Ordinary Days, Extraordinary Times

A 24-hour perspective

The Federal Reserve Bank of Atlanta is one of twelve regional Reserve Banks in the United States that, together with the Board of Governors in Washington, D.C., make up the Federal Reserve System—the nation's central bank. Since its establishment by an act of Congress in 1913, the Federal Reserve System's primary role has been to foster a sound financial system and a healthy economy.

To advance this goal, the Atlanta Fed helps formulate monetary policy, supervises banks and bank and financial holding companies, and provides payment services to depository institutions and the federal government.

Through its six offices in Atlanta, Birmingham, Jacksonville, Miami, Nashville, and New Orleans, the Federal Reserve Bank of Atlanta serves the Sixth Federal Reserve District, which comprises Alabama, Florida, Georgia, and parts of Louisiana, Mississippi, and Tennessee.

Ordinary Days, Extraordinary Times

Federal Reserve Bank of Atlanta

2004 Annual Report

Contents

Robert P. Forrestal

1931–2004

In Memoriam

Former Federal Reserve Bank of Atlanta President Robert P. Forrestal passed away May 25, 2004. He served as president from 1983 through 1995. Forrestal joined the Atlanta Fed in 1970 and led the bank through a period of profound change in the banking industry and the economy. He is remembered as an intellectual, an innovator, and a gracious leader.

Jack Guynn, Atlanta Fed president and chief executive officer (right), and Pat Barron, first vice president and chief operating officer

Message from the President

In the forty years that I have been working at the Atlanta Fed, the U.S. economy and financial system have grown more complex with every passing year. Throughout this evolution the Federal Reserve has changed dramatically too. What was once an ordinary day for an everyday employee has exploded into workplace demands that we couldn't foresee years ago. And extraordinary circumstances and events—international threats and unrest, the perks and pitfalls of a global computer network, and the unpredictable and uncontrollable forces of nature—test us daily.

For our staff, change also comes in the form of relentless innovation and cost pressures that continue to reshape the financial services industry, including the Fed. We are asking more of each worker—retraining, retooling, and rethinking the processes that have worked well in the past.

I can say, however, that as we meet and manage change, we hold on to the core corporate values that have served us over time. Chief among these guiding principles is our dedication to excellence, day after day and year after year.

The Fed, as a system, has responded aggressively to change with more collaboration among Reserve Banks. The twelve banks continually look for opportunities to become more efficient and more effective in the way we do business. For example, the Fed in 2004 developed a check reengineering plan in response to the declining use of paper checks. That plan, to date, has required the Federal Reserve to reduce the number of its check processing locations while continuing to provide a nationwide service.

As our organization has become more responsive and nimble, our employees have developed new and better skills. The number of employees with advanced degrees and specialty training at the Atlanta Fed has never been higher, yet we are doing more work with fewer people. In fact, our Sixth Federal Reserve District payroll has declined from more than 2,400 in 1999 to about 2,100 at the end of 2004.

Some of these adjustments have been difficult, but the Atlanta Fed must ensure its strategy, tactics, and workforce continue to evolve to fulfill our unique public mission. And that mission is to help formulate and implement sound monetary policy, to provide stringent supervision of financial institutions, and to supply top-quality payment services.

Ultimately, our success depends on each person and the day-to-day attention to detail they provide, and I am pleased by what we were able to accomplish across our organization in 2004.

The people you will see on the following pages are just a few examples of the kind of dedicated employees required to meet the very special responsibilities and high expectations of the Federal Reserve. The essays tell the business side of the story, but our people complete the picture.

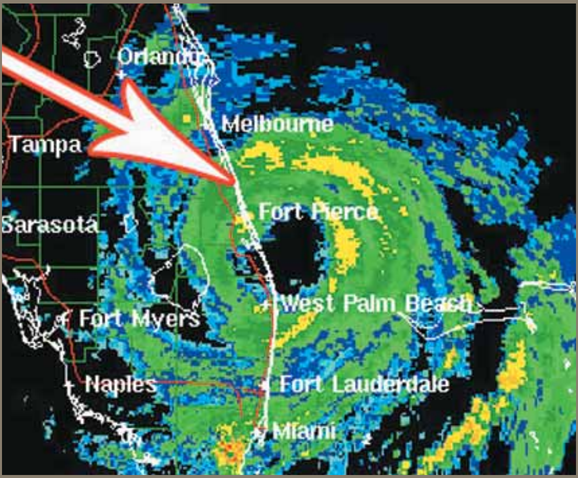
While the Atlanta Fed had a solid year in 2004, there is no time to pause and reflect on our accomplishments. Many challenges are ahead, and every day on the job requires unrelenting focus and execution for the Atlanta Fed to keep pace with a changing economy and financial system.

Jack Guynn

"When the hurricanes came, we knew we were going to have some long days and have heavy volume. We knew we would have to come in early and leave late and do our best to get the payouts in a timely manner. We are committed to each other as a team and motivated by pride."

Vernell Daise, cash handling specialist, Jacksonville Branch

07:55:12 a.m.



"Hurricane Charley carves path of destruction across Florida . . . more than 20 dead, ¼ million without power."

CNN Special Report
August 21, 2004

Dedication during the storm

Handling millions of dollars in cash. Reconciling banks' currency deposit statements—down to the dollar—against the amount said to have been shipped. Following strict procedures to ensure all of these valuables are properly accounted for. Supplementing high-tech processing with manual procedures to spot even the most sophisticated counterfeits. These tasks and others make up an ordinary day for employees working in Federal Reserve cash departments across the country.

The "other" tasks include being prepared for contingencies like severe weather, power outages, and even terrorist attacks. When the power goes out and technology shuts down, the public knows that essentials such as food, water, and batteries will likely have to be paid for in cash, vastly increasing the amount of cash needed in the local economy. During such emergencies the work of Fed cash employees moves beyond the ordinary.

Planning for the unexpected

Early last summer the Atlanta Fed finished a new plan for hurricane preparedness. Within a few months the new guidelines were put to the ultimate test: Four hurricanes hit the Sixth Federal Reserve District in August and September, destroying homes, businesses, roads, and other public infrastructure. Nationwide, the storms of 2004 cost some $40 billion to repair, and much of the damage occurred in Florida and other parts of the region served by the Atlanta Fed.

Every day during the week prior to the landfall of Hurricane Frances, the bank's Miami Branch paid out two-and-a-half times more cash than it does on an ordinary day. During August and September, when four storms hit Florida one after the other, the Jacksonville Branch paid out 50 percent more cash than in the same two months in 2003. And when the meteorologists predicted that New Orleans would take a hit from Hurricane Ivan, the Crescent City Fed branch maintained its essential operations even as many of its employees were kept away by major evacuations and highway closings in advance of the anticipated violent storm.

Distributing so much extra cash meant that in most branches of the Atlanta Fed those staff identified as essential personnel had to make their way to work despite the weather, and in some cases employees put in fourteen-hour days to respond to customer needs outside of normal business hours.

The power of teamwork

The Atlanta Fed's response to the extraordinary barrage of hurricanes emphasizes more than ever the importance of clearly defined roles and procedures for almost any event, from natural disasters to civil disturbances. But a contingency plan like the one in place at every Federal Reserve Bank is just pieces of paper. Its success depends on the dedication of staff to carry it out when the time comes.

No one knows when the next disaster will strike, but the Atlanta Fed's six offices will be ready to keep the cash flowing.

"We collect the data, and it's our job to process and analyze the numbers as soon as they are available. We provide an updated report for the economists and give our take on what it means. It's all part of the process that goes into briefing the bank president before he goes into the FOMC meetings."

Nicholas Haltom, senior economic analyst

08:29:06 a.m.

"Mr. Greenspan emphasized the Fed's readiness to respond if inflation heats up. Although the Fed doesn't 'perceive' a need to raise rates rapidly, he said, it will 'if the economy shows signs of exhibiting significant inflationary pressures.'"

Wall Street Journal
July 21, 2004

Every day a new piece of the economic puzzle

At 8:30 a.m. on the third Wednesday of every month, the U.S. Labor Department publishes the latest consumer price index (the CPI), a composite of prices from a hypothetical basket of goods and services that consumers purchase. Changes in the index reflect broad-based price changes across the economy. These movements in the CPI, along with other inflation measures, are of special interest to the Federal Reserve because of its congressional mandate to keep inflation low and prices stable.

Keeping track of the economy

On those Wednesdays, Federal Reserve Bank of Atlanta economic analysts await the CPI release so that they can comb through the components of the data series, interpret the numbers in light of past performance and other economic developments, and quickly provide analysis in support of the bank's monetary policymaking role through the Atlanta Fed's president and its directors. The twelve Federal Reserve Bank presidents, along with the seven governors of the Federal Reserve Board, take part in the deliberations of the Federal Open Market Committee, which sets a target for the federal funds rate—the rate at which banks borrow from each other short-term. Reserve Bank directors recommend changes in the discount rate, the interest rate banks are charged when they borrow from the Fed.

Despite their importance, the CPI and other inflation measures are only part of a vast array of data that Federal Reserve economic analysts track daily. Keeping abreast of statistical indicators of the economy's health is part of the daily routine at the Fed. That intense attention to the economy's performance flows primarily from the fact that monetary policy takes many months to play out. It must thus be modified long in advance on the basis of current business activity and expected changes in the direction of the economy. Keeping up with the economy on a real-time basis is also important because Fed presidents and staff economists make frequent speeches on the economy to help the public understand the Fed's current monetary policy stance.

Making the hard calls

Clearly, the daily work of Fed economic analysts and economists is complex and dynamic. The statistical series themselves do not provide a foolproof way to gauge the economy's future direction. Market economies change over the business cycle and from one cycle to the next. What is the U.S. economy's potential growth rate over time? How low should we hope for the unemployment rate to fall? What inflation rate is consistent with price stability, given the economy's current performance? Issues like these prompt Fed economists to refine existing economic models and develop entirely new ones to help better answer such questions.

In 2004 the Fed's economists faced new challenges as the economy gained momentum across many fronts, including labor markets, raising concerns about the Fed's accommodative monetary policy stance. The challenge for Fed researchers and policymakers was to monitor the constant changes in the U.S. economy to help the Fed act appropriately to avoid the risks of tipping the economic scales too far either way. As the year ended, with its extraordinary challenges, Fed policymakers had made considerable progress in removing the monetary policy stimulus that was no longer necessary or appropriate for an economic expansion that has developed good momentum.

Atlanta Fed analysts and economists never stop collecting and analyzing new data that may help policymakers better understand the overall economic picture. For the Fed's research staff, the complex puzzle of the U.S. economy makes even the most ordinary day unique.

"When you show up here for work, you never know if this is the day. We make it our business to always be prepared."

Corporal Anthony Preston, Atlanta Fed law enforcement, recalling the terrorist attacks of September 11, 2001

01:15:40 p.m.

"For the time being . . . [the] financial sector seems to be the primary focus [of terrorist plots]. . . . Let's raise [the threat level] to Orange . . . and assess protective measures, even at other financial institutions that may not be on the list."

Secretary Tom Ridge
U.S. Department of Homeland Security
Press Release and Q&A
August 1, 2004

Law enforcement prepares for new types of threats

Every visitor to the Atlanta Fed has interacted with one of the facility's law enforcement officers. These uniformed and armed security personnel are the first people visitors encounter on arriving and the last they see when leaving. This role is fitting because these men and women are tangible symbols of the Federal Reserve's responsibility to safeguard the nation's financial system.

In addition to monitoring security posts and serving as ambassadors for the bank, however, a law enforcement officer, on a typical day, might receive firearms recertification, take part in scenario-based training exercises, or administer first-aid to an injured employee as a first responder.

Because of their unique responsibilities, the Fed's law enforcement staff are trained to expect the unexpected. Many have previous military or police experience that has helped prepare them to respond to high-stress situations. Protecting the Federal Reserve is a 24/7 job.

An arm of the law

The Federal Reserve's Law Enforcement units assumed significant new responsibilities following the September 11, 2001, terrorist attacks. In that year Congress enacted the USA Patriot Act, part of which authorized Federal Reserve protection staff to become law enforcement officers with new powers to arrest suspects and to work more closely with their counterparts in federal, state, and local law enforcement.

Because the Fed plays a crucial role in the U.S. financial system, Reserve Banks must do more to protect our operations in the fight against terrorism. This new role in homeland defense is underscored by the stream of information collected from multiple law enforcement sources and analyzed by the District's law enforcement officers.

"Now we get as much intelligence information in a day as we used to get in a year," says Atlanta Captain Chuck Williams.

Tougher training requirements

The bank is not only better informed about threats but also has put tougher procedures and practices in place. Today's law enforcement officers are expected to continually acquire new knowledge and skills. Gone are the days when officers were known as "guards" who focused primarily on protecting cash. In 2004, the Atlanta Fed launched a full-time center to administer an intensive training program that mirrors much of the curriculum taught at the Federal Law Enforcement Training Center (FLETC). The 200-hour Basic Law Enforcement Training program is given to all new law enforcement officers in the Sixth District. The program is the first of its kind in the Federal Reserve System, and many other Reserve Banks have sent officers to the Atlanta Fed's program.

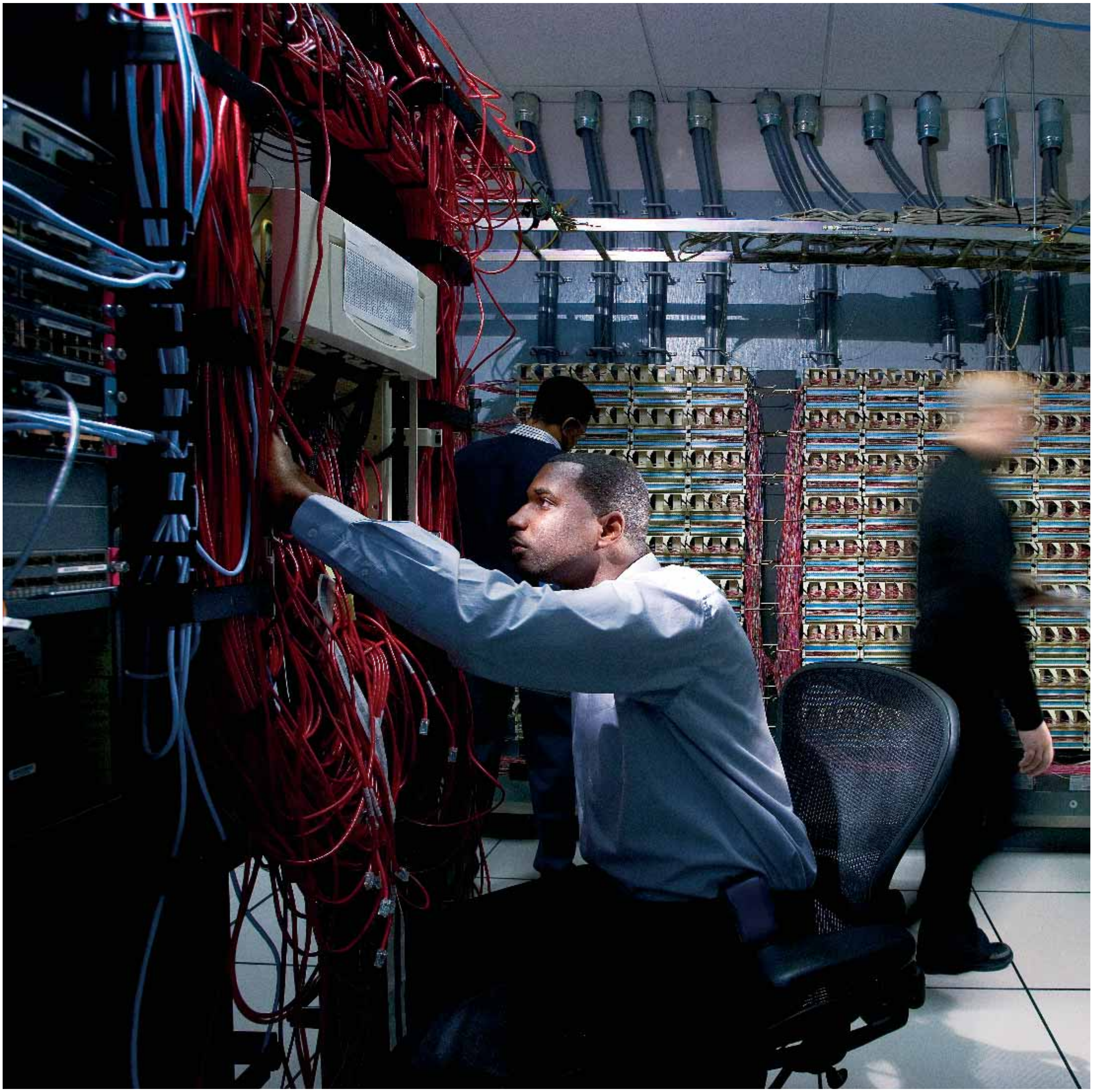
Today's officers must complete training on topics such as arrest procedures, basic constitutional law, physical control techniques, nonlethal weapons, communication, and interviewing techniques. All officers receive recurring training on a monthly basis to ensure the law enforcement team is capable of responding to emergencies and other contingencies at a moment's notice. The benchmark for officer training keeps rising. Law enforcement units in the Sixth Federal Reserve District recently launched a program to send officers to advanced courses at the FLETC facility.

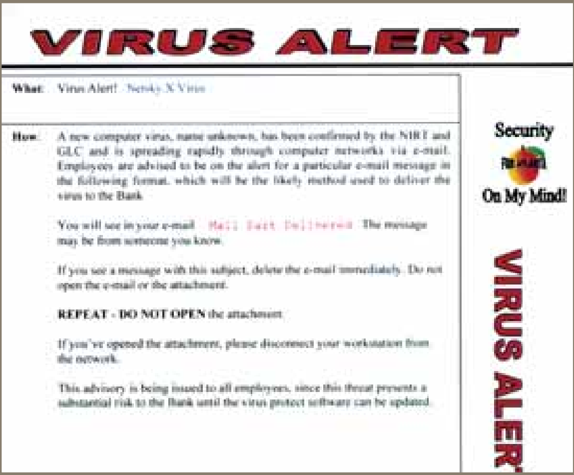
The role of Federal Reserve law enforcement officers has changed significantly over the last several years. As risks continue to evolve, the law enforcement professionals of the Atlanta Fed are more prepared than ever to counter whatever may come their way.

"I think a lot about the job we do making sure all of our applications and Web sites are up and running all of the time. We have to be responsive and keep our eyes on everything. We have to spend a lot of time keeping up with information security and revisiting vulnerabilities and testing new products. We take pride in getting the job done."

Durrell Lowery, senior systems analyst

07:56:17 p.m.




VIRUS ALERT

What: Virus Alert! Netsky X Virus

How: A new computer virus, name unknown, has been confirmed by the NIRT and GLC and is spreading rapidly through computer networks via e-mail. Employees are advised to be on the alert for a particular e-mail message in the following format, which will be the likely method used to deliver the virus to the Bank.

You will see in your e-mail Mail Date Delivered The message may be from someone you know.

If you see a message with this subject, delete the e-mail immediately. Do not open the e-mail or the attachment.

REPEAT - DO NOT OPEN the attachment.

If you've opened the attachment, please disconnect your workstation from the network.

This advisory is being issued to all employees, since this threat presents a substantial risk to the Bank until the virus protect software can be updated.

Security On My Mind!

VIRUS ALERT

"A new computer virus, name unknown, has been confirmed . . . and is spreading rapidly through computer networks via e-mail. Employees are advised to be on the alert for a particular e-mail message."

Federal Reserve Security Alert
Netsky X Virus
April 20, 2004

Defending against threats to information

Today the Federal Reserve, like the rest of the world, spins on information technology (IT). As so many workers do nowadays, many Fed staff use computers and e-mail and access the Internet every workday. But the Fed's use of IT goes beyond so-called office automation and extends to the way it conducts its core businesses. On any given day, an economist might use a special high-capacity personal computer to run a huge data set through a complex econometric model. A bank examiner might scrutinize a large financial holding company's mathematical risk assessment model for a new derivative product it is offering. And certainly the bank's check processing and cash processing staff will be relying on IT to conduct their work.

The modern Federal Reserve has been a leader in information technology innovations. In the 1960s and '70s the Fed converted cash and check processing from manual, paper processes to high-speed, high-tech operations. During those decades the Fed played a pivotal role in the development of the automated clearinghouse arrangements that enable huge volumes of paychecks, for example, to be deposited directly and mortgage payments to be debited directly. The Fed also developed the computerized system for managing the Treasury Department's vast issuances of bills, notes, and bonds.

Open environment brings security challenges

These mainframe-based technological advances were centralized and essentially closed systems that intrinsically afforded high security. Today's rapidly changing information technology environment offers far more capabilities but in a much more open and decentralized context.

Some of this new technology also carries the potential for exposure to attacks by computer viruses, worms, and other malicious software codes that have been launched against other organizations. The Atlanta Fed has coped with the growing threats of this so-called malware by strengthening the defensive perimeter that protects the bank's IT environment and systematically plugging potential gaps and vulnerabilities.

Of course, these measures cannot prevent all problems. Information security begins with people. The Atlanta Fed is constantly providing staff with new procedures to protect information.

Working with the Fed System

But the Federal Reserve Bank of Atlanta cannot pursue IT security single-mindedly. It must address security issues in the context of increasing interconnectivity among the Reserve Banks, which is part of a multiyear effort to eliminate duplication in internal IT systems and, generally, become more cost-efficient in the use of IT resources. Security efforts must also continue to allow for innovations like wireless technology and the use of powerful open-source technology like Linux as opposed to purely proprietary systems.

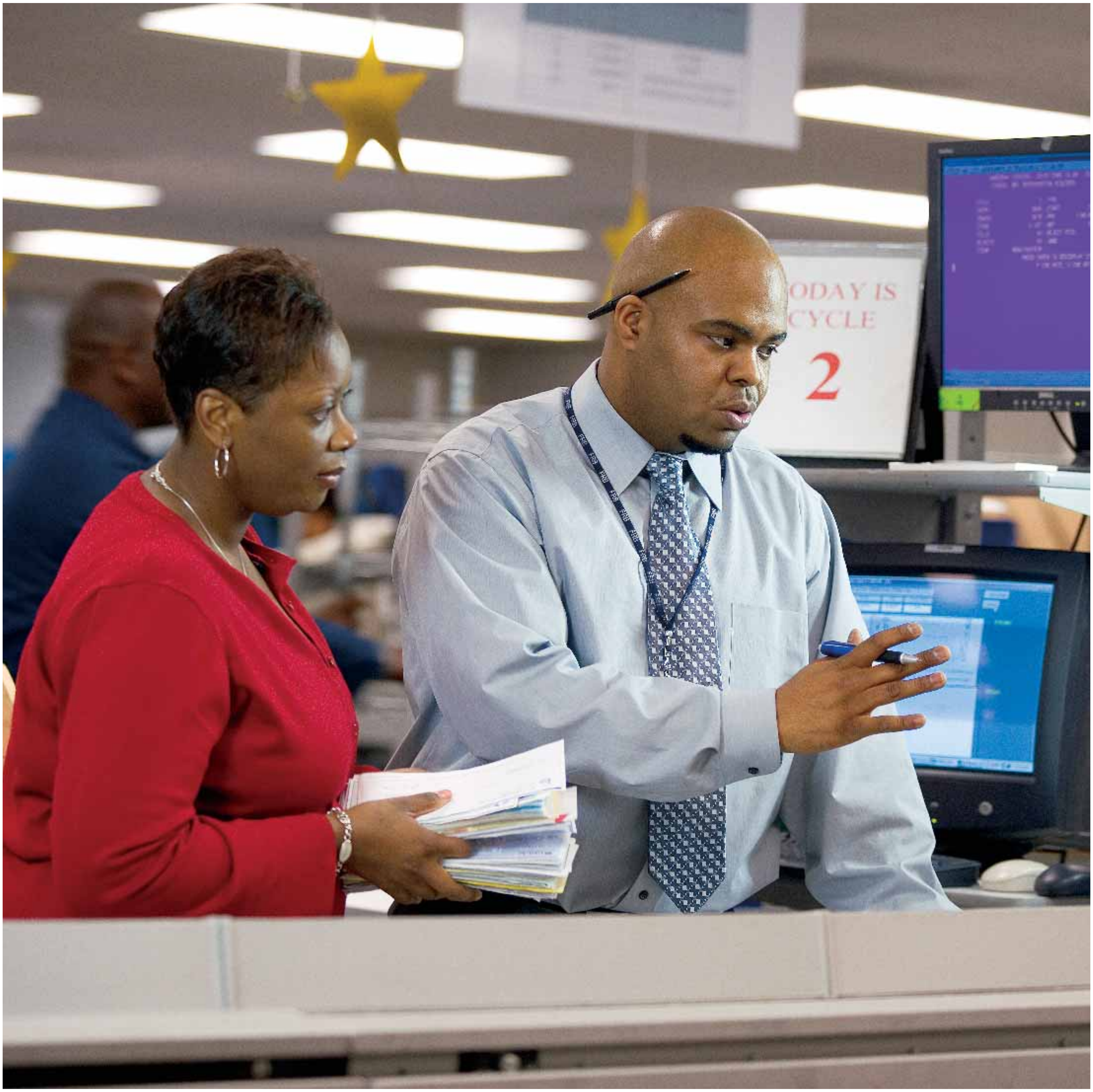
A 2004 example of this kind of balance between security and innovation was the Federal Reserve System's rollout of FedLine Advantage, Internet-based access to critical large-dollar payment transactions. The Atlanta Fed conducted its own experiment with secure silo communications via the Internet in the form of an independent network that research economists can use to exchange research with counterparts in academia without exposing other Federal Reserve networks.

The challenges for the Fed's IT program are extraordinary. It comes down to keeping the dragon at the gate in order to maintain security in today's rapidly changing and open IT environment. So, on any ordinary day, the Fed's goal is simply to maintain leading-edge security while guiding the way to the most efficient payment system, the highest-quality bank supervision, and the most sophisticated monetary policy analysis possible.

"In checks twenty years ago everything was balanced on paper. Now everything is on computer, and the new image systems are so much faster and better. I understand our business is changing almost daily, and, whatever comes up, I want to be a part of it."

Raphael Johnson, management associate, Payment Services/Processing

11:47:02 p.m.



"A new era in banking begins. . . . [Check 21] cleared the way for the simplified process by allowing digital images of checks to be deemed legal representation of payment."

MSNBC
Online Banking Special Report
October 28, 2004

The future of payments is now

On any given night the Federal Reserve Banks and their branches around the United States process approximately 50 million checks. The Fed's Atlanta office is one of the largest check processors in the nation, and the Sixth Federal Reserve District processes more checks by far than any other Fed district.

While most of us are asleep, an army of Fed employees is working every night to help ensure that most checks in the United States clear overnight. Checks start coming in from commercial banks around 11:00 p.m., delivered by check couriers from a nearby airport. In just a few hours they're run through high-speed processors, sorted, and sent throughout the country to the Federal Reserve office servicing the commercial bank on which they're drawn. By dawn this vast flow of paper is at its destinations, ready for presentment to the paying banks.

A complex and demanding job

The work of processing checks is intense. Accuracy is a must. Deadline pressures are extraordinary, and check employees must also adhere to strict productivity metrics. What's more, both summer and winter weather can play havoc with delivery schedules.

Not your routine job, even compared with a highly sophisticated manufacturing environment. Adding to the challenge in recent years, the U.S. payment system has seen a seismic shift as check usage has declined and electronic payments have grown significantly. This change has implications for the U.S. payment system but also for the Federal Reserve System, the nation's largest provider of check and automated clearinghouse (ACH) processing services.

Leading the way in managing change is the Federal Reserve's Retail Payments Office (RPO), based at the Atlanta Fed. In 2004 a Fed study found that the number of electronic transactions (credit cards, debit cards, and ACH transactions) eclipsed the number of check payments for the first time in U.S. history.

With the shift in payments, the sharper-than-expected drop in check volumes meant the Fed would have difficulty in meeting the provisions of the Monetary Control Act, which requires the Fed to cover all of its costs in providing check-processing services, including imputed profits it would have earned if it were a private-sector service provider. Maintaining the status quo in a declining check volume environment was not an option, and aggressive cost cutting was necessary.

Reengineering milestones

The RPO had to address this situation quickly because of its Systemwide responsibilities for check payments. During 2004 the Atlanta Fed moved check processing from Miami to Jacksonville as part of a reengineering initiative to eliminate check processing in thirteen Fed offices across the United States. The RPO staff determined that nine additional Fed facilities, including the Atlanta Fed's Nashville and Birmingham facilities, would need to combine processing services with other Fed sites.

While such consolidations are certainly difficult for all involved, the Federal Reserve has long championed greater efficiency in the payment system. Reinforcing that trend, in October 2004 the Reserve Banks successfully implemented a series of electronic check image processing services to satisfy the requirements of the Check Clearing for the 21st Century Act, or "Check 21." The act improves the efficiency of the processing system by creating a "substitute check," a paper printout of an electronic image that is the legal equivalent of the paper original.

As check payments continue to change, the Fed must meet the challenge of maintaining a large, efficient check operation while positioning its operations and the U.S. economy for the retail payment methods of the future.

"The landscape of financial services is changing dramatically. Every day is different, and that's what I like about my job. It's a matter of constantly staying ahead of the knowledge curve."

Debra Klimkiewicz, bank examiner

06:05:37 a.m.

“Corporate Governance Gets Top Priority: Lucy Griffin, editor of *Compliance Action*, notes the increased attention bank regulators are paying to corporate governance in the wake of Enron et al.”

BankersOnLine.com
Executive Briefing
July 2004

Higher expectations for financial compliance

With banking deregulation in the 1980s and ’90s, the U.S. financial system became much more flexible, dynamic, and geographically far reaching. Financial markets have gained vast new sources of capital, and, as banks have become more competitive, consumers often enjoy a wider selection of products and lower fees for services.

For the bank examiners and regulators responsible for helping to keep our financial system safe and sound, daily work has become more complex. With the spread of securitization, increased reliance on information technologies, and other innovations, bank supervision today involves worrying about not only credit risk in lending activities but also operational, market, and liquidity risk.

Boardrooms under scrutiny

As they confront these challenges, Federal Reserve Supervision and Regulation staff must bring an increasingly broad set of skills and analytical expertise to their jobs. Some follow the traditional routine of traveling to small towns where they spend days examining community banks. More and more, though, they supplement on-site exams with off-site surveillance, especially for large banking organizations. Examiners also travel outside the region, working with teams of specialists from other Reserve Banks, and a growing number of examiners concentrate on niches such as private wealth management, real estate financing, or economic capital.

Whatever their focus, examiners must understand and recognize a wide range of potential problems, such as those brought to light following a wave of accounting and governance scandals that began to erupt beginning in 2001. The Sarbanes-Oxley Act of 2002 was written to address certain regulatory gaps and conflicts of interest, focusing supervisory attention on the top of the corporate hierarchy. Certainly, the ordinary role for commercial bank boards of directors has changed. Under Sarbanes-Oxley, corporate directors are expected to actively support regulatory compliance and are subject to criminal penalties designed to ensure that oversight responsibilities prevail.

All corporate directors have a legal and fiduciary obligation to protect shareholder interests. But banks’ crucial role in the U.S. economy, backed by federal deposit insurance, gives bank directors the added responsibility of ensuring that banks operate safely and soundly and with adequate capital and internal controls for the risks they assume.

A growing concern is whether a financial institution is at risk because of a legal or noncompliance issue that could damage its reputation, so Federal Reserve examiners have had to add reputational risk to the array of risks it considers.

Getting the new rules right

In particular, the USA Patriot Act extended banks’ regulatory compliance by amending the Bank Secrecy Act of 1970. The Patriot Act, passed in 2001 in the wake of terrorist attacks on U.S. soil, expands money-laundering coverage to overseas and nonbank financial institutions in an effort to shut down terrorist financing and sever the potential link between drug money and terrorism.

Under the Patriot Act, financial institutions are required to know certain information about their customers and to report any suspicious activity. The penalties for noncompliance can be severe, and the ensuing negative publicity could further damage the bank. Given the high stakes involved, it’s clear that bank managers and directors, along with Atlanta Fed examiners, face a heightened challenge.

This broader interpretation of risk and increasing expectations for enterprisewide risk management are parts of the Federal Reserve’s current approach to corporate governance. The challenge for financial institutions and Fed examiners is to sustain the innovative spirit that has made the financial services sector so successful while ensuring that organizations stay accountable to the public interest.

"Around the clock. Twenty-four hours a day. The Atlanta Fed is in motion, meeting its goals, on ordinary days and during extraordinary times."

Pat Barron, first vice president

06:24:11 a.m.

Sixth Federal Reserve District Directors

Federal Reserve Banks each have a board of nine directors. Directors provide economic information, have broad oversight responsibility for their bank's operations, and, with Board of Governors approval, appoint the bank's president and first vice president.

Six directors—three class A, representing the banking industry, and three class B—are elected by banks that are members of the Federal Reserve System. Three class C directors (including the chairman and deputy chairman) are appointed by the Board of Governors. Class B and C directors represent agriculture, commerce, industry, labor, and consumers in the district; they cannot be officers, directors, or employees of a bank; class C directors cannot be bank stockholders.

Fed branch office boards have five or seven directors; the majority are appointed by head-office directors and the rest by the Board of Governors.

Atlanta

Board of Directors

Left to right: Beall, Ratcliffe, Smith, Martin, Davis, Boas, Hickson, Fontenot, Perry; not pictured: Ritter

DAVID M. RATCLIFFE
CHAIRMAN
Chairman, President, and
Chief Executive Officer
Southern Company
Atlanta, Georgia

V. LARKIN MARTIN
DEPUTY CHAIRMAN
Managing Partner
Martin Farm
Courtland, Alabama

JAMES F. BEALL
Chairman, President, and
Chief Executive Officer
Farmers & Merchants Bank
Centre, Alabama

SUZANNE E. BOAS
President
Consumer Credit Counseling
Service of Greater Atlanta Inc.
Atlanta, Georgia

D. SCOTT DAVIS
Chief Financial Officer
United Parcel Service
Atlanta, Georgia

TERI G. FONTENOT
President and
Chief Executive Officer
Woman's Hospital
Baton Rouge, Louisiana

RICHARD G. HICKSON
Chairman and
Chief Executive Officer
Trustmark Corporation
Jackson, Mississippi

EGBERT L.J. PERRY
Chairman and
Chief Executive Officer
The Integral Group, LLC
Atlanta, Georgia

WILLIAM G. SMITH JR.
Chairman, President, and
Chief Executive Officer
Capital City Bank Group Inc.
Tallahassee, Florida

Federal Advisory Council Member

C. DOWD RITTER
(RESIGNED)
Chairman, President, and
Chief Executive Officer
AmSouth Bancorporation
Birmingham, Alabama

Birmingham
Branch Directors

Left to right: Crenshaw, Holcomb, Barnett, Sanford, Dodson, Bradley, Welborn

CATHERINE SLOSS CRENSHAW
CHAIRMAN
President
Sloss Real Estate Group Inc.
Birmingham, Alabama

JOHN B. BARNETT III
Monroeville Chairman and
President
BankTrust
Monroeville, Alabama

BOBBY A. BRADLEY
Retired Senior Vice President
and Group Manager
Science Applications
International Corporation
Computer Systems
Technology Group
Huntsville, Alabama

SAMUEL F. DODSON
Business Manager/
International Union of
Operating Engineers Local 312
President/Central Alabama
Building and Construction
Trades Council
Birmingham, Alabama

JOHN H. HOLCOMB III
Chairman and
Chief Executive Officer
Alabama National Bancorporation
Birmingham, Alabama

JAMES H. SANFORD
Chairman of the Board
HOME Place Farms Inc.
Prattville, Alabama

MILLER WELBORN
President
Welborn and Associates Inc.
Lookout Mountain, Tennessee

Jacksonville

Branch Directors

Left to right: Fisher, Sherrer, Titen, Hilton, Gabremariam, Heller, Smith

Miami

Branch Directors

Left to right: Gudorf, Sugrañes, Schwartzel, Schupp, Lopez, Jones, Keeley

ROSA SUGRAÑES
CHAIRMAN
Chairman
Iberia Tiles Corporation
Miami, Florida

FRANCIS V. GUDORF
President/Executive Director
Jubilee Community
Development Corporation
Miami, Florida

EDWIN A. JONES JR.
President
Angus Investments Inc.
Port St. Lucie, Florida

BRIAN E. KEELEY
President and
Chief Executive Officer
Baptist Health South Florida
Coral Gables, Florida

MIRIAM LOPEZ
Chairman and
Chief Executive Officer
TransAtlantic Bank
Miami, Florida

RUDY E. SCHUPP
President and
Chief Executive Officer
First United Bank
North Palm Beach, Florida

JOSEPH C. SCHWARTZEL
President
Meridian Broadcasting Inc.
Fort Myers, Florida

Nashville

Branch Directors

Left to right: Gaudette, Williams, Lawler, Swain, B. Franklin, S. Franklin, Spradley

F. RODNEY LAWLER
Chairman
Co-Founder and
Chief Executive Officer
Lawler-Wood, LLC
Knoxville, Tennessee

BETH DORTCH FRANKLIN
President and
Chief Executive Officer
Star Transportation Inc.
Nashville, Tennessee

SAM O. FRANKLIN III
Retired Chairman
SunTrust Bank, Nashville
Nashville, Tennessee

DANIEL A. GAUDETTE
Senior Vice President
North American Manufacturing
and Quality Assurance
Nissan North America Inc.
Smyrna, Tennessee

JAMES W. SPRADLEY JR.
President
Standard Candy Company Inc.
Nashville, Tennessee

MICHAEL B. SWAIN
President and
Chief Executive Officer
First National Bank
Oneida, Tennessee

DAVID WILLIAMS II
Vice Chancellor and
General Counsel
Vanderbilt University
Nashville, Tennessee

New Orleans

Branch Directors

Left to right: Kurzius, Slaughter, Cloutier, Dennis, Johnson, Shipp, Roberts

DAVE DENNIS
Chairman
President
Specialty Contractors &
Associates Inc.
Gulfport, Mississippi

C.R. CLOUTIER
President and
Chief Executive Officer
MidSouth Bank
Lafayette, Louisiana

DAVID E. JOHNSON
Chairman and
Chief Executive Officer
The First Bancshares Inc.
and The First, A National
Banking Association
Hattiesburg, Mississippi

LAWRENCE E. KURZIUS
President and
Chief Executive Officer
Zatarain's
Gretna, Louisiana

BEN TOM ROBERTS
Senior Executive Vice President
and Owner
Roberts Brothers Inc., Realtors
Mobile, Alabama

EARL L. SHIPP
Vice President and Site Director
The Dow Chemical Company
Plaquemine, Louisiana

CHRISTEL C. SLAUGHTER
Partner
SSA Consultants, LLC
Baton Rouge, Louisiana

Small Business, Agriculture, and Labor

Advisory Council

Left to right: Currie, Wofford, Williams, Holt, Bowman, Howard, Harris, Sandlin, Pierce, Reems; not pictured: Bourg, Freeman, Jarriel, Paulk, Savant

JOHN "RED" BOURG SR.
(DECEASED)
President
Louisiana AFL-CIO
Baton Rouge, Louisiana

HENRY F. BOWMAN
President
C&L Wood Products Inc.
Hartselle, Alabama

ROBERT G. CURRIE
Partner
Currie Sowards
Aquila Architects
Delray Beach, Florida

DARRELL S. FREEMAN SR.
President and
Chief Executive Officer
Zycron Computer Services Inc.
Nashville, Tennessee

OSCAR L. HARRIS JR.
Chief Executive Officer
and Founder
Turner Associates/
Architects & Planners Inc.
Atlanta, Georgia

MARK E. HOLT
Assistant Business Manager
Southeast Laborers'
District Council
Helena, Alabama

JAMES W. HOWARD JR.
President and
Chief Executive Officer
Atlanta Hardwood Corporation
Mableton, Georgia

DAVID JARRIEL
President
Dry Branch Farms Inc.
Collins, Georgia

THOMAS PAULK
President and
Chief Executive Officer
Alabama Farmers Cooperative Inc.
Decatur, Alabama

CHRISTINE W. PIERCE
Partner
Braver Schimler
Pierce Jenkins LLP
Atlanta, Georgia

PETE REEMS
Owner
Heart of Georgia
Freshwater Shrimp
Barnesville, Georgia

STEVEN M. SANDLIN
Vice President and Partner
Pay-Less Pharmacy Group
Decatur, Alabama

NOAH V. SAVANT
Assistant to Vice President
Communications Workers
of America
Decatur, Georgia

TRUDI K. WILLIAMS
Chief Executive Officer
TKW Consulting Engineers Inc.
Fort Myers, Florida

LAWTON WOFFORD
Executive Director of
Industry Relations
Hubbard ISA
Hiawassee, Georgia

Management
Committee

Left to right: Eisenbeis, Barron, DeBeer, Jones, Brown, Guynn, Oliver, Estes, Kepler, Herr, Berthaume; not pictured: Caldwell, Hawkins

JACK GUYNN
President and
Chief Executive Officer

PATRICK K. BARRON
First Vice President and
Chief Operating Officer

W. RONNIE CALDWELL
(RETIRED)
Executive Vice President
Financial Services/
Corporate Services Divisions

CHRISTOPHER G. BROWN
Senior Vice President and
Chief Financial Officer
Corporate Services Division

ANNE M. DEBEER
Senior Vice President
Corporate Services/
Financial Services Divisions

ROBERT A. EISENBEIS
Senior Vice President and
Director of Research
Research Division

WILLIAM B. ESTES III
Executive Vice President
Supervision and
Regulation Division

JAMES D. HAWKINS
(RETIRED)
Senior Vice President
Financial Services Division

FREDERICK R. HERR
Senior Vice President
System Retail Payments Office

RICHARD R. OLIVER
Senior Vice President
System Retail Payments Office

LOIS C. BERTHAUME
ADVISER
Vice President and
General Auditor
Auditing Department

MARY KEPLER
ADVISER
Vice President and
Director of Human Resources
Human Resources Department

RICHARD A. JONES
ADVISER
Senior Vice President and
General Counsel
Legal Department

Other Corporate Officers

Senior Vice Presidents

SCOTT DAKE
System Retail Payments Office

DONALD E. NELSON
Financial Services Central

Vice Presidents

ANDRE T. ANDERSON
Supervision and
Regulation Division

EDWARD C. ANDREWS
General Services Department
and Law Enforcement Unit

JOHN S. BRANIGIN
System Retail Payments Office

DAVID F. CARR
Human Resources Department

SUZANNA J. COSTELLO
Supervision and
Regulation Division

THOMAS J. CUNNINGHAM
Associate Director of Research
Research Division

LEAH DAVENPORT
Check Function Office

GERALD P. DWYER JR.
Research Department

J. STEPHEN FOLEY
Supervision and
Regulation Division

CYNTHIA GOODWIN
Supervision and
Regulation Division

MARY MANDEL
Executive Support Office

BOBBIE H. McCRACKIN
Public Affairs Officer
Public Affairs Department

JOHN D. PELICK
(RETIRED)
Systems/Information Security
Departments

WILLIAM T. ROBERDS
Research Department

ROBERT M. SCHENCK
Supervision and
Regulation Division

LARRY J. SCHULZ
System Retail Payments Office

ELLIS W. TALLMAN
Research Department

ADRIENNE M. WELLS
System Retail Payments Office

RONALD N. ZIMMERMAN
Supervision and
Regulation Division

Assistant Vice Presidents

VICKI A. ANDERSON
(RETIRED)
System Retail Payments Office
Miami Office

JOHN H. ATKINSON
Supervision and
Regulation Division

JAMES L. BROWN
(RETIRED)
General Services Department

JOAN H. BUCHANAN
Supervision and
Regulation Division

DAVID CHRISTERSON
System Retail Payments Office

CHAPELLE D. DAVIS
Supervision and
Regulation Division

W. JEFFREY DEVINE
Financial Services Division

MARIE C. GOODING
System Retail Payments Office

ROBERT HAWKINS
Supervision and
Regulation Division

CAROLYN C. HEALY
Supervision and
Regulation Division
Miami Office

JANET A. HERRING
Accounting Department

SUSAN HOY
Legal Department

JACQUELYN H. LEE
Automation Operations

DANIEL A. MASLANEY
(RESIGNED)
Financial Services
Technologies and Support

MARIE E. MCNALLY
Facilities Management

ELIZABETH MCQUERRY
System Retail Payments Office

D. PIERCE NELSON
Public Information Officer
Public Affairs Department

ALVIN L. PILKINTON JR.
Auditing Department

MARION P. RIVERS III
Supervision and
Regulation Division

JOHN C. ROBERTSON
Research Department

SUSAN L. ROBERTSON
System Retail Payments Office

MELINDA J. RUSHING
System Retail Payments Office

JUAN C. SANCHEZ
Supervision and
Regulation Division

DORIS SANTANA
Financial Statistics/
Structural Analysis

DAVID W. SMITH
Supervision and
Regulation Division

TIM R. SMITH
Community Relations Officer
Public Affairs Department

ARUNA SRINIVASAN
Credit and Risk Management

ALLEN STANLEY
Supervision and
Regulation Division

DAVID E. TATUM
Supervision and
Regulation Division

EDWINA M. TAYLOR
(RETIRED)
Statistical Reports Department

JULIUS G. WEYMAN
System Retail Payments Office

Branch Officers

Atlanta

JAMES M. McKEE
Senior Vice President and
Branch Manager

JEFFREY L. WELTZIEN
(RETIRED)
Vice President and
Assistant Branch Manager

CHRISTOPHER N. ALEXANDER
Assistant Vice President

ROBERT A. LOVE
Assistant Vice President

Jacksonville

CHRISTOPHER L. OAKLEY
Vice President and
Branch Manager

PAUL W. GRAHAM
Assistant Vice President

JOEL WARREN
Assistant Vice President

CHRISTINA WILSON
Assistant Vice President

Nashville

MELVYN K. PURCELL
Senior Vice President and
Branch Manager

ANNITA T. MOORE
Assistant Vice President and
Assistant Branch Manager

Birmingham

LEE C. JONES
Vice President and
Branch Manager

TREV B. BROWN
Assistant Vice President

CHARLES W. PRIME
Assistant Vice President

Miami

JAMES T. CURRY III
(RETIRED)
Vice President and
Branch Manager

JUAN DEL BUSTO
Vice President and
Assistant Branch Manager

FRED D. COX
(RETIRED)
Assistant Vice President

ROBERT A. DE ZAYAS
Assistant Vice President

ROBERT K. MORANDO
(RETIRED)
Assistant Vice President

New Orleans

ROBERT J. MUSSO
Senior Vice President and
Branch Manager

AMY S. GOODMAN
Vice President and
Assistant Branch Manager

EDWARD B. HUGHES
(RETIRED)
Assistant Vice President

EVETTE H. JONES
Assistant Vice President

Financial Reports

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2004 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled $2 million. To ensure auditor independence, the Board of Governors requires that PwC be independent in all matters relating to the audit. Specifically, PwC 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 2004, the bank did not engage PwC for advisory services.

Management's Assertion

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

The management of the Federal Reserve Bank of Atlanta ("FRB Atlanta") is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2004 (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 Federal Reserve Banks* ("Manual") and, as such, include amounts, some of which are based on judgments and estimates of management. 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 FRB Atlanta is responsible for maintaining an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management, and appropriate corrective measures are implemented.

Even an effective process of internal controls, 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.

The management of the FRB Atlanta assessed its process of internal controls over financial reporting, including the safeguarding of assets 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 (COSO). Based on this assessment, we believe that the FRB Atlanta maintained an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements.

Federal Reserve Bank of Atlanta

Jack Guynn
President and Chief Executive Officer

Patrick K. Barron
First Vice President and Chief Operating Officer

Christopher G. Brown
Senior Vice President and Chief Financial Officer

March 10, 2005
Atlanta, Georgia

Report of Independent Accountants

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

We have examined management's assertion, included in the accompanying Management Assertion, that the Federal Reserve Bank of Atlanta ("FRBA") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the financial statements as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. FRBA's management is responsible for maintaining effective internal control over financial reporting and safeguarding of assets as they relate to the financial statements. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that FRBA maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the financial statements as of December 31, 2004, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

This report is intended solely for the information and use of management and the Board of Directors and Audit Committee of FRBA and any organization with legally defined oversight responsibilities and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

March 16, 2005
Atlanta, Georgia

Report of Independent Auditors

To the Board of Governors of the Federal Reserve System
and the Board of Directors of the Federal Reserve Bank of Atlanta

We have audited the accompanying statements of condition of the Federal Reserve Bank of Atlanta (the "Bank") as of December 31, 2004 and 2003, and the related statements of income and changes in capital for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 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* and constitute 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, 2004 and 2003, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

March 16, 2005
Atlanta, Georgia

Statements of Condition

(in millions)	As of December 31, 2004	As of December 31, 2003
Assets		
Gold certificates	$ 894	$ 863
Special drawing rights certificates	166	166
Coin	82	82
Items in process of collection	637	723
Loans to depository institutions	8	5
U.S. government securities, net	48,931	45,639
Investments denominated in foreign currencies	1,181	1,127
Accrued interest receivable	343	341
Interdistrict settlement account	9,938	4,274
Bank premises and equipment, net	333	340
Other assets	42	43
Total assets	**$ 62,555**	**$ 53,603**
Liabilities and Capital		
Liabilities		
Federal Reserve Notes outstanding, net	$ 56,768	$ 48,296
Securities sold under agreements to repurchase	2,076	1,733
Deposits		
Depository institutions	1,722	1,608
Other deposits	2	2
Deferred credit items	796	855
Interest on Federal Reserve notes due U.S. Treasury	56	21
Accrued benefit costs	86	98
Other liabilities	17	12
Total liabilities	**$ 61,523**	**$ 52,625**
Capital		
Capital paid-in	$ 516	$ 489
Surplus	516	489
Total capital	**$ 1,032**	**$ 978**
Total liabilities and capital	**$ 62,555**	**$ 53,603**

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

Statements of Income

(in millions)	For the years ended December 31, 2004	December 31, 2003
Interest income		
Interest on U.S. government securities	$ 1,484	$ 1,530
Interest on investments denominated in foreign currencies	15	15
Total interest income	**$ 1,499**	**$ 1,545**
Interest expense		
Interest expense on securities sold under agreements to repurchase	$ 20	$ 15
Net interest income	**$ 1,479**	**$ 1,530**
Other operating income		
Income from services	$ 161	$ 166
Reimbursable services to government agencies	17	18
Foreign currency gains, net	68	155
Other income	3	3
Total other operating income	**$ 249**	**$ 342**
Operating expenses		
Salaries and other benefits	$ 152	$ 166
Occupancy expense	21	20
Equipment expense	22	24
Assessments by Board of Governors	77	79
Other expenses	94	94
Total operating expenses	**$ 366**	**$ 383**
Net income prior to distribution	**$ 1,362**	**$ 1,489**
Distribution of net income		
Dividends paid to member banks	$ 30	$ 29
Transferred to surplus	27	14
Payments to U.S. Treasury as interest on Federal Reserve notes	1,305	1,446
Total distribution	**$ 1,362**	**$ 1,489**

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

Statements of Changes in Capital

(in millions)	For the years ended December 31, 2004, and December 31, 2003		
	Capital Paid-In	Surplus	Total Capital
Balance at January 1, 2003			
(9.5 million shares)	$ 475	$ 475	$ 950
Transferred to surplus		14	14
Net change in capital stock issued			
(0.3 million shares)	14		14
Balance at December 31, 2003			
(9.8 million shares)	$ 489	$ 489	$ 978
Transferred to surplus		27	27
Net change in capital stock issued			
(0.5 million shares)	27		27
Balance at December 31, 2004			
(10.3 million shares)	$ 516	$ 516	$ 1,032

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

Notes to Financial Statements

1. STRUCTURE

The Federal Reserve Bank of Atlanta ("Bank") is 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 System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). 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 branches in Birmingham, Alabama; Jacksonville, Florida; Nashville, Tennessee; New Orleans, Louisiana; and Miami, Florida, serve the Sixth Federal Reserve District, which includes Georgia, Florida, Alabama, and portions of Louisiana, Tennessee, and Mississippi. Other major elements of the System are the Federal Open Market Committee ("FOMC") and the Federal Advisory Council. 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. Banks that are members of the System include all national banks and any state-chartered bank that applies and is approved for membership in the System.

Board of Directors

In accordance with the Federal Reserve Act, supervision and control of the Bank are 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, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. 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.

2. OPERATIONS AND SERVICES

The System performs a variety of services and operations. Functions include formulating and conducting monetary policy; participating actively in the payments mechanism, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check processing; distributing coin and currency; performing fiscal agency functions for the U.S. Treasury and certain federal agencies; serving as the federal government's bank; providing short-term loans to depository institutions; serving the consumer and the community by providing educational materials and information regarding consumer laws; supervising bank holding companies and state member banks; and administering other regulations of the Board of Governors. The Board of Governors' operating costs are funded through assessments on the Reserve Banks.

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of 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 is also authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange ("F/X") and securities contracts in, nine foreign currencies and to invest such foreign currency holdings ensuring adequate liquidity is maintained. In addition, FRBNY is authorized to maintain reciprocal currency arrangements ("F/X swaps") with various central banks and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the 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 the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared with 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 Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

The financial statements have been prepared in accordance with the Financial Accounting Manual. Differences exist between the accounting principles and practices of the System and accounting principles generally accepted in the United States of America ("GAAP"). The primary difference is the presentation of all security holdings at amortized cost, rather than at the fair value presentation requirements of GAAP. In addition, the Bank has elected not to present a Statement of Cash Flows. The Statement of Cash Flows has not been included because the liquidity and cash position of the Bank are not of primary concern to the users of these financial statements. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income, and Changes in Capital. A Statement of Cash Flows, therefore, would not provide any additional useful information. There are no other significant differences between the policies outlined in the Financial Accounting Manual and GAAP.

Each Reserve Bank provides services on behalf of the System for which costs are not shared. Major services provided on behalf of the System by the Bank, for which the costs were not redistributed to the other Reserve Banks, include Federal Reserve Information Technology Projects, Retail Payments Office, Retail Check-Related Projects, Accounting-Related Projects, Customer Support Projects, National Information Center for Supervision and Regulation, Audit Services, and Special Check-Related Projects.

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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. Unique accounts and significant accounting policies are explained below.

a. Gold Certificates

The Secretary of the Treasury is authorized to issue gold certificates to the Reserve Banks to monetize gold held by the U.S. Treasury. 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. These 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 lowered. 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 average Federal Reserve notes outstanding in each District.

b. Special Drawing Rights Certificates

Special drawing rights ("SDRs") 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. 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 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. At such time, 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 Federal Reserve notes outstanding in each District at the end of the preceding year. There were no SDR transactions in 2004 or 2003.

c. Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D 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. 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. 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 by the Board of Governors.

d. U.S. Government and Federal Agency Securities and Investments Denominated in Foreign Currencies

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities 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. Such authorizations are reviewed and approved annually by the FOMC.

The FRBNY has sole authorization by the FOMC to lend U.S. government securities held in the SOMA to U.S. government securities dealers and to banks participating in U.S. government securities clearing arrangements on behalf of the System in order to facilitate the effective functioning of the domestic securities market. These securities-lending transactions are fully collateralized by other U.S. government securities. FOMC policy requires the FRBNY to take possession of collateral in excess of the market values of the securities loaned. The market values of the collateral and the securities loaned are monitored by the FRBNY on a daily basis, with additional collateral obtained as necessary. The securities lent are accounted for in the SOMA.

F/X contracts are contractual agreements between two parties to exchange specified currencies, at a specified price, on a specified date. Spot foreign contracts normally settle two days after the trade date, whereas the settlement date on forward contracts is negotiated between the contracting parties but will extend beyond two days from the trade date. The FRBNY generally enters into spot contracts, with any forward contracts generally limited to the second leg of a swap/warehousing transaction.

The FRBNY, on behalf of the Reserve Banks, maintains renewable, short-term F/X swap arrangements with two authorized foreign central banks. The parties agree to exchange their currencies up to a pre-arranged 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 foreign currencies it may need for intervention operations to support the dollar and give the partner foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the F/X swap arrangements can be initiated by either the FRBNY or the partner foreign central bank and must be agreed to by the drawee. The F/X swaps are structured so that the party initiating the transaction (the drawer) bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an F/X swap in interest-bearing instruments.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the 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 Treasury and ESF for financing purchases of foreign currencies and related international operations.

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts that contain varying degrees of off-balance-sheet market risk because they represent contractual commitments involving future settlement and counterparty credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies 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 Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that may result in gains or losses when holdings are sold prior to maturity. Decisions regarding the securities and foreign currencies 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 currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

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. Securities sold under agreements to repurchase are accounted for as secured borrowing transactions with the associated interest expense recognized over the life of the transaction. Such transactions are settled by FRBNY. Interest income is accrued on a straight-line basis. Income earned on securities lending transactions is reported as a component of “Other income.” 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, net.”

Activity related to U.S. government securities bought outright, securities sold under agreements to repurchase, securities loaned, investments denominated in foreign currency, excluding those held under an F/X swap arrangement, and deposit accounts of foreign central banks and governments above core balances are allocated to each Reserve Bank. U.S. government securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

In 2003, additional interest income of $61 million, representing one day's interest on the SOMA portfolio, was accrued to reflect a change in interest accrual calculations, of which $4.1 million was allocated to the Bank. The effect of this change was not material; therefore, it was included in the 2003 interest income.

e. 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 estimated useful lives of assets ranging from two to fifty years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are amortized over the remaining useful life of the asset. Maintenance, repairs, and minor replacements are charged to operations in the year incurred. Costs incurred for software, either developed internally or acquired for internal use, during the application development stage 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.

f. Interdistrict Settlement Account

At the close of business each day, all Reserve Banks and branches assemble the payments due to or from other Reserve Banks and branches as a result of transactions involving accounts residing in other Districts that occurred during the day's operations. Such transactions may include funds settlement, check clearing and ACH operations, and allocations of shared expenses. The cumulative net amount due to or from other Reserve Banks is reported as the "Interdistrict settlement account."

g. 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) to the Reserve Banks upon deposit with such agents of certain 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 equal to the sum of the notes applied for by such Reserve Bank.

Assets eligible to be pledged as collateral security include all Federal Reserve Bank assets. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose 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 similarly 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 of 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, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents the Bank's Federal Reserve notes outstanding reduced by its currency holdings of $17,376 million, and $18,415 million at December 31, 2004 and 2003, respectively.

h. 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. As a member bank's capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Member banks are state-chartered banks that apply and are approved for membership in the System and all national banks. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. These shares are nonvoting with a par value of $100. They may not be transferred or hypothecated. By law, each member bank is entitled to receive an annual dividend of 6 percent on the paid-in capital stock. This cumulative dividend is paid semiannually. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

The Financial Accounting Standards Board (FASB) has deferred the implementation date for SFAS No. 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity” for the Bank. When applicable, the Bank will determine the impact and provide the appropriate disclosures.

i. Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. 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.

Pursuant to Section 16 of the Federal Reserve Act, Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury as interest on Federal Reserve notes excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

In the event of losses or an increase in capital paid-in, payments to the U.S. Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in. Weekly payments to the U.S. Treasury may vary significantly.

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. This amount is reported as a component of “Payments to U.S. Treasury as interest on Federal Reserve notes.”

j. Income and Costs Related to 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.

k. Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Bank’s real property taxes were $3 million for each of the years ended December 31, 2004 and 2003, and are reported as a component of “Occupancy expense.”

l. Restructuring Charges

In 2003, the System started the restructuring of several operations, primarily check, cash, and Treasury services. The restructuring included streamlining the management and support structures, reducing staff, decreasing the number of processing locations, and increasing processing capacity in the remaining locations. These restructuring activities continued in 2004.

Footnote 10 describes the restructuring and provides information about the Bank’s costs and liabilities associated with employee separations and contract terminations. The costs associated with the write-down of certain Bank assets are discussed in footnote 6. Costs and liabilities associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY.

4. U.S. GOVERNMENT SECURITIES

Securities bought outright are held in the SOMA at the FRBNY. An undivided interest in SOMA activity and the related premiums, discounts, and income, with the exception of securities purchased under agreements to resell, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings that occurs in April of each year. The settlement equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank’s allocated share of SOMA balances was approximately 6.744 percent and 6.756 percent at December 31, 2004 and 2003, respectively.

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

	2004	2003
Par value		
U.S. government		
Bills	$ 17,734	$ 16,540
Notes	24,334	21,845
Bonds	6,340	6,652
Total par value	48,408	45,037
Unamortized premiums	634	662
Unaccreted discounts	(111)	(60)
Total allocated to Bank	$ 48,931	$ 45,639

The total of the U.S. government securities, net held in the SOMA was $725,584 million and $675,569 million at December 31, 2004 and 2003, respectively.

The maturity distribution of U.S. government securities bought outright and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2004, was as follows (in millions):

Maturities of Securities Held	U.S. Government Securities (par value)	Securities Sold under Agreements to Repurchase (contract amount)
Within 15 days	$ 2,067	$ 2,076
16 days to 90 days	12,028	—
91 days to 1 year	11,492	—
Over 1 year to 5 years	14,045	—
Over 5 years to 10 years	3,667	—
Over 10 years	5,109	—
Total	$ 48,408	$ 2,076

At December 31, 2004 and 2003, U.S. government securities with par values of $6,609 million and $4,426 million, respectively, were loaned from the SOMA, of which $446 million and $299 million were allocated to the Bank.

At December 31, 2004 and 2003, securities sold under agreements to repurchase with contract amounts of $30,783 million and $25,652 million, respectively, and par values of $30,808 million and $25,658 million, respectively, were outstanding. The Bank's allocated share at December 31, 2004 and 2003, was $2,076 million and $1,733 million, respectively, of the contract amount and $2,078 million and $1,733 million, respectively, of the par value.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and 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 foreign governments.

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 5.528 percent and 5.671 percent at December 31, 2004 and 2003, respectively.

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

	2004	2003
European Union Euro		
Foreign currency deposits	$ 335	$ 390
Securities purchased under agreements to resell	118	117
Government debt instruments	212	115
Japanese Yen		
Foreign currency deposits	85	84
Government debt instruments	424	416
Accrued interest	7	5
Total	$ 1,181	$ 1,127

Total System investments denominated in foreign currencies were $21,368 million and $19,868 million at December 31, 2004 and 2003, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2004, was as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	European Euro	Japanese Yen	Total
Within 1 year	$ 496	$ 509	$ 1,005
Over 1 year to 5 years	166	—	166
Over 5 years to 10 years	10	—	10
Over 10 years	—	—	—
Total	$ 672	$ 509	$ 1,181

At December 31, 2004 and 2003, there were no material open foreign exchange contracts.

At December 31, 2004 and 2003, the warehousing facility was $5,000 million, with no balance outstanding.

6. BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of bank premises and equipment at December 31 is as follows (in millions):

	Maximum Useful Life (in years)	2004	2003
Bank premises and equipment			
Land	N/A	$ 41	$ 40
Buildings	50	245	241
Building machinery and equipment	20	37	36
Construction in progress	N/A	1	2
Furniture and equipment	10	126	161
Subtotal		$ 450	$ 480
Accumulated depreciation		(117)	(140)
Bank premises and equipment, net		$ 333	$ 340
Depreciation expense for the years ended		$ 18	$ 19

The Bank leases unused space to outside tenants. Those leases have terms ranging from one to ten years. Rental income from such leases was $582,000 and $647,000 for the years ended December 31, 2004 and 2003, respectively. Future minimum lease payments under noncancelable agreements in existence at December 31, 2004, were (in thousands):

2005	$ 391
2006	214
2007	214
2008	145
2009	111
Thereafter	666
	$ 1,741

The Bank has capitalized software assets, net of amortization, of $3 million for each of the years ended December 31, 2004 and 2003. Amortization expense was $3 million and $1 million for the years ended December 31, 2004 and 2003, respectively.

Assets impaired as a result of the Bank's restructuring plan, as discussed in footnote 10, include software and equipment. Asset impairment losses of $287,000 and $91,000 for the periods ending December 31, 2004 and 2003, respectively, were determined using fair values based on quoted market values or other valuation techniques and are reported as a component of "Other expenses."

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2004, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately five 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 for each of the years ended December 31, 2004 and 2003. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 2004, were (in thousands):

		Operating
2005	$	566
2006		315
2007		315
2008		315
2009		293
Thereafter		0
	$	1,804

At December 31, 2004, the Bank, acting on behalf of the Reserve Banks, had contractual commitments extending through the year 2007 totaling $112 million. As of December 31, 2004, none of these commitments was recognized. Purchases of $28 million and $18 million were made against these commitments during 2004 and 2003, respectively. It is estimated that the Bank's allocated share of these commitments will be $66 million. These commitments represent air and ground transportation services for the Federal Reserve Check Transportation System, which serves all Reserve Banks. The payments for the next five years under these commitments are (in millions):

		Commitment
2005	$	28
2006		27
2007		11
2008		—
2009		—

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears 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 such agreement at December 31, 2004 or 2003.

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 two 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") and the Benefit Equalization Retirement Plan ("BEP"). In addition, certain Bank officers participate in the Supplemental Employee Retirement Plan ("SERP").

The System Plan is a multi-employer plan with contributions fully funded by participating employers. Participating employers are the Federal Reserve Banks, the Board of Governors of the Federal Reserve System, and the Office of Employee Benefits of the Federal Reserve Employee Benefits System. No separate accounting is maintained of assets contributed by the participating employers. The FRBNY acts as a sponsor of the Plan for the System and the costs associated with the Plan are not redistributed to the Bank. The Bank's projected benefit obligation and net pension costs for the BEP and the SERP at December 31, 2004 and 2003, and for the years then ended, are 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 $6 million for each of the years ended December 31, 2004 and 2003, and are reported as a component of "Salaries and other benefits."

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. Net postretirement benefit costs are actuarially determined using a January 1 measurement date.

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

	2004	2003
Accumulated postretirement benefit obligation at January 1	$ 91.7	$ 64.8
Service cost-benefits earned during the period	2.0	2.0
Interest cost of accumulated benefit obligation	5.0	4.7
Actuarial loss	1.3	22.2
Special termination loss	—	0.2
Contributions by plan participants	0.9	0.6
Benefits paid	(3.8)	(2.8)
Plan amendments	(11.4)	—
Accumulated postretirement benefit obligation at December 31	$ 85.7	$ 91.7

At December 31, 2004 and 2003, the weighted average discount rate assumptions used in developing the benefit obligation were 5.75 percent and 6.25 percent, respectively.

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):

	2004	2003
Fair value of plan assets at January 1	$ —	$ —
Actual return on plan assets	—	—
Contributions by the employer	2.9	2.2
Contributions by plan participants	0.9	0.6
Benefits paid	(3.8)	(2.8)
Fair value of plan assets at December 31	$ —	$ —
Unfunded postretirement benefit obligation	$ 85.7	$ 91.7
Unrecognized prior service cost	15.1	20.8
Unrecognized net actuarial loss	(26.7)	(26.3)
Accrued postretirement benefit costs	$ 74.1	$ 86.2

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs.”

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

	2004	2003
Health care cost trend rate assumed for next year (percent)	9.00	10.00
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) (percent)	4.75	5.00
Year that the rate reaches the ultimate trend rate	2011	2011

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A 1 percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2004 (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	$ 1.4	$ (1.0)
Effect on accumulated postretirement benefit obligation	11.8	(9.7)

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

	2004	2003
Service cost-benefits earned during the period	$ 2.1	$ 2.0
Interest cost of accumulated benefit obligation	5.0	4.7
Amortization of prior service cost	(2.1)	(2.0)
Recognized net actuarial loss	0.8	0.2
Total periodic expense	$ 5.8	$ 4.9
Curtailment gain	(15.0)	—
Special termination loss	—	0.1
Net periodic postretirement benefit costs	$ (9.2)	$ 5.0

At December 31, 2004 and 2003, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 6.25 percent and 6.75 percent, respectively.

Net periodic postretirement benefit costs are reported as a component of "Salaries and other benefits."

A plan amendment that modified the credited service period eligibility requirements created curtailment gains. The recognition of special termination losses is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in footnote 10. Because the special termination loss is less than $50,000, the amount is not displayed in the tables above.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "Act") was enacted in December 2003. The Act 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. Following the guidance of the Financial Accounting Standards Board, the Bank elected to defer recognition of the financial effects of the Act until further guidance was issued in May 2004.

Benefits provided to certain participants are at least actuarially equivalent to Medicare Part D. The estimated effects of the subsidy, retroactive to January 1, 2004, are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit costs.

Following is a summary of the effects of the expected subsidy:

	2004
Decrease in the accumulated postretirement benefit obligation	$ 12.6
Decrease in the net periodic postretirement benefit costs	$ 1.8

Expected benefit payments (in millions):

	Without Subsidy	With Subsidy
2005	$ 3	$ 3
2006	3	3
2007	4	3
2008	4	4
2009	4	4
2010–2014	25	23
Total	$ 43	$ 40

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31, 2004, measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. For 2004, the Bank changed its practices for estimating postemployment costs and used a 5.25 percent discount rate and the same health care trend rates as were used for projecting postretirement costs. Costs for 2003, however, were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 2004 and 2003, were $12 million and $11 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2004 and 2003 operating expenses were $3 million and $2 million, respectively.

10. BUSINESS RESTRUCTURING CHARGES

In 2003, the Bank announced plans for restructuring to streamline operations and reduce costs, including consolidation of check operations and staff reductions in various functions of the Bank. In 2004, additional consolidation and restructuring initiatives were announced in the check operations. These actions resulted in the following business restructuring charges:

Major categories of expense (in millions):

	Total Estimated Costs	Accrued Liability 12/31/03	Total Charges	Total Paid	Accrued Liability 12/31/04
Employee separation	$ 13	$ 3	$ 7	$ 6	$ 4
Contract termination	—	—	—	—	—
Other	—	—	—	—	—
Total	$ 13	$ 3	$ 7	$ 6	$ 4

Employee separation costs are primarily severance costs related to identified staff reductions of approximately 345, including 160 staff reductions related to restructuring announced in 2003. These costs are reported as a component of "Salaries and other benefits."

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

Future costs associated with the restructuring that are not estimable and are not recognized as liabilities will be incurred in 2006.

The Bank anticipates substantially completing its announced plans by March 2006.

Pictured in photos
Left to right: front cover, Sandy Jarman, Supervision and Regulation; Randy Ingram, Facilities; Pete Bermudez, Payment Services; page 4, Vernell Daise and Mike Russo, Jacksonville Cash; page 6, Vanessa Mitchell and Nicholas Haltom, Research Department; page 8, Corporal Cara Kern and Corporal Anthony Preston, Atlanta Law Enforcement; page 10, Durrell Lowery, Systems; page 12, Jamila Thurman and Raphael Johnson, Payment Services; page 14, Debra Klimkiewicz, Supervision and Regulation; page 16, Pat Barron, First Vice President, and Leon Patterson, Payment Services

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