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Transition

...ar II, production has surged as consumers came back
big-ticket, credit-sensitive goods they deferred during
sofas and refrigerators. The rebound in consumer
signal to businesses. It tells them first to begin building
demand keeps growing, to increase spending in
laid-off workers or put up help-wanted notices.

...ly did not decline during the recent downturn,
last two years. And in interest-rate sensitive sectors
es, consumer spending has much faster; in fact, I've
was a sales boom. Consumers the last couple of years
nic policymakers any recovery to discuss in 2001.
might well stronger, though
r wallet trend in the consumer
t not

...a recovery weren't particularly
ring activity picked up steam in the first half
ear. Investment in equipment and software
mostly flat over the year while office and
and bankruptcy announcements dominated the
to elude some service industries

The Federal Reserve Bank of Atlanta is one of twelve regional Reserve Banks in the United States that, together with the Board of Governors in Washington, D.C., make up the Federal Reserve System—the nation's central bank. Since its establishment by an act of Congress in 1913, the Federal Reserve System's primary role has been to foster a sound financial system and a healthy economy.

To advance this goal, the Atlanta Fed helps formulate monetary policy, supervises banks and bank and financial holding companies, and provides payment services to depository institutions and the federal government.

Through its six offices in Atlanta, Birmingham, Jacksonville, Miami, Nashville, and New Orleans, the Federal Reserve Bank of Atlanta serves the Sixth Federal Reserve District, which comprises Alabama, Florida, Georgia, and parts of Louisiana, Mississippi, and Tennessee.

FEDERAL RESERVE BANK OF ATLANTA—2002 ANNUAL REPORT

THE PROCESS OF TRANSITION

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Jack Guynn, Atlanta Fed president and chief executive officer; John Wieland, chairman of the Atlanta Fed board of directors; and Pat Barron, first vice president and chief operating officer

MESSAGE FROM

THE PRESIDENT

Since it was established in 1913, the Federal Reserve System has been charged with the mission of conducting monetary policy, regulating banks, and operating payment systems. This basic mission has never changed even though the way we carry it out reflects nine decades of progress and transition. One of the original purposes of the Federal Reserve Act, for example—“to afford means of rediscounting commercial paper”—sounds as foreign to my ears today as “asymmetric directive” or “electronic payments” would have sounded to the Atlanta Fed’s first president (then called governor), Joseph McCord, early in the last century.

That’s no surprise. Whether an organization was created by an act of Congress or by the laws of supply and demand, the organization’s mission—the reason it exists—may change very little over time. But what it takes to fulfill that mission almost never stays the same.

In the long run, success demands an unwavering commitment to mission. It also demands organizational agility and a willingness to recognize and facilitate transitions.

Transition is a permanent feature of the U.S. economy. Our economy’s ability to anticipate and respond to changes in supply and demand, to innovate, and to adopt productivity-enhancing technologies is one of this country’s great sources of strength. I am constantly amazed, but never surprised, by the developments that take place every day in the U.S. economy.

Transitions in the economy and the financial system have serious implications for the nation’s central bank, and in 2002 the pace of change was particularly intense for the Federal Reserve, just as it was for the nation as a whole. Beyond the obvious

challenges they raise for forecasters and monetary policymakers, the changes taking place in the economy affect the financial institutions we supervise and regulate as well as the types of payment services we provide. Such changes affect the way we work, too—the labor markets in which we compete for talent and the technology we use in our daily work. Considering the Fed’s role in the U.S. economy, this is exactly the way it ought to be. If we’re going to play our role effectively, changes in the economy ought to be reflected at the Fed as well. And for the last nine decades, I believe they have been.

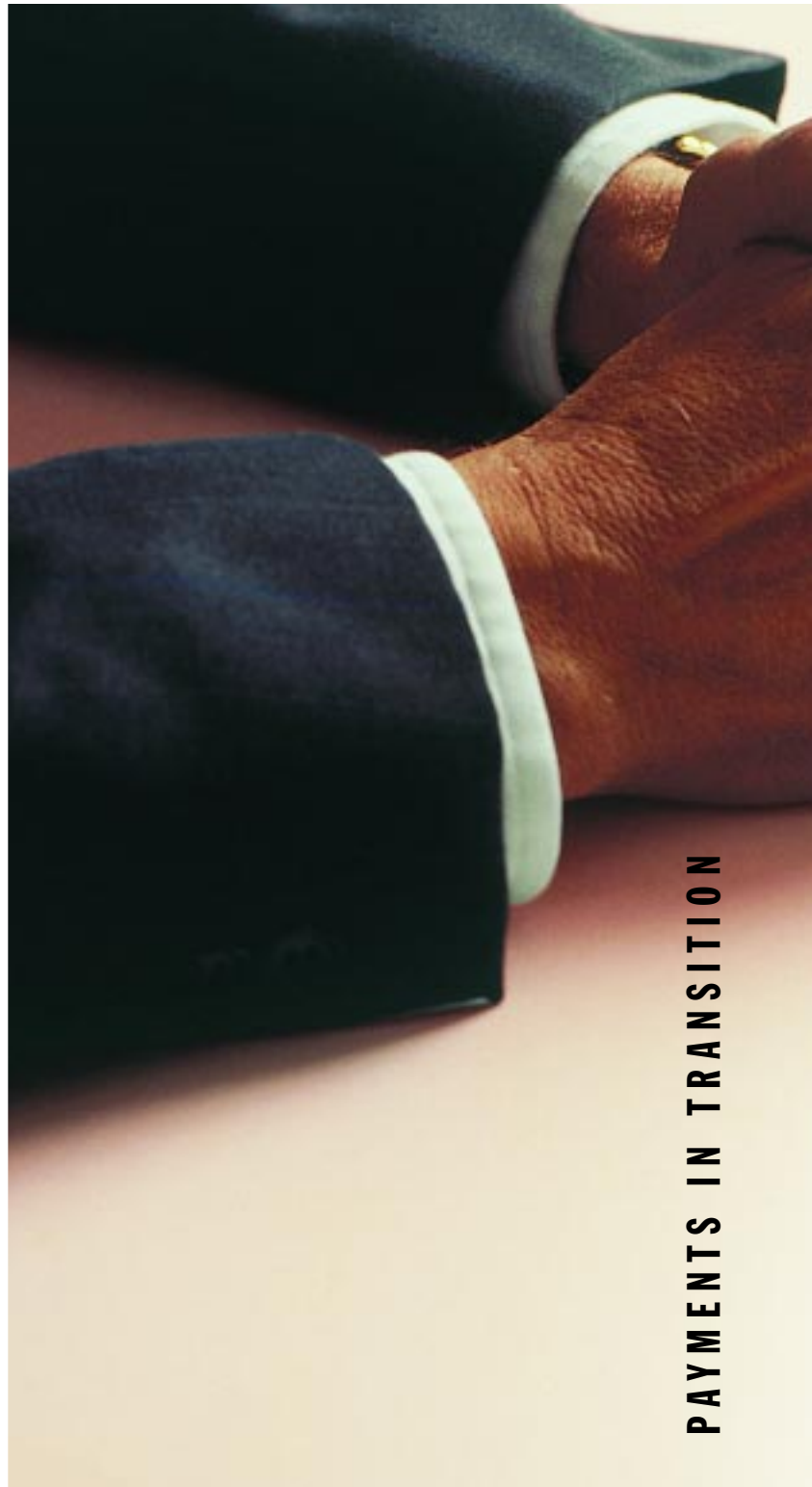
In this year’s annual report, some of the bank’s senior leaders talk about the transitions they’ve witnessed during their careers at the Fed, especially in 2002. Their stories demonstrate that the Atlanta Fed, with its dedicated leadership team and substantial institutional experience, is well positioned to respond to transitions in the economy and in the Federal Reserve System.



Jack Guynn



Richard Oliver, product manager of the Federal Reserve System's Retail Payments Office, has been with the Atlanta Fed since 1973. He has national responsibility for the System's check and automated clearinghouse operations.



PAYMENTS IN TRANSITION



For the U.S. payment system, transition has been a long time coming. But it has been a privilege to be involved in the changes.

In 1973, fresh out of graduate school, I joined the Federal Reserve Bank of Atlanta as a planning analyst. A year later I became administrator of the Georgia Automated Clearinghouse (ACH), where I found myself on the ground floor of an exciting partnership between the Fed, local Atlanta banks, and Georgia Tech. The goal of this collaboration was to develop a point-of-sale debit card system for the city of Atlanta—the first vision of a “cashless, checkless society.” Within another year, an electronic payment system began to take root with the implementation of a pilot Social Security direct deposit program in the state of Georgia.

Over the years, that electronic banking fervor was overtaken by the competing realities of what bankers wanted to do with technology and what consumers were willing to accept. Fifteen years after the Georgia ACH was founded, I was amazed to find that “electronic payments” still meant transfer to tape or paper, with final bank delivery made by couriers. (The joke was that EFT, the acronym for electronic funds transfer, really stood for “extra fast trucks.”) But with the Fed’s guidance, an all-electronic delivery network for ACH was born.

In 1992 I became the Federal Reserve System’s Retail Payments product manager, with responsibility for both the Federal Reserve System’s paper-based check and electronic ACH services. It was soon apparent that we needed more information in order to guide the development of the nation’s payments systems and to make wise investment decisions about the Fed’s infrastructure.

To help us understand the transitions taking place in payments, in 2001 the Fed funded the first statistically significant check payments research in twenty-two years. We discovered that national check volume is far lower than anyone in the banking industry believed and is trending downward. We learned, too, that electronic payment volume has been growing rapidly and that consumers are finally shifting their preferences and embracing electronic payments. This is a development the Federal Reserve has long supported.

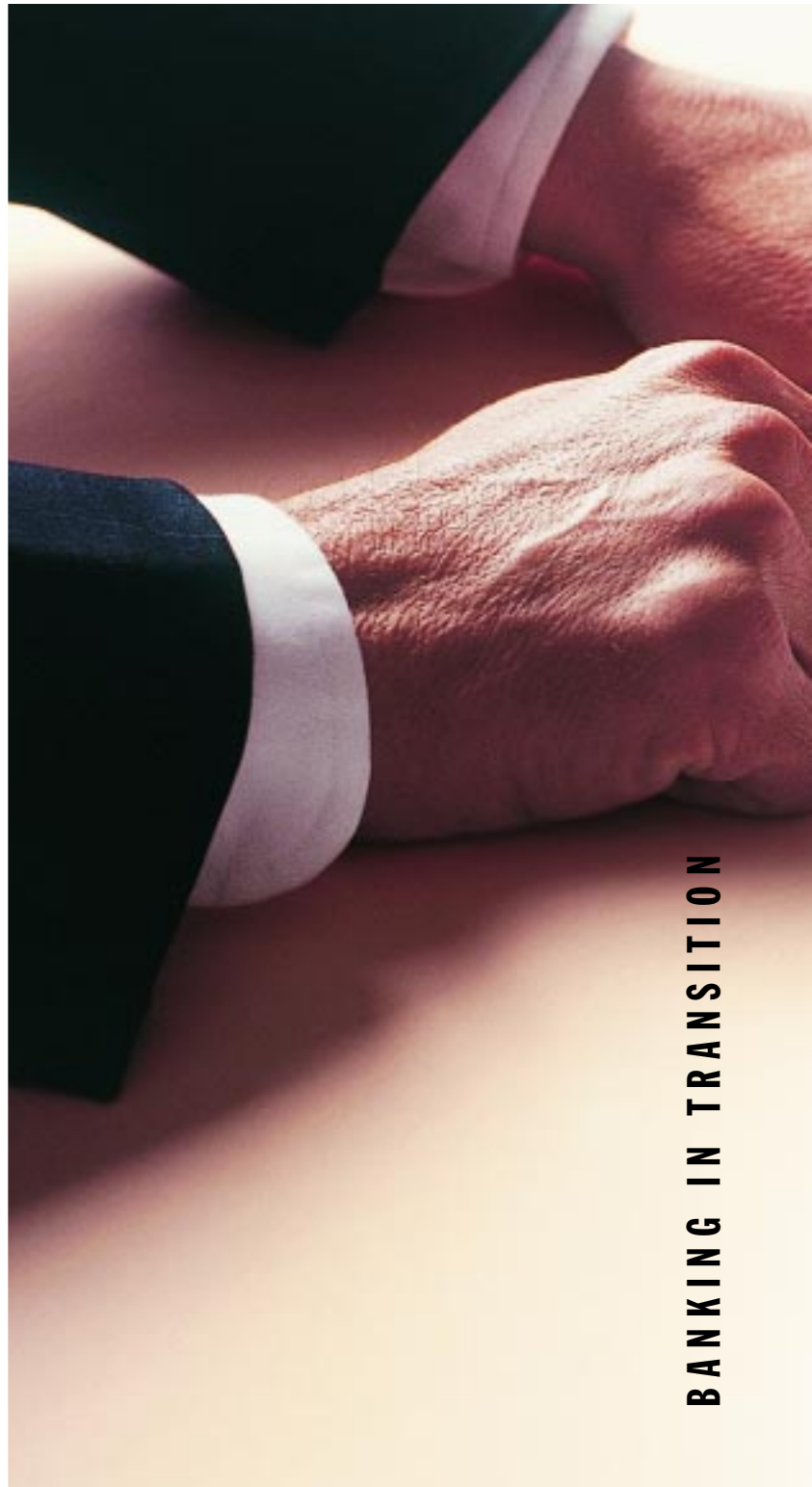
My excitement about this country’s long-awaited transition to a more efficient payment mechanism has been tempered by the difficult responsibility we now have in managing the Federal Reserve’s check business. Checks remain a large and important part of what we do, but check volume is also in an unprecedented decline. The check challenge will require a different mindset for us. But it’s encouraging to see that the ACH service we launched three decades ago has now transitioned into a significant business and that the electronic payment business is poised to play an even bigger role in check replacement services to consumers and businesses alike in the years ahead.

Little did I know that promise and payoff would be the bookends of my now thirty-year Atlanta Fed career.

Richard Oliver, Senior Vice President, Federal Reserve System Retail Payments Office



William Estes, who joined the Atlanta Fed in 1975, is senior vice president in charge of the supervision and regulation division. He is also a member of the Federal Reserve System's Strategic Plan Steering Committee and the Regional and Community Bank Committee.



BANKING IN TRANSITION



I can't think of an industry that has undergone a more fundamental—or, arguably, more successful—transition than banking has.

When I joined the Atlanta Fed as a bank examiner in 1975, the industry was still basically a product of our post–Depression era financial structure. Banks were highly regulated. The products they sold, the prices they charged, the markets they served—all were established by law. These legal strictures—the boundaries placed on competition—made banking reasonably safe and profitable for a number of years. But it became clear that this protected world of banking could not survive soaring inflation in the 1970s and the entry of unregulated nonbank competitors.

Just think about the transition that banks have made from that cozy world to today's marketplace and the hurdles that had to be overcome: the loss of corporate borrowers to capital markets, the disintermediation to mutual funds, problems with developing-country debt, the near extinction of the thrift industry, and so much more. Yet the industry has not just survived—it has prospered. Still, banking is a far different industry today, with very different people running it.

Banks have been forced to get smarter, more efficient, and more nimble. Huge investments in technology have allowed banks to lower overhead costs and do more work with fewer staff. Technology has also allowed banks to develop new products for a much wider market and new ways to manage risk for a more diverse investing public.

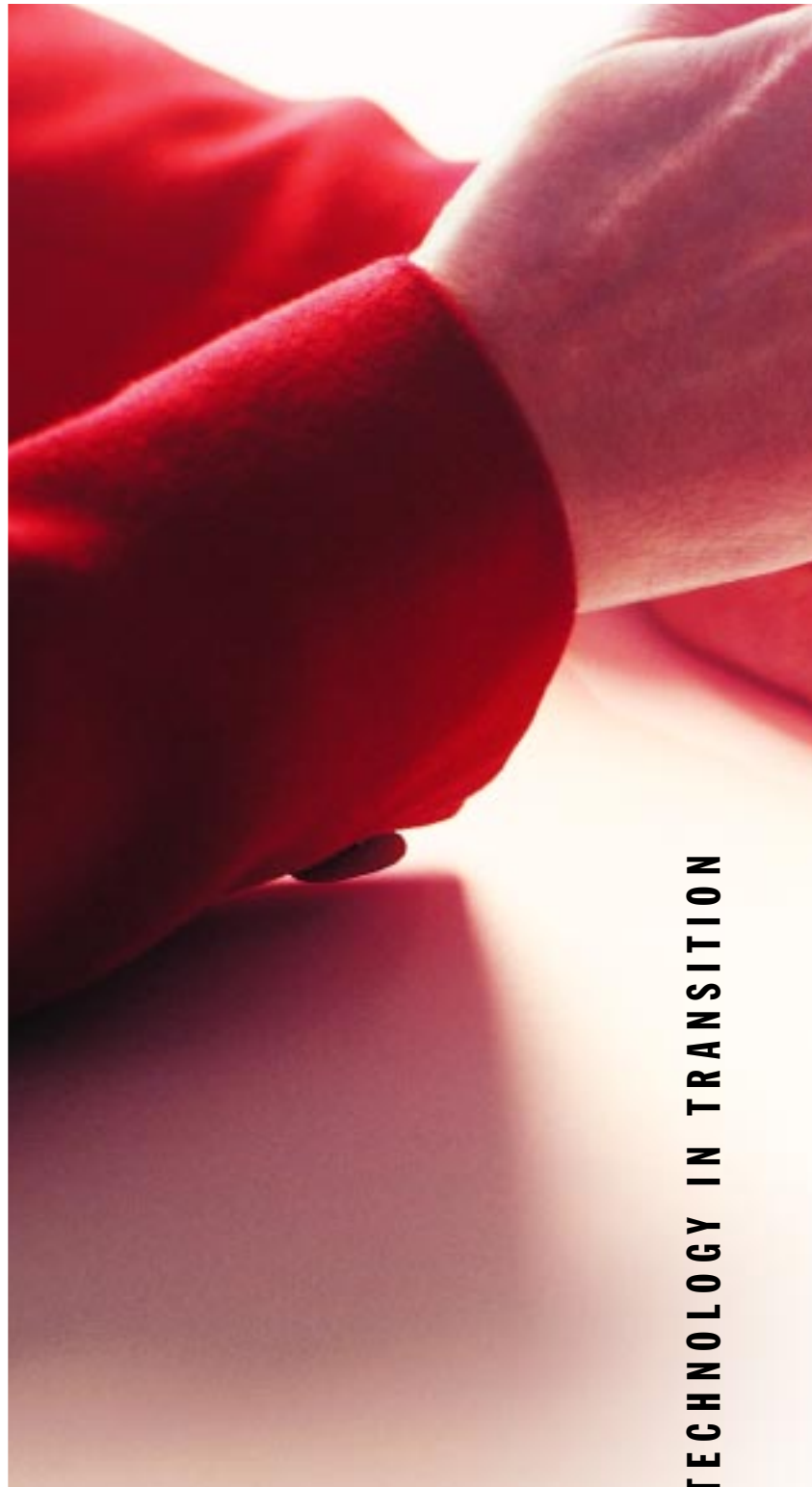
And bank supervisors have had to change along with the industry. At the Atlanta Fed, our set of quantitative skills is far broader and deeper than even a decade ago because we must now analyze the risk management models and processes that go along with vast portfolios diversified by product and geography.

The business of banking and its supervision have become more difficult, but the transitions continue apace. Other important American industries were heavily regulated throughout much of the twentieth century—airlines, trucking, and telecommunications all come to mind—and each had to deal with the challenges brought by a deregulated world. But none have made the transition to deregulation more successfully than banking. Today, the U.S. financial system is the strongest, most innovative, and most efficient in the world. It must continue to evolve to meet tomorrow's market demands and shocks, and bank supervisors must be committed to keeping pace with this continuing transition.

William Estes, Senior Vice President, Supervision and Regulation



Anne DeBeer, the bank's chief technology officer, began her Fed career with the Board of Governors in 1974 and came to the Atlanta Fed in 1987. She is responsible for the bank's corporate automation department and is supervising officer over the human resources function.



TECHNOLOGY IN TRANSITION



In the more than twenty-five years I've been with the Federal Reserve System, my responsibilities have included oversight for delivering, procuring, and, of course, using technology. I've learned that when it comes to technology support, transition never ends. Even so, in 2002 the pace of transition accelerated dramatically, both here at the Atlanta Fed and throughout the Federal Reserve System.

In the Sixth Federal Reserve District, for example, help desk and telecommunication support were consolidated from the Atlanta Fed's six branches to our headquarters while e-mail administration for the entire Federal Reserve System was centralized at the Philadelphia Fed. The Dallas, St. Louis, and Atlanta Feds were selected to support all of the Federal Reserve System's desktop PCs. The Kansas City Fed began preparing for Systemwide management of an automated human resources database application. And all Reserve Banks are now using software developed by the Atlanta Fed to account for the shares of bank stock issued to Federal Reserve member banks. Obviously, these and other developments could not have happened without the kind of technological advances that make remote support possible.

But centralizing tech support in the Federal Reserve System is not just a function of technology advances. Like so many organizations, we're responding to a larger imperative

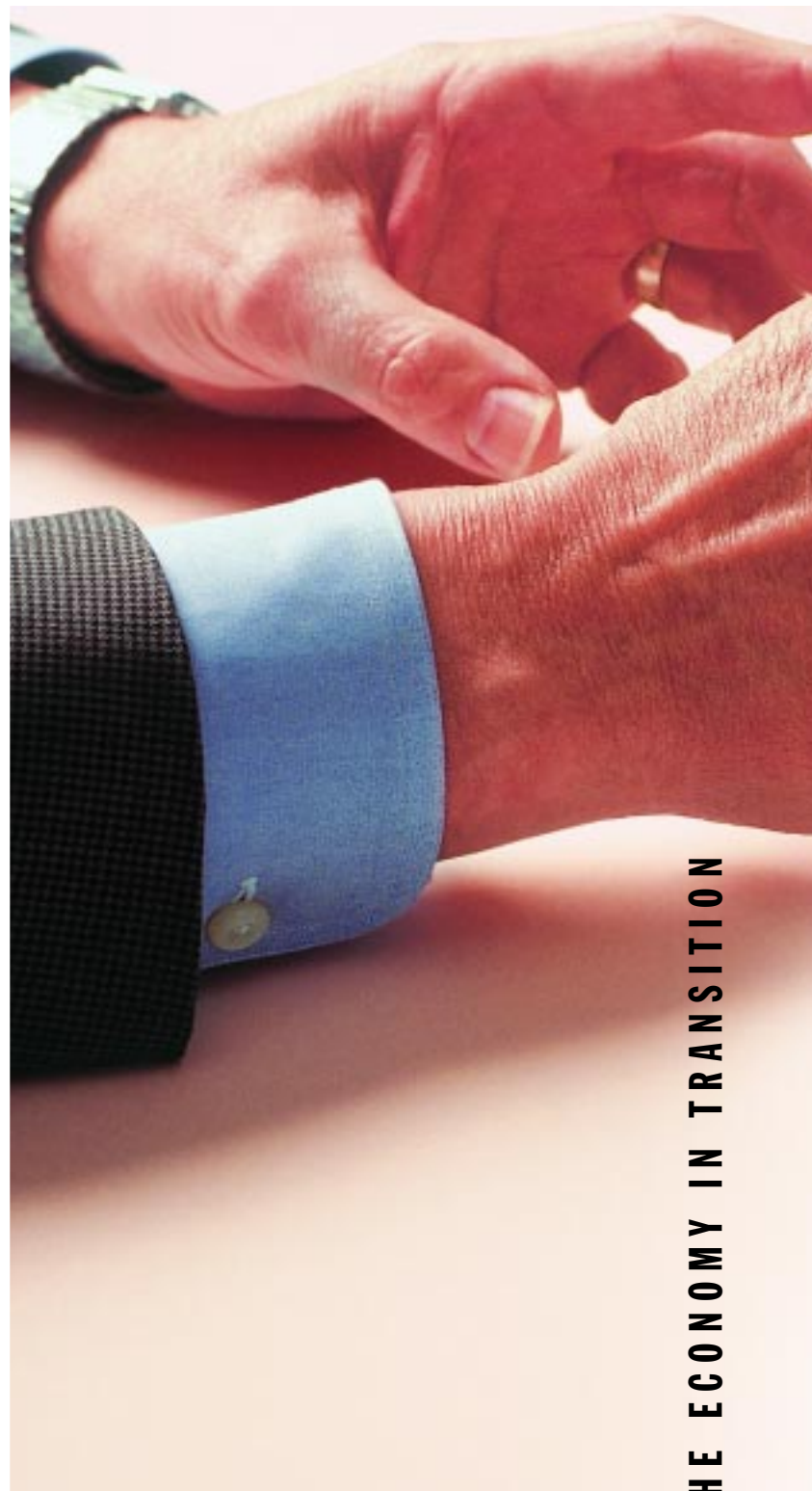
to reduce costs, eliminate duplication of systems, and better serve our customers who now operate nationally. For instance, over the last year, all Reserve Banks realized substantial cost savings by moving to a single vendor contract for long-distance telecommunication services. Unfortunately, though, improving efficiency and business alignment also made some reductions in staff necessary in information technology support departments throughout the System.

Of course, the Federal Reserve shares all these challenges—technological and business changes, cost containment, consolidation, and job reductions—with the public it was created to serve. And considering the role the Fed plays in the economy—as a monetary policymaker, bank supervisor, and payment system operator—that's exactly the way it ought to be.

But other aspects of technology management are perhaps unique to the Federal Reserve and require a higher level of flexibility, reliability, and security. Research economists need broad access to economic news and data. Bank examiners need to be able to retrieve banking data off-site with assured security. And in payment systems, where the Federal Reserve System handles more than \$3 trillion a day, there's a special duty to balance speed and efficiency with appropriate risk controls. Above all, the Fed's technology must be reliable and able to withstand severe disruptions to our systems such as those during a national emergency like 9/11. The challenge for technology managers at the Fed is to meet these established business needs with technology that never stops changing.

All of which is to say that for technology managers in the Federal Reserve System, progress is another word for transition.

Anne DeBeer, Senior Vice President, Corporate Services



Prior to joining the Atlanta Fed in 1996, Robert Eisenbeis, senior vice president and director of research, was the Wachovia Professor of Banking and associate dean for research at the Kenan-Flagler Business School at the University of North Carolina at Chapel Hill. He also worked for both the Federal Reserve Board of Governors and the Federal Deposit Insurance Corporation.



My economics career began in the 1960s at the Federal Reserve Board, where I helped monitor developments in the economy and financial markets. One remarkable feature of our economy then was the rapid pace of transition, and the pace is even faster today. Businesses, financial institutions, and the public have become remarkably adept at responding to changes in technology, laws and regulations, and the opportunities that present themselves in the marketplace.

Markets rise and fall, and so do the firms that compete in them. It's all part of the process of "creative destruction" described by the great economist Joseph Schumpeter. It's also what makes any market economy, and especially the United States, so dynamic in creating wealth and opportunities for workers and investors.

Still, the transitions within and across business cycles are particularly challenging for my colleagues and me as we attempt to provide economic policy advice to Atlanta Fed president Jack Guynn in his role as a member of the Federal Open Market Committee (FOMC).

Monetary policy acts with a lag, so when we put together policy recommendations before each FOMC meeting, we use economic models to forecast the likely pace of activity as well as how the economy might react to possible policy changes. These models rely on past

behavior to predict the future, but their results cannot be precise because the behavior of market participants never stops changing. Sound policy advice, therefore, requires basic research to be updated continually to account for behavioral changes. However, this research must be accompanied by heavy doses of judgment, refined through years of experience in following economic developments.

Needless to say, predicting where the economy may be going is often complicated by unpredictable shocks: the oil price jump in the 1970s, various Latin American debt crises, or the 9/11 terrorist attacks and the geopolitical uncertainties following them. Shocks can have positive and negative effects on the economy: They can jump-start a recovery or precipitate a recession, moderate or exacerbate inflationary pressures. Shocks also have a way of accelerating the creative destruction process, as they have during the recent recession.

Researchers at the Fed assess how the economy transitions from one phase of the business cycle to another with a view toward providing relevant input to the policy debate. In 2002, this assessment predicted that the recovery would be more gradual than previous recoveries because the recession that preceded it was different from previous recessions. Because consumer spending and housing markets remained firm during the latest recession, an acceleration in either of these key sectors was unlikely to lead a rebound in the economy.

Critical questions remain. Which sectors will lead or lag the recovery, and what policy options may facilitate stronger growth without also contributing to future imbalances or inflationary pressures? For all of 2002, the stance of monetary policy was accommodative. Will such a stance be enough in the face of the uncertainties we face in 2003? These are the questions that make the work of the Fed research team so rewarding and challenging.

Robert Eisenbeis, Senior Vice President and Director of Research



Cynthia Goodwin, vice president in charge of the human resources department, joined the Atlanta Fed in 1985 as a bank examiner. She assumed her current position in August 2002 and is an adviser to the bank's Management Committee.



HUMAN RESOURCES IN TRANSITION



I didn't know exactly what to expect when I assumed leadership responsibility for the human resources department last summer. In my eighteen years in the Fed's supervision and regulation division—first in Kansas City, then in Atlanta—I've personally witnessed the transformation of the U.S. banking industry from being highly regulated and provincial to market driven and global. And I wondered if an “internal” function like human resources would reflect the dramatic transitions taking place in the nation's economy and financial sector. I learned that, at the Atlanta Fed, it does.

Like so many organizations, the bank has been focusing on improving productivity and controlling costs. In 2002, human resources moved to a self-service business model for on-line health benefits enrollment and launched a number of important initiatives to improve efficiency in the human resource functions across the Federal Reserve System. Reserve Banks took a major step in that direction by standardizing self-insured medical and dental plans in 2002, with substantial cost savings to the banks and to employees. The Atlanta Fed also began preparing to centralize the payroll system, which, starting in 2003, will be managed by the Richmond Fed. All of these developments are consistent with transitions taking place in many other organizations.

There are other external and internal transitions affecting the Atlanta Fed's people as well. For example, staff reductions were announced in our payment services function as emerging technologies and changes in consumer and business preferences brought about a decline in the Fed's check business. To prepare for those transitions, the human resources department intensified its benefits planning and communication. We want to do everything we can to help our people remain employed with the Fed in different jobs or, in some instances, help ease their transition to employment with other organizations.

At the same time, we want to continue to recruit and retain people in a labor market that remains quite competitive for the talent we need. To that end, we moved toward a more market-based salary program in 2002. We also need to offer a work environment in which people can thrive. To measure the success of our initiatives, we administered our fourth comprehensive employee survey to find out how employees believe the bank is doing and ways it can improve. Also this past year, the Atlanta Fed's Diversity Advisory Council, which I was honored to serve as chair, took the lead in planning additional diversity awareness training for staff in 2003.

Much of my career in the Fed System has been an education in finance, and I'm looking forward to applying some of those lessons in human resources. I'm pleased to see that, for the Atlanta Fed, remaining an employer of choice means staying in front of transitions in the workplace and the economy.

Cynthia Goodwin, Vice President and Director of Human Resources

SIXTH FEDERAL RESERVE DISTRICT DIRECTORS

Federal Reserve Banks each have a board of nine directors. Directors provide economic information, have broad oversight responsibility for their Bank's operations, and, with Board of Governors approval, appoint the Bank's president and first vice president.

Six directors—three class A, representing the banking industry, and three class B—are elected by banks that are members of the Federal Reserve System. Three class C directors (including the chairman and deputy chairman) are appointed by the Board of Governors. Class B and C directors represent agriculture, commerce, industry, labor, and consumers in the district; they cannot be officers, directors, or employees of a bank; class C directors cannot be bank stockholders.

Fed branch office boards have five or seven directors; the majority are appointed by head-office directors and the rest by the Board of Governors.

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JACQUELYN H. LEE
Systems Department

DANIEL A. MASLANEY
Financial Services
Technologies
and Support

MARY M. McCORMICK
Planning and
Control Department

MARIE E. McNALLY
Facilities Management

ELIZABETH McQUERRY
System Retail
Payments Office

D. PIERCE NELSON
Public Information Officer
Public Affairs Department

ALVIN L. PILKINTON JR.
Assistant General Auditor
Auditing Department

TED G. REDDY III
(retired)
District Building Projects

MARION P. RIVERS III
Supervision and
Regulation Division

JOHN C. ROBERTSON
Research Department

SUSAN L. ROBERTSON
System Retail
Payments Office

MELINDA J. RUSHING
System Retail
Payments Office

JUAN C. SANCHEZ
Supervision and
Regulation Division

ROBERT T. SEXTON
Financial Services Support

DAVID W. SMITH
Supervision and
Regulation Division

TIM R. SMITH
Community
Relations Officer
Public Affairs Department

ARUNA SRINIVASAN
Credit and Risk
Management

ELLIS W. TALLMAN
Research Department

DAVID E. TATUM
Supervision and
Regulation Division

EDWINA M. TAYLOR
Statistical Reports
Department

MARGARET THOMAS
(retired)
System Retail
Payments Office

JULIUS G. WEYMAN
Check Relay

TAO ZHA
Research Department

BRANCH
OFFICERS

ATLANTA

JAMES M. McKEE
Senior Vice President
and Branch Manager

JEFFREY L. WELTZIEN
Vice President and
Assistant Branch Manager

CHRISTOPHER N. ALEXANDER
Assistant Vice President

ROBERT A. LOVE
Assistant Vice President

WILLIAM R. POWELL
Assistant Vice President

BIRMINGHAM

LEE C. JONES
Vice President and
Branch Manager

KATHLEEN A. YOUNG
Assistant Vice President
and Assistant Branch
Manager

TREV B. BROWN
Assistant Vice President

FREDRIC L. FULLERTON
Assistant Vice President

CHARLES W. PRIME
Assistant Vice President

JACKSONVILLE

ROBERT J. SLACK
(retired)
Senior Vice President
and Branch Manager

CHRISTOPHER L. OAKLEY
Vice President and
Branch Manager

DARRIN G. FINLEY
Assistant Vice President
and Assistant Branch
Manager

PAUL W. GRAHAM
Assistant Vice President

SHIRLEY G. PYATT
Assistant Vice President

MIAMI

JAMES T. CURRY III
Vice President and
Branch Manager

JUAN DEL BUSTO
Assistant Vice President
and Assistant Branch
Manager

FRED D. COX
Assistant Vice President

ROBERT A. DE ZAYAS
Assistant Vice President

ROBERT K. MORANDO
Assistant Vice President

NASHVILLE

MELVYN K. PURCELL
Senior Vice President
and Branch Manager

ANNITA T. MOORE
Assistant Vice President
and Assistant Branch
Manager

LEAH L. DAVENPORT
Assistant Vice President

JOEL E. WARREN
Assistant Vice President

NEW ORLEANS

ROBERT J. MUSSO
Senior Vice President
and Branch Manager

AMY S. GOODMAN
Vice President and
Assistant Branch Manager

EDWARD B. HUGHES
Assistant Vice President

EVETTE H. JONES
Assistant Vice President

FINANCIAL REPORTS

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

MANAGEMENT'S
ASSERTION

To the Board of Directors of the Federal Reserve Bank of Atlanta

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

The management of the FRB Atlanta 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 Atlanta 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, we believe that the FRB Atlanta maintained an effective process of internal controls over financial reporting, including the safeguarding of assets as they relate to the Financial Statements.

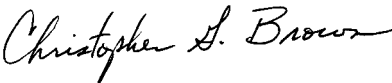
Federal Reserve Bank of Atlanta



Jack Guynn
President and Chief Executive Officer



Patrick K. Barron
First Vice President and Chief Operating Officer



Christopher G. Brown
Senior Vice President and Chief Financial Officer

February 19, 2003

REPORT OF
INDEPENDENT ACCOUNTANTS

To the Board of Directors of the Federal Reserve Bank of Atlanta

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

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

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

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



PricewaterhouseCoopers LLP

March 3, 2003
Atlanta, Georgia

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 Atlanta

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

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

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

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



PricewaterhouseCoopers LLP

March 3, 2003
Atlanta, Georgia

STATEMENTS OF
CONDITION

(in millions)	As of December 31, 2002	As of December 31, 2001
Assets		
Gold certificates	\$ 926	\$ 871
Special drawing rights certificates	166	166
Coin	103	113
Items in process of collection	748	149
Loans to depository institutions	8	7
U.S. government and federal agency securities, net	45,508	38,624
Investments denominated in foreign currencies	1,231	1,046
Accrued interest receivable	388	392
Interdistrict settlement account	0	7,088
Bank premises and equipment, net	345	353
Other assets	38	36
Total assets	\$ 49,461	\$ 48,845
Liabilities and capital		
Liabilities		
Federal Reserve notes outstanding, net	\$ 42,368	\$ 46,323
Securities sold under agreements to repurchase	1,502	0
Deposits		
Depository institutions	1,735	1,169
Other deposits	135	5
Deferred credit items	972	137
Interest on Federal Reserve notes due U.S. Treasury	0	33
Interdistrict settlement account	1,692	0
Accrued benefit costs	93	91
Other liabilities	14	17
Total liabilities	\$ 48,511	\$ 47,775
Capital		
Capital paid-in	\$ 475	\$ 535
Surplus	475	535
Total capital	\$ 950	\$ 1,070
Total liabilities and capital	\$ 49,461	\$ 48,845

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

STATEMENTS OF INCOME

(in millions)	For the years ended	
	December 31, 2002	December 31, 2001
Interest income		
Interest on U.S. government and federal agency securities	\$ 1,772	\$ 2,013
Interest on investments denominated in foreign currencies	20	23
Interest on loans to depository institutions	0	1
Total interest income	\$ 1,792	\$ 2,037
Interest expense		
Interest expense on securities sold under agreements to repurchase	\$ 1	\$ 0
Net interest income	\$ 1,791	\$ 2,037
Other operating income (loss)		
Income from services	\$ 125	\$ 134
Reimbursable services to government agencies	13	13
Foreign currency gains (losses), net	152	(103)
U.S. government and federal agency securities gains, net	5	22
Other income	4	6
Total other operating income	\$ 299	\$ 72
Operating expenses		
Salaries and other benefits	\$ 158	\$ 154
Occupancy expense	21	19
Equipment expense	26	28
Assessments by Board of Governors	46	45
Other expenses	94	96
Total operating expenses	\$ 345	\$ 342
Net income prior to distribution	\$ 1,745	\$ 1,767
Distribution of net income		
Dividends paid to member banks	\$ 28	\$ 30
Transferred (from) to surplus	(60)	40
Payments to U.S. Treasury as interest on Federal Reserve notes	1,777	1,697
Total distribution	\$ 1,745	\$ 1,767

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

STATEMENTS OF CHANGES IN CAPITAL

(in millions)	For the years ended December 31, 2002, and December 31, 2001		
	Capital Paid-In	Surplus	Total Capital
Balance at January 1, 2001			
(9.9 million shares)	\$ 495	\$ 495	\$ 990
Net income transferred to surplus		40	40
Net change in capital stock issued			
(0.8 million shares)	40		40
Balance at December 31, 2001			
(10.7 million shares)	\$ 535	\$ 535	\$ 1,070
Net income transferred from surplus		(60)	(60)
Net change in capital stock redeemed			
(1.2 million shares)	(60)		(60)
Balance at December 31, 2002			
(9.5 million shares)	\$ 475	\$ 475	\$ 950

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

NOTES TO FINANCIAL STATEMENTS

1. STRUCTURE

The Federal Reserve Bank of Atlanta (“Bank”) is part of the Federal Reserve System (“System”) created by Congress under the Federal Reserve Act of 1913 (“Federal Reserve Act”), which established the central bank of the United States. The System consists of the Board of Governors of the Federal Reserve System (“Board of Governors”) and twelve Federal Reserve Banks (“Reserve Banks”). The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics. The Bank and its branches in Birmingham, Alabama; Jacksonville, Florida; Nashville, Tennessee; New Orleans, Louisiana; and Miami, Florida, serve the Sixth Federal Reserve District, which includes Georgia, Florida, Alabama, and portions of Louisiana, Tennessee, and Mississippi. Other major elements of the System are the Federal Open Market Committee (“FOMC”) and the Federal Advisory Council. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York (“FRBNY”) and, on a rotating basis, four other Reserve Bank presidents. Banks that are members of the System include all national banks and any state-chartered bank that applies and is approved for membership in the System.

Board of Directors

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

2. OPERATIONS AND SERVICES

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

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

3. SIGNIFICANT ACCOUNTING POLICIES

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

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

Effective January 2001, the System implemented procedures to eliminate the sharing of costs by Reserve Banks for certain services a Reserve Bank may provide on behalf of the System. Major services provided for the System by the Bank, for which the costs will not be redistributed to the other Reserve Banks, include

- Federal Reserve Information Technology Projects
- Retail Payments Office
- Retail Check-Related Projects
- Cash-Related Projects
- Accounting-Related Projects
- Financial Services Policy Committee
- Customer Support Projects
- National Information Center for Supervision and Regulation
- Audit Services
- Special Check-Related Projects

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

a. 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 \$42½ 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.

b. Special Drawing Rights Certificates

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

c. Loans to Depository Institutions

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

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

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

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

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

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 counterparty credit risk. The FRBNY controls credit risk by obtaining credit approvals, establishing transaction limits, and performing daily monitoring procedures.

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

U.S. government and federal agency securities and investments denominated in foreign currencies comprising the SOMA are recorded at cost, on a settlement-date basis, and adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Interest income is accrued on a straight-line basis and is reported as “Interest on U.S. government and federal agency securities” or “Interest on investments denominated in foreign currencies,” as appropriate. Income earned on securities lending transactions is reported as a component of “Other income.” Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as “U.S. government and federal agency securities gains, net.” Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as “Foreign currency gains (losses), net.” Foreign currencies held through F/X swaps, when initiated by the counterparty, 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 sold under agreements to repurchase, securities loaned, investments denominated in foreign currency, interest income and expense, securities lending fee income, amortization of premiums and discounts on securities bought outright, gains and losses on sales of securities, and realized and

unrealized gains and losses on investments denominated in foreign currencies, excluding those held under an F/X swap arrangement, are allocated to each Reserve Bank. Income from securities lending transactions undertaken by the FRBNY are also allocated to each Reserve Bank. Securities purchased under agreements to resell and unrealized gains and losses on the revaluation of foreign currency holdings under F/X swaps and warehousing arrangements are allocated to the FRBNY and not to other Reserve Banks.

e. Bank Premises, Equipment, and Software

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

f. 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."

g. Federal Reserve Notes

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

The "Federal Reserve notes outstanding, net" account represents the Bank's Federal Reserve notes outstanding, reduced by its currency holdings of \$16,757 million and \$18,763 million at December 31, 2002, and December 31, 2001, respectively.

h. 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.

i. Surplus

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

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

j. Income and Costs Related to Treasury Services

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

k. Taxes

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

4. U.S. GOVERNMENT AND FEDERAL AGENCY SECURITIES

Securities bought outright are held in the SOMA at the FRBNY. An undivided interest in SOMA activity and the related premiums, discounts, and income, with the exception of securities purchased under agreements to resell, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of interdistrict clearings. The settlement, performed in April of each year, equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding. The Bank’s allocated share of SOMA balances was approximately 7.120 percent and 6.876 percent at December 31, 2002 and 2001, respectively.

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

	2002	2001
Par value		
Federal agency	\$ 1	\$ 1
U.S. government		
Bills	16,140	12,520
Notes	21,211	18,286
Bonds	7,464	7,128
Total par value	\$ 44,816	\$ 37,935
Unamortized premiums	767	777
Unaccreted discounts	(75)	(88)
Total allocated to Bank	\$ 45,508	\$ 38,624

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

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

Maturities of Securities Held	Par value		Total
	U.S. Government Securities	Federal Agency Obligations	
Within 15 days	\$ 1,954	\$ —	\$ 1,954
16 days to 90 days	10,981	—	10,981
91 days to 1 year	10,099	1	10,100
Over 1 year to 5 years	12,301	—	12,301
Over 5 years to 10 years	3,795	—	3,795
Over 10 years	5,685	—	5,685
Total	\$ 44,815	\$ 1	\$ 44,816

As mentioned in note 3, in December 2002, the FRBNY replaced MSP transactions with securities sold under agreements to repurchase. At December 31, 2002, securities sold under agreements to repurchase with a contract amount of \$21,091 million and a par value of \$23,188 million were outstanding, of which \$1,502 million and \$1,594 million, respectively, were allocated to the Bank. At December 31, 2001, MSP transactions involving U.S. government securities with a par value of \$21,098 million were outstanding, of which \$1,502 million was allocated to the Bank. Securities sold under agreements to repurchase and MSP transactions are generally overnight arrangements.

At December 31, 2002 and 2001, U.S. government securities with par values of \$1,841 million and \$7,345 million, respectively, were loaned from the SOMA, of which \$131 million and \$505 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 purchased under agreements to resell. These investments are guaranteed as to principal and interest by the foreign governments.

Each Reserve Bank is allocated a share of foreign-currency-denominated assets, the related interest income, and realized and unrealized foreign currency gains and losses, with the exception of unrealized gains and losses on F/X swaps and warehousing transactions. This allocation is based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. The Bank's allocated share of investments denominated in foreign currencies was approximately 7.281 percent and 7.183 percent at December 31, 2002 and 2001, respectively.

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

	2002	2001
European Union Euro		
Foreign currency deposits	\$ 406	\$ 330
Government debt instruments		
including agreements to resell	240	193
Japanese Yen		
Foreign currency deposits	130	136
Government debt instruments		
including agreements to resell	449	382
Accrued interest	6	5
Total	\$ 1,231	\$ 1,046

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

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

Maturities of Investments Denominated in Foreign Currencies		
Within 1 year	\$	1,136
Over 1 year to 5 years		66
Over 5 years to 10 years		29
Over 10 years		0
Total	\$	1,231

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

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

6. BANK PREMISES AND EQUIPMENT

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

	2002	2001
Bank premises and equipment		
Land	\$ 40	\$ 39
Buildings	236	235
Building machinery and equipment	33	33
Construction in progress	4	1
Furniture and equipment	167	163
	480	471
Accumulated depreciation	(135)	(118)
Bank premises and equipment, net	\$ 345	\$ 353

Depreciation expense was \$20 million and \$18 million for the years ended December 31, 2002 and 2001, respectively.

The Bank leases unused space to outside tenants. Those leases have terms ranging from one to five years. Rental income from such leases was \$1 million for each of the years ended December 31, 2002 and 2001, respectively. Future minimum payments under agreements in existence at December 31, 2002, were immaterial.

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2002, the Bank was obligated under noncancelable leases for premises and equipment with terms ranging from one to approximately seven 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 \$2 million and \$5 million for the years ended December 31, 2002 and 2001, respectively. Certain of the Bank's leases have options to renew.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with terms of one year or more, at December 31, 2002, were (in thousands):

	Operating
2003	\$ 572
2004	576
2005	549
2006	280
2007	280
Thereafter	536
	\$ 2,793

At December 31, 2002, other commitments and long-term obligations in excess of one year were \$154.8 million. These contracts represent air and ground transportation services for the Federal Reserve Check Transportation System of which approximately \$137.7 million had not yet been recognized.

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, 2002 or 2001.

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

8. RETIREMENT AND THRIFT PLANS

Retirement Plans

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

Thrift Plan

Employees of the Bank may also participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Bank's Thrift Plan contributions totaled \$6 million and \$5 million for the years ended December 31, 2002 and 2001, respectively, and are reported as a component of "Salaries and other benefits."

9. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS AND POSTEMPLOYMENT BENEFITS

Postretirement Benefits Other Than Pensions

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

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

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

	2002	2001
Accumulated postretirement benefit obligation at January 1	\$ 63.9	\$ 60.2
Service cost-benefits earned during the period	1.7	1.9
Interest cost of accumulated benefit obligation	4.2	4.7
Actuarial loss	0.2	9.5
Contributions by plan participants	0.2	0.4
Benefits paid	(3.0)	(2.2)
Plan amendments (curtailments, special termination benefits)	(2.4)	(10.6)
Accumulated postretirement benefit obligation at December 31	\$ 64.8	\$ 63.9

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

	2002	2001
Fair value of plan assets at January 1	\$ —	\$ —
Actual return on plan assets	—	—
Contributions by the employer	2.8	1.8
Contributions by plan participants	0.2	0.4
Benefits paid	(3.0)	(2.2)
Fair value of plan assets at December 31	\$ —	\$ —
Unfunded postretirement benefit obligation	\$ 64.8	\$ 63.9
Unrecognized initial net transition asset (obligation)	—	—
Unrecognized prior service cost	22.8	22.2
Unrecognized net actuarial gain (loss)	(4.3)	(4.1)
Accrued postretirement benefit costs	\$ 83.3	\$ 82.0

Accrued postretirement benefit costs are reported as a component of “Accrued benefit costs.”

At December 31, 2002 and 2001, the weighted average discount rate assumptions used in developing the benefit obligation were 6.75 percent and 7.0 percent, respectively.

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

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2002 (in millions):

	One Percentage Point Increase	One Percentage Point Decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	\$ 1.2	\$ 1.0
Effect on accumulated postretirement benefit obligation	10.9	8.6

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

	2002	2001
Service cost-benefits earned during the period	\$ 1.7	\$ 1.9
Interest cost of accumulated benefit obligation	4.2	4.7
Amortization of prior service cost	(1.8)	(1.0)
Recognized net actuarial loss	0.0	0.0
Net periodic postretirement benefit costs	\$ 4.1	\$ 5.6

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

Postemployment Benefits

The Bank offers benefits to former or inactive employees. Postemployment benefit costs are actuarially determined and include the cost of medical and dental insurance, survivor income, and disability benefits. Costs were projected using the same discount rate and health care trend rates as were used for projecting postretirement costs. The accrued postemployment benefit costs recognized by the Bank at December 31, 2002 and 2001, were \$10 million and \$9 million, respectively. This cost is included as a component of "Accrued benefit costs." Net periodic post-employment benefit costs included in 2002 and 2001 operating expenses were \$2 million in each year.

10. SUBSEQUENT EVENT

In January 2003, the System announced plans to restructure its check collection operations. The restructuring plans include streamlining the check management structure, reducing staff, decreasing the number of check-processing locations, and increasing processing capacity in other locations. The restructuring, which is expected to begin in 2003 and conclude by the end of 2004, will result in the Bank discontinuing its check operations at the Miami office, increasing its check processing capacity at the Jacksonville office, and consolidating its check adjustment function at the Jacksonville office. At this time, the Reserve Banks have not developed detailed estimates of the cost of the restructuring plan in the aggregate or for the individual Reserve Banks affected.

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