

# FEDERAL HOME LOAN BANKS

2006

## COMBINED FINANCIAL REPORT

This Combined Financial Report provides financial information on the Federal Home Loan Banks. Investors should use this Combined Financial Report, together with the other information expressly provided by the Federal Home Loan Banks for this purpose, when considering whether or not to purchase the consolidated bonds and consolidated discount notes (collectively referred to in this Combined Financial Report as consolidated obligations) of the Federal Home Loan Banks.

**The Securities Act of 1933, as amended, does not require the registration of consolidated obligations. No registration statement has been filed with the Securities and Exchange Commission with respect to the consolidated obligations. None of the Securities and Exchange Commission, the Federal Housing Finance Board, or any State securities commission has approved or disapproved the consolidated obligations or has passed upon the accuracy or adequacy of any offering material.**

**The consolidated obligations are not obligations of the United States and are not guaranteed by the United States.**

Neither this Combined Financial Report nor any offering material provided by the Office of Finance on behalf of the Federal Home Loan Banks concerning any offering of consolidated obligations describes all the risks of investing in consolidated obligations. Prior to investing in consolidated obligations investors should consult their financial and legal advisors about the risks of investing in any particular issue of consolidated obligations.

The financial information contained in this Combined Financial Report is as of and for periods ended on or before December 31, 2006. This document is available on the Federal Home Loan Banks' Office of Finance web site at: [www.fhlf-of.com](http://www.fhlf-of.com).

Investors should direct questions about the Federal Home Loan Banks' Combined Financial Report to the Federal Home Loan Banks' Office of Finance, Senior Director of Accounting Policy & Financial Reporting. Investors should direct questions about the Federal Home Loan Banks' consolidated obligations to the Federal Home Loan Banks' Office of Finance, Marketing & Corporate Communications Division. The address is Federal Home Loan Banks' Office of Finance, 11921 Freedom Drive, Suite 1000, Reston, VA 20190, (703) 467-3600, and the web site is [www.fhlf-of.com](http://www.fhlf-of.com). The Office of Finance will provide additional copies of this Combined Financial Report upon request. Please contact the Office of Finance to receive subsequent annual and quarterly financial reports.

**Investors should not assume, based on the delivery of this Combined Financial Report, that there has been no change in the financial condition of the Federal Home Loan Banks since December 31, 2006.**

The date of this Combined Financial Report is March 30, 2007.

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Consolidated obligations issued under the Federal Home Loan Banks' Global Debt Program may be listed on the Euro MTF market of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange has allocated the number 2306 to the Federal Home Loan Banks' Global Debt Program for listing purposes. Under the Federal Home Loan Banks' agreement with the underwriter(s) of a particular series of consolidated obligations, any series of consolidated obligations listed on the Luxembourg Stock Exchange may be delisted if the continuation of the listing has become unduly onerous in the opinion of the issuer, and the issuer has agreed with the underwriter(s) that it will use reasonable efforts to list the consolidated obligations on another stock exchange.

## **EXPLANATORY STATEMENT ABOUT FHLBANKS COMBINED FINANCIAL REPORT**

The Federal Home Loan Banks Office of Finance (Office of Finance) assumed responsibility for the preparation of the combined financial reports of the Federal Home Loan Banks (FHLBanks) in 2001, which previously had been prepared by the Federal Housing Finance Board (Finance Board). The Office of Finance does not have the same access to information about the FHLBanks as the Finance Board does in its capacity as regulator of the FHLBanks. In connection with its responsibilities in preparing combined financial reports, the Office of Finance is responsible for combining the financial information it receives from each of the FHLBanks. Each FHLBank is responsible for the financial information it provides to the Office of Finance and the underlying data it provides to the Office of Finance for inclusion in the combined financial reports.

The combined financial reports of the FHLBanks are intended to be used by investors who invest in the consolidated bonds and consolidated discount notes of the FHLBanks. These consolidated obligations are the joint and several obligations of the FHLBanks. This means that each individual FHLBank is responsible to the registered holders of the consolidated obligations for the payment of principal of and interest on all consolidated obligations issued by the FHLBanks.

Even though the consolidated obligations are the joint and several obligations of all of the FHLBanks, each FHLBank is a separately chartered entity. Each has its own board of directors and management. This is the case even though some financial institutions may have one or more affiliates that is a member of one or more FHLBanks. There is no system-wide central management of the FHLBanks. All FHLBanks are subject to regulations issued by the Finance Board, which periodically examines each FHLBank's operations.

Although each FHLBank has publicly available financial information, the financial information relating to the FHLBanks is presented to investors in consolidated obligations on a "combined" basis because this is considered more convenient for investors than providing financial information on each FHLBank on a stand-alone basis only. Investors should note, however, that this combined presentation describes a combination of assets and liabilities for this purpose only. This combined presentation in no way indicates that these assets and liabilities are under joint management and control. Each individual FHLBank manages its operations independently and with only minimal consideration as to how the transactions it enters into might affect the combined financial results.

In addition, each FHLBank's board of directors and management is responsible for establishing its own accounting and financial reporting policies in accordance with U.S. generally accepted accounting principles (GAAP). The 12 FHLBanks' accounting and financial reporting policies and practices are not necessarily always identical because different policies and/or presentations are permitted under GAAP in certain circumstances. However, all 12 FHLBanks' accounting and financial reporting policies conform to GAAP. Statements in this report may be qualified by a term such as "generally", "primarily", "typically" or words of similar meaning to indicate that the statement is generally applicable to all FHLBanks or the kinds of transactions described but which may not be applicable to all 12 FHLBanks as a result of their differing business practices and accounting and financial reporting policies under GAAP. An investor should review available information on individual FHLBanks to obtain more specific information on an FHLBank's business practices and accounting and financial reporting policies.

The FHLBanks occasionally engage in transactions in which one FHLBank transfers its direct liability on outstanding consolidated bonds to another FHLBank that assumes the direct liability on those outstanding consolidated bonds. By engaging in these transactions, two FHLBanks are able to better match their funding needs. Excess funds held by one FHLBank are transferred to another FHLBank that needs them. These transfers generally result in costs for the FHLBank that assumes the liability for the debt that are equal to or lower than those available for a similarly-sized transaction in the capital markets at that time. Because the consolidated bonds are the joint and several obligation of all 12 FHLBanks, these interbank transactions have no effect on the holders of the consolidated bonds. (See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Results of Operations—Interbank Transfers of Liability on Outstanding Consolidated Bonds and Their Effect on Combined Net Income” and Note 1 to the accompanying combined financial statements.)

### **AVAILABLE INFORMATION ON INDIVIDUAL FHLBANKS**

The FHLBanks provide information on their operations on an ongoing basis.

Pursuant to a Finance Board regulation, each FHLBank is subject to certain reporting requirements of the Securities Exchange Act of 1934, as amended (1934 Act) and must file certain periodic reports and other information with the U.S. Securities and Exchange Commission (SEC). These periodic reports and other information filed pursuant to the 1934 Act, including each FHLBank’s description of the risk factors applicable to that FHLBank, may be inspected without charge and copied at prescribed rates at the public reference facilities of the SEC’s principal office at 100 F Street, N.E., Washington, D.C. 20549. Investors may obtain information on the operation of the SEC’s public reference facilities by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site at: <http://www.sec.gov> that will contain the periodic reports and other information filed by the FHLBanks with the SEC.

On August 8, 2006, all 12 FHLBanks’ registrations with the SEC were effective. Each FHLBank prepares individual financial reports containing financial information relating to its financial condition and results of operations and files this information annually with the SEC on Form 10-K and quarterly on Form 10-Q. All of this information is made available on the respective web site of each FHLBank. The web site of the Office of Finance is located at [www.fhlf-of.com](http://www.fhlf-of.com). This site also contains links to the web sites of each individual FHLBank.

Please note that we are providing all of the web site addresses and the identification of available information above solely as a matter of convenience. These web site addresses are not intended to be active links and their contents and the other available information are not a part of this report and are not intended to be incorporated by reference into this report.

## FEDERAL HOME LOAN BANKS

### SUMMARY FINANCIAL DATA

(Dollar amounts in millions)

	2006	2005	2004	2003	2002
<b>At December 31,</b>					
Advances .....	\$ 640,681	\$619,860	\$581,216	\$514,037	\$489,338
Mortgage loans held for portfolio, net .....	97,974	105,240	113,922	113,438	60,455
Investments(1) .....	270,663	266,454	224,911	189,561	206,394
Total assets .....	1,016,469	997,389	924,751	822,418	763,052
Deposits and borrowings .....	21,172	21,758	21,174	23,260	29,907
Consolidated obligations, net(2) .....	934,214	915,901	845,738	740,721	673,383
Subordinated notes(3) .....	1,000				
Mandatorily redeemable capital stock .....	1,094	1,451	1,153		
Capital stock—Class B putable(4) .....	38,882	37,786	31,819	15,082	7,733
Capital stock—Class A putable(4) .....	532	498	326		
Capital stock—Preconversion putable(4) .....	2,587	3,759	7,947	22,621	27,453
Total capital stock putable(5) (6) .....	<u>42,001</u>	<u>42,043</u>	<u>40,092</u>	<u>37,703</u>	<u>35,186</u>
Retained earnings(2) .....	3,143	2,600	1,744	1,098	716
Total capital(5) .....	44,985	44,480	41,863	38,980	36,200
<b>Average balances for the year ended</b>					
<b>December 31,</b>					
Advances .....	638,656	607,581	551,928	501,942	476,529
Mortgage loans held for portfolio, net .....	101,368	109,940	114,434	88,959	39,749
Investments(1) .....	257,893	229,834	208,377	195,789	203,063
Total assets .....	1,007,703	954,837	881,481	794,980	728,368
Deposits and borrowings .....	19,149	20,104	21,955	30,316	29,474
Consolidated obligations(2) .....	924,204	873,519	799,460	703,570	644,841
Subordinated notes(3) .....	553				
Mandatorily redeemable capital stock .....	1,187	1,342	805		
Capital stock—Class B putable(4) .....	38,383	33,289	22,546	12,000	981
Capital stock—Class A putable(4) .....	517	394	68		
Capital stock—Preconversion putable(4) .....	3,246	7,378	16,232	24,646	33,190
Total capital stock putable(5) (6) .....	<u>42,146</u>	<u>41,061</u>	<u>38,846</u>	<u>36,646</u>	<u>34,171</u>
Retained earnings(2) .....	3,040	2,232	1,487	969	911
<b>Operating results for the year ended</b>					
<b>December 31,</b>					
Net interest income(6) (7) .....	4,293	4,207	4,171	3,877	3,722
Net income(2) (6) .....	2,612	2,525	1,994	1,885	1,507
Cash and stock dividends(6) .....	2,069	1,669	1,348	1,503	1,540
Weighted average dividend rate(6) (8) .....	4.91%	4.06%	3.47%	4.10%	4.51%
Return on average equity .....	5.80%	5.84%	4.93%	4.97%	4.28%
Return on average assets .....	0.26%	0.26%	0.23%	0.24%	0.21%
Net interest margin(6) (7) (9) .....	0.43%	0.45%	0.48%	0.49%	0.52%
<b>At December 31,</b>					
Total capital ratio(6) (10) .....	4.43%	4.46%	4.53%	4.74%	4.74%

- (1) Investments consist of:
- a) held-to-maturity securities;
  - b) available-for-sale securities;
  - c) trading securities;
  - d) interest-bearing deposits;
  - e) securities purchased under agreements to resell; and
  - f) Federal funds sold.

- (2) See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Results of Operations—Interbank Transfers of Liabilities on Outstanding Consolidated Bonds and Their Effect on Combined Net Income” and “Explanatory Statement about FHLBanks Combined Financial Report.”
- (3) On June 13, 2006, the FHLBank of Chicago issued \$1.0 billion of subordinated notes that mature on June 13, 2016. Moody’s and Standard and Poor’s rated the subordinated notes Aa2 and AA-. The subordinated notes are not obligations of, and are not guaranteed by, the United States government or any of the FHLBanks other than the FHLBank of Chicago. (See Note 15 to the accompanying combined financial statements.)
- (4) The FHLBanks of Cincinnati, Pittsburgh and Seattle each implemented its respective capital plan during 2002. The FHLBanks of Indianapolis, Des Moines and Dallas each implemented its respective capital plan during 2003. The FHLBanks of Atlanta, Boston, San Francisco and Topeka each implemented its respective capital plan during 2004. The FHLBank of New York implemented its capital plan in 2005. For 2006, the corresponding balance for capital stock—Preconversion puttable relates solely to the FHLBank of Chicago. (See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Legislative and Regulatory Developments” and Note 16 to the accompanying combined financial statements.)
- (5) FHLBank capital stock is redeemable at the request of a member subject to the statutory redemption periods and other conditions and limitations. (See “Business—Capital, Capital Rules and Dividends” and Note 16 to the accompanying combined financial statements.)
- (6) Effective January 1, 2004, the FHLBanks reclassified \$946 million of their outstanding capital stock to “mandatorily redeemable capital stock” in the liability section of the Statement of Condition as a result of adopting Statement of Financial Accounting Standards (SFAS) No. 150, *Accounting for Certain Financial Instruments and Characteristics of both Liabilities and Equity* (SFAS 150). Upon adoption, the FHLBanks also recorded estimated dividends earned as a part of the carrying value of the mandatorily redeemable capital stock. The difference between the prior carrying amount and the mandatorily redeemable capital stock of \$1 million was recorded as a cumulative effect of a change in accounting principle in the Statement of Income. For the years ended December 31, 2006, 2005 and 2004, dividends on mandatorily redeemable capital stock in the amounts of \$60 million, \$48 million and \$22 million were recorded as interest expense. Although the mandatorily redeemable capital stock is not included in capital for financial reporting purposes, it is considered capital for regulatory purposes. (See Note 16 to the accompanying combined financial statements for information on the significant restrictions on stock redemption.)
- (7) Net interest income is net interest income before (reversal) provision for credit losses. For the year ended December 31, 2002, the FHLBanks have reclassified realized gains and losses (e.g., net interest payments) on stand-alone derivative instruments used in economic hedges. Previously, realized gains and losses on stand-alone derivatives used in economic hedges were classified within net interest income after (reversal) provision for credit losses, while unrealized gains (losses) on these derivatives were recorded in net gains (losses) on derivatives and hedging activities within other income. To be consistent with the current presentation, these amounts have been reclassified and are now included in net gains (losses) on derivatives and hedging activities within other income for the year ended December 31, 2002. For the years ended December 31, 2003 and 2002, the FHLBanks reclassified prepayment fee income from other income to net interest income to be consistent with the current presentation.
- (8) Weighted average dividend rates are cash and stock dividends divided by the average of capital stock eligible for dividends.
- (9) Net interest margin is net interest income before (reversal) provision for credit losses, represented as a percentage of average earning assets.
- (10) Total capital ratio is capital stock plus retained earnings and accumulated other comprehensive income, represented as a percentage of total assets at period end. This capital ratio is computed in accordance with U.S. Generally Accepted Accounting Principles.



## BUSINESS

### General Information

The 12 Federal Home Loan Banks (FHLBanks) are government-sponsored enterprises of the United States of America, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended (FHLBank Act). The Office of Finance is a joint office of the FHLBanks established by the Federal Housing Finance Board (Finance Board) to facilitate the issuance and servicing of the consolidated obligations of the FHLBanks and to prepare this financial report. The Finance Board is an independent agency within the executive branch of the U.S. government charged with the regulation of the FHLBanks and the Office of Finance.

The primary purpose of the FHLBanks is to enable their member financial institutions (members) to assure the flow of credit and other services for housing and community development. The FHLBanks serve the general public by providing liquidity to members, thereby increasing the availability of credit for residential mortgages and community investments. The FHLBanks provide a readily available, low-cost source of funds to their members. In addition, most of the FHLBanks provide members with a means of enhancing liquidity by purchasing or funding member home mortgages through mortgage programs developed for their members. Under these programs, members are offered the opportunity to sell qualifying mortgages to, or fund them through, an FHLBank. Members can also borrow from an FHLBank to fund low-income housing, helping the members satisfy their regulatory requirements under the Community Reinvestment Act (CRA). Finally, the FHLBanks offer their members a variety of services such as: correspondent banking; cash management; security safekeeping; wire transfers; letters of credit; and settlements.

The following table presents the FHLBanks' asset mix at December 31, 2006 and 2005.

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
	<u>Percentage of Total Assets</u>	<u>Percentage of Total Assets</u>
Advances .....	63.0%	62.1%
Investments .....	26.6%	26.7%
Mortgage loans held for portfolio, net.....	9.6%	10.6%
Other assets .....	<u>0.8%</u>	<u>0.6%</u>
Total assets.....	<u>100.0%</u>	<u>100.0%</u>

The FHLBanks fund their assets and operations principally through the sale of debt instruments to the public, known as consolidated obligations, through the Office of Finance. Each FHLBank is jointly and severally liable with the other FHLBanks for all consolidated obligations issued. Consolidated obligations are not obligations of the United States, and the U.S. government does not guarantee them. Additional funds are provided by:

- deposits;
- other borrowings; and
- the issuance of capital stock.



The following table presents the FHLBanks' liability and capital mix at December 31, 2006 and 2005.

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
	<u>Percentage of Total Assets</u>	<u>Percentage of Total Assets</u>
Total consolidated obligations, net.....	91.9%	91.8%
Deposits .....	1.9%	1.9%
Other liabilities .....	1.8%	1.8%
Total capital .....	<u>4.4%</u>	<u>4.5%</u>
Total liabilities and capital .....	<u>100.0%</u>	<u>100.0%</u>

The FHLBanks are cooperatives, which means that only members and former members own the capital stock in each of the FHLBanks and receive dividends on their investment in capital stock from the earnings of their respective FHLBank. Membership is limited to regulated depositories and insurance companies engaged in housing finance. A table identifying members of the FHLBanks by type of financial institution is included on page 113. Each FHLBank operates as a separate entity within a defined geographic region of the country, known as its "district." Each financial institution that becomes a member of an FHLBank may only be a member of one FHLBank, and generally may purchase capital stock only in the FHLBank whose district includes the state where the member's principal corporate offices are located. Each FHLBank is privately-owned and has its own board of directors, management and employees. Membership is voluntary.

As a member-owned cooperative, each FHLBank conducts the majority of its credit and mortgage program businesses almost exclusively with members. An FHLBank may also purchase short-term investments, Federal funds and mortgage-backed securities from members. All investments are market rate transactions and all mortgage-backed securities are purchased through securities brokers or dealers.

The major source of revenue for the FHLBanks is interest income earned on advances, investments and mortgage loans held for portfolio. The major items of expense for the FHLBanks are interest paid on consolidated obligations and member deposits; REFCORP and AHP assessments; and employee salaries and benefits. A key driver of net interest income and net income is the return the FHLBanks receive on invested capital because there is no related interest expense.

### **Historical Perspective**

The fundamental business of the FHLBanks is to provide a readily available, competitively-priced source of funds in a wide range of maturities to meet the demands of members and non-member housing associates. Congress created the FHLBanks in 1932 to improve the availability of funds to support home ownership. Although the FHLBanks were initially capitalized with government funds, their members have provided all the FHLBanks' capital for over 50 years.

Congress originally granted access to advances only to those institutions with the potential to make and hold long-term, amortizing home mortgage loans. Such institutions were primarily Federally- and state-chartered savings and loan associations, cooperative banks, and state-chartered savings banks (thrift institutions). As a result, FHLBanks and their member thrift institutions became an integral part of the home mortgage financing system in the United States. However, a variety of factors, including a severe recession, record-high interest rates, and deregulation, resulted in significant losses for thrift institutions in the 1980s. In reaction to the significant cost to the American taxpayer of resolving failed thrift institutions, Congress restructured the home mortgage financing system in 1989 by passing the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). Congress reaffirmed the housing finance mission of the FHLBanks, and expanded

membership eligibility in the FHLBanks to include commercial banks and credit unions with a commitment to housing finance.

## Advances

The FHLBanks make loans, called “advances,” to their members and eligible housing associates on the security of mortgages and other collateral pledged by the borrowing member or housing associate. Advances are the largest category of assets of the FHLBanks on a combined basis, representing 63.0 percent of total assets at December 31, 2006 and 62.1 percent of total assets at December 31, 2005. Advances generally are collateralized by mortgages held in member portfolios. Because portfolio lenders may originate loans that they are unwilling or unable to sell in the secondary mortgage market, FHLBank advances can serve as a funding source for a variety of conforming and nonconforming mortgages. FHLBank advances support important housing markets, including those focused on low- and moderate-income households. For those members that choose to sell or securitize their mortgages, FHLBank advances can provide interim funding.

Each FHLBank develops its program of advances to meet the particular needs of its members. The FHLBanks offer a wide array of fixed- and variable-rate advances, with maturities ranging from one day to 30 years. The FHLBanks offer both standard and customized advance structures. The more standard advances include the following:

- *Fixed-Rate Advances.* Fixed-rate advances have maturities ranging from one day to 30 years. The FHLBanks also offer convertible fixed-rate advances, which allow the FHLBanks to convert to open-line advances or other structures after an agreed upon lockout period. In addition, the FHLBanks offer putable fixed-rate advances, which allow FHLBanks to put or extinguish their fixed-rate advances and borrowers to enter into new advances. Maturities of convertible and putable fixed-rate advances generally range from one month to 15 years.
- *Variable-Rate Advances.* Variable-rate advances include advances with maturities less than 30 days to 10 years, where the interest rates reset periodically at a fixed spread to LIBOR or other specified standardized indices. Depending upon the advance selected, the member can have a cap on the interest rate or prepay the advance with or without a prepayment fee.
- *Fixed-Rate Amortizing Advances.* Fixed-rate amortizing advances have final maturities that range from one year to 30 years, with the principal repaid over the term of the advances with monthly, quarterly, semi-annual or annual amortization periods. Amortizing advances may be fully amortizing to the maturity date, or may have a balloon payment at maturity.
- *Variable- to Fixed-Rate Convertible Advances.* Variable- to fixed-rate convertible advances have maturities that range from two years to 10 years, with a defined lockout period during which the interest rates adjust based on a spread to LIBOR. At the end of the lockout period, these advances may convert to fixed-rate advances. The fixed rates on the converted advances are determined at origination.
- *Open-Line Advances.* Open-line advances are designed to provide flexible funding to meet borrowers’ daily liquidity needs and can be drawn for one day. These advances are automatically renewed until the member pays down the advances. Interest rates are set daily.

Customized advances may include:

- advances with non-standard interest rate indices;
- advances with standardized interest rate indices that are averaged;
- advances with embedded optionality (such as interest rate caps, floors and collars, and call and put options); and
- advances with partial prepayment symmetry. Partial prepayment symmetry means that the FHLBank may charge the member a prepayment fee or pay the member a prepayment fee, depending on certain factors such as changes in interest rates, when the advance is prepaid.

Pursuant to the FHLBank Act, the FHLBanks are permitted to make advances to non-members that are approved mortgagees under Title II of the National Housing Act (housing associates). In addition, to be eligible for advances from an FHLBank, housing associates must also:

- be chartered under law and have succession;
- be subject to inspection and supervision by some governmental agency; and
- lend their own funds as their principal activity in the mortgage field.

Housing associates are not subject to certain provisions applicable to members under the FHLBank Act. For example, they do not purchase capital stock in an FHLBank. However, the same regulatory lending requirements generally apply to them as apply to members.

FHLBank advances can also provide funding to smaller lenders that lack diverse funding sources. Smaller community lenders very often do not have access to many of the funding alternatives available to larger financial entities, including repurchase agreements, commercial paper and brokered deposits. The FHLBanks give these lenders access to wholesale funding at competitive prices.

FHLBank credit products also help members in the management of their assets and liabilities. The FHLBanks can offer advances that are matched to the maturity and prepayment characteristics of mortgage loans. These advances can reduce a member's interest-rate risk associated with holding long-term, fixed-rate mortgages. Alternatively, members can also enter into interest-rate exchange agreements directly with an FHLBank to reduce their exposure to interest-rate risk. In addition, an FHLBank may make commitments for advances to a member covering a pre-defined period. This program aids members and the FHLBanks in their cash flow planning and enables members to reduce their funding risk.

The FHLBanks help members meet their responsibilities under the CRA. Through the Affordable Housing Program (AHP), the Community Investment Program (CIP) and the Community Investment Cash Advance (CICA) programs, members have access to subsidized and other low-cost funding to create affordable rental and homeownership opportunities and for commercial and economic development activities that benefit very low- to moderate-income neighborhoods, thereby contributing to the revitalization of these communities.

From the establishment of the CIP and CICA in 1990 through 2005, the latest information available on the Finance Board's web site, approximately \$34.7 billion in FHLBank-supported lending for housing development has financed over 609 thousand housing units. In addition to housing developments, over \$9.3 billion in FHLBank-supported community lending has helped finance thousands of local economic community development projects.

For 15 years, the AHP has provided significant resources for housing development across the 50 states and U.S. territories. The FHLBanks awarded AHP subsidies of \$245 million in 2005, the latest information available on the Finance Board's web site, for projects designed to provide approximately 42 thousand housing units. From the inception of the AHP in 1990 through 2005, the latest information available on the Finance Board's web site, the FHLBanks have awarded over \$2.5 billion in AHP subsidies to facilitate development of affordable housing projects designed to create approximately 519 thousand units for very low- to moderate-income families. The FHLBanks are one of the largest sources of private funding for affordable housing in the nation. (See Note 9 to the accompanying combined financial statements.)

The FHLBanks serve as a source of liquidity for their members. Access to FHLBank advances can reduce the amount of low-yielding liquid assets a member would otherwise need to hold to ensure the same amount of liquidity. The FHLBanks' members are required to pledge collateral to secure their advances, which is described in more detail in "Risk Management—Credit Risk—Managing Credit Risk—Advances."

## **Acquired Member Asset Programs—Mortgage Loans Held for Portfolio**

The FHLBanks have programs to purchase mortgage loans from, and fund mortgage loans through, Participating Financial Institutions (PFIs). The primary programs are the Mortgage Partnership Finance (MPF®) Program<sup>1</sup> and the Mortgage Purchase Program (MPP). Under the MPF Program, loans are funded through or purchased from PFIs.

The current MPF FHLBanks are the FHLBanks of Atlanta, Boston, Chicago, Dallas, Des Moines, New York, Pittsburgh, San Francisco and Topeka. On October 6, 2006, the FHLBank of San Francisco announced that it would no longer offer new master commitments to purchase mortgage loans from its PFIs under the MPF Program. The FHLBank of Chicago acts as “MPF Provider” and provides programmatic and operational support to the MPF FHLBanks and their PFIs.

The current MPP FHLBanks are Cincinnati, Indianapolis and Atlanta. In March 2005, the FHLBank of Seattle announced that it is exiting its MPP by ceasing to enter into new master commitment contracts under the MPP.

*MPF Loans and MPP Loans.* Many members who originate mortgage loans choose to sell these loans into the secondary market rather than hold them in their own portfolios. Under the MPF Program and MPP, the FHLBanks principally invest in qualifying five-year to 30-year conventional conforming and government-guaranteed (mortgage loans insured or guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, the Rural Housing Service of the Department of Agriculture (RHS) and/or the Department of Housing and Urban Development (HUD)) fixed-rate mortgage loans and participations in pools of such mortgage loans, secured by one-to-four family residential properties, by purchasing them from or funding them through participating members. Under the MPF Program, one or more MPF FHLBanks may participate in all or a portion of the acquired mortgage loans obtained from a PFI of another MPF FHLBank. Mortgage loans held for portfolio represented 9.6 percent of the FHLBanks’ combined total assets at December 31, 2006 and 10.6 percent of the FHLBanks’ combined total assets at December 31, 2005. At December 31, 2006, the FHLBanks had invested in MPF loans and MPP loans in all 50 states, the District of Columbia and Puerto Rico. No single zip code represented more than one percent of either MPF loans or MPP loans outstanding at December 31, 2006.

Under the mortgage programs, an FHLBank manages the interest-rate risk, prepayment option risk and liquidity risk of the fixed-rate mortgage loans in which it holds an interest, while the corresponding member manages the origination and servicing activities. Each FHLBank holding an interest in a mortgage loan, and the member selling the mortgage loan share in the credit risk of the mortgage loans pursuant to a master agreement and master commitment contract. Under these programs, a participating member, referred to as a PFI, provides a measure of credit-loss protection to the FHLBank(s) holding interests in loans generated by the PFI. In the case of the MPF Program, the selling PFI receives a credit-enhancement fee, and in the case of MPP, the selling PFI benefits from the Lender Risk Account (LRA). In the case of the MPF Program, all loss allocations to a PFI and its FHLBank are covered by each master commitment contract between that PFI and its FHLBank. In the case of MPP, all loss allocations to a PFI and its FHLBank are based upon individual pools of loans covered by each master commitment contract between that PFI and its FHLBank.

A more detailed discussion of the credit enhancement and risk-sharing arrangements and loan product information for the MPF Program and MPP is included under “Risk Management—Credit Risk—Managing Credit Risk—Mortgage Loans Held for Portfolio” below and in the “Supplemental Information” section.

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<sup>1</sup> “Mortgage Partnership Finance,” “MPF,” “MPF Shared Funding” and “eMPF” are registered trademarks of the FHLBank of Chicago.

*MPF Product Information/MPP Product Information.* A variety of MPF products have been developed to meet the differing needs of PFIs, but they are all premised on the same risk-sharing concept. The MPP operates with a single structure but also includes FHA-insured mortgage loans.

**PRODUCT COMPARISON CHART  
MPF PROGRAM AND MPP\***

<b>Product Name</b>	<b>FHLBank First Loss Account Size</b>	<b>PFI Credit Enhancement Description</b>	<b>Average Credit Enhancement Amount</b>	<b>Credit Enhancement Fee to PFI</b>	<b>Credit Enhancement Fee Offset(1)</b>	<b>Servicing Fee to PFI</b>
Original MPF	3 to 5 basis points/added each year based on the unpaid balance	Equivalent to "AA"	1.76%	8 to 11 basis points/year—paid monthly	No	25 basis points/year
MPF 100	100 basis points fixed based on the size of the loan pool at closing	After First Loss Account to "AA"	1.52%	7 to 11 basis points/year—paid monthly; performance-based after 2 or 3 years	Yes—after first 2 to 3 years	25 basis points/year
MPF 125	100 basis points fixed based on the size of the loan pool at closing	After First Loss Account to "AA"	1.91%	7 to 10 basis points/year—paid monthly; performance-based	Yes	25 basis points/year
MPF Plus	Sized to equal expected losses	0 to 20 basis points after First Loss Account and Supplemental Mortgage Insurance (SMI) to "AA"	1.70%	6.5 to 8.5 basis points/year—plus 8 to 10 basis points/year performance-based (delayed for 1 year); all fees paid monthly	Yes	25 basis points/year
MPF Government(2)	N/A	N/A (Unreimbursed servicing expenses)	N/A	N/A	N/A	44 basis points/year plus 2 basis points/year—paid monthly (U.S. Government loan fee)
MPP	30 to 50 basis points based on pool risk factors and expected losses	After First Loss Account to "AA" using SMI	N/A	N/A	N/A	25 basis points/year
MPP FHA	N/A	Unreimbursed servicing expenses	N/A	N/A	N/A	44 basis points/year

\* Current as of December 31, 2006

- (1) Future payouts of performance-based credit enhancement fees are reduced when losses are allocated to the First Loss Account.
- (2) Formerly called Original MPF for FHA/VA. For master commitments issued prior to February 2, 2007, the PFI is paid a monthly government loan fee equal to 0.02 percent (2 basis points) per annum based on the month end outstanding aggregate principal balance of the master commitment, which is in addition to the customary 0.44 percent (44 basis points) per annum servicing fee that continues to apply for master commitments issued after February 1, 2007, and that is retained by the PFI on a monthly basis, based on the outstanding aggregate principal balance of the mortgage loans.

*MPF Shared Funding Program.* Several FHLBanks participate in the MPF Shared Funding Program, which is administered by an unrelated third party. This program allows mortgage loans originated through the MPF Program to be sold to a third party-sponsored trust and "pooled" into securities. The FHLBank of Chicago purchased MPF Shared Funding securities in two transactions



in 2003 and sold a portion of the MPF Shared Funding to other FHLBanks at the original transaction closing. The investments are classified as held-to-maturity securities and are reported at amortized cost of \$489 million and \$556 million at December 31, 2006 and 2005. These securities, which are rated AA, are not publicly traded and are not guaranteed by any of the FHLBanks.

### **Investments**

The FHLBanks maintain portfolios of investments for liquidity purposes, to manage capital stock repurchases and redemptions and to provide additional earnings. This investment income also bolsters the FHLBanks' capacity to meet their commitments to affordable housing and community investment, to cover operating expenses and to satisfy the Resolution Funding Corporation (REFCORP) assessment, as discussed in more detail in the "Business-Tax Status" section. To ensure the availability of funds to meet the credit needs of their members, the FHLBanks maintain portfolios of short-term investments issued by highly-rated institutions, which include:

- overnight Federal funds;
- term Federal funds;
- interest-bearing certificates of deposits; and
- commercial paper.

The FHLBanks also enhance interest income by maintaining longer-term investment portfolios. These include mortgage-backed securities (MBS) issued by government-sponsored mortgage agencies and enterprises or those that carry the highest ratings from Moody's Investors Service (Moody's) or Standard & Poor's Ratings Services (S&P) at the time of purchase, securities issued by U.S. government-sponsored agencies and instrumentalities, and securities issued by state or local housing finance agencies. The long-term investment portfolios provide the FHLBanks with higher returns than those available in the short-term money markets. Investments represented 26.6 percent of the FHLBanks' combined total assets at December 31, 2006 and 26.7 percent of the FHLBanks' combined total assets at December 31, 2005.

Finance Board regulations prohibit the FHLBanks from investing in certain types of securities and limit the FHLBanks' investment in MBS and asset-backed securities. These restrictions and limitations are set out in more detail in "Risk Management—Credit Risk—Managing Credit Risk—Investments."

### **Debt Financing—Consolidated Obligations**

Consolidated obligations, consisting of bonds and discount notes, are the principal funding source for the FHLBanks and are the joint and several obligations of the 12 FHLBanks. Consolidated obligations represent the primary source of liabilities used by the FHLBanks to fund advances, the mortgage programs and investments. All consolidated obligations are issued through the Office of Finance on behalf of the 12 FHLBanks. Regardless of the method of issuance, the Office of Finance can issue consolidated obligations only when an FHLBank provides a request for and agrees to accept the funds.

Consolidated obligations represented an amount equal to 91.9 percent of total assets at December 31, 2006 and 91.8 percent of the FHLBanks' combined total assets at December 31, 2005. The capital markets have traditionally considered the FHLBanks' obligations as being equivalent to "Federal agency" debt. As a result, although the U.S. government does not guarantee the FHLBanks' debt, the FHLBanks have traditionally had ready access to funding at relatively favorable rates. The FHLBanks' ability to access the capital markets through the sale of consolidated obligations, across the entire maturity spectrum and through a variety of debt structures, allows the FHLBanks to manage their balance sheets effectively and efficiently.

Consolidated obligations are currently rated Aaa/P-1 by Moody's Investor Service and AAA/ A-1+ by S&P. These are the highest ratings available for such debt from a Nationally

Recognized Statistical Rating Organization (NRSRO). These ratings indicate that the FHLBanks have an extremely strong capacity to meet their commitments to pay principal and interest on consolidated obligations and that the consolidated obligations are judged to be of the highest quality with minimal credit risk. The ratings on the FHLBanks' consolidated obligations also reflect the FHLBank System's status as a government-sponsored enterprise (GSE). These ratings have not been affected by rating actions taken with respect to individual FHLBanks. Investors should note that a rating issued by an NRSRO is not a recommendation to buy, sell or hold securities and that the ratings may be revised or withdrawn by the NRSRO at any time. Investors should evaluate the rating of each NRSRO independently.

Consolidated obligations are generally issued with either fixed-rate payment terms or variable-rate payment terms that use a variety of indices to reset interest rates. The interest rate indices typically include:

- the London Interbank Offered Rate (LIBOR);
- the Constant Maturity Treasury (CMT); and
- the 11th District Cost of Funds Index (COFI).

In connection with the sale of any particular issue of consolidated obligations, any FHLBank receiving the proceeds may enter into interest-rate exchange agreements or other transactions with or arranged by the applicable securities dealer, bank, affiliate, or an unaffiliated third party. Certain securities dealers and banks and their affiliates also engage in other transactions with and perform services for the FHLBanks. These services include the purchase and sale of investment securities. In some cases, some or all of the net proceeds from an issue of consolidated obligations may be loaned to a member that is affiliated with the securities dealer involved in underwriting that issue.

Although each FHLBank is primarily liable for the portion of consolidated obligations (COs) corresponding to the proceeds received by that FHLBank, each FHLBank is also jointly and severally liable with the other 11 FHLBanks for the payment of principal of and interest on all COs. Under Finance Board regulations, if the principal of or interest on any CO issued on behalf of one of the FHLBanks is not paid in full when due, the FHLBank responsible for the payment may not pay dividends to, or redeem or repurchase shares of stock from, any member of the FHLBank. The Finance Board, in its sole discretion, may require any FHLBank to make principal or interest payments due on any COs, whether or not the primary obligor FHLBank has defaulted on the payment of that obligation.

To the extent that an FHLBank makes any payment on a CO on behalf of another FHLBank, the paying FHLBank shall be entitled to reimbursement from the FHLBank otherwise responsible for the payment. However, if the Finance Board determines that an FHLBank is unable to satisfy its obligations, then the Finance Board may allocate the outstanding liability among the remaining FHLBanks on a pro-rata basis in proportion to each FHLBank's participation in all COs outstanding, or on any other basis that the Finance Board may determine.

The Finance Board has never required an FHLBank to repay obligations in excess of its participation nor have they allocated to an FHLBank any outstanding liability of any other FHLBank's COs.

Finance Board regulations require that each FHLBank maintain the following types of assets, free from any lien or pledge, in an amount at least equal to the amount of that FHLBank's participation in the total consolidated obligations outstanding:

- Cash;
- Obligations of, or fully guaranteed by, the United States;
- Secured advances;



- Mortgages, which have any guaranty, insurance or commitment from the United States or any agency of the United States;
- Investments described in Section 16(a) of the FHLBank Act (e.g., securities that a fiduciary or trust fund may purchase under the laws of the state in which the FHLBank is located); and
- Other securities that are assigned a rating or assessment by an NRSRO that is equivalent or higher than the rating or assessment assigned by that NRSRO to consolidated obligations.

In addition, each FHLBank must adhere to the leverage limits set by the FHLBank Act. At December 31, 2006, each FHLBank was in compliance with these requirements.

*Discount Notes.* On a daily basis, FHLBanks may request that specific amounts of discount notes with specific maturity dates be offered by the Office of Finance for sale through certain securities dealers. The Office of Finance commits to issue discount notes on behalf of the requesting FHLBanks when dealers submit orders for the specific discount notes offered for sale. The FHLBanks receive funding based on the time of their request, the rate requested for issuance, the trade date, the settlement date and the maturity date. If all terms of the request are the same except for the time of the request, then the FHLBank may receive from zero to 100 percent of the proceeds of the sale of the discount notes issued depending on the time of the request, the maximum costs the FHLBank or other FHLBanks, if any, participating in the same issuance of discount notes are willing to pay for the discount notes, and the amount of orders for the discount notes submitted by dealers.

Twice weekly, FHLBanks may also request that specific amounts of discount notes with fixed maturity dates ranging from four to 26 weeks be offered by the Office of Finance through competitive auctions conducted with securities dealers in the discount note selling group. One or more of the FHLBanks may also request that amounts of those same discount notes be offered for sale for their benefit through the same auction. The discount notes offered for sale through competitive auction are not subject to a limit on the maximum costs the FHLBanks are willing to pay. The FHLBanks receive funding based on their requests at a weighted-average rate of the winning bids from the dealers. If the bids submitted are less than the total of the FHLBanks' requests, an FHLBank receives funding based on that FHLBank's capital relative to the capital of other FHLBanks offering discount notes.

These discount notes presently have a maturity range of up to one year. They are sold at a discount and mature at par.

*Consolidated Bonds.* Consolidated bonds are issued primarily to raise intermediate and long-term funds. They can be issued and distributed through negotiated or competitively bid transactions with approved underwriters or selling group members. Consolidated bonds generally carry fixed- or variable-rate payment terms and have maturities ranging from one month to 30 years, although there is no statutory or regulatory limitation as to their maturity.

To meet the specific needs of certain investors in consolidated obligations, both fixed-rate bonds and variable-rate bonds issued by the FHLBanks may contain certain embedded features, which can result in complex coupon payment terms and call features. When consolidated obligation bonds with these kinds of features are issued, the FHLBank concurrently enters into interest-rate exchange agreements that contain offsetting features, which effectively alter the terms of the bonds to straight-forward variable-rate bonds tied to an index.

The FHLBanks also use the TAP Issue Program to issue fixed-rate, noncallable (bullet) bonds. This program uses specific maturities that may be reopened daily during a three-month period through competitive auctions. The goal of the TAP Issue Program is to aggregate frequent smaller bond issues into a larger bond issue that may have greater market liquidity.

## Debt Financing—Subordinated Notes

Under Section 11(a) of the FHLBank Act, no FHLBank is permitted to issue individual debt unless it has received approval from the Finance Board. As approved by the Finance Board, on June 13, 2006, the FHLBank of Chicago issued \$1.0 billion of 10-year subordinated notes. These subordinated notes are the sole obligation of the FHLBank of Chicago and are not consolidated obligations. No other FHLBanks has requested approval to issue subordinated notes.

## Deposits

The FHLBanks offer demand, overnight and term deposit programs to their members and to qualifying non-members. The FHLBank Act allows each FHLBank to accept deposits from:

- its members;
- any institution for which it is providing correspondent services;
- other FHLBanks; or
- other U.S. government instrumentalities.

Deposit programs, although not as significant as other funding sources, provide some of the funding resources for the FHLBanks. To a much lesser extent than consolidated obligations, deposits also provide funding for advances and investments. At the same time, they offer members a low-risk earning asset that satisfies their regulatory liquidity requirements. Deposits represented an amount equal to 1.9 percent of the FHLBanks' combined total assets at December 31, 2006 and December 31, 2005.

The following table presents term deposits issued in amounts of \$100,000 or more at December 31, 2006 and 2005 (dollar amounts in millions):

<u>Term Deposits by Maturity</u>	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
3 months or less . . . . .	\$345	\$370
Over 3 through 6 months . . . . .	56	40
Over 6 through 12 months . . . . .	13	14
Over 12 months . . . . .	<u>27</u>	<u>20</u>
Total . . . . .	<u>\$441</u>	<u>\$444</u>

## Capital, Capital Rules and Dividends

The capital stock and retained earnings of the FHLBanks are also a source of funding. At December 31, 2006, approximately 4.44 percent of the combined total assets of the FHLBanks were funded by capital stock and retained earnings. Total capital under GAAP, which includes accumulated other comprehensive income, represented an amount equal to 4.43 percent of the combined total assets of the FHLBanks at December 31, 2006.

*Post-Gramm-Leach-Bliley Act (GLB Act) Capital Structure.* In January 2001, the Finance Board published a final rule implementing a new capital structure for the FHLBanks, as required by the GLB Act. The Finance Board's final rule implementing a new capital structure for the FHLBanks had the following effects:

- it established risk-based and leverage capital requirements for the FHLBanks;
- it permitted the FHLBanks to issue different classes of stock with different rights and preferences; and
- it required each FHLBank to submit, by October 29, 2001, a capital plan for approval by the Finance Board.

As of July 18, 2002, the Finance Board had approved a capital structure plan for each FHLBank. The capital rule provides a transition period that grants each FHLBank up to three years from the effective date of its capital plan to comply with its new capital structure. Each of the FHLBanks of Cincinnati, Pittsburgh and Seattle implemented its respective new capital plan during 2002. Each of the FHLBanks of Indianapolis, Des Moines and Dallas implemented its respective new capital plan during 2003. Each of the FHLBanks of Atlanta, Boston, San Francisco and Topeka implemented its respective new capital plan during 2004. The FHLBank of New York implemented its new capital plan during 2005. Each of these FHLBanks was in compliance with its capital plan as of the effective date of its plan. The FHLBank of Chicago has not yet implemented a new capital plan and will delay implementation of a new capital structure until a time mutually agreed upon with the Finance Board. Also, the FHLBank of Chicago may propose amendments to its capital plan, originally approved by the Finance Board on June 12, 2002. On October 11, 2006, the Finance Board approved a number of changes to the capital plan of the FHLBank of Seattle and on January 26, 2007, the FHLBank of Seattle's board approved a reduction in the FHLBank of Seattle's minimum capital-to-assets ratio from 4.25 percent to 4.05 percent (See "Business—Oversight, Audits and Examinations" and Note 21 to the accompanying combined financial statements).

*Pre-GLB Act Capital Structure.* At December 31, 2006, only the FHLBank of Chicago had not yet implemented a new capital plan and therefore it continues to operate under the pre-GLB Act capital model, as modified by its regulatory supervisory agreement. Until the FHLBank of Chicago implements its new capital plan, the pre-GLB Act capital rules will remain in effect. Under these pre-GLB Act rules, each member is required to purchase capital stock equal to the greater of \$500, one percent of its mortgage-related assets or five percent of its outstanding FHLBank advances. A member could, at the discretion of the FHLBank, redeem at par value any capital stock greater than its statutory requirement or sell this capital stock to other members of the FHLBank at par value. Capital stock outstanding under the pre-GLB Act rules is redeemable at the option of a member upon six months' notice if the member withdraws from the FHLBank.

Effective July 1, 2000, until the FHLBank of Chicago has fully implemented its new capital plan, its leverage limit is based on a ratio of assets to capital, pursuant to a final rule issued by the Finance Board. Effective January 1, 2004, capital for the leverage ratio calculation is based on capital as determined under GAAP plus mandatorily redeemable capital stock. Under Finance Board regulations, the FHLBank of Chicago is currently subject to a leverage limit that provides that its total assets may not exceed 25 times its total regulatory capital stock, retained earnings and reserves, provided that non-mortgage assets (after deducting the amounts of deposits and capital) do not exceed 11 percent of such total assets. For purposes of this regulation, non-mortgage assets means total assets less advances, acquired member assets, standby letters of credit, derivative contracts with members, certain mortgage-backed securities, and other investments specified by the Finance Board. This requirement may also be viewed as a percentage regulatory capital ratio where the FHLBank of Chicago's total regulatory capital stock, retained earnings and reserves must be at least 4 percent of the FHLBank of Chicago's total assets. If the FHLBank of Chicago is unable to meet the foregoing requirement based on its asset composition, this FHLBank would still be able to remain in compliance with the leverage requirement so long as its total assets did not exceed 21 times total regulatory capital stock, retained earnings and reserves (that is, the FHLBank of Chicago's total regulatory capital stock, retained earnings and reserves must be at least 4.76 percent of its total assets). At December 31, 2006, the FHLBank of Chicago had a leverage ratio of 4.9 percent. In connection with the FHLBank of Chicago's issuance of subordinated notes, the Finance Board granted approvals and waivers to allow it to include a percentage of the outstanding principal amount of the subordinated notes in determining compliance with its regulatory capital and minimum regulatory ratio requirements. (See Notes 15 and 16 to the accompanying combined financial statements.)

*Capital Adequacy and Form Rules under the GLB Act.* The GLB Act permits each FHLBank to issue one or more of two classes of stock, each with sub-classes. Class A stock is

redeemable on six months' written notice from a member and Class B stock is redeemable on five years' written notice from a member. Each class of stock is subject to certain conditions and limitations that may limit the ability of an FHLBank to effect these redemptions. Under the GLB Act, membership in an FHLBank became voluntary for all members. If a member withdraws its membership from an FHLBank, it may not acquire shares of any FHLBank for five years after the date on which its divestiture of capital stock is completed. This restriction does not apply if the member is transferring its membership from one FHLBank to another. (See "Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Capital Adequacy." Additionally, see "Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Legislative and Regulatory Developments" for discussion regarding a recently issued Finance Board rule that may change the dividend payment practices of the FHLBanks.)

The GLB Act defines "permanent capital" for each FHLBank as the amount paid-in for Class B stock, plus the amount of an FHLBank's retained earnings, as determined in accordance with GAAP. Under the GLB Act and the final rule implementing it, "total capital" for regulatory capital adequacy purposes for each FHLBank operating under a new capital plan is defined as the sum of the FHLBank's permanent capital; *plus*

- the amounts paid-in by its members for Class A stock;
- any general loss allowance, if consistent with GAAP and not established for specific assets; and
- other amounts from sources determined by the Finance Board as available to absorb losses.

Under the GLB Act and the implementing final rule, an FHLBank is subject to risk-based capital rules under its new capital structure plan once the plan is fully implemented. Only permanent capital (as previously defined) can satisfy the risk-based capital requirement. In addition, the GLB Act specifies a five percent minimum leverage ratio based on total capital, which includes a 1.5 weighting factor applicable to permanent capital, and a four percent minimum total capital ratio that does not include the 1.5 weighting factor applicable to permanent capital. An FHLBank may not redeem or repurchase any of its capital stock without Finance Board approval if the Finance Board or that FHLBank's board of directors determines that the FHLBank has incurred or is likely to incur losses that result in or are likely to result in charges against the capital of that FHLBank. This applies even if that FHLBank is in compliance with its minimum capital requirements. As a result, whether or not a member may have its capital stock in an FHLBank repurchased (at an FHLBank's discretion at any time before the end of the redemption period) or redeemed (at a member's request, completed at the end of a redemption period) at any given time will depend on whether the FHLBank is in compliance with its three regulatory capital requirements (leverage ratio, total capital ratio and risk-based capital). At December 31, 2006, the FHLBank of Seattle, as a result of its supervisory agreement with the Finance Board, was operating under certain restrictions, including a 4.25 percent minimum regulatory capital ratio requirement. The Finance Board removed this supervisory agreement on January 11, 2007. On January 26, 2007, the FHLBank of Seattle's board of directors approved a minimum regulatory capital ratio requirement of 4.05 percent. (See "Business—Oversight, Audits and Examinations" for more information.) Some boards of directors and/or management teams of FHLBanks have agreed to maintain higher total capital-to-assets ratios or limit dividend payments as part of their retained earnings policies. As these limitations may be revised from time to time, they are more flexible than the minimum requirements prescribed by statute.

For purposes of compliance with the regulatory minimum total capital ratio and leverage ratio, capital includes all of the FHLBank members' capital stock and retained earnings, and allowance for losses and any other amount from sources available to absorb losses that the Finance Board has determined by regulation to be appropriate to include in determining total capital. At January 1, 2004, regulatory capital exceeded capital as determined under GAAP, because regulatory capital

includes mandatorily redeemable capital stock. All FHLBanks that were subject to these requirements at December 31, 2006 were in compliance at that date.

Once an FHLBank implements a new capital plan under the GLB Act, it becomes subject to the Finance Board's risk-based capital regulations. This regulatory framework requires each FHLBank to maintain sufficient permanent capital to meet its combined credit risk, market risk and operations risk components.

The credit risk component of the risk-based capital requirement of an FHLBank is determined by adding together the credit risk capital charges computed for assets, off-balance sheet items and derivative contracts. These computations are based on, among other things, the credit risk percentages assigned to each item as required by the Finance Board.

The market risk component of the risk-based capital requirement of an FHLBank is the sum of:

- (1) the market value of its portfolio at risk from movements in interest rates that could occur during times of market stress; plus
- (2) any amount by which the current market value of its total capital falls short of 85 percent of book value.

Each FHLBank must calculate the market value of its portfolio at risk and the current market value of its total capital by using either an internal market risk model or internal cash flow model approved by the Finance Board. The Finance Board has approved the models used by the 11 FHLBanks that have implemented their new capital plans. Although each FHLBank models its own market risk, the Finance Board has reviewed and approved the modeling approach and underlying assumptions used by each FHLBank. The Finance Board reviews these modeling approaches on an ongoing basis.

The operational risk component of the risk-based capital requirement of an FHLBank is equal to 30 percent of the sum of its credit risk and market risk components of the risk-based capital requirement. The Finance Board can approve a reduction in this percentage. For reasons of safety and soundness, the Finance Board may also require an individual FHLBank to maintain greater permanent capital than is required by the risk-based capital requirements previously described.

### Regulatory Capital Requirements (Dollar amounts in millions)

FHLBank*	Minimum Regulatory Capital Ratio Requirement	At December 31, 2006				
		Minimum Regulatory Capital Requirement	Actual Capital Ratio	Total Regulatory Capital (1)	Permanent Capital (2)	Required Risk-Based Capital
Boston . . . . .	4.0%	\$2,299	4.4%	\$ 2,542	\$ 2,542	\$ 342
New York . . . . .	4.0%	3,268	4.9%	4,025	4,025	612
Pittsburgh . . . . .	4.0%	3,095	4.7%	3,655	3,647	509
Atlanta . . . . .	4.0%	5,630	4.5%	6,394	6,394	830
Cincinnati . . . . .	4.0%	3,255	5.0%	4,050	4,050	577
Indianapolis . . . . .	4.0%	1,875	4.5%	2,111	2,111	522
Des Moines . . . . .	4.0%	1,682	5.5%	2,315	2,315	491
Dallas . . . . .	4.0%	2,226	4.7%	2,598	2,598	446
Topeka . . . . .	4.0%	2,110	4.2%	2,225	1,647	467
San Francisco . . . . .	4.0%	9,797	4.4%	10,865	10,865	1,182
Seattle . . . . .	4.0%(3)	2,141	4.3%	2,303	2,303	326



FHLBank*	At December 31, 2006			
	Minimum Leverage Ratio Requirement	Minimum Weighted Leverage Capital Requirement	Actual Leverage Ratio	Actual Weighted Leverage Capital
Boston .....	5.0%	\$ 2,873	6.6%	\$ 3,813
New York .....	5.0%	4,085	7.4%	6,037
Pittsburgh .....	5.0%	3,869	7.1%	5,478
Atlanta .....	5.0%	7,038	6.8%	9,591
Cincinnati .....	5.0%	4,069	7.5%	6,075
Indianapolis.....	5.0%	2,343	6.8%	3,167
Des Moines.....	5.0%	2,102	8.3%	3,472
Dallas .....	5.0%	2,783	7.0%	3,898
Topeka.....	5.0%	2,637	5.8%	3,049
San Francisco .....	5.0%	12,246	6.7%	16,298
Seattle .....	5.0%	2,676	6.5%	3,454

\* Only includes FHLBanks that have implemented a new capital plan at December 31, 2006.

- (1) Total regulatory capital is defined as the sum of permanent capital, the amounts paid for Class A capital stock, any general allowance for losses and any other amount from sources available to absorb losses that the Finance Board has determined by regulation to be appropriate to include in determining total capital. Total regulatory capital also includes mandatorily redeemable capital stock.
- (2) Permanent capital is defined as retained earnings and regulatory capital Class B stock. The mandatorily redeemable capital stock is considered capital for regulatory purposes.
- (3) On January 11, 2007, the Finance Board terminated the Written Agreement between the FHLBank of Seattle and the Finance Board dated December 10, 2004. Subsequently, on January 26, 2007 due to the termination of the Written Agreement, the FHLBank of Seattle's board authorized the FHLBank of Seattle to lower the minimum capital-to-assets ratio from 4.25 percent to 4.05 percent. Prior to the termination of the Written Agreement, the FHLBank of Seattle maintained a minimum supervisory capital-to-assets ratio of 4.25 percent which was required under its business plan submitted to the Finance Board in April 2005, and accepted by the Finance Board in May 2005.

*Description of Capital Plans of FHLBanks Converted Through 2006.*

The following FHLBanks offer a single class of Class B capital stock. Upon five years' written notice, a member can elect to have the FHLBank redeem its capital stock, subject to certain conditions and limitations. Each FHLBank can repurchase a member's excess capital stock at its discretion at any time prior to the end of the redemption period, provided that FHLBank will continue to meet its regulatory capital requirements after the repurchase.

<u>FHLBank</u>	<u>Description</u>
Boston	The FHLBank of Boston requires member institutions to maintain stock based on a percentage of the member's Membership Stock Investment Base and on a percentage of advances, standby letters of credit, intermediated derivative contracts, acquired member assets and certain commitments outstanding with the FHLBank.
San Francisco	The FHLBank of San Francisco requires member institutions to maintain stock based on the greater of a percentage of the member's membership asset value or a percentage of advances outstanding plus a percentage of any portion of mortgage loans purchased and held by the FHLBank.
Dallas	The FHLBank of Dallas requires member institutions to maintain stock based on a percentage of the member's total assets and on a percentage of advances and acquired member assets outstanding with the FHLBank.
Des Moines	The FHLBank of Des Moines requires member institutions to maintain stock based on a percentage of the member's total assets and on a percentage of advances, acquired member assets, standby letters of credit, and certain commitments outstanding with the FHLBank.
Cincinnati	The FHLBank of Cincinnati requires member institutions to maintain stock based on a percentage of the member's total assets and on a percentage of advances and acquired member assets outstanding with the FHLBank.
Pittsburgh	The FHLBank of Pittsburgh requires member institutions to maintain stock based on a percentage of their outstanding FHLBank borrowings, a percentage of their unused borrowing capacity with the FHLBank and a specified percentage of the principal balance of residential mortgage loans previously sold to the FHLBank and still held by the FHLBank.



The FHLBanks of New York, Atlanta and Indianapolis each offer two sub-classes of Class B capital stock, Class B1 and Class B2. Upon five years' written notice, a member can elect to have the FHLBank redeem its capital stock, subject to certain conditions and limitations. The FHLBanks of New York, Atlanta and Indianapolis can repurchase excess stock of both sub-classes at their discretion at any time prior to the end of the redemption period, provided that FHLBank will continue to meet its regulatory capital requirements after the repurchase.

<u>FHLBank</u>	<u>Description</u>
New York	Class B1 stock is issued to meet membership stock purchase requirements. Class B2 stock is issued to meet activity-based requirements. The FHLBank of New York requires member institutions to maintain Class B1 stock based on a percentage of the member's mortgage-related assets and Class B2 stock-based on a percentage of advances and acquired member assets outstanding with the FHLBank and certain commitments outstanding with the FHLBank. Class B1 and Class B2 stockholders have the same voting rights and dividend rates.
Atlanta	Class B1 stock is issued to meet membership stock purchase requirements. The FHLBank of Atlanta requires member institutions to maintain stock based on a percentage of the member's total assets. Each member is required to maintain a minimum investment in Class B2 shares to meet its activity-based stock requirement. A member's activity-based requirement is based on a percentage of outstanding advances, acquired member assets and any targeted debt/equity investment sold by the member to the FHLBank. Class B1 and Class B2 stockholders have the same voting rights and dividend rates.
Indianapolis	Class B1 stock is issued to meet membership and activity stock purchase requirements. The FHLBank of Indianapolis requires member institutions to maintain stock based on a percentage of the member's total assets and on a percentage of advances and acquired member assets outstanding with the FHLBank. Class B1 stock is converted into shares of Class B2 stock in the event that a member withdraws from membership; a member is the non-surviving entity in a merger; if a financial institution's membership is terminated involuntarily or as a result of a relocation; or if the stock becomes subject to a redemption request by a member; while the stock is needed to meet the member's stock requirement. Class B1 and Class B2 stockholders have the same voting rights. The only difference between the Class B1 stock and Class B2 stock is that the dividend rate for the Class B2 stock is lower than the dividend rate for the Class B1 stock.

Prior to October 2006, the FHLBank of Seattle offered two sub-classes of Class B capital stock, Class B1 and Class B2. Upon five years' written notice, a member could elect to have the FHLBank redeem its capital stock, subject to certain conditions and limitations. The FHLBank of Seattle could repurchase excess stock of both sub-classes at its discretion at any time prior to the end of the redemption period, provided that it will continue to meet its regulatory capital requirements after the repurchase.

<u>FHLBank</u>	<u>Description</u>
Seattle	<p>Class B1 stock is issued to meet membership and activity stock purchase requirements. The FHLBank of Seattle requires member institutions to maintain stock based on a percentage of a member's mortgage loans and on a percentage of advances and acquired member assets depending on the amount outstanding with the FHLBank. Excess Class B1 stock above the lesser of \$50 million or the total stock purchase requirement converts to Class B2 stock. Class B1 and Class B2 stockholders have the same voting rights. Dividends on Class B1 stock may not exceed the sum of (1) the FHLBank's earnings for that quarter plus (2) net earnings previously retained, less (3) the amount of any dividends that the FHLBank's Board of Directors declares on Class B2 stock. Dividends on Class B2 stock may be declared only at a rate equal to the lower of (A) the Class B1 stock dividend or (B) 73.47% times the sum of the daily average of three- month LIBOR during the quarter minus 0.25%. Any dividends declared must be paid equally to the Class B1 and Class B2 stock, up to the maximum dividends permitted on the Class B2 stock, after which dividends may be paid solely to the Class B1 stockholders.</p>

In October 2006, the Finance Board approved a number of changes to the FHLBank of Seattle's capital plan including the consolidation of Class B1 and Class B2 stock into a single Class B stock and the creation of a new Class A stock with a six-month redemption period. The dividend rate that will be declared on Class A stock could theoretically differ from the dividend rate declared on Class B stock. Class A and B stockholders will have the same voting rights. Another feature of the FHLBank of Seattle's updated capital plan is the use of an excess stock pool through October 1, 2008. Members that have fully utilized all of their existing capital stock will be able to obtain advances without purchasing additional FHLBank of Seattle stock, subject to certain restrictions.

The FHLBank of Topeka offers a single series of Class A capital stock and a single series of Class B capital stock. Upon six months' written notice, a member can elect to have the FHLBank redeem its Class A capital stock, subject to certain conditions and limitations. Upon five years' written notice, a member can elect to have the FHLBank redeem its Class B capital stock, subject to certain conditions and limitations. The FHLBank of Topeka can repurchase any excess capital stock at its discretion at any time prior to the end of the redemption period, provided that it will continue to meet its regulatory capital requirements after the repurchase.

<u>FHLBank</u>	<u>Description</u>
Topeka	<p>Class A stock is used to meet a member's asset-based stock purchase requirement and Class B capital stock is used to meet a member's activity-based stock purchase requirement. Class A and Class B stock share in dividends equally up to the dividend parity threshold, then the dividend rate for Class B stock can exceed the rate for Class A stock, but the Class A stock dividend rate can never exceed the Class B stock dividend rate. Class A and Class B stockholders have the same voting rights.</p>

*Dividends and Retained Earnings.* The FHLBanks may pay dividends from retained earnings and current income. The board of directors of each FHLBank may declare and pay dividends out of retained earnings and current-period earnings in either cash or capital stock. Under the Finance Board’s final rule, which became effective on January 29, 2007, an FHLBank is prohibited from issuing new excess stock, including through the use of stock dividends, if the amount of excess stock exceeds one percent of the FHLBank’s assets. Also included in this final rule is a provision requiring the FHLBanks to declare and pay dividends only after net income for each quarterly period has been determined. As the result of a resolution passed by the FHLBank of Seattle’s board of directors, the FHLBank of Seattle may only pay cash dividends in an amount up to 50 percent of its calendar year-to-date earnings. The board of directors of each FHLBank has adopted a retained earnings policy that includes a target amount of retained earnings as well as a plan that will enable the FHLBank to reach the target amount of retained earnings. (See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Legislative and Regulatory Developments” for discussion regarding a recently issued Finance Board rule that may change the dividend payment practices of the FHLBanks.)

### **Other Mission-Related Activities**

In addition to supporting residential mortgage lending, one of the core missions of the FHLBanks is to support community development through affordable housing and community investment. Set forth below are a number of programs administered by the FHLBanks targeted to fulfill that mission. These programs have provided affordable home ownership and rental opportunities for hundreds of thousands of very low- to moderate-income families and strengthened communities across the U.S. and its territories.

*Housing Programs.* There are two key FHLBank housing programs that provide members with grants and other low-cost funds to finance housing.

- The Affordable Housing Program is a subsidy program that provides grants and interest-rates subsidies on loans to members.
- The Community Investment Program for housing is a lending program through which members borrow advances (loans) at an FHLBank’s cost of funds, plus reasonable administrative costs, or obtain triple-A-rated letters of credit from the FHLBanks.

Funds from both of these programs can be used for the purchase, construction or rehabilitation of very low- to moderate-income owner-occupied or rental housing.

The AHP subsidizes the cost of owner-occupied and rental housing for individuals and families with incomes at or below 80 percent of the area median income; and in the rental housing at least 20 percent of the units must be reserved for households with incomes at or below 50 percent of area median income (AMI). The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an advance. AHP funds are primarily available through a competitive application program at each of the FHLBanks.

In the competitive AHP application program, members submit applications on behalf of one or more sponsors of eligible housing projects. Projects must meet certain eligibility requirements and score successfully in order to obtain funding under the AHP competitive application program. AHP funds are also awarded through the homeownership set-aside program. Under this program, an FHLBank may set aside up to the greater of \$4.5 million or 35 percent of its AHP funds each year to assist low- and moderate-income households purchase homes, provided that at least one-third of the FHLBank’s set-aside allocation is made available to assist first-time homebuyers. Members obtain the AHP set-aside funds from the FHLBank and then use them as grants to eligible households. Set-aside funds may be used for down-payment, closing cost, counseling or rehabilitation assistance in connection with the household’s purchase or rehabilitation of an owner-occupied unit. Each FHLBank sets its own maximum grant amount, which may not exceed \$15,000 per household. All 12 of the FHLBanks have AHP homeownership set-aside programs.

*Economic Community Development Programs.* In addition to housing, the CIP can be used for economic development in low- to-moderate income neighborhoods. The FHLBanks also offer long-term advances, often at below-market interest rates and for long terms, through other Community Investment Cash Advance (CICA) programs.

CICA programs provide financing for projects that are targeted to certain economic development activities. Economic development projects include commercial, industrial, manufacturing, social service, infrastructure projects, and public facility projects and activities. These include commercial, industrial, manufacturing and social services projects, infrastructure, and public facilities and services. CICA lending is targeted to specific beneficiaries, including small businesses and certain geographic areas. Two types of CICA programs benefit households at specified income levels. These are:

- *Rural Development Funding:* Projects in rural areas for beneficiaries with incomes at or below 115% of the AMI; and
- *Urban Development Funding Program:* Projects in urban areas for targeted beneficiaries with incomes at or below 100% of the AMI.

In addition, FHLBank members may obtain advances through the CIP, which is also used for affordable housing, to finance projects located in low- or moderate-income neighborhoods or that benefit low- or moderate-income families.

Currently, all the FHLBanks offer the CIP and one or more other types of CICA programs for economic development. Members may use the proceeds of CICA funding to finance targeted economic development projects directly (loan originations and purchases) or indirectly (lending to other lenders for eligible purposes). Each FHLBank has a Community Lending Plan, in which its program objectives for economic development are described. Approved “housing associates” (non-member lenders such as state housing finance agencies and tribal housing authorities) may use certain CICA programs. Some FHLBanks have additional community lending programs designed to retain or create jobs or otherwise improve the economic status of communities.

*Community Support Program* Members are required to meet standards of community support activities, which they document by submitting a Community Support Statement to the Finance Board approximately every two years to retain access to long-term credit from an FHLBank. The standards take into account each member’s performance under the Community Reinvestment Act of 1977, and the member’s record of lending to first-time homebuyers.

### **Use of Interest-Rate Exchange Agreements**

Each FHLBank’s risk management policy establishes guidelines for its use of interest-rate exchange agreements (also referred to as derivatives). The FHLBanks can use the following instruments as part of their interest-rate risk management and funding strategies:

- interest-rate swaps;
- swaptions;
- interest-rate cap and floor agreements;
- calls;
- puts; and
- futures and forward contracts.

Finance Board regulation and each FHLBank’s risk management policy prohibit trading in or the speculative use of these derivative instruments and limit credit risk arising from these instruments. The FHLBanks may use derivatives only to reduce funding costs for consolidated obligations and to manage their interest-rate risk, mortgage prepayment risk and foreign currency risk positions.

In general, the FHLBanks use interest-rate exchange agreements in three ways:

- (1) by designating them as a fair-value or cash-flow hedge of an underlying financial instrument, a firm commitment or an anticipated transaction;
- (2) by acting as an intermediary between members and the capital markets; or
- (3) in asset/liability management.

For example, an FHLBank may use interest-rate exchange agreements in its overall interest-rate risk management to adjust the interest-rate sensitivity of consolidated obligations to approximate more closely the interest-rate sensitivity of assets (including advances, investments, and mortgage loans) and/or to adjust the interest-rate sensitivity of advances, investments, and mortgage loans to approximate more closely the interest-rate sensitivity of liabilities. In addition to using interest-rate exchange agreements to manage mismatches of interest-rate terms between assets and liabilities, an FHLBank may also use interest-rate exchange agreements to:

- manage embedded optionality in assets and liabilities;
- hedge the market value of existing assets, liabilities and anticipated transactions;
- hedge the duration risk of prepayable instruments; and
- to achieve lower funding costs.

An FHLBank may enter into interest-rate exchange agreements concurrently with the issuance of consolidated obligations to achieve lower all-in funding costs. This allows the FHLBank to create synthetic variable-rate debt at a cost that is lower than the cost of a variable-rate cash instrument issued directly by the FHLBank. This strategy of issuing bonds while simultaneously entering into interest-rate exchange agreements enables the FHLBank to offer a wider range of attractively-priced advances to its members. Whether the debt continues to be attractive depends on price relationships in both the bond market and the interest-rate exchange market. When conditions in these markets change, an FHLBank may alter the types and/or the terms of consolidated obligations it issues. The FHLBanks may enter into interest-rate exchange agreements and/or other transactions with (or arranged by) the applicable securities dealers, banks, or one or more of their affiliates, or an unaffiliated third party.

The most common ways in which the FHLBanks use derivatives are to:

- reduce funding costs by combining a derivative with a consolidated obligation. as the cost of a combined funding structure can be lower than the cost of a comparable consolidated obligation bond;
- preserve a favorable interest-rate spread between the yield of an asset (e.g., an advance) and the cost of the related liability (e.g., the consolidated obligation bond used to fund the advance). Without the use of derivatives, this interest-rate spread could be reduced or eliminated when a change in the interest rate on the advance does not match a change in the interest rate on the bond;
- mitigate the adverse earnings effects of the shortening or extension of certain assets (e.g., advances or mortgage assets) and liabilities; and
- protect the value of existing asset or liability positions or of anticipated transactions.

(See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Critical Accounting Policies and Estimates—Accounting for Derivatives” and “Risk Management—Quantitative and Qualitative Disclosures about Market Risk—Qualitative Disclosures about Market Risk—Interest-Rate Exchange Agreements.”)



## Competition

*Advances.* Demand for FHLBank advances is affected by, among other things, the cost of other sources of liquidity available to FHLBank members, including deposits. Each FHLBank individually competes with its members' depositors as well as suppliers of secured and unsecured wholesale funding. These competitors may include investment banks, commercial banks and, in certain circumstances, one or more other FHLBanks, when one or more affiliates of their members are members of other FHLBanks. Smaller members may have access to alternative funding sources only through sales of securities under agreements to resell, while larger members may have access to all of the alternatives previously listed. Large members may also have independent access to the national and global credit markets, including covered bonds. The availability of alternative funding sources to members can significantly influence the demand for FHLBank advances and this availability can vary as a result of a variety of factors including:

- market conditions;
- products;
- structures;
- members' creditworthiness; and
- availability of collateral.

*Mortgage Loans Held for Portfolio.* The activities of the FHLBanks' MPF and MPP business are subject to significant competition in purchasing conventional, conforming fixed-rate mortgage and government-guaranteed/insured loans. The FHLBanks face competition in customer service, the prices paid for these assets, and in ancillary services such as automated underwriting. The most direct competition for mortgages comes from other housing GSEs that also purchase conventional, conforming fixed-rate mortgage loans, specifically the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), as well as from other investors. These investors may seek to hold conventional, conforming fixed-rate mortgage loans. The volume of conventional, conforming fixed-rate mortgages has declined with the rise in interest rates and competitive products, such as hybrid adjustable-rate mortgages, which the FHLBanks do not purchase. This trend could continue and the demand for MPF and MPP products could diminish. In general, this competitive environment may present a challenge for certain FHLBanks in the achievement of their financial goals. The FHLBanks continuously reassess their potential for success in attracting and retaining customers for their products and services.

*Debt Issuance.* Each FHLBank also competes with the U.S. government, Fannie Mae, Freddie Mac and other GSEs, as well as corporate, sovereign and supranational entities, for funds raised through the issuance of unsecured debt in the national and global debt markets. If the supply of competing debt products increases without a corresponding increase in demand, or if certain investors change their view of investing in FHLBank debt, debt costs may rise or less debt may be issued at the same cost than would otherwise be the case. In addition, regulatory initiatives, which tend to reduce investments by certain depository institutions in unsecured debt with greater price volatility or interest-rate sensitivity than fixed-rate, fixed-maturity instruments of the same maturity, may adversely affect the availability and cost of funds raised through the issuance of certain types of unsecured debt. Although the available supply of funds has kept pace with the funding needs of the FHLBanks' members (as expressed through FHLBank debt issuance), investors should not rely on the belief that this will continue to be the case in the future.

*Interest-Rate Exchange Agreements.* The sale of callable debt and the simultaneous execution of callable interest-rate exchange agreements that mirror the debt sold has been an important source of competitive funding for the FHLBanks. As such, the availability of markets for callable debt and interest-rate exchange agreements may be an important factor in determining the FHLBanks' relative cost of funds. There is considerable competition in the markets for callable debt and for

interest-rate exchange agreements among issuers of high credit quality. Investors should not rely on the belief that the current breadth and depth of these markets will be sustained in the future.

### **Oversight, Audits and Examinations**

The FHLBanks are supervised and regulated by the Finance Board. The Finance Board ensures that the FHLBanks:

- operate in a safe and sound manner;
- remain adequately capitalized and able to raise funds in the capital markets; and
- carry out their housing and community development finance mission.

The Finance Board also establishes regulations governing the operations of the FHLBanks. More detailed information relating to the Finance Board is contained in “Supplemental Information—FHLBanks’ Regulator.”

The Government Corporation Control Act provides that, before a government corporation issues and offers obligations to the public, the Secretary of the Treasury shall prescribe the form, denomination, maturity, interest rate, and conditions of the obligations; the way and time issued; and the selling price. The FHLBanks meet the definition of government corporations under the Government Corporation Control Act. The FHLBank Act also authorizes the Secretary of the Treasury, at his or her discretion, to purchase consolidated obligations up to an aggregate principal amount of \$4 billion. There have been no borrowings outstanding under this authority since 1977. The U.S. Department of the Treasury receives the Finance Board’s annual report to Congress, weekly reports reflecting securities transactions of the FHLBanks, and other reports reflecting the operations of the FHLBanks. The Treasury Department has recently adopted additional procedures relating to the review of other GSE debt issuance and may review the procedures under which the FHLBanks operate.

Each FHLBank and the Office of Finance has an internal audit department and the board of directors of each FHLBank has an audit committee. An independent registered public accounting firm audits the annual financial statements of each FHLBank and the annual combined financial statements of the FHLBanks prepared by the Office of Finance. The independent registered public accounting firm conducts these audits following auditing standards of the Public Company Accounting Oversight Board (United States) and *Government Auditing Standards* issued by the Comptroller General of the United States. The FHLBanks, the Finance Board, and Congress all receive the audited financial statements. The FHLBanks must submit annual management reports to the Congress, the President of the United States, the Office of Management and Budget, and the Comptroller General of the United States. These reports include:

- a statement of financial condition;
- a statement of operations;
- a statement of capital;
- a statement of cash flows;
- a statement of internal accounting and administrative control systems; and
- the report of the independent registered public accounting firm on the financial statements.

The Comptroller General of the United States has the authority under the FHLBank Act to audit or examine the Finance Board and the FHLBanks and to decide the extent to which they fairly and effectively fulfill the purposes of the FHLBank Act. Furthermore, the Government Corporation Control Act provides that the Comptroller General of the United States may review any audit of the financial statements conducted by an independent registered public accounting firm. If the Comptroller General of the United States conducts such a review, he or she must report the results and provide his or her recommendations to the Congress, the Office of Management and Budget,



and the FHLBank under review. The Comptroller General of the United States may also conduct his or her own audit of any financial statements of any FHLBank.

*Updates on Supervisory Agreements with the Finance Board.*

*FHLBank of Chicago Agreement with the Finance Board.* On June 30, 2004, the FHLBank of Chicago entered into a Written Agreement with the Finance Board to address issues identified in the Finance Board's 2004 examination of the FHLBank of Chicago. Under the Written Agreement, the FHLBank of Chicago agreed to implement changes to enhance its risk management, capital management, governance, and internal control practices; to submit a business and capital plan to the Finance Board; and to maintain a regulatory capital ratio of 5.1 percent. The Written Agreement has subsequently been amended three times in order to adjust the FHLBank of Chicago's minimum regulatory capital requirements as further described below. The Written Agreement also prohibits the FHLBank of Chicago from increasing the aggregate net book value of its acquired member assets (i.e., mortgage loans) under the MPF Program to no greater than 10 percent per annum. The FHLBank of Chicago remains in compliance with this restriction.

Under the Written Agreement, the FHLBank of Chicago engaged independent outside consultants to report on its (i) management and board oversight, (ii) risk management policies and practices, (iii) internal audit functions, and (iv) accounting, recordkeeping and reporting practices and controls. The initiatives resulting from the Written Agreement and consulting reviews were focused on (i) enhanced governance, including improved reporting to the FHLBank of Chicago's board of directors, increased frequency and documentation of board and board-level committee meetings, and a restructuring of board committees including the establishment of a Risk Management Committee; (ii) a substantial increase in risk management staff and enhanced infrastructure, the adoption of an enterprise risk management framework, improved market risk modeling, research and oversight capabilities, and a materially enhanced risk assessment process; (iii) the recruitment of an experienced senior internal audit manager, the dedication of increased audit resources, and changes to audit methodology and practices; and (iv) adjustments to accounting policy, improvements in hedge accounting documentation and reporting, increased accounting staff and support, and substantial enhancement of policies and procedures associated with the transfer of debt between the FHLBank of Chicago and the other FHLBanks. The FHLBank of Chicago has implemented recommendations from these studies.

The FHLBank of Chicago's business and capital management plan submitted to the Finance Board in accordance with the Written Agreement included the following:

- delaying implementation of a new capital plan until a time mutually agreed upon between the FHLBank of Chicago and the Finance Board;
- exploring alternative methods of capitalizing and funding acquired member assets under the MPF Program;
- adoption of a new retained earnings and dividend policy; and
- an initiative to reduce outstanding voluntary capital stock (capital stock held by members in excess of their statutory requirement).

The FHLBank of Chicago is exploring the development of off-balance sheet strategies for the MPF Program. The FHLBank of Chicago adopted a new retained earnings and dividend policy in April 2006.

Although the FHLBank of Chicago committed to a reduction of voluntary capital stock under its business and capital management plan for 2005—2007, net redemptions from January 1, 2005 through October 17, 2005 resulted in the FHLBank of Chicago's voluntary capital stock to regulatory capital ratio being reduced to less than its target amount for the end of year 2005. With the reduction in the dividend rate from an average of 6.125 percent paid in 2004 to 3.75 percent (annualized rate) which was paid in the fourth quarter 2005 (based upon third quarter 2005

results), the FHLBank of Chicago expected the redemption rate to accelerate even more in the remaining months of 2005. On October 18, 2005, the FHLBank of Chicago board of directors discontinued redemptions of voluntary capital stock for a period of time as permitted by the FHLBank Act and Finance Board regulations.

On October 18, 2005, the FHLBank of Chicago also entered into Amendment No. 1 to its Written Agreement with the Finance Board, which reduced its minimum required regulatory capital ratio from 5.1 percent to 4.5 percent and added a requirement that the FHLBank of Chicago maintain an aggregate minimum regulatory capital stock of \$3.978 billion. Mandatorily redeemable capital stock under SFAS 150 and related capital stock dividends are considered capital stock for regulatory purposes.

On April 18, 2006, the FHLBank of Chicago entered into Amendment No. 2 to its Written Agreement with the Finance Board, which reduced its minimum regulatory capital stock requirement by \$204 million from \$3.978 billion to \$3.774 billion. In addition, the Finance Board also approved the FHLBank of Chicago's application to issue subordinated notes.

On May 16, 2006, the FHLBank of Chicago board of directors voted to allow for the redemption of voluntary capital stock in accordance with capital stock redemption guidelines approved by the Finance Board and redemption windows announced by the FHLBank of Chicago.

On June 6, 2006, the FHLBank of Chicago entered into Amendment No. 3 to its Written Agreement with the Finance Board, which became effective on June 13, 2006, upon receipt of proceeds from its subordinated notes issuance. Amendment No. 3 replaced the FHLBank of Chicago's aggregate minimum regulatory capital stock requirement of \$3.774 billion with a requirement to maintain an aggregate amount of outstanding regulatory capital stock plus a designated amount of its subordinated notes of at least \$3.5 billion.

Amendment No. 3 replaced the FHLBank of Chicago's prior minimum regulatory capital ratio requirement with a requirement to maintain a ratio of regulatory capital stock, plus retained earnings, plus a designated amount of its subordinated notes to assets of at least 4.5 percent.

On June 20, 2006, the FHLBank of Chicago used a portion of the net proceeds from the sale of subordinated notes to redeem \$795 million of voluntary capital stock from members in accordance with its capital stock redemption guidelines. On December 14, 2006, the FHLBank of Chicago redeemed another \$375 million of voluntary capital stock from members which, when combined with the \$795 million voluntary capital stock redemption during the second quarter, resulted in approximately 60 percent of voluntary capital stock outstanding as of December 31, 2005 being redeemed by the end of 2006. The FHLBank of Chicago expects to announce a redemption period in the fourth quarter of 2007, subject to Finance Board authorization of this additional voluntary capital stock redemption.

The FHLBank of Chicago continues to make progress on and has met nearly all of the requirements under the Written Agreement with the Finance Board, including the following: acquiring MPF loans within required limits; complying with its minimum capital requirements; completing required outside consulting studies of management, risk management, hedge accounting, and internal audit practices; implementing recommendations from those studies; and receiving Finance Board approval of its retained earnings and dividend policy. The FHLBank of Chicago still needs to implement certain recommendations related to its market risk modeling.

*Future Earnings.* The FHLBank of Chicago anticipates significantly lower net income in 2007 compared to 2006 due to a continued reduction in net interest income. It anticipates that net interest income will be significantly decreased primarily as a result of the following factors:

- Reduced MPF loan volume
- Reduced capital stock
- Amortization of prior hedging costs as required under SFAS 133

- Outstanding debt with above market interest rates and overall increased funding costs.

These trends may continue beyond 2007.

The FHLBank of Chicago is considering various expense reduction initiatives. It is also reviewing balance sheet restructuring alternatives, some of which may have significant short-term adverse effects on its net income, and other means of increasing future income. At this time, it is unable to predict whether such balance sheet restructuring alternatives will be implemented in 2007 or the extent of reductions to retained earnings that may result from the implementation of such alternatives. Further, it is unable to predict how, or when, expense management initiatives will impact its overall profitability.

*FHLBank of Seattle Agreement with the Finance Board.* On January 11, 2007, due to, among other things, the successful progress on the FHLBank of Seattle's business plan, the Finance Board terminated the written agreement between the FHLBank of Seattle and the Finance Board, dated December 10, 2004.

### **Tax Status**

Although the FHLBanks are exempt from all Federal, state, and local taxation, except for local real estate tax, they are required to make payments to REFCORP. Each FHLBank is required to pay 20 percent of income calculated in accordance with GAAP after the assessment for AHP, but before the assessment for REFCORP. In addition, each year the FHLBanks must set aside for the AHP the greater of \$100 million or 10 percent of their current year's regulatory income after REFCORP. In 2004, the Finance Board modified the AHP calculation to add back interest expense on mandatorily redeemable capital stock to income before charges for AHP but after assessments for REFCORP. Prior to 2004, assessments for REFCORP and AHP equated to an effective income tax rate of 26.5 percent for the FHLBanks. In 2004 and going forward, assessments for REFCORP and AHP equate to an effective minimum income tax rate of 26.5 percent; this effective rate will be higher for those FHLBanks with interest expense for mandatorily redeemable capital stock. Cash dividends received by FHLBank members are taxable and do not benefit from the exclusion for corporate dividends received. The combined REFCORP and AHP assessments were \$942 million, \$907 million and \$730 million for the years ended December 31, 2006, 2005 and 2004.

### **Office of Finance**

The consolidated obligations of the FHLBanks are issued through the Office of Finance. In addition to facilitating and executing the issuance of the consolidated obligations, the Office of Finance also:

- services all outstanding debt;
- prepares the FHLBanks' Quarterly and Annual Combined Financial Reports;
- serves as a source of information for the FHLBanks on capital markets developments;
- administers REFCORP and the Financing Corporation (FICO); and
- manages relationships of the FHLBanks with the rating agencies as they relate to the consolidated obligations.

Pursuant to Finance Board regulations, the Office of Finance, often in conjunction with the FHLBanks, has adopted policies and procedures for consolidated obligations that may be issued by the FHLBanks. The policies and procedures relate to the frequency and timing of issuance of consolidated obligations, issue size, minimum denomination, selling concessions, underwriter qualifications and selection, currency of issuance, interest rate change or conversion features, call or put features, principal amortization features, and selection of clearing organizations and outside counsel. The Office of Finance has responsibility for facilitating and approving the issuance of the consolidated obligations in accordance with these policies and procedures. In addition, the Office of

Finance has the authority to redirect, limit or prohibit the FHLBanks' requests to issue consolidated obligations that are otherwise allowed by its policies and procedures if it determines that its action is consistent with the Finance Board requirement that consolidated obligations be issued efficiently and at the lowest all-in cost over time, consistent with: prudent risk management practices, prudent debt parameters, short- and long-term market conditions, and the FHLBanks' role as government-sponsored enterprises; maintaining reliable access to the short-term and long-term capital markets; and positioning the issuance of debt to take advantage of current and future capital market opportunities. The Office of Finance's authority to redirect, limit or prohibit the FHLBank's requests for issuance of consolidated obligations has not adversely affected the FHLBank's ability to finance its operations.

## PROPERTIES AND GEOGRAPHIC DISTRIBUTION

The FHLBanks operate in all 50 states, the District of Columbia and U.S. territories. Each FHLBank generally serves members whose headquarters are located in its specifically-defined geographic district. Each FHLBank's name and address, the states and territories comprising each district, and its number of members, at December 31, 2006, is as follows:

<u>FHLBank Name and Address</u>	<u>States and Territories</u>	<u>Number of Members</u>
<p>FHLBank of Boston                      111 Huntington Avenue                      Boston, MA 02199                      Business number: (617) 292-9600                      The FHLBank of Boston leases space at this property.</p>	<p>Connecticut, Maine,                      Massachusetts, New Hampshire,                      Rhode Island, Vermont</p>	465
<p>FHLBank of New York                      101 Park Avenue                      New York, NY 10178-0599                      Business number: (212) 681-6000                      The FHLBank of New York leases space at this property.</p>	<p>New Jersey, New York,                      Puerto Rico, Virgin Islands</p>	293
<p>FHLBank of Pittsburgh                      601 Grant Street                      Pittsburgh, Pennsylvania 15219                      Business number: (412) 288-3400                      The FHLBank of Pittsburgh leases space at this property.</p>	<p>Delaware, Pennsylvania,                      West Virginia</p>	334
<p>FHLBank of Atlanta                      1475 Peachtree Street, N.E.                      Atlanta, Georgia 30309                      Business number: (404) 888-8000                      The FHLBank of Atlanta owns this property.</p>	<p>Alabama, District of Columbia,                      Florida, Georgia, Maryland,                      North Carolina, South Carolina,                      Virginia</p>	1,210
<p>FHLBank of Cincinnati                      Atrium Two, Suite 1000                      221 East Fourth Street                      Cincinnati, Ohio 45202                      Business number: (513) 852-7500                      The FHLBank of Cincinnati leases space at this property.</p>	<p>Kentucky, Ohio, Tennessee</p>	741

<u>FHLBank Name and Address</u>	<u>States and Territories</u>	<u>Number of Members</u>
FHLBank of Indianapolis 8250 Woodfield Crossing Boulevard Indianapolis, Indiana 46240 Business number: (317) 465-0200 The FHLBank of Indianapolis owns this property.	Indiana, Michigan	430
FHLBank of Chicago 111 East Wacker Drive, Suite 800 Chicago, Illinois 60601 Business number: (312) 565-5700 The FHLBank of Chicago leases space at this property.	Illinois, Wisconsin	858
FHLBank of Des Moines Skywalk Level 801 Walnut Street, Suite 200 Des Moines, Iowa 50309 Business number: (515) 281-1000 The FHLBank of Des Moines leases space at this property.	Iowa, Minnesota, Missouri, North Dakota, South Dakota	1,247
FHLBank of Dallas 8500 Freepoint Parkway South Suite 600 Irving, Texas 75063 Business number: (214) 441-8500 The FHLBank of Dallas owns this property.	Arkansas, Louisiana, Mississippi, New Mexico, Texas	895
FHLBank Topeka One SW Security Benefit Place Suite 100 Topeka, Kansas 66606 Business number: (785) 233-0507 The FHLBank Topeka leases space at this property.	Colorado, Kansas, Nebraska, Oklahoma	886
FHLBank of San Francisco 600 California Street San Francisco, California 94108 Business number: (415) 616-1000 The FHLBank of San Francisco leases space at this property.	Arizona, California, Nevada	387
FHLBank of Seattle 1501 Fourth Avenue, 18th Floor Seattle, Washington 98101 Business number: (206) 340-2300 The FHLBank of Seattle leases space at this property.	Alaska, American Samoa, Guam, Hawaii, Idaho, Montana, Northern Mariana Islands, Oregon, Utah, Washington, Wyoming	379

FHLBank Name and Address

Federal Home Loan Banks  
Office of Finance  
11921 Freedom Drive, Suite 1000  
Reston, Virginia 20190  
Business number: (703) 467-3600  
*www.fhlf-of.com*  
The Office of Finance leases space at  
this property

The FHLBanks and the Office of Finance maintain leased, off-site, back-up facilities.

Individual FHLBank web sites can be accessed from the external link at the Office of Finance web site. All of these web site addresses are provided as a matter of convenience only, and their contents are not made part of this report and are not intended to be incorporated by reference into this report.

**EMPLOYEES**  
**(at December 31, 2006 and 2005)**

FHLBank	December 31, 2006			December 31, 2005			Full-time Employee Increase (Decrease)
	Full-time	Part-time	Total	Full-time	Part-time	Total	
Boston .....	189	2	191	180	3	183	9
New York .....	225	7	232	212	9	221	13
Pittsburgh .....	239	7	246	239	6	245	0
Atlanta .....	338	11	349	330	9	339	8
Cincinnati .....	174	4	178	169	4	173	5
Indianapolis .....	147	9	156	151	7	158	(4)
Chicago .....	450	9	459	440	6	446	10
Des Moines .....	177	12	189	173	12	185	4
Dallas .....	168		168	145		145	23
Topeka .....	162	5	167	152	5	157	10
San Francisco .....	248	6	254	237	5	242	11
Seattle .....	118		118	126		126	(8)
Office of Finance ..	71	2	73	69	1	70	2

The increase in employees at most FHLBanks is primarily the result of staffing additions to support:

- increased regulatory requirements for risk management,
- SEC registration and filings, and
- preparation for compliance with Sarbanes-Oxley requirements.

**LEGAL PROCEEDINGS**

The FHLBanks are subject to various pending legal proceedings arising in the normal course of business. The FHLBanks and the Office of Finance are not a party to, nor are they subject to, any pending legal proceeding that is likely to have a material adverse effect on the results of operations or financial condition of the FHLBanks.



**SUBMISSION OF MATTERS TO VOTE OF CAPITAL STOCKHOLDERS  
OTHER THAN ELECTION OF DIRECTORS**

None.

**MARKET FOR FHLBANKS' CAPITAL STOCK AND  
RELATED STOCKHOLDER MATTERS**

As a cooperative, each FHLBank conducts its advances business and acquired member asset programs almost exclusively with its members. There is no established marketplace for the FHLBanks' stock and it is not publicly traded. FHLBank stock is purchased by members at the stated par value of \$100 and may be redeemed at its stated par value of \$100 per share upon the request of a member subject to applicable redemption periods as well as certain conditions and limitations. At December 31, 2006, the FHLBanks had 420 million shares of capital stock outstanding. The FHLBanks are not required to register their securities under the Securities Act of 1933 (as amended). Pursuant to a Finance Board regulation, each FHLBank has become an effective SEC registrant and is subject to certain reporting requirements of the 1934 Act.

*Voting Rights.* Members holding capital stock on December 31 of the preceding year can participate in the annual election process for FHLBank directors. Eligible members may nominate and elect representatives from members in their state to serve three-year terms on the board of directors of their FHLBank. For each directorship to be filled in an election, each member institution that is located in the state to be represented by the directorship is entitled to cast one vote for each share of stock that the member was required to hold at December 31 of the calendar year immediately preceding the election year; provided, however, that the number of votes that any member may cast for any one directorship shall not exceed the average number of shares of stock that were required to be held by all members located in the state to be represented on that date.

*Regulatory Capital Stock.* The information on capital stock presented in the table is for individual FHLBank members. The information is not aggregated to the holding-company level of those members. Some of the institutions listed are affiliates of the same holding company and some of the institutions listed have affiliates that are members but that are not listed in the tables.

**Top 10 Regulatory Capital Stock Holding Members at December 31, 2006  
(Dollar amounts in millions)**

<u>Name</u>	<u>City</u>	<u>State</u>	<u>Capital Stock (\$Millions)</u>
Citibank, N.A.(1)	Las Vegas	NV	\$ 3,399
Washington Mutual Bank(2)(3)	Henderson	NV	2,115
World Savings Bank, FSB*(4)	Oakland	CA	1,343
Countrywide Bank, NA	Alexandria	VA	1,292
Sovereign Bank*(5)	Reading	PA	913
IndyMac Bank, FSB	Pasadena	CA	762
Washington Mutual Bank, FSB*	Salt Lake City	UT	590
Charter One Bank, NA*	Cleveland	OH	582
World Savings Bank, FSB Texas(4)	Houston	TX	575
US Bank, NA(6)	Cincinnati	OH	540
			\$12,111

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\* Indicates that an officer or director of the member was an FHLBank director in 2006.

- (1) On October 1, 2006, Citibank (West), FSB, (the FHLBank of San Francisco's member) was reorganized into its affiliate Citibank, N.A. and Citibank, N.A., assumed the outstanding capital stock of Citibank (West), FSB.
- (2) Includes \$146 million in FHLBank of Dallas capital stock from the acquisition of Bank United, a former member of the FHLBank of Dallas.
- (3) Includes \$5 million in FHLBank of New York capital stock from the acquisition of Dime Savings Bank of New York, FSB, a former member of the FHLBank of New York.
- (4) On October 1, 2006, Golden West Financial Corporation, the parent company of World Savings Bank, FSB (the FHLBank of San Francisco's member) and World Savings Bank, FSB Texas (the FHLBank of Dallas' member) merged with Wachovia Corporation. World Savings Bank, FSB, and World Savings Bank, FSB Texas have remained members of the FHLBanks of San Francisco and Dallas after the merger.
- (5) Includes \$7 million in FHLBank of Boston capital stock acquired through a merger with former members of the FHLBank of Boston.
- (6) Includes \$14 million in FHLBank of Des Moines capital stock acquired through a merger with former member of the FHLBank of Des Moines.

Regulatory capital stock includes all FHLBank members' capital stock plus mandatorily redeemable capital stock, which is reclassified as a liability in accordance with SFAS 150. (See Note 16 to the accompanying combined financial statements.)

For information on the top five holders of capital stock of each FHLBank and their holdings at December 31, 2006, please refer to "Supplemental Information—Five Largest Regulatory Capital Stockholders of and Borrowers from Each FHLBank."

## **RISK FACTORS**

The following discussion summarizes certain of the risks and uncertainties facing the FHLBanks as they potentially affect investors in the consolidated obligations. The list is not exhaustive and there may be other risks and uncertainties that are not described below that may also affect the FHLBanks' businesses. Any of these risks or uncertainties, if realized, could negatively affect the FHLBanks' financial condition or results of operations, which in turn could reduce the value of FHLBank membership. Each FHLBank describes the risk factors it faces in its business in its periodic reports filed with the SEC. (See "Available Information on Individual FHLBanks.")

### ***The FHLBanks' funding depends on their ability to access the capital markets.***

The FHLBanks' primary source of funds is the sale of FHLBank System consolidated obligations in the capital markets, including the short-term discount note market. The FHLBanks' ability to obtain funds through the sale of consolidated obligations depends in part on prevailing conditions in the capital markets (including investor demand), which are beyond the FHLBanks' control. Accordingly, the FHLBanks may not be able to obtain funding on acceptable terms, if at all. If the FHLBanks cannot access funding when needed on acceptable terms, their ability to support and continue their operations could be adversely affected, which could negatively affect their financial condition and results of operations, and the value of FHLBank membership.

### ***Changes in the credit ratings on FHLBank System consolidated obligations may adversely affect the cost of consolidated obligations, which could adversely affect an FHLBank's financial condition and results of operations and the value of FHLBank membership.***

FHLBank System consolidated obligations have been assigned Aaa/P-1 and AAA/A-1+ ratings by Moody's and S&P. Rating agencies may from time to time change a rating or issue negative reports, which may adversely affect the cost of funds of one or more FHLBanks and the ability to issue consolidated obligations on acceptable terms. A higher cost of funds or the impairment of the ability to issue consolidated obligations on acceptable terms could also adversely

affect the FHLBanks' financial condition and results of operations and the value of FHLBank membership.

***The FHLBanks rely upon derivative instrument transactions to reduce their interest-rate risk, and changes in their credit ratings may adversely affect their ability to enter into derivative instrument transactions on acceptable terms.***

Each FHLBank's financial strategies are highly dependent on its ability to enter into derivative instrument transactions on acceptable terms to reduce its interest-rate risk. Rating agencies may from time to time change a rating or issue negative reports, which may adversely affect an FHLBank's ability to enter into derivative instrument transactions with acceptable parties on satisfactory terms in the quantities necessary to manage its interest-rate risk on consolidated obligations. This could negatively affect the FHLBanks' financial condition and results of operations and the value of FHLBank membership.

***The FHLBanks are governed by Federal laws and regulations, which could change or be applied in a manner detrimental to the FHLBanks' operations.***

The FHLBanks are GSEs, organized under the authority of the FHLBank Act, and, as such, are governed by Federal laws and regulations of the Finance Board, an independent agency in the executive branch of the federal government. From time to time, Congress has amended the FHLBank Act in ways that have significantly affected the FHLBanks and the manner in which the FHLBanks carry out their housing finance mission and business operations. New or modified legislation enacted by Congress or regulations adopted by the Finance Board could have a negative effect on the FHLBanks' ability to conduct business or their costs of doing business.

Changes in regulatory or statutory requirements or in their application could result in, among other things, changes in the FHLBanks' cost of funds, retained earnings requirements, debt issuance, dividend payment limits, form of dividend payments, capital redemption and repurchase limits, permissible business activities, the size, scope, or nature of the FHLBanks' lending, investment, or mortgage purchase program activities, or increased compliance costs. Changes that restrict dividend payments, the growth of the FHLBanks' current business, or the creation of new products or services could negatively affect the FHLBanks' results of operations or financial condition, or the value of FHLBank membership. Further, the regulatory environment affecting members could be changed in a manner that would negatively affect their ability to acquire or own an FHLBank's capital stock or take advantage of an FHLBank's products and services.

***Changes in the regulation of GSEs or the FHLBanks' status as GSEs may adversely affect the FHLBanks' business activities, future advance balances, the cost of debt issuance, and the value of FHLBank membership.***

GSEs, such as Fannie Mae, Freddie Mac, and the FHLBank System, have grown significantly in recent years. As a result of this growth, these GSEs have actively issued debt securities to fund their operations. In addition, negative accounting and other announcements by Fannie Mae and Freddie Mac have created pressure on debt pricing, as investors have perceived their debt instruments as bearing increased risk.

As a result of these factors, the FHLBank System may have to pay a higher rate of interest on consolidated obligations to make them attractive to investors. If the FHLBanks maintain their existing pricing on advances, the resulting increase in the cost of issuing consolidated obligations could cause the FHLBanks' advances to be less profitable and reduce their net interest margins (the difference between the interest rate received on advances and the interest rate paid on consolidated obligations). If, in response to this decrease in net interest margin, the FHLBanks change the pricing of their advances, the advances may no longer be attractive to their members, and outstanding advances balances may decrease. In either case, the increased cost of issuing consoli-

dated obligations could negatively affect the FHLBanks' financial condition and results of operations, and the value of FHLBank membership.

***Changes in interest rates could significantly affect the FHLBanks' financial condition, results of operations, and the value of FHLBank membership.***

The FHLBanks realize income primarily from the spread between interest earned on their outstanding advances and investments and interest paid on their consolidated obligations and other liabilities. The FHLBanks may experience instances when either their interest-bearing liabilities will be more sensitive to changes in interest rates than their interest-earning assets, or vice versa. In either case, interest-rate movements contrary to the FHLBanks' position could negatively affect their financial condition, results of operations, and the value of FHLBank membership. Moreover, the effect of changes in interest rates can be exacerbated by prepayment and extension risk, which is the risk that mortgage-related assets will be refinanced by the mortgagor in low interest-rate environments or will remain outstanding longer than expected at below-market yields when interest rates increase.

***A loss or change of business activities with large members could adversely affect the FHLBanks' results of operations, financial condition, and the value of FHLBank membership.***

Some FHLBanks have a high concentration of advances and capital with certain members. If these members withdraw from membership in the FHLBank System, which could occur as a result of increased consolidation in the financial services industry, their withdrawal could result in a reduction of the FHLBanks' total combined assets, capital, and net income. If one or more of these members were to prepay its advances or repay the advances as they mature, and no other advances were made to replace them, it could result in a reduction of the FHLBanks' total combined assets, capital, and net income. The timing and magnitude of the effect of a reduction in the amount of advances would depend on a number of factors, including the:

- amount and period over which the advances were prepaid or repaid;
- amount and timing of any corresponding decreases in activity-based capital;
- profitability of the advances;
- size and profitability of the FHLBanks' short- and long-term investments; and
- extent to which consolidated obligations matured as the advances were prepaid or repaid.

***The FHLBanks' financial condition and results of operations, and the value of FHLBank membership, could be adversely affected by FHLBank exposure to credit risk.***

The FHLBanks have exposure to credit risk in that the market value of an obligation may decline as a result of deterioration in the creditworthiness of the obligor or the credit quality of a security instrument. In addition, the FHLBanks assume secured and unsecured credit risk exposure associated with the risk that a borrower or counterparty could default and an FHLBank could suffer a loss if it could not fully recover amounts owed to it on a timely basis. A credit loss, if material, could have an adverse effect on the FHLBanks' financial condition and results of operations, and the value of FHLBank membership.

***An FHLBank's financial condition and results of operations, and the value of FHLBank membership, could be adversely affected by a failure in its pledged collateral protection.***

The FHLBanks require that all outstanding advances to their borrowers be fully collateralized. In addition, for mortgage loans purchased under the MPF and MPP programs, the FHLBanks require that the outstanding credit enhancement obligations of their borrowers not covered through the purchase of SMI be fully collateralized. The FHLBanks evaluate the types of collateral pledged by their borrowers and assign a borrowing capacity to the collateral, generally based on a percentage

of its market value. The devaluation or inability to liquidate the collateral in the event of a default by the obligor could cause an FHLBank to incur a credit loss and adversely affect the financial condition and results of operations of one or more FHLBanks, and the value of FHLBank membership.

***An FHLBank may not be able to meet its obligations as they come due or meet the credit and liquidity needs of its members in a timely and cost-effective manner.***

The FHLBanks seek to be in a position to meet their members' credit and liquidity needs and pay their obligations without maintaining excessive holdings of low-yielding liquid investments or being forced to incur unnecessarily high borrowing costs. In addition, each FHLBank maintains a contingency liquidity plan designed to enable it to meet its obligations and the liquidity needs of members in the event of operational disruptions or short-term disruptions in the capital markets. An FHLBank's inability to manage its liquidity position or its contingency liquidity plan in a manner to meet its obligations and the credit and liquidity needs of its members could affect adversely the FHLBanks' financial condition and results of operations, and the value of FHLBank membership.

***The FHLBanks face competition for advances, loan purchases, and access to funding, which could adversely affect their businesses, and the FHLBanks' efforts to make advance pricing attractive to their members may affect earnings.***

The FHLBanks' primary business is making advances to their members. Each FHLBank competes with other suppliers of wholesale funding, both secured and unsecured, including investment banks, commercial banks and, in certain circumstances, other FHLBanks. The FHLBanks' members have access to alternative funding sources, which may offer more favorable terms than the FHLBanks do on their advances, including more flexible credit or collateral standards. The FHLBanks may make changes in policies, programs, and agreements affecting members from time to time, including, without limitation, policies, programs, and agreements affecting the availability of and conditions for access to advances and other credit products, the mortgage purchase programs, the AHP, and other programs, products, and services, could cause members to obtain financing from alternative sources. In addition, many competitors are not subject to the same regulations, which may enable those competitors to offer products and terms that the FHLBanks are not able to offer.

The availability to the FHLBanks' members of alternative funding sources that are more attractive may significantly decrease the demand for the FHLBanks' advances. Lowering the interest rates charged on the FHLBanks' advances to compete with these alternative funding sources may decrease the profitability of the FHLBanks' advances. A decrease in the demand for the FHLBanks' advances or a decrease in the FHLBanks' profitability on advances could adversely affect the FHLBanks' financial condition and results of operations and may adversely affect the value of FHLBank membership.

Most of the FHLBanks also compete, primarily with Fannie Mae and Freddie Mac, for the purchase of mortgage loans from members. Some FHLBanks may also compete with other FHLBanks with which their members have a relationship through affiliates. Most of the FHLBanks offer the MPF Program to their members, and some offer a similar program known as the MPP. Competition among FHLBanks for MPF program business may be affected by the requirement that a member and its affiliates can sell loans into the MPF Program through only one FHLBank relationship at a time. Increased competition may result in a reduction in the amount of mortgage loans the FHLBanks are able to purchase and, therefore, lower income from this part of their businesses. Each FHLBank also competes with the U.S. Department of the Treasury, Fannie Mae, Freddie Mac, and other GSEs, as well as corporate, sovereign, and supranational entities, for funds raised through the issuance of unsecured debt in the national and global debt markets. Increases in the supply of competing debt products may, in the absence of increases in demand, result in higher debt costs or lower amounts of debt issued at the same cost than otherwise would be the case. Increased competition could adversely affect the FHLBanks' ability to have access to funding,



reduce the amount of funding available to the FHLBanks, or increase the cost of funding available to the FHLBanks. Any of these effects could adversely affect the FHLBanks' financial condition and results of operations, and the value of FHLBank membership.

***The FHLBanks rely heavily on information systems and other technology.***

Each FHLBank relies heavily on its information systems and other technology to conduct and manage its business, as well as the information systems and other technology used by the Office of Finance. If they were to experience a failure or interruption in any of these systems or other technology, the FHLBanks may be unable to conduct and manage their business effectively, including, without limitation, their advance and hedging activities. Although each of the FHLBanks and the Office of Finance has implemented a business resumption plan, it may not be able to prevent, timely and adequately address, or mitigate the negative effects of any failure or interruption. Any failure or interruption could adversely affect its member relations, risk management, and profitability, which could negatively affect the FHLBanks' financial condition, and results of operations, and the value of FHLBank membership.

***Economic downturns and changes in Federal monetary policy could have an adverse effect on the FHLBanks' business and their results of operations.***

The FHLBanks' businesses and results of operations are sensitive to general business and economic conditions. These conditions include short- and long-term interest rates, inflation, money supply, fluctuations in both debt and equity capital markets, and the strength of the United States economy and the local economies in which the FHLBanks conduct their business. If any of these conditions decline, the FHLBanks' businesses and results of operations could be adversely affected. For example, a prolonged economic downturn could result in members becoming delinquent or defaulting on their advances. In addition, the FHLBanks' business and results of operations are significantly affected by the fiscal and monetary policies of the federal government and its agencies, including the Federal Reserve Board, which regulates the supply of money and credit in the United States. The Federal Reserve Board's policies directly and indirectly influence the yield on interest-earning assets and the cost of interest-bearing liabilities and the demand for FHLBank debt.



**SELECTED FINANCIAL DATA**  
(Dollar amounts in millions)

	At December 31,				
	2006	2005	2004	2003	2002
<b>Balance Sheet</b>					
Advances .....	\$ 640,681	\$619,860	\$581,216	\$514,037	\$489,338
Mortgage loans, net .....	97,974	105,240	113,922	113,438	60,455
Investments(1) .....	270,663	266,454	224,911	189,561	206,394
Other assets(2) .....	7,151	5,835	4,702	5,382	6,865
Total assets .....	<u>\$1,016,469</u>	<u>\$997,389</u>	<u>\$924,751</u>	<u>\$822,418</u>	<u>\$763,052</u>
Deposits and borrowings .....	\$ 21,172	\$ 21,758	\$ 21,174	\$ 23,260	\$ 29,907
Consolidated obligations, net .....	934,214	915,901	845,738	740,721	673,383
Other liabilities(3) (4) .....	16,098	15,250	15,976	19,457	23,562
Total liabilities .....	<u>\$ 971,484</u>	<u>\$952,909</u>	<u>\$882,888</u>	<u>\$783,438</u>	<u>\$726,852</u>
Total capital stock putable(5) .....	\$ 42,001	\$ 42,043	\$ 40,092	\$ 37,703	\$ 35,186
Retained earnings .....	3,143	2,600	1,744	1,098	716
Accumulated other comprehensive income .....	(159)	(163)	27	179	298
Total capital(4) .....	<u>\$ 44,985</u>	<u>\$ 44,480</u>	<u>\$ 41,863</u>	<u>\$ 38,980</u>	<u>\$ 36,200</u>

	For the Year Ended December 31,				
	2006	2005	2004	2003	2002
<b>Income Statement</b>					
Total interest income(6) .....	\$ 50,567	\$ 35,420	\$ 21,925	\$ 19,076	\$ 21,476
Total interest expense(4) (6) .....	46,274	31,213	17,754	15,199	17,754
Net interest income(4) .....	4,293	4,207	4,171	3,877	3,722
(Reversal) provision for credit losses .....	(1)	1	(5)	(4)	9
Net interest income after (reversal) provision for credit losses(4) .....	4,294	4,206	4,176	3,881	3,713
Net (losses) gains on trading securities .....	(127)	(304)	(106)	(319)	708
Net realized (losses) gains from sale of held-to-maturity securities .....	(6)	(1)	13	(158)	
Net gains (losses) on derivatives and hedging activities(6) .....	83	(23)	(784)	(309)	(1,931)
Other non-interest income (loss), net(6) (7) .....	53	268	(13)	5	12
Total other income (loss) .....	3	(60)	(890)	(781)	(1,211)
Operating expenses .....	671	657	547	450	393
Finance Board .....	32	32	26	24	26
Office of Finance .....	25	24	20	18	16
Other .....	15	16	19	15	17
Total other expense .....	743	729	612	507	452
Affordable Housing Program .....	295	282	225	218	168
REFCORP. ....	647	625	505	490	375
Total assessments .....	942	907	730	708	543
Cumulative effect of change in accounting principles before assessments(4) (8) .....		15	50		
Net income(4) .....	<u>\$ 2,612</u>	<u>\$ 2,525</u>	<u>\$ 1,994</u>	<u>\$ 1,885</u>	<u>\$ 1,507</u>

(1) Investments include:

- a) held-to-maturity securities;
- b) available-for-sale securities;
- c) trading securities;
- d) interest-bearing deposits;
- e) securities purchased under agreements to resell; and
- f) Federal funds sold.

(2) Other assets include cash and due from banks, accrued interest receivable, premises and equipment, net, and derivative assets.

(3) Other liabilities include subordinated notes, mandatorily redeemable capital stock, accrued interest payable, accruals for AHP obligations, payable to REFCORP and derivative liabilities.

- (4) Effective January 1, 2004, the FHLBanks reclassified \$946 million of outstanding capital stock to “mandatorily redeemable capital stock” in the liability section of the Statement of Condition as a result of adopting SFAS 150. Upon adoption, the FHLBanks also recorded estimated dividends earned as a part of the carrying value of the mandatorily redeemable capital stock. The difference between the prior carrying amount and the mandatorily redeemable capital stock of \$1 million was recorded as a cumulative effect of a change in accounting principle in the Statement of Income. For the years ended December 31, 2006, 2005 and 2004, dividends on mandatorily redeemable capital stock in the amounts of \$60 million, \$48 million and \$22 million were recorded as interest expense. Although the mandatorily redeemable capital stock is not included in capital for financial reporting purposes, it is considered capital for regulatory purposes. (See Note 16 to the accompanying combined financial statements for information on the significant restrictions on stock redemption.)
- (5) The FHLBanks’ capital stock is redeemable at the request of the member subject to statutory redemption periods and certain other conditions and limitations. (See “Business—Capital, Capital Rules and Dividends” and Note 16 to the accompanying combined financial statements.)
- (6) For the year ended December 31, 2002, the FHLBanks reclassified realized gains and losses (e.g., net interest payments) on stand-alone derivative instruments used in economic hedges. Previously, realized gains and losses on stand-alone derivatives used in economic hedges were classified within net interest income after (reversal) provision for credit losses while unrealized gains (losses) on these derivatives were recorded in net gains (losses) on derivatives and hedging activities within other income. These amounts have been reclassified and are now included in net gains (losses) on derivatives and hedging activities within other income for the year ended December 31, 2002 to be consistent with the current presentation. For the years ended December 31, 2003 and 2002, the FHLBanks also reclassified prepayment fee income from other income to net interest income to be consistent with the current presentation.
- (7) Other non-interest income (loss), net includes service fees and net realized gains (losses) from sale of available-for-sale securities.
- (8) The FHLBanks of Chicago, Pittsburgh, Atlanta, Boston, Dallas, Des Moines and New York changed their method of accounting per SFAS No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans and Initial Direct Costs of Leases*, in 2004 and 2005. (See Note 2 to the accompanying combined financial statements.)

## **FINANCIAL DISCUSSION AND ANALYSIS OF COMBINED FINANCIAL CONDITION AND COMBINED RESULTS OF OPERATIONS**

Investors should read this financial discussion and analysis of combined financial condition and combined results of operations together with the combined financial statements and the notes beginning on page 117 of this Combined Financial Report. Each FHLBank addresses its financial condition and results of operations in its periodic reports filed with the SEC. A financial discussion and analysis of the combined financial condition and combined results of operations is provided in this report for investors because this is considered more convenient than providing each FHLBank's management discussion and analysis of financial condition and results of operations on a stand-alone basis only. There is no system-wide central management of the FHLBanks, and each FHLBank manages its operations independently and with only minimal consideration as to how transactions it enters into might affect the combined financial results. The financial discussion and analysis of combined financial condition and combined results of operations does not generally include a description of how each FHLBank's operations affect the combined financial condition and combined results of operations. This level of information about each of the FHLBanks is addressed in that FHLBank's periodic reports filed with the SEC. (See "Available Information on Individual FHLBanks" on page 3 and "Explanatory Statement about FHLBanks Combined Financial Report" on page 2.)

Amounts used to calculate percentage variances are based on numbers in millions. As a result, recalculations may not produce the same results when the relevant amounts are disclosed only in billions.

### **Forward-Looking Information**

Statements contained in this report, including statements describing the objectives, projections, estimates, or future predictions of the FHLBanks and the Office of Finance may be "forward-looking statements." These statements may use forward-looking terminology, such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or their negatives or other variations on these terms. Investors should note that, by their nature, forward-looking statements involve risk or uncertainty and that actual results could differ materially from those expressed or implied in these forward-looking statements or could affect the extent to which a particular objective, projection, estimate, or prediction is realized.

These forward-looking statements involve risks and uncertainties including, but not limited to, the following:

- changes in interest rates, housing prices, employment rates and the general economy;
- the size and volatility of the residential mortgage market;
- demand for FHLBank advances resulting from changes in FHLBank members' deposit flows and credit demands;
- volatility of market prices, rates, and indices or other factors that could affect the value of investments or collateral held by the FHLBanks as security for the obligations of FHLBank members and counterparties to interest-rate exchange agreements and similar agreements, which could result from the effects of, and changes in, various monetary or fiscal policies and regulations, including those determined by the Federal Reserve Board and the Federal Deposit Insurance Corporation;
- political events, including legislative, regulatory, judicial, or other developments that affect the FHLBanks, their members, counterparties and/or investors in the consolidated obligations of the FHLBanks, such as changes in the FHLBank Act of 1932 or Finance Board regulations that affect FHLBank operations, and regulatory oversight (including the Secretary of the Treasury's authority relating to the issuance of consolidated obligations);

- competitive forces, including other sources of funding available to FHLBank members, other entities borrowing funds in the capital markets, and the ability to attract and retain skilled individuals;
- the pace of technological change and the ability to develop and support technology and information systems, including the Internet, sufficient to manage the risks of the FHLBanks' business effectively;
- loss of large members through mergers and similar activities;
- changes in domestic and foreign investor demand for consolidated obligations and/or the terms of interest-rate exchange agreements and similar agreements, including changes in the relative attractiveness of consolidated obligations as compared to other investment opportunities;
- the availability, from acceptable counterparties, of derivative financial instruments of the types and in the quantities needed for risk management purposes;
- timing and volume of market activity;
- volatility of reported results due to changes in the fair value of certain instruments/assets;
- the ability to introduce new FHLBank products and services and successfully manage the risks associated with those products and services, including new types of collateral used to secure advances;
- the FHLBanks' ability to identify, manage, mitigate and/or remedy internal control weaknesses and other operational risks;
- the FHLBanks' ability to implement business process improvements;
- risk of loss arising from litigation filed against one or more of the FHLBanks;
- significant business disruptions resulting from natural or other disasters, acts of war or terrorism;
- the effect of new accounting standards, including the development of supporting systems; and
- inflation/deflation.

## **Business Overview**

*Financial Performance.* As cooperatives, the FHLBanks seek to maintain a balance between their public policy mission and their ability to provide adequate returns on the capital supplied by their members. The FHLBanks achieve this balance by delivering low-cost financing to members to help them meet the credit needs of their communities and by paying dividends. In view of their cooperative nature, the FHLBanks' financial strategies are designed to enable the FHLBanks to expand and contract in response to the credit needs of their members.

The FHLBanks invest their capital in high-quality, short- and intermediate-term financial instruments. This strategy allows the FHLBanks to maintain liquidity to satisfy member demand for short- and long-term funds, repay maturing consolidated obligations, and meet other obligations. This strategy also reduces the risk of loss when investments are liquidated if an FHLBank elects to repurchase excess capital stock. The dividends paid by an FHLBank are largely the result of the FHLBank's earnings on invested member capital, net earnings on advances to members and investment returns on mortgage loans and investments. These are offset by the FHLBank's operating expenses and assessments. The board of directors and management of each FHLBank determine the pricing of member credit and the FHLBank's dividend policies based on the needs of its members.

*Different FHLBank Business Strategies.* Each FHLBank is operated as a separate entity with its own management, employees and board of directors but under the supervisory and regulatory

framework of the Finance Board. However, the management and board of directors of each FHLBank determine the best approach for meeting the FHLBank's business objectives and serving its members. As such, the management and board of directors of each FHLBank have developed their own business strategies and initiatives to fulfill the FHLBank's mission and they reevaluate these strategies and initiatives from time to time. For example, some FHLBanks have actively pursued the purchase of mortgage loans from their members through the acquired member asset programs, while other FHLBanks have offered a program to their members but have not actively marketed the program or their members have not invested significant resources to develop or expand the programs. At December 31, 2006, mortgage loans purchased through the acquired member asset programs as a percentage of total assets varied from a high of 44 percent for the FHLBank of Chicago to a low of less than 1 percent for the FHLBank of Dallas. In addition, in March 2005, the FHLBank of Seattle announced that it plans to develop an exit strategy from its MPP. The FHLBank of Seattle is no longer accepting additional master commitments, has completed all of its delivery commitments and is not purchasing additional mortgages. In October 2006, the FHLBank of San Francisco announced it would no longer offer new master commitments to purchase mortgage loans from its PFIs under the MPF Program.

## Comparative Highlights

### *Financial Highlights.*

(Dollar amounts in millions)	For the Year Ended December 31,			For the Year Ended 2006 vs. 2005 Increase		For the Year Ended 2005 vs. 2004 Increase	
	2006	2005	2004	\$	%	\$	%
Net interest income (before (reversal) provision for credit losses) . . . . .	\$4,293	\$4,207	\$4,171	\$ 86	2.0%	\$ 36	0.9%
Net income . . . . .	2,612	2,525	1,994	87	3.4%	531	26.6%

Net interest income increased in 2006 over 2005 due to higher interest income on advances and investments as a result of increases in advances outstanding and investments and the effect of higher yields on advances and investments. The increase in advances outstanding is driven by member demand. The yield on advances was higher due to the increase in short- and long-term interest rates during 2005 that continued until mid-2006. Interest income on investments also increased primarily due to higher interest rates. The increase in net income was primarily caused by increases in net interest income and total other income, partially offset by increases in other expenses and assessments. The change in total other income resulted from lower net losses on trading securities and net gains on derivatives and hedging activities.

Net interest income increased in 2005 over 2004 due to higher interest income on advances and investment income as a result of increases in advances and investments and the effect of higher yields on advances and investments. The increase in advances is driven by member demand. The yield on advances was higher due to the increase in short- and long-term interest rates during 2005. Interest income on investments also increased primarily due to higher interest rates. The increase in net income was primarily caused by the increase in net interest income and reduction in total other loss in other income, partially offset by increases in other expenses and assessments. The reduction in total loss in other income resulted from lower losses on derivatives and hedging activities and lower net losses on investments.

	For the Year Ended December 31,			Percentage Increase	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Total operating expenses (dollar amounts in millions) . .	<u>\$671</u>	<u>\$657</u>	<u>\$546</u>	2.1%	20.3%

Operating expenses increased in 2006 and 2005 as a result of an increase in the number of employees to support increased requirements for risk management, SEC registration and filings, and preparations for compliance with Sarbanes-Oxley requirements.

	For the Year Ended December 31,		Percentage Increase
	2006	2005	
Daily average total assets (dollar amounts in billions) . . . . .	<u>\$1,007.7</u>	<u>\$954.8</u>	5.5%

The increase in average assets is primarily the result of the growth in the FHLBanks' advances outstanding and investment portfolios.

The FHLBanks' hedge accounting strategies and trading securities resulted in the following (dollar amounts in millions):

	For the Years Ended December 31,			2006 vs. 2005 Increase	2005 vs. 2004 (Decrease) Increase
	2006	2005	2004		
Net losses on trading securities . . . . .	\$(127)	\$(304)	\$(106)	\$177	\$(198)
Net gains (losses) on derivatives and hedging activities . . . . .	83	(23)	(784)	106	761

Key amounts as a percentage of total assets are as follows (dollar amounts in billions):

	December 31, 2006		December 31, 2005		2006 vs. 2005 Percentage Increase (Decrease)
	Amount	Percentage of Total Assets	Amount	Percentage of Total Assets	
Advances . . . . .	<u>\$ 640.7</u>	<u>63.0%</u>	<u>\$619.9</u>	<u>62.1%</u>	<u>3.4%</u>
Investments . . . . .	<u>270.7</u>	<u>26.6%</u>	<u>266.5</u>	<u>26.7%</u>	<u>1.6%</u>
Mortgage loans held for portfolio, net	<u>98.0</u>	<u>9.6%</u>	<u>105.2</u>	<u>10.6%</u>	<u>(6.9)%</u>
Total assets . . . . .	<u>1,016.5</u>		<u>997.4</u>		<u>1.9%</u>
Total consolidated obligations, net . . .	<u>934.2</u>		<u>915.9</u>		<u>2.0%</u>
Total capital . . . . .	<u>45.0</u>		<u>44.5</u>		<u>1.1%</u>

Investments and advances remained relatively flat as a percentage of total assets. Mortgage loans held for portfolio, however, decreased as a percentage of total assets. Consolidated obligations increased to support the growth in total assets.

The growth in the FHLBanks' advances outstanding balance from December 31, 2005 to December 31, 2006 reflects demand by members for wholesale funding. Some of the advances growth over the past several years has been attributable to convertible and putable advances. Convertible advances feature one or more put option(s) sold by a member to an FHLBank that allows the FHLBank to convert the advance from fixed-rate to variable-rate. A convertible advance carries an interest rate lower than a comparable-maturity advance that does not have the conversion feature. When an FHLBank makes a putable advance, it has the right to terminate the advance at its discretion, which the FHLBank normally would exercise when interest rates increase. If an FHLBank elects to terminate the advance, the member may apply for a new advance at the then-current advance rates, subject to all applicable credit requirements. In addition, some members have taken advantage of the still relatively low interest-rate environment, increasing their demand for advances. Some FHLBanks have also experienced growth in advances as a result of large member demand for short-term or adjustable-rate advances. Mortgage loans held for portfolio decreased as a result of market conditions including higher long-term interest rates, lower origination and refinancing volumes and member preference for issuing variable-rate and/or interest-only mortgages, which the FHLBanks do not purchase as part of their acquired member asset programs.



The increase in capital in 2006 is attributable to a number of factors including: the requirement that each new member must purchase stock in its FHLBank based on each FHLBank's capital stock purchase requirements, increases in advances, the accumulation of retained earnings, and the payment and use of stock dividends instead of cash dividends. A number of FHLBanks have increased their accumulated retained earnings as a result of regulatory requirements and to offset the possible effect of temporary income volatility associated with SFAS 133. The FHLBanks' GAAP capital-to-assets ratio was 4.43 percent at December 31, 2006, compared with 4.46 percent at December 31, 2005.

The return on average assets was 26 basis points in 2006 and 2005. The return on average equity was 5.80 percent in 2006, which is four basis points lower than in 2005. The decrease in return on average equity is due primarily to the higher percentage increase in the average invested equity balance in comparison to net income. The weighted-average dividend rate was 4.91 percent in 2006, compared with 4.06 percent one year earlier. The dividend rate has been affected by each FHLBank's respective retained earnings policies.

## **Financial Trends**

*Conditions in Financial Markets.* The primary external factors that affect net interest income are market interest rates, credit spreads and the general state of the economy.

Interest rates during a reporting period affect the FHLBanks' profitability, due primarily to the short-term structure of earning assets and the effect of higher interest rates on invested capital. At December 31, 2006 and 2005, the majority of investments, excluding mortgage-backed securities, and approximately 39 percent of the outstanding advances, had stated maturities of less than one year. Additionally, a significant portion of the FHLBanks' advances has been hedged with interest-rate exchange agreements in which a short-term rate is received. The demand for FHLBank debt, as well as current short-term interest rates, as represented, for example, by the overnight Federal funds target rate, has an effect on the FHLBanks' profitability as measured by net interest income and return on average equity.

Interest rates also directly affect the FHLBanks through earnings on invested capital. Because the FHLBanks operate at relatively low net spreads between the yield earned on their assets and the cost of liabilities compared to other financial institutions, generally due to the FHLBanks' cooperative structures, a relatively higher proportion of FHLBank income is generated from the investment of member-supplied capital at the average asset yield as compared to other financial institutions. Consequently, changes in asset yields tend to have a greater effect on FHLBank profitability than on the profitability of financial institutions in general. Most FHLBanks' return on capital follows short-term rates such as the Federal funds or 3-Month LIBOR rates, while certain FHLBank average asset yields and corresponding returns on capital have been driven by longer-term assets, such as mortgage loans purchased through the mortgage purchase programs and MBS and CMO-related investment holdings.

Certain capital markets developments may also affect the performance of the FHLBanks. Specifically, the pricing relationships between the mortgage, agency, and derivative markets and the level of market price volatility may affect the attractiveness of mortgage products for the FHLBanks as well as the cost of FHLBank debt.

The overall customer deposit balances and asset growth of FHLBank member institutions may affect the demand for FHLBank advances.

*2006 Compared to 2005.* The following table presents information on key average market interest rates for the years ended December 31, 2006 and 2005 and key market interest rates at December 31, 2006 and 2005.

	Year-to-date December 31, 2006 12-Month Average	Year-to-date December 31, 2005 12-Month Average	December 31, 2006 Ending Rate	December 31, 2005 Ending Rate	YTD Average 2006 vs. 2005 Variance	Ending 2006 vs. 2005 Variance
Federal funds rate(1) . . . . .	4.96%	3.19%	5.25%	4.25%	1.77	1.00
3-month LIBOR(1) . . . . .	5.20%	3.57%	5.36%	4.54%	1.63	0.82
2-year U.S. Treasury(1) . . . . .	4.82%	3.84%	4.81%	4.40%	0.98	0.41
5-year U.S. Treasury(1) . . . . .	4.75%	4.04%	4.70%	4.35%	0.71	0.35
10-year U.S. Treasury(1) . . . . .	4.79%	4.28%	4.70%	4.39%	0.51	0.31
15-year residential mortgage note rate(2) . . . . .	6.03%	5.41%	5.93%	5.74%	0.62	0.19
30-year residential mortgage note rate(2) . . . . .	6.38%	5.85%	6.22%	6.15%	0.53	0.07

(1) Sources: Bloomberg and Lehman Brothers.

(2) Average calculated using “The Mortgage Bankers Association Weekly Application Survey.” December 31, 2006 ending rate is from the last week in December 2006 and December 31, 2005 ending rate is from the last week in December 2005.

The Federal Reserve Board, through its Federal Open Market Committee, increased the Federal funds rate by 25 basis points four times during 2006. This resulted in a 100 basis point increase in the Federal funds rate to 5.25 percent. Other short-term interest rates followed the upward trend of the Federal funds rate. For example, the average three-month LIBOR rate increased approximately 163 basis points from 2005 to 2006. Additionally, the spread between long-term and short-term rates continued to narrow, causing additional flattening, and at times, inversion, of the yield curve. This flattening was evidenced by average Treasury rates for two-year obligations increasing 98 basis points, while five-year and 10-year obligations increased 71 basis points and 51 basis points. The average interest rate on the 15-year, fixed-rate residential mortgage loan rose to 6.03 percent in 2006, an increase of 62 basis points from the corresponding average interest rate in 2005, while the average interest rate on the 30-year, fixed-rate residential mortgage loan rose to 6.38 percent during 2006, an increase of 53 basis points from the corresponding average interest rate in 2005.

The Securities Industry and Financial Markets Association’s February 2007 “Research Quarterly” noted that new issuance volume in the U.S. bond market totaled \$6.13 trillion during 2006, an increase of 11.1 percent from the \$5.52 trillion issued during 2005, and the second highest issuance year ever. The housing sector correction, coupled with growth in the issuance of non-agency mortgage-backed securities, contributed to a 6.9 percent decrease in agency mortgage-backed securities issuance during this 12-month period. The Securities Industry and Financial Markets Association’s February 2007 “Research Quarterly” noted that agency long-term bond issuance volume in 2006 totaled \$744.1 billion, up 11.2 percent from the \$669.0 billion issued during 2005. Included in this number is the FHLBanks’ long-term bond issuance of \$322.5 billion, a 9.2 percent increase from 2005.

During 2006, the issuance of callable FHLBank consolidated obligations increased, as callable debt has become a core component of the FHLBanks’ interest-rate risk management strategy. During the second half of 2006, as rates fell and volatility remained at historically low levels, investors increased demand for callable bonds in an effort to maintain yield. In addition, with the yield curve providing little incentive to extend maturities, investor demand for short-term debt was strong.

The mortgage market continues to undergo a number of changes. On the supply side, during 2006, despite slightly higher interest rates on fixed-rate mortgages, the flat to slightly inverted yield curve provided incentive for many borrowers to shy away from variable-rate and/or interest-only mortgages and refinance into 30-year, fixed-rate mortgages. In addition, mortgage originations and refinancing volumes were down. On the demand side, domestic commercial banks and overseas investors have continued to increase mortgage purchases. While Fannie Mae and Freddie Mac increased their mortgage purchases in 2006, they have not approached their mortgage portfolio growth rates from the early part of this decade. These trends are due in part to continuing regulatory mandates, such as temporary retained portfolio growth limits and excess capital requirements, as well as continuing legislative uncertainty. In addition, growing demand for agency mortgage-backed securities by the U.S. dollar portfolios of foreign central banks reduced the number of mortgage investment opportunities for Fannie Mae and Freddie Mac. During 2006, Fannie Mae and Freddie Mac reported no growth in their combined retained portfolios, producing little incremental debt funding demand. The resulting supply reduction, coupled with continuing growth in demand for GSE debt by foreign central banks that continue to experience significant growth in reserves, allowed the FHLBanks to issue debt at more attractive rates than might otherwise have been possible.

For the year ended December 31, 2006, the Federal Deposit Insurance Corporation (FDIC) reported that total assets and deposits of all FDIC-insured institutions increased compared to the year ended December 31, 2005. Total assets for all FDIC-insured institutions increased 9.0 percent. Total domestic deposits for all FDIC-insured institutions were \$6.63 trillion, a 6.6 percent gain over year-end 2005 balances, while total loans increased 7.7 percent over the same period. The growth in deposits, if sustained, may lower the future demand for advances from the FHLBanks.

*2005 Compared to 2004.* The following table presents information on key average market interest rates for the years ended December 31, 2005 and 2004 and key market interest rates at December 31, 2005 and 2004.

	Year-to-date December 31, 2005 12-Month Average	Year-to-date December 31, 2004 12-Month Average	December 31, 2005 Ending Rate	December 31, 2004 Ending Rate	YTD Average 2005 vs. 2004 Variance	Ending 2005 vs. 2004 Variance
Federal funds rate(1) . . . . .	3.19%	1.35%	4.25%	2.25%	1.84	2.00
3-month LIBOR(1) . . . . .	3.57%	1.62%	4.54%	2.56%	1.95	1.98
2-year U.S. Treasury(1) . . . . .	3.84%	2.36%	4.40%	3.07%	1.48	1.33
5-year U.S. Treasury(1) . . . . .	4.04%	3.42%	4.35%	3.61%	0.62	0.74
10-year U.S. Treasury(1) . . . . .	4.28%	4.26%	4.39%	4.22%	0.02	0.17
15-year residential mortgage note rate(2) . . . . .	5.41%	5.13%	5.74%	5.12%	0.28	0.62
30-year residential mortgage note rate(2) . . . . .	5.85%	5.78%	6.15%	5.67%	0.07	0.48

(1) Source: Bloomberg.

(2) Average calculated using "The Mortgage Bankers Association Weekly Application Survey." December 31, 2005 ending rate is from the last week in December 2005 and December 31, 2004 ending rate is from the last week in December 2004.

The Federal Reserve Board, through its Federal Open Market Committee, increased the Federal funds rate by 25 basis points eight times during 2005. This resulted in a 200 basis point increase in the Federal funds rate during 2005 to 4.25 percent. Other short-term interest rates followed the trend of the Federal funds rate. For example, the average three-month LIBOR rate increased approximately 195 basis points from 2004 to 2005. Additionally, the spread between long-term and short-term rates narrowed, causing the yield curve to flatten and briefly invert near year-end for the first time in five years. This flattening was evidenced by average Treasury rates for two-

year obligations increasing 148 basis points, while five-year and 10-year obligations increased 62 basis points and two basis points. The average interest rate on the 15-year, fixed-rate residential mortgage loan rose to 5.41 percent in 2005, an increase of 28 basis points from the corresponding average interest rate in 2004, while the average interest rate on the 30-year, fixed-rate residential mortgage loan rose to 5.85 percent during 2005, an increase of seven basis points from the corresponding average interest rate in 2004.

The Bond Market Association's February 2006 "Research Quarterly" noted that new issuance volume in the U.S. bond market totaled \$5.52 trillion during 2005, a slight increase of 0.6 percent from the \$5.49 trillion issued during 2004. Historically low mortgage rates and median housing price appreciation contributed to a 9.1 percent increase in agency mortgage-backed securities issuance during this 12-month period. The Bond Market Association's February 2006 "Research Quarterly" noted that agency long-term bond issuance volume in 2005 totaled \$669.0 billion, down 24.1 percent from the \$881.8 billion issued during 2004. Included in this number is the FHLBanks' long-term bond issuance of \$295.3 billion, a 24.2 percent decrease from 2004. During 2005, as a result of slowly increasing long-term interest rates, the redemption of callable FHLBank consolidated obligations slowed, continuing the trend from the previous year.

The mortgage market underwent a number of changes. On the supply side, during 2005, many borrowers favored hybrid adjustable-rate and/or interest-only mortgages over 30-year, fixed-rate mortgages. This trend developed even though savings in borrowing rates from hybrid adjustable-rate mortgages declined as the yield curve flattened. Higher interest rates reduced the attractiveness of 15- and 30-year fixed-rate mortgages for home purchases and refinancing, further reducing the supply in this sector of the market. On the demand side, commercial banks and overseas investors increased mortgage purchases, substituting for purchases that Fannie Mae and Freddie Mac made in past years. Fannie Mae decreased its mortgage purchases significantly in 2005 as compared to 2004, while Freddie Mac increased its mortgage purchases moderately over the same time period. However, Freddie Mac has not approached its mortgage portfolio growth rate from 2003. These trends are due in part to the continuing regulatory and political scrutiny over these GSEs. Diminished debt issuance by Fannie Mae and limited debt issuance by Freddie Mac reduced supply in the agency debt markets and allowed the FHLBanks to issue debt at more attractive rates than might otherwise have been the case.

For the year ended December 31, 2005, the FDIC reported that total assets and deposits of all FDIC-insured institutions increased compared to the year ended December 31, 2004. Total assets for all FDIC-insured institutions increased 7.6 percent. Total domestic deposits for all FDIC-insured institutions were \$6.22 trillion, an 8.8 percent gain over year-end 2004 balances, while total loans increased 9.8 percent over the same period. The growth in deposits, if sustained, may lower the future demand for advances from the FHLBanks.

## Combined Statement of Condition

*SFAS 133.* SFAS 133 requires that assets and liabilities hedged with derivative instruments designated under fair value hedging relationships be adjusted for changes in fair value even as other assets and liabilities continue to be carried on a historical cost basis. In discussing changes in the Combined Statement of Condition for 2006 compared to 2005, the SFAS 133 fair value adjustments for advances, available-for-sale securities, mortgage loans held for portfolio and consolidated obligations have been included. All other fair value adjustments were less than one percent of the book value. The SFAS 133 fair value adjustments for advances, available-for-sale securities, mortgage loans held for portfolio and consolidated obligations are as follows.

### SFAS 133 Basis Adjustments (Dollar amounts in millions)

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Advances at pre-SFAS 133 value .....	\$641,386	\$620,167
SFAS 133 basis adjustments .....	<u>(705)</u>	<u>(307)</u>
Advances at carrying value.....	<u>\$640,681</u>	<u>\$619,860</u>
Available-for-sale securities at pre-SFAS 133 value(1) .....	\$ 6,592	\$ 5,476
SFAS 133 basis adjustments .....	<u>69</u>	<u>123</u>
Available-for-sale securities at carrying value .....	<u>\$ 6,661</u>	<u>\$ 5,599</u>
Mortgage loans held for portfolio at pre-SFAS 133 value .....	\$ 97,921	\$105,251
SFAS 133 basis adjustments .....	<u>60</u>	<u>(1)</u>
Mortgage loans held for portfolio at carrying value.....	<u>\$ 97,981</u>	<u>\$105,250</u>
Consolidated obligations at pre-SFAS 133 value.....	\$936,924	\$922,553
SFAS 133 basis adjustments .....	<u>(2,710)</u>	<u>(6,652)</u>
Consolidated obligations at carrying value .....	<u>\$934,214</u>	<u>\$915,901</u>

(1) Book value includes fair value adjustments under SFAS No. 115.

The following discussion contains additional information on the major categories of the FHLBanks' Statement of Condition: advances, investments, mortgage loans held for portfolio, consolidated obligations and capital.

*Advances.* Even with improved liquidity of FHLBank members resulting from increases in deposits, advances have been increasing in recent years, reflecting the use of advances by commercial bank members to fund asset growth in excess of deposit growth and the development of advance products tailored to specific member funding needs.

**Advances by Redemption Terms  
(Dollar amounts in millions)**

Redemption Term — Amount	December 31, 2006		December 31, 2005	
	Amount	Weighted-Average Interest Rate	Amount	Weighted-Average Interest Rate
Overdrawn demand deposit accounts . . . . .	\$ 22		\$ 49	
Due in 1 year or less . . . . .	252,399	5.06%	242,932	4.04%
Due after 1 year through 2 years . . . . .	113,971	4.98%	108,014	4.09%
Due after 2 years through 3 years . . . . .	80,728	5.07%	94,998	4.34%
Due after 3 years through 4 years . . . . .	46,978	5.13%	38,696	4.37%
Due after 4 years through 5 years . . . . .	48,158	5.19%	47,236	4.86%
Thereafter . . . . .	94,650	4.55%	82,722	4.32%
Index amortizing advances . . . . .	<u>4,645</u>	4.47%	<u>5,727</u>	4.30%
Total par value . . . . .	<u>641,551</u>	4.98%	<u>620,374</u>	4.22%
Commitment fees . . . . .	(3)		(3)	
Discount on AHP advances . . . . .	(63)		(58)	
Premium on advances . . . . .	18		26	
Discount on advances . . . . .	(117)		(172)	
SFAS 133 hedging adjustments . . . . .	<u>(705)</u>		<u>(307)</u>	
Total . . . . .	<u>\$640,681</u>		<u>\$619,860</u>	

Index amortizing advances require repayment in accordance with predetermined amortization schedules linked to various indices. Usually, as market interest rates rise (fall), the maturity of an index amortizing advance extends (contracts).

**Advances by Interest Rate Payment Terms  
(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005	
	Amount	Percentage of Total	Amount	Percentage of Total
Par amount of advances:				
Fixed-rate . . . . .	\$354,742	55%	\$357,032	58%
Variable-rate . . . . .	<u>286,809</u>	<u>45%</u>	<u>263,342</u>	<u>42%</u>
Total . . . . .	<u>\$641,551</u>	<u>100%</u>	<u>\$620,374</u>	<u>100%</u>

**Advance Originations  
(Dollar amounts in billions)**

	2006	2005	2004	2006 vs. 2005 Decrease		2005 vs. 2004 Increase	
				\$	%	\$	%
Advance originated . . .	\$7,285.0	\$8,373.6	\$7,523.0	\$(1,088.6)	(13.0)%	\$850.6	11.3%

This generally reflected a significant increase in demand by members for short- and longer-term advances as a result of the interest-rate environment and heavy refinancing activity in advances. (See Note 8 to the accompanying combined financial statements.)

The FHLBanks make significant use of interest-rate exchange agreements to alter cash flows on certain advances, particularly convertible and puttable advances. (See “Business—Use of Interest-Rate Exchange Agreements.”)



Many of the FHLBanks' advances are callable at the option of a member. However, the FHLBanks charge a prepayment fee when members terminate certain advances. Members may repay other advances on specified dates (call dates) without incurring prepayment fees (callable advances).

**Advances by Year of Maturity or Next Call Date  
(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005		Increase	
	Amount	Percentage of Total	Amount	Percentage of Total	\$	%
Overdrawn demand deposit accounts . .	\$ 22	0.0%	\$ 49	0.0%		
Due in 1 year or less . . . . .	293,796	45.8%	280,594	45.2%		
Due after 1 year through 2 years . . . .	115,969	18.1%	106,422	17.2%		
Due after 2 years through 3 years . . . .	76,636	11.9%	90,764	14.6%		
Due after 3 years through 4 years . . . .	39,759	6.3%	32,682	5.3%		
Due after 4 years through 5 years . . . .	42,427	6.6%	37,720	6.1%		
Thereafter . . . . .	68,297	10.6%	66,416	10.7%		
Index amortizing advances . . . . .	4,645	0.7%	5,727	0.9%		
Total par value . . . . .	<u>\$641,551</u>	<u>100.0%</u>	<u>\$620,374</u>	<u>100.0%</u>		
Callable advances outstanding . . . . .	<u>\$ 29,659</u>		<u>\$ 23,608</u>		<u>\$6,051</u>	25.6%

**Convertible and Putable Advances Outstanding  
(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005	
	Amount	Percentage of Par Value	Amount	Percentage of Par Value
Convertible advances outstanding . . . . .	\$41,885	6.5%	\$45,686	7.4%
Putable advances outstanding . . . . .	<u>55,428</u>	<u>8.7%</u>	<u>53,428</u>	<u>8.6%</u>
Convertible or Putable Advances Outstanding . . .	<u>\$97,313</u>	<u>15.2%</u>	<u>\$99,114</u>	<u>16.0%</u>

The FHLBanks also offer convertible and putable advances. Convertible advances allow the FHLBank to convert the fixed-rate advance to an open-line advance or other structure after an agreed-upon lockout period. A convertible advance carries an interest rate lower than a comparable-maturity advance that does not have a conversion feature. With a putable advance, an FHLBank has the right to terminate the advance at its discretion, which the FHLBank normally would exercise when interest rates increase, and the borrower may apply for a new advance.

**Year of Maturity or Next Put/Convert Date  
(Dollar amounts in millions)**

Year of Maturity or Next Put/Convert Date	December 31, 2006		December 31, 2005		Increase	
	Amount	Percentage of Total	Amount	Percentage of Total	\$	%
Overdrawn demand deposit accounts . . . . .	\$ 22	0.0%	\$ 49	0.0%		
Due in 1 year or less . . . . .	317,728	49.5%	310,654	50.1%		
Due after 1 year through 2 years . . .	120,530	18.9%	118,580	19.1%		
Due after 2 years through 3 years . .	82,973	12.9%	90,330	14.6%		
Due after 3 years through 4 years . .	35,447	5.5%	32,971	5.3%		
Due after 4 years through 5 years . .	41,394	6.5%	29,044	4.7%		
Thereafter . . . . .	38,812	6.0%	33,019	5.3%		
Index amortizing advances . . . . .	4,645	0.7%	5,727	0.9%		
Total par value . . . . .	<u>\$641,551</u>	<u>100.0%</u>	<u>\$620,374</u>	<u>100.0%</u>	<u>\$21,177</u>	<u>3.4%</u>

*Investments.* All securities are held by the FHLBanks for investment liquidity or asset-liability management purposes. Certain investment securities are classified as trading for liquidity or asset-liability management purposes. Finance Board regulations do not expressly prohibit the FHLBanks from trading in investments, but none of the FHLBanks currently operates security-trading accounts for speculative purposes.

At December 31, 2006 and 2005, 99.95 percent and 99.97 percent of the total investments classified on the Statement of Condition as held-to-maturity, available-for-sale or trading securities were rated in the two highest investment rating categories for long-term or short-term investments.

The FHLBanks use interest-rate exchange agreements to alter the cash flows on certain investment securities. (See “Business — Use of Interest-Rate Exchange Agreements.”)

**Investments  
(Dollar amounts in billions)**

	December 31,		(Decrease)/Increase	
	2006	2005	\$	%
Investments, excluding mortgage-backed securities . . . . .	\$140.5	\$144.2	(3.7)	(2.6)%
Mortgage-backed securities . . . . .	130.2	122.3	7.9	6.5%
Total investments . . . . .	<u>\$270.7</u>	<u>\$266.5</u>	<u>\$ 4.2</u>	<u>1.6%</u>

**Investments**  
**(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005		2006 vs. 2005	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Investments	Dollar Variance	Percentage Variance
Held-to-maturity securities . . . . .	\$142,482	52.6%	\$134,480	50.5%	\$8,002	6.0%
Available-for-sale securities . . . . .	6,661	2.5%	5,599	2.1%	1,062	19.0%
Trading securities . . . . .	5,687	2.1%	7,181	2.7%	(1,494)	(20.8)%
Total investment securities . . . . .	<u>154,830</u>	<u>57.2%</u>	<u>147,260</u>	<u>55.3%</u>	<u>7,570</u>	5.1%
Interest-bearing deposits . . . . .	33,872	12.5%	35,342	13.3%	(1,470)	(4.2)%
Securities purchased under agreements to resell . . . . .	4,905	1.8%	3,295	1.2%	1,610	48.9%
Federal funds sold . . . . .	77,056	28.5%	80,557	30.2%	(3,501)	(4.3)%
Total investments . . . . .	<u>\$270,663</u>	<u>100.0%</u>	<u>\$266,454</u>	<u>100.0%</u>	<u>\$4,209</u>	1.6%

**Investment Securities**  
**(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005		2006 vs. 2005	
	Amount	Percentage of Total Investments	Amount	Percentage of Total Investments	Dollar Variance	Percentage Variance
U.S. Treasury obligations . . . . .	\$ 102	0.1%	\$ 102	0.1%	\$	0.0%
Commercial paper . . . . .	8,220	5.3%	5,831	4.0%	2,389	41.0%
Other U.S. obligations* . . . . .	953	0.6%	1,133	0.8%	(180)	(15.9)%
Government-sponsored enterprises** . . . . .	11,690	7.5%	13,450	9.1%	(1,760)	(13.1)%
State or local housing agency obligations . . . . .	3,240	2.1%	4,002	2.7%	(762)	(19.0)%
Other . . . . .	397	0.3%	414	0.3%	(17)	(4.1)%
	<u>24,602</u>	<u>15.9%</u>	<u>24,932</u>	<u>17.0%</u>	<u>(330)</u>	<u>(1.3)%</u>
Mortgage-backed securities:						
Other U.S. obligations* . . . . .	538	0.3%	756	0.5%	(218)	(28.8)%
Government-sponsored enterprises** . . . . .	44,897	29.0%	42,465	28.8%	2,432	5.7%
Other*** . . . . .	84,793	54.8%	79,107	53.7%	5,686	7.2%
	<u>130,228</u>	<u>84.1%</u>	<u>122,328</u>	<u>83.0%</u>	<u>7,900</u>	<u>6.5%</u>
Total investment securities . . . . .	<u>\$154,830</u>	<u>100.0%</u>	<u>\$147,260</u>	<u>100.0%</u>	<u>\$ 7,570</u>	5.1%

\* Other U.S. obligations primarily consists of Government National Mortgage Association (Ginnie Mae) and/or Small Business Administration (SBA) investment pools.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of private-label mortgage-backed securities.

**Mortgage-Backed Securities Investment Portfolio**  
**(Expressed as a percentage of total mortgage-backed securities holdings)**  
**(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005	
	Amount	Percentage	Amount	Percentage
Private-label residential mortgage-backed securities .....	\$ 76,874	58.9%	\$ 70,109	57.3%
Government-sponsored enterprises residential mortgage-backed securities** .....	44,897	34.5%	42,465	34.7%
Home equity loans .....	3,228	2.5%	3,445	2.8%
Private-label commercial mortgage-backed securities .....	3,863	3.0%	4,596	3.8%
Other U.S. obligations residential mortgage-backed securities* .....	538	0.4%	756	0.6%
Shared Funding Program mortgage-backed certificates .....	489	0.4%	556	0.5%
Manufactured housing loans .....	339	0.3%	401	0.3%
<b>Total mortgage-backed securities .....</b>	<b><u>\$130,228</u></b>	<b><u>100.0%</u></b>	<b><u>\$122,328</u></b>	<b><u>100.0%</u></b>

\* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

Finance Board policy limits additional investments in mortgage-backed securities if an FHLBank's investments in mortgage-backed securities exceed 300 percent of the sum of that FHLBank's previous month-end capital plus its mandatorily redeemable capital stock on the day it purchases the securities. The FHLBank of Chicago may include a designated amount of subordinated notes in calculating compliance with this requirement. The Shared Funding Program mortgage-backed certificates, however, are not subject to this 300 percent limit.

**Mortgage-Backed Securities to Total Capital Ratio**  
**(Dollar amounts in billions)**

	December 31, 2006	December 31, 2005	2006 to 2005 Increase (Decrease)	
			\$	%
Mortgage-backed securities .....	\$130.2	\$122.3	\$ 7.9	6.5%
Shared Funding Program .....	<u>0.5</u>	<u>0.6</u>	(0.1)	(12.1)%
Mortgage-backed securities (excluding Shared Funding Program) .....	<u>\$129.7</u>	<u>\$121.7</u>	8.0	6.5%
Total capital(1) and designated amount of applicable subordinated notes .....	<u>\$ 47.1</u>	<u>\$ 45.9</u>	1.2	2.5%
Ratio of mortgage-backed securities (excluding Shared Funding Program) to total capital(1) and designated amount of applicable subordinated notes .....	<u>2.76</u>	<u>2.65</u>		

(1) Represents the sum of the total capital and mandatorily redeemable capital stock, which is considered capital for regulatory purposes.

Historically, the FHLBanks have been one of the major providers of Federal funds, allowing the FHLBanks to warehouse and provide balance sheet liquidity to meet unexpected borrowing demands from members. The FHLBanks also invest in U.S. agency obligations, some of which are

structured debt issued by other GSEs. The FHLBanks use interest-rate exchange agreements to hedge the interest-rate risk associated with a portion of the investments in debt and to alter the cash flows on certain investment securities. (See Notes 5, 6 and 7 to the accompanying combined financial statements.)

*Trading Securities.*

**Trading Securities  
(Dollar amounts in millions)**

	December 31,	
	2006 Estimated Fair Value	2005 Estimated Fair Value
Government-sponsored enterprises**	\$5,307	\$6,590
State or local housing agency obligations	60	61
Other	<u>2</u>	<u>2</u>
	5,369	6,653
Mortgage-backed securities:		
Other U.S. obligations*	95	132
Government-sponsored enterprises***	158	249
Other****	<u>65</u>	<u>147</u>
	318	528
Total	<u>\$5,687</u>	<u>\$7,181</u>

\* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

\*\*\*\* Primarily consists of private-label mortgage-backed securities.

**Maturity and Yield Characteristics of Non-Mortgage-Backed Securities  
within Trading Securities  
(Dollar amounts in millions)**

Year of Maturity	December 31, 2006		December 31, 2005	
	Estimated Fair Value	Yield	Estimated Fair Value	Yield
<b>Non-mortgage-backed securities</b>				
Due in one year or less	\$ 78	6.59%	\$ 295	6.60%
Due after one year through five years	3,334	3.74%	3,211	4.88%
Due after five years through ten years	1,908	3.69%	3,097	4.35%
Due after ten years	<u>49</u>	6.68%	<u>50</u>	6.69%
Total	<u>\$5,369</u>		<u>\$6,653</u>	

*Available-for-Sale Securities.*

**Available-for-Sale Securities  
(Dollar amounts in millions)**

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury obligations .....	\$ 106	\$	\$ (4)	\$ 102
Commercial paper .....	1,189		(1)	1,188
Government-sponsored enterprises* .....	2,041	1	(8)	2,034
Other .....	384	3		387
	<u>3,720</u>	4	(13)	3,711
Mortgage-backed securities:				
Government-sponsored enterprises** .....	675	2	(5)	672
Other*** .....	2,274	4		2,278
	<u>2,949</u>	6	(5)	2,950
<b>Total .....</b>	<b><u>\$6,669</u></b>	<b><u>\$10</u></b>	<b><u>\$(18)</u></b>	<b><u>\$6,661</u></b>

\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of private-label mortgage-backed securities.

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury obligations .....	\$ 108	\$	\$ (6)	\$ 102
Commercial paper .....	1,149	2		1,151
Government-sponsored enterprises* .....	1,748	2	(10)	1,740
Other .....	395	8		403
	<u>3,400</u>	12	(16)	3,396
Mortgage-backed securities:				
Government-sponsored enterprises** .....	901	2	(6)	897
Other*** .....	1,305	1		1,306
	<u>2,206</u>	3	(6)	2,203
<b>Total .....</b>	<b><u>\$5,606</u></b>	<b><u>\$15</u></b>	<b><u>\$(22)</u></b>	<b><u>\$5,599</u></b>

\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of private-label mortgage-backed securities.



**Amortized Cost and Estimated Fair Value of  
Available-for-Sale Securities by Contractual Maturity  
(Dollar amounts in millions)**

<u>Year of Maturity</u>	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less .....	\$2,262	\$2,261	\$1,831	\$1,833
Due after one year through five years .....	681	671	754	745
Due after five through ten years .....	23	23	23	23
Due after ten years .....	<u>754</u>	<u>756</u>	<u>792</u>	<u>795</u>
	3,720	3,711	3,400	3,396
Mortgage-backed securities .....	<u>2,949</u>	<u>2,950</u>	<u>2,206</u>	<u>2,203</u>
Total .....	<u>\$6,669</u>	<u>\$6,661</u>	<u>\$5,606</u>	<u>\$5,599</u>

Expected maturities of certain securities, including mortgage-backed securities, will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

**Maturity and Yield Characteristics of  
Available-for-Sale Non-Mortgage-Backed Securities**

<u>Year of Maturity</u>	<u>December 31, 2006</u>	<u>December 31, 2005</u>
<b>Non-mortgage-backed securities</b>		
Due in one year or less .....	5.06%	3.84%
Due after one year through five years .....	4.44%	4.13%
Due after five years through ten years .....	5.85%	5.85%
Due after ten years .....	7.34%	7.27%

*Held-to-Maturity Securities.*

**Held-to-Maturity Securities  
(Dollar amounts in millions)**

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper .....	\$ 7,032	\$	\$	\$ 7,032
Other U.S. obligations* .....	953	4	(1)	956
Government-sponsored enterprises** .....	4,349	22	(42)	4,329
State or local housing agency obligations ...	3,180	28	(11)	3,197
Other .....	8			8
	<u>15,522</u>	<u>54</u>	<u>(54)</u>	<u>15,522</u>
Mortgage-backed securities:				
Other U.S. obligations* .....	443	3	(4)	442
Government-sponsored enterprises*** ..	44,067	89	(740)	43,416
Other**** .....	82,450	170	(1,020)	81,600
	<u>126,960</u>	<u>262</u>	<u>(1,764)</u>	<u>125,458</u>
Total .....	<u>\$142,482</u>	<u>\$316</u>	<u>\$(1,818)</u>	<u>\$140,980</u>

\* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

\*\*\*\* Primarily consists of private-label mortgage-backed securities.

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper .....	\$ 4,680	\$ 5	\$	\$ 4,685
Other U.S. obligations* .....	1,133	8	(2)	1,139
Government-sponsored enterprises** .....	5,120	30	(70)	5,080
State or local housing agency obligations ...	3,941	53	(4)	3,990
Other .....	9			9
	<u>14,883</u>	<u>96</u>	<u>(76)</u>	<u>14,903</u>
Mortgage-backed securities:				
Other U.S. obligations* .....	624	4	(5)	623
Government-sponsored enterprises*** ..	41,319	80	(748)	40,651
Other**** .....	77,654	166	(1,118)	76,702
	<u>119,597</u>	<u>250</u>	<u>(1,871)</u>	<u>117,976</u>
Total .....	<u>\$134,480</u>	<u>\$346</u>	<u>\$(1,947)</u>	<u>\$132,879</u>

\* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

\*\*\*\* Primarily consists of private-label mortgage-backed securities.

**Amortized Cost and Estimated Fair Value of  
Held-to-Maturity Securities by Contractual Maturity  
(Dollar amounts in millions)**

<u>Year of Maturity</u>	<u>2006</u>		<u>2005</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less . . . . .	\$ 10,215	\$ 10,202	\$ 6,799	\$ 6,803
Due after one year through five years . .	1,847	1,834	3,600	3,544
Due after five through ten years . . . . .	641	657	873	908
Due after ten years . . . . .	<u>2,819</u>	<u>2,829</u>	<u>3,611</u>	<u>3,648</u>
	15,522	15,522	14,883	14,903
Mortgage-backed securities . . . . .	<u>126,960</u>	<u>125,458</u>	<u>119,597</u>	<u>117,976</u>
Total . . . . .	<u>\$142,482</u>	<u>\$140,980</u>	<u>\$134,480</u>	<u>\$132,879</u>

Expected maturities of certain securities, including mortgage-backed securities, will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

**Maturity and Yield Characteristics of  
Held-to-Maturity Non-Mortgage-Backed Securities**

<u>Year of Maturity</u>	<u>December 31, 2006</u>	<u>December 31, 2005</u>
<b>Non-mortgage-backed securities</b>		
Due in one year or less . . . . .	4.83%	4.31%
Due after one year through five years . . . . .	4.69%	3.65%
Due after five years through ten years . . . . .	5.45%	5.57%
Due after ten years . . . . .	5.75%	4.93%

*Mortgage Loans Held for Portfolio.*

**Mortgage Loans Held for Portfolio  
(Dollar amounts in millions)**

	December 31, 2006	Percentage of Total	December 31, 2005	Percentage of Total	2006 vs. 2005	
					\$	%
<b>Real Estate:</b>						
Fixed medium-term* single-family mortgages .....	\$26,715	27.4%	\$ 30,324	29.0%	\$(3,609)	(11.9)%
Fixed long-term single-family mortgages .....	70,748	72.6%	74,357	71.0%	(3,609)	(4.9)%
Multifamily mortgages .....	29	0.0%	31	0.0%	(2)	(6.5)%
Nonresidential mortgages .....		0.0%	3	0.0%	(3)	(100.0)%
	<u>97,492</u>	<u>100.0%</u>	<u>104,715</u>	<u>100.0%</u>	<u>(7,223)</u>	<u>(6.9)%</u>
Premiums .....	693		831		(138)	(16.6)%
Discounts .....	(307)		(344)		37	(10.8)%
Deferred loan costs, net .....	43		49		(6)	(12.2)%
SFAS 133 hedging adjustments . . .	<u>60</u>		<u>(1)</u>		<u>61</u>	<u>6100.0%</u>
Total mortgage loans held for portfolio .....	<u>\$97,981</u>		<u>\$105,250</u>		<u>\$(7,269)</u>	<u>(6.9)%</u>

\* Medium-term is defined as a term of 15 years or less.

The mortgage loans held for portfolio decreased as a result of higher mortgage interest rates and member preference to issue variable-rate and interest-only mortgages that the FHLBanks do not purchase through their mortgage purchase programs. For most FHLBanks, principal pay downs and maturities of mortgage loans held for portfolio have been greater than new mortgage loans held for portfolio purchases and fundings. In addition, the FHLBank of Chicago has not purchased or funded new MPF loans at the same levels as in the past due to capital limitations. Also, effective March 1, 2006, the FHLBank of Chicago no longer entered into new master commitments with other FHLBanks to purchase participation interests unless the FHLBank of Chicago has a pre-existing contractual obligation with another FHLBank. This has reduced the FHLBank of Chicago's level of purchases and fundings compared to prior years.

At December 31, 2006, the FHLBanks of Chicago, Des Moines and Indianapolis held the largest percentage of the mortgage loans held for portfolio balances with 39 percent, 12 percent and 10 percent of the combined mortgage loans held for portfolio balance. No other FHLBank held 10 percent or more of the combined mortgage loans held for portfolio balance at December 31, 2006. In March 2005, the FHLBank of Seattle announced that it is exiting the MPP and would no longer enter into new master commitment contracts under the MPP. In October 2006, the FHLBank of San Francisco announced that it would no longer offer new master commitments to purchase mortgage loans from its PFIs under the MPF Program.

**Mortgage Loans Held for Portfolio by Program Types  
(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005		December 31, 2006 vs. December 31, 2005	
	Amount	Percentage of Total Loans	Amount	Percentage of Total Loans	Dollar Variance	Percentage Variance
MPF, mortgage loans held for portfolio . . . . .	\$72,781	74.3%	\$ 79,750	75.8%	\$(6,969)	(8.7)%
MPP, mortgage loans held for portfolio . . . . .	25,169	25.7%	25,464	24.2%	(295)	(1.2)%
Other mortgage loans . . . . .	31	0.0%	36	0.0%	(5)	(13.9)%
Total mortgage loans held for portfolio . . . . .	<u>\$97,981</u>	<u>100.0%</u>	<u>\$105,250</u>	<u>100.0%</u>	<u>\$(7,269)</u>	<u>(6.9)%</u>
Allowance for credit losses—MPF . . . . .	\$ 6	85.7%	\$ 9	90.0%	\$ (3)	(33.3)%
Allowance for credit losses—Other . . . . .	1	14.3%	1	10.0%		0%
Total allowance for credit losses . . . . .	<u>\$ 7</u>	<u>100.0%</u>	<u>\$ 10</u>	<u>100.0%</u>	<u>\$ (3)</u>	<u>(30.0)%</u>
MPF, mortgage loans held for portfolio, net . . . . .	\$72,775	74.3%	\$ 79,741	75.8%	\$(6,966)	(8.7)%
MPP, mortgage loans held for portfolio, net . . . . .	25,169	25.7%	25,464	24.2%	(295)	(1.2)%
Other mortgage loans, net . . . . .	30	0.0%	35	0.0%	(5)	(14.3)%
Total mortgage loans held for portfolio, net . . . . .	<u>\$97,974</u>	<u>100.0%</u>	<u>\$105,240</u>	<u>100.0%</u>	<u>\$(7,266)</u>	<u>(6.9)%</u>
Net mortgage loans held for portfolio as a percentage of total assets . . . . .		<u>9.6%</u>		<u>10.6%</u>		
Mortgage loan principal collected . . . . .	<u>\$13,470</u>		<u>\$ 23,171</u>			
Mortgage loan purchased/funded . . . . .	<u>\$ 6,262</u>		<u>\$ 14,741</u>			

Each of the FHLBanks has established an appropriate allowance for credit losses for mortgage loan programs or has determined that no loan loss allowances is necessary, and the management of each FHLBank believes that it has the policies and procedures in place to appropriately manage its mortgage loan credit risk.

The other “Mortgage loans held for portfolio, net” balances relate to the Affordable Multifamily Participation Program (AMPP) established by the FHLBank of Atlanta, and the Community Mortgage Asset (CMA) program balance held by the FHLBank of New York. Through AMPP, members may sell to the FHLBank of Atlanta participations in loans on affordable multifamily rental properties. These assets do not carry external credit enhancements. Through the CMA program, the FHLBank of New York participates in residential, multifamily and community economic development mortgage loans originated by its members. The FHLBank of Atlanta suspended acquisitions under AMPP in 2006. The FHLBank of New York suspended acquisitions under the CMA program in late 2001.

**Mortgage Loans by Loan Type**  
(Dollar amounts in millions at par value)

	December 31, 2006	Percentage of Total	December 31, 2005	Percentage of Total	2006 vs. 2005 (Decrease)	
					Amount	Percentage
Government-insured loans . . . .	\$10,024	10.3%	\$ 11,799	11.3%	\$(1,775)	(15.0)%
Conventional loans . . . . .	87,463	89.7%	92,899	88.7%	(5,436)	(5.9)%
Other loans . . . . .	5	0.0%	17	0.0%	(12)	(70.6)%
Total par value . . . . .	<u>\$97,492</u>	<u>100.0%</u>	<u>\$104,715</u>	<u>100.0%</u>	<u>\$(7,223)</u>	<u>(6.9)%</u>

**Allowance for Credit Losses on Mortgage Loans**  
(Dollar amounts in millions)

	2006	2005	2004
Balance, beginning of year . . . . .	\$10	\$10	\$15
Charge-offs . . . . .		(1)	(1)
Recoveries . . . . .		1	1
Net charge-offs . . . . .			
Reversal for credit losses . . . . .	(3)		(5)
Balance, end of year . . . . .	<u>\$ 7</u>	<u>\$10</u>	<u>\$10</u>

The FHLBanks' outstanding net mortgage loans held for portfolio, nonperforming loans, loans 90 days or more past due and accruing interest, loans in foreclosure and real estate owned at December 31, 2006, 2005 and 2004 are as follows (dollar amounts in millions):

	December 31, 2006	December 31, 2005	December 31, 2004
Mortgage loans held for portfolio, net . . . . .	<u>\$97,974</u>	<u>\$105,240</u>	<u>\$113,922</u>
Nonperforming mortgage loans held for portfolio . .	<u>66</u>	<u>87</u>	<u>50</u>
Mortgage loans held for portfolio past due 90 days or more and still accruing interest(1) . . . . .	<u>372</u>	<u>411</u>	<u>290</u>
Loans in foreclosure . . . . .	<u>51</u>	<u>48</u>	<u>42</u>
Real estate owned . . . . .	<u>33</u>	<u>24</u>	<u>25</u>

(1) Mortgage loans insured or guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, RHS and HUD.

The FHLBanks' interest contractually due and actually received for nonperforming loans during the period for the year ended December 31, 2006, 2005 and 2004 are as follows (dollar amounts in millions):

	For the Year Ended December 31, 2006	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Interest contractually due during the period . . . . .	\$2.5	\$3.7	\$6.1
Interest actually received during the period . . . . .	<u>1.5</u>	<u>2.3</u>	<u>3.5</u>
Shortfall . . . . .	<u>\$1.0</u>	<u>\$1.4</u>	<u>\$2.6</u>



There was no realized loss on mortgage loans in 2006. Realized losses on mortgage loans were \$336 thousand in 2005 and \$302 thousand in 2004.

*Consolidated Obligations.*

*General.* Consolidated obligations issued through the Office of Finance are the principal source of funds used by the FHLBanks to make advances, purchase mortgages and make investments. Consolidated obligations consist of consolidated bonds and consolidated discount notes, which differ, among other ways, in their maturities and in some of the intended uses of the funds they provide. Finance Board regulation prohibits an FHLBank from purchasing directly or indirectly a consolidated obligation as part of the consolidated obligation's initial issuance.

The FHLBanks make significant use of interest-rate exchange agreements to alter the cash flows on certain consolidated obligations. (See "Business — Use of Interest Rate Exchange Agreements.")

**Average Consolidated Obligations Outstanding  
at Par Value  
(Dollar amounts in billions)**

	<u>2006</u>	<u>2005</u>	<u>(Decrease)/ Increase</u>	
			<u>\$</u>	<u>%</u>
Overnight discount notes . . . . .	\$ 23.0	\$ 24.1	\$(1.1)	(4.6)%
Term discount notes . . . . .	<u>137.0</u>	<u>142.6</u>	<u>(5.6)</u>	<u>(3.9)%</u>
Total discount notes . . . . .	160.0	166.7	(6.7)	(4.0)%
Bonds . . . . .	<u>785.0</u>	<u>728.9</u>	<u>56.1</u>	<u>7.7%</u>
Total consolidated obligations . . . . .	<u><u>\$945.0</u></u>	<u><u>\$895.6</u></u>	<u><u>\$49.4</u></u>	<u><u>5.5%</u></u>

**Consolidated Obligations Outstanding  
(Dollar amounts in millions)**

	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Amount</u>	<u>Percentage of Total Consolidated Obligations, Net</u>	<u>Amount</u>	<u>Percentage of Total Consolidated Obligations, Net</u>
Consolidated obligations, net:				
Discount notes . . . . .	\$157,549	16.9%	\$179,694	19.6%
Bonds . . . . .	<u>776,665</u>	<u>83.1%</u>	<u>736,207</u>	<u>80.4%</u>
Total consolidated obligations, net . . . . .	<u><u>\$934,214</u></u>	<u><u>100.0%</u></u>	<u><u>\$915,901</u></u>	<u><u>100.0%</u></u>

**Consolidated Bonds Outstanding  
by Year of Maturity  
(Dollar amounts in millions)**

<u>Year of Maturity</u>	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Amount</u>	<u>Weighted-Average Interest Rate</u>	<u>Amount</u>	<u>Weighted-Average Interest Rate</u>
Due in 1 year or less . . . . .	\$241,542	4.24%	\$225,904	3.31%
Due after 1 year through 2 years . . . . .	200,601	4.48%	168,696	3.76%
Due after 2 years through 3 years . . . . .	92,331	4.65%	125,280	3.96%
Due after 3 years through 4 years . . . . .	58,984	4.69%	55,561	4.06%
Due after 4 years through 5 years . . . . .	48,989	5.03%	48,875	4.47%
Thereafter . . . . .	140,244	4.88%	120,159	4.59%
Index amortizing notes . . . . .	<u>6,555</u>	4.94%	<u>6,943</u>	4.87%
Total par value . . . . .	789,246	4.55%	751,418	3.87%
Bond premium . . . . .	347		458	
Bond discount . . . . .	(9,078)		(9,007)	
SFAS 133 hedging adjustments . . . . .	<u>(3,845)</u>		<u>(6,657)</u>	
Subtotal . . . . .	776,670		736,212	
Bonds held in treasury . . . . .	<u>(5)</u>		<u>(5)</u>	
Total . . . . .	<u>\$776,665</u>		<u>\$736,207</u>	

**Consolidated Bonds Outstanding  
by Year of Maturity or Next Call Date  
(Dollar amounts in millions)**

<u>Year of Maturity or Next Call Date</u>	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Due in 1 year or less . . . . .	\$476,308	\$482,834
Due after 1 year through 2 years . . . . .	143,574	109,250
Due after 2 years through 3 years . . . . .	49,843	67,700
Due after 3 years through 4 years . . . . .	30,189	24,268
Due after 4 years through 5 years . . . . .	25,033	20,159
Thereafter . . . . .	57,744	40,264
Index amortizing notes . . . . .	<u>6,555</u>	<u>6,943</u>
Total par value . . . . .	<u>\$789,246</u>	<u>\$751,418</u>

**Consolidated Bonds Outstanding by Redemption Feature  
(Dollar amounts in millions)**

	December 31,	
	2006	2005
<b>Par Amount of consolidated bonds:</b>		
Non callable/nonputable .....	\$414,542	\$397,083
Callable .....	374,302	353,934
Putable .....	402	401
Total par value .....	\$789,246	\$751,418

**Consolidated Bonds Outstanding(1)  
by Payment Terms at Par Value  
(Par amounts in billions)**

	December 31, 2006		December 31, 2005	
	Amount	Percentage of Total	Amount	Percentage of Total
Fixed-rate, Noncallable .....	\$329.1	41.5%	\$315.5	41.7%
Fixed-rate, Callable .....	350.7	44.2%	300.9	39.7%
Step-Ups/Step-Downs .....	51.1	6.4%	65.8	8.7%
Single-index Non-capped Floaters .....	25.7	3.2%	34.8	4.6%
Zero-coupon, Callable .....	11.0	1.4%	10.8	1.4%
Amortizing Prepayment Linked Securities ...	6.9	0.9%	7.3	1.0%
Capped Floaters .....	6.7	0.9%	6.8	1.0%
Range .....	7.1	0.9%	6.4	0.8%
Conversion .....	3.6	0.4%	6.4	0.8%
Other .....	2.0	0.2%	2.4	0.3%
Total .....	\$793.9	100.0%	\$757.1	100.0%

(1) Not adjusted for interbank holdings of consolidated obligations totaling \$5 billion at December 31, 2006 and \$6 billion at December 31, 2005.

Bonds issued through the Office of Finance often have investor-determined features. The decision to issue a bond using a particular structure is based upon the desired amount of funding and the ability of the FHLBank(s) receiving the proceeds of the bonds issued to hedge the risks. The issuance of a bond with a simultaneously-transacted associated interest-rate exchange agreement usually results in a funding vehicle with a lower cost than the FHLBanks could otherwise achieve. The continued attractiveness of such debt/swap transactions depends on price relationships in both the bond and interest-rate exchange markets. If conditions in these markets change, the FHLBanks may alter the types or terms of the bonds issued. The increase in funding alternatives available to the FHLBanks through negotiated debt/swap transactions is beneficial to the FHLBanks because it:

- diversifies the investor base;
- reduces funding costs; and
- provides additional asset/liability management tools.

(See Notes 14 and 18 to the accompanying combined financial statements.)

*Consolidated Discount Notes.* Consolidated discount notes are issued primarily to provide short-term funds. The issuance of such notes is intended to satisfy, for example:

- advances with short maturities or repricing intervals due to seasonal and cyclical fluctuations in the flow of savings and mortgage financings;
- convertible advances or callable/puttable advance programs;
- variable-rate advance programs; or
- money-market investments.

These discount notes presently have a maturity range of up to 365 days. They are sold at a discount and mature at par.

*Debt Financing Activity.* The minimal growth in the FHLBanks' assets in 2006 was primarily financed by a 2.0 percent increase in consolidated obligations of \$18.3 billion. Most of the increase in the FHLBanks' assets in 2005 was funded by an 8.3 percent increase in consolidated obligations of \$70.2 billion. (See Notes 14 and 18 to the accompanying financial statements.)

The FHLBanks have diversified sources and channels of funding as the need for funding from the capital markets has grown. The Global Debt Program provided \$134.0 billion and \$117.2 billion at par in term funds in 2006 and 2005. In mid-1999, the Office of Finance implemented the TAP Issue Program. This program consolidates the issuance through daily auctions of domestic bullet bonds of common maturities by re-opening previously issued bonds. TAP issues generally remain open for three months, after which they are closed and a new series of TAP issues is opened to replace them. This Program has reduced the number of separate bullet bonds issued, but more importantly has enhanced market awareness through increased issue size, secondary market activity, and utility, while providing enhanced funding diversification for the FHLBanks. Through this program, the Office of Finance seeks to enhance the liquidity of these issues. In 2006, \$41.4 billion of bonds were issued through the TAP Issue Program. This represents an increase of \$11.9 billion from 2005. The FHLBanks continue to issue debt that is both competitive and attractive in the marketplace. In addition, the FHLBanks continuously monitor and evaluate their debt issuance practices to ensure that consolidated obligations are efficiently and competitively priced.

Bonds can be negotiated individually or auctioned competitively through approximately 100 underwriters. Bonds offered daily via auction include fixed-rate bullets (through the TAP Issue Program discussed above) and American-style callables. Underwriters may contact the Office of Finance if there is a structure/dollar target they need to meet investor demand, although many times they negotiate directly with the FHLBanks. In either case, dealers receive rapid response to their inquiries, as well as fast execution. Competitively bid transactions are generally initiated by an FHLBank funding need of a particular structure and size. Dealers are invited to bid and the trade is executed.

	<u>Percentage of Total Issued in 2006</u>	<u>Percentage of Total Issued in 2005</u>
Competitive bid .....	15.86%	15.66%
Negotiated transactions.....	<u>84.14%</u>	<u>84.34%</u>
Total .....	<u>100.00%</u>	<u>100.00%</u>

	<u>Percentage of Total Issued in 2006</u>	<u>Percentage of Total Issued in 2005</u>
Fixed-rate, Fixed-term, Noncallable (Bullet) .....	46.00%	40.89%
Callable .....	45.53%	39.68%
Step-Ups/Step-Downs .....	1.92%	6.15%
Single-Index Floaters .....	5.05%	7.95%
Other.....	<u>1.50%</u>	<u>5.33%</u>
Total .....	<u>100.00%</u>	<u>100.00%</u>

**Consolidated Bonds Issued at Par Value  
(Dollar amounts in billions)**

<u>December 31,</u>	
<u>2006</u>	<u>2005</u>
<u>\$322.5</u>	<u>\$295.3</u>

The increase in consolidated bonds issued at par value occurred primarily because of the increase in bond maturities during 2006. The FHLBanks make extensive use of callable debt. At December 31, 2006, \$376.5 billion of callable debt at par was outstanding (without an interbank holding adjustment of \$2.2 billion). This represents 47 percent of total bonds outstanding at par.

Consolidated discount notes accounted for 96.1 percent of the proceeds from the sale of consolidated obligations in 2006. Much of the discount note activity reflects the refinancing of overnight discount notes.

*Capital.*

**Total Capital  
(Dollar amounts in billions)**

<u>December 31, 2006</u>	<u>December 31, 2005</u>	<u>Dollar Variance</u>	<u>Percentage Variance</u>
\$45.0	\$44.5	\$0.5	1.1%

The growth in total capital was due primarily to:

- the accumulation of retained earnings to absorb temporary earnings volatility attributable to hedge ineffectiveness or potential unrealized losses on trading securities; and
- the payment and use of stock dividends instead of cash dividends by the FHLBanks of Cincinnati, Dallas, Topeka and San Francisco.

Over the same period, total assets grew faster than total capital. This caused the FHLBanks' GAAP capital-to-assets ratio to decrease to 4.43 percent at year-end 2006, from 4.46 percent at year-end 2005. The FHLBanks of Boston, New York, Pittsburgh, Atlanta, Cincinnati, Indianapolis, Des Moines, Dallas, Topeka, San Francisco and Seattle converted to their new capital structures before year-end 2005. These conversions were treated as capital transactions and were accounted for at par value. (See "Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Legislative and Regulatory Developments" and Note 16 to the accompanying combined financial statements.)

**Results of Operations**

*Change in Amortization and Accretion Method of Deferred Premiums and Discounts on Mortgage Loans Held for Portfolio and Mortgage-Backed Securities.* Effective January 1, 2004, the FHLBanks of Chicago and Pittsburgh each changed its method of accounting for premiums and

discounts and other deferred loan origination fees under SFAS No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases* (SFAS 91) on mortgage loans held for portfolio. In addition, the FHLBank of Pittsburgh changed its method of accounting for premiums and discounts and other deferred loan origination fees under SFAS 91 on mortgage-backed securities. As a result of implementing the change in accounting for amortization and accretion from the retrospective method to the contractual method, the FHLBanks recorded a cumulative effect of a change in accounting principle effective January 1, 2004, resulting in an increase in retained earnings of \$41 million for the FHLBank of Chicago and \$10 million for the FHLBank of Pittsburgh. (See Note 2 to the accompanying combined financial statements.)

Effective January 1, 2005, the FHLBanks of Boston, Dallas, Des Moines and New York each changed its method of accounting for premiums and discounts and other deferred loan origination fees under SFAS 91 on mortgage loans held for portfolio. In addition, the FHLBanks of Atlanta and Des Moines changed their method of accounting for premiums and discounts and other deferred loan origination fees under SFAS 91 on mortgage-backed securities. As a result of implementing the change in accounting for amortization and accretion from the retrospective method to the contractual method, the FHLBanks recorded a cumulative effect of a change in accounting principle effective January 1, 2005 resulting in a decrease to income before assessments of \$3 million for the FHLBank of Atlanta, an increase to income before assessments of \$7 million for the FHLBank of Boston, an increase to income before assessments of \$1 million for the FHLBank of Dallas, an increase to income before assessments of \$9 million for the FHLBank of Des Moines and an increase to income before assessments of \$1 million for the FHLBank of New York. (See Note 2 to the accompanying combined financial statements.)

*Interbank Transfers of Liability on Outstanding Consolidated Bonds and Their Effect on Combined Net Income.* Combined net income of the FHLBanks was affected by interbank transfers of liability on outstanding consolidated bonds. These transactions arise when one FHLBank transfers its direct liability on outstanding consolidated bonds to another FHLBank that assumes the direct liability on those outstanding consolidated bonds. By engaging in these transactions, two FHLBanks are able to better match their funding needs by transferring excess funds held by one FHLBank to another FHLBank that needs funds. Transfer transactions allow the assuming FHLBank to achieve equal or lower funding costs than would be available to it for a similarly sized transaction in the capital markets at the time of the transfer. Because the consolidated bonds are the joint and several obligation of all 12 FHLBanks, these interbank transactions have no effect on the holders of the consolidated bonds.

*Description of the Transactions.* As part of its overall asset/liability management strategy, an FHLBank may issue more debt than it needs at the time of issuance to fund its business. This allows the FHLBank to take advantage of favorable funding prices for large-size transactions in anticipation of using the proceeds at a later time to fund the acquisition of assets, such as mortgages or advances. In other cases, an FHLBank may have excess liquidity due to the prepayment of mortgages. Instead of continuing to retain the excess funds for use in its own business, an FHLBank may elect to transfer a portion of its liability to an FHLBank with more immediate funding needs. The funds are transferred to the assuming FHLBank together with the corresponding liability under the consolidated bonds. The assuming FHLBank assumes this liability at fair value which represents an all-in cost equal to or lower than it would have otherwise obtained for the same amount and maturity in the capital markets at that time. In this type of transaction, the FHLBank that transfers a liability for the consolidated bond also unwinds the related portion of any hedge transactions it entered into when the consolidated bond was issued. It can also take other steps in order to manage its interest rate exposure on the debt transferred. For example, it can:

- terminate the interest-rate exchange agreement entered into with respect to the transferred debt; or



- eliminate the underlying assets (e.g., through the sale of investment securities with similar characteristics to those consolidated bonds being offered for transfer or through the prepayment of mortgages).

The transferring FHLBank treats the transfer as a debt extinguishment because that FHLBank has been released from being the primary obligor. Specifically, the release is made effective by the Office of Finance recording the transfer in its records. The Office of Finance provides release by acting within the confines of the Finance Board regulations that govern the determination of which FHLBank is the primary obligor. The assuming FHLBank becomes the primary obligor because it now is directly responsible for repaying the debt. The transferring FHLBank continues to disclose the transferred debt as a contingent liability because it still has joint and several liability with respect to repaying the transferred consolidated obligation.

The initial carrying amount for the bond is the amount (including any premium or discount) the assuming FHLBank paid the transferring FHLBank. Under this transfer scenario, no transaction with a third party independent of the FHLBanks takes place. Under the principles of combination accounting, combining adjustments are required to reflect the transaction as if the transferring FHLBank still holds the bond for purposes of the combined financial statements of the FHLBanks. This has the following results:

- (1) the debt extinguishment transaction (including any gain or loss) is eliminated;
- (2) all balance sheet and income statement effects with respect to the premium or discount related to the purchase of the bonds by the assuming FHLBank are eliminated; and
- (3) the original premium or discount, concession fees and SFAS 133 basis adjustments of the transferring FHLBank are reinstated and amortized over the life of the bond.

These amounts are eliminated as combining adjustments in the combining schedules accompanying the combined financial statements and will reverse over the remaining term of the consolidated bonds. These transactions do not affect the holders of the consolidated bonds, as the consolidated bonds are the joint and several obligation of all 12 FHLBanks. (See Note 1 to the accompanying combined financial statements and the related FHLBanks combining schedules.)

*Loss of Hedge Accounting under SFAS 133.* As described in the 2005 Combined Financial Report dated November 8, 2006, the FHLBanks of Atlanta, Dallas, Des Moines, Indianapolis and Pittsburgh corrected their accounting to conform with SFAS 133 and restated their financial statements at December 31, 2004, 2003, 2002 and 2001, and for the periods ended December 31, 2004, 2003, 2002 and 2001. The FHLBanks of Chicago and Topeka also corrected their accounting to conform with SFAS 133 and restated their financial statements at December 31, 2003, 2002 and 2001, and for the periods ended December 31, 2003, 2002 and 2001. The majority of these FHLBanks' hedges involved in the restatements were highly-effective economic transactions and would have been eligible for hedge accounting if they had been appropriately documented at hedge inception. The loss of hedge accounting resulted in a one-sided mark-to-market; therefore, these FHLBanks recorded the market value changes in the derivative and not the hedged item, resulting in income statement volatility during the periods affected. The loss of hedge accounting by these FHLBanks has introduced significant volatility to the combined financial results during the periods affected, thereby affecting comparability between years. The net cumulative effect on combined retained earnings resulting from these timing differences has been and is expected to be immaterial.

*Net Interest Income.*

**Changes in Net Interest Income  
(Dollar amounts in millions)**

	For the Years Ended December 31,			For the Year Ended 2006 vs. 2005		For the Year Ended 2005 vs. 2004	
	2006	2005	2004	Increase/(Decrease) \$	Increase/(Decrease) %	Increase/(Decrease) \$	Increase/(Decrease) %
<b>Interest Income</b>							
Advances .....	\$32,411	\$20,782	\$ 9,995	\$11,629	56.0%	\$10,787	107.9%
Prepayment fees on advances, net.....	44	75	184	(31)	(41.3)%	(109)	(59.2)%
Mortgage loans held for portfolio .....	5,155	5,416	5,535	(261)	(4.8)%	(119)	(2.1)%
Investments and other .....	<u>12,957</u>	<u>9,147</u>	<u>6,211</u>	<u>3,810</u>	41.7%	<u>2,936</u>	47.3%
Total interest income .....	<u>50,567</u>	<u>35,420</u>	<u>21,925</u>	<u>15,147</u>	42.8%	<u>13,495</u>	61.6%
<b>Interest Expense</b>							
Consolidated obligations.....	45,214	30,516	17,440	14,698	48.2%	13,076	75.0%
Other .....	<u>1,060</u>	<u>697</u>	<u>314</u>	<u>363</u>	52.1%	<u>383</u>	122.0%
Total interest expense.....	<u>46,274</u>	<u>31,213</u>	<u>17,754</u>	<u>15,061</u>	48.3%	<u>13,459</u>	75.8%
<b>Net Interest Income Before (Reversal)</b>							
Provision for Credit Losses.....	<u>\$ 4,293</u>	<u>\$ 4,207</u>	<u>\$ 4,171</u>	<u>\$ 86</u>	2.0%	<u>\$ 36</u>	0.9%

The increases in net interest income before (reversal) provision for credit losses from 2005 to 2006 and from 2005 to 2006 are attributable to an increase in interest rates as well as growth in advances and investments during 2006, partially offset by an increase in consolidation obligation expenses.

The FHLBanks are required by Finance Board regulations to price advances no lower than their marginal cost of raising matching-maturity funds and the related administrative and operating costs. Subject to satisfying this requirement, the FHLBanks may also consider competitive factors in setting advances prices. They charge their members a prepayment fee if members prepay certain advances before their original maturities. The Finance Board's regulations generally require such a fee on advances with a maturity or repricing period of more than six months. The fee must be sufficient to make the FHLBank financially indifferent to the borrower's decision to prepay the advances. Changes in prepayment fees from 2005 to 2006 and from 2004 to 2005 can be attributed to the then-prevailing interest rates, which resulted in a decrease in refinancing activities during 2006 and 2005, and for certain FHLBanks where a member was acquired by an out of district member, resulting in prepayment of the former members' advances.

The increase in 2006 investments and other interest income relates primarily to the higher interest-rate environment and higher volume of advances and investments outstanding, compared to 2005. The increase in 2005 investments and other interest income relates primarily to the higher interest-rate environment and higher volume of investments outstanding, compared to 2004.

*Net Income.*

**Changes in Net Income  
(Dollar amounts in millions)**

	For the Years Ended December 31,			For the Year Ended 2006 vs. 2005 Increase		For the Year Ended 2005 vs. 2004 Increase	
	2006	2005	2004	\$	%	\$	%
	<b>NET INCOME</b> .....	\$2,612	\$2,525	\$1,994	\$87	3.4%	\$531

The increase in net income for 2006 compared to 2005 can be primarily attributed to the effect of higher interest rates when compared to 2005 and a \$63 million reduction in total other loss in other income (resulting in a total other income balance of \$3 million during 2006), which was partially offset by a \$14 million increase in other expenses and a \$35 million increase in assessments.

The increase in net income for 2005 compared to 2004 can be primarily attributed to the effect of higher interest rates when compared to 2004 and a \$830 million reduction in total other loss in other income which was partially offset by a \$117 million increase in other expenses and a \$177 million increase in assessments.

The \$63 million decrease in total other loss in other income primarily related to a reduction in net losses on derivatives and hedging activities of \$106 million, a decrease in net losses on trading securities of \$177 million and an increase in other, net income by \$57 million partially offset by a \$270 million decrease in net gains (losses) from sale of available-for-sale securities.

The \$830 million decrease in total other loss in other income primarily related to a reduction in net losses on derivatives and hedging activities of \$761 million and a \$284 million change to net gain on sale of available-for-sale securities partially offset by an increase in net losses on trading securities of \$198 million. The one-sided marks on derivatives resulting from the loss of hedge accounting by the restating FHLBanks increased the net losses on derivatives and hedging activities by \$493 million for 2004.

Total operating expenses were \$671 million in 2006, compared to \$657 million and \$546 million in 2005 and 2004. In 2006, AHP and REFCORP assessments were \$942 million compared to \$907 million and \$730 million in 2005 and 2004.

The 2006 combining adjustment for the elimination of the transfers of interbank consolidated bond liabilities and interbank fees and commissions related to the MPF Program resulted in a temporary increase in other income of \$16 million, a decrease in other expenses of \$4 million, and a reduction in interest expense on consolidated obligation bonds of \$7 million. This led to a combined net increase in net income of \$27 million. This increase is primarily related to the reversal of the interbank bond transfer-related losses recorded during 2006. Total interbank consolidated bonds of \$1,434 million at par value were transferred from an FHLBank to another FHLBank during 2006.

The 2005 combining adjustment for the elimination of the transfers of interbank consolidated bond liabilities and interbank fees and commissions related to the MPF Program resulted in a temporary decrease in other loss of \$3 million, a decrease in other expenses of \$3 million, and a reduction in interest expense on consolidated obligation bonds of \$24 million. This led to a combined net increase in net income of \$30 million. This increase is primarily related to the reversal of the interbank bond transfer-related gains previously eliminated. Total interbank consolidated bonds of \$1,385 million at par value were transferred from an FHLBank to another FHLBank during 2005.

The 2004 combining adjustment for the elimination of the transfers of interbank consolidated bond liabilities and interbank fees and commissions related to the MPF Program resulted in a temporary increase in other loss of \$50 million, a decrease in other expenses of \$1 million, and a reduction in interest expense on consolidated obligation bonds of \$22 million. This led to a combined temporary net reduction of \$27 million. These reductions resulted from the fact that hedge losses

associated with the transferred bonds recorded were realized, while the gains from the interbank bond transfer were eliminated. Total interbank consolidated bonds of \$4,353 million at par value were transferred from an FHLBank to another FHLBank during 2004.

Under SFAS 133, all derivatives are recorded at fair value. An FHLBank is required to recognize unrealized losses or gains on derivative positions, regardless of whether offsetting gains or losses on the underlying assets or liabilities being hedged are permitted to be recognized in a symmetrical manner. SFAS 133, therefore, introduces the potential for a considerable timing difference between income recognition from assets or liabilities and the income effects of hedge instruments entered into to mitigate interest-rate risk and cash-flow variability. The adoption of SFAS 133 has led to more volatility in reported earnings. The loss of hedge accounting and the resulting effect of the one-sided mark have also led to more volatility. During 2005, the FHLBank of Dallas realized net gains of \$245 million on the sale of certain available-for-sale securities, many of which were sold to offset the loss of hedge accounting under SFAS 133. Also, during 2005, as a result of the loss of hedge accounting under SFAS 133, the FHLBank of Des Moines discontinued the use of its mortgage loan hedge strategy and terminated its remaining structured mortgage swaps. As a result of the loss of hedge accounting, the FHLBank of Des Moines recorded a gain or loss on the hedging instruments without recording the corresponding loss or gain on the hedged items. In 2005, loss of hedge accounting was the primary reason for the FHLBank of Des Moines' increase in net gains on derivatives and hedging activities of \$391 million, which was partially offset by a decrease in their net interest income of \$210 million. Due to changes in market prices and interest rates, an FHLBank may use certain hedge strategies that do not qualify for symmetrical hedge accounting treatment under SFAS 133 accounting rules because these strategies are more economically cost-effective than alternative strategies that would qualify for symmetrical hedge accounting.

*Earnings Analysis.*

**Change in Earnings Components  
(Dollar amounts in millions)**

	2006 vs. 2005		2005 vs. 2004		2004 vs. 2003	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
<b>Income Statement</b>						
Increase in interest income . . . . .	\$15,147	42.8%	\$13,495	61.6%	\$ 2,849	14.9%
Increase in total interest expense . . . . .	<u>15,061</u>	48.3%	<u>13,459</u>	75.8%	<u>2,555</u>	16.8%
Increase in net interest income . . . . .	86	2.0%	36	0.9%	294	7.6%
Change in (reversal) provision for credit losses . . . . .	<u>(2)</u>	(200.0)%	<u>6</u>	120.0%	<u>(1)</u>	25.0%
Increase in net interest income after (reversal) provision for credit losses . . . . .	<u>88</u>	2.1%	<u>30</u>	0.7%	<u>295</u>	7.6%
Increase (decrease) in net gains (losses) on trading securities . . . . .	177	58.2%	(198)	(186.8)%	213	66.8%
Increase (decrease) in net gains (losses) on derivatives and hedging activities . . . . .	106	460.9%	761	97.1%	(475)	(153.7)%
(Decrease) increase in other non-interest income, net . . . . .	<u>(220)</u>	82.4%	<u>267</u>	n/a	<u>153</u>	100.0%
Increase (decrease) in total non-interest income (loss) . . . . .	<u>63</u>	105.0%	<u>830</u>	93.3%	<u>(109)</u>	(14.0)%
Increase in total other expense . . . . .	<u>14</u>	1.9%	<u>117</u>	19.1%	<u>105</u>	20.7%
Increase in Affordable Housing Program . . . . .	13	4.6%	57	25.3%	7	3.2%
Increase in REFCORP . . . . .	<u>22</u>	3.5%	<u>120</u>	23.8%	<u>15</u>	3.1%
Increase in total assessments . . . . .	<u>35</u>	3.9%	<u>177</u>	24.2%	<u>22</u>	3.1%
Change in cumulative effect of change in accounting principles before assessments . . . . .	<u>(15)</u>	(100.0)%	<u>(35)</u>	(70.0)%	<u>50</u>	n/a
Increase in net income . . . . .	<u>\$ 87</u>	3.4%	<u>\$ 531</u>	26.6%	<u>\$ 109</u>	5.8%

The following table presents average balances and yields of major earning asset categories and the funding sources for those earning assets. It also presents spreads between yields on total earning assets and the cost of interest-bearing liabilities and spreads between yields on total earning assets and the cost of total funding sources (i.e., interest-bearing liabilities plus capital plus other interest-free liabilities funding earning assets). The primary source of FHLBank earnings is net interest income. This is the interest earned on advances, mortgages, investments and invested capital, *minus* interest paid on consolidated obligations, deposits and other borrowings.

**Spread and Yield Analysis**  
**(Dollar amounts in millions)**

	2006			2005			2004		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
<b>Earning assets:</b>									
Advances . . . . .	\$638,656	\$32,455	5.08%	\$607,581	\$20,857	3.43%	\$551,928	\$10,179	1.84%
Mortgage loans held for portfolio . . . . .	101,375	5,155	5.09%	109,951	5,416	4.93%	114,449	5,535	4.84%
<b>Investments:</b>									
Interest-bearing deposits and other . . . . .	35,128	1,782	5.07%	25,057	836	3.34%	22,187	319	1.44%
Securities purchased under agreements to resell . . . . .	3,942	197	5.00%	3,413	115	3.37%	4,051	54	1.33%
Federal funds sold . . . . .	68,718	3,456	5.03%	57,509	1,915	3.33%	44,918	625	1.39%
Trading securities . . . . .	6,498	365	5.62%	8,016	438	5.46%	8,713	444	5.10%
Available-for-sale securities . . . . .	6,104	298	4.88%	10,122	346	3.42%	12,171	286	2.35%
Held-to-maturity securities . . . . .	<u>137,503</u>	<u>6,859</u>	4.99%	<u>125,717</u>	<u>5,497</u>	4.37%	<u>116,337</u>	<u>4,483</u>	3.85%
Total investments . . . . .	<u>257,893</u>	<u>12,957</u>	5.02%	<u>229,834</u>	<u>9,147</u>	3.98%	<u>208,377</u>	<u>6,211</u>	2.98%
Total earning assets . . . . .	<u>\$997,924</u>	<u>\$50,567</u>	5.07%	<u>\$947,366</u>	<u>\$35,420</u>	3.74%	<u>\$874,754</u>	<u>\$21,925</u>	2.51%
<b>Funded by:</b>									
Consolidated obligations . . . . .	\$924,204	\$45,214	4.89%	\$873,519	\$30,516	3.49%	\$799,460	\$17,440	2.18%
Interest-bearing deposits and other borrowings(1) . . . . .	<u>20,690</u>	<u>1,060</u>	5.12%	<u>21,218</u>	<u>697</u>	3.28%	<u>22,608</u>	<u>314</u>	1.39%
Total interest-bearing liabilities . . . . .	<u>944,894</u>	<u>46,274</u>	4.90%	<u>894,737</u>	<u>31,213</u>	3.49%	<u>822,068</u>	<u>17,754</u>	2.16%
Capital and other non-interest-bearing funds . . . . .	<u>53,030</u>			<u>52,629</u>			<u>52,686</u>		
Total funding . . . . .	<u>\$997,924</u>	<u>\$46,274</u>	4.64%	<u>\$947,366</u>	<u>\$31,213</u>	3.29%	<u>\$874,754</u>	<u>\$17,754</u>	2.03%
<b>Spread on:</b>									
Total interest-bearing liabilities . . . . .			0.17%			0.25%			0.35%
Total funding (net interest margin) (2) . . . . .			0.43%			0.45%			0.48%

(1) The balances do not include non-interest bearing deposits and include mandatorily redeemable capital stock balances and related interest expenses. The 2006 average balance includes subordinated notes and related interest expenses.

(2) Net interest margin is net interest income before provision (reversal) for credit losses as a percentage of average earning assets.

A significant portion of net interest income results from earnings on assets funded by non-interest-bearing capital. This source of net interest income increased primarily because short-term interest rates rose, on average, in 2006 over 2005. The increase in the current year's net interest income from this source more than offset the lower net interest income caused by a decrease of 8 basis points in the spread between asset yields and interest-bearing liability costs.

This decrease in the combined spread on total interest-bearing liabilities from 2005 to 2006 is generally due to FHLBanks that have experienced:

- lower average mortgage loans held for portfolio, which generally have higher spreads than advances and investments, and new mortgage assets having narrower spreads,
- increased volume of lower spread advances relative to the overall asset mix,

- loss of hedge accounting under SFAS 133, and
- higher cost of funds attributable to the flattening of the yield curve.

The net interest margin and spread on interest-bearing liabilities are affected by the inclusion or exclusion of net interest income/expense associated with the FHLBanks' interest-rate exchange agreements. For example, if the interest-rate exchange agreements qualify for fair-value hedge accounting under SFAS 133, the net interest income/expense associated with the derivative is included in the calculation of the spread on interest-bearing liabilities and net interest margin. If the interest-rate exchange agreements do not qualify for fair-value hedge accounting under SFAS 133 ("economic hedges"), the net interest income/expense associated with the interest-exchange agreements is excluded from the calculation of the spread on interest-bearing liabilities and net interest margin.

The combined spread on interest-bearing liabilities and any spread on net interest margin for 2004, and to a lesser extent 2005 and 2006, have been significantly affected by the FHLBanks that lost hedge accounting under SFAS 133, thereby affecting comparability between years. The loss of hedge accounting and resulting one-sided market value adjustments influence the timing of income recognition related to these highly-effective economic transactions. The acceleration of income or loss in one period is expected to result in a corresponding reduction or increase in earnings in future periods. The net cumulative effect on combined retained earnings resulting from these timing differences has been and is expected to be immaterial.

The cost of consolidated obligations issued by the FHLBanks is affected by many factors including:

- the issuance volume of Treasury and GSE debt securities;
- the dollar balance of Treasury and GSE debt outstanding;
- the portfolio growth trends of the GSEs;
- domestic and foreign investor demand;
- market views on the future direction of credit spreads;
- the level of and spread between short- and long-term interest rates; and
- fixed-income market volatility.

During 2006, consolidated bond and discount note issuance was four percent lower than the previous year due to decreased issuance of discount notes. The par value of consolidated obligations outstanding rose by \$14.3 billion—bonds increased by \$36.5 billion and discount notes decreased by \$22.2 billion. Fannie Mae and Freddie Mac did not report any growth in the firms' combined retained portfolios during 2006, producing little incremental debt funding demand. Compared to the prior year, aggregate weighted-average, new-issue funding costs for FHLBank bonds and auctioned discount notes improved relative to benchmark market indices. Rising dollar reserves held by foreign central banks increased demand for U.S. dollar-denominated securities.

In the second half of 2006, short-term yields for Treasury securities rose above yields for intermediate- and long-term securities. This condition developed, in part, due to policy actions by the Federal Reserve Board. In this environment, which did not offer investors a yield premium to purchase longer-dated maturities, a large proportion of FHLBank bonds was issued with short-term maturity dates. In addition, 2006 was characterized by historically low levels of fixed-income market volatility. In this environment, a large proportion of FHLBank bonds were issued with an embedded call option. The dollar amount of callable bonds redeemed prior to maturity was higher in 2006 compared with the prior year. The dollar volume of FHLBank bonds called prior to maturity increased in the fourth quarter of the year.



During 2005, total bond and discount note issuance was 18 percent higher than the previous year as a result of increased issuance of discount notes. Consolidated obligations outstanding rose by \$68 billion, bonds increased by \$56 billion and discount notes increased by \$12 billion. Compared to the prior year, aggregate weighted-average new-issue funding costs for bonds and auctioned discount notes improved relative to benchmark market indices.

During 2005, short-term interest rates rose and the yield differential between short- and long-term interest rates narrowed. The dollar amount of callable bonds called prior to maturity was lower in 2005 compared with the prior year. Noncallable fixed-rate bonds comprised a larger proportion of bond issuance in 2005 compared with the prior year.

Changes in both volume and interest rates have a direct influence on changes in net interest income and net interest margin. The following table summarizes changes in interest income and interest expense between 2006 and 2005 and between 2005 and 2004. Changes in interest income and interest expense not identifiable as either volume-related or rate-related, but rather equally attributable to both volume and rate changes, have been allocated to the volume and rate categories based upon the proportion of the absolute value of the volume and rate changes.

**Rate and Volume Analysis  
(Dollar amounts in millions)**

	2006 vs. 2005			2005 vs. 2004		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Volume	Rate	Total	Volume	Rate	Total
<b>Interest Income:</b>						
Advances .....	\$1,116	\$10,482	\$11,598	\$1,119	\$9,559	\$10,678
Mortgage loans held for portfolio .....	(432)	171	(261)	(220)	101	(119)
Investments .....	<u>1,210</u>	<u>2,600</u>	<u>3,810</u>	<u>690</u>	<u>2,246</u>	<u>2,936</u>
Total interest income .....	<u>1,894</u>	<u>13,253</u>	<u>15,147</u>	<u>1,589</u>	<u>11,906</u>	<u>13,495</u>
<b>Interest Expense:</b>						
Consolidated obligations .....	1,860	12,838	14,698	1,745	11,331	13,076
Deposits and other borrowings(1) .....	<u>(18)</u>	<u>381</u>	<u>363</u>	<u>(20)</u>	<u>403</u>	<u>383</u>
Total interest expense .....	<u>1,842</u>	<u>13,219</u>	<u>15,061</u>	<u>1,725</u>	<u>11,734</u>	<u>13,459</u>
Changes in net interest income ...	<u>\$ 52</u>	<u>\$ 34</u>	<u>\$ 86</u>	<u>\$ (136)</u>	<u>\$ 172</u>	<u>\$ 36</u>

(1) The average balances used for the calculation do not include non-interest bearing deposits and include cash and stock dividends on mandatorily redeemable capital stock as interest expense. The average balance used for the 2006 calculation includes subordinated notes and related interest expenses.

Other Income (Loss).

**Other Income (Loss)**  
**(Dollar amounts in millions)**

	For the Years Ended December 31,		
	2006	2005	2004
Service fees .....	\$ 25	\$ 27	\$ 27
Net losses on trading securities .....	(127)	(304)	(106)
Net realized (losses) gains from sale of available-for-sale securities .....	(3)	267	(17)
Net realized (losses) gains from sale of held-to-maturity securities .....	(6)	(1)	13
Net gains (losses) on derivatives and hedging activities .....	83	(23)	(784)
Other, net .....	31	(26)	(23)
Total other income (loss) .....	\$ 3	\$ (60)	\$ (890)

The changes in total other loss from 2006 to 2005 and 2005 to 2004 relate primarily to the change in derivatives and hedging activities and changes in gains (losses) on investment securities. During 2005, the FHLBank of Dallas sold certain available-for-sale securities, resulting in net realized gains of \$245 million.

**Effect of Hedging Activities on Earnings by Product**  
**(Dollar amounts in millions)**

Earnings Effect for the Year Ended December 31, 2006	Advances	Investments	MPF/ MPP Loans	COs- Bonds	COs- Discount Notes	Balance Sheet	Intermediary Positions	Total
Amortization/accretion of hedging activities in net margin .....	\$(76)	\$ 2	\$ 9	\$(83)	\$(15)	\$	\$	\$(163)
Net gains (losses) on derivatives and hedging activities .....	51	95	(58)	(2)	7	(9)	(1)	83
Net losses on trading securities .....	_____	(127)	_____	_____	_____	_____	_____	(127)
Total .....	\$(25)	\$ 30	\$(49)	\$(85)	\$ (8)	\$ (9)	\$ (1)	\$(207)

  

Earnings Effect For the Year Ended December 31, 2005	Advances	Investments	MPF/ MPP Loans	COs- Bonds	COs- Discount Notes	Balance Sheet	Total
Amortization/accretion of hedging activities in net margin .....	\$(116)	\$ (2)	\$ (8)	\$ (5)	\$(21)	\$	\$(152)
Net gains (losses) on derivatives and hedging activities .....	77	60	(43)	(103)	12	(26)	(23)
Net losses on trading securities .....	_____	(304)	_____	_____	_____	_____	(304)
Total .....	\$ (39)	\$ (246)	\$ (51)	\$ (108)	\$ (9)	\$ (26)	\$ (479)

<u>Earnings Effect For the Year Ended December 31, 2004</u>	<u>Advances</u>	<u>Investments</u>	<u>MPP/ MPP Loans</u>	<u>COs- Bonds</u>	<u>COs- Discount Notes</u>	<u>Deposits</u>	<u>Balance Sheet</u>	<u>Intermediary Positions</u>	<u>Total</u>
Amortization/accretion of hedging activities in net margin .....	\$(92)	\$ 1	\$ (31)	\$102	\$ 24	\$(27)	\$	\$	\$ (23)
Net gains (losses) on derivatives and hedging activities.....	132	(304)	(565)	122	(55)		(22)	(92)	(784)
Net losses on trading securities.....		(106)							(106)
Total .....	<u>\$ 40</u>	<u>\$(409)</u>	<u>\$(596)</u>	<u>\$224</u>	<u>\$(31)</u>	<u>\$(27)</u>	<u>\$(22)</u>	<u>\$(92)</u>	<u>\$(913)</u>

*Operating Expenses.*

**Operating Expenses  
(Dollar amounts in millions)**

	<u>For the Years Ended December 31,</u>			<u>Percentage Increase (Decrease)</u>	
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2006 vs. 2005</u>	<u>2005 vs. 2004</u>
Salaries and employee benefits.....	\$407	\$368	\$316	10.6%	16.5%
Cost of quarters .....	35	43	33	(18.6)%	30.3%
Other .....	<u>229</u>	<u>246</u>	<u>197</u>	(6.9)%	24.9%
Total operating expenses .....	<u>\$671</u>	<u>\$657</u>	<u>\$546</u>	2.1%	20.3%
Operating expenses as a percentage of average assets (basis points) .....	<u>6.7</u>	<u>6.9</u>	<u>6.2</u>		

The increases in salaries and benefits in 2006, 2005 and 2004 primarily reflect the following:

- higher staffing levels to support increased regulatory requirements for risk management, SEC registration and filings and preparations for compliance with Sarbanes-Oxley requirements;
- general increases in pay and benefits; and
- an increase in pension costs.

The increase in cost of quarters in 2005 was primarily due to the FHLBank of Seattle realizing \$5.4 million of abandonment cost. The FHLBank of Seattle vacated leased office space to align with the reduction in staff, primarily due to the FHLBank of Seattle exiting the MPP. The other expenses include the administrative and operating costs of providing advances, and managing the investment portfolios and mortgage purchase programs, as well as member correspondent services.

<u>(Dollar amounts in millions)</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2006 vs. 2005 Increase (Decrease)</u>		<u>2005 vs. 2004 Increase (Decrease)</u>	
				<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
Finance Board expenses .....	\$ 32	\$ 32	\$ 26	\$	0.0%	\$6	23.1%
Office of Finance expenses .....	25	24	20	1	4.2%	4	20.0%
Other expenses excluded from operating expenses .....	15	16	20	(1)	(6.3)%	(4)	(20.0)%
Affordable Housing Program expenses .....	295	282	225	13	4.6%	57	25.3%

*Finance Board Expenses.* The FHLBanks fund the costs of operating the Finance Board. These costs are under the sole control of the Finance Board. Finance Board expenses are allocated

among the FHLBanks based on each FHLBank's percentage of total combined regulatory capital stock plus retained earnings. These expenses increased in 2005 from 2004 due to increases in Finance Board examination and supervision staff and expenditures associated with the development and operation of Finance Board systems for the measurement and monitoring of interest-rate risk at the FHLBanks. These increases are associated with increases in both the size of the FHLBanks and the complexity of their operations.

*Office of Finance Expenses.* The FHLBanks also fund the costs of the Office of Finance. The Office of Finance, a joint office of the FHLBanks, issues and services consolidated obligations, prepares the FHLBanks' combined quarterly and annual financial reports, and fulfills certain other functions. The expenses of the Office of Finance are allocated among the FHLBanks based on each FHLBank's percentage of total capital stock, percentage of consolidated obligations issued, and percentage of consolidated obligations outstanding. The 2006 and 2005 expenses have increased due to increased marketing expenses and the requirement for the FHLBanks to register their capital stock with the SEC and related preparation for compliance with Sarbanes-Oxley requirements.

*Other.* Other expenses are excluded from operating expenses. The other expenses for 2006, 2005 and 2004 include approximately \$15 million, \$16 million and \$15 million of certain MPF and/or MPP master servicing and custodial fees.

*Affordable Housing Program.* Annually, the FHLBanks must set aside for the AHP the greater of \$100 million or 10 percent of regulatory income, after the assessment for REFCORP. Regulatory income is income before assessments, plus interest expense related to mandatorily redeemable capital stock under SFAS 150, less the assessment for REFCORP. The Finance Board requires each FHLBank to add back interest expense related to mandatorily redeemable capital stock before the calculation of its AHP assessment. Changes in the AHP assessments for 2006, 2005 and 2004 reflect the overall trend of the FHLBanks' net income. AHP helps members provide subsidized and other low-cost funding to create affordable rental and home ownership opportunities. Funding is also used for commercial and economic development activities that benefit low- and moderate-income neighborhoods, thus contributing to the revitalization of these neighborhoods. All FHLBank operating costs for the AHP are included in operating expenses, so all AHP assessments go directly to support affordable housing projects.

*Community Investment Program.* At December 31, 2006, the FHLBanks had \$5.6 billion of CIP housing advances and \$1.8 billion of CIP commercial and economic development advances outstanding.

*Other Housing and Community Economic Development Programs.* Each of the FHLBanks has established a number of other voluntary housing and community economic development programs specifically developed for its members. These programs are funded by the FHLBanks separate from AHP.

## **REFCORP Payment**

Each FHLBank is required to make payments to REFCORP (20 percent of annual GAAP net income after payment of AHP assessments) until the total amount of payments actually made is equivalent to a \$300 million annual annuity whose final maturity date is April 15, 2030. The Finance Board will shorten or lengthen the period during which the FHLBanks must make payments to REFCORP depending on actual payments relative to the referenced annuity. In addition, the Finance Board, in consultation with the Secretary of the Treasury, selects the appropriate discounting factors used in calculating the annuity.

The REFCORP assessment of the FHLBanks was \$162 million (cash payment of \$162 million) for the fourth quarter of 2006 and \$647 million (cash payment of \$684 million) for the year 2006. The cash payments are made based on preliminary GAAP net income amounts due to the timing requirement of the payment. Any FHLBank with a net loss for a quarter is not required to pay the REFCORP assessment for that quarter. The differences between the assessment amount

shown in the Statement of Income and the actual cash payments from the FHLBanks for the fourth quarter and the year ended December 31, 2006 primarily represent amounts due to the adoption of SFAS 150. As specified in the Finance Board regulation that implements section 607 of the GLB Act, the amount by which the REFCORP payment for any quarter exceeds the \$75 million benchmark payment is used to simulate the purchase of zero-coupon Treasury bonds to “defease” all or a portion of the most-distant remaining quarterly benchmark payment. The \$87 million by which the fourth-quarter REFCORP payment exceeded the \$75 million quarterly benchmark will fully defease the remaining \$54 million portion of the benchmark payment due on January 15, 2016, the benchmark payment due on October 15, 2015, and defease \$3 million of the \$75 million benchmark payment due on July 15, 2015. The defeased benchmark payments (or portions thereof) can be reinstated if future actual REFCORP payments fall short of the \$75 million benchmark in any quarter.

As a result of the REFCORP payments of \$684 million made by the FHLBanks in 2006, the overall period during which the FHLBanks must continue to make quarterly payments was shortened to July 15, 2015, effective at December 31, 2006. This date assumes that the FHLBanks will pay exactly \$300 million annually after December 31, 2006 until the annuity is fully satisfied. This compares to the outside date of October 15, 2017, effective at December 31, 2005, based on REFCORP payments made through 2005.

**REFCORP Defeasance Summary  
For Fourth Quarter 2006 Payment  
(Dollar amounts in millions)**

<u>Payment Due Date</u>	<u>Amount of Benchmark Payment Defeased*</u>	<u>Interest Rate Used to Discount the Future Benchmark Payment</u>	<u>Present Value of Benchmark Payment Defeased**</u>
January 15, 2016 (most distant remaining payment) .....	\$ 54	4.76%	\$35
October 15, 2015 .....	75	4.77%	50
July 15, 2015 .....	<u>3</u>	4.76%	<u>2</u>
Total .....	<u>\$132</u>		<u>\$87</u>

\* Subject to possible subsequent reinstatement.

\*\* Actual cash payment of \$162 million made based on estimated net income.

**Capital Adequacy**

The FHLBank Act prescribes minimum capital stock requirements for the FHLBanks. (See “Business—Capital, Capital Rules and Dividends” for a detailed explanation of these requirements.) In addition, an individual FHLBank, at the discretion of its board of directors and/or management, may institute a higher capital requirement in order to meet internally-established thresholds or to address supervisory matters.

In 2003, the Finance Board issued guidance calling for each FHLBank to assess, at least once a year, the adequacy of its retained earnings under various future financial and economic scenarios, including:

- parallel and non-parallel interest-rate shifts;
- changes in the basis relationship between different yield curves; and
- changes in the credit quality of the FHLBank’s assets.

Management and the board of directors of each FHLBank review the capital structure of that FHLBank (including retained earnings) on a periodic basis to make sure the capital structure

supports the risk associated with its assets and addresses applicable regulatory and supervisory matters.

Some boards of directors and/or management teams of FHLBanks have agreed with the Office of Supervision of the Finance Board either to maintain higher total capital-to-assets ratios or limit dividend payments as part of their retained earnings policies. At December 31, 2006, each of the FHLBanks was in compliance with its statutory minimum capital requirements and any internally-established or supervisory limitations. As these limitations may be revised from time to time, they are more flexible than the minimum requirements prescribed by statute. (See “Business-Oversight, Audits and Examinations” for more information on the Finance Board’s regulatory agreements with the FHLBanks of Chicago and Seattle.) At January 11, 2007, the FHLBank of Seattle is no longer under a Finance Board supervisory agreement.

At December 31, 2006, 93.4 percent of the capital of the FHLBanks consisted of capital stock, while 6.6 percent consisted of retained earnings and accumulated other comprehensive income. At December 31, 2006, the FHLBanks had an aggregate GAAP capital-to-assets ratio of 4.43 percent. This compares with a GAAP capital-to-assets ratio of 4.46 percent at December 31, 2005. (See “Business—Capital, Capital Rules and Dividends” and Note 16 to the accompanying combined financial statements.)

## **Liquidity**

The FHLBanks need liquidity to:

- satisfy their members’ demand for short- and long-term funds;
- repay maturing consolidated obligations; and
- meet other obligations, including any mandatory redemptions of capital stock.

The FHLBanks also maintain liquidity to repurchase excess capital stock in their discretion upon the request of a member.

Each FHLBank is required to maintain liquidity in accordance with the FHLBank Act, certain Finance Board regulations and with policies established by its management and board of directors. The FHLBanks seek to be in a position to meet the credit and liquidity needs of their members without maintaining excessive holdings of low-yielding liquid investments or being forced to incur unnecessarily high borrowing costs. The FHLBanks’ primary sources of liquidity are short-term investments and the issuance of new consolidated obligation bonds and discount notes. The GSE status and rating have historically provided the FHLBanks with excellent access to capital markets. Consolidated obligations enjoy GSE status; however, they are not obligations of the United States and the United States does not guarantee them. The FHLBanks’ consolidated obligations are rated Aaa/P-1 by Moody’s and AAA/A-1+ by Standard & Poor’s. These are the highest ratings available for such debt from an NRSRO. These ratings indicate that the FHLBanks have an extremely strong capacity to meet their commitments to pay principal of and interest on consolidated obligations and that the consolidated obligations are judged to be of the highest quality with minimal credit risk. The ratings also reflect the FHLBanks’ status as GSEs. These ratings were not affected by rating actions taken with respect to individual FHLBanks in 2005 and 2006. (See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Recent Rating Agency Actions.”) Investors should note that a rating issued by an NRSRO is not a recommendation to buy, sell or hold securities and that the ratings may be revised or withdrawn by the NRSRO at any time. Investors should evaluate the rating of each NRSRO independently.

In addition, under certain circumstances the U.S. Treasury may acquire up to \$4 billion of consolidated obligations of the FHLBanks. (See as noted in the “Business—Oversight, Audits and Examinations.”) Other short-term borrowings, such as Federal funds purchased, securities sold under agreements to repurchase, and loans from other FHLBanks, also provide liquidity.



Each FHLBank also maintains a contingency liquidity plan designed to enable it to meet its obligations and the liquidity needs of members in the event of operational disruptions at the FHLBanks or the Office of Finance, or short-term capital market disruptions. (See “Risk Management—Liquidity Risk.”)

### **Critical Accounting Policies and Estimates**

*Accounting for Derivatives.* The FHLBanks adopted SFAS 133 on January 1, 2001. SFAS 133 requires that all derivative instruments be recorded on the statement of condition at their fair values. Changes in fair value of derivatives are recorded each period in current-period earnings or accumulated other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. SFAS 133 has led to more volatility in the statement of income because of changes in market prices and interest rates.

As noted under “Risk Management-Quantitative and Qualitative Disclosures about Market Risk—Qualitative Disclosures about Market Risk—Interest-Rate Exchange Agreements,” by regulation, an FHLBank may use derivative instruments only to mitigate identifiable risks. All of the derivatives of an FHLBank are positioned to offset some or all of the risk exposure inherent in its member lending, investment, or funding activities. Under SFAS 133, an FHLBank is required to recognize unrealized losses or gains on derivative positions regardless of whether offsetting gains or losses on the underlying assets or liabilities being hedged are permitted to be recognized in a symmetrical manner. Therefore, the accounting framework imposed by SFAS 133 introduces the potential for a considerable mismatch between the timing of income and expense recognition from assets or liabilities and the income effects of hedge instruments positioned to mitigate market risk and cash-flow variability. Therefore, during periods of significant changes in interest rates, an FHLBank’s reported GAAP earnings may exhibit considerably greater variability than had been reported prior to the full implementation of SFAS 133. The FHLBanks have generally continued their practice of utilizing the most cost-efficient hedging techniques available. The FHLBanks view the accounting consequences resulting from the choice of a particular hedging technique as an important but secondary consideration. The FHLBanks anticipate that this approach will result in enhanced long-term performance, while recognizing the potential for increased variability in quarterly earnings as reported under the requirements of SFAS 133. Because the FHLBanks generally manage their derivatives positions with primary emphasis on economic cost-effectiveness as opposed to symmetrical accounting results, SFAS 133 has led to more volatility in the reported earnings for the FHLBanks due to changes in market prices and interest rates.

From time to time, the FHLBanks may serve as intermediaries for their member institutions by entering into offsetting interest-rate exchange agreements between their members and other counterparties. This intermediation allows smaller members access to the derivatives market. The derivatives used in intermediary activities do not qualify for hedge accounting treatment and are separately marked-to-market through other income in “net gain (loss) on derivatives and hedging activities.” The net result of the accounting for these derivatives does not significantly affect the operating results of the FHLBanks. All derivative contracts which an FHLBank enters into with a member for this purpose are generally accompanied by counterparty trades that offset the member trade except for a negligible spread that the FHLBank receives as compensation for this member service. Generally, no fees are charged to members for this type of transaction.

*SFAS 133: Accounting for Derivative Hedging Relationships.*

Accounting for a hedging relationship depends on the characteristics of the derivative and hedged item and their correlation to one another. A hedge relationship is created from the documented designation of a derivative financial instrument as hedging the FHLBank's exposure either to changes in the fair value of a financial instrument or to a change in future cash flows attributable to an on-balance sheet financial instrument or for an anticipated transaction. The accounting the FHLBanks use for typical hedge transactions can be summarized as follows:

Hedge Type	Hedged Item	Accounting Recognition
Fair-Value	Recognized asset or liability or unrecognized firm commitment	Changes in fair values of derivative and hedged item (related to the risk being hedged) are recognized in current-period earnings
Cash-Flow	Anticipated transaction (including those from recognized asset or liability with variable cash flows)	Effective portion of fair value of derivative is deferred in accumulated other comprehensive income and recognized in earnings when the related forecasted transaction affects earnings (Any ineffectiveness is recognized in current-period earnings.)
Non-SFAS 133 Qualifying Hedge (Economic Hedges)	Does not meet SFAS 133 hedge criteria (economic hedge of an identified risk)	Fair value of derivative is recognized in current-period earnings

The following is a more detailed discussion of the FHLBanks' accounting for hedge transactions:

*Fair-Value Hedges.* A fair-value hedge hedges the exposure to changes in the fair value of an asset or liability that is attributed to a particular risk. There are four specific risks that a fair-value hedge can mitigate, namely changes to:

- (1) the overall fair value of the hedged item;
- (2) the fair value attributable to changes in the designated benchmark interest rate;
- (3) the fair value attributable to changes in the related foreign currency exchange rates; and
- (4) the fair value attributable to changes in credit risk.

If the risk designated as being hedged is not the risk under (1) above, two or more of the other risks may simultaneously be selected as being hedged.

Changes in the fair value of a derivative that is effective as a fair-value hedge (and that is designated as and qualifies as a fair-value hedge), along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk (including changes that reflect losses or gains on firm commitments), are recorded in current-period earnings. Any ineffectiveness of a hedge (which represents the amount by which the change in the fair value of the derivative differs from the change in the fair value of the hedged item) is also recorded in current-period earnings.

*Cash-Flow Hedges.* A cash-flow hedge hedges the exposure to variability in expected future cash flows. There are four specific risks that a cash-flow hedge can mitigate, namely changes in:

- (1) the overall hedged cash flows;
- (2) cash flows due to changes in the designated benchmark interest rates (interest-rate risk);

- (3) functional currency cash flows due to foreign exchange risk; and
- (4) cash flows due to credit risk.

Changes in the fair value of a derivative that is effective as a cash-flow hedge (and that is designated as and qualifies as a cash-flow hedge), to the extent that the hedge is effective, are recorded in accumulated other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction. Any ineffectiveness of the hedge (which represents the amount by which the offsetting change in the fair value of the derivative differs from the change in the variability in the cash flows of the anticipated transaction) is recorded in current-period earnings.

*Foreign Currency Hedge.* Changes in the fair value of a foreign currency hedge are recorded in either current-period earnings or accumulated other comprehensive income, depending on whether the hedging relationship satisfies the criteria for a fair-value hedge or cash-flow hedge.

*Non-SFAS 133 Qualifying Hedge (Economic Hedges).* A non-SFAS 133 qualifying hedge (a so-called “economic hedge”) is an interest-rate exchange agreement hedging specific or non-specific underlying assets, liabilities or firm commitments that does not qualify for hedge accounting under the rules of SFAS 133, but is an acceptable hedging strategy under the risk management policy of the FHLBank and regulatory requirements of the Finance Board. An economic hedge, by definition, introduces the potential for earnings variability due to the change in fair value recorded on the interest-rate exchange agreement(s) that is not offset by corresponding changes in the value of the economically hedged assets, liabilities, or firm commitments. The fair value of this derivative is recognized in current-period earnings.

The following paragraphs summarize the applicable accounting treatments (hedge indicators) for fair-value and cash-flow hedging relationships under SFAS 133. These are:

- the short-cut treatment;
- the highly-effective treatment (also known as the “long-haul” method of accounting); and
- the not-highly-effective treatment.

*Short-cut Treatment.* A short-cut hedging relationship implies that the hedge between an interest-rate swap and an interest-bearing financial instrument is considered to be perfectly correlated. Therefore, changes in the fair value of the interest-rate swap and the interest-bearing financial instrument will perfectly offset one another, as a short-cut relationship assumes no ineffectiveness. To qualify for short-cut accounting treatment, a number of restrictive conditions must be met.

*Highly-Effective Treatment.* A highly-effective hedging relationship indicates that the FHLBank assesses, prospectively and retrospectively, whether the derivative and hedged item will be highly effective in offsetting changes in fair value attributable to the hedged risk. The changes in fair value for the derivative and the hedged item may or may not perfectly offset one another. Any difference in the change of fair value between the two will be recognized as a net gain or loss in the statement of income. This treatment is also known as the “long-haul” method of accounting. To maintain the highly-effective relationship, this testing of the effectiveness of the hedge is performed at the inception of the hedge and on an ongoing basis. Typically, the FHLBanks perform dollar-offset prospective testing at the inception of the hedge and calculate retrospective regressions after a sufficient number of data points have been accumulated to render a statistically significant result. Alternatively, FHLBanks may employ regression-based testing prospectively based on simulated valuations derived from historical market data. If during this testing of effectiveness the hedge fails to maintain effectiveness at any point, the hedge relationship will be deemed ineffective. As a result, the hedged item’s changes in fair value will no longer be evaluated under SFAS 133, and will be treated as not-highly-effective.

*Not-Highly-Effective Treatment—Non-SFAS 133 Qualifying Hedge (Economic Hedges).* A not-highly-effective hedging relationship indicates that, although an offsetting relationship between fair values or cash flows of the hedge and hedged items may be demonstrated, the relationship is not considered highly effective in accordance with the requirements of SFAS 133. This relationship does not qualify for hedge accounting treatment under SFAS 133 and, therefore, the hedged item's changes in fair value are not evaluated. Changes in the fair value of such economic hedges of assets or liabilities for asset/liability management are recorded in current-period earnings.

*Fair Values.* At December 31, 2006, certain of the assets and liabilities of the FHLBanks, including investments classified as available-for-sale and trading, as well as all derivatives, and mandatorily redeemable capital stock are presented in the Combined Statement of Condition at fair value. Under GAAP, the fair value of an asset or liability is the amount at which that asset could be bought or sold, or that liability could be incurred or settled, in a current transaction between willing parties, other than in liquidation. Fair values play an important role in the valuation of certain of the assets, liabilities and hedging transactions of the FHLBanks. Management of each FHLBank also estimates the fair value of collateral that its members pledge against advance borrowings, to confirm that the FHLBank has sufficient collateral to meet regulatory requirements and to protect it from a loss. Fair values are based on market prices, if such prices are available. If market quotes are not available, fair values are based on either:

- discounted cash flows, using market estimates of interest rates and volatility; or
- dealer prices and prices of similar instruments.

Pricing models and their underlying assumptions are based on the best estimates of management of each FHLBank with respect to:

- discount rates;
- prepayments;
- market volatility; and
- other factors.

These assumptions may have a significant effect on the reported fair values of assets and liabilities, including derivatives, and the income and expense related thereto. The use of different assumptions, as well as changes in market conditions, could result in materially different net income and retained earnings. The FHLBanks do not necessarily use the same dealer prices, models and assumptions in determining the fair values of their respective assets, liabilities and derivatives.

*Consolidated Obligations.* An FHLBank records a liability for consolidated obligations on its Statement of Condition based on the proceeds it actually receives from the issuance of those consolidated obligations. In addition, each FHLBank is jointly and severally obligated for the payment of all consolidated obligations of all of the FHLBanks. As a result, should one or more of the FHLBanks be unable to repay its participation in any consolidated obligation, the Finance Board may call upon any of the other FHLBanks to repay all or part of those obligations. In view of the high credit quality of each FHLBank, the possibility that an FHLBank would be unable to repay its participation in consolidated obligations is considered to be remote. Furthermore, under current Finance Board regulation, all FHLBanks are required to maintain a rating of not less than double-A. As a result, the joint and several obligation of each FHLBank with respect to the other FHLBanks' share of the consolidated obligations is not recorded on the statements of condition of the individual FHLBanks or the combining schedules accompanying the combined financial statements. The Combined Statement of Condition reflects the total liability for the consolidated obligations, net of interbank holdings. (See "Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Recent Rating Agency Actions" for more information.)

*Amortization of Premium and Accretion of Discount on Investment Securities and Purchased Mortgage Loans.* When an FHLBank purchases investment assets and mortgage loans under the

MPF Program or MPP, it may not pay the seller the exact amount of the unpaid principal balance. If an FHLBank pays more than the unpaid principal balance, and purchases the assets at a premium, the premium reduces the yield the FHLBank recognizes on the assets below the coupon amount. Conversely, if the FHLBank pays less than the unpaid principal balance and purchases the asset at a discount, the discount increases the yield above the coupon amount.

The FHLBanks amortize premiums and accrete discounts in accordance with the requirements of SFAS 91. Where appropriate and allowed under SFAS 91, certain FHLBanks use estimates of prepayments and apply a level-yield calculation on a retrospective basis. The FHLBanks of Des Moines and Pittsburgh apply a level-yield methodology over the contractual life of their mortgage-backed securities and purchased mortgage loans. The FHLBanks of Boston, Chicago and Dallas apply a level-yield methodology over the contractual life of their purchased mortgage loans. The FHLBank of Atlanta applies a level-yield methodology over the contractual life of its mortgage-backed securities. The remaining FHLBanks currently apply the retrospective method on mortgage-backed securities and/or purchased mortgage loans for which prepayments reasonably can be expected and estimated. Use of the retrospective method may increase volatility of reported earnings during periods of changing interest rates.

#### *Provision for Credit Losses.*

*Advances.* Since their inception, none of the FHLBanks has experienced a credit loss on advances. None of the FHLBanks' management anticipates any credit loss on advances. The FHLBanks are required by Finance Board regulation to obtain sufficient collateral on advances to protect against losses. They are permitted to accept only certain collateral on their advances, such as:

- U.S. government or government-agency securities;
- residential mortgage loans;
- deposits in the FHLBank; and
- other real estate-related assets.

Each FHLBank may require additional collateral (whether or not that additional collateral meets the eligibility criteria set forth above) or require that the borrower substitute existing collateral at any time. The FHLBank also has a statutory lien upon each member's FHLBank stock as additional security for the indebtedness of that member. At December 31, 2006 and 2005, the rights to collateral (either loans or securities), on a member-by-member basis, held by the FHLBanks had an estimated fair value that exceeded the outstanding advances. Management of each FHLBank believes that adequate policies and procedures are in place to effectively manage that FHLBank's respective credit risk.

*Mortgage Loans — MPF.* Each FHLBank that holds mortgage loans under the MPF Program has a provision for credit losses on mortgage loans held under that program. Each FHLBank bases its allowance on its management's estimate of credit losses inherent in its mortgage loan portfolio at the balance sheet date. These losses are estimated net of recoveries under the credit enhancement obligation of the corresponding PFI. The estimate is either based on the individual FHLBank's loan portfolio performance history or is based on analysis of industry statistics for similar mortgage loan portfolios.

Management of each FHLBank believes that adequate policies and procedures are in place to manage its MPF credit risk effectively.

*Mortgage Loans — MPP.* Each FHLBank that has acquired mortgage loans under MPP has either a minimal provision for credit losses on mortgage loans acquired under MPP or no such provision at all, due to the structure of the allocation of credit risk under that program. Credit losses are provided for by a combination of lender risk accounts and private mortgage insurance.

Management of each FHLBank believes that adequate policies and procedures are in place to manage its MPP credit risk effectively.

A more detailed description of how the FHLBanks manage their credit risk with respect to MPF and MPP loans is included in “Risk Management—Credit Risk—Managing Credit Risk—Mortgage Loans Held for Portfolio” and in the “Supplemental Information.”

**REFCORP Payments.** The Statements of Financial Condition do not set forth a liability for the mandatory REFCORP payments of the FHLBanks. No liability is recorded because each FHLBank must pay 20 percent of its GAAP net income (after payment of its AHP obligation) to REFCORP to support the payment of part of the interest on the bonds issued by REFCORP. The future payments of each FHLBank are contingent upon future earnings that cannot be estimated under SFAS No. 5, *Accounting for Contingencies*. As a result, the REFCORP payments are disclosed as a long-term statutory payment requirement and are treated similar to a tax for accounting purposes.

### **Off-Balance Sheet Arrangements and Other Commitments**

In the ordinary course of business, the FHLBanks engage in financial transactions that, in accordance with GAAP, are not recorded on the FHLBanks’ Statement of Condition or may be recorded on the FHLBanks’ Statement of Condition in amounts that are different from the full contract or notional amount of the transactions. The FHLBanks routinely enter into commitments to extend advances, issue standby letters of credit and/or fund unused lines of credit. These commitments and standby letters of credit may not necessarily represent future cash requirements of the FHLBanks. Some of these commitments are expected to expire without being drawn upon. At December 31, 2006, the FHLBanks had \$26.4 billion of commitments to extend advances, issue standby letters of credit and fund unused lines of credit, and \$20.1 billion in standby letters of credit outstanding. The FHLBanks entered into \$10.3 billion par value of consolidated bonds and \$263 million par value of consolidated discount notes that had traded but not yet settled at December 31, 2006.



## Contractual Obligations

In the ordinary course of operations, the FHLBanks enter into certain contractual obligations. The following table summarizes the FHLBanks' significant contractual obligations at December 31, 2006.

### Payments Due or Expiration Terms by Type of Contractual Obligation (Dollar amounts in millions)

December 31, 2006	Payments due or expiration terms by period				Total
	< 1 Year	1 to <3 Years	3 to <5 Years	5 years and >	
Consolidated bonds(1) . . . . .	\$241,565	\$293,442	\$109,464	\$144,775	\$789,246
Capital lease obligations . . . . .	7	13	12	5	37
Operating leases . . . . .	24	47	40	63	174
Standby bond purchase agreements . . . . .	1,002	337	399	97	1,835
Commitments to fund/purchase mortgage loans . . . . .	242				242
Other unconditional purchase obligations . . . . .	3,367	188		13	3,568
Unconditional purchase obligations	<u>4,611</u>	<u>525</u>	<u>399</u>	<u>110</u>	<u>5,645</u>
Subordinated notes . . . . .				1,000	1,000
Mandatorily redeemable capital stock . . . . .	248	348	478	20	1,094
Securities sold under agreements to repurchase . . . . .	800	200	800	400	2,200
Other long-term obligations . . . . .	87	2	1	4	94
Total contractual obligations . . . .	<u>\$247,342</u>	<u>\$294,577</u>	<u>\$111,194</u>	<u>\$146,377</u>	<u>\$799,490</u>

(1) Does not include discount notes and is based on contractual maturities; the actual timing of payments could be affected by factors affecting redemptions.

## Legislative and Regulatory Developments

*Finance Board Adopts Process for Appointing Directors.* On January 18, 2007, the Finance Board adopted an interim final rule establishing procedures for the selection of appointed directors to the boards of the FHLBanks. Under the rule, the FHLBanks are responsible for identifying potential directors, conducting a preliminary assessment of their eligibility and qualifications, and sending two nominees for each vacant appointive directorship to the Finance Board for its consideration. The nominations must be accompanied by a completed eligibility form that demonstrates the qualifications of each nominee to serve on the board of an FHLBank. The Finance Board will review each nomination and decide whether to appoint directors from the submitted list of nominees. If the Finance Board declines to appoint any of the nominees, it may require the FHLBank to submit additional nominees for consideration. The FHLBanks cannot predict if or when the Finance Board will complete the appointment of directors to these vacant directorships. Further, the Finance Board has asked for comments on this interim final rule, so it is possible that further changes may be made.

*Finance Board Adopts Final Rule Limiting Excess Stock.* On December 22, 2006, the Finance Board adopted a final rule prohibiting FHLBanks from issuing new excess stock if the amount of excess stock exceeds one percent of the FHLBank's assets. The final rule became effective on January 29, 2007. Under the rule, any FHLBank with excess stock greater than one percent of its total assets will be prevented from further increasing excess stock by paying stock dividends or otherwise issuing new excess stock. Also included in the final rule is a provision requiring the FHLBanks to declare and pay dividends only out of previously retained earnings or

current net earnings. At December 31, 2006, the FHLBanks of Cincinnati, Indianapolis, Chicago, and Seattle had excess stock outstanding greater than one percent of total assets, while the remaining FHLBanks did not have excess stock outstanding greater than one percent of total assets. Most of the FHLBanks pay cash, rather than stock dividends. The FHLBanks of Cincinnati, Dallas, Topeka, and San Francisco paid stock dividends during 2006. No FHLBank believes the final rule will have a material effect on its results of operations or financial condition. Previously, the Finance Board had issued a proposed rule that would have established minimum amounts of retained earnings for the FHLBanks. While the provisions regarding minimum amounts of retained earnings were not carried forward into the final rule, it is possible that the Finance Board may take up the matter in a subsequent rule making.

*Finance Board Adopts Final Rule Modifying Calculations for Required Annual AHP Contributions.* On September 13, 2006, the Finance Board adopted a final rule modifying the calculations for the FHLBanks' required annual AHP contributions. Under the final rule, which became effective on January 1, 2007, each FHLBank's required annual AHP contribution is limited to its annual net earnings. By existing regulation, each FHLBank contributes annually to its AHP Program the greater of ten percent of its annual net earnings or its pro-rata share of an aggregate of \$100 million contributed by all of the FHLBanks, such pro-rata share being made on the basis of each FHLBank's annual net earnings in relation to all FHLBanks' annual net earnings.

*Proposed Changes to GSE Regulation.* Congress may enact legislation that is designed to strengthen the regulation of Fannie Mae, Freddie Mac and the FHLBanks and to address other GSE reform issues. It is impossible to predict whether any provisions relating to the Finance Board and the FHLBanks will be included in any such legislation and what such provisions may be. It is further impossible to predict whether the House of Representatives and the Senate will approve such legislation and whether any such change in regulatory structure will be signed into law. Finally, it is impossible to predict when any such change would go into effect if it were to be enacted, and what effect the legislation would ultimately have on the Finance Board or the FHLBanks.

*U.S. Department of the Treasury to Review GSE Debt Issuance Approval Process.* The U.S. Department of the Treasury has announced that it will review its process for approving the GSEs' debt issuance. This review is being undertaken in order to ensure that, in light of current circumstances, the Treasury continues to act as an appropriate custodian of the powers the Congress granted to it when the GSE charters were created. Under their charters, GSEs are permitted to issue debt only upon the approval of the Secretary of the Treasury. Although the approval process has changed in the past from time to time, approvals have been routinely and cooperatively granted. As a result of this review, the approval process could change again, which could affect the amount, timing, structures and interest costs of the FHLBank System's consolidated obligation issuances and which, in turn, could affect the FHLBanks' ability to continue to achieve its mission and corporate objectives. At this time, the FHLBanks cannot predict what effects, if any, will result from actions taken as a result of the Treasury's review.

*Capital Plans Implementation Status.* The FHLBank of New York implemented its new capital plan in 2005; the FHLBanks of Atlanta, Boston, San Francisco and Topeka implemented new capital plans during 2004; the FHLBanks of Indianapolis, Dallas and Des Moines implemented new capital plans during 2003; and the FHLBanks of Cincinnati, Pittsburgh and Seattle implemented new capital plans during 2002. The existing capital structure of the FHLBank of Chicago will remain in place until it implements its new capital plan. Under the new capital plans, the FHLBanks are subject to risk-based capital rules. Until the FHLBank of Chicago implements its new capital plan, the prior capital adequacy rules remain in effect. (See Note 16 to the accompanying combined financial statements.)

*Change in Federal Reserve Bank Policy Statement on Payments System Risk.* On July 20, 2006, the Federal Reserve Board began requiring the Federal Reserve Banks to release interest and principal payments on securities issued by GSEs and international organizations only when the issuer's Federal Reserve account contains sufficient funds to cover these payments. The Federal

Reserve Banks had been processing and posting these payments to depository institutions' Federal Reserve accounts by 9:15 a.m. Eastern Time, the same posting time as for U.S. Treasury interest and principal payments, even if the issuer had not fully funded its payments. On June 23, 2006, the 12 FHLBanks and the Office of Finance entered into the Federal Home Loan Banks' P&I Funding and Contingency Plan Agreement to ensure sufficient funds are available.

### Recent Rating Agency Actions

#### Federal Home Loan Banks Long-Term and Short-Term Credit Ratings At March 30, 2007

	S&P		Moody's	
	Long-Term/ Short-Term Rating	Outlook	Long-Term/ Short-Term Rating	Outlook
Atlanta .....	AAA/A-1+	Stable	Aaa/P-1	Stable
Boston .....	AAA/A-1+	Stable	Aaa/P-1	Stable
Chicago .....	AA+/A-1+	Negative	Aaa/P-1	Stable
Cincinnati .....	AAA/A-1+	Stable	Aaa/P-1	Stable
Dallas .....	AAA/A-1+	Stable	Aaa/P-1	Stable
Des Moines .....	AAA/A-1+	Negative	Aaa/P-1	Stable
Indianapolis .....	AAA/A-1+	Stable	Aaa/P-1	Stable
New York .....	AAA/A-1+	Stable	Aaa/P-1	Stable
Pittsburgh .....	AAA/A-1+	Stable	Aaa/P-1	Stable
San Francisco .....	AAA/A-1+	Stable	Aaa/P-1	Stable
Seattle(1) .....	AA+/A-1+	Stable	Aaa/P-1	Stable
Topeka .....	AAA/A-1+	Stable	Aaa/P-1	Stable

(1) At December 31, 2006, the outlook for the FHLBank of Seattle was negative. On January 19, 2007, S&P revised its outlook on the FHLBank of Seattle to stable from negative.

### RISK MANAGEMENT

The fundamental business of each FHLBank is to provide a readily available, competitively-priced source of funds in a wide range of maturities to meet the demands of its members and housing associates. The principal sources of funds for these activities are consolidated obligations and, to a lesser extent, capital and deposits from members. Lending and investing funds, and engaging in interest-rate exchange agreements, can potentially expose the FHLBanks to a number of risks. These risks include credit risk and interest-rate risk. The FHLBanks are also subject to operational risk and business risk. To control these risks, each FHLBank has established policies and practices to evaluate and manage its credit, business, operational and interest-rate risk positions. The Finance Board has established regulations governing the risk management practices of the FHLBanks. The FHLBanks must file periodic compliance reports with the Finance Board. The Finance Board conducts an annual on-site examination of each FHLBank and the Office of Finance as well as off-site analyses.

The FHLBanks do not have any special purpose entities or any other types of off-balance sheet conduits. All derivatives are recorded in the Statements of Condition at fair value. Finance Board regulation prohibits the speculative use of interest-rate exchange agreements. The FHLBanks do not trade derivatives for short-term profit.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Managing Interest Rate Risk

Interest-rate risk is the risk that relative and absolute changes in interest rates may adversely affect an institution's financial condition. The goal of an interest-rate risk management strategy is not necessarily to eliminate interest-rate risk, but to manage it by setting appropriate limits. The FHLBanks generally approach managing interest-rate risk by acquiring and maintaining a portfolio of assets and liabilities and entering into related interest-rate exchange agreements to limit the expected mismatches in duration. The FHLBanks manage interest-rate risk in several different ways, which are more fully discussed below.

The FHLBanks measure interest-rate risk exposure by various methods, including the calculation of duration of equity. Duration of equity measures how sensitive a theoretical market value of equity is to changes in interest rates. Higher duration numbers, whether positive or negative, indicate greater volatility in the market value of equity in response to changing interest rates. Under the Finance Board regulations, the FHLBank of Chicago, which has not yet converted to its new capital plan, must ensure that its duration of equity stays within a range of +5 to -5 years, based on current interest rates using the consolidated obligation cost curve or an appropriate discounting methodology. If one assumes an instantaneous parallel increase or decrease in interest rates of 200 basis points, the duration of equity of this FHLBank must stay within a range of +7 to -7 years. The FHLBank of Chicago reports the results of its duration of equity calculations to the Finance Board each quarter; however, each FHLBank that has converted to its new capital structure is no longer subject by regulation to the duration of equity requirements. The capital adequacy rules of the Finance Board require each FHLBank that has implemented a new capital plan to hold permanent capital in an amount sufficient to cover the sum of its credit, market and operations risks, as these risks are defined by the Finance Board's capital rule. Each of these FHLBanks has developed a market risk model that calculates the market risk component of this requirement. (See Duration of Equity table on page 100.)

The optionality embedded in certain financial instruments held by the FHLBanks can create interest-rate risk. When a member prepays an advance, this can lead to lower future income for the FHLBank. If the principal portion of the advance being prepaid is reinvested in assets yielding a lower return, but that principal amount continues to be funded by the original (higher-cost) debt, the FHLBank can suffer lower net returns. To protect against this risk, each FHLBank generally charges members a prepayment fee to compensate the FHLBank for this potential loss, making it financially indifferent to the prepayment. When an FHLBank offers advances (other than short-term advances) that a member may prepay without a prepayment fee, it usually finances these advances with callable debt or otherwise hedges this option.

The FHLBanks hold mortgage-related investments, such as:

- mortgage loans;
- mortgage-backed securities; and
- agency obligations.

Because mortgage-related investments contain prepayment options, changes in interest rates cause the expected maturities of these investments to become shorter or longer. Finance Board regulation limits this source of interest-rate risk by restricting the types of mortgage-backed securities the FHLBanks may own. FHLBanks may own only those mortgage-backed securities whose changes in average life under certain interest-rate shock scenarios are limited. The FHLBanks may hedge against this contraction risk by funding some mortgage-related investments with consolidated obligations that have call features. In addition, the FHLBanks may use caps, floors and other interest-rate exchange agreements to manage the extension and contraction variability of mortgage-related investments.

The FHLBanks may also use interest-rate exchange agreements to transform the characteristics of investment securities other than mortgage-backed securities.

## **Qualitative Disclosures about Market Risk**

### **Interest-Rate Exchange Agreements**

#### *Types of Interest-Rate Exchange Agreements*

*General.* To manage their exposure to changes in interest rates, the FHLBanks enter into the following kinds of derivatives (which are referred to in this Financial Report as “interest-rate exchange agreements”):

- interest-rate swaps;
- options;
- swaptions;
- interest-rate caps and floors; and
- futures and forward contracts.

Consistent with Finance Board regulation, the FHLBanks enter into interest-rate exchange agreements only to reduce the market risk exposure inherent in otherwise unhedged assets and funding positions. Management of an FHLBank utilizes interest-rate exchange agreements in the most cost-efficient strategy and may enter into interest-rate exchange agreements that do not necessarily qualify for hedge accounting under SFAS 133 accounting rules. As a result, for these economic hedges the FHLBanks recognize only the change in fair value of these interest-rate exchange agreements in other income. They are recognized as net realized and unrealized gains (losses) on derivatives and hedging activities. No fair value adjustments of the asset, liability or firm commitment are recorded to offset these changes.

*Interest-Rate Swaps.* An interest-rate swap is an agreement between two entities to exchange cash flows in the future. The agreement sets the dates on which the cash flows will be paid and the manner in which the cash flows will be calculated. One of the simplest forms of an interest-rate swap involves the promise by one party to pay cash flows equivalent to the interest on a notional principal amount at a predetermined fixed rate for a given period of time. In return for this promise, this party receives cash flows equivalent to the interest on the same notional principal amount at a variable rate index for the same period of time. The variable rate in most FHLBank interest-rate exchange agreements is LIBOR.

*Options.* Premiums paid to acquire options in a fair-value hedge relationship are accounted for at the fair value of the derivative at inception of the hedge and are reported in derivative assets or derivative liabilities. Premiums paid are considered the fair value of the option at inception of the hedge.

*Swaptions.* A swaption is an option on a swap that gives the buyer the right to enter into a specified interest-rate swap at a certain time in the future. When used as a hedge, a swaption can protect an FHLBank that is planning to lend or borrow funds in the future against future interest rate changes. The FHLBanks purchase both payer swaptions and receiver swaptions. A payer swaption is the option to make fixed interest payments at a later date and a receiver swaption is the option to receive fixed interest payments at a later date.

*Interest-Rate Caps and Floors.* In a cap agreement, a cash flow is generated if the price or rate of an underlying variable rises above a certain threshold (or “cap”) price. In a floor agreement, a cash flow is generated if the price or rate of an underlying variable falls below a certain threshold (or “floor”) price. Caps are used in conjunction with liabilities and floors are used in conjunction with assets. Caps and floors are designed as protection against the interest rate on a variable-rate asset or liability rising above or falling below a certain level.



*Futures.* The FHLBanks use futures contracts in order to hedge interest-rate risk. SFAS 133 permits the benchmark interest rate to be the designated risk in a hedge of interest-rate risk. The benchmark interest rate encompasses both U.S. Treasury rates and LIBOR. In order to hedge benchmark interest-rate risk, the FHLBanks enter into Eurodollar futures contracts that they can demonstrate are highly correlated to LIBOR.

Eurodollar futures contracts are based on three-month Eurodollar interest rates. All futures contracts are standardized, with specific value dates and fixed contract sizes. Eurodollar futures contracts are traded through the Chicago Mercantile Exchange. They provide for daily cash settlements in order to ensure against the risk of default by a counterparty.

*Foreign Currencies.* At times, the FHLBanks have issued some consolidated obligations denominated in currencies other than U.S. dollars. The FHLBanks use forward exchange contracts to hedge currency risk on such consolidated obligations. These contracts exchange different currencies at specified rates on specified dates in the future. These contracts effectively simulate the conversion of consolidated obligations denominated in foreign currencies into ones denominated in U.S. dollars. At December 31, 2006, there were no outstanding consolidated obligations denominated in foreign currencies.

#### *Application of Interest-Rate Exchange Agreements*

*General.* The FHLBanks use these derivatives to adjust the effective maturity, repricing frequency or option characteristics of financial instruments in order to achieve certain risk-management objectives. Derivative financial instruments are used by the FHLBanks in three ways:

- by designating them as a fair-value or cash-flow hedge of an underlying financial instrument, a firm commitment or an anticipated transaction;
- by acting as an intermediary; or
- in asset/liability management (i.e., non-SFAS 133 “economic” hedges).

For example, the FHLBanks use interest-rate exchange agreements in their overall interest-rate risk management to effectively adjust the interest-rate sensitivity of consolidated obligations to match more closely the interest-rate sensitivity of assets (i.e., advances, investments and mortgage loans). These derivatives are also used to effectively adjust the interest-rate sensitivity of assets to match more closely the interest-rate sensitivity of liabilities. In addition to using interest-rate exchange agreements to manage mismatches of interest rates between assets and liabilities, the FHLBanks also use interest-rate exchange agreements for the following purposes:

- to manage embedded options in assets and liabilities;
- to hedge the market value of existing assets, liabilities and anticipated transactions;
- to hedge the duration risk of prepayable instruments; and
- to reduce funding costs.

Each FHLBank reevaluates its hedging strategies from time to time and may change the hedging techniques it uses or adopt new strategies.

*Consolidated Obligations.* An FHLBank manages the risk arising from changing market prices and volatility of a consolidated obligation by matching the cash inflow on the interest-rate exchange agreement with the cash outflow on the consolidated obligation. In addition, the FHLBanks require collateral agreements on some interest-rate exchange agreements. While consolidated obligations are the joint and several obligations of the FHLBanks, one or more of the FHLBanks may also serve individually as counterparties to interest-rate exchange agreements associated with specific debt issues.

In a typical transaction of this kind, an FHLBank issues a fixed-rate consolidated obligation and simultaneously enters into a matching interest-rate exchange agreement. The counterparty in



this interest-rate exchange agreement pays the issuing FHLBank a fixed cash flow that is designed to mirror (both in timing and amount) the cash outflow the issuing FHLBank must pay on the consolidated obligation. In return, the FHLBank pays a variable cash flow that closely matches the interest payments it receives on short-term or variable-rate advances. Such transactions are treated as fair-value hedges under SFAS 133. By acting in both the capital and the swap markets, the FHLBanks can raise funds at lower costs than through the issuance of simple fixed- or variable-rate consolidated obligations in the capital markets alone.

*Advances.* By issuing convertible advances, an FHLBank may purchase put options from a member that allow the FHLBank to convert the advance from a fixed rate to a variable rate if interest rates increase. A convertible advance carries an interest rate lower than a comparable-maturity fixed-rate advance that does not have the conversion feature. With a puttable advance, an FHLBank effectively purchases a put option from the member that allows the FHLBank to put or extinguish the fixed-rate advance, which the FHLBank normally would exercise when interest rates increase, and the borrower may elect to enter into a new advance. An FHLBank may hedge these advances by entering into a cancelable interest-rate exchange agreement.

*Mortgage Loans Held for Portfolio.* The prepayment options embedded in mortgage assets held by the FHLBanks can extend or reduce the expected maturities of these investments if prepayments occur earlier or later than originally estimated. In addition, to the extent the FHLBanks purchase mortgage assets at premiums or discounts, net income could be affected by such changes in the expected maturity. Net income could be reduced if the FHLBanks replace the mortgages with lower-yielding assets without reducing higher funding costs at the same time.

Swaps, futures and other options may be combined into a portfolio of derivatives that is linked to a portfolio of mortgage loans. The portfolio of mortgage loans consists of one or more pools of similar assets. Similar assets are designated by factors such as product type and coupon. As the portfolio of loans changes due to new loans, liquidations and payments, the derivative portfolio is modified accordingly to hedge the interest-rate and prepayment risks effectively. A new hedging relationship is created with each change to the loan portfolio.

Options may also be used to hedge embedded prepayment risk on the mortgages. Many of these hedges are not tied to a specific mortgage. To manage the prepayment risk embedded in the mortgage loans, the FHLBanks also purchase derivatives such as:

- interest-rate caps and floors;
- swaptions;
- callable swaps;
- calls; and
- puts.

Although these derivatives are valid economic hedges against the prepayment risk of the loans, they are not specifically linked to individual loans.

The FHLBanks analyze the risk of their mortgage portfolios on a regular basis and consider the interest-rate environment under various rate scenarios. They also perform analyses of the duration and convexity of their portfolios.

*Mortgage Purchase Commitment Strategies.* The FHLBanks economically hedge the market value of commitments to purchase fixed-rate mortgage loans by using derivatives that have similar market value characteristics. These mortgage purchase commitments are considered derivatives. The FHLBanks normally hedge these commitments by selling mortgage-backed securities to be announced (TBA MBS) or other derivatives for forward settlement.

The FHLBanks may also hedge a firm commitment for a forward-starting advance through the use of an interest-rate swap. In this case, the swap functions as the hedging instrument for both the

firm commitment and the subsequent advance. The basis movement associated with the firm commitment will be included as a basis adjustment of the advance at the time the commitment is terminated and the advance is issued. The basis adjustment will then be amortized into interest income over the life of the advance.

*Investment Securities.* The FHLBanks primarily invest in mortgage-backed securities, U.S. agency securities and the taxable portion of state or local housing finance agency securities. The interest-rate and prepayment risks associated with these investment securities is managed through a combination of debt issuance and derivatives. The FHLBanks may manage prepayment and duration risk by funding investment securities with consolidated obligations that contain call features. The FHLBanks may also manage the risk arising from changing market prices and volatility of investment securities by matching the cash outflow on the interest-rate exchange agreements with the cash inflow on the investment securities. The derivatives held by the FHLBank that are currently associated with trading securities, carried at fair value, and held-to-maturity securities, carried at amortized cost, are designated as economic hedges. The changes in fair values of these derivatives are recorded in current-period earnings.

For available-for-sale securities that have been hedged and qualify as a fair-value hedge, the FHLBanks record the portion of the change in value related to the risk being hedged in other income as net realized and unrealized gains (losses) on derivatives and hedging activities, together with the related change in the fair value of the related interest-rate exchange agreements. The amount of the change related to the unhedged risk is recorded in accumulated other comprehensive income as an unrealized gain or loss on available-for-sale securities. For available-for-sale securities that have been hedged and qualify as a cash-flow hedge, the FHLBanks record the effective portion of the change in value of the interest-rate exchange agreements related to the risk being hedged in accumulated other comprehensive income as unrealized gains or losses on hedging activities. The ineffective portion is recorded in other income.

Finance Board policies also limit the FHLBanks' exposure to interest rate and prepayment risks from investments in MBS and asset-backed securities. Under these policies, the total book value of MBS owned by an FHLBank may not exceed 300 percent of the FHLBank's previous month-end regulatory capital plus its mandatorily redeemable capital stock on the day it purchases the securities. The FHLBank of Chicago may include a designated amount of subordinated notes in calculating compliance with this requirement. The Shared Funding Program mortgage-backed certificates, however, are not subject to this 300 percent limit.

In addition, the FHLBanks are prohibited from purchasing:

- interest-only or principal-only stripped MBS;
- residual-interest or interest-only classes of collateralized mortgage obligations (CMOs) or real-estate mortgage investment conduits (REMICs); and
- both variable-rate MBS with rates at their contractual cap on the trade date and fixed-rate MBS that have average lives that vary more than six years under an assumed instantaneous interest rate change of 300 basis points.

*Anticipated Debt Issuance.* Certain FHLBanks use derivatives to "lock-in" the cost of funding prior to an anticipated debt issuance. The portion of the change in fair value of the derivative deemed effective is reported in accumulated other comprehensive income. The ineffective portion is recorded in other income. The derivative is terminated upon issuance of the debt instrument. Amounts reported in accumulated other comprehensive income are reclassified to earnings in the periods in which earnings are affected by the variability of the cash flows of the debt that was issued.

*Variable Cash Streams.* Certain FHLBanks use derivatives to hedge the variability of cash flows over a specified period of time as a result of the issuances and maturities of short-term, fixed-rate instruments such as discount notes. The maturity dates of the cash flow streams are matched to the maturity dates of the derivatives. The change in the fair value of the derivatives is recorded in

accumulated other comprehensive income. If the derivatives are terminated prior to their maturity dates, the amount in accumulated other comprehensive income is recognized over the remaining lives of the specified cash streams as unrealized gains or losses on hedging activities.

*Intermediation.* To meet the asset/liability management needs of their members, the FHLBanks may enter into offsetting interest-rate exchange agreements. Under these agreements, the FHLBanks act as an intermediary between members and other counterparties. This intermediation grants smaller members indirect access to the interest-rate swap market. The derivatives used in intermediary activities do not receive SFAS 133 hedge accounting treatment and are separately marked-to-market through earnings. The net result of the accounting for these derivatives does not significantly affect the operating results of the FHLBanks.

*Derivative Notional Amounts.* The notional amount of derivatives serves as a factor in determining periodic interest payments or cash flows received and paid.

The following table categorizes the estimated fair value of derivative financial instruments, excluding accrued interest by product, and type of accounting treatment. The categories “Fair Value” and “Cash Flow” represent hedge strategies for which hedge accounting is achieved. The category “Economic” represents hedge strategies for which hedge accounting is not achieved.

**Total Derivative Financial Instrument by Product  
(Dollar amounts in millions)**

	December 31, 2006		December 31, 2005	
	Total Notional	Total Estimated Fair Value (excludes accrued interest)	Total Notional	Total Estimated Fair Value (excludes accrued interest)
<b>Advances</b>				
Fair Value-existing cash item . . . . .	\$ 235,567	\$ 717	\$239,362	\$ 412
Fair Value-firm commitments . . . . .	53		1,266	2
Cash Flow-anticipated transaction . . . . .	1,925	20	575	2
Economic . . . . .	<u>7,349</u>	<u>3</u>	<u>18,846</u>	<u>15</u>
Total . . . . .	<u>244,894</u>	<u>740</u>	<u>260,049</u>	<u>431</u>
<b>Investments</b>				
Fair Value-existing cash item . . . . .	1,560	(134)	2,095	(178)
Economic (includes trading securities hedges) . . . . .	<u>12,043</u>	<u>(121)</u>	<u>13,102</u>	<u>(214)</u>
Total . . . . .	<u>13,603</u>	<u>(255)</u>	<u>15,197</u>	<u>(392)</u>
<b>MPF/MPP Loans Held for Portfolio</b>				
Fair Value-existing cash item . . . . .	33,115	26	14,634	109
Standalone-delivery commitments . . . . .	221		202	1
Economic (including TBAs) . . . . .	<u>16,053</u>	<u>2</u>	<u>14,496</u>	<u>7</u>
Total . . . . .	<u>49,389</u>	<u>28</u>	<u>29,332</u>	<u>117</u>
<b>Consolidated Obligations-Bonds</b>				
Fair Value-existing cash item . . . . .	506,990	(3,187)	452,933	(5,972)
Cash Flow-anticipated transaction . . . . .			1,184	6
Economic . . . . .	<u>65,768</u>	<u>(53)</u>	<u>41,945</u>	<u>(84)</u>
Total . . . . .	<u>572,758</u>	<u>(3,240)</u>	<u>496,062</u>	<u>(6,050)</u>

	December 31, 2006		December 31, 2005	
	Total Notional	Total Estimated Fair Value (excludes accrued interest)	Total Notional	Total Estimated Fair Value (excludes accrued interest)
<b>Consolidated Obligations-Discount Notes</b>				
Fair Value-existing cash item.....	2,146	(1)		
Cash Flow-existing cash item.....			2,600	133
Economic .....	15,520	42	11,648	43
Total .....	17,666	41	14,248	176
<b>Deposits</b>				
Fair Value.....	20	4	20	5
Total .....	20	4	20	5
<b>Balance Sheet</b>				
Economic .....	7,242	3	6,265	2
Total .....	7,242	3	6,265	2
<b>Intermediary Positions</b>				
Intermediaries .....	2,874	1	3,481	2
Total .....	2,874	1	3,481	2
<b>Total notional and estimated fair value</b>	<b>\$ 908,446</b>	<b>\$(2,678)</b>	<b>\$824,654</b>	<b>\$(5,709)</b>
Total derivatives excluding accrued interest .....		\$(2,678)		\$(5,709)
Accrued interest.....		1,418		779
Net derivative balances .....		\$(1,260)		\$(4,930)
Net derivative asset balances .....		\$ 1,626		\$ 945
Net derivative liability balances .....		(2,886)		(5,875)
Net derivative balances .....		\$(1,260)		\$(4,930)

The notional amount of derivatives represents neither the actual amounts exchanged nor the overall exposure of the FHLBanks to credit and market risk. The overall amount that could potentially be subject to credit loss is much smaller. Notional values are not meaningful measures of the risks associated with derivatives. The risks of derivatives can be measured meaningfully on a portfolio basis. This measurement must take into account the derivatives, the item being hedged and any offsets between the two.

In accordance with SFAS 133, each FHLBank classifies derivative assets and derivative liabilities according to the net fair value of derivatives with each of its counterparties because these swaps are covered by a master netting agreement. If the net fair value of derivatives with one of its counterparties is positive, it is classified as an asset by that FHLBank. If the net fair value of derivatives with one of its counterparties is negative, it is classified as a liability by that FHLBank. At December 31, 2006, the FHLBanks had combined derivative assets of \$1.6 billion and combined derivative liabilities of \$2.9 billion. At December 31, 2005, the FHLBanks had combined derivative assets of \$945 million and combined derivative liabilities of \$5.9 billion. The \$3.0 billion decrease in combined derivative liabilities from December 31, 2005 to December 31, 2006 is largely the result of interest rate changes.

## Quantitative Disclosure about Market Risk

The FHLBanks use duration to measure their exposure to changes in interest rates. Duration is the weighted-average maturity (typically measured in months or years) of the cash flows of an instrument, weighted by the present value of those cash flows. Duration measures the time required to recapture an investment, assuming repaid principal is reinvested. The longer the duration, the higher the risk. Duration is also a measure of price volatility. For example, if interest rates on an instrument with a duration of five years change by one percent, the value of this instrument will change by five percent.

Duration of equity can be described as follows:

$$\frac{\text{duration of assets weighted by market value} \textit{ minus} \textit{ duration of liabilities weighted by market value}}{\text{market value of equity}}$$

Each FHLBank has an internal modeling system for measuring duration of equity and duration gap to provide to their regulator, the Finance Board, and, therefore, individual FHLBank measurements may not be directly comparable since not all FHLBanks manage to these risk measures.

For the FHLBank of Chicago, which has not yet converted to its new capital plan, Finance Board policy requires that it maintain its duration of equity (at current interest rates using the consolidated obligation cost curve or an appropriate discounting methodology) within a range of +/-5 years. The FHLBank of Chicago must maintain its duration of equity, under an assumed instantaneous +/-200 basis points parallel increase or decrease in interest rates, within a range of +/-7 years.

The other 11 FHLBanks have converted to their new capital structures and are no longer subject by regulation to the duration of equity requirements and therefore may not manage their operations to remain within these Finance Board policy requirements.

Each FHLBank also calculates and measures its duration gap. The duration gap is the difference between the estimated durations (market value sensitivity) of assets and liabilities (including the effect of interest-rate exchange agreements) and reflects the extent to which estimated maturity and repricing cash flows for assets and liabilities are matched.

### Duration Gap (In months)

<u>FHLBank</u>	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Boston . . . . .	0.2	0.8
New York . . . . .	0.3	0.2
Pittsburgh . . . . .	0.7	1.0
Atlanta . . . . .	0.8	0.3
Cincinnati . . . . .	1.0	1.0
Indianapolis . . . . .	1.6	2.2
Chicago . . . . .	0.9	(0.1)
Des Moines . . . . .	0.0	(0.5)
Dallas . . . . .	0.2	0.4
Topeka . . . . .	1.3	0.7
San Francisco . . . . .	0.7	0.6
Seattle . . . . .	0.0	(0.8)

The table below reflects measurements by the FHLBank of Chicago, which has not yet converted to its new capital structure, of its exposure to interest-rate risk in accordance with Finance Board policy. The table summarizes the interest-rate risk associated with all instruments entered into by the FHLBank of Chicago.

**Duration of Equity  
(In years)**

December 31, 2006			December 31, 2005		
<u>+ 200 basis point change</u>	<u>Base</u>	<u>- 200 basis point change*</u>	<u>+ 200 basis point change</u>	<u>Base</u>	<u>- 200 basis point change*</u>
0.0	3.1	1.4	3.4	(0.5)	(3.4)

\* The Finance Board regulation restricts the down rate from assuming a negative interest rate. Therefore, the FHLBank of Chicago adjusts the down rate accordingly.

**LIQUIDITY RISK**

Liquidity risk is the risk that an FHLBank will be unable to meet its financial obligations as they come due or meet the funding needs of its members in a timely, cost-effective manner. There are two types of liquidity risk that affect the FHLBanks:

1. *Operational Liquidity Risk:* the potential inability of an FHLBank to meet its deposit liquidity requirements to fund the anticipated (or unanticipated) day-to-day needs through its normal sources of funding, including the short-term discount note market; and
2. *Contingency Liquidity Risk:* the potential inability of an FHLBank to meet its liquidity needs due to an unanticipated increase in funding requests from its members or in the event it cannot access the capital markets, including the short-term discount note market, for a period of time due to a contingency such as a market disruption, operational failure or problems with its credit quality.

To address liquidity risk, the FHLBank Act and Finance Board regulations set liquidity requirements for the FHLBanks. The board of directors of the individual FHLBanks may also set additional liquidity policies.

Under the FHLBank Act, each FHLBank must have an amount equal to its current deposits invested in:

- investments in obligations of the U.S. government and its agencies;
- deposits in eligible banks or trust companies; or
- advances with a maturities that do not exceed five years

to cover its operational risk.

In addition, to address contingency risk Finance Board regulations require each FHLBank to have sources of funding on hand to ensure its normal operational requirements for a period of up to five days, in the event it is unable to access the consolidated obligation debt markets.

The FHLBanks' primary sources of liquidity are short-term investments and the issuance of consolidated obligation bonds and discount notes. Each of the FHLBanks was in compliance with its respective liquidity requirements at December 31, 2006.

**CREDIT RISK**

**General**

Credit risk is the risk of loss due to default or non-performance of an obligor or counterparty. While the credit risk the FHLBanks face on advances is minimal, they are subject to credit risk on



investments (including mortgage-backed securities), mortgage loans held for portfolio and interest-rate exchange agreements. Each FHLBank follows guidelines established by the Finance Board and its board of directors regarding unsecured extensions of credit, whether on-or off-balance sheet. Finance Board regulation limits the amounts and terms of unsecured credit exposure to any counterparty other than the U.S. government. Unsecured credit exposure to any counterparty is limited by the credit quality and capital level of that counterparty and by the capital level of the FHLBank.

### **Managing Credit Risk**

*Advances.* Each FHLBank manages its credit exposure to advances through a combined approach that provides for the ongoing review of the financial condition of its borrowers coupled with a conservative collateral policy. The FHLBanks protect against credit risk on advances by collateralizing all advances. The FHLBank Act requires that FHLBanks obtain and maintain from their members collateral to secure advances at the time these are originated or renewed. Collateral arrangements will vary with member credit quality, borrowing capacity, collateral availability, and overall member credit exposure. Members are also required to collateralize any letters of credit issued for their benefit by an FHLBank. Each FHLBank can call for additional or substitute collateral during the life of an advance to protect its security interest. Collateral eligible to secure advances includes:

- 1) one-to-four family and multifamily mortgage loans (delinquent for no more than 90 days) and securities representing such mortgages;
- 2) securities issued, insured or guaranteed by the U.S. government or any U.S. government agency (for example, mortgage-backed securities issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae);
- 3) cash or deposits in the FHLBank; and
- 4) certain other collateral that is real estate-related, provided that the collateral has a readily ascertainable value and that the FHLBank can perfect a security interest in it.

Residential mortgage loans are the principal form of collateral for advances. As a matter of course, the FHLBanks perfect the security interests granted to them. In addition, the FHLBanks must take any steps necessary to ensure that the security interest in all collateral pledged by non-depository institutions for an advance is as secure as the security interest in collateral pledged by depository institutions.

The FHLBank Act permits members that qualify as a “community financial institution” (which is defined in the FHLBank Act as an FDIC-insured depository institution that had average assets for the past three calendar years totaling no more than \$567 million during 2005, \$587 million during 2006 and \$599 million during 2007) also to pledge small-business, small-farm, and small-agribusiness loans, to the extent that its FHLBank accepts such loans as collateral for advances.

Under the FHLBank Act, an FHLBank has a statutory lien on that FHLBank’s capital stock held by its members, which serves as further collateral for the indebtedness of these members to the FHLBank. In order to borrow from its FHLBank, a member must pledge collateral in the form of a blanket lien or by specific identification, or deliver such collateral to the FHLBank or its agent. Under the FHLBank Act, a security interest granted to an FHLBank by a member is entitled to a priority over the claims and rights of any party (including any receiver, conservator, trustee or similar lien creditor), except the claims and rights of a party that would be entitled to priority under otherwise applicable law and is an actual *bona fide* purchaser for value of such collateral or is an actual secured party whose security interest in such collateral is perfected in accordance with applicable state law.

No FHLBank has ever experienced a credit loss on an advance. However, the expanded eligible collateral for community financial institutions and lending to non-member housing associates

increases the credit risk to the FHLBanks. Advances to community financial institutions secured with expanded eligible collateral represent approximately \$5 billion of the total \$642 billion of advances outstanding at par value at December 31, 2006. Advances to housing associates represent \$132 million of the total \$642 billion of advances outstanding at par value at December 31, 2006. The management of each FHLBank believes it has adequate policies and procedures in place to manage its credit risk on advances effectively.

*Investments.* In order to minimize credit risk on investments, the FHLBanks are required to operate within certain statutory and regulatory limits. Under Finance Board regulations, the FHLBanks are prohibited from investing in certain types of securities, which include:

- instruments, such as common stock, that represent an ownership in an entity, other than stock in small business investment companies, or certain investments targeted at low-income persons or communities;
- instruments issued by non-U.S. entities, other than those issued by U.S. branches and agency offices of foreign commercial banks (e.g., Federal funds);
- non-investment grade debt instruments, other than certain investments targeted at low-income persons or communities and instruments that were downgraded after their purchase by the FHLBank;
- whole mortgages or other whole loans, other than:
  - 1) whole mortgages or loans acquired under an FHLBank's mortgage purchase program;
  - 2) certain investments targeted to low-income persons or communities;
  - 3) certain marketable direct obligations of state, local, or tribal government units or agencies, having at least the second-highest credit rating from an NRSRO;
  - 4) mortgage-backed securities or asset-backed securities backed by manufactured housing loans, home equity loans, and pools of commercial and residential mortgage loans that are labeled as subprime or having certain subprime characteristics; and
  - 5) certain foreign housing loans authorized under section 12(b) of the FHLBank Act; and
- non-U.S. dollar-denominated securities.

The FHLBanks further manage credit risk on investment securities by investing in highly-rated investment securities. At December 31, 2006 and 2005, 99.96 percent and 99.99 percent of all investments by the FHLBanks in mortgage-backed securities were rated triple-A.

**Investment Securities Ratings  
(Dollar amounts in millions)**

<u>Investment Rating</u>	<u>December 31, 2006*</u>		<u>December 31, 2005**</u>	
	<u>Amounts</u>	<u>Percentage of Total Investments</u>	<u>Amounts</u>	<u>Percentage of Total Investments</u>
<b>Long-term Rating</b>				
Triple-A . . . . .	\$144,944	93.6%	\$139,796	95.0%
Double-A . . . . .	1,002	0.6%	1,218	0.8%
<b>Short-term Rating</b>				
A-1 or higher/P-1 . . . . .	8,674	5.6%	6,057	4.1%
A-2/P-2 . . . . .	133	0.1%	150	0.1%
Unrated investment securities . . . . .	77	0.1%	39	0.0%
Total . . . . .	<u>\$154,830</u>	<u>100.0%</u>	<u>\$147,260</u>	<u>100.0%</u>

\* This chart does not reflect changes in any rating, outlook or watch status after December 31, 2006. The ratings were obtained from S&P, Moody's and/or Fitch.

\*\* This chart does not reflect changes in any rating, outlook or watch status after December 31, 2005. The ratings were obtained from S&P, Moody's and/or Fitch.

**Unsecured Credit Exposure  
(Dollar amounts in billions)**

	<u>December 31, 2006</u>	<u>December 31, 2005</u>	<u>Decrease</u>	
			<u>Amount</u>	<u>Percentage</u>
Unsecured credit exposure of FHLBanks to counterparties, excluding U.S. government, U.S. government agencies, and instrumentalities(1) . . . .	<u>\$119.1</u>	<u>\$121.0</u>	<u>\$(1.9)</u>	<u>(1.5)%</u>
Maturities of unsecured credit exposure:				
Overnight . . . . .	43.8%	40.5%		
2-30 days . . . . .	38.0%	26.3%		
31-90 days . . . . .	17.5%	30.1%		
91-270 days . . . . .	0.7%	3.1%		

(1) Included in this total at December 31, 2006 and 2005 is unsecured credit of \$897 million and \$1.8 billion to Washington Mutual Bank (formerly Washington Mutual Bank, FA). Washington Mutual Bank had advances of \$38.5 billion and \$64.5 billion from the FHLBanks of San Francisco, Dallas and New York at December 31, 2006 and 2005. Additionally, its affiliated Washington Mutual Bank, FSB, had advances of \$5.8 billion and \$4.3 billion from the FHLBank of Seattle at December 31, 2006 and 2005.

Most of this unsecured credit exposure was related to Federal funds sold and commercial paper (dollar amounts in billions):

	<u>December 31,</u>		<u>(Decrease)/Increase</u>	
	<u>2006</u>	<u>2005</u>	<u>Amount</u>	<u>Percentage</u>
Federal funds sold . . . . .	\$77.1	\$80.6	\$(3.5)	(4.3)%
Commercial paper . . . . .	8.2	5.8	2.4	41.0%

At December 31, 2006, the FHLBanks had aggregate unsecured credit exposure of more than \$1 billion to each of 41 counterparties. The aggregate unsecured credit exposure to these 41 counterparties represented 76 percent of the FHLBanks' unsecured credit exposure to non-government counterparties.

All of the advances were secured borrowings. In February 2001, Washington Mutual Bank (formerly Washington Mutual Bank, FA), acquired Bank United, Houston, Texas. Before its acquisition, Bank United renegotiated \$7.6 billion of its advances from the FHLBank of Dallas. The principal purpose of these renegotiations was to extend the term of these advances. Following the acquisition, Washington Mutual Bank is responsible for the repayment of these advances to the FHLBank of Dallas. The outstanding balance of \$3.5 billion is included in the Washington Mutual Bank advance amount noted above.

On January 7, 2002, Washington Mutual, Inc. finalized its acquisition of the parent company of Dime Savings Bank of New York. Before the acquisition in January 2002, Dime Savings Bank of New York, FSB, replaced maturing short-term advances and borrowed new advances, both with intermediate maturities, totaling \$8.6 billion from the FHLBank of New York. After the merger, Washington Mutual Bank is responsible for the repayment of these advances to the FHLBank of New York. The outstanding balance of \$104 million is included in the Washington Mutual Bank advance amount noted above.

*Mortgage Loans Held for Portfolio.* All 12 FHLBanks have established or participate in acquired member asset mortgage purchase programs as services to their members. All of the

programs involve the investment by each FHLBank in loans either funded by the FHLBank through, or purchased directly from, PFIs, or participations in such loans acquired from other FHLBanks. The Finance Board authorized all of the FHLBanks to hold acquired member assets, such as assets acquired under the MPF Program developed by the FHLBank of Chicago and assets acquired under the MPP program developed by the FHLBanks of Cincinnati, Indianapolis and Seattle. In March 2005, the FHLBank of Seattle announced that it would exit its MPP by ceasing to enter into new master commitment contracts under the MPP. All of the FHLBanks except Cincinnati, Indianapolis and Seattle offer the MPF Program to their members. On October 6, 2006, the FHLBank of San Francisco announced that it would no longer offer new master commitments to purchase mortgage loans from its PFIs under the MPF Program. Under these programs, the FHLBank purchases/funds mortgage assets from or through members or housing associates, for which the members or housing associates continue to bear a portion of the credit risk. The mortgage loans purchased/funded under these programs may carry more credit risk than advances, even though the respective member or housing associate provides credit enhancement. The credit risk under these programs is managed as follows:

- *MPF Loans:* Credit losses on conventional MPF Loans not absorbed by the borrower's equity in the mortgaged property, property insurance or PMI (primary mortgage insurance issued by qualified companies for mortgage loans with loan-to-value ratios (LTVs) greater than 80% which covers all types of losses except those generally classified as special hazard losses) are allocated for each master commitment between the MPF FHLBank and PFI as follows:
  - First, to the MPF FHLBank, up to an agreed-upon amount, called a "First Loss Account" or "FLA."
  - Second, to the PFI under its credit enhancement obligation, losses for each Master Commitment in excess of the FLA, if any, up to the CE Amount. The CE Amount may consist of a direct liability of the PFI to pay credit losses up to a specified amount, a contractual obligation of the PFI to provide SMI or a combination of both. For a description of the CE Amount calculation see "MPF Program—Setting Credit Enhancement Levels."
  - Third, any remaining unallocated losses are absorbed by the MPF FHLBank.
- The FLA is structured by the MPF FHLBank as a memo account to track losses not covered by the credit enhancement amount provided by the PFI (or not yet recovered by the withholding of performance-based credit enhancement fees). The amount of the FLA varies by product. It may be set as a specified number of basis points of the outstanding principal balance of mortgage loans delivered by the PFI or it may initially be set at zero and grown on a monthly basis. The FLA is not a cash collateral account, and it does not give an MPF FHLBank any right/obligation to receive/pay cash or any other collateral, but rather it functions as a tracking mechanism for determining the point after which the PFI, in its role as credit enhancer, would be required to reimburse an MPF FHLBank under the credit enhancement amount for losses incurred. The PFI is paid a monthly credit enhancement fee for managing credit risk on the mortgage loans. In certain cases, the credit enhancement fees are performance-based, which provides incentive to the PFI to minimize credit losses on MPF Loans. These fees may be withheld to recover losses incurred by the MPF FHLBank for losses for each Master Commitment in excess of the FLA, if any, up to an agreed-upon amount (the credit enhancement amount) are covered by the PFI's credit enhancement obligation. The PFI's credit enhancement amount is sized using the MPF Program Methodology to equal the amount of losses in excess of, or including, the FLA (depending on the MPF product) that would need to be paid so that any losses in excess of the CE Amount and initial FLA would be equivalent to losses experienced by an investor in a "AA" rated mortgage-backed security. The PFI may procure SMI to cover losses equal to all or a portion of the credit enhancement amount (except that losses generally classified as

special hazard losses are covered by the portion of the credit enhancement amount covered by the PFI or by the MPF FHLBank and not by SMI).

- *MPP Loans:* At the time the underlying conventional loan is funded, a “Lender Risk Account” is established by the FHLBank for each PFI selling an MPP loan. The “second layer” of losses that exceed coverage of the PMI are absorbed by the Lender Risk Account of the respective PFI that originated the MPP loan. After five years, if the balance of the funds in the Lender Risk Account exceeds the required balance, the excess amounts are distributed to the PFI based on a step-schedule set forth in the master commitment contract that establishes the Lender Risk Account. Once an MPP loan has been outstanding for more than 11 years, a balance is not required to be maintained in the Lender Risk Account with respect to that loan. To cover losses that exceed the PMI and the balance in the Lender Risk Account, each PFI is required to provide SMI, adding an additional layer of credit support to the MPP loan. This insurance reduces the overall loss exposure to approximately 50 percent of the property value at the time of the loan origination, subject, in certain cases, to an aggregate stop-loss provision in the SMI policy. If any loss extends beyond the insurance coverage and the balance held in the Lender Risk Account, the FHLBank(s) holding the interest(s) in the affected MPP loan would be responsible for absorbing this remaining loss.

All of the FHLBanks participating in these programs have established appropriate loan loss allowances or have determined that no loan loss allowances are necessary. Management at each FHLBank believes that it has adequate policies and procedures in place to manage this credit risk appropriately. Neither the PFI credit enhancements nor the mortgage loans are rated. An FHLBank must hold risk-based capital against acquired member assets or pools of assets that have an implied credit rating less than double-A. The Finance Board’s acquired member asset rule specifies that assets must consist of either:

- whole loans eligible to secure advances (excluding mortgages above the conforming loan limit);
- whole loans secured by manufactured housing; or
- state and local housing finance agency bonds.

In addition, this rule mandates that the FHLBank must have a nexus with the member or housing associate. All pools of acquired member assets must have a credit-risk-sharing arrangement with a member, housing associate or third-party mortgage insurer that limits the credit-risk exposure of the FHLBank to no less than an investment-grade. The relevant credit-risk exposure must be determined by a formal rating or a comparable methodology. The Finance Board’s acquired member asset rule also applies to securities created by the MPF Shared Funding Program. All of the mortgage loans acquired under these programs that were not government-insured were credit-enhanced by members to a level at least equivalent to an investment-grade rating. FHLBanks that participate in these programs believe that credit risk exposure to loan servicers is minimal.

The following tables set out the geographic concentration of mortgage loans held for portfolio by the FHLBanks. By acquiring mortgage loans from various members under their MPF Program and MPP, the FHLBanks can mitigate geographic concentration risk. These tables show the geographic concentration on an aggregated basis for all 12 FHLBanks that purchase or fund loans under the MPF Program and MPP. As a result, the tables do not necessarily reflect the actual geographic concentration with respect to each individual FHLBank.

**Geographic Concentration of MPF Program (1) (2)**

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Midwest .....	32%	31%
Northeast .....	16%	16%
Southeast .....	20%	20%
Southwest .....	16%	16%
West .....	<u>16%</u>	<u>17%</u>
Total .....	<u>100%</u>	<u>100%</u>

**Geographic Concentration of MPP(1) (2)**

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Midwest .....	33%	32%
Northeast .....	12%	12%
Southeast .....	21%	21%
Southwest .....	16%	16%
West .....	<u>18%</u>	<u>19%</u>
Total .....	<u>100%</u>	<u>100%</u>

(1) Calculated percentage based on unpaid principal at the end of each period.

- (2) Midwest consists of IA, IL, IN, MI, MN, ND, NE, OH, SD and WI.  
 Northeast consists of CT, DE, MA, ME, NH, NJ, NY, PA, PR, RI, VI and VT.  
 Southeast consists of AL, DC, FL, GA, KY, MD, MS, NC, SC, TN, VA and WV.  
 Southwest consists of AR, AZ, CO, KS, LA, MO, NM, OK, TX and UT.  
 West consists of AK, CA, GU, HI, ID, MT, NV, OR, WA and WY.

The FHLBanks' MPF loans held for portfolio are dispersed across all 50 states, the District of Columbia and Puerto Rico. No single zip code represented more than one percent of MPF loans outstanding at December 31, 2006. The median size of an MPF loan was approximately \$115,000 at December 31, 2006. The MPF loan statistics have been compiled on a combined basis by aggregating each participating FHLBank's information and therefore do not reflect the concentration levels and mortgage loan portfolio information at individual participating FHLBanks.

The FHLBanks' MPP mortgage loans held for portfolio are dispersed across all 50 states and the District of Columbia. No single zip code accounted for more than one percent of MPP loans outstanding at December 31, 2006. The median size of an MPP loan was approximately \$137,000 at December 31, 2006. The MPP mortgage loan statistics have been compiled on a combined basis by aggregating each participating FHLBank's information and therefore do not reflect the concentration levels and mortgage loan portfolio information at individual participating FHLBanks.



The following table provides the weighted-average FICO® scores and weighted-average loan-to-value at origination for MPF loans and MPP loans outstanding at December 31, 2006 and 2005:

	2006		2005	
	MPF	MPP	MPF	MPP
Weighted-average FICO® score at origination(1) . . . . .	734	746	736	745
Weighted-average loan-to-value at origination . . . . .	68%	69%	67%	69%

(1) FICO® score is a widely-used credit industry model developed by Fair, Isaac and Company, Inc. to assess borrower credit quality with scores ranging from 150 to 950.

The MPF loan statistics were compiled and obtained from the FHLBank of Chicago and MPP mortgage loan statistics were compiled on a combining basis by aggregating each participating MPP FHLBank’s information; therefore, they do not reflect the weighted-average FICO® score and weighted-average loan-to-value at origination at individual participating FHLBanks.

*Derivatives and Counterparty Ratings.* In addition to market risk, each FHLBank is subject to credit risk because of the potential non-performance by counterparties to derivative agreements. The amount of counterparty risk on derivatives depends on the extent to which netting procedures and other credit enhancements are used to mitigate the risk. At December 31, 2006, five counterparties represented approximately 53 percent of the total notional amount of outstanding derivative transactions and each had a credit rating of single-A or better. For the year ended December 31, 2006, none of these counterparties represented more than 10 percent of the FHLBanks’ net exposure after collateral. Each FHLBank manages counterparty credit risk through credit analysis, collateral management and other credit enhancements. The FHLBanks are also required to follow the requirements set forth by Finance Board regulation. The FHLBanks require collateral on interest-rate exchange agreements. The amount of net unsecured credit exposure that is permissible with respect to each counterparty, before a collateral requirement is triggered, depends on the credit rating of that counterparty. A counterparty must deliver collateral to an FHLBank if the total market value of the FHLBank’s exposure to that counterparty rises above a specific trigger point. As a result of these risk mitigation initiatives, the management of each FHLBank does not anticipate any credit losses on its interest-rate exchange agreements.

The contractual or notional amount of interest-rate exchange agreements reflects the involvement of an FHLBank in the various classes of financial instruments. The maximum credit risk of an FHLBank with respect to interest-rate exchange agreements is the estimated cost of replacing favorable interest-rate swaps, forward agreements and purchased caps and floors if the counterparty defaults, *minus* the value of any related collateral. In determining maximum credit risk, the FHLBanks consider, with respect to each counterparty, accrued interest receivables and payables as well as the legal right to offset assets and liabilities.

**Derivative Counterparty Credit Exposure**  
**(Dollar amounts in millions)**  
**At December 31, 2006**

<u>Credit Rating*</u>	<u>Notional Amount</u>	<u>Total Net Exposure at Fair Value</u>	<u>Total Net Exposure Collateralized</u>	<u>Net Exposure After Collateral</u>
Triple-A .....	\$ 15,938	\$ 9	\$	\$ 9
Double-A .....	591,210	1,112	581	531
Single-A .....	299,505	483	385	98
Triple-B .....	9			
Unrated(1) .....	374	1	1	1
	<u>907,036</u>	<u>1,605</u>	<u>966</u>	<u>639</u>
Intermediaries(2) .....	1,189	22	22	
Delivery commitments .....	221	1	1	
Total derivatives .....	<u>\$908,446</u>	<u>\$1,628</u>	<u>\$989</u>	<u>\$639</u>

**At December 31, 2005**

<u>Credit Rating**</u>	<u>Notional Amount</u>	<u>Total Net Exposure at Fair Value</u>	<u>Total Net Exposure Collateralized</u>	<u>Net Exposure After Collateral</u>
Triple-A .....	\$ 20,613	\$ 8	\$ 7	\$ 1
Double-A .....	468,040	431	326	105
Single-A .....	327,666	455	366	89
Triple-B .....	5,504			
Unrated(1) .....	656			
	<u>822,479</u>	<u>894</u>	<u>699</u>	<u>195</u>
Intermediaries(2) .....	1,981	32	32	
Delivery commitments .....	194	1	1	
Total derivatives .....	<u>\$824,654</u>	<u>\$927</u>	<u>\$732</u>	<u>\$195</u>

\* This chart does not reflect changes in any rating, outlook or watch status after December 31, 2006. The ratings were obtained from S&P, Moody's and/or Fitch.

\*\* This chart does not reflect changes in any rating, outlook or watch status after December 31, 2005. The ratings were obtained from S&P, Moody's and/or Fitch.

- (1) Unrated counterparties represent broker-dealers utilized to purchase or sell forward contracts relating to TBA MBS to hedge the market value of commitments on fixed-rate mortgage loans. All broker-dealer counterparties are subjected to thorough credit review procedures in accordance with an FHLBank's risk management policy. There was \$1 million of exposure at December 31, 2006 and no exposure at December 31, 2005 related to these unrated counterparties.
- (2) Collateral held with respect to interest-rate exchange agreements with member institutions represents either collateral physically held by or on behalf of the FHLBank or collateral assigned to the FHLBank, as evidenced by a written security agreement, and held by the member institution for the benefit of that FHLBank.

Excluding fully collateralized interest-rate exchange agreements in which the FHLBanks are intermediaries for members, over 99.96 percent of the notional amount of the FHLBanks' outstanding interest-rate exchange agreements are with counterparties rated single-A or higher. At December 31, 2006, 30 counterparties represented 99.97 percent of the total notional amount of the FHLBanks' outstanding interest-rate exchange agreements excluding agreements in which the FHLBanks are intermediaries. Approximately 54 percent of these agreements are with 20 counterparties that are rated double-A or higher. Approximately 46 percent of these agreements are with 10 counterparties that are rated single-A.

## **OPERATIONAL RISK**

Operational risk is the risk of potential loss due to:

- human error;
- systems malfunctions;
- man-made or natural disasters;
- fraud; or
- circumvention or failure of internal controls.

The FHLBanks have established comprehensive systems of risk assessments, as well as financial and operating policies and procedures, to mitigate the likelihood of such occurrences and the potential for damage that could result from them. They have also instituted appropriate insurance coverage for such risks. The policies and procedures of the FHLBanks include controls to ensure that system-generated data are reconciled to source documentation on a regular basis. The internal audit department of each FHLBank, which reports directly to the audit committee of the individual FHLBank, regularly monitors compliance by the FHLBank with established policies and procedures. In addition, each FHLBank has a disaster recovery plan that is designed to restore critical business processes and systems in the event of disasters. Some of the operational risks of the FHLBanks, however, are beyond their control. Furthermore, the failure of other parties to address their operational risk adequately could adversely affect the FHLBanks.

## **BUSINESS RISK**

Business risk is the risk of an adverse effect on the profitability of an FHLBank as a result of external factors. These external factors may occur in both the short- and long-term. Business risk includes political, strategic, reputation and/or regulatory events that are beyond the control of the individual FHLBank. From time to time, proposals or changes in laws and regulations are made or considered, which could affect the status of the FHLBanks and their costs of doing business.

The board of directors and management of each FHLBank try to mitigate these business risks through long-term strategic planning and by continually monitoring economic indicators and their external environment.

*FHLBank Member Concentration Risk.* A number of FHLBanks also have member concentration risk. An FHLBank's financial strategies are generally designed to enable it to safely expand and contract its assets, liabilities and capital in response to changes in its member base and in its members' credit needs. An FHLBank's capital generally grows when members are required to purchase additional capital stock as they increase their advances borrowings or other business activities with their FHLBank. Some FHLBanks may also repurchase excess capital stock from members as business activities with the FHLBank decline. As a result of these strategies, the FHLBanks have been able to achieve their mission by meeting member credit needs and paying dividends while sometimes managing significant fluctuations in assets, liabilities and/or capital.

A number of FHLBanks have concentrations in advances and therefore analyze the implications for their financial management and profitability if they were to lose the advances business of one or more of these members.

If an FHLBank loses one or more large borrowers that represent a significant portion of its business, the FHLBank could, depending on the magnitude of the effect, compensate for the loss by lowering dividend rates, raising advances rates, attempting to reduce operating expenses, or by undertaking some combination of these actions. The magnitude of the effect would depend, in part, on the FHLBank's size and profitability at the time the institution ceases to be a borrower.

**FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Quarterly Results of Operations**

**Selected Quarterly Financial Data (Unaudited)**

**Statements of Income  
(Dollar amounts in millions)**

	<u>2006 Quarter Ended</u>			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
<b>Income Statement</b>				
Total interest income .....	\$11,360	\$12,261	\$13,404	\$13,542
Total interest expense .....	<u>10,317</u>	<u>11,192</u>	<u>12,319</u>	<u>12,446</u>
Net interest income .....	1,043	1,069	1,085	1,096
Provision (reversal) for credit losses .....	<u>1</u>	<u>          </u>	<u>(1)</u>	<u>(1)</u>
Net interest income after provision (reversal) for credit losses .....	<u>1,042</u>	<u>1,069</u>	<u>1,086</u>	<u>1,097</u>
Service fees .....	6	7	7	5
Net (losses) gains on trading securities .....	(148)	(105)	140	(14)
Net realized (losses) gains from sale of available-for-sale securities .....	(4)	1	(1)	1
Net realized losses from sale of held-to-maturity securities .....	<u>          </u>	<u>(2)</u>	<u>(4)</u>	<u>          </u>
Net gains (losses) on derivatives and hedging activities .....	128	92	(158)	21
Other, net .....	<u>4</u>	<u>7</u>	<u>13</u>	<u>7</u>
Total non-interest (loss) income .....	<u>(14)</u>	<u>          </u>	<u>(3)</u>	<u>20</u>
Operating .....	165	168	161	177
Finance Board and Office of Finance .....	15	15	14	13
Other .....	<u>4</u>	<u>7</u>	<u>2</u>	<u>2</u>
Total other expense .....	<u>184</u>	<u>190</u>	<u>177</u>	<u>192</u>
Affordable Housing Program .....	71	72	75	77
REFCORP. ....	<u>154</u>	<u>161</u>	<u>166</u>	<u>166</u>
Total assessments .....	<u>225</u>	<u>233</u>	<u>241</u>	<u>243</u>
Net income .....	<u>\$ 619</u>	<u>\$ 646</u>	<u>\$ 665</u>	<u>\$ 682</u>

	2005 Quarter Ended			
	March 31	June 30	September 30	December 31
<b>Income Statement</b>				
Total interest income .....	\$7,346	\$8,313	\$9,326	\$10,435
Total interest expense .....	6,293	7,291	8,291	9,339
Net interest income .....	1,053	1,022	1,035	1,096
Provision (reversal) for credit losses .....	1	—	—	(1)
Net interest income after provision (reversal) for credit losses .....	1,052	1,022	1,035	1,097
Service fees .....	4	8	9	6
Net (losses) gains on trading securities .....	(189)	196	(215)	(97)
Net realized (losses) gains from sale of available- for-sale securities .....	(2)	4	264	1
Net realized losses from sale of held-to-maturity securities .....	—	—	—	(1)
Net gains (losses) on derivatives and hedging activities .....	231	(681)	306	122
Other, net .....	(8)	4	7	(29)
Total non-interest income (loss) .....	36	(469)	371	2
Operating .....	150	159	154	194
Finance Board and Office of Finance .....	16	15	11	14
Other .....	3	6	5	2
Total other expense .....	169	180	170	210
Affordable Housing Program .....	75	34	100	73
REFCORP .....	173	64	226	162
Total assessments .....	248	98	326	235
Income before cumulative effect of change in accounting principles .....	671	275	910	654
Cumulative effect of change in accounting principles before assessments .....	15	—	—	—
Net income .....	<u>\$ 686</u>	<u>\$ 275</u>	<u>\$ 910</u>	<u>\$ 654</u>

#### **CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON COMBINED ACCOUNTING AND FINANCIAL DISCLOSURE**

There were no changes in accountants or disagreements with accountants in the period covered by this Combined Financial Report. See the Supplemental Information section of this report for the Audit Committee Charter relating to the combined financial reports and audit fees.

#### **DIRECTORS AND EXECUTIVE OFFICERS OF FHLBANKS**

*FHLBank Directors.* The FHLBank Act provides for a board of at least 14 directors to govern each FHLBank. The members of each FHLBank elect a majority of the FHLBank's directors, each of whom is elected for a three-year term. The FHLBank Act requires the Finance Board to appoint at least six directors to each FHLBank's board. Each appointed director is generally appointed for a three-year term; however, in late 2006 the Finance Board appointed two directors to the board of directors of each FHLBank to serve the final year of vacancies in three-year terms that would have

begun on January 1, 2005. Previously the Finance Board had not appointed directors to fill terms beginning in 2005 and 2006. According to the FHLBank Act, at least two of the directors of each FHLBank appointed by the Finance Board must come from organizations with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing, or financial consumer protections.

On March 27, 2007, the Finance Board adopted a final rule establishing procedures for the selection of appointed directors to the boards of the FHLBanks. Under the final rule, each FHLBank is responsible for identifying potential directors, conducting a preliminary assessment of their eligibility and qualifications, and sending up to two nominees for each of its vacant appointive directorships to the Finance Board for its consideration. The nominations must be accompanied by a completed eligibility form that demonstrates the qualifications of each nominee to serve on the board of an FHLBank. The Finance Board will review each nomination and decide whether to appoint directors from the submitted list of nominees. If the Finance Board declines to appoint any of the nominees, it may require the FHLBank to submit additional nominees for consideration.

The board of directors of each FHLBank has the responsibility to establish policies and programs that carry out the FHLBank's housing finance mission. Each board of directors adopts and reviews policies governing the FHLBank's credit, investment, and funding activities, and oversees the implementation of these policies. The directors also must adopt policies to manage the FHLBank's exposure to credit, liquidity, and interest-rate risk. In addition, each board of directors is responsible for monitoring that FHLBank's compliance with Finance Board regulations.

*Compensation of Directors.* The GLB Act limits the annual compensation of FHLBank directors. The Finance Board adjusts these compensation amounts based on the percentage annual increase in the Consumer Price Index. The compensation limits for 2006 were \$29,357 for a chair, \$23,486 for a vice chair and \$17,614 for all other directors.

In addition, the FHLBanks reimburse directors for necessary and reasonable travel, subsistence and other related expenses incurred in connection with their official duties.

*FHLBank President.* Each FHLBank president reports to the board of directors of the respective FHLBank. The responsibilities of the president include:

- management of the FHLBank;
- administration of the programs of the FHLBank; and
- compliance with the regulations and policies of the Finance Board.

Each FHLBank president participates in regular meetings with the presidents of the other FHLBanks.

(See "Supplemental Information—FHLBank Management and Compensation" for biographies.)

## **EXECUTIVE COMPENSATION**

See "Supplemental Information—FHLBank Management and Compensation" for the compensation of the FHLBank presidents and managing director of the Office of Finance.

## **SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS**

Each FHLBank is a cooperative. The members own all the stock of the FHLBanks, the majority of the directors of each FHLBank is elected by and from the membership, and the FHLBanks conduct their advances almost exclusively with members.



*Members.*

**Membership by Type of Member**

	<u>Commercial Banks</u>	<u>Thriffs</u>	<u>Credit Unions</u>	<u>Insurance Companies</u>	<u>Total</u>
December 31, 2002 .....	5,886	1,390	660	75	8,011
December 31, 2003 .....	5,946	1,344	729	82	8,101
December 31, 2004 .....	5,936	1,292	801	92	8,121
December 31, 2005 .....	5,916	1,276	846	111	8,149
December 31, 2006 .....	5,871	1,245	875	134	8,125

Membership in an FHLBank is voluntary. A member must give notice of its intent to withdraw. The GLB Act permits each FHLBank to issue one or more of two classes of stock, each with subclasses. Class A stock is redeemable on six months written notice from a member and Class B stock is redeemable on five years written notice from a member. Capital stock outstanding under the pre-GLB Act rules, which only applies to the FHLBank of Chicago at December 31, 2006, is redeemable at the option of a member upon six months notice if the member withdraws from the FHLBank. If a member withdraws its membership from an FHLBank, it may not acquire shares of any FHLBank for 5 years after the date on which its divestiture of capital stock is completed. This restriction does not apply if the member is transferring its membership from one FHLBank to another.

Between January 1, 1993 and December 31, 2006, 110 FHLBank members withdrew for reasons other than merger or acquisition. During 2006, 17 members gave notice to withdraw for reasons other than merger or acquisition. The affected FHLBanks do not expect these withdrawals to have a material adverse effect on their results of operations or financial condition.

**Regulatory Capital Stock Held by Type of Member  
(Dollar amounts in billions)**

	<u>Commercial Banks</u>	<u>Thriffs</u>	<u>Credit Unions</u>	<u>Insurance Companies</u>	<u>Other(1)</u>	<u>Total</u>
December 31, 2002 .....	\$18.4	\$13.8	\$1.2	\$0.5	\$1.3	\$35.2
December 31, 2003 .....	20.5	13.8	1.4	1.1	0.9	37.7
December 31, 2004(2) .....	19.5	17.4	1.8	1.6	0.9	41.2
December 31, 2005(2) .....	20.4	18.6	1.8	1.6	1.1	43.5
December 31, 2006(2) .....	23.1	15.6	1.9	1.6	0.9	43.1

(1) The other category includes capital stock of members involved in mergers with non-members. Advances to a member involved in a merger must be repaid before or at maturity, if the surviving institution is a non-member institution. Until these advances are repaid, the former member must continue to hold capital stock to support the advances.

(2) Includes mandatorily redeemable capital stock, which is considered capital for regulatory purposes.

The holdings of commercial bank members at December 31, 2006 represent 53.6 percent of the total regulatory capital stock of the FHLBanks. The regulatory capital stock held by thrift institution members at December 31, 2006 represented 36.2 percent of the total regulatory capital stock of the FHLBanks.

*Member Borrowers.*

**Member Borrowers**

	<u>Commercial Banks</u>	<u>Thriffs</u>	<u>Credit Unions</u>	<u>Insurance Companies</u>	<u>Total</u>
December 31, 2002 .....	4,144	1,001	217	37	5,399
December 31, 2003 .....	4,282	970	272	42	5,566
December 31, 2004 .....	4,492	962	328	43	5,825
December 31, 2005 .....	4,417	999	397	46	5,859
December 31, 2006 .....	4,245	954	414	50	5,663

The percentage of total members borrowing decreased to 69.7 percent at December 31, 2006, as compared to 71.9 percent at December 31, 2005. The 83 borrowers with advance holdings of \$1 billion or more at December 31, 2006, held 69.0 percent of total advances. The 92 borrowers with advance holdings of \$1 billion or more at December 31, 2005 held 66.7 percent of total advances.

**Advances  
(Dollar amounts in billions)**

	<u>Commercial Banks</u>	<u>Thriffs</u>	<u>Credit Unions</u>	<u>Insurance Companies</u>	<u>Other(1)</u>	<u>Total(2)</u>
December 31, 2002 .....	\$251.3	\$182.9	\$6.9	\$5.1	\$24.3	\$470.5
December 31, 2003 .....	274.0	192.5	9.1	8.0	18.0	501.6
December 31, 2004 .....	254.7	278.9	11.4	11.1	20.0	576.1
December 31, 2005 .....	270.0	307.8	14.6	11.5	16.5	620.4
December 31, 2006 .....	339.2	256.7	18.9	14.2	12.6	641.6

- (1) The other category includes advances to housing associates and members involved in mergers with a non-member. Advances to a member involved in a merger must be repaid before or at maturity, if the surviving institution is a non-member institution.
- (2) Total advance amounts are at par value and will not agree to the Statement of Condition. The differences between the par and book value amounts primarily relate to basis adjustments arising from hedges under SFAS 133 for book purposes.

**Top 10 Member Holding Advances  
at December 31, 2006  
(Dollar amounts in millions)**

The information presented on advances in the table is for individual FHLBank members. The data are not aggregated to the holding-company level. Some of the institutions listed are affiliates of the same holding company, and some of the institutions listed have affiliates that are members but that are not listed in the tables.

<u>Name</u>	<u>City</u>	<u>State</u>	<u>Advances(1)</u>	<u>Percentage of Total Advances</u>
Citibank, N.A.(2)	Las Vegas	NV	\$ 72,323	11.3%
Washington Mutual Bank(3) (4)	Henderson	NV	38,481	6.0%
Countrywide Bank, NA	Alexandria	VA	28,150	4.4%
World Savings Bank, FSB*(5)	Oakland	CA	22,846	3.6%
Sovereign Bank*(6)	Reading	PA	18,193	2.8%
World Savings Bank, FSB Texas(5)	Houston	TX	11,763	1.8%
Charter One Bank NA*(7)	Cleveland	OH	10,777	1.7%
IndyMac Bank, FSB	Pasadena	CA	10,413	1.6%
Bank of America Oregon, NA	Portland	OR	10,060	1.6%
Hudson City Savings Bank*	Paramus	NJ	8,873	1.4%
			<u>\$231,879</u>	<u>36.2%</u>

\* An asterisk indicates that an officer or director of the member was an FHLBank director in 2006.

- (1) Member advance amounts and the total advance amounts are at par value, and the total advance amount will not agree to the Statement of Condition. The difference between the par and book value amounts primarily relates to basis adjustments arising from hedges under SFAS 133 for book purposes.
- (2) On October 1, 2006, Citibank (West), FSB, (the FHLBank of San Francisco's member) was reorganized into its affiliate Citibank, N.A., and Citibank, N.A., assumed the outstanding advances of Citibank (West), FSB.
- (3) Includes \$3,513 million in FHLBank of Dallas advances from the acquisition of Bank United, a former member of the FHLBank of Dallas.
- (4) Includes \$104 million in FHLBank of New York advances from the acquisition of Dime Savings Bank of New York, FSB, a former member of the FHLBank of New York.
- (5) On October 1, 2006, Golden West Financial Corporation, the parent company of World Savings Bank, FSB (the FHLBank of San Francisco's member) and World Savings Bank, FSB Texas (the FHLBank of Dallas' member) merged with Wachovia Corporation. World Savings Bank, FSB, and World Savings Bank, FSB Texas have remained members of the FHLBanks of San Francisco and Dallas after the merger.
- (6) Includes \$146 million in FHLBank of Boston advances from acquisition of former members of the FHLBank of Boston.
- (7) Includes \$5 million in FHLBank of Indianapolis advances from acquisition of former member of the FHLBank of Indianapolis.

For information on the top five largest borrowers by each FHLBank at December 31, 2006, please refer to "Supplemental Information—Five Largest Regulatory Capital Stockholders of and Borrowers from Each FHLBank."

*Housing Associates.* At year-end 2006, the FHLBanks had \$131 million in advances outstanding to 16 housing associates, down from \$619 million at year-end 2005. Housing associates eligible to borrow include 42 state housing finance agencies, 10 county housing finance agencies, 3 city housing authorities, 3 housing development corporations, and 1 tribal housing corporation.

## **CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Each FHLBank is a member-owned cooperative, whose members elect a majority of that FHLBank's directors from among the members. The FHLBanks conduct their advances and mortgage loan business almost exclusively with members. As a result, in the normal course of business, the FHLBanks regularly extend credit to members whose officers and directors may serve as directors of the FHLBanks. This credit is extended on market terms that are no more favorable to these "related" members than comparable transactions with other members of the same FHLBank. As of December 31, 2006, the FHLBanks had \$98.6 billion of advances outstanding to members whose officers were serving as directors of the FHLBanks. This amounted to 15.4 percent of total advances at par.

An FHLBank may also purchase short-term investments, Federal funds and mortgage-backed securities from members. All investments are market rate transactions and all mortgage-backed securities are purchased through securities brokers or dealers.

**FEDERAL HOME LOAN BANKS  
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## AUDIT COMMITTEE REPORT

By Finance Board regulation, the Office of Finance (OF) Board performs the duties of an audit committee in connection with the oversight of the preparation of the Federal Home Loan Banks' (FHLBanks) annual combined financial report. The OF Board is appointed by the Finance Board and is comprised of two FHLBank presidents and an appointee with demonstrated expertise in financial markets. The outside director was appointed to serve in September 2003. In connection with its duties as an audit committee, the OF Board has adopted a written charter, which is presented on page 255. The OF Board members are not required to satisfy any express qualification or independence standards governing their service as an "audit committee;" however, each FHLBank's board of directors has established an audit committee, the members of which are required to meet express qualification and independence standards established by the Finance Board. (See "Explanatory Statement about FHLBanks Combined Financial Report.")

The OF Board has reviewed and discussed the audited financial statements with senior management of the Office of Finance, and discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, as amended.

The OF Board has also received the written disclosures and the letter from the independent auditors required by Independence Standards Board Standard No. 1, and has discussed with the independent auditors the independent auditors' independence.

Based on the review and discussions referred to above, the OF Board decided to include the combined audited financial statements in the FHLBanks' 2006 Combined Financial Report.

Terry Smith, Chair  
L. Parker Harrell, Jr.  
David Hehman  
March 29, 2007



## REPORT OF INDEPENDENT AUDITORS

To the Shareholders of the Federal Home Loan Banks and  
The Board of Directors of the Federal Home Loan Banks Office of Finance:

In our opinion, the accompanying combined statements of condition and the related combined statements of income, capital and of cash flows shown on pages 120 to 183 present fairly, in all material respects, the combined financial position of the Federal Home Loan Banks (the "FHLBanks") at December 31, 2006 and 2005 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. These combined financial statements are the responsibility of the management of the Office of Finance and the FHLBanks. Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, certain FHLBanks changed their method of accounting for amortization of deferred loan origination fees and premiums and discounts paid to and received on mortgage loans under Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

Our audits were made for the purpose of forming an opinion on the combined financial statements taken as a whole; we have also audited each of the individual FHLBank financial statements. The combining information shown on pages 184 to 217 is presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual FHLBanks. However, the combining information has been subjected to the auditing procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.



McLean, Virginia  
March 30, 2007

**FEDERAL HOME LOAN BANKS**  
**COMBINED STATEMENT OF CONDITION**

(Dollar amounts in millions and capital stock shares in thousands)

	<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>ASSETS</b>		
Cash and due from banks (Note 3) .....	\$ 330	\$ 356
Interest-bearing deposits .....	33,872	35,342
Securities purchased under agreements to resell (Note 4) .....	4,905	3,295
Federal funds sold .....	77,056	80,557
Trading securities includes \$522 and \$1,738 pledged as collateral in 2006 and 2005 that may be repledged (Note 5) .....	5,687	7,181
Available-for-sale securities includes \$1,382 and \$1,109 pledged as collateral in 2006 and 2005 that may be repledged(a) (Note 6) .....	6,661	5,599
Held-to-maturity securities includes \$580 and \$1,593 pledged as collateral in 2006 and 2005 that may be repledged(b) (Note 7) .....	142,482	134,480
Advances (Note 8) .....	640,681	619,860
Mortgage loans held for portfolio .....	97,981	105,250
Less: allowance for credit losses on mortgage loans .....	7	10
Mortgage loans held for portfolio, net (Note 11) .....	97,974	105,240
Accrued interest receivable .....	4,344	3,721
Premises, software, and equipment, net .....	217	200
Derivative assets (Note 18) .....	1,626	945
Other assets .....	634	613
Total assets .....	\$1,016,469	\$997,389
<b>LIABILITIES</b>		
Deposits (Note 12):		
Interest-bearing .....	\$ 18,748	\$ 18,935
Non-interest-bearing .....	224	229
Total deposits .....	18,972	19,164
Borrowings (Note 13):		
Securities sold under agreements to repurchase .....	2,200	2,594
Total borrowings .....	2,200	2,594
Consolidated obligations, net (Note 14):		
Discount notes .....	157,549	179,694
Bonds .....	776,665	736,207
Total consolidated obligations, net .....	934,214	915,901
Subordinated notes (Note 15) .....	1,000	
Mandatorily redeemable capital stock (Note 16) .....	1,094	1,451
Accrued interest payable .....	8,549	6,315
Affordable Housing Program (Note 9) .....	805	739
Payable to REFCORP (Note 10) .....	165	197
Derivative liabilities (Note 18) .....	2,886	5,875
Other liabilities .....	1,599	673
Total liabilities .....	971,484	952,909
Commitments and contingencies (Notes 20 and 21)		
<b>CAPITAL (Note 16)</b>		
Capital Stock:		
Capital stock Class B putable (\$100 par value) issued and outstanding shares: 388,819 shares in 2006 and 377,871 shares in 2005 .....	38,882	37,786
Capital stock Class A putable (\$100 par value) issued and outstanding shares: 5,323 shares in 2006 and 4,978 shares in 2005 .....	532	498
Capital stock Pre-conversion putable (\$100 par value) issued and outstanding shares: 25,870 shares in 2006 and 37,589 shares in 2005 .....	2,587	3,759
Total capital stock .....	42,001	42,043
Retained earnings .....	3,143	2,600
Accumulated other comprehensive income:		
Net unrealized losses on available-for-sale securities (Note 6) .....	(8)	(6)
Net unrealized losses relating to hedging activities (Note 18) .....	(114)	(145)
Other (Note 17) .....	(37)	(12)
Total capital .....	44,985	44,480
Total liabilities and capital .....	\$1,016,469	\$997,389

(a) Amortized cost: \$6,669 and \$5,606 at December 31, 2006 and 2005.

(b) Fair values: \$140,980 and \$132,879 at December 31, 2006 and 2005.

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

**FEDERAL HOME LOAN BANKS**  
**COMBINED STATEMENT OF INCOME**  
(Dollar amounts in millions)

	For the Years Ended December 31,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
<b>INTEREST INCOME</b>			
Advances .....	\$32,411	\$20,782	\$ 9,995
Prepayment fees on advances, net .....	44	75	184
Interest-bearing deposits .....	1,777	830	313
Securities purchased under agreements to resell .....	197	115	54
Federal funds sold .....	3,456	1,915	625
Trading securities .....	365	438	444
Available-for-sale securities .....	298	346	286
Held-to-maturity securities .....	6,859	5,497	4,483
Mortgage loans held for portfolio .....	5,155	5,416	5,535
Other .....	5	6	6
Total interest income .....	<u>50,567</u>	<u>35,420</u>	<u>21,925</u>
<b>INTEREST EXPENSE</b>			
Consolidated obligations—Discount notes .....	7,873	5,309	2,207
Consolidated obligations—Bonds .....	37,341	25,207	15,233
Deposits .....	813	523	230
Securities sold under agreements to repurchase .....	152	123	57
Subordinated notes .....	31		
Mandatorily redeemable capital stock .....	60	48	22
Other borrowings .....	4	3	5
Total interest expense .....	<u>46,274</u>	<u>31,213</u>	<u>17,754</u>
<b>NET INTEREST INCOME</b> .....	4,293	4,207	4,171
(Reversal) provision for credit losses .....	<u>(1)</u>	<u>1</u>	<u>(5)</u>
<b>NET INTEREST INCOME AFTER (REVERSAL) PROVISION FOR CREDIT LOSSES</b> .....	<u>4,294</u>	<u>4,206</u>	<u>4,176</u>
<b>OTHER INCOME (LOSS)</b>			
Service fees .....	25	27	27
Net losses on trading securities .....	(127)	(304)	(106)
Net realized (losses) gains from sale of available-for-sale securities .....	(3)	267	(17)
Net realized (losses) gains from sale of held-to-maturity securities .....	(6)	(1)	13
Net gains (losses) on derivatives and hedging activities .....	83	(23)	(784)
Other, net .....	31	(26)	(23)
Total other income (loss) .....	<u>3</u>	<u>(60)</u>	<u>(890)</u>
<b>OTHER EXPENSE</b>			
Operating .....	671	657	546
Finance Board .....	32	32	26
Office of Finance .....	25	24	20
Other .....	15	16	20
Total other expense .....	<u>743</u>	<u>729</u>	<u>612</u>
<b>INCOME BEFORE ASSESSMENTS</b> .....	<u>3,554</u>	<u>3,417</u>	<u>2,674</u>
Affordable Housing Program .....	295	282	225
REFCORP .....	647	625	505
Total assessments .....	<u>942</u>	<u>907</u>	<u>730</u>
<b>INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLES</b> .....	2,612	2,510	1,944
Cumulative effect of change in accounting principles before assessments (Note 2) .....		15	50
<b>NET INCOME</b> .....	<u>\$ 2,612</u>	<u>\$ 2,525</u>	<u>\$ 1,994</u>

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

**FEDERAL HOME LOAN BANKS**  
**COMBINED STATEMENT OF CAPITAL**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**  
**(Dollar amounts and shares in millions)**

	Capital Stock Class B*		Capital Stock Class A*		Capital Stock Pre-conversion*		Total Capital Stock*		Retained Earnings	Accumulated Other Comprehensive Income	Total Capital
	Shares	Par Value	Shares	Par Value	Shares	Par Value	Shares	Par Value			
<b>BALANCE, DECEMBER 31, 2003</b>									\$1,098	\$ 179	\$38,980
Proceeds from sale of capital stock	150	\$15,082			225	\$22,621	375	\$37,703			17,637
Repurchase/redemption of capital stock	99	9,976	5		78	7,656	177	17,637			(12,618)
Net shares reclassified to mandatorily redeemable capital stock	(77)	(7,715)			(49)	(4,903)	(126)	(12,618)			(3,579)
Comprehensive income:	(19)	(1,883)			(16)	(1,696)	(35)	(3,579)			
Net income									1,994		1,994
Other comprehensive income:											
Net unrealized gains on available-for-sale securities										5	5
Reclassification adjustment for losses included in net income relating to available-for-sale securities										18	18
Net unrealized losses relating to hedging activities										(218)	(218)
Reclassification adjustment for losses included in net income relating to hedging activities										46	46
Other										(3)	(3)
Total comprehensive income											1,842
Conversion to Class B or Class A shares	159	15,778	3	321	(162)	(16,099)					
Dividends on capital stock:											
Cash											(398)
Stock	6	581			4	368	10	949			(1)
<b>BALANCE, DECEMBER 31, 2004</b>									1,744	27	41,863
Proceeds from sale of capital stock	318	31,819	3	326	80	7,947	401	40,092			20,961
Repurchase/redemption of capital stock	175	17,622	7		32	3,332	207	20,961			(17,098)
Net shares reclassified to mandatorily redeemable capital stock	(148)	(14,799)			(23)	(2,299)	(171)	(17,098)			(2,899)
Comprehensive income:	(14)	(1,382)	2	165	(16)	(1,682)	(28)	(2,899)			
Net income									2,525		2,525
Other comprehensive income:											
Net unrealized gains on available-for-sale securities										65	65
Reclassification adjustment for gains included in net income relating to available-for-sale securities										(267)	(267)
Net unrealized gains relating to hedging activities										20	20
Reclassification adjustment for gains included in net income relating to hedging activities										(7)	(7)
Other										(1)	(1)
Total comprehensive income											2,335
Conversion to Class B or Class A shares	37	3,747			(37)	(3,747)					
Dividends on capital stock:											
Cash											(677)
Stock	9	779			2	208	11	987			(5)
<b>BALANCE, DECEMBER 31, 2005</b>	377	37,786	5	498	38	3,759	420	42,043	2,600	(163)	44,480

	Capital Stock Class B*		Capital Stock Class A*		Capital Stock Pre-conversion*		Total Capital Stock*		Retained Earnings	Accumulated Other Comprehensive Income	Total Capital	
	Shares	Par Value	Shares	Par Value	Shares	Par Value	Shares	Par Value				
Proceeds from sale of capital stock	185	18,372	6		34		185	18,412			18,412	
Repurchase/redemption of capital stock	(168)	(16,826)					(168)	(16,826)			(16,826)	
Net shares reclassified to mandatorily redeemable capital stock	(14)	(1,400)	28		(12)	(1,206)	(26)	(2,578)			(2,578)	
Comprehensive income:												
Net income									2,612		2,612	
Other comprehensive income:												
Net unrealized losses on available-for-sale securities									(4)	(4)	(4)	
Reclassification adjustment for losses included in net income relating to available-for-sale securities									2	2	2	
Net unrealized gains relating to hedging activities									31	31	31	
Reclassification adjustment for gains included in net income relating to hedging activities									2	2	2	
Other												
Total comprehensive income									(27)	(27)	2,643	
Adjustment to initially apply SFAS 158											(27)	
Conversion to Class B or Class A shares												
Dividends on capital stock:												
Cash	9	950					9	950			(1,122)	
Stock	389	\$38,882	5	\$532	26	\$ 2,587	420	\$42,001	(947)		3	
<b>BALANCE, DECEMBER 31, 2006</b>												\$44,985

\* Puttable

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

**FEDERAL HOME LOAN BANKS**  
**COMBINED STATEMENT OF CASH FLOWS**  
(Dollar amounts in millions)

	For the Years Ended December 31,		
	2006	2005	2004
<b>OPERATING ACTIVITIES</b>			
Net income . . . . .	\$ 2,612	\$ 2,525	\$ 1,994
Cumulative effect of change in accounting principles before assessments . . . . .		(15)	(50)
Income before cumulative effect of change in accounting principles . . . . .	<u>2,612</u>	<u>2,510</u>	<u>1,944</u>
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization . . . . .	564	610	1,044
Change in net fair value adjustment on derivative and hedging activities . . . . .	(637)	(768)	(436)
Other adjustments . . . . .	27	(194)	46
Net change in:			
Trading securities . . . . .	1,114	1,098	(212)
Accrued interest receivable . . . . .	(621)	(898)	(258)
Other assets . . . . .	(73)	(70)	(56)
Accrued interest payable . . . . .	2,231	1,491	263
Other liabilities* . . . . .	<u>71</u>	<u>217</u>	<u>97</u>
Total adjustments . . . . .	<u>2,676</u>	<u>1,486</u>	<u>488</u>
Net cash provided by operating activities . . . . .	<u>5,288</u>	<u>3,996</u>	<u>2,432</u>
<b>INVESTING ACTIVITIES</b>			
Net change in:			
Interest-bearing deposits . . . . .	1,470	(12,053)	(6,541)
Securities purchased under agreements to resell . . . . .	(1,610)	(400)	3,529
Federal funds sold . . . . .	3,502	(25,960)	(17,933)
Principal collected on other loans . . . . .	1	1	1
Premises, software and equipment . . . . .	(63)	(59)	(52)
Available-for-sale securities:			
Proceeds . . . . .	111,513	106,274	75,899
Purchases . . . . .	(112,557)	(99,510)	(77,042)
Held-to-maturity securities:			
Net increase in short-term . . . . .	(2,177)	(1,299)	(1,253)
Proceeds from long-term . . . . .	27,088	36,131	37,935
Purchases of long-term . . . . .	(31,918)	(45,844)	(49,989)
Advances:			
Proceeds . . . . .	7,263,818	8,329,280	7,448,849
Made . . . . .	(7,284,995)	(8,373,590)	(7,523,030)
Mortgage loans held for portfolio:			
Principal collected . . . . .	13,470	23,171	23,571
Purchases . . . . .	(6,262)	(14,741)	(24,373)
Proceeds from sales of foreclosed assets . . . . .	<u>59</u>	<u>61</u>	<u>75</u>
Net cash used in investing activities . . . . .	<u>(18,661)</u>	<u>(78,538)</u>	<u>(110,354)</u>



	<b>For the Years Ended December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>FINANCING ACTIVITIES</b>			
Net change in:			
Deposits and pass-through reserves . . . . .	\$ (301)	\$ 733	\$ (2,194)
Borrowings . . . . .	(282)	(295)	76
Net proceeds from issuance of consolidated obligations:			
Discount notes . . . . .	7,038,245	7,378,761	6,139,744
Bonds . . . . .	323,228	296,094	385,004
Payments for maturing and retiring consolidated obligations:			
Discount notes . . . . .	(7,060,638)	(7,367,338)	(6,135,715)
Bonds . . . . .	(285,365)	(234,075)	(281,305)
Net proceeds from issuance of subordinated notes . . . . .	994		
Proceeds from issuance of capital stock . . . . .	18,412	20,961	17,637
Payments for redemption of mandatorily redeemable capital stock . . . . .	(2,965)	(2,632)	(2,455)
Payments for repurchase/redemption of capital stock . . . . .	(16,826)	(16,989)	(12,597)
Cash dividends paid . . . . .	(1,155)	(642)	(380)
Net cash provided by financing activities . . . . .	<u>13,347</u>	<u>74,578</u>	<u>107,815</u>
Net (decrease) increase in cash and cash equivalents . . . . .	(26)	36	(107)
Cash and cash equivalents at beginning of the year . . . . .	356	320	427
Cash and cash equivalents at end of the year . . . . .	<u>\$ 330</u>	<u>\$ 356</u>	<u>\$ 320</u>
<b>Supplemental Disclosures:</b>			
Interest paid . . . . .	<u>\$ 39,999</u>	<u>\$ 26,903</u>	<u>\$ 16,430</u>
AHP payments, net . . . . .	<u>\$ 226</u>	<u>\$ 209</u>	<u>\$ 215</u>
REFCORP assessments paid . . . . .	<u>\$ 675</u>	<u>\$ 535</u>	<u>\$ 428</u>

\* Other liabilities includes the net change in the REFCORP receivable/payable.

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

## Federal Home Loan Banks

### Notes to Combined Financial Statements

#### Background Information

These financial statements present the combined financial position and results of operations of the 12 Federal Home Loan Banks (FHLBanks). The FHLBanks and the Federal Home Loan Banks' Office of Finance (Office of Finance) are regulated by the Federal Housing Finance Board (Finance Board). The FHLBanks serve the public by enhancing the availability of credit for residential mortgages and targeted community development. They provide a readily available, competitively-priced source of funds to their member institutions. The FHLBanks are cooperatives whose member institutions own nearly all of the capital stock of each FHLBank. Former members own the remaining capital stock to support business transactions still carried on the FHLBanks' Statement of Condition. All holders of an FHLBank's capital stock are entitled to receive dividends on their capital stock, to the extent declared by the FHLBank's board of directors. Regulated financial depositories and insurance companies engaged in residential housing finance may apply for membership. All members must purchase stock in their district's FHLBank.

The Finance Board, an independent agency in the executive branch of the U.S. government, supervises and regulates the FHLBanks and the Office of Finance. The Finance Board's principal purpose is to ensure that the FHLBanks operate in a safe and sound manner. In addition, the Finance Board ensures that the FHLBanks carry out their housing finance mission, remain adequately capitalized, and are able to raise funds in the capital markets. Also, the Finance Board establishes policies and regulations governing the operations of the FHLBanks. Each FHLBank operates as a separate entity with its own management, employees and board of directors. The FHLBanks do not have any special purpose entities or any other type of off-balance sheet conduits.

The FHLBanks' debt instruments, known as consolidated obligations, are the joint and several obligations of all 12 FHLBanks and are the primary source of funds for the FHLBanks. Deposits, other borrowings and capital stock issued to members provide other funds. Each FHLBank primarily uses these funds to provide advances to members and to purchase loans from members through its Mortgage Purchase Program (MPP)/Mortgage Purchase Finance (MPF®) Program(1). Some FHLBanks also offer their member institutions correspondent services, such as wire transfer, security safekeeping, and settlement services.

#### Note 1—Summary of Significant Accounting Policies

*Principles of Combination.* The combined financial statements include the financial records of the 12 FHLBanks. Material transactions among the FHLBanks have been eliminated in accordance with combination accounting principles under U.S. generally accepted accounting principles (GAAP), including Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. The significant transactions of this sort between the FHLBanks are: 1) transfers of direct liability on bonds between FHLBanks—consolidated obligations issued on behalf of one FHLBank and transferred to and assumed by another FHLBank and 2) purchases of bonds—consolidated obligations issued on behalf of one FHLBank and purchased by another FHLBank in the open market.

*Transfers of Direct Liability on Bonds Between FHLBanks.* The transferring FHLBank treats the transfer as a debt extinguishment as the transferring FHLBank has been released from being the primary obligor. Specifically, the release is made effective by the Office of Finance recording the transfer in its records. The Office of Finance provides release by acting within the confines of the Finance Board regulations that govern the determination of which FHLBank is the primary obligor. The assuming FHLBank becomes the primary obligor because it now is directly responsible for

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(1) "Mortgage Partnership Finance," "MPF," "MPF Shared Funding" and "eMPF" are registered trademarks of the FHLBank of Chicago.

repaying the debt. The transferring FHLBank continues to disclose the transferred debt as a contingent liability because it still has a joint and several liability with respect to repaying the transferred consolidated obligation.

The FHLBank assuming the consolidated bond liability accounts for the bond at its historical cost with the initial carrying amount being the amount paid to the transferring FHLBank by the assuming FHLBank in exchange for the assumption, including any premium or discount. There have not been any transactions with a third party independent of the FHLBanks under the transfer scenario. Therefore, under combination accounting principles, combining adjustments are required to reflect the transaction as if the transferring FHLBank still held the bond for purposes of the FHLBanks' combined financial statements. The debt extinguishment transaction, including any gain or loss, is eliminated, all balance sheet and income statement effects related to the assuming FHLBank's premium or discount related to the purchase of the bonds are eliminated and the transferring FHLBank's original premium or discount, concession fees and SFAS 133 basis adjustments are reinstated and amortized over the life of the bond.

*Purchases of Bonds.* All purchase transactions occur at market prices with third parties, and the purchasing FHLBanks treat these bonds as investments. Under combination accounting principles, the investment and the bonds and related interest income and expense are eliminated in combination.

No other transactions among the FHLBanks have a material effect on operating results.

*Segment Reporting.* For the purposes of Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Finance Board regulations consider each FHLBank to be a segment.

*Basis of Presentation and Use of Estimates.* The FHLBanks' accounting and financial reporting policies conform to GAAP. The preparation of financial statements in accordance with GAAP requires each FHLBank's management to make subjective assumptions and estimates that may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expense. The most significant of these estimates includes the fair value of derivatives. Actual results could differ from these estimates significantly.

Additionally, the preparation of combined financial statements in accordance with GAAP requires management to make subjective assumptions and estimates that may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expense. The most significant of these estimates includes the fair value of derivatives. Actual results could differ from these estimates significantly.

The following summary of significant accounting policies has been compiled from the 12 FHLBanks' individual summaries of significant accounting policies. While the 12 FHLBanks' accounting and financial reporting policies are not necessarily always the same, each FHLBank is responsible for establishing its own accounting and financial reporting policies in accordance with GAAP. The following paragraphs describe the more significant accounting policies followed by the FHLBanks, including the more notable GAAP differences.

*Interest-Bearing Deposits in Banks, Securities Purchased Under Agreements to Resell, and Federal Funds Sold.* These investments provide short-term liquidity and are carried at cost. The FHLBanks treat securities purchased under agreements to resell as collateralized financings.

*Investment Securities.* The FHLBanks carry, at cost, investments for which they have both the ability and intent to hold to maturity, adjusted for periodic principal repayments, amortization of premiums and accretion of discounts. Amortization of premiums and accretion of discounts are computed using a level-yield methodology.

The FHLBanks classify certain investments acquired for purposes of liquidity and asset/liability management as trading and carry them at fair value. The FHLBanks record changes in the fair value of these investments through other income. However, the FHLBanks do not

participate in speculative trading practices and hold these investments indefinitely as each FHLBank's management periodically evaluates its liquidity needs.

The FHLBanks classify investments that they may sell before maturity as available-for-sale and carry them at fair value. The change in value of the available-for-sale securities not being hedged by derivative instruments is recorded in other comprehensive income as net unrealized gains or losses on available-for-sale securities. For available-for-sale securities that have been hedged and qualify as a fair-value hedge, the FHLBanks record the portion of the change in value related to the risk being hedged in other income as "Net gains (losses) on derivatives and hedging activities" together with the related change in the fair value of the derivative, and record the remainder of the change in other comprehensive income as "Net unrealized gains (losses) on available-for-sale securities." For available-for-sale securities that have been hedged and qualify as a cash-flow hedge, the FHLBanks record the effective portion of the change in value of the derivative related to the risk being hedged in other comprehensive income as "Net unrealized gains (losses) relating to hedging activities." The ineffective portion is recorded in other income and presented as "Net gains (losses) on derivatives and hedging activities."

Under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115), changes in circumstances may cause an FHLBank to change its intent to hold a certain security to maturity without calling into question its intent to hold other debt securities to maturity in the future. Thus, the sale or transfer of a held-to-maturity security due to certain changes in circumstances, such as evidence of significant deterioration in the issuer's creditworthiness or changes in regulatory requirements, is not considered to be inconsistent with its original classification. Other events that are isolated, nonrecurring, and unusual for the FHLBanks that could not have been reasonably anticipated may cause an FHLBank to sell or transfer a held-to-maturity security without necessarily calling into question its intent to hold other debt securities to maturity.

In addition, in accordance with SFAS 115, sales of debt securities that meet either of the following two conditions may be considered as maturities for purposes of the classification of securities: 1) the sale occurs near enough to its maturity date (or call date if exercise of the call is probable) that interest-rate risk is substantially eliminated as a pricing factor and the changes in market interest rates would not have a significant effect on the security's fair value, or 2) the sale of a security occurs after the FHLBank has already collected a substantial portion (at least 85 percent) of the principal outstanding at acquisition due either to prepayments on the debt security or to scheduled payments on a debt security payable in equal installments (both principal and interest) over its term.

The FHLBanks compute the amortization and accretion of premiums and discounts on mortgage-backed securities using either the contractual method or the retrospective method over the estimated cash flows of the securities. As discussed in Note 2, the contractual method recognizes the income effects of premiums and discounts over the contractual life of the securities based on the actual behavior of the underlying assets and reflects the contractual terms of the securities without regard to changes in estimated prepayments based on assumptions about future borrower behavior. The retrospective method requires that an FHLBank estimate prepayments over the estimated life of the securities and make a retrospective adjustment of the effective yield each time that FHLBank changes the estimated life as if the new estimate had been known since the original acquisition date of the securities.

The FHLBanks compute the amortization and accretion of premiums and discounts on other investments using a level-yield methodology.

The FHLBanks compute gains and losses on sales of investment securities using the specific identification method and include these gains and losses in other income.

Each FHLBank regularly evaluates outstanding investments for changes in fair value and records impairment when a decline in fair value is deemed to be other than temporary. An

investment is deemed impaired if the fair value of the investment is less than its amortized cost. After the investment is determined to be impaired, an FHLBank evaluates whether this decline in value is other than temporary. When evaluating whether the impairment is other than temporary, an FHLBank takes into consideration whether or not it is going to receive all of the investment's contractual cash flows and the FHLBank's intent and ability to hold the investment for a sufficient amount of time to recover the unrealized losses. In addition, an FHLBank considers issuer or collateral specific factors, such as rating agency actions and its business and financial outlook. An FHLBank also evaluates broader industry and sector performance indicators.

If there is an other-than-temporary impairment in the value of an investment, the decline in value is recognized as a loss and presented in the Statement of Income as other expense. The FHLBanks have not experienced any other-than-temporary impairment in the value of their investments during 2006, 2005 or 2004.

*Advances.* The FHLBanks present advances (loans to members) net of unearned commitment fees and discounts on advances for the Affordable Housing Program (AHP), as discussed below. The FHLBanks amortize the premiums and accrete the discounts on advances to interest income using a level-yield methodology. The FHLBanks credit interest on advances to income as earned. Following the requirements of the Federal Home Loan Bank Act of 1932 (FHLBank Act) as amended, each FHLBank obtains sufficient collateral on advances to protect it from losses. The FHLBank Act limits eligible collateral to certain investment securities, residential mortgage loans, cash or deposits with the FHLBanks, and other eligible real estate-related assets. As Note 8 more fully describes, community financial institutions (FDIC-insured institutions with average assets over the preceding three-year period of \$587 million or less during 2006) are eligible to utilize expanded statutory collateral rules that include small business and agricultural loans, and securities representing a whole interest in such secured loans. The FHLBanks have not incurred any credit losses on advances since their inception. Each FHLBank evaluates the creditworthiness of its members and non-member borrowers on an ongoing basis and classifies as impaired any advance with respect to which management believes it is probable that all principal and interest due will not be collected according to its contractual terms. Impaired advances are valued using the present value of expected future cash flows discounted at the advance's effective interest rate, the advance's observable market price or, if collateral dependent, the fair value of the advance's underlying collateral. When an advance is classified as impaired, the accrual of interest is discontinued and unpaid accrued interest is reversed. Advances do not return to accrual status until brought current with respect to both principal and interest and if management believes future principal payments are no longer in doubt. Based upon the collateral held as security for its advances and the repayment history of the FHLBanks' advances, management of each FHLBank believes that an allowance for credit losses on its advances is unnecessary.

*Mortgage Loans Held for Portfolio.* All 12 FHLBanks have established member mortgage purchase asset programs as services to their members. The programs involve the investment by an FHLBank in loans created or acquired by members. The Finance Board authorized all of the FHLBanks to hold acquired member assets, such as assets acquired under the MPF Program developed by the FHLBank of Chicago and the MPP developed by the FHLBanks of Cincinnati, Indianapolis and Seattle. However, in March 2005, the FHLBank of Seattle announced it is exiting from its MPP. Exiting the MPP is intended to enable the FHLBank of Seattle to lower its overall risk profile and reduce its operating cost structure. On October 6, 2006, the FHLBank of San Francisco announced that it would no longer offer new commitments to purchase mortgage loans from its PFIs under the MPF Program.

Under these programs, an FHLBank invests in government (mortgage loans insured or guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, the Rural Housing Service of the Department of Agriculture (RHS) and/or the Department of Housing and Urban Development (HUD)) and conventional residential mortgage loans, which are either funded by the FHLBank, purchased from its participating members, or participations in pools of eligible mortgage loans purchased from other FHLBanks. The FHLBank manages the liquidity and



interest-rate risk, and optionality of the loans, while its participating members either retain or release the marketing and servicing activities. If participating in the servicing released program, the member concurrently sells the servicing of the mortgage loans to a designated mortgage service provider. The FHLBank and its participating members share the credit risk on the conventional loans. The member assumes credit losses up to a contractually specified credit enhancement obligation amount. (See “Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations—Risk Management—Credit Risk—Managing Credit Risk—Mortgage Loans Held for Portfolio” for further discussion about MPF and MPP loss allocations.)

*MPF Credit Enhancement.* For conventional MPF Loan products, Participating Financial Institutions (PFIs) assume or retain a portion of the credit risk on the MPF Loans that are funded by, or sold to, a participating FHLBank by providing credit enhancement (CE Amount) either through a direct liability to pay credit losses up to a specified amount or through a contractual obligation to provide supplemental mortgage guaranty insurance (SMI).

Under the MPF Program, the PFI’s credit enhancement protection level (CEP Amount) may take the form of the CE Amount, and/or the PFI may contract for a contingent performance-based credit enhancement fee whereby such fees are reduced by losses up to a certain amount arising under the Master Commitment. The required PFI CE Amount may vary depending on the MPF product alternatives selected. Under the AMA Regulation, any portion of the CE Amount that is a PFI’s direct liability must be collateralized by the PFI in the same way that advances from the MPF FHLBank are collateralized. All of the PFI’s obligations under the PFI Agreement are secured under its regular advances agreement with the MPF FHLBank. The MPF FHLBank may request additional collateral to secure the PFI’s obligations.

PFIs are paid a credit enhancement fee (CE Fee) for managing credit risk and in some instances, all or a portion of the CE Fee may be performance-based. CE fees are paid monthly and are determined based on the remaining unpaid principal balance of the MPF Loans. CE fees, payable to a PFI as compensation for assuming credit risk, are recorded as an offset to mortgage loan interest income when paid by the MPF FHLBank. The MPF FHLBank also pays performance-based CE fees which are based on actual performance of the pool of MPF Loans under each individual master commitment. To the extent that losses in the current month exceed performance-based CE fees accrued, the remaining losses may be recovered from future performance CE fees payable to the PFI.

*MPP Credit Enhancement.* A lender risk account (LRA) is funded by an FHLBank either up front as a portion of the purchase proceeds or through a portion of the net interest remitted monthly by the member. The LRA is a lender-specific account funded by the FHLBank in an amount approximately sufficient to cover expected losses on the pool of mortgages. The LRA funds are used to offset any losses that may occur. After five years, excess funds over required balances are distributed to the member in accordance with a step-down schedule that is established at the time of a master commitment contract. No LRA balance is required after eleven years. The total balance of all LRAs is recorded in other liabilities and totaled \$84 million and \$72 million at December 31, 2006 and 2005.

In addition to the expected losses covered by the LRA, the member selling conventional loans is required to purchase Supplemental Mortgage Insurance (SMI) as an enhancement to cover losses over and above losses covered by the LRA. The FHLBank is listed as the insured and this coverage serves to further limit the exposure to losses. The total credit enhancement, which includes borrower’s equity, primary mortgage insurance (if applicable), the LRA and the SMI are intended to provide the equivalent to an investment-grade “AA” rating under the S&P LEVELS rating methodology (although the assets are not rated by S&P or any other agency). In the event the LRA and the standard SMI policy do not provide sufficient loss protection to support the equivalent investment-grade rating, additional mortgage insurance coverage called SMI Plus also must be purchased by the member. This policy covers the expected losses to achieve an equivalent investment-grade rating over and above the LRA and SMI.



*Accounting for Mortgage Loans Held in Portfolio.* The FHLBanks classify mortgage loans as held for investment and, accordingly, report them at their principal amount outstanding, net of deferred loan fees, unamortized premiums and discounts, SFAS 133 hedging adjustments, and mark-to-market basis adjustments on loans initially classified as mortgage purchase commitments.

The FHLBanks defer and amortize deferred loan costs (agent fees), premiums and discounts paid to and received by an FHLBank's participating member, and basis adjustments as interest income using either the contractual method or the retrospective method. Under the retrospective method, actual prepayment experience and estimates of future principal prepayments are used in calculating the estimated lives of the mortgage loans. The FHLBank aggregates the mortgage loans by similar characteristics (type, maturity, note rate and acquisition date) in determining prepayment estimates. The retrospective method requires a retrospective adjustment each time the FHLBank changes the estimated amounts as if the new estimate had been known since the original acquisition date of the assets. The contractual method recognizes the income effects of premiums and discounts based on the actual behavior of the underlying assets and reflects the contractual terms of the assets without regard to changes in estimates based on assumptions about future borrower behavior. As discussed in Note 2 to these financial statements, certain FHLBanks use the contractual method and other FHLBanks use the retrospective method.

The FHLBanks record credit enhancement fees paid to PFIs as a reduction to mortgage loan interest income. The FHLBanks may receive other non-origination fees, such as delivery commitment extension fees and pair-off fees. Extension fees are received when a member requests to extend the period of the delivery commitment beyond the original stated maturity and are recorded in other income as received. Pair-off fees are received when the amount funded is less than a specific percentage of the delivery commitment amount and price adjustment fees are received when the amount funded is greater than a specified percentage of the delivery commitment amount. To the extent that pair-off fees relate to under-deliveries of loans, they are included in the mark-to-market of the related delivery commitment derivative. If they relate to over-deliveries, they represent purchase price adjustments to the related loans acquired and are recorded as part of the loan basis.

The FHLBanks place a conventional mortgage loan on nonaccrual status when the collection of the contractual principal or interest is 90 days or more past due. However, there are exceptions, such as when a loan is well-secured and in the process of collection (e.g., through credit enhancements), or when an FHLBank's agreements with its PFIs include monthly settlement on a schedule/scheduled basis. Monthly settlement on a schedule/scheduled basis means that the PFI is obligated to remit the contractual mortgage payments on mortgage loans sold to the FHLBank, regardless of whether or not the PFI received payment from the mortgagor. For those mortgage loans placed on nonaccrual status, accrued but uncollected interest is reversed against interest income. The FHLBanks record cash payments received on nonaccrual loans as interest income and a reduction of principal.

An FHLBank bases the allowance for credit losses on its management's estimate of credit losses inherent in the FHLBank's mortgage loan portfolio at the balance sheet date. Actual losses greater than defined levels are offset by the member's credit enhancement. An FHLBank performs periodic reviews of its portfolio to identify the losses inherent within the portfolio and to determine the likelihood of collection of the portfolio. The overall allowance is determined by an analysis that includes consideration of various data observations such as past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, and prevailing economic conditions. As a result of this analysis, the MPP FHLBanks have determined that each member's obligation for losses and the mortgage insurance coverage exceeds the inherent loss in the portfolio. Accordingly, no allowance for loan losses is considered necessary. As a result of this analysis, the combined financial statements reflect an aggregate allowance for loan losses with respect to MPF loans in the amounts of \$7 million and \$10 million at December 31, 2006 and 2005.

*MPF Shared Funding Program.* Several FHLBanks participate in the MPF Shared Funding Program, which is administered by an unrelated third party. This program allows mortgage loans

originated through the MPF Program to be sold to a third party-sponsored trust and “pooled” into securities. The FHLBank of Chicago purchased MPF Shared Funding securities in two transactions in 2003 and sold a portion of the MPF Shared Funding to other FHLBanks at the original transaction closing. The investments are classified as held-to-maturity securities and are reported at amortized cost of \$489 million and \$556 million at December 31, 2006 and 2005. These securities, which are rated AA, are not publicly traded and are not guaranteed by any of the FHLBanks.

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46), a new interpretation on consolidation accounting. In December 2003, the FASB issued a revision to FIN 46 (FIN 46-R) to address various technical corrections and implementation issues that had arisen since the issuance of FIN 46. Application of FIN 46-R to the FHLBanks is limited to the MPF Shared Funding securities and certain investments in mortgage-backed securities. With regard to the Shared Funding Program, certain of the FHLBanks currently hold MPF Shared Funding securities which they believe were issued by qualifying special purpose entities (QSPEs) that are sponsored by One Mortgage Partners Corporation, a subsidiary of JPMorgan Chase. A QSPE generally can be described as an entity whose permitted activities are limited to passively holding financial assets and distributing cash flows to investors based on pre-set terms. A QSPE must meet certain criteria in SFAS 140 to be considered a QSPE. FIN 46-R does not require an investor to consolidate a QSPE, as long as the investor does not have the unilateral ability to liquidate the QSPE or cause it to no longer meet the QSPE criteria. The affected FHLBanks meet this scope exception for QSPEs under FIN 46-R, and accordingly, do not consolidate their investments in the MPF Shared Funding securities. Further, even if the special purpose entities were not QSPEs, these FHLBanks would not consolidate under FIN 46-R because they hold the senior interest, rather than the residual interest, in these securities.

*Affordable Housing Program.* The FHLBank Act requires each FHLBank to establish and fund an AHP (see Note 9). The FHLBank charges the required funding for AHP to earnings and establishes a liability. The AHP funds provide subsidies to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. The FHLBank issues AHP advances at interest rates below the customary interest rate for non-subsidized advances. When the FHLBank makes an AHP advance, the present value of the variation in the cash flow caused by the difference in the interest rate between the AHP advance rate and the FHLBank’s related cost of funds for comparable maturity funding is charged against the AHP liability and recorded as a discount on the AHP advance. As an alternative, the FHLBank has the authority to make the AHP subsidy available to members as a grant.

*Prepayment Fees.* The FHLBanks charge a member a prepayment fee when the member prepays certain advances before the original maturity. The FHLBanks record prepayment fees net of SFAS 133 basis adjustments included in the book basis of the advance as “Prepayment fees on advances, net” in the interest income section of the Statement of Income. In cases in which the FHLBank funds a new advance concurrent with the prepayment of an existing advance, the FHLBank evaluates whether the new advance meets the accounting criteria to qualify as a modification of an existing advance or as a new advance in accordance with EITF Issue No. 01-7, *Creditor’s Accounting for a Modification or Exchange of Debt Instruments*, and SFAS No. 91 *Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans and Initial Direct Costs of Leases* (SFAS 91). If the new advance qualifies as a modification of the existing advance, the net prepayment fee on the prepaid advance is deferred, recorded in the basis of the modified advance and amortized over the life of the modified advance in advance interest income.

For modified prepaid advances that are hedged and meet the hedge accounting requirements of SFAS 133, the FHLBank terminates the hedging relationship upon prepayment and records the associated fair value gains and losses, adjusted for the prepayment fees, in interest income. If the FHLBank funds a new advance to a member concurrent with or within a short period of time after the prepayment of a previous advance to that member, the FHLBank evaluates whether the new

advance qualifies as a modification of the original hedged advance, including analysis of (i) whether the effective yield on the new advance is at least equal to the effective yield for a comparable advance to a similar member that is not refinancing or restructuring and (ii) whether the modification of the original advance is more than minor. If the new advance qualifies as a modification of the original hedged advance, the fair value gains or losses of the advance and the prepayment fees are included in the carrying amount of the modified advance, and gains or losses and prepayment fees are amortized in interest income over the life of the modified advance using a level-yield methodology. If the modified advance is also hedged and the hedge meets the hedging criteria in accordance with SFAS 133, it is marked to fair value after the modification, and subsequent fair value changes are recorded in other income.

If the FHLBank determines that the transaction does not qualify as a modification of an existing advance, it is treated as an advance termination with subsequent funding of a new advance and the net fees are recorded as “Prepayment fees on advances, net” in the interest income section of the Statement of Income.

*Commitment Fees.* The FHLBanks defer commitment fees for advances and amortize them to interest income using a level-yield methodology. Refundable fees are deferred until the commitment expires or until the advances are made. The FHLBanks record commitment fees for standby letters of credit as a deferred credit when they receive the fees and accrete them using the straight-line method over the term of the standby letter of credit. Each FHLBank management believes that the likelihood of standby letters of credit being drawn upon is remote based upon past experience.

*Derivatives.* Accounting for derivatives is addressed in SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of Effective Date of FASB Statement No. 133*, SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS 133). All derivatives are recognized on the balance sheet at their fair values. Each derivative is designated as one of the following:

- (1) a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment (a “fair-value” hedge);
- (2) a hedge of a forecasted transaction or the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a “cash-flow” hedge);
- (3) a hedge of the foreign currency component of a hedged item in a fair-value or cash-flow hedge;
- (4) a non-qualifying hedge of an asset or liability (“economic hedge”) for asset-liability management purposes; or
- (5) a non-qualifying hedge of another derivative (an “intermediation” hedge) that is offered as a product to members or used to offset other derivatives with non-member counterparties.

Changes in the fair value of a derivative that is designated and qualifies as a fair-value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk (including changes that reflect losses or gains on firm commitments), are recorded in other income as “Net gains (losses) on derivatives and hedging activities.”

Changes in the fair value of a derivative that is designated and qualifies as a cash-flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, a component of capital, until earnings are affected by the variability of the cash flows of the hedged transaction (i.e., until the periodic recognition of interest on a variable-rate asset or liability is typically recorded in other income as “Net gains (losses) on derivatives and hedging activities”).

Changes in the fair value of a derivative that is designated and qualifies as a foreign currency hedge are recorded in either current-period earnings, if the hedging relationship satisfies the criteria for a fair-value hedge or in other comprehensive income if the hedging relationship satisfies the criteria for a cash-flow hedge.

For both fair-value and cash-flow hedges, any hedge ineffectiveness (which represents the amount by which the change in the fair value of the derivative differs from the change in the fair value of the hedged item or the variability in the cash flows of the forecasted transaction) is recorded in other income as “Net gains (losses) on derivatives and hedging activities.”

Changes in the fair value of a derivative not qualifying as a hedge are recorded in current-period earnings with no fair value adjustment to an asset or a liability. Both the net interest on the derivative and the fair value adjustments are recorded in other income as “Net gains (losses) on derivatives and hedging activities.” Cash flows associated with stand-alone derivatives are reflected as cash flows from operating activities in the Statements of Cash Flows.

The differentials between accruals of interest receivables and payables on derivatives designated as fair value or cash flow hedges are recognized as adjustments to the income or expense of the designated underlying investment securities, advances, consolidated obligations or other financial instruments. The differentials between accruals of interest receivables and payables on intermediated derivatives for members and other economic hedges are recognized in other income as “Net gains (losses) on derivatives and hedging activities.”

The FHLBanks routinely issue debt and make advances in which a derivative instrument is “embedded.” Upon execution of these transactions, the FHLBank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the advance or debt (the host contract) and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When the FHLBank determines that (1) the embedded derivative has economic characteristics that are not clearly and closely related to the economic characteristics of the host contract and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and designated as a stand-alone derivative instrument pursuant to an economic hedge. However, if the entire contract (the host contract and the embedded derivative) is to be measured at fair value, with changes in fair value reported in current-period earnings (such as an investment security classified as “trading” under SFAS 115), or if the FHLBank cannot reliably identify and measure the embedded derivative for purposes of separating that derivative from its host contract, the entire contract is carried on the balance sheet at fair value and no portion of the contract is designated as a hedging instrument.

If hedging relationships meet certain criteria specified in SFAS 133, they are eligible for hedge accounting and the offsetting changes in fair value of the hedged items may be recorded in earnings. The application of hedge accounting generally requires an FHLBank to evaluate the effectiveness of the hedging relationships on an ongoing basis and to calculate the changes in fair value of the derivatives and related hedged items independently. This is known as the “long-haul” method of accounting. Transactions that meet more stringent criteria qualify for the “short-cut” method of hedge accounting in which an assumption can be made that the change in fair value of a hedged item exactly offsets the change in fair value of the related derivative.

Derivatives are typically executed at the same time as the hedged advances or consolidated obligations, and the FHLBanks designate the hedged item in a qualifying hedge relationship at the trade date. In many hedging relationships, the FHLBank may designate the hedging relationship upon its commitment to disburse an advance or trade a consolidated obligation in which settlement occurs within the shortest period of time possible for the type of instrument based on market settlement conventions. The FHLBank defines market settlement conventions for advances to be five business days or less and for consolidated obligations to be thirty calendar days or less, using a next business day convention. The FHLBank then records the changes in fair value of the derivative



and the hedged item beginning on the trade date. When the hedging relationship is designated on the trade date and the fair value of the derivative is zero on that date, the FHLBank meets the criteria within SFAS 133 for applying the short-cut method provided all the other criteria of paragraph 68 of SFAS 133 are also met.

When hedge accounting is discontinued because the FHLBank determines that the derivative no longer qualifies as an effective fair-value hedge of an existing hedged item, the FHLBank continues to carry the derivative on the balance sheet at its fair value, ceases to adjust the hedged asset or liability for changes in fair value, and amortizes the cumulative basis adjustment on the hedged item into earnings over the remaining life of the hedged item using a level-yield methodology.

When hedge accounting is discontinued because the FHLBank determines that the derivative no longer qualifies as an effective cash-flow hedge of an existing hedged item, the FHLBank continues to carry the derivative on the balance sheet at its fair value and reclassifies the cumulative other comprehensive income adjustment into earnings when earnings are affected by the existing hedge item (i.e., the original forecasted transaction).

Under limited circumstances, when the FHLBank discontinues cash-flow hedge accounting because it is no longer probable that the forecasted transaction will occur by the end of the originally specified time period, or within the following two months, but it is probable the transaction will still occur in the future, the gain or loss on the derivative remains in accumulated other comprehensive income and is recognized as earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within the following two months, the gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings.

When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the FHLBank continues to carry the derivative on the balance sheet at its fair value, removing from the balance sheet any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current-period earnings.

*Mandatorily Redeemable Capital Stock.* As further discussed in Note 16, the FHLBanks adopted SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (SFAS 150), effective January 1, 2004. In compliance with FAS 150, the FHLBanks reclassify stock subject to redemption from equity to a liability after a member provides written notice of redemption, gives notice of intention to withdraw from membership, or withdraws from membership by merger or acquisition, charter termination, or other involuntary termination from membership, because the member's shares will then meet the definition of a mandatorily redeemable financial instrument. Shares meeting this definition are reclassified to a liability at fair value. Dividends declared on shares classified as a liability in accordance with SFAS 150 are accrued at the expected dividend rate and reflected as interest expense in the Statement of Income. Once redeemed, the repayment of these mandatorily redeemable financial instruments (by repurchase or redemption of the shares) is reflected as a financing cash outflow in the Statement of Cash Flows.

*Premises, Software, and Equipment.* The FHLBanks record premises, software and equipment at cost less accumulated depreciation and amortization. The FHLBanks' accumulated depreciation and amortization related to premises, software and equipment was \$250 million and \$208 million at December 31, 2006 and 2005. The FHLBanks compute depreciation on the straight-line method over the estimated useful lives of relevant assets ranging from one to forty years. They amortize leasehold improvements on the straight-line basis over the shorter of the estimated useful life of the improvement or the remaining term of the lease. The FHLBanks capitalize improvements and major renewals but expense ordinary maintenance and repairs when incurred. Depreciation and amortization expense for premises, software and equipment was \$48 million, \$43 million and \$35 million for the years ended December 31, 2006, 2005 and 2004. The FHLBanks include gains and losses on the disposal of premises, software and equipment in other income. The net realized

gain (loss) on disposal of premises, software and equipment was less than \$1 million, \$(12) million and \$1 million in 2006, 2005 and 2004.

The cost of computer software developed or obtained for internal use is accounted for in accordance with Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). SOP 98-1 requires the cost of purchased software and certain costs incurred in developing computer software for internal use to be capitalized and amortized over future periods. At December 31, 2006 and 2005, the FHLBanks had \$111 million and \$104 million in unamortized computer software costs. Amortization of computer software costs charged to expense was \$29 million, \$28 million and \$21 million for the years ended December 31, 2006, 2005 and 2004.

*Concessions on Consolidated Obligations.* The FHLBanks defer and amortize, using a level-yield methodology, the amounts paid to dealers in connection with the sale of consolidated obligations over the terms or the estimated lives of the consolidated obligations. The Office of Finance prorates the amount of the concession to each FHLBank based upon the percentage of the debt issued that is assumed by the FHLBank. Unamortized concessions were \$328 million and \$347 million at December 31, 2006 and 2005 and are included in "Other assets." Amortization of such concessions is included in consolidated obligation interest expense and totaled \$143 million, \$131 million and \$220 million in 2006, 2005, and 2004.

*Discounts and Premiums on Consolidated Obligations.* The FHLBanks expense the discounts on consolidated obligation discount notes using a level-yield methodology over the term of the related notes due to their short-term nature. They accrete the discounts and amortize the premiums on consolidated bonds to interest expense using a level-yield methodology over the term to maturity or the estimated life of the corresponding consolidated obligation bond.

*Resolution Funding Corporation (REFCORP) Assessments.* Although the FHLBanks are exempt from ordinary Federal, State, and local taxation, except for local real estate tax, they are required to make payments to the Resolution Funding Corporation (REFCORP). Each FHLBank is required to pay 20 percent of income calculated in accordance with GAAP after the assessment for AHP, but before the assessment for REFCORP. The AHP and REFCORP assessments are calculated simultaneously because of their interdependence on each other. The FHLBanks accrue their REFCORP assessment on a monthly basis. Calculation of the AHP assessment is discussed in Note 9. REFCORP has been designated as the calculation agent for the AHP and REFCORP assessments. Each FHLBank provides its net income before AHP and REFCORP to the Resolution Funding Corporation, which then performs the calculations for each quarter-end.

The FHLBanks will continue to expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a \$300 million annual annuity (or a scheduled payment of \$75 million per quarter) whose final maturity date is April 15, 2030, at which point the required payment of each FHLBank to REFCORP will be fully satisfied. The Finance Board, in consultation with the Secretary of the Treasury, selects the appropriate discounting factors to be used in this annuity calculation. The FHLBanks use the actual payments made to determine the amount of the future obligation that has been defeased. The cumulative amount to be paid to REFCORP by the FHLBanks is not determinable at this time because it depends on the future earnings of all FHLBanks and prevailing interest rates. If an FHLBank experienced a net loss during a quarter, but still had net income for the year, the FHLBank's obligation to REFCORP would be calculated based on its year-to-date net income. The FHLBank would be entitled to a refund of amounts paid for the full year that were in excess of its calculated annual obligation. If the FHLBank had net income in subsequent quarters, it would be required to contribute additional amounts to meet its calculated annual obligation. If an FHLBank experienced a net loss for a full year, that FHLBank would have no obligation to REFCORP for the year.

The Finance Board is required to extend the term of the FHLBanks' obligation to REFCORP for each calendar quarter in which there is a deficit quarterly payment. A deficit quarterly payment is the amount by which the combined FHLBanks actual quarterly payment falls short of



\$75 million. The benchmark payments or portions of them could be reinstated if the actual REFCORP payments of the FHLBanks fall short of \$75 million in a quarter. The maturity date of the REFCORP obligation may be extended beyond April 15, 2030 if such extension is necessary to ensure that the value of the aggregate amounts paid by the FHLBanks exactly equals a \$300 million annual annuity. Any payment beyond April 15, 2030 will be paid to the Department of the Treasury.

As a result of the REFCORP payments of \$684 million made by the FHLBanks in 2006, the overall period during which the FHLBanks must continue to make quarterly payments was shortened to July 15, 2015, effective December 31, 2006. This compares to the outside date of October 15, 2017, effective December 31, 2005, based on REFCORP payments made through 2005.

*Finance Board Expenses.* The FHLBanks are assessed for the costs of operating the Finance Board, the FHLBanks' primary regulator. The Finance Board allocates its operating and capital expenditures to the FHLBanks based on each FHLBank's percentage of total combined regulatory capital stock plus retained earnings.

*Office of Finance Expenses.* The FHLBanks are assessed for the costs of operating the Office of Finance, which manages the sale of consolidated obligations. The Office of Finance allocates its operating and capital expenditures based equally on each FHLBank's percentage of capital stock, percentage of consolidated obligations issued and percentage of consolidated obligations outstanding.

*Estimated Fair Values.* Some of the FHLBanks' financial instruments lack an available trading market characterized by transactions between a willing buyer and a willing seller engaging in an exchange transaction. Therefore, the FHLBanks use internal models employing significant estimates and present value calculations when disclosing estimated fair values. The FHLBanks assume that book value approximates fair value for financial instruments with three months or less to repricing or maturity. Note 19 details the estimated fair values of the FHLBanks' financial instruments.

*Cash Flows.* In the Statement of Cash Flows, the FHLBanks consider cash and due from banks as cash and cash equivalents. Federal funds sold are not treated as cash equivalents for purposes of the Statement of Cash Flows, but instead are treated as short-term investments and are reflected in the investing activities section of the Statement of Cash Flows.

In 2005, the FHLBank of New York adopted an accounting policy to reflect gains/losses on debt extinguishments in the operating activities section of its Statement of Cash Flows and to report the cash payments from the early retirement of debt net of these amounts in the financing activities section of its Statement of Cash Flows. The remaining 11 FHLBanks report an operating adjustment on the Statement of Cash Flows for gains or losses on debt extinguishments.

*Reclassifications.* Certain amounts in the 2005 and 2004 financial statements have been reclassified to conform to the 2006 presentation.

## **Note 2—Changes and Adoptions of Accounting Principles, Accounting Adjustments, Change in Accounting Estimate, and Recently Issued Accounting Standards and Interpretations**

*Change in Amortization and Accretion Method of Deferred Premiums and Discounts on Mortgage Loans Held for Portfolio and Mortgage-Backed Securities.* Certain FHLBanks have changed their method of accounting for premiums and discounts and other deferred loan origination fees on mortgage loans. In addition, certain FHLBanks have changed their method of accounting for premiums and discounts and other deferred loan origination fees under SFAS 91 on mortgage-backed securities. Historically, each FHLBank deferred and amortized agent fees and premiums and discounts paid to and received by its members as interest income over the estimated lives of the related mortgage loans (the "retrospective method"). Actual prepayment experience and estimates of future principal repayments were used in calculating such estimated lives.

Effective January 1, 2004, each of the FHLBanks of Chicago and Pittsburgh changed its method of amortizing such premiums and discounts from the retrospective method to the contractual method. Under the contractual method, the FHLBank amortizes premiums and discounts over the contractual life of the asset, which the FHLBank believes is more consistent with the actual behavior of the underlying mortgage loans and reflects the contractual terms of the assets without regard to changes in estimates based on assumptions about future borrower behavior. These FHLBanks believe this method is preferable because it relies less than the previous method on the use of estimates inherent in calculating weighted-average lives that are used to determine the loan pool amortization periods. As a result, the contractual method does not create income volatility related to estimated changes, but instead reflects volatility related to actual loan behavior.

As a result of implementing the above changes in accounting under SFAS 91, these FHLBanks recorded a cumulative effect of a change in accounting principle, effective January 1, 2004. This change resulted in an increase to retained earnings of \$41 million for the FHLBank of Chicago and \$10 million for the FHLBank of Pittsburgh.

Effective January 1, 2005, the FHLBank of Atlanta changed its method of accounting for deferred premiums and discounts on mortgage-backed securities under SFAS 91 to the contractual method. The FHLBank of Atlanta believes that the contractual method is preferable to the retrospective method because, under the contractual method, the income effects of premiums and discounts are recognized in a manner that reflects the actual behavior of the underlying assets during the period in which the behavior occurs, while also reflecting the contractual terms of the assets without regard to changes in estimates based on assumptions about future borrower behavior.

As a result of implementing this change in accounting under SFAS 91, the FHLBank of Atlanta recorded a cumulative effect of a change in accounting principle, effective January 1, 2005. This change resulted in a decrease to retained earnings of \$3 million.

Effective January 1, 2005, the FHLBank of Boston changed its method of accounting for premiums and discounts on MPF mortgage loans under SFAS 91 to the contractual method. The FHLBank of Boston believes that the contractual method is preferable to the retrospective method because under the contractual method, the income effects of premiums and discounts are recognized in a manner that is reflective of the actual behavior of the underlying assets during the period in which the behavior occurs while also reflecting the contractual terms of the assets without regard to changes in estimated prepayments based on assumptions about future borrower behavior.

As a result of implementing the change in accounting principle for amortization and accretion from the retrospective method to the contractual method, the FHLBank of Boston recorded a cumulative effect of a change in accounting principle effective January 1, 2005, that resulted in an increase to income before AHP and REFCORP assessments of \$7 million.

Effective January 1, 2005, the FHLBank of Dallas changed its method of accounting for the amortization and accretion of mortgage loan premiums and discounts under SFAS 91 to the contractual method. The FHLBank believes that the contractual method is preferable to the retrospective method because, under the contractual method, the income effects of premiums and discounts are recognized in a manner that is reflective of the actual behavior of the mortgage loans during the period in which the behavior occurs while also reflecting the contractual terms of the assets without regard to changes in estimated prepayments based upon assumptions about future borrower behavior.

As a result of the change in method of amortizing premiums and accreting discounts on mortgage loans, the FHLBank of Dallas recorded a cumulative effect of a change in accounting principle effective January 1, 2005. Net of assessments, this change increased net income for the year ended December 31, 2005 by \$1 million. If the contractual method had been used to amortize premiums and accrete discounts in prior years, the FHLBank's net income would not have been materially different from the reported amounts.

Effective January 1, 2005, the FHLBank of Des Moines changed its method of amortizing and accreting premiums, discounts, and other nonrefundable fees on mortgage loans and mortgage-backed securities to the contractual method. The FHLBank believes the contractual method is preferable to the retrospective method because under the contractual method, the income effects of premiums, discounts, and other nonrefundable fees are recognized in a manner that is reflective of the actual behavior of the underlying assets during the period in which the behavior occurs while also reflecting the contractual terms of the assets without regard to changes in estimated prepayments based on assumptions about future borrower behavior.

As a result of implementing this change, the FHLBank of Des Moines recorded a \$9 million cumulative effect of a change in accounting principle in the statement of income (before assessments) for the year ended December 31, 2005.

Effective January 1, 2005, the FHLBank of New York changed its method of amortizing and accreting premiums and discounts on mortgage loans to the contractual method, in accordance with SFAS 91. The FHLBank believes that the contractual method is preferable because under the contractual method, the income effects of premiums and discounts are recognized in a manner that is reflective of the actual behavior of the mortgage loans during the period in which the behavior occurs without regard to changes in estimates based on assumptions about future borrower behavior.

As a result of the change in accounting principle, income of \$1 million, before assessments, was recorded on January 1, 2005 as a cumulative effect of change in accounting principle.

*SFAS 155.* On February 16, 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140* (SFAS 155), which resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets* (DIG Issue D1). SFAS 155 amends SFAS 133 to simplify the accounting for certain derivatives embedded in other financial instruments (hybrid financial instruments) by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise required bifurcation, provided that the entire hybrid financial instrument is accounted for on a fair value basis. SFAS 155 also establishes the requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, which replaces the interim guidance in DIG Issue D1. SFAS 155 amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities—a replacement of FASB Statement 125* (SFAS 140) to allow a qualifying special-purpose entity to hold a derivative financial instrument that pertains to beneficial interests other than another derivative financial instrument. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006 (January 1, 2007 for the FHLBanks), with earlier adoption allowed. The FHLBanks do not expect the adoption of this statement to have a material effect on their financial condition, results of operations or cash flows.

*DIG Issue B40.* On December 20, 2006, the FASB issued Derivatives Implementation Group (DIG) Issue No. B40, *Application of Paragraph 13(b) to Securitized Interest in Prepayable Financial Assets* (DIG Issue B40). DIG Issue B40 clarifies when a securitized interest in prepayable financial assets is subject to the conditions in paragraph 13(b) of SFAS 133. DIG Issue B40 will become effective upon an entity's initial adoption of SFAS 155 (January 1, 2007 for the FHLBanks). The FHLBanks do not expect the adoption of this statement to have a material effect on their financial condition, results of operations or cash flows.

*SFAS 157.* On September 15, 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). In defining fair value, SFAS 157 retains the exchange price notion in earlier definitions of fair value. However, the definition of fair value under SFAS 157 focuses on the price that would be received to sell an asset or paid to transfer a liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). SFAS 157 applies whenever other accounting pronouncements require or permit assets or liabilities to be

measured at fair value. Accordingly, SFAS 157 does not expand the use of fair value in any new circumstances. SFAS 157 also establishes a fair value hierarchy that prioritizes the information used to develop assumptions used to determine the exit price. Under this standard, fair value measurements will be separately disclosed by level within the fair value hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for the FHLBanks) and interim periods within those fiscal years, with early adoption permitted provided the entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. The FHLBanks have not yet determined the effect that the adoption of this statement will have on their financial condition, results of operations or cash flows.

*SFAS 158.* On September 29, 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158), which requires employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. Specifically, SFAS 158 requires employers to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations at the end of the employer's fiscal year (with limited exceptions), and recognize changes in the funded status of a defined benefit postretirement plan in comprehensive income in the year in which the changes occur. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective at the end of the fiscal year ending after December 15, 2006, for entities with publicly traded equity securities, and at the end of the fiscal year ending after June 15, 2007 for all other entities. The requirement to measure plan assets and benefit obligations at the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. Earlier application of the recognition or measurement date provisions is encouraged; however, early application must be for all of an employer's benefit plans. The FHLBanks' adoption of SFAS 158 at December 31, 2006 did not have a material effect on their financial condition, results of operations or cash flows.

*SFAS 159.* On February 15, 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 creates a fair value option allowing, but not requiring, an entity to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities, with changes in fair value recognized in earnings as they occur. It requires entities to separately display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. Additionally, SFAS 159 requires an entity to provide information that would allow users to understand the effect on earnings of changes in the fair value on those instruments selected for the fair value election. SFAS 159 is effective at the beginning of an entity's first fiscal year beginning after November 15, 2007 (January 1, 2008 for the FHLBanks). Early adoption is permitted at the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS 157. Although the FHLBanks have not yet determined the effect that the implementation of SFAS 159 will have on their financial condition, results of operations or cash flows, the FHLBanks believe that, if implemented, SFAS 159 could have a material impact on their financial condition, results of operations or cash flows.

*SEC Staff Accounting Bulletin No. 108.* In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years ending on or



after November 15, 2006. The FHLBanks' adoption of SAB 108 at December 31, 2006 did not have a material effect on their financial condition, results of operations or cash flows.

**Note 3—Cash and Due from Banks**

*Compensating Balances.* The FHLBanks maintain collected cash balances with commercial banks in return for certain services. These agreements contain no legal restrictions on the withdrawal of funds. The average compensating balances for the years ended December 31, 2006 and 2005 were approximately \$27 million and \$25 million.

In addition, the FHLBanks maintained average required clearing balances with various Federal Reserve Banks of approximately \$125 million and \$118 million for the years ended December 31, 2006 and 2005. These are required clearing balances and may not be withdrawn; however, the FHLBanks may use earnings credits on these balances to pay for services received from the Federal Reserve Banks. The FHLBanks may also maintain average collected balances with the Federal Reserve Banks as clearing balances and to facilitate the movement of funds to support the FHLBank's activities. There are no legal restrictions under these agreements on the withdrawal of these funds.

*Pass-through Deposit Reserves.* The FHLBanks act as pass-through correspondents for member institutions required to deposit reserves with the Federal Reserve Banks. The amount shown as cash and due from banks includes pass-through reserves deposited with the Federal Reserve Banks of approximately \$164 million and \$151 million at December 31, 2006 and 2005.

**Note 4—Securities Purchased Under Agreements to Resell**

The FHLBanks have entered into purchases of securities under agreements to resell those securities. These amounts represent short-term loans and are classified as assets in the Statement of Condition. Securities purchased under agreements to resell are held in safekeeping in the name of the relevant FHLBank. Should the market value of the underlying securities decrease below the market value required as collateral, the counterparty must place an equivalent amount of additional securities in safekeeping in the name of the FHLBank or the dollar value of the resale agreement will be decreased accordingly.

**Note 5—Trading Securities**

*Major Security Types.* Trading securities at December 31, 2006 and 2005 were as follows (dollar amounts in millions):

	December 31,	
	2006	2005
	<u>Estimated</u>	<u>Estimated</u>
	<u>Fair Value</u>	<u>Fair Value</u>
Government-sponsored enterprises* . . . . .	\$5,307	\$6,590
State or local housing agency obligations . . . . .	60	61
Other . . . . .	<u>2</u>	<u>2</u>
	5,369	6,653
Mortgage-backed securities:		
Other U.S. obligations** . . . . .	95	132
Government-sponsored enterprises*** . . . . .	158	249
Other**** . . . . .	<u>65</u>	<u>147</u>
	<u>318</u>	<u>528</u>
Total . . . . .	<u>\$5,687</u>	<u>\$7,181</u>

- \* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or Tennessee Valley Authority, which are not obligations of the U.S. Government.
- \*\* Other U.S. obligations primarily consists of Government National Mortgage Association (Ginnie Mae) and/or Small Business Administration (SBA) investment pools.
- \*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.
- \*\*\*\* Primarily consists of private-label mortgage-backed securities.

Net losses on trading securities during the years ended December 31, 2006, 2005 and 2004, includes a change in net unrealized holding losses of \$92 million, \$295 million and \$147 million for securities held on December 31, 2006, 2005 and 2004.

#### Note 6—Available-for-Sale Securities

*Major Security Types.* Available-for-sale securities at December 31, 2006 were as follows (dollar amounts in millions):

	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury obligations .....	\$ 106	\$	\$ (4)	\$ 102
Commercial paper .....	1,189		(1)	1,188
Government-sponsored enterprises* .....	2,041	1	(8)	2,034
Other .....	<u>384</u>	<u>3</u>	<u>—</u>	<u>387</u>
	3,720	4	(13)	3,711
Mortgage-backed securities:				
Government-sponsored enterprises** .....	675	2	(5)	672
Other*** .....	<u>2,274</u>	<u>4</u>	<u>—</u>	<u>2,278</u>
	<u>2,949</u>	<u>6</u>	<u>(5)</u>	<u>2,950</u>
Total .....	<u>\$6,669</u>	<u>\$10</u>	<u>\$(18)</u>	<u>\$6,661</u>

- \* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.
- \*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.
- \*\*\* Primarily consists of private-label mortgage-backed securities.



Available-for-sale securities at December 31, 2005 were as follows (dollar amounts in millions):

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury obligations .....	\$ 108	\$	\$ (6)	\$ 102
Commercial paper .....	1,149	2		1,151
Government-sponsored enterprises* .....	1,748	2	(10)	1,740
Other .....	395	8		403
	<u>3,400</u>	<u>12</u>	<u>(16)</u>	<u>3,396</u>
Mortgage-backed securities:				
Government-sponsored enterprises** .....	901	2	(6)	897
Other*** .....	1,305	1		1,306
	<u>2,206</u>	<u>3</u>	<u>(6)</u>	<u>2,203</u>
Total .....	<u>\$5,606</u>	<u>\$15</u>	<u>\$(22)</u>	<u>\$5,599</u>

\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

\*\*\* Primarily consists of private-label mortgage-backed securities.

The following table summarizes the available-for-sale securities with unrealized losses at December 31, 2006. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position (dollar amounts in millions).

	Less than 12 Months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations .....	\$	\$	\$ 102	\$ (4)	\$ 102	\$ (4)
Commercial Paper .....	1,188	(1)			1,188	(1)
Government-sponsored enterprises* .....	651	(4)	572	(4)	1,223	(8)
Mortgage-backed securities:						
Government-sponsored enterprises** ..			437	(5)	437	(5)
Total temporarily impaired .....	<u>\$1,839</u>	<u>\$(5)</u>	<u>\$1,111</u>	<u>\$(13)</u>	<u>\$2,950</u>	<u>\$(18)</u>

\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

The FHLBanks have reviewed their investment security holdings and have determined that all unrealized losses reflected above are temporary, based in part on the creditworthiness of the issuers as well as the underlying collateral. The FHLBanks believe that it is probable that they will be able to collect all amounts due according to the contractual terms of the individual securities. Based upon the creditworthiness of the issuers and because the FHLBanks have the ability and the intent to hold such securities through to recovery of the unrealized losses, they do not consider the investments to be other-than-temporarily impaired at December 31, 2006.

The following table summarizes the available-for-sale securities with unrealized losses at December 31, 2005. The unrealized losses are aggregated by major security type and length of time

that individual securities have been in a continuous unrealized loss position (dollar amounts in millions).

	<u>Less than 12 Months</u>		<u>12 months or more</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
U.S. Treasury obligations . . . . .	\$	\$	\$ 103	\$ (6)	\$ 103	\$ (6)
Government-sponsored enterprises* . . . . .	842	(5)	791	(5)	1,633	(10)
Mortgage-backed securities:						
Government-sponsored enterprises** . . . . .	<u>342</u>	<u>(5)</u>	<u>302</u>	<u>(1)</u>	<u>644</u>	<u>(6)</u>
Total temporarily impaired . . . . .	<u>\$1,184</u>	<u>\$(10)</u>	<u>\$1,196</u>	<u>\$(12)</u>	<u>\$2,380</u>	<u>\$(22)</u>

\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or Tennessee Valley Authority, which are not obligations of the U.S. Government.

\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.

*Redemption Terms.* The amortized cost and estimated fair value of available-for-sale securities at December 31, 2006 and 2005 by contractual maturity are shown below (dollar amounts in millions). Expected maturities of some securities and mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

<u>Year of Maturity</u>	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less . . . . .	\$2,262	\$2,261	\$1,831	\$1,833
Due after one year through five years . . . . .	681	671	754	745
Due after five through ten years . . . . .	23	23	23	23
Due after ten years . . . . .	<u>754</u>	<u>756</u>	<u>792</u>	<u>795</u>
	3,720	3,711	3,400	3,396
Mortgage-backed securities . . . . .	<u>2,949</u>	<u>2,950</u>	<u>2,206</u>	<u>2,203</u>
Total . . . . .	<u>\$6,669</u>	<u>\$6,661</u>	<u>\$5,606</u>	<u>\$5,599</u>

The amortized cost of the FHLBanks' mortgage-backed securities classified as available-for-sale includes net premiums of \$4 million at December 31, 2006 and net discounts of \$5 million at December 31, 2005.

*Interest-Rate Payment Terms.* The following table details additional interest-rate payment terms for investment securities classified as available-for-sale at December 31, 2006 and 2005 (dollar amounts in millions):

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Amortized cost of available-for-sale securities other than mortgage-backed securities:		
Fixed-rate .....	\$3,716	\$3,396
Variable-rate .....	<u>4</u>	<u>4</u>
	<u>3,720</u>	<u>3,400</u>
Amortized cost of available-for-sale mortgage-backed securities:		
Pass-through securities:		
Fixed-rate .....	661	916
Variable-rate .....	3	
Collateralized mortgage obligations:		
Fixed-rate .....	203	226
Variable-rate .....	<u>2,082</u>	<u>1,064</u>
	<u>2,949</u>	<u>2,206</u>
Total .....	<u>\$6,669</u>	<u>\$5,606</u>

*Gains and Losses.* The FHLBanks realized \$3 million, \$298 million and \$29 million in gross gains on the sale of available-for-sale securities for 2006, 2005 and 2004. The FHLBanks realized \$6 million, \$8 million and \$40 million in gross losses on the sale of available-for-sale securities in 2006, 2005 and 2004.

## Note 7—Held-to-Maturity Securities

### *Major Security Types.*

Held-to-maturity securities at December 31, 2006, were as follows (dollar amounts in millions):

	<u>December 31, 2006</u>			<u>Estimated Fair Value</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	
Commercial paper .....	\$ 7,032	\$	\$	\$ 7,032
Other U.S. obligations* .....	953	4	(1)	956
Government-sponsored enterprises** .....	4,349	22	(42)	4,329
State or local housing agency obligations .....	3,180	28	(11)	3,197
Other .....	<u>8</u>			<u>8</u>
	15,522	54	(54)	15,522
Mortgage-backed securities:				
Other U.S. obligations* .....	443	3	(4)	442
Government-sponsored enterprises*** .....	44,067	89	(740)	43,416
Other**** .....	<u>82,450</u>	<u>170</u>	<u>(1,020)</u>	<u>81,600</u>
	<u>126,960</u>	<u>262</u>	<u>(1,764)</u>	<u>125,458</u>
Total .....	<u>\$142,482</u>	<u>\$316</u>	<u>\$(1,818)</u>	<u>\$140,980</u>

- \* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.
- \*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.
- \*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.
- \*\*\*\* Primarily consists of private-label mortgage-backed securities.

Held-to-maturity securities at December 31, 2005, were as follows (dollar amounts in millions):

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper .....	\$ 4,680	\$ 5	\$	\$ 4,685
Other U.S. obligations* .....	1,133	8	(2)	1,139
Government-sponsored enterprises** .....	5,120	30	(70)	5,080
State or local housing agency obligations .....	3,941	53	(4)	3,990
Other .....	9			9
	<u>14,883</u>	<u>96</u>	<u>(76)</u>	<u>14,903</u>
Mortgage-backed securities:				
Other U.S. obligations* .....	624	4	(5)	623
Government-sponsored enterprises*** .....	41,319	80	(748)	40,651
Other**** .....	77,654	166	(1,118)	76,702
	<u>119,597</u>	<u>250</u>	<u>(1,871)</u>	<u>117,976</u>
Total .....	<u>\$134,480</u>	<u>\$346</u>	<u>\$(1,947)</u>	<u>\$132,879</u>

- \* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.
- \*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.
- \*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.
- \*\*\*\* Primarily consists of private-label mortgage-backed securities.

The following table summarizes the held-to-maturity securities with unrealized losses at December 31, 2006. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position (dollar amounts in millions).

	Less than 12 Months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other U.S. obligations* .....	\$ 35	\$	\$ 168	\$ (1)	\$ 203	\$ (1)
Government-sponsored enterprises** .....	777	(8)	2,370	(34)	3,147	(42)
State or local housing agency obligations .....	1,377	(7)	191	(4)	1,568	(11)
Mortgage-backed securities:						
Other U.S. obligations* .....	18		129	(4)	147	(4)
Government-sponsored enterprises*** .....	7,856	(27)	24,408	(713)	32,264	(740)
Other**** .....	15,339	(27)	43,809	(993)	59,148	(1,020)
Total temporarily impaired . . . .	<u>\$25,402</u>	<u>\$(69)</u>	<u>\$71,075</u>	<u>\$(1,749)</u>	<u>\$96,477</u>	<u>\$(1,818)</u>

- \* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.
- \*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or Tennessee Valley Authority, which are not obligations of the U.S. Government.
- \*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.
- \*\*\*\* Primarily consists of private-label mortgage-backed securities.

The FHLBanks have reviewed their held-to-maturity investments and have determined that all unrealized losses reflected above are temporary based on the creditworthiness of the issuers as well as the underlying collateral. The FHLBanks believe it is probable that they will be able to collect all amounts due according to the contractual terms of the individual securities. Additionally, the FHLBanks have the ability and the intent to hold such securities through to recovery of the unrealized losses, they do not consider the investments to be other-than-temporarily impaired at December 31, 2006.

The following table summarizes the held-to-maturity securities with unrealized losses at December 31, 2005. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position (dollar amounts in millions).

	Less than 12 Months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Other U.S. obligations* . . . . .	\$ 105	\$ (1)	\$ 30	\$ (1)	\$ 135	\$ (2)
Government-sponsored enterprises** . . . . .	1,093	(13)	1,804	(57)	2,897	(70)
State or local housing agency obligations . . . . .	1,162	(2)	159	(2)	1,321	(4)
Mortgage-backed securities:						
Other U.S. obligations* . . . . .	165	(1)	95	(4)	260	(5)
Government-sponsored enterprises*** . . . . .	16,929	(245)	12,756	(503)	29,685	(748)
Other**** . . . . .	<u>40,577</u>	<u>(432)</u>	<u>24,457</u>	<u>(686)</u>	<u>65,034</u>	<u>(1,118)</u>
Total temporarily impaired . . . .	<u>\$60,031</u>	<u>\$(694)</u>	<u>\$39,301</u>	<u>\$(1,253)</u>	<u>\$99,332</u>	<u>\$(1,947)</u>

- \* Other U.S. obligations primarily consists of Ginnie Mae and/or SBA investment pools.
- \*\* Primarily consists of securities issued or guaranteed by Freddie Mac, Fannie Mae and/or the Tennessee Valley Authority, which are not obligations of the U.S. Government.
- \*\*\* Primarily consists of securities issued or guaranteed by Freddie Mac and/or Fannie Mae, which are not obligations of the U.S. Government.
- \*\*\*\* Primarily consists of private-label mortgage-backed securities.

*Redemption Terms.* The amortized cost and estimated fair value of held-to-maturity securities at December 31, 2006 and 2005 are shown below (dollar amounts in millions). Expected maturities of some securities and mortgage-backed securities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment fees.

<u>Year of Maturity</u>	<u>2006</u>		<u>2005</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in one year or less . . . . .	\$ 10,215	\$ 10,202	\$ 6,799	\$ 6,803
Due after one year through five years . .	1,847	1,834	3,600	3,544
Due after five through ten years . . . . .	641	657	873	908
Due after ten years . . . . .	<u>2,819</u>	<u>2,829</u>	<u>3,611</u>	<u>3,648</u>
	15,522	15,522	14,883	14,903
Mortgage-backed securities . . . . .	<u>126,960</u>	<u>125,458</u>	<u>119,597</u>	<u>117,976</u>
Total . . . . .	<u>\$142,482</u>	<u>\$140,980</u>	<u>\$134,480</u>	<u>\$132,879</u>

The amortized cost of the FHLBanks' mortgage-backed securities classified as held-to-maturity includes net discounts of \$206 million and \$74 million at December 31, 2006 and 2005.

*Interest-Rate Payment Terms.* The following table details additional interest-rate payment terms for investment securities classified as held-to-maturity at December 31, 2006 and 2005 (dollar amounts in millions):

	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Amortized cost of held-to-maturity securities other than mortgage-backed securities:		
Fixed-rate . . . . .	\$ 13,095	\$ 9,091
Variable-rate . . . . .	<u>2,427</u>	<u>5,792</u>
	<u>15,522</u>	<u>14,883</u>
Amortized cost of held-to-maturity mortgage-backed securities:		
Pass-through securities:		
Fixed-rate . . . . .	21,040	18,347
Variable-rate . . . . .	1,421	1,016
Collateralized mortgage obligations:		
Fixed-rate . . . . .	65,329	65,518
Variable-rate . . . . .	<u>39,170</u>	<u>34,716</u>
	<u>126,960</u>	<u>119,597</u>
Total . . . . .	<u>\$142,482</u>	<u>\$134,480</u>

*Gains and Losses.* The FHLBanks realized less than \$1 million for 2006 and 2005 and \$13 million for 2004 in gross gains on the sale of held-to-maturity securities. The FHLBanks realized \$6 million and \$1 million for 2006 and 2005 and less than \$1 million for 2004 in gross losses on the sale of held-to-maturity securities.



## Note 8—Advances

*Redemption Terms.* At December 31, 2006 and 2005, the FHLBanks had advances outstanding, including AHP advances (see Note 9), at interest rates ranging from 0 percent to 10 percent, as summarized below (dollar amounts in millions). Advances with interest rates of 0 percent are AHP-subsidized advances.

<u>Redemption Term—Amount</u>	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Amount</u>	<u>Weighted Average Interest Rate</u>	<u>Amount</u>	<u>Weighted Average Interest Rate</u>
Overdrawn demand deposit accounts . . .	\$ 22		\$ 49	
Due in 1 year or less . . . . .	252,399	5.06%	242,932	4.04%
Due after 1 year through 2 years . . . .	113,971	4.98%	108,014	4.09%
Due after 2 years through 3 years . . . .	80,728	5.07%	94,998	4.34%
Due after 3 years through 4 years . . . .	46,978	5.13%	38,696	4.37%
Due after 4 years through 5 years . . . .	48,158	5.19%	47,236	4.86%
Thereafter . . . . .	94,650	4.55%	82,722	4.32%
Index amortizing advances . . . . .	<u>4,645</u>	4.47%	<u>5,727</u>	4.30%
Total par value . . . . .	<u>641,551</u>	4.98%	<u>620,374</u>	4.22%
Commitment fees . . . . .	(3)		(3)	
Discount on AHP advances . . . . .	(63)		(58)	
Premium on advances . . . . .	18		26	
Discount on advances . . . . .	(117)		(172)	
SFAS 133 hedging adjustments . . . . .	<u>(705)</u>		<u>(307)</u>	
Total . . . . .	<u>\$640,681</u>		<u>\$619,860</u>	

Index-amortizing advances require repayment according to predetermined amortization schedules linked to the level of various indices. Usually, as market interest rates rise (fall), the maturity of an index-amortizing advance extends (contracts).

The FHLBanks offer advances to members that may be prepaid on pertinent dates (call dates) without incurring prepayment or termination fees (callable advances). Other advances may only be prepaid by paying a fee to the FHLBank (prepayment fee) that makes the FHLBank financially indifferent to the prepayment of the advance. At December 31, 2006 and 2005, the FHLBanks had callable advances of \$29,659 million and \$23,608 million.

The following table summarizes advances at December 31, 2006 and 2005, by year of maturity or next call date for callable advances (dollar amounts in millions):

<u>Year of Maturity or Next Call Date</u>	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Overdrawn demand deposit accounts . . . . .	\$ 22	\$ 49
Due in 1 year or less . . . . .	293,796	280,594
Due after 1 year through 2 years . . . . .	115,969	106,422
Due after 2 years through 3 years . . . . .	76,636	90,764
Due after 3 years through 4 years . . . . .	39,759	32,682
Due after 4 years through 5 years . . . . .	42,427	37,720
Thereafter . . . . .	68,297	66,416
Index amortizing advances . . . . .	<u>4,645</u>	<u>5,727</u>
Total par value . . . . .	<u>\$641,551</u>	<u>\$620,374</u>

The FHLBanks also offer puttable advances. With a puttable advance, an FHLBank effectively purchases a put option from the member that allows the FHLBank to put or extinguish the fixed-rate advance, which the FHLBank normally would exercise when interest rates increase, and the borrower may elect to enter into a new advance. At December 31, 2006 and 2005, the FHLBanks had puttable advances outstanding totaling \$55,428 million and \$53,428 million.

The FHLBanks also offer convertible advances. With a convertible advance, an FHLBank purchases an option from the member that allows the FHLBank to convert the interest rate from fixed to variable by terminating the fixed-rate advance, which the FHLBank normally would exercise when interest rates increase, and offering a variable-rate advance. At December 31, 2006 and 2005, the FHLBanks had convertible advances outstanding totaling \$41,885 million and \$45,686 million.

The following table summarizes advances at December 31, 2006 and 2005, by year of maturity or next put/convert date (dollar amounts in millions):

<u>Year of Maturity or Next Put/Convert Date</u>	<u>December 31, 2006</u>	<u>December 31, 2005</u>
Overdrawn demand deposit accounts . . . . .	\$ 22	\$ 49
Due in 1 year or less . . . . .	317,728	310,654
Due after 1 year through 2 years . . . . .	120,530	118,580
Due after 2 years through 3 years . . . . .	82,973	90,330
Due after 3 years through 4 years . . . . .	35,447	32,971
Due after 4 years through 5 years . . . . .	41,394	29,044
Thereafter . . . . .	38,812	33,019
Index amortizing advances . . . . .	<u>4,645</u>	<u>5,727</u>
Total par value . . . . .	<u>\$641,551</u>	<u>\$620,374</u>

*Security Terms.* The FHLBanks lend to financial institutions involved in housing finance within their districts according to Federal statutes, including the FHLBank Act. The FHLBank Act requires each FHLBank to obtain sufficient collateral on advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans, cash or deposits and member capital stock in the FHLBank, and other eligible real estate-related assets as collateral on such advances. Community Financial Institutions (CFIs) are eligible under expanded statutory collateral rules to use secured small-business, small farm and small agriculture loans, and securities representing a whole interest in such secured loans. Since the FHLBank of Chicago has not yet converted to its new capital plan, the FHLBank Act requires that total advances from the FHLBank of Chicago to a member may not exceed 20 times the member's capital stock in the FHLBank of Chicago. At December 31, 2006 and 2005, the FHLBanks had rights to collateral with an estimated value greater than the related outstanding advances. On the basis of the financial condition of the borrower, the type of security agreement, and other factors, each FHLBank imposes one of two requirements to protect its secured collateral:

- Allows a borrower to retain possession of the collateral assigned to the FHLBank if the member (or borrower) executes a written security agreement and agrees to hold such collateral for the benefit of the FHLBank; or
- Requires the borrower specifically to assign or place physical possession of such collateral with the FHLBank or a third-party custodian approved by the FHLBank.

Beyond these provisions, Section 10(e) of the FHLBank Act affords any security interest granted by a member to an FHLBank priority over the claims or rights of any other party except those claims that would be entitled to priority under otherwise applicable law and which are held by bona fide purchasers for value or by secured parties with perfected security interests.

*Credit Risk.* While the FHLBanks have never experienced a credit loss on an advance to a member, the expansion of collateral for CFIs provides the potential for additional credit risk for the FHLBanks. The management of each FHLBank has the policies and procedures in place to appropriately manage this credit risk. Accordingly, the FHLBanks have not provided any allowances for losses on advances.

The FHLBanks' potential credit risk from advances is concentrated in commercial banks and savings institutions. At December 31, 2006 and 2005, the FHLBanks had \$433 billion and \$402 billion of advances outstanding that were greater than or equal to \$1 billion per member. These advances were made to 79 and 88 member institutions, respectively, representing 67.6 percent and 64.7 percent of total advances outstanding. The FHLBanks hold sufficient collateral to cover the advances to these institutions, and the FHLBanks do not expect to incur any credit losses on these advances.

*Interest-Rate Payment Terms.* The following table details additional interest-rate payment terms for advances at December 31, 2006 and 2005 (dollar amounts in millions):

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
Par amount of advances:		
Fixed-rate .....	\$354,742	\$357,032
Variable-rate .....	<u>286,809</u>	<u>263,342</u>
Total .....	<u>\$641,551</u>	<u>\$620,374</u>

*Prepayment Fees.* The FHLBanks record prepayment fees received from members on prepaid advances net of any associated SFAS 133 hedging fair-value adjustments on those advances.

The net amount of prepayment fees is reflected as interest income in the Statement of Income. Gross advance prepayment fees received from members were \$133 million, \$168 million and \$1,593 million for the three years ended December 31, 2006, 2005 and 2004.

**Note 9—Affordable Housing Program (AHP)**

Section 10(j) of the FHLBank Act requires each FHLBank to establish an AHP. Each FHLBank provides subsidies in the form of direct grants and below-market interest rate advances to members who use the funds to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Annually, the FHLBanks must set aside for the AHP the greater of \$100 million or 10 percent of regulatory income. Regulatory income is income before assessments, plus interest expense related to mandatorily redeemable capital stock under SFAS 150, less the assessment for REFCORP. The AHP and REFCORP assessments are calculated simultaneously because of their interdependence on each other. Each FHLBank accrues this expense monthly based on its income. An FHLBank reduces its AHP liability as members use subsidies. Calculation of the REFCORP assessment is discussed in Note 10.

If an FHLBank experienced a regulatory loss during a quarter, but still had regulatory income for the year, the FHLBank's obligation to the AHP would be calculated based on the FHLBank's year-to-date regulatory income. If the FHLBank had regulatory income in subsequent quarters, it would be required to contribute additional amounts to meet its calculated annual obligation. If the FHLBank experienced a regulatory loss for a full year, the FHLBank would have no obligation to the AHP for the year except in the following circumstance. If the result of the aggregate 10 percent calculation described above is less than \$100 million for all 12 FHLBanks, then the FHLBank Act requires that each FHLBank contribute such prorated sums as may be required to assure that the aggregate contribution of the FHLBanks equals \$100 million. The pro ration would be made on the basis of the income of the FHLBanks for the previous year.

There was no shortfall, as described above, in 2006, 2005 or 2004. If an FHLBank finds that its required contributions are contributing to the financial instability of that FHLBank, it may apply to

the Finance Board for a temporary suspension of its contributions. The FHLBanks did not make any such applications in 2006, 2005 or 2004. The FHLBanks had outstanding principal in AHP-related advances of \$326 million and \$313 million at December 31, 2006 and 2005.

An analysis of the AHP liability for the years ended December 31, 2006 and 2005 is as follows (dollar amounts in millions):

	<u>2006</u>	<u>2005</u>
Balance at beginning of year . . . . .	\$ 739	\$668
Expense . . . . .	295	282
Subsidy usage, net . . . . .	<u>(229)</u>	<u>(211)</u>
Balance at end of year . . . . .	<u>\$ 805</u>	<u>\$739</u>

**Note 10—Resolution Funding Corporation (REFCORP)**

Each FHLBank is required to pay 20 percent of income calculated in accordance with GAAP after the assessment for AHP, but before the assessment for REFCORP. The AHP and REFCORP assessments are calculated simultaneously because of their interdependence on each other. Each FHLBank accrues its REFCORP assessment on a monthly basis. Calculation of the AHP assessment is discussed in Note 9. REFCORP has been designated as the calculation agent for AHP and REFCORP assessments. Each FHLBank provides its net income before AHP and REFCORP to REFCORP, which then performs the calculations for each quarter end.

The FHLBanks will continue to expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a \$300 million annual annuity (or a scheduled payment of \$75 million per quarter) whose final maturity date is April 15, 2030, at which point the required payment of each FHLBank to REFCORP will be fully satisfied. The Finance Board, in consultation with the U.S. Treasury, selects the appropriate discounting factors to be used in this annuity calculation. The FHLBanks use the actual payments made to determine the amount of the future obligation that has been defeased. The cumulative amount to be paid to REFCORP by each FHLBank is not determinable at this time because it depends on the future earnings of all FHLBanks and interest rates. If an FHLBank experienced a net loss during a quarter, but still had net income for the year, the FHLBank’s obligation to REFCORP would be calculated based on the FHLBank’s year-to-date GAAP net income. The FHLBank would be entitled to a refund of amounts paid for the full year that were in excess of its calculated annual obligation. If the FHLBank had net income in subsequent quarters, it would be required to contribute additional amounts to meet its calculated annual obligation. If the FHLBank experienced a net loss for a full year, the FHLBank would have no obligation to REFCORP for the year.

The Finance Board is required to extend the term of the FHLBanks’ obligation to REFCORP for each calendar quarter in which there is a deficit quarterly payment. A deficit quarterly payment is the amount by which the FHLBanks’ actual quarterly payment falls short of \$75 million.

The FHLBanks’ aggregate payments through 2006 have exceeded the scheduled payments, effectively accelerating payment of the REFCORP obligation and shortening its remaining term to the third quarter of 2015. The FHLBanks’ aggregate payments through 2006 have satisfied \$3 million of the \$75 million scheduled payment for the third quarter of 2015 and all scheduled payments thereafter. This date assumes that the FHLBanks will pay exactly \$300 million annually after December 31, 2006 until the annuity is satisfied.

The benchmark payments or portions of them could be reinstated if the actual REFCORP payments of the FHLBanks fall short of \$75 million in a quarter. The maturity date of the REFCORP obligation may be extended beyond April 15, 2030 if such extension is necessary to ensure that the value of the aggregate amounts paid by the FHLBanks exactly equals a \$300 million annual annuity. Any payment beyond April 15, 2030 will be paid to the Department of Treasury.

## Note 11—Mortgage Loans Held for Portfolio

Under two programs, the FHLBanks hold single-family mortgage loans that are funded through, or credit-enhanced by, and serviced by members. The Finance Board has authorized different and much smaller mortgage loan purchase programs not confined to single-family mortgage loans at the FHLBanks of New York and Atlanta.

The following table presents information at December 31, 2006 and 2005 on mortgage loans held by all FHLBanks under all programs (dollar amounts in millions):

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
Real Estate:		
Fixed medium-term* single-family mortgages . . . . .	\$ 26,715	\$ 30,324
Fixed long-term single-family mortgages . . . . .	70,748	74,357
Multifamily mortgages . . . . .	29	31
Nonresidential mortgages . . . . .	<u>          </u>	<u>          3</u>
	97,492	104,715
Premiums . . . . .	693	831
Discounts . . . . .	(307)	(344)
Deferred loan costs, net . . . . .	43	49
SFAS 133 hedging adjustments . . . . .	<u>          60</u>	<u>          (1)</u>
Total mortgage loans held for portfolio . . . . .	<u>\$ 97,981</u>	<u>\$105,250</u>

\* Medium-term is defined as a term of 15 years or less.

The following table details the par value of mortgage loans held for portfolio outstanding at December 31, 2006 and 2005 (dollar amounts in millions):

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
Government-insured loans . . . . .	\$ 10,024	\$ 11,799
Conventional loans . . . . .	87,463	92,899
Other loans . . . . .	<u>          5</u>	<u>          17</u>
Total par value . . . . .	<u>\$ 97,492</u>	<u>\$104,715</u>

The allowances for credit losses were as follows (dollar amounts in millions):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance, beginning of year . . . . .	\$10	\$10	\$15
Charge-offs . . . . .	<u>          </u>	(1)	(1)
Recoveries . . . . .	<u>          </u>	<u>          1</u>	<u>          1</u>
Net charge-offs . . . . .	<u>          </u>	<u>          </u>	<u>          </u>
Reversal for credit losses . . . . .	<u>          (3)</u>	<u>          </u>	<u>          (5)</u>
Balance, end of year . . . . .	<u>\$ 7</u>	<u>\$10</u>	<u>\$10</u>

At December 31, 2006 and 2005, the FHLBanks had \$66 million and \$87 million of nonaccrual loans. Generally, only government-guaranteed/insured loans (e.g., FHA, VA, RHS and HUD) continue to accrue after delinquency of 90 days or more. However, there are exceptions, such as when a loan is well-secured and in the process of collection (e.g., through credit enhancements), or when a PFI is obligated to remit the contractual mortgage payments on mortgage loans sold to an FHLBank, regardless of whether or not the PFI received payment from the borrower.

The estimated fair value of the mortgage loans held for portfolio at December 31, 2006 and 2005 is reported in Note 19.

Mortgage loans, other than those included in large groups of smaller-balance homogeneous loans, are considered impaired when, based on current information and events, it is probable that the FHLBank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreement. At December 31, 2006 and 2005, the FHLBanks had recorded \$26 million and \$11 million of investments in impaired mortgage loans.

The FHLBanks record credit enhancement fees as a reduction to mortgage loan interest income. Credit enhancement fees totaled \$90 million, \$100 million and \$105 million for the years ended December 31, 2006, 2005 and 2004.

The following table presents changes in the Lender Risk Account for the years ended December 31, 2006 and 2005 (dollar amounts in millions):

	<u>December 31,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
Lender Risk Account at beginning of year . . . . .	\$72	\$58
Additions . . . . .	15	16
Claims . . . . .	(1)	(1)
Scheduled distributions . . . . .	<u>(2)</u>	<u>(1)</u>
Lender Risk Account at end of year . . . . .	<u>\$84</u>	<u>\$72</u>

**Note 12—Deposits**

The FHLBanks offer demand and overnight deposits to members and qualifying non-members. In addition, the FHLBanks offer short-term deposit programs to members. A member that services mortgage loans may deposit in its FHLBank funds collected in connection with the mortgage loans, pending disbursement of such funds to the owners of the mortgage loans; the FHLBanks classify these items as other deposits on the balance sheet.

Deposits classified as demand, overnight and other, pay interest based on a daily interest rate. Term deposits pay interest based on a fixed rate determined at the issuance of the deposit. The average interest rates on average deposits during 2006, 2005 and 2004 were 4.84 percent, 3.13 percent and 1.25 percent.

The following table details interest bearing and non-interest bearing deposits at December 31, 2006 and 2005 (in millions):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Interest-bearing:		
Demand and overnight . . . . .	\$ 17,512	\$ 17,903
Term . . . . .	441	456
Other . . . . .	<u>795</u>	<u>576</u>
Total interest-bearing . . . . .	18,748	18,935
Non-interest-bearing:		
Demand and overnight . . . . .	103	133
Other . . . . .	<u>121</u>	<u>96</u>
Total non-interest-bearing . . . . .	<u>224</u>	<u>229</u>
Total deposits . . . . .	<u>\$ 18,972</u>	<u>\$ 19,164</u>



### **Note 13—Borrowings**

*Securities Sold Under Agreements to Repurchase.* Certain FHLBanks have sold securities under repurchase agreements. The amounts received under these agreements represent short-term borrowings and are classified as liabilities on the Statement of Condition. These FHLBanks have delivered securities sold under agreements to repurchase to the primary dealer. Should the market value of the underlying securities fall below the market value required as collateral, the relevant FHLBank must deliver additional securities to the dealer.

### **Note 14—Consolidated Obligations**

Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated bonds and discount notes. The FHLBanks issue consolidated obligations through the Office of Finance as their agent. In connection with each debt issuance, each FHLBank specifies the amount of debt it wants issued on its behalf. The Office of Finance tracks the amount of debt issued on behalf of each FHLBank. In addition, each FHLBank separately tracks and records as a liability its specific portion of consolidated obligations and is the primary obligor for its specific portion of consolidated obligations issued. The Finance Board and the U.S. Secretary of the Treasury have oversight over the issuance of FHLBank debt through the Office of Finance. Consolidated bonds are issued primarily to raise intermediate and long-term funds for the FHLBanks and are not subject to any statutory or regulatory limits on their maturity. Consolidated discount notes are issued primarily to raise short-term funds. These notes sell at less than their face amount and are redeemed at par value when they mature.

Although each FHLBank is primarily liable for its portion of consolidated obligations (i.e., those issued on its behalf), each FHLBank is also jointly and severally liable with the other 11 FHLBanks for the payment of principal and interest on all consolidated obligations of each of the FHLBanks. The Finance Board, at its discretion, may require any FHLBank to make principal or interest payments due on any consolidated obligation whether or not the consolidated obligation represents a primary liability of such FHLBank. Although it has never occurred, to the extent that an FHLBank makes any payment on a consolidated obligation on behalf of another FHLBank that is primarily liable for such consolidated obligation, Finance Board regulations provide that the paying FHLBank is entitled to reimbursement from the non-complying FHLBank for any payments made on its behalf and other associated costs (including interest to be determined by the Finance Board). If, however, the Finance Board determines that the non-complying FHLBank is unable to satisfy its repayment obligations, then the Finance Board may allocate the outstanding liabilities of the non-complying FHLBank among the remaining FHLBanks on a pro-rata basis in proportion to each FHLBank's participation in all consolidated obligations outstanding. The Finance Board reserves the right to allocate the outstanding liabilities for the consolidated obligations between the FHLBanks in any other manner it may determine to ensure that the FHLBanks operate in a safe and sound manner.

The par amounts of the FHLBanks' outstanding obligations, including consolidated obligations held by other FHLBanks, were approximately \$952 billion and \$937 billion at December 31, 2006 and 2005. Regulations require each FHLBank to maintain unpledged qualifying assets equal to its participation in the consolidated obligations outstanding. Qualifying assets are defined as cash; secured advances; assets with an assessment or rating at least equivalent to the current assessment or rating of the consolidated obligations; obligations of or fully guaranteed by the United States, obligations, participations or other instruments of or issued by Fannie Mae or Ginnie Mae; mortgages, obligations or other securities which are or have been sold by Freddie Mac under the FHLBank Act; and such securities as fiduciary and trust funds may invest in under the laws of the state in which an FHLBank is located.

Each FHLBank's leverage limit is based on a ratio of assets to capital, rather than a ratio of liabilities to capital. The Finance Board's former regulations prohibited the issuance of consolidated obligations if such issuance would bring the FHLBanks' outstanding consolidated obligations and

other unsecured senior liabilities above 20 times the FHLBanks' total capital. The Finance Board's Financial Management Policy also applied this limit on an FHLBank-by-FHLBank basis. The final rule deletes the FHLBanks' overall leverage limit from the regulations, but generally limits each FHLBank's assets to no more than 21 times its capital. Nevertheless, an FHLBank whose non-mortgage assets, after deducting deposits and capital, do not exceed 11 percent of its assets may have total assets in an amount not greater than 25 times its capital. After an FHLBank implements its new capital plan, it becomes subject to the Finance Board's risk-based capital requirements (see Note 16).

To provide the holders of consolidated obligations issued before January 29, 1993 (prior bondholders) the protection equivalent to that provided under the FHLBanks' previous leverage limit of 12 times FHLBanks' regulatory capital stock, prior bondholders have a claim on a certain amount of the qualifying assets (Special Asset Account or SAA) if regulatory capital stock is less than 8.33 percent of consolidated obligations. Mandatorily redeemable capital stock is considered capital stock for determining the FHLBanks' compliance with this requirement.

At December 31, 2006 and 2005, the FHLBanks' regulatory capital stock equaled 4.5 percent and 4.6 percent of the par value of consolidated obligations outstanding, and the required minimum pledged asset balance was approximately \$26 thousand and \$110 thousand. Further, the regulations require each FHLBank to transfer qualifying assets in the amount of its allocated share of the FHLBanks' SAA to a trust for the benefit of the prior bondholders if its capital-to-assets ratio falls below two percent. At December 31, 2006 and 2005 no FHLBank had a capital-to-assets ratio less than two percent; therefore, no assets were being held in a trust. In addition, no trust has ever been established as a result of this regulation, as the ratio has never fallen below two percent.

*General Terms.* Consolidated obligations are issued with either fixed-rate coupon payment terms or variable-rate coupon payment terms that use a variety of indices for interest-rate resets including the LIBOR Constant Maturity Treasury (CMT), 11th District Cost of Funds Index (COFI), and others. In addition, to meet the expected specific needs of certain investors in consolidated obligations, both fixed-rate bonds and variable-rate bonds may also contain certain features, which may result in complex coupon payment terms and call or put options. When such consolidated obligations are issued, the FHLBanks enter into derivatives containing offsetting features that effectively convert the terms of the bond to those of a simple variable-rate bond or a fixed-rate bond.

These consolidated obligations, beyond having fixed-rate or simple variable-rate coupon payment terms, may also have the following broad terms regarding either principal repayment or coupon payment terms:

- *Indexed principal redemption bonds* (index-amortizing notes) repay principal according to predetermined amortization schedules that are linked to the level of a certain index. At December 31, 2006 and 2005, most of the index-amortizing notes had fixed-rate coupon payment terms. Usually, as market interest rates rise (fall), the maturity of the index-amortizing notes extends (contracts); and
- *Optional principal redemption bonds* (callable bonds) that an FHLBank may redeem in whole or in part at its discretion on predetermined call dates according to the terms of the bond offerings.

With respect to interest payments, consolidated bonds may also have the following terms:

- *Step-up bonds* generally pay interest at increasing fixed rates for specified intervals over the life of the bond. These bonds generally contain provisions enabling the FHLBanks to call bonds at their option on the step-up dates;
- *Inverse floating bonds* have coupons that increase as an index declines and decrease as an index rises;

- *Conversion bonds* have coupons that an FHLBank may convert from fixed to variable, or variable to fixed, or from one U.S. or other currency index to another, at its discretion on predetermined dates according to the terms of the bond offerings;
- *Comparative index bonds* have coupon rates determined by the difference between two or more market indices, typically CMT and LIBOR; and
- *Range bonds* pay interest at variable rates provided a specified index is within a specified range. The computation of the variable interest rate differs for each bond issue, but the bond generally pays zero interest or a minimal rate if the specified index is outside the specified range;
- *Zero-coupon bonds* are long-term, discounted instruments that earn a fixed yield to maturity or the optional principal redemption date. All principal and interest are paid at maturity or on the optional principal redemption date, if exercised prior to maturity.

*Interest-Rate Payment Terms.* The following table details interest-rate payment terms for consolidated bonds at December 31, 2006 and 2005 (dollar amounts in millions).

	<u>2006</u>	<u>2005</u>
<b>Par value of consolidated bonds:</b>		
Fixed rate . . . . .	\$683,144	\$619,488
Step-up . . . . .	50,679	65,272
Simple variable-rate . . . . .	31,334	39,865
Inverse floating rate . . . . .	98	99
Fixed rate that converts to variable rate . . . . .	2,731	3,764
Variable rate that converts to fixed rate . . . . .	721	2,906
Comparative-index . . . . .	80	2,949
Range bonds . . . . .	7,015	3,286
Zero-coupon . . . . .	11,443	11,378
Other . . . . .	<u>2,001</u>	<u>2,411</u>
Total par value . . . . .	<u>\$789,246</u>	<u>\$751,418</u>

*Redemption Terms.* The following is a summary of the FHLBanks' consolidated bonds outstanding at December 31, 2006 and 2005, by year of maturity (dollar amounts in millions):

<u>Year of Maturity</u>	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Amount</u>	<u>Weighted Average Interest Rate</u>	<u>Amount</u>	<u>Weighted Average Interest Rate</u>
Due in 1 year or less . . . . .	\$241,542	4.24%	\$225,904	3.31%
Due after 1 year through 2 years . . . . .	200,601	4.48%	168,696	3.76%
Due after 2 years through 3 years . . . . .	92,331	4.65%	125,280	3.96%
Due after 3 years through 4 years . . . . .	58,984	4.69%	55,561	4.06%
Due after 4 years through 5 years . . . . .	48,989	5.03%	48,875	4.47%
Thereafter . . . . .	140,244	4.88%	120,159	4.59%
Index amortizing notes . . . . .	<u>6,555</u>	4.94%	<u>6,943</u>	4.87%
Total par value . . . . .	789,246	4.55%	751,418	3.87%
Bond premium . . . . .	347		458	
Bond discount . . . . .	(9,078)		(9,007)	
SFAS 133 hedging adjustments . . . . .	<u>(3,845)</u>		<u>(6,657)</u>	
Subtotal . . . . .	776,670		736,212	
Bonds held in treasury . . . . .	<u>(5)</u>		<u>(5)</u>	
Total . . . . .	<u>\$776,665</u>		<u>\$736,207</u>	

Consolidated bonds outstanding at December 31, 2006 and 2005, include callable bonds totaling \$374,302 million and \$353,934 million. The FHLBanks use fixed-rate callable debt to finance callable advances (see Note 8) and mortgage-backed securities. Simultaneous with such a debt issue, an FHLBank may also enter an interest-rate swap (in which the FHLBank pays a variable rate and receives a fixed rate) with a call feature that mirrors the option embedded in the debt (a sold callable swap). The combined sold callable swap and callable debt allows the FHLBank to provide members with attractively priced variable-rate advances.

The FHLBanks' consolidated bonds outstanding include (dollar amounts in millions):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
<b>Par amount of consolidated bonds:</b>		
Non callable/nonputable . . . . .	\$414,542	\$397,083
Callable . . . . .	374,302	353,934
Putable . . . . .	<u>402</u>	<u>401</u>
Total par value . . . . .	<u>\$789,246</u>	<u>\$751,418</u>

The following table summarizes consolidated bonds outstanding at December 31, 2006 and 2005, by year of maturity or next call date (dollar amounts in millions):

<u>Year of Maturity or Next Call Date</u>	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Due in 1 year or less . . . . .	\$476,308	\$482,834
Due after 1 year through 2 years . . . . .	143,574	109,250
Due after 2 years through 3 years . . . . .	49,843	67,700
Due after 3 years through 4 years . . . . .	30,189	24,268
Due after 4 years through 5 years . . . . .	25,033	20,159
Thereafter . . . . .	57,744	40,264
Index amortizing notes . . . . .	6,555	6,943
Total par value . . . . .	<u>\$789,246</u>	<u>\$751,418</u>

*Bonds Denominated in Foreign Currencies.* Consolidated bonds issued can be denominated in foreign currencies. Concurrent with these issuances, the FHLBanks exchange the interest and principal payment obligations related to the issues for equivalent amounts denominated in U.S. dollars. There were no bonds denominated in foreign currencies at December 31, 2006 and 2005.

*Consolidated Discount Notes.* Consolidated discount notes are issued to raise short-term funds. Discount notes are consolidated obligations with original maturities of up to 365 days. These notes are issued at less than their face amount and redeemed at par value when they mature.

The FHLBanks' participation in consolidated discount notes, all of which are due within one year, was as follows (dollar amounts in millions):

	<u>Book Value</u>	<u>Par Value</u>	<u>Weighted-Average Interest Rate</u>
December 31, 2006 . . . . .	<u>\$157,549</u>	<u>\$158,122</u>	<u>5.13%</u>
December 31, 2005 . . . . .	<u>\$179,694</u>	<u>\$180,350</u>	<u>4.00%</u>

**Note 15—Subordinated Notes**

On June 13, 2006, the FHLBank of Chicago issued \$1.0 billion of subordinated notes that mature on June 13, 2016. Moody's and Standard and Poor's rated these subordinated notes Aa2 and AA-. The subordinated notes are not obligations of, and are not guaranteed by, the United States government or any of the FHLBanks other than the FHLBank of Chicago. The subordinated notes are unsecured obligations and rank junior in priority of payment to the FHLBank of Chicago's "senior liabilities." Senior liabilities include all of the existing and future liabilities, such as deposits, consolidated obligations for which the FHLBank of Chicago is the primary obligor, and consolidated obligations of the other FHLBanks for which the FHLBank of Chicago is jointly and severally liable.

Senior liabilities do not include the FHLBank of Chicago's existing and future liabilities related to payments of "junior equity claims" (all such payments to, and redemptions of shares from, holders of its capital stock being referred to as "junior equity claims") and payments to, or redemption of shares from, any holder of its capital stock that is barred or required to be deferred for any reason, such as noncompliance with any minimum regulatory capital requirement applicable to the FHLBank of Chicago. Also, senior liabilities do not include any liability that, by its terms, expressly ranks equal with or junior to the subordinated notes. Pursuant to an order of the Finance Board, the FHLBank of Chicago will not make any payment to, or redeem shares from, any holder of capital stock which it is obligated to make, on or after any applicable interest payment date or the

maturity date of the subordinated notes unless it has paid, in full, all interest and principal due in respect of the subordinated notes on a particular date.

The subordinated notes may not be redeemed, in whole or in part, prior to maturity, and do not contain any provisions permitting holders to accelerate the maturity thereof on the occurrence of any default or other event. The subordinated notes were issued at par, and accrue interest at a rate of 5.625% per annum. Interest is payable semi-annually in arrears on each June 13 and December 13, commencing December 13, 2006. The FHLBank of Chicago will defer interest payments if five business days prior to any interest payment date it does not satisfy any minimum regulatory leverage ratio then applicable to it.

The FHLBank of Chicago may not defer interest on the subordinated notes for more than five consecutive years and in no event beyond their maturity date. If the FHLBank of Chicago defers interest payments on the subordinated notes, interest will continue to accrue and will compound at a rate of 5.625% per annum. Any interest deferral period ends when the FHLBank of Chicago satisfies all minimum regulatory leverage ratios to which it is subject, after taking into account all deferred interest and interest on such deferred interest. During the periods when interest payments are deferred, the FHLBank of Chicago may not declare or pay dividends on, or redeem, repurchase or acquire its capital stock (including mandatorily redeemable capital stock). At December 31, 2006, the FHLBank of Chicago satisfied the minimum regulatory leverage ratios applicable to the FHLBank of Chicago, and it had not deferred any interest payments.

The Finance Board has granted approvals and waivers to allow the FHLBank of Chicago to include a percentage of the outstanding principal amount of the subordinated notes (Designated Amount) in determining compliance with its regulatory capital and minimum regulatory leverage ratio requirements and to calculate its maximum permissible holdings of mortgage-backed securities and unsecured credit, subject to phase-outs beginning in the sixth year following issuance, as follows (dollar amounts in millions):

<u>Time Period</u>	<u>Percentage of Designated Amount</u>	<u>Designated Amount Included</u>
Issuance through June 13, 2011 . . . . .	100%	\$1,000
June 14, 2011 through June 13, 2012 . . . . .	80%	800
June 14, 2012 through June 13, 2013 . . . . .	60%	600
June 14, 2013 through June 13, 2014 . . . . .	40%	400
June 14, 2014 through June 13, 2015 . . . . .	20%	200
June 14, 2015 through June 13, 2016 . . . . .	0%	

**Note 16—Capital**

The Gramm-Leach-Bliley Act of 1999 (GLB Act) required each FHLBank to adopt a Capital Plan and convert to a new capital structure. By July 18, 2002, the Finance Board had approved the capital structure plan of each FHLBank.

As of December 31, 2006, the FHLBanks of Boston, New York, Pittsburgh, Atlanta, Cincinnati, Indianapolis, Des Moines, Dallas, Topeka, San Francisco and Seattle have implemented their respective capital plans. Each conversion was considered a capital transaction and was accounted for at par value. Each FHLBank that has converted to a new capital structure is subject to three capital requirements under its Capital Plan and the Finance Board rules and regulations: (1) risk-based capital, (2) total capital and (3) leverage capital. First, under the risk-based capital requirement, an FHLBank must maintain at all times permanent capital defined as Class B stock and retained earnings in an amount at least equal to the sum of its credit risk, market risk, and operations risk capital requirements, all of which are calculated in accordance with the rules and regulations of the Finance Board. The Finance Board may require an FHLBank to maintain a greater amount of permanent capital than is required by the risk-based capital requirements as defined. Second, an FHLBank is required to maintain at all times a total capital-to-assets ratio of at



least four percent. Total capital is the sum of permanent capital, Class A stock, any general loss allowance, if consistent with GAAP and not established for specific assets, and other amounts from sources determined by the Finance Board as available to absorb losses. Third, an FHLBank is required to maintain at all times a leverage capital-to-assets ratio of at least five percent. Leverage capital is defined as the sum of (i) permanent capital weighted 1.5 times and (ii) all other capital without a weighting factor. Mandatorily redeemable capital stock is considered capital for determining the FHLBank's compliance with its regulatory requirements. If an FHLBank is not in compliance with the capital requirements at the effective date, it must come into compliance within a transition period of up to three years. During that period, the existing leverage limit established by Finance Board regulations will continue to apply.

Until the FHLBank of Chicago implements its new capital plan, the pre-GLB Act capital rules remain in effect. In particular, the pre-GLB Act rules require members to purchase capital stock equal to the greater of \$500, 1 percent of its mortgage-related assets or 5 percent of its outstanding FHLBank advances. Effective May 16, 2006, the FHLBank of Chicago adopted voluntary capital stock redemption guidelines pursuant to which it notifies members on a periodic basis of its intention to redeem up to a specified dollar amount of voluntary capital stock. The FHLBank of Chicago invites members to submit requests for redemption of voluntary capital stock (including capital stock that becomes voluntary capital stock in connection with advance repayments). Under the redemption guidelines, if aggregate member requests exceed the pre-announced redemption amount, voluntary capital stock is redeemed on a pro-rata basis.. Capital stock outstanding under the pre-GLB Act rules is redeemable at the option of a member upon six-months' notice if the member withdraws from the FHLBank of Chicago.

At December 31, 2006, all of the FHLBanks were in compliance with their risk-based capital rules as follows (dollar amounts in millions):

<u>FHLBank*</u>	<u>Minimum Regulatory Capital Ratio Requirement</u>	<u>At December 31, 2006</u>				
		<u>Minimum Regulatory Capital Requirement</u>	<u>Actual Capital Ratio</u>	<u>Total Regulatory Capital(1)</u>	<u>Permanent Capital(2)</u>	<u>Required Risk-Based Capital</u>
Boston . . . . .	4.0%	\$2,299	4.4%	\$2,542	\$2,542	\$ 342
New York . . . . .	4.0%	3,268	4.9%	4,025	4,025	612
Pittsburgh . . . . .	4.0%	3,095	4.7%	3,655	3,647	509
Atlanta . . . . .	4.0%	5,630	4.5%	6,394	6,394	830
Cincinnati . . . . .	4.0%	3,255	5.0%	4,050	4,050	577
Indianapolis . . . . .	4.0%	1,875	4.5%	2,111	2,111	522
Des Moines . . . . .	4.0%	1,682	5.5%	2,315	2,315	491
Dallas . . . . .	4.0%	2,226	4.7%	2,598	2,598	446
Topeka . . . . .	4.0%	2,110	4.2%	2,225	1,647	467
San Francisco . . . . .	4.0%	9,797	4.4%	10,865	10,865	1,182
Seattle . . . . .	4.0%(3)	2,141	4.3%	2,303	2,303	326

FHLBank*	At December 31, 2006			
	Minimum Leverage Ratio Requirement	Minimum Weighted Leverage Capital Requirement	Actual Leverage Ratio	Actual Weighted Leverage Capital
Boston . . . . .	5.0%	\$2,873	6.6%	\$3,813
New York . . . . .	5.0%	4,085	7.4%	6,037
Pittsburgh . . . . .	5.0%	3,869	7.1%	5,478
Atlanta . . . . .	5.0%	7,038	6.8%	9,591
Cincinnati . . . . .	5.0%	4,069	7.5%	6,075
Indianapolis . . . . .	5.0%	2,343	6.8%	3,167
Des Moines . . . . .	5.0%	2,102	8.3%	3,472
Dallas . . . . .	5.0%	2,783	7.0%	3,898
Topeka . . . . .	5.0%	2,637	5.8%	3,049
San Francisco . . . . .	5.0%	12,246	6.7%	16,298
Seattle . . . . .	5.0%	2,676	6.5%	3,454

\* Only includes FHLBanks that have implemented a new capital plan as of December 31, 2006.

- (1) Total regulatory capital is defined as the sum of permanent capital, the amounts paid for Class A capital stock, any general allowance for losses and any other amount from sources available to absorb losses that the Finance Board has determined by regulation to be appropriate to include in determining total capital. Total regulatory capital also includes mandatorily redeemable capital stock.
- (2) Permanent capital is defined as retained earnings and regulatory capital Class B stock. The mandatorily redeemable capital stock is considered capital for regulatory purposes.
- (3) On January 11, 2007, the Finance Board terminated the Written Agreement between the FHLBank of Seattle and the Finance Board dated December 10, 2004. Subsequently, on January 26, 2007, due to the termination of the Written Agreement, the FHLBank of Seattle's board authorized the FHLBank of Seattle to lower the minimum capital-to-assets ratio from 4.25 percent to 4.05 percent. Prior to the termination of the Written Agreement, the FHLBank of Seattle maintained a minimum supervisory capital-to-assets ratio of 4.25 percent which was required under its business plan submitted to the Finance Board in April 2005, and accepted by the Finance Board in May 2005.

The GLB Act made membership voluntary for all members. Members can redeem Class A stock by giving six months' written notice, and members can redeem Class B stock by giving five years' written notice, subject to certain restrictions. Any member that withdraws from membership may not be readmitted to membership in any FHLBank until five years from the divestiture date for all capital stock that is held as a condition of membership, as that requirement is set out in an FHLBank's capital plan, unless the institution has cancelled its notice of withdrawal prior to that date, before being readmitted to membership in any FHLBank. This restriction does not apply if the member is transferring its membership from one FHLBank to another.

An FHLBank's board of directors may declare and pay dividends out of previously retained earnings and current earnings in either cash or capital stock, assuming the FHLBank is in compliance with Finance Board rules.

The FHLBank of Chicago will delay implementation of a new capital structure until a time mutually agreed upon with the Finance Board. Also, the FHLBank of Chicago may propose amendments to its capital plan, originally approved by the Finance Board on June 12, 2002. (See "FHLBank of Chicago Agreement with the Finance Board" on page 166.)

At December 31, 2006 and 2005, the 10 largest holders of capital stock held \$12.1 billion and \$11.0 billion of the aggregate capital stock of the FHLBanks. Washington Mutual Bank (formerly Washington Mutual, FA) and its affiliate Washington Mutual Bank, FSB together held \$2.7 billion and \$4.3 million of the FHLBanks' capital stock.

*Mandatorily Redeemable Capital Stock.* The FHLBanks adopted SFAS 150 on January 1, 2004. In compliance with SFAS 150, the FHLBanks reclassified capital stock subject to redemption from equity to liability once a member exercises a written redemption right, gives notice of intent to withdraw from membership, or attains non-member status by merger or acquisition, charter termination, or involuntary termination from membership. The FHLBank of Chicago, which has not yet converted to its new capital structure, will reclassify stock subject to redemption from equity to liability once the six-month notification period has expired. Shares of capital stock meeting these definitions are reclassified to a liability at fair value. Dividends related to capital stock classified as a liability are accrued at the expected dividend rate and reported as interest expense in the Statement of Income. The repayment of these mandatorily redeemable financial instruments is reflected as a financing cash outflow in the Statement of Cash Flows.

Each FHLBank is a cooperative whose member financial institutions and former members own all of the relevant FHLBank's capital stock. Member shares cannot be purchased or sold except between an FHLBank and its members at its \$100 per share par value. If a member cancels its written notice of redemption or notice of withdrawal, the FHLBank will reclassify mandatorily redeemable capital stock from a liability to equity in compliance with SFAS 150. After the reclassification, dividends on the capital stock would no longer be classified as interest expense.

On January 1, 2004, the FHLBanks reclassified \$946 million of their outstanding capital stock to "Mandatorily redeemable capital stock" in the liability section of the Statement of Condition. Upon adoption, the FHLBanks also recorded estimated dividends earned as a part of the carrying value of the mandatorily redeemable capital stock. The difference between the prior carrying amount and the mandatorily redeemable capital stock of \$1 million was recorded as a cumulative effect of a change in accounting principle in the Statement of Income. For the years ended December 31, 2006, 2005 and 2004, dividends on mandatorily redeemable capital stock in the amount of \$60 million, \$48 million and \$22 million were recorded as interest expense.

At December 31, 2006 and 2005, the FHLBanks had \$1,094 million and \$1,451 million in capital stock subject to mandatory redemption with payment subject to each FHLBank's waiting period and the FHLBank continuing to meet its minimum regulatory capital requirements. These amounts have been classified as a liability in the Statement of Condition in accordance with SFAS 150.

The following table provides the number of members that notified the FHLBanks of their decisions to voluntarily redeem their capital stock and the number of redemptions during 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Beginning of the year—total number of members that notified the FHLBanks to voluntarily redeem their capital stock . . . . .	148	88
During the year—total number of members that notified the FHLBanks to voluntarily redeem their capital stock due to:		
Withdrawals from membership including mergers and acquisitions . . .	87	82
Repurchase of excess capital stock . . . . .	658	194
During the year—the FHLBanks had completed the redemptions of this many members due to:		
Withdrawals from membership including mergers and acquisitions . . .	(69)	(44)
Repurchase of excess capital stock . . . . .	(623)	(172)
Other . . . . .	<u>(2)</u>	<u>—</u>
At year end—total number of members that had notified the FHLBanks to voluntarily redeem their capital stock . . . . .	<u>199</u>	<u>148</u>

At December 31, 2006, 51 members and former members requested redemptions of capital stock that have not been reclassified as mandatorily redeemable capital stock due to the terms of the affected FHLBanks' capital plan requirements.

The following table shows the amount of mandatorily redeemable capital stock by year of redemption at December 31, 2006 and 2005 (dollar amounts in millions). The year of redemption in the table is the later of the end of the five-year redemption period, or the maturity date of the activity the stock is related to, if the capital stock represents the activity-based stock purchase requirement of a non-member (former member that withdrew from membership, merged into a non-member or was otherwise acquired by a non-member). Consistent with the capital plan currently in effect, an FHLBank is not required to redeem membership stock until five years after the membership is terminated or the FHLBank receives notice of withdrawal. However, if membership is terminated due to merger or consolidation, the FHLBank may recalculate the disappearing institution's membership stock requirement following such termination and the stock may be deemed excess stock subject to repurchase at the FHLBank's discretion. The FHLBanks are not required to redeem activity-based stock until the later of the expiration of the notice of redemption or until the activity to which the capital stock relates no longer remains outstanding. If activity-based stock becomes excess stock as a result of an activity no longer remaining outstanding, the FHLBanks may repurchase such shares, in their sole discretion, subject to the statutory and regulatory restrictions on capital stock redemption discussed below.

<u>Contractual Year of Repurchase</u>	<u>2006</u>	<u>2005</u>
Year 1 .....	\$ 242	\$ 290
Year 2 .....	211	114
Year 3 .....	143	384
Year 4 .....	91	184
Year 5 .....	388	447
Thereafter .....	<u>19</u>	<u>32</u>
Total .....	<u>\$1,094</u>	<u>\$1,451</u>

The FHLBanks' activity for mandatorily redeemable capital stock was as follows in 2006 and 2005 (dollar amounts in millions):

	<u>2006</u>	<u>2005</u>
Balance, beginning of year .....	\$1,451	\$1,153
Capital stock subject to mandatory redemption reclassified from equity:		
Withdrawals .....	521	620
Other redemptions .....	2,057	2,346
Capital stock previously subject to mandatory redemption reclassified to equity:		
Other redemptions .....		(66)
Redemption of mandatorily redeemable capital stock:		
Withdrawals .....	(1,066)	(228)
Other redemptions .....	(1,899)	(2,405)
Stock dividend classified as mandatorily redeemable .....	<u>30</u>	<u>31</u>
Balance, end of year .....	<u>\$1,094</u>	<u>\$1,451</u>

A member may cancel or revoke its written notice of redemption or its notice of withdrawal from membership prior to the end of the five-year redemption period. Each FHLBank's capital plan provides the terms for cancellation fees that may be incurred by the member upon such cancellation.

*Statutory and Regulatory Restrictions on Capital Stock Redemption.* In accordance with the GLB Act, each class of FHLBank stock is considered putable by the member. However, there are significant statutory and regulatory restrictions on the obligation, or right, to redeem the outstanding stock. Statutory and regulatory restrictions on the redemption of FHLBank stock include the following:

- An FHLBank may not redeem any capital stock if, following such redemption, the FHLBank would fail to satisfy any of its minimum capital requirements (i.e., a capital/asset ratio requirement and a risk-based capital/asset ratio requirement established by the Finance Board). By law, no FHLBank stock may be redeemed if the FHLBank becomes undercapitalized so only a minimal portion of outstanding stock qualifies for redemption consideration.
- An FHLBank may not redeem any capital stock without approval of the Finance Board if either its board of directors, or the Finance Board, determines that it has incurred, or is likely to incur, losses resulting, or expected to result, in a charge against capital while such charges are continuing or expected to continue.

Additionally, an FHLBank may not redeem or repurchase shares of capital stock from any member of the FHLBank if (1) the principal or interest due on any consolidated obligation has not been paid in full; (2) the FHLBank fails to certify in writing to the Finance Board that it will remain in compliance with its liquidity requirements and will remain capable of making full and timely payment of all of its current obligations; (3) the FHLBank notifies the Finance Board that it cannot provide the foregoing certification, projects it will fail to comply with statutory or regulatory liquidity requirements or will be unable to timely and fully meet all of its obligations; (4) the FHLBank actually fails to comply with statutory or regulatory liquidity requirements or to timely and fully meet all of its current obligations, or enters or negotiates to enter into an agreement with one or more FHLBank to obtain financial assistance to meet its current obligations.

If the FHLBank is liquidated, after payment in full to the FHLBank's creditors, the FHLBank's stockholders will be entitled to receive the par value of their capital stock. In addition, the FHLBank's Class B stockholders will be entitled to any retained earnings in an amount proportional to the stockholder's share of the total shares of capital stock. In the event of a merger or consolidation, the board of directors shall determine the rights and preferences of the FHLBank's stockholders, subject to any terms and conditions imposed by the Finance Board.

In addition to possessing the authority to prohibit stock redemptions, an FHLBank's board of directors has the right to call for the FHLBank's members, as a condition of membership, to make additional capital stock purchases as needed to satisfy statutory and regulatory capital requirements under the GLB Act.

Each FHLBank's board of directors has a statutory obligation to review and adjust member capital stock requirements in order to comply with the FHLBank's minimum capital requirements, and each member must comply promptly with any such requirement. However a member could reduce its outstanding business with the FHLBank as an alternative to purchasing stock.

If, during the period between receipt of a stock redemption notification from a member and the actual redemption (which may last indefinitely if an FHLBank is undercapitalized, does not have the required credit rating, etc.), an FHLBank is either liquidated or forced to merge with another FHLBank, the redemption value of the stock will be established after the settlement at par of all senior claims. Generally, no claims would be subordinated to the rights of FHLBank stockholders.

The GLB Act states that an FHLBank may repurchase, in its sole discretion, any member's stock investments that exceed the required minimum amount.

*Finance Board Adopts Final Rule Limiting Excess Stock.* On December 22, 2006, the Finance Board adopted a final rule prohibiting FHLBanks from issuing new excess stock if the amount of excess stock exceeds one percent of the FHLBank's assets. The final rule became effective on January 29, 2007. Under the rule, any FHLBank with excess stock greater than one



percent of its total assets will be prevented from further increasing member excess stock by paying stock dividends or otherwise issuing new excess stock. Also included in the final rule is a provision requiring the FHLBanks to declare and pay dividends only out of known income. At December 31, 2006, the FHLBanks of Cincinnati, Indianapolis, Chicago, and Seattle had excess stock outstanding greater than one percent of total assets, while the remaining FHLBanks did not have excess stock outstanding greater than one percent of total assets. Most of the FHLBanks pay cash, rather than stock dividends. The FHLBanks of Cincinnati, Dallas, Topeka and San Francisco paid stock dividends during 2006. No FHLBank believes the final rule will have a material effect on its results of operations or financial condition. Previously, the Finance Board had issued a proposed rule that would have established minimum amounts of retained earnings for the FHLBanks. While the provisions regarding minimum amounts of retained earnings were not carried forward into the final rule, it is possible that the Finance Board may take up the matter in a subsequent rulemaking.

*FHLBank of Chicago Agreement with the Finance Board.* The FHLBank of Chicago's Written Agreement with the Finance Board, which originally required that it maintain a minimum regulatory capital ratio of 5.1 percent, has been amended three times to adjust the minimum regulatory capital requirements. On October 18, 2005, The FHLBank of Chicago entered into Amendment No. 1 to its Written Agreement with the Finance Board which reduced the minimum required capital ratio from 5.1 percent to 4.5 percent and added a requirement that the FHLBank of Chicago maintain minimum regulatory capital stock of \$3.978 billion. Mandatorily redeemable capital stock under SFAS 150 and related capital stock dividends are considered capital stock for regulatory purposes. At December 31, 2005, the FHLBank of Chicago was in compliance with both of these minimum regulatory capital requirements.

On April 18, 2006, the FHLBank of Chicago entered into Amendment No. 2 to the Written Agreement with the Finance Board, which reduced the minimum regulatory capital stock requirement by \$204 million from \$3.978 billion to \$3.774 billion.

On May 16, 2006, the FHLBank of Chicago board of directors voted to allow for the redemption of voluntary capital stock in accordance with capital stock redemption guidelines approved by the Finance Board and redemption windows announced by the FHLBank of Chicago.

On June 6, 2006, the FHLBank of Chicago entered into Amendment No. 3 to the Written Agreement, which became effective on June 13, 2006, upon receipt of proceeds from its subordinated notes issuance. Under Amendment No. 3, the FHLBank of Chicago must maintain both: (i) a ratio of the sum of its regulatory capital stock, plus retained earnings, plus a percentage of the outstanding principal amount of the subordinated notes (Designated Amount) to its total assets of at least 4.5 percent, and (ii) an aggregate amount of regulatory capital stock plus the face value of the outstanding subordinated notes in the Designated Amount of at least \$3.500 billion.

On June 20, 2006, the FHLBank of Chicago used a portion of the net proceeds from the sale of subordinated notes to redeem \$795 million of voluntary capital stock from members in accordance with its capital stock redemption guidelines. On December 14, 2006, the FHLBank of Chicago redeemed another \$375 million of voluntary capital stock from members which, when combined with the \$795 million voluntary capital stock redemption during the second quarter, resulted in approximately 60 percent of voluntary capital stock outstanding as of December 31, 2005 being redeemed by the end of 2006.

As of December 31, 2006, the FHLBank of Chicago was in compliance with all of its minimum regulatory capital requirements.

*FHLBank of Seattle Agreement with the Finance Board.* On January 11, 2007, the Finance Board terminated the Written Agreement between the FHLBank of Seattle and the Finance Board, dated December 10, 2004. Subsequently, on January 26, 2007 due to the termination of the Written Agreement, the FHLBank of Seattle's board authorized the FHLBank of Seattle to lower the minimum capital-to-assets ratio from 4.25 percent to 4.05 percent. Prior to the termination of the Written Agreement, the FHLBank of Seattle maintained a minimum supervisory capital-to-assets



ratio of 4.25 percent which was required under its business plan submitted to the Finance Board in April 2005, and accepted by the Finance Board in May 2005. The FHLBank of Seattle was in compliance with the applicable regulatory and supervisory capital requirements at all times during 2006 and 2005.

**Note 17—Employee Retirement Plans**

The FHLBanks, except for the FHLBank of San Francisco, participate in the Pentegra Defined Benefit Plan for Financial Institutions (Pentegra Defined Benefit Plan), a tax-qualified defined-benefit pension plan, formerly known as the Financial Institutions Retirement Fund. The plan covers substantially all officers and employees of the FHLBanks. However, only FHLBank of Dallas employees hired before January 1, 2007 and FHLBank of Seattle employees hired before January 1, 2004 participate in the Pentegra Defined Benefit Plan. The FHLBanks’ contributions to the Pentegra Defined Benefit Plan through June 30, 1987 represented the normal cost of the plan. The plan reached the full-funding limitation, as defined by the Employee Retirement Income Security Act, for the plan year beginning July 1, 1987, because of favorable investment and other actuarial experience during previous years. As a result, the Pentegra Defined Benefit Plan suspended employer contributions for all plan years ending after June 30, 1987. However, contributions to the plan have resumed for the 11 FHLBanks that participate in the plan. Funding and administrative costs of the Pentegra Defined Benefit Plan charged to other operating expenses were \$50 million, \$42 million and \$30 million in 2006, 2005 and 2004. The Pentegra Defined Benefit Plan is a multi-employer plan in which assets, contributed by one participating employer, may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. As a result, disclosure of the accumulated benefit obligations, plan assets, and the components of annual pension expense attributable to the FHLBanks are not presented herein.

The FHLBanks, except for the FHLBanks of Atlanta, San Francisco and Seattle, also participate in the Pentegra Defined Contribution Plan for Financial Institutions, a tax-qualified, defined-contribution pension plan, formerly known as the Financial Institutions Thrift Plan. The FHLBanks of Atlanta, San Francisco and Seattle have similar defined-contribution plans. The FHLBanks contribute a percentage of the participants’ compensation by making a matching contribution equal to a percentage of voluntary employee contributions, subject to certain limitations. The FHLBanks contributed \$10 million, \$8 million and \$7 million in the years ended December 31, 2006, 2005 and 2004.

In addition, several FHLBanks maintain deferred compensation plans, available to all or select employees and directors, depending on the terms of each FHLBank’s plan. The plans’ liabilities consist of the accumulated compensation deferrals and accrued earnings on the deferrals. The FHLBanks’ minimum obligations for these plans at December 31, 2006 and 2005 were \$70 million and \$50 million. Operating expense includes deferred compensation and accrued earnings of \$5 million, \$3 million and \$4 million in the years ended December 31, 2006, 2005, and 2004.

The FHLBanks adopted SFAS 158 at December 31, 2006. The amounts recognized in the financial statements upon adoption were as follows (dollar amounts in millions):

**Incremental Effect of Applying SFAS 158  
on Individual Line Items in the Statement of Condition  
December 31, 2006**

	<u>Before Application of SFAS 158</u>	<u>Adjustments</u>	<u>After Application of SFAS 158</u>
Other liabilities .....	\$ 1,573	\$26	\$ 1,599
Total liabilities.....	971,458	26	971,484
Other accumulated comprehensive income ..	(11)	(26)	(37)
Total capital.....	45,011	(26)	44,985

Certain FHLBanks offer supplemental retirement and postretirement benefit plans to retirees. There are no funded plan assets that have been designated to provide postretirement benefits. The obligations and funding status of the FHLBanks' supplemental retirement plans and postretirement benefit plans at December 31, 2006 and 2005 were as follows (dollar amounts in millions):

	<u>Supplemental Retirement Plan</u>		<u>Postretirement Benefit Plan</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of the year . . . . .	\$ 97	\$ 82	\$ 39	\$ 33
Service cost . . . . .	6	5	3	2
Interest cost . . . . .	5	5	3	2
Amendments—changes in assumptions . . . . .		2	(4)	(1)
Actuarial loss (gain) . . . . .	2	6	(2)	4
Benefits paid . . . . .	(6)	(3)	(1)	(1)
Settlements and curtailments . . . . .	1			
Benefit obligation at end of year . . . . .	<u>\$ 105</u>	<u>\$ 97</u>	<u>\$ 38</u>	<u>\$ 39</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of the year . . . . .	\$ 10	\$ 6	\$	\$
Actual return on plan assets . . . . .	1	1		
Employer contributions . . . . .	6	5	1	1
Benefits paid . . . . .	(5)	(2)	(1)	(1)
Settlements and curtailments . . . . .	(1)			
Fair value of plan assets at end of the year . . . . .	<u>11</u>	<u>10</u>		
Funded status . . . . .	<u>\$ (94)</u>	(87)	<u>\$ (38)</u>	(39)
Unrecognized net actuarial loss . . . . .		34		
Unrecognized prior service (benefit) cost . . . . .		(1)		8
Unrecognized transition obligation . . . . .		4		2
Net amount recognized . . . . .		<u>\$ (50)</u>		<u>\$ (29)</u>

Amounts recognized in the Statements of Condition for the FHLBanks' supplemental retirement plans and postretirement benefit plans at December 31, 2006 were (dollar amounts in millions):

	<u>Supplemental Retirement Plan</u>	<u>Postretirement Benefit Plan</u>
	<u>2006</u>	<u>2006</u>
Other assets . . . . .	\$ 6	\$
Other liabilities . . . . .	<u>(70)</u>	<u>(28)</u>
	<u>\$ (64)</u>	<u>\$ (28)</u>

Amounts recognized in accumulated other comprehensive income at December 31, 2006 consist of (dollar amounts in millions):

	<u>Supplemental Retirement Plan</u>	<u>Postretirement Benefit Plan</u>
	<u>2006</u>	<u>2006</u>
Net actuarial loss .....	\$24	\$ 5
Prior service cost (benefit) .....	1	(6)
Transition obligation .....	<u>3</u>	<u>(2)</u>
	<u>\$28</u>	<u>\$(3)</u>

Amounts recognized in the Statement of Condition for the FHLBanks' supplemental retirement plans at December 31, 2005 were as follows (dollar amounts in millions). This table is not applicable to 2006 as funded status is reported on the Statement of Condition:

	<u>Supplemental Retirement Plan</u>
	<u>2005</u>
Accrued benefit liability .....	\$(63)
Other assets .....	1
Accumulated other comprehensive gain .....	<u>12</u>
Net amount recognized .....	<u>\$(50)</u>

The accumulated benefit obligation for the supplemental retirement plans was \$48 million and \$32 million at December 31, 2006 and 2005.

Components of the net periodic benefit cost for the FHLBanks' supplemental retirement and postretirement benefit plans for the years ended December 31, 2006, 2005 and 2004 were (dollar amounts in millions):

	<u>Supplemental Retirement Plan</u>			<u>Postretirement Benefit Plan</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Service cost .....	\$ 6	\$ 5	\$ 5	\$3	\$2	\$2
Interest cost .....	5	5	5	2	2	2
Expected return on plan assets .....	(1)	(1)				
Amortization of net loss .....	4	5	3	1	1	
Amortization of net obligation .....			1			
Settlement and curtailment loss .....	<u>2</u>		<u>1</u>			
Net periodic benefit cost .....	<u>\$16</u>	<u>\$14</u>	<u>\$15</u>	<u>\$6</u>	<u>\$5</u>	<u>\$4</u>

The estimated net actuarial loss, prior service benefit and transition obligation that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are (dollar amounts in millions):

	<u>Supplemental Retirement Plan</u>	<u>Postretirement Benefit Plan</u>
	<u>2006</u>	<u>2006</u>
Net actuarial loss .....	\$2	\$1
Prior service benefit .....		(1)
Transition obligation .....	<u>1</u>	<u>—</u>
	<u>\$3</u>	<u>\$</u>

The measurement date used to determine the current year's benefit obligation was December 31, 2006, except for the FHLBank of San Francisco, which used a measurement date of September 30, 2006.

The increase in the minimum liability included in other comprehensive income was \$1 million for the year ended December 31, 2005.

Key assumptions used for the actuarial calculations to determine benefit obligations for the FHLBanks' supplemental retirement plans and postretirement benefit plans for the years ended December 31, 2006 and 2005 were (displayed as a range from low to high):

	Supplemental Retirement Plan		Postretirement Benefit Plan	
	2006	2005	2006	2005
Discount rate . . . . .	5.50% – 5.75%	5.50%	5.65% – 6.00%	5.50% – 5.75%
Salary increases . . . . .	4.50% – 5.50%	4.50% – 5.50%		

Key assumptions used for the actuarial calculations to determine net periodic benefit cost for the FHLBanks' supplemental retirement plans and postretirement benefit plans for the years ended December 31, 2006, 2005 and 2004 were (displayed as a range from low to high):

	Supplemental Retirement Plan			Postretirement Benefit Plan		
	2006	2005	2004	2006	2005	2004
Discount rate . . . . .	5.50% – 5.75%	5.50% – 6.00%	5.75% – 7.50%	5.50% – 5.75%	5.50% – 6.00%	5.75% – 6.75%
Salary increases . . . . .	4.50% – 5.50%	4.50% – 5.50%	4.50% – 5.50%			
Expected return on plan assets . . . . .	8.00%	8.00%	8.00%			

Assumed health care cost trend rates for the FHLBanks' postretirement benefit plans at December 31, 2006 and 2005 were:

	2006	2005
Health care cost trend rates:*		
Assumed for next year . . . . .	7.00% – 13.00%	8.00% – 13.00%
Ultimate rate . . . . .	4.50% – 5.25%	4.50% – 5.25%
Year that ultimate rate is reached . . . . .	2009 – 2017	2009 – 2014

\* Table excludes certain postretirement health benefit plan assumptions for the FHLBank of San Francisco because this plan's costs are capped at 1998 levels. As a result, changes in the health care cost trend rates will have no effect on the FHLBank of San Francisco's accumulated postretirement benefit obligation or service or interest costs.

The effect of a percentage point increase in the assumed healthcare cost trend rates would be an increase in postretirement benefit expense of \$1 million and an increase in accumulated postretirement benefit obligation (APBO) of \$6 million. The effect of a percentage point decrease in the assumed healthcare trend cost rates would be a decrease in postretirement benefit expense of \$1 million and a decrease in APBO of \$5 million.

The supplemental retirement plans and postretirement benefit plans are not funded; therefore, no contributions will be made in 2007 except for the payment of benefits, except for the FHLBank of San Francisco, which expects to contribute \$2 million to its supplemental retirement plan.

The weighted-average asset allocations at December 31, 2006 and 2005 for the FHLBank of San Francisco by asset category are as follows:

	<u>Supplemental Retirement Plan</u>	
	<u>2006</u>	<u>2005</u>
Cash and cash equivalents .....	2%	2%
Equities mutual funds .....	60%	60%
Fixed income mutual funds .....	<u>38%</u>	<u>38%</u>
Total .....	<u>100%</u>	<u>100%</u>

Estimated future benefit payments reflecting expected future services for the years ended December 31 were as follows (dollar amounts in millions):

<u>Years</u>	<u>Payments</u>
2007 .....	\$12
2008 .....	7
2009 .....	7
2010 .....	8
2011 .....	9
2012-2016 .....	56

**Note 18—Derivatives and Hedging Activities**

The FHLBanks may enter into interest-rate swaps (including callable and putable swaps), swaptions, interest-rate cap and floor agreements, calls, puts, and futures and forward contracts (collectively, derivatives) to manage its exposure to changes in interest rates.

The FHLBanks may adjust the effective maturity, repricing frequency, or option characteristics of financial instruments to achieve risk management objectives. The FHLBanks use derivatives in several ways: by designating them as either a fair-value or cash-flow hedge of an underlying financial instrument or a forecasted transaction, by acting as an intermediary, or in asset-liability management (i.e., an economic hedge). For example, the FHLBanks use derivatives in its overall interest-rate risk management to adjust the interest-rate sensitivity of consolidated obligations to approximate more closely the interest-rate sensitivity of assets (advances, investments, and mortgage loans), and/or to adjust the interest-rate sensitivity of advances, investments, or mortgage loans to approximate more closely the interest-rate sensitivity of liabilities.

In addition to using derivatives to manage mismatches of interest rates between assets and liabilities, the FHLBanks also use derivatives as follows: (1) to manage embedded options in assets and liabilities, (2) to hedge the market value of existing assets and liabilities and anticipated transactions, (3) to hedge the duration risk of prepayable instruments, (4) to exactly offset other derivatives executed with members (when an FHLBank serves as an intermediary) and (5) to reduce funding costs.

Consistent with Finance Board regulation, an FHLBank enters into derivatives only to reduce the interest-rate risk exposures inherent in otherwise unhedged assets and funding positions, to achieve the FHLBank’s risk management objectives, and to act as an intermediary between its members and counterparties. FHLBank management uses derivatives when they are considered to be the most cost-effective alternative to achieve the FHLBank’s financial and risk management objectives. Accordingly, an FHLBank may enter into derivatives that do not necessarily qualify for hedge accounting (economic hedges).

An economic hedge is defined as a derivative hedging specific or non-specific underlying assets, liabilities, or firm commitments that does not qualify or was not designated for hedge accounting, but is an acceptable hedging strategy under an FHLBank’s risk management program. These

economic hedging strategies also comply with Finance Board regulatory requirements prohibiting speculative hedge transactions. An economic hedge by definition introduces the potential for earnings variability caused by the changes in fair value on the derivatives that are recorded in an FHLBank's income but not offset by corresponding changes in the value of the economically hedged assets, liabilities, or firm commitments. As a result, an FHLBank recognizes only the change in fair value of these derivatives in other income as "Net gains (losses) on derivatives and hedging activities" with no offsetting fair value adjustments for the asset, liability, or firm commitment.

#### *Types of Assets and Liabilities Hedged.*

The FHLBanks document all relationships between derivatives designated as hedging instruments and hedged items, its risk management objectives and strategies for undertaking various hedge transactions, and its method of assessing effectiveness. This process includes linking all derivatives that are designated as fair value, cash flow, or foreign currency hedges to (1) assets and liabilities on the Statement of Condition, (2) firm commitments, or (3) forecasted transactions. An FHLBank also formally assesses (both at the hedge's inception and at least quarterly) whether the derivatives that it uses in hedging transactions have been effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain effective in future periods. Each FHLBank typically uses regression analyses or other statistical analyses to assess the effectiveness of its hedges.

The FHLBanks discontinue hedge accounting prospectively when: (1) it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative and/or the hedged item expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur in the originally expected period; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument in accordance with SFAS 133 is no longer appropriate.

*Consolidated Obligations*—While consolidated obligations are the joint and several obligations of the FHLBanks, each FHLBank has consolidated obligations for which it is the primary obligor. Each FHLBank enters into derivatives to hedge the interest rate risk associated with its specific debt issuances.

For instance, in a typical transaction, fixed-rate consolidated obligations are issued for one or more FHLBanks, and each FHLBank simultaneously enters into a matching derivative in which the counterparty pays fixed cash flows to the FHLBank designed to mirror in timing and amount the cash outflows the FHLBank pays on the consolidated obligation. These transactions are treated as fair-value hedges under SFAS 133. In this typical transaction, the FHLBank pays a variable cash flow that closely matches the interest payments it receives on short-term or variable-rate advances (typically one- or three-month LIBOR). This intermediation between the capital and derivatives markets permits the FHLBanks to raise funds at lower costs than would otherwise be available through the issuance of simple fixed- or variable-rate consolidated obligations in the capital markets.

*Advances*—With issuances of puttable advances, an FHLBank effectively purchases a put option from the member that allows the FHLBank to terminate the fixed-rate advance, which the FHLBank normally would exercise when interest rates increase, and offer a variable-rate advance. With issuances of convertible advances, an FHLBank purchases an option from the member that allows the FHLBank to convert the interest rate from a fixed rate to a variable rate by terminating the fixed-rate advance, which the FHLBank normally would exercise when interest rates increase, and offering a variable-rate advance. These types of hedges are treated as fair-value hedges under SFAS 133.

The optionality embedded in certain financial instruments held by the FHLBanks can create interest-rate risk. When a member prepays an advance, the FHLBank could suffer lower future income if the principal portion of the prepaid advance were invested in lower-yielding assets that



continue to be funded by higher-cost debt. To protect against this risk, the FHLBank generally charges a prepayment fee that makes it financially indifferent to a member's decision to prepay an advance. When the FHLBank offers advances (other than short-term advances) that a member may prepay without a prepayment fee, it usually finances such advances with callable debt or otherwise hedges this option.

*Mortgage Loans*—The FHLBanks invest in fixed-rate mortgage loans. The prepayment options embedded in mortgage loans can result in extensions or contractions in the expected repayment of these investments, depending on changes in estimated prepayment speeds. The FHLBanks manage the interest-rate and prepayment risks associated with mortgages through a combination of debt issuance and derivatives. The FHLBanks issue both callable and noncallable debt and prepayment linked consolidated obligations to achieve cash flow patterns and liability durations similar to those expected on the mortgage loans. Interest-rate swaps, to the extent the payments on the mortgages result in simultaneous reduction of the notional amount on the swaps, may receive fair value hedge accounting under which changes in the fair value of the swaps, and changes in the fair value of the mortgages that are attributable to the hedged risk, are recorded in current period earnings.

A combination of swaps and options, including futures, may be used as a portfolio of derivatives linked to a portfolio of mortgage loans. The portfolio of mortgage loans consists of one or more pools of similar assets, as determined by factors such as product type and coupon. As the portfolio of loans changes due to new loans, liquidations and payments, the derivative portfolio is modified accordingly to hedge the interest-rate and prepayment risks effectively. A new hedging relationship is created with each change to the loan and derivative portfolios; such relationship is treated as a fair-value hedge.

Options may also be used to hedge prepayment risk on the mortgages, many of which are not identified to specific mortgages and, therefore, do not receive fair-value or cash-flow hedge accounting treatment. The options are marked-to-market through current-period earnings and presented in the Statement of Income as "Net gains (losses) on derivatives and hedging activities." The FHLBanks may also purchase interest-rate caps and floors, swaptions, callable swaps, calls, and puts to minimize the prepayment risk embedded in the mortgage loans. Although these derivatives are valid economic hedges against the prepayment risk of the loans, they are not specifically linked to individual loans and, therefore, do not receive either fair-value or cash-flow hedge accounting. The derivatives are marked-to-market through earnings.

*Anticipated Streams of Future Cash Flows*—The FHLBanks may enter into an option to hedge a specified future variable cash stream as a result of rolling over short-term, fixed-rate financial instruments such as LIBOR advances and discount notes. The option will effectively cap the variable cash stream at a predetermined target rate.

*Firm Commitment Strategies*—In accordance with SFAS 149, certain mortgage purchase commitments entered into after June 30, 2003, are considered derivatives. The FHLBanks normally hedge these commitments by selling to be announced (TBA) mortgage-backed securities or other derivatives for forward settlement. A TBA represents a forward contract for the sale of mortgage-backed securities at a future agreed upon date. The mortgage purchase commitment and the TBA used in the firm commitment hedging strategy are recorded as a derivative asset or derivative liability at fair value, with changes in fair value recognized in current-period earnings. When the mortgage purchase commitment derivative settles, the current market value of the commitment is included with the basis of the mortgage loan and amortized accordingly.

The FHLBanks may also hedge a firm commitment for a forward starting advance through the use of an interest-rate swap. In this case, the swap will function as the hedging instrument for both the firm commitment and the subsequent advance. The basis movement associated with the firm commitment will be rolled into the basis of the advance at the time the commitment is terminated and the advance is issued. The basis adjustment will then be amortized into interest income over the life of the advance.

*Investments*—The FHLBanks invest in U.S. agency obligations, mortgage-backed securities, and the taxable portion of state or local housing finance agency obligations. The interest-rate and prepayment risks associated with these investment securities is managed through a combination of debt issuance and derivatives. The FHLBanks may manage the prepayment and interest rate risks by funding investment securities with consolidated obligations that have call features or by hedging the prepayment risk with caps or floors, callable swaps or swaptions. These investment securities may be classified as held-to-maturity, available-for-sale or trading securities.

For available-for-sale securities that have been hedged and qualify as a fair-value hedge, the FHLBanks record the portion of the change in value related to the risk being hedged in other income as “Net gains (losses) on derivatives and hedging activities” together with the related change in the fair value of the derivative, and the remainder of the change in other comprehensive income as “Net unrealized gains (losses) on available-for-sale securities.” For available-for-sale securities that have been hedged and qualify as a cash-flow hedge, the FHLBanks record the effective portion of the change in value of the derivative related to the risk being hedged in other comprehensive income as a “Net unrealized gains (losses) relating to hedging activities.” The ineffective portion is recorded in other income in the Statement of Income and presented as “Net gains (losses) on derivatives and hedging activities.”

The FHLBanks may also manage the risk arising from changing market prices or cash flows of investment securities classified as trading by entering into derivatives (economic hedges) that offset the changes in fair value or cash flows of the securities. The market value changes of both the trading securities and the associated derivatives are included in other income in the Statement of Income and presented as part of the “Net gains (losses) on trading securities” and “Net gains (losses) on derivatives and hedging activities.”

*Anticipated Debt Issuance*—The FHLBanks may enter into interest-rate swaps for the anticipated issuance of fixed-rate bonds to lock in the cost of funding. The interest-rate swap is terminated upon issuance of the fixed-rate bond, with the realized gain or loss on the interest-rate swap recorded in other comprehensive income. Realized gains and losses reported in accumulated other comprehensive income are recognized as earnings in the periods in which earnings are affected by the cash flows of the fixed rate bonds.

#### *Managing Credit Risk on Derivatives*

The FHLBanks are subject to credit risk due to the risk of nonperformance by counterparties to the derivative agreements. The degree of counterparty risk depends on the extent to which master netting arrangements are included in such contracts to mitigate the risk. The FHLBanks manage counterparty credit risk through credit analysis, collateral requirements and adherence to the requirements set forth in FHLBank policies and Finance Board regulations. Based on credit analyses and collateral requirements, the management of each FHLBank does not anticipate any credit losses on its derivative agreements.

The contractual or notional amount of derivatives reflects the involvement of the FHLBanks in the various classes of financial instruments. The notional amount of derivatives does not measure the credit risk exposure of the FHLBanks, and the maximum credit exposure of the FHLBanks is substantially less than the notional amount. The FHLBanks require collateral agreements on all derivatives that establish collateral delivery thresholds. The maximum credit risk is the estimated cost of replacing interest-rate swaps, forward agreements, mandatory delivery contracts for mortgage loans, and purchased caps and floors that have a net positive market value, assuming the counterparty defaults and the related collateral, if any, is of no value to the FHLBanks. This collateral has not been sold or repledged.

At December 31, 2006 and 2005, the FHLBanks’ maximum credit risk, as defined above, was approximately \$1,628 million and \$927 million. These totals include \$1,102 million and \$313 million of net accrued interest receivable. In determining maximum credit risk, the FHLBanks consider accrued interest receivables and payables, and the legal right to offset derivative assets and liabilities

by counterparty. The FHLBanks held securities and cash with a fair value of \$1,001 million and \$731 million as collateral at December 31, 2006 and 2005. Additionally, collateral with respect to derivatives with member institutions includes collateral assigned to an FHLBank, as evidenced by a written security agreement and held by the member institution for the benefit of the FHLBank.

Each FHLBank transacts most of its derivatives with large banks and major broker-dealers. Some of these banks and broker-dealers or their affiliates buy, sell, and distribute consolidated obligations. Note 20 discusses assets pledged by the FHLBanks to these counterparties.

The FHLBanks have issued some consolidated obligations denominated in currencies other than U.S. dollars, and the FHLBanks use forward exchange contracts to hedge foreign currency risk. These contracts are agreements to exchange different currencies at specified future dates and at specified rates. The use of these contracts effectively simulates the conversion of these consolidated obligations denominated in foreign currencies to ones denominated in U.S. dollars. Such transactions are treated as foreign currency fair-value hedges under SFAS 133, whereby the fair value changes of the foreign-currency-denominated obligation and the forward contract are recorded in current-period earnings. At December 31, 2006 and 2005, there were no consolidated obligations denominated in foreign currencies. The FHLBanks are not exposed to any amounts of foreign currency risk.

*Intermediation.* To assist its members in meeting their hedging needs, an FHLBank may act as an intermediary between the members and other counterparties by entering into offsetting derivatives. This intermediation allows smaller members access to the derivatives market. The derivatives used in intermediary activities do not qualify for SFAS 133 hedge accounting treatment and are separately marked-to-market through earnings. The net result of the accounting for these derivatives does not significantly affect the operating results of the FHLBanks. These amounts are recorded in other income and presented as “Net gains (losses) on derivatives and hedging activities.”

Derivatives in which an FHLBank is an intermediary may arise when the FHLBank: (1) enters into derivatives with members and offsetting derivatives with other counterparties to meet the needs of its members, and (2) enters into derivatives to offset the economic effect of other derivatives that are no longer designated to either advances, investments, or consolidated obligations.

The notional principal of derivatives in which the FHLBanks were intermediaries was \$2,284 million and \$3,486 million at December 31, 2006 and 2005.

*Financial Statement Effect and Additional Financial Information*

Net gains (losses) on derivatives and hedging activities for the years ended December 31, 2006, 2005 and 2004 are as follows:

**Net Gains (Losses) on Derivatives and Hedging Activities  
(Dollar amounts in millions)**

	<u>For the Year Ended</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Gains (losses) related to fair-value hedge ineffectiveness . . . . .	\$21	\$(25)	\$ 38
Gains (losses) on economic hedges . . . . .	63	2	(865)
(Losses) gains related to cash-flow hedge ineffectiveness . . . . .	<u>(1)</u>	<u>      </u>	<u>43</u>
Net gains (losses) on derivatives and hedging activities . . . . .	<u>\$83</u>	<u>\$(23)</u>	<u>\$(784)</u>

There were no material amounts for the years ended December 31, 2006, 2005 and 2004 that were reclassified into earnings as a result of the discontinuance of cash-flow hedges because it became probable that the original forecasted transactions would not occur by the end of the originally specified time period or within a two-month period thereafter. At December 31, 2006, the

deferred net gains (losses) on derivative instruments accumulated in other comprehensive income expected to be reclassified to earnings during the next twelve months is not material. The maximum length of time over which the FHLBanks are hedging their exposure to the variability in future cash flows for forecasted transactions, excluding those forecasted transactions related to the payment of variable interest on existing financial instruments, is generally no more than six months. For the FHLBank of Chicago, the maximum length of time over which forecasted transactions are hedged is seven years relating to traditional member finance activities.

The following table represents outstanding notional balances and estimated fair values of the derivatives outstanding at December 31, 2006 and 2005 (dollar amounts in millions):

	2006		2005	
	Notional	Estimated Fair Value	Notional	Estimated Fair Value
<b>Interest-rate Swaps:</b>				
Fair Value .....	\$757,782	\$(2,681)	\$686,563	\$(5,827)
Cash Flow .....			1,058	1
Economic .....	103,088	(161)	89,896	(302)
<b>Interest-rate Swaptions:</b>				
Fair Value .....	4,990	36	4,037	65
Economic .....	11,314	19	9,521	39
<b>Interest-rate Caps/Floors:</b>				
Fair Value .....	10,217	71	14,723	143
Cash Flow .....	1,925	20	3,301	140
Economic .....	12,261	18	10,171	34
<b>Interest-rate Futures/Forwards:</b>				
Fair Value .....	6,462		4,948	(3)
Economic .....	116		93	
<b>Mortgage Delivery Commitments:</b>				
Economic .....	221		202	1
<b>Other:</b>				
Economic .....	70		141	
Total .....	<u>\$908,446</u>	<u>\$(2,678)</u>	<u>\$824,654</u>	<u>\$(5,709)</u>
Total derivatives excluding accrued interest .....		\$(2,678)		\$(5,709)
Accrued interest .....		1,418		779
Net derivative balances .....		<u>\$(1,260)</u>		<u>\$(4,930)</u>
Net derivative asset balances .....		\$ 1,626		\$ 945
Net derivative liability balances .....		<u>(2,886)</u>		<u>(5,875)</u>
Net derivative balances .....		<u>\$(1,260)</u>		<u>\$(4,930)</u>

#### Note 19—Estimated Fair Values

The following estimated fair value amounts have been determined by the FHLBanks using available market information and each FHLBank's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to the FHLBanks at December 31, 2006 and 2005. Although an FHLBank uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique or valuation methodology. For example, because an active secondary market does not exist for a portion of the

FHLBanks' financial instruments, in certain cases, fair values are not subject to precise quantification or verification and may change as economic and market factors and evaluation of those factors change. Therefore, these estimated fair values are not necessarily indicative of the amounts that would be realized in current market transactions. The Fair Value Summary Tables do not represent an estimate of the overall market value of the FHLBanks as going concerns, which would take into account future business opportunities.

*Cash and due from banks.* The estimated fair value approximates the recorded book balance.

*Interest-bearing deposits and investment securities.* The estimated fair value is determined based on quoted prices, excluding accrued interest, at the last business day of the year for instruments with more than three months to maturity. When quoted prices are not available, the estimated fair value is determined by calculating the present value of the expected future cash flows and reducing the amount for accrued interest receivable. For instruments with three months or less to maturity, the recorded book balance approximates the estimated fair value.

*Securities purchased under agreements to resell.* The estimated fair value is determined by calculating the present value of the future cash flows for instruments with more than three months to maturity. The discount rates used in these calculations are the rates for securities with similar terms. For instruments with three months or less to maturity, the recorded book balance approximates the estimated fair value.

*Federal funds sold.* The estimated fair value is determined by calculating the present value of the expected future cash flows for instruments with more than three months to maturity. The discount rates used in these calculations are the rates for Federal funds with similar terms. The estimated fair value approximates the recorded book balance of Federal funds with three months or less to maturity.

*Advances and other loans.* The FHLBanks determine the estimated fair value of advances with fixed rates and more than three months to maturity and advances with complex variable rates by calculating the present value of expected future cash flows from the advances and excluding the amount of the accrued interest receivable. The discount rates used in these calculations are the replacement advance rates for advances with similar terms. In accordance with the Finance Board's advances regulations, advances with a maturity or repricing period greater than six months require a prepayment fee sufficient to make the FHLBanks financially indifferent to the borrower's decision to prepay the advances. Therefore, the estimated fair value of advances does not assume prepayment risk. The estimated fair value approximates the recorded book balance of advances with variable rates and fixed rates with three months or less to maturity or repricing.

*Mortgage loans held for portfolio.* The estimated fair values for mortgage loans are determined based on quoted market prices of similar mortgage loans available in the market or modeled prices. Market prices are determined assuming similar pricing with other agency mortgage-backed securities and mortgage loans held for portfolio, and are highly dependent upon the underlying prepayment assumptions. The modeled prices start with prices for new mortgage-backed securities issued by U.S. government sponsored enterprises. Prices are then adjusted for differences in coupon, average loan rate, seasoning and cash flow remittance between the FHLBank's mortgage loans and mortgage-backed securities. The referenced mortgage-backed securities are highly dependent upon the underlying prepayment assumptions priced in the secondary market. Changes in the prepayment rates often have a material effect on the fair value estimates. Since these underlying prepayment assumptions are made at a specific point in time, they are susceptible to material changes in the near term.

*Accrued interest receivable and payable.* The estimated fair value approximates the recorded book value.

*Derivative assets/liabilities.* The FHLBanks base the estimated fair values of derivatives with similar terms on available market prices including accrued interest receivable and payable. However, active markets do not exist for many types of financial instruments. Consequently, fair



values for these instruments must be estimated using techniques such as discounted cash-flow analysis and comparisons to similar instruments. Estimates developed using these methods are highly subjective and require judgments regarding significant matters such as the amount and timing of future cash flows and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Because these estimates are made at a specific point in time, they are susceptible to material near-term changes. The fair values are netted by counterparty where such legal right of offset exists. If these netted amounts are positive, they are classified as an asset and if negative, a liability.

*Deposits.* The FHLBanks determine fair values of deposits with fixed-rates and more than three months to maturity by calculating the present value of expected future cash flows from the deposits and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of deposits with similar terms. The estimated fair value approximates the recorded book balance for deposits with variable rates and fixed rates with three months or less to maturity or repricing.

*Borrowings.* The FHLBanks determine the estimated fair value of borrowings with fixed rates and more than three months to maturity by calculating the present value of expected future cash flows from the borrowings and reducing this amount for accrued interest payable. The discount rates used in these calculations are the cost of borrowings with similar terms. For borrowings with variable rates and fixed rates with three months or less to maturity or repricing, the estimated fair value approximates the recorded book balance.

*Consolidated obligations.* The FHLBanks estimate fair values based on: the cost of raising comparable term debt, independent market-based prices received from a third-party pricing service, or internal valuation models. The estimated cost of issuing debt includes non-interest selling costs.

*Subordinated notes.* Fair value is determined based on independent market-based prices received from a third-party pricing service.

*Mandatorily redeemable capital stock.* The fair value of capital subject to mandatory redemption is generally at par value as indicated by member contemporaneous purchases and sales at par value. Fair value also includes estimated dividend earned at the time of reclassification from equity to liabilities, until such amount is paid, and any subsequently declared stock dividend. FHLBank stock can only be acquired by members at par value and redeemed at par value. FHLBank stock is not traded and no market mechanism exists for the exchange of stock outside the cooperative structure.

*Commitments.* The estimated fair value of the FHLBanks' commitments to extend credit, including letters of credit, was immaterial at December 31, 2006 and 2005.

*Commitments to extend credit for mortgage loans.* Certain mortgage loan purchase commitments, are recorded as derivatives at their fair value.

The estimated fair value of the FHLBanks' commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The estimated fair value of these fixed-rate loan commitments also takes into account the difference between current and committed interest rate.



The carrying values and estimated fair values of the FHLBanks' financial instruments at December 31, 2006 and 2005 are as follows (dollar amounts in millions):

**2006 FAIR VALUE SUMMARY TABLE**

<u>Financial Instruments</u>	<u>2006</u>		
	<u>Carrying Value</u>	<u>Net Unrealized Gains/(Losses)</u>	<u>Estimated Fair Value</u>
<b>Assets:</b>			
Cash and due from banks . . . . .	\$ 330	\$	\$ 330
Interest-bearing deposits . . . . .	33,872	(1)	33,871
Securities purchased under agreements to resell . . . . .	4,905		4,905
Federal funds sold . . . . .	77,056	87	77,143
Trading securities . . . . .	5,687		5,687
Available-for-sale securities . . . . .	6,661		6,661
Held-to-maturity securities . . . . .	142,482	(1,502)	140,980
Advances . . . . .	640,681	(267)	640,414
Mortgage loans held for portfolio, net . . . . .	97,974	(2,293)	95,681
Accrued interest receivable . . . . .	4,344		4,344
Derivative assets . . . . .	1,626		1,626
<b>Liabilities:</b>			
Deposits . . . . .	(18,972)	7	(18,965)
Securities sold under repurchase agreements . . . . .	(2,200)	(109)	(2,309)
Consolidated obligations:			
Discount notes . . . . .	(157,549)	18	(157,531)
Bonds . . . . .	(776,665)	2,210	(774,455)
Subordinated notes . . . . .	(1,000)	(29)	(1,029)
Mandatorily redeemable capital stock . . . . .	(1,094)		(1,094)
Accrued interest payable . . . . .	(8,549)		(8,549)
Derivative liabilities . . . . .	(2,886)		(2,886)
<b>Other:</b>			
Commitments to extend credit for advances . . . . .	7	(3)	4
Standby bond purchase agreements . . . . .		3	3
Other . . . . .	(1)	1	

## 2005 FAIR VALUE SUMMARY TABLE

<u>Financial Instruments</u>	2005		
	Carrying Value	Net Unrealized Gains/(Losses)	Estimated Fair Value
<b>Assets:</b>			
Cash and due from banks .....	\$ 356	\$	\$ 356
Interest-bearing deposits .....	35,342	(3)	35,339
Securities purchased under agreements to resell .....	3,295		3,295
Federal funds sold .....	80,557	16	80,573
Trading securities .....	7,181		7,181
Available-for-sale securities .....	5,599		5,599
Held-to-maturity securities .....	134,480	(1,601)	132,879
Advances .....	619,860	(454)	619,406
Mortgage loans held for portfolio, net .....	105,240	(2,103)	103,137
Accrued interest receivable .....	3,721		3,721
Derivative assets .....	945		945
<b>Liabilities:</b>			
Deposits .....	(19,164)	2	(19,162)
Securities sold under repurchase agreements ..	(2,594)	(108)	(2,702)
Consolidated obligations:			
Discount notes .....	(179,694)	110	(179,584)
Bonds .....	(736,207)	2,002	(734,205)
Mandatorily redeemable capital stock .....	(1,451)		(1,451)
Accrued interest payable .....	(6,315)		(6,315)
Derivative liabilities .....	(5,875)		(5,875)
<b>Other:</b>			
Commitments to extend credit for advances ..	1	(2)	(1)
Standby bond purchase agreements .....		4	4
Other .....	(1)	1	

### Note 20—Commitments and Contingencies

As described in Note 14, as provided by the Act or Finance Board regulation, consolidated obligations are backed only by the financial resources of the FHLBanks. The joint and several liability regulation of the Finance Board authorizes the Finance Board to require any FHLBank to repay all or a portion of the principal and interest on consolidated obligations for which another FHLBank is the primary obligor. No FHLBank has had to assume or pay the consolidated obligation of another FHLBank.

The FHLBanks considered the guidance under FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others—an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34* (FIN 45), and determined it was not necessary to recognize the fair value of the FHLBanks' joint and several liability for all of the consolidated obligations. The joint and several obligations are mandated by Finance Board regulations and are not the result of arms-length transactions among the FHLBanks. The FHLBanks have no control over the amount of the guaranty or the determination of how each FHLBank would perform under the joint and several obligations. Because the FHLBanks are subject to the authority of the Finance Board as it relates to decisions involving the allocation of the joint and several liability for the FHLBanks' consolidated

obligations, the FHLBanks' joint and several obligation is excluded from the initial recognition and measurement provisions of FIN 45. Accordingly, the FHLBanks have not recognized a liability for the joint and several obligations related to other FHLBanks' consolidated obligations at December 31, 2006 and 2005. The par amounts of the outstanding consolidated obligations for which the FHLBanks are jointly and severally liable were approximately \$952 billion and \$937 billion at December 31, 2006 and 2005. In addition, the FHLBank of Chicago has \$1 billion (par amount) outstanding related to subordinated notes that are not the joint and several obligation of the other 11 FHLBanks (see Note 15).

Commitments that legally bind and unconditionally obligate the FHLBanks for additional advances totaled approximately \$3,587 million and \$4,497 million at December 31, 2006 and 2005. Commitments generally are for periods up to 12 months. Standby letters of credit are executed for members for a fee. A standby letter of credit is a short-term financing arrangement between the FHLBank and its member. If the FHLBank is required to make payment for a beneficiary's draw, these amounts are converted into a collateralized advance to the member. Outstanding standby letters of credit were as follows:

	<u>2006</u>	<u>2005</u>
Outstanding notional (dollar amounts in millions) . . . . .	\$20,068	\$10,893
Original terms . . . . .	less than one month to 20 years	
Final expiration year . . . . .	2024	2024

Unearned fees for transactions prior to 2003, as well as the value of the guarantees related to standby letters of credit entered into after 2002, are recorded in other liabilities and amount to \$16 million and \$12 million at December 31, 2006 and 2005. Based on credit analyses performed by each FHLBank's management as well as collateral requirements, the FHLBanks have not deemed it necessary to record any additional liability on these commitments. Commitments are fully collateralized at the time of issuance (see Note 8). The estimated fair values of commitments at December 31, 2006 and 2005 are reported in Note 19.

Certain FHLBanks have entered into standby bond purchase agreements with state housing authorities within their district whereby the FHLBank, for a fee, agrees to purchase and hold the authorities' bonds until the designated marketing agent can find a suitable investor or the housing authority repurchases the bond according to a schedule established by the standby agreement. Each standby agreement dictates the specific terms that would require the FHLBank to purchase the bond. The bond purchase commitments entered into by these FHLBanks have expiration periods up to eight years, no later than 2014, though some are renewable at the option of an FHLBank. Total commitments for standby bond purchases were \$1,835 million at December 31, 2006, with nine state housing authorities. Total commitments for standby bond purchases were \$1,917 million at December 31, 2005, with nine state housing authorities. During 2006 and 2005, the FHLBanks were required to purchase 18 and zero bonds under these agreements.

Commitments that unconditionally obligate the FHLBanks to fund or purchase mortgage loans totaled \$242 million and \$219 million at December 31, 2006 and 2005. Commitments are generally for periods not to exceed 365 days. Of these amounts, \$221 million and \$202 million at December 31, 2006 and 2005 represent commitments that obligate the FHLBanks to purchase closed mortgage loans from their members, which are recorded at fair value as derivatives under SFAS 149 (see Note 18). Commitments that obligate the FHLBanks to table fund mortgage loans are not considered derivatives under SFAS 149. Unused lines of credit and other commitments totaled \$22,857 million and \$22,495 million at December 31, 2006 and 2005.

The FHLBanks generally execute interest-rate exchange agreements with major banks and broker-dealers and generally enter into bilateral collateral agreements. At December 31, 2006, the FHLBanks had pledged, as collateral, securities with a carrying value of \$2,939 million, of which

\$455 million cannot be sold or repledged and \$2,484 million can be sold or repledged, to counterparties who have market risk exposure from the FHLBanks related to derivatives.

The FHLBanks entered into \$10,319 million (par value) of consolidated bonds and \$263 million (par value) of consolidated discount notes that had traded but not settled at December 31, 2006.

The FHLBanks charged to operating expenses net rental costs of approximately \$26 million, \$26 million and \$24 million for the years ended December 31, 2006, 2005 and 2004. Future minimum rentals at December 31, 2006, are as follows (dollar amounts in millions):

<u>Year</u>	<u>Premises</u>	<u>Equipment</u>	<u>Total</u>
Year 1 .....	\$ 22	\$2	\$ 24
Year 2 .....	22	2	24
Year 3 .....	22	1	23
Year 4 .....	21	1	22
Year 5 .....	18		18
Thereafter .....	63	—	63
Total .....	<u>\$168</u>	<u>\$6</u>	<u>\$174</u>

Lease agreements for FHLBank premises generally provide for increases in the basic rentals resulting from increases in property taxes and maintenance expenses. Such increases are not expected to have a material effect on the FHLBanks.

The FHLBanks are subject to legal proceedings arising in the normal course of business. After consultation with legal counsel, management of each FHLBank does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on its FHLBank's financial condition or results of operations.

Notes 8, 9, 14, 15, 16, 18, 19 and 21 discuss other commitments and contingencies.

#### **Note 21—Subsequent Events**

*FHLBank of Boston Dividend Payment.* On February 16, 2007, the FHLBank of Boston's board of directors approved payment of a cash dividend at an annualized rate of 6.75 percent based on capital stock balances outstanding during the fourth quarter of 2006. The dividend amounted to \$39.8 million and was paid on March 2, 2007.

*FHLBank of Pittsburgh Member Restructuring.* On December 21, 2006, Sovereign Bank, the FHLBank of Pittsburgh's largest customer, announced a balance sheet restructuring that involves de-leveraging of approximately \$10.0 billion in wholesale assets and \$10.0 billion in wholesale funding, including FHLBank System advances (loans), during the first quarter of 2007.

As of December 31, 2006, Sovereign's loans outstanding accounted for \$18.0 billion, or 36.5% of the FHLBank of Pittsburgh's \$49.3 billion total loans to members portfolio. As of March 13, 2007, Sovereign's loans outstanding had declined \$2.1 billion from year-end 2006 levels.

*FHLBank of Indianapolis Mortgage Loans Transactions with Member.* On January 22, 2007, the FHLBank of Indianapolis' member, LaSalle Bank Midwest, NA sold its subsidiary, ABN AMRO Mortgage Group, to Citigroup. The FHLBank of Indianapolis has been purchasing mortgage loans from LaSalle Bank Midwest, NA that were originated by ABN AMRO Mortgage Group, its U.S.-based, wholesale residential mortgage broker origination platform and servicing business. Although the FHLBank of Indianapolis can no longer purchase mortgage loans originated by ABN AMRO Mortgage Group, its mortgage loans from ABN AMRO Mortgage Group of \$4,285,688,000, representing 42.9% of its mortgage loans outstanding, at par, at December 31, 2006, will remain outstanding until maturity or prepayment. Further, the FHLBank of Indianapolis can still make advances to LaSalle Bank Midwest, NA, or purchase mortgage loans from them as

LaSalle Bank Midwest, NA will remain in the retail residential mortgage business. At December 31, 2006, the FHLBank of Indianapolis held \$5,200,171,000 (par value) of advances to LaSalle Bank Midwest, NA, which represented 23.2% of its total advances, at par. LaSalle Bank Midwest, NA had a capital balance of \$334,110,000 at December 31, 2006, which represented 17.2% of the FHLBank of Indianapolis' capital stock balance.

*FHLBank of Seattle Termination of the Finance Board Agreement.* On January 11, 2007, the FHLBank of Seattle's regulator, the Finance Board, terminated the Written Agreement between the FHLBank of Seattle and the Finance Board dated as of December 10, 2004. The Written Agreement imposed certain requirements on the FHLBank of Seattle relating to its risk management, capital structure, corporate governance, and capital plan. The Written Agreement had required the FHLBank of Seattle to, among other things:

- Develop a business plan (which the FHLBank of Seattle first implemented as its three-year business and capital management plan in May 2005 and which has since been updated) acceptable to the Finance Board, that, among other things: (1) did not increase its market, credit, or operational risk profiles; (2) specified a minimum regulatory capital-to-assets ratio that was consistent with the business strategy presented in the business plan; and (3) established appropriate capital stock, retained earnings and dividend policies;
- Engage consultants to conduct independent reviews of its senior management and its board's oversight and of its risk management policies, procedures and practices, and respond to any recommendations of the independent consultants; and,
- Prohibit increases in its mortgage loan assets held for portfolio (i.e., purchases from its members through its mortgage purchase program, which the FHLBank of Seattle has been exiting since early 2005) by an amount in excess of 10% of the net book value of such assets at November 18, 2004, which was \$10.6 billion, unless the Finance Board agreed otherwise.

The termination of the Written Agreement will not affect:

- the indefinite suspension of its repurchase of any Class B stock, except upon approval of the Finance Board and as first approved by the FHLBank of Seattle's board in May 2005 and updated in December 2006; and
- dividend restrictions generally providing that dividend payments may not exceed 50.0% of year-to-date GAAP net income as approved by its board in December 2006.

*FHLBank of Seattle Board Approval Regarding Reduction of Minimum Capital-to-Assets Ratio.* On January 26, 2007, the FHLBank of Seattle's Board approved a reduction in the FHLBank of Seattle's minimum capital-to-assets ratio from 4.25% to 4.05%. The FHLBank of Seattle intends to continue to take action pursuant to its updated business plan.

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CONDITION**  
**DECEMBER 31, 2006**

(Dollar amounts in millions)

	Combined	Combining Adjustments	Boston	New York	Pittsburgh	Atlanta
<b>ASSETS</b>						
Cash and due from banks	\$ 330	\$	\$ 8	\$ 39	\$ 78	\$ 29
Interest-bearing deposits	33,872		940	5,591	3,615	796
Deposits with other FHLBanks for mortgage loan programs		(12)			5	5
Securities purchased under agreements to resell	4,905		3,250			
Federal funds sold	77,056		2,607	3,661	3,370	10,532
Trading securities	5,687	(321)	151			4,515
Available-for-sale securities	6,661	(57)	988		66	
Held-to-maturity securities	142,482	(4,225)	7,306	11,251	12,939	19,330
Advances	640,681		37,342	59,013	49,335	101,476
Mortgage loans held for portfolio	97,981		4,502	1,484	6,967	3,004
Less: allowance for credit losses on mortgages loans	7			1	1	1
Mortgage loans held for portfolio, net	97,974		4,502	1,483	6,966	3,003
Accrued interest receivable	4,344	(59)	214	406	417	692
Premises, software, and equipment, net	217		6	11	22	31
Derivative assets	1,626		129	225	499	259
Other assets	634	6	27	23	64	90
<b>Total assets</b>	<b>\$1,016,469</b>	<b>\$(4,668)</b>	<b>\$57,470</b>	<b>\$81,703</b>	<b>\$77,376</b>	<b>\$140,758</b>
<b>LIABILITIES</b>						
Deposits:						
Interest-bearing:						
Demand and overnight	\$ 17,512	\$	\$ 1,087	\$ 2,182	\$ 1,056	\$ 4,445
Term	441		29	80	1	13
Deposits from other FHLBanks for mortgage loan programs		(12)				
Other	795		3	126	352	142
<b>Total interest-bearing</b>	<b>18,748</b>	<b>(12)</b>	<b>1,119</b>	<b>2,388</b>	<b>1,409</b>	<b>4,600</b>
Non-interest-bearing:						
Demand and overnight	103			2	17	20
Other	121		5			
<b>Total non-interest-bearing</b>	<b>224</b>		<b>5</b>	<b>2</b>	<b>17</b>	<b>20</b>
<b>Total deposits</b>	<b>18,972</b>	<b>(12)</b>	<b>1,124</b>	<b>2,390</b>	<b>1,426</b>	<b>4,620</b>
Borrowings:						
Securities sold under agreements to repurchase	2,200					500
<b>Total borrowings</b>	<b>2,200</b>					<b>500</b>
Consolidated obligations, net:						
Discount notes	157,549		17,724	12,191	17,845	4,934
Bonds	776,665	(4,548)	35,518	62,043	53,627	122,068
<b>Total consolidated obligations, net</b>	<b>934,214</b>	<b>(4,548)</b>	<b>53,242</b>	<b>74,234</b>	<b>71,472</b>	<b>127,002</b>
Subordinated notes	1,000					
Mandatorily redeemable capital stock	1,094		12	110	8	216
Accrued interest payable	8,549	(59)	358	735	566	1,387
Affordable Housing Program	805		45	102	49	130
Payable to REFCORP	165		13	17	15	23
Derivative liabilities	2,886		121	108	144	570
Other liabilities	1,599		23	103	62	136
<b>Total liabilities</b>	<b>971,484</b>	<b>(4,619)</b>	<b>54,938</b>	<b>77,799</b>	<b>73,742</b>	<b>134,584</b>
<b>CAPITAL</b>						
Capital Stock:						
Capital stock Class B putable (\$100 par value) issued and outstanding	38,882		2,343	3,546	3,384	5,772
Capital stock Class A putable (\$100 par value) issued and outstanding	532					
Capital stock Pre-conversion putable (\$100 par value) issued and outstanding	2,587					
<b>Total capital stock</b>	<b>42,001</b>		<b>2,343</b>	<b>3,546</b>	<b>3,384</b>	<b>5,772</b>
Retained earnings	3,143	(44)	187	368	255	407
Accumulated other comprehensive income:						
Net unrealized (losses) gains on available-for-sale securities	(8)		3		2	
Net unrealized (losses) gains relating to hedging activities	(114)	(5)	2	(5)	(5)	
Other	(37)		(3)	(5)	(2)	(5)
<b>Total capital</b>	<b>44,985</b>	<b>(49)</b>	<b>2,532</b>	<b>3,904</b>	<b>3,634</b>	<b>6,174</b>
<b>Total liabilities and capital</b>	<b>\$1,016,469</b>	<b>\$(4,668)</b>	<b>\$57,470</b>	<b>\$81,703</b>	<b>\$77,376</b>	<b>\$140,758</b>



Cincinnati	Indianapolis	Chicago	Des Moines	Dallas	Topeka	San Francisco	Seattle
\$ 4	\$ 15	\$ 23	\$ 30	\$ 96	\$	\$ 7	\$ 1
6,536	394		11	174	4,327	9,323	2,165
				1		1	
1,150			305			200	
9,642	7,324	6,470	1,625	5,495	8,055	15,443	2,832
5		532		24	704	77	
1,188		3,097	562	715	102		
12,099	6,545	11,915	5,715	7,194	8,377	30,348	13,688
41,956	22,282	26,179	21,855	41,168	28,445	183,669	27,961
8,461	10,021	37,945	11,775	450	2,374	4,631	6,367
		1		1	1	1	
8,461	10,021	37,944	11,775	449	2,373	4,630	6,367
301	136	379	93	188	176	1,078	323
8	11	51	7	25	20	12	13
13	99	41	36	91	67	20	147
24	42	83	27	30	93	107	18
<u>\$81,387</u>	<u>\$46,869</u>	<u>\$86,714</u>	<u>\$42,041</u>	<u>\$55,650</u>	<u>\$52,739</u>	<u>\$244,915</u>	<u>\$53,515</u>
\$ 827	\$ 847	\$ 1,242	\$ 879	\$ 2,326	\$ 1,108	\$ 587	\$ 926
88		95	20	45	1	5	64
		12					
12	61	30		53	1	2	13
927	908	1,379	899	2,424	1,110	594	1,003
		22	42				
	12	92			8	4	
	12	114	42		8	4	
927	920	1,493	941	2,424	1,118	598	1,003
		1,200	500				
		1,200	500				
21,947	10,471	11,166	4,685	8,226	16,736	30,128	1,496
53,239	32,844	67,744	33,066	41,684	32,039	199,300	48,041
75,186	43,315	78,910	37,751	49,910	48,775	229,428	49,537
		1,000					
137	151	14	65	160	46	106	69
559	384	690	300	444	337	2,280	568
96	26	63	45	43	36	147	23
17	7	9	6	8	9	39	2
108	63	195	163	168	204	995	47
450	48	57	21	54	42	568	35
77,480	44,914	83,631	39,792	53,211	50,567	234,161	51,284
3,658	1,793		1,906	2,248	1,475	10,616	2,141
					532		
		2,587					
3,658	1,793	2,587	1,906	2,248	2,007	10,616	2,141
256	167	606	344	190	172	143	92
(1)		(8)			(4)		
		(99)				(2)	
(6)	(5)	(3)	(1)	1	(3)	(3)	(2)
3,907	1,955	3,083	2,249	2,439	2,172	10,754	2,231
<u>\$81,387</u>	<u>\$46,869</u>	<u>\$86,714</u>	<u>\$42,041</u>	<u>\$55,650</u>	<u>\$52,739</u>	<u>\$244,915</u>	<u>\$53,515</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CONDITION**  
**DECEMBER 31, 2005**  
**(Dollar amounts in millions)**

	Combined	Combining Adjustments	Boston	New York	Pittsburgh	Atlanta
<b>ASSETS</b>						
Cash and due from banks	\$ 356	\$	\$ 10	\$ 22	\$ 115	\$ 13
Interest-bearing deposits	35,342		2,130	8,699	3,254	249
Deposits with other FHLBanks for mortgage loan programs		(11)			6	5
Securities purchased under agreements to resell	3,295					
Federal funds sold	80,557		4,775	2,925	2,320	13,029
Trading securities	7,181	(329)	217			5,260
Available-for-sale securities	5,599	(57)	1,016		331	
Held-to-maturity securities	134,480	(5,275)	6,329	9,566	11,035	19,629
Advances	619,860		38,068	61,902	47,493	101,265
Mortgage loans held for portfolio	105,250		4,888	1,468	7,653	2,861
Less: allowance for credit losses on mortgages loans	10		2	1	1	1
Mortgage loans held for portfolio, net	105,240		4,886	1,467	7,652	2,860
Accrued interest receivable	3,721	(68)	190	378	304	621
Premises and equipment, net	200		6	11	15	31
Derivative assets	945		45	19	317	157
Other assets	613	7	28	25	56	94
<b>Total assets</b>	<b>\$997,389</b>	<b>\$(5,733)</b>	<b>\$57,700</b>	<b>\$85,014</b>	<b>\$72,898</b>	<b>\$143,213</b>
<b>LIABILITIES</b>						
Deposits:						
Interest-bearing:						
Demand and overnight	\$ 17,903	\$	\$ 571	\$ 2,637	\$ 882	\$ 5,071
Term	456		24	20	10	43
Deposits from other FHLBanks for mortgage loan programs		(11)				
Other	576		3		169	77
Interest-bearing	18,935	(11)	598	2,657	1,061	5,191
Non-interest-bearing:						
Demand and overnight	133			1	22	44
Other	96		4			
Non-interest-bearing	229		4	1	22	44
<b>Total deposits</b>	<b>19,164</b>	<b>(11)</b>	<b>602</b>	<b>2,658</b>	<b>1,083</b>	<b>5,235</b>
Borrowings:						
Securities sold under agreements to repurchase	2,594					500
<b>Total borrowings</b>	<b>2,594</b>					<b>500</b>
Consolidated obligations, net:						
Discount notes	179,694		24,340	20,511	14,580	9,579
Bonds	736,207	(5,577)	29,442	56,769	53,143	119,173
<b>Total consolidated obligations, net</b>	<b>915,901</b>	<b>(5,577)</b>	<b>53,782</b>	<b>77,280</b>	<b>67,723</b>	<b>128,752</b>
Mandatorily redeemable capital stock	1,451		8	18	17	143
Accrued interest payable	6,315	(68)	277	498	436	1,067
Affordable Housing Program	739		36	91	37	106
Payable to REFCORP	197		13	14	15	21
Derivative liabilities	5,875		256	492	278	1,199
Other liabilities	673		48	78	49	108
<b>Total liabilities</b>	<b>952,909</b>	<b>(5,656)</b>	<b>55,022</b>	<b>81,129</b>	<b>69,638</b>	<b>137,131</b>
<b>CAPITAL</b>						
Capital Stock:						
Capital stock Class B putable (\$100 par value) issued and outstanding	37,786		2,532	3,590	3,079	5,753
Capital stock Class A putable (\$100 par value) issued and outstanding	498					
Capital stock Pre-conversion putable (\$100 par value) issued and outstanding	3,759					
<b>Total capital stock</b>	<b>42,043</b>		<b>2,532</b>	<b>3,590</b>	<b>3,079</b>	<b>5,753</b>
Retained earnings	2,600	(71)	135	291	189	329
Accumulated other comprehensive income:						
Net unrealized (losses) gains on available-for-sale securities	(6)		8		1	
Net unrealized (losses) gains relating to hedging activities	(145)	(6)	4	5	(8)	
Other	(12)		(1)	(1)	(1)	
<b>Total capital</b>	<b>44,480</b>	<b>(77)</b>	<b>2,678</b>	<b>3,885</b>	<b>3,260</b>	<b>6,082</b>
<b>Total liabilities and capital</b>	<b>\$997,389</b>	<b>\$(5,733)</b>	<b>\$57,700</b>	<b>\$85,014</b>	<b>\$72,898</b>	<b>\$143,213</b>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 5	\$ 38	\$ 33	\$ 42	\$ 62	\$	\$ 12	\$ 4
6,284	914		700	384	4,399	6,899	1,430
1,000		390	305			750	850
7,488	4,655	6,555	2,985	7,896	4,504	16,997	6,428
6	43	1,087	9	46	714	128	
1,151		1,790	250	1,015	103		
12,291	6,820	7,893	5,978	8,205	7,440	29,691	14,878
40,262	25,814	24,921	22,283	46,457	27,087	162,873	21,435
8,418	9,540	42,006	13,019	543	2,423	5,215	7,216
		1	1	1	1	1	
8,418	9,540	42,005	13,018	542	2,422	5,214	7,216
239	119	336	100	191	151	909	251
8	11	49	2	25	19	9	14
	97	232	19		22	24	13
28	41	55	32	29	99	96	23
<u>\$ 77,180</u>	<u>\$48,092</u>	<u>\$85,346</u>	<u>\$45,723</u>	<u>\$64,852</u>	<u>\$46,960</u>	<u>\$223,602</u>	<u>\$ 52,542</u>
\$ 836	\$ 723	\$ 663	\$ 816	\$ 3,788	\$ 791	\$ 407	\$ 718
60		51	11	29	95	30	83
		11					
14	77	226			8	2	
910	800	951	827	3,817	894	439	801
		27	38	1			
1		79			7	5	
1		106	38	1	7	5	
911	800	1,057	865	3,818	901	444	801
		1,200	500				394
		1,200	500				394
17,578	9,367	16,778	4,067	11,220	13,435	27,618	10,621
53,520	34,972	61,118	37,130	46,122	29,888	182,625	37,882
71,098	44,339	77,896	41,197	57,342	43,323	210,243	48,503
418	44	222	85	319	64	47	66
437	328	551	316	397	251	1,448	377
91	27	78	46	39	31	126	31
16	7	12	51	8	13	27	
428	193	136	379	406	413	1,561	134
72	51	56	23	49	46	58	35
73,471	45,789	81,208	43,462	62,378	45,042	213,954	50,341
3,503	2,156		1,932	2,299	1,290	9,520	2,132
					498		
		3,759					
3,503	2,156	3,759	1,932	2,299	1,788	9,520	2,132
208	149	525	330	178	137	131	69
2		(9)		(3)	(5)		
		(137)				(3)	
(4)	(2)		(1)		(2)		
3,709	2,303	4,138	2,261	2,474	1,918	9,648	2,201
<u>\$ 77,180</u>	<u>\$48,092</u>	<u>\$85,346</u>	<u>\$45,723</u>	<u>\$64,852</u>	<u>\$46,960</u>	<u>\$223,602</u>	<u>\$ 52,542</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2006**

(Dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>INTEREST INCOME</b>						
Advances . . . . .	\$32,411	\$	\$1,990	\$3,283	\$2,434	\$5,254
Prepayment fees on advances, net . . . . .	44		1	19	1	1
Interest-bearing deposits . . . . .	1,777		85	301	178	34
Deposits with other FHLBanks for mortgage loan programs . . . . .		(1)				1
Securities purchased under agreements to resell . . . . .	197		66			
Federal funds sold . . . . .	3,456		160	145	219	535
Trading securities . . . . .	365	(20)	11			283
Available-for-sale securities . . . . .	298	(3)	45		7	
Held-to-maturity securities . . . . .	6,859	(141)	370	580	551	927
Mortgage loans held for portfolio . . . . .	5,155		238	76	373	152
Loans to other FHLBanks . . . . .		(1)				
Other . . . . .	5					
<b>Total interest income . . . . .</b>	<b>50,567</b>	<b>(166)</b>	<b>2,966</b>	<b>4,404</b>	<b>3,763</b>	<b>7,187</b>
<b>INTEREST EXPENSE</b>						
Consolidated obligations — Discount notes . . . . .	7,873		1,177	902	655	353
Consolidated obligations — Bonds . . . . .	37,341	(171)	1,457	2,944	2,703	5,911
Deposits . . . . .	813		28	85	58	219
Deposits from other FHLBanks for mortgage loan programs . . . . .		(1)				
Borrowings from other FHLBanks . . . . .		(1)	1			
Securities sold under agreements to repurchase . . . . .	152				1	23
Subordinated notes . . . . .	31					
Mandatorily redeemable capital stock . . . . .	60		1	3	2	9
Other borrowings . . . . .	4					1
<b>Total interest expense . . . . .</b>	<b>46,274</b>	<b>(173)</b>	<b>2,664</b>	<b>3,934</b>	<b>3,419</b>	<b>6,516</b>
<b>NET INTEREST INCOME . . . . .</b>	<b>4,293</b>	<b>7</b>	<b>302</b>	<b>470</b>	<b>344</b>	<b>671</b>
(Reversal) provision for credit losses . . . . .	(1)		(2)		2	
<b>NET INTEREST INCOME AFTER (REVERSAL) PROVISION FOR CREDIT LOSSES . . . . .</b>	<b>4,294</b>	<b>7</b>	<b>304</b>	<b>470</b>	<b>342</b>	<b>671</b>
<b>OTHER INCOME (LOSS)</b>						
Service fees . . . . .	25		3	3	5	2
Net losses on trading securities . . . . .	(127)		(2)			(99)
Net realized losses from sale of available-for-sale securities . . . . .	(3)					
Net realized losses from sale of held-to-maturity securities . . . . .	(6)					
Net gains (losses) on derivatives and hedging activities . . . . .	83		11	10	7	91
Other, net . . . . .	31	16		(26)	2	2
<b>Total other income (loss) . . . . .</b>	<b>3</b>	<b>16</b>	<b>12</b>	<b>(13)</b>	<b>14</b>	<b>(4)</b>
<b>OTHER EXPENSE</b>						
Operating . . . . .	671		45	63	57	92
Finance Board . . . . .	32		1	3	2	4
Office of Finance . . . . .	25		2	3	2	3
Other . . . . .	15	(4)	1			3
<b>Total other expense . . . . .</b>	<b>743</b>	<b>(4)</b>	<b>49</b>	<b>69</b>	<b>61</b>	<b>102</b>
<b>INCOME BEFORE ASSESSMENTS . . . . .</b>	<b>3,554</b>	<b>27</b>	<b>267</b>	<b>388</b>	<b>295</b>	<b>565</b>
Affordable Housing Program . . . . .	295		22	32	25	47
REFCORP. . . . .	647		49	71	54	104
<b>Total assessments . . . . .</b>	<b>942</b>		<b>71</b>	<b>103</b>	<b>79</b>	<b>151</b>
<b>NET INCOME . . . . .</b>	<b>\$ 2,612</b>	<b>\$ 27</b>	<b>\$ 196</b>	<b>\$ 285</b>	<b>\$ 216</b>	<b>\$ 414</b>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$2,290	\$1,175	\$1,189	\$1,136	\$2,182	\$1,413	\$8,776	\$1,289
6	3	8		2	1	1	1
234	49		11	18	249	558	60
54		15	15			35	12
309	337	428	139	197	217	522	248
	1	45		2	37	6	
60		122	22	42	3		
549	311	536	273	417	407	1,500	579
430	510	2,023	615	28	123	243	344
1							
				1	4		
<u>3,933</u>	<u>2,386</u>	<u>4,366</u>	<u>2,211</u>	<u>2,889</u>	<u>2,454</u>	<u>11,641</u>	<u>2,533</u>
925	439	745	269	390	671	980	367
2,566	1,682	3,034	1,721	2,124	1,525	9,799	2,046
43	56	52	35	146	38	18	35
		1					
		91	29				8
		31					
13	4	5	3	13	3	4	
					2	1	
<u>3,547</u>	<u>2,181</u>	<u>3,959</u>	<u>2,057</u>	<u>2,673</u>	<u>2,239</u>	<u>10,802</u>	<u>2,456</u>
386	205	407	154	216	215	839	77
			(1)				
<u>386</u>	<u>205</u>	<u>407</u>	<u>155</u>	<u>216</u>	<u>215</u>	<u>839</u>	<u>77</u>
1	1	1	2	3	1	1	2
	(1)	(17)		(1)	(7)		
		(3)					
							(6)
2	(4)	(28)	2	(5)	11	(14)	
3	2	14	5	4	(1)	3	7
<u>6</u>	<u>(2)</u>	<u>(33)</u>	<u>9</u>	<u>1</u>	<u>4</u>	<u>(10)</u>	<u>3</u>
36	38	109	39	46	28	78	40
3	2	3	2	2	1	7	2
2	1	2	1	1	2	5	1
5	2	4			2		2
<u>46</u>	<u>43</u>	<u>118</u>	<u>42</u>	<u>49</u>	<u>33</u>	<u>90</u>	<u>45</u>
346	160	256	122	168	186	739	35
30	13	21	10	15	16	61	3
63	29	47	23	31	34	136	6
93	42	68	33	46	50	197	9
<u>\$ 253</u>	<u>\$ 118</u>	<u>\$ 188</u>	<u>\$ 89</u>	<u>\$ 122</u>	<u>\$ 136</u>	<u>\$ 542</u>	<u>\$ 26</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2005**

(Dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>INTEREST INCOME</b>						
Advances	\$20,782	\$	\$1,093	\$2,168	\$1,527	\$3,437
Prepayment fees on advances	75		9	7	2	2
Interest-bearing deposits	830		64	194	61	31
Securities purchased under agreements to resell	115		30			
Federal funds sold	1,915		123	98	57	240
Trading securities	438	(25)	14		3	317
Available-for-sale securities	346	(18)	29	19	17	
Held-to-maturity securities	5,497	(227)	288	566	383	848
Mortgage loans held for portfolio	5,416	1	211	69	402	132
Loans to other FHLBanks		(1)				
Other	6					
Total interest income	<u>35,420</u>	<u>(270)</u>	<u>1,861</u>	<u>3,121</u>	<u>2,452</u>	<u>5,007</u>
<b>INTEREST EXPENSE</b>						
Consolidated obligations—Discount notes	5,309		570	659	528	224
Consolidated obligations—Bonds	25,207	(293)	1,017	2,002	1,580	3,958
Deposits	523		18	62	31	153
Borrowings from other FHLBanks		(1)			1	
Securities sold under agreements to repurchase	123					29
Mandatorily redeemable capital stock	48		2	3	1	9
Other borrowings	3				1	
Total interest expense	<u>31,213</u>	<u>(294)</u>	<u>1,607</u>	<u>2,726</u>	<u>2,142</u>	<u>4,373</u>
<b>NET INTEREST INCOME</b>	<u>4,207</u>	<u>24</u>	<u>254</u>	<u>395</u>	<u>310</u>	<u>634</u>
Provision (reversal) for credit losses	1		1		2	
<b>NET INTEREST INCOME AFTER PROVISION (REVERSAL) FOR CREDIT LOSSES</b>	<u>4,206</u>	<u>24</u>	<u>253</u>	<u>395</u>	<u>308</u>	<u>634</u>
<b>OTHER INCOME (LOSS)</b>						
Service fees	27		2	5	4	3
Net (loss) gain on trading securities	(304)		(7)		(1)	(215)
Net realized gain (loss) from sale of available-for-sale securities	267			2		
Net realized loss from sale of held-to-maturity securities	(1)					
Net (loss) gain on derivatives and hedging activities	(23)	6	(11)	(10)	4	137
Other, net	(26)	(3)	(14)	(15)		1
Total other (loss) income	<u>(60)</u>	<u>3</u>	<u>(30)</u>	<u>(18)</u>	<u>7</u>	<u>(74)</u>
<b>OTHER EXPENSE</b>						
Operating	657		42	59	50	76
Finance Board	32		1	4	2	4
Office of Finance	24		2	2	2	3
Other	16	(3)	1			3
Total other expense	<u>729</u>	<u>(3)</u>	<u>46</u>	<u>65</u>	<u>54</u>	<u>86</u>
<b>INCOME BEFORE ASSESSMENTS</b>	<u>3,417</u>	<u>30</u>	<u>177</u>	<u>312</u>	<u>261</u>	<u>474</u>
Affordable Housing Program	282		15	26	21	40
REFCORP	625		34	57	48	87
Total assessments	<u>907</u>		<u>49</u>	<u>83</u>	<u>69</u>	<u>127</u>
<b>INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLES</b>						
Cumulative effect of change in accounting principles before assessments	15		7	1		(3)
<b>NET INCOME</b>	<u>\$ 2,525</u>	<u>\$ 30</u>	<u>\$ 135</u>	<u>\$ 230</u>	<u>\$ 192</u>	<u>\$ 344</u>



<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$1,527	\$ 942	\$ 804	\$ 901	\$1,642	\$961	\$5,091	\$ 689
	2	1		3	43	1	5
152	13		12	14	115	151	23
22		12	10			37	4
225	87	216	53	132	142	424	118
	4	53	1	6	37	15	13
46	32	47	18	153	3		
536	279	250	194	308	297	1,112	663
428	441	2,160	689	34	123	280	446
1							
				1	5		
<u>2,937</u>	<u>1,800</u>	<u>3,543</u>	<u>1,878</u>	<u>2,293</u>	<u>1,726</u>	<u>7,111</u>	<u>1,961</u>
677	278	540	160	270	433	700	270
1,878	1,266	2,404	1,378	1,718	1,038	5,709	1,552
29	31	36	24	70	26	16	27
		57	20		2		15
13	2	2	2	12		2	
	(1)				2	1	
<u>2,597</u>	<u>1,576</u>	<u>3,039</u>	<u>1,584</u>	<u>2,070</u>	<u>1,501</u>	<u>6,428</u>	<u>1,864</u>
340	224	504	294	223	225	683	97
		(3)			1		
<u>340</u>	<u>224</u>	<u>507</u>	<u>294</u>	<u>223</u>	<u>224</u>	<u>683</u>	<u>97</u>
2	1	1	2	3	1	1	2
	(5)	(37)		(4)	(23)	(14)	2
	20	(3)	3	245			(1)
(1)	7	(16)	39	(91)	29	(89)	(27)
3	2	13	2	4	(17)	2	(4)
<u>4</u>	<u>25</u>	<u>(42)</u>	<u>46</u>	<u>157</u>	<u>(10)</u>	<u>(100)</u>	<u>(28)</u>
34	36	121	36	46	25	70	62
3	2	3	2	2	1	6	2
2	1	2	1	2	1	5	1
4	2	6			2		1
<u>43</u>	<u>41</u>	<u>132</u>	<u>39</u>	<u>50</u>	<u>29</u>	<u>81</u>	<u>66</u>
<u>301</u>	<u>208</u>	<u>333</u>	<u>301</u>	<u>330</u>	<u>185</u>	<u>502</u>	<u>3</u>
26	17	28	25	28	15	41	
55	38	61	57	61	34	92	1
<u>81</u>	<u>55</u>	<u>89</u>	<u>82</u>	<u>89</u>	<u>49</u>	<u>133</u>	<u>1</u>
220	153	244	219	241	136	369	2
			9	1			
<u>\$ 220</u>	<u>\$ 153</u>	<u>\$ 244</u>	<u>\$ 228</u>	<u>\$ 242</u>	<u>\$136</u>	<u>\$ 369</u>	<u>\$ 2</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2004**

(Dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>INTEREST INCOME</b>						
Advances	\$9,995	\$	\$ 596	\$1,242	\$ 613	\$1,578
Prepayment fees on advances, net	184		54	6	1	20
Interest-bearing deposits	313		11	61	12	11
Securities purchased under agreements to resell	54		9			
Federal funds sold	625		34	16	28	74
Trading securities	444	(27)	18		11	288
Available-for-sale securities	286	(21)	16	8	10	
Held-to-maturity securities	4,483	(143)	242	546	302	703
Mortgage loans held for portfolio	5,535	1	198	48	406	97
Loans to other FHLBanks		(1)				
Other	6					
Total interest income	<u>21,925</u>	<u>(191)</u>	<u>1,178</u>	<u>1,927</u>	<u>1,383</u>	<u>2,771</u>
<b>INTEREST EXPENSE</b>						
Consolidated obligations — Discount notes	2,207		110	254	194	73
Consolidated obligations — Bonds	15,233	(212)	843	1,377	872	2,055
Deposits	230		9	22	15	60
Borrowings from other FHLBanks		(1)			1	
Securities sold under agreements to repurchase	57					16
Mandatorily redeemable capital stock	22		1	6		1
Other borrowings	5				2	
Total interest expense	<u>17,754</u>	<u>(213)</u>	<u>963</u>	<u>1,659</u>	<u>1,084</u>	<u>2,205</u>
<b>NET INTEREST INCOME</b>	<u>4,171</u>	<u>22</u>	<u>215</u>	<u>268</u>	<u>299</u>	<u>566</u>
(Reversal) provision for credit losses	(5)					1
<b>NET INTEREST INCOME AFTER (REVERSAL) PROVISION FOR CREDIT LOSSES</b>	<u>4,176</u>	<u>22</u>	<u>215</u>	<u>268</u>	<u>299</u>	<u>565</u>
<b>OTHER INCOME (LOSS)</b>						
Service fees	27		2	5	4	3
Net (losses) gains on trading securities	(106)		(8)		(3)	(57)
Net realized (losses) gains from sale of available-for-sale securities	(17)					
Net realized gains from sale of held-to-maturity securities	13				3	
Net (losses) gains on derivatives and hedging activities	(784)	(2)	(7)	8	(106)	(42)
Other, net	(23)	(48)	(40)	(4)	1	1
Total other (loss) income	<u>(890)</u>	<u>(50)</u>	<u>(53)</u>	<u>9</u>	<u>(101)</u>	<u>(95)</u>
<b>OTHER EXPENSE</b>						
Operating	546		37	51	42	63
Finance Board	26		2	3	2	3
Office of Finance	20		1	2	2	2
Other	20	(1)				2
Total other expense	<u>612</u>	<u>(1)</u>	<u>40</u>	<u>56</u>	<u>46</u>	<u>70</u>
<b>INCOME BEFORE ASSESSMENTS</b>	<u>2,674</u>	<u>(27)</u>	<u>122</u>	<u>221</u>	<u>152</u>	<u>400</u>
Affordable Housing Program	225		10	19	13	33
REFCORP	505		22	40	30	73
Total assessments	<u>730</u>		<u>32</u>	<u>59</u>	<u>43</u>	<u>106</u>
<b>INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE</b>	<u>1,944</u>	<u>(27)</u>	<u>90</u>	<u>162</u>	<u>109</u>	<u>294</u>
Cumulative effect of change in accounting principle before assessments	50			(1)	10	
<b>NET INCOME</b>	<u>\$1,994</u>	<u>\$ (27)</u>	<u>\$ 90</u>	<u>\$ 161</u>	<u>\$ 119</u>	<u>\$ 294</u>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 771	\$ 518	\$ 549	\$ 513	\$ 868	\$491	\$1,834	\$ 422
69	10	5	1	7	3	7	1
91	5		4	7	36	61	14
1		6	4			33	1
105	47	85	26	32	32	111	35
	7	55	1	12	36	28	15
15	49	33	18	155	3		
496	243	207	103	171	262	706	645
405	368	2,270	759	47	87	309	540
1							
				1	5		
<u>1,954</u>	<u>1,247</u>	<u>3,210</u>	<u>1,429</u>	<u>1,300</u>	<u>955</u>	<u>3,089</u>	<u>1,673</u>
372	140	286	78	119	141	376	64
1,265	872	2,165	828	924	641	2,164	1,439
13	14	22	13	29	13	6	14
		31	10				
2	1	2	1	7		1	
					3		
<u>1,652</u>	<u>1,027</u>	<u>2,506</u>	<u>930</u>	<u>1,079</u>	<u>798</u>	<u>2,547</u>	<u>1,517</u>
302	220	704	499	221	157	542	156
	(1)		(5)				
<u>302</u>	<u>221</u>	<u>704</u>	<u>504</u>	<u>221</u>	<u>157</u>	<u>542</u>	<u>156</u>
2	1	1	2	3	1	1	2
	(5)	(28)	(1)	(8)	4	(12)	12
		(22)	6		(1)		
			4				6
40	(6)	(127)	(353)	(91)	(13)	(69)	(16)
2	1	49	5	3	3	4	
<u>44</u>	<u>(9)</u>	<u>(127)</u>	<u>(337)</u>	<u>(93)</u>	<u>(6)</u>	<u>(76)</u>	<u>4</u>
29	30	106	29	36	21	61	41
2	1	3	1	2	1	4	2
3	1	2	1	1	1	3	1
3	2	10			1		3
<u>37</u>	<u>34</u>	<u>121</u>	<u>31</u>	<u>39</u>	<u>24</u>	<u>68</u>	<u>47</u>
309	178	456	136	89	127	398	113
25	14	41	11	8	10	32	9
57	33	91	25	16	24	73	21
<u>82</u>	<u>47</u>	<u>132</u>	<u>36</u>	<u>24</u>	<u>34</u>	<u>105</u>	<u>30</u>
227	131	324	100	65	93	293	83
		41					
<u>\$ 227</u>	<u>\$ 131</u>	<u>\$ 365</u>	<u>\$ 100</u>	<u>\$ 65</u>	<u>\$ 93</u>	<u>\$ 293</u>	<u>\$ 83</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CAPITAL**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Shares and dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>CAPITAL STOCK CLASS B</b>						
<b>PUTABLE SHARES</b>						
<b>BALANCE, DECEMBER 31, 2003</b> . . . .	150				23	
Proceeds from sale of capital stock . . . . .	99		5		58	
Repurchase/redemption of capital stock . . .	(77)		(7)		(54)	
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(19)		(1)			(5)
Conversion to Class B or Class A shares . .	159		24			57
Capital stock dividends . . . . .	6					
<b>BALANCE, DECEMBER 31, 2004</b> . . . .	318		21		27	52
Proceeds from sale of capital stock . . . . .	175		8	3	84	40
Repurchase/redemption of capital stock . . .	(148)		(4)	(4)	(80)	(34)
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(14)					(1)
Conversion to Class B or Class A shares . .	37			37		
Capital stock dividends . . . . .	9					
<b>BALANCE, DECEMBER 31, 2005</b> . . . .	377		25	36	31	57
Proceeds from sale of capital stock . . . . .	185		5	35	49	41
Repurchase/redemption of capital stock . . .	(168)		(7)	(33)	(45)	(39)
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(14)			(2)	(1)	(1)
Conversion to Class B or Class A shares . .						
Capital stock dividends . . . . .	9					
<b>BALANCE, DECEMBER 31, 2006</b> . . . .	<u>389</u>		<u>23</u>	<u>36</u>	<u>34</u>	<u>58</u>
<b>CAPITAL STOCK CLASS A</b>						
<b>PUTABLE SHARES</b>						
<b>BALANCE, DECEMBER 31, 2003</b>						
Proceeds from sale of capital stock . . . . .						
Repurchase/redemption of capital stock . . .						
Net shares reclassified to mandatorily redeemable capital stock . . . . .						
Conversion to Class B or Class A shares . .	3					
Capital stock dividends . . . . .						
<b>BALANCE, DECEMBER 31, 2004</b> . . . .	3					
Proceeds from sale of capital stock . . . . .						
Repurchase/redemption of capital stock . . .						
Net shares reclassified to mandatorily redeemable capital stock . . . . .	2					
Conversion to Class B or Class A shares . .						
Capital stock dividends . . . . .						
<b>BALANCE, DECEMBER 31, 2005</b> . . . .	5					
Proceeds from sale of capital stock . . . . .						
Repurchase/redemption of capital stock . . .						
Net shares reclassified to mandatorily redeemable capital stock . . . . .						
Conversion to Class B or Class A shares . .						
Capital stock dividends . . . . .						
<b>BALANCE, DECEMBER 31, 2006</b> . . . .	<u>5</u>					

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
36	19		21	27			24
1	1		8	8	2	16	
	(1)		(6)	(6)		(3)	
(1)			(1)	(4)	(2)		(5)
					15	63	
<u>2</u>	<u>1</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2</u>	<u>1</u>
38	20		22	25	15	78	20
	1		8	4	5	21	1
			(11)	(7)		(8)	
(5)					(8)		
<u>2</u>	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>1</u>	<u>4</u>	<u>—</u>
35	22		19	23	13	95	21
1	1		7	4	7	35	
	(3)		(7)	(6)		(28)	
(1)	(2)				(6)	(1)	
<u>2</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>1</u>	<u>5</u>	<u>—</u>
<u>37</u>	<u>18</u>	<u>—</u>	<u>19</u>	<u>22</u>	<u>15</u>	<u>106</u>	<u>21</u>
					3		
					3		
					2		
					5		
					5		

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CAPITAL—(Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Shares and dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>CAPITAL STOCK PRE-CONVERSION</b>						
<b>PUTABLE SHARES</b>						
<b>BALANCE, DECEMBER 31, 2003</b> . . . . .	225		24	36		49
Proceeds from sale of capital stock . . . . .	78		1	22		35
Repurchase/redemption of capital stock . . .	(49)			(18)		(27)
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(16)		(1)	(3)		
Conversion to Class B or Class A shares . .	(162)		(24)			(57)
Capital stock dividends . . . . .	4					
<b>BALANCE, DECEMBER 31, 2004</b> . . . . .	80			37		
Proceeds from sale of capital stock . . . . .	32			23		
Repurchase/redemption of capital stock . . .	(23)			(23)		
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(16)					
Conversion to Class B or Class A shares . .	(37)			(37)		
Capital stock dividends . . . . .	2					
<b>BALANCE, DECEMBER 31, 2005</b> . . . . .	38					
Proceeds from sale of capital stock . . . . .						
Repurchase/redemption of capital stock . . .						
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(12)					
Conversion to Class B or Class A shares . .						
Capital stock dividends . . . . .						
<b>BALANCE, DECEMBER 31, 2006</b> . . . . .	<u>26</u>					
<b>TOTAL CAPITAL STOCK PUTABLE</b>						
<b>SHARES</b>						
<b>BALANCE, DECEMBER 31, 2003</b> . . . . .	375		24	36	23	49
Proceeds from sale of capital stock . . . . .	177		6	22	58	35
Repurchase/redemption of capital stock . . .	(126)		(7)	(18)	(54)	(27)
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(35)		(2)	(3)		(5)
Capital stock dividends . . . . .	10					
<b>BALANCE, DECEMBER 31, 2004</b> . . . . .	401		21	37	27	52
Proceeds from sale of capital stock . . . . .	207		8	26	84	40
Repurchase/redemption of capital stock . . .	(171)		(4)	(27)	(80)	(34)
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(28)					(1)
Capital stock dividends . . . . .	11					
<b>BALANCE, DECEMBER 31, 2005</b> . . . . .	420		25	36	31	57
Proceeds from sale of capital stock . . . . .	185		5	35	49	41
Repurchase/redemption of capital stock . . .	(168)		(7)	(33)	(45)	(39)
Net shares reclassified to mandatorily redeemable capital stock . . . . .	(26)			(2)	(1)	(1)
Capital stock dividends . . . . .	9					
<b>BALANCE, DECEMBER 31, 2006</b> . . . . .	<u>420</u>		<u>23</u>	<u>36</u>	<u>34</u>	<u>58</u>



<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
		42			17	57	
		11			2	7	
					(2)	(2)	
		(12)			(18)	(63)	
—	—	<u>2</u>	—	—	<u>1</u>	<u>1</u>	—
		43					
		9					
		(16)					
—	—	<u>2</u>	—	—	—	—	—
		38					
		(12)					
—	—	<u>26</u>	—	—	—	—	—
36	19	42	21	27	17	57	24
1	1	11	8	8	4	23	
	(1)		(6)	(6)	(2)	(5)	
(1)		(12)	(1)	(4)	(2)		(5)
<u>2</u>	<u>1</u>	<u>2</u>	—	—	<u>1</u>	<u>3</u>	<u>1</u>
38	20	43	22	25	18	78	20
	1	9	8	4	5	21	1
			(11)	(7)		(8)	
(5)		(16)			(6)		
<u>2</u>	<u>1</u>	<u>2</u>	—	<u>1</u>	<u>1</u>	<u>4</u>	—
35	22	38	19	23	18	95	21
1	1		7	4	7	35	
	(3)		(7)	(6)		(28)	
(1)	(2)	(12)			(6)	(1)	
<u>2</u>	—	—	—	<u>1</u>	<u>1</u>	<u>5</u>	—
<u>37</u>	<u>18</u>	<u>26</u>	<u>19</u>	<u>22</u>	<u>20</u>	<u>106</u>	<u>21</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CAPITAL—(Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Shares and dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>CAPITAL STOCK CLASS B</b>						
<b>PUTABLE PAR VALUE</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$ 15,082	\$	\$	\$	\$ 2,342	\$
Proceeds from sale of capital stock .....	9,976		479		5,805	
Repurchase/redemption of capital stock .....	(7,715)		(692)		(5,433)	
Net shares reclassified to mandatorily redeemable capital stock .....	(1,883)		(58)		(18)	(457)
Conversion to Class B or Class A shares .....	15,778		2,357			5,682
Capital stock dividends .....	581					
<b>BALANCE, DECEMBER 31, 2004</b> .....	31,819		2,086		2,696	5,225
Proceeds from sale of capital stock .....	17,622		802	276	8,398	3,962
Repurchase/redemption of capital stock .....	(14,799)		(356)	(433)	(8,012)	(3,382)
Net shares reclassified to mandatorily redeemable capital stock .....	(1,382)				(3)	(52)
Conversion to Class B or Class A shares .....	3,747			3,747		
Capital stock dividends .....	779					
<b>BALANCE, DECEMBER 31, 2005</b> .....	37,786		2,532	3,590	3,079	5,753
Proceeds from sale of capital stock .....	18,372		540	3,470	4,877	4,060
Repurchase/redemption of capital stock .....	(16,826)		(722)	(3,283)	(4,540)	(3,894)
Net shares reclassified to mandatorily redeemable capital stock .....	(1,400)		(7)	(231)	(32)	(147)
Conversion to Class B or Class A shares .....						
Capital stock dividends .....	950					
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ 38,882</u>	<u>\$</u>	<u>\$2,343</u>	<u>\$3,546</u>	<u>\$ 3,384</u>	<u>\$ 5,772</u>
<b>CAPITAL STOCK CLASS A</b>						
<b>PUTABLE PAR VALUE</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$	\$	\$	\$	\$	\$
Proceeds from sale of capital stock .....	5					
Repurchase/redemption of capital stock .....						
Net shares reclassified to mandatorily redeemable capital stock .....						
Conversion to Class B or Class A shares .....	321					
Capital stock dividends .....						
<b>BALANCE, DECEMBER 31, 2004</b> .....	326					
Proceeds from sale of capital stock .....	7					
Repurchase/redemption of capital stock .....						
Net shares reclassified to mandatorily redeemable capital stock .....	165					
Conversion to Class B or Class A shares .....						
Capital stock dividends .....						
<b>BALANCE, DECEMBER 31, 2005</b> .....	498					
Proceeds from sale of capital stock .....	6					
Repurchase/redemption of capital stock .....						
Net shares reclassified to mandatorily redeemable capital stock .....	28					
Conversion to Class B or Class A shares .....						
Capital stock dividends .....						
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ 532</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$3,645	\$1,918	\$	\$2,117	\$2,661	\$	\$	\$2,399
90	72		761	837	187	1,651	94
	(33)		(584)	(642)		(331)	
(87)	(29)		(62)	(407)	(180)	(55)	(530)
151	89			44	1,453	6,286	
					19	214	64
3,799	2,017		2,232	2,493	1,479	7,765	2,027
25	125		858	419	492	2,155	110
	(16)		(1,120)	(695)	(3)	(771)	(11)
(497)	(13)		(38)	(8)	(763)	(6)	(2)
176	43			90	85	377	8
3,503	2,156		1,932	2,299	1,290	9,520	2,132
38	54		680	457	673	3,511	12
	(252)		(703)	(609)	(31)	(2,792)	
(92)	(165)		(3)	(9)	(558)	(153)	(3)
209				110	101	530	
<u>\$3,658</u>	<u>\$1,793</u>	<u>\$</u>	<u>\$1,906</u>	<u>\$2,248</u>	<u>\$1,475</u>	<u>\$10,616</u>	<u>\$2,141</u>
\$	\$	\$	\$	\$	\$	\$	\$
					5		
						321	
						326	
						7	
						165	
						498	
						6	
						28	
<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$ 532</u>	<u>\$</u>	<u>\$</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CAPITAL—(Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Shares and dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>CAPITAL STOCK PRE-CONVERSION PUTABLE</b>						
<b>PAR VALUE</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$ 22,621	\$	\$ 2,428	\$ 3,638	\$	\$ 4,921
Proceeds from sale of capital stock .....	7,656		53	2,174		3,477
Repurchase/redemption of capital stock .....	(4,903)		(14)	(1,799)		(2,716)
Net shares reclassified to mandatorily redeemable capital stock .....	(1,696)		(110)	(358)		
Conversion to Class B or Class A shares .....	(16,099)		(2,357)			(5,682)
Capital stock dividends .....	368					
<b>BALANCE, DECEMBER 31, 2004</b> .....	7,947			3,655		
Proceeds from sale of capital stock .....	3,332			2,391		
Repurchase/redemption of capital stock .....	(2,299)			(2,299)		
Net shares reclassified to mandatorily redeemable capital stock .....	(1,682)					
Conversion to Class B or Class A shares .....	(3,747)			(3,747)		
Capital stock dividends .....	208					
<b>BALANCE, DECEMBER 31, 2005</b> .....	3,759					
Proceeds from sale of capital stock .....	34					
Repurchase/redemption of capital stock .....						
Net shares reclassified to mandatorily redeemable capital stock .....	(1,206)					
Conversion to Class B or Class A shares						
Capital stock dividends .....						
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ 2,587</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
<b>TOTAL CAPITAL STOCK PUTABLE PAR VALUE</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$ 37,703	\$	\$ 2,428	\$ 3,638	\$ 2,342	\$ 4,921
Proceeds from sale of capital stock .....	17,637		532	2,174	5,805	3,477
Repurchase/redemption of capital stock .....	(12,618)		(706)	(1,799)	(5,433)	(2,716)
Net shares reclassified to mandatorily redeemable capital stock .....	(3,579)		(168)	(358)	(18)	(457)
Capital stock dividends .....	949					
<b>BALANCE, DECEMBER 31, 2004</b> .....	40,092		2,086	3,655	2,696	5,225
Proceeds from sale of capital stock .....	20,961		802	2,667	8,398	3,962
Repurchase/redemption of capital stock .....	(17,098)		(356)	(2,732)	(8,012)	(3,382)
Net shares reclassified to mandatorily redeemable capital stock .....	(2,899)				(3)	(52)
Capital stock dividends .....	987					
<b>BALANCE, DECEMBER 31, 2005</b> .....	42,043		2,532	3,590	3,079	5,753
Proceeds from sale of capital stock .....	18,412		540	3,470	4,877	4,060
Repurchase/redemption of capital stock .....	(16,826)		(722)	(3,283)	(4,540)	(3,894)
Net shares reclassified to mandatorily redeemable capital stock .....	(2,578)		(7)	(231)	(32)	(147)
Capital stock dividends .....	950					
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ 42,001</u>	<u>\$</u>	<u>\$ 2,343</u>	<u>\$ 3,546</u>	<u>\$ 3,384</u>	<u>\$ 5,772</u>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$	\$	\$ 4,155	\$	\$	\$ 1,740	\$ 5,739	\$
		1,090			173	689	
					(173)	(201)	
		(1,215)			(13)		
					(1,774)	(6,286)	
		262			47	59	
		4,292					
		941					
		(1,682)					
		208					
		3,759					
		34					
		(1,206)					
<u>\$</u>	<u>\$</u>	<u>\$ 2,587</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
\$3,645	\$1,918	\$ 4,155	\$ 2,117	\$2,661	\$ 1,740	\$ 5,739	\$2,399
90	72	1,090	761	837	365	2,340	94
	(33)		(584)	(642)	(173)	(532)	
(87)	(29)	(1,215)	(62)	(407)	(193)	(55)	(530)
151	89	262		44	66	273	64
3,799	2,017	4,292	2,232	2,493	1,805	7,765	2,027
25	125	941	858	419	499	2,155	110
	(16)		(1,120)	(695)	(3)	(771)	(11)
(497)	(13)	(1,682)	(38)	(8)	(598)	(6)	(2)
176	43	208		90	85	377	8
3,503	2,156	3,759	1,932	2,299	1,788	9,520	2,132
38	54	34	680	457	679	3,511	12
	(252)		(703)	(609)	(31)	(2,792)	
(92)	(165)	(1,206)	(3)	(9)	(530)	(153)	(3)
209				110	101	530	
<u>\$3,658</u>	<u>\$1,793</u>	<u>\$ 2,587</u>	<u>\$ 1,906</u>	<u>\$2,248</u>	<u>\$ 2,007</u>	<u>\$10,616</u>	<u>\$2,141</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CAPITAL—(Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**  
**(Shares and dollar amounts in millions)**

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>RETAINED EARNINGS</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$ 1,098	\$ (74)	\$ 62	\$ 127	\$ 3	\$ 109
Net income .....	1,994	(27)	90	161	119	294
Dividends on capital stock:						
Cash .....	(398)		(56)	(65)	(45)	(186)
Stock .....	(950)					
<b>BALANCE, DECEMBER 31, 2004</b> .....	1,744	(101)	96	223	77	217
Net income .....	2,525	30	135	230	192	344
Dividends on capital stock:						
Cash .....	(677)		(96)	(162)	(80)	(232)
Stock .....	(992)					
<b>BALANCE, DECEMBER 31, 2005</b> .....	2,600	(71)	135	291	189	329
Net income .....	2,612	27	196	285	216	414
Dividends on capital stock:						
Cash .....	(1,122)		(144)	(208)	(150)	(336)
Stock .....	(947)					
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ 3,143</u>	<u>\$ (44)</u>	<u>\$ 187</u>	<u>\$ 368</u>	<u>\$ 255</u>	<u>\$ 407</u>
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$ 179	\$	\$ (18)	\$ (2)	\$ (10)	\$
Net unrealized gains (losses) on available-for-sale securities .....	5		16	2	1	
Reclassification adjustment for losses (gains) included in net income relating to available-for-sale securities .....	18					
Net unrealized (losses) gains relating to hedging activities .....	(218)				(2)	
Reclassification adjustment for losses (gains) included in net income relating to hedging activities .....	46		(1)	1		
Other .....	(3)				(1)	
<b>BALANCE, DECEMBER 31, 2004</b> .....	27		(3)	1	(12)	
Net unrealized gains (losses) on available-for-sale securities .....	65		16			
Reclassification adjustment for losses (gains) included in net income relating to available-for-sale securities .....	(267)			(2)		
Net unrealized gains (losses) relating to hedging activities .....	20		1	6	4	
Reclassification adjustment for (gains) losses included in net income relating to hedging activities .....	(7)	(6)	(2)	(2)		
Other .....	(1)		(1)	1		
<b>BALANCE, DECEMBER 31, 2005</b> .....	(163)	(6)	11	4	(8)	
Net unrealized (losses) gains on available-for-sale securities .....	(4)		(5)		1	
Reclassification adjustment for losses included in net income relating to available-for-sale securities .....	2					
Net unrealized gains (losses) relating to hedging activities .....	31			(10)	3	
Reclassification adjustment for losses (gains) included in net income relating to hedging activities .....		1	(2)			
Other .....	2			2	1	
Adjustment to initially apply SFAS 158 .....	(27)		(2)	(6)	(2)	(5)
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ (159)</u>	<u>\$ (5)</u>	<u>\$ 2</u>	<u>\$ (10)</u>	<u>\$ (5)</u>	<u>\$ (5)</u>



<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 92	\$ 43	\$ 386	\$109	\$ 5	\$ 60	\$ 119	\$ 57
227	131	365	100	65	93	293	83
			(46)				
<u>(151)</u>	<u>(89)</u>	<u>(262)</u>	<u>—</u>	<u>(44)</u>	<u>(66)</u>	<u>(273)</u>	<u>(65)</u>
168	85	489	163	26	87	139	75
220	153	244	228	242	136	369	2
	(46)		(61)				
<u>(180)</u>	<u>(43)</u>	<u>(208)</u>	<u>—</u>	<u>(90)</u>	<u>(86)</u>	<u>(377)</u>	<u>(8)</u>
208	149	525	330	178	137	131	69
253	118	188	89	122	136	542	26
	(99)	(107)	(75)				(3)
<u>(205)</u>	<u>(1)</u>	<u>—</u>	<u>—</u>	<u>(110)</u>	<u>(101)</u>	<u>(530)</u>	<u>—</u>
<u>\$ 256</u>	<u>\$167</u>	<u>\$ 606</u>	<u>\$344</u>	<u>\$ 190</u>	<u>\$ 172</u>	<u>\$ 143</u>	<u>\$ 92</u>
\$ (3)	\$ 66	\$ 32	\$ (1)	\$ 136	\$ (9)	\$ (12)	\$
	(24)	(31)	6	33	2		
		22	(6)		2		
		(217)				1	
		39				7	
<u>(1)</u>	<u>(1)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
(4)	41	(155)	(1)	169	(5)	(4)	
2	(23)	(5)	3	73	(1)		
	(20)	3	(3)	(245)			
		9					
		2				1	
					(1)		
(2)	(2)	(146)	(1)	(3)	(7)	(3)	
(3)		(1)		3	1		
		2					
		38					
						1	
	(1)						
<u>(2)</u>	<u>(2)</u>	<u>(3)</u>	<u>—</u>	<u>1</u>	<u>(1)</u>	<u>(3)</u>	<u>(2)</u>
<u>\$ (7)</u>	<u>\$ (5)</u>	<u>\$(110)</u>	<u>\$ (1)</u>	<u>\$ 1</u>	<u>\$ (7)</u>	<u>\$ (5)</u>	<u>\$ (2)</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CAPITAL—(Continued)**  
**FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

(Shares and dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>TOTAL CAPITAL</b>						
<b>BALANCE, DECEMBER 31, 2003</b> .....	\$ 38,980	\$ (74)	\$2,472	\$ 3,763	\$ 2,335	\$ 5,030
Proceeds from sale of capital stock .....	17,637		532	2,174	5,805	3,477
Repurchase/redemption of capital stock .....	(12,618)		(706)	(1,799)	(5,433)	(2,716)
Net shares reclassified to mandatorily redeemable capital stock .....	(3,579)		(168)	(358)	(18)	(457)
Comprehensive income:						
Net income .....	1,994	(27)	90	161	119	294
Other comprehensive income:						
Net unrealized gains (losses) on available-for-sale securities .....	5		16	2	1	
Reclassification adjustment for losses (gains) included in net income relating to available-for-sale securities .....	18					
Net unrealized (losses) gains relating to hedging activities .....	(218)				(2)	
Reclassification adjustment for losses (gains) included in net income relating to hedging activities .....	46		(1)	1		
Other .....	(3)				(1)	
Total comprehensive income .....	<u>1,842</u>	<u>(27)</u>	<u>105</u>	<u>164</u>	<u>117</u>	<u>294</u>
Dividends on capital stock:						
Cash .....	(398)		(56)	(65)	(45)	(186)
Stock .....	(1)					
<b>BALANCE, DECEMBER 31, 2004</b> .....	41,863	(101)	2,179	3,879	2,761	5,442
Proceeds from sale of capital stock .....	20,961		802	2,667	8,398	3,962
Repurchase/redemption of capital stock .....	(17,098)		(356)	(2,732)	(8,012)	(3,382)
Net shares reclassified to mandatorily redeemable capital stock .....	(2,899)				(3)	(52)
Comprehensive income:						
Net income .....	2,525	30	135	230	192	344
Other comprehensive income:						
Net unrealized gains (losses) on available-for-sale securities .....	65		16			
Reclassification adjustment for (gains) losses included in net income relating to available-for-sale securities .....	(267)			(2)		
Net unrealized gains (losses) relating to hedging activities .....	20		1	6	4	
Reclassification adjustment for (gains) losses included in net income relating to hedging activities .....	(7)	(6)	(2)	(2)		
Other .....	(1)		(1)	1		
Total comprehensive income .....	<u>2,335</u>	<u>24</u>	<u>149</u>	<u>233</u>	<u>196</u>	<u>344</u>
Dividends on capital stock:						
Cash .....	(677)		(96)	(162)	(80)	(232)
Stock .....	(5)					
<b>BALANCE, DECEMBER 31, 2005</b> .....	44,480	(77)	2,678	3,885	3,260	6,082
Proceeds from sale of capital stock .....	18,412		540	3,470	4,877	4,060
Repurchase/redemption of capital stock .....	(16,826)		(722)	(3,283)	(4,540)	(3,894)
Net shares reclassified to mandatorily redeemable capital stock .....	(2,578)		(7)	(231)	(32)	(147)
Comprehensive income:						
Net income .....	2,612	27	196	285	216	414
Other comprehensive income:						
Net unrealized (losses) gains on available-for-sale securities .....	(4)		(5)		1	
Reclassification adjustment for losses included in net income relating to available-for-sale securities .....	2					
Net unrealized gains (losses) relating to hedging activities .....	31			(10)	3	
Reclassification adjustment for losses (gains) included in net income relating to hedging activities .....		1	(2)			
Other .....	2			2	1	
Total comprehensive income .....	<u>2,643</u>	<u>28</u>	<u>189</u>	<u>277</u>	<u>221</u>	<u>414</u>
Adjustment to initially apply SFAS 158 .....	(27)		(2)	(6)	(2)	(5)
Dividends on capital stock:						
Cash .....	(1,122)		(144)	(208)	(150)	(336)
Stock .....	3					
<b>BALANCE, DECEMBER 31, 2006</b> .....	<u>\$ 44,985</u>	<u>\$ (49)</u>	<u>\$2,532</u>	<u>\$ 3,904</u>	<u>\$ 3,634</u>	<u>\$ 6,174</u>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$3,734	\$2,027	\$ 4,573	\$ 2,225	\$2,802	\$1,791	\$ 5,846	\$2,456
90	72	1,090	761	837	365	2,340	94
(87)	(33)	(1,215)	(584)	(642)	(173)	(532)	
	(29)		(62)	(407)	(193)	(55)	(530)
227	131	365	100	65	93	293	83
	(24)	(31)	6	33	2		
		22	(6)		2		
		(217)				1	
		39				7	
(1)	(1)						
<u>226</u>	<u>106</u>	<u>178</u>	<u>100</u>	<u>98</u>	<u>97</u>	<u>301</u>	<u>83</u>
			(46)				(1)
3,963	2,143	4,626	2,394	2,688	1,887	7,900	2,102
25	125	941	858	419	499	2,155	110
	(16)		(1,120)	(695)	(3)	(771)	(11)
(497)	(13)	(1,682)	(38)	(8)	(598)	(6)	(2)
220	153	244	228	242	136	369	2
2	(23)	(5)	3	73	(1)		
	(20)	3	(3)	(245)			
		9					
		2				1	
					(1)		
<u>222</u>	<u>110</u>	<u>253</u>	<u>228</u>	<u>70</u>	<u>134</u>	<u>370</u>	<u>2</u>
	(46)		(61)				
(4)					(1)		
3,709	2,303	4,138	2,261	2,474	1,918	9,648	2,201
38	54	34	680	457	679	3,511	12
	(252)		(703)	(609)	(31)	(2,792)	
(92)	(165)	(1,206)	(3)	(9)	(530)	(153)	(3)
253	118	188	89	122	136	542	26
(3)		(1)		3	1		
		2					
		38					
						1	
	(1)						
<u>250</u>	<u>117</u>	<u>227</u>	<u>89</u>	<u>125</u>	<u>137</u>	<u>543</u>	<u>26</u>
(2)	(2)	(3)		1	(1)	(3)	(2)
	(99)	(107)	(75)				(3)
4	(1)						
<u>\$3,907</u>	<u>\$1,955</u>	<u>\$ 3,083</u>	<u>\$ 2,249</u>	<u>\$2,439</u>	<u>\$2,172</u>	<u>\$10,754</u>	<u>\$2,231</u>

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2006**

(Dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>OPERATING ACTIVITIES:</b>						
Net income .....	\$ 2,612	\$ 27	\$ 196	\$ 285	\$ 216	\$ 414
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization .....	564	(7)	100	(36)	248	63
Change in net fair value adjustment on derivative and hedging activities .....	(637)		(101)	(173)	(145)	(129)
Other adjustments .....	27	5	(1)		2	
Net change in:						
Trading securities .....	1,114	(365)	65			750
Accrued interest receivable .....	(621)	(9)	(24)	(29)	(112)	(71)
Other assets .....	(73)		3			(4)
Accrued interest payable .....	2,231	9	81	237	130	320
Other liabilities .....	71		12	28	11	37
Total adjustments .....	<u>2,676</u>	<u>(367)</u>	<u>135</u>	<u>27</u>	<u>134</u>	<u>966</u>
Net cash provided by (used in) operating activities .....	<u>5,288</u>	<u>(340)</u>	<u>331</u>	<u>312</u>	<u>350</u>	<u>1,380</u>
<b>INVESTING ACTIVITIES:</b>						
Net change in:						
Interest-bearing deposits .....	1,470		1,190	3,108	(361)	(547)
Securities purchased under agreements to resell .....	(1,610)		(3,250)			
Federal funds sold .....	3,502		2,169	(736)	(1,050)	2,497
Deposits to other FHLBanks for mortgage loan programs .....		(1)			1	
Principal collected on other loans .....	1					
Premises, software and equipment .....	(63)		(2)	(4)	(9)	(5)
Available-for-sale securities:						
Proceeds .....	111,513				266	
Purchases .....	(112,557)					
Held-to-maturity securities:						
Net (increase) decrease in short-term .....	(2,177)				(171)	
Proceeds from long-term .....	27,088	(1,050)	2,460	2,311	1,611	3,769
Purchases of long-term .....	(31,918)		(3,440)	(4,000)	(3,326)	(3,473)
Advances:						
Proceeds .....	7,263,818		695,115	580,752	652,740	174,424
Made .....	(7,284,995)		(694,425)	(578,048)	(654,623)	(174,694)
Mortgage loans held for portfolio:						
Principal collected .....	13,470		637	167	1,048	321
Purchases .....	(6,262)		(261)	(185)	(383)	(465)
Proceeds from sales of foreclosed assets .....	59					
Net cash (used in) provided by investing activities .....	<u>(18,661)</u>	<u>(1,051)</u>	<u>193</u>	<u>3,365</u>	<u>(4,257)</u>	<u>1,827</u>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 253	\$ 118	\$ 188	\$ 89	\$ 122	\$ 136	\$ 542	\$ 26
(36)	16	118	54	38	34	(2)	(26)
(75)	(17)	286	(20)	(103)	(76)	98	(182)
13		(10)	(1)	10	8	2	(1)
2	43	528	9	21	10	51	
(62)	(17)	(41)	7	3	(25)	(169)	(72)
(2)	(5)	(59)			(1)	(6)	1
122	55	137	(16)	47	86	832	191
18	(7)	(18)	(49)	4	2	40	(7)
(20)	68	941	(16)	20	38	846	(96)
233	186	1,129	73	142	174	1,388	(70)
(252)	520		689	210	72	(2,424)	(735)
(150)		390				550	850
(2,154)	(2,669)	85	1,360	2,401	(3,551)	1,554	3,596
					1		
(2)	(1)	(19)	(5)	(4)	(4)	(6)	(2)
108,395		1,692	875	285			
(108,375)		(2,993)	(1,189)				
(6)		131	(278)		(936)	(917)	
2,142	1,032	1,231	1,047	1,585	1,360	6,674	2,916
(1,576)	(743)	(5,391)	(495)	(575)	(1,345)	(5,822)	(1,732)
1,974,813	89,061	93,520	96,519	508,840	444,820	1,854,536	98,678
(1,976,598)	(85,521)	(94,810)	(96,139)	(503,538)	(446,209)	(1,875,178)	(105,212)
1,106	1,138	5,641	1,596	92	276	603	845
(1,164)	(1,633)	(1,565)	(359)		(229)	(18)	
		59					
(3,821)	1,184	(2,029)	3,621	9,296	(5,745)	(20,448)	(796)

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CASH FLOWS — (Continued)**  
**FOR THE YEAR ENDED DECEMBER 31, 2006**

(Dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>FINANCING ACTIVITIES:</b>						
Net change in:						
Deposits and pass-through reserves .....	\$ (301)	\$	\$ 523	\$ (389)	\$ 343	\$ (614)
Deposits from other FHL Banks for mortgage loan programs .....		1				
Borrowings .....	(282)			117		
Net proceeds from issuance of consolidated obligations:						
Discount notes .....	7,038,245		729,039	592,280	158,264	493,373
Bonds .....	323,228	(134)	17,116	32,547	19,054	55,097
Bonds transferred from other FHLBanks .....		(1,453)	20			68
Payments for maturing and retiring consolidated obligations:						
Discount notes .....	(7,060,638)		(735,686)	(600,579)	(155,169)	(498,049)
Bonds .....	(285,365)	1,530	(11,179)	(26,696)	(18,744)	(52,842)
Bonds transferred to other FHLBanks .....		1,447		(780)		
Net proceeds from issuance of subordinated notes .....	994					
Proceeds from issuance of capital stock .....	18,412		540	3,470	4,877	4,060
Payments for redemption of mandatorily redeemable capital stock .....	(2,965)		(3)	(139)	(41)	(74)
Payments for repurchase/redemption of capital stock ..	(16,826)		(722)	(3,283)	(4,540)	(3,894)
Cash dividends paid .....	(1,155)		(174)	(208)	(174)	(316)
Net cash provided by (used in) financing activities ..	<u>13,347</u>	<u>1,391</u>	<u>(526)</u>	<u>(3,660)</u>	<u>3,870</u>	<u>(3,191)</u>
Net (decrease) increase in cash and cash equivalents ..	(26)		(2)	17	(37)	16
Cash and cash equivalents at beginning of the year ....	356		10	22	115	13
Cash and cash equivalents at end of the year .....	<u>\$ 330</u>	<u>\$</u>	<u>\$ 8</u>	<u>\$ 39</u>	<u>\$ 78</u>	<u>\$ 29</u>
<b>Supplemental Disclosures:</b>						
Interest paid .....	<u>\$ 39,999</u>	<u>\$</u>	<u>\$ 2,584</u>	<u>\$ 2,643</u>	<u>\$ 2,326</u>	<u>\$ 5,791</u>
AHP payments, net .....	<u>\$ 226</u>	<u>\$</u>	<u>\$ 11</u>	<u>\$ 21</u>	<u>\$ 12</u>	<u>\$ 23</u>
REFCORP assessments paid .....	<u>\$ 675</u>	<u>\$</u>	<u>\$ 49</u>	<u>\$ 68</u>	<u>\$ 54</u>	<u>\$ 101</u>



<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 17	\$ 120	\$ 437	\$ 76	\$ (1,388)	\$ 217	\$ 154	\$ 203
		(1)			(5)		(394)
821,870	852,748	701,308	738,751	572,533	824,872	202,008	351,199
20,411	7,699	21,696	5,858	13,808	10,959	93,614	25,503
		562				803	
(817,495)	(851,664)	(706,911)	(738,144)	(575,554)	(821,606)	(199,490)	(360,291)
(20,870)	(9,941)	(15,041)	(10,126)	(18,471)	(8,963)	(78,655)	(15,367)
		(667)					
		994					
38	54	34	680	457	679	3,511	12
(384)	(58)	(1,414)	(23)	(180)	(551)	(98)	
	(252)		(703)	(609)	(31)	(2,792)	
	(99)	(107)	(75)				(2)
3,587	(1,393)	890	(3,706)	(9,404)	5,571	19,055	863
(1)	(23)	(10)	(12)	34		(5)	(3)
5	38	33	42	62		12	4
\$ 4	\$ 15	\$ 23	\$ 30	\$ 96	\$	\$ 7	\$ 1
\$ 3,467	\$ 1,654	\$ 3,820	\$ 2,017	\$ 2,643	\$ 2,044	\$ 8,744	\$ 2,266
\$ 24	\$ 14	\$ 36	\$ 12	\$ 11	\$ 11	\$ 40	\$ 11
\$ 62	\$ 30	\$ 50	\$ 67	\$ 30	\$ 38	\$ 124	\$ 2

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2005**

(Dollar amounts in millions)

	Combined	Combining Adjustments	Boston	New York	Pittsburgh	Atlanta
<b>OPERATING ACTIVITIES</b>						
Net income . . . . .	\$ 2,525	\$ 30	\$ 135	\$ 230	\$ 192	\$ 344
Cumulative effect of change in accounting principle before assessments . . . . .	(15)		(7)	(1)		3
Income before cumulative effect of change in accounting principle . . . . .	2,510	30	128	229	192	347
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization . . . . .	610	(23)	31	32	68	71
Change in net fair value adjustment on derivative and hedging activities . . . . .	(768)	(6)	4	(68)	(118)	(290)
Other adjustments . . . . .	(194)	6	14	(2)	3	(1)
Net change in:						
Trading securities . . . . .	1,098		79		89	445
Accrued interest receivable . . . . .	(898)	(11)	(49)	(61)	(92)	(95)
Other assets . . . . .	(70)		(1)	1		(5)
Accrued interest payable . . . . .	1,491	11	53	61	136	322
Other liabilities* . . . . .	217		15	21	30	40
Total adjustments . . . . .	1,486	(23)	146	(16)	116	487
Net cash provided by (used in) operating activities . . . . .	3,996	7	274	213	308	834
<b>INVESTING ACTIVITIES</b>						
Net change in:						
Interest-bearing deposits . . . . .	(12,053)		525	(5,892)	(1,913)	522
Securities purchased under agreements to resell . . . . .	(400)		1,500			
Federal funds sold . . . . .	(25,960)		812	47	(65)	(1,832)
Deposits to other FHLBanks for mortgage loan programs . . . . .		(2)				
Principal collected on other loans . . . . .	1					
Premises, software and equipment . . . . .	(59)		(1)	(2)	(9)	(10)
Available-for-sale securities:						
Proceeds . . . . .	106,274			1,736	300	
Purchases . . . . .	(99,510)			(1,020)		
Held-to-maturity securities:						
Net (increase) decrease in short-term . . . . .	(1,299)				(76)	
Proceeds from long-term . . . . .	36,131	(2,750)	2,609	3,015	2,210	4,796
Purchases of long-term . . . . .	(45,844)		(2,854)	(708)	(4,540)	(7,020)
Advances:						
Proceeds . . . . .	8,329,280		724,533	434,148	2,304,901	135,145
Made . . . . .	(8,373,590)		(732,635)	(428,577)	(2,314,105)	(141,979)
Mortgage loans held for portfolio:						
Principal collected . . . . .	23,171		868	161	1,903	755
Purchases . . . . .	(14,741)		(1,753)	(451)	(951)	(1,401)
Proceeds from sales of foreclosed assets . . . . .	61					
Net cash (used in) provided by investing activities . . . . .	(78,538)	(2,752)	(6,396)	2,457	(12,345)	(11,024)

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 220	\$ 153	\$ 244	\$ 228	\$ 242	\$ 136	\$ 369	\$ 2
			(9)	(1)			
220	153	244	219	241	136	369	2
(16)	(6)	205	21	11	33	135	48
	(96)	(47)	27	(364)	(33)	298	(75)
13	(19)	3	(3)	(235)	21	2	4
2	45	(359)	8	33	26	474	256
(53)	(9)	(24)	(2)	17	(19)	(511)	11
1		(53)	(5)	1	1	(10)	
48	84	35	26	66	8	639	2
19	22	(45)	56	51	8	7	(7)
14	21	(285)	128	(420)	45	1,034	239
234	174	(41)	347	(179)	181	1,403	241
(503)	(404)		(481)	246	(1,275)	(1,648)	(1,230)
(300)						(750)	(850)
55	(1,375)	(1,817)	(2,410)	(5,216)	(874)	(8,536)	(4,749)
				2			
					1		
(3)	(1)	(14)	(1)	(3)	(3)	(5)	(7)
96,736	1,081	1,038	613	4,770			
(96,929)		(1,308)	(253)				
(3)		(729)	456		(219)	(728)	
2,757	1,465	1,361	957	1,717	2,312	8,580	7,102
(3,320)	(2,205)	(1,967)	(2,657)	(2,658)	(2,238)	(13,991)	(1,686)
2,261,563	48,593	22,126	107,756	509,753	353,713	1,348,109	78,940
(2,260,801)	(49,576)	(23,109)	(103,157)	(509,223)	(353,732)	(1,371,065)	(85,631)
1,695	1,543	8,913	2,634	162	339	894	3,304
(1,760)	(3,321)	(4,150)	(466)		(328)	(70)	(90)
		61					
(813)	(4,200)	405	2,991	(450)	(2,304)	(39,210)	(4,897)

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CASH FLOWS—(Continued)**  
**FOR THE YEAR ENDED DECEMBER 31, 2005**

(Dollar amounts in millions)

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>FINANCING ACTIVITIES</b>						
Net change in:						
Deposits and pass-through reserves . . . . .	\$ 733	\$	\$ (287)	\$ 347	\$ 34	\$ (178)
Deposits from other FHLBanks for mortgage loan programs . . . . .		2				
Borrowings . . . . .	(295)			(102)		(500)
Net proceeds from issuance of consolidated obligations:						
Discount notes . . . . .	7,378,761		670,612	671,632	1,046,171	346,184
Bonds . . . . .	296,094	(5)	11,713	23,380	25,638	49,401
Bonds transferred from other FHLBanks . . . . .		(1,384)		6	66	308
Payments for maturing and retiring consolidated obligations:						
Discount notes . . . . .	(7,367,338)		(666,419)	(670,836)	(1,046,770)	(349,655)
Bonds . . . . .	(234,075)	2,734	(9,812)	(26,641)	(13,337)	(35,580)
Bonds transferred to other FHLBanks . . . . .		1,398		(230)	(50)	
Proceeds from issuance of capital stock . . . . .	20,961		802	2,667	8,398	3,962
Payments for redemption of mandatorily redeemable capital stock . . . . .						
	(2,632)		(50)	(108)	(5)	(148)
Payments for repurchase/redemption of capital stock . . . . .	(16,989)		(356)	(2,623)	(8,012)	(3,382)
Cash dividends paid . . . . .	(642)		(83)	(162)	(73)	(217)
Net cash provided by (used in) financing activities . . . . .	<u>74,578</u>	<u>2,745</u>	<u>6,120</u>	<u>(2,670)</u>	<u>12,060</u>	<u>10,195</u>
Net increase (decrease) in cash and cash equivalents . . . . .	36		(2)		23	5
Cash and cash equivalents at beginning of the year . . . . .	320		12	22	92	8
Cash and cash equivalents at end of the year . . . . .	<u>\$ 356</u>	<u>\$</u>	<u>\$ 10</u>	<u>\$ 22</u>	<u>\$ 115</u>	<u>\$ 13</u>
<b>Supplemental Disclosures:</b>						
Interest paid . . . . .	<u>\$ 26,903</u>	<u>\$</u>	<u>\$ 1,522</u>	<u>\$ 1,944</u>	<u>\$ 1,405</u>	<u>\$ 3,804</u>
AHP payments, net . . . . .	<u>\$ 209</u>	<u>\$</u>	<u>\$ 10</u>	<u>\$ 16</u>	<u>\$ 6</u>	<u>\$ 20</u>
REFCORP assessments paid . . . . .	<u>\$ 535</u>	<u>\$</u>	<u>\$ 26</u>	<u>\$ 53</u>	<u>\$ 36</u>	<u>\$ 75</u>

\* Other liabilities includes the net change in the REFCORP receivable/payable.

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ (130)	\$ (79)	\$ (164)	\$ 60	\$ 1,818	\$ 15	\$ (491)	\$ (212)
		(2)					
					(7)		314
951,365	756,512	429,961	532,070	445,221	848,802	229,517	450,714
16,613	11,252	17,255	10,573	18,597	8,288	93,719	9,670
86		81		427	75	242	93
(952,424)	(757,768)	(430,062)	(533,006)	(441,078)	(848,151)	(228,242)	(442,927)
(14,832)	(5,961)	(15,773)	(12,701)	(24,035)	(6,731)	(58,310)	(13,096)
		(1,118)					
25	125	941	858	419	499	2,155	110
(130)		(1,471)	(12)	(27)	(665)	(16)	
	(16)		(1,120)	(695)	(3)	(771)	(11)
	(46)		(61)				
573	4,019	(352)	(3,339)	647	2,122	37,803	4,655
(6)	(7)	12	(1)	18	(1)	(4)	(1)
11	45	21	43	44	1	16	5
\$ 5	\$ 38	\$ 33	\$ 42	\$ 62	\$	\$ 12	\$ 4
\$ 2,502	\$ 1,183	\$ 3,006	\$ 1,477	\$ 1,956	\$ 1,440	\$ 4,802	\$ 1,862
\$ 24	\$ 13	\$ 32	\$ 8	\$ 10	\$ 10	\$ 47	\$ 13
\$ 54	\$ 31	\$ 92	\$ 20	\$ 28	\$ 28	\$ 85	\$ 7

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2004**

(Dollar amounts in millions)

	Combined	Combining Adjustments	Boston	New York	Pittsburgh	Atlanta
<b>OPERATING ACTIVITIES</b>						
Net income	\$ 1,994	\$ (27)	\$ 90	\$ 161	\$ 119	\$ 294
Cumulative effect of change in accounting principle before assessments	(50)			1	(10)	
Income before cumulative effect of change in accounting principle	1,944	(27)	90	162	109	294
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Depreciation and amortization	1,044	(21)	115	13	115	141
Change in net fair value adjustment on derivative and hedging activities	(436)	2	(90)	(14)	(60)	(73)
Other adjustments	46	46	40		(3)	1
Net change in:						
Trading securities	(212)		104		44	(624)
Accrued interest receivable	(258)	55	(3)	(28)	(12)	(45)
Other assets	(56)		3	(8)	8	2
Accrued interest payable	263	(55)	(45)	12	(12)	1
Other liabilities *	97		3	(1)	23	33
Total adjustments	488	27	127	(26)	103	(564)
Net cash provided by (used in) operating activities	2,432		217	136	212	(270)
<b>INVESTING ACTIVITIES</b>						
Net change in:						
Interest-bearing deposits	(6,541)		(2,555)	(1,153)	(513)	(169)
Securities purchased under agreements to resell	3,529		(1,000)			
Federal funds sold	(17,933)		(3,161)	(1,829)	(1,255)	(6,272)
Deposits to other FHLBanks for mortgage loan programs		(15)		1	1	2
Principal collected on other loans	1					
Loans to FHLBanks		(60)		60		
Premises, software and equipment	(52)		(2)	(1)	(4)	(7)
Available-for-sale securities:						
Proceeds	75,899		142		183	
Purchases	(77,042)	49	(25)	(711)	(452)	
Held-to-maturity securities:						
Net (increase) decrease in short-term	(1,253)				172	
Proceeds from long-term	37,935	(2,020)	1,911	3,512	3,015	5,062
Purchases of long-term	(49,989)	6,525	(1,459)	(4,036)	(4,106)	(7,922)
Advances:						
Proceeds	7,448,849		509,135	533,165	2,029,834	113,747
Made	(7,523,030)		(513,706)	(538,667)	(2,034,813)	(123,308)
Mortgage loans held for portfolio:						
Principal collected	23,571		976	146	2,173	284
Purchases	(24,373)		(473)	(655)	(2,857)	(744)
Proceeds from sales of foreclosed assets	75					
Net cash (used in) provided by investing activities	(110,354)	4,479	(10,217)	(10,168)	(8,622)	(19,327)

\* Other liabilities includes the net change in the REFCORP receivable/payable.



<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ 227	\$ 131	\$ 365	\$ 100	\$ 65	\$ 93	\$ 293	\$ 83
		(41)					
227	131	324	100	65	93	293	83
82	82	292	24	28	63	80	30
(88)	(68)	288	(148)	46	(253)	18	4
1		(25)	(16)	6	1	1	(6)
4	12	6	19	63	(143)	315	(12)
15	9	15		(34)	(10)	(180)	(40)
(1)	(5)	(73)	(1)	3	(2)	30	(12)
40	(3)	11	42	(1)	(10)	281	2
20	(2)	23	10	(5)	6	(11)	(2)
73	25	537	(70)	106	(348)	534	(36)
300	156	861	30	171	(255)	827	47
504	(267)		62	(328)	(728)	(1,964)	570
(700)		29				5,100	100
(292)	(2,213)	285	625	277	(1,833)	(3,027)	762
				(1)		12	
					1		
(3)	(2)	(14)	2	(9)	(3)	(2)	(7)
72,038		2,343	943	140	110		
(72,111)		(3,743)	(49)				
(2)		(751)	(1,348)		365	311	
2,989	1,877	1,858	903	1,896	2,756	7,658	6,518
(3,842)	(2,210)	(2,113)	(2,114)	(2,225)	(2,781)	(13,283)	(10,423)
2,325,820	46,255	25,813	74,479	561,820	344,917	836,409	47,455
(2,324,944)	(43,227)	(23,914)	(78,633)	(568,489)	(345,812)	(884,705)	(42,812)
2,005	1,578	10,165	2,685	260	184	847	2,268
(2,307)	(1,920)	(9,621)	(1,849)		(1,939)	(439)	(1,569)
		75					
(845)	(129)	412	(4,294)	(6,659)	(4,763)	(53,083)	2,862

**FEDERAL HOME LOAN BANKS**  
**COMBINING SCHEDULES—STATEMENTS OF CASH FLOWS—(Continued)**  
**FOR THE YEAR ENDED DECEMBER 31, 2004**

**(Dollar amounts in millions)**

	<u>Combined</u>	<u>Combining Adjustments</u>	<u>Boston</u>	<u>New York</u>	<u>Pittsburgh</u>	<u>Atlanta</u>
<b>FINANCING ACTIVITIES</b>						
Net change in:						
Deposits and pass-through reserves	\$ (2,194)	\$	\$ (55)	\$ 197	\$ (279)	\$ 773
Deposits from other FHLBanks for mortgage loan programs		15				
Borrowings	76					
Loans from FHLBanks		60			(60)	
Net proceeds from issuance of consolidated obligations:						
Discount notes	6,139,744		384,763	961,591	1,166,338	297,074
Bonds	385,004	(6,574)	9,914	29,338	29,305	61,788
Bonds transferred from other FHLBanks		(4,292)	346	206	631	992
Payments for maturing and retiring consolidated obligations:						
Discount notes	(6,135,715)		(370,037)	(958,795)	(1,162,738)	(288,257)
Bonds	(281,305)	1,996	(14,589)	(22,582)	(25,114)	(53,139)
Bonds transferred to other FHLBanks		4,316				
Proceeds from issuance of capital stock	17,637		532	2,174	5,805	3,477
Payments for redemption of mandatorily redeemable capital stock						
stock	(2,455)		(110)	(231)		(218)
Payments for repurchase/redemption of capital stock	(12,597)		(706)	(1,799)	(5,433)	(2,716)
Cash dividends paid	(380)		(55)	(66)	(36)	(177)
Net cash provided by (used in) financing activities	<u>107,815</u>	<u>(4,479)</u>	<u>10,003</u>	<u>10,033</u>	<u>8,419</u>	<u>19,597</u>
Net (decrease) increase in cash and cash equivalents	(107)		3	1	9	
Cash and cash equivalents at beginning of the year	427		9	21	83	8
Cash and cash equivalents at end of the year	<u>\$ 320</u>	<u>\$</u>	<u>\$ 12</u>	<u>\$ 22</u>	<u>\$ 92</u>	<u>\$ 8</u>
<b>Supplemental Disclosures:</b>						
Interest paid	<u>\$ 16,430</u>	<u>\$</u>	<u>\$ 1,270</u>	<u>\$ 1,116</u>	<u>\$ 822</u>	<u>\$ 2,071</u>
AHP payments, net	<u>\$ 215</u>	<u>\$</u>	<u>\$ 8</u>	<u>\$ 30</u>	<u>\$ 5</u>	<u>\$ 25</u>
REFCORP assessments paid	<u>\$ 428</u>	<u>\$</u>	<u>\$ 23</u>	<u>\$ 16</u>	<u>\$ 19</u>	<u>\$ 51</u>

<u>Cincinnati</u>	<u>Indianapolis</u>	<u>Chicago</u>	<u>Des Moines</u>	<u>Dallas</u>	<u>Topeka</u>	<u>San Francisco</u>	<u>Seattle</u>
\$ (377)	\$ (333)	\$ (1,109)	\$ (200)	\$ (198)	\$ (256)	\$ (53)	\$ (304)
		(15)					
					(3)		79
826,021	723,507	460,664	293,729	67,039	477,895	230,933	250,190
32,856	14,292	24,746	20,290	29,543	13,512	109,014	16,980
350			500	371	200	334	362
(836,841)	(723,325)	(464,280)	(294,198)	(71,583)	(475,095)	(236,572)	(253,994)
(21,496)	(14,213)	(16,832)	(15,999)	(18,913)	(11,365)	(53,210)	(15,849)
		(4,316)					
90	72	1,090	761	837	365	2,340	94
(54)		(1,204)	(3)	(86)	(62)	(21)	(466)
	(33)		(584)	(642)	(173)	(511)	
			(46)				
549	(33)	(1,256)	4,250	6,368	5,018	52,254	(2,908)
4	(6)	17	(14)	(120)		(2)	1
7	51	4	57	164	1	18	4
<u>\$ 11</u>	<u>\$ 45</u>	<u>\$ 21</u>	<u>\$ 43</u>	<u>\$ 44</u>	<u>\$ 1</u>	<u>\$ 16</u>	<u>\$ 5</u>
<u>\$ 1,583</u>	<u>\$ 892</u>	<u>\$ 2,493</u>	<u>\$ 930</u>	<u>\$ 1,080</u>	<u>\$ 756</u>	<u>\$ 1,901</u>	<u>\$ 1,516</u>
<u>\$ 22</u>	<u>\$ 18</u>	<u>\$ 31</u>	<u>\$ 8</u>	<u>\$ 10</u>	<u>\$ 9</u>	<u>\$ 35</u>	<u>\$ 14</u>
<u>\$ 53</u>	<u>\$ 27</u>	<u>\$ 81</u>	<u>\$ 21</u>	<u>\$ 21</u>	<u>\$ 22</u>	<u>\$ 69</u>	<u>\$ 25</u>

**SUPPLEMENTAL INFORMATION**  
**ADDITIONAL INFORMATION ON FHLBANKS' REGULATOR AND BUSINESS**

**FHLBanks' Regulator**

The FHLBanks are supervised and regulated by the Finance Board. The Finance Board is comprised of five board members. Four board members are appointed by the President of the United States, with the advice and consent of the Senate, to serve seven-year terms. The fifth member of the board is the Secretary of the Department of Housing and Urban Development (HUD), or such other person as the Secretary may designate. The Finance Board is financed by assessments from the FHLBanks. No tax dollars or other appropriations support the operations of the Finance Board or the FHLBanks. To assess the safety and soundness of the FHLBanks, the Finance Board conducts annual on-site examinations of each FHLBank and the Office of Finance, as well as periodic off-site reviews. In addition, each FHLBank is required to submit monthly financial information on its financial condition and results of operations to the Finance Board. This information is available to all FHLBanks.

The President designates one of the four appointed directors to serve as chairman of the Finance Board. Each of the four appointed directors must have experience or training in housing finance or a commitment to providing specialized housing credit. Not more than three directors may be members of the same political party. At least one director must come from an organization with more than a two-year history of representing consumer or community interests in banking services, credit needs, housing or financial consumer protections. The directors serve on a full-time basis.

At December 31, 2006, the directors of the Finance Board were:

- Chairman Ronald A. Rosenfeld;
- Alphonso Jackson (HUD Secretary);
- Geoffrey S. Bacino
- Alicia R. Castaneda; and
- Allan I. Mendelowitz.

The Finance Board has broad regulatory authority over the FHLBanks. The Finance Board may issue and serve a notice of charges upon any FHLBank or executive officer or director of an FHLBank under certain circumstances. The Finance Board may take such action it determines that the FHLBank, executive officer or director is engaging or has engaged in an unsafe or unsound practice in conducting the business of that FHLBank, or in any conduct that violates any provision of the FHLBank Act or any law, order, rule or regulation or any written condition imposed by the Finance Board, or any written agreement entered into by the FHLBank with the Finance Board. The Finance Board may also issue an order requiring a party to take affirmative action to correct conditions resulting from violations or practices or to limit activities of an FHLBank or any executive officer or director of an FHLBank to the same extent as appropriate Federal banking agencies may take with respect to insured depository institutions.

The Finance Board is located at 1625 Eye Street, N.W., Washington, DC, 20006 and its web site is [www.FHFB.gov](http://www.FHFB.gov).

## **Mortgage Partnership Finance® (MPF®) Program<sup>1</sup> and Mortgage Purchase Program (MPP)**

### **MPF Program**

*This description of the MPF Program was provided by the FHLBank of Chicago.*

#### *Introduction*

The MPF Program is a secondary mortgage market structure under which the FHLBank of Chicago purchases and funds eligible mortgage loans from or through participating financial institution members (PFIs) and purchases participations in pools of eligible mortgage loans from other FHLBanks (collectively, MPF Loans). MPF Loans are conforming conventional and Government (i.e., insured or guaranteed by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the Rural Housing Service of the Department of Agriculture (RHS) or HUD) fixed-rate mortgage loans secured by one-to-four family residential properties with maturities ranging from 5 years to 30 years or participations in such mortgage loans. MPF Loans that are Government loans are called “MPF Government Loans.”

There are currently five MPF Loan products from which PFIs may choose. Four of these products (Original MPF, MPF 125, MPF Plus and MPF Government) are closed loan products in which the FHLBank of Chicago purchases loans that have been acquired or have already been closed by the PFI with its own funds. However, under the MPF 100 product, the FHLBank of Chicago “table funds” MPF Loans; that is, the FHLBank of Chicago provides the funds through the PFI as its agent to make the MPF Loan to the borrower. The PFI performs all the traditional retail loan origination functions under this and all other MPF products. With respect to the MPF 100 product, the FHLBank of Chicago is considered the originator of the MPF Loan for accounting purposes since the PFI is acting as its agent when originating the MPF Loan.

The FHLBank of Chicago developed the MPF Program in order to help fulfill its housing mission, to diversify its assets beyond its Traditional Member Finance segment and to provide an additional source of liquidity to its members that choose to sell mortgage loans into the secondary market rather than holding them in their own portfolio. Finance Board regulations define the acquisition of acquired member assets (AMA) as a core mission activity of the FHLBanks. In order for MPF Loans to meet the AMA requirements, the FHLBank of Chicago structures purchases and fundings so that the credit risk associated with MPF Loans is shared with PFIs.

The FHLBank of Chicago also provides other FHLBanks (MPF FHLBanks) the ability to purchase and fund MPF Loans with their member PFIs. In addition, the FHLBank of Chicago provides programmatic and operational support to those MPF FHLBanks and their PFIs in its role as “MPF Provider.” The current MPF FHLBanks are the FHLBanks of Atlanta, Boston, Chicago, Dallas, Des Moines, New York, Pittsburgh, San Francisco and Topeka. Since October 2006, the FHLBank of San Francisco no longer offers new master commitments to purchase mortgage loans from its PFIs under the MPF Program although it is retaining its existing portfolio of mortgage loans.

MPF FHLBanks generally acquire whole loans from their respective PFIs but may also acquire them from a member PFI of another MPF FHLBank with permission of the PFI’s respective MPF FHLBank or may acquire participations from another MPF FHLBank. The FHLBank of Chicago currently purchases MPF Loans directly from PFIs of the FHLBank of Dallas and pays the FHLBank of Dallas a fee for acting as its marketing agent.

The MPF Program is designed to allocate the risks of MPF Loans among the MPF FHLBanks and PFIs and to take advantage of their respective strengths. PFIs have direct knowledge of their mortgage markets and have developed expertise in underwriting and servicing residential mortgage loans. By allowing PFIs to originate MPF Loans, whether through retail or wholesale operations,

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<sup>1</sup> “Mortgage Partnership Finance,” “MPF,” “MPF Shared Funding” and “eMPF” are registered trademarks of the Federal Home Loan Bank of Chicago.

and to retain or acquire servicing of MPF Loans, the MPF Program gives control of those functions that most impact credit quality to PFIs. The MPF FHLBanks are responsible for managing the interest-rate risk, prepayment risk and liquidity risk associated with owning MPF Loans.

For conventional MPF Loan products, PFIs assume or retain a portion of the credit risk on the MPF Loans they cause to be funded by or they sell to an MPF FHLBank by providing credit enhancement (CE Amount) either through a direct liability to pay credit losses up to a specified amount or through a contractual obligation to provide supplemental mortgage guaranty insurance (SMI). The PFI's CE Amount covers losses for MPF Loans under a master commitment in excess of the MPF FHLBank's first loss account (FLA). PFIs are paid a credit enhancement fee (CE Fee) for managing credit risk and in some instances all or a portion of the CE Fee may be performance based.

#### *MPF Provider*

In its role as MPF Provider, the FHLBank of Chicago establishes the eligibility standards under which an MPF FHLBank member may become a PFI, the structure of MPF Loan products and the eligibility rules for MPF Loans. In addition, the MPF Provider manages the pricing and delivery mechanism for MPF Loans and the back-office processing of MPF Loans in its role as master servicer and master custodian. The MPF Provider has engaged Wells Fargo Bank N.A. as its vendor for master servicing and as the primary custodian for the MPF Program. The MPF Provider has also contracted with other custodians meeting MPF Program eligibility standards at the request of certain PFIs. These other custodians are typically affiliates of PFIs and in some cases a PFI acts as self-custodian.

The MPF Provider publishes and maintains the MPF Origination Guide and MPF Servicing Guide (together "MPF Guides"), which detail the requirements PFIs must follow in originating or selling and servicing MPF Loans. The MPF Provider maintains the infrastructure through which MPF FHLBanks may fund or purchase MPF Loans through their PFIs. This infrastructure includes both a telephonic delivery system and a web-based delivery system accessed through the eMPF® website. In exchange for providing these services, the MPF Provider receives a fee from each of the MPF FHLBanks.

#### *PFI Eligibility*

Members and eligible housing associates may apply to become a PFI of their respective MPF FHLBank. If a member is an affiliate of a holding company which has another affiliate that is an active PFI, the member is only eligible to become a PFI if it is a member of the same MPF FHLBank as the existing PFI. The MPF FHLBank reviews the general eligibility of the member, its servicing qualifications and ability to supply documents, data and reports required to be delivered by PFIs under the MPF Program. The member and its MPF FHLBank sign an MPF Program Participating Financial Institution Agreement (PFI Agreement) that provides the terms and conditions for the sale or funding of MPF Loans, including required credit enhancement, and establishes the terms and conditions for servicing MPF Loans. All of the PFI's obligations under the PFI Agreement are secured in the same manner as the other obligations of the PFI under its regular advances agreement with the MPF FHLBank. The MPF FHLBank has the right under the advances agreement to request additional collateral to secure the PFI's obligations.

#### *Mortgage Standards*

Mortgage loans delivered under the MPF Program must meet the underwriting and eligibility requirements in the MPF Guides, as amended by any waiver granted to a PFI exempting it from complying with specified provisions of the MPF Guides. PFIs may utilize an approved automated



underwriting system or underwrite MPF Loans manually. The current underwriting and eligibility guidelines under the MPF Guides with respect to MPF Loans are broadly summarized as follows:

- *Mortgage characteristics.* MPF Loans must be qualifying 5-year to 30-year conforming conventional or Government fixed-rate, fully amortizing mortgage loans, secured by first liens on owner-occupied one-to-four unit single-family residential properties and single unit second homes. Conforming loan size, which is established annually as required by Finance Board regulations, may not exceed the loan limits permitted to be set by the Office of Federal Housing Enterprise Oversight (“OFHEO”) each year. Condominium, planned unit development and manufactured homes are acceptable property types as are mortgages on leasehold estates (though manufactured homes must be on land owned in fee simple by the borrower).
- *Loan-to-Value Ratio and Primary Mortgage Insurance.* The maximum LTV for conventional MPF Loans must not exceed 95%, while FHLBank AHP mortgage loans may have LTVs up to 100% (but may not exceed 105% total LTV, which compares the property value to the total amount of all mortgages outstanding against a property). Government MPF Loans may not exceed the LTV limits set by the applicable government agency. Conventional MPF Loans with LTVs greater than 80% require certain amounts of mortgage guaranty insurance (MI), called primary MI, from an MI company rated at least “AA” or “Aa” and listed in S&P’s LEVELS® modeling software which calculates the PFI’s required CE amount.
- *Documentation and Compliance with Applicable Law.* The mortgage documents and mortgage transaction must comply with all applicable laws and mortgage loans must be documented using standard Fannie Mae/Freddie Mac Uniform Instruments.
- *Ineligible Mortgage Loans.* The following types of mortgage loans are not eligible for delivery under the MPF Program: (1) mortgage loans that are not ratable by S&P; (2) mortgage loans not meeting the MPF Program eligibility requirements as set forth in the MPF Guides and agreements; and (3) mortgage loans that are classified as high cost, high rate, high risk, Home Ownership and Equity Protection Act (HOEPA) loans or loans in similar categories defined under predatory lending or abusive lending laws.

The MPF Guides also contain MPF Program policies which include anti-predatory lending policies, eligibility requirements for PFIs such as insurance requirements and annual certification requirements, loan documentation and custodian requirements, as well as detailing the PFI’s servicing duties and responsibilities for reporting, remittances, default management and disposition of properties acquired by foreclosure or deed in lieu of foreclosure.

A majority of the states, and some municipalities, have enacted laws against mortgage loans considered predatory or abusive. Some of these laws impose liability for violations not only on the originator, but also upon purchasers and assignees of mortgage loans. The MPF Provider takes measures that it considers reasonable and appropriate to reduce its exposure to potential liability under these laws and is not aware of any claim, action or proceeding asserting that it is liable under these laws. However, the MPF Provider can not assure that it will never have any liability under predatory or abusive lending laws.

#### *MPF Loan Deliveries*

In order to deliver mortgage loans under the MPF Program, the PFI and MPF FHLBank will enter into a best efforts master commitment (Master Commitment) which provides the general terms under which the PFI will deliver mortgage loans to an MPF FHLBank, including a maximum loan delivery amount, maximum CE Amount and expiration date. PFIs may then request to enter into one or more mandatory funding or purchase commitments (each, a Delivery Commitment), which is a mandatory commitment of the PFI to sell or originate eligible mortgage loans. Each MPF Loan delivered must conform to specified ranges of interest rates, maturity terms and business days

for delivery (which may be extended for a fee) detailed in the Delivery Commitment or it will be rejected by the MPF Provider. Each MPF Loan under a Delivery Commitment is linked to a Master Commitment so that the cumulative credit enhancement level can be determined for each Master Commitment.

The sum of MPF Loans delivered by the PFI under a specific Delivery Commitment cannot exceed the amount specified in the Delivery Commitment without the assessment of a price adjustment fee. Delivery Commitments that are not fully funded by their expiration dates are subject to pair-off fees (fees charged to a PFI for failing to deliver the amount of loans specified in a Delivery Commitment) or extension fees (fees charged to a PFI for extending the time deadline to deliver loans on a Delivery Commitment), which protect the MPF FHLBank against changes in market prices.

In connection with each sale to or funding by an MPF FHLBank, the PFI makes customary representations and warranties in the PFI Agreement and under the MPF Guides and include eligibility and conformance of the MPF Loans with the requirements in the MPF Guides, compliance with predatory lending laws and the integrity of the data transmitted to the MPF Provider. Once an MPF Loan is funded or purchased, the PFI must deliver a qualifying promissory note and certain other required documents to the designated custodian, who reports to the MPF Provider whether the documentation package matches the funding information transmitted to the MPF Provider and otherwise meets MPF Program requirements.

The MPF Provider conducts an initial quality assurance review of a selected sample of MPF Loans from each PFI's initial MPF Loan delivery. Thereafter, the MPF Provider performs periodic reviews of a sample of MPF Loans to determine whether the reviewed MPF Loans complied with the MPF Program requirements at the time of acquisition. Any exception that indicates a negative trend is discussed with the PFI and can result in the suspension or termination of a PFI's ability to deliver new MPF Loans if the concern is not adequately addressed.

When a PFI fails to comply with the requirements of the PFI Agreement, MPF Guides, applicable law or terms of mortgage documents, the PFI may be required to provide an indemnification covering related losses or to repurchase the MPF Loans which are impacted by such failure if it cannot be cured. Reasons for which a PFI could be required to repurchase an MPF Loan may include but are not limited to MPF Loan ineligibility, breach of representation or warranty under the PFI Agreement or the MPF Guides, failure to deliver the required MPF Loan document package to an approved custodian, servicing breach or fraud.

The MPF Provider does not currently conduct any quality assurance reviews of MPF Government Loans. However, it does allow PFIs to repurchase delinquent MPF Government Loans so that they may comply with loss mitigation requirements of the applicable government agency in order to preserve the insurance or guaranty coverage. The repurchase price is equal to the current scheduled principal balance and accrued interest on the MPF Government Loan. In addition, just as for conventional MPF Loans, if a PFI fails to comply with the requirements of the PFI Agreement, MPF Guides, applicable law or terms of mortgage documents, the PFI may be required to repurchase the MPF Government Loans which are impacted by such failure.

Set forth below is a table detailing the PFIs' repurchases of MPF Loans:

**Total MPF Loans Repurchased**

<u>(Dollars in millions)</u>	<u>December 31,</u>			
	<u>2006</u>		<u>2005</u>	
	<u>Amount</u>	<u>Count</u>	<u>Amount</u>	<u>Count</u>
Conventional .....	\$23	193	\$ 31	292
Government .....	<u>48</u>	<u>473</u>	<u>100</u>	<u>972</u>
Total .....	<u>\$71</u>	<u>666</u>	<u>\$131</u>	<u>1,264</u>

### *MPF Products*

A variety of MPF Loan products have been developed to meet the differing needs of PFIs. There are currently five MPF products that PFIs may choose from: Original MPF, MPF 100, MPF 125, MPF Plus and MPF Government. The products have different credit risk sharing characteristics based upon the different levels for the FLA and CE Amount and the types of CE Fees (performance based or fixed amount).

### *MPF Loan Participations*

The MPF Provider may purchase participation interests in MPF Loans from other MPF FHLBanks and may also sell participation interests to other MPF FHLBanks at the time MPF Loans are acquired. The participation percentages in MPF Loans may vary by each Master Commitment, by agreement of the MPF FHLBank selling the participation interests (the Owner Bank), the FHLBank of Chicago in its role as MPF Provider, and other MPF FHLBanks purchasing a participation interest. Effective March 1, 2006, the MPF Provider no longer enters into agreements to purchase participation interests in new Master Commitments from other MPF FHLBanks though it has pre-existing contractual obligations that could result in its acquiring additional participation interests.

The Owner Bank is responsible for evaluating, monitoring, and reporting to any participant MPF FHLBank the creditworthiness of each PFI initially, and at least annually thereafter. The Owner Bank is responsible for ensuring that adequate collateral is available from each of its PFIs to secure any direct obligation portion of the PFI's CE Amount. The Owner Bank is also responsible for enforcing the PFI's obligations under its PFI Agreement.

Participation percentages for MPF Loans may range from 100% to be retained by the Owner Bank to 100% participated to another MPF FHLBank. The participation percentages do not change during the period that a Master Commitment is open unless the MPF FHLBanks contractually agree to change their respective shares or the Owner Bank exercises the right to require us to acquire a 100% participation for delivery commitments for a particular day. If the specified participation percentage in a Master Commitment never changes, then the percentage for risk-sharing of losses will remain unchanged throughout the life of the Master Commitment.

The risk sharing and rights of the Owner Bank and participating MPF FHLBank(s) are as follows:

- each pays its respective pro rata share of each MPF Loan acquired under a Delivery Commitment and related Master Commitment based upon the participation percentage in effect at the time;
- each receives its respective pro rata share of principal and interest payments and is responsible for credit enhancement fees based upon its participation percentage for each MPF Loan under the related Delivery Commitment, and for the Original MPF product, each is responsible for monthly allocations to the FLA based upon the unpaid principal balance of, and its participation percentage for, each MPF Loan; and
- each is responsible for its respective pro rata share of FLA exposure and losses incurred with respect to the Master Commitment based upon the overall risk sharing percentage for the Master Commitment, except that for the Original MPF product, each shares in exposure to loss based on its respective percentage of the FLA at the time the loss is allocated.

The FLA and CE Amount apply to all the MPF Loans in a Master Commitment regardless of participation arrangements, so an MPF FHLBank's share of credit losses is based on its respective participation interest in the entire Master Commitment. For example, assume a MPF FHLBank's specified participation percentage was 25% under a \$100 million Master Commitment and that no changes were made to the Master Commitment. The MPF FHLBank risk sharing percentage of credit losses would be 25%. In the case where an MPF FHLBank changes its initial percentage in

the Master Commitment, the risk sharing percentage will also change. For example, if an MPF FHLBank were to acquire 25% of the first \$50 million and 50% of the second \$50 million of MPF Loans delivered under a Master Commitment, the MPF FHLBank would share in 37.5% of the credit losses in that \$100 million Master Commitment, while it would receive principal and interest payments on the individual MPF Loans that remain outstanding in a given month, some in which it may own a 25% interest and the others in which it may own a 50% interest.

The arrangement is slightly different for the Original MPF product because each MPF FHLBank's participation percentage in the FLA is based upon its share of each MPF Loan as the FLA increases over time. If the participation percentage never changes over the life of a Master Commitment, then the risk of loss is based on the MPF FHLBank's respective investment percentage in the Master Commitment. If the percentage participations differ for various MPF Loans, each MPF FHLBank's percentage of the FLA will be impacted by those differences because MPF Loans are acquired and repaid at different times. For example, if a Master Commitment had a total FLA of \$100,000 (as of the date of the loss), and one participant MPF FHLBank's FLA is \$25,000 and the other MPF FHLBank's FLA is \$75,000, then the first MPF FHLBank would pay 25% of the loss incurred at such time and the other MPF FHLBank would pay 75%.

### *MPF Servicing*

The PFI or its servicing affiliate generally retains the right and responsibility for servicing MPF Loans it delivers. The PFI is responsible for collecting the borrower's monthly payments and otherwise dealing with the borrower with respect to the MPF Loan and the mortgaged property. Based on monthly reports the PFI is required to provide the master servicer, appropriate withdrawals are made from the PFI's deposit account with the applicable MPF FHLBank. In some cases, the PFI has agreed to advance principal and interest payments on the scheduled remittance date when the borrower has failed to pay, provided that the collateral securing the MPF Loan is sufficient to reimburse the PFI for advanced amounts. The PFI recovers the advanced amounts either from future collections or upon the liquidation of the collateral securing the MPF Loans.

If an MPF Loan becomes delinquent, the PFI is required to contact the borrower to determine the cause of the delinquency and whether the borrower will be able to cure the default. The MPF Guides permit certain types of forbearance plans. Upon any MPF Loan becoming 90 days or more delinquent, the master servicer monitors and reviews the PFI's default management activities for that MPF Loan, including timeliness of notices to the mortgagor, forbearance proposals, property protection activities, and foreclosure referrals, all in accordance with the MPF Guides. Upon liquidation of any MPF Loan and submission of each realized loss calculation from the PFI, the master servicer reviews the realized loss calculation for conformity with the primary mortgage insurance requirements, if applicable, and conformity to the cost and timeliness standards of the MPF Guides. The master servicer disallows the reimbursement to the PFI of any servicing advances related to the PFI's failure to perform in accordance with the MPF Guides. If there is a loss on a conventional MPF Loan, the loss is allocated to the Master Commitment and shared in accordance with the risk sharing structure for that particular Master Commitment. The servicer pays any gain on sale of real-estate owned property to the MPF FHLBank, or in the case of a participation, to the MPF FHLBanks based upon their respective interest in the MPF Loan. However, the amount of the gain is available to reduce subsequent losses incurred under the Master Commitment before such losses are allocated between the MPF FHLBank and the PFI.

The MPF Provider monitors the PFI's compliance with MPF Program requirements throughout the servicing process, and the MPF Provider brings any material concerns to the attention of the MPF FHLBank. Minor lapses in servicing are charged to the PFI. Major lapses in servicing could result in a PFI's servicing rights being terminated for cause and the servicing of the particular MPF Loans being transferred to a new, qualified servicing PFI. In addition, the MPF Guides require each PFI to maintain errors and omissions insurance and a fidelity bond and to provide an annual certification with respect to its insurance and its compliance with the MPF Program requirements.



Although PFIs or their servicing affiliates generally service the MPF Loans delivered by the PFI, certain PFIs choose to sell the servicing rights on a concurrent basis (servicing released) or in a bulk transfer to another PFI which is permitted with the consent of the MPF FHLBanks involved. One PFI has been designated to acquire servicing under the MPF Program's concurrent sale of servicing option. In addition, several PFIs have acquired servicing rights on a concurrent servicing released basis or bulk transfer basis without the direct support from the MPF Program.

#### *MPF Shared Funding® Program*

In 2003, the FHLBank of Chicago invested in AMA eligible securities through the MPF Shared Funding program. The MPF Shared Funding program provides a platform to allow mortgage loans to be sold through the MPF Program system to a third party-sponsored trust and "pooled" into securities. Similar to its MPF Provider role, the FHLBank of Chicago serves as master servicer and master custodian for the benefit of the holders of the securities. Under the program, the FHLBank of Chicago purchases the AMA eligible securities, which are rated at least AA, and may either retain the securities or sell them to other FHLBanks. No residual interest is created or retained on the FHLBank of Chicago's balance sheet.

Aside from potential liquidity benefits on future transactions, there is not a material difference in the FHLBank of Chicago's risk profile or earnings between holding MPF Shared Funding securities and holding the mortgage loans backing the securities. The FHLBank of Chicago has not completed any MPF Shared Funding transactions since June 2003. The principal balance of the MPF Shared funding securities held by the FHLBank of Chicago was \$369 million and \$417 million at December 31, 2006 and 2005.

#### *Credit Enhancement Structure*

##### *Overview*

The MPF FHLBank and PFI share the risk of credit losses on MPF Loans by structuring potential losses on conventional MPF Loans into layers with respect to each Master Commitment. The first layer or portion of credit losses that an MPF FHLBank is potentially obligated to incur is determined based upon the MPF Product selected by the PFI and is referred to as the First Loss Account (FLA). The FLA functions as a tracking mechanism for determining the point after which the PFI, in its role as credit enhancer, would be required to cover losses. The FLA is not a cash collateral account, and does not give an MPF FHLBank any right or obligation to receive or pay cash or any other collateral. For MPF products with performance based credit enhancement fees (CE Fees), the MPF FHLBank may withhold CE Fees to recover losses at the FLA level essentially transferring a portion of the first layer risk of credit loss to the PFI.

The portion of credit losses that a PFI is potentially obligated to incur is referred to as its credit enhancement amount (CE Amount). The PFI's CE Amount represents a direct liability to pay credit losses incurred with respect to a Master Commitment or the requirement of the PFI to obtain and pay for a supplemental mortgage guaranty insurance (SMI) policy insuring the MPF FHLBank for a portion of the credit losses arising from the Master Commitment. The PFI may procure SMI to cover losses equal to all or a portion of the CE Amount (except that losses generally classified as special hazard losses are covered by the PFI's direct liability or the MPF FHLBank, not by SMI). The final CE Amount is determined once the Master Commitment is closed (i.e., when the maximum amount of MPF Loans are delivered or the expiration date has occurred). For a description of how the PFI's CE Amount is determined.

The PFI receives a CE Fee in exchange for providing the CE Amount which may be used to pay for SMI. CE Fees are paid monthly and are determined based on the remaining unpaid principal balance of the MPF Loans under the Master Commitment. The CE Fee and CE Amount may vary depending on the MPF product selected. CE Fees payable to a PFI as compensation for assuming credit risk are recorded as an offset to MPF Loan interest income when paid by the MPF Provider. The MPF Provider also pays performance CE Fees which are based on actual perform-

ance of the pool of MPF Loans in each Master Commitment. To the extent that losses in the current month exceed performance CE Fees accrued, the remaining losses may be recovered from withholding future performance CE Fees payable to the PFI.

#### *Loss Allocation*

Credit losses on conventional MPF Loans not absorbed by the borrower's equity in the mortgaged property, property insurance or primary mortgage insurance are allocated between the MPF FHLBank and PFI as follows:

- *First*, to the MPF FHLBank, up to an agreed upon amount, called a First Loss Account (FLA).

*Original MPF.* The FLA starts out at zero on the day the first MPF Loan under a Master Commitment is purchased but increases monthly over the life of the Master Commitment at a rate that ranges from 0.03% to 0.05% (3 to 5 basis points) per annum based on the month-end outstanding aggregate principal balance of the Master Commitment. The FLA is structured so that over time, it should cover expected losses on a Master Commitment, though losses early in the life of the Master Commitment could exceed the FLA and be charged in part to the PFI's CE Amount.

*MPF 100 and MPF 125.* The FLA is equal to 1.00% (100 basis points) of the aggregate principal balance of the MPF Loans funded under the Master Commitment. Once the Master Commitment is fully funded, the FLA is expected to cover expected losses on that Master Commitment, although the MPF FHLBank may economically recover a portion of losses incurred under the FLA by withholding performance CE Fees payable to the PFI.

*MPF Plus.* The FLA is equal to an agreed-upon number of basis points of the aggregate principal balance of the MPF Loans funded under the Master Commitment that is not less than the amount of expected losses on the Master Commitment. Once the Master Commitment is fully funded, the FLA is expected to cover expected losses on that Master Commitment, although the MPF FHLBank may economically recover a portion of losses incurred under the FLA by withholding performance CE Fees payable to the PFI.

- *Second*, to the PFI under its credit enhancement obligation, losses for each Master Commitment in excess of the FLA, if any, up to the CE Amount. The CE Amount may consist of a direct liability of the PFI to pay credit losses up to a specified amount, a contractual obligation of the PFI to provide SMI or a combination of both.
- *Third*, any remaining unallocated losses are absorbed by the MPF FHLBank.

With respect to participation interests, MPF Loan losses allocable to the MPF FHLBank are allocated amongst the participating MPF FHLBanks pro ratably based upon their respective participation interests in the related Master Commitment.

#### *Setting Credit Enhancement Levels*

Finance Board regulations require that MPF Loans be sufficiently credit enhanced so that an MPF FHLBank's risk of loss is limited to the losses of an investor in an "AA" rated mortgage-backed security, unless it maintains additional retained earnings or risk based capital, as applicable, in addition to a general allowance for losses.

In its role as MPF Provider, the FHLBank of Chicago analyzes the risk characteristics of each MPF Loan (as provided by the PFI) using S&P's LEVELS<sup>®</sup> model in order to determine the required CE Amount for a loan or group of loans to be funded or acquired by an MPF FHLBank (MPF Program Methodology). The PFI's CE Amount (including the SMI policy for MPF Plus) is calculated using the MPF Program Methodology to equal the difference between the amount needed for the Master Commitment to have a rating equivalent to a "AA" rated mortgage-backed security and an MPF FHLBank's initial FLA exposure (which is zero for the Original MPF



product). An MPF FHLBank determines its FLA exposure by taking the initial FLA and reducing it by the estimated value of any performance-based CE Fees that would be payable to the PFI.

For MPF Plus, the PFI is required to provide an SMI policy covering the MPF Loans in the Master Commitment and having a deductible initially equal to the FLA. Depending upon the amount of the SMI policy (determined in part by the amount of the CE Fees paid to the PFI), the PFI may or may not have any direct liability on the CE Amount.

An MPF FHLBank is required to recalculate the estimated credit rating of a Master Commitment if there is evidence of a decline in credit quality of the related MPF Loans.

#### *Credit Enhancement Fees*

The structure of the CE Fee payable to the PFI depends upon the product type selected. For Original MPF, the PFI is paid a monthly CE Fee between 0.09% and 0.11% (9 to 11 basis points) per annum and paid monthly based on the aggregate outstanding principal balance of the MPF Loans in the Master Commitment.

For MPF 100 and MPF 125, the PFI is paid a monthly CE Fee between 0.07% and 0.10% (7 and 10 basis points) per annum and paid monthly on the aggregate outstanding principal balance of the MPF Loans in the Master Commitment. The PFI's monthly CE Fee is performance based in that it is reduced by losses charged to the FLA. For MPF 100, the CE Fee is fixed for the first two or three years of a Master Commitment and thereafter becomes performance based. For MPF 125, the CE Fee is performance based for the entire life of the Master Commitment.

For MPF Plus, the performance-based portion of the CE Fee is typically between 0.06% and 0.07% (6 and 7 basis points) per annum and paid monthly on the aggregate outstanding balance of the MPF Loans in the Master Commitment. The performance based CE Fee is reduced by losses charged to the FLA and is paid one year after accrued based on monthly outstanding balances. The fixed portion of the CE Fee is typically 0.07% (7 basis points) per annum and paid monthly on the aggregate outstanding principal balance of the MPF Loans in the Master Commitment. The performance CE Fee is lower for Master Commitments without a direct PFI CE Amount.

At December 31, 2006 and 2005, the amount of FLA remaining for losses for all MPF FHLBanks, excluding amounts that may be recovered by the withholding of performance CE Fees, was \$548 million and \$525 million, respectively. Except with respect to Original MPF, an MPF FHLBank's losses incurred under the FLA can be recovered by withholding future performance CE Fees otherwise paid to its PFIs. For the years ended December 31, 2006, 2005 and 2004, of the \$87 million, \$95 million and \$99 million of total CE Fees paid by the MPF FHLBanks, respectively, \$44 million, \$48 million and \$50 million were performance-based credit enhancement fees, respectively.

Only MPF Government Loans are eligible for sale under the MPF Government Product. The PFI provides and maintains insurance or a guaranty from the applicable government agency (i.e., the FHA, VA, RHS or HUD) for MPF Government Loans and the PFI is responsible for compliance with all government agency requirements and for obtaining the benefit of the applicable insurance or guaranty with respect to defaulted MPF Government Loans. For Master Commitments issued prior to February 2, 2007, the PFI is paid a monthly government loan fee equal to 0.02% (2 basis points) per annum based on the month end outstanding aggregate principal balance of the Master Commitment. This amount is in addition to the customary 0.44% (44 basis points) per annum servicing fee that continues to apply for Master Commitments issued after February 2, 2007, and that is retained by the PFI on or after a monthly basis, based on the outstanding aggregate principal balance of the MPF Government Loans. Only PFIs that are licensed or qualified to originate and service MPF Government Loans by the applicable government agency or agencies and that maintain a mortgage loan delinquency ratio that is acceptable to the MPF Provider and that is comparable to the national average and/or regional delinquency rates as published by the Mortgage

Bankers Association are eligible to sell and service MPF Government Loans under the MPF Program.

*Credit Risk Exposure on MPF Loans*

An MPF FHLBank's credit risk on MPF Loans is the potential for financial loss due to borrower default or depreciation in the value of the real estate collateral securing the MPF Loan, offset by the PFI's credit enhancement protection. Under the MPF Program, the PFI's credit enhancement protection (CEP Amount) may take the form of a contingent performance based CE Fee whereby such fees are reduced by losses up to a certain amount arising under the Master Commitment and the CE Amount (which represents a direct liability to pay credit losses incurred with respect to that Master Commitment or may require the PFI to obtain and pay for an SMI policy insuring the MPF FHLBank for a portion of the credit losses arising from the Master Commitment). Under the AMA Regulation, any portion of the CE Amount that is a PFI's direct liability must be collateralized by the PFI in the same way that advances are collateralized. The PFI Agreement provides that the PFI's obligations under the PFI Agreement are secured along with other obligations of the PFI under its regular advances agreement and further, that we may request additional collateral to secure the PFI's obligations.

The table below summarizes the average PFI CE Amount of all Master Commitments funded or purchased by the MPF FHLBanks for each MPF Product:

**Average PFI CE Amount by Product as a Percentage of Master Commitments Funded or Purchased by the MPF FHLBanks**

	<u>December 31, 2006</u>	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Original MPF . . . . .	1.76%	1.80%	1.66%
MPF 100 . . . . .	0.52%	0.50%	0.44%
MPF 125 . . . . .	0.91%	0.92%	0.75%
MPF Plus(1) . . . . .	1.33%	1.34%	1.35%
MPF Government(2) . . . . .	N/A	N/A	N/A

- (1) CE amount includes SMI policy coverage.
- (2) Formerly called Original MPF for FHA/VA.

The MPF FHLBanks also face credit risk of loss on MPF Loans to the extent such losses are not recoverable from the PFI either directly or indirectly through performance based CE Fees, or from an SMI insurer, as applicable. The outstanding balance of MPF Loan portfolios exposed to credit losses not recoverable from the applicable government agency with respect to MPF Government Loans (including servicer paid losses not covered by the applicable federal agency), the PFI CEP Amount, primary mortgage insurance (PMI), or other SMI coverage was approximately \$63 billion, \$68 billion and \$73 billion at December 31, 2006, 2005 and 2004. The MPF FHLBanks' actual credit exposure is significantly less than these amounts because the borrower's equity, which represents the fair value of underlying property in excess of the outstanding MPF Loan balance, has not been considered because the fair value of all underlying properties is not readily determinable. However, because the typical MPF Loan to value ratio is less than 100% and PMI covers loan to value ratios in excess of 80%, a significant decline in value of the underlying property would have to occur before the MPF FHLBanks are exposed to credit losses.

The risk-sharing of credit losses between MPF FHLBanks for participations is based on each MPF FHLBank's percentage interest in the Master Commitment. Accordingly, the credit risk assumed by a MPF FHLBank is driven by its percentage interest in each Master Commitment.

The MPF Program (including MPF Shared Funding securities) included \$72.3 billion (at par value) of outstanding assets for all MPF FHLBanks at December 31, 2006 of which \$37.7 billion (par value) were owned or participated in by the FHLBank of Chicago and the remaining

\$34.6 billion (par value) were owned or participated in by the other MPF FHLBanks. More than 795 commercial banks, thrifts, credit unions and insurance companies are approved PFIs that deliver MPF Loans into the MPF Program secured by homes in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands.

The following table summarizes the par value of combined MPF Loans outstanding according to the ten largest state concentrations:

(Dollars in millions)	December 31, 2006		December 31, 2005	
	Par Value	Percentage of Total	Par Value	Percentage of Total
California . . . . .	\$ 8,146	11.3%	\$ 9,329	11.8%
Wisconsin . . . . .	7,482	10.3%	7,640	9.6%
Illinois . . . . .	5,363	7.4%	5,638	7.1%
Texas . . . . .	4,076	5.6%	4,532	5.7%
Minnesota . . . . .	2,847	3.9%	3,106	3.9%
Pennsylvania . . . . .	2,802	3.9%	3,038	3.8%
New York . . . . .	2,799	3.9%	3,050	3.8%
Florida . . . . .	2,614	3.6%	3,004	3.8%
Virginia . . . . .	2,353	3.3%	2,629	3.3%
Maryland . . . . .	2,177	3.0%	2,458	3.1%
All other states . . . . .	31,664	43.8%	34,969	44.1%
Total par value of MPF Loans . . . . .	<u>\$72,323</u>	<u>100.0%</u>	<u>\$79,393</u>	<u>100.0%</u>

The following table presents MPF loan concentrations by PFI for MPF loan purchases and fundings by the MPF FHLBanks that exceeded 10% of all MPF loan purchases and fundings for the years ended December 31, 2006, 2005 and 2004.

(Dollars in millions) PFI	Loan Purchases and Funding Concentrations by PFI For the Years Ended December 31,					
	2006		2005		2004	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
National City Bank . . .	\$ 396	11.5%	\$1,092	12.1%	\$ 3,558	19.3%
Branch Banking & Trust . . . . .	361	10.5%	N/A	N/A	N/A	N/A
Balboa Reinsurance Company . . . . .	N/A	N/A	3,109	34.4%	3,804	20.7%
LaSalle Bank, N.A . . .	N/A	N/A	N/A	N/A	2,326	12.6%
All Other Institutions	<u>2,674</u>	<u>78.0%</u>	<u>4,829</u>	<u>53.5%</u>	<u>8,743</u>	<u>47.4%</u>
Total . . . . .	<u>\$3,431</u>	<u>100.0%</u>	<u>\$9,030</u>	<u>100.0%</u>	<u>\$18,431</u>	<u>100.0%</u>

N/A — not applicable, as amount is less than ten percent.

### Mortgage Purchase Program (MPP)

*This description of the MPP was provided by the MPP FHLBanks.*

**Overview.** MPP is offered by the FHLBanks of Atlanta, Cincinnati, and Indianapolis and was also offered by the FHLBank of Seattle in 2004. MPP, which was introduced in 2000, enables these FHLBanks to purchase directly from members both their qualifying conforming fixed-rate conventional one-to-four family mortgages and residential mortgages insured by the FHA. Each MPP FHLBank has approved members, known as PFIs, which sell them mortgage loans. A PFI may also be a third-party servicer (subject to MPP FHLBank approval) of loans sold to an MPP FHLBank by other member PFIs.

A “conforming” mortgage refers to the maximum amount permissible to be lent as a regular prime (i.e., non-jumbo, non-sub prime) mortgage. Established each year by the Office of Federal Housing Enterprise Oversight (OFHEO) based on data published by the Finance Board on average home prices, that amount was \$417,000 in 2006. A “conventional” mortgage refers to non-government-guaranteed/insured mortgages. The FHLBanks are permitted to purchase qualifying mortgage loans within any state or territory of the United States. The FHLBanks do not use any trust or intermediary to purchase mortgage loans from members under this program.

Each MPP FHLBank holds purchased mortgage loans on their balance sheet. Finance Board regulations do not specifically authorize these FHLBanks to sell loans purchased in the MPP, either directly or by securitization, or to purchase any mortgage loans other than those identified in the paragraph above. Prior to engaging in any such business, an FHLBank would need to obtain Finance Board approval of the new business activity. While the FHLBanks have considered the feasibility and economic benefits of selling mortgage loan assets from time to time to third parties as a risk management tool, they have no plans to request the authority to sell or securitize their mortgage loan portfolio.

MPP directly supports the FHLBanks’ public policy mission of supporting housing finance. By selling mortgage loans to these FHLBanks, members increase their balance sheet liquidity and remove from their balance sheet assets that carry interest rate and prepayment risk. The MPP FHLBanks believe the MPP, along with the similar programs at other FHLBanks, promotes a greater degree of competition among mortgage investors, which should benefit households. A primary reason these FHLBanks established the MPP was to enable small- and medium-sized community-based financial institutions to participate more effectively in the secondary mortgage market. Secondly, these FHLBanks believe the MPP enhances their long-term profitability on a risk-adjusted basis which should augment the return on stockholders’ capital investment in the MPP FHLBanks.

The four MPP FHLBanks have agreed to share the costs of developing and maintaining the computer systems that support loan acquisition, but each MPP FHLBank is responsible for operating its own program. Each MPP FHLBank is responsible for marketing the program to its members and for funding and hedging any loans acquired through the program. Each MPP FHLBank is responsible for the development and maintenance of the program guide governing origination, underwriting and servicing of the loans sold to it through its MPP, and each MPP FHLBank establishes its own origination, underwriting and servicing criteria, including eligibility standards for loans that may be sold to it, as well as other requirements for its MPP. Each MPP FHLBank provides the systems and back office support for its program, including transaction processing. In some circumstances, an MPP FHLBank may grant its PFI a waiver exempting it from complying with specified provisions of the MPP FHLBank’s program requirements.

*Management of Credit Risk.* Like the MPF Program, MPP is governed by the AMA Regulation, and mortgage loans purchased from PFIs under the program also carry sufficient credit enhancements to give them a quasi-credit risk exposure equivalent to “AA” rated assets based upon the Standard & Poor’s LEVELS® rating methodology. The MPP mortgage loans are not, however, rated by Standard & Poor’s or any other rating agency.

Under MPP, the FHLBank assumes the interest-rate risk associated with the acquired mortgage assets, while the PFI manages the credit risk. A PFI is compensated for sharing in a portion of the risk associated with the loans sold to the MPP FHLBank by receiving funds from an LRA. This risk-sharing relationship recognizes the individual strengths of the MPP FHLBank and the PFI.

The credit enhancement layers in MPP consist of the borrower’s equity, primary MI (if applicable), the LRA, and SMI. The LRA is a lender-specific account funded by the MPP FHLBank in an amount approximately sufficient to cover expected losses based on the S&P LEVELS® rating methodology. The LRA is funded either initially as a portion of the purchase price (a Fixed LRA), or over time as a portion of interest paid. The LRA typically ranges between 30 to

50 basis points of the outstanding principal balance of the mortgage loans. The exact amount of the LRA is determined in conjunction with the SMI provider, and the final pricing received on the SMI may be affected by the amount of the LRA. Once the LRA has reached the required amount, but typically not before five years in the case of the Fixed LRA, the MPP FHLBank will pay to the PFI on an annual basis any unused funds in the LRA that are no longer required to cover expected losses. Eleven years after the closing of the mortgage pool, the MPP FHLBank extinguishes the LRA and pays any remaining funds to the PFI.

In MPP, SMI generally covers mortgages with an LTV of 50 percent or greater. The specified LTV may change in the future. In addition, the MPP FHLBanks anticipate that SMI policies will contain an aggregate loss limit whereby the total amount payable by the SMI provider under the policy will be less than the total unpaid principal balances on the insured loans.

FHA-backed mortgage loans have a 100 percent U.S. government guarantee and, therefore, these FHLBanks believe that they have no credit risk exposure from these loans.

### **MPP Credit Risk Structure**

- |                                              |                                                                                                                                                                                                                       |
|----------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Homeowner's Equity</b>                    | • Homeowner equity provides an initial cushion against potential credit losses.                                                                                                                                       |
| <b>Primary Mortgage Insurance</b>            | • Primary mortgage insurance is required on loans with a loan-to-value ratio in excess of 80%, and mitigates credit risk by absorbing part of any actual losses.                                                      |
| <b>Lender Risk Account (LRA)</b>             | • The participating member's lender risk account absorbs losses beyond homeowner's equity and primary mortgage insurance. Lender risk account balances not used to cover losses are returned to the member over time. |
| <b>Supplemental Mortgage Insurance (SMI)</b> | • The participating member's supplemental mortgage insurance absorbs losses beyond the lender risk account and enhances the credit of the underlying pool of mortgages to an investment-grade equivalent.             |
| <b>MPP FHLBanks</b>                          | • The MPP FHLBanks would assume potential losses in excess of the combined value of the homeowner's equity, primary mortgage insurance, lender risk amount, and supplemental mortgage insurance.                      |

*Earnings from the Mortgage Purchase Program.* Earnings from the MPP come from monthly interest payments due to the MPP FHLBank. Reported interest income on each loan is computed as the mortgage note rate multiplied by the loan's principal balance outstanding, adjusted for the following:

- minus servicing costs;
- minus the cost of SMI (required for conventional loans only);
- plus the net amortization of purchase premiums or accretion of purchase discounts; and
- plus the net amortization or accretion of fair value adjustments for purchase commitments.

These FHLBanks consider the cost of the LRA and SMI when they establish prices of conventional loans. Each of these credit enhancement structures is accounted for in the valuation of an FHLBank's expected return on acquired mortgage loans and in a credit risk review performed during the pooling process at which time the dollar amount specified in the PFI's Master Commitment Contract is fulfilled and the commitment is closed. The pricing of each structure



depends on a number of factors and is PFI-specific. These FHLBanks do not receive any guarantee or other fees for retaining the risk of losses in excess of the LRA and SMI.

### FHLBANK MANAGEMENT AND COMPENSATION

*FHLBank Directors.* The following persons served as chair or vice chair of the FHLBanks during 2006 or are serving in one of these capacities in 2007:

*Robert F. Verdonck*, 61, has served as a director of the FHLBank of Boston since January 1, 1998, and his term as a director will expire on December 31, 2008. Mr. Verdonck has served as chair of the board in 2004, 2005 and 2006, and has been elected to serve as chair of the board through 2007. Mr. Verdonck is president and chief executive officer of East Boston Savings Bank, located in Peabody, Massachusetts. He also serves as president and chief executive officer of Meridian Financial Services, Inc., holding company for East Boston Savings Bank. He has held various positions at East Boston Savings Bank for the past 23 years. Mr. Verdonck serves as a director of The Savings Bank Life Insurance Company of Massachusetts, which is a member of the FHLBank of Boston as well as Hampshire First Bank.

*Joyce H. Errecart*, 56, has served as a director of the FHLBank of Boston since January 23, 2004, and her term as a director expires on December 31, 2007. Rep. Errecart has been elected to serve as vice chair of the board for 2006 and 2007. Rep. Errecart is Representative to the Vermont House of Representatives, located in Montpelier, Vermont. Rep. Errecart was elected to the Vermont House in 2002. Prior to holding public office, Rep. Errecart served as Vermont's Commissioner of Taxes and practiced law in Burlington, Vermont.

*George L. Engelke, Jr.*, 68, was elected chair of the FHLBank of New York, effective January 2005. Mr. Engelke is also the chairman, president, and chief executive officer of Astoria Financial Corporation and its subsidiary Astoria Federal Savings and Loan Association, having joined in 1971. He is a member of the Board of Trustees of Long Island University, past chair and current member of the board of directors of the Community Preservation Corporation, a member of the Advisory Board of Directors of Neighborhood Housing Services of New York City, Inc. and the Federal Reserve Bank of New York's Thrift Institutions Advisory Panel. Mr. Engelke is a member of the Board of Directors of the New York Bankers Association and a member of the Governmental Affairs Steering Committee and the Government Affairs Council of America's Community Bankers. He previously served as a member of the Financial Accounting Standards Board Advisory Council.

*David W. Lindstrom*, 67, has served as the vice chair of the FHLBank of New York since January 2005. Mr. Lindstrom is president, chief executive officer, and director of Franklin Savings Bank of Pilesgrove, NJ, which he joined in 1981. He has served on the New Jersey League's Board of Governors and as its chair. He is currently a member of the New Jersey League's Government Affairs Council, the Legislative and Regulatory Affairs Committee, and a director of the League's subsidiary Banker's Cooperative Group, Inc. Mr. Lindstrom is on America's Community Bankers Government Affairs Committee and is a member of the Pentegra Services Group Defined Benefit board of directors. He has also served as chair of the Pentegra Services Group Defined Contribution board of directors. In addition, he has served as a director and chairman of the Philadelphia Federal Reserve Thrift Council and serves as chair of America's Community Bankers Directors Publication Advisory Group.

*Marvin N. Schoenhals*, 60, was elected to the board of directors of the FHLBank of Pittsburgh in 1997 and currently serves as its chairman. Mr. Schoenhals has served as president and chief executive officer of Wilmington Savings Fund Society, FSB, DE since November 1990 and was elected chairman in October 1992. He is a member of the board of directors of Burris Logistics and since 1998, has served on the boards of directors of Brandywine Fund, Inc., Brandywine Blue Fund, Inc. and Brandywine Advisors Fund, Inc. Mr. Schoenhals also serves on the board of the Delaware State Chamber of Commerce.



*Dennis S. Marlo*, 64, has served on the board of directors of the FHLBank of Pittsburgh since December 2002 and currently serves as its vice-chairman. He is currently an executive vice president of Sovereign Bank in Reading, Pennsylvania. Mr. Marlo came to Sovereign through its acquisition of ML Bancorp, Inc., where he was president and chief executive officer of the holding company and the Main Line Bank subsidiary. Prior to that, he was employed for 25 years at KPMG Peat Marwick and its predecessor organizations, where he retired as a partner in the firm. He is currently a member of the Board of Trustees of Harcum College in Bryn Mawr, Pennsylvania; the Advisory Board of the Pennsylvania Trust Company in Radnor, Pennsylvania; the Lankenau Hospital Foundation Board of Trustees in Wynnewood, Pennsylvania; and the Council of President's Associates of LaSalle University in Philadelphia. He is also a member of both the American and Pennsylvania Institutes of Certified Public Accountants and the Financial Managers Society, serving on its national board of directors.

*John D. Kottmeyer*, 57, served as the chair of the FHLBank of Atlanta through December 31, 2006. Mr. Kottmeyer served as the executive vice president and treasurer for AmSouth Bank in Birmingham, Ala., from 1995 through 2006. Before joining AmSouth, Mr. Kottmeyer was a senior vice president with Bank of America.

*Scott C. Harvard*, 52, was elected chair of FHLBank of Atlanta effective January 1, 2007. He previously served as vice chair from January 1, 2005 through December 31, 2006. Mr. Harvard has served as president and chief executive officer and a director of Shore Financial Corporation, a publicly-traded bank holding company with headquarters in Onley, Va., since 1997. He has served as president and chief executive officer of its subsidiary, Shore Bank, since 1985.

*Jerry J. Williams*, 47, was elected vice chair of the FHLBank of Atlanta effective January 1, 2007. He has been chairman, president, and chief executive officer of Orion Bancorp Inc., a privately-owned bank holding company headquartered in Naples, Florida, since 1988. Mr. Williams also is chairman, president, and chief executive officer of Orion Bank. He has served on the boards of numerous civic and charitable organizations in Florida. Mr. Williams currently serves on the board of directors of the Florida Bankers Association and is a member of the Government Relations Council of the American Bankers Association.

*Charles J. Koch*, 60, was the chair of the FHLBank of Cincinnati through December 31, 2006. Mr. Koch has been chairman of the board of Charter One Bank, N.A., Cleveland Ohio, since 1995. Since 2004, Mr. Koch has been vice chairman and a director of Citizens Financial Group, Providence, Rhode Island, the parent of Charter One, and a director of the Royal Bank of Scotland plc, Edinburgh, Scotland, the parent of Citizens Financial. Mr. Koch is also chairman of the board of trustees of John Carroll University, and a trustee of Case Western Reserve University.

*Carl F. Wick*, 67, was elected chair of the FHLBank of Cincinnati effective January 2007. Mr. Wick was previously vice chair of the FHLBank of Cincinnati board of directors since March 2005. Mr. Wick was employed by NCR Corporation from 1966 to 1994, when he retired. He continued to provide consulting services on a part-time basis to NCR into 1997. He is the owner of Wick and Associates, a business consulting firm, is a member of the Ohio Board of Education, and serves as a director for the Ohio Harness Horseman's Association. He is also a partner/owner in Gwinnie Lou Stables, Ltd., a standardbred horse breeding and racing farm.

*Richard C. Baylor*, 52, was elected vice chair of the FHLBank of Cincinnati board of directors effective January 2007. Mr. Baylor was named Chairman of Camco Financial Corporation and Advantage Bank on November 9, 2006. Mr. Baylor has been President and Chief Executive Officer of Advantage Bank, Cambridge, Ohio, since June 2001. He also has served as President and Chief Executive Officer of Camco Financial Corporation, the holding company for Advantage Bank, since January 2000 and was Executive Vice President/Chief Operating Officer of Camco Financial Corporation from October 1998 to January 2000. Mr. Baylor has been a director of Camco Financial Corporation since 2001. From August 1989 until June 1998, he served as a Vice President of State Savings Bank, Columbus, Ohio.

*Paul C. Clabuesch*, 58, is chair of the FHLBank of Indianapolis and has served as a member of the board of directors since January 2003. He is the chairman, president and chief executive officer of Thumb Bancorp, Inc., a bank holding company, and Thumb National Bank and Trust, located in Pigeon, Michigan. Mr. Clabuesch also serves as the chairman of the board of trustees of Scheurer Hospital, in Pigeon, Michigan, and has served on that board since 1975.

*Charles L. Crow*, 63, is vice chair of the FHLBank of Indianapolis and has served as a member of the board of directors since January 2002. He is the chairman, president and chief executive officer of Community Bank, in Noblesville, Indiana and chairman of Community Bancshares, Inc. a bank holding company in Noblesville, Indiana. Mr. Crow is also the immediate past chairman of the Indiana Bankers Association.

*James K. Caldwell*, 63, was elected chair of the FHLBank of Chicago on December 13, 2005, and served in that capacity during 2006. Mr. Caldwell's board term ended as of December 31, 2006. Mr. Caldwell has been president and chief executive officer of the First Citizens State Bank of Whitewater, in Whitewater, Wisconsin, since 1979. Mr. Caldwell is the president of Whitewater Bancorp, Vice President of Palmyra State Bank, and a director of Weiler & Company. Mr. Caldwell served as the President of the Wisconsin Bankers Association from 1993 to 1994. Mr. Caldwell is past chairman of the University of Wisconsin, Whitewater Foundation and continues to serve as board member. Mr. Caldwell also chaired the Whitewater Community Development Authority and serves on the board and executive committee of the Fairhaven Corporation, a Senior Citizens Home, where he is currently Chairman of the Board of Directors.

*P. David Kuhl*, 57, was elected chair of the FHLBank of Chicago on December 12, 2006, and has served in that capacity since January 1, 2007. Mr. Kuhl served as vice chair of the FHLBank of Chicago during 2006. Mr. Kuhl has served as a director of Busey Bank in Urbana, Illinois since September 2006 and also serves as a director for First Busey Securities Inc. and First Busey Trust and Investment Company. From 2001 to 2006, Mr. Kuhl served as Chairman of the Board and CEO of Busey Bank. Mr. Kuhl has been with the Busey Bank since 1979, serving previously as President, CEO and Director from 1993 to 2001 and Executive Vice President from 1979 to 1993. Mr. Kuhl previously served as a director for First Busey Corporation, First Busey Insurance Services and First Busey Resources. First Busey Corporation is the holding company for Busey Bank, First Busey Securities and First Busey Trust and Investment Company. Prior to his employment with First Busey Bank, Mr. Kuhl was Executive Vice President of First National Bank of Rantoul from 1973 to 1979.

*James F. McKenna*, 62, was elected vice chair of the FHLBank of Chicago on December 12, 2006, and has served in that capacity since January 1, 2007. Mr. McKenna joined North Shore Bank in 1970 and has served as President and Chief Executive Officer since 1975. He previously served as Chairman of the Wisconsin League of Financial Institutions. Mr. McKenna served as a Director of the FHLBank of Chicago from 1986 to 1991. He served as a member of the Thrift Institution Advisory Committee to the Federal Reserve Board from 2001 to 2002. Locally, Mr. McKenna has served as Chairman of the Zoological Society of Milwaukee County, Chairman of the Milwaukee Public Museum, and Chairman of the Junior Achievement of Wisconsin. He presently is a member of the Greater Milwaukee Committee. Nationally, he has served as a Director of the America's Community Bankers and chaired many of its committees. .

*Randy L. Newman*, 53, is chair of the FHLBank of Des Moines. Mr. Newman currently serves as chairman and chief executive officer of Alerus Financial Corporation and Alerus Financial Bank in Grand Forks, North Dakota, and has served as chairman since 1993. For several years prior to joining the organization in 1981, Mr. Newman was a full-time instructor in the Management and Finance Department of the University of North Dakota. Mr. Newman was elected to his first term as chair of the Bank's Board of Directors effective January 1, 2004. Mr. Newman serves on the following Bank committees: Executive and Governance Committee (chair), Risk Management Committee, Audit Committee, Bank Operations Committee, Human Resources and Compensation Committee, and the Housing and Economic Development Committee.

*Michael K. Guttau*, 60, is the vice chair of the FHLBank of Des Moines. Mr. Guttau has served as chairman and president of Treynor State Bank in Treynor, Iowa, since 1978. He is actively involved with the American Bankers Association, Iowa Bankers Association, and the Iowa Independent Bankers. Currently, he is chair of the Southwest Iowa Industrial Site Marketing Committee and Deaf Missions. Mr. Guttau also is president of the Treynor Foundation Corporation. Mr. Guttau was the Iowa Superintendent of Banking from 1995 through 1999. Mr. Guttau serves on the following Bank committees: Executive and Governance Committee (vice chair), Risk Management Committee (chair), Audit Committee, and the Human Resources and Compensation Committee.

*Chesley N. Brooks, Jr.*, 66, served as chairman of the board of directors of the FHLBank of Dallas from February 2005 through December 2006. Mr. Brooks has served as chairman and chief executive officer of Omnibank, N.A., a member of the FHLBank of Dallas, since 1978. He joined Omnibank (Houston, Texas) in 1974. From 1994 to 1999, Mr. Brooks served on the board of directors of the Texas Bankers Association (TBA). From 1998 to 1999, he served on the TBA's Executive Committee and as chairman of its Government Relations Council. During 2006, he served on the Federal Home Loan Bank Committee of the American Bankers Association, the Legislative Committee of the Independent Bankers Association of Texas, and on the Council of Federal Home Loan Banks.

*Lee R. Gibson*, 50, is Chairman of the Board of Directors of the FHLBank of Dallas and has served in that capacity since January 1, 2007. Mr. Gibson serves as Executive Vice President and Chief Financial Officer of Southside Bank (a member of the FHLBank of Dallas) and its publicly traded holding company, Southside Bancshares, Inc. (Tyler, Texas). He has served as Executive Vice President since 1990 and as Chief Financial Officer since 2000. Mr. Gibson also serves as a director of Southside Bank. Before joining Southside Bank in 1984, Mr. Gibson served as an auditor for Ernst & Young. He currently serves on the Council of Federal Home Loan Banks and the Executive Board of the East Texas Area Council of Boy Scouts. Mr. Gibson also serves as Chairman of the Executive Committee of the FHLBank of Dallas' Board of Directors. He is a Certified Public Accountant.

*Mary E. Ceverha*, 62, is vice chairman of the board of directors of the FHLBank of Dallas and has served in that capacity since December 2005. From January 2005 to December 2005, she served as acting vice chairman of the board of directors of the FHLBank of Dallas. From 2001 to 2005, Ms. Ceverha served as a director and president of Trinity Commons, Inc. From 2001 to 2004, she also served as a director and president of Trinity Commons Foundation, Inc. Founded by Ms. Ceverha in 2001, these not-for-profit enterprises were organized to coordinate fundraising and other activities relating to the construction of the Trinity River Project in Dallas, Texas. She currently serves as Vice Chair of the foundation's Government Relations Committee and remains active in its fundraising efforts. Ms. Ceverha currently serves on the Council of Federal Home Loan Banks and is a member of the Greater Dallas Planning Council. Further, she serves on the steering committee of the President's Council for the University of Texas Southwestern Medical Center, which raises funds for medical research. She is a former board member and president of Friends of Fair Park, a non-profit citizens group dedicated to the preservation of Fair Park, a national historic landmark in Dallas, Texas. From 1995 to 2004, she served on the Texas State Board of Health. Ms. Ceverha also serves as vice chairman of the Executive Committee of the FHLBank of Dallas' board of directors.

*Ronald K. Wentz*, 56, is chair of the FHLBank of Topeka and has served in that position since 2000. He has been president and chief executive officer of Golden Belt Bank, Hays, Kansas since 1974.

*Lindel E. Pettigrew*, 64, is vice chairman of the FHLBank of Topeka and has served in that position since January 2007. He has been president of Chickasha Bank & Trust, Chickasha, Oklahoma since 1973.

*Robert E. Caldwell, II*, 36, served as an appointed director of the FHLBank Topeka from January 2004 through December 2006 and was reappointed January 2007 to a one year term. He served as vice chairman of the FHLBank Board of Directors commencing January 2004 through December 2006. Mr. Caldwell is president and CEO of Hampton Enterprises, Inc. He previously served as general counsel for Linweld, Inc. a large independent manufacturer and distributor of industrial/medical gases and welding supplies.

*Timothy R. Chrisman*, 60, is the chairman of the board of directors of the FHLBank of San Francisco and was vice chairman of the board of directors of the FHLBank of San Francisco in 2004. Mr. Chrisman has been an officer of Pacific Western National Bank, Santa Monica, California, since March 2005. Prior to that, he was a director of Commercial Capital Bank and Commercial Capital Bancorp, based in Irvine, California, from June 2004 to March 2005. In 2004, Commercial Capital Bancorp acquired Hawthorne Savings, Hawthorne, California, where Mr. Chrisman was chairman of the board from 1995 to 2004. Mr. Chrisman is also the chief executive officer of Chrisman & Company, Inc., a retained executive search firm he founded in 1980. Since 2005, he has served as chairman of the Council of Federal Home Loan Banks and chairman of the chair-vice chair committee of the Federal Home Loan Bank System.

*James P. Giralдин*, 54, has served as the vice chairman of the board of directors of the FHLBank of San Francisco since January 2006. Mr. Giralдин has been chief operating officer of First Federal Bank of California, Santa Monica, California, since 1997 and president since 2002. He joined the company in 1992 as executive vice president and chief financial officer. Prior to joining First Federal Bank of California, Mr. Giralдин served as chief executive officer of Irvine City Bank, Irvine, California, for five years. He previously served as chief financial officer for two other savings and loan associations and was a certified public accountant with KPMG LLP.

*Mike C. Daly*, 55, has served as a director of the FHLBank of Seattle since 2002 and as chairman since 2005. In 1981, Mr. Daly opened First State Bank in Wheatland, Wyoming, an independent community bank, where he serves as chairman. Since 1985, Mr. Daly has served as chairman and chief executive officer of Wheatland Bankshares, Inc., a single bank holding company that owns 100% of First State Bank. Mr. Daly currently serves as one of three FHLBank of Seattle representatives on the Council of Federal Home Loan Banks.

*Craig E. Dahl*, 57, has served as a director of the FHLBank of Seattle since 2004 and as vice chair since 2005. Since 1996, Mr. Dahl has served as president, chief executive officer, and a director of Alaska Pacific Bancshares, Inc. and its wholly-owned subsidiary, Alaska Pacific Bank, federally chartered savings banks.

*FHLBank Presidents.* The following persons served as presidents of the FHLBanks during 2006 or are serving in this capacity in 2007:

*Michael A. Jessee*, 60, has been president and chief executive officer of the FHLBank of Boston since May 1989. Before that, he served 12 years with the FHLBank of San Francisco as executive vice president and chief operating officer; executive vice president, economics and corporate policy; senior vice president and chief economist; and assistant vice president and director of research. Mr. Jessee also worked as an economist with the Federal Reserve Bank of New York and in corporate planning and correspondent banking with the Bank of Virginia. He currently serves as chairman, board of trustees, State Street Navigator Securities Lending Trust; trustee, Randolph-Macon College; and director, Pentegra Defined Benefit Plan for Financial Institutions. He holds a Ph.D., M.A. and M.B.A. from The Wharton School at the University of Pennsylvania, and a B.A. from Randolph-Macon College.

*Alfred A. DelliBovi*, 60, was elected president of the FHLBank of New York in November 1992. As president, he serves as the chief executive officer and directs the FHLBank of New York's overall operations to facilitate the extension of credit products and services to 293 neighborhood-based lenders. Mr. DelliBovi is a member of the Pentegra Group Defined Contribution Plan Board of Directors. Previously, Mr. DelliBovi served as Deputy Secretary of the U.S. Department of



Housing and Urban Development, from 1989 until 1992. In May 1992, President Bush appointed Mr. DelliBovi Co-Chairman of the Presidential Task Force on Recovery in Los Angeles. Mr. DelliBovi served as a senior official at the U.S. Department of Transportation in the Reagan Administration, was elected to four terms in the New York State Assembly, and earned a Master of Public Administration degree from Bernard M. Baruch College, City University of New York.

*John R. Price*, 68, became president and chief executive officer of the FHLBank of Pittsburgh on January 2, 2006. Prior to joining the FHLBank of Pittsburgh, Mr. Price was a senior advisor to the Institute of International Finance. Mr. Price also held several senior-level positions at JP Morgan Chase & Co. in New York (formerly Manufacturers Hanover Trust Co. which later merged into Chemical Bank and Chase Manhattan Bank). Mr. Price was responsible for the mortgage banking and consumer finance subsidiaries; led the team advising the U.S. government on the securitization of \$5 billion of community development and rural low-income housing loans, and earlier served as corporate secretary. Mr. Price graduated from Grinnell College in Iowa, was named a Rhodes Scholar, earned advanced degrees in Development Economics and Diplomatic History from Queens College at Oxford University and received his law degree from Harvard Law School. Mr. Price was a member of the board and chair of the audit committee of the Principal Financial Corporation, is a life trustee of Grinnell College and was the founding chairman of Americans for Oxford. Mr. Price also served as president of the Bankers Association for Finance and Trade.

*Raymond R. Christman*, 57, retired from the FHLBank of Atlanta in January 2007. He had served as president and chief executive officer since 1999. He has over a decade of experience in the FHLBank System, previously serving as chairman of FHLBank of Pittsburgh. Before that, Mr. Christman served in several executive-level positions in both the private and public sector, including Secretary of Commerce for the Commonwealth of Pennsylvania from 1987 to 1991. Mr. Christman is active in civic and charitable affairs in Atlanta. Mr. Christman holds a B.A. in business from Florida State University and a master's degree from the Graduate School of Public and International Affairs at the University of Pittsburgh.

*William H. Ott, Jr.*, 54, has served as interim president and chief executive officer of the FHLBank of Atlanta since February 1, 2007. From 2003 to the present, Mr. Ott has served as President of PEAC Ventures, Inc., a corporate advisory firm. From 2002 to 2003, Mr. Ott served as the Chief Operating Officer of Visa U.S.A. Inc., a credit card issuer. From 1998 to 2002, Mr. Ott served as a group executive in charge of retail, small business, consumer banking, marketing and operations, for St. George Bank, a commercial bank based in Sydney, Australia. He currently serves as a director and chairman of the audit committee of E\*TRADE Bank. He also serves as an advisor to the Ethics and Compliance Officer Association, a professional association for managers of ethics, compliance and business conduct programs. Mr. Ott holds a B.A. from San Jose State University and an M.B.A. from the University of Santa Clara.

*David H. Hehman*, 58, is president and chief executive officer of the FHLBank of Cincinnati. He was named president and chief executive officer in 2003, following a 25-year career at the FHLBank of Cincinnati during which he held positions including chief financial officer and executive vice president. In addition to his duties at the FHLBank of Cincinnati, Mr. Hehman serves as chair of the FHLBank Presidents' Conference. He also represents the FHLBank of Cincinnati on Pentegra's Retirement Fund, and was appointed by the Finance Board as an FHLBank president member of the Office of Finance board of directors. Outside the FHLBank of Cincinnati, Mr. Hehman also serves on the board of directors of Brighton Properties, Inc., a nonprofit affordable housing and social services agency in Newport, Kentucky, and the Economic Advisory Committee for the Greater Cincinnati Chamber of Commerce. Mr. Hehman was an assistant professor of finance and economics at Xavier University, Cincinnati, where he received his bachelor's and master's degrees in economics, studying under a Presidential Scholarship. He completed his doctorate in economics at the University of Cincinnati. He has written articles for numerous financial journals and banking industry publications.

*Martin L. Heger*, 62, was president and chief executive officer of the FHLBank of Indianapolis from February 1992 to December 2006. Before that, he served the FHLBank of Indianapolis as executive vice president and chief operating officer, and vice president and division head for the Michigan division. Earlier, Mr. Heger spent 13 years in various management positions with the National Bank of Detroit.

*Brian K. Fike*, 48, became interim president and chief executive officer of the FHLBank of Indianapolis on December 30, 2006, having served in various positions with the FHLBank of Indianapolis since 1985. Prior to his current appointment, Mr. Fike served as senior vice president, director of marketing.

*J. Mikesell Thomas*, 56, has been president and chief executive officer of the FHLBank of Chicago since August 2004. Prior to his employment with the FHLBank of Chicago, Mr. Thomas served as an independent financial advisor to companies on a range of financial and strategic issues from April 2001 to August 2004. Mr. Thomas was a managing director of Lazard Freres & Company, where he was responsible for advising management and boards of client companies on strategic transactions from January 1995 to March 2001. He held positions of increasing responsibility at First Chicago Corporation, including chief financial officer and later, executive vice president and co-head of corporate and institutional banking, from 1973 to 1995. Mr. Thomas is trustee and chair of the audit committee for the following trusts: The UBS Funds, UBS Relationship Funds and SMA Relationship Trust. He is a trustee and a member of the audit committee of UBS Private Portfolios Trust and director and chair of the audit committee of Fort Dearborn Income Securities, Inc.

*Richard S. Swanson*, 57, was elected by the board of directors to the position of president and chief executive officer of the FHLBank of Des Moines on June 1, 2006. Prior to joining the Bank, Mr. Swanson was a principal of the Seattle law firm of Hillis, Clark, Martin and Peterson for two years where he provided counsel in the areas of finance, banking law, and SEC regulation. From 2000 to 2003, Mr. Swanson served as chairman and chief executive officer of HomeStreet Bank in Seattle, Washington, and had served as its chief executive officer since 1990. As an industry-elected director from HomeStreet Bank, Mr. Swanson served on the board of directors of the FHLBank of Seattle from 2000 to 2003, and served as the board's vice chair from 2002 to 2003. He currently serves as a director of Triad Guaranty, Inc. and Alaska Growth Capital.

*Neil N. Fruechte*, 67, was appointed acting president and chief executive officer on December 22, 2005 by the FHLBank of Des Moines' board of directors, and stepped down from such position on May 31, 2006 upon the board's election of Richard S. Swanson as president and chief executive officer of the FHLBank of Des Moines. Prior to his appointment, Mr. Fruechte had served on the board since January 2001.

*Terry Smith*, 50, serves as president and chief executive officer of the FHLBank of Dallas and has served in such capacity since August 2000. Prior to that, he served as executive vice president and chief operating officer of the FHLBank of Dallas, responsible for the financial and risk management, credit and collateral, financial services, accounting, and information systems functions. Mr. Smith joined the FHLBank of Dallas in January 1986 to coordinate the hedging and asset/liability management functions, and was promoted to chief financial officer in 1988. He served in that capacity until his appointment as chief operating officer in 1991. Mr. Smith currently serves as vice chairman of the board of directors of the FHLBanks' Office of Finance and as chairman of the audit committee of the FHLBanks' Office of Finance. He also serves on the Council of Federal Home Loan Banks and the board of directors of the Pentegra Defined Benefit Plan for Financial Institutions. Mr. Smith currently serves as Chairman of the Investment Committee for the Pentegra Defined Benefit Plan for Financial Institutions.

*Andrew J. Jetter*, 51, became president and chief executive officer of FHLBank of Topeka in September 2002. He also served as executive vice president and chief operating officer from January 1998 to September 2002. He joined the FHLBank in 1987 as an attorney and was promoted to general counsel in 1989, vice president in 1993, and senior vice president in 1996.



*Dean Schultz*, 60, has been president and chief executive officer of the FHLBank of San Francisco since April 1991. Mr. Schultz is a member of the board of directors of Social Compact, an organization dedicated to increasing business leadership for and investment in lower-income communities. Prior to joining the FHLBank of San Francisco, Mr. Schultz was executive vice president of the FHLBank of New York, where he had also served as senior vice president and general counsel. From 1980 to 1984, he was senior vice president and general counsel with First Federal Savings and Loan Association of Rochester, New York. He previously was a partner in a Rochester law firm.

*James E. Gilleran*, 73, has served as president and chief executive officer of the FHLBank of Seattle since June 2005. From 2001 to April 2005, Mr. Gilleran served as director of the Office of Thrift Supervision, or the OTS, an office of the Department of the Treasury of the United States which regulates the thrift industry. From 1994 to 2000, he served as chairman and chief executive officer of the Bank of San Francisco, a financial banking institution. Mr. Gilleran currently serves as one of three FHLBank of Seattle representatives on the Council of Federal Home Loan Banks. Mr. Gilleran has announced his resignation from the FHLBank of Seattle effective May 1, 2007.

*Managing Director, FHLBanks' Office of Finance.* *John K. Darr*, 62, has served as managing director of the Office of Finance since July 1992. Before joining the Office of Finance, he served as president of Ryland Acceptance Advisors, managing director of Prudential Bache Capital Funding, executive vice president of administration and finance of the Student Loan Marketing Association (Sallie Mae), and treasurer of the FHLBank of San Francisco, among other positions.

*FHLBanks' Office of Finance Board of Directors.* At December 31, 2006, the directors of the FHLBanks' Office of Finance were L. Parker Harrell, Terry Smith, the president of the FHLBank of Dallas, and David H. Hehman, the president of the FHLBank of Cincinnati.

*L. Parker Harrell, Jr.*, 69, was appointed to serve as the private citizen director on the Office of Finance Board of Directors by the Finance Board on September 10, 2003. Mr. Harrell was appointed to the remainder of a three-year term that expired March 31, 2004, and for a three-year term that follows. Mr. Harrell was chief operating officer of Korn/Ferry International Europe and also the director of Global Financial Services for the international executive search firm until October 1, 2006. Mr. Harrell began his career in banking with Wachovia Bank & Trust Company. He entered the executive search field in 1974 when he joined a New York firm, later serving as president of his own recruiting firm. Prior to joining Korn/Ferry in 1984, he was a managing director of Arthur Young & Company.

### **Regulations Governing the Selection and Compensation of FHLBank and Office of Finance Employees**

As specified in the GLB Act, the selection and compensation of FHLBank officers and employees are subject to the approval of the board of directors and management of each individual FHLBank. The Finance Board exercises similar supervisory and examination authority over the Office of Finance and its board of directors as it exercises over an FHLBank and its board of directors. Finance Board regulations require the Office of Finance board of directors to select, employ, determine the compensation for, and assign the duties of the managing director/chief executive officer.

*Compensation and Discussion and Analysis.* Each FHLBank’s board of directors and management are responsible for establishing that FHLBank’s compensation philosophy and objectives, and each FHLBank includes a compensation discussion and analysis relating to all material elements of the compensation of its named executive officers in its annual report on Form 10-K filed with the SEC. (See “Available Information on Individual FHLBanks.”) The following information has been provided for each FHLBank primarily based on the presentation it used in its annual report Form 10-K for the year ended December 31, 2006. The presentations may not be consistent due to differing FHLBank practices and application and interpretation of the rules.

**FHLBank Presidents and Office of Finance Managing Director**  
**Summary Compensation Table**  
**for Year 2006**

<u>FHLBank Name</u>	<u>President/Managing Director Name</u>		<u>Salary(\$)</u>	<u>Bonus(\$)</u>	<u>Non-Equity Incentive Plan Compensation(\$)</u>	<u>Change in Pension Value and Nonqualified Deferred Compensation Earnings(\$)</u>	<u>All Other Compensation(\$)</u>	<u>Total(\$)</u>
Boston	Michael A. Jessee	(1)	569,250	38,045	261,955	539,000	98,043	1,506,293
New York	Alfred A. DelliBovi	(2)	560,018		349,364	294,000	73,047	1,276,429
Pittsburgh	John R. Price	(3)	500,004		250,001	111,000	499,005	1,360,010
Atlanta	Raymond R. Christman	(4)	562,825			190,267	71,220	824,312
Cincinnati	David H. Hehman	(5)	530,266	50,000	339,219	744,000	50,354	1,713,839
Indianapolis	Brian K. Fike	(6)(7)	202,020		35,354	129,000	12,202	378,576
Indianapolis	Martin L. Heger	(7)	600,002		150,001	1,882,000	48,266	2,680,269
Chicago	J. Mikesell Thomas	(8)	676,000		676,000	281,000	41,215	1,674,215
Des Moines	Richard Swanson	(9)	315,000	118,125			35,606	468,731
Des Moines	Neil N. Fruechte	(10)	150,000	30,000			30,000	210,000
Dallas	Terry Smith	(11)	565,000		118,090	111,000	244,192	1,038,282
Topeka	Andrew J. Jetter	(12)	533,750		285,347	371,117	59,859	1,250,073
San Francisco	Dean M. Schultz	(13)	650,000	329,500	244,200	407,092	53,952	1,684,744
Seattle	James E. Gilleran	(14)	542,769		271,385		26,812	840,966
Office of Finance	John K. Darr	(15)	560,000	377,854	237,350	1,056,000	27,787	2,258,991

- (1) The FHLBank of Boston does not have any arrangements that provide for payments upon termination or a change in control. There is a severance policy where all employees are eligible. Under the severance policy if Mr. Jessee’s employment is terminated, either involuntarily or by mutual agreement, for reasons other than “cause” (for example poor performance, poor attendance, insubordination), Mr. Jessee is entitled to receive an amount equal to one year’s salary. The severance policy does not constitute a contractual relationship between the FHLBank of Boston and Mr. Jessee, and the FHLBank of Boston reserves the right to modify, revoke, suspend, terminate, or change the severance policy at any time without notice.
- (2) The FHLBank of New York is an “at will” employer and does not provide written employment agreements to any of its employees. However, employees, including the president, receive (a) cash compensation (i.e., base salary and a “variable” or “at-risk” short-term incentive compensation plan), (b) retirement related benefits (i.e., defined benefit and defined contribution plans) and (c) other benefits. Other benefits, which are available to all regular employees, include medical, dental, vision care, life, business travel accident, and short and long term disability insurance, flexible spending accounts, an employee assistance program, educational development assistance, voluntary life insurance, long term care insurance and fitness center reimbursement. An additional benefit offered to all officers, age 40 or greater, or who are at VP level or above, is a physical examination every 18 months.
- (3) Mr. Price had a separate employment agreement which would have provided for base salary, medical insurance and outplacement services had his employment been severed without cause during 2006. The FHLBank of Pittsburgh has no separate change in control contracts.
- (4) The FHLBank of Atlanta does not have a formal severance arrangement with its president. The FHLBank of Atlanta’s board of directors may, in its discretion, provide severance benefits to the president in the event of his termination of employment. The FHLBank of Atlanta does not provide a “gross up” benefit for any golden parachute excise tax payable with respect to such service payments.

- (5) Other than normal pension benefits and eligibility to participate in the FHLBank of Cincinnati's retiree medical and retiree life insurance programs, no perquisites or other special benefits are provided to the president in the event of a change in control, resignation, retirement or other termination of employment.
- (6) Mr. Fike became interim president and chief executive officer of the FHLBank of Indianapolis on December 30, 2006 upon Mr. Heger's retirement on December 29, 2006.
- (7) The FHLBank of Indianapolis maintained a key employee severance agreement for its former president until his retirement on December 29, 2006 and maintains a key employee severance agreement for its interim president. Under the terms of the agreement, if a termination occurs under certain circumstances, the president was entitled to 2.99 times the average of the three preceding years' base salary, bonus, and other cash compensation, salary deferrals and matching contributions to the qualified and non-qualified plans, compensation for the loss of the use of a company vehicle, continued medical and dental plan coverage, a gross up amount to cover the increased tax liability, and an additional three years credit to age and years of service for the DB plan and the supplemental executive retirement plan.
- (8) The FHLBank of Chicago's president has a separate severance benefit under his employment agreement. If Mr. Thomas' employment agreement is terminated by the FHLBank of Chicago without cause or by Mr. Thomas with good reason, Mr. Thomas is entitled to receive an amount equal to two times the sum of his base salary at the date of termination plus his minimum total incentive compensation at such date. The base salary amounts are payable within 10 days of the date a release is executed and 50% of the total incentive compensation amount is payable on each of the first two anniversaries of the termination date. No severance is payable in connection with a non-renewal of the employment agreement.
- (9) Mr. Swanson was named President/CEO on June 1, 2006 at an annual salary of \$540,000. The bonus amount represents the guaranteed gainsharing payout at the target level as outlined in his employment agreement. Eligibility in the pension plans begins following one year of service. Amounts in the All Other Compensation column represent \$5,250, \$750/month, in car allowance, \$13,720 in non-deductible relocation expenses, \$10,141 in deductible relocation expenses, and \$6,495 in tax gross-up on non-deductible relocation expenses. Mr. Swanson's employment agreement will be terminated upon the occurrence of any one of the following events: his death, he is incapacitated from illness, accident, or other disability, and is unable to perform his normal duties for a period of ninety consecutive days, upon 30 days' written notice, or the expiration of the term of the employment agreement, or any extension or renewal thereof. Additionally, Mr. Swanson's employment agreement may be terminated by the FHLBank for cause or by Mr. Swanson for good reason, or by the FHLBank or Mr. Swanson without cause upon thirty days written notice to the other party. If Mr. Swanson's employment is terminated by the FHLBank without cause or by Mr. Swanson with good reason, he shall be entitled to (1) severance payments equal to two times his base salary for the calendar year in which the termination occurs, (2) the minimum total incentive compensation for the calendar year in which the termination occurs prorated as of such date, and (3) the benefit to which he would be entitled to receive beginning June 1, 2009 under the benefit equalization plan, which shall automatically vest. No severance shall be paid in connection with the expiration or non-renewal of the employment agreement. The total value of the change in control provisions at December 31, 2006 was \$1.2 million.
- (10) Mr. Fruechte was appointed acting president on December 22, 2005 by the FHLBank of Des Moines's board of directors, and stepped down from such position on May 31, 2006 upon the board's election of Richard S. Swanson as resident and chief executive officer of the FHLBank of Des Moines. Prior to his appointment, Mr. Fruechte had served on the board since January 2001. Salary represents a prorated amount paid pursuant to an employment agreement between the FHLBank of Des Moines and Mr. Fruechte for his services as acting president and chief executive officer from December 22, 2005 to March 31, 2006.
- (11) The FHLBank of Dallas president is employed on an at-will basis. No employment agreement or contract of any kind exists between the FHLBank of Dallas and the president. However, the FHLBank of Dallas has a Reduction in Workforce Policy ("RIF Policy") that applies to all FHLBank of Dallas employees, including the president. With certain exceptions, the RIF Policy provides severance pay and the continuation of certain employee benefits for any employee in a job position that is eliminated as a result of a merger and/or consolidation, or when warranted by economic conditions, functional reorganization, or technological obsolescence (a "triggering event"). The severance benefit provided under the RIF Policy is based upon an employee's age, length of service, base salary and job grade level at the time of termination, subject to certain minimum and maximum amounts. In no event may the severance benefit paid to any employee under the RIF Policy exceed an amount equal to one year's base salary plus the continuation of certain employee benefits for a one-year period. In addition, employees are entitled to cash out any accrued and unused vacation (but not unused flex leave). If the president voluntarily resigns, retires or is discharged for cause, he is not entitled to any benefits under the RIF Policy. The FHLBank of Dallas reserves the right in its sole discretion to amend or discontinue the RIF Policy at any time. An amount of \$668,194 would have been payable to the president at December 31, 2006 if a triggering event had occurred on that date.
- (12) The FHLBank Topeka does not have a separate employment agreement with its president. The FHLBank Topeka provides severance benefits to its executive officers pursuant to the FHLBank Topeka's Officer Severance Policy. The policy's primary objective is to provide a level of protection to officers, including the

president, from loss of income during a period of unemployment. An officer of the FHLBank Topeka is eligible to receive severance pay under the policy if the FHLBank Topeka terminates the officer's employment with or without cause, subject to certain limitations. Provided the requirements of the policy are met and the president provides the FHLBank Topeka an enforceable release, the president will receive severance pay equal to 52 weeks of the president's final base salary.

- (13) Mr. Schultz's \$329,500 amount represents awards made under the FHLBank of San Francisco annual short-term cash incentive compensation plan and the \$244,200 amount represents awards made under the FHLBank of San Francisco's long-term cash incentive compensation plan. The FHLBank of San Francisco president is employed on an at-will basis. Mr. Schultz may receive severance benefits in the event that Mr. Schultz's employment is terminated because the job or position is eliminated or substantially modified, equal to the greater of: (i) 12 weeks of the president's base salary, or (ii) the sum of three weeks of the president's base salary plus three weeks of the president's base salary for each full year of service at the FHLBank of San Francisco to a maximum of 52 weeks. The FHLBank of San Francisco's current severance policy also provides one month of continued health and life insurance benefits and, at the FHLBank's discretion, outplacement assistance.
- (14) If Mr. Gilleran's employment is terminated without cause, he is entitled to receive continuing payments of severance pay at a rate equal to his then-current base salary, for a period of 12 months from the date of such termination. If his employment is terminated as a result of a change of control, Mr. Gilleran will be entitled to receive a lump sum severance payment in an amount equal to 24 months of his then-current salary. In addition, the FHLBank of Seattle would pay Mr. Gilleran's premiums for continued health insurance benefits for a period of 18 months. Mr. Gilleran has announced his resignation from the FHLBank of Seattle effective May 1, 2007.
- (15) Mr. Darr's non-equity incentive compensation consists of \$377,854 awarded under the Office of Finance's annual short-term incentive compensation and \$237,350 awarded under the Office of Finance's long-term incentive plan. On June 11, 2002, the OF board adopted a resolution establishing a severance agreement for John K. Darr. The agreement provides the following in the event Mr. Darr is involuntarily terminated during the period of July 1, 2002 to June 30, 2008: 1) one and one half times the annual base salary in effect at time of termination plus one and one half times the average annual incentive award received during the preceding three years, to be paid monthly over an 18 month period, 2) credit in the Supplemental Executive Retirement Plan for the severance compensation, 3) employer match of 6% of severance compensation will be credited to the Supplemental Thrift Plan, 4) medical coverage will continue at the employer/employee rate in effect at the time of termination for the length of the severance period. All other benefits will terminate upon commencement of the severance period, 5) lump sum payment of accrued vacation, not to exceed 240 hours, and 6) for each 12 month period beginning July 1, 2002 which elapses, the maximum severance compensation will be reduced by 1/6.

## All Other Compensation for Year 2006

FHLBank Name	President/Managing Director Name	Termination of employment or change of control if triggered	Contribution or other allocations made by the FHLBank to vested and/or unvested defined contribution plans (\$)	Dollar value of any insurance premiums paid by the FHLBank with respect to life insurance for the benefit of the president (\$)	Gross-ups or other amounts reimbursed for the payment of taxes (\$)	Perquisites and Other Personal Benefits (\$)*	Other (\$)	Total (\$)
Boston	Michael A. Jessee	(1)	38,634	6,510		39,279	13,620	98,043
New York	Alfred A. DelliBovi	(2)	33,600	12,102		12,432	14,913	73,047
Pittsburgh	John R. Price	(3)	30,000		201,732	267,273		499,005
Atlanta	Raymond R. Christman	(4)	33,768	23,000		14,452		71,220
Cincinnati	David H. Hehman		50,354					50,354
Indianapolis	Brian K. Fike		12,121	81				12,202
Indianapolis	Martin L. Heger	(5)	36,104	240	489	10,333	1,100	48,266
Chicago	J. Mikesell Thomas	(6)				41,215		41,215
Des Moines	Richard Swanson	(7)				35,606		35,606
Des Moines	Neil N. Fruechte						30,000	30,000
Dallas	Terry Smith	(8)	154,544		10,249	24,666	54,733	244,192
Topeka	Andrew J. Jetter	(9)	43,643	1,606		13,379	1,231	59,859
San Francisco	Dean M. Schultz	(10)	39,000	3,727		10,075	1,150	53,952
Seattle	James E. Gilleran		26,812					26,812
Office of Finance	John K. Darr	(11)	5,425	2,195		19,286	881	27,787

\* Only individual amounts greater than \$25,000 are disclosed in the footnotes.

- (1) Perquisites and other benefits amount for Mr. Jessee includes the following: financial planning services, personal use of FHLBank-provided vehicle, club membership dues, medical expense reimbursements and spousal travel expenses.
- (2) Perquisites and other benefits amount for Mr. DelliBovi includes the following: personal use of FHLBank-provided vehicle.
- (3) Perquisites and other benefits amount for Mr. Price includes the following: \$258,000 for relocation assistance, and other personal benefits.
- (4) Perquisites and other benefits amount for Mr. Christman includes the following: personal use of FHLBank-provided vehicle, club membership dues and other personal benefits.
- (5) Perquisites and other benefits amount for Mr. Heger includes the following: personal use of FHLBank-provided vehicle, club membership dues and other personal benefits.
- (6) Perquisites and other benefits amount for Mr. Thomas includes the following: \$37,635 for reimbursement of independent medical plan premiums, and the remainder for commuting expenses.
- (7) Perquisites and other benefits amount for Mr. Swanson includes the following: personal use of FHLBank-provided vehicle and \$30,356 for housing and other living expenses including relocation assistance and payments for the president to stay at his or her personal residence.
- (8) Perquisites and other benefits amount for Mr. Smith includes the following: personal use of FHLBank-provided vehicle, use of FHLBank-owned computer and spousal travel expenses.
- (9) Perquisites and other benefits amount for Mr. Jetter includes the following: personal use of FHLBank-provided vehicle, club membership and spousal travel expenses.
- (10) Perquisites and other benefits amount for Mr. Schultz includes the following: personal use of FHLBank-provided vehicle, health club membership dues and commuting expenses.
- (11) Perquisites and other benefits amount for Mr. Darr includes the following: financial planning services, personal use of OF-provided vehicle and health club membership dues.

## Grants of Plan Based Awards for Year 2006

FHLBank Name	President/Managing Director Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards		
			Threshold(\$)	Target(\$)	Maximum(\$)
Boston	Michael A. Jessee	NA	142,313	199,238	284,625
New York	Alfred A. DelliBovi	1/18/07	128,379	233,416	443,490
Pittsburgh	John R. Price	(1)	110,000	192,500	275,000
		(2)	214,500	429,000	858,000
Atlanta	Raymond R. Christman	1/1/2006(3)	168,848	253,271	365,836
		1/1/2006(2)	84,424	168,848	281,413
Cincinnati	David H. Hehman	1/23/2006	127,500	280,500	382,500
		2/19/2006	68,853	152,997	252,450
Indianapolis	Brian K. Fike	1/26/2006	53,619	106,061	141,414
Indianapolis	Martin L. Heger	1/26/2006	227,501	450,002	600,002
Chicago	J. Mikesell Thomas	1/1/2004	0	0	0
		1/1/2006	676,000	676,000	845,000
		1/1/2006	(8,471)	263,389	578,589
Des Moines	Richard Swanson				
Des Moines	Neil N. Fruechte				
Dallas	Terry Smith		101,700	271,200	339,000
Topeka	Andrew J. Jetter	01/01/2006		56,650	80,726
		04/01/2006		59,400	84,645
		07/01/2006		59,400	84,645
		10/01/2006		118,113	168,310
San Francisco	Dean M. Schultz	(2)	97,500	195,000	390,000
Seattle	James E. Gilleran(4)	1/1/2005			
		1/1/2006			
Office of Finance	John K. Darr	1/18/2006	140,000	280,000	420,000

- (1) Represents estimate of annual incentive compensation for January 1, 2007 through December 31, 2007.
- (2) Represents estimate of long-term incentive compensation for the three-year performance cycle beginning January 1, 2006 and ending December 31, 2008.
- (3) Represents estimate of annual short-term incentive compensation for January 1, 2006 through December 31, 2006.
- (4) As a result of Mr. Gilleran's resignation effective April 30, 2007, he will not receive his long-term cash-based incentive compensation awards for the 2005-2007 and 2006-2008 performance plans. The threshold, target and maximum amounts awarded to Mr. Gilleran had he remained under the employ of the FHLBank of Seattle at the time the plan award payments are made for the 2005-2007 performance plan would have been \$26,250, \$52,500 and \$78,750 and for the 2006-2008 performance plan would have been \$27,038, \$54,075, and \$81,113.



## Pension Benefits for Year 2006

FHLBank Name	President/Managing Director Name		Plan Name *	Number of Years Credited Service	Present Value of Accumulated Benefit (\$)	Payments During 2006
Boston	Michael A. Jessee	(1)	Pentegra DBP	29.3	1,102,000	
			Pension BEP	29.9	3,871,000	
New York	Alfred A. DelliBovi	(2)	Pentegra DBP	13.8	655,000	
			Nonqualified DBP of the BEP	13.8	1,954,000	
Pittsburgh	John R. Price	(3)	Pentegra DBP	0.4	20,000	
			SERP	1.0	91,000	
Atlanta	Raymond R. Christman	(4)	Pentegra DBP	7.5	261,000	
			BEP	7.5	786,000	
Cincinnati	David H. Hehman	(5)	Pentegra DBP	28.9	1,130,000	
			BEP DB	28.9	3,673,000	
Indianapolis	Brian K. Fike	(6) (7)	Pentegra DBP	24.0	512,000	
			SERP	24.0	228,000	
Indianapolis	Martin L. Heger	(7)	Pentegra DBP	29.0	1,079,000	
			SERP	29.0	6,237,000	
Chicago	J. Mikesell Thomas	(8)	Pentegra DBP	1.8	55,000	
			BEP	1.8	249,000	
Des Moines	Richard Swanson					
Des Moines	Neil N. Fruechte					
Dallas	Terry Smith	(9)	Pentegra DBP	21.0	849,000	
Topeka	Andrew J. Jetter	(10)	Pentegra DBP	18.6	354,000	
			BEP	18.6	1,079,000	
San Francisco	Dean M. Schultz	(11)	Cash Balance Plan	21.8	195,556	
			FIRF	11.0	392,565	
			BEP	21.8	1,478,361	
			Deferred Compensation Plan	21.8	44,540	
			SERP	4.0	419,691	
Seattle	James E. Gilleran					
Office of Finance	John K. Darr	(12)	Pentegra DBP	14.6	703,000	
			SERP	19.3	3,673,000	

\* Pentegra DBP = Pentegra Defined Benefit Plan for Financial Institutions  
 BEP = Benefit Equalization Plan  
 SERP = Supplemental Executive Retirement Plan  
 FIRF = Financial Institutions Retirement Fund

- (1) • Formula: 2.375 percent  $\times$  high three-year average compensation  $\times$  credited years of service, subject to a maximum annual benefit amount not to exceed 80 percent of high three-year average compensation.
- Compensation is the highest three-year compensation (salary and incentive) paid in the year.
  - The regular form of retirement benefits is a straight-life annuity including a lump-sum retirement death benefit.

Mr. Jessee's credited years of service for the Pentegra DBP includes 11.8 years of service at a previous employer that participated in the Pentegra DBP, and the credited years of service for the Pension BEP includes 12.4 years of service at that previous employer.

- (2) • Formula: 2.5 percent  $\times$  years of benefit service (not to exceed 30)  $\times$  high three-year average compensation.
- Three-year average compensation is comprised of salary and incentive payments as such terms are used in the Summary Compensation table. The benefit calculation is based on the average annual compensation for the three consecutive years of highest compensation during the years of credited service.
  - The regular form of the retirement benefit is a straight-life annuity with a death benefit equal to 12 times the annual benefit less the amount of benefits paid before death.

- (3) • Formula: 2 percent  $\times$  years of benefit service  $\times$  high three-year average compensation.
  - Compensation covered for the Pentegra Defined Benefit Plan includes annual base salary, subject to IRS limitations. Compensation covered for the SERP includes annual base salary and annual incentive compensation, without regard to IRS limitations.
  - The regular form of retirement benefits provides a single life annuity; a lump sum option is also available.
- (4) • Formula: 2.5 percent  $\times$  years of service (not to exceed 30 years)  $\times$  high three-year average compensation.
  - Compensation used for retirement plan calculations includes the high-three-year average of regular salary at January 1 and incentive compensation paid in the prior calendar year as reported in the Summary Annual Compensation table above.
  - The regular form of all retirement benefits provides for an annual retirement benefit, expressed as a single, straight life annuity, plus a death benefit.
- (5) • Formula: 2.5 percent  $\times$  years of benefit service  $\times$  high three-year average salary.
  - Salary is defined as Salary, Bonus and the amount included in the Non-Equity Incentive Compensation Plan column for the short-term incentive plan as reported in the Summary Compensation Table. For 2006 the entire amount reported in the Non-Equity Incentive Compensation Plan column is for the short-term incentive plan.
  - The regular form of retirement benefits is a straight-life annuity including a lump-sum retirement death benefit.
- (6) Mr. Fike's credited years of service include 22 years as an employee of the FHLBank of Indianapolis and two years of service with a prior employer that participated in the Defined Benefit Plan. The additional two years of benefit service with the previous employer increased the present value of Mr. Fike's overall benefit by approximately \$43,000 for the Defined Benefit Plan and \$19,000 for the SERP.
- (7) • Formula: 2.5 percent  $\times$  years of benefit service  $\times$  high three-year average compensation plus an annual retiree cost of living adjustment of three percent without regard to the IRS limits.
  - The remuneration covered includes salary, incentive compensation, and any other compensation, that is reflected on the Internal Revenue Service Form W-2 (exclusive of any compensation deferred from a prior year).
  - The regular form of retirement benefits provides for a lump sum payment, monthly, quarterly, semi-annual or annual installments up to 20 years or a combination of lump sum and annual payments.
  - Benefit payments commencing before age 65 are reduced by applying an early retirement factor based on the employee's age when payments begin. The allowance payable at age 65 would be reduced by 3 percent for each year under age 65. If the sum of the age and years of vesting service at termination of employment is at least 70, the retirement allowance would be reduced by 1.5 percent for each year under age 65.
- (8) • Formula: 2.25 percent  $\times$  the number of years credit service  $\times$  highest five-year average salary.
  - Compensation is the average annual salary (base and short-term incentive compensation) for the five consecutive years of highest salary during the benefit service.
  - The regular form of retirement benefits is an annuity or a lump-sum retirement death benefit.
- (9) • Compensation covered by the plan includes taxable compensation as reported on the FHLBank of Dallas' president's W-2 (exclusive of any compensation deferred from a prior year) plus any pre-tax contributions to the FHLBank of Dallas' Section 401(k) plan and/or Section 125 cafeteria plan, subject to the 2006 IRS limitation of \$220,000 per year. From time to time, the IRS will increase the maximum compensation limit for qualified plans; future increases, if any, would be expected to increase the estimated annual benefits payable. For 2007, the maximum compensation limit was increased to \$225,000 per year. The benefit is computed as:
 

Formula: Starting July 1, 2003 – 2 percent  $\times$  years of service  $\times$  high three-year average compensation (consecutive years) Prior to July 1, 2003 – 3 percent  $\times$  years of service  $\times$  high three-year average compensation (consecutive years)

  - The pension plan is a qualified defined benefit plan and is therefore subject to the IRS maximum compensation limit, which for 2006 was \$220,000 per year. The regular form of retirement benefit is a straight-life annuity that includes a lump-sum death benefit. The normal retirement age is 65, but the plan provides for an unreduced retirement benefit beginning at age 60 (if hired prior to July 1, 2003) or age 62 (if hired on or after July 1, 2003). The FHLBank of Dallas does not have a supplemental defined benefit plan that covers compensation in excess of the IRS maximum limit; accordingly, the above table reflects the estimated pension benefits payable to its president based solely on the IRS compensation limit as his compensation exceeded such limit.
  - The pension plan limits the maximum years of benefit service (both prior to July 1, 2003 and after July 1, 2003) to 30 years.

- **Special Non-Qualified Deferred Compensation Plan**

The president also participates in the FHLBank of Dallas' Special Non-Qualified Deferred Compensation Plan (the Plan), a defined contribution plan that was established in October 2004 primarily to provide supplemental retirement benefits to most of the FHLBank of Dallas' executive officers. Each participant's benefit under the Plan consists of contributions made by the FHLBank of Dallas on the participant's behalf, plus an allocation of the investment gains or losses on the assets used to fund the Plan. Generally, benefits under the Plan vest when the participant reaches age 62, except for certain amounts contributed on the president/chief executive officer's behalf and the earnings thereon, which provide for earlier vesting as specified in the Plan. If the officer terminates employment or is removed from the Plan prior to vesting, all benefits under the Plan are forfeited. Contributions to the Plan are determined solely at the discretion of the FHLBank of Dallas' board of directors; the FHLBank of Dallas has no obligation to make future contributions to the Plan. The ultimate benefit to the participant is based solely on the contributions made on his or her behalf and the earnings thereon; the FHLBank of Dallas does not guaranty a specific benefit amount or investment return to any participant. In addition, the FHLBank of Dallas has the right at any time to amend or terminate the Plan, or remove a participant from the Plan at its discretion, provided, however, that no amendment, modification or termination may reduce the then vested account balance of any participant. If, at retirement, a participant's vested account balance is at least \$25,000, the participant may elect to receive such amount in quarterly installments over a period of one to five years or in a single lump sum payment. If a participant's vested account balance is less than \$25,000 at retirement, a lump sum payment is required. At December 31, 2006, the approximate unvested balance of the president's account was \$400,000 (of which approximately \$201,000 vests on January 1, 2010).

- (10) • Formula: Starting September 2003 Pentegra Defined Plan Benefit = 2.0 percent × years of benefit service (not to exceed 30 years) × high three-year average compensation. Benefit service begins one year after employment.

Prior to September 2003 FIRF Benefit = 2.25 percent × years of benefit service (not to exceed 30 years) × high three-year average compensation. Benefit service begins one year after employment.

- Compensation covered includes annual base salary plus incentive compensation without regard to IRS limitations.
- The regular form of retirement benefits provides a straight-life annuity with 10 years certain.

- (11) ***Cash Balance Plan and the Financial Institutions Retirement Fund***

The FHLBank of San Francisco began offering benefits under the Cash Balance Plan on January 1, 1996. The Cash Balance Plan is a tax-qualified defined benefit pension plan that covers employees who have completed a minimum of six months of service, including the president. Each year, eligible employees accrue benefits equal to 6% of their total annual compensation (which includes base salary and short-term cash incentive compensation) plus interest equal to 6% of their account balances accrued through the prior year, referred to as the annual benefit component of the Cash Balance Plan.

The benefits under the Cash Balance Plan annual benefit component vest 20% per year and are fully vested after an employee completes 5 years of service (beginning in 2008, participants will fully vest after 3 years of service). Vested amounts are generally payable in a lump sum or in an annuity when the employee leaves the Bank.

Prior to offering benefits under the Cash Balance Plan, the FHLBank of San Francisco participated in the Financial Institutions Retirement Fund, or the FIRF. The FIRF is a multiple-employer tax-qualified defined benefit pension plan. The FHLBank of San Francisco withdrew from the FIRF on December 31, 1995.

When the FHLBank of San Francisco withdrew from the FIRF, benefits earned under the FIRF as of December 31, 1995, were fully vested and the value of those benefits was then frozen. As of December 31, 1995, the FHLBank of San Francisco calculated each participant's FIRF benefit based on the participant's then-highest three consecutive years' average pay multiplied by the participant's years of service multiplied by two percent, referred to as the frozen FIRF benefit. Upon retirement, participants will be eligible to receive their frozen FIRF benefits.

In addition, to preserve the value of the participant's frozen FIRF benefit, the FHLBank of San Francisco maintains the ratio of each participant's frozen FIRF annuity payments to the participant's highest three consecutive years' average pay as of December 31, 1995 (annuity ratio), which is referred to as the net transition benefit component of the Cash Balance Plan. Upon retirement, each participant with a frozen FIRF benefit will receive a net transition benefit under the Cash Balance Plan that equals his or her highest three consecutive years' average pay at retirement multiplied by his or her annuity ratio minus the frozen FIRF benefit.

- ***Benefit Equalization Plan***

The Benefit Equalization Plan is a non-qualified plan that is designed to restore retirement benefits lost under the Cash Balance Plan and the FHLBank of San Francisco's Savings Plan (a defined contribution plan)

because of compensation and benefits limitations imposed on the Cash Balance Plan and the Savings Plan under the Internal Revenue Code (IRC). An employee's benefits that would have been credited or accrued under the Cash Balance Plan or the Savings Plan but for the limitations imposed on those plans under the IRC are credited or accrued under the Benefit Equalization Plan. The amounts credited or accrued under the Benefit Equalization Plan vest according to the corresponding provisions of the Cash Balance Plan and the Savings Plan.

• *Deferred Compensation Plan*

The FHLBank of San Francisco's Deferred Compensation Plan is a non-qualified plan, consisting of three components: (1) employee deferral of current compensation; (2) make-up matching contributions that would have been made by the FHLBank of San Francisco under the Savings Plan had the base salary compensation not been deferred; and (3) make-up pension benefits that would have been earned under the Cash Balance Plan had total annual compensation (base salary and short-term cash incentive compensation) not been deferred.

• *Supplemental Executive Retirement Plan*

Effective January 1, 2003, the FHLBank of San Francisco began providing a Supplemental Executive Retirement Plan to the FHLBank of San Francisco's senior officers, including the president. This plan is a non-qualified retirement benefit plan that provides a cash balance benefit to the FHLBank of San Francisco's senior officers that is in addition to the Cash Balance Plan benefits. The Supplemental Executive Retirement Plan supplements the Cash Balance Plan benefits to provide a competitive postretirement compensation package that is intended to help the FHLBank of San Francisco attract and retain key senior officers who are critical to the success of the FHLBank of San Francisco.

- (12) • Formula: Starting April 2003 — 2.25 percent × years of benefit service × high three-year average compensation.

Prior to April 2003 — 2.50 percent x years of benefit service x high three-year average compensation.

- Compensation includes base salary and incentive compensation.
- The regular form of retirement benefit is a straight-life annuity including a lump-sum retirement death benefit.

**Non-Qualified Deferred Compensation for Year 2006**

<u>FHLBank Name</u>	<u>President/Managing Director Name</u>	<u>President/Managing Director Contributions in 2006 (\$)</u>	<u>FHLBank Contributions in 2006 (\$)</u>	<u>Aggregate Withdrawals/Distributions (\$)</u>	<u>Aggregate Earnings in 2006 (\$)</u>	<u>Aggregate Balance at 12/31/06 (\$)</u>
Boston	Michael A. Jessee	42,617	27,249		109,240	1,058,028
New York	Alfred A. DelliBovi	36,004	19,600		83,210	1,053,333
Pittsburgh	John R. Price	185,002	30,000		3,803	218,805
Atlanta	Raymond R. Christman	47,536	23,769		37,389	460,152
Cincinnati	David H. Hehman	292,130	37,154		172,338	1,615,551
Indianapolis	Brian K. Fike	15,002	900		3,068	80,638
Indianapolis	Martin L. Heger	109,000	25,964		104,391	1,024,382
Chicago	J. Mikesell Thomas					
Des Moines	Richard Swanson					
Des Moines	Neil N. Fruechte					
Dallas	Terry Smith	40,000	141,344	66,774	50,495	563,351
Topeka	Andrew J. Jetter	44,792	26,875		43,797	557,776
San Francisco	Dean M. Schultz				79,973	478,088
Seattle	James E. Gilleran	135,692	9,463		8,825	153,980
Office of Finance	John K. Darr	97,000	28,175		287,264	2,150,158

## Compensation of Directors

In accordance with the regulations of the Finance Board and the GLB Act, the FHLBanks have established formal policies governing the compensation and travel reimbursement provided their directors. The goal of the policies is to compensate members of the board of directors for work performed on behalf of the FHLBanks. Under these policies, compensation consists of per-meeting fees, which are subject to an annual cap. The fees compensate directors for:

- time spent reviewing materials sent to them on a periodic basis by the FHLBanks;
- preparation for meetings;
- participation in any other activities for the FHLBanks; and
- actual time spent attending the meetings of the board or its committee.

Directors are also reimbursed for reasonable FHLBank-related travel expenses. The compensation limits for 2006 were \$29,357 for a chairperson, \$23,486 for a vice chairperson and \$17,614 for all other directors. Total directors' fees and other travel expense paid by the FHLBanks during 2006, 2005 and 2004 were \$4.6 million, \$5.5 million, and \$5.9 million.

### Director Compensation for Year 2006

<u>FHLBank Name</u>	<u>Director Name</u>	<u>Position</u>	<u>Fees Earned (\$)</u>	<u>Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)</u>	<u>All Other Compensation (\$)</u>	<u>Total (\$)</u>
Boston	Robert F. Verdonck	Chair	29,357			29,357
Boston	Joyce H. Errecart	Vice-chair	23,486			23,486
New York	George L. Engelke, Jr	Chair	29,357			29,357
New York	David W. Lindstrom	Vice-chair	23,486			23,486
Pittsburgh	Marvin N. Schoenhals	Chair	22,000		12	22,012
Pittsburgh	Dennis S. Marlo	Vice-chair	23,486		12	23,498
Atlanta	John D. Kottmeyer	Chair	29,357			29,357
Atlanta	Scott C. Harvard	Vice-chair	23,486			23,486
Cincinnati	Charles J. Koch	Chair	29,357			29,357
Cincinnati	Carl F. Wick	Vice-chair	23,486			23,486
Indianapolis	Paul C. Clabuesch	Chair	29,357			29,357
Indianapolis	Charles L. Crow	Vice-chair	23,486			23,486
Chicago	James K. Caldwell	Chair	29,357			29,357
Chicago	P. David Kuhl	Vice-chair	23,486			23,486
Des Moines	Randy L. Newman	Chair	29,357			29,357
Des Moines	Michael K. Guttau	Vice-chair	23,486			23,486
Dallas	Chesley N. Brooks, Jr	Chair	29,357			29,357
Dallas	Mary E. Ceverha	Vice-chair	23,486			23,486
Topeka	Ronald K. Wentte	Chair	29,357	1,040	1,000	31,397
Topeka	Robert E. Caldwell, II	Vice-chair	23,486		1,000	24,486
San Francisco	Timothy R. Chrisman	Chair	29,357			29,357
San Francisco	James P. Giralдин	Vice-chair	23,486			23,486
Seattle	Mike C. Daly	Chair	29,357			29,357
Seattle	Craig E. Dahl	Vice-chair	23,486			23,486
Office of Finance	L. Parker Harrell, Jr	Chair	29,357			29,357

**FIVE LARGEST REGULATORY CAPITAL STOCKHOLDERS OF AND BORROWERS  
FROM EACH FHLBANK**

The following table presents information on the five largest regulatory capital stockholders by FHLBank at December 31, 2006. The information presented on capital stock in the table is for individual FHLBank members. The data is not aggregated to the holding-company level. Some of the institutions listed are affiliates of the same holding company, and some of the institutions listed may have affiliates that are members but that are not listed in the tables.

**Top 5 Regulatory Capital Stockholders by FHLBank  
at December 31, 2006  
(Dollar amounts in millions)**

<u>District</u>	<u>Name</u>	<u>City</u>	<u>State</u>	<u>Capital Stock (\$Millions)</u>	<u>Percent of FHLBank Capital Stock (1)</u>
Boston	Bank of America Rhode Island, NA	Providence	RI	\$ 324	13.8%
	Citizens Bank of Massachusetts	Boston	MA	183	7.8%
	Webster Bank, NA	Waterbury	CT	96	4.1%
	New Alliance Bank	New Haven	CT	93	4.0%
	Citizens Bank of Rhode Island	Providence	RI	90	3.8%
			<u>\$ 786</u>	<u>33.5%</u>	
New York	Hudson City Savings Bank*	Paramus	NJ	\$ 445	12.2%
	New York Community Bank*	Westbury	NY	394	10.8%
	HSBC Bank USA, NA	New York	NY	360	9.8%
	Manufacturers and Traders Trust Company	Buffalo	NY	218	6.0%
	Astoria FS & LA*	Long Island City	NY	154	4.2%
			<u>\$1,571</u>	<u>43.0%</u>	
Pittsburgh	Sovereign Bank*	Reading	PA	\$ 906	26.7%
	Citicorp Trust Bank, FSB	Newark	DE	439	12.9%
	GMAC Bank (5)	Midvale	UT	355	10.5%
	ING Bank, FSB	Wilmington	DE	286	8.4%
	Citizens Bank of Pennsylvania	Philadelphia	PA	134	4.0%
			<u>\$2,120</u>	<u>62.5%</u>	
Atlanta	Countrywide Bank, NA	Alexandria	VA	\$1,292	21.6%
	BB&T of NC	Winston-Salem	NC	379	6.3%
	SunTrust Bank	Atlanta	GA	359	6.0%
	Bank United, FSB	Coral Gables	FL	283	4.7%
	E*Trade Bank	Arlington	VA	244	4.1%
			<u>\$2,557</u>	<u>42.7%</u>	
Cincinnati	Charter One Bank, NA*	Cleveland	OH	\$ 582	15.4%
	US Bank, NA	Cincinnati	OH	526	13.9%
	Fifth Third Bank	Cincinnati	OH	368	9.7%
	Ohio Savings Bank, FSB	Cleveland	OH	214	5.7%
	National City Bank	Cleveland	OH	176	4.6%
			<u>\$1,866</u>	<u>49.3%</u>	



<u>District</u>	<u>Name</u>	<u>City</u>	<u>State</u>	<u>Capital Stock (\$Millions)</u>	<u>Percent of FHLBank Capital Stock (1)</u>
Indianapolis	LaSalle Bank Midwest, NA	Troy	MI	\$ 334	17.2%
	Flagstar Bank, FSB	Troy	MI	278	14.3%
	Fifth Third Bank	Grand Rapids	MI	150	7.7%
	National City Bank, Cleveland (6)	Cleveland	OH	91	4.7%
	Republic Bank (7)	Lansing	MI	75	3.9%
			<u>\$ 928</u>	<u>47.8%</u>	
Chicago	LaSalle Bank, NA*	Chicago	IL	\$ 230	8.8%
	One Mortgage Partners Corp.	Chicago	IL	172	6.6%
	Mid America Bank, FSB	Clarendon Hills	IL	146	5.6%
	Associated Bank, NA	Green Bay	WI	121	4.7%
	M&I Marshall & Ilsley Bank	Milwaukee	WI	120	4.6%
			<u>\$ 789</u>	<u>30.3%</u>	
Des Moines	Superior Guaranty Insurance Company	Minneapolis	MN	\$ 464	23.6%
	Transamerica Occidental Life Insurance Company	Cedar Rapids	IA	81	4.1%
	AmerUs Life Insurance Company	Des Moines	IA	78	3.9%
	TCF National Bank	Wayzata	MN	74	3.8%
	Transamerica Life Insurance Company	Cedar Rapids	IA	68	3.4%
			<u>\$ 765</u>	<u>38.8%</u>	
Dallas	World Savings Bank, FSB Texas (4)	Houston	TX	\$ 575	23.9%
	Guaranty Bank	Austin	TX	262	10.9%
	Washington Mutual Bank (2)	Henderson	NV	146	6.1%
	Capital One, NA	New Orleans	LA	113	4.7%
	Franklin Bank, SSB	Austin	TX	99	4.1%
			<u>\$1,195</u>	<u>49.7%</u>	
Topeka	US Central Federal Credit	Lenexa	KS	\$ 304	14.8%
	MidFirst Bank	Oklahoma City	OK	291	14.1%
	Capitol Federal Savings Bank	Topeka	KS	168	8.2%
	Security Life of Denver Insurance	Denver	CO	118	5.8%
	Security Benefit Life	Topeka	KS	64	3.1%
			<u>\$ 945</u>	<u>46.0%</u>	
San Francisco	Citibank, N.A. (3)	Las Vegas	NV	\$3,399	31.7%
	Washington Mutual Bank	Henderson	NV	1,964	18.3%
	World Savings Bank, FSB* (4)	Oakland	CA	1,343	12.5%
	IndyMac Bank, FSB	Pasadena	CA	762	7.1%
	Bank of America California, NA	San Francisco	CA	339	3.2%
			<u>\$7,807</u>	<u>72.8%</u>	
Seattle	Washington Mutual Bank, FSB*	Salt Lake City	UT	\$ 590	26.7%
	Bank of America Oregon, NA	Portland	OR	249	11.3%
	Washington Federal Savings	Seattle	WA	129	5.9%
	Merrill Lynch Bank, USA	Salt Lake City	UT	122	5.5%
	American Savings Bank, FSB	Honolulu	HI	98	4.4%
			<u>\$1,188</u>	<u>53.8%</u>	

\* An asterisk indicates that an officer or director of the member was an FHLBank director in 2006.

(1) For consistency with the individual FHLBank's presentation of its top 5 capital stockholders at December 31, 2005, amounts used to calculate percentages of FHLBank regulatory capital stock are based on numbers in

thousands. Accordingly, recalculations using the amounts in millions as disclosed in this report may not produce the same results.

- (2) The amount relates to the outstanding regulatory capital stock of Bank United, a former member of the FHLBank of Dallas, which was acquired by Washington Mutual Bank, FA, a member of the FHLBank of San Francisco, during 2001. The outstanding regulatory capital stock of the FHLBank of Dallas owned by Washington Mutual Bank, results from the acquisition.
- (3) On October 1, 2006, Citibank (West), FSB, (the FHLBank of San Francisco's member) was reorganized into its affiliate Citibank, N.A., and Citibank, N.A., assumed the outstanding capital stock of Citibank (West), FSB.
- (4) On October 1, 2006, Golden West Financial Corporation, the parent company of World Savings Bank, FSB (the FHLBank of San Francisco's member) and World Savings Bank, FSB Texas (the FHLBank of Dallas' member) merged with Wachovia Corporation. World Savings Bank, FSB, and World Savings Bank, FSB Texas have remained members of the FHLBanks of San Francisco and Dallas after the merger.
- (5) Formerly known as GMAC Automotive Bank. For FHLBank membership purposes, its principal place of business is Horsham, PA.
- (6) On July 24, 2006, National City Corporation completed the consolidation of its subsidiary banks under a single national bank charter outside the FHLBank of Indianapolis' district, thereby terminating their membership in the FHLBank of Indianapolis. At December 31, 2006, such entities had \$91 million of mandatorily redeemable capital stock outstanding.
- (7) Republic Bancorp, Inc., the parent company of Republic Bank, and Citizens Banking Corporation, the parent company of Citizens Bank, merged effective December 29, 2006 to become Citizens Republic Bancorp. The amount as presented represents regulatory capital stock related only to Republic Bank.

**Top 5 Advance Holding Borrowers by FHLBank  
at December 31, 2006  
(Dollar amounts in millions)**

<u>District</u>	<u>Name</u>	<u>City</u>	<u>State</u>	<u>Advances (1) (\$Millions)</u>	<u>Percent of FHLBank Advances (2)</u>
Boston	Bank of America Rhode Island, NA	Providence	RI	\$ 7,708	20.6%
	Citizens Bank of Massachusetts	Boston	MA	3,859	10.3%
	New Alliance Bank	New Haven	CT	1,708	4.6%
	Citizens Bank of Rhode Island	Providence	RI	1,668	4.5%
	Webster Bank, NA	Waterbury	CT	1,064	2.8%
				<u>\$ 16,007</u>	<u>42.8%</u>
New York	Hudson City Savings Bank*	Paramus	NJ	\$ 8,873	15.0%
	New York Community Bank*	Westbury	NY	7,879	13.4%
	HSBC Bank USA, NA	New York	NY	5,010	8.5%
	Manufacturers and Traders Trust Company	Buffalo	NY	3,423	5.8%
	Astoria FS & LA*	Long Island City	NY	2,480	4.2%
				<u>\$ 27,665</u>	<u>46.9%</u>
Pittsburgh	Sovereign Bank*	Reading	PA	\$ 18,047	36.5%
	GMAC Bank (6)	Midvale	UT	7,279	14.7%
	Citicorp Trust Bank, FSB	Newark	DE	6,609	13.4%
	Citizens Bank of Pennsylvania	Philadelphia	PA	2,000	4.0%
	Lehman Brothers Bank, FSB	Wilmington	DE	1,000	2.0%
				<u>\$ 34,935</u>	<u>70.6%</u>
Atlanta	Countrywide Bank, NA	Alexandria	VA	\$ 28,150	27.6%
	SunTrust Bank	Atlanta	GA	7,427	7.3%
	BB&T of NC	Winston-Salem	NC	7,018	6.9%
	Bank United, FSB	Coral Gables	FL	5,789	5.7%
	E*Trade Bank	Arlington	VA	4,869	4.8%
				<u>\$ 53,253</u>	<u>52.3%</u>

<u>District</u>	<u>Name</u>	<u>City</u>	<u>State</u>	<u>Advances (1) (\$Millions)</u>	<u>Percent of FHLBank Advances (2)</u>
Cincinnati	Charter One Bank NA*	Cleveland	OH	\$ 10,772	25.7%
	US Bank, NA	Cincinnati	OH	6,757	16.1%
	Fifth Third Bank	Cincinnati	OH	4,048	9.6%
	Ohio Savings Bank, FSB	Cleveland	OH	3,971	9.5%
	National City Bank	Cleveland	OH	1,201	2.9%
				<u>\$ 26,749</u>	<u>63.8%</u>
Indianapolis	Flagstar Bank, FSB	Troy	MI	\$ 5,407	24.2%
	LaSalle Bank Midwest, NA	Troy	MI	5,200	23.2%
	Republic Bank (7)	Lansing	MI	955	4.3%
	Citizens Bank of Flint (7)	Flint	MI	647	2.9%
	Jackson National Life Insurance Co.	Lansing	MI	600	2.7%
				<u>\$ 12,809</u>	<u>57.3%</u>
Chicago	LaSalle Bank, NA*	Chicago	IL	\$ 4,416	16.8%
	M&I Marshall & Ilsley Bank	Milwaukee	WI	2,394	9.1%
	Mid America Bank, FSB	Clarendon Hills	IL	2,155	8.2%
	One Mortgage Partners Corp.	Chicago	IL	1,615	6.2%
	State Farm Bank, FSB	Bloomington	IL	1,563	6.0%
				<u>\$ 12,143</u>	<u>46.3%</u>
Des Moines	Transamerica Occidental Life Insurance Company	Cedar Rapids	IA	\$ 1,600	7.3%
	AmerUs Life Insurance Company	Des Moines	IA	1,511	6.9%
	TCF National Bank	Wayzata	MN	1,425	6.5%
	Transamerica Life Insurance Company	Cedar Rapids	IA	1,300	6.0%
	Bank Midwest, NA	Kansas City	MO	586	2.7%
				<u>\$ 6,422</u>	<u>29.4%</u>
Dallas	World Savings Bank, FSB Texas (5)	Houston	TX	\$ 11,763	28.6%
	Guaranty Bank	Austin	TX	5,076	12.3%
	Washington Mutual Bank (3)	Henderson	NV	3,513	8.5%
	Franklin Bank, SSB	Austin	TX	2,309	5.6%
	Capital One, NA	New Orleans	LA	2,147	5.2%
				<u>\$ 24,808</u>	<u>60.2%</u>
Topeka	Midfirst Bank	Oklahoma City	OK	\$ 5,696	20.0%
	US Central Federal Credit	Lenexa	KS	4,000	14.1%
	Capitol Federal Savings Bank	Topeka	KS	3,296	11.6%
	Security Life of Denver Insurance	Denver	CO	2,334	8.2%
	Security Benefit Life	Topeka	KS	1,269	4.5%
				<u>\$ 16,595</u>	<u>58.4%</u>
San Francisco	Citibank, N.A. (4)	Las Vegas	NV	\$ 72,323	39.3%
	Washington Mutual Bank	Henderson	NV	34,864	19.0%
	World Savings Bank, FSB* (5)	Oakland	CA	22,846	12.4%
	IndyMac Bank, FSB	Pasadena	CA	10,413	5.7%
	Bank of America California	San Francisco	CA	7,220	3.9%
				<u>\$147,666</u>	<u>80.3%</u>

<u>District</u>	<u>Name</u>	<u>City</u>	<u>State</u>	<u>Advances (1) (\$Millions)</u>	<u>Percent of FHLBank Advances (2)</u>
Seattle	Bank of America Oregon, NA	Portland	OR	\$ 10,060	35.9%
	Washington Mutual Bank, FSB*	Salt Lake City	UT	5,822	20.8%
	Washington Federal Savings	Seattle	WA	1,500	5.4%
	Sterling Savings Bank*	Spokane	WA	1,306	4.7%
	American Savings Bank, FSB	Honolulu	WA	730	2.6%
				<u>\$ 19,418</u>	<u>69.4%</u>

\* An asterisk indicates that an officer or director of the member was an FHLBank director in 2006.

- (1) Member advance amounts and the total advance amounts are at par value, and the total advance amount will not agree to the combined Statement of Condition. The difference between the par and book value amounts primarily relates to basis adjustments arising from hedges under SFAS 133 for book purposes.
- (2) For consistency with the individual FHLBank's presentation of its top 5 advance holders at December 31, 2006, amounts used to calculate percentages of FHLBank advances are based on numbers in thousands. Accordingly, recalculations using the amounts in millions as disclosed in this report may not produce the same results.
- (3) The amount relates to the outstanding advances of Bank United, a former member of the FHLBank of Dallas, which was acquired by Washington Mutual Bank, FA, a member of the FHLBank of San Francisco during 2001. The outstanding advances of Washington Mutual Bank with the FHLBank of Dallas result from the acquisition.
- (4) On October 1, 2006, Citibank (West), FSB, (the FHLBank of San Francisco's member) was reorganized into its affiliate Citibank, N.A., and Citibank, N.A., assumed the outstanding advances of Citibank (West), FSB.
- (5) On October 1, 2006, Golden West Financial Corporation, the parent company of World Savings Bank, FSB (the FHLBank of San Francisco's member) and World Savings Bank, FSB Texas (the FHLBank of Dallas' member) merged with Wachovia Corporation. World Savings Bank, FSB, and World Savings Bank, FSB Texas have remained members of the FHLBanks of San Francisco and Dallas after the merger.
- (6) Formerly known as GMAC Automotive Bank. For FHLBank membership purposes, its principal place of business is Horsham, PA.
- (7) Republic Bancorp, Inc., the parent company of Republic Bank, and Citizens Banking Corporation, the parent company of Citizens Bank, merged effective December 29, 2006 to become Citizens Republic Bancorp.

#### AUDIT FEES

The following table sets forth the aggregate fees billed to the FHLBanks for the years ended December 31, 2006 and 2005 by their principal independent public accountant, PricewaterhouseCoopers LLP (dollar amounts in millions):

	<u>2006</u>	<u>2005</u>
Audit fees .....	\$10.7	\$13.0
Audit related fees.....	1.8	2.0
All other fees .....	<u>0.1</u>	<u>0.3</u>
Total fees .....	<u>\$12.6</u>	<u>\$15.3</u>

The *audit fees* for the years ended December 31, 2006 and 2005 were for professional services rendered for the annual audits and quarterly reviews of the individual and combined financial statements of the FHLBanks, and for review of financial information related to the FHLBanks' Securities and Exchange Commission (SEC) registration process and subsequent SEC filings.

The *audit related fees* for the years ended December 31, 2006 and 2005 were for assurance and related services primarily related to accounting consultations, FHLBank capital plan conversions and internal control reviews.

All *other fees* for the years ended December 31, 2006 and 2005 were for services rendered for non-financial information system related consulting. No fees were paid to the principal independent public accountant for financial information system design and implementation.

The FHLBanks' audit committees and the board of directors of the Office of Finance, acting as the audit committee for the combined financial reports, pre-approve audit and non-audit services provided by the principal independent public accountant. Also, they annually consider whether the services identified under the caption "all other fees" are compatible with maintaining the principal accountants' independence.

## **AUDIT COMMITTEE CHARTER, COMBINED FINANCIAL REPORTS**

### **Mission Statement**

The Office of Finance (OF) Board acts as an audit committee in connection with the oversight of the preparation of the FHLBanks' annual and quarterly combined financial reports, which shall include the combined financial statements of the FHLBanks. In that role, the OF Board shall review the combined financial statements. To achieve this objective, the OF Board will direct senior management of the Office of Finance to maintain the reliability and integrity of the accounting policies and financial reporting and disclosure practices of the OF.

In accordance with guidance from the Federal Housing Finance Board, the OF Board shall not be responsible for the underlying financial statements and other data of the FHLBanks contained in the combined financial reports, and is entitled to rely on those financial statements and other data as submitted by the individual FHLBanks. Furthermore, the combined financial reports and combined financial statements are the responsibility of the OF and its senior management and the OF Board can only review the material in an oversight capacity.

### **Roles and Responsibilities**

In connection with the financial reports and consistent with Finance Board guidance, the OF Board is responsible for:

- Reviewing the FHLBanks' combined financial statements, the external auditor's opinion on the annual combined financial statements, and the combined annual and quarterly financial reports, including the nature and extent of any significant changes in accounting principles or the application thereof.
- Ensuring that policies are in place that are reasonably designed to achieve disclosure and transparency regarding the FHLBanks' financial performance on a combined basis.
- Reviewing the scope of audit services required, significant accounting policies, significant risks and exposures, audit activities and audit findings with respect to the combined financial statements of the FHLBanks.
- Reviewing the activities and organizational structure of the OF's Department of Accounting Policy & Financial Reporting.
- Monitoring the accomplishments of the Senior Director, Accounting Policy & Financial Reporting's goals and objectives.
- Approving the external auditor's annual engagement letter, which shall require the external auditor to review the FHLBanks' combined financial statements prior to their inclusion in the FHLBanks' quarterly combined financial reports.
- Reviewing and approving audit plans of the external auditors relating to the combined financial statements.
- Reviewing the performance of the FHLBanks' external auditor.
- Making determinations regarding the appointment, renewal, or termination of the external auditor.

- Providing an independent, direct communication channel between the OF Board and the OF's Director, Internal Audit, the FHLBanks' external auditors and Finance Board examiners.
- Conducting or authorizing investigations into any matters within the OF Board's scope or responsibilities as it relates to the FHLBanks' combined financial reports.
- Reviewing the programs and policies of the OF designed to ensure compliance with applicable laws, regulations and policies relating to the disclosure process supporting the FHLBanks' joint debt issuance programs and monitoring the results of these compliance efforts.
- Determining that no restrictions are imposed on combined audit scope.
- Determining the extent to which internal auditors review computer systems and applications, the security of such systems and applications, and the contingency plan for processing financial information in the event of a systems breakdown.
- Obtaining reasonable assurance that significant findings and recommendations made by the Director, Internal Audit and external auditors relating to the FHLBanks' combined financial reports are received and discussed on a timely basis, including evaluating management's response to the findings and reports.
- Coordinating the OF's response to Finance Board examination reports as they relate to the FHLBanks' combined financial reports.
- Considering such other matters in relation to the preparation and publication of the FHLBanks' combined financial reports as the OF Board may, in its discretion, determine to be advisable.
- Prepare a report for inclusion in the FHLBanks' combined annual financial report describing the discharge of its responsibilities in this capacity, to the extent required by law.

### **Interaction with External Auditors**

The continued independence of the independent auditors in accordance with professional auditing standards and SEC requirements, as practicable, shall be reviewed periodically with management, as well as with the external auditors. The Committee shall require annually the written statement and letter from the external auditors disclosing relationships between the system and the external auditors, consistent with Independence Standards Board Standard No. 1, and shall discuss with the external auditors their independence in fact, as well as consulting and other non-audit services provided by the external auditors, to determine any potential effect on independence.

Subsequent to each audit, the OF Board shall meet with the external auditors to review and discuss accounting and audit matters, including, but not limited to:

- Significant auditing or accounting areas of concern,
- New or unusual transactions, balances or financial statement disclosures of significance,
- The external auditors' judgments about the quality of the FHLBanks' combined accounting principles as applied,
- The representation letters provided to the external auditors by the FHLBanks,
- The level of support provided by each FHLBank's management, accounting and internal audit personnel, and
- Any other matters required to be discussed by Statement of Auditing Standards (SAS) 61 (as amended) and other concerns the external auditors have with respect to positions taken in the combined financial statements.



The OF Board shall also review and discuss any matters that the external auditors are required under professional auditing standards to communicate to the OF Board, such as:

- Significant audit adjustments,
- Disagreements with management, and
- Any irregularities or illegal acts detected during the audit.

The OF Board will also review the responses of management with regard to these matters.

Prior to release to the public, the annual combined audited financial statements of the FHLBanks shall be reviewed by the OF Board and discussed with management and the external auditors. The purpose of the review shall be to determine whether to accept the audited financial statements presented to it for publication in the annual financial report. The OF Board shall inquire about the following:

- Significant variations in financial information between reporting periods.
- Consistency of the Financial Discussion and Analysis of Combined Financial Condition and Combined Results of Operations section of the annual combined financial report.
- Changes or proposed changes in accounting standards or rules issued by the Financial Accounting Standards Board or the SEC or the Finance Board that have an effect on the financial statements.
- Significant reporting or operational issues affecting the combined financial statements.
- Accounting accruals, reserves and estimates made by management of the FHLBanks having a material impact on the financial statements.

The above responsibilities of the OF Board will be discharged through review of combined audit reports and discussions with the external auditors, and the Senior Director, Accounting Policy & Financial Reporting. The Director, Internal Audit and external auditors shall have access to the OF Board on matters concerning the financial reports without the need for any prior management knowledge or approval.

## **Charters**

The OF Board shall review, assess the adequacy of, and, where appropriate, amend the Charter of the OF Board acting as “Audit Committee” in connection with the financial report function on an annual basis. Amendments to the Charter can be adopted and approved at any time. This Charter shall be re-adopted and re-approved not less often than every three years.

## **Meetings**

The OF Board shall meet at least twice annually with the OF’s Senior Director, Accounting Policy & Financial Reporting. The OF Board shall meet in executive session with each of the Director, Internal Audit, Senior Director, Accounting Policy and Financial Reporting, the external auditors and other senior management of the OF at least annually to review the matters which are the subject of this charter. Written minutes shall be prepared for each meeting. The OF Board, or its chairman, shall also meet with the external auditors, the Senior Director, Accounting Policy & Financial Reporting, and other senior management of the OF quarterly to review each quarterly financial report prior to its publication.