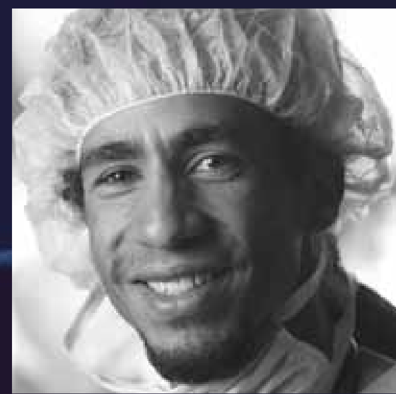
From Brawn *to* Brains

How Immigration Works for America



2010 ANNUAL REPORT

FEDERAL RESERVE BANK OF DALLAS

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Letter from the

President

Immigration has played an integral part in shaping the economic, social and cultural development of this country. From architecture and medicine to technology and statesmanship, immigrants have contributed to our nation's success.

The photos on the inside of the front and back covers of this annual report are but a few of America's notable immigrants. They are remarkable in their contributions to science, technology, business, government, literature, sports and philanthropy.

(continued on next page)

Winning the future will become increasingly difficult unless we figure out a practical way to allow greater access to foreign-born human capital that will contribute to American prosperity.

We have distinguished immigrants serving on the Dallas Fed and regional banks' boards of directors. Renu Khator—who joined the Federal Reserve Bank of Dallas board in January 2011—is the University of Houston System's first woman chancellor and the first Indian immigrant to lead a tier one U.S. research university. In addition to Renu, G.P. Singh (India) and Jorge Bermudez (Cuba) are also successful first-generation immigrants. I am proud to have them on our team.

As with these immigrants, the story of the Fisher family spans cities, states, countries and continents. My father hailed from Australia, and my mother, born in South Africa, was the daughter of Norwegians. When my parents first tried to enter this country in 1939, they were redirected to living part-time in Tijuana, Mexico, until gaining U.S. citizenship in 1947. I was born in Los Angeles in March 1949, the felicitous byproduct of an otherwise fretful business trip to Shanghai that ended abruptly as Mao's forces entered that city.

My family's story is dramatic. But it is by no means unique. Immigrants—as my parents could attest—are drawn to this country from a variety of places for a number of reasons. A common thread is the opportunity to improve their lot and become part of the American Dream. Whatever small contribution my family has made to the development of the U.S. is at least partially a testament to the value of immigrants and their labors.

Emma Lazarus' oft-cited depiction in "The New Colossus" —Lady Liberty's poor and huddled masses yearning to breathe free—no longer paints the whole

picture. Skilled immigrants, including scientists, doctors, engineers and mathematicians, cross our borders every year hoping to become part of the American fabric. Instead of queuing up on Ellis Island, as many of our ancestors did, they enter at airports and reside in cities all across the country. They are equipped, trained and educated—often at American universities—and ready to participate in our society.

In the well-researched and thought-provoking essay that follows, Dallas Fed Research Officer Pia Orrenius and Agnes Scott College Professor Madeline Zavodny describe how our economy has evolved from "brawn and machines" to "brains and microchips." The comparative advantage of the U.S. economy lies in providing high-value-added services and brain-intensive goods such as semiconductors and pharmaceuticals to the rest of the world.

Skilled, highly educated immigrants are ready to power our mighty economic machine into the 21st century and beyond. Unfortunately, we are often turning these workers away. In many cases, we blatantly discard the returns on our own education investments. Consider this: Many skilled immigrants, sponsored by their U.S. employers, are waiting up to 10 years for a green card allowing permanent legal residence. For many, this comes only after they have patiently waited for and received an elusive H-1B work visa. Rather than encouraging people to stay and work, our immigration policy turns away some of the most promising foreign talent, sending them home to, in turn, compete against us.

Winning the future will become increasingly difficult unless we figure out a practical way to allow greater access to foreign-born human capital that will contribute to American prosperity. America is still the world's economic powerhouse. But we can't afford to rest on our laurels. Countries around the world are recruiting our most-talented business leaders and scholars to manage their strongest companies and direct their greatest universities. Our economy will continue to move up the value-added ladder and stay ahead of the competition—including China and other emerging powers—if we continue attracting the "best and brightest."

In addition to the insightful piece on immigration, I encourage you to read our 2010 "Year in Review" on page 18. It has been a year of change that included passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act, rollout of the Treasury's all-electronic payment initiative and the planned transformation of our San Antonio Branch to a standard cash depot. Amid these changes, the men and women of the Dallas Fed continue to make significant contributions to the Federal Reserve System and the Eleventh District—an area that covers 360,000 square miles, populated by 27 million hard-working Texans, Louisianans and New Mexicans. We remain committed to keeping up with the changing nature of a globalized economy, while serving the ever-increasing needs of our dynamic regional economy.

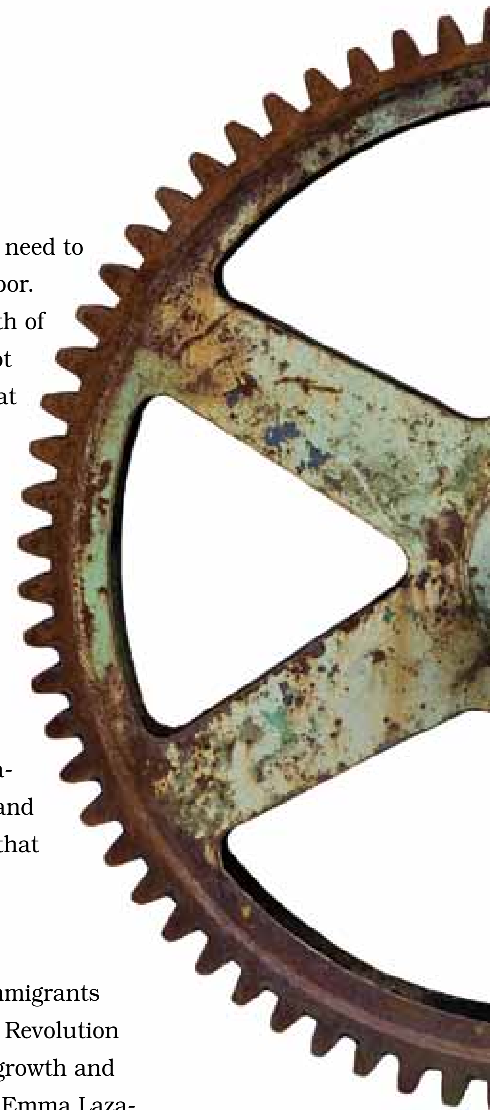
Richard W. Fisher

From Brawn *to* Brains

Immigrants help fuel the U.S. economy, representing about one in every six workers. Because of accelerated immigration and slowing U.S. population growth, foreign-born workers accounted for almost half of labor force growth over the past 15 years.[1] Public attention has focused mainly on the large number of low-skilled immigrant workers, but the number of high-skilled immigrants actually grew faster during the period. Highly educated immigrants filled critical jobs in the science, engineering, information technology and health care sectors as well as fostered innovation and created high-tech businesses.

How Immigration Works for America

By Pia Orrenius and Madeline Zavodny



Future U.S. prosperity depends on having a skilled workforce. This requires educating the native-born population and continuing to attract the world's best and brightest to the U.S. For decades, the nation has been the world leader in attracting skilled immigrants who, until recently, had few good alternatives. Today, other destination countries increasingly recognize the economic benefits of these workers and are designing policies to attract them, even as the immigrants' nations of origin seek ways to entice them to return home.

The U.S. immigration system, meanwhile, has not kept up. Piecemeal fixes have turned current law into a web of outmoded, contradictory and inefficient quotas, rules and regulations. For example, the number of high-skilled immigrant workers admitted on temporary visas has doubled since 1996, but the number of employment-based permanent-residence visas, or "green cards," has remained the same. As a result, the wait for employment-based green cards extends more than a decade. It's not known how many high-skilled immigrants are turned away by the broken system, but the U.S. risks falling behind in the global race for talent if immigration laws are not reformed.

Immigration legislation has been put on the back burner while lawmakers have focused on the recession, health care, tax policy and financial reform. At the same time, the economic downturn has wracked U.S. labor markets and damped public support for comprehensive immigration reform. Given the distressed housing market, high unemployment and sluggish job growth in a still-nascent economic recovery, U.S. workers may not see the need to replenish the workforce with foreign labor.

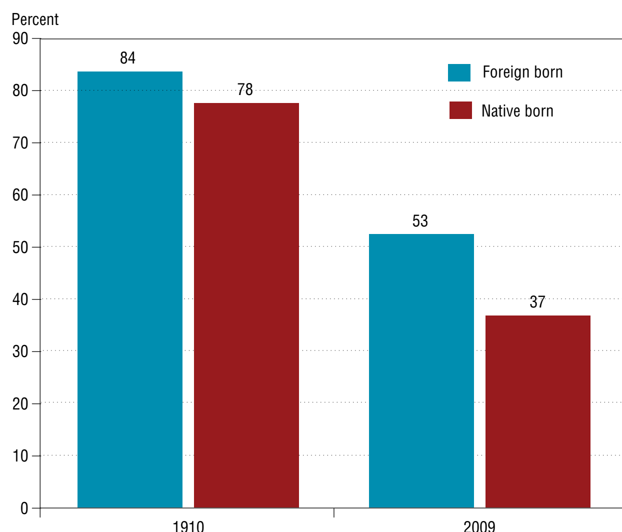
Although dealing with the aftermath of the recession is important, it should not stand in the way of creating policies that lay the groundwork now for stronger economic growth tomorrow. Highly educated immigrants help build the nation's human capital, which, together with physical capital and technological progress, forms the foundation of the nation's future. This report examines historical perspectives on immigration, who comes to the U.S. and why, the economic and fiscal impacts of immigration, the problems with current policy and the arguments for immigration reform that prioritizes brains over brawn.

A Historical Perspective

Since the first arrivals, waves of immigrants have shaped the nation. The Industrial Revolution ushered in a period of rapid economic growth and high levels of immigration. By the time Emma Lazarus wrote her famous poem, "The New Colossus," in 1883, the national image was not just of people remaking the nation but also of the nation remaking the people. "Give me your tired, your poor, your huddled masses yearning to breathe free," Lazarus wrote, as if coming to America changed the fate of the "homeless" and "tempest-tossed." To enter America was to go through the "golden door," presumably to a place where even the most common of men and

Technology has done away with much of the need for swaths of workers to perform manual labor, and blue-collar wages are falling.

Chart 1
Blue-Collar Work on the Decline



NOTE: Percentage of workers age 25 and over in blue-collar occupations in 1910 and 2009.

SOURCES: 1910 census; 2009 American Community Survey.

women could find fortune.

Lazarus' poem is rooted in the U.S. experience during the late 19th and early 20th centuries. The economy absorbed massive immigrant influxes. The lure of economic opportunity was not lost on Europeans and Asians who struggled to survive at home. Once in the U.S., Europeans cultivated farmland in the Midwest, Chinese laborers toiled on railroads in the West and immigrants of all nationalities fueled urban industrialization in the Northeast and Great Lakes states. Before the 1880s, immigration to the United States—and throughout the world—was largely unregulated. The movement of people to the U.S. was limited more by migration costs than by restrictive government regulation. Policies were permissive by design, to settle and claim the West, but also because economic growth was possible only with more workers, and more workers led to greater growth. Land was abundant, labor was scarce and wages were rising.

How are things different today? To be sure, the country no longer has a vast expanse of empty, productive land. Agriculture and manufacturing, mainstays of the 19th-century U.S. economy, employ a shrinking number of workers. Technology has done away with much of the need for swaths of workers to perform manual labor, and blue-collar wages are falling. Meanwhile, the economy has shifted toward the service sector.

These long-run trends have manifested themselves in the labor market in an important way: fewer blue-collar workers. The proportion of native-born individuals employed in blue-collar occupations today is less than half what it was in 1910, the historical peak of U.S. immigration (*Chart 1*). Among immigrants, who are disproportionately employed in blue-collar occupations, the fraction working in these jobs has fallen to 53 percent from 84 percent a century ago.[2] These statistics highlight another important fact: Immigrants' and natives' skill levels differ more today than in 1910. The gap between the immigrant and native blue-collar employment share has grown to 16

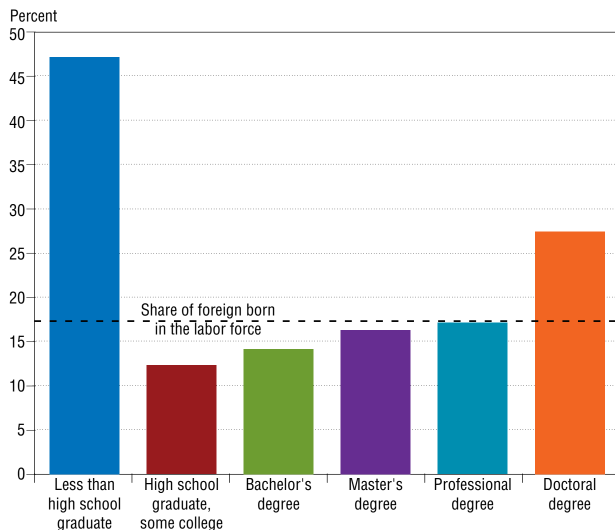
percentage points, compared with 6 percentage points a century ago.

The Changing U.S. Workforce: Where Immigrants Fit

One of the most dramatic transformations of the U.S. workforce in the post-war years has been its rising educational attainment. In 1950, 64 percent of U.S.-born workers lacked a high school diploma. Today, fewer than 10 percent have not completed high school. This rapid rise in U.S. workers' education levels created an opening for low-skilled foreign labor that was readily filled, both legally and illegally. Low-skilled immigrants are increasingly employed in service jobs as well as disproportionately in the traditional industries: agriculture, construction and manufacturing. Service industries where low-skilled immigrants dominate include landscaping and building maintenance, food preparation, personal care and service, transportation and health care.

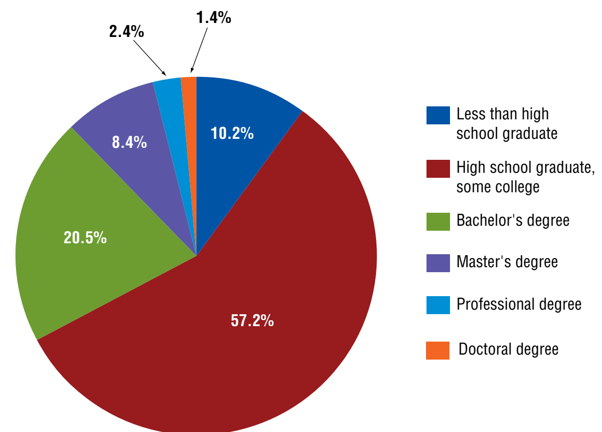
All told, immigrants make up almost half of workers in the U.S. lacking a high school degree (*Chart 2*). The immigrant shares among workers in the middle of the education distribution—those who graduated from high school or college—are much lower at 12 percent and 14 percent, respectively. For workers with master's degrees, the foreign-born share rises to 16 percent; for those with professional degrees, such as doctors and lawyers, it is 17 percent; and among doctoral degree holders, the share reaches 27 percent. Overall, 17 percent of workers age 25 and older were foreign born in 2009 (*dotted line on Chart 2*). Immigrants, thus, are concentrated at the bottom and top of the education distribution. Most U.S. workers are in the middle of the education distribution (*Chart 3*). Workers with at least a high school diploma but not a bachelor's degree represent 57 percent of the workforce.

Chart 2
Immigrant Workers Overrepresented at Extremes of the Education Distribution



NOTE: Percentage of foreign workers age 25 and over in the U.S. labor force by education.
SOURCE: 2009 American Community Survey.

Chart 3
Most Workers Have High School but Not College Degree
(Labor force by education)



NOTE: Percentage of foreign and native workers age 25 and over in the U.S. labor force by education.
SOURCE: 2009 American Community Survey.

Although the U.S. tapped Western Europe for skilled labor for over a century, rising education levels in Asia, unrest in the Middle East and the collapse of the U.S.S.R. have generated new streams of skilled workers for U.S. employers.

High-Skilled Immigrants

High-skilled immigrants tend to complement high-skilled native-born workers by flowing into fast-growing fields where native labor supply cannot keep up.[3] As a result, highly educated immigrants are over-represented in some of the most skill-intensive occupations (*Chart 4*). They make up 45 percent of medical scientists and 37 percent of computer programmers, for example. Immigrants also have a large presence in medicine, engineering, higher education, accounting

Of Note

Mexico–U.S. Migration in Structural Decline?

The housing crisis and recession produced sharp declines in Mexico–U.S. migration. While these demand-side factors influence the volume of Mexican migrants, supply-side factors are important too, especially in the long run. Labor supply shocks caused by changes in the size of birth cohorts explain as much as a third of U.S. immigration from Mexico in recent decades.[1] With Mexico in the midst of one of history's most dramatic demographic transitions, declining population growth there carries significant implications for the future of Mexican immigration to the U.S.

From the late 1970s to 2010, fertility rates in Mexico fell from 6.8 to 2.2 children per woman, just above the "replacement rate" of 2.1 needed for a country's population to remain stable.[2] Factors leading to declining fertility rates include a large drop in infant mortality, rising education levels and increased female labor-force participation.[3] Public policy also had an impact. The Mexican government launched an aggressive family planning campaign in the early 1970s, since expanded to include rural areas. Population growth has slowed dramatically as a result.

If this trend continues, Mexico's population will shift significantly toward older cohorts and away from the younger generations who tend to migrate. The youngest age group (ages 0–14) is on track to represent 16 percent of the population in 2050, compared with 28 percent today.[4] Older cohorts (ages 65 and up), by contrast, will likely rise to 22 percent from 7 percent over the same period. Current concerns about the inflow of Mexican immigrants are likely to diminish as the Mexican population ages and the share of young workers in the labor force declines dramatically.

Notes

[1] "The Great Mexican Emigration," by Gordon H. Hanson and Craig McIntosh, *Review of Economics and Statistics*, vol. 92, no. 4, 2010, pp. 798–810.

[2] Data from "World Population Prospects: 2008 Revision," Population Division, Department of Economic and Social Affairs, United Nations, 2008.

[3] "Are Young Cohorts of Women Delaying First Birth in Mexico?," by Alfonso Miranda, *Journal of Population Economics*, vol. 19, no. 1, 2006, pp. 55–70.

[4] See note 2.

and auditing, nursing and architecture. On average, immigrants make up 15.5 percent of the high-skilled labor force (*dotted line on Chart 4*).

Although the U.S. tapped Western Europe for skilled labor for over a century, rising education levels in Asia, unrest in the Middle East and the collapse of the U.S.S.R. have generated new streams of skilled workers for U.S. employers. Census data show 80 percent of workers in the U.S. who arrived from India have at least a bachelor's degree, followed by Taiwan, Japan, Iran, the former U.S.S.R. and South Korea (*Chart 5*).[4]

Low-Skilled Immigrants

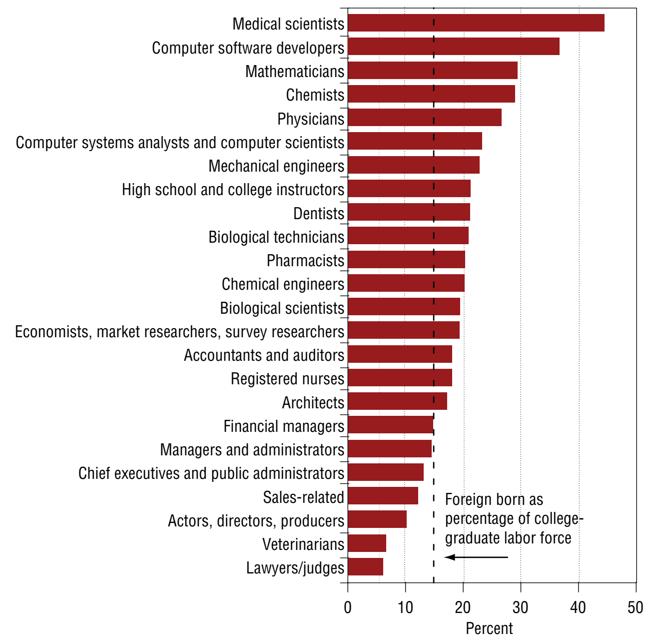
The least-educated workers come from Mexico, Central America and the Caribbean. This is largely a result of geographic proximity, continued demand for low-skilled labor among U.S. employers and large wage differentials. Research suggests a Mexican immigrant earns about 2.5 times as much (in purchasing-power-adjusted terms) in the U.S. as he would have if he remained in his native country.[5] For a Haitian immigrant, earnings are as much as 10 times greater in the U.S. than at home.[6]

Because immigration policy makes it hard for low-skilled workers to be admitted to the U.S. unless they have a close relative here who can sponsor them, many enter illegally. Estimates suggest there are almost 8 million unauthorized immigrant workers in the U.S. today, the great majority with less than a high school education.[7] As many as 80 percent of Mexican immigrants initially arrived as unauthorized immigrants.[8]

Immigration and the Economy: A Bigger Pie

Immigrants differ from natives; they tend to have either a great deal more or a great deal less education than the average native, and they are clustered in certain occupations. Another difference is language. About 32 percent of immigrants report that they either do not speak English or do not speak it well. Although immigrants may have fewer skills than natives, being different isn't bad.[9] In fact, differences

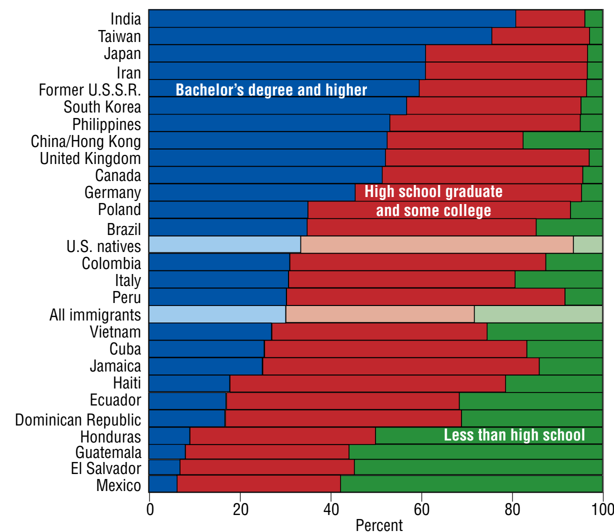
Chart 4
STEM, Health Care Occupations Rely on High-Skilled Foreign Workers



NOTES: Percentage of foreign-born workers age 25 and over with bachelor's degree or higher in selected occupations. STEM stands for science, technology, engineering and mathematics.

SOURCE: 2009 American Community Survey.

Chart 5
Highest-Educated Immigrants Are From Asia, Iran, Former U.S.S.R.



NOTE: Composition of educational attainment among immigrants by country of origin.

SOURCE: 2009 American Community Survey.

are crucial. There would be no economic gains to immigration for natives if immigrants were clones of natives or, in economic jargon, *perfect substitutes*. Differences can create complementarities, with immigrant workers making natives better off.

How does immigration affect the economy? Its first-order effect is boosting the number of available workers, increasing total output and gross domestic product (GDP). Most of the gain in GDP accrues to immigrant workers in the form of their earnings, but natives gain as well. Business owners benefit from lower labor costs and a larger customer base. Natives benefit from lower prices. In cases where immigrants and natives are complements, lower prices can have far-reaching effects. For example, research shows the immigration-induced decline in the cost of child care and housekeeping has significantly increased the labor supply of skilled native women.[10]

One drawback of immigration's economic effects is uneven distribution of the gains. Employers, investors and complementary workers benefit while substitutable workers lose out. These losses are concentrated at the low-wage end of the labor market because so many immigrants are low-skilled. Although there is general belief that immigration has hurt low-skilled native workers, there is no consensus on the size of the impact.[11]

Estimates of the immigration-induced GDP increase that accrues to natives—known as the "immigration surplus"—are typically based on simulations of macroeconomic models or back-of-the-envelope calculations. Standard competitive models produce small estimates, between 0.1 and 0.3 percent of U.S. GDP.[12] The immigration surplus is larger if immigrants are

Of Note

States Fight Bright Flight

For years, a number of states, especially in the Midwest and Northeast, have dealt with either domestic net outmigration or brain drain, the mass departure of young skilled workers for other states. Net domestic emigration has been a concern in California, Iowa, Connecticut, Kansas and Ohio. Illinois, Michigan and New York have experienced especially high outmigration, with more than 1.4 million residents leaving in the past decade.

States have launched initiatives to combat brain drain and skilled labor shortages. These initiatives aim to retain and attract workers, primarily in critical skill areas. They range from boosting workforce skills through investment in community colleges and apprenticeships, such as Maryland's Skills2Compete program, to targeting high-tech job growth, as with Michigan's 21st Century Jobs Fund. Other programs, such as Vermont's Next Generation Workforce project, provide cash grants to businesses that create critical-skills jobs.

Some states have even launched ambitious Internet-based campaigns that leverage online networking to connect former residents with job opportunities in advanced fields. With names such as "Move Back to Nebraska" and "You Belong in Connecticut," these campaigns seek to brand states with skilled-labor shortages as attractive places to "Stay, Work, Play" (New Hampshire).

Though the success of these nascent initiatives remains to be seen, it is clear that many states have felt the negative ramifications of skilled-labor shortages and are working to stem the flow.

complementary to natives and complementary to capital. This is more likely to occur if immigrants are highly skilled. High-skilled immigrants tend to attract capital and work in occupations where native-born labor is scarce, creating a larger immigration surplus.

High-Skilled Immigrants and Economic Growth

If high-skilled immigrants are also more innovative and entrepreneurial, the immigration surplus is larger still. In this case, immigration can actually boost productivity growth, leading to a higher long-run rate of economic growth.[13] Recent research provides convincing empirical evidence that high-skilled immigrants play an important role in innovation and, in certain sectors, entrepreneurship. Highly educated immigrants receive patents at more than twice the rate of highly educated natives. The difference has been linked to immigrants' overrepresentation in STEM (science, technology, engineering and mathematics) fields and the growing number of immigrants entering on employment-based and student visas.[14] There is also evidence of positive spillovers on natives, meaning that immigrants not only raise innovation directly but also boost overall patent activity, perhaps by attracting additional resources and boosting specialization.[15]

High-skilled immigrants' entrepreneurial activities have been instrumental in the growth of the U.S. high-tech sector, for example.[16] Immigrants founded 25 percent of U.S. high-tech startups between 1995 and 2005.[17] Immigrants have much higher rates of business creation than natives and slightly higher self-employment rates.[18]

Efficiency Gains From Immigration

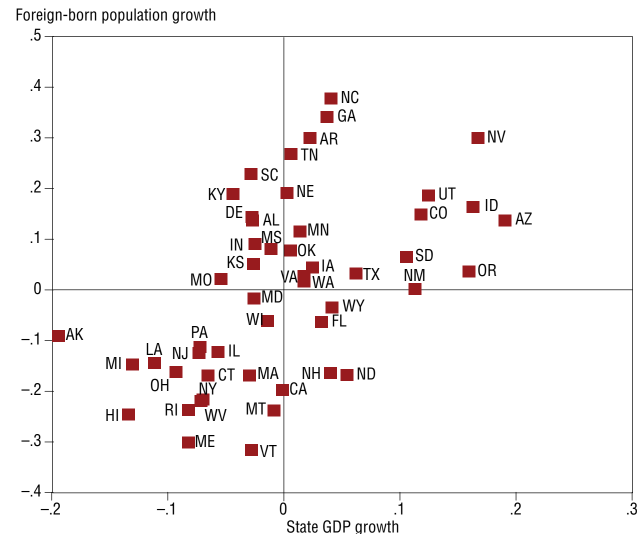
Immigration can help the economy in a number of other ways, many that economists have not studied in-depth. Immigrants are more mobile than natives, for example, responding more readily to regional differences in economic opportunity.[19] Foreign-born workers are more likely than natives to move to where the jobs are (and leave where jobs aren't). In this way, they increase labor market efficiency by alleviating labor shortages and speeding up wage convergence. A simple plot of foreign-born population growth against real GDP growth by state shows the great majority of states clustered in the lower left and upper right quadrants, demonstrating that immigration and economic activity are positively correlated (*Chart 6*).

Immigration also can lead to greater efficiency if production is characterized by economies of scale. These can occur in a number of ways when the population increases: Fixed costs per unit fall as production rises; larger markets lead to a better division of labor and greater specialization; higher production volume leads to more learning-by-doing; and a larger population makes more investment in infrastructure worthwhile. There is little empirical evidence quantifying these gains.[20]

Fiscal Impact of Immigration

Conventional estimates of the economic impact of immigration on natives, discussed above, suggest

Chart 6
Immigrants Go Where the Jobs Are



NOTE: Coordinates indicate deviation from average foreign-born population growth (vertical axis) and from average real state GDP growth (horizontal axis) from 1990 to 2009.

SOURCES: 1990 census; 2009 American Community Survey; Bureau of Economic Analysis.

Low-skilled immigrants are a net fiscal drain, but overall, immigration need not be. High-skilled immigrants can offset the fiscal cost of low-skilled immigrants. The net effect depends on each group's relative share.

it is a small fraction of GDP overall, but likely higher if more immigrants are skilled. Estimates of the fiscal impact of immigration are also more favorable the greater the share of high-skilled immigrants. Immigration's fiscal impact is the difference between taxes paid by immigrants and the cost of government services they receive. Since income is so highly correlated with education, the fiscal impact of an immigrant essentially depends on educational attainment. The same is true for natives.

Estimates from 1996—the most recent comprehensive estimates available—indicate that immigrants with less than a high school diploma cost $89,000 more than they contribute in taxes over their lifetimes, while immigrants with more than a high school education contribute $105,000 more in taxes than they use in public services.[21] In other words, low-skilled immigrants are a net fiscal drain, but overall, immigration need not be. High-skilled immigrants can offset the fiscal cost of low-skilled immigrants. The net effect depends on each group's relative share.

Immigration's adverse fiscal impacts are most felt at the local level. State and local governments meet many of the needs of low-skilled immigrants by bearing the bulk of the cost of education and public hospitals and part of the cost of public assistance programs, such as public health insurance (Medicaid and the Children's Health Insurance Program, or CHIP) and traditional welfare (Temporary Assistance for Needy Families, or TANF).

In 2010, about 31 percent of immigrant-headed households participated in a major means-tested public assistance program, compared with 19 percent of native-headed households.[22] The difference is entirely explained by Medicaid and CHIP participation, a consequence of the low rates of private health insurance coverage among immigrant families.

Some policymakers argue that more immigration can remedy the looming shortfalls in pay-as-you-go programs, such as Social Security. Although a large increase in immigration can extend trust fund solvency a few years, higher levels of immigration would

do little to reduce Social Security's overall unfunded liabilities, which are in the trillions.[23]

A more attainable goal may be to mitigate federal budget deficits. An interesting 2000 study showed that a selective immigration policy that admitted 1.6 million high-skilled immigrants age 40–44 years old annually into a hypothetical U.S.-style economy with a 50 percent debt-to-GDP ratio would have balanced the budget within five years and eventually eliminated the national debt.[24] Balancing the budget via tax increases instead would have required a 4.4 percentage point increase in income tax rates, according to that study.

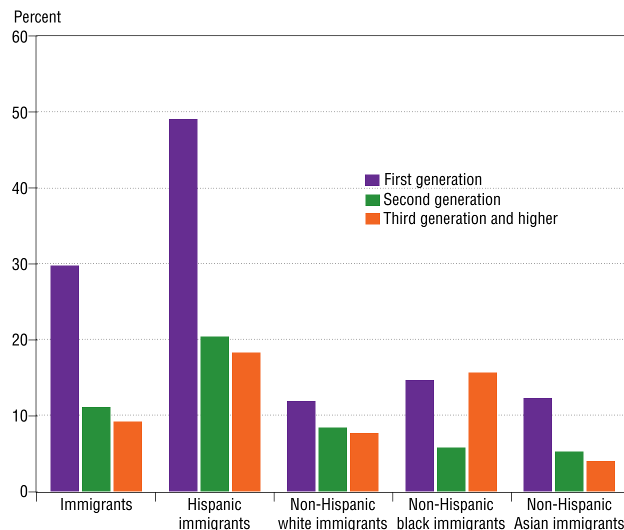
The Second Generation

High-skilled immigrants, thus, can help the fiscal picture. But many immigrants have relatively low education levels and impose significant fiscal costs. One silver lining is that these costs dissipate in the very long run as their descendants assimilate and "pay back" the costs imposed by their predecessors. Economic or educational assimilation is, therefore, a very important piece of the immigration calculation. Although many first-generation immigrants lack even a high school degree, their descendants generally reach typical U.S. education outcomes over time.

Patterns of educational attainment by generation suggest immigrants' children, the second generation, show a large improvement over the first generation, with the share lacking a high school degree declining steeply from 30 percent to 11 percent (*Chart 7*). Improvements tend to continue but at a slower pace in the third generation, with the exception of non-Hispanic blacks, who appear to backslide in the third generation.

With education playing such a central role in immigrant integration and with so many low-education immigrants, the challenge facing U.S. schools is formidable. In California, 50 percent of children enrolled in K–12 schools are either immigrants or the children of immigrants. In Texas, the share is 32 percent; nationally, it is 22 percent. These children have advantages and disadvantages—they are likely to be bi-

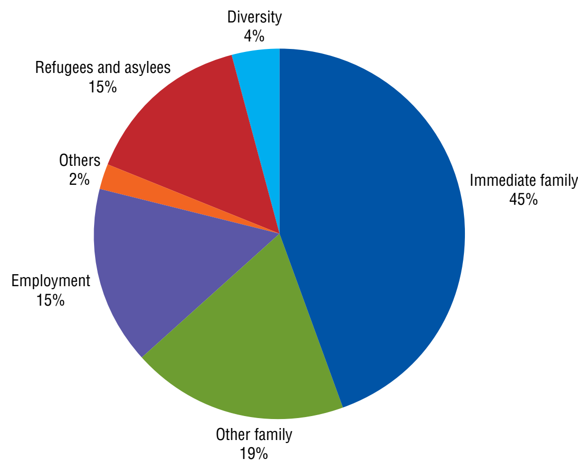
Chart 7
Second-Generation Education Outcomes a Big Improvement Over Parents
(Individuals age 25 and over lacking a high school diploma)



SOURCE: 2009 American Community Survey.

With education playing such a central role in immigrant integration and with so many low-education immigrants, the challenge facing U.S. schools is formidable.

Chart 8
Green Cards Go Mostly to Family, Humanitarian Immigrants



NOTE: Share of legal permanent residents by admission class (2005 through 2009).
SOURCE: *Yearbook of Immigration Statistics*, Department of Homeland Security.

lingual and have parents who want them to succeed, but many are from families with limited resources. Compounding the problem is that states and localities are confronting significant budget cuts in coming years, cuts that will undoubtedly impact schools.

Implications for Immigration Policy

The benefits of immigration accrue from high- and low-skilled immigrants. Both tend to complement the native workforce, bringing brains or brawn to locations and occupations where there is a need. The Hispanic immigrant population in Louisiana jumped nearly 20 percent following Hurricane Katrina, as workers converged there to assist the cleanup and reconstruction.

High-skilled workers, however, come with more benefits and fewer costs than low-skilled workers. And their skills are key to the vitality and growth of some of the nation's most successful industries and to research and development. In addition, many high-skilled immigrants work in industries that produce tradable goods or services, meaning companies can employ their workers here or overseas. Google can hire programmers to work in Mountain View, Calif., or in Guangzhou or Hyderabad or any of the other 49 non-U.S. cities in which it currently operates. If it cannot get visas for its workers, it can just employ them overseas.[25] For all these reasons, the U.S. has a lot to gain from rewriting U.S. immigration policy to focus more on high-skilled and employment-based immigration.

Existing policy is rooted in the 1965 amendments to the Immigration and Nationality Act, which made family reunification the primary objective. The U.S. annually issues about 1.1 million green cards, allowing permanent legal residence. About 85 percent go to family members of U.S. citizens or permanent legal residents, people seeking humanitarian refuge and "diversity immigrants," who come from countries with low rates of immigration to the United States (*Chart 8*).[26] The remaining 15 percent go to people who are immigrating for work reasons—but half of these are

for workers' spouses and children, meaning a mere 7 percent of green cards go to so-called principal workers, most of whom are high-skilled. No other major developed economy gives such a low priority to employment-based immigration (*Table 1*).

The U.S. has created several temporary visa programs in the past two decades to help compensate for the low number of employment-based green cards (*Chart 9*). The best known is the H-1B program, which admits about 131,000 workers in a typical year, many of them high-skilled Indians going to work in the information technology sector.[27] Another important temporary job-based measure is the Trade NAFTA (TN) visa, which brings in an additional 72,000 professionals, mostly from Canada. The L1 program allows multinational corporations' intracompany transferees (about 74,000), and the O1 program provides visas for a small number of workers of "extraordinary ability."

Unprecedented green card queues are a byproduct of expanding temporary, but not permanent, visas for high-skilled personnel. More than 1 million high-skilled workers are waiting for an employment-based green card, and untold numbers have given up on waiting or even applying. For those in the queue, their applications have been approved, but their green cards won't be available for years because of strict numerical limits on employment-based permanent visas. There also are country-of-origin limits that restrict the number of immigrants from populous nations such as China and India.

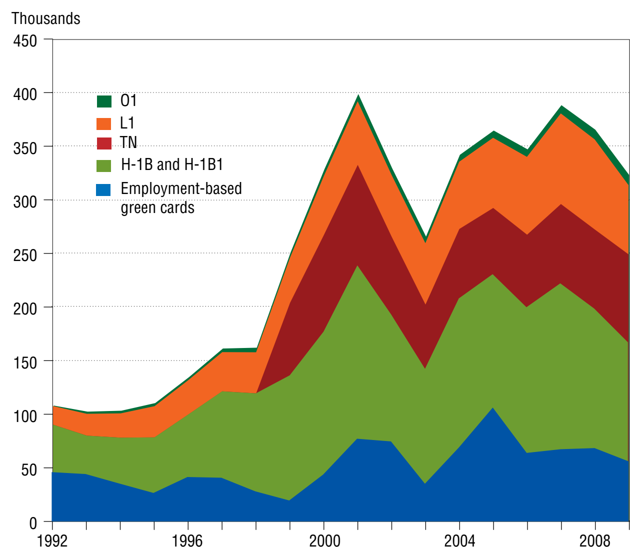
Expanding employment-based immigration would offer a host of benefits, including more high-skilled and procyclical immigration. Employment-based immigration is demand driven, which means it declines when the U.S. labor market weakens, as it did during the recent recession. The high-tech boom of the late 1990s and the housing and financial boom of the mid-2000s produced rapid expansion in visa issuance, while the 2001 recession, subsequent jobless recovery and the recession that began in late 2007 were all periods of visa declines. While temporary work-based visas responded to the business cycle, the total

Table 1
U.S. Lags Behind Other Nations in Share of Work-Based Immigrants

Country	Total number (thousands)	Work (percent)	Family (percent)	Humanitarian (percent)	Other (percent)
South Korea	195	81	17	0	2
Switzerland	139	80	14	5	2
Spain	392	79	20	0	1
Italy	425	65	31	3	1
Germany	228	59	22	16	2
United Kingdom	347	58	31	1	10
Australia	206	42	51	6	1
France	168	34	52	7	8
Canada	247	25	62	13	0
United States	1,107	7	73	15	5

NOTES: Only includes OECD countries. Work includes free-movement migrants. Percentages may not add to 100 due to rounding.
SOURCE: *International Migration Outlook 2010*, Organization for Economic Cooperation and Development.

Chart 9
Temporary Visas, Not Green Cards, Driving High-Skilled Immigration

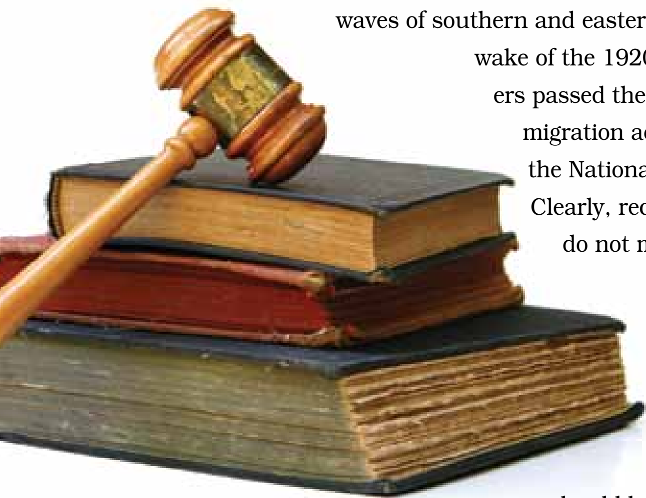


NOTE: Number of visas issued to high-skilled workers by visa type and fiscal year.
SOURCES: Statistical Yearbook of the Immigration and Naturalization Service; *Yearbook of Immigration Statistics*, Department of Homeland Security; State Department visa office.

number of green cards issued has not changed much. Green card issuance barely budged in 2008 and 2009, during the worst recession in 80 years, despite the more than 6 percent drop in employment nationwide and steep rise in unemployment.

Conclusion

Although immigration has played a fundamental role in shaping the U.S., it has always been controversial. In the 19th century, natives agonized over the German influx, then the Irish and then the Chinese. In the 20th century, natives revolted against the waves of southern and eastern Europeans. In the wake of the 1920–21 recession, lawmakers passed the most restrictive immigration act in the nation's history, the National Origins Act of 1924. Clearly, recessions and immigration do not mix well. Still, most of the postwar period has been devoted to loosening restrictions or finding ways around them.



Immigration laws should be rewritten to focus on economic priorities. These include leveraging high-skilled immigration to build the nation's human capital base, retain skilled jobs, foster research and development, and bolster competitiveness. These payoffs will take years to occur but require making changes now. Other economic goals, such as making inflows more cyclical, can be readily achieved with a greater share of employment-based visas. Labor demand is naturally cyclical, and work-based immigration will decline in downturns and rise in expansions.

As global growth shifts increasingly to emerging markets, such as China and India, competition for skilled workers will only increase. The share of Chinese students educated abroad—most of them in the critical STEM fields—who return to China to work has doubled since 2001. Globalization and technological change already favor high-skilled workers, in a trend that goes back decades. Since the early 1970s, the inflation-adjusted wages of only the most highly educated U.S. workers have consistently risen. Blue-collar pay, particularly for men, has declined in real terms. The nature of economic growth has shifted from brawn and machines to brains and microchips. Immigration policy should reflect this change and be a tool that helps secure the nation's prosperity, now and in the future.

Orrenius is a research officer and senior economist at the Federal Reserve Bank of Dallas and Madeline Zavodny is a professor of economics at Agnes Scott College.

Notes

The authors thank Carlos Zarazaga and Jason Saving for comments and Linda Bi for excellent research assistance. We also thank Payton Odom for his contributions.

[1] This report uses the terms foreign born and immigrant interchangeably to refer to individuals born abroad to foreign-born parents and uses native born to refer to anyone born in the U.S. (or born abroad to U.S. citizens).

[2] The decennial census did not ask about education or income until 1940. We use data on workers' occupations to proxy for the shares of low-skilled (blue-collar) and high-skilled (white-collar) workers.

[3] Since 1993, the number of U.S. citizens and permanent residents enrolled in graduate studies in science and engineering (S&E) has risen, although not as fast as the number of foreign students. Foreign students who were doctoral graduates in S&E made up 33 percent of total graduates in 2007. See appendix Table 2-30 in "Science and Engineering Indicators 2010," National Science Board, Arlington, Va., 2010.

[4] The former U.S.S.R. consists of Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[5] "The Place Premium: Wage Differences for Identical Workers Across the U.S. Border," by Michael Clemens, Claudio Montenegro and Lant Pritchett, Center for Global Development, Working Paper no. 148, July 2008, www.cgdev.org/content/publications/detail/16352.

[6] For a historical comparison with domestic migration, personal income per capita was 2.4 times higher in New England than in the South in 1929, 2.7 times higher in the mid-Atlantic states, and 2.2 times higher in the Midwest (authors' calculations based on

Bureau of Economic Analysis data not adjusted for differences in purchasing power).

[7] "U.S. Unauthorized Immigration Flows Are Down Sharply Since Mid-Decade," by Jeffrey S. Passel and D'Vera Cohn, Pew Hispanic Center report, September 2010, http://pewhispanic.org/files/reports/126.pdf.

[8] "Mexican Immigrants: How Many Come? How Many Leave?," by Jeffrey S. Passel and D'Vera Cohn, Pew Hispanic Center report, July 2009, http://pewhispanic.org/files/reports/112.pdf.

[9] Differences in English ability may create opportunities for native-born workers to move up the skill chain. See "Task Specialization, Immigration and Wages," by Giovanni Peri and Chad Sparber, *American Economic Journal: Applied Economics*, vol. 1, no. 3, 2009, pp. 135–69. As Peri and Sparber show, immigration appears to push natives into jobs that require communication skills, an area where natives have an advantage over immigrants with limited English fluency.

[10] "Low-Skilled Immigration and the Labor Supply of Highly Educated Women," by Patricia Cortés and José Tessada, University of Chicago Graduate School of Business, unpublished paper, 2009.

[11] See "The Economic Analysis of Immigration," by George J. Borjas, in *Handbook of Labor Economics*, vol. 3, part 1, 1999, pp. 1697–1760; and "Is the New Immigration Really So Bad?," by David Card, *Economic Journal*, vol. 115, no. 507, 2005, pp. 300–23. Economists agree, however, that in the long run, wages are not affected by immigration. This is because the capital stock should adjust in the long run. If the number of workers increases as a result of immigration, wages initially fall and returns to capital increase. As the amount of capital increases in the long run in response to higher returns to capital, the returns to capital and labor revert to their initial levels.

[12] See note 11, Borjas (1999), and "Immigration's Economic Impact," by the Council of Economic Advisers, Washington, D.C.: Government Printing Office, June 2007.

[13] *The Theory of Economic Development*, by Joseph Schumpeter, Cambridge, Mass.: Harvard University Press, 1934; "A Model of Growth Through Creative Destruction," by Philippe Aghion and Peter Howitt, *Econometrica*, vol. 60, no. 2, 1992, pp. 323–51.

[14] "How Much Does Immigration Boost Innovation?," by Jennifer Hunt and Marjolaine Gauthier-Loiselle, *American Economic Journal: Macroeconomics*, vol. 2, no. 2, 2010, pp. 31–56; "The Supply Side of Innovation: H-1B Visa Reforms and U.S. Ethnic Invention," by William R. Kerr and William F. Lincoln, Harvard Business School, Working Paper no. 09-005, December 2008; "Which Immigrants Are Most Innovative and Entrepreneurial? Distinctions by Entry Visa," by Jennifer Hunt, National Bureau of Economic Research, Working Paper no. 14920, April 2009; "The Contribution of International Graduate Students to U.S. Innovation," by Gnanaraj Chellaraj, Keith E. Maskus and Aaditya Mattoo, *Review of International Economics*, vol. 16, no. 3, 2008, pp. 444–62.

[15] See note 14, Hunt and Gauthier-Loiselle (2010).

[16] *Silicon Valley's New Immigrant Entrepreneurs*, by AnnaLee Saxenian, San Francisco: Public Policy Institute of California, 1999.

[17] "America's New Immigrant Entrepreneurs," by Vivek Wadhwa, AnnaLee Saxenian, Ben Rissing and Gary Gereffi, Duke Science, Technology and Innovation Paper no. 23, January 2007, http://people.ischool.berkeley.edu/~anno/Papers/Americas_new_immigrant_entrepreneurs_I.pdf.

[18] Estimates suggest immigrants are 30 percent more likely to start a business. See "Estimating the Contribution of Immigrant Business Owners to the U.S. Economy," by Robert W. Fairlie, Small Business Administration, Washington, D.C.: Government Printing Office, November 2008. Immigrant self-employment rates are 11.3 percent versus 9.1 percent for natives (authors' calculations based on 2010 Current Population Survey data). This difference in self-employment is driven by less-educated immigrants, perhaps because of their relatively poor labor market options.

[19] See "Does Immigration Grease the Wheels of the Labor Market?," by George J. Borjas, *Brookings Papers on Economic Activity*, 2001, pp. 69–119. Borjas estimates that the efficiency gains accruing to natives from a greater rate of regional wage convergence are around $5 billion to $10 billion per year.

[20] One recent study concludes that immigration raises total factor productivity, perhaps by increasing task specialization. See "The Effect of Immigration on Productivity: Evidence from U.S. States," by Giovanni Peri, National Bureau of Economic Research, Working Paper no. 15507, November 2009.

[21] *The New Americans: Economic, Demographic and Fiscal Effects of Immigration*, James P. Smith and Barry Edmonston, ed., Washington, D.C.: National Academies Press, 1997.

[22] Calculations are based on March 2010 Current Population Survey. Major means-tested programs are TANF, Medicaid, CHIP, Supplemental Security Income (SSI) and Supplemental Nutrition Assistance Program (SNAP, or food stamps).

[23] "The 2010 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds," Washington, D.C.: U.S. Government Printing Office, August 2010, www.ssa.gov/OACT/TR/2010/tr2010.pdf.

[24] "Sustaining Fiscal Policy Through Immigration," by Kjetil Storesletten, *Journal of Political Economy*, vol. 108, no. 2, 2000, pp. 300–23.

[25] "Tech Recruiting Clashes With Immigration Rules," by Matt Richtel, *New York Times*, April 11, 2009.

[26] Countries eligible for the diversity visa lottery include many African and European nations. Applicants from Ghana, Bangladesh and Ethiopia were the top recipients of visas in the 2011 lottery.

[27] Although the official H-1B cap is 85,000 visas (65,000 plus 20,000 for holders of U.S. advanced degrees), the nonprofit sector is exempt from the cap.

Year in Review

The Federal Reserve Bank of Dallas, with branches in Houston, San Antonio and El Paso, serves the Eleventh Federal Reserve District, made up of Texas, southern New Mexico and northern Louisiana. This important region employs over 11 million workers and produces an economic output greater than that of Mexico or Australia and, until recently, India.

The regional economy emerged from recession during 2010, posting 2.2 percent job growth and adding 241,000 jobs, more than any other Federal Reserve District. Economic growth varied over the year; rapid job growth in late spring was followed by a weak third quarter, but by year's end, employment was growing more consistently. Areas of the economy that turned in especially strong growth included the energy and service sectors. Encouragingly, hard-hit sectors such as manufacturing and construction also began improving, though problems in residential and commercial real estate remained evident.

The district faces a number of challenges, including funding health and education spending in a difficult budgetary environment. Nevertheless, due to its favorable business climate, diversified economy and entrepreneurial spirit, the Eleventh District likely will continue to outperform the nation.

Financial and Treasury Services

The Dallas Fed contributes to the district's vibrant economy by ensuring an efficient, stable and secure payments system. In 2010, the Bank provided cash services to more than 4,000 financial institutions and branches. The Dallas Fed circulated 5.8 million notes valued at more than $105 billion.

To improve efficiency and reduce operating costs, the Bank announced that a cash depot arrangement will replace San Antonio cash services in 2011. Such a depot uses an off-site facility, usually operated by an armored carrier, as the point of delivery and receipt for cash. Currency processing and storage is provided by another Fed location—in this case, the Houston office.

The Dallas Fed wound down its check services, transferring those operations to the Atlanta Fed. Every aspect of the transition was completed on time and met or exceeded expectations.

An important function of the Federal Reserve is providing services to the U.S. Department of the Treasury. The *Go Direct* ® contact center—established at the Dallas Fed in 2004—helps the Treasury reduce the number of paper checks by enrolling federal benefit recipients in direct deposit. In 2010, the contact center processed about 590,000 enrollments and has processed more than 3 million enrollments since its inception.

Go Direct is preparing for the U.S. Treasury's all-electronic payment initiative—which will mandate the direct deposit of all non-tax-related federal benefit payments. The initiative is expected to save the Treasury approximately $300 million over the next five years. The contact center is projected to process more than 5 million enrollments by the March 1, 2013, deadline.

Banking Supervision

The Dallas Fed helps ensure the safety and soundness of financial insitutions through its lending programs and supervisory activities. Lending programs offered through the discount window help relieve liquidity strains by providing a source of short-term funding to depository institutions.

As financial markets strengthened in 2010, the Bank's discount window continued to provide a ready backstop that helped maintain market confidence by issuing 156 loans totaling approximately $3 billion. Additionally, discount window staff played an important role in the Federal Reserve System's new term deposit facility—a program through which Federal Reserve Banks offer interest-bearing term deposits to eligible institutions.

The Dallas Fed's banking supervision and regulation activities contributed to financial safety and soundness, both within the Eleventh District and nationwide. At year-end 2010, the Dallas Fed supervised 36 state member banks and 526 bank holding companies ranging from more than $50 billion to less than $20 million in total assets.

The Eleventh District banking system outperformed the rest of the nation in 2010, allowing the Dallas Fed to lend examination staff to other districts where unfavorable conditions required additional examination resources.

The Dodd–Frank Wall Street Reform and Consumer Protection Act will bring new responsibilities to banking supervision in 2011, including supervisory responsibility for thrift holding companies. The groundwork laid in 2010 has positioned the Bank well to assume these responsibilities.

Research and Public Outreach

Through an array of publications, public programs and outreach efforts, the Dallas Fed provides valuable research and insight to enhance public understanding of the global, national and regional economies.

In 2010, the Bank expanded its web presence by adding two new monthly research publications to the website—one that provides a discussion of inflation developments (*Behind the Numbers: PCE Inflation Update*) and another that offers a snapshot of the regional economy (*Texas Economic Indicators*).

The Dallas Fed organized a number of research conferences in 2010. "U.S. and Mexico Manufacturing: Common Bonds" explored the role the U.S. plays in global manufacturing and how Mexico complements the U.S. through the maquiladora industry. Another research conference explored the emerging and growing importance of the nanotechnology industry.

Staff economists published numerous research papers in major policy journals, including the *American Economic Review: Papers and Proceedings*, *Economic Journal* and *Journal of Monetary Economics*. In addition, economists published a range of articles in *Economic Letter* and *Southwest Economy* on policy-related topics, including the housing and financial crisis, the role of the Fed's term auction facility, the impact of too-big-to-fail banks on monetary policy, the Texas Manufacturing Outlook Survey and the macroeconomics of energy.

The Dallas Fed's Globalization and Monetary Policy Institute continues to contribute valuable insight into the effects of global developments on America's economy and monetary policy. The institute circulated 27 new working papers in 2010—bringing the total number to 67—and organized two conferences. In March, a conference to mark the 10th anniversary of the euro was held jointly with the Peterson Institute for International Economics, and in September, the institute organized a conference on "Microeconomic Sources of Real Exchange Rate Behavior" jointly with the Center for International Price Research at Vanderbilt University.

The Bank's financial industry economists advocated and implemented policies and practices for enhancing financial system stability and performance. Policy articles covered topics ranging from the macroprudential regulation of credit cycles, to loan modifications and financial recovery, to reaching the unbanked in Mexico. The staff also built and refined analytical tools used across the Federal Reserve System for monitoring the financial condition of banks and other financial institutions, such as thrifts and credit unions.

The Dallas Fed delivered an array of economic programs and services to students and teachers throughout the district. One of the year's highlights was "Conversation with the Chairman," which featured Ben Bernanke interacting with educators across the nation. This event was the result of an effort led by the Dallas and Cleveland Feds' economic education functions.

The Federal Reserve's response to the financial crisis continued to be a primary focus for the Bank's public programs. Program offerings were augmented by a new webcasting platform, allowing the Bank to reach a broad audience across the district and the nation effectively and efficiently. Live webcasts were produced for bankers, teachers, and economic and community development audiences.

As part of a Federal Reserve initiative to enhance communication and feedback with community bankers, the Bank established a Community Depository Institutions Advisory Council, composed of 12 representatives from financial institutions of various sizes in the district. The council will provide senior Dallas Fed officials with grassroots information on economic and banking conditions, regulatory policies and payments issues.

As consumers and communities continued to recover from the financial crisis, Bank staff collaborated with cities and civic groups across the district to mitigate home foreclosures and promote neighborhood stabilization. The Bank also launched the Dallas Fed Community Outlook Survey—a quarterly online survey designed to assess the financial condition of low- and moderate-income individuals and communities.

Throughout 2010, the Bank provided leadership and technical assistance for district partnerships and coalitions in the areas of asset building, community development finance and access to capital—organizing four conferences, 15 workshops and roundtables, eight webcasts and national conference calls, reaching thousands of participants.

The staff of the Dallas Fed and its branches strive to provide effective banking supervision and the high-quality financial services, economic research and public outreach needed to foster a sound financial system and healthy economy.

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and Chief Executive Officer

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and Chief Operating Officer

ur mission:

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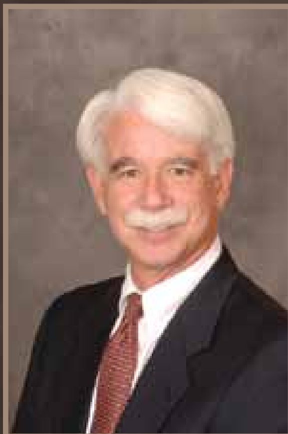

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San Antonio

As of December 31, 2010

Management's Report on Internal Control Over Financial Reporting

March 22, 2011

To the Board of Directors of the
Federal Reserve Bank of Dallas:

The management of the Federal Reserve Bank of Dallas (FRBD) is responsible for the preparation and fair presentation of the Statements of Condition as of December 31, 2010 and 2009, and the Statements of Income and Comprehensive Income, and Statements of Changes in Capital for the years then ended (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 as set forth in the *Financial Accounting Manual for the Federal Reserve Banks* (FAM), and as such, include some amounts that 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 FAM and include all disclosures necessary for such fair presentation.

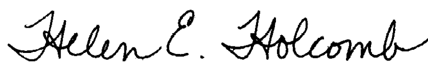
The management of the FRBD is responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of the Financial Statements in accordance with the FAM. 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 FRBD 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 FRBD maintained effective internal control over financial reporting as it relates to the Financial Statements.

Federal Reserve Bank of Dallas

President



First Vice President

Chief Financial Officer

Independent Auditors' Report

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

We have audited the accompanying Statements of Condition of the Federal Reserve Bank of Dallas ("FRB Dallas") as of December 31, 2010 and 2009 and the related Statements of Income and Comprehensive Income, and of Changes in Capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. We also have audited the internal control over financial reporting of the FRB Dallas as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The FRB Dallas's management is responsible for these Financial Statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these Financial Statements and an opinion on the FRB Dallas's internal control over financial reporting 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 and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the Financial Statements included examining, on a test basis, evidence supporting the amounts and disclosures in the Financial Statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

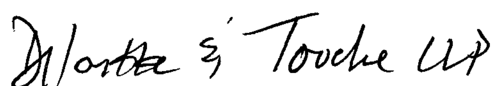
The FRB Dallas's internal control over financial reporting is a process designed by, or under the supervision of, the FRB Dallas's principal executive and principal financial officers, or persons performing similar functions, and effected by the FRB Dallas's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purposes in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System. The FRB Dallas's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the FRB Dallas; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of

Financial Statements in accordance with the accounting principles established by the Board of Governors of the Federal Reserve System, and that receipts and expenditures of the FRB Dallas are being made only in accordance with authorizations of management and directors of the FRB Dallas; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the FRB Dallas's assets that could have a material effect on the Financial Statements.

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

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

In our opinion, such Financial Statements present fairly, in all material respects, the financial position of the FRB Dallas as of December 31, 2010 and 2009, and the results of its operations for the years then ended, on the basis of accounting described in Note 4. Also, in our opinion, the FRB Dallas maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.



March 22, 2011

Statements of Condition (in millions)

	December 31, 2010	December 31, 2009
ASSETS		
Gold certificates	$ 652	$ 621
Special drawing rights certificates	282	282
Coin	239	214
Items in process of collection	21	33
Loans:		
Depository institutions	—	392
System Open Market Account:		
Treasury securities, net	44,802	38,970
Government-sponsored enterprise debt securities, net	6,423	8,092
Federal agency and government-sponsored enterprise mortgage-backed securities, net	42,188	44,432
Foreign currency denominated assets, net	358	325
Central bank liquidity swaps	1	132
Accrued interest receivable	597	610
Bank premises and equipment, net	270	276
Other assets	37	37
Total assets	**$ 95,870**	**$ 94,416**
LIABILITIES AND CAPITAL		
Liabilities		
Federal Reserve notes outstanding, net	$ 64,174	$ 49,642
System Open Market Account:		
Securities sold under agreements to repurchase	2,507	3,758
Other liabilities	—	29
Deposits:		
Depository institutions	25,112	22,826
Other deposits	1	1
Interest payable to depository institutions	3	2
Accrued benefit costs	105	103
Deferred credit items	73	109
Accrued interest on Federal Reserve notes	69	51
Interdistrict settlement account	3,007	17,174
Other liabilities	15	15
Total liabilities	**95,066**	**93,710**
Capital		
Capital paid-in	402	353
Surplus (including accumulated other comprehensive loss of $14 million and $18 million at December 31, 2010 and 2009, respectively)	402	353
Total capital	**804**	**706**
Total liabilities and capital	**$ 95,870**	**$ 94,416**

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

Statements of Income and Comprehensive Income (in millions)

	For the Years Ended	
	December 31, 2010	December 31, 2009
INTEREST INCOME		
Loans:		
Depository institutions	$ 1	$ 10
System Open Market Account:		
Securities purchased under agreements to resell	—	1
Treasury securities, net	1,155	1,073
Government-sponsored enterprise debt securities, net	154	97
Federal agency and government-sponsored enterprise mortgage-backed securities, net	1,965	977
Foreign currency denominated assets, net	3	4
Central bank liquidity swaps	—	32
Total interest income	**3,278**	**2,194**
INTEREST EXPENSE		
System Open Market Account:		
Securities sold under agreements to repurchase	4	4
Deposits:		
Depository institutions	51	36
Total interest expense	55	40
Net interest income	**3,223**	**2,154**
NON-INTEREST INCOME (LOSS)		
System Open Market Account:		
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	35	44
Foreign currency gains (losses), net	8	(3)
Compensation received for service costs provided	13	28
Reimbursable services to government agencies	14	14
Other income	4	10
Total non-interest income	**74**	**93**
OPERATING EXPENSES		
Salaries and benefits	125	126
Occupancy	23	25
Equipment	10	12
Assessments:		
Board of Governors operating expenses and currency costs	48	33
Bureau of Consumer Financial Protection and Office of Financial Research	1	—
Other	30	29
Total operating expenses	**237**	**225**
Net income prior to distribution	**3,060**	**2,022**
Change in funded status of benefit plans	4	(3)
Comprehensive income prior to distribution	**$ 3,064**	**$ 2,019**
DISTRIBUTION OF COMPREHENSIVE INCOME		
Dividends paid to member banks	$ 24	$ 17
Transferred to surplus and change in accumulated other comprehensive loss	49	82
Payments to Treasury as interest on Federal Reserve notes	2,991	1,920
Total distribution	**$ 3,064**	**$ 2,019**

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

Statements of Changes in Capital for the Years Ended December 31, 2010, and December 31, 2009 (in millions, except share data)

		Surplus			
	Capital Paid-In	Net Income Retained	Accumulated Other Comprehensive Loss	Total Surplus	Total Capital
BALANCE AT JANUARY 1, 2009 (5,419,438 shares)	$ 271	$ 286	$ (15)	$ 271	$ 542
Net change in capital stock issued (1,630,658 shares)	82	—	—	—	82
Transferred to surplus and change in accumulated other comprehensive loss	—	85	(3)	82	82
BALANCE AT DECEMBER 31, 2009 (7,050,096 shares)	$ 353	$ 371	$ (18)	$ 353	$ 706
Net change in capital stock issued (986,886 shares)	49	—	—	—	49
Transferred to surplus and change in accumulated other comprehensive loss	—	45	4	49	49
BALANCE AT DECEMBER 31, 2010 (8,036,982 shares)	**$ 402**	**$ 416**	**$ (14)**	**$ 402**	**$ 804**

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

Federal Reserve Bank of Dallas Abbreviations:

ABCP — Asset-backed commercial paper
ACH — Automated clearinghouse
AMLF — Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
ASC — Accounting Standards Codification
BEP — Benefit Equalization Retirement Plan
Bureau — Bureau of Consumer Financial Protection
Dodd–Frank Act — The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010
ESF — Exchange Stabilization Fund
FAM — *Financial Accounting Manual for Federal Reserve Banks*
FASB — Financial Accounting Standards Board
Fannie Mae — Federal National Mortgage Association
Freddie Mac — Federal Home Loan Mortgage Corporation
FOMC — Federal Open Market Committee
FRBA — Federal Reserve Bank of Atlanta (as applicable)
FRBNY — Federal Reserve Bank of New York (as applicable)
GAAP — Accounting principles generally accepted in the United States of America
GSE — Government-sponsored enterprise
IMF — International Monetary Fund
MBS — Mortgage-backed securities
OEB — Office of Employee Benefits of the Federal Reserve System
OFR — Office of Financial Research
SDR — Special drawing rights
SERP — Supplemental Retirement Plan for Select Officers of the Federal Reserve Banks
SFAS — Statement of Financial Accounting Standards
SOMA — System Open Market Account
STRIPS — Separate Trading of Registered Interest and Principal of Securities
TAF — Term Auction Facility
TBA — To be announced
TDF — Term Deposit Facility
TIPS — Treasury Inflation-Protected Securities
TOP — Term Securities Lending Facility Options Program
TSLF — Term Securities Lending Facility

Notes to Financial Statements

1. STRUCTURE

The Federal Reserve Bank of Dallas (Bank) is part of the Federal Reserve System (System) and is one of the 12 Federal 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 serves the Eleventh Federal Reserve District, which includes Texas and portions of Louisiana and New Mexico.

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. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

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

2. OPERATIONS AND SERVICES

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

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

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, federal agency and government-sponsored enterprise (GSE) debt securities, federal agency and GSE mortgage-backed securities (MBS), the purchase of these securities under agreements to resell, and the sale of these securities under agreements to repurchase. The FRBNY holds the resulting securities and agreements in a portfolio known as the System Open Market Account (SOMA). The FRBNY is authorized to lend the Treasury securities and federal agency and GSE debt securities that are held in the SOMA.

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

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

costs were not reimbursed by the other Reserve Banks include Check Automation Services; National Examination Data System; Desktop Services Center; Lawson Central Business Administration Function; Accounts, Risk and Credit System; and *Go Direct*®.

3. FINANCIAL STABILITY ACTIVITIES

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

Large-Scale Asset Purchase Programs

The FOMC authorized and directed the FRBNY to purchase $300 billion of longer-term Treasury securities to help improve conditions in private credit markets. The FRBNY began the purchases of these Treasury securities in March 2009 and completed them in October 2009. On August 10, 2010, the FOMC announced that the Federal Reserve will maintain the level of domestic securities holdings in the SOMA portfolio by reinvesting principal payments from GSE debt securities and federal agency and GSE MBS in longer-term Treasury securities. On November 3, 2010, the FOMC announced its intention to expand the SOMA portfolio holdings of longer-term Treasury securities by an additional $600 billion by June 2011. The FOMC will regularly review the pace of these securities purchases and the overall size of the asset purchase program and will adjust the program as needed to best foster maximum employment and price stability.

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

Central Bank Liquidity Swaps

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which could be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements. U.S. dollar liquidity swap arrangements were authorized with 14 foreign central banks to provide liquidity in U.S. dollars to overseas markets. The authorization for these swap arrangements expired on February 1, 2010. In May 2010, U.S. dollar liquidity swap arrangements were reestablished with the Bank of Canada, the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank; these arrangements will expire on August 1, 2011.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. The authorization for these swap arrangements expired on February 1, 2010.

Lending to Depository Institutions

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

Lending to Primary Dealers

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

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

Other Lending Facilities

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

4. SIGNIFICANT ACCOUNTING POLICIES

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

Limited differences exist between the accounting principles and practices in the FAM and accounting principles generally accepted in the United States (GAAP), due to the unique nature of the Bank's powers and responsibilities as part of the nation's central bank and given the System's unique responsibility to conduct monetary policy. The primary differences are the presentation of all SOMA securities holdings at amortized cost and the recording of such securities on a settlement-date basis. The cost basis of Treasury securities, GSE debt securities, and foreign government debt instruments is adjusted for amortization of premiums or accretion of discounts on a straight-line basis, rather than using the interest method required by GAAP. Amortized cost, rather than the fair value presentation, more appropriately reflects the Bank's securities holdings given the System's unique responsibility to conduct monetary policy. Accounting for

these securities on a settlement-date basis, rather than the trade-date basis required by GAAP, more appropriately reflects the timing of the transaction's effect on the quantity of reserves in the banking system. Although the application of fair value measurements to the securities holdings may result in values substantially greater or less than their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold before maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Bank does not present a Statement of Cash Flows as required by GAAP because the liquidity and cash position of the Bank are not a primary concern given the Reserve Banks' unique powers and responsibilities. Other information regarding the Bank's activities is provided in, or may be derived from, the Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the FAM and GAAP.

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

a. Consolidation

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

b. Gold and Special Drawing Rights Certificates

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

SDR certificates are issued by the International Monetary Fund (IMF) to its members in proportion to each member's quota in the IMF at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. SDRs are recorded by the Bank at original cost. In 2009, the Treasury issued $3 billion in SDR certificates to the Reserve Banks, of which $184 million was allocated to the Bank. There were no SDR transactions in 2010.

c. Coin

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

d. Loans

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

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

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

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell (repurchase transactions). These repurchase transactions are settled through a tri-party arrangement. In a tri-party arrangement, two commercial custodial banks manage the collateral clearing, settlement, pricing, and pledging and provide cash and securities custodial services for and on behalf of the Bank and counterparty. The collateral pledged must exceed the principal amount of the transaction by a margin determined by the FRBNY for each class and maturity of acceptable collateral. Collateral designated by the FRBNY as acceptable under repurchase transactions primarily includes Treasury securities (including TIPS and STRIPS Treasury securities); direct obligations of several federal agency and GSE-related agencies, including Fannie Mae and Freddie Mac; and pass-through MBS of Fannie Mae, Freddie Mac, and Ginnie Mae. The repurchase transactions are accounted for as financing transactions with the associated interest income recognized over the life of the transaction. Repurchase transactions are reported at their contractual amount as "System Open Market Account: Securities purchased under agreements to resell," and the related accrued interest receivable is reported as a component of "Accrued interest receivable" in the Statements of Condition.

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

Treasury securities and GSE debt securities held in the SOMA may be lent to primary dealers to facilitate the effective functioning of the domestic securities markets. Overnight securities lending transactions are fully collateralized by Treasury securities that have fair values in excess of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income" in the Statements of Income and Comprehensive Income.

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

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

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

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY entered into dollar roll transactions (dollar rolls), which primarily involve an initial transaction to purchase or sell "to be announced" (TBA) MBS for delivery in the current month combined with a simultaneous agreement to sell or purchase TBA MBS on a specified future date. The FRBNY also executed a limited number of TBA MBS coupon swap transactions, which involve a simultaneous sale of a TBA MBS and purchase of another TBA MBS of a different coupon rate. The FRBNY's participation in the dollar roll and coupon swap markets furthers the MBS purchase program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets more generally. The FRBNY accounts for outstanding commitments under dollar roll and coupon swaps on a settlement-date basis. Based on the terms of the FRBNY dollar roll and coupon swap transactions, transfers of MBS upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Transfers and Servicing*, and the related outstanding commitments are accounted for as sales or purchases upon settlement. Net gains resulting from dollar roll and coupon swap transactions are reported as "Non-interest income (loss): System Open Market Account: Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

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 foreign currency denominated assets are reported as "Foreign currency gains (losses), net" in the Statements of Income and Comprehensive Income.

Activity related to Treasury securities, GSE debt securities, and federal agency and GSE MBS, including the premiums, discounts,

and realized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. Activity related to foreign currency denominated assets, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

Warehousing is an arrangement under which the FOMC has approved the exchange, at the request of the Treasury, of U.S. dollars for foreign currencies held by the Treasury over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury for financing purchases of foreign currencies and related international operations. Warehousing agreements are designated as held-for-trading purposes and are valued daily at current market exchange rates. Activity related to these agreements is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

g. Central Bank Liquidity Swaps

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

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

U.S. dollar liquidity swaps

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

The foreign central bank compensates the FRBNY based on the foreign currency amounts it holds for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as "Interest income: Central bank liquidity swaps" in the Statements of Income and Comprehensive Income.

Foreign currency liquidity swaps

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

h. Interdistrict Settlement Account

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

i. Bank Premises, Equipment, and Software

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

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

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

j. Federal Reserve Notes

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

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

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

"Federal Reserve notes outstanding, net" in the Statements of Condition represents the Bank's Federal Reserve notes outstanding, reduced by the Bank's currency holdings of $11,980 million and $13,731 million at December 31, 2010 and 2009, respectively.

At December 31, 2010 and 2009, all Federal Reserve notes issued to the Reserve Banks were fully collateralized. At December 31, 2010, all gold certificates, all special drawing right certificates, and $925 billion of domestic securities held in the SOMA were pledged as collateral. At December 31, 2010, no investments denominated in foreign currencies were pledged as collateral.

k. Deposits

Depository Institutions

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

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

Other

Other deposits include foreign central bank and foreign government deposits held at the FRBNY that are allocated to the Bank.

l. Items in Process of Collection and Deferred Credit Items

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

m. Capital Paid-in

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

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

n. 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. Accumulated other comprehensive income is reported as a component of "Surplus" in the Statements of Condition and the Statements of Changes in Capital. Additional information regarding the classifications of accumulated other comprehensive income is provided in Notes 12 and 13.

o. Interest on Federal Reserve Notes

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

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

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 Treasury in the following year.

p. Income and Costs Related to Treasury Services

When directed by the Secretary of the Treasury, the Bank is required by the Federal Reserve Act to serve as fiscal agent and depositary of the United States government. By statute, the Treasury has appropriations to pay for these services. During the years ended December 31, 2010 and 2009, the Bank was reimbursed for all services provided to the Treasury as its fiscal agent.

q. Compensation Received for Service Costs Provided

The Federal Reserve Bank of Atlanta (FRBA) has overall responsibility for managing the Reserve Banks' provision of check and ACH services to depository institutions and, as a result, recognizes total System revenue for these services on its Statements of Income and Comprehensive Income. Similarly, the FRBNY manages the Reserve Banks' provision of Fedwire funds and securities services and recognizes total System revenue for these services on its Consolidated Statements of Income and Comprehensive

Income. The FRBA and the FRBNY compensate the applicable Reserve Banks for the costs incurred to provide these services. The Bank reports this compensation as "Compensation received for service costs provided" in the Statements of Income and Comprehensive Income.

r. Assessments

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

During the period prior to the Bureau transfer date of July 21, 2011, there is no fixed limit on the funding that can be provided to the Bureau and that is assessed to the Reserve Banks; the Board of Governors must provide the amount estimated by the Secretary of the Treasury needed to carry out the authorities granted to the Bureau under the Dodd–Frank Act and other federal law. After the transfer date, the Dodd–Frank Act requires the Board of Governors to fund the Bureau in an amount not to exceed a fixed percentage of the total operating expenses of the Federal Reserve System as reported in the Board of Governors' 2009 annual report. The fixed percentage of total operating expenses of the System is 10 percent for 2011, 11 percent for 2012, and 12 percent for 2013. After 2013, the amount will be adjusted in accordance with the provisions of the Dodd–Frank Act.

The Board of Governors assesses the Reserve Banks to fund the operations of the OFR for the two-year period following enactment of the Dodd–Frank Act; thereafter, the OFR will be funded by fees assessed on certain bank holding companies.

s. 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 $4 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Operating expenses: Occupancy" in the Statements of Income and Comprehensive Income.

t. Restructuring Charges

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

Note 14 describes the Bank's restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain Bank assets are discussed in Note 9. 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.

u. Recently Issued Accounting Standards

In June 2009, FASB issued Statement of Financial Accounting Standards (SFAS) 166, *Accounting for Transfers of Financial Assets*—an amendment to FASB Statement No. 140, (codified in ASC 860). The new standard revises the criteria for recognizing transfers of financial assets as sales and clarifies that the transferor must consider all arrangements when determining if the transferor has surrendered control. The adoption of this accounting guidance was effective for the Bank for the year beginning on January 1, 2010, and did not have a material effect on the Bank's financial statements.

In July 2010, the FASB issued Accounting Standards Update 2010–20, *Receivables* (Topic 310), which requires additional disclosures about the allowance for credit losses and the credit quality of loan portfolios. The additional disclosures include a rollforward of the allowance for credit losses on a disaggregated basis and more information, by type of receivable, on credit quality indicators, including the amount of certain past due receivables and troubled debt restructurings and significant purchases and sales. The adoption of this accounting guidance is effective for the Bank on December 31, 2011, and is not expected to have a material effect on the Bank's financial statements.

5. LOANS

Loans outstanding at December 31, 2010 and 2009, were as follows (in millions):

	2010	2009
Primary, secondary, and seasonal credit	$ —	$ 2
TAF	—	390
Total loans to depository institutions	**$ —**	**$ 392**

Loans to Depository Institutions

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

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of the Bank to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local gov-

ernment obligations; asset-backed securities; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Bank, which is typically fair value reduced by a margin.

Depository institutions that are eligible to borrow under the Bank's primary credit program were eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conducted auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans were extended on a short-term basis, with terms ranging from 28 to 84 days. All advances under the TAF program were collateralized to the satisfaction of the Bank. All TAF loan principal and accrued interest was fully repaid.

Loans to depository institutions are monitored daily to ensure that borrowers continue to meet eligibility requirements for these programs. The financial condition of borrowers is monitored by the Bank and, if a borrower no longer qualifies for these programs, the Bank will generally request full repayment of the outstanding loan or, for primary or seasonal credit lending, may convert the loan to a secondary credit loan.

Collateral levels are reviewed daily against outstanding obligations, and borrowers that no longer have sufficient collateral to support outstanding loans are required to provide additional collateral or to make partial or full repayment.

Allowance for loan loss

At December 31, 2010 and 2009, the Bank did not have any impaired loans and no allowance for loan losses was required. There were no impaired loans during the years ended December 31, 2010 and 2009.

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

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA. The Bank's allocated share of SOMA balances was approximately 4.199 percent and 4.835 percent at December 31, 2010 and 2009, respectively.

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

	2010				
	Par	Unamortized premiums	Unaccredited discounts	Total amortized cost	Fair value
Bills	$ 773	$ —	$ —	$ 773	$ 773
Notes	32,471	590	(32)	33,029	33,790
Bonds	9,649	1,375	(24)	11,000	12,167
Total Treasury securities	**$ 42,893**	**$ 1,965**	**$ (56)**	**$ 44,802**	**$ 46,730**
GSE debt securities	$ 6,192	$ 232	$ (1)	$ 6,423	$ 6,583
Federal agency and GSE MBS	$ 41,660	$ 593	$ (65)	$ 42,188	$ 43,082

	2009				
	Par	Unamortized premiums	Unaccredited discounts	Total amortized cost	Fair value
Bills	$ 891	$ —	$ —	$ 891	$ 891
Notes	27,479	316	(48)	27,747	28,191
Bonds	9,179	1,183	(30)	10,332	11,155
Total Treasury securities	**$ 37,549**	**$ 1,499**	**$ (78)**	**$ 38,970**	**$ 40,237**
GSE debt securities	$ 7,730	$ 363	$ (1)	$ 8,092	$ 8,096
Federal agency and GSE MBS	$ 43,921	$ 586	$ (75)	$ 44,432	$ 44,207

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

	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Bills	$ 18,422	$ 18,422	$ 18,423	$ 18,423
Notes	786,575	804,703	573,877	583,040
Bonds	261,955	289,757	213,672	230,717
Total Treasury securities	**$ 1,066,952**	**$ 1,112,882**	**$ 805,972**	**$ 832,180**
GSE debt securities	$ 152,972	$ 156,780	$ 167,362	$ 167,444
Federal agency and GSE MBS	$ 1,004,695	$ 1,026,003	$ 918,927	$ 914,290

The fair value amounts in the above tables are presented solely for informational purposes. Although the fair value of security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have

no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. The fair value of federal agency and GSE MBS was determined using a model-based approach that considers observable inputs for similar securities; fair value for all other SOMA security holdings was determined by reference to quoted prices for identical securities.

The fair value of the fixed-rate Treasury securities, GSE debt securities, and federal agency and GSE MBS in the SOMA's holdings is subject to market risk, arising from movements in market variables, such as interest rates and securities prices. The fair value of federal agency and GSE MBS is also affected by the rate of prepayments of mortgage loans underlying the securities.

The following table provides additional information on the amortized cost and fair values of the federal agency and GSE MBS portfolio at December 31, 2010 and 2009 (in millions):

Distribution of MBS holdings by coupon rate	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Allocated to the Bank:				
3.5%	$ 14	$ 15	$ 18	$ 17
4.0%	7,041	7,071	8,225	8,014
4.5%	20,897	21,365	21,002	20,870
5.0%	9,718	9,974	9,449	9,497
5.5%	3,910	4,026	4,998	5,057
6.0%	542	562	615	624
6.5%	66	69	125	128
Total	**$ 42,188**	**$ 43,082**	**$ 44,432**	**$ 44,207**
SOMA:				
3.5%	$ 341	$ 352	$ 363	$ 365
4.0%	167,675	168,403	170,119	165,740
4.5%	497,672	508,798	434,352	431,646
5.0%	231,420	237,545	195,418	196,411
5.5%	93,119	95,873	103,379	104,583
6.0%	12,910	13,376	12,710	12,901
6.5%	1,558	1,656	2,586	2,644
Total	**$1,004,695**	**$1,026,003**	**$ 918,927**	**$ 914,290**

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

	Securities Purchased Under Agreements to Resell		Securities Sold Under Agreements to Repurchase	
	2010	2009	2010	2009
Allocated to the Bank:				
Contract amount outstanding, end of the year	$ —	$ —	$ 2,507	$ 3,758
Average daily amount outstanding, during the year	—	150	2,561	3,136
Maximum balance outstanding, during the year	—	3,318	3,758	3,758
Securities pledged (par value), end of the year	—	—	1,833	3,765
SOMA:				
Contract amount outstanding, end of the year	$ —	$ —	$ 59,703	$ 77,732
Average daily amount outstanding, during the year		3,616	58,476	67,837
Maximum balance outstanding, during the year	—	80,000	77,732	89,525
Securities pledged (par value), end of the year	—	—	43,642	77,860

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value. The FRBNY executes transactions for the purchase of securities under agreements to resell primarily to temporarily add reserve balances to the banking system. Conversely, transactions to sell securities under agreements to repurchase are executed primarily to temporarily drain reserve balances from the banking system.

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, and securities sold under agreements to repurchase that were allocated to the Bank at December 31, 2010, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Over 5 years to 10 years	Over 10 years	Total
Treasury securities (par value)	$ 412	$ 1,042	$ 2,278	$18,459	$14,023	$ 6,679	$42,893
GSE debt securities (par value)	47	581	1,197	2,983	1,285	99	$ 6,192
Federal agency and GSE MBS (par value)	—	—	—	1	1	41,658	$41,660
Securities sold under agreements to repurchase (contract amount)	2,507	—	—	—	—	—	$ 2,507

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2010, which differs from the stated maturity primarily because the weighted average life factors in prepayment assumptions, is approximately 4.2 years.

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

	Allocated to the Bank		SOMA	
	2010	2009	2010	2009
Treasury securities	$ 927	$ 991	$ 22,081	$ 20,502
GSE debt securities	68	54	1,610	1,108

Other liabilities, which are related to purchases of federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the Bank has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Bank's obligation to pay for the securities when delivered. The amount of other liabilities allocated to the Bank and held in the SOMA at December 31, was as follows (in millions):

	Allocated to the Bank		SOMA	
	2010	2009	2010	2009
Other liabilities	—	29	—	601

The FRBNY enters into commitments to buy Treasury and GSE debt securities and records the related securities on a settlement-date basis. There were no commitments to buy Treasury and GSE debt securities as of December 31, 2010. These commitments had contractual settlement dates extending through January 4, 2011.

The FRBNY enters into commitments to buy federal agency and GSE MBS and records the related MBS on a settlement-date basis.

During the years ended December 31, 2010 and 2009, the Reserve Banks recorded net gains from dollar roll and coupon swap related transactions of $782 million and $879 million, respectively, of which $35 million and $44 million, respectively, was allocated to the Bank. These net gains are reported as "Non-interest income (loss): Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Statements of Income and Comprehensive Income.

There were no commitments to buy or sell federal agency or GSE MBS as of December 31, 2010.

7. FOREIGN CURRENCY DENOMINATED ASSETS

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

The Bank's allocated share of foreign currency denominated assets was approximately 1.375 percent and 1.286 percent at December 31, 2010 and 2009, respectively.

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

	2010	2009
Euro:		
Foreign currency deposits	$ 97	$ 95
Securities purchased under agreements to resell	34	33
Government debt instruments	64	64
Japanese yen:		
Foreign currency deposits	53	44
Government debt instruments	110	89
Total allocated to the Bank	**$ 358**	**$ 325**

At December 31, 2010 and 2009, the fair value of foreign currency denominated assets, including accrued interest, allocated to the Bank was $360 million and $328 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 Treasury securities, GSE debt securities, and federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of a Reserve Bank, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

Total Reserve Bank foreign currency denominated assets were $26,049 million and $25,272 million at December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the fair value of the total Reserve Bank foreign currency denominated assets, including accrued interest, was $26,213 million and $25,480 million, respectively.

The remaining maturity distribution of foreign currency denominated assets that were allocated to the Bank at December 31, 2010, was as follows (in millions):

	Within 15 days	16 days to 90 days	91 days to 1 year	Over 1 year to 5 years	Total allocated to the Bank
Euro	$ 75	$ 41	$ 28	$ 51	$ 195
Japanese yen	56	8	33	66	$ 163
Total allocated to the bank	**$ 131**	**$ 49**	**$ 61**	**$ 117**	**$ 358**

At December 31, 2010 and 2009, the authorized warehousing facility was $5.0 billion, with no balance outstanding.

There were no transactions related to the authorized reciprocal currency arrangements with the Bank of Canada and the Bank of Mexico during the years ended December 31, 2010 and 2009.

There were no foreign exchange contracts outstanding as of December 31, 2010.

The FRBNY enters into commitments to buy foreign government debt instruments and records the related securities on a settlement-date basis. As of December 31, 2010, there were $209 million of outstanding commitments to purchase euro-denominated government debt instruments, of which $3 million was allocated to the Bank. These securities settled on January 4, 2011, and replaced euro-denominated government debt instruments held in the SOMA that matured on that date.

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

8. CENTRAL BANK LIQUIDITY SWAPS

U.S. Dollar Liquidity Swaps

The Bank's allocated share of U.S. dollar liquidity swaps was approximately 1.375 percent and 1.286 percent at December 31, 2010 and 2009, respectively.

The total foreign currency held under U.S. dollar liquidity swaps in the SOMA at December 31, 2010 and 2009, was $75 million and $10,272 million, respectively, of which $1 million and $132 million, respectively, was allocated to the Bank. All of the U.S. dollar liquidity swaps outstanding at December 31, 2010, were transacted with the European Central Bank and had remaining maturity distributions of less than 15 days.

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2010 and 2009.

9. BANK PREMISES, EQUIPMENT, AND SOFTWARE

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

	2010	2009
Bank premises and equipment:		
Land and land improvements	$ 63	$ 63
Buildings	229	229
Building machinery and equipment	44	44
Construction in progress	4	1
Furniture and equipment	66	64
Subtotal	406	401
Accumulated depreciation	(136)	(125)
Bank premises and equipment, net	**$ 270**	**$ 276**
Depreciation expense, for the years ended December 31	**$ 14**	**$ 17**

The Bank leases space to outside tenants with remaining lease terms ranging from 5 to 7 years. Rental income from such leases was $2 million and $3 million for the years ended December 31, 2010 and 2009, respectively, and is reported as a component of "Other income" in the Statements of Income and Comprehensive Income. Future minimum lease payments that the Bank will receive under noncancelable lease agreements in existence at December 31, 2010, are as follows (in thousands):

2011	$ 1,428
2012	1,462
2013	1,462
2014	1,462
2015	1,269
Thereafter	1,553
Total	**$ 8,636**

The Bank had capitalized software assets, net of amortization, of $2 million and $3 million at December 31, 2010 and 2009, respectively. Amortization expense was $2 million for each of the years ended December 31, 2010 and 2009. Capitalized software assets are reported as a component of "Other assets" in the Statements of Condition, and the related amortization is reported as a component of "Operating expenses: Other" in the Statements of Income and Comprehensive Income.

10. COMMITMENTS AND CONTINGENCIES

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

At December 31, 2010, the Bank was obligated under noncancelable leases for premises and equipment with remaining terms ranging from 1 to approximately 5 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was $258 thousand and $231 thousand for the years ended December 31, 2010 and 2009, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 2010, were not material.

At December 31, 2010, there were no material unrecorded unconditional purchase commitments or obligations in excess of one year.

Under the Insurance Agreement of the Federal Reserve Banks, each of the Reserve Banks has agreed to bear, on a per incident basis, a share of certain 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 of a Reserve Bank's capital paid-in to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under the agreement at December 31, 2010 or 2009.

11. 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 employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System (OEB) participate in the Retirement Plan for Employees of the Federal Reserve System (System Plan). In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan (BEP), and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Bank (SERP). In addition, under the Dodd–Frank Act, employees of the Bureau can elect to participate in the System Plan. There were no Bureau participants in the System Plan as of December 31, 2010.

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, Board of Governors, and OEB and in the future will provide retirement benefits to certain employees of the Bureau. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. During the years ended December 31, 2010 and 2009, costs associated with the System Plan were not reimbursed by other participating employers.

The Bank's projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2010 and 2009, and for the years then ended, were not material.

Thrift Plan

Employees of the Bank participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System (Thrift Plan). The Bank matches employee contributions based on a specified formula. Effective April 1, 2009, the Bank matches 100 percent of the first 6 percent of employee contributions from the date of hire and provides an automatic employer contribution of 1 percent of eligible pay. For the first three months of the year ended December 31, 2009, the Bank matched 80 percent of the first 6 percent of employee contributions for employees with less than five years of service and 100 percent of the first 6 percent of employee contributions for employees with five or more years of service. The Bank's Thrift Plan contributions totaled $5 million and $4 million for the years ended December 31, 2010 and 2009, respectively, and are reported as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income.

12. POSTRETIREMENT BENEFITS OTHER THAN RETIREMENT PLANS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Retirement Plans

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

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

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

	2010	2009
Accumulated postretirement benefit obligation at January 1	**$ 92.1**	**$ 83.8**
Service cost-benefits earned during the period	3.7	3.0
Interest cost on accumulated benefit obligation	5.3	5.0
Net actuarial (gain) loss	(3.3)	3.5
Contributions by plan participants	1.4	1.3
Benefits paid	(6.0)	(4.8)
Medicare Part D subsidies	0.3	0.3
Accumulated postretirement benefit obligation at December 31	**$ 93.5**	**$ 92.1**

At December 31, 2010 and 2009, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.25 percent and 5.75 percent, respectively.

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

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

	2010	2009
Fair value of plan assets at January 1	$ —	$ —
Contributions by the employer	4.3	3.2
Contributions by plan participants	1.4	1.3
Benefits paid	(6.0)	(4.8)
Medicare Part D subsidies	0.3	0.3
Fair value of plan assets at December 31	$ —	$ —
Unfunded obligation and accrued postretirement benefit cost	**$ 93.5**	**$ 92.1**
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 1.2	$ 1.5
Net actuarial loss	(15.1)	(19.6)
Total accumulated other comprehensive loss	**$ (13.9)**	**$ (18.1)**

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:

	2010	2009
Health care cost trend rate assumed for next year	8.00%	7.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2017	2015

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, 2010 (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	$ 1.6	$ (1.3)
Effect on accumulated postretirement benefit obligation	12.3	(10.2)

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

	2010	2009
Service cost-benefits earned during the period	$ 3.7	$ 3.0
Interest cost on accumulated benefit obligation	5.3	5.0
Amortization of prior service cost	(0.3)	(0.4)
Amortization of net actuarial loss	1.2	1.1
Total periodic expense	**9.9**	**8.7**
Curtailment gain	—	(0.2)
Net periodic postretirement benefit expense	**$ 9.9**	**$ 8.5**
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense (credit) in 2011 are shown below:		
Prior service cost	$ (0.2)	
Net actuarial loss	0.8	
Total	**$ 0.6**	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2010 and 2009, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit costs were 5.75 percent and 6.00 percent, respectively.

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

A curtailment gain associated with restructuring programs that are described in Note 14 was recognized in net income in the year ended December 31, 2009, related to employees who terminated employment during 2009.

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 are reflected in actuarial gain in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were $0.3 million and $0.4 million in the years ended December 31, 2010 and 2009, respectively. Expected receipts in 2011, related to benefits paid in the years ended December 31, 2010 and 2009, are $0.1 million.

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

	Without Subsidy	With Subsidy
2011	$ 4.5	$ 4.2
2012	4.8	4.5
2013	5.1	4.7
2014	5.6	5.1
2015	6.0	5.5
2016–2020	35.1	31.3
Total	**$ 61.1**	**$ 55.3**

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Bank at December 31, 2010 and 2009, were $8 million and $9 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 2010 and 2009 operating expenses were $1 million and $3 million, respectively, and are recorded as a component of "Salaries and benefits" in the Statements of Income and Comprehensive Income.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME AND OTHER COMPREHENSIVE INCOME

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

	Amount Related to Postretirement Benefits Other Than Retirement Plans
Balance at January 1, 2009	**$ (15)**
Change in funded status of benefit plans:	
Net actuarial loss arising during the year	(4)
Amortization of net actuarial loss	1
Change in funded status of benefit plans—other comprehensive loss	(3)
Balance at December 31, 2009	**$ (18)**
Change in funded status of benefit plans:	
Net actuarial gain arising during the year	3
Amortization of net actuarial loss	1
Change in funded status of benefit plans—other comprehensive loss	4
Balance at December 31, 2010	**$ (14)**

Additional detail regarding the classification of accumulated other comprehensive loss is included in Note 12.

14. BUSINESS RESTRUCTURING CHARGES

In 2010, the Reserve Banks announced the consolidation of some of their currency processing operations. As a result of this initiative, currency processing operations performed by the San Antonio Branch will be consolidated into the Houston Branch.

In 2009, the Bank announced that in 2010 it will eliminate its check print-site function, which is the only remaining check operation performed by the Bank.

Before 2009, the Reserve Banks announced the acceleration of their check restructuring initiatives to align the check processing infrastructure and operations with declining check processing volumes. The new infrastructure consolidated operations into two regional Reserve Bank processing sites: one in Cleveland, for paper check processing, and one in Atlanta, for electronic check processing.

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

	2010 Restructuring Plans	2009 Restructuring Plans	2008 and Prior Restructuring Plans	Total
Information related to restructuring plans as of December 31, 2010:				
Total expected costs related to restructuring activity	$ 2.4	$ 1.0	$ 2.9	$ 6.3
Estimated future costs related to restructuring activity	0.9	—	—	0.9
Expected completion date	2011	2010	2009	
Reconciliation of liability balances:				
Balance at January 1, 2009	**$ —**	**$ —**	**$ 2.5**	**$ 2.5**
Employee separation costs	—	1.0	—	1.0
Adjustments	—	—	(0.2)	(0.2)
Payments	—	—	(2.0)	(2.0)
Balance at December 31, 2009	**$ —**	**$ 1.0**	**$ 0.3**	**$ 1.3**
Employee separation costs	1.4	0.1	—	1.5
Adjustments	—	(0.2)	—	(0.2)
Payments	—	(0.7)	(0.3)	(1.0)
Balance at December 31, 2010	**$ 1.4**	**$ 0.2**	**$ —**	**$ 1.6**

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

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

Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 11.

15. SUBSEQUENT EVENTS

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2010. Subsequent events were evaluated through March 22, 2011, which is the date that the Bank issued the financial statements.

In 2010, the Board of Governors engaged Deloitte & Touche LLP (D&T) for the audits of the individual and combined financial statements of the Reserve Banks and the consolidated financial statements of the limited liability companies (LLCs) that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the Federal Reserve Bank of New York. Fees for D&T's services are estimated to be $8.0 million, of which approximately $1.6 million were for the audits of the LLCs.[1] To ensure auditor independence, the Board of Governors requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of Reserve Banks, or in any other way impairing its audit independence. In 2010, the Bank did not engage D&T for any non-audit services.

[1] Each LLC will reimburse the Board of Governors for the fees related to the audit of its financial statements from the entity's available net assets.

Volume of Operations

(UNAUDITED)

	Number of Items Handled (Thousands)		Dollar Amount (Millions)	
	2010	2009	2010	2009
SERVICES TO DEPOSITORY INSTITUTIONS				
CASH SERVICES				
Federal Reserve notes processed	2,819,488	2,772,001	52,863	51,151
Currency received from circulation	2,926,159	2,930,894	52,905	51,736
Coin received from circulation	1,535,617	599,886	163	100
CHECK PROCESSING				
Commercial—processed	—	70,699	—	59,496
Check 21 Substitute Check—processed	731,060	844,594	773,039	885,536
LOANS				
Advances made	156*	594*	3,132	29,574

** Individual loans, not in thousands.*

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AIDS researcher
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Martina Navratilova
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Fareed Zakaria
Journalist
India

Elias Zerhouni
NIH director
Algeria

About the Dallas Fed

The Federal Reserve Bank of Dallas is one of 12 regional Federal Reserve Banks in the United States. Together with the Board of Governors in Washington, D.C., these organizations form the Federal Reserve System and function as the nation's central bank. The System's basic purpose is to provide a flow of money and credit that will foster orderly economic growth and a stable dollar. In addition, Federal Reserve Banks supervise banks and bank holding companies and provide certain financial services to the banking industry, the federal government and the public.

The Federal Reserve Bank of Dallas has served the financial institutions in the Eleventh District since 1914. The district encompasses 360,000 square miles and comprises the state of Texas, northern Louisiana and southern New Mexico. The three branch offices of the Dallas Fed are in El Paso, Houston and San Antonio.

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