

Tempora mutantur, et nos mutamur in illis. –Ovid Times are changing, and we are changing in them.



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From the Boardroom

he world changed on September 11, 2001. On that day we bore witness to the worst and best of the human condition, as wanton destruction gave way to bravery and heroism. The events of September 11 will continue to affect us, personally and professionally, long into the future.

We recognize that those events affected every area of this Bank and its employees, from the Protection officers who instituted additional security measures, to the employees who transported checks or coordinated cash shipments without benefit of air travel, to those who operated the discount window for extended periods. Across the Bank, no less than across the Federal Reserve System, individual upon individual ensured that the monetary system remained stable and operational. We take this opportunity to thank our employees for their exemplary service, both in a time of crisis and throughout the year.

Even before September 11, an escalating rate of change was a familiar aspect of our environment. It seems fitting, then, that our annual report for the year 2001 should examine the effects of change on the world "Inside the San Francisco Fed." It is especially fitting that the report should include comments from our employees on how they adapt to change as well as initiate it. We also asked our staff a simple question, "Why do you work here?" Their responses echoed with the words "service," "challenge," and "meaningful work." Our employees know that their work matters, and that they can make a difference in a changing world.

We also would like to extend our thanks and appreciation to our Twelfth District directors for their invaluable counsel during 2001. 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 Warren K.K. Luke (Chairman, President, and Chief Executive Officer, Hawaii National Bank, Honolulu, Hawaii) who completed his term of service on the Head Office Board during 2001, after serving nine years in that capacity.

In addition, we would like to express our sincere thanks and appreciation to the other directors who completed their terms of service during 2001: on the Seattle Branch Board, Richard R. Sonstelie (Chairman of the Board (Retired), Puget Sound Energy, Inc., Bellevue, Washington) who served five years as Chairman of the Seattle Branch Board and Helen M. Rockey (President and Chief Executive Officer (Retired) Just for Feet, Inc., Seattle, Washington); and on the Twelfth District Advisory Council, Walter F. Payne, Jr. (President Emeritus, Blue Diamond Growers, Sacramento, California) who served as Chairman of the Advisory Council the final two years of his term.

Chairman

Robert T. Parry









INSIDE THE

San Francisco Fed

ometimes the correct response to sudden, cataclysmic change is the right mix of stability and fluidity. As events unfolded on September 11, 2001, the Federal Reserve System simply announced that it continued to operate, that its discount window was available to meet liquidity needs. Behind that concise statement lay an enormous effort by a great many people, and, despite the tragedy, the economic system remained stable in this country and throughout the world.

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Even before September 11, however, the pace of change required dexterity on the part of the Twelfth Federal Reserve District and its employees. This article will focus on four major Bank functions, with comments from some of the employees who are implementing changes within these functions.

Banking Supervision and Regulation

Financial modernization has changed banks' business, and technology has changed the way they operate.

Economic Research

Technological innovation is a driving force behind economic growth in the U.S. and the Twelfth District.

Customer Support

Intense competition in the marketplace means that excellent customer service may be the single most important factor that retains a client's business.

Cash Services

There is a lot more cash than there used to be and many more places where it may be obtained.



In the Twelfth District, more than four out of five state member banks, which are mostly community banks, have a presence on the Internet . . .

Banking Supervision and Regulation

he evolution of the banking industry has had wide-ranging implications for the Division of Banking Supervision and Regulation (BS&R). Financial modernization has changed the business that banks do, while technology has changed the way banks do business. As banking supervisors, the Bank has adapted to this change and helped the financial community respond to the risks and challenges of the evolving environment.

Financial Modernization

The financial landscape has changed remarkably over the years, with the boundaries between banks and other types of financial companies becoming increasingly blurred. While making loans and taking deposits still represent the core business of most banks, many have expanded their activities into asset securitization, mutual funds, insurance, and securities brokerage. In a number of ways the Gramm-Leach-Bliley Financial Modernization Act of 1999 merely recognized how far the banking industry already had evolved. However, the Act also created the concept of financial holding companies and granted the Federal Reserve a unique role as "umbrella" supervisor in their oversight.

Technology

Banks long have moved to adopt better technology to modernize their information systems, including back-office operations. Much more visible to the consumer has been the dramatic growth of Internet banking. While some of the country's biggest banks have pioneered on-line banking, even small banks are venturing onto the Web. In the Twelfth District, more than four out of five state member banks, which are mostly community banks, have a presence on the Internet, and about three-quarters of these offer fully transactional on-line banking services such as account transfers and bill payment.



Implications for Bank Supervisors

In response to these evolving trends in the banking industry, bank examiners have adjusted their approach to supervision and built an increasingly diverse set of skills necessary to evaluate and monitor financial institutions. Over the years they have moved from "point-in-time" evaluations connected to on-site examinations to a more continuous supervision framework, which has enabled a more timely response to change. Senior Examiner Keith Coughlin comments: "I helped one of our supervised institutions develop a more robust risk management process, which was a rewarding experience for both me and the institution. Because the bank's activities are closely tied to the venture capital market and the technology sector, its business model poses some unique risks and issues."

Keith Coughlin

"I helped one of our supervised institutions develop a more robust risk management process, which was a rewarding experience ..."

BS&R has made a concerted effort to train staff in areas such as information technology supervision. Financial Examinations Team Leader Marie Labat says, "We've moved to integrate information technology assessments into our overall safety and soundness examinations, a process that's required a considerable amount of education for staff. We now address information technology risk management during all phases of our exams, from the planning process to the final report." And, according to Consumer Affairs Principal Bonita Jones, "We've also developed a new set of skills to understand the information technology processes at banks that deliver consumer products over the Internet."

Another training effort involves economic capital modeling, as Senior Examiner Peter Eggenberger explains: "Technology has made it possible to

develop models that banks can use to measure risk better. It's been an evolutionary process, starting with market risk and







moving to credit risk; in the future we'll see quantification of operational risk. There's more homework for examiners, since we need to understand the models as well as the regulatory policies."

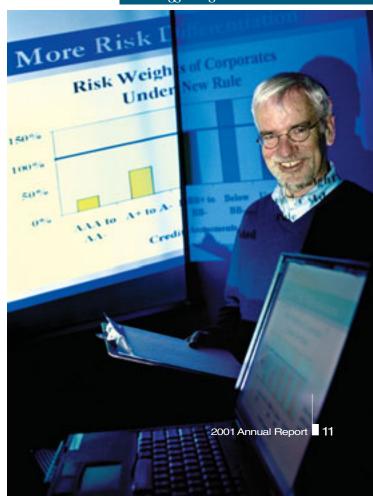
"We now address information technology risk management during all phases of our exams . . ."

In building the necessary skills, the Federal Reserve has set up formal and informal structures to leverage the expertise of individual Reserve Banks for the benefit of the System. In addition, the Fed has worked to develop a consistent approach to supervising nontraditional banking companies.

Bonita Jones



Peter Eggenberger





Tim Byun

"I think technology will continue to change the way we examine banks."

Efforts to reshape the supervisory process not only enrich Bank staff and the organization, but also benefit the institutions that it supervises in this dynamic banking environment. Examiner Tim Byun says, "I think technology will continue to change the way we examine banks. We're getting smarter, and we're doing our jobs better. For example, it's easier to monitor banks between exams. Financial modernization will also require us to understand how to monitor insurance and other activities that banks are becoming more involved in." As the industry evolves, the Bank will continue to position itself to respond.



... innovation and the application of new technologies will set the tone for economic performance.

Economic Research

erhaps the most striking development in the economy as a whole has been the tremendous surge in productivity, driven in large part by technological innovation-from advances in computing equipment and software to telecommunications. The Economic Research department has taken into account the growing prominence of technological innovation in the U.S., and particularly in the Twelfth District.

In 2001 high technology's luster seemed to fade as the country entered a recession that was, at least initially, primarily based on a downturn in information technology. This downturn acted as a reminder that much of high technology sector growth is cyclical. Thus, there is little doubt that, in the next expansion, innovation and the application of new technologies will set the tone for economic performance.

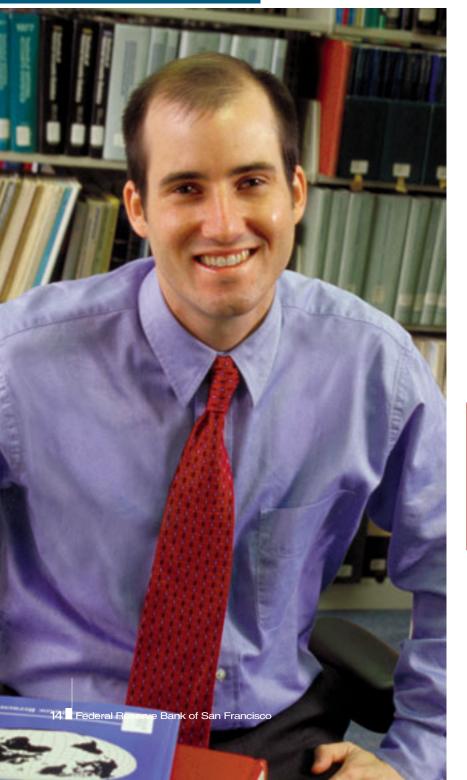
This is especially true for the economy of the Twelfth District. Whether measured by venture capital investment, number of patents, dollar value of exports, or employment and payroll, the District has a large share of the nation's top high technology centers.

Bolstering the Research Effort

In 2001 the Bank expanded the depth and breadth of its analysis of economic issues related to innovation, the technology sectors, and productivity. New staff joined the economists in the nonfinancial microanalysis group, which conducts research and policy analysis on labor markets, industry sectors, state and local government finance, and the regional economy more generally.

New to the department is Economist Daniel Wilson, whose research is to understand the sources of productivity growth and identify the policy implications. "This area of research is extremely interesting and as important as any in economics," Dan says. "Productivity growth is the key to advancing our standard of living and having the resources to enhance economic well-being more broadly."

Daniel Wilson



It is widely understood that increasing investment in plants and equipment–known as capital deepening–can lead to higher productivity. "The research suggests that much of the gain in productivity in recent years has come from improvements in the quality of capital equipment, not just from adding more machines," Dan explains. "That is, it has been the investment in new equipment that embodies advanced technologies that has helped to boost productivity growth."

"Productivity growth is the key to advancing our standard of living and having the resources to enhance economic well-being more broadly." producing the equipment. Research Advisor Mary Daly, who joined the department in 1996 and who also studies applied microeconomics, has applied her research on the effects of information technology growth in the Twelfth District to a broader area. "Looking nationwide," Mary says, "I found that many regional development agencies believe that, in order to be successful in the way that, say, Silicon Valley is successful, it's necessary to attract information technology-producing firms to an area in large numbers." However, Mary's findings show that this growth stimulus is not exclusive to information technology producers, and that attracting a concentration of information technology-using firms can have a comparable effect on growth.

One of the research findings is that productivity gains appear to be shared by both the firms using the new capital equipment and the firms

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New employee and Regional Analyst Lily Hsueh is working on a comprehensive analysis of the links between the IT sectors and the performance of regional economies within the District. "With the IT sectors accounting for up to a third of economic activity in metro areas in the District," Lily says, "it is important to understand how that dependence affects the regional economies."

Lily Hsueh



The work of Dan, Mary, and Lily complements the research agendas of other economists in Economic Research. During the year the department published several papers on high technology topics, including the use of computers by small businesses and another on productivity gains in banking. Other topics include a review of the links between unemployment and productivity. In addition, economists are investigating how gains in productivity are split between technologyproducing sectors and other sectors in the economy.



Customer Support

The need for constant improvement in productivity and increased efficiency in a competitive marketplace is not limited to high technology-related activity, but extends across all areas of an organization's operations.

In 2001 the Bank created a new customer service department, its employees dedicated strictly to customer support. When the new structure is fully implemented, customer service employees will answer questions relating to checks, cash, accounting, billing, funds transfer, book-entry securities, Automated Clearing House (ACH), electronic connections, business development follow-up, and certain Treasury services.

Formerly, questions relating to these matters were handled by the appropriate Bank department. As Customer Service Supervisor Gwen Brame notes, "For Los Angeles check inquiries alone, we average about 165 calls

Gwen Brame



daily." The new structure streamlines customers' interface with the Bank and allows business areas to focus on their work.

The initiative began in the Twelfth District's Northern Region, where customers of the Portland, Salt Lake City, and Seattle branches began to use a toll-free telephone number that gives them a single point of contact with knowledgeable staff. As Northern Region Manager of Customer Support Colleen Everroad says, "The key to the rather quick and successful transition was the staff, their enthusiasm, and great team focus."

Jennifer Scholting



... the Twelfth District is implementing a Bankwide customer service certification training program to improve service for internal as well as external customers.

"... it has been a great opportunity for the department, as the analysts expand their knowledge of Federal Reserve Bank operations."

Customer Service Representative Jennifer Scholting echoes this sentiment: "I really like working with customers as well as the staff here-we work as a team. I enjoy working with financial institutions of any size. There is always something new to learn."

Portland-based Cheryl Bassett visited the Salt Lake City and Seattle branches so that she could help customers better in her new customer service role. "Each branch office has unique operational demands," she says, "so if I know, for example, from which office a customer obtains cash, I can handle an inquiry better."

Customer Service Training

To make the new department successful, the Twelfth District is implementing a Bankwide customer service certification training program to improve service for internal as well as external customers. The new structure requires considerable cross-training. "Through this rather fast transition, it has been a challenge to cross-train quickly enough," Colleen Everroad says. "But it has been a great opportunity for the department, as the analysts expand their knowledge of Federal Reserve Bank operations."

Glenda Stefanek • Colleen Everroad • Cheryl Bassett



Account Coordinator Hisani Washington has trained two of the Customer Service Help Desk staff; she now acts as a resource for any complex accounting questions the Help Desk receives. With 16 years of experience in the Customer Accounting department, Hisani's view of customer service is quite simple: "In order to give good customer service, it's important to work with good people. I've had wonderful people to work for we've got a really good, tight-knit group. We all work well together."

Hisani enjoys good relationships with customers as well as with colleagues. "When you talk to customers over a long period of time, you get to know them, and they get to know you. It's almost like family. We build rapport, and I really like that." She added, "It's up to us to help customers get any problems resolved and, we hope, ensure those problems do not happen again."

Outreach—Virtual and Actual

The Bank is also improving customer service in cyberspace by developing the "E-notice," piloted by the Corporate Services department in 2001. One of Corporate Services' duties is to dispatch customer announcement letters and District circular letters generated by other Bank departments. In the past, it often took a number of days for these communications to reach their intended recipients by regular mail.

Corporate Services now posts letters or circulars directly to the Internet and sends an e-mail to clients with a link to the information. Corporate Services Project Analyst Erin McGowan believes that "e-mail is the preferred method of communication for business. The customer receives critical information quickly."

Hisani Washington



"I've had wonderful people to work for—we've got a really good, tight-knit group. We all work well together."

"Some financial institutions had already asked for reduced paper mailings from the Bank, and now our customers appreciate the much more timely notice of financial and regulatory information."

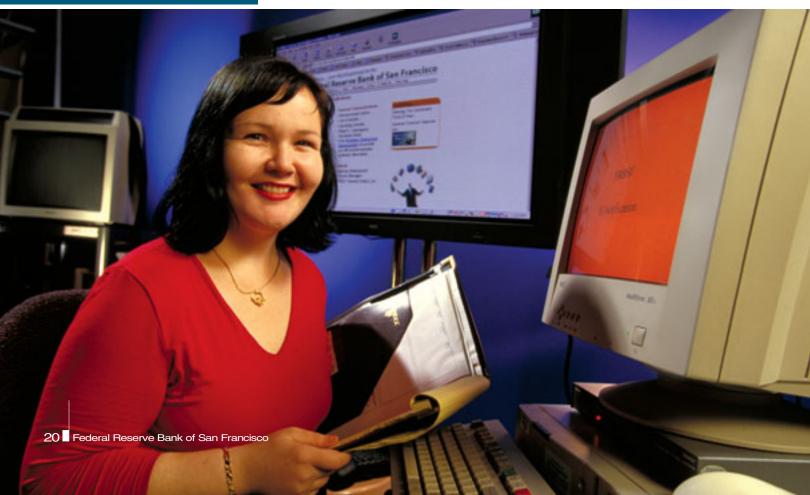
Customer response to the E-notice has been positive. As Erin says, "Some financial institutions had already asked for reduced paper mailings from the Bank, and now our customers appreciate the much more timely notice of financial and regulatory information."

The importance of outreach to customers is further reflected by the Summer Symposiums held in 18 different Twelfth District locations during 2001. Each two-day symposium covered topics such as accounting and billing, as well as key initiatives such as check modernization. The symposiums enabled the Bank to contact a large number of customers—970 participants total—with excellent results. Additional outreach programs are planned for 2002.

Progress Report

An important element of the change in customer support is to monitor progress, and so the Bank will poll customers to see if it is meeting expectations and to find out what could be improved. As Northern Region Manager of Customer Support Colleen Everroad says, "I believe that once we have fully centralized customer support, our customers will see very positive results."

Erin McGowan





The value of U.S. currency in circulation has risen from \$30.4 billion in 1960 to \$593 billion at the end of 2001 . . .

Cash Services

The first fixed-value coins were issued over 2,500 years ago, so we can safely say that coin is a very old payment system. Even so, neither our venerable coins nor our notes are immune to change, which comes from many directions: users, technology, marketplace conditions, and the government.

The value of U.S. currency in circulation has risen from \$30.4 billion in 1960 to \$593 billion at the end of 2001; about two-thirds of this is held abroad. Over the same period, denomination preferences changed. In 1960 people held only 2 percent of their currency in hundred-dollar notes compared to 19 percent in 2001, while one-dollar notes dropped from 46 percent to 35 percent of notes outstanding.

In the currency marketplace, technology also has driven change through improvements in communication, software, hardware, and information management. Technological development has made cash more readily available—perhaps the most visible example is the ubiquitous presence of automated teller machines, of which the country now has about 230,000. Another new way to obtain cash is by using a debit card at the point of sale, making retail establishments dispensers of cash as well as of goods. To process all the additional coin and currency, counting equipment has become faster and more sophisticated. Additionally, cash usage and inventory information can be managed more efficiently because software and communications allow prompt information access—for example, by using the telephone or Internet.

The government also initiates change. From 1996 to 2000 the United States introduced redesigned currency with improved anti-counterfeiting capability, the first such major change since the 1920s. In 1999 the U.S. Mint launched its 50-State Quarter Program, and in early 2000 the Golden Dollar coin began to circulate.



Cash Changes at the Fed

Changes in Reserve Bank operations reflect these changes in cash. The San Francisco Bank became the Cash Product Office for the Federal Reserve System in 2001, which means that the Bank's perspective on cash operations takes on a national focus. The Bank collaborates with key government agencies such as the U.S. Treasury, the Bureau of Engraving and Printing, and the U.S. Mint to ensure proper inventory levels of notes and coin and an effective distribution system are maintained. The Bank also cooperates with the Secret Service to create effective deterrents to counterfeiting.

Senior Project Analyst Brian Coulter of the Cash Product Office says that the popularity of the State Quarters program and the Golden Dollar contributes to the need to manage coin more closely. "While you may not often see Golden Dollars in supermarket cash registers, they are, in fact, widely used," Brian says. "For example, you will find them in post office and other vending machines, and they are used by transit authorities as change from ticket machines and in toll road transactions. More Golden Dollars have gone into circulation in two years than in the entire life span of the Susan B. Anthony dollar coins, first introduced in 1979."

> The San Francisco Bank became the Cash Product Office for the Federal Reserve System in 2001, which means that the Bank's perspective on cash operations takes on a national focus.

Phoenix is the District's first highly automated cash processing center and represents one of the most technologically advanced processing centers in the country.

Advanced Automation in the Phoenix Processing Center

In September 2001 the Bank opened the Phoenix Processing Center to serve the cash needs of Arizona and surrounding Twelfth District communities. Phoenix is the District's first highly automated cash processing center and represents one of the most technologically advanced processing centers in the country. The Center uses state-of-the-art robotic cranes and Automated Guided Vehicles to move large amounts of currency safely, quickly, and reliably. The elimination of some of the most dangerous and difficult work has been well received by Center employees.

Joel VanZee • Los Angeles Cash



Standard Cash Automation

Standard Cash Automation (SCA) is an automated currency and coin inventory tracking and reporting application, a unified platform that will meet the needs of customers throughout the Federal Reserve System. "SCA allows the Bank to be more efficient and to make customer-friendly changes more quickly," says Cash Product Office Vice President Marla Borowski. "Standardization also makes things easier for customers whose operations span more than one District." The Salt Lake City Branch in the Twelfth District was the first office in the country to implement SCA officially in 2001; the program ultimately will be operational nationwide by 2003.

Omnia mutantur . . . - Ovid All things are changed . . .

e can be sure that change is a constant, if not escalating, element of our lives. And in the face of change, sudden or constant, Bank employees regularly demonstrate their adaptability and ability to perform their roles. If the past is a precursor to the future, it is certain that they will continue to meet the needs of their customers and constituencies and do their part to foster a stable economy.



Executive Committee

Clockwise from left:

John F. Moore First Vice President (seated)

Susan A. Sutherland Senior Vice President

> Mark Mullinix Executive Vice President (seated)

Kerry Webb Senior Vice President

Jack H. Beebe Senior Vice President and Director of Research

Terry S. Schwakopf Executive Vice President (seated)

> Robert T. Parry President (seated)

FINANCIAL SERVICES

The Bank made significant progress toward its goals of improving customer service, streamlining operations, and increasing revenue in 2001. Complex efforts continued during the year to upgrade and standardize check and cash operations platforms.

- The Phoenix Processing Center opened on September 4, 2001, improving the quality of cash services available to the Arizona market, and serving as a new currency warehouse for the Los Angeles office.
- The Bank made significant progress toward its goal of establishing two comprehensive customer support centers in San Francisco and Portland. When completed, the new Customer Support function will provide support to customers for questions relating to: checks, cash, accounting, billing, funds transfer, book-entry securities, ACH, electronic connections, business development follow-up, and certain Treasury services.
- The Bank developed a new Check to ACH Conversion (CTAC) service in collaboration with a major credit card bank in the Northwest. CTAC will capture payment data from checks received by lockbox payment processors and convert the items into ACH payments for collection. This process will significantly speed up the check collection process, as well as minimize the number of times that paper checks are handled.
- The Bank established a new direction for the System's cash services business, assuming leadership of the national Cash Product Office (CPO) in March. The CPO developed the "Long-Term Cash" initiative, an effort to reduce overuse of Federal Reserve currency processing services by

inducing banks to weigh the societal cost of their decisions to deposit currency with the Federal Reserve.

- The Bank piloted and received approval to move forward with Federal Reserve Systemwide implementation of the bar code-based Automated Depositor Identification (ADI) system, which associates a bundle of currency with the depositing institution, allowing the Bank to monitor customer deposit quality better.
- The Bank piloted and deployed the Reserves Web Interface (RWI), a product that provides Web-based access to reserve requirement data to internal Federal Reserve System users.
- Standard Cash Automation (SCA), a Federal Reserve System-standard automated currency and coin inventory tracking application, was implemented in four District offices.
- The Bank completed hardware, software, and network changes in preparation for conversion to Check Modernization, a project designed to create a more efficient check processing environment that includes standard, centrally managed platforms for item processing, check adjustments, and image services, as well as Webbased delivery of check services.
- To reduce costs and streamline the provision of services, ACH, Funds Transfer, and Book-Entry Transfer services activities were consolidated to a limited number of sites in the Federal Reserve System. The multi-phased consolidations, which eliminated those services in the Twelfth District, were completed successfully around year-end.

Bank Highlights

ECONOMIC RESEARCH

The research of staff economists continued at a high level in 2001, resulting in 13 articles accepted for publication in peer-reviewed professional economics journals. This research underpins the staff's support of the Bank's and the System's policy missions. This support includes briefings to the Bank President and the Boards of Directors, participation on System committees, and the Department's public speaking and publications programs. For a full description of the year's work, see the *Economic Review* (available on frbsf.org).

- Macroeconomic and policy research focused on such topics as how much weight Fed policymakers put on smoothing interest rates, the effects of policy and other macro factors on the term structure of interest rates, and estimates of the Fed's emphasis on inflation under different Chairmen.
- Banking and regulation research topics included incorporating equity market variables into supervisory monitoring models for bank holding companies and a theoretical comparison of two mechanisms for disposing of failed bank assets.
- Research in the international area focused mainly on Pacific Basin issues and included such topics as the impact of Japan's regulatory reforms on bank equity values, the trade effect of currency crises, an analysis of the justification for international lending of last resort, and pegging and stabilization policies in developing countries.

- Energy problems in California and the West were special topics throughout the year in the regional and financial discussions. Aspects addressed included analysis of electricity and natural gas markets, the effects of energy problems on bond rates, stock values, and corporate profits, and the impact of the energy market developments on energy firms and state and local financing in California.
- The Bank cohosted and organized two professional conferences with the Stanford Institute for Economic Policy Research at Stanford University. One conference, "Asset Prices, Exchange Rates, and Monetary Policy," featured papers by Federal Reserve staff, researchers from the Central Bank of Norway, the Central Bank of Sweden, and the Bank of England, as well as noted academics.
- For the third consecutive year, the Pacific Basin Center and the World Bank Institute cosponsored a four-day seminar in Bangkok, Thailand, for some 50 senior policymakers from Africa, Asia, and North America. The topic in 2001 was "Managing Capital Flows and Monetary Policy in Developing and Transitioning Economies."
- Economic Research hosted a joint System conference with Supervision and Regulation which included papers on early detection of inadequate capitalization of U.S. commercial banks, forecasting bank health, forecasting supervisory resources, market information for supervisory surveillance, and issues on banking and the business cycle.

BANKING SUPERVISION AND REGULATION

The Banking Supervision and Regulation (BS&R) division continued to promote safety and soundness in the banking system and to ensure compliance with applicable laws and regulations. In addition, BS&R continued to encourage banking institutions to responsibly meet the financial needs of their communities. Some examples of the division's activities are as follows:

- BS&R developed a Risk Assessment Council which identified the most significant risks facing District financial institutions and developed action plans to address those risks.
- In light of the economic downturn, BS&R revisited the scope of future supervisory activities and, for example, in many cases, expanded loan coverage because of increased credit risk.
- BS&R developed the Commercial Real Estate Web site, a comprehensive nationwide real estate database with analyses and monitoring reports, which is available to staff throughout the Federal Reserve System.
- A new publication, the *Japan Bank Monitor*, was created to share information throughout the Federal Reserve System on new developments and trends in the Asia-Pacific region.
- In Compliance, BS&R responded to change by initiating a number of new supervisory programs, refined procedures, and trained bankers and examiners on privacy regulations.

The Community Affairs unit coordinated and hosted workshops to discuss solutions to credit issues in Native American land; cohosted the National Community Development Lending School in conjunction with the Cleveland Reserve Bank and Case Western University in Cleveland; and coordinated several community outreach seminars for leaders of affordable housing lending organizations.

OUTREACH

The Bank continued its educational outreach programs on the purposes and functions of the Federal Reserve System.

- The Bank expanded its congressional calling program to better inform government representatives on the role the Federal Reserve plays in the local and national economy and the informational resources available from our Bank.
- The Bank published the inaugural edition of Econ Ed and the Fed. This biannual newsletter provides teaching materials and resources, including Web sites, classroom ideas, programs, and other information to high school educators in the Twelfth District.
- The Bank led the Federal Reserve System effort to market the new Federal Reserve education Web site, FederalReserveEducation.org.
- The Bank launched its redesigned public Web site, frbsf.org.

Summary of Operations

Custody Services	Volume (in thousands)		
Cash Services	1999	2000	2001
Currency notes paid into circulation	5,369,630	5,490,977	5,810,826
Food stamp coupons processed	367,350	284,971	288,241
Securities Services			
Other Treasury original issues	63	41	0
Book-entry securities processed	527	141	129
Payments Services Check Services			
Commercial checks collected	2,312,940	2,425,359	1,924,729
Government checks processed	46,034	38,809	60,584
Return items processed	33,849	33,729	35,558
Electronic Payments Services			
Wire transfers processed	27,088	27,743	30,896
Automated Clearing House transactions processed	574,872	640,946	738,230
Discounts and Advances			
Total discounts and transactions *	647	969	451
Number of financial institutions accommodated *	130	130	116

^{*} Whole number (not in thousands)

Employee Responses to

"Why do you work here?"

Ailene Adamson, Executive Assistant

What makes this a great place to work are my colleagues; without them, it's just a place to work. With them, it's a place to work that's stimulating, challenging, and, yes, fun, too!

Andres Curtolo, Senior Project Analyst

Personally, I like the challenges that my job poses on a daily basis. The mystique associated with the Fed is something I enjoy being a part of. There is a little extra pride I take in saying that I work for the Federal Reserve Bank.

Beki Bolivar Jaramillo, Custodian

My position as a custodian gives me the opportunity to provide a pleasant and clean environment for all of the professional personnel who work in each department.

Bruce Ito, Associate Community Affairs Specialist

I work in the Community Affairs unit, which helps ensure that the Community Reinvestment Act (CRA) is implemented in the Twelfth District. As a former social worker, I appreciate the spirit of the CRA and the dedication of those who work to implement it.

Charles Kang, Project Analyst

When I began my career at the Federal Reserve four years ago I knew it was (and still is) a cornerstone and the economic nervous system of this country. It would have been foolish not to work for one of the most durable and constant institutions in the U.S.

Danny Ramos, Operations Specialist

I love the challenge, job security, good benefits, and retirement plans.

Diane Rosenberger, Research Librarian

Interesting work—what librarians do today is nothing like what I learned in school—and always new challenges, an excellent manager, and wonderful colleagues.



Employee Responses to

"Why do you work here?"

Ellen Kolowich, Senior Manager

Because it satisfies these important needs for me: security, recognition, and sense of family. I've worked here nearly 30 years, worked hard, been recognized and rewarded for those efforts, and have made friends that I consider part of my extended family. The work/life balance has been there for me when I needed it.

Jim LeVoir, Manager

Because the Fed's bottom line isn't necessarily about dollars and cents. Ours is a public policy bottom line. Everything we do is, or should be, ultimately designed to produce a long-term positive impact on our nation's economy. It's a huge responsibility, but it's tremendously satisfying.

Jimmy Kamada, Director

First, I feel good about the role the Federal Reserve plays in monetary policy, financial services, and in the regulation and supervision of the banking industry. Second, Fed employees are dedicated and hard-working. Third, I've worked in San Francisco, Los Angeles, and Seattle, and have responsibilities in Portland and Salt Lake City, and I've met a lot of nice people.

Kate Wheatman, Communications Specialist

My work is interesting and challenging to me. I wholeheartedly appreciate working in an environment where excellence is expected, and my coworkers are great – smart, conscientious, ethical, and considerate.

Kathryn Lawrence, Manager

The Federal Reserve is extremely diverse in its employee base and has a dynamic approach to management development, which makes this a fascinating and ever-changing place to work.

Lena Robinson, Community Affairs Specialist

The Fed represents many things that I am proud to be associated with. Two that stand out are integrity and intellectual excellence, which make me want to give of my very best. It is wonderful to work in an environment where my colleagues are not just very smart, but also creative and friendly.

Libby Wood, Vice President

We are always conscious of the role of the Fed in the U.S. and world economies, and everyone here wants to do the right thing. I believe our motivation isn't based on personal gain as much as it is on our ability to contribute to the greater good.



Employee Responses to "Why do you work here?"

Lowell Bethel, Protection Officer

My sense of fulfillment comes from knowing that my job matters. This is the best job I've ever had because of the quality, integrity, and professionalism of my fellow Fed team employees.

Mary Ann Clause, Staff Assistant

One of my reasons is inspiring team leadership. Getting the job done together. A sense of personal and group pride at the end of each day, because we achieved. Everybody wins.

Mary Wujek, Director

The Fed plays a critical role stabilizing the underpinnings of our trust: our ability to perform basic transactions. I'm proud to support that effort.

Melissa Jaffe, Public Affairs Specialist

I work here because each day I meet another employee who becomes a role model by demonstrating integrity in actions and words. While all the employees are extremely busy, people take the time to catch up in the cafeteria lines or in the hallways with one another—even the highest-level officers.

Philip B Johnson, Manager

Recently coming from an entrepreneurial background, I was somewhat concerned about a large organization such as the Fed having tolerance for risk, innovation, and independent thinking. In the two years I have been here I have been consistently challenged and, when successful, rewarded for accomplishing just these things. Suffice it to say, I have been more than pleasantly surprised.

PJ Jones, Executive Staff Assistant

I work with very intelligent people who have a minimum of one degree, oftentimes two, and some are working on a third. Many people here speak two, three, and more languages fluently, and we have a diverse ethnic staff that gives one a chance to learn about different people and cultures. Add to this the fascinating world of finance and the global economy. In other words, it's a wonderful place to be employed.

Rita Chargualaf, Vault Teller

I work here because of the challenges and the gratification. It's challenging because every day is a new learning adventure different from my past work experiences. Also, it's meaningful and fulfilling because we serve the public and are able to establish a sense of community contribution.



Employee Responses to -

"Why do you work here?"

Stanley Mills, Building Technician

The Bank provides an environment where each day is different; one can say Building Services is anything but routine. The importance of keeping the environment to such high standards rests upon the building technicians. You'll not find a more diverse and talented bunch than the Los Angeles crew. We take lots of pride in seeing the results of our work.

Steve Derahian, Operations Analyst

I can sum up why I work here in eight simple words: "Service is our duty; quality is our goal," or, on a more personal note, "Service is my duty; quality is my goal."

Stuart Vandel, Examiner

I don't come to work at the Fed every day; rather, I come on a part-time schedule. The other days I stay home with our two young children. This flexibility that the Fed offers and the chance to work for our central bank with its talented people are the reasons I like coming to work here—and sometimes you just gotta get out of the house!

Susan Sutherland, Senior Vice President

I work at the Fed for several reasons which are very much interrelated: I am always learning and being challenged, both intellectually as well as professionally; I'm surrounded by smart, engaged, and engaging people; and, together, we make a difference in a unique, fascinating, and very important organization. I'm proud to be a part of all that!

Todd Glissman, Group Vice President

I continue to work at the San Francisco Fed because I have been blessed to work in a variety of roles under inspired leadership who are willing to take risks to make a difference in ways that improve our global, national, and regional banking environment and to improve the benefits for all of us working here.

Travis Hallett, Protection Department

I like working in Protection, and it's a great honor and privilege to have helped to open the Phoenix Processing Center. I am very proud and honored to be here, and I continue to work and strive for excellence to make the people who gave me a chance in the Federal Reserve System proud of me and my accomplishments.

Branch Managers



Left to right

Left to right

Kerry Webb Andy Wolcott Senior Vice President (Seattle)
Group Vice President (Salt Lake City)

Rick Hornsby Group Vice President (Portland)

Mark Mullinix Executive Vice President (Los Angeles)



Bank Officers & Principals

Executive Committee

Robert T. Parry

President and Chief Executive Officer

John F. Moore

First Vice President and Chief Operating Officer National Cash Product Director

Jack H. Beebe

Senior Vice President and Director of Research

Mark Mullinix

Executive Vice President, District Finance and Administration National Cash Product Manager

Terry S. Schwakopf

Executive Vice President, Banking Supervision and Regulation and District Public Information

Susan A. Sutherland

Senior Vice President, District Cash Services, Human Resources, Legal, Statistics, and Structure

D. Kerry Webb

Senior Vice President, Check, Business Development, Electronic Payments, Product Support, and Customer Support

San Francisco Office

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Senior Vice President

Michael J. Stan

Senior Vice President and Chief Information Officer

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

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Vice President

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Glenn D. Rudebusch

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Research Publications Advisor

Simon H. Kwan

Research Advisor

Ramon Moreno

Research Advisor

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Research Advisor

Bharat Trehan

Research Advisor

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Executive Vice President

Roger W. Replogle

Group Vice President

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Group Vice President

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Vice President

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Seattle Branch

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Vice President

Pamela R. Anderson

Director

Lynn M. Jorgensen

Jimmy F. Kamada

Director

Phoenix Processing Center

Robert E. Kellar, Jr.

Director



San Francisco



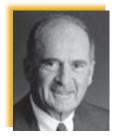
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Deputy Chairman George M. Scalise President Semiconductor Industry Association San Jose, California



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Jack McNally Business Manager (Retired) International Brotherhood of **Electrical Workers** Local Union 1245 and Principal JKM Consulting Sacramento, California



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



Richard W. Decker, Jr. Chairman and Cofounder Belvedere Capital Partners LLC San Francisco, California



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



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



Lori R. Gay President Los Angeles Neighborhood Housing Services, Inc. Los Angeles, California



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



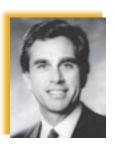
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D. Linn Wiley President and CEO Citizens Business Bank Ontario, California



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





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George Passadore President, Oregon Wells Fargo Bank Portland, Oregon



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





December 31, 2001



PricewaterhouseCoopers LLP

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, 2001 (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, and as such, include amounts, some of which are based on judgments and estimates of management.

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 (COSO). Based on this assessment, the management of the FRB-SF believes that the 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
President

by
John F. Moore
First Vice Parry

The Colom T. Marre

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First Vice President



Report of Independent Accountants

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, 2001 included in the accompanying Management's Assertion. The assertion is the responsibility of FRB San Francisco management. Our responsibility is to express an opinion on the assertions based on our examination.

Our examination was made in accordance with 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 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, 2001, is fairly stated, in all material respects, based upon criteria described in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Pricewaterhouse Loopus LLP

March 4, 2002

San Francisco, California



Report of Independent Accountants

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, 2001 and 2000, and the related statements of income and changes in capital for the years then ended. 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. 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.

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, 2001 and 2000, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

Pricewaterhouse Loopus LLP

March 4, 2002

San Francisco, California

Statements of Condition (in millions)

	As of December 31,			
Assets		2001		2000
Gold certificates	\$	1 12/	\$	1 1/2
)	1,136	\$	1,162
Special drawing rights certificates		234		234
Coin		144		155
Items in process of collection		267		1,727
Loans to depository institutions		_		23
U.S. government and federal agency securities, net		56,590		56,511
Investments denominated in foreign currencies		1,673		1,609
Accrued interest receivable		575		658
Bank premises and equipment, net		229		222
Other assets		36		40
Total assets	\$	60,884	\$	62,341
Liabilities:	.	10.011	*	/ /
Federal Reserve notes outstanding, net	\$	49,314	\$	55,264
Deposits:				
Depository institutions		2,129		2,632
Other deposits		5		6
Deferred credit items		489		1,394
Interest on Federal Reserve notes due U.S. Treasury		53		133
Interdistrict settlement account		7,226		1,241
Accrued benefit costs		68		69
Other liabilities		8		18
Total liabilities		59,292		60,757
Capital:				
Capital paid-in		796		792
Surplus		796		792
Total capital		1,592		1,584

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

60,884

Total liabilities and capital

62,341

Statements of Income (in millions)

			years ended cember 31,
		2001	2000
Interest income:			
Interest on U.S. government and federal agency securities	\$	3,050	\$ 3,412
Interest on investments denominated in foreign currencies		37	28
Interest on loans to depository institutions		1	1
Total interest income		3,088	3,441
Other operating income (loss):			
Income from services		96	92
Reimbursable services to government agencies		20	25
Foreign currency losses, net		(162)	(145)
U.S. government securities gains (losses), net		32	(9)
Other income		11	8
Total other operating income (loss)		(3)	(29)
Operating expenses:			
Salaries and other benefits		177	168
Occupancy expense		17	16
Equipment expense		25	21
Assessments by Board of Governors		67	68
Other expenses		74	91
Total operating expenses		360	364
Net income prior to distribution	\$	2,725	\$ 3,048
Distribution of net income:			
Dividends paid to member banks	\$	48	\$ 44
Transferred to surplus		4	517
Payments to U.S. Treasury as interest on Federal Reserve note	es	2,673	2,487
Total distribution	\$	2,725	\$ 3,048

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

Statements of Changes in Capital For the years ended December 31, 2001 and December 31, 2000 (in millions)

	Capital Paid-in	Surplus	Total Capital
Balance at January 1, 2000			
(13 million shares)	\$ 660	\$ 660	\$ 1,320
Net income transferred to surplus	_	517	517
Surplus transfer to the U.S. Treasury	-	(385)	(385)
Net change in capital stock issued (3 million shares)	132	_	132
Balance at December 31, 2000			
(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

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

1. Organization

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. 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.

Structure

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. In accordance with the Federal Reserve Act, supervision and control of the Bank are exercised by a Board of Directors. 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

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, 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 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.

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. Data for 2001 reflects the adoption of this policy. Major services provided for the System by this bank, for which the costs will not be redistributed to the other Reserve Banks, include: Statistics and Reserves, Enterprise Wide Adjustment, Office of Support Services, National Information Center-Central Operations, and Cash Product Office.

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

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.

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 amounts 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 2001.

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 any loans were deemed to be uncollectible, an appropriate reserve would be established. Interest is accrued using the applicable discount rate established at least every fourteen days by the Board of Directors of the Reserve 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.

Matched sale-purchase transactions are accounted for as separate sale and purchase transactions. Matched sale-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.

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.

Foreign exchange ("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 prearranged maximum amount and for an agreed upon period of time (up to twelve months), at an agreed upon interest rate. These arrangements give the FOMC temporary access to 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. However, decisions regarding the securities and foreign currencies transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, 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 straightline 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 (losses), net." Foreign-currency-denominated assets are revalued daily at current 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 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.

Balances of U.S. government and federal agency securities bought outright, securities loaned, investments denominated in foreign currency, interest income, 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.

Statement of Financial Accounting Standards No. 133, as amended and interpreted, became effective on January 1, 2001. For the periods presented, the Reserve Banks had no derivative instruments required to be accounted for under the standard.

Bank Premises and Equipment

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. Internally developed software is capitalized based on the cost of direct materials and services and those indirect costs associated with developing, implementing, 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 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, triparty 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. 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 Federal Reserve notes reduced by currency held in the vaults of the Bank of \$20,372 million and \$22,001 million at December 31, 2001 and 2000, respectively.

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. 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.

The Consolidated Appropriations Act of 2000 (Public Law 106-113, Section 302) directed the Reserve Banks to transfer to the U.S. Treasury additional surplus funds of \$3,752 million during the Federal Government's 2000 fiscal year. Federal Reserve Bank of San Francisco transferred \$385 million to the U.S. Treasury. Reserve Banks were not permitted to replenish surplus for these amounts during fiscal year 2000, which ended September 30, 2000; however, the surplus was replenished by December 31, 2000.

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 services to the Treasury Department that have been billed but not paid are immaterial and included in Other expenses. The costs of providing fiscal agency and depository services to the Treasury Department that have been billed but not paid are immaterial and included in "Other expenses."

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, with the exception of securities held under agreements to resell and the related premiums, discounts and income, 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 10.075 percent and 10.899 percent at December 31, 2001 and 2000, respectively.

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

2001	2000
\$ 1	\$ 14
18,343	19,481
26,793	26,177
10,444	10,112
55,581	55,784
1,139	1,061
(130)	(334)
\$ 56,590	\$ 56,511
	\$ 1 18,343 26,793 10,444 55,581 1,139 (130)

Total SOMA securities bought outright were \$561,701 million and \$518,501 million at December 31, 2001 and 2000, respectively.

The maturity distribution of U.S. government and federal agency securities bought outright, which were allocated to the Bank at December 31, 2001, were as follows (in millions):

			Pa	ar value		
Maturities of Securities Held	Go	U.S. overnment		eral Agen oligations	icy	Total
Within 15 days	\$	1,077		_	\$	1,077
16 days to 90 days		12,548		_		12,548
91 days to 1 year		13,160		_		13,160
Over 1 year to 5 years		15,430		1		15,431
Over 5 years to 10 years		5,374		_		5,374
Over 10 years		7,991		_		7,991
Total	\$	55,580	\$	1	\$	55,581

At December 31, 2001 and 2000, matched sale-purchase transactions involving U.S. government securities with par values of \$23,188 million and \$21,112 million, respectively, were outstanding, of which \$2,336 million and \$2,301 million were allocated to the Bank. Matched sale-purchase transactions are generally overnight arrangements.

At December 31, 2001 and 2000, U.S. government securities with par values of \$7,345 million and \$2,086 million, respectively, were loaned from the SOMA, of which \$740 million and \$227 million were allocated to the Bank.

5. Investments Denominated in Foreign Currencies

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and the Bank for International Settlements, and invests in foreign government debt instruments. Foreign government debt instruments held include both securities bought outright and securities held 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 11.491 percent and 10.270 percent at December 31, 2001 and 2000, respectively.

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

	2001	2000	
European Union Euro:			
Foreign currency deposits	\$ 528	\$ 476	
Government debt instruments including agreements to resell	310	279	
Japanese Yen:			
Foreign currency deposits	217	282	
Government debt instruments including agreements to resell	611	565	
Accrued interest	7	7	
Total	\$ 1,673	\$ 1,609	

Total investments denominated in foreign currencies were \$14,559 million and \$15,670 million at December 31, 2001 and 2000, respectively.

The maturity distribution of investments denominated in foreign currencies which were allocated to the Bank at December 31, 2001, was as follows (in millions):

Within 1 year	\$ 1,576
Over 1 year to 5 years	46
Over 5 years to 10 years	51
Over 10 years	_
Total	\$ 1,673

At December 31, 2001 and 2000, there were no open foreign exchange contracts or outstanding F/X swaps.

At December 31, 2001 and 2000, the warehousing facility was \$5 billion, with zero outstanding.

6. Bank Premises and Equipment

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

	2001	20	00
Bank premises and equipment:			
Land	\$ 24	\$	24
Buildings	179	1	164
Building machinery and equipment	42		39
Construction in progress	1		6
Furniture and equipment	135	1	124
	381	3	357
Accumulated depreciation	(152)	(1	36)
Bank premises and equipment, net	\$ 229	\$ 2	221

Depreciation expense was \$20 million and \$18 million for the years ended December 31, 2001 and 2000, respectively.

The Bank leases unused space to outside tenants. Those leases have terms ranging from 1 to 6 years. Rental income from such leases was \$1 million for the years ended December 31, 2001 and 2000, respectively. Future minimum lease receivable under noncancelable agreements in existence at December 31, 2001, were (in millions):

2002	\$ 1.1
2003	1.1
2004	.2
2005	.2
2006	.2
Thereafter	.1
	\$ 2.9

7. Commitments and Contingencies

At December 31, 2001, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from 1 to approximately 4 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 \$858 thousand and \$644 thousand for the years ended December 31, 2001 and 2000, 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, 2001, were not material.

Under the Insurance Agreement of the Federal Reserve Banks dated as of March 2, 1999, each of the Reserve Banks has agreed to bear, on a per incident basis, a pro rata share of losses in excess of 1 percent of the capital paid-in of the claiming Reserve Bank, up to 50 percent of the total capital paid-in of all Reserve Banks. Losses are borne in the ratio that a Reserve Bank's capital paid-in bears to the total capital paid-in of all Reserve Banks at the beginning of the calendar year in which the loss is shared. No claims were outstanding under such agreement at December 31, 2001 or 2000.

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"). 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, 2001 and 2000, and for the years then ended, are not material.

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled \$6 million and \$5 million for the years ended December 31, 2001 and 2000, 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):

33.4	\$	29.8
0.7		
· · · ·		0.7
2.3		2.1
0.1		(0.1)
0.3		0.2
(2.2)		(2.1)
4.2		2.8
38.8	\$	33.4
	2.3 0.1 0.3 (2.2)	0.1 0.3 (2.2)

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):

	2001	2	000
Fair value of plan assets at January 1	\$ _	\$	_
Actual return on plan assets	_		_
Contributions by the employer	1.9		1.9
Contributions by plan participants	0.3		0.2
Benefits paid	(2.2)		(2.1)
Fair value of plan assets at December 31	\$ -	\$	_
Unfunded postretirement benefit obligation	\$ 38.8	\$	33.4
Unrecognized prior service cost	4.3		9.9
Unrecognized net actuarial gain	14.0		15.0
Accrued postretirement benefit costs	\$ 57.1	\$	58.3

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

At December 31, 2001 and 2000, the weighted-average assumption used in developing the postretirement benefit obligation were 7.0 percent and 7.5 percent, respectively.

The weighted-average assumption used in developing the postretirement benefit obligation as of December 31 is as follows:

	2001	2000
Discount rate	7.0%	7.5%

For measurement purposes, a 10.00 percent annual rate of increase in the cost of covered health care benefits was assumed for 2002. Ultimately, the health care cost trend rate is expected to decrease gradually to 5.00 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, 2001 (in millions):

	1 Perc	entage	1 Percentage	
	Point	Increase	Point	Decrease
Effect on aggregate of service and interest				
cost components of net periodic postretirement benefit costs	\$	0.2	\$	(0.2)
Effect on accumulated postretirement benefit obligation		2.5		(2.2)

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

	2001	2000
Service cost-benefits earned during the period	\$ 0.7	\$ 0.7
Interest cost of accumulated benefit obligation	2.3	2.1
Amortization of prior service cost	(1.4)	(1.6)
Recognized net actuarial loss	(0.9)	(0.8)
Net periodic postretirement benefit costs	\$ 0.7	\$ 0.4

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, 2001 and 2000, were \$12 million and \$11 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic postemployment benefit costs included in 2001 and 2000 operating expenses were \$2 million for each year.

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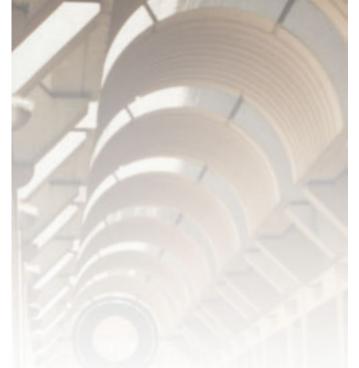
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The Federal Reserve Bank of San Francisco is one of twelve regional Federal Reserve Banks across the U.S. that, together with the Board of Governors in Washington, D.C., serve as our nation's central bank.

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 Arizona, the Phoenix Processing Center. 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.

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