Inspiring Confidence
The Fed's Response to 9/11

FEDERAL RESERVE BANK OF CHICAGO 2001 ANNUAL REPORT

REPORT CONTENTS

From left: President and Chief Executive Officer MICHAEL MOSKOW, Deputy Chairman ROBERT DARNALL, Chairman ARTHUR MARTINEZ, and First Vice President and Chief Operating Officer GORDON WERKEMA.

In the post-9/11 world in which we all live, "Ground Zero" has assumed a special significance. Like millions of other people, I saw from a distance many tragic and unforgettable images of Ground Zero. But it wasn't until last November that I viewed the area in person. It was an unforgettably sad and moving experience. I left Ground Zero with a more complete realization of the human loss, physical devastation and bravery of those caught in the attack and involved in the rescue efforts.

While Ground Zero is the site of an American tragedy, I believe it has also become a symbol of something hopeful—the tenacity, enterprise and resolve of the American people. Along with hundreds of millions of people across the world, I am confident the U.S. will continue to rebound stronger than ever.

The terrorists' intentions may never be fully understood, but one of their goals—to disrupt our economy—was clear. The World Trade Center was an important symbol of our free-enterprise system, located in our nation's financial center. In the aftermath of the attack, the risk of a cascading crisis in our financial system was very real. And yet, only a few short hours after the attacks, the financial system had begun to recover and resume operations.

This quick recovery was due to the extraordinary efforts of many people from a wide range of public- and private-sector organizations. I'm proud of the Federal Reserve's role in this effort, which was very much in keeping with our origins and the classic mission of a central bank. Congress created the Federal Reserve in 1914 in response to a series of financial crises. Since its very beginning, the Fed's mission has included maintaining financial stability and containing systemic risk.

The Federal Reserve System's response to 9/11 involved all of its diverse responsibilities—implementing monetary policy, providing financial services and supervising and regulating banks. As detailed in the following article, the Chicago Fed faced challenges in each of these areas. And like the rest of the Fed System, the Chicago Fed rose to these challenges. I'd like to thank Chicago Fed staff at all of our six offices for their outstanding efforts. And I'd like to make a special note of the extraordinary efforts of the New York Fed, which continued to operate despite its location just a few short blocks from Ground Zero.

As Chairman Greenspan has pointed out, the crisis highlighted the advantages of our nation's diversified and decentralized economic and financial structure. On a day-to-day basis, our nation's financial system operates within a physical infrastructure. Without robust private-sector participation and effective supervisory oversight, local disasters affecting the infrastructure can spill over into the broader economy and increase systemic risk. At first glance, our financial system may seem duplicative or inefficient, encompassing banks, security firms, insurance companies and many other participants. But the competition encouraged by these many participants increases innovation and flexibility—qualities that were essential on 9/11.

Similarly, the Fed's regional structure, with its decentralized design and mixture of public and private features, may seem overly complex. Yet our structure fosters strong links to our customers and stakeholders; extends the geographical span of our operations, knowledge and resources; and encourages innovation. These advantages served the Fed well in meeting the challenge of 9/11.

While our financial system recovered very quickly, the effect on the economy has been longer-lasting. The attack shook an already weak economy. The Federal Open Market Committee (FOMC) responded decisively, cutting the target for the federal funds rate by $1\frac{3}{4}$ percentage points during the final four months of 2001. These actions built on earlier policy moves during 2001 in which the target fed funds rate was reduced by 3 percentage points. Overall, the FOMC reduced the target fed funds rate during 2001 from $6\frac{1}{2}$ percent to $1\frac{3}{4}$ percent—the lowest level in more than 40 years.

Though the economy was weakened by the attack, our longer-term prospects continue to be favorable. The U.S. economy is increasingly resilient to shocks. Deregulated financial markets, more flexible labor markets and major advances in information technology all provide a foundation for solid economic growth. Another important factor has been increased globalization. It is perhaps a natural reaction to seek a reduced level of economic interaction among nations following 9/11. But we must not lose sight of the many economic benefits of globalization—for the U.S. as well as all other nations. Open markets and expanded trade are some of the best ways to increase economic growth, particularly in developing countries.

Our nation has endured a tremendous tragedy. However, the resiliency and strength of our free-enterprise system, which served us so well after 9/11, will help us continue to prosper in the future.

The Chicago Fed had a successful year in 2001, as reflected in the recap of our accomplishments on pages 23-27. I'd like to extend my appreciation to our staff for their hard work and dedication and to our directors for their leadership and counsel. In particular, I'd like to thank three individuals who completed their service as directors: Richard Bell and Stephen Polk on our Detroit board, and Arthur Martinez on our Chicago board. A special note of gratitude to Arthur, who provided especially noteworthy service as chairman for two years and deputy chairman for three years, and will continue on as a director into part of 2002.

As we look forward, the events of 2001 have only strengthened our resolve at the Chicago Fed to accomplish our mission: to further the public interest by fostering a sound economy and stable financial system.

MICHAEL H. MOSKOW
PRESIDENT AND CHIEF EXECUTIVE OFFICER
MARCH 26, 2002

Inspiring Confidence
The Fed's Response to 9/11

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Many responded to 9/11 with extraordinary and heroic acts.

Many others, however, responded in less visible and dramatic ways by doing their jobs well in difficult circumstances, part of a collective effort that restored our nation's stability.

The following article chronicles how the Chicago Fed's staff responded on 9/11 and during the critical week after.

The News Breaks

During a breakfast meeting with staff, President and CEO Michael Moskow is listening to an employee make a point when he sees First Vice President and COO Gordon Werkema signaling him from the doorway. Moskow excuses himself. Werkema informs him that a jet has crashed into the North Tower of the World Trade Center. Minutes later, a second plane crashes into the South Tower. Terrorism is suspected.

Moskow and Werkema convene an emergency meeting of the Bank's leadership team—the Management Committee. As the meeting starts, the media reports that a plane has crashed into the Pentagon. Fifteen minutes later, the South Tower collapses. The meeting is hectic; information is sketchy. People monitor events on TV and get updates on their cell phones.

The Committee focuses on assessing the situation and making sure employees are safe at the Bank's seven regional locations. Closing is not an option, although the Bank can evacuate to a back-up site.

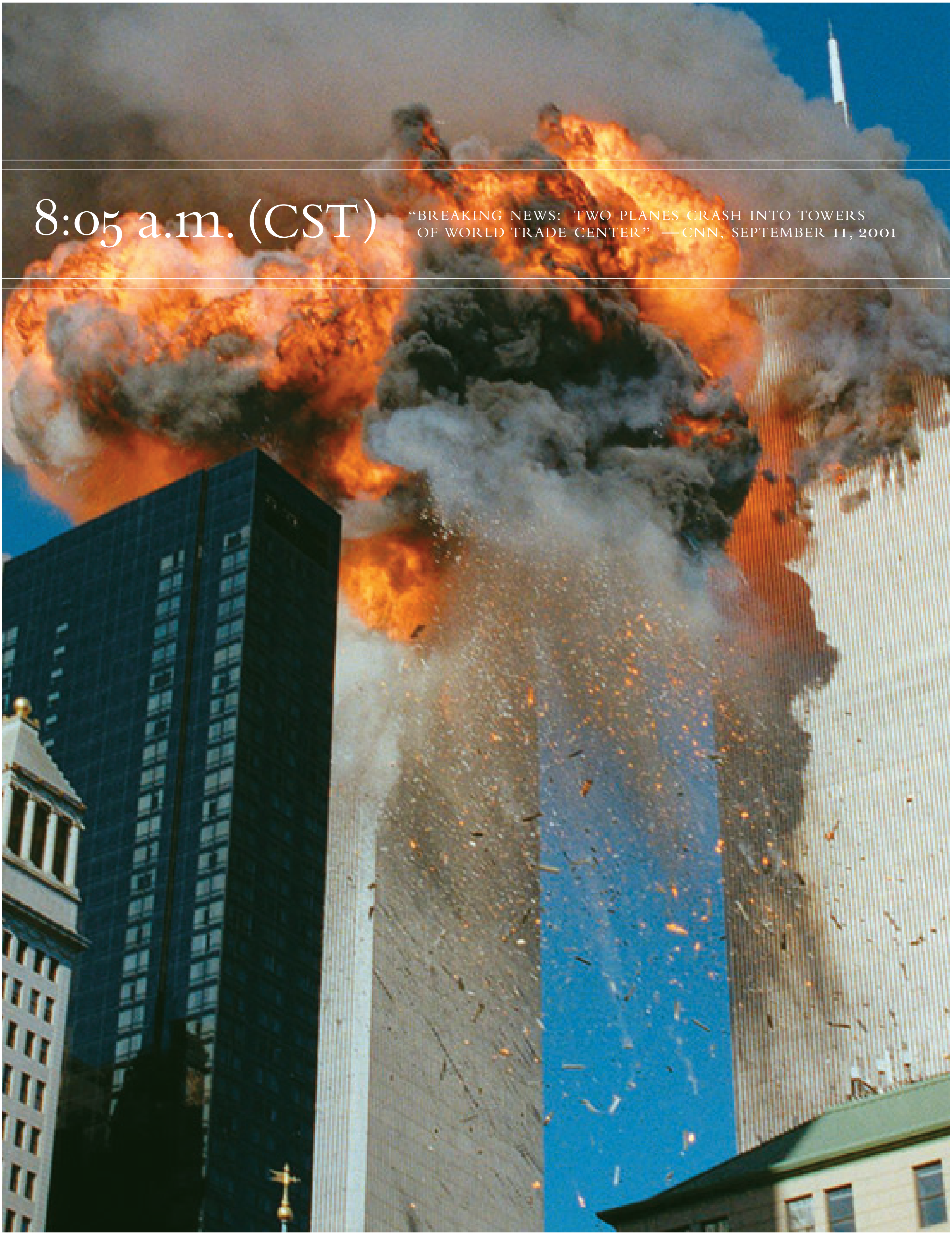
"The Fed has a crucial role to play during an economic or financial crisis," notes Werkema. "Closing the Fed in those circumstances would be like shutting down the fire department because there are too many fires."

The Committee tries to determine if staff is in danger. Employees at the Chicago Office are particularly anxious because they are only one block away from one of the world's tallest buildings, the Sears Tower. The Protection department reports that it has already increased security, particularly at the Chicago and Detroit offices, which are more visible symbols of the Fed than the other offices.

The Committee decides to give staff who are not "mission-critical" the option to go home for that day. Other staff are asked to stay. While the Bank continues operating at each office, a back-up site in Chicago is ready to go by 10:30 a.m., if needed (all times are CST).

8:05 a.m. (CST)

"BREAKING NEWS: TWO PLANES CRASH INTO TOWERS OF WORLD TRADE CENTER" —CNN, SEPTEMBER 11, 2001



AP/WIDE WORLD PHOTOS

8:45 a.m. (CST)

"BREAKING NEWS: AMERICAN FLIGHT 77 CRASHES INTO PENTAGON" —CNN, SEPTEMBER 11, 2001

Situation in Washington, D.C.

In Washington, D.C., Jack Wixted, senior vice president in charge of Supervision and Regulation (S&R) at the Chicago Fed, hears a muffled explosion in the distance at about 8:45 a.m. Wixted, attending a meeting at the Federal Reserve Board, runs to a rooftop terrace. He can see smoke rising from the Pentagon, about two miles from the Board building. Board staff, already in emergency mode, scramble to evaluate the situation and its implications for employees.

The Board's S&R division sets up a "war room," using the model established during Y2K planning. The Board arranges for regular conference calls with the Federal Reserve Banks to gather up-to-date information on the banking system.

Despite Wixted's absence, S&R staff in Chicago quickly arrange for a Seventh District version of a war room. It's essential to gather high-quality information and avoid rumors. An S&R staffer in Chicago writes in bold letters on a board in the war room: "Just the Facts."

The Crisis in New York

Meanwhile, at the New York Fed at about 9 a.m., Carl Vander Wilt, senior vice president and chief financial officer at the Chicago Fed, hears a distant, deep rumbling—the South Tower has collapsed. Vander Wilt, in New York for a Fed meeting on discount window policy, stepped off the subway at the World Trade Center just 23 minutes before the first attack. As Vander Wilt looks out the 10th-floor window, a slowly rising curtain of ash and soot begin to block the sun.

"At that point we felt vulnerable," says Vander Wilt. "We thought a plane had hit somewhere close to the New York Fed, but we didn't know where."

The New York Fed building becomes a safe haven for hundreds of people out on the street in the suffocating ash and soot. Some feel their way along the building to find the entrance. New York Fed staff begin to pass out face masks or moistened paper towels to fellow employees and fellow New Yorkers caught in the attack.

The Bank Responds

At approximately 9:30 a.m., the North Tower of the World Trade Center collapses. Ten square blocks in the heart of the nation's financial center lie in ruins. The wholesale destruction in Manhattan has the potential to temporarily cripple the U.S. financial system. However, the extent of the damage to the financial system is still unclear. Obtaining up-to-date information and analysis is crucial. The Federal Reserve Board and the 12 Reserve Banks work in concert to gather and exchange information.

Throughout the morning, Chicago Fed staff at all levels are in constant contact with banks and other key players in the economy. President Michael Moskow talks to the CEOs of large banks as well as other businesses. Financial Services staff call their counterparts at commercial banks; S&R employees contact banks they supervise.

The Chicago Fed plays a key role in evaluating the implications for the futures market. Although the markets are closed, Bank staff exchange information with contacts in the futures industry.

In each of these areas, the Chicago Fed takes advantage of its network of established contacts to quickly reach the right person. This intelligence is passed on to the Board of Governors and Fed System groups during conference calls scheduled throughout the day.

At the same time, the Bank's Customer Support and Contact Center is receiving dozens of calls from financial institutions seeking assurance that the Chicago Fed is still operating. The Bank issues a press statement: "The Federal Reserve Bank of Chicago is open for business and will continue to provide services to financial institutions in the Seventh District."

With the Protection manager out on Bank business, Sergeant ALDROW RICHARDSON stepped up to coordinate the Detroit Branch's security response to 9/11.

RICHARD LAMM, director of the financial markets and payment system risk unit, kept in close touch with key players from the derivatives exchanges and clearing organizations in Chicago.

PAM KEMPKEN, check manager in the Milwaukee Office, was one of many employees in the Bank's six offices who helped process the backlog of checks caused by the shutdown in air traffic.

SUSAN KINNEY & ROBERT VILLARREAL were two of the 44 staff members in the Customer Support and Contact Center who answered hundreds of calls from bankers on 9/11.

KEVIN GEARIN, Detroit Branch supervisor, was one of many employees in Chicago and Detroit who ensured financial institutions had access to cash on 9/11.

CHARLOTTE BROWN, funds transfer specialist in Electronic Payments, volunteered to work until 11 p.m. on 9/11 to give banks more time to close their books.

Responding to Liquidity Concerns

Staff at the Chicago Fed and throughout the System work to get a handle on the extent of the problem. Liquidity is a major concern. The attacks have disrupted the immense daily flow of payments and settlements in the U.S. Many of these transactions flow through banks and brokerages in New York. The Fed's task: Contain the disruption and prevent it from spilling over into the rest of the economy.

A particular concern is the commercial paper market—a crucial source of liquidity for major corporations. Many companies have trouble "rolling over" their paper and turn to their lines of credit at banks to cover the shortfalls. Banks, dealing with their own liquidity issues, struggle to meet the needs of their customers.

Among those contacting Moskow is the CEO of a major company who has to meet his payroll on September 13. The company had invested funds in commercial paper scheduled to mature on September 12. But with markets at a virtual standstill, this routine operation is now fraught with uncertainty.

Roger Ferguson, vice chairman of the Federal Reserve Board, convenes a conference call of the Federal Reserve Bank presidents at 10:30 a.m. Ferguson is acting in the absence of Alan Greenspan, who is trying to make his way back to the U.S. from a conference in Switzerland. With the markets in a state of shock, it is clear the discount window—a last resort for banks that need to borrow from the Fed—will play an important role in providing liquidity. Following the conference call, the Board issues a brief statement: "The Federal Reserve System is open and operating. The discount window is available to meet liquidity needs."

Keeping Payments Flowing

Throughout the day, the Bank also focuses on its payments services—cash, check and electronic. The Fed's immediate concern: preventing gridlock in the payments network, the central nervous system of the financial sector.

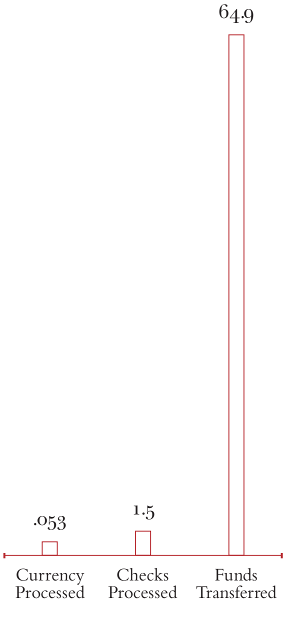
The Fed's large-dollar transfer service, Fedwire, is critical. The early reports on Tuesday morning are positive—Fedwire is running smoothly throughout the country, except for some minor disruptions in New York. The blockages in the financial system are due to key private-sector firms being incapacitated by the attack. Later in the day, the Fed extends its processing hours for Fedwire from the normal 5:30 p.m. closing until 10:45 p.m. This gives banks directly affected by the attack more time to close their books.

The focus shifts to cash. "Once you know Fedwire is up during a crisis, cash rises to the top of the list," notes COO Werkema. "During a time of uncertainty, people have a natural reaction to try to get cash. And if it's not there, you have the potential for panic."

The Bank's Chicago and Detroit offices let financial institutions know they have access to cash. Complicating the process is hesitation on the part of some armored carrier companies to operate in Chicago on September 11 due to security concerns.

"What we told banks is, 'Forget about the usual schedule for distributing cash. If you need cash, we will provide it,'" says Lupe Garcia, assistant vice president in the Cash department. One bank requests an emergency shipment of $1.2 million. The Chicago Fed makes special arrangements to send it within hours. Overall, though, banks report only a moderate increase in ATM withdrawals on September 11 and 12. The fact that consumers can get cash deflates the potential for panic withdrawals.

CASH, CHECK AND FEDWIRE
2001 DOLLAR AMOUNTS
Federal Reserve Bank of Chicago, in Trillions



Moving the Checks

A BRIEF EXPLANATION OF FLOAT

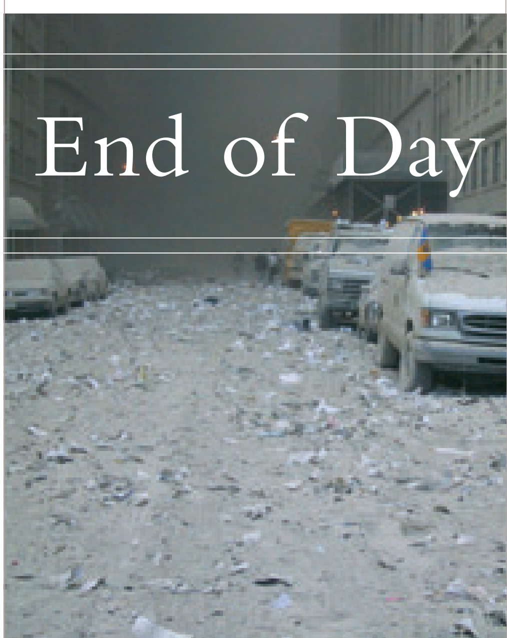
In providing check services, the Fed normally credits the accounts of banks depositing checks according to a fixed availability schedule. If bad weather or some other factor causes a delay, the Fed cannot collect payments from banks in a timely manner. So if the Fed sticks to existing availability schedules, it would credit banks for deposited checks before it received the corresponding credit from the banks on which the checks were drawn. Having credits in two different accounts simultaneously causes float.

Even as it monitors electronic payments and cash, the Fed faces a fast-approaching crisis in check processing. The Fed System annually processes more than 17 billion checks, about one-third of the nation's total volume. The Fed uses planes to move much of this volume, transporting 43,000 pounds of checks by air among 45 processing sites. At 8:25 a.m., the Federal Aviation Administration shuts down air traffic indefinitely, leaving the Fed to improvise. Fed staff throughout the country begin working on alternate ground transportation.

The Fed has to decide how to handle potential massive "float"—check funds that are in the process of collection. In the early afternoon, the Federal Reserve announces it will continue providing credits based on existing schedules, despite the delays in collection. The inevitable result is record levels of float. The move eliminates uncertainty and provides additional liquidity.

In Chicago, Assistant Vice President Mike Hoppe and other staff meet with bankers on Tuesday afternoon to explain the decision. "The mood was very somber," Hoppe says. "People were still in a state of shock and disbelief about the attacks. They were grateful we were granting credits, but also really surprised. One of the Fed's goals is help make the payments system more efficient. This wasn't an efficient way to do things in normal circumstances. But keeping the payments moving in this crisis was more important than anything else."

End of Day in New York



AP/WIDE WORLD PHOTOS

Carl Vander Wilt walks back to his hotel at about 6 p.m. after completing his final conference call at the New York Fed. "There was a thick layer of white ash and dust everywhere—about two inches on the ground," Vander Wilt recalls. "I left a trail of footprints. The streets were deserted, except for police and military. I remember seeing a lone policeman in the distance, with his blue uniform standing out in the white-ash landscape."

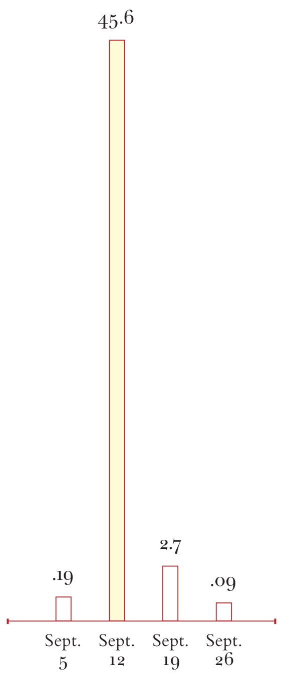
Stabilizing the Markets

Following the chaotic events of September 11, the Fed's key challenge is to stabilize financial markets. The Chicago Fed Loan department gears up for a record-breaking day on Wednesday morning. Already, loan staff dealt with a steady stream of calls on September 11.

Wednesday turns out to be even busier.

DAILY LOAN VOLUMES

Federal Reserve System, in Billions



"What we had to do was very clear," says Loan Officer Jerome Julian. "We knew we had to make loans. And we knew we had to work within the Fed's lending rules to be as accommodating as possible."

The Fed requires banks to pledge collateral, such as U.S. government securities, to receive loans. As a result of Y2K planning, most banks have their collateral "pre-pledged" to the Fed so it will be quickly available in an emergency.

"The entire Fed System uses the same online loan application system," notes Katie Stembridge, a loan analyst. "When a bank calls, we pull up their file to check collateral and process the request. The loan then needs to be approved by our loan officer. The entire process takes just a few minutes."

In one case, a bank that urgently needs a loan cannot provide the usual collateral. The Bank switches to alternative arrangements to secure the loan, a back-up process established as part of Y2K preparations. The loan is processed within hours.

The Fed System provides a record $45 billion in loans on Wednesday. The week before the attack, daily lending averaged less than ½ of one percent of that amount. The Chicago Fed provides about $4.3 billion in loans on Wednesday, also a record amount.

Examiner PAUL DECKER worked with other S&R staff to monitor the Seventh District's banking situation.

New officer JEROME JULIAN directed the record-breaking loan efforts following 9/11. Loan Analyst KATIE STEMBRIDGE volunteered to work until midnight on 9/11.

KAREN BOYKIN, webmaster in the Customer Relations and Support Office, quickly provided information to bankers on the System's financial services Web site.

Flooding the Market with Liquidity

GETTING THE WORD OUT TO CUSTOMERS

With effective communications at a premium, the System's Customer Relations and Support Office (CRSO) plays a critical role. CRSO, responsible for the Fed's nationwide customer support and marketing, is managed at the Chicago Fed.

Several improvements previously spearheaded by CRSO prove to be helpful. Account managers for each of the 50 largest banks using Fed services are already in place. On the morning of 9/11, Chicago Fed Senior Vice President Dick Anstee instructs the account managers to contact their bank on a regular basis. In addition, the Fed's national financial services Web site, established in 1998, becomes a critical tool for quickly disseminating information to customers.

That same morning, the Open Market Desk at the New York Fed begins another day's work. It's not a typical day. The New York Fed building is just a few short blocks from the massive destruction at Ground Zero. And the Fed is facing unprecedented liquidity demands.

The Desk will play a key role as it carries out open market operations—the buying and selling of securities—under the direction of the Federal Open Market Committee (FOMC). The Fed begins to flood the financial system with record levels of liquidity by executing repurchase agreements. These overnight loans collaterallized with government securities are used routinely in open market operations, but seldom top a few billion dollars each day.

On Wednesday, the Fed injects $38 billion, more than double the previous record. Thursday, the Fed shatters that mark with $70 billion. The next day, the Fed injects even more—$81 billion.

In addition, the Fed does not offset the float generated by check-processing delays. Typically, if check deliveries are delayed, the Fed "soaks up" the float through open market operations. The Fed opts to let the float remain, providing additional liquidity. The result is $23 billion in float on September 12 and a daily average of $28 billion in float for the week ending September 19.

The Fed is also active on the international front. Soon after the attack, foreign banks located in the U.S. face a problem: They can't obtain funding—specifically dollars—due to the disruption in the financial markets. On September 12, the FOMC votes during a conference call to establish or enlarge 30-day "swap agreements" with the European Central Bank. Similar agreements are later approved for the Bank of Canada and the Bank of England. The swaps enable the foreign central banks to trade dollars for an equivalent amount of foreign currency. The foreign central banks are then able to quickly provide dollars to foreign banks located in the U.S. The swaps result in an additional $90 billion in liquidity.

"The Fed used every possible means to add liquidity—the discount window, open market operations, float—and even used swap lines in an innovative way to help foreign central banks provide liquidity to foreign banks in the U.S.," says Curt Hunter, the Bank's director of research. "If you compare the financial system to a plumbing system—then there were a lot of pipes blocked after 9/11. But the Fed flooded the system so liquidity was temporarily available through existing, still-functioning pipelines."

Monitoring the Banking System

Since early on September 11, S&R's war room in Chicago serves as a coordination point for gathering and passing on information about the region's banking situation. The Chicago Fed acts as an information clearinghouse—answering questions from banks, conveying information to them, and passing on information to the Fed System. The Bank's practice of designating an examiner as a "single point of contact" for a bank helps provide clear lines of communication.

Among the issues tracked by the Fed: Are banks limiting access to lines of credit? And how exposed is the banking system to the industries most affected by the crisis, such as airlines, insurance and travel?

Examiner Paul Decker, a 17-year veteran who has experienced a number of banking crises, notes, "We had never seen anything like this. There were a host of problems—all happening at once. The money wasn't flowing. Some banks had too much money; some were short. The commercial paper market had collapsed. Commercial banks were under intense pressure. There was a lot of apprehension and uncertainty. We told banks, 'We're here. We're not going anywhere. Whatever we can do to support you, we'll do it.'"

Decker, a pilot during the Vietnam War, keeps a photo of his old F4 jet on his desk. "When things got really hectic, I'd look over at the photo and think it could be worse. I have to admit I looked at that photo several times."

Decker ends his day on Thursday at about 8 p.m. by bringing pizza to the staff he's working with at a commercial bank. "I wasn't there to monitor their activities," notes Decker. "I just wanted to provide moral support as they finished off another long day."

STRANDED FAR FROM HOME

Like many Fed employees, Alan Greenspan is stranded far from home on 9/11. Greenspan, in Switzerland for a central banking conference, eventually hitches a ride home on a military cargo jet.

AP/WIDE WORLD PHOTOS

The trip home for Chicago Fed S&R staffers Sherry Bormann and Zoriana Kurzeja exemplifies the experiences of many. In San Francisco on business when the attack occurred, Bormann and Kurzeja begin the long drive to Chicago on September 12.

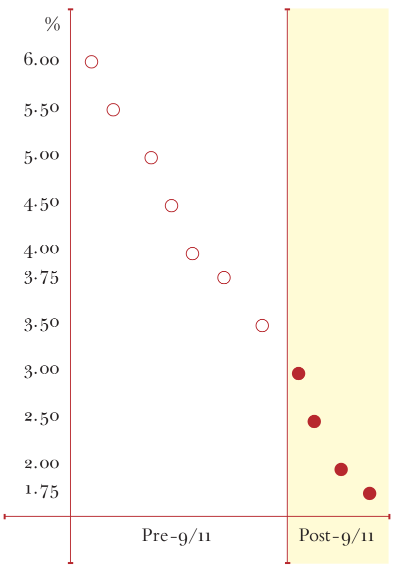
"There was a gentleness in the country at that time," Bormann recalls. "It was a much kinder, gentler country that we crossed."

Focusing on the Economy

By the end of the week, financial markets are still shaky but more stable. The Fed increases its focus on the longer-term implications for the economy. Earlier in the week, on September 13, Moskow participates in an FOMC conference call. The Committee has a detailed discussion of banking and other financial market conditions. Participants also discuss the outlook for opening the stock exchanges, closed since September 11 and scheduled to reopen on the 17th.

2001 FED FUNDS RATE CHANGES

In Percent



The Committee decides the situation is too uncertain for an immediate monetary policy move, but that action will be needed very soon. An FOMC call is scheduled for Monday, September 17.

On Friday morning, Chicago Fed Economist Rick Kaglic works on a special edition of the "Beige Book," the Fed's summary of regional economic conditions based on anecdotal information. The Federal Reserve Board has asked each Reserve Bank to help develop a post-9/11 "Beige Book."

As they do for each of the eight annual editions of the "Beige Book," Kaglic and a small team of associates contact up to 100 people working in the Seventh District in fields such as manufacturing, retail, finance, real estate and construction. The team seeks information on how businesses reacted to September 11 and if they have changed their business plans. Seventh District contacts confirm that business activity is at a standstill except for items such as gas and groceries and services such as insurance.

Moskow, an FOMC voting member in 2001, continues to call business contacts in the region as he has throughout the week. Prior to the Monday FOMC meeting, he consults with Curt Hunter, the head of Economic Research, about the state of the economy. Working with Hunter, Moskow develops the key points he wants to share at the meeting and evaluates how he should vote.

Economist RICK KAGLIC helped track regional conditions for a special edition of the "Beige Book" following 9/11.

Analyst RICH STEFANICH was one of several Statistics staff members who responded to special requests from the Federal Reserve Board to collect statistical information from banks following 9/11.

CAREY WRIGHT, manager of Protection in Chicago, took the initiative to increase security immediately following the 9/11 attacks. Many Protection staff worked 12- to 16-hour days following 9/11.

Getting the Checks Out

The Bank's Midway facility broke a record for processing checks thanks to the efforts of staff such as Supervisor SONJA HENNINGS and Senior Processor ANDREW HALL.

On Friday afternoon, the Bank's check staff are in a state of high alert. Planes are now flying; employees know a deluge of checks will inevitably follow. During the last three days, the Fed System delivered roughly 75 percent of its normal check volume by cobbling together a temporary truck-delivery network. But the Fed still needs to move millions of checks by air.

One of the pressure points in the System is the Bank's check operation in Chicago. The office serves as a "funnel point" for Midwest check volume. In addition, a number of large customers in Chicago temporarily shift their check work to the Fed due to the crisis.

Just a week earlier, the check operation had moved from downtown Chicago to a more efficient space on the Southwest side of the city near Midway Airport. Staff spent a hectic week making the move. "We got to the point where we had a good 'just-moved-in-the-house feeling,' and then the attacks came," notes Check Supervisor Sonja Hennings.

On Friday afternoon, the dam breaks. Checks start arriving in large numbers. Staff have already agreed to work extended hours over the weekend. Soon, every square foot of unoccupied space is covered with hundreds of bags of checks waiting to be processed. The incoming checks replace bags of processed checks that can now be shipped to the airport. The new check work arrives in a steady flow.

"The trucks just kept coming," remembers Senior Processor Andrew Hall. "We started to wonder when they were going to stop. Right after you made a dent and could see over a pile of checks, more would come."

By early Sunday morning, staff breathe a sigh of relief. The worst is over. Midway staff processed more than six million checks over the weekend—a record for the Chicago check operation.

"There were some high-fives, some tired high-fives," says Hall. "We got more checks than I've ever seen. We all pushed hard. The newer people were helped by the more experienced ones. We all pulled together and got it done."

ORLANDA HUDSON, check coordinator at the Detroit Branch, worked to assure check customers that their accounts would be charged and credited properly during the week of 9/11.

Responding with Monetary Policy

On Monday, September 17, the FOMC starts its conference call at 6:30 a.m. The meeting is scheduled early so the Fed can announce a decision before the stock markets reopen. The Committee faces an unusually uncertain outlook.

Prior to September 11, the economy was struggling, with some tentative signs of improvement in the third quarter. The shock of 9/11 will sap the strength of an already weak economy. The question is how much and for how long. "The situation was very severe," Moskow notes. "Activity had ground to a halt. Consumers weren't going to stores. And some stores weren't reopening. There was a brief cessation in economic activity."

After observing a moment of silence in honor of the 9/11 victims, the Committee takes only 25 minutes to take decisive action—it cuts the fed funds target by half a percentage point.

During the remainder of 2001, the FOMC reduces the fed funds target by an additional 1¼ percentage points to 1¾ percent—the lowest level in 40 years. These actions follow the Fed's policy moves during the first eight months of the year, which reduced the fed funds target from 6½ percent to 3½ percent.

However, the economy continues to struggle after 9/11. With people in shock and glued to their TVs, consumer spending growth falls sharply in September. Spending by consumers later recovers, buoyed in part by aggressive price discounting and low mortgage rates. Business spending, on the other hand, declines as companies liquidate excess inventories and put capital spending plans on hold. In addition, economies overseas weaken, dampening the appetite for U.S. exports. In November, the National Bureau of Economic Research announces that the economy entered into a recession in March of 2001.

By year-end, there are some preliminary signs that the economy is reaching bottom. An upturn during 2002 is a reasonable prospect, although the outlook is more uncertain than usual. Over the broader horizon, the prospects for the economy remain bright. Factors such as deregulated financial markets, more flexible labor markets and technology advances have enhanced America's ability to absorb shocks and provide a foundation for solid economic growth.

The Situation Stabilizes

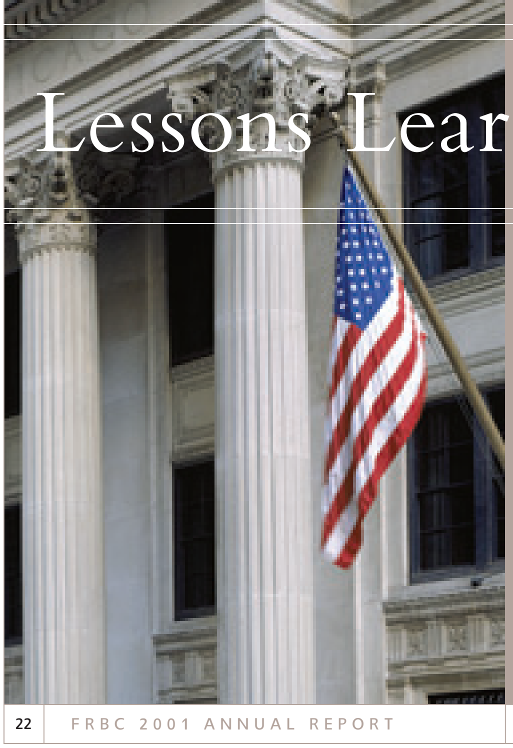
A little over a week after the attack, financial markets are more stable. Discount window borrowing and Fed float are back to normal levels; check operations and other services are proceeding smoothly. Customers and stakeholders give the Fed high marks for its efforts. One commercial bank takes a creative approach and sends a thousand packages of LifeSavers™ candy to each of the 45 Fed offices.

Looking back at the quick recovery of the financial system, Alan Greenspan said, "…we are blessed with a financial system that is creative, that is flexible, that is innovative. Banks—including the central bank—were there when they were needed and did what was required with dispatch."

The crisis gives Chicago Fed staff an enhanced understanding of the central bank's critical role. "I got a better idea of how many people depend on us to get the money out on the street," says Check Supervisor Hennings. "Our job is to be a bank for banks. That's what we tried to do and we succeeded."

As the crisis winds down, there is more time to reflect. Like millions of other Americans, Chicago Fed staff come together on September 14 to watch the national memorial service on TV and honor the victims of the attack. Responding to the many examples of heroism throughout the nation, employees sing "God Bless America."

Speaking to staff at the gathering, Moskow notes that "our hearts, thoughts and prayers go out to the victims of this tragedy and their loved ones." He thanks employees for their efforts during an emotional and stressful time for the entire nation. "In times of crisis like this, a stable financial system is crucial and the Fed is called upon. The System and the Chicago Fed have been more than equal to the challenge. You have done an outstanding job."



Lessons Learned

Each crisis provides a chance to improve. The Chicago Fed appoints a review team to look at the Bank's response to 9/11. Similar reviews take place at the System level and at other Reserve Banks. Among the approved recommendations from the Chicago Fed review:

- Streamline the crisis management process to facilitate quicker decisions.
- Develop a more formal crisis communication plan for external and internal audiences.
- Take additional measures to ensure the safety of employees in the post-9/11 environment.
- Enhance business continuity planning by increasing the involvement of each department.

2001 Accomplishments

The Federal Reserve Bank of Chicago had another successful year in 2001, with significant accomplishments in its four functional areas: Economic Research, Supervision and Regulation (S&R), Financial Services, and Support Activities. In addition to responding to 9/11, the Bank's notable accomplishments include assuming responsibility for the System's Customer Relations and Support Office (CRSO), opening a check processing facility in Chicago, and developing a new Visitors Center.

The following long-term goals provided a broad strategic framework for 2001 activities:

1. Sharpen focus on customers and stakeholders.
2. Successfully execute Federal Reserve System leadership assignments.
3. Contribute to the discussion and development of public policy issues.
4. Continually improve operational efficiency.
5. Continue to prepare staff to meet the Bank's evolving needs.

FIRST QUARTER

★ The Bank introduces the "Chicago Fed National Activity Index," a monthly index that gauges current and future economic activity.

★ The *Journal of Finance* publishes Nicola Cetorelli's "Banking Market Structure, Financial Dependence, and Growth: International Evidence from Industry Data," one of 32 Chicago Fed papers published or accepted for publication in academic journals during 2001.

★ The Bank expands its mentoring program, tapping internal resources to help staff develop their talents and skills.

★ Consumer and Community Affairs works with local organizations to launch the "Housing Opportunities Partnership of Southeast Wisconsin," designed to promote housing opportunities in the region.

★ The Bank's conference, "Chicago's Global Economic Connections," examines the effect of immigration, foreign investment and trade on the city's economy.

★ UseDirectPayment.com, developed by the Chicago Fed to encourage electronic bill payment, is expanded to banks and billers throughout the Seventh District.

★ S&R reduces regulatory burden by combining whenever possible bank holding company inspections, safety and soundness exams and specialty exams.

★ Responding to customer feedback, the Chicago Fed launches seminars for bankers that cover information on a variety of financial services in a single session.

★ S&R holds a training seminar for System examiners, one of the initiatives it undertakes as the Fed's competency center on private equity merchant banking.

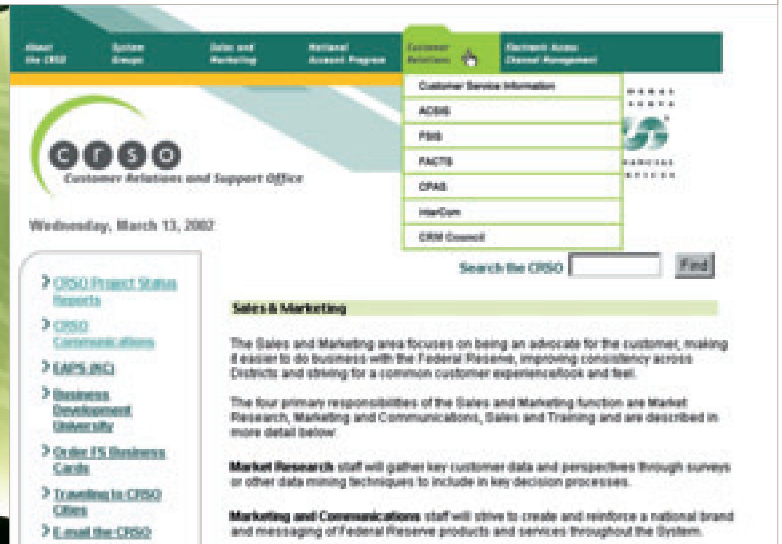
VISITORS CENTER OPENS

The Bank opens a 5,500 square-foot Visitors Center in July as part of an ongoing effort to reach out to the public. The Center explains in an engaging, hands-on way the role of a central bank and the evolution of money and banking. In an opening ceremony, Chairman Alan Greenspan dedicates the Center in honor of Nancy Goodman, who played a key role in the Bank's outreach efforts for three decades.

To introduce the Center more broadly, the Bank hosts a series of sneak previews for media, employees, and other audiences. The official public opening attracts 600 people. The outreach effort also provides an opportunity to unveil the Bank's new public art collection, "Images of the Seventh District." Together, the art collection and Visitors Center represent the Bank's strong commitment to public outreach.

SECOND QUARTER

- ★ William Conrad, first vice president and chief operating officer, retires after 42 years of service and is succeeded by Gordon Werkema, formerly executive vice president at the San Francisco Reserve Bank.
- ★ Economic Research initiates an ongoing series of papers and public forums examining the Midwest's infrastructure and long-term growth prospects.
- ★ The Chicago Fed is selected to lead the System's initiative regarding Electronic Bill Presentment and Payment (EBPP), which includes making strategic recommendations to the Fed System.
- ★ S&R hosts a meeting with banking, insurance and securities regulators, part of an ongoing effort to build relationships with financial supervisors.
- ★ S&R's technology lab, a unique regulatory resource, holds one of 35 training sessions for Federal Reserve and other examiners on how to evaluate information technology risk.
- ★ The "Conference on Bank Structure and Competition," generally regarded as the nation's leading conference on financial public-policy issues, focuses on the financial safety net.
- ★ The Chicago Fed is selected to implement, for the Fed System, a Web-based application for developing budgets on a central server.
- ★ S&R creates a new risk-analysis unit, which proactively identifies risks facing District banks and allocates supervisory resources to address them.



CRSO ESTABLISHED

The Chicago Fed is selected to lead the System's Customer Relations and Support Office (CRSO). The new office is successfully established at the Chicago Fed in June. CRSO manages several national financial services functions—sales and marketing, national accounts, customer support, and electronic distribution channels. The overall goal for CRSO is to help ensure consistency and excellence in financial services to customers nationwide.

During 2001, CRSO focuses on: restructuring the National Account Program, which supports the System's largest customers; developing national marketing campaigns for several products; piloting new FedLine for the Web applications; and developing a national strategy for managing customer relationships.

THIRD QUARTER

★ The Des Moines Office sets a System record for the fewest check-processing errors during a three-month period. The Office goes on to lead the System in the fewest errors per 100,000 checks for all of 2001.

★ The Customer Call Center implements interactive voice response and web applications, providing customers with better information and more flexible options.

★ The Bank publishes "Productivity Growth in the 1990s: Technology, Utilization, or Adjustment?," by Susanto Basu, John Fernald and Mathew Shapiro, one of 26 working papers produced by Economic Research during the year.

★ The Chicago and Detroit Cash departments implement new software used to account for thousands of daily cash transactions.

★ The Chicago Fed continues to play a leading role in executive education and development for the System, organizing a highly successful Leadership Conference for Fed senior officers. In addition, it hosts a special conference for "alumni," who have attended previous Leadership Conferences.

★ S&R holds a conference on "de novo" (start-up) banks, one of a series of outreach efforts on regulatory issues.

★ State and local policymakers, academics, and urban real-estate professionals attend a Bank conference examining the prospects of large central cities such as Chicago.

★ The Bank surveys all staff as part of an ongoing effort to build a stronger culture and engage employees. As results are shared, employees form work groups to develop plans to strengthen their connection to work.

NEW CHECK FACILITY COMPLETED

The Chicago check operation successfully moves in September to a new location on the Southwest side of the city near Midway Airport. The move to a new 55,000 square-foot space, completed on schedule and within budget, enables the Bank to provide more flexible and convenient service to customers. Among the advantages: staff can process checks more quickly in the new facility. This enables the Bank to provide customers with new deposit options.

FOURTH QUARTER

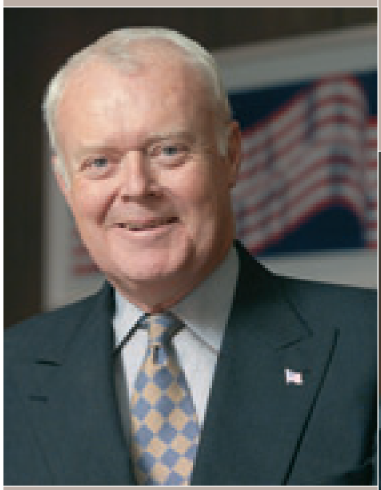
- ★ Bankers and policymakers attend "International Money Transfers," a Chicago Fed conference examining remittances and their use by the "unbanked" population.
- ★ The Bank comments on options being considered by the Federal Reserve Board to reduce risk to the payments system, one of a series of public-comment responses on complex policy issues during 2001.
- ★ More than 12,000 visitors tour the Chicago Fed during 2001.
- ★ The "Big Problem with Small Change," a book co-authored by Chicago Fed Economist Francois Velde, is described in *The Economist* as "a fascinating new history of money."
- ★ The Chicago Fed moves forward on a System-wide check modernization initiative with four offices successfully converting to a new, standard check-adjustment system by year-end.
- ★ The Bank completes diversity training for all of its managers as well as all new employees.
- ★ The Bank signs up the 1,174th depository institution submitting its statistical reports via the Internet.
- ★ S&R chairs the System task force charged with studying the business value of technology investment for the Fed's supervisory function.
- ★ Economic Research brings together regulators and participants from the financial industry and academia to evaluate the complexities involved with resolving problems at large, complex banking organizations.
- ★ The Chicago Fed's Audit function receives a Commitment to Quality Improvement Award from the Institute of Internal Auditors.
- ★ The Indianapolis Office ranks first in the Fed System for the highest number of check items handled per work hour and the lowest unit costs.
- ★ The Bank supervises 199 state member banks and 988 bank holding companies, the largest number in the Fed System.

BANK SUPPORTS COMMUNITY
Bank staff gather in June to help build a playground for a day-care center on the West Side of Chicago. Such community-based efforts took place throughout 2001 and intensified following September 11. Like millions of other Americans, Chicago Fed staff reach out to help those affected by the 9/11 attacks. Employees organize fund-raising efforts and take part in blood drives held at the Bank's offices. Overall, staff from each of the Bank's six offices participate in roughly 40 community service projects during 2001. Among the other 2001 activities: collecting food, clothing, toys and child-care items for those in need; teaching economics-related topics to hundreds of students via Junior Achievement; and assisting low-income families in preparing tax returns through the Tax Counseling Project.

LOOKING TO THE FUTURE

Given the rapidly evolving economic and financial environment, the Bank will face new challenges during 2002 in developing monetary policy, providing financial services, and supervising banks. While continuing to focus on its varied ongoing responsibilities, the Chicago Fed has identified four high-priority goals for 2002:

1. Carry out System responsibilities for leading CRSO.
2. Build on progress as a System S&R expert on internet and wireless banking; large, complex banking organizations; and private equity merchant banking.
3. Contribute to System policy on emerging financial services.
4. Achieve superior performance in financial services.



Chairman

ARTHUR C. MARTINEZ

Retired Chairman
and Chief Executive Officer
Sears, Roebuck and Co.
Hoffman Estates, Illinois

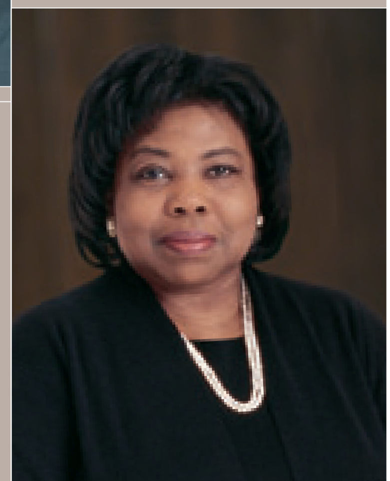
Deputy Chairman

ROBERT J. DARNALL

Chairman
Prime Advantage Chicago
Chicago, Illinois

JACK B. EVANS

President
The Hall-Perrine Foundation
Cedar Rapids, Iowa

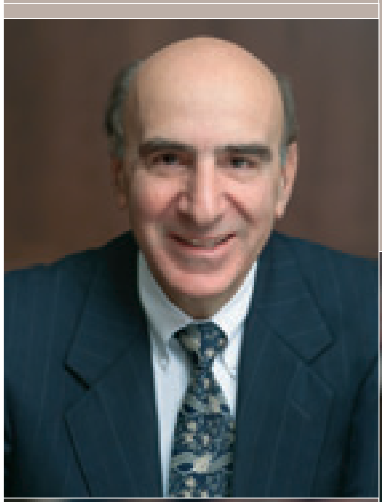


CONNIE E. EVANS

President and
Chief Executive Officer
WSEP Ventures
Chicago, Illinois

ROBERT R. YOHANAN

Managing Director
and Chief Executive Officer
First Bank & Trust
Evanston, Illinois



ALAN R. TUBBS

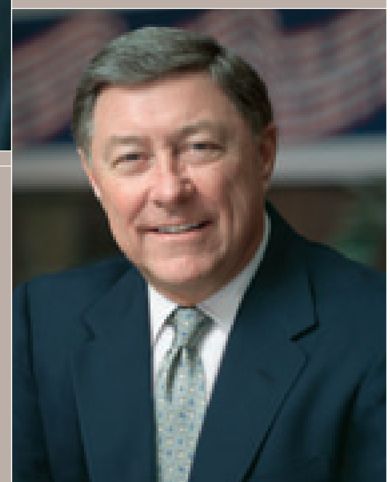
President
Maquoketa State Bank
and Ohnward Bancshares
Maquoketa, Iowa

JAMES H. KEYES

Chairman and
Chief Executive Officer
Johnson Controls, Inc.
Milwaukee, Wisconsin

WILLIAM A. OSBORN

Chairman and
Chief Executive Officer
Northern Trust Corp.
and Northern Trust Co.
Chicago, Illinois



W. JAMES FARRELL

Chairman and
Chief Executive Officer
Illinois Tool Works, Inc.
Glenview, Illinois

Chairman

TIMOTHY D. LEULIETTE

President and
Chief Executive Officer
Metaldyne
Plymouth, Michigan

STEPHEN R. POLK

Chairman and
Chief Executive Officer
R.L. Polk & Co.
Southfield, Michigan

IRMA B. ELDER

President
Elder Ford
Troy, Michigan

RICHARD M. BELL

Retired President and
Chief Executive Officer
The First National Bank
of Three Rivers
Three Rivers, Michigan

DAVID J. WAGNER

Chairman
Fifth Third Bank
Grand Rapids, Michigan

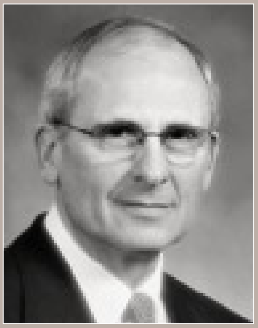
EDSEL B. FORD II

Director
Ford Motor Company
Dearborn, Michigan

MARK T. GAFFNEY

President
Michigan AFL-CIO
Lansing, Michigan

Two new directors joined the Detroit board in 2002:

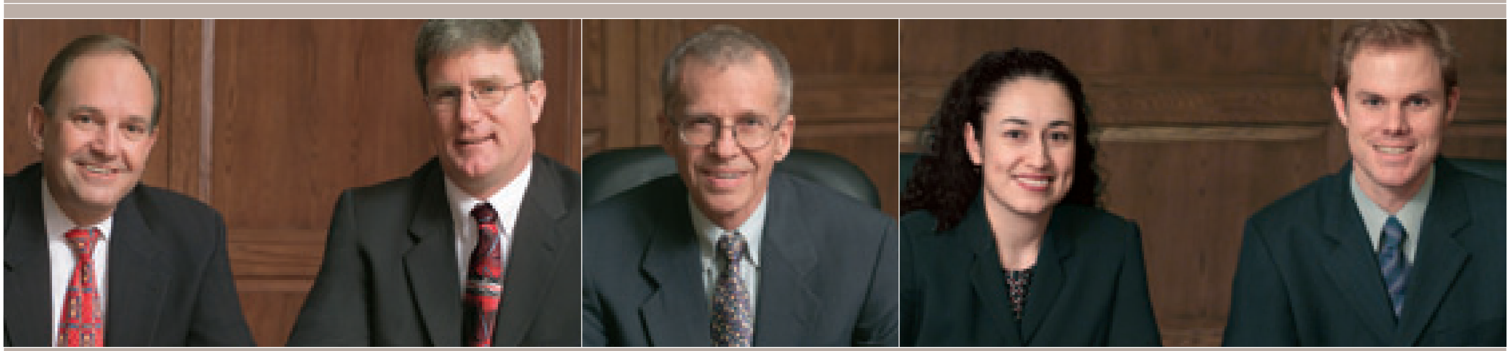


Robert E. Churchill (left), chairman and chief executive officer, Citizens National Bank, Cheboygan, Michigan, replaced Richard Bell, whose term expired on December 31, 2001.

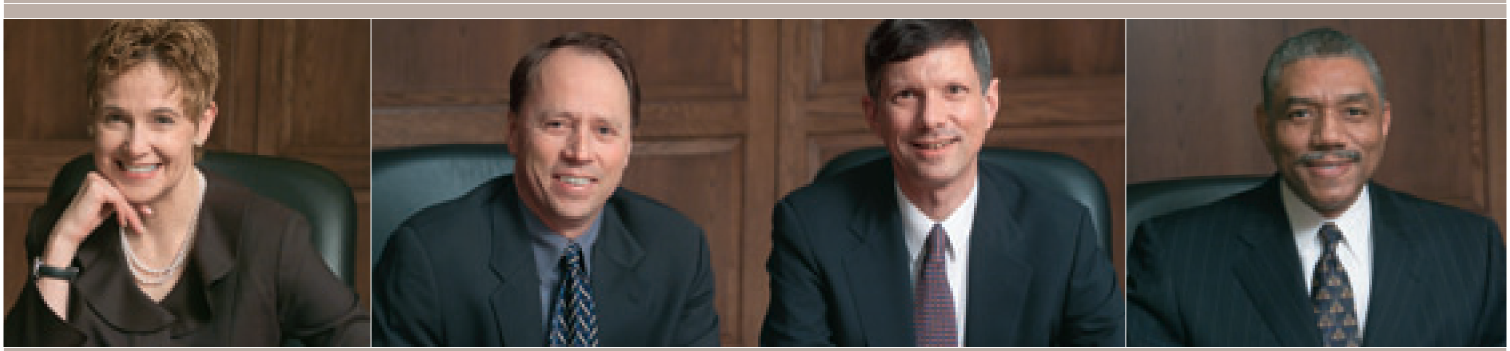
Irvin D. Reid (right), president, Wayne State University, Detroit, Michigan, replaced Steven Polk, whose term expired on December 31, 2001.

Federal Reserve Bank of Chicago Management Committee (from left):
MICHAEL MOSKOW, GORDON WERKEMA, CARL VANDER WILT, and JEROME JOHN.

Federal Reserve Bank of Chicago Management Committee continued (from left):
JOHN WIXTED, ANGELA ROBINSON, BARBARA BENSON, CHARLES FURBEE, and RICHARD ANSTEE.



Federal Reserve Bank of Chicago Management Committee continued (from left):
GLENN HANSEN, BRIAN EGAN, WILLIAM GRAM, CYNTHIA CASTILLO, and NATE WUERFFEL.



Federal Reserve Bank of Chicago Management Committee continued (from left):
KAREN KANE, WILLIAM BAROUSKI, EDWARD GREEN, and WILLIAM HUNTER.

Michael H. Moskow
President and
Chief Executive Officer

Gordon Werkema
First Vice President and
Chief Operating Officer

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Senior Vice President
and Director of
Research

Edward J. Green
Senior Policy Advisor

Jean L. Valerius
Vice President and
Senior Policy Advisor

Regional Economic Programs

William A. Testa
Vice President and
Economic Advisor

Financial Markets Regulation and Payments Issues

Douglas D. Evanoff
Vice President and
Economic Advisor

Elijah Brewer III
Assistant Vice President
and Economic Advisor

James T. Moser
Research Officer and
Economic Advisor

Robert R. Bliss
Senior Economist and
Economic Advisor

Robert DeYoung
Senior Economist and
Economic Advisor

David A. Marshall
Senior Economist and
Economic Advisor

Macroeconomic Policy Research

Charles L. Evans
Vice President and
Economic Advisor

Spencer D. Krane
Vice President and
Economic Advisor

Anne Marie L. Gonczy
Assistant Vice President
and Economic Advisor

William A. Strauss
Senior Economist and
Economic Advisor

Microeconomic Policy Research

Daniel G. Sullivan
Vice President and
Economic Advisor

Paula R. Worthington
Research Officer and
Economic Advisor

Statistics

Angela D. Robinson
Vice President
and Director of
Research Statistics
and EEO Officer

Loretta C. Ardaugh
Statistical Reports
Officer

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Director

Catherine M. Bourke
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Regional Director–
Indiana and Michigan

Karen Whalen-Ward
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Wisconsin

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Indiana and Michigan

Martha L. Muhs
Regional Director–Iowa

Arthur J. Zaino
Regional Director–
Illinois

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Division Leader

A. Raymond Bacon
Director

Adrian B. D'Silva
Director

Mark H. Kawa
Supervisory Director

Ralph A. Livesay
Supervisory Director

Michael E. Plaskett
Supervisory Director

Risk Analysis

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Vice President

Philip G. Jackson
Director

Technology Supervision and Operations

David E. Ritter
Vice President and
Division Leader

Gregory J. Bartnicki
Director

Frederick L. Miller
Director

**Includes directors and senior economists and economic advisors.*

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Senior Vice President

Valerie J. Van Meter
Vice President

Jeffrey S. Anderson
Vice President

Kathrine Kielma
Assistant Vice President

Daniel F. Reimann
Assistant Vice President

Beverly A. Schatte
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Strategic Marketing and Customer Service

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Rosemarie V. Gould
Administrative Officer

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Vice President

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Vice President

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Cynthia L. Rasche
Assistant Vice President

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Assistant Vice President

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Leatrice S. Mack
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James R. Holland
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Assistant Vice President

Margaret K. Koenigs
Assistant Vice President

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Assistant Vice President

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R. Steve Crain
Assistant Vice President

Business Resumption, Asset Management, Budget and Facilities

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Assistant Vice President

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Vice President and Associate General Counsel

Yurii Skorin
Vice President and Associate General Counsel

Anna M. Voytovich
Vice President and Associate General Counsel

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Loans, Accounting, Payment System Risk and Reserves

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Vice President

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Robert A. Lyon
Advisor

Sara Ungari
Accounting Officer

Financial and Management Services

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Assistant Vice President

Joan Mielke
Operations Officer

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Glenn C. Hansen
General Auditor

Robert M. Casey
Assistant General Auditor

Joseph B. Green
Assistant Vice President

As of December 31, 2001

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Chairman and Chief Executive Officer
Harris Bankcorp, Inc.
Chicago, Illinois

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Chicago, Illinois

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Janesville, Wisconsin

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Kelly Services, Inc.
Troy, Michigan

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Challenger, Gray & Christmas, Inc.
Chicago, Illinois

Sheila Cochran
Milwaukee County Labor Council, AFL-CIO
Milwaukee, Wisconsin

Carl Gallman
International Association of Machinists & Aerospace Workers
Westchester, Illinois

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United Steelworkers of America
East Chicago, Indiana

Matthew Harper
Pioneer Hi-Bred International, Inc.
Des Moines, Iowa

Dennis Williams
United Auto Workers
Des Plaines, Illinois

David Newby
Wisconsin State AFL-CIO
Milwaukee, Wisconsin

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Brook Furniture Rental, Inc.
Arlington Heights, Illinois

Thomas Crosby
American National/ The Insurance Exchange
Crestwood, Illinois

Ralph Deger
Bushman Equipment, Inc.
Butler, Wisconsin

David Fisher
Onthank Company
Des Moines, Iowa

George Franco
National Financial Corporation (NFC)
Milwaukee, Wisconsin

Yolanda Gomez-Stupka
National Native American Business Alliance
Bingham Farms, Michigan

Jan Hayhow
Michigania, Inc.
Lansing, Michigan

Christopher LaMothe
Indiana Chamber of Commerce
Indianapolis, Indiana

Ritch LeGrand
LeGrand & Company
Sioux City, Iowa

Karen Lennon
SomerCor 504, Inc.
Chicago, Illinois

Jeffrey Padden
Public Policy Associates, Inc.
Lansing, Michigan

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Liberty Federal Bank
Hinsdale, Illinois

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Milledgeville State Bank
Milledgeville, Illinois

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First Busey Corp.
Urbana, Illinois

Richard K. McCord
Illinois National Bancorp
Springfield, Illinois

Indiana

Brent Clifton
Grabill Bank
Grabill, Indiana

Michael L. Cox
First Merchants Corporation
Muncie, Indiana

Chuck Crow
Community Bank
Noblesville, Indiana

Michael Kubacki
Lake City Bank
Warsaw, Indiana

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First Federal Savings Bank of Iowa
Fort Dodge, Iowa

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Quad City Bank & Trust Company
Bettendorf, Iowa

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Raccoon Valley State Bank
Adel, Iowa

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Security National Bank
Sioux City, Iowa

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Century Bank & Trust
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Bad Axe, Michigan

David S. Hickman
United Bank & Trust
Tecumseh, Michigan

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First National Bank
Gaylord, Michigan

Joseph F. Salas
CSB Bank
Capac, Michigan

Wisconsin

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The Pineries
Stevens Point, Wisconsin

Mike Falbo
State Financial Bank
Hales Corners, Wisconsin

Richard Hansen
Johnson Bank
Racine, Wisconsin

Philip G. Holland
Ixonia State Bank
Ixonia, Wisconsin

David Kopperud
Peoples State Bank
Wausau, Wisconsin

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Southside Trust & Savings Bank
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Southeast National Bank of Moline
Davenport, Illinois

Mitch Borneman
Heritage Bank of Central Illinois
Trivoli, Illinois

Steve Danko
Soy Capital Bank
Decatur, Illinois

Pete Jain
Citizens Equity Federal Credit Union
Peoria, Illinois

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Peoples Bank of Macon
Macon, Illinois

Wilbur R. Lancaster
Union Planters Bank
Decatur, Illinois

Linda Little
Bank Illinois
Champaign, Illinois

Diane McCluskey
Independent Bankers' Bank
Springfield, Illinois

John McEvoy
Metro Bank N.A.
East Moline, Iowa

Mike McKenzie
First Capital Bank
Peoria, Illinois

Randall Ross
First Mid-Illinois Bank & Trust
Mattoon, Illinois

Jerald Sarnes
The Havana National Bank
Havana, Illinois

Donald Schlorff
Busey Bank
Urbana, Illinois

Chicago Metropolitan

Donna Adam
Manufacturers Bank
Chicago, Illinois

John Collins
Mid-States Corporate Federal Credit Union
Warrenville, Illinois

John Dabrowski
Devon Bank
Chicago, Illinois

Thomas Darovic
Superior Bank, FSB
Oak Brook Terrace, Illinois

Edward Furticella
Peoples Bank SB
Munster, Indiana

Larry Gardner
1st Source Bank
South Bend, Indiana

Savannah Hannah
Financial Federal Trust
Chicago Ridge, Illinois

Ron Hunt
American Chartered Bank
Schaumburg, Illinois

Mary Kosar
NLSB
New Lenox, Illinois

Richard Marra
Metro Federal Credit Union
Arlington Heights, Illinois

Brian D. Payne
National City Bank
Springfield, Illinois

Charles Sanger
Bank Calumet
Hammond, Indiana

Deborah Schneider
First Midwest Bank, N.A.
Joliet, Illinois

Larry Stewart
AMCORE Financial, Inc.
Rockford, Illinois

Barbara Yeates-Peryer
Cole Taylor Bank
Chicago, Illinois

Indiana

H. Matthew Ayers
State Bank of Lizton
Lizton, Indiana

Steven Bailey
First Bank of Berne
Berne, Indiana

Lynn Bierlein
Salin Bank and Trust
Indianapolis, Indiana

Debbie L. Cox
Irwin Union Bank & Trust
Columbus, Indiana

Steven D. Flowers
Bank One
Indianapolis, Indiana

Dee Ann Hammel
First Federal Savings Bank
Huntington, Indiana

Stan V. Hart
Terre Haute First National Bank
Terre Haute, Indiana

Rita Hyden
Union Bank and Trust
North Vernon, Indiana

Sherri Jones
Phillips Federal Credit Union
Fort Wayne, Indiana

Jim Miller
Greenfield Banking Company
Greenfield, Indiana

Rebecca Morgan
Lincoln Federal Savings Bank
Plainfield, Indiana

Robert J. Ralston
Lafayette Bank & Trust Company
Lafayette, Indiana

Glenn Raver
Union Bank and Trust
Greensburg, Indiana

Steven Reynolds
Farmers Bank Frankfort
Frankfort, Indiana

Iowa

Steve Anderson
First American Bank
Clive, Iowa

Daniel G. Augustine
Security National Bank
Sioux City, Iowa

Randy Bergman
Bankers Trust
Des Moines, Iowa

Barrie Christman
Principal Bank
Des Moines, Iowa

Leann Cook
First Federal Savings
of Alpena
St. Charles, Michigan

Jerry Fannon
Lincoln Savings Bank
Reinbeck, Iowa

Dale C. Froehlich
Community State Bank
Ankeny, Iowa

Jim Hubinger
First Federal Savings
of Apena
St. Charles, Michigan

Randy Johnson
Commercial Trust
& Savings Bank
Storm Lake, Iowa

Vicki Kieliszewski
Huron National Bank
Rogers City, Michigan

Paulette Kierzek
Huron National Bank
Rogers City, Michigan

Nelson Klavitter
Dubuque Bank & Trust
Dubuque, Iowa

Sandra Koenig
First Federal Savings
of Alpena
St. Charles, Michigan

Judy Lynch
Isabella Bank & Trust
Mt. Pleasant, Michigan

Victor Quinn
Quad City Bank & Trust
Bettendorf, Iowa

Marti T. Rodamaker
First Citizens
National Bank
Mason City, Iowa

MaryAnn Schaffer
Community State Bank
St. Charles, Michigan

Robert A. Steen
Bridge Community Bank
Mechanicsville, Iowa

Northern Michigan

Dennis P. Angner
Isabella Bank & Trust
Mt. Pleasant, Michigan

Nikki Cole
State Savings Bank
of Frankfort
Frankfort, Michigan

Jan Davison
Commercial Bank
Ithaca, Michigan

Susan A. Eno
Citizens National Bank
Cheboygan, Michigan

Sally Gapinski
First National Bank
of Gaylord
Gaylord, Michigan

Marilyne Joy
Charlevoix State Bank
Charlevoix, Michigan

Bill Kirsten
First National Bank
of Gaylord
Gaylord, Michigan

Sandra Koenig
First Federal Savings
of Alpena
St. Charles, Michigan

Sharla Leach
Alden State Bank
Alden, Michigan

Sue Meredith
Honor State Bank
Honor, Michigan

Susan Norris
First National Bank
of Gaylord
Gaylord, Michigan

Victoria Sager
Central State Bank
Beulah, Michigan

Nancy Sorensen
West Shore Bank
Scottsville, Michigan

Kenneth Sterling
First Community Bank
Harbor Springs,
Michigan

Kathy Taskey
First National Bank
of Gaylord
Gaylord, Michigan

Janie Williamson
Huron Community Bank
East Tawas, Michigan

Kathleen Vogt
Community State Bank
St. Charles, Michigan

Debra Woodland
Commercial Bank
Ithaca, Michigan

Western Michigan

Don Baldwin
Sturgis Bank & Trust
Sturgis, Michigan

Joanne Brady
First National Bank
Three Rivers, Michigan

Linda Comps-Klinge
State Bank of Caledonia
Caledonia, Michigan

Mike Diamond
State Bank of Caledonia
Caledonia, Michigan

Cindy Dwyer
Hillsdale County
National Bank
Hillsdale, Michigan

Marianne Essing
Byron Center State Bank
Byron Center, Michigan

Linda Grouleau
Eaton Federal
Savings Bank
Charlotte, Michigan

Joan Heffelbower
Hastings City Bank
Hastings, Michigan

D. Scott Hines
First National Bank
Three Rivers, Michigan

Jaylen T. Johnson
Southern Michigan
Bank & Trust
Coldwater, Michigan

Linda Kaminski
Kalamazoo County
State Bank
Schoolcraft, Michigan

Kyle Kunnen
Grand Bank
Grand Rapids,
Michigan

Sharon Mrozek
Alliance Banking
Company
New Buffalo, Michigan

Brad Slagh
Byron Center State Bank
Byron Center, Michigan

Debra Smith
Hillsdale County
National Bank
Hillsdale, Michigan

Emily Stafford
Hastings City Bank
Hastings, Michigan

Wendell Stoeffler
Ionia County
National Bank
Ionia, Michigan

Jerry Van Blarcom
Southern Michigan
Bank & Trust
Coldwater, Michigan

Detroit Metropolitan

Gordon Bade
Capac State Bank
Capac, Michigan

Aleta Bame
Metrobank
Farmington Hills,
Michigan

Peggy Bachli
Bank of Ann Arbor
Ann Arbor, Michigan

Richard Bauer
Fidelity Bank
Birmingham, Michigan

Daniel Brown
Sterling Bank & Trust
Southfield, Michigan

Paul Fuller
Republic Bank
Lansing, Michigan

Joseph Hallman
Citizens State Bank
New Baltimore,
Michigan

Sue Harmon
Onsted State Bank
Onsted, Michigan

Bruce Hoppenworth
Citizens First
Savings Bank
Port Huron, Michigan

Laird Kellie
Lapeer County
Bank & Trust Co.
Lapeer, Michigan

Stephen M. Mazurek
Bank of Lenawee
Adrian, Michigan

Karmen McMillan
Citizens First
Savings Bank
Port Huron, Michigan

Mike McMinn
Metrobank
Farmington Hills,
Michigan

Kendall Rieman
Thumb National Bank
Pigeon, Michigan

Benjamin Schott
Thumb National Bank
Pigeon, Michigan

Vonda Zuhlke
Tri-County Bank
Brown City, Michigan

Michigan Credit Unions

Tim Benecke
Dow Chemical
Employees CU
Midland, Michigan

Steve Brewer
Capital Area School
Employees CU
Lansing, Michigan

Melissa Brickley
Capital Area School
Employees CU
Lansing, Michigan

Cathy Burnham
Credit Union One
Ferndale, Michigan

Debbie Burley
Community Choice CU
Redford Township,
Michigan

Jennifer Childs
American One FCU
Jackson, Michigan

Linda Clark
Kellogg FCU
Battle Creek, Michigan

Tim Collia
Education
Community CU
Kalamazoo, Michigan

Lynda Connell
First Resource FCU
St. Joseph, Michigan

Mark Emeret
Capital Area School
Employees CU
Lansing, Michigan

Linda Hall
Community Choice CU
Livonia, Michigan

Vicki Hawkins
Dort FCU
Flint, Michigan

Linda Hess
Security FCU
Flint, Michigan

Judith Hillock
Research FCU
Warren, Michigan

Jeff Jackson
Michigan State
University CU
East Lansing, Michigan

Michelle Jensen
First Resource CU
St. Joseph, Michigan

Jaquetta Jones
Capital Area School
Employees CU
Lansing, Michigan

Lynne Kindy
Team One CU
Saginaw, Michigan

Carol Lapinski
Michigan State
University CU
East Lansing, Michigan

Michele Myrick
E&A CU
Marysville, Michigan

Terry Pearson
Capital Area School
Employees CU
Lansing, Michigan

Bill Pierson
American One FCU
Jackson, Michigan

Gaye Saucedo
Detroit Federal
Employees CU
Southfield, Michigan

Mark Schuiling
Dow Chemical
Employees CU
Midland, Michigan

Melanie Simeone
Community Choice CU
Livonia, Michigan

Tracie Smitterberg
Detroit Federal
Employees CU
Southfield, Michigan

Lisa Tyrell
T&C FCU
Bloomfield Hills,
Michigan

Angelica Young
First Resource FCU
St. Joseph, Michigan

Wisconsin

Terry Anderegg
Mutual Savings Bank
Milwaukee, Wisconsin

Susan Baker
St. Francis Bank
Milwaukee, Wisconsin

Dennis Conerton
Blackhawk State Bank
Beloit, Wisconsin

Robert W. Fouch
Wisconsin Corporate
Central Credit Union
Muskego, Wisconsin

Gail Groleau
Anchor Bank
Madison, Wisconsin

Werner Kant
Educators Credit Union
Racine, Wisconsin

Richard Kostner
Associated Data Services
Green Bay, Wisconsin

Bret Melhouse
Firstar Bank
Milwaukee, Wisconsin

James Mingey
M&I Data Services
Milwaukee, Wisconsin

Ronald L. Slater
Bankers Bank
Madison, Wisconsin

Thomas M. Smith
Johnson Bank
Kenosha, Wisconsin

Mara Todorvic
Bank One Data Services
Milwaukee, Wisconsin

DIRECTORS

Members of the Federal Reserve Bank of Chicago's boards of directors are selected to represent a cross section of the Seventh District economy, including consumers, industry, agriculture, the service sector, labor and commercial banks of various sizes.

The Chicago board consists of nine members. Member banks elect three bankers and three nonbankers. The Board of Governors appoints three additional nonbankers and designates the Reserve Bank chair and deputy chair from among its three appointees.

The Detroit Branch has a seven-member board of directors. The Board of Governors appoints three nonbankers and the Chicago Reserve Bank board appoints four additional directors. The Branch board selects its own chair each year, with the approval of the Chicago board. All Reserve Bank and Branch directors serve three-year terms, with a two-term maximum.

Director appointments and elections at the Chicago Reserve Bank and its Detroit Branch effective in 2001 were:

- Arthur C. Martinez redesignated chairman.
- Robert J. Darnall redesignated deputy chairman.
- W. James Farrell appointed to a three-year term.
- William A. Osborn elected to complete two-years of an unexpired term.
- Jack B. Evans re-elected to a second three-year term.
- Robert R. Yohanan re-elected to a second three-year term.
- Timothy D. Leuliette re-appointed to a second three-year term as a Branch director and re-designated Branch chairman.

At year-end 2001 the following appointments and elections to terms beginning in 2002 were announced:

- Robert J. Darnall designated chairman.
- W. James Farrell designated deputy chairman.
- Robert E. Churchill appointed to a three-year term as Branch director.
- Irvin D. Reid appointed to a three-year term as Branch director.

ADVISORY COUNCILS

The Federal Advisory Council, which meets quarterly to discuss business and financial conditions with the Board of Governors in Washington, D.C., is comprised of one banker from each of the 12 Federal Reserve Districts. Each year the Chicago Reserve Bank's board of directors selects a representative to this group. Alan G. McNally, chairman and chief executive officer, Harris Bankcorp, Inc., was re-appointed to serve a one-year term beginning January 1, 2002.

Members of the Community Bank Council served the first year of their terms in 2001. Members of the Advisory Council on Agriculture, Labor and Small Business, served the second year of their terms in 2001. The councils provide a vital communication link between the Bank and these important sectors.

OFFICERS

The Bank's board of directors acted on the following promotions during 2001:

- Anna M. Voytovich to vice president and associate general counsel, Legal.
- Eve M. Boboch to assistant vice president, Financial Services.
- Deirdre A. Gehant to assistant vice president, Human Resource Services.

New officers appointed by the board in 2001 were:

- Gordon Werkema to first vice president.
- Spencer D. Krane to vice president and economic advisor, Economic Research.
- Catharine M. Lemieux to vice president, Supervision and Regulation.
- G. Douglas Tillett to vice president, Corporate Communications.
- James L. Buziecki to assistant vice president, Information Technology Services.
- Kathrine Kielma to assistant vice president, Customer Relations and Support Office.
- Daniel F. Reimann to assistant vice president, Customer Relations and Support Office.
- Michael Blanks to building construction officer, Detroit Branch.
- Jerome E. Julian to loans and reserves officer, Loans.
- Joan Mielke to operations officer, Financial and Management Services.
- Beverly A. Schatte to operations officer, Customer Relations and Support Office.
- Sara Ungari to accounting officer, Accounting.

William C. Conrad, first vice president, retired after 42 years of service. David R. Allardice, senior vice president and branch manager, retired after 27 years of service.

	DOLLAR AMOUNT		NUMBER OF ITEMS	
	2001	2000	2001	2000
CHECK & ELECTRONIC PAYMENTS				
Checks, NOWs, & Share Drafts Processed	1.5 Trillion	1.7 Trillion	2.3 Billion	2.3 Billion
Fine Sort & Packaged Checks Handled	16.8 Billion	21.1 Billion	29.9 Million	40.0 Million
U.S. Government Checks Processed	42.4 Billion	37.5 Billion	43.8 Million	35.9 Million
Automated Clearing House (ACH) Items Processed	2.6 Trillion	2.5 Trillion	920.5 Million	869.8 Million
Transfer of Funds	64.9 Trillion	57.0 Trillion	22.3 Million	20.7 Million
CASH OPERATIONS				
Currency Received and Counted	52.9 Billion	51.0 Billion	3.2 Billion	3.1 Billion
Unfit Currency Destroyed	7.3 Billion	9.5 Billion	639.8 Million	731.3 Million
Coin Bags Received and Processed	1.6 Billion	1.3 Billion	2.8 Million	3.5 Million
SECURITIES SERVICES FOR DEPOSITORY INSTITUTIONS				
Safekeeping Balance December 31:				
Definitive Securities	135.9 Billion	124.5 Billion	5.4 Thousand	6.4 Thousand
Book Entry Securities	284.6 Billion	277.9 Billion	—	—
Purchase & Sale	1.3 Billion	1.6 Billion	2.5 Thousand	5.2 Thousand
Book Entry Government Securities	4.1 Trillion	3.8 Trillion	837.8 Thousand	709.0 Thousand
LOANS TO DEPOSITORY INSTITUTIONS				
Total Loans Made During Year	15.6 Billion	7.9 Billion	0.7 Thousand	2.1 Thousand
SERVICES TO U.S. TREASURY AND GOVERNMENT AGENCIES				
Food Stamps Redeemed	364.2 Million	640.2 Million	76.4 Million	127.4 Million
Sell Direct Transactions Processed	683.0 Million	655.8 Million	15.0 Thousand	16.4 Thousand

FEDERAL RESERVE BANK OF CHICAGO

MANAGEMENT ASSERTION

FEBRUARY 2002

TO THE BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF CHICAGO

The management of the Federal Reserve Bank of Chicago (FRBC) 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 FRBC 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 FRBC 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 FRBC believes that the FRBC 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 CHICAGO

MICHAEL MOSKOW PRESIDENT AND CHIEF EXECUTIVE OFFICER	GORDON WERKEMA FIRST VICE PRESIDENT AND CHIEF OPERATING OFFICER

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
One North Wacker
Chicago, IL 60606
Telephone (312) 298-2000

REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS OF THE FEDERAL RESERVE BANK OF CHICAGO

We have examined management's assertion that the Federal Reserve Bank of Chicago ("FRBC") 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 responsibilty of FRBC's 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 FRBC 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.

PricewaterhouseCoopers LLP

MARCH 4, 2002

PricewaterhouseCoopers

PricewaterhouseCoopers LLP
One North Wacker
Chicago, IL 60606
Telephone (312) 298-2000

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 CHICAGO

We have audited the accompanying statements of condition of The Federal Reserve Bank of Chicago (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 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, 2001 and 2000, and results of its operations for the years then ended, on the basis of accounting described in Note 3.

PricewaterhouseCoopers LLP

MARCH 4, 2002
CHICAGO, ILLINOIS

STATEMENTS OF CONDITION (in Millions)

As of December 31,	2001	2000
ASSETS		
Gold Certificates	$ 1,028	$ 1,064
Special Drawing Rights Certificates	212	212
Coin	117	114
Items in Process of Collection	526	1,119
Loans to Depository Institutions	15	25
U.S. Government and Federal Agency Securities, Net	63,617	62,020
Investments Denominated in Foreign Currencies	1,333	1,409
Accrued Interest Receivable	646	722
Interdistrict Settlement Account	6,071	—
Bank Premises and Equipment, Net	136	135
Other Assets	48	37
Total Assets	**$ 73,749**	**$ 66,857**
LIABILITIES AND CAPITAL		
Liabilities:		
Federal Reserve Notes Outstanding, Net	$ 68,119	$ 61,206
Deposits		
Depository Institutions	3,498	2,796
Other Deposits	4	4
Deferred Credit Items	386	575
Interest on Federal Reserve Notes Due U.S. Treasury	43	132
Interdistrict Settlement Account	—	770
Accrued Benefit Cost	88	85
Other Liabilities	25	25
Total Liabilities	**$ 72,163**	**$ 65,593**
Capital:		
Capital Paid-In	793	632
Surplus	793	632
Total Capital	**$ 1,586**	**$ 1,264**
Total Liabilities and Capital	**$ 73,749**	**$ 66,857**

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

STATEMENTS OF INCOME (in Millions)

For the years ended December 31,	2001	2000
INTEREST INCOME		
Interest on U.S. Government and Federal Agency Securities	$ 3,403	$ 3,545
Interest on Investments Denominated in Foreign Currencies	30	24
Interest on Loans to Depository Institutions	2	6
Total Interest Income	**$ 3,435**	**3,575**
OTHER OPERATING INCOME (LOSS)		
Income From Services	$ 110	$ 98
Reimbursable Services to Government Agencies	11	20
Foreign Currency Losses, Net	(131)	(127)
U.S. Government Securities Gains (Losses), Net	36	(9)
Other Income	13	9
Total Other Operating Income (Loss)	**$ 39**	**$ (9)**
OPERATING EXPENSES		
Salaries and Other Benefits	$ 157	$ 141
Occupancy Expense	20	19
Equipment Expense	21	19
Cost of Unreimbursed Treasury Services	—	1
Assessments by Board of Governors	65	66
Other Expenses	80	101
Total Operating Expenses	**$ 343**	**$ 347**
Net Income Prior to Distribution	**$ 3,131**	**$ 3,219**
DISTRIBUTION OF NET INCOME		
Dividends Paid to Member Banks	$ 43	$ 36
Transferred to Surplus	162	391
Payments to U.S. Treasury as Interest on Federal Reserve Notes	2,926	2,792
Total Distribution	**$ 3,131**	**$ 3,219**

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

STATEMENTS OF CHANGES IN CAPITAL (in Millions)

For the years ended December 31, 2001 and December 31, 2000	CAPITAL PAID-IN	SURPLUS	TOTAL CAPITAL
Balance at January 1, 2000 (11.6 Million Shares)	**$ 578**	**$ 578**	**$ 1,156**
Net Income Transferred to Surplus	–	391	391
Surplus Transfer to the U.S. Treasury	–	(337)	(337)
Net Change in Capital Stock Issued (1.0 Million Shares)	54	–	54
Balance at December 31, 2000 (12.6 Million Shares)	**$ 632**	**$ 632**	**$ 1,264**
Net Income Transferred to Surplus	–	161	161
Net Change in Capital Stock Issued (3.2 Million Shares)	161	–	161
Balance at December 31, 2001 (15.9 Million Shares)	**$ 793**	**$ 793**	**$ 1,586**

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

1. ORGANIZATION

The Federal Reserve Bank of Chicago ("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 branch in Detroit, Michigan, serve the Seventh Federal Reserve District, which includes Iowa and portions of Michigan, Illinois, Wisconsin and Indiana. In accordance with the Federal Reserve Act, supervision and control of the Bank is 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 of 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.

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. 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 national business development and customer support.

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.

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 $42 2/9 a fine troy ounce. The Board of Governors allocates the gold certificates among Reserve Banks once a year based upon 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 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.

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 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.

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.

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

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

In connection with its foreign currency activities, the FRBNY, on behalf of the Reserve Banks, may enter into contracts which contain varying degrees of off-balance sheet market risk, because they represent contractual commitments involving future settlement and 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. 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 straight-line basis and is reported as "Interest on U.S. government and federal agency securities" or "Interest on investments denominated in foreign currencies," as appropriate. Income earned on securities lending transactions is reported as a component of "Other income." Gains and losses resulting from sales of securities are determined by specific issues based on average cost. Gains and losses on the sales of U.S. government and federal agency securities are reported as *"U.S. government securities gains (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 agencies 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. 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.

E. 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.

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 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 $6,424 million, and $9,479 million at December 31, 2001 and 2000, 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. 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 Chicago transferred $337 million to the U.S. Treasury. Reserve Banks were not permitted to replenish the 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.

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. 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."

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, 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 approximately 11.326 percent and 11.961 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
PAR VALUE		
Federal Agency	$ 1	$ 16
U.S. Government:		
Bills	20,621	21,380
Notes	30,120	28,729
Bonds	11,740	11,098
Total Par Value	$ 62,482	$ 61,223
Unamortized Premiums	1,280	1,164
Unaccreted Discounts	(145)	(367)
Total Allocated to Bank	$ 63,617	$ 62,020

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):

	PAR VALUE		
Maturities of Securities Held	*U.S. Govt. Securities*	*Federal Agency Obligations*	*Total*
Within 15 Days	$ 1,210	–	$ 1,210
16 Days to 90 Days	14,106	–	14,106
91 Days to 1 Year	14,795	–	14,795
Over 1 Year to 5 Years	17,346	$ 1	17,347
Over 5 Years to 10 Years	6,041	–	6,041
Over 10 Years	8,983	–	8,983
Total	$62,481	$ 1	$ 62,482

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 $2,626 million and $2,525 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 $832 million and $250 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 9.158 percent and 8.994 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, were as follows (in millions):

	2001	2000
European Union Euro:		
Foreign Currency Deposits	$ 420	$ 417
Government Debt Instruments Including Agreements to Resell	247	244
Japanese Yen:		
Foreign Currency Deposits	173	248
Government Debt Instruments Including Agreements to Resell	487	494
Accrued Interest	6	6
Total	$ 1,333	$ 1,409

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, were as follows (in millions):

Maturities of Investments Denominated in Foreign Currencies	
Within 1 Year	$ 1,256
Over 1 Year to 5 Years	37
Over 5 Years to 10 Years	40
Over 10 Years	—
Total	$ 1,333

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	2000
Bank Premises and Equipment:		
Land	$ 6	$ 6
Buildings	131	129
Building Machinery and Equipment	17	17
Construction in Progress	3	1
Furniture and Equipment	107	101
	$ 264	$ 254
Accumulated Depreciation	(127)	(119)
Bank Premises and Equipment, Net	$ 137	$ 135

Depreciation expense was $15 million for each of 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 10 years. Rental income from such leases was $3 million for each of the years ended December 31, 2001, and 2000. Future minimum lease payments under non-cancelable agreements in existence at December 31, 2001, were (in millions):

2002	$ 2
2003	3
2004	3
2005	2
2006	2
Thereafter	3
Total	$ 15

7. COMMITMENTS AND CONTINGENCIES

At December 31, 2001, the Bank was obligated under non-cancelable leases for premises and equipment with terms ranging from 1 to approximately 10 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 $3 million and $2 million for each of 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, net of sublease rentals, with terms of one year or more, at December 31, 2001, were (in millions):

	Operating
2002	$ 2
2003	2
2004	1
2005	1
2006	1
Thereafter	1
Total	$ 8

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.

On September 4, 2001, the Bank sold its Westgate facility for a total of $3 million. The gain of $1 million is reported as a component of "Other income."

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 $4.7 million and $4.4 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 cost is actuarially determined using a January 1 measurement date.

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

	2001	2000
Accumulated Postretirement Benefit Obligation at January 1	$ 70.1	$ 67.3
Service Cost-Benefits Earned During the Period	1.5	1.4
Interest Cost of Accumulated Benefit Obligation	5.4	4.7
Actuarial (Gain) Loss	10.0	(0.1)
Contributions by Plan Participants	0.3	0.2
Benefits Paid	(4.1)	(3.4)
Plan Amendments, Acquisitions, Foreign Currency Exchange Rate Changes, Business Combinations, Divestitures, Curtailments, Settlements, Special Termination Benefits	(8.0)	–
Accumulated Postretirement Benefit Obligation at December 31	**$ 75.2**	**$ 70.1**

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

	2001	2000
Fair Value of Plan Assets at January 1	$ –	$ –
Actual Return on Plan Assets	–	–
Contributions by the Employer	3.7	3.2
Contributions by Plan Participants	0.3	0.2
Benefits Paid	(4.0)	(3.4)
Fair Value of Plan assets at December 31	**$ –**	**$ –**
Unfunded Postretirement Benefit Obligation	75.2	70.1
Unrecognized Prior Service Cost	18.6	13.9
Unrecognized Net Actuarial Gain	(17.1)	(9.3)
Accrued Postretirement Benefit Cost	**$ 76.7**	**$ 74.7**

Accrued postretirement benefit cost is reported as a component of "Accrued benefit cost."

At December 31, 2001 and 2000, the weighted average discount rate assumptions used in developing the benefit obligation were 7.0 percent and 7.5 percent, respectively.

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):

	One Percentage Point Increase	*One Percentage Point Decrease*
Effect on Aggregate of Service and Interest Cost Components of Net Periodic Postretirement Benefit Cost	$ 1.3	$ (1.0)
Effect on Accumulated Postretirement Benefit Obligation	11.9	(9.5)

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

	2001	2000
Service Cost-Benefits Earned During the Period	$ 1.5	$ 1.4
Interest Cost of Accumulated Benefit Obligation	5.4	4.7
Amortization of Prior Service Cost	(1.3)	(1.3)
Recognized Net Actuarial Loss	0.2	–
Net Periodic Postretirement Benefit Cost	**$ 5.8**	**$ 4.8**

Net periodic postretirement benefit cost is 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 $11 million and $10 million, respectively. This cost is included as a component of "Accrued benefit cost." Net periodic postemployment benefit costs included in 2001 and 2000 operating expenses were $2 million for each year.

10. SUBSEQUENT EVENT

Subsequent to December 31, 2001 Federal Reserve System management determined that it would not proceed with an ongoing technology project. Accordingly, in 2002 the Bank will record an asset impairment of $7 million for assets currently held by the Bank on behalf of the System.

ADDITIONAL INFORMATION

Testimony and Speeches Regarding 9/11:

- "The Condition of the Financial Markets," Alan Greenspan, Federal Reserve Board, Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 20, 2001. www.federalreserve.gov/boarddocs/testimony/2001/.

- "Monetary Policy and Economic Outlook," Alan Greenspan, Federal Reserve Board, Testimony before the Joint Economic Committee, U.S. Congress, October 17, 2001. www.federalreserve.gov/boarddocs/testimony/2001/.

- "The September 11 Tragedy and the Response of the Financial Industry," Alan Greenspan, Federal Reserve Board, October 23, 2001. www.federalreserve.gov/boarddocs/speeches/2001/.

- "Assessing the Impact of September 11," Michael Moskow, Federal Reserve Bank of Chicago, October 25, 2001. www.chicagofed.org/newsandevents/speeches/index.cfm#2001.

- "A Supervisory Perspective on Disaster Recovery and Business Continuity," Roger Ferguson, Federal Reserve Board, March 4, 2002. www.federalreserve.gov/boarddocs/speeches/2002/.

Additional Information on Post-9/11 FOMC Actions:

- Federal Open Market Committee statements and minutes. www.federalreserve.gov/fomc/.

General Information on the Topics Covered in this Report:

- Fedpoints series: "How Currency Gets into Circulation," #1; "Repurchase and Matched Sale Transactions," #4; "Float," #8; "Discount Window," #10; "Federal Funds," #15; "Commercial Paper," #29; "Open Market Operations," #32; "Fedwire," #43; "Federal Open Market Committee," #48. www.newyorkfed.org/pihome/fedpoint/index.html.

In-depth Information on the Federal Reserve and Open Market Operations:

- "Understanding Open Market Operations." www.newyorkfed.org/pihome/addpub/omo.html.

- "The Federal Reserve System: Purposes and Functions." www.federalreserve.gov/pf/pf.htm.

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OUR MISSION

The Federal Reserve Bank of Chicago is one of 12 regional Reserve Banks across the United States that, together with the Board of Governors in Washington, D.C., serve as the nation's central bank. The role of the Federal Reserve System, since its establishment by an act of Congress passed in 1913, has been to foster a strong economy, supported by a stable financial system.

To this end, the Federal Reserve Bank of Chicago participates in the formulation and implementation of national monetary policy, supervises and regulates state-member banks, bank holding companies and foreign bank branches, and provides financial services to depository institutions and the U.S. government. Through its head office in Chicago, branch in Detroit, regional offices in Des Moines, Indianapolis and Milwaukee, and facility in Peoria, the Federal Reserve Bank of Chicago serves the Seventh Federal Reserve District, which includes major portions of Illinois, Indiana, Michigan and Wisconsin, plus all of Iowa.

OUR VISION

- Further the public interest by fostering a sound economy and stable financial system

- Provide products and services of unmatched value to those we serve

- Set the standard for excellence in the Federal Reserve System

- Work together, value diversity, communicate openly, be creative and fair

- Live by our core values of integrity, respect, responsibility and excellence

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