

Financial Review

INTRODUCTION

The financial section of the American Express Company's Annual Report consists of this Financial Review, the Consolidated Financial Statements that follow and the related notes. This introduction is designed to provide some perspective regarding the information contained in the financial section.

Business Operations

American Express Company (the company) is primarily engaged in the business of providing travel related services, financial advisory services and international banking services throughout the world. The company generates revenue from a variety of sources including global payments such as charge and credit cards; travel services including airline, hotel and rental car reservations; and a wide range of retail financial service products.

Financial Reporting

The company follows accounting principles generally accepted in the United States (GAAP). In addition to information provided on a GAAP basis, the company discloses certain data on a "managed basis." These data, which should be read only as a supplement to GAAP information, assume there have been no securitization transactions, i.e., as if all securitized cardmember loans and related income effects are reflected in the company's balance sheet and income statement. See Travel Related Services' and American Express Financial Advisors' Results of Operations sections for further discussion of and reasons for this approach.

Organization of Information

- | This Financial Review section (pages 26 to 53) is designed to provide the reader of the financial statements with a narrative on the company's financial results. It discusses the results of operations and liquidity and capital resources on a consolidated basis and for each segment of the business.
- | The Consolidated Financial Statements (pages 54 through 57) include the company's income and cash flow performance and its financial position.
- | The Notes to the Consolidated Financial Statements (pages 58 to 84) contain the company's accounting policies (pages 58 through 63), detailed information on balances within the financial statements, certain contingencies and commitments (pages 72 and 73), and the results of each of the company's segments (page 81).
- | The Report of Management (page 85) describes management's responsibilities regarding the company's financial statements.
- | The Report of Independent Auditors (page 86) contains the opinion of Ernst & Young LLP regarding the company's financial statements.

CONSOLIDATED RESULTS OF OPERATIONS

The company's 2002 financial results reflect solid growth in the company's card businesses, lower expenses due to the success of ongoing reengineering programs, strong credit quality and the benefits of lower funding costs.

The company reported 2002 net income and diluted earnings per share (EPS) of \$2.67 billion and \$2.01, respectively, up significantly from \$1.31 billion and \$0.98, respectively, in 2001, which were both 53 percent lower than 2000. The 2001 results included restructuring charges of \$631 million (\$411 million after-tax), \$98 million (\$65 million after-tax) of one-time costs and waived customer fees resulting from the September 11th terrorist attacks, and a charge of \$1.01 billion (\$669 million after-tax) reflecting losses in the high-yield portfolio at American Express Financial Advisors (AEFA).

On a trailing 12-month basis, return on average shareholders' equity was 20.6 percent.

The following discussion is presented on a basis consistent with GAAP unless otherwise noted.

Consolidated revenues were \$23.8 billion, up 5 percent from \$22.6 billion in 2001 reflecting 2 percent growth at Travel Related Services (TRS), 17 percent growth at AEFA and 15 percent growth at American Express Bank (AEB). 2001 revenues were 5 percent lower than 2000. As discussed in further detail below, the increase in 2002 was due primarily to higher discount

and lending net finance charge revenue from greater spending and borrowing on American Express cards, higher interest and dividends primarily from the investment portfolio of AEFA, higher income from securitization activities at TRS, as well as higher card fee revenue. These increases were partially offset by lower management fees, weaker travel revenues and reduced other revenues. 2001 consolidated revenues declined due to lower interest and dividends on AEFA's investment portfolio, which reflect the investment losses mentioned earlier, weaker travel revenues and lower management and distribution fees.

Discount revenue rose 3 percent during 2002 as a result of a 4 percent increase in billed business partially offset by a lower discount rate. Discount revenue fell 1 percent in 2001 as a slight increase in billed business was more than offset by a lower discount rate.

Interest and dividends increased 40 percent over 2001, which was 35 percent lower than 2000. The increase in 2002 and the decrease in 2001 are both primarily due to AEFA's \$1.01 billion of investment losses during 2001 mentioned previously.

Management and distribution fees declined 7 percent in 2002 due to lower average assets under management, partially offset by higher distribution fees. The distribution fee increase is the result of lower mutual fund sales being more than offset by other product related sales increases. In 2001, management and distribution fees declined 13 percent due to lower average assets under management and weaker sales, particularly in mutual fund products, reflecting the negative impact of weak equity market conditions throughout the year.

Income from securitizations at TRS rose 35 percent in 2002 and 42 percent in 2001 primarily driven by a higher average balance of cardmember lending securitizations as well as higher portfolio yields.

Net card fees increased slightly in 2002 and 2001, reflecting the growth in cards-in-force in both years. The average fee per card remained at \$34 in both 2002 and 2001, down from \$36 in 2000, reflecting the mix shift toward lower and no fee products.

Cardmember lending net finance charge revenue at TRS grew 4 percent during 2002 primarily due to improved spreads reflecting the benefits of improved funding costs coupled with an overall decrease in the proportion of the portfolio on introductory rates. In 2001, cardmember lending net finance charge revenue at TRS rose 14 percent from higher worldwide lending balances and wider net interest margins.

Travel commissions and fees declined 8 percent in 2002 as a result of a 10 percent contraction in travel sales reflecting the weaker corporate travel environment throughout the year. Travel commissions and fees declined 16 percent in 2001 as a result of a 24 percent contraction in travel sales due to the effects of the September 11th terrorist attacks and the weaker corporate travel environment.

All other revenues decreased 4 percent in 2002, including a 10 percent decrease at TRS, versus a 4 percent increase in 2001, including a 1 percent decrease at TRS. The decrease in 2002 included significantly lower interest income on investments held within card funding vehicles partially offset by higher insurance related revenues. The 2001 increase was primarily driven by higher insurance related revenues.

Consolidated expenses decreased 4 percent in 2002 reflecting a 5 percent decrease at TRS, a 1 percent decrease at AEFA and a 6 percent decrease at AEB. These declines were due to lower funding costs, a decline in human resources expense, reduced provisions for losses and benefits and the benefits of reengineering activities and expense control initiatives. Consolidated expenses increased 6 percent in 2001 primarily due to larger provisions for losses and benefits and the impact of the restructuring charges and one-time costs and waived customer fees noted previously.

Human resources expense declined in both 2002 and 2001 primarily as a result of a 15 percent reduction in the number of employees since the beginning of 2001 and the benefit of reengineering activities over the past two years, including the impact of a technology outsourcing agreement which had the effect of moving certain technology related costs from human resources expense to professional services expense.

Total provisions for losses and benefits declined 3 percent in 2002, resulting from a 20 percent reduction in the charge card provision at TRS due to strong credit quality, reflected in an improved past due rate and net loss ratio, and an 8 percent reduction in provision for losses and benefits on annuities and investment certificates, primarily due to lower crediting rates on the investment certificate product. These decreases were partially offset by a 14 percent increase in life insurance,

international banking and other provisions and a 4 percent increase in cardmember lending provisions at TRS. Total provisions for losses and benefits in 2001 increased 20 percent primarily due to a 48 percent increase in the cardmember lending provision at TRS, which was largely the result of portfolio growth and maturation; a 31 percent increase in life insurance, international banking and other provisions; and a 19 percent increase in charge card provisions at TRS, primarily due to higher volumes and generally weaker economic and business conditions.

Professional services expense rose 22 percent and 8 percent during 2002 and 2001, respectively. The increase in 2002 is primarily the result of the technology outsourcing agreement discussed earlier.

Marketing and promotion expense increased 19 percent in 2002 primarily due to an 18 percent increase at TRS relating to the launch of the new brand advertising campaign and the introduction of new card products. In 2001, marketing and promotion expense declined 14 percent, primarily due to a similar 14 percent decrease at TRS, as certain marketing efforts were rationalized in light of the weaker business environment.

Occupancy expense decreased 7 percent in 2002 primarily due to the benefits of reengineering activities. Occupancy expense increased slightly in 2001 versus 2000.

Interest expense declined 28 percent in 2002 including a 31 percent decrease in charge card interest expense at TRS primarily due to the benefit of a lower effective cost of funds. Interest expense increased 11 percent in 2001 including a 20 percent increase at TRS primarily as a result of higher borrowing rates.

Other expenses rose 16 percent in 2002 including a 20 percent increase at TRS, while 2001 expenses were relatively unchanged from 2000 levels. The increases in 2002 resulted primarily from higher expenses related to cardmember loyalty programs, losses on certain strategic investments versus gains in the prior year, and increases in deferred acquisition costs (DAC) related expenses, including a \$44 million net increase in DAC expenses in the third quarter of 2002 as a result of a comprehensive review of the company's DAC related practices. See AEFA's Results of Operations for further discussion of DAC.

In the third and fourth quarters of 2001, the company recorded aggregate restructuring charges of \$631 million (\$411 million after-tax). The aggregate restructuring charges consisted of \$369 million for severance related to the original plans to eliminate approximately 12,900 jobs and \$262 million of exit costs primarily consisting of \$138 million of charges related to consolidation of real estate facilities, \$35 million of asset impairment charges, \$26 million in loss provisions, \$25 million in contract termination costs and \$24 million of currency translation losses.

During 2002, the company adjusted the 2001 restructuring charges by taking back into income a net pretax amount of \$31 million which is comprised of the reversal of severance and related benefits of \$62 million partially offset by additional net exit costs related to various office facilities of \$31 million. Additionally, during 2002, the company recorded restructuring charges of \$24 million, of which \$19 million was recorded at TRS and \$5 million was recorded at AEB. These new charges primarily relate to certain international operations and consist of \$17 million of severance and related benefits and \$7 million of other exit costs. See Note 19 to the Consolidated Financial Statements for further information.

The estimated savings realized from restructuring initiatives during 2002 was approximately \$0.6 billion. Further, the company expects the savings for 2003 to be approximately \$0.7 billion, a portion of which will flow through to earnings in the form of improved operating expense margins. The rest is expected to be reinvested into business areas with high-growth potential.

In the third quarter of 2001, the company incurred \$98 million (\$65 million after-tax) of one-time costs and business interruption losses related to the September 11th terrorist attacks. These losses included provisions for credit exposures to travel industry service establishments and insurance claims, as well as approximately \$8 million of waived finance charges and late fees. Further, during 2002, \$7 million (\$4 million after-tax) of this amount was reversed as a result of lower than anticipated insured loss claims. As of December 31, 2002, the company incurred total expenditures of approximately \$198 million related to the terrorist attacks of September 11th, which are expected to be substantially covered by insurance and, consequently, did not impact results.

Effective January 1, 2002, the company adopted Statement of Financial Accounting Standards (SFAS) No. 142 “Goodwill and Other Intangible Assets,” which established new accounting and reporting standards for goodwill and other intangible assets. Under the new rules, goodwill and other intangible assets deemed to have indefinite lives are no longer amortized but are instead subject to annual impairment tests. Management completed goodwill impairment tests as of the date of initial adoption and again during 2002. Such tests did not indicate impairment.

The following table presents the impact to net income and EPS of goodwill amortization for the year ended December 31, 2001:

(Millions, except per share amounts)	Net Income	Basic EPS	Diluted EPS
Reported	\$ 1,311	\$ 0.99	\$ 0.98
Add back: Goodwill amortization (after-tax)	\$ 82	\$ 0.06	\$ 0.06
Adjusted	\$ 1,393	\$ 1.05	\$ 1.04

Looking forward in 2003, the company expects continued uncertainty in the economy and financial markets. In addition, the prospect of war and other geopolitical uncertainty could have a negative impact on the economy, consumer confidence and the company’s results.

Certain Critical Accounting Policies

The company’s significant accounting policies are described in Note 1 to the Consolidated Financial Statements. The following provides information about certain critical accounting policies that are important to the Consolidated Financial Statements and that involve estimates requiring significant management assumptions and judgments about the effect of matters that are uncertain. These policies relate to reserves for cardmember credit losses, Membership Rewards costs, investment securities valuation and deferred acquisition costs.

Provisions for credit losses

Provisions for credit losses related to cardmember loans and receivables is one of the largest operating expenses of the company. The company’s reserves for credit losses represent management’s estimate of the amount necessary to absorb future credit losses inherent in the company’s outstanding portfolio of loans and receivables. Management’s evaluation process requires numerous estimates and judgments. Reserves for these credit losses are primarily based upon models which analyze portfolio statistics and management’s judgment. The analytic models take into account numerous factors, including average write-off rates for various stages of receivable aging (i.e., current, 30 days, 60 days, 90 days) over a 24-month period, average bankruptcy rates and average recovery rates. In exercising its judgment in setting reserve levels, management considers levels derived from these models and external indicators, such as leading economic indicators, unemployment rate, consumer confidence index, purchasing manager’s index, bankruptcy filings and the regulatory environment. Loans are charged-off when management deems amounts to be uncollectible, which is generally determined by the number of days the amount is past due. To the extent historical credit experience is not indicative of future performance or other assumptions used by management do not prevail, loss experience could differ significantly, resulting in either higher or lower future provisions for credit losses, as applicable.

Membership Rewards costs

The company’s Membership Rewards loyalty program allows enrolled cardmembers to earn points that can be redeemed for a broad range of travel rewards, retail merchandise and gourmet gifts. The company makes payments to its reward partners when cardmembers redeem their points and establishes reserves to cover the cost of future reward redemptions. The provision for the cost of Membership Rewards is based upon points awarded which are ultimately expected to be redeemed by cardmembers and the current weighted average cost per point of redemption. The ultimate points to be redeemed are estimated based on many factors, including a review of past behavior of cardmembers segmented by product, year of enrollment in the program, spend level and duration in the program. Past behavior is used to predict when current enrollees will attrite and their ultimate redemption rate. In addition, the cumulative balance sheet liability for unredeemed points is adjusted over time based on actual redemption and cost experience as well as current trends with respect to redemptions. To the extent that the estimates differ from actual experience, the company’s future Membership Rewards program cost could be higher or lower, as applicable.

Investment securities valuation

Generally, investment securities are carried at fair value on the balance sheet with unrealized gains (losses) recorded in equity, net of income tax provisions (benefits). Gains and losses are recognized in the results of operations upon disposition of the securities. In addition, losses are also recognized when management determines that a decline in value is other-than-temporary, which requires judgment regarding the amount and timing of recovery. Indicators of other-than-temporary impairment for debt securities include issuer downgrade, default or bankruptcy. The company also considers the extent to which cost exceeds fair value, the duration of time of that decline, and management's judgment about the issuer's current and prospective financial condition. Fair value is generally based on quoted market prices. However, the company's investment portfolio also contains structured investments of various asset quality, including collateralized debt obligations (CDOs) and secured loan trusts (backed by high-yield bonds and bank loans), which are not readily marketable. As a result, the carrying values of these structured investments are based on cash flow projections which require a significant degree of management judgment as to default and recovery rates of the underlying investments and, as such, are subject to change. If actual future cash flows are less than projected, additional losses would be realized.

Deferred acquisition costs

AEFA's DAC represent the costs of acquiring new business, principally direct sales commissions and other distribution and underwriting costs, that have been deferred on the sale of annuity, insurance and certain mutual fund products. For annuity and insurance products, DAC are amortized over periods approximating the lives of the business, generally as a percentage of premiums or estimated gross profits or as a portion of the interest margins associated with the products. For certain mutual fund products, DAC are generally amortized over fixed periods on a straight-line basis.

For annuity and insurance products, the projections underlying the amortization of DAC require the use of certain assumptions, including interest margins, mortality rates, persistency rates, maintenance expense levels and customer asset value growth rates for variable products. Management routinely monitors a wide variety of trends in the business, including comparisons of actual and assumed experience. Management reviews and, where appropriate, adjusts its assumptions with respect to customer asset value growth rates on a quarterly basis. Management monitors other principal DAC assumptions, such as persistency, mortality rate, interest margin and maintenance expense level assumptions, each quarter. Unless management identifies a material deviation over the course of the quarterly monitoring, management reviews and updates these DAC assumptions annually in the third quarter of each year. When assumptions are changed, the percentage of estimated gross profits or portion of interest margins used to amortize DAC may also change. A change in the required amortization percentage is applied retrospectively; an increase in amortization percentage will result in an acceleration of DAC amortization while a decrease in amortization percentage will result in a deceleration of DAC amortization. The impact on results of operations of changing assumptions with respect to the amortization of DAC can be either positive or negative in any particular period, and is reflected in the period in which such changes are made.

CONSOLIDATED LIQUIDITY AND CAPITAL RESOURCES

The company believes allocating capital to its growing businesses with a return on risk-adjusted equity in excess of their cost of capital will continue to build shareholder value. The company's philosophy is to retain earnings sufficient to enable it to meet its growth objectives, and, to the extent capital exceeds investment opportunities, return excess capital to shareholders. The company has indicated that, assuming it achieves its financial objectives of 12-to-15% EPS growth, 18-to-20% return on equity growth and 8% revenue growth, on average and over time, it will seek to return an average of 65 percent of capital generated each year to shareholders.

Liquidity refers to the company's ability to meet its current and future cash needs primarily by issuing debt and securitizing receivables and, to a lesser extent, by selling investments. In addition, the company maintains committed back-up lines of credit. The company's liquidity is managed by its Treasury department. Additionally, the company's liquidity needs are reviewed on an ongoing basis including analyses of severe stress scenarios.

Share Repurchases

The company has in place a share repurchase program both to offset in whole or in part the issuance of new shares as part of employee compensation plans and to reduce shares outstanding. In June 2002, the company announced that it had resumed its share repurchase program after suspending it at the end of the second quarter of 2001 due to the negative effect on book equity of the 2001 high-yield portfolio losses at AEFA.

The company repurchases its common shares primarily by open market purchases using several brokers at competitive commission and fee rates. In addition, common shares may also be purchased from the company-sponsored Incentive Savings Program (ISP) to facilitate the ISP's required disposal of shares when employee-directed activity results in an excess common share position. Such purchases are made at market price without commissions or other fees. Repurchases may also be accomplished by prepayments for cash under the company's agreements with third parties, which are described below. During 2002, the company repurchased 33 million common shares at an average price of \$35. Since the inception of the share repurchase program in September 1994, 390 million shares have been acquired under authorizations to repurchase up to 570 million shares, including purchases made under the agreements with third parties. Included in the 2002 repurchase amount are 17 million shares delivered to the company as part of the prepayments discussed below.

In August 1999 and March 2000, the company entered into agreements under which a financial institution purchased an aggregate 29.5 million of the company's common shares at an average purchase price of \$50.41 per share. These agreements were entered into to partially offset the company's exposure to the effect on diluted earnings per share of outstanding in-the-money stock options issued under the company's stock option program. Each of the agreements terminates after five years, at which time the company is required to deliver an amount equal to the original purchase price for the shares. The company may elect to settle this amount at any time (i) physically, by paying cash against delivery of the shares held by the financial institution or (ii) on a net cash or net share basis. During the term of these agreements, the company, on a monthly basis, will either receive from or issue to the financial institution a quantity of shares so that the value of the remaining shares held by the financial institution is equal to the original aggregate purchase price.

The contracts were initially recorded at their fair value within equity on the company's balance sheet in accordance with Emerging Issues Task Force (EITF) Issue 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." Subsequent activity is recorded in equity as long as the contracts continue to meet the requirements of EITF Issue 00-19. Net settlements under the agreements resulted in the company issuing 0.4 million shares and 12.3 million shares in 2002 and 2001, respectively. The company has the right to terminate these agreements at any time upon full settlement. The company may prepay outstanding amounts at any time prior to the end of the five-year term, and from time to time, may make such prepayments in lieu of, or in addition to, its share repurchase program, which either separately or together would be expected to have the same effect on outstanding shares as a purchase under the share repurchase program. In 2002 and 2001, the company elected to prepay \$600 million and \$350 million, respectively, of the aggregate outstanding amount. At December 31, 2002, 15.3 million shares of the company's common stock continued to be held by the financial institution in support of the remaining balance of approximately \$535 million.

To the extent that the price of the company's common stock declines to levels substantially lower than current levels for a sustained period of time, there could be an adverse impact on basic and diluted earnings per share. The maximum number of company common shares that could potentially be distributed pursuant to these agreements would not exceed 62 million shares as adjusted for shares delivered by the company and shares delivered to the company.

Off-Balance Sheet Arrangements and Certain Contractual Obligations

The company's off-balance sheet arrangements and contractual obligations include:

Related to Structured Investments

- \$17.1 billion of securitized U.S. cardmember and equipment lease receivables described further in Note 4 of the Consolidated Financial Statements.
- \$1.5 billion of book value relating to certain structured investments, including collateralized debt obligations and secured loan trusts, which are both managed and partially owned by the company, described further in Note 2 to the Consolidated Financial Statements. These structured investments may be considered variable interest entities under Financial Accounting Standards Board (FASB) Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46), as discussed in Note 1 of the Consolidated Financial Statements. See also AEFA Results of Operations section.

Other Off-Balance Sheet Items and Guarantees

- \$126 billion of unused credit available to cardmembers, as part of established lending product agreements. Total unused credit available to cardmembers does not represent potential future cash requirements as a significant portion of this unused credit may not be drawn. The company's charge card products have no pre-set spending limit and, therefore, are not reflected herein.
- \$3.8 billion of committed payments for worldwide business arrangements, principally related to TRS.
- \$2.4 billion of minimum aggregate rental commitments under all noncancellable operating leases (net of subleases); \$0.3 billion in less than one year, \$0.6 billion in one through three years, and the remainder thereafter.
- \$1.0 billion of loan commitments and other lines of credit, nearly all of which matures in less than one year.
- \$1.4 billion of bank standby letters of credit and bank guarantees and commercial and other letters of credit, \$1.2 billion maturing in less than one year, the remainder maturing in one to three years. \$0.9 billion is within the scope of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), and therefore is included in Note 11 to the Consolidated Financial Statements. At December 31, 2002, the company held \$684 million and \$148 million of collateral supporting standby letters of credit and guarantees, and commercial and other letters of credit, respectively.
- \$86 billion related to TRS cardmember protection plans, as well as other guarantees in the ordinary course of business that are within the scope of FIN 45, and therefore included in Note 11 to the Consolidated Financial Statements. Expenses relating to claims under these guarantees did not exceed \$60 million in 2002.

Long-term Debt

- \$16.3 billion of long-term debt, \$8.4 billion maturing in less than one year, \$7.1 billion maturing in one through three years, and the remainder maturing thereafter.

In addition to the items that are listed above, the company has entered into other contracts in the normal course of business that involve potential future cash payments, which are either required or contingent upon the occurrence of certain events. Management believes payments under these contracts will not have a material adverse impact on liquidity.

Financing Activities

The company's most significant borrowing and liquidity needs are associated with TRS' card businesses. TRS pays merchants for card transactions and bills cardmembers accordingly. TRS funds merchant payments during the period cardmember loans and receivables are outstanding. See TRS' Liquidity and Capital Resources section for further discussion regarding TRS' specific financing activities, including the owned receivable portfolio. AEFA's borrowing needs are less significant as its funds are generated through operations, primarily by the sale of insurance, annuity, or certificate products. AEB's principal funding source is customer deposits. It could experience a tightening of liquidity if customer deposits were withdrawn to the extent that loans, which are generally not readily marketable, would have to be liquidated. Such a tightening, which is not expected to occur, could be funded, among other means, by the sale of investment securities.

The company's credit ratings are critical to maintaining short-term funding sources and determining related interest costs. Rating agencies review factors such as capital adequacy, liquidity, business volumes, asset quality and economic market trends, among others, in assessing the company's appropriate ratings. See Risk Management section below for a discussion of the potential effects of a rating downgrade.

The company maintains sufficient equity capital to support its businesses. Discretion is maintained to shift capital among business units as appropriate. For example, the company may infuse additional capital into subsidiaries to maintain capital at targeted levels, which include consideration of debt ratings and regulatory requirements. These infused amounts can affect both Parent Company capital and liquidity levels. The company maintains flexibility to manage these effects, including the issuance of public debt or the reduction of projected common share buybacks. Additionally, the company may transfer short-term funds within the company to meet liquidity needs, subject to and in compliance with various contractual and regulatory constraints.

The Parent Company generally funds shareholder dividends and other general corporate financing needs through an intercompany dividend policy. The Board of Directors has authorized a Parent Company commercial paper program supported by a \$1 billion multi-purpose credit facility that expires in increments through 2007. There was no Parent Company commercial paper outstanding during 2002 or 2001, and no borrowings have been made under this credit facility.

Total Parent Company long-term debt outstanding was \$2.7 billion and \$2.1 billion at December 31, 2002 and 2001, respectively. During 2002, the Parent Company issued \$750 million of 3.75% notes due 2007, using the proceeds for general corporate purposes. At December 31, 2002 and 2001, the Parent Company had \$2.8 billion and \$3.6 billion, respectively, of debt or equity securities available for issuance under shelf registrations filed with the Securities and Exchange Commission (SEC).

The company maintained committed back-up lines of credit totaling \$11.5 billion (including the \$1.0 billion at the Parent Company mentioned earlier) at December 31, 2002. The availability of the credit lines is subject to the company's compliance with certain financial covenants, including the maintenance by the company of consolidated tangible net worth of at least \$775 billion, the maintenance by American Express Credit Corporation (Credco), a wholly-owned subsidiary of TRS, of a 1.25 ratio of combined earnings and fixed charges to fixed charges, and the compliance by American Express Centurion Bank (Centurion Bank), a wholly-owned subsidiary of TRS, with applicable regulatory capital adequacy guidelines. At December 31, 2002, the company's consolidated tangible net worth was approximately \$12 billion, Credco's ratio of combined earnings and fixed charges to fixed charges was 1.38 and Centurion Bank exceeded the Federal Deposit Insurance Corporation's "well capitalized" regulatory capital adequacy guidelines.

In addition, TRS, Centurion Bank, Credco, American Express Overseas Credit Corporation Limited, a wholly-owned subsidiary of Credco, and AEB have established programs for the issuance, outside the United States, of debt instruments to be listed on the Luxembourg Stock Exchange. The maximum aggregate principal amount of debt instruments outstanding at any one time under the program will not exceed \$6.0 billion. At December 31, 2002 and 2001, \$0.5 billion and \$1.3 billion of debt, respectively, was outstanding under this program.

Risk Management

The company's risk management objective is to monitor and control risk exposures to earn returns commensurate with the appropriate level of risk assumed. Management establishes and oversees implementation of Board-approved policies covering the company's funding, investments and the use of derivative financial instruments. The company's Treasury department, along with various asset and liability committees in its business segments, is responsible for managing financial market risk exposures within the context of Board-approved policies. See Note 9 to the Consolidated Financial Statements for a discussion of the company's use of derivatives.

The Corporate Risk Management Committee (CRMC) supplements the risk management capabilities resident within the business segments by routinely reviewing key financial market, credit, operational and other risk concentrations across the company and recommending action where appropriate. The CRMC promotes a rigorous understanding of risks across the company and supports senior management in making risk-return decisions.

Hedging strategies for financial market risk exposures are established, maintained and monitored by the company's Treasury department. A variety of strategies and instruments are employed to manage interest rate, foreign currency and equity market

exposures. The extent of the company's unhedged exposures varies over time based on current foreign exchange and interest rates, equity market levels, the macro-economic environment and the hedging impact on particular business objectives.

Management considers the risk of liquidity and cost of funds from the company's financing activities. Management believes a decline in the company's long-term credit rating by two levels could result in the company having to significantly reduce its commercial paper and other short-term borrowings and replace them, in part, by drawing on existing credit lines. Remaining borrowing requirements would be addressed through other means such as additional securitizations, increased deposit taking and the sale of investment securities. This would result in higher interest expense on the company's commercial paper and other debt, as well as higher fees related to unused lines of credit. The company believes a two level downgrade is unlikely due to its capital position and growth prospects.

The company's foreign exchange exposures arise primarily from cross-currency charges made by cardmembers, as well as from cash flow and balance sheet exposures denominated in foreign currencies. The company primarily uses spot and forward foreign exchange contracts to manage the cross border transaction exposures resulting from cardmember cross border spending in which the merchant transaction currency differs from the billing currency.

In addition, the company funds a portion of its local currency operations by raising U.S. dollar funding and converting U.S. dollars to local currency through foreign exchange derivative contracts. These foreign exchange instruments are sometimes combined with interest rate swaps to achieve the desired level of local market interest rate risk. Finally, the U.S. dollar value of anticipated future earnings in foreign currencies is economically managed from time to time using foreign exchange forward contracts.

The company also uses master netting agreements which allow the company to settle multiple contracts with a single counterparty in one net receipt or payment in the event of counterparty default.

The risk management sections for each segment include sensitivity analyses of different types of market risk and estimate the effects of hypothetical sudden and sustained changes in the applicable market conditions on the ensuing year's earnings, based on year-end positions. The market changes, assumed to occur as of year-end, are a 100 basis point increase in market interest rates, a 10 percent strengthening of the U.S. dollar versus all other currencies, and a 10 percent decline in the value of equity securities under management at AEFA. Computations of the prospective effects of hypothetical interest rate, foreign exchange rate and equity market changes are based on numerous assumptions, including relative levels of market interest rates, foreign exchange rates and equity prices, as well as the levels of assets and liabilities. The hypothetical changes and assumptions will be different from what actually occurs in the future. Furthermore, the computations do not incorporate actions that management could take if the hypothetical market changes actually occur. As a result, actual earnings consequences will differ from those quantified.

SUPPLEMENTAL INFORMATION — MANAGED NET REVENUES

The following supplemental information is presented on the basis used by management to evaluate operations. It differs in two respects from the accompanying financial statements, which are prepared in accordance with GAAP. First, revenues are presented as if there had been no asset securitizations at TRS. This format is generally termed on a managed basis, as further discussed in the TRS section of the Financial Review. Second, revenues are considered net of AEFA's provisions for losses and benefits for annuities, insurance and investment certificate products, which are essentially spread businesses, as further discussed in the AEFA section of the Financial Review. A reconciliation of consolidated revenues from a GAAP to a net managed basis is as follows:

Years Ended December 31, (Millions)	2002	2001	2000
GAAP revenues	\$ 23,807	\$ 22,582	\$ 23,675
Effect of TRS securitizations	948	743	321
Effect of AEFA provisions for losses and benefits	(1,954)	(1,966)	(1,911)
Managed net revenues	\$ 22,801	\$ 21,359	\$ 22,085

Managed net revenues increased 7 percent in 2002 to \$22.8 billion, compared with \$21.4 billion in 2001 which was 3 percent lower than 2000. Managed net revenues rose in 2002 due to greater discount revenues, higher lending spreads and loan balances, and higher revenues related to AEFA's investment portfolio. These items were partially offset by lower management fees and weaker travel revenues. 2001 net revenues declined due to lower spreads on AEFA's investment portfolio, weaker travel revenues as well as lower management and distribution fees. These items were partially offset by an increase in cards-in-force, larger loan balances and greater insurance revenues.

See TRS and AEFA segments for a discussion of why a managed basis presentation at TRS and net revenues at AEFA is used by management and is important to investors.

TRAVEL RELATED SERVICES

Results of Operations

STATEMENTS OF INCOME

Years Ended December 31, (Millions)	2002	2001	2000
Net revenues:			
Discount revenue	\$ 7,931	\$ 7,714	\$ 7,779
Net card fees	1,726	1,675	1,651
Lending:			
Finance charge revenue	1,995	2,363	2,280
Interest expense	510	939	1,025
Net finance charge revenue	1,485	1,424	1,255
Travel commissions and fees	1,408	1,537	1,821
Travelers Cheque investment income	375	394	387
Securitization income	1,941	1,432	1,012
Other revenues	2,855	3,183	3,215
Total net revenues	17,721	17,359	17,120
Expenses:			
Marketing and promotion	1,456	1,237	1,434
Provision for losses and claims:			
Charge card	960	1,195	1,006
Lending	1,369	1,318	891
Other	149	164	105
Total	2,478	2,677	2,002
Charge card interest expense	1,001	1,443	1,202
Net discount expense	—	96	489
Human resources	3,503	3,992	4,126
Other operating expenses	6,207	5,442	5,154
Restructuring charges	(4)	414	—
Disaster recovery charge	—	79	—
Total expenses	14,641	15,380	14,407
Pretax income	3,080	1,979	2,713
Income tax provision	945	520	784
Net income	\$ 2,135	\$ 1,459	\$ 1,929

Travel Related Services reported net income of \$2.1 billion in 2002, a 46 percent increase from \$1.5 billion in 2001, which was down 24 percent from 2000. 2001 results included restructuring charges of \$414 million (\$267 million after-tax) and one-time costs and waived customer fees directly related to the September 11th terrorist attacks of \$87 million (\$57 million after-tax).

The following management discussion includes information on both a GAAP basis and managed basis. The managed basis presentation assumes there have been no securitization transactions, i.e., all securitized cardmember loans and related income effects are reflected in the company's balance sheet and income statement, respectively. The company presents TRS information on a managed basis because that is the way the company's management views and manages the business. Management believes that a full picture of trends in the company's cardmember lending business can only be derived by evaluating the performance of both securitized and non-securitized cardmember loans. Asset securitization is just one of several ways for the company to fund cardmember loans. Use of a managed basis presentation, including non-securitized and securitized cardmember loans, presents a more accurate picture of the key dynamics of the cardmember lending business, avoiding distortions due to the mix of funding sources at any particular point in time. For example, irrespective of the mix, it is important for management and investors to see metrics, such as changes in delinquencies and write-off rates, for the entire cardmember lending portfolio because it is more representative of the economics of the aggregate cardmember relationships and ongoing business performance and trends over time. It is also important for investors to see the overall growth of cardmember loans and related revenue and changes in market share, which are significant metrics in evaluating the company's performance and which can only be properly assessed when all non-securitized and securitized cardmember loans are viewed together on a managed basis.

On a GAAP basis, results reflect only net finance charge revenue on the owned portfolio, comprised of unsecuritized cardmember and other loans. Revenues relating to the company's retained interest in securitized loan receivables are shown in securitization income, which includes gains on securitizations (as discussed below), net finance charge revenue on retained interests in securitized loans and servicing income. Securitization income increased 35 percent in 2002 and 42 percent in 2001 as a result of a higher average balance of cardmember lending securitizations and improved spreads. Other revenue decreased 10 percent in 2002 as a result of lower interest income on investment and liquidity pools held within card funding vehicles. In 2001, other revenue was flat. See Selected Statistical Information below for data relating to TRS' owned portfolio.

TRS' results for the years ended December 31, 2002, 2001 and 2000 included net cardmember lending securitization gains of \$136 million (\$88 million after-tax), \$155 million (\$101 million after-tax) and \$142 million (\$92 million after-tax), respectively. Management views the gains from securitizations as discretionary benefits to be used for card acquisition expenses, which are reflected in both marketing and promotion and other operating expenses. Consequently, the managed basis presentation for the years ended December 31, 2002, 2001 and 2000 assumes that lending securitization gains were offset by higher marketing and promotion expense of \$81 million, \$92 million and \$86 million, respectively, and other operating expense of \$55 million, \$63 million and \$56 million, respectively. Accordingly, the incremental expenses, as well as the gains, have been eliminated. The following table reconciles the GAAP basis for certain TRS income statement line items to the managed basis information, where different.

GAAP Basis to Managed Basis Reconciliation — Effect of Securitizations

Years Ended December 31, (Millions)

	GAAP Basis			Effect of Securitizations						
				Securitization Effect			Managed Basis			
	2002	2001	2000	2002	2001	2000	2002	2001	2000	
Net revenues:										
Discount revenue	\$ 7,931	\$ 7,714	\$ 7,779							
Net card fees	1,726	1,675	1,651	\$ —	\$ 16	\$ 2	\$ 1,726	\$ 1,691	\$ 1,653	
Lending:										
Finance charge revenue	1,995	2,363	2,280	2,509	2,259	1,697	4,504	4,622	3,977	
Interest expense	510	939	1,025	340	545	569	850	1,484	1,594	
Net finance charge revenue	1,485	1,424	1,255	2,169	1,714	1,128	3,654	3,138	2,383	
Travel commissions and fees	1,408	1,537	1,821							
Travelers Cheque investment income	375	394	387							
Securitization income	1,941	1,432	1,012	(1,941)	(1,432)	(1,012)	—	—	—	
Other revenues	2,855	3,183	3,215	720	445	203	3,575	3,628	3,418	
Total net revenues	17,721	17,359	17,120	948	743	321	18,669	18,102	17,441	
Expenses:										
Marketing and promotion	1,456	1,237	1,434	(81)	(92)	(86)	1,375	1,145	1,348	
Provision for losses and claims:										
Charge card	960	1,195	1,006	—	36	151	960	1,231	1,157	
Lending	1,369	1,318	891	1,098	925	595	2,467	2,243	1,486	
Other	149	164	105							
Total	2,478	2,677	2,002	1,098	961	746	3,576	3,638	2,748	
Charge card interest expense	1,001	1,443	1,202	(14)	33	206	987	1,476	1,408	
Net discount expense	—	96	489	—	(96)	(489)	—	—	—	
Human resources	3,503	3,992	4,126							
Other operating expenses	6,207	5,442	5,154	(55)	(63)	(56)	6,152	5,379	5,098	
Restructuring charges	(4)	414	—							
Disaster recovery charge	—	79	—							
Total expenses	14,641	15,380	14,407	\$ 948	\$ 743	\$ 321	\$ 15,589	\$ 16,123	\$ 14,728	
Pretax income	3,080	1,979	2,713							
Income tax provision	945	520	784							
Net income	\$ 2,135	\$ 1,459	\$ 1,929							

The following discussion of TRS' results is presented on a managed basis.

In 2002, TRS' net revenues rose 3 percent as a result of greater net finance charge revenue, higher cardmember spending and increased cards-in-force, partially offset by lower travel commissions and fees, Travelers Cheque investment income and other revenues. These increases reflect the benefits of higher net finance charge revenue from the cardmember lending portfolio due to higher loan balances and improved spreads and growth in worldwide billed business. 2001 net revenues were 4 percent higher than 2000 as increased cards-in-force, growth in cardmember loans outstanding and higher fee revenue were partially offset by relatively flat worldwide billed business and lower travel commissions and fees. The 2001 performance reflected overall weakness in the economy, especially within the travel and entertainment sectors.

Discount revenue rose 3 percent during 2002 as a result of a 4 percent increase in billed business partially offset by a lower discount rate. Discount revenue fell 1 percent in 2001 as billed business growth was more than offset by a lower discount rate. The 4 percent increase in billed business in 2002 primarily resulted from a 4 percent growth in cards-in-force and higher spending per basic cardmember worldwide. U.S. cards-in-force rose 2 percent and 4 percent in 2002 and 2001, respectively, reflecting the impact of more selective consumer card and small business acquisition activities during the past year in light of weak economic conditions. International cards-in-force increased 8 percent and 12 percent in 2002 and 2001, respectively, due to growth in proprietary card products, as well as network card growth. Proprietary card growth was slower during 2002, reflecting attrition due to adverse business conditions in Argentina, Brazil and Hong Kong. Cards-in-force growth accelerated worldwide in the second half of 2002, including the addition of over 900,000 cards in the fourth quarter.

U.S. billed business rose 4 percent reflecting 8 percent growth within the consumer card business (on 10 percent higher transaction volume), 4 percent growth in small business services volume and a 3 percent decline within Corporate Services. U.S. non-T&E related volume categories (which represented approximately 63 percent of U.S. billed business during 2002) grew 9 percent versus last year while U.S. T&E volumes declined 2 percent. Worldwide airline related volume declined 6 percent on a single-digit decline in the average airline charge and flat transaction volumes. The decline in the discount rate in 2001 reflects the cumulative impact of stronger than average growth in the lower rate retail and other "everyday spend" merchant categories (i.e., supermarkets, discounters, etc.).

Net card fees increased slightly in 2002 and 2001, reflecting the growth in cards-in-force in both years. The average fee per card remained at \$34 in both 2002 and 2001, down from \$36 in 2000, reflecting the mix shift toward lower and no fee products.

Lending net finance charge revenue rose 16 percent and 32 percent in 2002 and 2001, respectively. During 2002, average worldwide lending balances increased 7 percent. The net interest yield on the U.S. portfolio rose, as a decrease in the proportion of the portfolio on introductory rates and the benefit of declining funding costs throughout both years were partially offset by the evolving mix of products toward more lower-rate offerings.

Travel commissions and fees declined 8 percent in 2002 as a result of a 10 percent contraction in travel sales reflecting the weaker corporate travel environment throughout the year. Travel commissions and fees declined 16 percent in 2001 as a result of a 24 percent contraction in travel sales due to the effects of the September 11th terrorist attacks and the weaker corporate travel environment. Other revenues decreased 2 percent in 2002 due to significantly lower interest income on investment and liquidity pools held within card funding vehicles, which partially offset higher insurance related revenues. The increases in other revenues in 2001 include the effect of higher card related fee income and larger insurance premiums.

Marketing and promotion expense increased 20 percent in 2002 from the launch of the new brand advertising campaign, the introduction of the new charge cards with Membership Rewards built-in and the Cash Rebate card, more loyalty marketing, and an increase in selected card acquisition activities. Marketing and promotion expense declined 15 percent in 2001 as certain marketing efforts were rationalized in light of the weaker business environment.

The charge card provision on card products decreased 22 percent in 2002 on strong credit quality reflected in an improved past due rate and loss ratio. The net loss ratio decreased to 0.38% in 2002 from 0.42% in 2001. Charge card provision increased in 2001 due to higher volumes and generally weaker economic and business conditions. The worldwide lending provision rose in both 2002 and 2001, reflecting portfolio growth and, in 2002, increased reserve coverage levels. In 2001, the increase was also due to generally weaker economic and business conditions, as unemployment and bankruptcies increased. The net write-off rate was 6.0% in 2002 versus 5.6% in 2001.

Charge card interest expense declined 33 percent in 2002 due to a lower effective cost of funds and a lower average receivable balance. Charge card interest expense rose in 2001 as a result of higher borrowing rates which were partly offset by lower billed business volumes.

In 2002 and 2001, human resources expense decreased 12 percent and 3 percent, respectively, as a result of a lower average number of employees, reflecting ongoing reengineering efforts throughout both years, and, in 2002, the impact of a technology outsourcing agreement. Other operating expenses increased 14 percent in 2002 due to higher costs related to cardmember loyalty programs, losses primarily from strategic investments versus gains in the prior year, as well as the impact of the technology outsourcing agreement, which transferred costs from human resources expense, although at a lower level. These increases were partially offset by reengineering initiatives and other cost containment efforts. Similarly, in 2001, other operating expenses rose due to cardmember loyalty programs, business growth and lower gains than the prior year, partially offset by reengineering activities and other cost containment efforts.

SELECTED STATISTICAL INFORMATION

(Billions, except percentages and where indicated)
Years Ended December 31,

	2002	2001	2000
Total cards-in-force (millions):			
United States	35.1	34.6	33.3
Outside the United States*	22.2	20.6	18.4
Total	57.3	55.2	51.7
Basic cards-in-force (millions):			
United States	26.9	26.8	26.3
Outside the United States*	18.3	15.6	13.9
Total	45.2	42.4	40.2
Card billed business:			
United States	\$ 234.1	\$ 224.5	\$ 221.7
Outside the United States	77.3	73.5	75.0
Total	\$ 311.4	\$ 298.0	\$ 296.7
Average discount rate*	2.64%	2.67%	2.70%
Average basic cardmember spending (dollars)*	\$ 7,645	\$ 7,666	\$ 8,229
Average fee per card — managed (dollars)*	\$ 34	\$ 34	\$ 36
Non-Amex brand:**			
Cards-in-force (millions)	0.7	0.7	0.6
Billed business	\$ 3.7	\$ 3.4	\$ 3.2
Travel sales	\$ 15.5	\$ 17.2	\$ 22.6
Travel commissions and fees/sales	9.1%	8.9%	8.1%
Travelers Cheque:			
Sales	\$ 22.1	\$ 23.5	\$ 24.6
Average outstandings	\$ 6.5	\$ 6.4	\$ 6.4
Average investments	\$ 6.9	\$ 6.6	\$ 6.2
Tax equivalent yield	8.7%	9.0%	8.9%

* Cards-in-force include proprietary cards and cards issued under network partnership agreements outside the U.S. Average Discount Rate, Average Basic Cardmember Spending and Average Fee per Card are computed from proprietary card activities only. At September 30, 2002, 1.5 million of Canadian lending cards were transferred to basic (though these types of cards were available under a supplemental card program) as the specific cards were issued under a stand-alone offer. The impact of this transfer on the year ended December 31, 2001 would have been to increase Basic Cards-in-Force Outside the U.S. to 16.8 million and decrease Average Basic Cardmember Spending to \$7,447.

** These data relate to Visa and Eurocards issued in connection with joint venture activities.

SELECTED STATISTICAL INFORMATION (continued)

(Billions, except percentages and where indicated)
Years Ended December 31,

	2002	2001	2000
Charge card receivables:			
Total receivables	\$ 26.3	\$ 26.2	\$ 29.0
90 days past due as a % of total	2.2%	2.9%	2.3%
Loss reserves (millions)	\$ 930	\$ 1,032	\$ 964
% of receivables	3.5%	3.9%	3.3%
% of 90 days past due	162%	136%	142%
Net loss ratio	0.38%	0.42%	0.36%
U.S. Lending—Owned Basis:			
Total loans	\$ 17.1	\$ 16.9	\$ 17.4
Past due loans as a % of total:			
30–89 days	2.0%	2.0%	1.7%
90+ days	1.3%	1.3%	0.8%
Loss reserves (millions):			
Beginning balance	\$ 668	\$ 553	\$ 505
Provision	954	998	663
Net charge-offs/other	(824)	(883)	(615)
Ending balance	\$ 798	\$ 668	\$ 553
% of loans	4.7%	3.9%	3.2%
% of past due	143%	120%	124%
Average loans	\$ 15.3	\$ 16.9	\$ 14.9
Net write-off rate	5.9%	5.5%	4.4%
U.S. Lending—Managed Basis:			
Total loans	\$ 34.3	\$ 32.0	\$ 28.7
Past due loans as a % of total:			
30–89 days	1.9%	2.1%	1.9%
90+ days	1.2%	1.2%	0.9%
Loss reserves (millions):			
Beginning balance	\$ 1,077	\$ 820	\$ 672
Provision	2,053	1,933	1,258
Net charge-offs/other	(1,833)	(1,676)	(1,110)
Ending balance	\$ 1,297	\$ 1,077	\$ 820
% of loans	3.8%	3.4%	2.9%
% of past due	120%	101%	104%
Average loans	\$ 32.0	\$ 30.7	\$ 25.8
Net write-off rate	6.0%	5.6%	4.4%
Net interest yield	9.8%	8.8%	7.6%

TRS' owned portfolio is primarily comprised of cardmember receivables generated by the company's charge card products, unsecuritized U.S. cardmember loans, international cardmember loans and unsecuritized equipment leasing receivables.

As discussed more fully in Financing Activities, the company securitizes U.S. cardmember loans as part of its financing strategy; consequently, the level of unsecuritized U.S. cardmember loans is primarily a function of the company's financing requirements. As a portfolio, unsecuritized U.S. cardmember loans tend to be less seasoned than securitized loans, primarily because of the lead time required to designate and securitize each loan. The company does not securitize international loans. Delinquency, reserve coverage and net write-off rates have historically been generally comparable between the company's owned and managed portfolios.

Liquidity and Capital Resources

SELECTED BALANCE SHEET INFORMATION (GAAP BASIS)

December 31, (Billions, except percentages)	2002	2001
Accounts receivable, net	\$ 28.1	\$ 28.5
Travelers Cheque investments	\$ 7.4	\$ 6.8
U.S. cardmember loans	\$ 17.1	\$ 16.9
Total assets	\$ 72.2	\$ 69.4
Travelers Cheques outstanding	\$ 6.6	\$ 6.2
Short-term debt	\$ 21.7	\$ 31.8
Long-term debt	\$ 14.8	\$ 6.0
Total liabilities	\$ 64.9	\$ 62.7
Total shareholder's equity	\$ 7.3	\$ 6.7
Return on average equity*	29.9%	21.9%
Return on average assets**	3.2%	2.1%

* Computed on a trailing 12-month basis excluding the effect on Shareholder's Equity of unrealized gains or losses related to SFAS No. 115 and SFAS No. 133.

** Computed on a trailing 12-month basis excluding the effect on total assets of unrealized gains or losses related to SFAS No. 115 and SFAS No. 133 to the extent that they directly affect Shareholder's Equity.

Financing Activities

TRS funds its charge card receivables and cardmember loans using various funding sources, such as long- and short-term debt, medium-term notes, commercial paper and asset securitizations. In 2002, the company shifted its funding strategy to reduce its reliance on short-term debt; at December 31, 2002, short-term debt was 56% of total debt versus 80% a year ago. Charge card receivables are predominantly funded by Credco and its subsidiaries while funding for cardmember loans is primarily through Centurion Bank.

Securitizations

The American Express Credit Account Master Trust (the Trust) securitized \$4.6 billion and \$4.3 billion of loans in 2002 and 2001, respectively, through the public issuance of investor certificates. During 2002 and 2001, \$2 billion and \$1 billion, respectively, of investor certificates that were previously issued by the Trust matured. The securitized assets consist of loans arising in a portfolio of designated consumer American Express Credit Card, Optima Line of Credit and Sign & Travel/Extended Payment Option revolving credit accounts or features owned by Centurion Bank, a wholly-owned subsidiary of TRS, and, in the future, may include other charge or credit accounts, features or products. At December 31, 2002 and 2001, TRS had a total of \$16.9 billion and \$14.3 billion, respectively, of Trust-related securitized loans which are not on the Consolidated Balance Sheets. In early 2003, the company securitized an additional \$920 million of loans.

Under the terms of the Trust pooling and servicing agreement, the occurrence of certain events could result in the Trust being required to pay down the investor certificates before their expected payment dates over an early amortization period. Examples of these events include: the failure or the decline of the securitized assets to generate specified yields over a defined period of time, and the decline of the total of the securitized assets' principal balances below a specified percentage of total investor certificates outstanding after the failure to add additional securitized assets as required by the agreement. The company does not expect an early amortization event to occur. In the event of a pay down, \$15.4 billion of assets would revert to the balance sheet and an alternate source of funding of a commensurate amount would have to be obtained. Had a total pay down hypothetically occurred at a single point in time at December 31, 2002, the one-time negative effect on results of operations would have been approximately \$693 million pretax, to re-establish reserves and accelerate amortization of the interest-only strip related to the \$16.9 billion of cardmember loans that would revert to the balance sheet.

The American Express Master Trust (the Master Trust) securitizes charge card receivables generated under designated American Express Card, Gold Card and Platinum Card consumer accounts through the issuance of trust certificates. In 2002 and 2001, the Master Trust securitized \$1.8 billion and \$750 million, respectively, which remain on the Consolidated Balance Sheets. In 2001, \$600 million of accounts receivable trust certificates that were previously issued by the Master Trust matured from the charge card securitization portfolio. The Master Trust specifies events, the occurrence of which would result in a pay

down. The company does not expect a pay down to occur. While virtually no financial statement impact would result from a pay down, an alternate source of funding for \$4.8 billion of receivables would have to be obtained.

With respect to both the Trust and the Master Trust, a decline in the actual or implied short-term credit rating of TRS below A-1/P-1 will trigger a requirement that TRS, as servicer, transfer collections on the securitized assets to investors on a daily, rather than a monthly, basis or make alternative arrangements with the rating agencies so as to allow TRS to continue to transfer collections on a monthly basis. Such alternative arrangements include obtaining appropriate guarantees for the performance of the payment and deposit obligations of TRS, as servicer.

TRS also securitizes equipment lease receivables. At December 31, 2002 and 2001, the amount sold and outstanding to third party investors was \$254 million and \$675 million, respectively. These sales result in a reduction of interest expense and provisions for losses, as well as servicing revenue, all of which are insignificant to the company's results of operations.

Other Financing Activities

TRS, primarily through Credco, maintained commercial paper outstanding of approximately \$11.2 billion at an average interest rate of 1.3% and approximately \$18.0 billion at an average interest rate of 1.9% at December 31, 2002 and 2001, respectively. Additionally, during 2002, Credco issued an aggregate of \$6.8 billion of medium-term notes at fixed and floating rates with maturities of one to three years. This reflects a shift in the funding strategy as the company is placing less reliance on short-term debt. In early 2003, Credco issued an additional \$2 billion of floating rate medium-term notes, with maturities of one year that can be extended by the holders to up to five years.

Bank notes issued and Fed Funds purchased by Centurion Bank totaled approximately \$8 billion during 2002. Borrowings under bank lines of credit totaled \$1.2 billion and \$1.3 billion at December 31, 2002 and 2001, respectively.

As of December 31, 2002, Credco had the ability to issue approximately \$3.2 billion of debt securities under a shelf registration statement filed with the SEC, which amount was increased to approximately \$18.2 billion in early 2003. In addition, approximately \$10 billion of the company's unused lines of credit supporting TRS' commercial paper borrowings were allocated to Credco at December 31, 2002. These lines expire in increments from 2003 through 2007. Also, TRS had \$2.6 billion in committed back-up lines of credit available at December 31, 2002 for other corporate purposes.

Risk Management

For TRS' charge card and fixed rate lending products, interest rate exposure is managed through a combination of shifting the mix of funding toward fixed rate debt and through the use of derivative instruments, with an emphasis on interest rate swaps, that effectively fix TRS' interest expense for the length of the swap. The company endeavors to lengthen the maturity of interest rate hedges in periods of falling interest rates and to shorten their maturity in periods of rising interest rates. For the majority of its cardmember loans, which are linked to a floating rate base and generally reprice each month, TRS uses floating rate funding. TRS regularly reviews its strategy and may modify it. Nontrading interest rate products, primarily interest rate swaps, with notional amounts of approximately \$44 billion (a portion of which extends to 2005) were outstanding at December 31, 2002.

The detrimental effect on TRS' pretax earnings of a hypothetical 100 basis point increase in interest rates would be approximately \$50 million (\$40 million related to the U.S. dollar) and \$48 million (\$31 million related to the U.S. dollar), based on 2002 and 2001 year-end positions, respectively. This effect is primarily a function of the extent of variable rate funding of charge card and fixed rate lending products, to the degree that interest rate exposure is not managed by derivative financial instruments.

TRS' foreign exchange risk arising from cross-currency charges and balance sheet exposures is managed primarily by entering into agreements to buy and sell currencies on a spot or forward basis. At December 31, 2002, foreign currency products with total notional amounts of approximately \$6.4 billion were outstanding, including foreign currency forward sales with notional amounts of \$645 million which were contracted to manage a substantial portion of anticipated cash flows from operations in major overseas markets for 2003.

Based on the year-end 2002 and 2001 foreign exchange positions, but excluding the forward contracts managing the anticipated overseas operating results for the subsequent year, the effect on TRS' earnings of a hypothetical 10 percent strengthening of the U.S. dollar would be immaterial. With respect to the forward contracts related to anticipated overseas operating results for the subsequent year, a 10 percent strengthening would create hypothetical pretax gains of \$59 million and \$29 million

related to the 2002 and 2001 year-end positions, respectively. Such gains, if any, would mitigate the negative effect of a stronger U.S. dollar on overseas earnings for the subsequent year.

AMERICAN EXPRESS FINANCIAL ADVISORS

Results of Operations

STATEMENTS OF INCOME

Years Ended December 31, (Millions)	2002	2001	2000
Revenues:			
Investment income	\$ 2,058	\$ 1,162	\$ 2,292
Management and distribution fees	2,292	2,458	2,812
Other revenues	1,267	1,171	1,026
Total revenues	5,617	4,791	6,130
Expenses:			
Provision for losses and benefits:			
Annuities	1,034	989	1,018
Insurance	737	648	556
Investment certificates	183	329	337
Total	1,954	1,966	1,911
Human resources	1,898	1,969	2,093
Other operating expenses	907	762	643
Restructuring charges	—	107	—
Disaster recovery charge	[7]	11	—
Total expenses	4,752	4,815	4,647
Pretax income (loss)	865	[24]	1,483
Income tax provision (benefit)	233	[76]	451
Net income	\$ 632	\$ 52	\$ 1,032

American Express Financial Advisors' net income increased to \$632 million in 2002 from \$52 million in 2001, a 95 percent decline from 2000. Included in 2001 results are restructuring charges of \$107 million (\$70 million after-tax) and one-time costs of \$11 million (\$8 million after-tax) directly related to the September 11th terrorist attacks. In addition, 2001 investment income and results included \$1.01 billion in charges (\$669 million after-tax) from the write down and sale of high-yield securities and from reducing risk within its investment portfolio. 2002 results include a benefit of \$7 million (\$4 million after-tax) to reverse a portion of the 2001 September 11th related reserves as a result of lower than anticipated insured loss claims. Total revenues rose 17 percent in 2002 due to higher investment income, reflecting the impact of the high-yield losses noted previously and higher levels of invested assets, higher insurance premiums and advice services fees, and higher distribution fees partially offset by reduced management fees from lower average levels of managed assets. Total revenues fell 22 percent in 2001 due to lower yields on investment portfolio products, reduced management and distribution fees and the high-yield losses noted earlier.

Investment income increased 77 percent reflecting the effect of the \$1.01 billion in investment losses noted previously, higher average invested assets and the effect of depreciation in the S&P 500 this year on the value of options hedging outstanding stock market certificates and equity indexed annuities, which was offset in the related provisions for losses and benefits. Investment income decreased 49 percent in 2001 as the benefit from growth in average invested assets was more than offset by the high-yield losses mentioned earlier and from the decrease in the value of options hedging the outstanding stock market certificates, which was offset in the certificate provision for losses and benefits. Lower average yields, primarily due to the investment portfolio repositioning, also contributed to the decline in investment income during 2001.

AEFA's gross realized gains on sales of securities classified as Available-for-Sale, using the specific identification method, were \$342 million, \$157 million and \$48 million for the years ended December 31, 2002, 2001 and 2000, respectively. Gross realized losses on sales were (\$168 million), (\$529 million) and (\$35 million) for the same periods. AEFA also recognized losses of

(\$204 million), (\$428 million) and (\$55 million) in other-than-temporary impairments on structured securities and corporate debt securities for the years ended December 31, 2002, 2001 and 2000, respectively.

For the year ended December 31, 2001, the "Investment Income" line in the Statement of Income is reduced by a \$34 million charge (\$22 million after-tax) related to the cumulative effect of the adoption of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets" as of January 1, 2001. Before this accounting change, which the company deems immaterial, the company's consolidated net income for the year ended December 31, 2001 was \$1,333 million, basic earnings per common share was \$1.01, and diluted earnings per common share was \$1.00.

Management and distribution fees declined 7 percent in 2002 due to lower average assets under management, partially offset by higher distribution fees. The distribution fee increase is the result of lower mutual fund sales being more than offset by other product related sales increases. In 2001, management and distribution fees declined 13 percent due to lower average assets under management and weaker sales, particularly in mutual fund products, reflecting the negative impact of weak equity market conditions throughout the year.

Other revenues rose in both 2002 and 2001 due to increased life and property-casualty insurance premiums and charges and higher financial planning and advice service fees.

The provision for losses and benefits for annuities increased 5 percent during 2002 reflecting a higher inforce level, increased costs related to guaranteed minimum death benefits, and the effect of depreciation in the S&P 500 on equity indexed annuities, partially offset by the benefit of a lower crediting rate. In 2001, the provision for losses and benefits for annuities declined due to lower fixed annuities inforce and the benefit of lower crediting rates. Insurance provisions for losses and benefits rose in 2002 and 2001, reflecting higher inforce levels in both years and, in 2002, higher claims, partially offset by a lower crediting rate. Investment certificate provisions for losses and benefits decreased 44 percent during 2002 due to lower crediting rates, partially offset by higher average reserve levels and the effect on the stock market certificate product of depreciation in the S&P 500 during 2002. Investment certificate provisions for losses and benefits decreased slightly in 2001 as higher average reserve levels were offset by lower crediting rates.

In the following table, the company presents AEFA's aggregate revenues on a basis that is net of provisions for losses and benefits because the company manages the AEFA business and evaluates its financial performance, where appropriate, in terms of the "spread" on its products. An important part of AEFA's business is margin related, particularly the insurance, annuity and certificate businesses. One of the gross margin drivers for the AEFA business is the return on invested cash, primarily generated by sales of insurance, annuity and investment certificates, less provisions for losses and benefits on these products. These investments tend to be interest rate sensitive. Thus, GAAP revenues tend to be higher in periods of rising interest rates, and lower in times of decreasing interest rates. The same relationship is true of provisions for losses and benefits, only it is more accentuated period-to-period because rates credited to customers' accounts generally reset at shorter intervals than the yield on underlying investments. The company presents this portion of the AEFA business on a net basis to eliminate potentially less informative comparisons of period-to-period changes in revenue and provisions for losses and benefits in light of the impact of these changes in interest rates.

Years Ended December 31, (Millions)	2002	2001	2000
Total GAAP revenues	\$ 5,617	\$ 4,791	\$ 6,130
Less: Provision for losses and benefits –			
Annuities	1,034	989	1,018
Insurance	737	648	556
Investment certificates	183	329	337
Total	1,954	1,966	1,911
Net revenues	\$ 3,663	\$ 2,825	\$ 4,219

Human resources expense declined 4 percent in 2002, reflecting lower field force compensation-related costs and the benefits of reengineering and cost containment initiatives within the home office where the average number of employees was down 15 percent from last year. Human resources expense also declined in 2001, reflecting lower field force compensation-related expenses due to the decline in the number of advisors and the impact of lower volumes on advisor compensation, as well as the

benefits of reengineering and cost containment initiatives. In addition, 2001 expenses included an unfavorable net DAC adjustment of \$39 million. Other operating expenses increased in both years. The 2002 increase reflects the impact of the technology outsourcing agreement, which resulted in the transfer of costs from human resources expense, a higher minority interest for premium deposits related to a joint venture with AEB, and a \$44 million net increase in DAC expenses related to AEFA's third quarter 2002 adjustment discussed below. In 2001, the increase reflects accelerated investing activities for various strategic, reengineering, technology and product development projects and a higher minority interest related to the premium deposits joint venture with AEB. In 2001, other operating expenses included an unfavorable DAC adjustment of \$28 million.

For annuity and insurance products, the projections underlying the amortization of DAC require the use of certain assumptions, including interest margins, mortality rates, persistency rates, maintenance expense levels, and customer asset value growth rates for variable products. Management routinely monitors a wide variety of trends in the business, including comparisons of actual and assumed experience. Management reviews and, where appropriate, adjusts its assumptions with respect to customer asset value growth rates on a quarterly basis. Management monitors other principal DAC assumptions, such as persistency, mortality rate, interest margin and maintenance expense level assumptions, each quarter. Unless management identifies a material deviation over the course of the quarterly monitoring, management reviews and updates these DAC assumptions annually in the third quarter of each year. When assumptions are changed, the percentage of estimated gross profits or portion of interest margins used to amortize DAC may also change. A change in the required amortization percentage is applied retrospectively; an increase in amortization percentage will result in an acceleration of DAC amortization while a decrease in amortization percentage will result in a deceleration of DAC amortization. The impact on results of operations of changing assumptions with respect to the amortization of DAC can be either positive or negative in any particular period, and is reflected in the period in which such changes are made. In 2002, excluding the third quarter, the impact of resetting these assumptions, along with the impact of unfavorable equity market performance, was an acceleration of \$22 million pretax of DAC amortization. Third quarter impacts are described below.

During the third quarter of 2002, AEFA completed a comprehensive review of its DAC related practices. The specific areas reviewed included costs deferred and DAC amortization periods in addition to customer asset value growth rate assumptions (which are typically reviewed on a quarterly basis) and other assumptions including mortality rates and product persistency (which are typically updated on an annual basis in the third quarter). As a result of this review, AEFA took certain actions that resulted in a net \$44 million increase in expenses in the third quarter of 2002.

- I AEFA reset its customer asset value growth rate assumptions for variable annuity and variable life products to anticipate near-term and long-term growth at an annual rate of 7%. The customer asset value growth rate is the rate at which contract values are assumed to appreciate in the future. This rate is net of asset fees, and anticipates a blend of equity and fixed income investments. Prior to resetting these assumptions, AEFA was projecting long-term customer asset value growth at 7.5% and near-term growth at approximately twice that rate. The impact of resetting these assumptions, along with the impact of unfavorable third quarter 2002 equity market performance, was an acceleration of \$173 million pretax of DAC amortization. Going forward, AEFA intends to continue to use a mean reversion method as a guideline in setting the near-term customer asset value growth rate, also referred to as the mean reversion rate. In periods when market performance results in actual contract value growth at a rate different than that assumed, AEFA will reassess the near-term rate in order to continue to project its best estimate of long-term growth. For example, if actual contract value growth during a quarter is less than 7% on an annualized basis, AEFA would increase the mean reversion rate assumed over the near term to the rate needed to achieve the long-term annualized growth rate of 7% by the end of that period, assuming this long-term view is still appropriate.
- I AEFA revised certain mortality and persistency assumptions for universal and variable universal life insurance products and fixed and variable annuity products to better reflect actual experience and future expectations. The company completed a project to update the mortality table used in pricing universal and variable universal life products and in valuing the associated DAC. The most recently published life insurance industry mortality table was used as a starting point, and was then modified based on AEFA's experience. AEFA also observed that recent persistency of its universal life products was consistently better than expected, and determined the trend justified an improvement in assumed persistency rates. Additionally, AEFA reviewed and updated persistency assumptions for fixed and variable deferred annuity products. AEFA also reviewed

the periods over which DAC is amortized for fixed and variable deferred annuity products. Analysis showed that significant volumes of advisor-distributed fixed annuities were expected to persist beyond AEFA's 10-year DAC amortization period. As a result, the company extended the amortization period from 10 to 15 years to be more consistent with the period over which significant profits were expected and would result in a more appropriate matching of revenues and expense. Similarly, AEFA made slight increases in the amortization periods used for certain blocks of advisor-distributed variable annuities. These changes, along with revised assumptions projecting more favorable persistency and mortality rates, resulted in a decrease in DAC expense of \$155 million pretax.

- Finally, AEFA reviewed its acquisition costs to clarify those costs that vary with and are primarily related to the acquisition of new and renewable annuity and insurance contracts, or are incremental and vary directly with the acquisition of back-end loaded mutual funds. AEFA revised the types and amounts of costs deferred, in part to reflect the impact of advisor platform changes and the effects of related reengineering. This resulted in an increase in expense of \$26 million pretax recognized in the third quarter of 2002.

The adjustments made to customer asset value growth rate assumptions should reduce the risk of adverse DAC adjustments going forward, while changes made to mortality and persistency assumptions and DAC amortization periods somewhat increase the risk of adverse adjustments. Overall, AEFA believes it is less exposed to the risk of adverse DAC adjustments as a result of these changes. The changes relating to the types and amounts of costs deferred will somewhat accelerate the recognition of ongoing expenses, although these additional expenses should be offset to some extent as reengineering and other cost control initiatives are expected to mitigate their impact.

Impact of recent market-volatility on Results of Operations

Various aspects of AEFA's business are impacted by equity market levels and other market-based events. Three areas in particular involve DAC, asset management fees and structured investments. The direction and magnitude of the changes in equity markets can increase or decrease DAC expense levels and asset management fees and correspondingly affect results of operations in any particular period. Similarly, the value of AEFA's structured investment portfolio is impacted by various market factors. Persistency of, or increases in, bond and loan default rates, among other factors, could result in negative adjustments to the market values of these investments in the future, which would adversely impact results of operations. See discussion of structured investments below.

SELECTED STATISTICAL INFORMATION

Years Ended December 31, (Millions, except where indicated)	2002	2001	2000
Life insurance inforce (billions)	\$ 119.0	\$ 107.9	\$ 98.1
Deferred annuities inforce (billions)	\$ 41.0	\$ 41.3	\$ 45.3
Assets owned, managed or administered (billions):			
Assets managed for institutions	\$ 42.3	\$ 49.7	\$ 55.0
Assets owned, managed or administered for individuals:			
Owned assets:			
Separate account assets	22.0	27.3	32.3
Other owned assets	51.7	44.2	41.3
Total owned assets	73.7	71.5	73.6
Managed assets	81.6	98.7	112.0
Administered assets	33.0	33.4	34.4
Total	\$ 230.6	\$ 253.3	\$ 275.0
Market appreciation (depreciation) during the period:			
Owned assets:			
Separate account assets	\$ (5,057)	\$ (5,752)	\$ (5,109)
Other owned assets	\$ 898	\$ 879	\$ 106
Managed assets	\$ (16,788)	\$ (18,662)	\$ (14,467)

SELECTED STATISTICAL INFORMATION (continued)

Years Ended December 31, (Millions, except percentages and where indicated)	2002	2001	2000
Cash sales:			
Mutual funds	\$ 31,945	\$ 33,581	\$ 44,068
Annuities	8,541	5,648	5,886
Investment certificates	4,088	3,788	3,297
Life and other insurance products	710	895	900
Institutional	3,727	5,006	6,601
Other	5,201	5,276	3,557
Total cash sales	\$ 54,212	\$ 54,194	\$ 64,309
Number of financial advisors	11,689	11,535	12,663
Fees from financial plans and advice services	\$ 113.9	\$ 107.5	\$ 97.7
Percentage of total sales from financial plans and advice services	73.3%	72.5%	68.1%

Liquidity and Capital Resources

SELECTED BALANCE SHEET INFORMATION

December 31, (Billions, except percentages)	2002	2001
Investments	\$ 38.2	\$ 33.6
Separate account assets	\$ 22.0	\$ 27.3
Deferred acquisition costs	\$ 3.8	\$ 3.7
Total assets	\$ 73.7	\$ 71.5
Client contract reserves	\$ 37.3	\$ 32.8
Separate account liabilities	\$ 22.0	\$ 27.3
Total liabilities	\$ 67.4	\$ 66.1
Total shareholder's equity	\$ 6.3	\$ 5.4
Return on average equity*	11.6%	1.0%

* Computed on a trailing 12-month basis excluding the effect on Shareholder's Equity of unrealized gains or losses related to SFAS No. 115 and SFAS No. 133.

AEFA's total assets and liabilities increased in 2002 primarily due to higher investments and client contract reserves which were partially offset by decreases in separate account assets and liabilities, which declined primarily as a result of market depreciation. AEFA's total assets and liabilities decreased in 2001 due to declines in separate account assets and liabilities as a result of market depreciation, partly offset by positive net sales. Investments primarily include corporate debt and mortgage-backed securities. AEFA's corporate debt securities comprise a diverse portfolio with the largest concentrations, accounting for approximately 63 percent of the portfolio, in the following industries: banking and finance, utilities, communications and media, and transportation. Investments include \$2.4 billion and \$1.3 billion in below investment grade debt securities at December 31, 2002 and 2001, respectively, and \$4.0 billion in investment loans at both December 31, 2002 and 2001. Non-performing assets relative to invested assets (excluding short-term cash positions) were 0.1% at both December 31, 2002 and 2001. Investments are principally funded by sales of insurance, annuities and certificates and by reinvested income. Maturities of these investments are largely matched with the expected future payments of insurance and annuity obligations.

During 2002, AEFA continued to hold investments in CDOs and secured loan trusts (SLTs), some of which are also managed by AEFA. As a condition to its managing certain CDOs, AEFA is required to invest in the residual or "equity" tranche of the CDO, which is typically the most subordinated tranche of securities issued by the CDO entity. AEFA invested in CDOs and SLTs as part of its investment strategy in order to pay a competitive rate to contractholders' accounts. AEFA's exposure as an investor is limited solely to its aggregate investment in the CDOs and SLTs, and it has no obligations or commitments, contingent or otherwise, that could require any further funding of such investments. As of December 31, 2002, the carrying values of the CDO residual tranches and SLT notes were \$28 million and \$684 million, respectively. CDOs and SLTs are illiquid investments. As an investor in the residual tranche of CDOs, AEFA's return correlates to the performance of portfolios of high-yield bonds and/or bank loans. As a noteholder of SLTs, AEFA's return is based on a reference portfolio of loans. The carrying value

of the CDO and SLT investments and AEFA's projected return are based on discounted cash flow projections that require a significant degree of management judgment as to assumptions primarily related to default and recovery rates of the high-yield bonds and/or bank loans either held directly by the CDO or in the reference portfolio of the SLT and, as such, are subject to change. Generally, the SLTs are structured such that the principal amount of the loans in the reference portfolio may be up to five times that of the par amount of the notes held by AEFA. Although the exposure associated with AEFA's investment in CDOs and SLTs is limited to the carrying value of such investments, they are volatile investments and have a substantial degree of risk associated with them because the amount of the initial value of the loans and/or other debt obligations in the related portfolios is significantly greater than AEFA's exposure. Deterioration in the value of the high-yield bonds or bank loans would likely result in deterioration of AEFA's investment return with respect to the relevant CDO or SLT, as the case may be. In the event of significant deterioration of a portfolio, the relevant CDO or SLT may be subject to early liquidation, which could result in further deterioration of the investment return or, in severe cases, loss of the carrying amount. See Note 1 to the Consolidated Financial Statements.

During 2001 the company placed a majority of its rated CDO securities and related accrued interest, as well as a relatively minor amount of other liquid securities (collectively referred to as transferred assets), having an aggregate book value of \$905 million, into a securitization trust. In return, the company received \$120 million in cash (excluding transaction expenses) relating to sales to unaffiliated investors and retained interests in the trust with allocated book amounts aggregating \$785 million. As of December 31, 2002, the retained interests had a carrying value of \$754 million, of which \$520 million is considered investment grade. The company has no obligations, contingent or otherwise, to such unaffiliated investors. One of the results of this transaction is that increases and decreases in future cash flows of the individual CDOs are combined into one overall cash flow for purposes of determining the carrying value of the retained interests and related impact on results of operations.

AEFA's client contract reserves are for current and future obligations related to fixed annuities, investment certificates, and life and disability insurance. The obligations for fixed annuities, universal life contracts and investment certificates are based on the underlying contract accumulation values. The obligations for other traditional life insurance products are based on various assumptions, including mortality rates, morbidity rates and policy persistency. To the extent that actual future experience differs with respect to other traditional life insurance products, these reserves would be adjusted through the provision for losses and benefits.

Separate account assets, primarily investments carried at market value, and liabilities represent funds held for the exclusive benefit of variable annuity and variable life insurance contract holders. AEFA earns investment management, administration and other fees from the related accounts.

The National Association of Insurance Commissioners (NAIC) adopted Risk Based Capital (RBC) requirements for life insurance companies. The RBC requirements are to be used as minimum capital requirements by the NAIC and states to identify companies that merit further regulatory action. At December 31, 2002, AEFA's life insurance businesses had adjusted capital in excess of amounts requiring regulatory action. Any dividend distributions in 2003 in excess of 10% of statutory capital and surplus would require approval of the Department of Commerce of the State of Minnesota.

In light of the investment losses recorded during the first half of 2001, AEFA received a capital contribution of \$490 million from the Parent Company during 2001.

Risk Management

At AEFA, interest rate exposures arise primarily within its insurance and investment certificate subsidiaries. Rates credited to customers' accounts generally reset at shorter intervals than the yield on underlying investments. Therefore, AEFA's interest spread margins are affected by changes in the general level of interest rates. The extent to which the level of rates affects spread margins is managed primarily by a combination of modifying the maturity structure of the investment portfolio and entering into swaps or other derivative instruments that effectively lengthen the rate reset interval on customer liabilities. Interest rate derivatives with notional amounts totaling approximately \$4.8 billion were outstanding at December 31, 2002 to hedge interest rate exposures.

The negative effect on AEFA's pretax earnings of a 100 basis point increase in interest rates, which assumes repricings and customer behavior based on the application of proprietary models, to the book of business at December 31, 2002 and 2001, would be approximately \$21 million and \$35 million for 2002 and 2001, respectively.

AEFA has two primary exposures to the general level of equity markets: asset management fees and customer crediting rates based upon the returns on equity markets. AEFA earns fees from the management of equity securities in variable annuities, variable insurance, proprietary mutual funds and other managed assets. The amount of fees is generally based on the value of the portfolios, and thus is subject to fluctuation with the general level of equity market values. To reduce the sensitivity of AEFA's fee revenues to the general performance of equity markets, AEFA has from time to time entered into various combinations of financial instruments that mitigate the negative effect on fees that would result from a decline in the equity markets. In addition, AEFA writes and purchases index options to manage the margin related to certain investment certificate and annuity products that pay interest based upon the relative change in a major stock market index between the beginning and end of the product's term. At December 31, 2002, equity-based derivatives with a net notional amount of \$208 million were outstanding to hedge equity market exposures.

The negative effect on AEFA's pretax earnings of a 10 percent decline in equity markets would be approximately \$57 million and \$81 million based on assets under management, certificate and annuity business in-force, and index options as of December 31, 2002 and 2001, respectively.

AEFA's owned investment securities are, for the most part, held by its life insurance and investment certificate subsidiaries, which primarily invest in long-term and intermediate-term fixed income securities to provide their clients with a competitive rate of return on their investments while controlling risk. Investment in fixed income securities is designed to provide AEFA with a targeted margin between the interest rate earned on investments and the interest rate credited to clients' accounts. AEFA does not trade in securities to generate short-term profits for its own account.

AEFA's life insurance and investment certificate subsidiaries' investment committees regularly review models projecting various interest rate scenarios and risk/return measures and their effect on the profitability of the company. The committees' objectives are to structure their investment security portfolios based upon the type and behavior of the products in the liability portfolios to achieve targeted levels of profitability within defined risk parameters and to meet contractual obligations. Part of the committees' strategies include the use of derivatives, such as interest rate caps, swaps and floors, for risk management purposes.

AMERICAN EXPRESS BANK

Results of Operations

STATEMENTS OF OPERATIONS

Years Ended December 31, (Millions)	2002	2001	2000
Net revenues:			
Interest income	\$ 606	\$ 698	\$ 735
Interest expense	246	396	484
Net interest income	360	302	251
Commissions and fees	215	203	214
Foreign exchange income and other revenues	170	144	126
Total net revenues	745	649	591
Expenses:			
Human resources	236	247	257
Other operating expenses	244	255	273
Provision for losses:			
Ongoing	147	65	28
Restructuring related	—	26	—
Total provision for losses	147	91	28
Restructuring charges	(3)	70	—
Total expenses	624	663	558
Pretax income (loss)	121	(14)	33
Income tax provision (benefit)	41	(1)	4
Net income (loss)	\$ 80	\$ (13)	\$ 29

American Express Bank reported net income of \$80 million in 2002, compared with a net loss of \$13 million in 2001. 2001 results included restructuring charges of \$96 million (\$65 million after-tax). Net revenues rose 15 percent in 2002, primarily due to higher net interest income and foreign exchange income and other revenue. In 2001, net revenues rose 10 percent.

Net interest income in 2002 increased from a year ago due to the effects of lower funding costs. In 2001, net interest income increased, primarily due to higher consumer loans and the effects of lower funding costs, partially offset by decreases in corporate banking volumes. In 2002, commissions and fees increased due to growth in loan originations in the Personal Financial Services (PFS) business and greater non-credit transactions in the Financial Institutions Group, partially offset by lower results in Corporate Banking. In 2001, commissions and fees decreased due to lower results in corporate banking and lower mutual fund fees within the financial institution business, partially offset by higher loan volumes in PFS. In 2002, foreign exchange income and other revenue increased primarily because of higher joint venture income, due to lower funding costs within the premium deposits joint venture with AEFA. In 2001, foreign exchange income and other revenue increased due to higher income from the premium deposit joint venture, partially offset by lower corporate banking revenue and other joint venture income.

Combined human resources and other operating expenses declined in both 2002 and 2001, reflecting the benefits of reengineering activities and tighter expense controls. Provision for losses increased substantially in 2002 primarily due to higher bankruptcy related write-offs in the consumer lending portfolio in Hong Kong. In 2001, provisions for losses increased primarily due to higher PFS loan volumes.

SELECTED STATISTICAL INFORMATION

December 31, (Billions)	2002	2001	2000
Assets managed*/administered	\$ 12.5	\$ 11.4	\$ 10.6
Assets of non-consolidated joint ventures	\$ 1.8	\$ 1.9	\$ 2.1

* Includes assets managed by American Express Financial Advisors.

Liquidity and Capital Resources

SELECTED BALANCE SHEET INFORMATION

December 31, (Billions, except percentages and where indicated)	2002	2001
Total loans	\$ 5.6	\$ 5.3
Total non-performing loans (millions)	\$ 119	\$ 123
Other non-performing assets (millions)	\$ 15	\$ 22
Reserve for credit losses (millions)*	\$ 158	\$ 148
Loan loss reserve as a % of total loans	2.7%	2.4%
Total PFS loans	\$ 1.6	\$ 1.6
30+ days past due PFS loans as a % of total	5.4%	4.5%
Total assets	\$ 13.2	\$ 11.9
Deposits	\$ 9.5	\$ 8.4
Total liabilities	\$ 12.3	\$ 11.1
Total shareholder's equity (millions)	\$ 947	\$ 761
Return on average assets**	0.67%	(0.11)%
Return on average common equity***	11.5%	(2.0)%
Risk-based capital ratios:		
Tier I	10.9%	11.1%
Total	11.4%	12.2%
Leverage ratio	5.3%	5.3%
*Allocation of reserves (millions):		
Loans	\$ 151	\$ 128
Other assets, primarily derivatives	6	4
Other liabilities	1	16
Total reserve for credit losses	\$ 158	\$ 148

** Computed on a trailing 12-month basis excluding the effect on total assets of unrealized gains or losses related to SFAS No. 115 and SFAS No. 133 to the extent that they directly affect Shareholder's Equity.

*** Computed on a trailing 12-month basis excluding the effect on Shareholder's Equity of unrealized gains or losses related to SFAS No. 115 and SFAS No. 133.

AEB had worldwide loans outstanding at December 31, 2002 of approximately \$5.6 billion, up from \$5.3 billion at December 31, 2001. Activity during 2002 included a \$400 million net decrease in corporate and other banking loans, which was more than offset by a \$500 million increase in consumer and private banking loans and a \$200 million increase in financial institution loans. As of December 31, 2002, consumer and private banking loans comprised 66 percent of total loans versus 60 percent at December 31, 2001. Corporate Banking and other loans comprised 9 percent of total loans at December 31, 2002 versus 18 percent at December 31, 2001. In addition to the loan portfolio, other banking activities, such as securities, unrealized gains on foreign exchange and derivatives contracts, various contingencies and market placements added approximately \$8.0 billion and \$7.3 billion to AEB's credit exposures at December 31, 2002 and 2001, respectively. Included in these additional exposures are relatively lower risk cash and securities related balances totaling \$5.8 billion at December 31, 2002.

Risk Management

AEB employs a variety of financial instruments in managing its exposure to fluctuations in interest and currency rates. Derivative instruments consist principally of foreign exchange spot and forward contracts, foreign currency options, interest rate swaps, futures and forward rate agreements. Generally, they are used to manage specific interest rate and foreign exchange exposures related to deposits, long-term debt, equity, loans and securities holdings. At December 31, 2002, interest rate products with notional amounts totaling approximately \$7.7 billion and \$0.6 billion for trading and nontrading purposes, respectively, were outstanding. Notional amounts outstanding at December 31, 2002 for foreign currency products were approximately \$18.1 billion and \$5.3 billion for trading and nontrading purposes, respectively. Additionally, equity products with notional amounts of \$120 million were outstanding at December 31, 2002.

The negative effect of a 100 basis point increase in interest rates on AEB's pretax earnings would be \$18 million at both December 31, 2002 and 2001. The effect on earnings of a 10 percent strengthening of the U.S. dollar would be negligible and, with respect to translation exposure of foreign operations, would result in a \$16 million and \$11 million charge against equity as of December 31, 2002 and 2001, respectively.

AEB utilizes foreign exchange and interest rate products to meet the needs of its customers. Customer positions are usually, but not always, offset. They are evaluated in terms of AEB's overall interest rate or foreign exchange exposure. AEB also takes limited proprietary positions. Potential daily exposure from trading activities is calculated using a Value at Risk methodology. This model employs a parametric technique using a correlation matrix based on historical data. The Value at Risk measure uses a 99 percent confidence interval to estimate potential trading losses over a one-day period. At December 31, 2002 and 2001, the Value at Risk for AEB was less than \$2 million.

Asset/liability and market risk management at AEB are supervised by the Asset and Liability Committee, which comprises senior business managers of AEB. It meets monthly and monitors: (i) liquidity, (ii) capital exposure, (iii) capital adequacy, (iv) market risk and (v) investment portfolios. The committee evaluates current market conditions and determines AEB's tactics within risk limits approved by AEB's Board of Directors. AEB's treasury and risk management operations issue policies and control procedures and delegate risk limits throughout AEB's regional trading centers.

CORPORATE AND OTHER

Corporate and Other reported net expenses of \$176 million, \$187 million and \$180 million in 2002, 2001 and 2000, respectively. 2001 results include \$14 million (\$9 million after-tax) of the restructuring charges noted earlier.

Included in 2002 results were the final preferred stock dividends from Lehman Brothers totaling \$69 million (\$59 million after-tax) compared with \$46 million (\$39 million after-tax) in both 2001 and 2000. The dividends were offset by business building initiatives in each year.

OTHER REPORTING MATTERS

Accounting Developments

In November 2002, the FASB issued Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others” (FIN 45), which provides accounting and disclosure requirements for certain guarantees. The accounting provisions of FIN 45, which are effective for certain guarantees issued or modified beginning January 1, 2003, will impact the company based upon the fair value amount of guarantees that are issued or modified beginning at that time. The company is still evaluating the impact of adopting FIN 45 on the Consolidated Financial Statements; the disclosure requirements of FIN 45 are addressed in Note 11 to the Consolidated Financial Statements.

In January 2003, the FASB issued Interpretation No. 46, “Consolidation of Variable Interest Entities” (FIN 46), which addresses consolidation by business enterprises of variable interest entities (VIEs). The accounting provisions and disclosure requirements of FIN 46 are effective immediately for VIEs created after January 31, 2003, and are effective for reporting periods beginning after June 15, 2003, for VIEs created prior to February 1, 2003. The company is still evaluating the impact of adopting FIN 46 on the Consolidated Financial Statements. It is likely that the company will either consolidate or disclose additional information about VIEs when FIN 46 becomes fully effective. Certain disclosures are required for financial statements issued after January 31, 2003 and are addressed in Note 1 to the Consolidated Financial Statements.

On December 31, 2002, the FASB issued SFAS No. 148, “Accounting for Stock-Based Compensation — Transition and Disclosure.” The company has applied the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 and related interpretations in accounting for its stock-based employee compensation plans. No stock-based employee compensation expense is reflected in net income for the years ended December 31, 2002, 2001 or 2000, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2003, the company will adopt, prospectively, the fair value recognition provisions of SFAS No. 123 “Accounting for Stock-Based Compensation,” and expense all new awards granted to employees after January 1, 2003. While the company cannot predict the full year 2003 unfavorable impact on diluted EPS, the negative effect associated with the stock options granted in January 2003 is expected to be \$0.01 per share. See Notes 1 and 14 to the Consolidated Financial Statements for further discussion.

In June 2001, the FASB issued SFAS No. 143, “Accounting for Asset Retirement Obligations.” This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The company has adopted the provisions of the Statement as of January 1, 2003. The impact to the company’s financial statements is expected to be immaterial.

In July 2002, the FASB issued SFAS No. 146, “Obligations Associated with Disposal Activities.” The Statement is effective for exit or disposal activities initiated after December 31, 2002. Previously issued financial statements shall not be restated. The provisions of EITF Issue 94-3 shall continue to apply for an exit activity initiated under an exit plan that met the criteria of Issue 94-3 prior to this Statement’s initial application. This Statement will impact the company’s accounting for any future restructuring activities.

Forward-Looking Statements

This Annual Report includes forward-looking statements, which are subject to risks and uncertainties. The words “believe,” “expect,” “anticipate,” “optimistic,” “intend,” “plan,” “aim,” “will,” “should,” “could,” “likely,” and similar expressions are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. The company undertakes no obligation to update or revise any forward-looking statements. Factors that could cause actual results to differ materially from these forward-looking statements include, but are not limited to: the company’s ability to successfully implement a business model that allows for significant earnings growth based on revenue growth that is lower than historical levels, including the ability to improve its operating expense to revenue ratio both in the short-term and over time, which will depend in part on the effectiveness of reengineering and other cost control initiatives, as well as factors impacting the company’s revenues; the company’s ability to grow its business and meet or exceed its return on equity target by reinvesting approximately 35% of annually generated capital, and returning approximately 65% of such capital to shareholders, over time, which will depend on the company’s ability

to manage its capital needs and the effect of business mix, acquisitions and rating agency requirements; the ability to increase investment spending, which will depend in part on the equity markets and other factors affecting revenues, and the ability to capitalize on such investments to improve business metrics; fluctuation in the equity markets, which can affect the amount and types of investment products sold by AEFA, the market value of its managed assets, management and distribution fees received based on those assets and the amount of amortization of DAC; changes in assumptions relating to DAC which also could impact the amount of DAC amortization; potential deterioration in AEFA's high-yield and other investments, which could result in further losses in AEFA's investment portfolio; the ability of AEFA to sell certain high-yield investments at expected values and within anticipated timeframes and to maintain its high-yield portfolio at certain levels in the future; developments relating to AEFA's platform structure for financial advisors, including the ability to increase advisor productivity (including new clients), increase the growth of productive new advisors and create efficiencies in the infrastructure; AEFA's ability to roll out new and attractive products in a timely manner and effectively manage the economics in selling a growing volume of non-proprietary products; investment performance in AEFA's businesses; the success, timeliness and financial impact, including costs, cost savings and other benefits, of reengineering initiatives being implemented or considered by the company, including cost management, structural and strategic measures such as vendor, process, facilities and operations consolidation, outsourcing (including, among others, technologies operations), relocating certain functions to lower cost overseas locations, moving internal and external functions to the internet to save costs, the scale-back of corporate lending in certain regions, and planned staff reductions relating to certain of such reengineering actions; the ability to control and manage operating, infrastructure, advertising and promotion and other expenses as business expands or changes, including balancing the need for longer-term investment spending; the impact on the company's businesses and uncertainty created by the September 11th terrorist attacks, and the potential negative effect on the company's businesses and infrastructure, including information technology systems, of any such attacks or disaster in the future; the impact on the company's businesses resulting from a war with Iraq; the company's ability to recover under its insurance policies for losses resulting from the September 11th terrorist attacks; the overall level of consumer confidence; consumer and business spending on the company's travel related services products, particularly credit and charge cards and growth in card lending balances, which depend in part on the ability to issue new and enhanced card products and increase revenues from such products, attract new cardholders, capture a greater share of existing cardholders' spending, sustain premium discount rates, increase merchant coverage, retain cardmembers after low introductory lending rates have expired, and expand the global network services business; the ability to execute the company's global corporate services strategy, including greater penetration of middle market companies, increasing capture of non-T&E spending through greater use of the company's purchasing card and other means, and further globalizing business capabilities; the ability to manage and expand cardmember benefits, including Membership Rewards,[®] in a cost effective manner; the triggering of obligations to make payments to certain co-brand partners, merchants, vendors and customers under contractual arrangements with such parties under certain circumstances; successfully expanding the company's on-line and off-line distribution channels and cross-selling financial, travel, card and other products and services to its customer base, both in the U.S. and abroad; effectively leveraging the company's assets, such as its brand, customers and international presence, in the Internet environment; investing in and competing at the leading edge of technology across all businesses; a downturn in the company's businesses and/or negative changes in the company's and its subsidiaries' credit ratings, which could result in contingent payments under contracts, decreased liquidity and higher borrowing costs; increasing competition in all of the company's major businesses; fluctuations in interest rates, which impact the company's borrowing costs, return on lending products and spreads in the investment and insurance businesses; credit trends and the rate of bankruptcies, which can affect spending on card products, debt payments by individual and corporate customers and businesses that accept the company's card products and returns on the company's investment portfolios; foreign currency exchange rates; political or economic instability in certain regions or countries, which could affect lending activities, among other businesses; legal and regulatory developments, such as in the areas of consumer privacy and data protection; acquisitions; the adoption of recently issued accounting rules related to the consolidation of variable interest entities, including those involving collateralized debt obligations, secured loan trusts, mutual funds, hedge funds and limited partnerships that the company manages and/or invests in, which could affect both the company's balance sheet and results of operations; and outcomes in litigation. A further description of these and other risks and uncertainties can be found in the company's Annual Report on Form 10-K for the year ended December 31, 2002, and its other reports filed with the SEC.