FLEETBOSTON FINANCIAL CORP
Form 10-Q
August 14, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for quarterly period ended June 30, 2002

Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period ______________ to ______________

Commission File Number 1-6366

FLEETBOSTON FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Rhode Island	**05-0341324**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

100 Federal Street
Boston, Massachusetts
(Address of principal executive office) **02110**
(Zip Code)

(617) 434-2200
(Registrant s telephone number, including area code)

(Former name, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

The number of shares of common stock of the Registrant outstanding as of July 31, 2002 was 1,047,716,409.

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PART I. FINANCIAL INFORMATION

FINANCIAL SUMMARY

Dollars in millions, except per share amounts	Three months ended June 30 2002	2001	Six months ended June 30 2002	2001
Earnings				
Net interest income (FTE)[a]	$ 1,656	$ 1,889	$ 3,388	$ 3,792
Noninterest income	1,004	1,149	2,416	2,447
Noninterest expense	1,597	1,873	3,163	4,452
Provision for credit losses	1,250	313	1,658	627
(Loss)/income from continuing operations	(106)	521	630	674
(Loss)/income from discontinued operations	(280)	10	(281)	(2)
Net (loss)/income	(386)	531	349	672
Per Common Share				
Basic earnings:				
Continuing operations	$ (.11)	$ .47	$ .59	$ .60
Net income	(.37)	.48	.32	.60
Diluted earnings:				
Continuing operations	(.11)	.47	.59	.60
Net income	(.37)	.48	.32	.60
Cash dividends declared	.35	.33	.70	.66
Book value	15.79	17.47	15.79	17.47
Ratios				
Continuing operations:				
Return on average assets[b]	nm	1.02%	.67%	.66%
Return on average common equity	nm	10.84	7.14	6.96
Net income:				
Return on average assets	nm	1.01	.36	.64
Return on average common equity	nm	11.05	3.91	6.94
Total equity to assets (period-end)	8.80%	9.54	8.80	9.54
Tangible common equity to assets	6.37	7.41	6.37	7.41
Tier 1 risk-based capital	8.15	8.47	8.15	8.47
Total risk-based capital	11.82	12.25	11.82	12.25
Leverage	8.11	8.29	8.11	8.29
At June 30				
Total assets	$191,040	$202,134	$191,040	$202,134
Loans and leases	116,201	127,845	116,201	127,845
Deposits	121,114	123,343	121,114	123,343
Long-term debt	22,654	27,816	22,654	27,816
Stockholders equity	16,816	19,276	16,816	19,276
Nonperforming assets	3,891	1,394	3,891	1,394

(a) The fully taxable equivalent (FTE) adjustment included in net interest income was $14 million and $17 million for the three months ended June 30, 2002 and 2001, respectively, and $36 million and $33 million for the six months ended June 30, 2002 and

2001, respectively.

(b) Net income from continuing operations divided by total average assets less average assets of discontinued operations.nm not meaningful

This discussion and analysis is part of our Quarterly Report on Form 10-Q to the Securities and Exchange Commission, or the SEC. This discussion updates our Annual Report on Form 10-K for the year ended December 31, 2001 and our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2002, both of which we previously filed with the SEC. You should read this information together with the financial information contained in the 10-K and the 10-Q. Certain prior period amounts presented in this discussion and analysis have been reclassified to conform to current period classifications.

Unless otherwise indicated or unless the context requires otherwise, all references in this discussion and analysis to FleetBoston, we, us, our or similar references mean FleetBoston Financial Corporation. Headquartered in Boston, Massachusetts, we are a diversified financial services company with approximately $191 billion in assets, and we currently rank as the seventh-largest financial holding company in the United States based on total assets.

Our key lines of business include Wholesale Banking, which includes commercial finance, corporate banking, commercial banking and small business services; Personal Financial Services, which includes consumer and community banking, wealth management and brokerage; Capital Markets, which includes brokerage market-making and principal investing; and International Banking, principally in Latin America. You can read more about these business lines and their supporting business units in the Line of Business Information section of this discussion and analysis.

This discussion and analysis contains certain forward-looking statements with respect to our financial condition, results of operations, future performance and business. These statements are based on certain assumptions by management which involve risks and uncertainties. Actual results may differ materially from those contemplated by these statements due to many factors, including, but not limited to:

- general political and economic conditions, either domestically or internationally;
- the political, economic and social uncertainties in Argentina;
- political and economic uncertainties in Brazil, as well as the economic uncertainties in Uruguay;
- further deterioration in credit quality, including the resultant effect on the levels of our provision for credit losses, nonperforming assets, net charge-offs and reserve for credit losses;
- continued weakness in global capital markets in general, and the technology and telecommunications industries in particular, and the impact of that weakness on our Principal Investing and other capital markets business lines;
- legislative or regulatory developments, including changes in laws or regulations concerning taxes, banking, securities, reserve methodologies, deposit insurance, capital requirements and risk-based capital guidelines;
- changes in accounting rules, policies, practices and procedures with respect to certain proposals under consideration by U.S. legislators and regulatory and self-regulatory bodies; and

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legal and regulatory proceedings and related matters with respect to the financial services industry.

We recorded a loss of $386 million, or $.37 per share, in the second quarter of 2002 compared to net income of $531 million, or $.48 per share, in the second quarter of 2001. For the six months ended June 30, 2002, net income was $349 million, or $.32 per share, compared to $672 million, or $.60 per share, for the prior year period.

Included in these results was a loss of $280 million from discontinued operations for the second quarter of this year and $281 million for the first six months of 2002, which resulted from a series of strategic decisions announced in April 2002 designed to re-deploy capital to our core businesses and to reduce earnings volatility. These decisions, which we previously discussed in our first quarter 2002 10-Q, included our intent to sell our investment banking subsidiary, Robertson Stephens, our student loan processing subsidiary, AFSA Data Corporation, or AFSA, and our fixed income business in Asia. You can obtain more information about these and other strategic decisions in our Current Report on Form 8-K dated April 16, 2002, which we filed with the SEC.

We completed the sale of AFSA on June 10, 2002, and recorded a related after-tax gain of $173 million. We have actively marketed Robertson Stephens and the Asia fixed income business since April 2002, and as of June 30, 2002, these businesses were held for sale. Accordingly, they are presented in the accompanying consolidated balance sheet at the lesser of carrying value or estimated fair value less costs to sell, including related exit costs. With respect to Robertson Stephens, since we were unable to sell this business as a unit to a third party or reach an agreement for an employee buyout, we announced in July 2002 that we would be winding down the operations of this business unit. Accordingly, we are actively selling the assets of this business, terminating lease and other agreements, and expect to substantially complete these efforts during the third quarter of 2002. We expect to substantially complete the disposal of the Asia fixed income business by early next year.

The AFSA sale gain, and estimated after-tax losses related to Robertson Stephens and Asia of $421 million and $30 million, respectively, are included in results from discontinued operations in our income statement. This line also includes the operating results of these businesses for the respective periods. We have presented all prior period information on the same basis. For more financial information with respect to these businesses, refer to Note 2 to the consolidated financial statements included in this 10-Q.

The remainder of this discussion and analysis reflects results from continuing operations, unless otherwise noted. On this basis, for the three months ended June 30, 2002, we incurred a net loss of $106 million, or $.11 per share, compared to net income of $521 million, or $.47 per share, for the three months ended June 30, 2001. In the six-month period, we earned $630 million, or $.59 per share, in 2002 compared to $674 million, or $.60 per share, in the same period a year ago. Lower earnings for the 2002 periods were primarily attributable to the continued economic deterioration in Argentina and additional provisions for domestic credit losses. Prior year results reflected after-tax charges related to the Summit acquisition, the sale of our mortgage banking business, restructurings within our capital markets businesses, investment write-downs and business sale gains. These current and prior year items are discussed in more detail elsewhere in this discussion and analysis.

Results for both the second quarter and first six months of 2002 continued to be adversely impacted by the slowdown in the U.S. economy that began in the latter half of 2000, particularly revenues from our capital markets and investment services businesses. 2002 results, however, were positively impacted by lower operating expenses from the corporate-wide cost containment program disclosed in previous SEC filings and significantly lower write-downs of investments in our Principal Investing portfolio. In addition, compared to 2001, 2002 earnings benefited by $.06 per share in each of the first and second quarters from the discontinuance of goodwill amortization, in accordance with the new goodwill accounting standard, SFAS No. 142, which we adopted on January 1, 2002. Prior periods were not restated. This standard is more fully discussed in Note 6 to the consolidated financial statements included in this 10-Q.

LINE OF BUSINESS INFORMATION

Our customer-focused organizational structure includes four principal lines of business: Wholesale Banking, Personal Financial Services, Capital Markets, and International Banking. You can obtain additional information about the products and services offered by each line of business in the Line of Business Information section of Management s Discussion and Analysis included in our 2001 Annual Report on Form 10-K previously filed with the SEC.

We may periodically restate business line results based on modifications to our management reporting and profitability measurement methodologies and changes in organizational alignment. We have restated the information for the quarter and six months ended June 30, 2001 presented throughout this section to reflect the revised organizational structure implemented in October 2001, as well as management reporting modifications implemented through June 30, 2002. The information appearing throughout this section is presented on both a fully taxable equivalent and a continuing operations basis.

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Line of Business Earnings Summary

Six months ended June 30	2002	2001	2002	2001	2002	2001
Dollars in millions	Net Income/(Loss)		Total Revenue		Return on Equity	
Wholesale Banking	$623	$685	$2,331	$2,418	18%	20%
Personal Financial Services	516	536	3,089	3,049	16	20
Capital Markets	(4)	(316)	81	(412)	nm	nm
International Banking	(398)	224	190	886	nm	31
All Other	(107)	(455)	113	298	nm	nm
Total	$630	$674	$5,804	$6,239	7%	7%

nm not meaningful

The following discussion focuses on the components of each of our four major business lines, and explains results in terms of their underlying businesses.

Wholesale Banking

	Three months ended June 30		Six months ended June 30	
Dollars in millions	2002	2001	2002	2001
Income statement data:				
Net interest income	$761	$832	$1,544	$1,658
Noninterest income	402	395	787	760
Total revenue	1,163	1,227	2,331	2,418
Provision for credit losses	186	160	367	324
Noninterest expense	458	474	928	957
Tax expense	207	237	413	452

Net income	$312	$356	$623	$685
Balance sheet data:				
Average assets	$86,131	$94,073	$87,498	$95,542
Average loans and leases	75,737	83,762	77,007	84,885
Average deposits	35,505	31,970	35,453	32,005
Return on equity	18%	20%	18%	20%

Wholesale Banking earned $312 million in the second quarter of 2002, a decrease of $44 million from the prior year quarter. Earnings from the underlying business units reflected reduced demand for both loan- and capital markets-related products as the economic environment remained weak. In addition, economic conditions have impacted credit quality, contributing to an increase in nonperforming loans and the provision for credit losses. Higher cash management fees, resulting from higher sales and cross-selling activities, along with the impact of cost saving initiatives implemented in 2001, helped to moderate the negative impact of the weak economic climate.

Three months ended June 30 *Dollars in millions*	2002 Net Income	2001	2002 Total Revenue	2001	2002 Return on Equity	2001
Commercial Finance	$120	$149	$373	$402	18%	21%
Corporate Banking	68	87	289	317	13	17
Commercial Banking	66	63	250	248	20	18
Small Business	58	57	251	260	28	27
Total	$312	$356	$1,163	$1,227	18%	20%

Commercial Finance earned $120 million in the current year quarter, compared to $149 million in 2001. Higher credit costs were partially offset by increased customer demand for cash management services and growth in the commercial real estate lending unit. Growth in the commercial real estate portfolio was more than offset by declines in certain segments of the asset-based lending portfolio, which we repositioned to reduce credit exposure. Quarterly average balances of lease financing receivables for the second quarters of 2002 and 2001, composed of net investments in direct financing, leveraged and operating leases, were $14.5 billion and $14.7 billion, respectively. Included in the $14.5 billion was $750 million (approximately $75 million our single largest exposure) invested in the domestic commercial airline sector, substantially all of which related to major trunk and commuter airlines. Average aggregate loans and leases were $36.1 billion for the quarter ended June 30, 2002, down from $38.4 billion a year earlier.

Corporate Banking, which includes several businesses such as traditional corporate banking and debt capital markets, as well as foreign exchange and derivatives, earned $68 million for the quarter, a decrease of 22% compared to 2001. This decline was driven by decreases in loan volumes resulting, in part, from repositioning of the portfolio to reduce credit exposure, and by lower foreign exchange fees due to current market conditions. This decline was partially offset by higher cash management fees. Average loans were $20.9 billion for the second quarter of 2002, compared to

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$24.7 billion for the 2001 period, a decline of $3.8 billion, or 15%.

As we discussed in our first quarter 2002 10-Q, we announced in April of this year that we intended to reduce our exposure to targeted, non-strategic areas of corporate lending by $10 billion. Thirty percent of this exposure consists of funded loans, with the remainder composed of unfunded, or off-balance sheet, commitments. This reduction effort is progressing, and plans are currently in place to exit or reduce exposures by over $10 billion. We anticipate that this effort, about 75% of which we expect to complete by the end of this year, will result in an improved risk profile.

Commercial Banking, which is composed of middle market lending, government banking, and global services, earned $66 million in the second quarter of 2002, an increase of $3 million from the prior year. A higher level of cash management fees and lower operating expenses, resulting from cost saving initiatives implemented in 2001, more than offset the impact of reduced loan demand. Quarterly average loan balances decreased $1.9 billion to $14.6 billion, while deposits, particularly within the government banking unit, grew approximately $2.5 billion to $14.5 billion, when compared to the prior year.

Small Business earned $58 million in the second quarter of 2002, up slightly from the second quarter of 2001. The introduction of new products and continued emphasis on cross-selling, as well as the impact of cost saving initiatives implemented in 2001, offset declining deposit spreads. For 2002, quarterly average loans were $4.1 billion, slightly below the prior year quarterly average of $4.2 billion, while quarterly average deposits were $13.5 billion compared to $12.8 billion.

Personal Financial Services

Dollars in millions	Three months ended June 30 2002	Three months ended June 30 2001	Six months ended June 30 2002	Six months ended June 30 2001
Income statement data:				
Net interest income	$930	$924	$1,850	$1,865
Noninterest income	625	588	1,239	1,184
Total revenue	1,555	1,512	3,089	3,049
Provision for credit losses	234	240	462	463
Noninterest expense	913	854	1,833	1,743
Tax expense	143	153	278	307
Net income	$265	$265	$516	$536
Balance sheet data:				
Average assets	$50,517	$48,433	$50,838	$48,572
Average loans	39,604	38,025	39,920	38,624
Average low-cost core deposits	53,497	48,959	52,932	48,263

Return on equity	16%	19%	16%	20%

Personal Financial Services earned $265 million in the current year quarter, consistent with 2001. The group benefited from solid loan growth, particularly in home equity products, strong growth in low-cost core deposits, and effective expense management. These factors combined to offset the impact of lower deposit spreads and a decline in the market value of assets under management. The overall rate of return for this business line was also impacted by goodwill recorded in connection with the 2001 acquisition of Liberty Asset Management, which is currently being integrated into our Columbia Management Group.

Three months ended June 30	2002	2001	2002	2001	2002	2001
Dollars in millions	Net Income		Total Revenue		Return on Equity	
Consumer Financial Services	$206	$209	$1,098	$1,125	21%	22%
Wealth Management and Brokerage	59	56	457	387	9	14
Total	$265	$265	$1,555	$1,512	16%	19%

Consumer Financial Services, which includes the Consumer Banking & Distribution, Community Investment Group and Credit Card businesses, earned $206 million in the second quarter of 2002, a decrease of just over 1% from the $209 million earned in the same quarter a year ago. This change in earnings resulted from the declining interest rate environment, which drove down loan yields and put pressure on spreads in the deposit-taking businesses, as we continued our customer-focused strategy and did not pass on the full impact of these rate declines to our deposit customers. Partially offsetting the declines was a beneficial change in deposit mix, as low-cost deposit balances in this business unit increased 10%, or $4.3 billion, while higher-cost time deposits decreased $4.1 billion. In addition, expense management and cost savings resulting from the Summit acquisition helped to offset lower revenue levels. Results also benefited from an increase in credit card volumes and an improved mix in the consumer loan portfolio that we achieved through the planned exit from certain less profitable indirect lending portfolios.

The Wealth Management and Brokerage unit is composed of the Columbia Management Group, the Private Clients Group, and our Quick & Reilly brokerage group. These units, although negatively impacted by weak market conditions, saw their earnings increase 5% to $59 million in the current quarter, compared to $56 million in 2001, as a result of effective expense management. Declines in the market value of assets under management, which reflected the overall lower valuation of the stock market, were offset by additional volume, approximately $48 billion, from the fourth quarter 2001 Liberty acquisition. In addition, average daily trading volumes dropped 21%, and average margin loans decreased approximately $.7 billion from June 30, 2001. The market value of domestic assets under management was $156 billion as of June 30, 2002 (including $48 billion from Liberty) versus $121 billion as of June 30, 2001.

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Capital Markets

Dollars in millions	Three months ended June 30 2002	Three months ended June 30 2001	Six months ended June 30 2002	Six months ended June 30 2001
Income statement data:				
Net interest income	$(24)	$(36)	$(44)	$(67)
Noninterest income	31	(352)	125	(345)
Total revenue	7	(388)	81	(412)
Noninterest expense	45	51	89	109
Tax benefit	(15)	(172)	(4)	(205)
Net loss	$(23)	$(267)	$(4)	$(316)
Return on equity	nm	nm	nm	nm

nm not meaningful

Capital Markets includes Fleet Specialist and Principal Investing. These units continued to be affected by adverse market conditions, as more fully discussed below.

Three months ended June 30 *Dollars in millions*	Net Income/(Loss) 2002	Net Income/(Loss) 2001	Total Revenue 2002	Total Revenue 2001	Return on Equity 2002	Return on Equity 2001
Fleet Specialist	$24	$26	$73	$82	30%	31%
Principal Investing	(47)	(293)	(66)	(470)	nm	nm
Total	$(23)	$(267)	$7	$(388)	nm	nm

nm not meaningful

Fleet Specialist is one of the largest specialist firms on the NYSE, representing the common and preferred stocks of more than 500 companies and accounting for roughly 19% of the volume on the Big Board. It earned $24 million in 2002, a decrease of $2 million, or 8%, from the second quarter of 2001. The impact of an increase in the average daily trading volume of 9,000 trades per day, or 13%, was offset by lowered profit opportunities and narrowed spreads from difficult market conditions, compared to the second quarter of 2001.

Principal Investing recorded a net loss of $47 million in the second quarter of 2002, compared to a net loss of $293 million a year ago. These quarterly results were affected by after-tax write-downs of $43 million and $290 million, respectively, taken against this portfolio, reflecting the impairment of value that resulted from the continued weakness in the U.S. economy. At June 30, 2002, the aggregate carrying value of the Principal Investing portfolio was $3.7 billion, a decline of 9% from the second quarter of 2001, due primarily to write-downs. As we discussed in our first quarter 2002 10-Q, we announced our intent in April of this year to reduce the size of this portfolio to approximately $2.5 billion over the next couple of years.

International Banking

	Three months ended June 30		Six months ended June 30	
Dollars in millions	2002	2001	2002	2001
Income statement data:				
Net interest income	$190	$296	$438	$577
Noninterest income	(391)	160	(248)	309
Total revenue	(201)	456	190	886
Provision for credit losses	328	30	405	61
Noninterest expense	183	230	375	469
Tax (benefit)/expense	(237)	73	(192)	132
Net (loss)/income	$(475)	$123	$(398)	$224
Balance sheet data:				
Average assets	$21,588	$25,514	$22,724	$25,086
Average loans	14,988	15,995	15,778	15,700
Average deposits	7,601	10,922	8,294	10,761
Return on equity	nm	33%	nm	31%

nm not meaningful

International Banking reported a net loss of $475 million in the second quarter of 2002, compared to net income of $123 million in the second quarter of 2001. The vast majority of this decrease was directly related to the political and economic situation in Argentina. Argentina s net loss for the quarter was $489 million, compared to net income of $46 million in the prior year, and reflects the impact of an additional credit provision and securities charges, as well as dramatic changes in the Argentine government s monetary and fiscal policies. These government-mandated policies include the pesofication of loans and deposits that had been denominated in U.S. dollars, the abolishment of the fixed currency exchange rate, the elimination of the inflation indexation on many consumer loans, the court-ordered payout of certain frozen deposits, and valuation adjustments on foreign exchange contracts. Brazil reported break-even earnings for the current quarter, which were down $57 million compared to 2001 s levels. Brazil s results reflected the decision to reposition the balance sheet and reduce risk in that country, which we announced in April 2002. You can read more detailed information about Argentina and Brazil in the Country Risk section of this discussion and analysis.

All Other

All Other includes transactions not allocated to our principal business lines, the residual impact of methodology allocations, such as the provision for credit losses, reserve for credit losses and equity allocations, combined with transfer pricing offsets. For instance, the provision for credit losses is generally allocated to business lines on an expected loss basis. Expected loss is an estimate of the average loss rate that individual credit portfolios will experience over an economic cycle, based on our historical loss experience and various market data. This methodology differs from the method used to determine our consolidated provision for credit losses for

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any given period, which is based on an evaluation of the adequacy of the reserve for credit losses considering the risk characteristics in the portfolio at a point in time. The difference between the sum of the provisions for each line of business determined using this methodology and the consolidated provision is included in All Other. You can find more information about our consolidated reserve methodology in the Reserve for Credit Losses section of Management s Discussion and Analysis in our 2001 10-K.

The business activities of our Treasury unit are also included in All Other. The Treasury unit is responsible for managing our securities and residential mortgage portfolios, the balance sheet management function and wholesale funding needs.

Results of All Other can fluctuate with changes affecting the consolidated provision for credit losses, one-time charges, gains and other corporate actions not driven by specific business units. All Other showed a net loss of $185 million in the current quarter, compared to net income of $44 million in 2001. In 2002, All Other included an additional provision for credit losses in the domestic commercial and industrial, or C&I, portfolio, partially offset by securities gains. In 2001, All Other included charges related to the Summit acquisition and related integration activity and a loss on the sale of our mortgage banking business. These were partially offset by gains from divestitures.

CONSOLIDATED RESULTS OF OPERATIONS

Net Interest Income

FTE basis *In millions*	Three months ended June 30 2002	 2001	Six months ended June 30 2002	 2001
Interest income	$2,673	$3,515	$5,359	$7,374
Tax-equivalent adjustment	14	17	36	33
Interest expense	1,031	1,643	2,007	3,615
Net interest income	$1,656	$1,889	$3,388	$3,792

Net interest income decreased $233 million, or 12%, in the quarterly comparison and $404 million, or 11%, in the six-month comparison, primarily the result of a decline in domestic loan volume, increases in domestic and international nonperforming loans, and the impact of Argentine government actions (i.e., allowing the peso to float against the U.S. dollar and converting into pesos certain assets and liabilities that were previously denominated in U.S. dollars) on the level of Argentine assets and liabilities. In addition, net interest income in the 2002 periods was adversely impacted by Argentine government-mandated rule changes subjecting all deposits to inflation-related indexation adjustments. An additional factor contributing to the decline in net interest income was the sale of the mortgage banking business in the second quarter of 2001. These declines were partially offset by an increase in low-cost domestic savings deposits and a decrease in higher-cost wholesale funding.

Net Interest Margin and Interest Rate Spread

TE basis *ollars in millions*	Three months ended June 30 2002 Average Balance	 Rate	 2001 Average Balance	 Rate	Six months ended June 30 2002 Average Balance	 Rate	 2001 Average Balance	 Rate
ecurities	$29,416	5.51%	$25,556	6.86%	$28,356	5.52%	$28,986	6.90
oans and leases:								

omestic	100,026	6.77	109,433	8.11	102,005	6.77	111,409	8.46
ternational	19,513	9.57	20,218	11.05	20,246	9.03	19,788	11.23
ue from brokers/dealers	3,860	1.47	4,424	4.00	3,915	1.45	3,913	4.56
ortgages held for sale	296	6.21	3,315	7.17	324	6.47	3,042	7.05
ther	7,625	5.59	13,479	6.49	8,815	5.14	10,559	7.81
otal interest earning assets	160,736	6.69	176,425	8.02	163,661	6.61	177,697	8.37
eposits	92,318	2.72	96,524	3.82	93,137	2.49	96,826	4.11
hort-term borrowings	13,212	3.05	19,857	5.14	14,541	3.39	20,518	5.98
ue to brokers/dealers	4,048	1.20	4,066	4.08	3,976	1.20	3,866	5.10
ong-term debt	23,433	5.00	28,815	5.93	24,183	4.88	30,092	6.25
terest bearing liabilities	133,011	3.11	149,262	4.41	135,837	2.97	151,302	4.81
terest rate spread		3.58		3.61		3.64		3.56
terest-free sources of funds	27,725		27,163		27,824		26,395	
otal sources of funds	$160,736	2.57%	$176,425	3.73%	$163,661	2.46%	$177,697	4.10%
et interest margin		4.12%		4.29%		4.15%		4.27%

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Net interest margin for the second quarter of 2002 declined 17 basis points compared to the prior year period. This decline resulted from our previously discussed deposit pricing strategy, an increase in the level of nonperforming loans and the above-mentioned inflation-related indexation rule changes in Argentina. Changes in the components of interest earning assets and interest bearing liabilities are discussed in more detail below.

Average securities increased $3.9 billion to $29.4 billion for the three months ended June 30, 2002. This increase was primarily due to net purchases, mostly of domestic debt securities, in the fourth quarter of 2001 and the first half of 2002.

Average domestic loans and leases decreased $9.4 billion for both the three and six months ended June 30, 2002 compared to the same periods in 2001, driven primarily by lower domestic commercial and residential loan levels as well as higher charge-offs in the 2002 periods. These declines were offset, in part, by an increase in consumer home equity loans. Quarter to quarter, average international loans and leases decreased $705 million to $19.5 billion mainly due to the devaluation of the Argentine peso, offset in part by increases in other countries.

Average mortgages held for sale decreased $3 billion compared to the second quarter of 2001, due to the sale of the mortgage banking business. We continue to originate mortgage loans through our retail banking branches.

Average other interest earning assets decreased $5.9 billion to $7.6 billion for the second quarter of 2002, the result of a decrease in securities purchased under agreements to resell.

The $4.2 billion decrease in average interest bearing deposits compared to the second quarter of 2001 reflects a $3.4 billion decline from Argentina, mainly the pesofication and the devaluation of the local currency, as well as a decline in domestic time deposits, the result of maturities and a shift from time deposits to money market deposits. Partially offsetting these declines was an $8.6 billion increase in average money market deposits.

The $6.6 billion decrease in average short-term borrowings is mainly attributable to a decreased use of treasury, tax and loan borrowings and other short-term borrowings as a funding source as a result of the excess funds from the sale of Fleet Mortgage. The decline in yields reflects Federal Reserve Board interest rate reductions throughout 2001.

Average long-term debt decreased $5.4 billion to $23.4 billion for the second quarter of 2002, reflecting maturities of debt throughout 2001 and the first half of 2002, offset, in part, by issuances during the same period. The decline in yields also reflects the impact of Federal Reserve Board interest rate reductions throughout 2001.

Provision for Credit Losses

The provision for credit losses for the second quarter and first six months of 2002 amounted to $1.3 billion and $1.7 billion, respectively, compared to $313 million and $627 million, respectively, for the 2001 periods. During the second quarter of 2002, as part of this increase, we recorded an additional provision of $300 million in consideration of the continued deterioration of the Argentine economy. The remainder of the provision for the current quarter was $950 million, reflecting the impact of the current domestic economic environment on large corporate credits, including the telecommunications sector, and certain fraud situations.

The provision for credit losses reflects management s assessment of the adequacy of the reserve for credit losses, considering the current risk characteristics of the loan portfolio and economic conditions. Levels of future provisions will continue to be a function of management s assessment of credit risk based upon its quarterly review of the reserve for credit losses, including assessments of the potential impact of domestic economic conditions and the continuing instability and resulting difficult operating environment in Latin America.

As a result of our lending to corporate borrowers, we are significantly impacted by the down portions of the credit cycle. Currently, we expect continued high credit costs during each of the next two quarters, though substantially less than the level incurred in the second quarter. However, the level of future provisions cannot be determined with certainty. You can obtain more information about the reserve for credit losses in the Reserve for Credit Losses section of Management s Discussion and Analysis, and in Notes 1 and 5 of the Notes to Consolidated Financial Statements, included in our 2001 10-K, as well as the Reserve for Credit Losses Activity section of this discussion and analysis. More information about Latin America is included in the Country Risk section of this discussion and analysis.

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Noninterest Income

	Three months ended June 30		Six months ended June 30	
In millions	2002	2001	2002	2001
Investment services revenue	$405	$330	$810	$673
Banking fees and commissions	383	399	766	782
Credit card revenue	155	162	327	327
Capital markets revenue	(126)	(172)	150	(187)
Gains on branch divestitures		263		353
Other	187	167	363	499
Total noninterest income	$1,004	$1,149	$2,416	$2,447

Noninterest income decreased $145 million in the second quarter of 2002 and $31 million in the first six months of 2002, compared to the same periods a year ago. Increases in investment services and capital markets revenues were more than offset by the absence of gains on branch divestitures in the 2002 periods. Investment services revenue benefited from the Liberty Asset Management acquisition which we completed in the fourth quarter of 2001. The improvement in capital markets revenue was primarily due to lower investment write-downs in the Principal Investing portfolio in the 2002 periods.

Investment Services Revenue

	Three months ended June 30		Six months ended June 30	
In millions	2002	2001	2002	2001
Investment management revenue	$284	$212	$576	$437
Brokerage fees and commissions	121	118	234	236
Total investment services revenue	$405	$330	$810	$673

Investment Management Revenue

	Three months	Six months

In millions	ended June 30 2002	2001	ended June 30 2002	2001
Columbia Management Group	$124	$26	$249	$53
Private Clients Group	85	95	172	193
Institutional businesses	34	38	69	81
International	23	34	49	72
Mutual Fund & Investment	15	16	30	32
Other	3	3	7	6
Total investment management revenue	$284	$212	$576	$437

Investment management revenue increased $72 million in the quarterly comparison and $139 million in the six-month comparison. This was primarily the result of the acquisition of Liberty, which is included in Columbia Management Group in the table above, offset, in part, by a lower market valuation of domestic assets under management as a result of the significant decline in the market during the first half of 2002, and a decline in Argentina s investment management revenue due to the devaluation of the peso. At June 30, 2002, total domestic and international assets under management amounted to $162 billion. Excluding $48 billion related to Liberty, such total was $114 billion, compared to $129 billion at June 30, 2001.

Banking Fees and Commissions

In millions	Three months ended June 30 2002	2001	Six months ended June 30 2002	2001
Cash management fees	$109	$92	$234	$176
Deposit account charges	104	125	210	254
Electronic banking fees	68	64	128	115
Other	102	118	194	237
Total banking fees and commissions	$383	$399	$766	$782

Banking fees and commissions declined $16 million in both the three- and six-month comparisons. Declines in deposit account charges and other fees resulted from the impact of devaluation on the reported levels of revenues and expenses in Argentina, as well as lower deposit fees related to a change in fee structure in line with our customer-focused strategy. These declines were partially offset by increases in cash management fees, driven by higher volumes/rates, and electronic banking fees.

Credit Card Revenue

Credit card revenue decreased 4% in the second quarter of 2002 compared to the second quarter of 2001 and remained flat in the six-month comparison. The three-month decline was primarily related to increased amortization of deferred acquisition costs, offset partially by higher interchange fees, reflective of greater card usage, and higher securitization income, reflective of a higher average securitization program size.

Capital Markets Revenue

In millions	Three months ended June 30 2002	Three months ended June 30 2001	Six months ended June 30 2002	Six months ended June 30 2001
Market-making revenue	$70	$86	$148	$194
Syndication/agency fees	39	56	80	94
Trading profits and commissions	28	32	67	88
Underwriting and advisory fees	14	12	24	23
Foreign exchange revenue	(23)	76	58	119
Principal investing	(46)	(436)	(34)	(494)
Securities (losses)/gains	(208)	2	(193)	(211)
Total capital markets revenue	$(126)	$(172)	$150	$(187)

Capital markets revenue improved $46 million in the quarterly comparison and $337 million in the six-month comparison, primarily due to a lower level of investment write-downs in the principal investing portfolio in the 2002 periods. Partially offsetting this increase were higher foreign exchange and securities losses in the three-month 2002 period, which are more fully described below. Revenues from capital markets activities are impacted by a variety of factors, including investor sentiment, the condition of the economy, interest rates and equity markets.

The $16 million decrease in market-making revenue in the quarterly comparison, and $46 million decrease in the six-month comparison, both resulted from lowered

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profit opportunities and narrowed spreads from difficult market conditions.

Syndication/agency fees decreased $17 million and $14 million in the three- and six-month periods, respectively, as a result of decreased syndication volume in the current year. Such fees are a function of the timing and level of syndication transactions.

Trading profits and commissions decreased $4 million for the quarter ended June 30, 2002 and $21 million for the six months ended June 30, 2002, primarily attributable to weakened domestic market conditions and a repositioning of the Brazilian portfolio to a more conservative approach.

Foreign exchange revenue was a loss of $23 million for the three months ended June 30, 2002, a decrease of $99 million from the 2001 quarter, and revenue of $58 million for the six months ended June 30, 2002, 51% lower than the 2001 period, principally due to government-related actions in Argentina.

Principal investing revenue increased $390 million for the quarter ended June 30, 2002 and $460 million for the first six months of 2002, due to lower investment write-downs recorded in the 2002 periods. During the first half of 2002, we recorded write-downs of approximately $71 million, compared to $602 million in the first half of 2001. During the second quarter and first half of 2002, we made new investments of $138 million and $273 million, respectively, compared to new investments of $215 million and $430 million, respectively, in the 2001 periods. As of June 30, 2002, the Principal Investing business had unfunded commitments totaling approximately $1.9 billion. These commitments are drawn down periodically throughout the life of the respective investment fund. As of June 30, 2002, the Principal Investing portfolio had an aggregate carrying value of approximately $3.7 billion, composed of direct investments in privately held companies and direct investments in companies whose stocks are publicly traded, as well as indirect investments in primary or secondary funds. As we discussed in our first quarter 2002 10-Q, we announced our intent in April of this year to reduce the size of this portfolio to approximately $2.5 billion over the next couple of years.

Securities losses of $208 million for the second quarter of 2002 consisted of $350 million of write-downs incurred in the Argentine government securities portfolio and $62 million of losses and write-downs related to a repositioning of the Brazilian portfolio, offset partly by approximately $200 million of domestic securities gains. The six month 2001 period included a loss of $265 million on securities sales after the Summit acquisition, offset by gains on sales of domestic bonds. Refer to the Country Risk section of this discussion and analysis for more information about the losses from Argentina and Brazil.

Other Noninterest Income

Gains on branch divestitures of $263 million in the second quarter of 2001 and $353 million in the first six months of 2001 resulted primarily from the divestitures required in connection with the BankBoston merger.

Other noninterest income for the three months ended June 30, 2002 increased $20 million compared to the same period a year ago and decreased $136 million in the six-month comparison. The six-month 2002 decrease was primarily due to the absence of $107 million of revenue included in the 2001 period related to the mortgage banking business, which we sold in the second quarter of 2001. Excluding this amount, other noninterest income declined $29 million year over year.

Noninterest Expense

	Three months ended June 30		Six months ended June 30	
In millions	2002	2001	2002	2001
Employee compensation and benefits	$837	$902	$1,646	$1,830
Occupancy and equipment	247	258	501	525
Marketing and public relations	52	57	102	113
Legal and other professional				

	39	53	73	115
Intangible asset amortization	22	94	44	190
Merger- and restructuring-related charges		38		476
Loss on sale of mortgage banking business		101		428
Other	400	370	797	775
Total noninterest expense	$1,597	$1,873	$3,163	$4,452

Noninterest expense decreased $276 million, or 15%, and $1.3 billion, or 29%, in the second quarter and the first six months of 2002, respectively, compared to the same periods in 2001. These declines reflected the absence of aggregate charges of $194 million and $1 billion related to the Summit acquisition, the sale of Fleet Mortgage and business unit restructurings recorded in the three- and six-month periods of 2001, respectively. Also contributing to the decline was the absence of goodwill amortization in the 2002 periods in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, which we adopted on January 1, 2002. The remaining decreases in noninterest expense for the three and six months ended June 30, 2002 resulted primarily from cost saving initiatives implemented in 2001.

Given the recent performance of investment markets and the related impact on long-term trends, we elected to reduce our pension assumption of expected long-term rate of return on pension plan assets from 10%, used in 2001, to 9.25%, for financial accounting purposes. In addition,

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we decided to pay plan expenses from our corporate assets in order to maintain more assets in the pension trust fund. Previously, plan expenses were paid from trust assets. We anticipate that the overall effect of both of these changes will result in additional noninterest expense of $19 million per year. This estimate is based on trust asset levels at the beginning of 2002. Notwithstanding these changes, for cash funding purposes the minimum required and maximum tax deductible contribution for 2002 is expected to be zero. Additional information about our pension plan, including funded status, is included in Note 11 of the Notes to Consolidated Financial Statements included in our 2001 10-K.

Income Taxes

We recorded an income tax benefit of $95 million for the second quarter of 2002, compared to income tax expense of $314 million for the same period a year ago. Our effective tax rate was 47.3% and 37.6% for the second quarters of 2002 and 2001, respectively, and 33.5% and 40.2% for the respective six-month periods. The higher tax rate for three months ended June 30, 2002 was attributable to the impact of the previously discussed second quarter 2002 charges related to Argentina and Brazil and the additional provision for credit losses. The higher 2001 year-to-date effective tax rate reflected the effect of nondeductible merger- and restructuring-related charges in connection with the Summit acquisition. The effective tax rates for the 2002 periods continue to be reduced by the elimination of goodwill amortization in accordance with SFAS No. 142.

Our overall tax position is complex and requires careful analysis by management to estimate the expected realization of income tax assets and liabilities. Realization of deferred tax assets, including foreign tax credits, arises from carrybacks to prior taxable periods, levels of future taxable income, including net foreign source income in certain periods, and the achievement of tax planning strategies. Management has determined that it is more likely than not that the deferred tax assets at June 30, 2002 can be realized. However, this determination involves estimates and assumptions about matters that are inherently uncertain, and unanticipated events or circumstances could cause actual results to differ from these estimates. Management continually monitors and evaluates the impact of current events and circumstances on the estimates and assumptions used in the recognition of deferred tax assets and the related tax positions. Additional information about our income taxes and related accounting policies is included in Notes 1 and 15 to the Consolidated Financial Statements included in our 2001 10-K.

FINANCIAL CONDITION

Risk Management

Our management of the risks inherent in our businesses is essential for understanding and assessing our financial performance and potential for creating long-term value. Four of the primary risk factors inherent in our businesses are credit risk, liquidity risk, market risk and operating risk. Any of these risks, if not effectively managed, can result in losses to FleetBoston, as well as erosion of our capital and damage to our reputation. We have a series of risk processes to identify the extent of risk involved in a business activity, to establish appropriate controls and to monitor compliance with our risk mitigation strategies. While these processes assist us in managing our risk exposures, they cannot fully insulate us from losses. Our businesses require us to take risks while seeking adequate compensation for the risks undertaken. Despite the best of efforts, losses can, and will, occur. Consequently, we continually seek to improve our risk management culture to better balance risks and returns while operating in a dynamic environment.

You can obtain additional information on our risk management infrastructure, and related credit risk, liquidity risk, market risk and operating risk management processes, in the Financial Condition section of Management s Discussion and Analysis included in our 2001 10-K. The following sections provide additional information about credit risk, liquidity risk and market risk.

Credit Risk Management

Credit risk is defined as the risk of loss arising from a counterparty s failure or inability to meet payment or performance terms of a contract with us. Our credit risk management processes are intended to address the management of all forms of credit risk, including balance sheet and off-balance sheet exposures, through the establishment of credit policies, the approval of underwriting standards and concentration limits and the granting of credit approval authorities.

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Loans and Leases

In millions	June 30, 2002	March 31, 2002	December 31, 2001
Domestic:			
Commercial and industrial	$43,980	$46,938	$48,486
Commercial real estate	11,452	11,915	11,517
Consumer	31,679	31,974	32,225
Lease financing	11,416	11,638	12,370
Total domestic loans and leases	98,527	102,465	104,598
International:			
Commercial	16,463	18,512	19,608
Consumer	1,211	1,540	2,782
Total international loans and leases	17,674	20,052	22,390
Total loans and leases	$116,201	$122,517	$126,988

Total loans and leases decreased $10.8 billion to $116.2 billion from December 31, 2001. This decrease was due to declines of $4.5 billion in domestic C&I loans and $954 million in lease financing, both resulting from runoff and lower business volume related to continued weak loan demand, as well as a decline of $546 million in domestic consumer loans, which is described below. Also contributing to the decline in C&I loans were charge-offs of $1.1 billion in the six months ended June 30, 2002, including the charge-off of certain large corporate and telecom credits and certain fraud situations. The $4.7 billion decrease in our international loan portfolio was due primarily to the impact of the Argentine peso devaluation on the U.S. dollar carrying value of Argentine loans. Brazilian loans also declined $800 million, primarily as a result of maturities during the second quarter, which were not renewed.

Consumer Loans

In millions	June 30, 2002	March 31, 2002	December 31, 2001

Domestic:			
Home equity	$15,713	$15,055	$13,862
Residential real estate	6,941	6,763	8,131
Credit card	4,976	5,718	5,547
Consumer margin loans	1,590	1,730	1,852
Student loans	884	993	949
Installment/other	1,575	1,715	1,884
Total domestic loans	31,679	31,974	32,225
International	1,211	1,540	2,782
Total consumer loans	$32,890	$33,514	$35,007

Compared to December 31, 2001, domestic consumer loans decreased $546 million to $31.7 billion at June 30, 2002. This decrease was mainly the result of a $1.2 billion decline in residential real estate loans, mainly attributable to loan runoff and refinancing, and a $571 million decline in domestic credit cards, the result of an $800 million securitization transaction that was completed in the second quarter of 2002. Also contributing to the decline was a $262 million decrease in consumer margin loans at Quick & Reilly due to reduced demand resulting from market conditions. Offsetting these declines was a $1.9 billion, or 13%, increase in home equity loans, resulting primarily from a fourth quarter 2001 promotion.

The $1.6 billion decline in international consumer loans from December 31, 2001 was substantially due to the impact of the Argentine peso devaluation on the U.S. dollar carrying value of Argentine loans.

Country Risk

Non-U.S. Operations

Our overseas activities are subject to economic and political conditions related to, and economic and regulatory policies of, the governments of the countries in which we conduct activities. In addition, local and regional economic conditions affect local economies and governments in varying degrees of severity and, accordingly, may also affect our Latin American and other overseas activities. You can obtain additional information about our overseas activities in the Country Risk section of Management s Discussion and Analysis included in our 2001 10-K.

The following tables present the total assets of, and cross-border outstandings to, Latin American countries in which we do business at June 30, 2002 and December 31, 2001. The total assets in each country include the related cross-border outstandings.

Total Assets *In billions*	June 30, 2002	Dec. 31, 2001
Argentina	$4.4	$9.3
Brazil	10.4	12.0
Chile	1.5	1.7

Colombia	.3	.3
Mexico	1.6	1.4
Panama	.5	.5
Peru	.6	.6
Uruguay	.7	.8
Other Latin America	.2	.3
Total Latin America	$20.2	$26.9

Cross-Border Outstandings, net of transfer risk mitigation *In billions*	June 30, 2002	Dec. 31, 2001
Argentina	$2.0	$3.3
Brazil	2.4	2.5
Chile	.7	.8
Colombia	.1	.1
Mexico	.8	.8
Panama	.2	.2
Peru	.1	.3
Uruguay	.4	.1
Other Latin America	.1	.3
Total Latin America	$6.8	$8.4

The remainder of this section presents updated information about our operations in Argentina and Brazil, including information concerning the effects of the ongoing economic and political situation in Argentina on these operations, as well as information concerning economic and political conditions in Brazil.

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In broad terms, the total assets of our overseas operations are subject to a number of risks, collectively referred to as country risk. Country risk includes the following:

- the possibility of deteriorating economic conditions;
- political and social upheaval;
- nationalization and expropriation of assets;
- exchange controls/restrictions on the remittance of funds (transfer or cross-border risk); and
- currency depreciation or devaluation.

Cross-border outstandings, which are included in the total assets of our overseas operations, are subject to transfer, or cross-border, risk in addition to credit risk. Cross-border risk is the risk that customers will be unable to meet their contractual repayment obligations of principal and/or interest as a result of actions taken by foreign governments, such as exchange controls, debt moratoria and restrictions on the remittance of funds. Cross-border outstandings include claims on third parties, as well as investments in, and funding of, our overseas operations.

Total cross-border outstandings to Argentina and Brazil, as defined, each amounted to 1% or more of our consolidated total assets at June 30, 2002 and December 31, 2001, respectively. There were no total cross-border outstandings to other countries which exceeded .75% of consolidated total assets at June 30, 2002 and December 31, 2001, respectively.

Argentina

As we discussed in our 2001 10-K, in early 2002 the Argentine government implemented measures to convert all U.S. dollar denominated loans and deposits into pesos and additional measures to deal with the economic crisis. Due to the impact of these measures on our Argentine operation, and the continued economic and political uncertainty in that country, we recorded the following charges during the three months ended June 30, 2002.

- A charge of $350 million was recorded against our Argentine government securities portfolio, mainly due to a write-down of the estimated value of the compensation bond to be received from the Argentine government for the difference between converting loans at a rate of 1 peso per U.S. dollar and deposits at 1.4 pesos per U.S. dollar.
- We increased our reserve for credit losses related to Argentine loans by $300 million due to concerns that the continued deterioration of the Argentine economy may impact customers ability to service their existing obligations. During the second quarter, on a discretionary basis, we placed substantially all sovereign-related loans and securities and a significant portion of private sector loans on nonaccrual status, bringing total nonperforming assets, or NPAs, in Argentina to $2 billion.
- An additional charge of $25 million was recorded, related to foreign exchange losses from judicial decrees that required banks to disburse funds to certain account holders at the current exchange rate. Refer to the Argentine Balance Sheet portion of this section for more information.

In addition, $251 million of translation losses ($143 million after-tax) were recorded in other comprehensive income, a component of stockholders equity, in the second quarter due to further weakening of the peso.

As a result of these actions, we have now taken cumulative pre-tax charges of approximately $2.3 billion since the beginning of the Argentine crisis. This includes a pre-tax unrealized loss of $542 million ($318 million after-tax), which is recorded in other comprehensive income, net of taxes.

Argentine Balance Sheet

We operate more than 120 branches in Argentina with total assets of approximately $4.4 billion and $9.3 billion at June 30, 2002 and December 31, 2001, respectively.

These assets, which are subject to the country risk described above, have the following components:

In billions	June 30, 2002	Dec. 31, 2001
Loans	$3.1	$6.7
Placements with central bank and other banks	.3	1.3
Securities	.4	.3
Fixed assets and other nonearning assets	.6	1.0
Total assets	$4.4	$9.3
Components of total assets:		
Assets recorded in the Argentine operation funded by liabilities from local residents	$1.3	$4.5
Cross-border outstandings see separate table	$3.1	$4.8

The table below presents the components of loans.

In billions	June 30, 2002	Dec. 31, 2001
Consumer	$ .4	$1.8
Corporate	2.3	3.7
Middle market	.2	.8
Sovereign	.2	.4
Total loans	$3.1	$6.7

The decline in Argentine total assets from December 31, 2001 resulted from the involuntary conversion of the majority of these assets into pesos and their subsequent devaluation as the peso weakened versus the U.S. dollar, as well as the aforementioned write-down of Argentine government securities. The peso has devalued by approximately 75% from December 31, 2001.

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The decline in loans from $6.7 billion at December 31, 2001 to $3.1 billion at June 30, 2002, is mainly attributable to the peso devaluation.

During the second quarter, on a discretionary basis, we placed substantially all sovereign-related loans and securities and a significant portion of private sector loans on nonaccrual status, bringing total NPAs in Argentina to $2 billion. Included in our consolidated reserve for credit losses is $1.2 billion related to Argentina. Net charge-offs for the second quarter of 2002 were $30 million. We expect that net charge-offs in Argentina will increase significantly during the remainder of 2002.

In addition, during the second quarter of 2002, the Interagency Country Exposure Review Committee, or ICERC, of U.S. banking regulators required the banking industry to establish an Allocated Transfer Risk Reserve, or ATRR, to cover certain Argentine cross-border exposure by June 30, 2002. Our ATRR requirement was $712 million at June 30, 2002, and this requirement was more than covered by the portion of our consolidated reserve for credit losses that we specifically allocated to Argentina, which was $1.2 billion at June 30, 2002.

We have $246 million on deposit with the Argentine central bank to meet statutory reserve requirements related to our Argentine operation s $1.2 billion of local deposits. We are required by local regulations to place the required reserves with the central bank based on a fixed percentage of each deposit received. The local deposits, and intercompany borrowings, primarily fund the balance sheet of our Argentine operation.

In December 2001, the Argentine government issued an order imposing limitations on the ability of bank customers in Argentina to withdraw funds from their accounts in Argentine banks (the corralito). Since the corralito was issued, a large number of customers of our Argentine operation, or BankBoston Argentina, have filed complaints in the Argentine courts against BankBoston Argentina seeking to invalidate the corralito on constitutional grounds and withdraw their funds. Due to this situation, and although we cannot determine the total number of claims pending in the judicial system, we have recorded foreign exchange losses of $126 million in the first six months of 2002, with $108 million recorded in the second quarter, including the $25 million charge discussed earlier in this section which is an estimate of the loss incurred related to outstanding claims. These losses represent the impact of paying depositors at the current exchange rate versus the 1.40 exchange rate, which was the rate used to originally convert U.S. deposits into pesos. Total foreign exchange losses from Argentina, including the losses referred to above, were $22 million in the first six months of 2002. This was comprised of $65 million of losses in the second quarter and $43 million of profits in the first quarter.

Also during the second quarter, the government reversed a measure that allowed banks to charge customers an inflation adjustment on consumer loans. However, deposit liabilities will continue to accrue the inflation adjustment. This situation has created a mismatch between inflation-adjusted assets and liabilities. This mismatch reduced net interest income by approximately $50 million in the second quarter of 2002.

These situations, as well as other Argentine government economic measures, may continue to significantly impact interest rate and liquidity risk related to the balance sheet of our Argentine operation. To date, we have not experienced significant liquidity issues, but we continue to closely monitor the impact of these measures, including the corralito-related claims, on our liquidity position. The future rate of inflation may increase the negative impact from the mismatch between inflation-adjusted assets and liabilities.

Included in Argentine total assets of $4.4 billion at June 30, 2002 and $9.3 billion at December 31, 2001, are cross-border outstandings, as follows. The net cross-border outstandings of $2 billion at June 30, 2002 are not net of the $1.2 billion of reserve for credit losses specifically allocated to Argentina.

In billions	June 30, 2002	Dec. 31, 2001
Argentina:		
Trade-related claims	$ .6	$1.0
Other claims on third parties	1.8	2.1

Investment in and funding of local operations	.7	1.7
Total cross-border outstandings	$3.1	$4.8
Cross-border risk mitigation:		
Insurance contracts	.7	.8
Guarantees, including trade-related of $.05 and $.2	.4	.7
Total cross-border outstandings, net of cross-border risk mitigation	$2.0	$3.3

(a) Commencing at December 31, 2001, we changed our method of reporting cross-border outstandings to include amounts not required in regulatory reporting. If Federal Financial Institutions Examination Council, or FFIEC, guidelines were used for reporting, total cross-border outstandings would have been $2.3 billion and $3.1 billion at June 30, 2002 and December 31, 2001, respectively.

(b) Total cross-border outstandings to Argentina were 1.6% and 2.3% of total consolidated assets at June 30, 2002 and December 31, 2001, respectively.

(c) The sector percentage allocations for banks, public and private cross-border claims on third parties under FFIEC guidelines for Argentina were 3.4%, 20.9% and 75.7% at June 30, 2002 and 1.7%, 10.9% and 87.4% at

December 31, 2001, respectively.[(d)] Cross-border commitments for Argentina at June 30, 2002 and December 31, 2001 were $115 million and $160 million, respectively.[(e)] Certain amounts at December 31, 2001 have been reclassified for comparative purposes.

The decrease in cross-border outstandings from December 31, 2001 was primarily due to losses recorded by the Argentine operation, and to translation losses recorded in other comprehensive income.

The $3.1 billion of cross-border outstandings at June 30, 2002 have the following cross-border risk mitigation:

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Of the $640 million of trade-related outstandings, $50 million are guaranteed, and are included in the $400 million of loans with guarantees discussed below; $590 million are not guaranteed, of which $270 million are short-term, and have historically received preferential treatment in cross-border risk events;

$700 million are covered by insurance. The insurance coverage is purchased from U.S. and foreign government, multilateral and private insurers. This coverage protects us from situations where repayment of these claims and intercompany funding is not permitted due to the inability of the customer to transfer funds or convert the necessary funds into the obligation currency due to government actions. FleetBoston is required to follow specific procedures to ensure coverage if a cross-border event occurs, including timely notification of such an event to the insurer and in the case of coverage on third party loans, evidence that the customer s nonpayment is not credit-related; and

$400 million represent loans with guarantees that cover credit and cross-border risk.

The Argentine government enacted exchange controls in December 2001 that limited the transfer of funds outside of that country. These regulations continue to be modified. As of June 30, 2002, our cross-border outstandings continue to be impacted by these regulations, and this has resulted in delays in the transfer of U.S. dollars outside of Argentina. At June 30, 2002, $1.1 billion of Argentine loans have been placed on discretionary nonaccrual status, bringing total NPAs in Argentina to $2 billion. This total includes Argentine sovereign bonds. We are unable to determine at the present time the ultimate impact those measures will have on our cross-border outstandings.

Argentine Mutual Funds

Our Argentine operation managed approximately $166 million of mutual funds at June 30, 2002. Certain of the Argentine government s economic measures, which restricted withdrawals of bank deposits, also applied to mutual fund redemptions. Therefore, mutual fund investors could not receive redemptions of their funds, and this has resulted in litigation, which we discussed in the Argentine Balance Sheet section.

Argentine Currency Position

Currency positions expose us to gains or losses that depend on the relationship between currency price movements and interest rate differentials. The following table presents our Argentine long U.S. dollar currency position, for which related foreign exchange gains or losses are recorded in our income statement. The increase in the long position in U.S. dollars is mainly due to the anticipated compensation bond, which we expect to be denominated in U.S. dollars. The continued evolution of the Argentine government s economic measures may impact the size and direction of our currency position in future periods.

	June 30, 2002		December 31, 2001	
In millions	Quarter-End	Daily Average	Quarter-End	Daily Average
Argentina [(a)(b)]	$257	$288	$52	$(23)

(a) Positive values reflect U.S. dollar assets funded by local currency liabilities (i.e., a long position in U.S. dollars).
(b) Negative values reflect local currency assets funded by U.S. dollars (i.e., a short position

in U.S.
dollars).

In addition to the currency exposure discussed above, our investment in and funding of local operations creates translation exposure, which arises from changes in the local currency exchange rate versus the U.S. dollar. As a result of the change in Argentina s financial system from U.S. dollars to pesos, we changed the functional currency of the Argentine unit from the U.S. dollar to the peso, in accordance with SFAS No. 52, Foreign Currency Translation, at the beginning of 2002. Translation gains and losses that result from this exposure, along with any offsetting hedge gains or losses related to covering this exposure, are recorded directly to other comprehensive income, net of tax. The government measures created a situation where our translation exposure could not be effectively hedged against currency rate changes, and at June 30, 2002, our translation exposure was approximately $.7 billion, which is presented in the table of cross-border outstandings on the previous page as investment in and funding of local operations. The cumulative impact recorded in other comprehensive income since implementing this accounting change has been a $542 million pre-tax unrealized loss, or $318 million after-tax.

We continue to monitor and evaluate the Argentine economic situation and related economic measures discussed above, and will adjust our strategy as deemed appropriate. However, in light of the changing economic measures and continuing economic, political and social uncertainty in the country, it is not possible to predict the impact that future developments may have on our operations in Argentina or the necessity to take future charges.

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Brazil

We operate more than 65 branches in Brazil with total assets of approximately $10.4 billion and $12 billion at June 30, 2002 and December 31, 2001, respectively. These assets are subject to country risk as described above and have the following components:

In billions	June 30, 2002	Dec. 31, 2001
Loans	$6.5	$7.3
Securities	1.1	1.9
Resale agreements	1.3	1.5
Other monetary assets	.7	.6
Fixed assets and other nonearning assets	.8	.7
Total assets	$10.4	$12.0
Components of total assets:		
Assets recorded in the Brazilian operation funded by liabilities from local residents	$2.7	$3.6
Cross-border outstandings see separate table	$7.7	$8.4

The table below presents the components of loans.

In billions	June 30, 2002	Dec. 31, 2001
Consumer	$ .3	$ .4
Corporate:		
Multinationals	2.4	3.1
Brazilian corporations	3.3	3.3
Middle market and financial institutions		

	.5	.5
Total loans	$6.5	$7.3

The decline in total assets mainly reflects the impact of the devaluation of the real against the U.S. dollar (18% from December 31, 2001), and our intent to reduce risk in Brazil by decreasing lending activities and repositioning the securities portfolio toward shorter maturities. As part of this initiative, we recorded a pre-tax security loss of $62 million during the second quarter to swap existing government securities for government securities with shorter maturities.

The decline in the loan portfolio was primarily due to not renewing loans that matured during the second quarter, mainly to multinational corporations. NPAs in the Brazilian portfolio were $67 million at June 30, 2002 compared to $18 million at December 31, 2001. The increase was primarily related to one telecommunication borrower. Net credit losses for the first half of 2002 were $11 million.

As part of our Brazilian operation s balance sheet management, we held approximately $3 billion of treasury assets (securities available for sale, resale agreements and other monetary assets in the preceding table) at June 30, 2002, compared to $4 billion at December 31, 2001. Of this total, securities available for sale, composed mainly of Brazilian government bonds, were $1 billion at June 30, 2002 compared to $1.5 billion at December 31, 2001. The decline was due to sales in the first quarter of 2002 and a lower market value. At June 30, 2002, the unrealized mark-to-market after-tax loss recorded in other comprehensive income was $57 million. At June 30, 2002, these securities had an average duration of approximately 1.5 years compared to 2 years at December 31, 2001. We also had $1.3 billion of resale agreements with banks in Brazil, which were collateralized by Brazilian government bonds.

Our Brazilian balance sheet is partially funded by third party liabilities where the provider assumes the transfer risk, which is discussed below, intercompany funding and local liabilities.

Included in Brazilian total assets of $10.4 billion and $12 billion at June 30, 2002 and December 31, 2001, respectively, are cross-border outstandings, which follow:

In billions	June 30, 2002	Dec. 31, 2001
Brazil:		
Trade-related claims	$3.8	$3.9
Other claims on third parties	1.6	1.8
Investment in and funding of local operation	2.3	2.7
Total cross-border outstandings	$7.7	$8.4
Cross-border risk mitigation:		
Insurance contracts	$1.0	$1.1
Other trade-related transfer risk mitigation	1.6	1.6
Third party funding		

	1.6	2.1
Guarantees, including trade-related of $.6	1.1	1.1
Total cross-border outstandings, net of cross-border risk mitigation	$2.4	$2.5

(a) Commencing at December 31, 2001, we changed our method of reporting cross-border outstandings to include amounts not required in regulatory reporting. If FFIEC guidelines were used for cross-border reporting, total cross-border outstandings would have been $4.9 billion and $5.1 billion at June 30, 2002 and December 31, 2001, respectively.

(b) Total cross-border outstandings to Brazil as a percentage of total consolidated assets were 4.1% at June 30, 2002 and December 31, 2001. (c) The sector percentage allocations for banks, public and private cross-border claims on third parties under FFIEC guidelines for Brazil were 20.9%, 15.5% and 63.6% at June 30, 2002 and 1.1%, 16.6% and 82.3% at December 31, 2001, respectively. (d) Cross-border commitments for Brazil at June 30, 2002 and December 31, 2001 were $80 million and $50 million, respectively. (e) Trade-related claims at June 30, 2002 and

December 31, 2001 include $1.7 billion funded by intercompany liabilities that are not reflected in investment in and funding of local operations.

Total cross-border outstandings decreased due to reductions in loans, available for sale securities and resale agreements. The decrease in total cross-border outstandings after cross-border risk mitigation is mostly offset by the decline in third party funding for transfer risk mitigation due to maturities, which were not renewed.

In addition, during the first half of 2002, the cross-border exposure on long-term trade and non-trade loans declined by approximately $170 million, which was offset by the increase in short-term trade loans.

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Our Brazilian operation actively uses various products to mitigate the cross-border risk related to its third party claims and intercompany funding. Cross-border risk mitigation related to the $7.7 billion of cross-border outstandings at June 30, 2002 amounted to $5.3 billion and is summarized below.

- $1 billion was covered by insurance contracts (see discussion in Argentina section for more information concerning these programs);
- $1.6 billion was related to transfer risk mitigation, all of which is trade-related and included in the $3.8 billion of trade-related claims in the table above. The cross-border risk mitigation is designed so that payment of these claims and intercompany funding is made outside of Brazil by third parties in the event of a cross-border risk event. The repayment is tied to trade transactions authorized and approved by the Brazilian central bank. In order to maintain our cross-border risk protection, it is necessary that the Brazilian export markets remain open;
- $1.6 billion of assets funded by third party liabilities where the provider assumes the transfer risk; these funds are typically raised from correspondent banks. Of the $1.6 billion, $500 million are trade-related. In these cases, the provider of funds assumes the risk of nonpayment if, at the time a payment is due on the funding, a cross-border risk event occurs due to government action. The provider of funds is contractually bound to either accept local currency in repayment or wait until the event ceases to exist to receive payment; and
- $1.1 billion represents loans with guarantees that cover credit and cross-border risk, of which $630 million are trade-related. The guarantees include a combination of guarantees from non-Brazilian domiciled companies, funded participations and other third party guarantees.

The third party funding and guarantees require us to perform certain actions to ensure our coverage under the various cross-border risk mitigation products.

In summary, our Brazilian trade-related exposure as of June 30, 2002 is as follows:

In billions	June 30, 2002
Assets with transfer-risk mitigation:	
Other transfer-risk mitigation	$1.6
Third party funding	.5
Guaranteed	.6
Assets with no transfer-risk mitigation:	
Short-term trade	.8
Long-term trade	.3
Total trade-related claims (refer to Brazil cross-border outstandings table)	$3.8

Mutual Funds

We acted as manager for approximately $5.4 billion of mutual funds in Brazil at June 30, 2002, which were invested primarily in Brazilian government securities.

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Brazilian Currency Position

Periodically, we establish currency positions in certain countries with the intention of taking advantage of expected movements in currency exchange rates. Currency positions expose us to gains or losses that depend on the relationship between currency price movements and interest rate differentials. The following table presents our Brazilian currency position.

	June 30, 2002		December 31, 2001	
In millions	Quarter-End	Daily Average	Quarter-End	Daily Average
Brazil [(a)(b)]	$(19)	$25	$(4)	$ 4

[(a)] Positive values reflect U.S. dollar assets funded by local currency liabilities (i.e., a long position in U.S. dollars).
[(b)] Negative values reflect local currency assets funded by U.S. dollars (i.e., a short position in U.S. dollars).

Although the local currency has devalued significantly versus the U.S. dollar during the first six months of 2002, our results of operations were not significantly impacted due to the modest positions held during this time.

The events in a country may have varying impacts on the different classes of assets based on the nature of the country risk event. A growing risk aversion environment in the international markets and the uncertainties associated with the October 2002 presidential elections have led to a gradual reduction in foreign capital inflows over the past few months. As a result, the Brazilian real has weakened, country risk premium has surged and local interest rates have increased. In August 2002, the Brazilian government succeeded in reaching a 15-month, $30 billion aid package from the International Monetary Fund, or IMF. As we discussed in the Country Risk section of Management s Discussion and Analysis included in our 2001 10-K, we consider the country risks when we establish internal risk limits. To date, our Brazilian operations have not been significantly impacted by the events in Argentina or the deterioration in economic conditions, although the increased risk has caused us to reduce our exposure to Brazil. We continue to closely monitor the situation in Argentina and the Brazilian economy and the potential impact it could have on our Brazilian operations.

Uruguay

The situations in Argentina and Brazil have also impacted the Uruguayan economy. The country is in the process of implementing new economic measures to address a loss of liquidity in the banking industry. In addition, the IMF and other multilateral organizations agreed in August 2002 to advance funding of $1.5 billion from their financial support package. Our Uruguayan assets and deposits declined by $100 million and $360 million, respectively, since December 31, 2001 to $700 million and $300 million, respectively, at June 30, 2002. The reduction in deposits has been replaced, in part, by an increase in intercompany borrowings. Currently, while our Uruguayan assets and deposits have declined further by $110 million and $70 million, respectively, since June 30, 2002, the rate of deposit outflows has stabilized. However, it is not possible to predict what additional effect, if any, the economic measures will have on our Uruguayan asset and deposit levels. We will continue to closely monitor developments in Uruguay and the other Latin American countries that we operate in and their potential impact on our Latin American operations.

Nonperforming Assets

In millions	June 30, 2002	March 31, 2002	Dec. 31, 2001
Domestic:			
Commercial and industrial			

	$1,561	$1,631	$1,363
Commercial real estate	68	59	63
Consumer	77	76	70
OREO	16	18	18
Total Domestic	$1,722	$1,784	$1,514
International:			
Commercial and industrial	$1,569	$160	$108
Commercial real estate	49	69	126
Consumer	84	47	87
Securities and OREO	467	10	14
Total International	$2,169	$286	$335
Total NPAs	$3,891	$2,070	$1,849

Throughout this 10-Q, including the table above, NPAs and related ratios do not include: (1) loans greater than 90 days past due and still accruing interest, and (2) assets held for sale by accelerated disposition, or AHAD, both of which we discuss later in this section.

NPAs at June 30, 2002 increased $1.8 billion compared to March 31, 2002, and $2 billion compared with December 31, 2001. The rise in NPAs was due primarily to an increase of $1.8 billion in Argentine nonperforming loans, or NPLs, as well as an increase in other nonperforming assets related to Argentina, specifically Argentine sovereign bonds. Most of this increase was done at management s discretion, as the underlying assets, in many instances, are currently performing. Excluding nonperforming assets related to Argentina ($2 billion at June 30, 2002, $202 million at March 31, 2002 and $263 million at December 31, 2001), NPAs increased $280 million from December 31, 2001 and were flat compared to March 31, 2002.

Total NPAs at June 30, 2002, as a percentage of related assets and as a percentage of total assets, were 3.33% and 2.04%, respectively, compared to 1.46% and .91%, respectively, at December 31, 2001. Excluding NPAs related to Argentina, NPAs as a percentage of related assets were 1.65% and 1.32% at June 30, 2002 and December 31, 2001, respectively.

Future levels of NPAs will be influenced by economic conditions, including the impact of those conditions on our customers, interest rates and other internal and external factors existing at the time.

Loans greater than 90 days past due and still accruing interest were $333 million, $380 million and $424 million at June 30, 2002, March 31, 2002 and December 31, 2001, respectively. Included in these 90 days past due and still accruing amounts were $174 million, $201 million and $282 million of consumer loans at June 30, 2002, March 31, 2002 and December 31, 2001, respectively.

At June 30, 2002 we had AHAD, which we classify as other assets in our consolidated balance sheet, with a net carrying value of $386 million, of which $310 million was not accruing interest. At December 31, 2001, the net carrying value of AHAD was $270 million, none of which was accruing interest. We make transfers to this category in accordance with our intention to focus appropriate resources on the quick disposition of these assets.

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Impaired Loans

We account for impaired loans in accordance with SFAS No. 114, Accounting by Creditors for Impairment of a Loan. Under the standard, once we have identified a loan as impaired, we measure impairment using discounted cash flows, observable market price or, in the case of collateral-dependent loans, the fair value of the collateral. When the recorded investment in an impaired loan exceeds the estimated fair value, we recognize such impairment as a valuation reserve, which we include as part of the overall reserve for credit losses.

The following table presents the status of impaired loans. Impaired loans, which are included in the NPA amounts disclosed above, are primarily commercial and commercial real estate loans on nonaccrual status.

In millions	June 30, 2002	Dec. 31, 2001
Impaired loans with a reserve	$2,044	$1,132
Impaired loans without a reserve	955	333
Total impaired loans	$2,999	$1,465
Reserve for impaired loans[a]	$1,172	$474
Quarterly average balance of impaired loans	$2,223	$1,398

[a] The reserve for impaired loans is part of our overall reserve for credit losses.

Reserve for Credit Losses Activity

Six months ended June 30 *Dollars in millions*	2002	2001
Balance at beginning of year	$3,634	$2,709
Loans charged off	(1,478)	(714)
Recoveries of loans charged off	111	125
Net charge-offs	(1,367)	(589)
Provision for credit losses	1,658	627
Other[a]	(58)	(1)

Balance at end of period	$3,867	$2,746
Ratios of net charge-offs to average loans	2.25%	.91%
Ratios of reserve for credit losses to period-end loans	3.33	2.15
Ratios of reserve for credit losses to period-end NPLs	113	202

(a) 2002 related to the devaluation of the peso in Argentina.

The reserve for credit losses to period-end loans was 3.33% at June 30, 2002, compared to 2.86% at December 31, 2001 and 2.15% at June 30, 2001. Excluding reserves related to Argentina of $1,156 million at June 30, 2002, $927 million at December 31, 2001, and $209 million at June 30, 2001, the reserve for credit losses to period-end loans was 2.40%, 2.25%, and 2.09%, respectively. The increase in Argentine reserves from December 31, 2001 to June 30, 2002 reflects an additional $300 million provision as a result of the continued deterioration of the Argentine economy. The reserve at June 30, 2002 allocated to Argentina included an ATRR required by banking regulators. You can read more detailed information about the ATRR in the Country Risk section of this discussion and analysis. On a consolidated basis, we currently anticipate continued high credit costs in 2002 in light of current economic conditions, though substantially less than the level incurred in the second quarter. Additional information about the reserve for credit losses is in the Reserve for Credit Losses section of Management s Discussion and Analysis included in our 2001 10-K.

Liquidity Risk Management

The objective of liquidity risk management is to ensure the ability of our parent company and its subsidiaries to meet their financial obligations, including the payment of deposits on demand or at their contractual maturity, the repayment of borrowings as they mature, the ability to fund new and existing loan and other funding commitments and the ability to take advantage of new business opportunities. You can obtain additional information about liquidity risk management, including sources of liquidity for our parent company and its banking and nonbanking subsidiaries, the risks posed by these sources of liquidity, and our contractual cash and other commercial and consumer commitments, in the Liquidity Risk Management section of Management s Discussion and Analysis and in Note 13 of the Notes to Consolidated Financial Statements contained in our 2001 10-K.

At June 30, 2002, our parent company had commercial paper outstanding of $945 million and short-term liquid assets of $3 billion, compared to $895 million and $3.1 billion, respectively, at December 31, 2001. The parent company manages its liquidity by maintaining short-term assets at an amount sufficient to meet payment of its short- and long-term debt maturities and net cash operating shortfall over a 12-month period. Short-term liquid assets include deposits placed by the parent company with its banking subsidiaries. Liquidity at the bank level is managed through the monitoring of anticipated changes in loans, core deposits and wholesale funds. The strength of the banking subsidiaries liquidity position is their base of core customer deposits. Liquidity may also be enhanced through the securitization of commercial and consumer receivables. During the second quarter of 2002, approximately $800 million of credit card receivables were securitized.

At June 30, 2002, our parent company had $2.3 billion available for the issuance of senior or subordinated

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debt securities and other debt securities, common stock, preferred stock or trust preferred securities, under a shelf registration statement filed with the SEC.

Based upon our parent company s level of excess funds and its ability to access the capital markets for additional funding when necessary, including its ability to issue debt and equity securities under its current shelf registration, we consider overall liquidity at June 30, 2002 sufficient to meet our current obligations to customers and debt holders, support expectations for future changes in asset and liability levels and carry on normal operations.

After the release of our second quarter 2002 financial results, Fitch Ratings lowered their ratings of FleetBoston debt, including a change in our parent company s long-term senior debt rating to A from A+ . In addition, Standard & Poor s Ratings Group affirmed their ratings of FleetBoston debt, including their rating of the parent company s long-term senior debt at its current level of A, but placed FleetBoston on negative outlook. We do not anticipate that these actions will have a material effect on FleetBoston s financial performance.

Market Risk Management

Market risk is defined as the sensitivity of income and capital to variations in interest rates, foreign exchange rates, equity prices, commodity prices and other market-driven rates or prices. We are exposed to market risk both in our trading activities and in our non-trading, or balance sheet management, activities. The market risk management processes for these activities apply to both balance sheet and off-balance sheet exposures. You can obtain additional information about market risk and market risk management policies in the Market Risk Management section of Management s Discussion and Analysis included in our 2001 10-K.

Trading Activities

Our trading activities create exposure to price risk, or the risk of loss in earnings arising from adverse changes in the value of trading portfolios of financial instruments. Exposure to price risk arises from market-making, dealing and position-taking in interest rate, equity, currency exchange rate and precious metals markets.

We use a value-at-risk, or VAR, methodology, based on industry-standard risk measurement techniques, to measure the overall price risk inherent in our trading activities. We more fully describe this methodology in the Trading Activities section of Management s Discussion and Analysis included in our 2001 10-K.

Under this methodology, aggregate VAR averaged $67 million daily for the six months ended June 30, 2002, an increase from the daily average for all of 2001. During this period, daily VAR ranged from a high of $107 million to a low of $28 million. At June 30, 2002, total VAR usage measured $105 million.

For the six months ended June 30, 2002, most of the price risk in our trading activities arose from foreign exchange trading activities, which increased to an average of $44 million, or 65% of aggregate average VAR. The majority of foreign exchange risk relates to our Argentine currency position, which reflects prevailing economic conditions and government measures implemented during the year. Additional information concerning this currency position appears in the Country Risk section of this discussion and analysis.

Risk from interest rate activities, which includes directional and spread components, for the six months ended June 30, 2002 averaged $18 million, or 27% of aggregate average VAR. Interest rate risk arises primarily from trading activity in various domestic fixed-income markets, the Brazilian sovereign and high-end corporate bond markets, and fixed-income markets in the Asia-Pacific region.

The contribution to VAR from equity trading activities for the first six months of 2002 decreased to an average of $5 million, or 8% of aggregate average VAR. The individual activities that generate most of these risks include our NYSE specialist firm, as well as NASDAQ market-making, equity trading and a convertible bond trading and underwriting business.

On a continuing operations basis, aggregate VAR averaged $61 million daily for the six months ended June 30, 2002. On this basis, daily VAR ranged from a high of $101 million to a low of $22 million. At June 30, 2002, total VAR usage measured $99 million. Foreign exchange activities generated about 72% of the aggregate average VAR, while smaller portions of the combined risk arose from interest rate (23%) and equities (5%) activities.

Our independent Market Risk Management function routinely validates our measurement framework by conducting backtests, which compare the actual daily trading-related results against the estimated VAR with a one-day holding period. In no instance during the first half of 2002 did a daily aggregate trading loss exceed the one-day aggregate VAR measure associated with that date.

For the six months ended June 30, 2002, daily trading-related revenues, which include certain components of capital markets revenue (trading profits and commissions, foreign exchange revenue and market-making revenue), as well as net interest income from these trading positions, ranged from a loss of $25.1 million to a profit of $19.8 million. For the 2001 period, those revenues ranged from a loss of $19.8 million to a profit of $22.1 million.

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Balance Sheet Management Activities

U.S. Dollar Denominated Risk Management

U.S. dollar denominated assets and liabilities comprise the majority of our balance sheet. Interest rate risk, defined as the exposure of net income and financial condition to adverse movements in interest rates, is by far the most significant non-trading market risk to which the U.S. dollar denominated positions are exposed, and this risk results almost entirely from our domestic operations. You can obtain additional information about our balance sheet management activities, including the sources of interest rate risk and how we manage such risk, in the Balance Sheet Management section of Management s Discussion and Analysis included in our 2001 10-K.

To measure interest rate risk, we perform net interest income simulation analysis, which involves projecting future net interest income from assets, liabilities, and derivative positions over a three-year horizon in various interest rate scenarios. In these analyses, we use the market s implied forecast for future interest rates as the base case. As of June 30, 2002, the market assumed that the Federal Reserve Board would keep short-term interest rates steady until near year-end, then begin pushing rates gradually higher. Estimated exposures relate to variances in the future path of interest rates from this base case.

The following table reflects the estimated exposure of net interest income for the next 12 months due to an immediate 200 basis point shift in the forecasted interest rates.

Rate Change (Basis Points)		*Estimated Exposure to Net Interest Income (In millions)*	
	June 30, 2002	March 31, 2002	Dec. 31, 2001
+200	$171	$109	$51
-200	(506)	(397)	(252)

We believe that the exposure of our net interest income to modest changes in interest rates is insignificant. It is important to note that, given the current low level of interest rates, this scenario implies a federal funds target interest rate near 0%.

Estimated net interest income exposure to a sudden and severe decline in interest rates is modestly higher at June 30, 2002 than at the prior quarter-end. This change is mainly a consequence of the lower level of intermediate and long-term interest rates on June 30, 2002. Starting from this lower level of rates, there is greater exposure to any further sharp decline in rates, related primarily to mortgage prepayments and core deposit pricing.

We also perform valuation analysis, which involves projecting future cash flows from assets, liabilities and derivative positions over a very long-term horizon, discounting those cash flows at selected interest rates considered appropriate in the circumstances, and then aggregating the discounted cash flows. The Economic Value of Equity, or EVE, is the estimated net present value of these discounted cash flows.

The following table reflects estimated EVE exposures assuming an immediate and prolonged shift in interest rates, which impact would be spread over a number of years. While an immediate shift in interest rates is used in this analysis to provide an estimate of exposure under an extremely adverse scenario, a gradual shift in interest rates would have a much more modest impact.

	Estimated Exposure to

Rate Change (Basis Points)	*Economic Value (In millions)*		
	June 30, 2002	March 31, 2002	Dec. 31, 2001
+200	$487	$137	$860
+100	508	274	696
-100	(765)	(522)	(738)
-200	(1,704)	(1,171)	(1,673)

Estimated EVE exposure to a sharp decline in interest rates is greater at June 30, 2002 than at March 31, 2002. This change mainly reflects the lower level of interest rates at June 30, 2002. Starting from this lower level of rates, any further sharp decline in rates would increase mortgage prepayments and reduce the value of core deposits.

Non-U.S. Dollar Denominated Risk Management

Our non-U.S. dollar denominated assets and liabilities are exposed to interest rate and foreign exchange rate risks. The majority of the non-U.S. dollar denominated interest rate and foreign exchange rate risk exposure stems from our operations in Latin America, primarily Argentina and Brazil. Historically, our exposure to non-trading interest rate risk in our Latin American operations has not been significant, and at June 30, 2002, this risk continued to be insignificant outside Argentina. Within Argentina, the ongoing political and economic instability has increased several risks, including sovereign, cross-border, credit, currency, and interest rate risks, which have all become highly interrelated. Until the Argentine crisis is resolved, the ultimate balances, currency denomination, repricing dynamics and maturity structure of certain assets and liabilities will remain uncertain, making it difficult to estimate precisely the amount of interest rate risk in that country. Exposure to non-trading foreign exchange rate risk in Latin American operations is managed using a VAR methodology, which we discuss more fully in the Trading Activities section of this discussion and analysis. You can obtain additional information about our interest rate and foreign exchange rate risks associated with our operations in Argentina in the Country Risk section of this discussion and analysis, and in our 2001 10-K.

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Risk Management Instruments

June 30, 2002 *Dollars in millions*	Notional Value	Weighted Average Maturity (Years)	Fair Value	Weighted Average Rate Receive	Weighted Average Rate Pay
Domestic interest rate risk management instruments					
Interest rate swaps:					
Receive fixed/pay variable hedging:					
variable-rate loans	$16,410				
fixed-rate deposits	290				
short-term debt	15				
long-term debt	1,384				
	18,099	3.7	$472	5.16%	1.99%
Pay fixed/receive variable hedging long-term debt	3,930	4.6	(23)	1.81	4.65
Options hedging variable-rate loans	5,000	.5	18		
Total domestic interest rate risk management instruments	27,029	3.3	467	4.56	2.47
International interest rate risk management instruments					
Interest rate swaps hedging foreign currency denominated variable-rate deposits	2	.3			
Interest rate futures hedging foreign currency denominated variable-rate resale agreements	60	1.7			

Total international interest rate risk management instruments
62 1.6

Total hedges of net interest income
$27,091 3.2 $467 4.56% 2.47%

International credit risk management instruments

Credit derivatives hedging variable-rate loans
392 2.5 12

Total hedges of credit risk
$392 2.5 $12

Foreign exchange risk management instruments[(a)]

Swaps hedging:

foreign currency denominated repurchase and resale agreements
$480 1.5 $10
foreign currency denominated short-term debt
70