0.4 million, respectively. Expected receipts in 2008, related to benefits paid in the year ended December 31, 2007 are \$0.2 million.

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

	Without Subsidy	With Subsidy
2008	\$ 7.2	\$ 6.6
2009	7.7	7.0
2010	8.0	7.3
2011	8.3	7.5
2012	8.6	7.7
2013-2017	45.0	39.7
Total	\$ 84.8	\$ 75.8

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2007 and 2006 were \$11 million and \$10 million, respectively. This

cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2007 and 2006 operating expenses were \$2.5 million and \$299 thousand, respectively, and are recorded as a component of "Salaries and other benefits" in the Statements of Income and Comprehensive Income.

10. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount Related to Postretirement Benefits other than Pensions
Balance at January 1, 2006	\$ -
Adjustment to initially apply SFAS No. 158	(41)
Balance at December 31, 2006	\$ (41)
Change in funded status of benefit plans:	
Prior service costs arising during the year	\$ (2)
Net actuarial gain arising during the year	11
Deferred curtailment gain	2
Amortization of prior service cost	(2)
Amortization of net actuarial loss	5
Change in funded status of benefits plans - other comprehensive income	\$ 14
Balance at December 31, 2007	\$ (27)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 9.

11. BUSINESS RESTRUCTURING CHARGES

2007 Restructuring Plans

In 2007, the Reserve Banks announced a restructuring initiative to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure will involve consolidation of operations into four regional Reserve Bank processing sites in Philadelphia, Cleveland, Atlanta, and Dallas.

2006 Restructuring Plans

In 2006, the Bank announced consolidation and restructuring initiatives in check adjustment operations.

2005 and Prior Restructuring Costs

The Bank incurred various restructuring charges prior to 2006 related to the restructuring of check operations to streamline operations and reduce costs.

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

	2005 & Prior Restructuring Plans	2006 Restructuring Plans	2007 Restructuring Plans	Total
<i>Information related to restructuring plans as of December 31, 2007:</i>				
Total expected costs related to restructuring activity	\$ 6.9	\$ 0.4	\$ 6.0	\$ 13.3
Expected completion date	2006	2009	2012	-
<i>Reconciliation of liability balances:</i>				
Balance at January 1, 2006	\$ 0.1	\$ -	\$ -	\$ 0.1
Employee separation costs and adjustments	(0.1)	1.0	-	0.9
Payments	-	-	-	-
Balance at December 31, 2006	\$ -	\$ 1.0	\$ -	\$ 1.0
Employee separation costs	-	-	6.0	6.0
Adjustments	-	(0.5)	-	(0.5)
Payments	-	(0.4)	-	(0.4)
Balance at December 31, 2007	\$ -	\$ 0.1	\$ 6.0	\$ 6.1

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

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

Restructuring costs associated with the impairment of certain Bank assets, including software, leasehold improvements, furniture, and equipment, are discussed in Note 6. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 8. Costs associated with enhanced postretirement benefits are disclosed in Note 9.

12. SUBSEQUENT EVENTS

In March 2008, the Board of Governors announced several initiatives to address liquidity pressures in funding markets and promote financial stability, including increasing the Term Auction Facility (see Note 3b) to \$100 billion and initiating a series of term repurchase transactions (see Notes 3d and 4) that may cumulate to \$100 billion. In addition, the Reserve Banks' securities lending program (see Notes 3d and 4) was expanded to lend up to \$200 billion of Treasury securities to primary dealers for a term of 28 days, secured by federal agency debt, federal agency residential mortgage-backed securities, agency collateralized mortgage obligations, non-agency AAA/Aaa-rated private-label residential mortgage-backed securities, and AAA/Aaa-rated commercial mortgage-backed securities. The FOMC also authorized increases in its existing temporary reciprocal currency arrangements (see Notes 3e and 5) with specific foreign central banks. These initiatives will affect 2008 activity related to loans to depository institutions, securities purchased under agreements to resell, U.S. government securities, net, and investments denominated in foreign currencies, as well as income and expenses. The effects of the initiatives do not require adjustment to the amounts recorded as of December 31, 2007.