Against the Grain

Federal Reserve Bank of Atlanta
2006 Annual Report

FEDERAL
RESERVE
BANK
of ATLANTA

Against the Grain

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Contents

Message from the First Vice President

In a world where new information is constantly bombarding us, it's easy to get distracted. But at the Atlanta Fed our approach is to look beyond the noisy discourse of the day-to-day and concentrate on doing the right thing for tomorrow. Sometimes our focus on the longer term leads us to make tough decisions—to go against the grain of conventional wisdom. That way of thinking is the theme of this year's annual report.

Fortunately, Congress had the foresight to establish the Federal Reserve System as an independent central bank, which is accountable to but separate from the U.S. government. At the Atlanta Fed we take this latitude seriously as we strive to be a leader within the Federal Reserve System.

The Fed calibrates monetary policy according to the best interests of the nation as a whole, but the Atlanta Fed also brings to the discussion our unique perspective from the southeastern United States. From the Gulf Coast communities that are still rebuilding after devastating hurricanes, to the booming cruise ports of Florida, to universities leading research in advanced technologies, our region is large, diverse, and economically dynamic. And as our world becomes smaller, the Southeast becomes more global, and our organization dedicates more and more attention to understanding developments in other countries, especially in Latin America.

During a year of changing economic conditions and uncertainty, Atlanta Fed economists developed new forecasting techniques in support of policies that keep inflation low and stable and economic growth at or near potential. I'm confident the Fed's policy actions in 2006 set the stage for positive economic outcomes in 2007 and beyond.

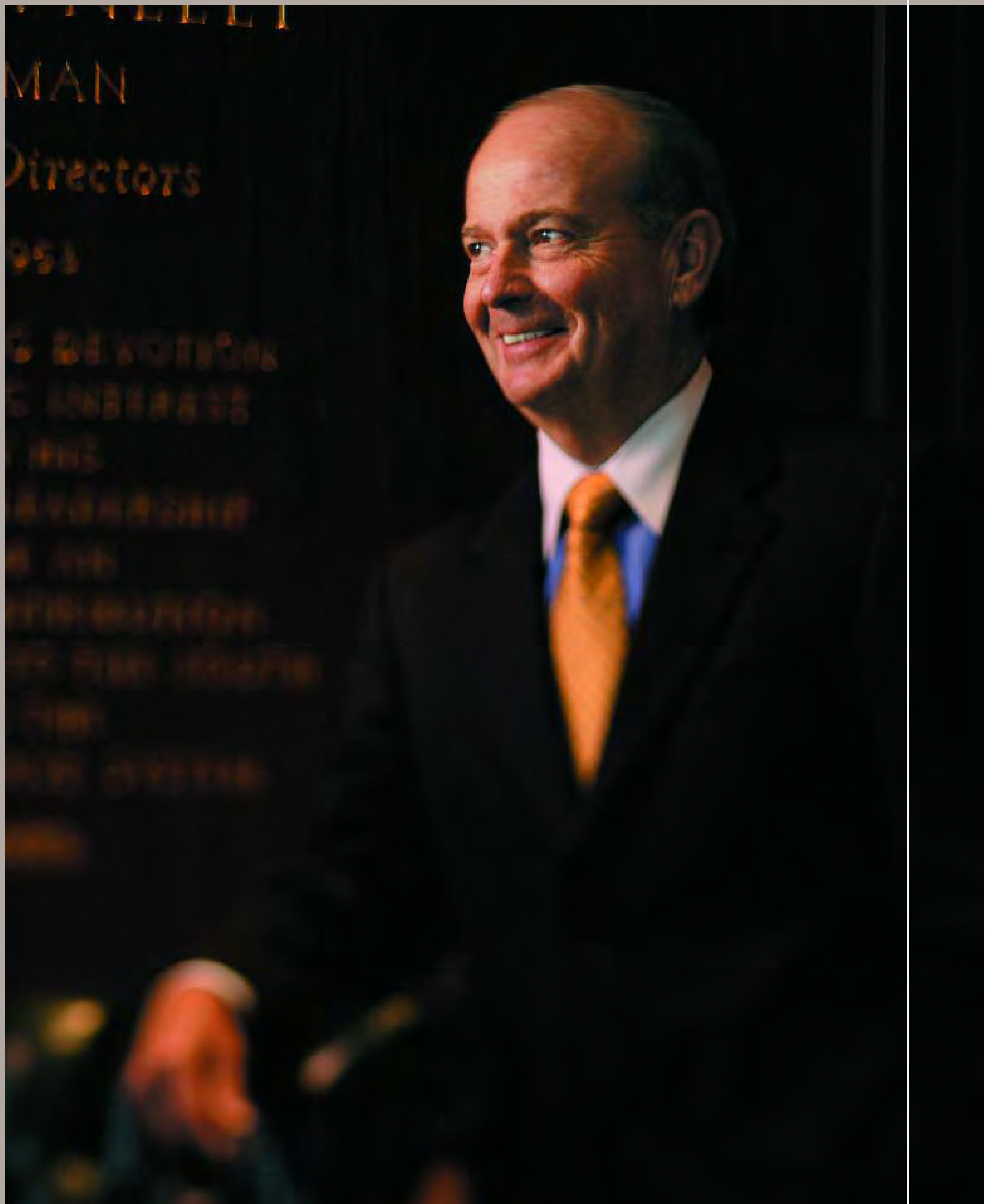
We move ahead with our eyes open to potential risks, including rapid growth in financial market innovations such as credit derivatives, a soft housing market, and elevated energy costs. Throughout our more than ninety-year history—especially during the late 1970s and early 1980s—the Fed has overcome severe threats. Today, as economic and financial events are unfolding more rapidly than ever, central bankers face a constantly changing matrix of challenges and opportunities.

Reflecting on our experience in central banking, I believe much of the economic prosperity we now enjoy is built on a foundation of going against the grain. As we continue to stay on the right course for the long term, I believe our nation's economic and financial future is very bright.

For much of 2006, the Atlanta Fed was led by President and Chief Executive Officer Jack Guynn, who retired in October after a forty-two-year career with the Fed. I hope you'll take a minute to read our tribute to him. Since Jack's retirement, following Fed procedures, I've had the pleasure of fulfilling the duties of president. We look ahead to new leadership in 2007 under Dennis Lockhart, who was named the new Atlanta Fed president and chief executive on February 8.

Throughout this transition for the bank, our directors played an important role, going above and beyond their normal duties to inform monetary policy. In closing, I would like to thank all of our directors—and especially Larkin Martin, who headed the presidential search committee—for their guidance in helping to secure top leadership in our organization for many years to come.

Patrick K. Barron



Atlanta Fed First Vice President and Chief Operating Officer Patrick K. Barron

Looking beyond conventional approaches

Early in 2006 the range of possible economic paths widened as rising energy costs and weakness in housing raised concerns about the sustainability of economic growth. Amid this uncertainty, the Federal Open Market Committee (FOMC) increased the fed funds rate during the first half of the year from 4.25 percent to 5.25 percent, continuing a process that began in June 2004.

As monetary accommodation was removed, Fed policymakers carefully weighed their options. Was the housing sector slowdown likely to place a heavy drag on economic growth? Were more rate hikes necessary to keep inflation and inflation expectations contained? Opinions were and remain mixed. But in August 2006 the Atlanta Fed voted with the majority to pause the Fed policy of steadily increasing rates in 25 basis point increments.

Price stability is a top priority across the Federal Reserve System. Inflation rates drifted upward perceptibly in 2006, and the Atlanta Fed's team of twenty-six Ph.D. economists filtered the data through innovative models to gain insights. Bank economists investigated not only the various headline inflation measures that include food and energy costs but also the core measures that exclude those volatile items, devoting considerable attention to specific inflation components and interpreting the often volatile and conflicting movements characteristic of inflation data.

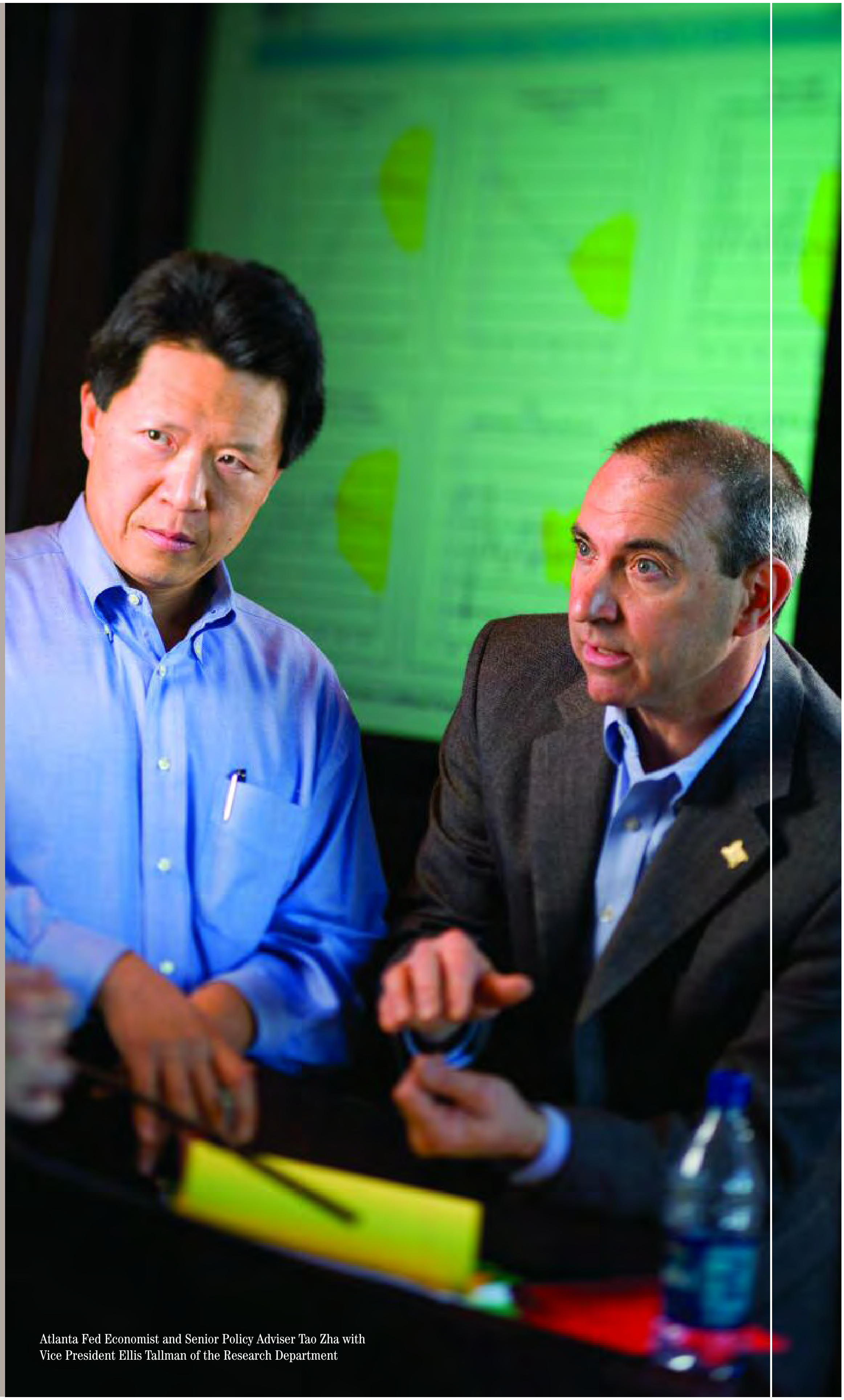
Amid the fluctuations, the economists began to notice patterns and informative signals. For instance, services inflation was rising rapidly, but prices for manufactured goods were relatively flat. And, given the weakening market for new and existing home purchases, it was not surprising that rental costs were increasing.

Effective monetary policy requires taking stock of the current economic situation not only by analyzing data but also by making forecasts. One such approach to forecasting was described in a 2006 paper titled "Were There Regime Switches in U.S. Monetary Policy?" by Atlanta Fed Senior Policy Adviser Tao Zha and Princeton University economist Christopher A. Sims. This paper outlines a technically innovative model used for forecasting inflation in 2006. Said Zha, "Monetary policy needs time to affect the economy. Our model signaled to us that we should wait for the lagged effects of monetary policy to play out on inflation."

This new approach, along with other evidence, indicated that past rate increases had not been given adequate time to take full effect and that past policy actions might have been sufficient to contain rising inflation and inflation expectations. This interpretation of the forecasts was a key input into the Atlanta Fed's recommendation and vote at FOMC meetings throughout 2006 and surfaced during intense debates about the proper time for a pause.

During the second half of 2006, the FOMC decided to keep the funds rate at 5.25 percent. For all of 2006, gross domestic product in the United States, the mostly widely used measure of economic growth, grew an estimated 3.3 percent—a slight decline from the previous year. An average of 187,000 new jobs were created per month in 2006, and the unemployment rate declined to very low levels. Although inflation measures in December were elevated, they were drifting downward moving into 2007.

For much of 2006 this favorable economic outcome was uncertain. But the Fed's work is never done. Economists remain vigilant about a wide range of risks. A willingness to look at nonconventional approaches such as Zha's dynamic forecasting techniques helps the Atlanta Fed to be a leader in the ever-changing business of monetary policy.



Atlanta Fed Economist and Senior Policy Adviser Tao Zha with
Vice President Ellis Tallman of the Research Department

Guidance for uncertain times

By most conventional measures, financial institutions adjusted well in 2006 to an environment of rapid change. Profits were high, credit quality was strong, and for the second consecutive year no banks failed. (This streak—the longest since deposit insurance was created in 1934—ended with the failure of a small Pennsylvania bank in February 2007). Banks entered 2006 with cautious optimism. The Southeast had enjoyed years of robust housing demand and related real estate development activity fed by in-migration, and sales and price appreciation in the housing sector had just completed another record year. Corporate lending also had regained momentum following a slow recovery from the 2001 recession.

As always, financial institutions confronted their share of challenges. A persistently flat yield curve pressured net interest margins in 2006, and as the months passed it became clear that housing demand had peaked late in 2005 and was slowing. The slowdown was fairly sharp in some previously strong markets in the Atlanta Fed's district, dampening mortgage and construction loan growth for many banks.

During periods of change, bank regulators often find themselves in the unpopular position of reminding bankers about the potential dangers of growing too much, too fast and of the need to maintain solid risk management practices consistent with banks' growth and mix of activities. Prudent central bankers and regulators have a responsibility to ask sometimes unpleasant "what if" questions—even in the face of enthusiasm in the marketplace.

As evidence mounted throughout the year of a cooling in the housing sector, Atlanta Fed Supervision and Regulation staff kept abreast of evolving regional real estate market conditions and mortgage financing instruments. In addition, the bank conducted outreach across the Federal Reserve System in 2006 to help raise awareness among other Federal Reserve System examiners of the changes in real estate markets and how they might affect commercial banking institutions.

Beyond their focus on real estate, Atlanta Fed bank supervisors were involved in a wide spectrum of other activities in 2006. For instance, Supervision and Regulation staff continued to play a critical role in facilitating the ongoing financial integration between the United States and Latin America. The staff provided extensive technical assistance to supervisors throughout Latin America on credit, market, and operations risk, among other issues.

In addition, the Supervision and Regulation Division's Community Affairs Department worked with the Federal Reserve's Atlanta-based Retail Payments Office to strengthen the Directo a México International Automated Clearinghouse (ACH) service. The group developed comprehensive materials addressing legal and regulatory issues associated with banking the immigrant population and presented the information at more than a dozen forums throughout the United States and in Mexico City in 2006.

The Atlanta Fed's supervision staff will remain focused on monitoring changes in real estate markets in 2007. And they remain committed to working constructively with supervised institutions as they manage exposures to a broad range of risks, working toward the common goal of maintaining a safe and sound banking system.

Assistant Vice Presidents Robert Hawkins and Brian Bowling of the Atlanta Fed Supervision and Regulation Division

Progress on the long journey to electronic payments

(Left to right) Robert Price, senior vice president, Cleveland Fed, with Nell Campbell-Drake, Retail Payments project director, Richard Oliver, executive vice president, and Elizabeth McQuerry, assistant vice president, all of the System Retail Payments Office

The long journey from paper to electronic payments in the United States has involved many unexpected impediments. Despite the rough terrain, 2006 was a year of substantial progress. The volume of payments made through the Fed's automated clearinghouse (ACH), for instance, increased 11 percent in part as a result of the conversion of paper checks to ACH debits, either at the point of purchase or at so-called lockboxes. The goal of establishing a seamless end-to-end electronic payment system is coming into closer view.

The Federal Reserve's Retail Payments Office (RPO), which is based at the Atlanta Fed, continued to play a leadership role in 2006 in the quest to make the backroom business of paying for goods and services more efficient. Sometimes this responsibility to encourage more efficient payments leads the Fed to go against the grain of an

industry invested in now-cumbersome methods for processing paper checks.

For instance, an important program to increase the speed of check payments is the Check Clearing for the 21st Century Act (Check 21) of 2003. After Check 21 took effect in October 2004, many banks were slow to convert to this new method for creating and sending electronic images of checks, which then can be printed on paper as "substitute checks" to the paying bank if required.

In 2006, however, many more banks came to see the advantages of faster payments through Check 21. The Atlanta Fed is the largest processor of Check 21 transactions in the Fed System. With these transactions gaining a critical mass of volume, the Atlanta Fed, like some other Reserve Banks, found it necessary in 2006 to invest in new high-speed printers, imaging technology, and other equipment to increase capacity. At the beginning of the year, the Atlanta Fed's main facility for Check 21 printed an average of 180,000 substitute checks a day; by year's end, the daily average was about 822,000. Processing facilities at the Nashville and Jacksonville branches reported proportionally similar increases.

While Check 21 expanded in 2006, the RPO proceeded with clearly painful but necessary plans to restructure more traditional check infrastructure in line with the Fed's congressional mandate to recover the costs of providing financial services. These changes, which included the closing of many check processing shops, were implemented across the Fed System, but as the Reserve Bank with the most branches (five), the Atlanta Fed endured some reductions. Check processing operations previously located at branches in

Substitute check printers at the Atlanta Fed

Miami, Birmingham, Nashville, and New Orleans have been moved to Atlanta over the past several years or are assigned to do so in the near future. The bank also shut down cash operations at the Birmingham Branch, which became a cash depot serviced from Atlanta as part of a separate nationwide effort to ensure cash processing offices are deployed to the most effective locations.

In a global economy, low-cost payments should not stop at national boundaries, and the Fed continued to lay the groundwork for international ACH payments growth, forging relationships with key "gateway" partners in Europe and North America. Along these lines, the Fed RPO's bank-centric Directo a México International ACH program gained traction in 2006 as a low-cost method for bank account holders in the United States to make remittance payments to Mexico.

Remittance payments are a rapidly growing and important market for businesses, individuals, and the U.S. government. Despite some public debate about this program during 2006, the Fed is committed to supporting and expanding efficient payments to Mexico as part of the Partnership for Prosperity approved in 2001 by the presidents of the United States and Mexico.

The transition to efficient payments will continue long past 2006. But the Atlanta Fed, working through the Federal Reserve System and with others in the financial services industry, is committed to confronting and overcoming the many challenges along the way to reaching our goals.

Asking tough questions on timely issues

When it comes to the healthy discourse needed to inform effective public policy, the Atlanta Fed has a tradition of leadership. Over the years, the bank has provided unique gatherings for getting to the heart of timely and difficult issues in the financial sector, and the bank's economists have a track record of conducting policy research whose results may go against the prevailing views in order to confront potential threats to a safe and vibrant marketplace.

In 2006 the theme of the bank's annual financial markets conference was "Hedge Funds: Creators of Risk?" During this two-and-a-half-day event, Fed Chairman Ben Bernanke was on hand to talk about hedge funds and the rapidly growing marketplace for buying and selling risks. Also on the agenda were policymakers from the Securities and Exchange Commission, other Federal Reserve Banks, the Commodity Futures Trading Commission, and other agencies.

Building a successful conference requires more than just inviting the best and brightest minds. The bank's approach involves bringing together divergent viewpoints: academic experts, policymakers, and market practitioners. Some participants advocated the merits of unfettered financial innovation. In turn, their views were challenged by others who argued that hedge funds pose a systemic risk to the financial sector and that more regulation, or at least greater transparency, is needed.

We believe this honest and open exchange of ideas leads to the kind of lively discussion that advances public knowledge in a meaningful way. In turn, this knowledge is invaluable as the Fed pursues its mission to ensure a safe yet dynamic financial sector.

Another issue that has attracted the attention of Atlanta Fed economists and others is the central role of government-sponsored enterprises (GSEs), especially Fannie Mae and Freddie Mae, in the $10.7 trillion market for U.S. residential mortgages.

Housing GSEs play an important role in the financial sector that the Fed believes warrants greater scrutiny. Over the years, these institutions have aided in the development of the U.S. secondary mortgage market and reduced the cost of mortgage credit.

The Fed's primary concern about Fannie Mae and Freddie Mac revolves around the potential for their mortgage-oriented investment portfolios to propagate financial disruptions. GSE obligations are perceived by financial markets to be implicitly guaranteed by the U.S. government. As a result, Fannie Mae and Freddie Mac have funding costs lower than AAA-rated fully private firms, an advantage that has helped the GSEs become two of the largest U.S. financial institutions.

In an April 2006 working paper, the Atlanta Fed concluded that limiting the size of the GSEs' mortgage-oriented portfolios would be the most desirable method of mitigating their systemic risk. While major GSE reform legislation did not move out of Congress in 2006, policymakers on Capitol Hill and elsewhere continue to evaluate the pros and cons of GSE portfolio limits as a method to reduce systemic risk.

Effective policy requires time and understanding that comes with the input of a broad range of perspectives. The Atlanta Fed is committed to providing ongoing analysis of complex issues and, in doing so, to facing the sometimes hard realities in our changing financial sector.

(Top) Shalini Patel, senior economic analyst, with Paula Tkac, financial economist and associate policy adviser, of the Atlanta Fed Research Department

(Bottom) Atlanta Fed Financial Economist and Policy Adviser Larry Wall with Financial Economist and Associate Policy Adviser Scott Frame

A Tribute to Retired President Jack Guynn

When Jack Guynn arrived at the Federal Reserve Bank of Atlanta in 1964 to help automate its operations, computers were the size of cars and less powerful than today's desktops. All currency notes were inspected by hand. There were no Atlanta Braves, New Orleans Saints, or Miami Dolphins, and the Atlanta Fed's Miami Branch office had not even been conceived.

Miami's population today is nearly five times what it was in 1964, and Atlanta is four times larger. And the Sixth Federal Reserve District has evolved from a region of smaller cities, ports, some factories, and agriculture to a vibrant, diverse economic region driven by thriving metropolitan areas.

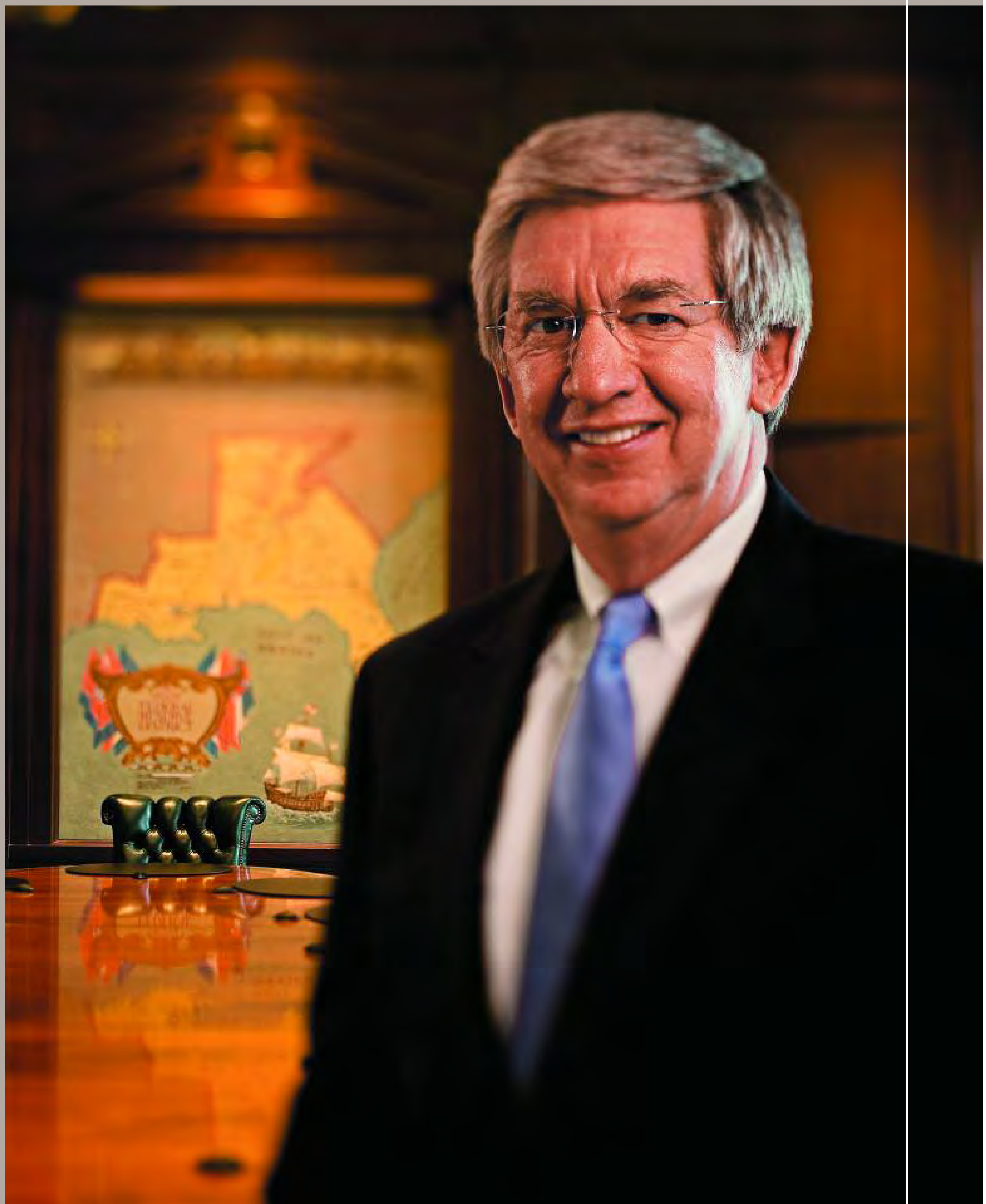
Guynn, who retired on October 1, played a role in virtually every fundamental change and major event at the bank in the past forty years, including automating every aspect of the operation, diversifying the workforce and management, making fundamental changes in payments, and dealing with banking crises in the South. In addition, Guynn was instrumental in opening the Miami Branch in 1971 and the new Atlanta headquarters building in 2001.

After more than a dozen years as first vice president, Guynn became the bank's thirteenth president and chief executive officer on January 1, 1996. His tenure as president was highlighted by his efforts to build a better understanding of the Fed's role in the economy among business and civic leaders throughout the Southeast and his success in making the Atlanta Fed a high-profile player in community activities.

Another important part of Guynn's presidency was his role in monetary policy as a member of the Federal Reserve's Federal Open Market Committee (FOMC). During the FOMC's deliberations in Washington, D.C., eight times a year, Guynn weighed in on the state of the economy and, as a rotating voting member of the committee, helped shape the Fed's role in stabilizing and boosting the economy.

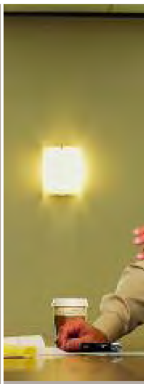
Guynn's tenure of forty-two years with the bank is the longest of any Sixth Federal Reserve District president. He is also the only Atlanta Fed president who spent his entire career with the bank.

As a tangible tribute to Guynn's work in bringing the bank closer to the community, the plaza in front of the Atlanta Fed near Peachtree and 11th Streets was named Jack Guynn Plaza.



(Left) A standing marker and marble flag pole stanchion designate Jack Guynn Plaza at the Atlanta Fed.

(Above) Jack Guynn, former president and chief executive officer of the Federal Reserve Bank of Atlanta, retired on October 1, 2006.



Highlights 2006

Federal Reserve Bank of Atlanta Year in Review

QUARTER ONE

• The Federal Reserve Banks secured their first patent in the payments arena for a method of matching a check adjustment request with a digital image of the check stored in a Reserve Bank's archives. The Atlanta Fed devised and helped implement the process.

• The New Orleans Branch's check operations were successfully consolidated into the Atlanta office in March.

QUARTER TWO

• After its cash operations were transferred to the Atlanta office and a cash depot serviced by Loomis Fargo, the Birmingham Branch now serves as a Federal Reserve System contingency site. The branch also maintains a small local staff in Supervision and Regulation and Economic Education.

• On the Atlanta Fed's first District Day of Service in April, 300 employees contributed more than 400 volunteer hours. As one of the activities on the Day of Service, employees processed enough food at the Atlanta Food Bank to provide more than 23,000 meals.

• To help originating banks track customers who initiate ACH payments, the Atlanta-based System Retail Payments Office introduced a FedACH Risk Origination Monitoring Service. The service, which allows originating institutions to set debit and credit dollar limits on themselves and their customers for one-time Internet, telephone, and point-of-purchase payments, is intended to hinder potential fraud and unethical transactions.

• The Atlanta Fed's Americas Center Web page began to provide Spanish and Portuguese translations of many Atlanta Fed publications, articles, and other information.

• After a trial program at the Jacksonville Branch in 2005 proved very effective, the Atlanta Fed's Atlanta office and branches in Miami, Nashville, and New Orleans began using explosive-sniffing canines to help inspect vehicles arriving at the bank.

QUARTER THREE

• The bank hosted a day-long public hearing sponsored by the Federal Reserve Board of Governors on issues affecting the home equity lending market. One of four sessions held across the country, the hearing was designed to gather information about how well consumer protection rules are working and how they might be improved.

• The Atlanta Fed continued to support foreign central banks' efforts to implement the bank's econometric macro modeling innovations. Several banks in Europe, Asia, and Latin America adopted or collaborated on

elements of the Atlanta Fed's forecasting and policy evaluation work.

• Staff from the bank's Supervision and Regulation Division participated in a range of technical assistance assignments in several countries, primarily in Latin America.

QUARTER FOUR

• Jack Guynn, president and chief executive officer of the Atlanta Fed for ten years, retired after forty-two years with the organization.

• By October, Check 21 volume had exploded, growing 15 percent each month in 2006. The Check 21 Business Operations group printed an average of 150,000 substitute checks per day in January. By the fourth quarter, the volume had grown to 822,000 per day.

• The Atlanta Fed–based System Retail Payments Office continued to cultivate growth of International ACH services through projects such as online seminars. To promote the Directo a México service, the Atlanta Fed joined Banco de México and a development bank owned by the Mexican government to educate U.S. financial institutions about ways to open accounts online for people in Mexico who receive money transfers from the United States.

• Building on the lessons learned from Hurricane Katrina, the bank produced a video to encourage financial preparedness and to educate teachers and students on the Federal Reserve's role in disaster recovery.

• Economic and financial education staff in each branch office established education advisory groups and hosted seminars, workshops, and conferences for educators throughout the Southeast.

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.

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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

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

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

L. PHILLIP HUMANN
Chairman and
Chief Executive Officer
SunTrust Banks Inc.
Atlanta, Georgia

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

LEE M. THOMAS
Past President and
Chief Operating Officer
Georgia-Pacific Corporation
Atlanta, Georgia

Federal Advisory Council Member

FREDERICK L. GREEN III
President and Chief Operating Officer
Synovus Financial Corporation
Columbus, Georgia

Seated, left to right: Perry, Ratcliffe, Martin; standing, left to right: Davis, Thomas, Smith, Humann, Beall, Fontenot; not pictured: Green

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Chairman
President
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Lookout Mountain, Tennessee

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

MARYAM B. HEAD
President
Ram Tool and Supply Company Inc.
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

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

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President and
Chief Executive Officer
Prudential Network Realty
Jacksonville, Florida

ROBERT L. FISHER
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Chief Executive Officer
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Tampa, Florida

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President
Amelia Island Plantation Company
Amelia Island, Florida

H. BRITT LANDRUM JR.
President and
Chief Executive Officer
Landrum Human Resource
Companies Inc.
Pensacola, Florida

ALAN ROWE
President and
Chief Executive Officer
1st Commercial Bank of Florida
Orlando, Florida

ELLEN S. TITEN
President
E.T. Consultants
Winter Park, Florida

Left to right: Healan, Rowe, Sherrer, Gabremariam, Titen, Fisher, Landrum

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

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

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Chairman and
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THOMAS H. SHEA
Regional Chief Executive
Officer–Florida/Caribbean
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Fort Myers, Florida

Left to right: Jones, Gudorf, Thompson, Lopez, Shea, Keeley, Hudson

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Chairman
First National Bank
Oneida, Tennessee

M. TERRY TURNER
President and
Chief Executive Officer
Pinnacle Financial Partners
Nashville, Tennessee

Left to right: Turner, Gaudette, London, Williams, Spradley, Ford, Swain; not pictured: Loughry

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President
Roberts Brothers Commercial and
Property Management Inc., Realtors
Mobile, Alabama

J. HERBERT BOYDSTUN
President and
Chief Executive Officer
Capital One, N.A.
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DAVE DENNIS
President and
Chief Executive Officer
Specialty Contractors and
Associates Inc.
Gulfport, Mississippi

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

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U.S. Consumer Foods
McCormick and Company Inc.
Baltimore, Maryland

EARL L. SHIPP
Global Business Vice President
for Oxides and Glycols
The Dow Chemical Company
Midland, Michigan

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

Left to right: Johnson, Dennis, Roberts, Kurzius, Boydstun; not pictured: Shipp, Slaughter

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President and
Chief Executive Officer
Florida Professional Firefighters
Tallahassee, Florida

JOYCE I. COOK
Chief Executive Officer
International CyberTrans
Brentwood, Tennessee

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Vice President/
Secretary-Treasurer
Advanced Agriculture Inc.
Lafayette, Louisiana

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Chief Executive Officer
and Founder
Turner Associates/
Architects and Planners Inc.
Atlanta, Georgia

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Coffee Perks
Jacksonville, Florida

JIMMY HAYNES
President
J.H. Haynes Electric Company
Gulfport, Mississippi

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

CYNTHIA JONES PARKS
President and
Chief Executive Officer
Jones Worley Communications
Atlanta, Georgia

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Chairman
SunSouth
Chief Executive Officer
ValCom Business Centers
Abbeville, Alabama

JACQUES KLEMPF
Chairman and President
Foodonics International Inc.
Jacksonville, Florida

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

NOAH SAVANT
Vice President
Communications Workers
of America
Decatur, Georgia

GUY TIPTON
President
Alabama District Council Ohio
Valley & Southern States Region
Hoover, Alabama

EVETTE WHITE
Chief Executive Officer
White/Thompson/
Cunningham/Regen
Nashville, Tennessee

GARY WISHNATZKI
President and
Chief Executive Officer
Wishnatzki Inc. d/b/a
Wishnatzki Farms
Plant City, Florida

Left to right: Jones Parks, Klempf, Harris, Wishnatzki, Paulk, White, Haynes, Cook, Savant, Tipton, Killebrew, Carver; not pictured: Guidry, Hartley, Howard

Sixth Federal Reserve District Officers

Management Committee

JACK GUYNN
(RETIRED)
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
Corporate Services Division

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

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

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

MARIE C. GOODING
Senior Vice President and
Director of Human Resources
Human Resources Department

FREDERICK R. HERR
Senior Vice President
System Retail Payments Office

RICHARD R. OLIVER
Executive Vice President
System Retail Payments Office

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

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

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

Other Corporate Officers

SENIOR VICE PRESIDENTS

HENRY BOURGAUX
System Retail Payments Office

SCOTT H. DAKE
System Retail Payments Office

JAMES M. McKEE
System Retail Payments Office

DONALD E. NELSON
System Retail Payments Office

WILLIAM J. TIGNANELLI
System Retail Payments Office

VICE PRESIDENTS

ANDRE T. ANDERSON
Supervision and
Regulation Division

JOHN S. BRANIGIN
System Retail Payments Office

DAVID F. CARR
(RETIRED)
Human Resources Department

SUZANNA J. COSTELLO
Supervision and
Regulation Division

THOMAS J. CUNNINGHAM
Associate Director of Research
Research Division

LEAH DAVENPORT
Check Function Office/
Atlanta Financial Services

GERALD P. DWYER JR.
Research Department

J. STEPHEN FOLEY
Supervision and
Regulation Division

CYNTHIA C. GOODWIN
Supervision and
Regulation Division

MARY M. KEPLER
Financial Management
and Planning

MARY M. MANDEL
Executive Support Office

BOBBIE H. McCRACKIN
Public Affairs Officer
Public Affairs Department

JOHN C. ROBERTSON
Research Department

ROBERT M. SCHENCK
Supervision and
Regulation Division

LARRY J. SCHULZ
(RETIRED)
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

CHRISTOPHER N. ALEXANDER
Atlanta Cash/ACH Operations

JOHN H. ATKINSON
Supervision and
Regulation Division

ROBERT LEE BAGOSY
Law Enforcement

WILLIAM B. BOWLING
Supervision and
Regulation Division

JOAN H. BUCHANAN
Supervision and
Regulation Division

DAVID J. CHRISTERSON
System Retail Payments Office

CHAPELLE D. DAVIS
Supervision and
Regulation Division

W. JEFFREY DEVINE
Check Function Office/
Business Development

JENNIFER GIBILTERRA
Check Function Office
Atlanta Office

PAUL GRAHAM
Check Function Office
Jacksonville Office

ROBERT D. HAWKINS
Supervision and
Regulation Division

CAROLYN ANN HEALY
Supervision and
Regulation Division

JANET A. HERRING
Financial Management
and Planning

SUSAN HOY
Legal Department

BRADLEY M. JOINER
Information Security/Systems

EVETTE H. JONES
Business Development

JACQUELYN H. LEE
Automation Operations

ROBERT A. LOVE
System Retail Payments Office

MARGARET DARLENE MARTIN
System Retail Payments Office

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

DORIS QUIROS
Financial Statistics/
Structure Analysis

MARION P. RIVERS III
(RETIRED)
Supervision and
Regulation Division

SUSAN L. ROBERTSON
System Retail Payments Office

MELINDA J. RUSHING
System Retail Payments Office

JUAN C. SANCHEZ
Supervision and
Regulation Division

DAVID W. SMITH
Supervision and
Regulation Division

TIMOTHY R. SMITH
Community Relations Officer
Public Affairs Department

ARUNA SRINIVASAN
Credit and Risk Management/
Enterprise Risk Management

CLIFFORD S. STANFORD
Human Resources Department

ALLEN D. STANLEY
Supervision and
Regulation Division

DAVID E. TATUM
Supervision and
Regulation Division

JOEL E. WARREN
Check Function Office
Jacksonville Office

CHARLES L. WEEMS
Check Function Office
Atlanta Office

JULIUS G. WEYMAN
System Retail Payments Office

KENNETH WILCOX
Check Function Office
Atlanta Office

STEPHEN W. WISE
Supervision and
Regulation Division

Branch Officers

BIRMINGHAM

LEE C. JONES
Vice President and
Branch Manager/
District Law Enforcement

CHARLES W. PRIME
Branch Administration

JACKSONVILLE

CHRISTOPHER L. OAKLEY
Vice President and
Branch Manager

CHRISTINA M. WILSON
Assistant Vice President

MIAMI

JUAN DEL BUSTO
Vice President and
Branch Manager

ROBERT A. DE ZAYAS
Assistant Vice President

NASHVILLE

MELVYN K. PURCELL
Senior Vice President and
Branch Manager

ANNITA T. MOORE
Assistant Vice President and
Assistant Branch Manager

NEW ORLEANS

ROBERT J. MUSSO
Senior Vice President and
Branch Manager

AMY S. GOODMAN
Vice President and
Assistant Branch Manager

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 2006 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled $4.2 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 2006, the bank did not engage PwC for any material 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, 2006 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the *Financial Accounting Manual for the Federal Reserve Banks* ("Manual"), and as such, include amounts, some of which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies and practices documented in the Manual and include all disclosures necessary for such fair presentation.

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

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

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

Management's assessment of the effectiveness of the FRB Atlanta's internal control over financial reporting as of December 31, 2006, is being audited by PricewaterhouseCoopers LLP, the independent registered public accounting firm which also is auditing the FRB Atlanta's Financial Statements.

Federal Reserve Bank of Atlanta

Patrick K. Barron
Interim President and Chief Executive Officer and
First Vice President and Chief Operating Officer

Christopher G. Brown
Senior Vice President and Chief Financial Officer

March 5, 2007

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 completed an integrated audit of the Federal Reserve Bank of Atlanta's 2006 financial statements, and of its internal control over financial reporting as of December 31, 2006, and an audit of its 2005 financial statements in accordance with the generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Financial statements

We have audited the accompanying statements of condition of the Federal Reserve Bank of Atlanta (the "Bank") as of December 31, 2006 and 2005, 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 generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our 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* which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2006 and 2005, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in the accompanying Management's report on Internal Control Over Financial Reporting, that the Bank maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Bank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Bank's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Bank's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

March 12, 2007

Statements of Condition

(in millions)	December 31, 2006	December 31, 2005
Assets		
Gold certificates	$ 1,023	$ 945
Special drawing rights certificates	166	166
Coin	93	89
Items in process of collection	324	1,281
Loans to depository institutions	3	7
U.S. government securities, net	65,602	58,040
Investments denominated in foreign currencies	1,382	829
Accrued interest receivable	563	451
Interdistrict settlement account	12,403	10,086
Bank premises and equipment, net	278	283
Other assets	82	93
Total assets	**$ 81,919**	**$ 72,270**
Liabilities and Capital		
Liabilities:		
Federal Reserve notes outstanding, net	$ 74,237	$ 65,614
Securities sold under agreements to repurchase	2,479	2,360
Deposits:		
Depository institutions	1,980	1,626
Other deposits	3	2
Deferred credit items	474	763
Interest on Federal Reserve notes due to U.S. Treasury	53	13
Accrued benefit costs	121	89
Other liabilities	20	19
Total liabilities	**79,367**	**70,486**
Capital:		
Capital paid-in	1,276	892
Surplus (including accumulated other comprehensive loss of $27 million at December 31, 2006)	1,276	892
Total capital	**2,552**	**1,784**
Total liabilities and capital	**$ 81,919**	**$ 72,270**

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

Statements of Income

(in millions)	For the year ended December 31, 2006	For the year ended December 31, 2005
Interest income:		
Interest on U.S. government securities	$ 2,888	$ 2,107
Interest on investments denominated in foreign currencies	24	13
Total interest income	**2,912**	**2,120**
Interest expense:		
Interest expense on securities sold under agreements to repurchase	110	61
Net interest income	**2,802**	**2,059**
Other operating income:		
Income from services	788	786
Reimbursable services to government agencies	15	17
Foreign currency gains (losses), net	79	(124)
Other income	7	6
Total other operating income	**889**	**685**
Operating expenses:		
Salaries and other benefits	172	165
Occupancy expense	21	21
Equipment expense	21	20
Compensation paid for services costs incurred	543	483
Assessments by the Board of Governors	86	72
Other expenses	121	145
Total operating expenses	**964**	**906**
Net income prior to distribution	**$ 2,727**	**$ 1,838**
Distribution of net income:		
Dividends paid to member banks	$ 64	$ 42
Transferred to surplus	411	376
Payments to U.S. Treasury as interest on Federal Reserve notes	2,252	1,420
Total distribution	**$ 2,727**	**$ 1,838**

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

Statements of Changes in Capital

(in millions) — For the years ended December 31, 2006, and December 31, 2005

		Surplus			
	Capital Paid-In	Net Income Retained	Accumulated Other Comprehensive Loss	Total Surplus	Total Capital
Balance at January 1, 2005 (10.3 million shares)	$ 516	$ 516	$ —	$ 516	$ 1,032
Net change in capital stock issued (7.5 million shares)	376	—	—	—	376
Transferred to surplus	—	376	—	376	376
Balance at December 31, 2005 (17.8 million shares)	$ 892	$ 892	$ —	$ 892	$ 1,784
Net change in capital stock issued (7.7 million shares)	384	—	—	—	384
Transferred to surplus	—	411	—	411	411
Adjustment to initially apply FASB Statement No. 158	—	—	(27)	(27)	(27)
Balance at December 31, 2006 (25.5 million shares)	$ 1,276	$ 1,303	$ (27)	$ 1,276	$ 2,552

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

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

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

2. OPERATIONS AND SERVICES

The Reserve Banks perform a variety of services and operations. Functions include participation in formulating and conducting monetary policy; participation in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distribution of coin and currency; performance of fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities; serving as the federal government's bank; provision of short-term loans to depository institutions; service to the consumer and the community by providing educational materials and information regarding consumer laws; and supervision of bank holding companies, state member banks, and U.S. offices of foreign banking organizations. The Reserve Banks also provide certain services to foreign central banks, governments, and international official institutions.

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

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

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

Major services provided on behalf of the System by the Bank, for which the costs were not redistributed to the other Reserve Banks, include 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.

During 2005, the Federal Reserve Bank of Atlanta ("FRBA") was assigned the overall responsibility for managing the Reserve Banks' provision of check services to depository institutions, and, as a result, recognizes total System check revenue on its Statements of Income. Because the other eleven Reserve Banks incur costs to provide check services, a policy was adopted by the Reserve Banks in 2005 that required that the FRBA compensate the other Reserve Banks for costs incurred to provide check services. In 2006 this policy was extended to the ACH services, which are managed by the FRBA, as well as to Fedwire funds transfer and securities transfer services, which are managed by the FRBNY. The FRBA and the FRBNY compensate the other Reserve Banks for the costs incurred to provide these services. Compensation paid by the Bank for check and ACH services is reported as a component of "Compensation paid for services costs incurred" in the Statements of Income, and the Bank would have reported $542 million as compensation paid had this policy been in place in 2005 for ACH services.

3. SIGNIFICANT ACCOUNTING POLICIES

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

Differences exist between the accounting principles and practices in the Financial Accounting Manual and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank. The primary difference is the presentation of all securities holdings at amortized cost, rather than using the fair value presentation required by GAAP. Amortized cost more appropriately reflects the Bank's securities holdings given its unique responsibility to conduct monetary policy. While the application of current market prices to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

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

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

a. Gold and Special Drawing Rights Certificates

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

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

SDR certificates are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates somewhat like gold certificates, to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the U.S. Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2006 or 2005.

b. Loans to Depository Institutions

Depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in regulations issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Bank. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Outstanding loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve Bank, subject to review and determination by the Board of Governors.

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

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

Activity related to U.S. government securities, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

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

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

U.S. government securities held in the SOMA are lent to U.S. government securities dealers in order to facilitate the effective functioning of the domestic securities market. Securities-lending transactions are fully collateralized by other U.S. government securities and the collateral taken is in excess of the market value of the securities loaned. The FRBNY charges the dealer a fee for borrowing securities and the fees are reported as a component of "Other income."

Activity related to securities sold under agreements to repurchase and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from the annual settlement of interdistrict clearings. Securities purchased under agreements to resell are allocated to FRBNY and not allocated to the other Reserve Banks.

e. FX Swap Arrangements and Warehousing Agreements

FX swap arrangements are contractual agreements between two parties, the FRBNY and an authorized foreign central bank, to exchange specified currencies, at a specified price, on a specified date. The parties agree to exchange their currencies up to a prearranged maximum amount and for an agreed-upon period of time (up to twelve months), at an agreed-upon interest rate. These arrangements give the FOMC temporary access to the foreign currencies it may need to intervene to support the dollar and give the authorized foreign central bank temporary access to dollars it may need to support its own currency. Drawings under the FX swap arrangements can be initiated by either party acting as drawer, and must be agreed to by the drawee party. The FX swap arrangements are structured so that the party initiating the transaction bears the exchange rate risk upon maturity. The FRBNY will generally invest the foreign currency received under an FX swap arrangement in interest-bearing instruments.

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

FX swap arrangements and warehousing agreements are revalued daily at current market exchange rates. Activity related to these agreements, with the exception of the unrealized gains and losses resulting from the daily revaluation, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Unrealized gains and losses resulting from the daily revaluation are allocated to FRBNY and not allocated to the other Reserve Banks.

f. Bank Premises, Equipment, and Software

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

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

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

g. Interdistrict Settlement Account

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

h. Federal Reserve Notes

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

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

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

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the currency issued to the Bank but not in circulation, of $23,938 million and $19,039 million at December 31, 2006 and 2005, respectively.

i. Items in Process of Collection and Deferred Credit Items

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

j. Capital Paid-in

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

k. Surplus

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

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

l. Interest on Federal Reserve Notes

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

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

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

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

The Bank is required by the Federal Reserve Act to serve as fiscal agent and depository of the United States. By statute, the Department of the Treasury is permitted, but not required, to pay for these services.

n. Assessments by the Board of Governors

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

o. 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 and $2 million for the years ended December 31, 2006 and 2005, respectively, and are reported as a component of "Occupancy expense."

p. Restructuring Charges

In 2003, the Reserve Banks began the restructuring of several operations, primarily check, cash, and U.S. Treasury services. The restructuring included streamlining the management and support structures, reducing staff, decreasing the number of processing locations, and increasing processing capacity in some locations. These restructuring activities continued in 2004 through 2006.

Note 11 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 impairment of certain of the Bank's assets are discussed in Note 6. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY. Costs and liabilities associated with enhanced post-retirement benefits are discussed in Note 9.

q. Implementation of FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

The Bank initially applied the provisions of FASB Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, at December 31, 2006. This accounting standard requires recognition of the overfunded or underfunded status of a defined benefit postretirement plan in the Statements of Condition, and recognition of changes in the funded status in the years in which the changes occur through comprehensive income. The transition rules for implementing the standard require applying the provisions as of the end of the year of initial implementation with no retrospective application. The incremental effects on the line items in the Statement of Condition at December 31, 2006, were as follows (in millions):

	Before Application of Statement 158	Adjustments	After Application of Statement 158
Accrued benefit costs	94	27	121
Total liabilities	$ 79,340	$ 27	$ 79,367
Surplus	1,303	(27)	1,276
Total capital	$ 2,579	$ (27)	$ 2,552

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

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 8.372 percent and 7.737 percent at December 31, 2006 and 2005, respectively.

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

	2006	2005
Par value:		
U.S. government:		
Bills	$ 23,191	$ 20,987
Notes	33,685	29,408
Bonds	8,332	7,181
Total par value	65,208	57,576
Unamortized premiums	729	682
Unaccreted discounts	(335)	(218)
Total allocated to the Bank	$ 65,602	$ 58,040

At December 31, 2006 and 2005, the fair value of the U.S. government securities allocated to the Bank, excluding accrued interest, was $66,630 million and $59,379 million, respectively, as determined by reference to quoted prices for identical securities.

The total of the U.S. government securities, net, held in the SOMA was $783,619 million and $750,202 million at December 31, 2006 and 2005, respectively. At December 31, 2006 and 2005, the fair value of the U.S. government securities held in the SOMA, excluding accrued interest, was $795,900 million and $767,472 million, respectively, as determined by reference to quoted prices for identical securities.

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

At December 31, 2006 and 2005, the total contract amount of securities sold under agreements to repurchase was $29,615 million and $30,505 million, respectively, of which $2,479 million and $2,360 million were allocated to the Bank. The total par value of the SOMA securities that were pledged for securities sold under agreements to repurchase at December 31, 2006 and 2005, was $29,676 million and $30,559 million, respectively, of which $2,484 million and $2,364 million were allocated to the Bank. The contract amount for securities sold under agreements to repurchase approximates fair value.

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, 2006, was as follows (in millions):

	U.S. Government Securities (Par Value)	Securities Sold Under Agreements to Repurchase (Contract Amount)
Within 15 days	$ 3,398	$ 2,479
16 days to 90 days	15,144	
91 days to 1 year	15,499	
Over 1 year to 5 years	18,767	
Over 5 years to 10 years	5,663	
Over 10 years	6,737	
Total allocated to the Bank	$ 65,208	$ 2,479

At December 31, 2006 and 2005, U.S. government securities with par values of $6,855 million and $3,776 million, respectively, were loaned from the SOMA, of which $574 million and $292 million, respectively, were allocated to the Bank.

5. INVESTMENTS DENOMINATED IN FOREIGN CURRENCIES

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

The Bank's allocated share of investments denominated in foreign currencies was approximately 6.746 percent and 4.383 percent at December 31, 2006 and 2005, respectively.

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

	2006	2005
European Union Euro:		
Foreign currency deposits	$ 421	$ 237
Securities purchased under agreements to resell	149	85
Government debt instruments	275	156
Japanese Yen:		
Foreign currency deposits	176	115
Government debt instruments	361	236
Total allocated to the Bank	$ 1,382	$ 829

At December 31, 2006 and 2005, the fair value of investments denominated in foreign currencies, including accrued interest, allocated to the Bank was $1,378 million and $831 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the U.S. government securities discussed in Note 4, unrealized gains or losses have no effect on the ability of a Reserve Bank, as a central bank, to meet its financial obligations and responsibilities.

Total System investments denominated in foreign currencies were $20,482 million and $18,928 million at December 31, 2006 and 2005, respectively. At December 31, 2006 and 2005, the fair value of the total System investments denominated in foreign currencies, including accrued interest, was $20,434 million and $18,965 million, respectively.

The maturity distribution of investments denominated in foreign currencies that were allocated to the Bank at December 31, 2006, was as follows (in millions):

	European Euro	Japanese Yen	Total
Within 15 days	$ 294	$ 176	$ 470
16 days to 90 days	160	82	242
91 days to 1 year	165	149	314
Over 1 year to 5 years	226	130	356
Over 5 years to 10 years	—	—	—
Over 10 years			
Total allocated to the Bank	$ 845	$ 537	$ 1,382

At December 31, 2006 and 2005, there were no open foreign exchange contracts.

At December 31, 2006 and 2005, 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):

	2006	2005
Bank premises and equipment:		
Land	$ 39	$ 39
Buildings	216	211
Building machinery and equipment	35	35
Construction in progress	3	3
Furniture and equipment	109	115
Subtotal	402	403
Accumulated depreciation	(124)	(120)
Bank premises and equipment, net	$ 278	$ 283
Depreciation expense, for the year ended December 31	$ 18	$ 19

The Bank leases space to outside tenants with remaining lease terms ranging from 2 to 10 years. Rental income from such leases was $1 million and $459 thousand for the years ended December 31, 2006 and 2005, respectively, and is reported as a component of "Other income." Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2006, are as follows (in millions):

2007	$ 2.2
2008	2.3
2009	2.0
2010	2.0
2011	1.3
Thereafter	3.0
Total	$ 12.8

The Bank has capitalized software assets, net of amortization, of $1 million and $2 million at December 31, 2006 and 2005, respectively. Amortization expense was $1 million and $2 million for the years ended December 31, 2006 and 2005, respectively. Capitalized software assets are reported as a component of "Other assets" and the related amortization is reported as a component of "Other expenses."

Assets impaired as a result of the Bank's restructuring plan, as discussed in Note 11, includes building, land, and equipment. Asset impairment losses of $1 million and $40 million for the periods ending December 31, 2006 and 2005, 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, 2006, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 3 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 $1 million for each of the years ended December 31, 2006 and 2005. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2006 are as follows (in thousands):

	Operating
2007	$ 345
2008	345
2009	346
Future minimum rental payments	$ 1,036

At December 31, 2006, the Bank, acting on behalf of the Reserve Banks, had contractual commitments extending through the year 2007 with a remaining amount of $11 million. As of December 31, 2006, commitments of $96 million were recognized. Purchases of $28 million and $29 million were made against these commitments during 2006 and 2005, respectively. It is estimated that the Bank's allocated share of these commitments will be $11 million. These commitments represent air and ground transportation for the Federal Reserve Check

Transportation System, which serves all Reserve Banks and have fixed components. The fixed payments for the next five years under these commitments are as follows (in millions):

	Fixed Commitment
2007	$ 11
2008	—
2009	—
2010	—
2011	—

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 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 the agreement at December 31, 2006 or 2005.

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

8. RETIREMENT AND THRIFT PLANS

Retirement Plans

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

The System Plan is a multi-employer plan with contributions funded by the participating employers. Participating employers are the Federal Reserve Banks, the Board of Governors, 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 System Plan and the costs associated with the Plan are not redistributed to other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2006 and 2005, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $6 million for each of the years ended December 31, 2006 and 2005, and are reported as a component of "Salaries and other benefits" in the Statements of Income. The Bank matches employee contributions based on a specified formula. For the years ended December 31, 2006 and 2005, the Bank matched 80 percent on the first 6 percent of employee contributions for employees with less than five years of service and 100 percent on the first 6 percent of employee contributions for employees with five or more years of service.

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits other than Pensions

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

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

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

	2006	2005
Accumulated postretirement benefit obligation at January 1	$ 83.5	$ 85.7
Service cost-benefits earned during the period	2.7	2.2
Interest cost on accumulated benefit obligation	4.5	4.1
Actuarial loss (gain)	12.0	(5.4)
Contributions by plan participants	1.3	1.2
Benefits paid	(4.3)	(4.3)
Plan amendments	5.5	—
Accumulated postretirement benefit obligation at December 31	$ 105.2	$ 83.5

At December 31, 2006 and 2005, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.75 percent and 5.50 percent, respectively.

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

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

	2006	2005
Fair value of plan assets at January 1	$ —	$ —
Contributions by the employer	3.0	3.1
Contributions by plan participants	1.3	1.2
Benefits paid	(4.3)	(4.3)
Fair value of plan assets at December 31	$ —	$ —
Unfunded postretirement benefit obligation	$ 105.2	$ 83.5
Unrecognized prior service cost		$ 12.9
Unrecognized net actuarial loss		(20.8)
Accrued postretirement benefit cost		$ 75.6
Amounts included in accumulated other comprehensive loss are shown below (in millions):		
Prior service cost	$ 5.2	
Net actuarial loss	(31.7)	
Total accumulated other comprehensive loss	$ (26.5)	

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

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

	2006	2005
Health care cost trend rate assumed for next year	9.00%	9.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2012	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, 2006 (in millions):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 1.3	$ (1.0)
Effect on accumulated postretirement benefit obligation	13.9	(11.5)

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

	2006	2005
Service cost-benefits earned during the period	$ 2.7	$ 2.2
Interest cost on accumulated benefit obligation	4.5	4.1
Amortization of prior service cost	(2.2)	(2.2)
Recognized net actuarial loss	1.0	0.5
Total periodic expense	6.0	4.6
Net periodic postretirement benefit expense	$ 6.0	$ 4.6
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2007 are shown below (in millions):		
Prior service cost	$ (1.2)	
Actuarial loss	2.9	
Total	$ 1.7	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2006 and 2005, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.50 percent and 5.75 percent, respectively.

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

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

There were no receipts of federal Medicare subsidies in the year ended December 31, 2006. Expected receipts in the year ending December 31, 2007, related to payments made in the year ended December 31, 2006, are $.3 million.

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

	Without Subsidy	With Subsidy
2007	$ 4.9	$ 4.5
2008	5.5	5.1
2009	6.1	5.7
2010	6.8	6.2
2011	7.4	6.8
2012–2016	42.9	38.6
Total	$ 73.6	$ 66.9

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, and disability benefits. The accrued postemployment benefit costs recognized by the Bank at December 31, 2006 and 2005, were $13 million and $12 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Statements of Condition. Net periodic postemployment benefit expense included in 2006 and 2005 operating expenses were $3 million and $2 million, respectively, and are recorded as a component of "Salaries and other benefits" in the Statements of Income.

10. ACCUMULATED OTHER COMPREHENSIVE INCOME

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

	Amount Related to Postretirement Benefits other than Pensions
Balance at December 31, 2005	$ —
Adjustment to initially apply FASB Statement No. 158	(27)
Balance at December 31, 2006	$ (27)

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

11. BUSINESS RESTRUCTURING CHARGES

In 2004, the Bank announced plans for restructuring to streamline operations and reduce costs, including consolidation of check operations and staff reduction in various functions of the Bank. In 2005, additional consolidation and restructuring initiatives were announced in the cash operations. These actions resulted in the following business restructuring charges (in millions):

	Total Estimated Costs	Accrued Liability 12/31/2005	Year Ended 12/31/2006 Total Charges	Year Ended 12/31/2006 Total Paid	Accrued Liability 12/31/2006
Employee separation	$ 10	$ 5	$ 2	$ 2	$ 5
Total	$ 10	$ 5	$ 2	$ 2	$ 5

Employee separation costs are primarily severance costs related to identified staff reductions of approximately 262, including 77 staff reductions related to restructuring announced in 2005. Costs related to staff reductions for the years ended December 31, 2005, are reported as a component of "Salaries and other benefits" in the Statements of Income. Contract termination costs include the charges resulting from terminating existing lease and other contracts and are shown as a component of "Other expenses."

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

Future costs associated with the restructuring that are not estimable and are not recognized as liabilities will be incurred in 2007. The Bank anticipates substantially completing its announced plans by July 2007.

Front and back covers

Members of the System Retail Payments Office meet in Atlanta: (front cover, from left) Richard Oliver, executive vice president, with Elizabeth McQuerry, assistant vice president, Atlanta Fed; (back cover, from left) Robert Price, senior vice president, Cleveland Fed, with Nell-Campbell Drake, Retail Payments project director, Atlanta Fed

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The 2006 Federal Reserve Bank of Atlanta Annual Report was created and produced by the Public Affairs Department.

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Will Sumpter and Associates, Atlanta

Printing
Seiz Printing

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.

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