

## Note 25. Disclosure Entities and Related Parties

SFFAS No. 47, *Reporting Entity* provides criteria for identifying organizations that are consolidation entities, disclosure entities and related parties, and how such organizations are reported within the *Financial Report*. For consolidation entities, the assets, liabilities, results of operations, and related activity are consolidated into the government's financial statements. For disclosure entities and related parties, balances and transactions with such entities are included in the financial statements and certain information about their relationship with the federal government is disclosed in the notes to the consolidated financial statements. Disclosure entities and related parties are important to the *Financial Report* but are not consolidated into the government's financial statements.

### Disclosure Entities

Disclosure entities are organizations similar to consolidation entities in that they are either (a) in the budget, (b) majority owned by the government, (c) controlled by the government, or (d) would be misleading to exclude. Disclosure entities have a greater degree of autonomy with the government than consolidation entities. In addition, organizations may be owned or controlled by the government as a result of (a) regulatory actions (such as organizations in receivership or conservatorship) or (b) other government intervention actions. Under such regulatory or other intervention actions, if the relationship with the government is not expected to be permanent, such entities generally would be classified as disclosure entities based on their characteristics taken as a whole.

Based on the criteria in GAAP for federal entities, the disclosure entities in the *Financial Report* are FR System, Fannie Mae, Freddie Mac, and National Railroad Passenger Corporation (more commonly referred to as Amtrak). In addition, there are additional disclosure entities reported by component reporting entities that do not meet the qualitative or quantitative criteria in SFFAS No. 47 to be reported in the *Financial Report*.

### Federal Reserve System

Congress, under the *Federal Reserve Act of 1913* (Federal Reserve Act), created the FR System. The FR System includes the Federal Reserve Board of Governors (Board), the FRBs, and Federal Open Market Committee (FOMC). Collectively, the FR System serves as the nation's central bank and is responsible for formulating and conducting monetary policy, issuing and distributing currency (Federal Reserve Notes), supervising and regulating financial institutions, providing nationwide payment systems (including large-dollar transfers of funds, Automated Clearing House (ACH) operations, and check collections), providing certain financial services to federal entities and fiscal principals, and serving as the U.S. government's bank. Monetary policy includes actions undertaken by the FR System that influence the availability and cost of money and credit as a means of helping to promote national economic goals. The FR System also conducts 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 its central bank responsibilities. The FR System is considered an independent central bank, and the executive branch of the government does not ratify its decisions.

The 12 FRBs are chartered under the Federal Reserve Act, which requires each member bank to own the capital stock of its FRB. Each FRB has a board of directors that exercises supervision and control of each FRB, with three members appointed by the Board, and six board members elected by their member banks. The FRBs participate in formulating and conducting monetary policy, distributing currency and coin, and serving as the government's fiscal agent, as well as the fiscal agent for other federal entities and fiscal principals. Fiscal principals, generally speaking, relate to banks, credit unions, savings and loans institutions. Additionally, the FRBs provide short-term loans to depository institutions and loans to participants in programs or facilities with broad-based eligibility in unusual and crucial circumstances when approved by the Board and the Secretary of the Treasury.

The government interacts with FRBs in a variety of ways, including the following:

- The FRBs serve as the government's fiscal agent and depository, executing banking and other financial transactions on the government's behalf. The government reimburses the FRBs for these services, the cost of which is included on the Statements of Net Cost;
- The FRBs hold Treasury and other federal securities in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy (see Note 11—Federal Debt Securities Held by the Public and Accrued Interest);
- The FRBs hold gold certificates issued by the government in which the certificates are collateralized by gold (see Note 2—Cash and Other Monetary Assets);
- The FRBs hold SDR certificates issued by the government which are collateralized by SDRs (see Note 2—Cash and Other Monetary Assets); and,

- The FRBs are required by Board policy to transfer their excess earnings to the government, which are included in Other Taxes and Receipts on the Statements of Operations and Changes in Net Position.

- **Federal Reserve System Structure**

The Board is an independent organization governed by seven members who are appointed by the President and confirmed by the Senate. The full term of a Board member is 14 years, and the appointments are staggered so that one term expires on January 31 of each even-numbered year. The Board has a number of supervisory and regulatory responsibilities for institutions including, among others, state-chartered banks that are members of the FR System, bank holding companies, and savings and loan holding companies. In addition, the Board has general supervisory responsibilities for the 12 FRBs, and issues currency (Federal Reserve Notes) to the FRBs for distribution.

The FOMC is comprised of the seven Board members and five of the 12 FRB presidents, and is charged with formulating and conducting monetary policy primarily through open market operations (the purchase and sale of certain securities in the open market), the principal tool of national monetary policy. These operations affect the amount of reserve balances available to depository institutions, thereby influencing overall monetary and credit conditions.

The 12 FRBs are chartered under the Federal Reserve Act, which requires each member bank to own the capital stock of its FRB. Supervision and control of each FRB is exercised by a board of directors, of which three are appointed by the Board of the FR System, and six are elected by their member banks. The FRBs participate in formulating and conducting monetary policy, distribute currency and coin, and serve as fiscal agents for the government, and other federal entities. Additionally, the FRBs provide short-term loans to depository institutions and loans to participants in programs or facilities with broad-based eligibility in unusual and exigent circumstances when approved by the Board and the Secretary of the Treasury.

- **Federal Reserve Monetary Policy Action**

During fiscal year 2018, the Federal Reserve FOMC gradually raised its target range for the federal funds rate and gradually reduced its securities in the SOMA. The Federal Reserve raised its target range for the federal funds rate from 1.0 – 1.25 percent in September 2017, to 2.0 – 2.25 percent in September 2018. The Federal Reserve reduced its U.S. Treasury and federal agency and government-sponsored enterprise mortgage-backed securities in the SOMA on its balance sheet from approximately \$4.4 trillion as of September 30, 2017, to approximately \$4.1 trillion as of September 30, 2018.

- **Federal Reserve System Assets, Liabilities, Revenues, Expenses, Gains, and Losses**

The FRBs hold Treasury and other securities in the SOMA for the purpose of conducting monetary policy. As of September 30, 2018, Treasury securities held by the FRBs totaled \$1,782.5 billion, which excludes \$531.8 billion in Treasury Securities used in overnight reverse repurchase transactions. As of September 30, 2017, Treasury securities held by the FRBs totaled \$1,964.7 billion, which excludes \$502.0 billion in Treasury securities used in overnight reverse repurchase transactions. Such securities are included in federal debt securities held by the public and accrued interest (see Note 11—Federal Debt Securities Held by the Public and Accrued Interest). For fiscal years ended September 30, 2018, and 2017, Treasury incurred interest cost relating to the FRB's U.S. Treasury holdings amounting to \$64.1 billion and \$63.8 billion, respectively, which is included in interest on Treasury securities held by the public on the Statement of Net Cost. Unrestricted Cash held on deposit at the FRBs as of September 30, 2018, and 2017, was \$378.5 billion and \$153.3 billion, respectively, and are included in cash and other monetary assets. In addition, restricted cash as of September 30, 2018, and 2017, was \$31.6 billion and \$26.1 billion, respectively; a significant portion is held on deposit at the FRBs (see Note 2—Cash and Other Monetary Assets).

Treasury securities are generally subject to the same market (principally interest-rate) and credit risks as other financial instruments. In the open market, the FRBs purchase and sell Treasury securities as a mechanism for controlling the money supply.

Financial and other information concerning the FR System, including financial statements for the Board and the FRBs, may be obtained at <https://federalreserve.gov>.

- **FRB Residual Earnings Transferred to the Government**

FRBs generate income from interest earned on securities, reimbursable services provided to federal entities, and the provision of priced services to depository institutions, as specified by the *Monetary Control Act of 1980*. Although the FRBs generate earnings from carrying out open market operations (via the earnings on securities held in the SOMA account), their execution of these operations is for the purpose of accomplishing monetary policy rather than generating earnings. Each FRB is required by Board policy to transfer to the government its residual (or excess) earnings, after providing for the cost of operations, payment of dividends, and surplus funds not to exceed an FRB's allocated portion

of an aggregate of \$7.5 billion for all FRBs. These residual earnings may vary due to, among other things, changes in the SOMA balance levels that may occur in conducting monetary policy. If an FRB's earnings for the year are not sufficient to provide for the cost of operations, payment of dividends, or allocated portion of \$7.5 billion aggregate surplus funds limitation, an FRB will suspend its payments to the government until such earnings become sufficient. These funds are part of restricted cash at the Federal Reserve (see Note 2—Cash and Other Monetary Assets). The FRB residual earnings of \$70.8 billion and \$81.3 billion for fiscal years ended September 30, 2018, and 2017, respectively, are reported as other taxes and receipts on the Statements of Operations and Changes in Net Position. Accounts and taxes receivables, net, includes a receivable for FRB's residual earnings which represents the earnings due to the General Fund as of September 30, but not collected by the General Fund until after the end of the month. As of September 30, 2018, and 2017, accounts receivable on FRB's residual earnings are \$0.4 billion and \$0.3 billion, respectively (see Note 3—Accounts and Taxes Receivables, Net).

### **Fannie Mae and Freddie Mac**

In 2008, during the financial crisis, the government placed Fannie Mae and Freddie Mac under conservatorship to help ensure their financial stability. For fiscal year 2018, these entities meet the criteria in SFFAS No. 47, for disclosure entities as both (a) "receiverships and conservatorships," and, (b) as entities wherein "federal government intervention actions resulted in control or ownership" with intervention actions not expected to be permanent. Accordingly, these entities are not consolidated into the *Financial Report*. This treatment is consistent with the reporting for these entities in fiscal year 2017 under SFFAC No. 2, *Entity and Display* (see Note 8—Investments in Government-Sponsored Enterprises for additional information).

### **Amtrak**

Amtrak was incorporated in 1971 pursuant to the *Rail Passenger Service Act of 1970* and is authorized to operate a nationwide system of passenger rail transportation. Amtrak is a private, for-profit corporation under 49 U.S.C. § 24301 and District of Columbia law. It is not a department, entity, or instrumentality of the federal government. Amtrak's classification as a disclosure entity is attributed to (a) being listed in the budget, (b) is financed mostly by sources other than taxes, and (c) governed by an independent Board of Directors comprised of 10 directors. The Secretary of Transportation (Secretary), who is a director by statute, and eight of the other Amtrak directors, are appointed by the President with the advice and consent of the U.S. Senate. The 10<sup>th</sup> board member, appointed by the board, is the President and Chief Executive Officer of Amtrak. Amtrak does not take actions on behalf of the government but benefits the national economy by providing a transportation option in 46 states and the District of Columbia.

The government (through the DOT) owns 100% of Amtrak's preferred stock (109,396,994 shares of \$100 par value). Each share of preferred stock is convertible into ten shares of common stock. The common stockholders have voting rights for "amendments to Amtrak's Articles of Incorporation proposed by the Board of Directors and for certain other extraordinary events." Although Section 4.02(g) of the Amtrak Articles of Incorporation allow for the conversion of preferred stock to common stock, the government would not convert its holdings without Congressional authorization. The government does not recognize the Amtrak preferred stock in its financial statements because, under the corporation's current financial structure, the preferred shares do not have a liquidation preference over the common shares, the preferred shares do not have any voting rights, and dividends are neither declared nor in arrears.

In addition to the purchase/ownership of the Amtrak preferred stock, the government has provided funding to Amtrak, since 1972, primarily through grants and loans. Amtrak receives grants from the government that cover a portion of the corporation's annual operating expenses and capital investments. Funding provided to Amtrak through grant agreements are included in the government's annual budget. Amtrak has a history of recurring operating losses and is dependent on subsidies from the government to operate. Amtrak's ability to continue operating in its current form is dependent upon the continued receipt of subsidies from the government.

The government has possession of two long-term notes with Amtrak. The first note is for \$4.0 billion and matures in 2975 and, the second note is for \$1.1 billion and matures in 2082 with renewable 99-year terms. Interest is not accruing on these notes as long as the current financial structure of Amtrak remains unchanged. If the financial structure of Amtrak changes, both principal and accrued interest are due and payable. The government does not recognize the long-term notes in its financial statements since the notes, with maturity dates of 2975 and 2082, are considered fully uncollectible due to the lengthy terms, Amtrak's history of operating losses, and ability to generate funds for repayment.

Financial and other information concerning Amtrak including financial statements may be obtained at <https://www.amtrak.com/reports-documents>.

## Related Parties

Related parties exist if the existing relationship, or one party to the existing relationship, has the ability to exercise significant influence over the party's policy decisions. Related parties do not meet the principles for inclusion, but are reported in the *Financial Report* if they maintain relationships of such significance that it would be misleading to exclude.

Based on the criteria in SFFAS No. 47, the related parties reported in the *Financial Report* are Federal Home Loan Banks (FHLBanks), IMF, Multilateral Banks, and Private Export Funding Corporation (PEFCO). In addition, there are additional related parties reported by component reporting entities that do not meet the criteria to be reported in the *Financial Report*.

### Federal Home Loan Banks

The government is empowered with supervisory and regulatory oversight of the 11 FHLBanks. The government is responsible for ensuring that each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal control, and carries out its housing and community development finance missions. Each FHLBank operates as a separate federally chartered corporation with its own board of directors, management, and employees. The FHLBanks were organized under the *Federal Home Loan Bank Act of 1932* and are GSEs. The FHLBanks are not government entities and do not receive financial support from taxpayers. The government does not guarantee, directly or indirectly, the debt securities or other obligations of FHLBanks. The FHLBanks are regulated by the FHFA, an independent federal entity.

By law, in the event of certain adverse circumstances, Treasury is authorized to purchase up to \$4.0 billion of obligations of the FHLBanks. Treasury has not used such authority. Also, in accordance with the *Government Corporations Control Act*, Treasury prescribes certain terms concerning the FHLBanks issuance of obligation to the public. Financial and other information concerning FHLBanks including financial statements may be obtained at <http://www.fhlbanks.com/>.

### International Monetary Fund and Multilateral Development Banks

The government currently maintains related party relationships with the IMF and the MDBs. The IMF is an international organization of 189 member countries that works to foster global monetary cooperation, secure financial stability, sustain economic growth, and reduce poverty around the world. The government holds the largest quota subscription of any member. The government's quota subscription serves as the key determinant for the government's 16.5 percent share of voting rights in various IMF decisions for which the government has a substantial voice. Since certain key IMF determinations require approval by at least 85 percent of the total voting power, the government (represented by the Secretary of the Treasury) exercises significant influence via its 16.5 percent voting share. The government's holdings in the IMF are in the form of highly liquid and interest-bearing instruments. The government has a liability due to the IMF, as well as an additional commitment (see Note 16—Other Liabilities and Note 19—Commitments for additional information). Historically, the government has not experienced a loss of value on its IMF holdings and management does not believe it is likely that the government will experience future losses on its holdings or as a result of its additional commitments.

Additionally, the government invests in and provides funding to the MDBs to support poverty reduction and promote sustainable economic growth in developing countries. The MDBs provide financial and technical support to foster economic growth and entrepreneurship, strengthen institutions, address the root causes of instability in fragile and conflict-affected countries, and respond to global crisis. The government's participation in the MDBs is in the form of financial contributions used to ensure the effectiveness and impact of the MDBs' global development agenda. The U.S. has voting power in each of the MDBs to which it contributes, ranging from approximately 6 percent to 50 percent (see Note 19—Commitments for additional information).

### Private Export Funding Corporation

The financial statements reflect the results of agreements with PEFCO. PEFCO, which is owned by a consortium of private-sector banks, industrial companies and financial services institutions, makes and purchases from private sector lenders, medium-term and long-term fixed-rate and variable-rate loans guaranteed by EXIM Bank to foreign borrowers to purchase U.S. made equipment "export loans."

EXIM Bank's credit and guarantee agreement with PEFCO provides that EXIM Bank will guarantee the due and punctual payment of interest on PEFCO's secured debt obligations which EXIM Bank has approved, and grants to EXIM Bank a broad measure of supervision over PEFCO's major financial management decisions, including the right to have representatives be present in all meetings of PEFCO's board of directors, advisory board, and exporters' council, and to review PEFCO's financials and other records. However, EXIM Bank does not have voting rights and does not influence normal operations. This agreement extends through December 31, 2020.

In addition, PEFCO has an agreement with EXIM Bank which provides that EXIM Bank will generally provide PEFCO with an unconditional guarantee covering the due and punctual payment of principal and interest on export loans PEFCO

makes and purchases. PEFCO's guarantees on the export loans plus the guarantees on the secured debt obligations aggregating to \$5,196.6 million at September 30, 2018 and \$6,120.0 million at September 30, 2017, are included by EXIM Bank in the total for guarantee, insurance and undisbursed loans and the allowance related to these transactions.

EXIM Bank received fees totaling \$40.8 million in fiscal year 2018 and \$60.7 million in fiscal year 2017 for the agreements.