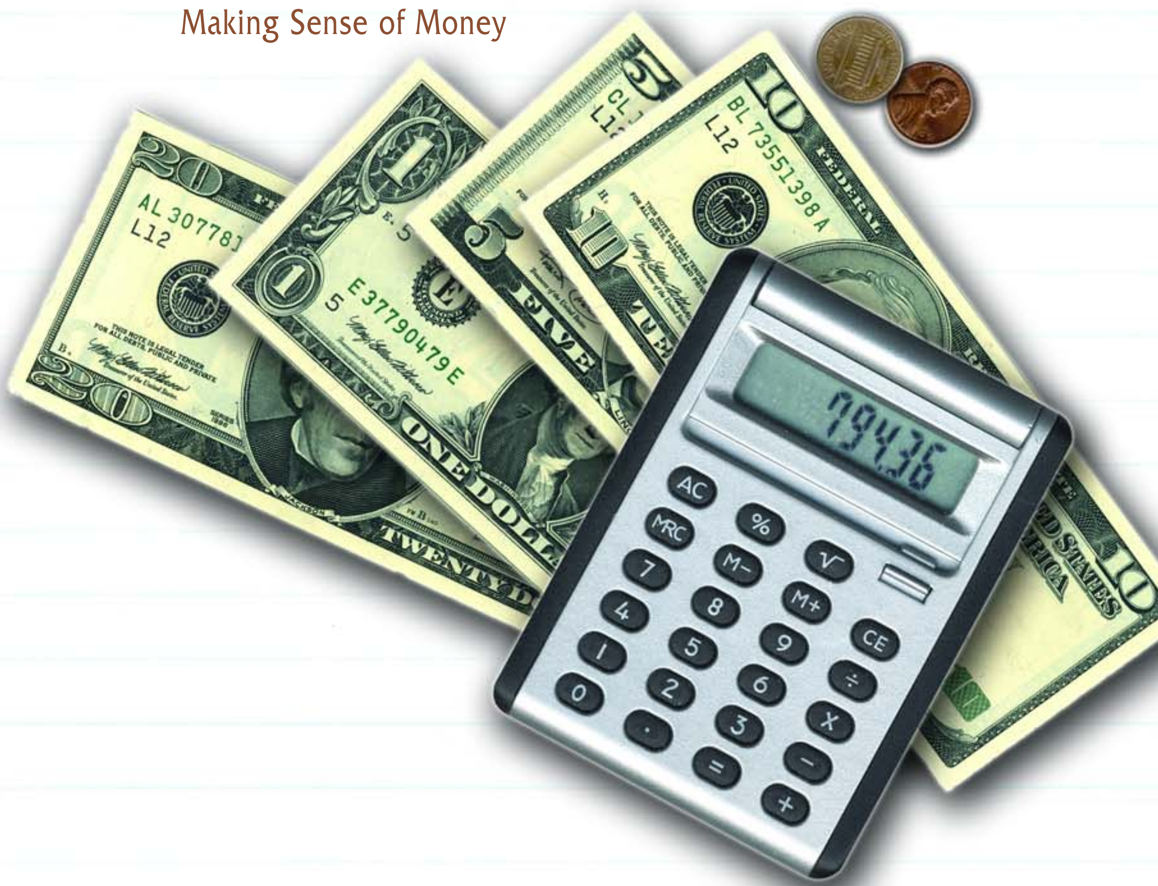
2002 Annual Report

Personal Financial Education

Making Sense of Money



FEDERAL RESERVE BANK OF SAN FRANCISCO

Manage Credit Wisely

Take Charge

Set Goals

Start Saving

Plan Your Financial Future

Manage Credit Wisely

Plan Your Financial Future

Set Goals

Start Saving

Plan Your Financial Future

Manage Credit Wisely

Protect Your Credit Rating

Start Saving

Take Charge

Table of Contents

George M. Scalise
Deputy Chairman
(Seated)

Robert T. Parry
President
(Standing)

John F. Moore
First Vice President
(Standing)

Nelson C. Rising
Chairman
(Seated)

Letter from the Boardroom

During 2002 we continued to address the challenges posed by the dramatic changes in the financial services marketplace. In recent years new technologies and financial deregulation have led to the emergence of nationwide branch networks, nonbank competitors, and a rapid shift to e-commerce. Within this new financial landscape, our District and others throughout the Federal Reserve were particularly challenged in our retail payments area by the reality that the long-expected move toward more efficient electronic payments is reducing the volume of checks that are written.

To address this trend, the Federal Reserve re-emphasized its commitment to remain a leader in providing payments services and, at the same time, announced intentions to streamline its check operations nationwide. Anticipating this change, our District refocused its payments business strategy to streamline operations, gain efficiencies, and control costs by realigning staffing levels with check volumes, more carefully targeting our business development efforts to the demands of the new marketplace, and offering new products to financial institutions. By doing so, we are better positioned to remain a competitive provider of financial services.

Financial and technological innovations also are dramatically impacting consumers, requiring greater financial sophistication when it comes to personal money management. Recognizing this impact, our Bank joined the other Reserve Banks around the country to increase the Federal Reserve's involvement in personal financial education. In this report, we look at the new world of money: the complexity that underscores the need for personal financial education now more than ever before, the benefits and challenges for consumers in the marketplace, and Federal Reserve resources and programs to help consumers "make sense of money." From a policymaker's perspective, knowledgeable financial consumers stimulate competition and innovation to support the health and productivity of our economy. This report also looks at economic factors contributing to the need for personal financial education and profiles innovative financial education programs in the Twelfth District.

We would like to take this opportunity to thank our employees for their commitment, innovative spirit, and talent, all of which contributed to our ability to address the challenges we faced during 2002.

We also would like to extend our thanks and appreciation to our Twelfth District directors for their invaluable counsel during 2002. The directors' independent assessment of economic and financial conditions throughout our nine western states is critical to the formulation of monetary policy. In particular, we acknowledge the many contributions of Robert S. Attiyeh (Senior Vice President and Chief Financial Officer (Retired) and Consultant, Amgen, Inc., Thousand Oaks, California) and of E. Lynn Caswell (Chairman and Managing Director, Zurich American Trust Company, AG, Laguna Niguel, California), both of whom completed their terms of service on the Head Office Board at the end of 2002 after serving six years each in that capacity.

In addition, we would like to express our sincere thanks and appreciation to the other directors and advisory council members who concluded their terms of service during 2002:

- on the Los Angeles Branch Board: Lori R. Gay (President, Los Angeles Neighborhood Housing Services, Inc., Los Angeles, California); John H. Gleason (Real Estate Development Consultant, California and Texas, ComPlan Advisory, LLC, Scottsdale, Arizona).
- on the Portland Branch Board: Nancy Wilgenbusch (President, Marylhurst University, Marylhurst, Oregon) who served as chairman of the Portland Branch Board for the last four years of her term; Phyllis Bell (President (Retired), Oregon Coast Aquarium, Newport, Oregon); Martin Brantley (President and General Manager (Retired), Oregon's 12-KPTV, Portland, Oregon). We also wish to acknowledge the contributions of former Portland Branch Board director Guy Williams of Coos Bay, Oregon—we were saddened to learn of his death in the fall of the year.
- on the Salt Lake City Branch Board: Maria Garciaz (Executive Director, Salt Lake Neighborhood Housing Services, Inc., Salt Lake City, Utah); J. Pat McMurray, (President and Chief Executive Officer, Idaho Region, Wells Fargo Bank, Boise, Idaho).
- on the Seattle Branch Board: Boyd E.Givan (Senior Vice President and Chief Financial Officer (Retired), The Boeing Company, Seattle, Washington) who served as chairman of the Seattle Branch Board for his final year; James C. Hawkanson (Chairman of the Board (Retired), The Commerce Bank of Washington, N.A., Seattle, Washington).
- on the Twelfth District Advisory Council: Robert L. Vice (President, BLV, Agribusiness Consultants, Fallbrook, California) who served as chairman of the Advisory Council the final year of his term; Lawrence S. Okinaga, (Partner, Carlsmith Ball, Honolulu, Hawaii).

Nelson C. Rising
Chairman

Robert T. Parry
President

No matter who you are, making informed financial decisions about what to do with your money will help build a more stable financial future for you and your family.

Federal Reserve Chairman Alan Greenspan

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Personal Financial Education

Making Sense of Money

No matter who you are, there's a lot to learn about money. On the face of it, this sounds straightforward, but technological innovations and a profusion of financial products make money management more complex—and financial education more important—than ever before.

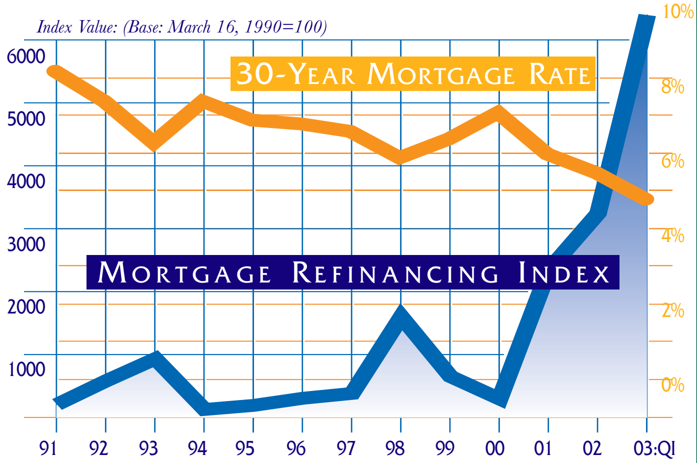
Consider this. Even when choosing basic financial products such as checking and savings accounts, today's consumers face a myriad of options compared to the traditional one-size-fits-all accounts of the past. Checking options include free, no interest accounts; fee-based, interest-bearing accounts; ATM-only accounts; and even plans tailored for college students, just to name a few. Savings options can include no fee, low interest accounts; market rate accounts with limited check-writing privileges; higher interest, higher cash balance accounts with limited transaction privileges; and indexed accounts.

Consumers often reap additional benefits when choosing financial services such as pay by phone, online banking, automatic bill pay, telephone banking, and credit card tie-ins. More decisions come into play if consumers opt to integrate checking, savings, and investment accounts into a portfolio of products. While these innovations provide consumers with greater options for tailoring personal financial plans, their complexity underscores the need for financial education. Like learning to drive a car safely, consumers must learn to navigate a complex financial road map to reach their goals.

Consumers shopping for mortgage loans or refinancing face a similar proliferation of choices that requires financial knowledge to make sound decisions. Even when choosing a standard 30-year mortgage, important financial decisions come into play such as how to evaluate interest rate and loan costs, when to lock-in a rate, and whether or not to pay points. These are not easy decisions and are especially difficult without financial knowledge.

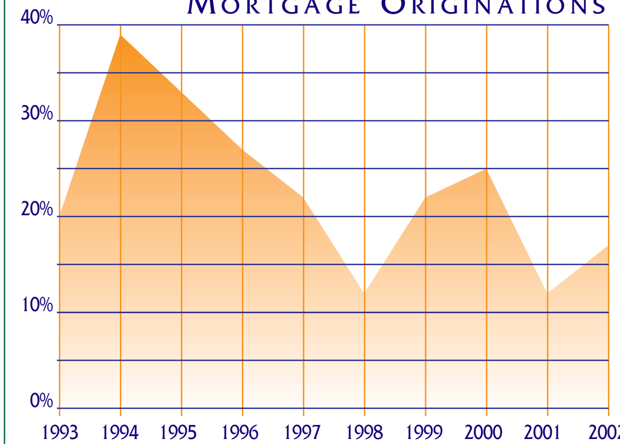
The year 2002 marked the lowest mortgage rates in over three decades. Low rates opened the door for many first-time homeowners to enter the market with fixed- and adjustable-rate mortgages (ARMs). Some adjustable mortgages offer an initial, low "teaser" rate and accompanying low monthly payment that adjusts after a predetermined period of time, anywhere from one month to seven years based on specified indices, with or without an interest rate cap. Other mortgage choices for homebuyers include zero or low down

Record Low Mortgage Rates in 2002 Led to a Record Year for Mortgage Refinancings



Sources: Mortgage Bankers Association of America and Freddie Mac

ARM Market Share as a Percentage of Total Mortgage Originations



Source: Mortgage Bankers Association of America

payment options. These alternatives usually require consumers to pay higher interest rates and private mortgage insurance if their down payments are less than 20 percent of the purchase price. Another option among the many available is an interest-only loan. These loans feature lower interest rates and low monthly payments as incentives, but result in the borrower not paying down any principal for a period of time—typically five to ten years—leaving an unchanged loan balance at the end of the period.

Like basic banking products, mortgage loan variations can enhance consumer welfare for those who understand the financial trade-offs. First-time homebuyers, homeowners who are more risk-tolerant, or those who are just beginning their working careers may prefer the trade-offs offered by an ARM or an interest-only loan, but these options may not be the best choices. Over time consumers opting for these loans may incur higher interest rates and/or negative amortization.

Zero or low down payment options provide opportunities for more consumers to get into the housing market, but may pose risks due to the higher monthly payments. The bottom line when considering mortgage options or other financial products is that the complexity and variety of choices require consumers to take an active, informed role when evaluating products. Without training or education, making personal financial decisions can be a confusing, frustrating, and even dangerous road to maneuver.

All-in-One Banking, Insurance, and Securities Services

When perusing financial services offered by banks, insurance companies, and securities brokerages, consumers may observe that many of the products are similar. Facilitated by the gradual relaxation of legal and regulatory restrictions, including major banking financial modernization legislation passed in 1999, the banking industry has evolved dramatically. While banks used to focus primarily on accepting deposits and making loans, they now may affiliate under common ownership with insurance companies, securities firms, and other nonbank entities to offer their customers a complete range of financial services. As a result, today's consumers can engage in "one stop" shopping, choosing from a host of financial products including investment, insurance, retirement, college tuition, and traditional banking services. As the lines between financial service providers blur and product complexity increases, consumers need the financial know-how to decipher features, including differentiating between insured and uninsured products, to make sound financial decisions.

Banking Evolution Meets Technology Revolution

The financial services boom and its impact on the need for personal financial education would not be as explosive without the push of technology and the Internet. Consumers can bank online, shop for mortgages at lending portals, and open e-brokerage accounts for their online investment portfolios. The impact of technology behind the scenes is just as dramatic. Using new technologies, consumer preferences can be matched with product offerings for targeted marketing campaigns. Credit scoring models use sophisticated technology to develop customer credit profiles that are the industry standard for assessing consumers' credit qualifications for mortgage products and other financial services.

The use of technology to fine-tune credit profiles has opened the door to a proliferation of new financial options for consumers who may not have been able to qualify under traditional credit standards. For example, with financial innovation and market deregulation, subprime mortgage lending has grown tremendously since the early 1990s, providing new homeownership opportunities for consumers with a limited or impaired credit history. To obtain these loans, consumers pay interest rates that are higher than market rates. According to data reported by *Inside B&C Lending*, a mortgage finance trade publication, subprime lending originations rose from $138 billion in 2000 to $173 billion in 2001, to a record high of $213 billion in 2002.

The rapid wave of technological and financial innovation requires greater sophistication from consumers and more personal responsibility to benefit from new financial opportunities. Consumer education is critical to dissect the marketing of financial products and to understand the implications of credit scoring and financial parameters associated with specialized products such as subprime loans.

Increase in Deceptive Lending Practices

Along with providing consumers with more choices, market innovation and deregulation have opened the door to an unsettling trend—a rise in deceptive lending. For mortgage products, deceptive lending practices may involve excessive fees and interest rates, "loan flipping" (frequent refinancing), unnecessary insurance, overly restrictive payment conditions, and misrepresentation of the impact of financial terms such as balloon payment loans. In extreme situations, predatory lending arrangements are explicitly formulated to lead to "equity stripping" and foreclosure.

The degree of predatory lending is difficult to measure, but anecdotal evidence indicates it is a serious problem. While legislation has been passed to curb abuses, overly restrictive laws may close the door to credit opportunities for previously underserved consumers. As a result, financial education is viewed as an important part of the solution. Many homeownership programs include anti-predatory lending educational components. In recent years, lenders and community organizations have partnered to launch awareness campaigns to educate and empower consumers.

Rise in Consumer Debt and Personal Bankruptcies, Drop in Personal Saving

Significant changes in personal financial conditions on the heels of the phenomenal growth of the "new economy" highlight policymakers' concerns over the need for personal money management. Consumer credit was a primary source of consumer spending during the 1990s and continued to expand through most of 2002. As measured by Federal Reserve Board quarterly household debt-service data, consumer debt hit a 20-year high in 2001, averaging just under 14.4 percent of disposable income. This measure dropped only slightly by the third quarter of 2002 to 14 percent.

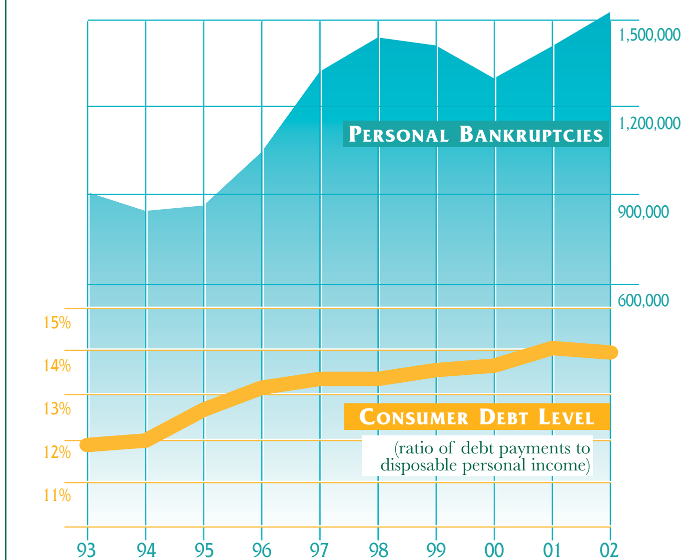
During 2002 a record number of personal bankruptcies added to the unsteady financial climate for consumers. According to data reported by the Administrative Office of the United States Courts, personal bankruptcies hit just over 1.5 million in 2002, a 6 percent increase over those recorded in 2001.

Lower personal saving may be another factor contributing to consumers' financial vulnerability. The U.S. personal saving rate has edged markedly lower since the 1980s when it averaged 8 percent according to the Federal Reserve Board's February 2003 *Monetary Policy Report*. In 2001 personal saving averaged 2.25 percent, rising to nearly 4 percent in 2002. Economists debate the saving measure because it doesn't reflect capital gains and pension contributions, but they clearly recognize the importance of saving as the basis for accumulating assets and mitigating personal financial setbacks.

Viewed together, all of these factors point to the need for personal financial education to help consumers plan for unforeseen economic shocks that may leave them financially vulnerable.

The new financial services marketplace offers the potential to enhance personal welfare and expand financial opportunities for knowledgeable consumers. Within this new marketplace, there is one certainty—the pace of financial and technological innovation will continue to increase and grow more complex. Sophisticated financial knowledge will be a prerequisite for consumers to take advantage of and keep pace with new financial opportunities. The challenge within this complex environment will be ensuring that everyone—regardless of their education, income, or age—has financial knowledge to benefit from these new opportunities.

Personal Bankruptcies and Consumer Debt Levels Increased over the Past Decade



Sources: Administrative Office of the United States Courts and Federal Reserve Board

Federal Reserve Financial Education Programs

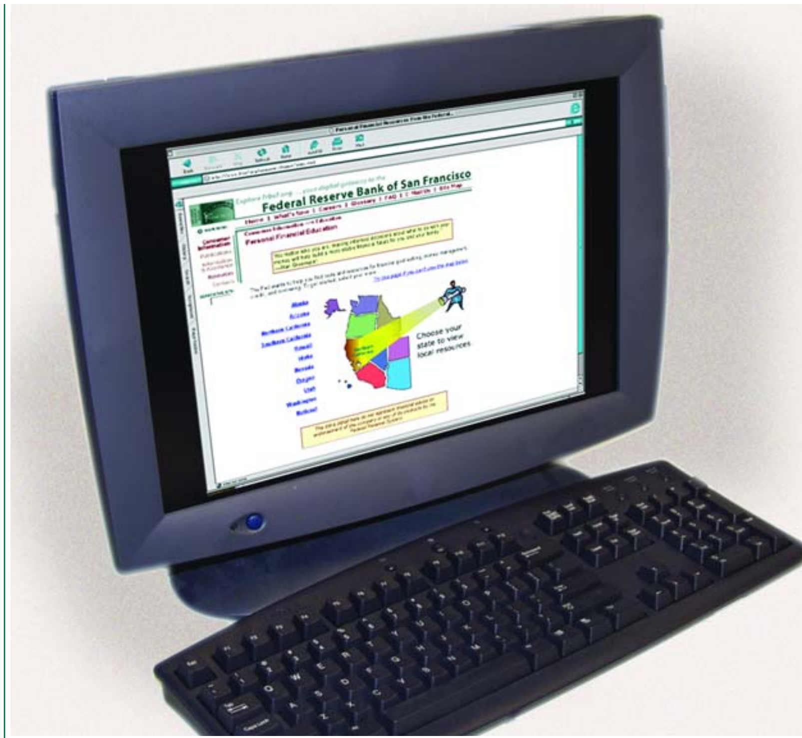
The San Francisco Reserve Bank and the other Reserve Banks around the country work with financial institutions, educational organizations, nonprofits, and public and private groups encouraging them to develop financial education resources and deliver programs. "Fostering these partnerships helps the Federal Reserve support its regulatory responsibilities related to the Community Reinvestment Act, which requires banks to meet the credit needs of their local communities including low- and moderate-income neighborhoods," says Joy Hoffmann, vice president of Community Affairs and Public Information. The San Francisco Reserve Bank's involvement in personal financial education takes numerous forms. The Bank actively leads and influences change in its local communities to help develop asset-building opportunities, credit access, and banking services for underserved consumers including immigrant markets. As a natural outgrowth of local efforts, the Bank has spearheaded a number of national programs, including the development of a national outreach strategy for Native American financial training.

The Bank's financial education outreach to educators involves sponsoring workshops and programs to bring financial education into the classroom. *Econ Ed and the Fed*, the Bank's economic education newsletter, reaches approximately 16,000 teachers throughout the West, spotlighting financial education topics and resources.

During 2002 the Federal Reserve System took part in numerous efforts to increase the visibility of personal financial education as a critical policy issue. Federal Reserve Chairman Alan Greenspan provided testimony on the importance of improving financial literacy for consumers before the U.S. Senate Committee on Banking, Housing, and Urban Affairs during hearings on financial literacy and education in America. Partnering with the National Council on Economic Education, the Minneapolis Reserve Bank convened a national summit attended by policymakers, educators, and business and community leaders from around the country with the goal of creating a road map to raise the nation's financial and economic literacy level through effective pre-college education.

In the first quarter of 2003 the Federal Reserve launched a national initiative that includes a public service announcement (PSA) and Web-based and printed resources to help consumers and Federal Reserve employees learn more about personal financial education. Federal Reserve Chairman Alan Greenspan is featured in the PSA, which debuted first for Federal Reserve employees. Reserve Banks around the country, including San Francisco, have augmented national materials with regional financial education resources and programs to help consumers and Federal Reserve employees in their local communities. The Federal Reserve Bank of San Francisco's Web site, frbsf.org, includes a section devoted to personal financial resources in the Twelfth District, along with online consumer resources covering credit and banking topics.

Moving forward, Hoffmann says encouraging research into what works in financial education will be an important focus for the Federal Reserve and the San Francisco Reserve Bank as will continuing active support of local initiatives. "Through our own research and partnerships with organizations working on the issue, we will be able to build upon existing programs, develop new ones, and make a difference with a wide range of audiences in need of financial education."



Visitors to the San Francisco Fed's financial education Web page click on a state in the Twelfth District to view local resources: frbsf.org/consumer/finance/index.html

The four programs profiled on the following pages demonstrate the Bank's commitment to financial education and illustrate common programs, their audiences, and goals. The programs include one aimed at Federal Reserve employees, one geared toward high school audiences, one focused on saving and homeownership opportunities in low- to moderate-income neighborhoods, and one promoting financial education for Native communities.

The majority of company savings and retirement programs are employee-directed contribution plans. Employees must elect to participate in the plans, then independently manage and invest their funds among options offering varying degrees of risk. Employee-directed plans increase an employee's responsibility to become a knowledgeable investor as decisions can have lifetime consequences—especially for those who don't participate. A survey cited in the November 2002 Federal Reserve Bulletin article, "Financial Literacy: An Overview of Practice, Research and Policy," indicates that as many as 30 percent of eligible employees do not participate in their employer retirement plans despite benefits such as employer matching components offered by some companies. Recognizing employee education is an important focus for financial education efforts, the Federal Reserve turned its attention inward in 2002, bringing a new financial education program to employees.

Financial Education for Employees

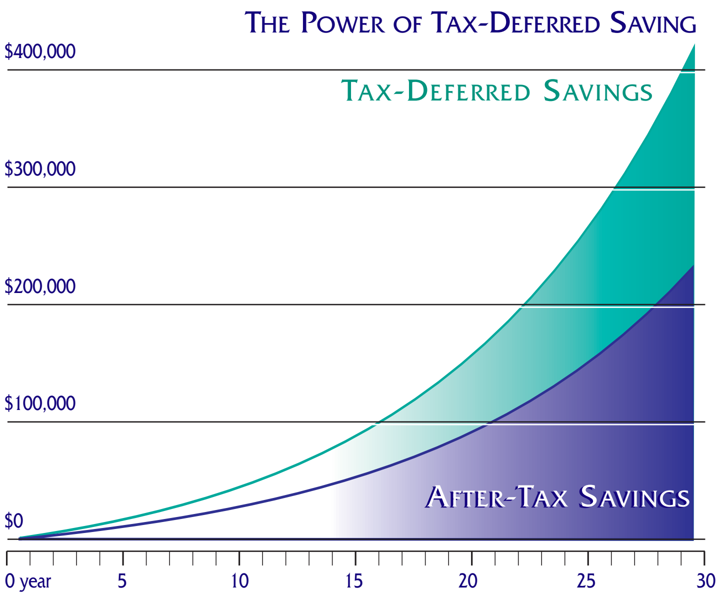
Federal Reserve System

During 2002 the Federal Reserve offered a retirement planning seminar for employees age 50 and older, the first in a series of personal financial planning seminars the Fed intends to offer its employees. San Francisco Reserve Bank President Robert T. Parry attended the seminar to view firsthand the quality of the program.

Robert T. Parry

Parry is a strong supporter of financial education efforts within the System. From his vantage point as an economist and monetary policymaker, Parry says the Fed's renewed emphasis on employee education is particularly important in light of the complexities of the financial marketplace and responsibilities employees have to direct their financial futures.

When asked what messages he would convey to employees about the importance of financial education, Parry says, "the first is to start early in their careers at the Fed, take advantage of the Bank's 401(k) program, the financial education workshops, and get additional help if needed." He adds that there are many instances where a good understanding of financial matters is invaluable: buying items on credit, financing a mortgage, investing, budgeting. All of these decisions have a better chance of success when employees are financially educated says Parry. He emphasizes these are messages that apply to all consumers because the economy will continue to change and grow more complex. “This requires employees and consumers to make long-term commitments to learning about financial issues for their personal well-being.” Parry says ultimately this personal commitment translates to national well-being and a more productive economy.



With tax-deferred retirement saving, such as through workplace 401(k) contributions, employees save more money and reduce taxable income, compared to after-tax saving. Taxes are paid on tax-deferred savings when funds are withdrawn; early withdrawals may be subject to a tax penalty.

Assumptions: Employee contributes 6 percent of $42,000 annual income to a tax-deferred account, earning a 9.6 percent average rate of return on a fixed rate investment over 30 years, with a marginal tax rate of 28 percent (single person).

Salt Lake City Branch employee Chris Matsen was another participant in the Fed’s inaugural financial education seminar. Matsen joined the seminar via a Web conference. “I wanted to increase my knowledge of the benefits that will be available to me as a retiree.” Matsen and other Federal Reserve employees supplement knowledge gained at the seminars with another valuable financial tool for Federal Reserve employees: a benefits Web site that helps employees plan for retirement and other financial goals. A frequently used feature of the site allows employees to input various financial and timeframe criteria for their retirement and other goals to model the financial implications of their choices. A quarterly personal finance newsletter for employees augments the Web site.

Based on the success of the initial seminar, the Federal Reserve is developing financial planning seminars for all employees to assist them in reaching their goals at various stages in their lives. “These programs are intended to help employees establish and achieve financial goals such as saving for a child’s education, building an emergency fund, investing wisely, and retirement planning,” says Todd Glissman, group vice president of District Human Resources. The seminars also will help employees understand tax implications, insurance options, and lifetime planning issues such as wills and trusts.

Glissman says the workplace is a logical venue for financial education. “Given that employees have more responsibility for planning their financial futures and have very busy lives, we believe it’s important to make sure they have the information and tools necessary to make sound decisions.”

Homeownership, savings, and small business ownership are the primary means for families to build wealth. Yet U.S. Treasury estimates indicate that approximately 35 million American households are without checking or savings accounts, the starting points for asset accumulation. During 2002 Senior Community Affairs Specialist Craig Nolte played an instrumental role in bringing Individual Development Account (IDA) savings programs to Utah and Idaho for the first time. "IDA programs financially empower and build wealth for individuals and families by providing them with often first-time opportunities to open savings accounts tied to financial goals," says Nolte. Nolte and Community Affairs Specialist John Olson held meetings in Utah and Idaho bringing lenders and nonprofits together to learn about the benefits of IDAs. Salt Lake Neighborhood Housing Services, a workshop attendee, is the first organization in Utah to offer IDAs.

IDA Savings Programs

Salt Lake Neighborhood Housing Services

In 2002 Salt Lake Neighborhood Housing Services (NHS) launched Utah's first Individual Development Account (IDA) program when four participants made initial deposits into their savings accounts at a local bank.

Maria Garciaz greets David Brown, president and CEO of First Utah Bank. First Utah and other financial institutions contributed resources to launch the IDA program.

Established in 1977, Salt Lake NHS is a nonprofit, community-based organization with a primary mission of revitalizing neighborhoods and creating affordable housing and homeownership opportunities for the community it serves in Salt Lake City, Utah. "IDAs are an important component of our asset-building strategy to promote economic independence for low- and moderate-income families and individuals in our community," says Maria Garciaz, the nonprofit's executive director. "By fostering self-sufficiency, IDAs contribute to long-term financial solutions to empower these groups and revitalize our neighborhoods."

Like IDA programs around the country, Salt Lake NHS offers participants who meet enrollment criteria a matched-savings account to fund higher education, purchase a home, or establish a small business. Typically nonprofits such as Salt Lake NHS administer IDA programs with matching funds obtained through contributions, grants, or foundations. Local financial institutions provide the savings accounts. For the Salt Lake program, participants' monthly deposits of $35 are matched at a four-to-one ratio for a year. Matched funds are withdrawn if participants do not meet their financial commitments.

Creating homeownership opportunities is a direct outcome of the IDA program and an important part of the Salt Lake NHS asset-building strategy according to Garciaz. "We set up the IDA program with homeownership in mind because of the tremendous potential for homeownership to build wealth and stability for families and neighborhoods."

Garciaz says financial education is an equally important component of the IDA program. Participants complete a Financial Fitness workshop covering issues such as credit, budgeting, and saving to qualify for the program. Attendees also learn how to cope with a financial emergency and how to make informed decisions to avoid becoming victims of predatory lending practices.

Once qualified, participants attend additional training related to their goals. Those saving for higher education must enroll in an eligible institution.

Potential homeowners participate in a homeownership-counseling program. Prospective small business owners must open their businesses within the nonprofit's service area and must attend courses provided by a small business development center before opening their doors.

A participant in the Salt Lake NHS IDA program signs papers to open his savings account.

The first four participants in the Salt Lake NHS IDA program are saving with the goal of funding higher education. Illustrating the exponential benefits of IDA programs, one participant already is thinking about the next step, opening a small business in his local community.

One premise that underlies all financial education studies is the importance of beginning the learning process early in life. A 2001 report by the U.S. General Accounting Office supports this. According to that report, more than 33 percent of surveyed students had a credit card before they entered college; another 46 percent said they acquired a credit card in their freshman year of college. Used wisely, credit cards can help students establish good financial habits and a positive credit history. However, students who lack solid financial knowledge may make poor decisions that can take years to overcome.

During 2002 Lorraine Thayer, a public information specialist at the Portland Federal Reserve Branch, stepped into the classroom to teach the basics of financial education to teens participating in a series of workshops sponsored by Sabin Community Development Corporation. "Much of the program's success is due to relationship building, spending time with the teens," says Thayer. She adds that once they link financial education to their goals, the students are excited about learning more.

Financial Education for Teens

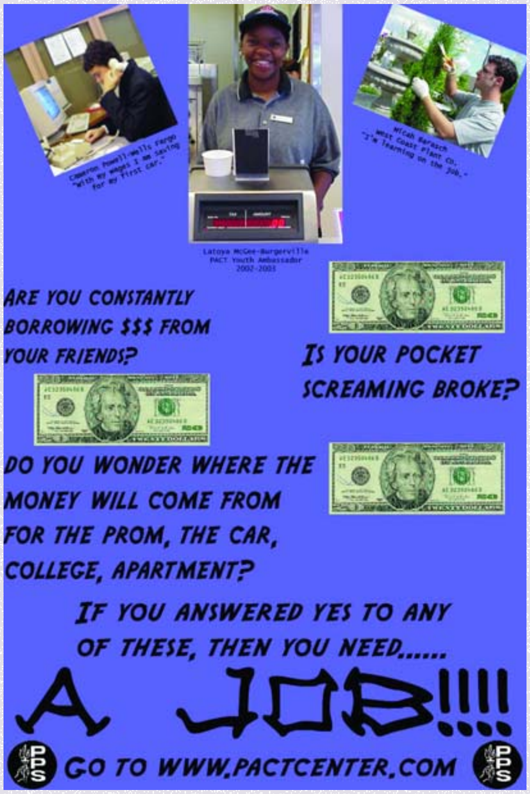
Sabin Community Development Corporation

When talking with Craig Fondren, economic empowerment manager at Sabin Community Development

Sabin CDC teens prepare to shoot a video about financial education with help from mentors (left to right) Craig Fondren, Felicia Allender-Brant, Denise Boston, and Lorraine Thayer.

Corporation (CDC), it is clear that financial education is the common ingredient in all of the nonprofit's youth programs. Founded in 1991, Sabin CDC is a community-based organization whose mission is to stabilize and improve the viability of the culturally diverse neighborhoods it serves in North/Northeast Portland, Oregon. Sabin CDC works to achieve its goals by creating affordable housing, homeownership, and business development opportunities for neighborhood residents. Recognizing that just providing a roof for a family is not enough, Sabin CDC's Executive Director Felicia Allender-Brant also has established venues to help teens, adults, and seniors in the nonprofit's neighborhoods build developmental life skills such as financial literacy and technology training. Partnerships with business, government, and community groups are integral to the success of the nonprofit's programs.

When Sabin CDC rolled out its first financial education program for high school students in 2002, it brought in the "home" team in the form of Steve Kerr and other starting lineup members of the Portland Trailblazers to deliver the training. "The Trailblazers really helped get the kids involved when we launched the program," says Fondren. Called the Game of Life, the training followed a game show format and used financial education curriculum developed by Federal Reserve Banks and Fannie Mae to reach 154 high school students. Students learned financial basics such as budgeting and saving. They also learned to distinguish between "needs" and "wants" and to create decision-making strategies to reach their financial goals.



Fondren notes that many students who completed the Game of Life also participate in Sabin's Youth Tech Corps, which includes a financial education component like all of Sabin's teen programs. Along with improving their own technology skills to develop financial spreadsheets and research financial information on the Internet, the teens go into Sabin's targeted neighborhoods during their third year in the program to teach adults similar computer and financial skills. Adults who have specific financial goals are provided with computers in their homes.

When asked about the results he sees from the teen programs, Fondren points to Cameron Powell and La Toya McGee, both the Game of Life graduates and Tech Corps members. Using skills learned at Sabin CDC and through a partnership with the Portland Public School's Portland Area Training Center, the two created a financial literacy and job preparedness section for the center's employment Web site for high school students. McGee also is the center's 2002/2003 Youth Ambassador. Carrying their skills into the workplace, the two have opened savings accounts and are depositing one-third of their paychecks to save for future financial goals.

By almost any economic indicator, Native Americans lag far behind the rest of the population. According to 2000 Census data, 26 percent of Native Americans are impoverished—more than twice the national average. Only 30 percent of Native Americans on tribal lands are homeowners, compared to 67 percent of the national population.

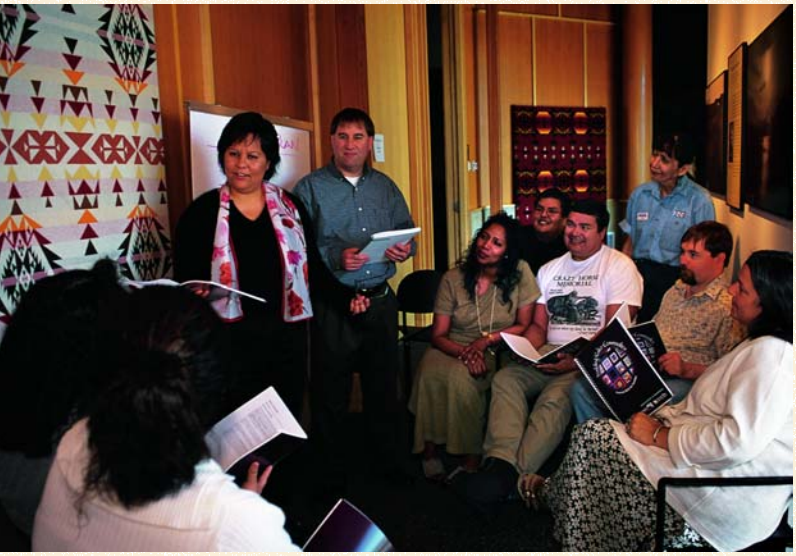
As part of an ongoing effort to increase access to capital and credit for Native Americans, the San Francisco Reserve Bank's Community Affairs unit partnered with First Nations Development Institute to bring personal financial education to Indian communities in 2002. "First Nations needed assistance rolling out their curriculum developed especially for Native communities," says Senior Community Affairs Specialist Craig Nolte. Nolte, with the support of colleagues such as Community Affairs Specialist Lena Robinson, conceived and spearheaded a strategy to market and deliver eight "train the trainer" workshops to approximately 300 tribal representatives and community development organizations that work with tribes throughout the Twelfth Federal Reserve District.

Building Native Communities:

Financial Skills for Families

First Nations Development Institute

When First Nations Development Institute looked toward developing a financial education curriculum to enhance the economic well-being of its Native communities, the nonprofit found its own ancestral history provided the best foundation. Established in 1980, First Nations is a nonprofit organization whose mission is to assist Native communities in controlling and leveraging their financial assets and in building their capacity to direct their economic future in ways that reflect tribal culture and goals. The ultimate goal is to build self-reliant communities. Through its subsidiary, Oweesta Corporation, and with funding provided by Fannie Mae, First Nations developed *Building Native Communities: Financial Skills for Families,* a culturally based curriculum designed to help Native people take control of their financial futures.



Barbara Holman and Craig Nolte lead a discussion among recent graduates of the Umatilla Tribe's financial education program.

"There is an inextricable link between the vitality of the reservation economy and the well-being of individual members," says Elsie Meeks, executive director of

Oweesta. Meeks says the *Building Native Communities* curriculum starts with the premise that self-reliance in Native communities begins with personal financial skills.

Tribes throughout North America and Hawaii have been practicing resource management skills for generations, ensuring the survival of their people. Recognizing the wisdom and success of traditional resource management, *Building Native Communities* draws from historical examples of saving, budgeting, and adapting new tools to benefit Native communities. Topics include developing and using a spending plan, managing money with checking and savings accounts, understanding credit and credit reports, and applying for a loan.

The Umatilla Tribe of Pendleton, Oregon, is one of numerous tribes seeing positive results from the training. Barbara Holman, the tribe's homeownership counselor, has trained more than 60 tribal members with the *Building Native Communities* curriculum. Holman says the weekly two-hour classes are intentionally kept small—no more than ten—to allow ample time for attendees to have their specific issues addressed. She reports there already have been several positive results. Workshop participants have been able to refinance auto loans from double- to single-digit interest rates, pay off debts and collections, dispute incorrect information on credit reports, increase credit scores up to 100 points within a year, and establish savings for the first time. The Umatilla experience illustrates the tremendous potential for personal financial education to bring about behavior change, which is the first step to greater self-reliance for tribal members and their communities.

Economic Research

Economic Research continued to produce high-quality research in monetary policy and macroeconomics, banking and financial studies, regional studies, and international economics, with a special focus on the Pacific Basin, to support the Bank's and System's policy and public outreach functions.

- Jack Beebe, who had served as director of Economic Research since 1987, retired in May 2002. John Judd, former associate director and head of the Macroeconomics section, assumed the director role. Glenn D. Rudebusch succeeded Mr. Judd as vice president and head of the Macroeconomics section.

- Twelve articles were accepted for publication in scholarly journals, and 35 working papers were published on topics such as monetary policy rules, shifts in trend productivity, bank performance in Asia, bank default probability, and the relationship among business investment, capacity, and uncertainty. Staff presented their work in seminars at institutions such as the Bank of England, the Brookings Institute, and at the National Bureau for Economic Research Summer Institute, the American Economic Association meetings, and the Econometrics Society meetings. Staff also delivered numerous presentations to the public on current issues in the U.S., regional, and international economies and published 38 articles in the *FRBSF Economic Letter.*

- Staff briefed the president and boards of directors on several special topics in 2002, including the housing market, the West Coast port labor negotiations and their economic impact, and monetary policy at the zero interest bound.

- The importance of technological developments to the national economy and the prominence of technology in the Twelfth District economy led to plans to establish a Center for Economic Research on Technology and Productivity. The center will be fully functional in late 2003 and plans include a working paper series and an annual conference.

- The Bank cohosted two professional conferences with the Stanford Institute for Economic Policy Research at Stanford University. Programs focused on "Macroeconomic Models for Monetary Policy" and "Technological Change." Federal Reserve staff, researchers from the European Central Bank, the Bank of England, the National Bank of Belgium, and noted academics presented and discussed papers.

- The Center for Pacific Basin Monetary and Economic Studies hosted a major conference on "Financial Issues in the Pacific Basin Region." This conference drew 75 policymakers and scholars from the U.S., Latin America, and Asia.

- For the fourth consecutive year, the Pacific Basin Center and the World Bank Institute cosponsored a week-long workshop for more than 50 senior policymakers from Africa, Asia, and North America. The 2002 conference looked at "Capital Flows, Monetary Policy, and the International Monetary System," which provided a framework for discussing the problems of managing capital flows and conducting monetary policy in emerging markets.

Bank Highlights

Banking Supervision & Regulation

Banking Supervision and Regulation (BS&R) continued to promote safety and soundness in the banking system by ensuring compliance with applicable laws and regulations. In addition, BS&R continued to encourage banking institutions to fulfill their Community Reinvestment Act (CRA) responsibilities by meeting the banking and credit needs of their local communities, including low- and moderate-income neighborhoods.

- The Bank led the System's Information Technology/Electronic Banking Task Force. The task force focused on the supervisory implications of emerging technologies and reliance on critical technology service providers.

- The Bank developed expertise related to regulatory issues contained in the USA Patriot Act of 2001, particularly with respect to broker dealers and mutual fund management within financial holding companies.

- The Bank developed and piloted a "Problem Bank School" that provides practical tools to identify and supervise institutions facing deteriorating financial conditions.

- To assist in the supervision of foreign banking organizations, the Bank completed two long-term policy studies on Information Technology and Bank Supervision and on Corporate Governance Practices in Asia's newly industrialized countries: Hong Kong, Singapore, South Korea, and Taiwan.

- The Bank implemented a comprehensive risk-monitoring program under which all state member banks are assigned to one of three risk tiers based on individual risk assessments.

- The Bank continued its leadership role promoting access to credit and financial services for Native communities. The Bank cosponsored the System conference on lending in Indian communities, which attracted over 400 participants from banking and economic development sectors and representatives from 57 tribal nations. Additionally, the Bank coordinated financial literacy "train the trainer" sessions that reached over 300 trainers from Native American, Native Hawaiian, and Native Alaskan communities.

- In support of CRA activities, the Bank continued its sponsorship of the annual National Community Development Lending School and CRA Leadership Councils and Roundtables, and convened meetings for the Association for Investment Consortia for Housing and the Economic Development Consortia Roundtable.

Bank Highlights

Financial Services and Services to the U.S. Treasury

During 2002 the Bank made significant progress toward its goals of improving customer service, streamlining operations, and reducing costs. These goals support the Bank's efforts to bring its cost structure, products, and operational efficiency in line with the dramatic changes in the financial services industry as institutions are challenged to provide faster, lower cost services to their customers.

- The Bank established a consolidated customer support center for Cash and Accounting customers and plans to expand this service to Check customers in 2003. The center is designed to provide customers with consistent service quality and after-sales support.
- The District's five check operations successfully converted to the new standard check platform as part of the System's Check Modernization Initiative to standardize check processing across all Reserve Banks.
- The Bank provided national leadership for the final conversions to the Enterprise Wide Adjustments platform across the System, another component of the Check Modernization Initiative.
- The Bank successfully piloted the Check to Automated Clearing House Conversion product with the Cleveland Reserve Bank. Developed in 2001, this electronic check-clearing product significantly speeds up the check clearing process and minimizes the handling of paper checks.
- The Bank successfully implemented Standard Cash Automation in the Portland and Los Angeles offices to complete the District's conversion to the Federal Reserve-standard automated coin and currency inventory tracking application.
- The Bank achieved significant productivity gains in cash processing during 2002. Measured in bundles processed per hour, the Bank averaged an 8.3 percent increase in productivity, resulting in significant cost savings.
- During 2002 the U.S. Treasury collected $2.8 billion through the use of the FedDebt and Treasury Offset programs, two software applications developed by the Bank. The Treasury awarded the Bank additional application development contracts following the success of these products.

Bank Highlights

Outreach

The Bank continued its educational outreach programs for the public on the purposes and functions of the Federal Reserve System. During 2002 the Bank also established a Community Perspectives program to support outreach efforts to community banks.

- The Bank launched a new Community Perspectives program to host forums around the District where community bankers and business leaders can provide input to the Bank on issues of regional importance. The Bank established the program to ensure that it maintains critical touchpoints with financial institutions, particularly at the senior management level, in light of a national shift in business development strategies.

- The Bank piloted a new program for university economics, finance, and business students. The symposia are designed to educate participants about the national economy, the function of the Federal Open Market Committee (FOMC), and the role of the central bank. In another effort, the Bank developed a central banking curriculum to accompany an international trade summit for high school students.

- The Bank's leadership role for the System's 2003 Financial Literacy Initiative resulted in the production of a public service announcement (PSA) in English and Spanish. To support the campaign, the Bank contributed to the development of a campaign brochure and a financial resources page on the System's education Web site, federalreserveeducation.org. Additionally, the Bank produced a financial education resource page on frbsf.org, the Twelfth District's Web site.

Summary of Operations

		Volume (in thousands)
Cash Services	**2002**	**2001**
Currency notes paid into circulation	5,749,365	5,688,888
Food stamp coupons processed	307,801	288,241
Check Services		
Commercial checks processed	1,841,660	1,927,235
Government checks processed	41,116	60,584
Return items processed	33,023	35,558
Discounts and Advances		
Total discounts and transactions *	446	451
Number of financial institutions accommodated *	93	116

**Whole number (not in thousands)*

Executive Committee

Seated from left:

John F. Moore
First Vice President and
Chief Operating Officer
National Cash Product
Director

Robert T. Parry
President and Chief
Executive Officer

Terry S. Schwakopf
Executive Vice President
Banking Supervision and
Regulation and District
Public Information

Standing from left:

Mark L. Mullinix
Executive Vice President
District Finance and
Administration
National Cash Product
Manager

Susan A. Sutherland
Senior Vice President
District Business
Continuity, Cash Services,
Human Resources, Legal,
Statistics, and Structure

John P. Judd
Senior Vice President and
Director of Research

D. Kerry Webb
Senior Vice President
Business Development,
Retail Payments, and
Customer Support

Branch Managers

From left to right:

Los Angeles	Seattle	Portland	Salt Lake City
Mark L. Mullinix	**D. Kerry Webb**	**Richard B. Hornsby**	**Andrea P. Wolcott**
Executive Vice President	Senior Vice President	Group Vice President	Group Vice President

Bank Officers & Principals

As of December 31, 2002

San Francisco Office

Robert T. Parry
President and
Chief Executive Officer

John F. Moore
First Vice President and
Chief Operating Officer

Terry S. Schwakopf
Executive Vice President

John P. Judd
Senior Vice President

Michael J. Murray
Senior Vice President

Michael J. Stan
Senior Vice President and
Chief Information Officer

Susan A. Sutherland
Senior Vice President

Todd A. Glissman
Group Vice President

John S. Hsiao
Group Vice President

Donald R. Lieb
Group Vice President

John H. Parrish
Group Vice President and General Auditor

Deborah S. Smyth
Group Vice President

David W. Walker
Group Vice President

Patricia A. Welch
Group Vice President

Bonnie R. Allen
Vice President

Teresa M. Curran
Vice President and Managing Director

Lee C. Dwyer
Vice President

Fred T. Furlong
Vice President

Eliot E. Giuili
Vice President

Reuven Glick
Vice President

Beverley-Ann Hawkins
Vice President

Joy K. Hoffmann
Vice President

Ann Marie Kohlligian
Vice President and Managing Director

Mark E. Levonian
Vice President

Darren S. Post
Vice President

Glenn D. Rudebusch
Vice President

Sharon Ruth
Vice President and General Counsel

Elizabeth L. Wood
Vice President

Randy Balducci
Director

Thomas A. Ballantyne
Director

Tracy Basinger
Director

Barbara A. Bennett
Director

Kenneth R. Binning
Director

Bank Officers & Principals

As of December 31, 2002

Richard K. Cabral
Director

James J. Callahan
Director

Thomas J. Carlon
Director

David J. Christerson
Director

Clifford N. Croxall
Director

Alice Farrell
Director

Ellen M. Hamilton
Director

Jackie C. Hicks
Director

Peter K. C. Hsieh
Director

Rick A. Miller
Director

Frederic P. Minardi
Director

David E. Reiser
Director

Philip M. Ryan
Director

Carl M. Segall
Director

Roxana R. Tsougarakis
Director

Paulette M. Wallace
Director

Mary E. Wujek
Director

Mary C. Daly
Research Advisor

Judith R. W. Goff
Research Publications Advisor

Simon H. Kwan
Research Advisor

Mark M. Spiegel
Research Advisor

Bharat Trehan
Research Advisor

Robert G. Valletta
Research Advisor

John C. Williams
Research Advisor

Nancy S. Emerson
Principal

Michael E. Johnson
Principal

Bonita G. Jones
Principal

Gopa Kumar
Principal

David J. Moore
Principal

Lincoln R. Morita
Principal

Maureen E. O'Byrne
Principal

Erik Z. Revai
Principal

Peggy L. Speck
Principal and
Secretary of the Board

Sallie H. Weissinger
Principal

Kevin E. Zerbe
Principal

Bank Officers & Principals

As of December 31, 2002

Los Angeles Branch

Mark L. Mullinix
Executive Vice President

Roger W. Replogle
Group Vice President

Robert G. Wiley
Group Vice President

Marla E. Borowski
Vice President

Jose Alonso
Director

Deborah Awai
Director

Anthony P. Dazzo
Director

Warren Howard
Director

Robert C. Johnson
Director

Steven E. Jung
Director

Robin A. Rockwood
Director

Joel K. Van Zee
Director

Dale L. Vaughan
Director

Robert Zavala, Jr.
Director

Richard J. Shershenovich
Principal

Portland Branch

Richard B. Hornsby
Group Vice President

Mary E. Lee
Director

Steven H. Walker
Director

Salt Lake City Branch

Andrea P. Wolcott
Group Vice President

Jed W. Bodily
Director

Seattle Branch

D. Kerry Webb
Senior Vice President

Mark A. Gould
Vice President

Pamela R. Anderson
Director

Lynn M. Jorgensen
Director

Jimmy F. Kamada
Director

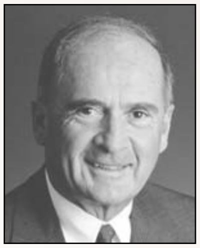
Phoenix Processing Center

Robert E. Kellar, Jr.
Director

Directors — San Francisco

As of January 1, 2003

Chairman of the Board and Federal Reserve Agent
Nelson C. Rising
Chairman and CEO
Catellus Development Corporation
San Francisco, California



Deputy Chairman
George M. Scalise
President
Semiconductor Industry Association
San Jose, California

Richard W. Decker, Jr.
Chairman and Co-founder
Belvedere Capital Partners LLC
San Francisco, California

Sheila D. Harris
Director
Arizona Department of Housing
Phoenix, Arizona

Richard C. Hartnack
Vice Chairman
Union Bank of California
Los Angeles, California

Jack McNally
Deputy Undersecretary
California Labor and Workforce Development Agency
Sacramento, California

David K. Y. Tang
Partner
Preston Gates & Ellis LLP
Seattle, Washington

Candace H. Wiest
President
Inland Empire National Bank
Riverside, California

Barbara L. Wilson
Idaho and Regional Vice President (Retired)
Qwest Corporation
Boise, Idaho

Federal Advisory Council Member

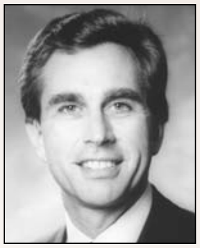
Michael E. O'Neill
Chairman, CEO and President
Bank of Hawaii Corporation
Honolulu, Hawaii

Directors — Los Angeles

As of January 1, 2003

Chairman of the Board
William D. Jones
Chairman, President and CEO
CityLink Investment Corporation
San Diego, California

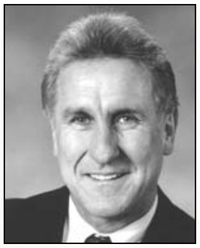
Sister Diane Donoghue
Executive Director
Esperanza Community Housing Corporation
Los Angeles, California



Russell Goldsmith
Chairman and CEO
City National Bank
Beverly Hills, California

Linda Griego
Managing Partner
Engine Co. No. 28
Los Angeles, California

Lonnie Kane
President
Karen Kane, Inc.
Los Angeles, California



Peter M. Thomas
Managing Director
Thomas and Mack Company
Las Vegas, Nevada

D. Linn Wiley
President and CEO
Citizens Business Bank
Ontario, California

Directors — Portland

As of January 1, 2003

Chairman of the Board
Karla S. Chambers
Vice President and Co-owner
Stahlbush Island Farms, Inc.
Corvallis, Oregon

Patrick Borunda
Principal
The Navigator Group
Yacolt, Washington

Judi Johansen
President and CEO
PacifiCorp
Portland, Oregon

Peter O. Kohler
President
Oregon Health and Science University
Portland, Oregon

George Passadore
Chairman, Oregon
Wells Fargo Bank
Portland, Oregon

William D. Thorndike, Jr.
President
Medford Fabrication
Medford, Oregon

Directors — Salt Lake City

As of January 1, 2003

Chairman of the Board
H. Roger Boyer
Chairman
The Boyer Company
Salt Lake City, Utah

A. Scott Anderson
President and CEO
Zions First National Bank
Salt Lake City, Utah

Gary L. Crocker
Chairman
ARUP Laboratories
Salt Lake City, Utah

William C. Glynn
President
Intermountain Industries, Inc.
Boise, Idaho

Curtis D. Harris
Chairman, President and CEO
Barnes Banking Company
Kaysville, Utah

Deborah B. Nielsen
President and CEO
United Way of Salt Lake
Salt Lake City, Utah

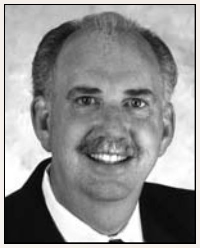
Peggy A. Stock
President Emeritus
Westminster College
Salt Lake City, Utah

Directors — Seattle

As of January 1, 2003

Chairman of the Board
Mic R. Dinsmore
Chief Executive Officer
Port of Seattle
Seattle, Washington

James R. Gill
President
Pacific Northwest Title
Holding Company
Seattle, Washington



Kenneth M. Kirkpatrick
President, Washington
Commercial Banking
U.S. Bank
Seattle, Washington

Betsy Lawer
Vice Chair and COO
First National Bank Alaska
Anchorage, Alaska

Mary E. Pugh
President
Pugh Capital Management, Inc.
Seattle, Washington

Peter H. Van Oppen
Chairman and CEO
Advanced Digital Information
Corporation
Redmond, Washington

David W. Wyckoff
Chairman and CEO
Wyckoff Farms, Inc.
Grandview, Washington

Advisory Council

As of January 1, 2003

Chairman
Duff Willey
President
Willey Automotive Group
Bountiful, Utah

Vice Chairman
Thomas E. Cleveland
Chairman and CEO
Access Business Finance
Bellevue, Washington

Roberto E. Barragan
President
Valley Economic Development Center, Inc.
Van Nuys, California

Barbara Bry
Senior Vice President, Business Development
Affinity2
San Diego, California

Paula R. Collins
Chief Executive Officer
WDG Ventures, Inc.
San Francisco, California

Manuel Cunha, Jr.
President
Nisei Farmers League
Fresno, California

Paul Ecke, III
Chairman and CEO
Paul Ecke Ranch
Encinitas, California

John H. Gleason
ComPlan Advisors LLC
Scottsdale, Arizona

Ed P. Mayne
President
Utah AFL-CIO
West Valley, Utah

Laura E. Naumes
Vice President
Naumes, Inc.
Medford, Oregon

Richard S. Walden
Chairman, President and CEO
Farmers Investment Company
Sahuarita, Arizona

Denice A. Young, CPA
President
Young Consulting Group and Real Estate Services
Torrance, California

2002
Financial Reports

The firm engaged by the Board of Governors for the audits of the individual and combined financial statements of the Reserve Banks for 2002 was PricewaterhouseCoopers LLP (PwC). Fees for these services totaled $1.0 million. In order to ensure auditor independence, the Board of Governors requires that PwC be independent in all matters relating to the audit. Specifically, PwC may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management decisions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2002, the Bank did not engage PwC for advisory services.

December 31, 2002

To the Board of Directors:

The management of the Federal Reserve Bank of San Francisco (FRB-SF) is responsible for the preparation and fair presentation of the Statement of Financial Condition, Statement of Income, and Statement of Changes in Capital as of December 31, 2002 (the "Financial Statements"). The Financial Statements have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System and as set forth in the Financial Accounting Manual for the Federal Reserve Banks ("Manual"), and as such, include amounts, some of which are based on judgments and estimates of management. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with the accounting principles, policies, and practices documented in the Manual and include all disclosures necessary for such fair presentation.

The management of the FRB-SF is responsible for maintaining an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements. Such internal controls are designed to provide reasonable assurance to management and to the Board of Directors regarding the preparation of reliable Financial Statements. This process of internal controls contains self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in the process of internal controls are reported to management and appropriate corrective measures are implemented.

Even an effective process of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error, and therefore can provide only reasonable assurance with respect to the preparation of reliable financial statements.

The management of the FRB-SF assessed its process of internal controls over financial reporting, including the safeguarding of assets reflected in the Financial Statements, based upon the criteria established in the "Internal Control–Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we believe that FRB-SF maintained an effective process of internal controls over financial reporting including the safeguarding of assets as they relate to the Financial Statements.

Federal Reserve Bank of San Francisco

by Robert T. Parry	by John Moore	by Mark Mullinix
Robert T. Parry	John F. Moore	Mark Mullinix
President	First Vice President	Principal Financial Officer

Report of Independent Accountants

PricewaterhouseCoopers

To the Board of Directors of the Federal Reserve Bank of San Francisco:

We have examined management's assertion that the Federal Reserve Bank of San Francisco ("FRB San Francisco") maintained effective internal control over financial reporting and the safeguarding of assets as they relate to the financial statements as of December 31, 2002, based on criteria described in "Internal Control–Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission included in the accompanying Management's Assertion. FRB San Francisco's management is responsible for maintaining effective internal control over financial reporting and the safeguarding of assets as they relate to the financial statements. Our responsibility is to express an opinion on the assertion based on our examination.

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

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

In our opinion, management's assertion that the FRB San Francisco maintained effective internal control over financial reporting and over the safeguarding of assets as they relate to the financial statements as of December 31, 2002, is fairly stated, in all material respects, based on criteria described in "Internal Control–Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

PricewaterhouseCoopers LLP

March 3, 2003
San Francisco, California

Report of Independent Accountants

PricewaterhouseCoopers

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

We have audited the accompanying statements of condition of the Federal Reserve Bank of San Francisco (the "Bank") as of December 31, 2002 and 2001, and the related statements of income and changes in capital for the years then ended, which have been prepared in conformity with the accounting principles, policies, and practices established by the Board of Governors of the Federal Reserve System. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audits.

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2002 and 2001, and results of its operations for the years then ended, in conformity with the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

March 3, 2003
San Francisco, California

Statements of Condition
As of December 31, 2002 and 2001 (in millions)

	2002	2001
Assets		
Gold certificates	$ 1,046	$ 1,136
Special drawing rights certificates	234	234
Coin	111	144
Items in process of collection	2,608	267
Loans to depository institutions	5	-
U.S. government and federal agency securities, net	54,835	56,590
Investments denominated in foreign currencies	1,833	1,673
Accrued interest receivable	468	575
Bank premises and equipment, net	233	229
Other assets	36	36
Total assets	$ 61,409	$ 60,884
Liabilities and Capital		
Liabilities:		
Federal Reserve notes outstanding, net	$ 52,772	$ 49,314
Securities sold under agreements to repurchase	1,810	-
Deposits:		
Depository institutions	2,273	2,129
Other deposits	4	5
Deferred credit items	2,584	489
Interest on Federal Reserve notes due U.S. Treasury	104	53
Interdistrict settlement account	43	7,226
Accrued benefit costs	69	68
Other liabilities	14	8
Total liabilities	59,673	59,292
Capital:		
Capital paid-in	868	796
Surplus	868	796
Total capital	1,736	1,592
Total liabilities and capital	$ 61,409	$ 60,884

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

Statements of Income
For the years ended December 31, 2002 and 2001 (in millions)

	2002	2001
Interest income:		
Interest on U.S. government and federal agency securities	$ 2,258	$ 3,050
Interest on investments denominated in foreign currencies	30	37
Interest on loans to depository institutions	-	1
Total interest income	2,288	3,088
Interest expense:		
Interest expense on securities sold under agreements to repurchase	1	-
Net interest income	2,287	3,088
Other operating income (loss):		
Income from services	98	96
Reimbursable services to government agencies	20	20
Foreign currency gains (losses), net	224	(162)
U.S. government securities gains, net	7	32
Other income	7	11
Total other operating income (loss)	356	(3)
Operating expenses:		
Salaries and other benefits	194	177
Occupancy expense	18	17
Equipment expense	24	25
Assessments by Board of Governors	56	67
Other expenses	64	74
Total operating expenses	356	360
Net income prior to distribution	$ 2,287	$ 2,725
Distribution of net income:		
Dividends paid to member banks	$ 50	$ 48
Transferred to surplus	72	4
Payments to U.S. Treasury as interest on Federal Reserve notes	2,165	2,673
Total distribution	$ 2,287	$ 2,725

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

Statements of Changes in Capital
For the years ended December 31, 2002 and 2001 (in millions)

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 2001 (16 million shares)	$ 792	$ 792	$ 1,584
Net income transferred to surplus	–	4	4
Net change in capital stock issued (0 million shares)	4	–	4
Balance at December 31, 2001 (16 million shares)	796	796	1,592
Net income transferred to surplus	–	72	72
Net change in capital stock issued (1 million shares)	72	–	72
Balance at December 31, 2002 (17 million shares)	$ 868	$ 868	$ 1,736

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

Notes to Financial Statements

1. Structure

The Federal Reserve Bank of San Francisco ("Bank") is part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act") which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System ("Board of Governors") and twelve Federal Reserve Banks ("Reserve Banks"). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank and its branches in Los Angeles, California, Portland, Oregon, Salt Lake City, Utah, and Seattle, Washington, serve the Twelfth Federal Reserve District, which includes Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, Washington, and the commonwealths or territories of American Samoa, Guam, and the Northern Mariana Islands. Other major elements of the System are the Federal Open Market Committee ("FOMC") and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY") and, on a rotating basis, four other Reserve Bank presidents. Banks that are members of the System include all national banks and any state chartered bank that applies and is approved for membership in the System.

Board of Directors

In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a Board of Directors. The Federal Reserve Act specifies the composition of the Board of Directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as Chairman and Deputy Chairman, are appointed by the Board of Governors, and six directors are elected by member banks. Of the six elected by member banks, three represent the public and three represent member banks. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

2. Operations and Services

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

The FOMC establishes policy regarding open market operations, oversees these operations, and issues authorizations and directives to the FRBNY for its execution of transactions. Authorized transaction types include direct purchase and sale of securities, matched sale-purchase transactions, the purchase of securities under agreements to resell, the sale of securities under agreements to repurchase, and the lending of U.S. government securities. The FRBNY is also authorized by the FOMC to hold balances of, and to execute spot and forward foreign exchange ("F/X") and securities contracts in nine foreign currencies, maintain reciprocal currency arrangements ("F/X swaps") with various central banks, and "warehouse" foreign currencies for the U.S. Treasury and Exchange Stabilization Fund ("ESF") through the Reserve Banks.

Notes to Financial Statements

3. Significant Accounting Policies

Accounting principles for entities with the unique powers and responsibilities of the nation's central bank have not been formulated by the Financial Accounting Standards Board. The Board of Governors has developed specialized accounting principles and practices that it believes are appropriate for the significantly different nature and function of a central bank as compared to the private sector. These accounting principles and practices are documented in the Financial Accounting Manual for Federal Reserve Banks ("Financial Accounting Manual"), which is issued by the Board of Governors. All Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the Financial Accounting Manual.

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

Effective January 2001, the System implemented procedures to eliminate the sharing of costs by Reserve Banks for certain services a Reserve Bank may provide on behalf of the System. Major services provided for the System by the Bank, for which the costs will not be redistributed to the other Reserve Banks, include: Statistics and Reserves, Enterprise Wide Adjustments, Cash Product Office, Check Standardization, and National Information Center - Central Operations.

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

Gold Certificates

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

Notes to Financial Statements

Special Drawing Rights Certificates

Special drawing rights ("SDRs") are issued by the International Monetary Fund ("Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDRs serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for United States participation in the SDR system, the Secretary of the U.S. Treasury is authorized to issue SDR certificates, somewhat like gold certificates, to the Reserve Banks. At such time, equivalent amounts in dollars are credited to the account established for the U.S. Treasury, and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDRs, at the direction of the U.S. Treasury, for the purpose of financing SDR certificate acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among Reserve Banks based upon Federal Reserve notes outstanding in each District at the end of the preceding year. There were no SDR transactions in 2002.

Loans to Depository Institutions

The Depository Institutions Deregulation and Monetary Control Act of 1980 provides that all depository institutions that maintain reservable transaction accounts or nonpersonal time deposits, as defined in Regulation D issued by the Board of Governors, have borrowing privileges at the discretion of the Reserve Banks. Borrowers execute certain lending agreements and deposit sufficient collateral before credit is extended. Loans are evaluated for collectibility, and currently all are considered collectible and fully collateralized. If loans were ever deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every fourteen days by the Boards of Directors of the Reserve Banks, subject to review by the Board of Governors. Reserve Banks retain the option to impose a surcharge above the basic rate in certain circumstances.

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

The FOMC has designated the FRBNY to execute open market transactions on its behalf and to hold the resulting securities in the portfolio known as the System Open Market Account ("SOMA"). In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes and directs the FRBNY to execute operations in foreign markets for major currencies in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC in carrying out the System's central bank responsibilities. Such authorizations are reviewed and approved annually by the FOMC.

In December 2002, the FRBNY replaced matched sale-purchase ("MSP") transactions with securities sold under agreements to repurchase. MSP transactions, accounted for as separate sale and purchase transactions, are transactions in which the FRBNY sells a security and buys it back at the rate specified at the commencement of the transaction. Securities sold under agreements to repurchase are treated as secured borrowing transactions with the associated interest expense recognized over the life of the transaction.

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

Notes to Financial Statements

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

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

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

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

While the application of current market prices to the securities currently held in the SOMA portfolio and investments denominated in foreign currencies may result in values substantially above or below their carrying values, these unrealized changes in value would have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio from time to time involve transactions that can result in gains or losses when holdings are sold prior to maturity. Decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, market values, earnings, and any gains or losses resulting from the sale of such currencies and securities are incidental to the open market operations and do not motivate its activities or policy decisions.

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as "Interest on U.S. government and federal agency securities" or "Interest on investments denominated in foreign currencies," as appropriate. Income earned on securities lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as "U.S. government securities gains, net." Foreign- currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains (losses), net."Foreign currencies held through F/X swaps, when initiated by the counter-party, and warehousing arrangements are revalued daily, with the unrealized gain or loss reported by the FRBNY as a component of "Other assets" or "Other liabilities," as appropriate.

Notes to Financial Statements

Balances of U.S. government and federal agency securities bought outright, securities sold under agreements to repurchase, securities loaned, investments denominated in foreign currencies, interest income and expense, securities lending fee income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Income from securities lending transactions undertaken by the FRBNY are also allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over estimated useful lives of assets ranging from 2 to 50 years. New assets, major alterations, renovations and improvements are capitalized at cost as additions to the asset accounts. Maintenance, repairs and minor replacements are charged to operations in the year incurred. Costs incurred for software, either developed internally or acquired for internal use, during the application development stage are capitalized based on the cost of direct services and materials associated with designing, coding, installing, or testing software.

Interdistrict Settlement Account

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

Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes are issued through the various Federal Reserve agents (the Chairman of the Board of Directors of each Reserve Bank) to the Reserve Banks upon deposit with such agents of certain classes of collateral security, typically U.S. government securities. These notes are identified as issued to a specific Reserve Bank. The Federal Reserve Act provides that the collateral security tendered by the Reserve Bank to the Federal Reserve agent must be equal to the sum of the notes applied for by such Reserve Bank. In accordance with the Federal Reserve Act, gold certificates, special drawing rights certificates, U.S. government and federal agency securities, repurchase agreements, loans to depository institutions, and investments denominated in foreign currencies are pledged as collateral for net Federal Reserve notes outstanding. The collateral value is equal to the book value of the collateral tendered, with the exception of securities, whose collateral value is equal to the par value of the securities tendered. Repurchase agreements are valued at the contract amount. The par value of securities pledged for securities sold under agreements to repurchase is similarly deducted. The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the Federal Reserve notes. The Reserve Banks have entered into an agreement which provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes of all Reserve Banks in order to satisfy their obligation of providing sufficient collateral for outstanding Federal Reserve notes. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, as obligations of the United States, Federal Reserve notes are backed by the full faith and credit of the United States government.

The "Federal Reserve notes outstanding, net" account represents the Bank's Federal Reserve notes outstanding, reduced by its currency holdings of $14,359 million, and $20,372 million at December 31, 2002 and 2001, respectively.

Notes to Financial Statements

Capital Paid-in

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

Surplus

The Board of Governors requires Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31. This amount is intended to provide additional capital and reduce the possibility that the Reserve Banks would be required to call on member banks for additional capital. Pursuant to Section 16 of the Federal Reserve Act, Reserve Banks are required by the Board of Governors to transfer to the U.S. Treasury excess earnings, after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in.

In the event of losses or a substantial increase in capital, payments to the U.S. Treasury are suspended until such losses are recovered through subsequent earnings. Weekly payments to the U.S. Treasury may vary significantly.

Income and Costs related to Treasury Services

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

Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property, which are reported as a component of "Occupancy expense."

4. U.S. Government and Federal Agency Securities

Securities bought outright are held in the SOMA at the FRBNY. An undivided interest in SOMA activity and the related premiums, discounts and income, with the exception of securities purchased under agreements to resell, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank's allocated share of SOMA balances was approximately 8.580 percent and 10.075 percent at December 31, 2002 and 2001, respectively.

Notes to Financial Statements

The Bank's allocated share of securities held in the SOMA at December 31, that were bought outright, was as follows (in millions):

	2002	2001
Par value:		
Federal agency	$ 1	$ 1
U.S. government:		
Bills	19,449	18,343
Notes	25,558	26,793
Bonds	8,994	10,444
Total par value	54,002	55,581
Unamortized premiums	923	1,139
Unaccreted discounts	(90)	(130)
Total allocated to Bank	$ 54,835	$ 56,590

Total SOMA securities bought outright were $639,125 million and $561,701 million at December 31, 2002 and 2001, respectively.

The maturity distribution of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 2002, was as follows (in millions):

	Par Value		
Maturities of Securities Held	U.S. Government Securities	Federal Agency Obligations	Total
Within 15 days	$ 2,355	$ –	$ 2,355
16 days to 90 days	13,232	–	13,232
91 days to 1 year	12,169	1	12,170
Over 1 year to 5 years	14,822	–	14,822
Over 5 years to 10 years	4,573	–	4,573
Over 10 years	6,850	–	6,850
Total	$ 54,001	$ 1	$ 54,002

As mentioned in Note 3, in December 2002, the FRBNY replaced MSP transactions with securities sold under agreements to repurchase. At December 31, 2002, securities sold under agreements to repurchase with a contract amount of $21,091 million and a par value of $23,188 million were outstanding, of which $1,810 million and $2,366 million, respectively, were allocated to the Bank. At December 31, 2001, MSP transactions involving U.S. government securities with a par value of $21,098 million were outstanding, of which $1,810 million was allocated to the Bank. Securities sold under agreements to repurchase and MSP transactions are generally overnight arrangements.

At December 31, 2002 and 2001, U.S. government securities with par values of $1,841 million and $7,345 million, respectively, were loaned from the SOMA, of which $158 million and $740 million were allocated to the Bank.

Notes to Financial Statements

5. Investments Denominated in Foreign Currencies

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

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 10.839 percent and 11.491 percent at December 31, 2002 and 2001, respectively.

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

	2002	2001
European Union Euro:		
Foreign currency deposits	$ 605	$ 528
Government debt instruments including agreements to resell	357	310
Japanese Yen:		
Foreign currency deposits	194	217
Government debt instruments including agreements to resell	668	611
Accrued interest	9	7
Total	$ 1,833	$ 1,673

Total investments denominated in foreign currencies were $16,913 million and $14,559 million at December 31, 2002 and 2001, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2002, was as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 year	1,692
Over 1 year to 5 years	98
Over 5 years to 10 years	43
Over 10 years	–
Total	$ 1,833

At December 31, 2002 and 2001, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 2002 and 2001, the warehousing facility was $5,000 million, with zero balance outstanding.

Notes to Financial Statements

6. Bank Premises and Equipment

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

	2002	2001
Bank premises and equipment:		
Land	$ 24	$ 24
Buildings	185	179
Building machinery and equipment	41	42
Construction in progress	8	1
Furniture and equipment	133	135
	391	381
Accumulated depreciation	(158)	(152)
Bank premises and equipment, net	$ 233	$ 229

Depreciation expense was $19 million and $20 million for the years ended December 31, 2002 and 2001, respectively.

The Bank leases unused space to outside tenants. Those leases have terms ranging from one to six years. Rental income from such leases was $2 million and $1 million for the years ended December 31, 2002 and 2001, respectively. Future minimum lease payments under noncancelable agreements in existence at December 31, 2002, were (in millions):

2003	$ 1.2
2004	.3
2005	.2
2006	.2
2007	.1
Thereafter	–
	$ 2.0

7. Commitments and Contingencies

At December 31, 2002, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately three years. These leases provide for increased rentals 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 $937 thousand and $858 thousand for the years ended December 31, 2002 and 2001, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases and capital leases, net of sublease rentals, with terms of one year or more, at December 31, 2002, were not material.

Under the Insurance Agreement of the Federal Reserve Banks dated March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of one percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 2002 or 2001.

Notes to Financial Statements

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

8. Retirement and Thrift Plans

Retirement Plans

The Bank currently offers two defined benefit retirement plans to its employees, based on length of service and level of compensation. Substantially all of the Bank's employees participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan") and the Benefit Equalization Retirement Plan ("BEP") and certain Bank officers participate in a Supplemental Employee Retirement Plan ("SERP"). The System Plan is a multi-employer plan with contributions fully funded by participating employers. No separate accounting is maintained of assets contributed by the participating employers. The Bank's projected benefit obligation and net pension costs for the BEP at December 31, 2002 and 2001 and for the SERP at December 31, 2002, and for the years then ended, are not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled $7 million and $6 million for the years ended December 31, 2002 and 2001, respectively, and are reported as a component of "Salaries and other benefits."

9. Postretirement Benefits Other Than Pensions and Postemployment Benefits

Postretirement benefits other than pensions

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

The Bank funds benefits payable under the medical and life insurance plans as due and, accordingly, has no plan assets. Net postretirement benefit costs are actuarially determined using a January 1 measurement date.

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

	2002	2001
Accumulated postretirement benefit obligation at January 1	$ 38.8	$ 33.4
Service cost-benefits earned during the period	1.0	.7
Interest cost of accumulated benefit obligation	2.6	2.3
Actuarial loss	2.3	.1
Contributions by plan participants	.4	.3
Curtailment loss	.1	–
Special termination loss	.1	–
Benefits paid	(3.9)	(2.2)
Plan amendments (curtailments, special termination benefits)	(2.9)	4.2
Accumulated postretirement benefit obligation at December 31	$ 38.5	$ 38.8

Notes to Financial Statements

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):

	2002	2001
Fair value of plan assets at January 1	$ –	$ –
Actual return on plan assets	–	–
Contributions by the employer	3.5	1.9
Contributions by plan participants	.4	.3
Benefits paid	(3.9)	(2.2)
Fair value of plan assets at December 31	$ –	$ –
Unfunded postretirement benefit obligation	$ 38.5	$ 38.8
Unrecognized prior service cost	5.9	4.3
Unrecognized net actuarial gain	11.0	14.0
Accrued postretirement benefit costs	$ 55.4	$ 57.1

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs."

At December 31, 2002 and 2001, the weighted average discount rate assumptions used in developing the benefit obligation were 6.8 percent and 7.0 percent, respectively.

For measurement purposes, a 9.0 percent annual rate of increase in the cost of covered health care benefits was assumed for 2003. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.0 percent by 2008, and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2002 (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	$ 1.8	$ (1.7)
Effect on accumulated postretirement benefit obligation	.2	(.2)

Notes to Financial Statements

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

	2002	2001
Service cost-benefits earned during the period	$ 1.0	$ .7
Interest cost of accumulated benefit obligation	2.6	2.3
Amortization of prior service cost	(1.0)	(1.4)
Recognized net actuarial loss	(.6)	(.9)
Net periodic postretirement benefit costs	$ 2.0	$ .7

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

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, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 2002 and 2001, were $13 million and $12 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2002 and 2001 operating expenses were $3 million and $2 million, respectively.

The Bank also accrued charges during the year ended December 31, 2002 of about $7 million for severance benefits associated with voluntary and involuntary separations of almost 250 employees that included separation pay and health benefits.

10. Subsequent Event

In January 2003, the System announced plans to restructure its check collection operations. The restructuring plans include streamlining the check management structure, reducing staff, decreasing the number of check-processing locations, and increasing processing capacity in other locations. The restructuring, which is expected to begin in 2003 and conclude by the end of 2004, will result in the Bank consolidating its check adjustment function at the Portland office.

At this time, the Reserve Banks have not developed detailed estimates of the cost of the restructuring plan in the aggregate or for the individual Reserve Banks affected.

The Federal Reserve Bank of San Francisco is one of twelve regional Federal Reserve Banks across the U.S. that, together with the Board of Governors in Washington, D.C., serve as our nation's central bank.

The Twelfth Federal Reserve District includes the nine western states—Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington—and American Samoa, Guam, and the Northern Mariana Islands. Branches are located in Los Angeles, Portland, Salt Lake City, and Seattle, with a cash facility in Phoenix. The largest District, it covers 35 percent of the nation's landmass, ranks first in the size of its economy, and is home to approximately 20 percent of the nation's population.

Twelfth Federal Reserve District
frbsf.org

San Francisco Head Office
P.O. Box 7702
San Francisco, CA 94120-7702

Los Angeles Branch
P.O. Box 512077
Los Angeles, CA 90051-0077

Portland Branch
P.O. Box 3436
Portland, OR 97208-3436

Salt Lake City Branch
P.O. Box 30780
Salt Lake City, UT 84130-0780

Seattle Branch
P.O. Box 3567
Seattle, WA 98124-3567

Phoenix Processing Center
P.O. Box 46460
Phoenix, AZ 85063-6460

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Managing Editor: Kevin Alecca

Editor: Lyndi Beale

Designer: Frank Serr

Photography: Frank Wing (Pages 2, 15, 19, 21, and 23-29)

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Manage Credit Wisely

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Set Goals

Start Saving

Plan Your Financial Future

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Set Goals

Start Saving

Plan Your Financial Future

Manage Credit Wisely

Protect Your Credit Rating

Start Saving

Take Charge