

# Statements of Condition

(In thousands, except par value)	December 31,	
	1999	1998
<b>Assets</b>		
Cash and due from banks	\$ 1,424	\$ 2,707
Interest-bearing deposits in banks	1,702,000	402,000
Securities purchased under agreements to resell	2,558,885	2,226,625
Federal funds sold	8,636,000	4,894,000
Investments held to maturity	10,382,029	7,973,811
Advances to members	90,513,829	63,989,305
Accrued interest receivable	2,099,622	1,521,982
Bank premises and equipment, net	4,324	73,249
Other assets	13,934	40,224
Total Assets	\$115,912,047	\$ 81,123,903
<b>Liabilities and Capital</b>		
<i>Liabilities:</i>		
Consolidated obligations, net		
Bonds	\$ 76,725,689	\$ 62,438,610
Discount notes	30,676,746	11,521,991
Total consolidated obligations	107,402,435	73,960,601
Deposits		
Demand and overnight	303,143	232,804
Term	23,810	245,411
Total deposits	326,953	478,215
Borrowings		
Other Federal Home Loan Banks	—	150,000
Securities sold under agreements to repurchase	—	150,000
Other	—	6,111
Total borrowings	—	306,111
Accrued interest payable	2,606,541	1,819,720
Affordable Housing Program	90,892	81,282
Payable to REFCORP	11,184	11,761
Other liabilities	35,643	30,911
Total Liabilities	110,473,648	76,688,601
Commitments and Contingencies: Note 14		
<i>Capital:</i>		
Capital stock (\$100 par value) issued and outstanding		
53,744 shares in 1999 and 44,016 in 1998	5,374,359	4,401,591
Retained earnings (subject to restrictions)	64,040	33,711
Total Capital	5,438,399	4,435,302
Total Liabilities and Capital	\$115,912,047	\$ 81,123,903

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

# Statements of Income

(In thousands)	For the Years Ended December 31,		
	1999	1998	1997
<b>Interest Income:</b>			
Advances to members	\$ 3,970,075	\$ 2,987,482	\$ 2,396,174
Interest-bearing deposits in banks	68,466	11,436	8,599
Securities purchased under agreements to resell	110,954	67,864	142,099
Federal funds sold	354,522	258,426	145,711
Investments held to maturity	524,809	486,508	431,559
Loans to other Federal Home Loan Banks	400	551	290
Total Interest Income	5,029,226	3,812,267	3,124,432
<b>Interest Expense:</b>			
Consolidated obligations	4,628,253	3,465,076	2,810,736
Deposits	11,552	14,921	11,314
Securities sold under agreements to repurchase	2,046	174	—
Borrowings from other Federal Home Loan Banks	72	22	144
Other borrowings	347	793	1,029
Total Interest Expense	4,642,270	3,480,986	2,823,223
<b>Net Interest Income</b>	386,956	331,281	301,209
<b>Other Income:</b>			
Prepayment fees, net	2,099	24,726	17,865
Services to members	852	702	599
Losses on interest rate exchange agreements, net	—	—	(19,768)
Gain on spin-off/termination involving Bank's Cash Balance Plan	10,507	—	—
Gain on sale of building	4,580	—	—
Other, net	2,007	5,017	3,969
Total Other Income	20,045	30,445	2,665
<b>Other Expense:</b>			
Operating expense	38,832	35,244	28,338
Federal Housing Finance Board and Office of Finance assessments	5,311	5,064	4,245
Affordable Housing Program	31,651	27,352	22,219
Total Other Expense	75,794	67,660	54,802
Income before extraordinary item	331,207	294,066	249,072
Extraordinary gain on early retirement of debt	1,346	—	—
<b>Net Income</b>	\$ 332,553	\$ 294,066	\$ 249,072

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

## Statements of Capital Accounts

(In thousands)	Capital Stock		Retained Earnings		Total
	Shares	Par Value	Restricted	Unrestricted	
<b>Balance, December 31, 1996</b>	31,400	\$3,140,010	\$10,348	\$ 34	\$ 10,382
Proceeds from sale of capital stock	3,493	349,284			
Redemption of capital stock	(1,547)	(154,724)			
Net income				249,072	249,072
Transfers from restricted retained earnings			(7,295)	7,295	—
Dividends on capital stock (6.10%):					
Cash payment				(42)	(42)
Stock issued	2,013	201,288		(201,288)	(201,288)
Capital distribution to REFCORP				(49,102)	(49,102)
<b>Balance, December 31, 1997</b>	35,359	3,535,858	3,053	5,969	9,022
Proceeds from sale of capital stock	7,806	780,594			
Redemption of capital stock	(1,357)	(135,689)			
Net income				294,066	294,066
Transfers to restricted retained earnings			27,601	(27,601)	—
Dividends on capital stock (5.76%):					
Cash payment				(46)	(46)
Stock issued	2,208	220,828		(220,828)	(220,828)
Capital distribution to REFCORP				(48,503)	(48,503)
<b>Balance, December 31, 1998</b>	44,016	4,401,591	30,654	3,057	33,711
Proceeds from sale of capital stock	12,938	1,293,784			
Redemption of capital stock	(5,755)	(575,494)			
Net income				332,553	332,553
Transfers to restricted retained earnings			7,978	(7,978)	—
Dividends on capital stock (5.36%):					
Cash payment				(52)	(52)
Stock issued	2,545	254,478		(254,478)	(254,478)
Capital distribution to REFCORP				(47,694)	(47,694)
<b>Balance, December 31, 1999</b>	53,744	\$5,374,359	\$38,632	\$ 25,408	\$ 64,040

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

# Statements of Cash Flows

(In thousands)	For the Years Ended December 31,		
	1999	1998	1997
<b>Cash Flows from Operating Activities:</b>			
Net Income	\$ 332,553	\$ 294,066	\$ 249,072
Extraordinary gain on early retirement of debt	(1,346)	—	—
Income before extraordinary item	331,207	294,066	249,072
Adjustments to reconcile net income before extraordinary item to net cash provided by operating activities:			
Depreciation and amortization:			
Net premiums and discounts on consolidated obligations and investments	(130,137)	(126,648)	(64,221)
Concessions on consolidated obligations	7,949	2,689	2,736
Bank premises and equipment	2,203	4,480	4,926
Deferred net losses on interest rate exchange agreements	13,255	6,776	11,653
Affordable Housing Program (AHP) liability and discount on AHP advances	9,956	11,026	9,498
Gain on sale of building	(4,580)	—	—
Gain on spin-off/termination of Cash Balance Plan	(10,507)	—	—
Increase in accrued interest receivable	(577,640)	(325,015)	(233,097)
Increase in accrued interest payable	786,821	354,151	310,718
Decrease (increase) in other assets	26,290	(2,992)	(11,940)
Increase (decrease) in other liabilities	(4,280)	(25,153)	42,852
Total adjustments	119,330	(100,686)	73,125
Net cash provided by operating activities	450,537	193,380	322,197
<b>Cash Flows from Investing Activities:</b>			
Net (increase) decrease in interest-bearing deposits in banks	(1,300,000)	(303,000)	23,000
Net increase in Federal funds sold	(3,742,000)	(2,565,000)	(689,000)
Net (increase) decrease in securities purchased under agreements to resell	(332,260)	(1,051,705)	2,052,475
Net (increase) decrease in short-term investments held to maturity	(867,413)	(1,151,284)	369,834
Purchases of mortgage-backed securities	(3,000,359)	(1,766,428)	(887,469)
Maturities of mortgage-backed securities	1,613,926	1,726,628	857,205
Principal collected on advances	195,964,633	101,722,700	96,605,334
Advances made to members	(222,489,710)	(116,439,905)	(106,696,381)
Proceeds from sale of building	92,661	—	—
Net increase to premises and equipment	(1,840)	(2,155)	(2,375)
Net cash used in investing activities	(34,062,362)	(19,830,149)	(8,367,377)
<b>Cash Flows from Financing Activities:</b>			
Net (decrease) increase in deposits	(151,262)	161,731	(43,534)
Net (decrease) increase in securities sold under agreements to repurchase	(150,000)	150,000	—
Net (decrease) increase in loans from other FHLBanks	(150,000)	150,000	—
Net decrease in other borrowings	(6,111)	—	(2,105)
Proceeds from sale of consolidated obligations:			
Bonds	50,945,749	75,641,248	39,107,418
Discount notes	159,964,172	133,102,425	164,006,101
Payments for maturing and retiring consolidated obligations:			
Bonds	(36,689,650)	(59,382,516)	(33,544,058)
Discount notes	(140,822,323)	(130,783,654)	(161,620,805)
Proceeds from issuance of capital stock	1,293,784	780,594	349,284
Payments for redemption of capital stock	(575,494)	(135,689)	(154,724)
Cash dividends paid	(52)	(46)	(42)
Capital distribution to REFCORP	(48,271)	(48,816)	(50,926)
Net cash provided by financing activities	33,610,542	19,635,277	8,046,609
Net (decrease) increase in cash and cash equivalents	(1,283)	(1,492)	1,429
Cash and cash equivalents at beginning of year	2,707	4,199	2,770
Cash and cash equivalents at end of year	\$ 1,424	\$ 2,707	\$ 4,199
<b>Supplemental Disclosures:</b>			
Interest paid during the year	\$ 3,810,217	\$ 3,118,914	\$ 2,489,845
Stock dividends issued during the year	\$ 254,478	\$ 220,828	\$ 201,288

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

*Years Ended December 31, 1999, 1998, and 1997  
(Dollars in thousands)*

### Background Information

The Federal Home Loan Bank of San Francisco (Bank), a federally chartered corporation, exempt from all federal, state and local taxation except for real property taxes, is one of 12 District Federal Home Loan Banks (FHLBanks), which together with their member institutions and the Office of Finance, under the supervision of the Federal Housing Finance Board (Finance Board), compose the FHLBank System (Bank System). The Bank is the largest of the 12 FHLBanks, and its assets and capital are each approximately one fifth of the combined assets and combined capital of the 12 FHLBanks as of December 31, 1999. The Bank System serves the public by enhancing the availability of residential mortgage and targeted community development credit by providing a readily available, low-cost source of funds to its member institutions. The Bank is a cooperative whose member institutions own the capital stock of the Bank and receive dividends on their investments. All regulated financial depositories and insurance companies engaged in residential housing finance are eligible to apply for membership. All members are required to purchase stock in their FHLBank.

The FHLBanks are supervised and regulated by the Finance Board, an independent federal agency in the executive branch of the United States Government. The Finance Board ensures that the FHLBanks operate in a safe and sound manner, carry out their housing finance mission, remain adequately capitalized, and can raise funds in the capital markets. Also, the Finance Board establishes policies and regulations governing the operations of the FHLBanks. Each FHLBank is operated as a separate entity with its own management, employees, and board of directors.

A primary source of funds for the FHLBanks is the proceeds from the sale to the public of Bank System debt instruments (consolidated obligations), which are the joint and several obligations of all FHLBanks. Other funds are provided by deposits, other borrowings, and the issuance of capital stock. All stock is owned by the FHLBanks' members.

In accordance with the Finance Board's regulations, the Bank has established a formal policy governing the compensation and expense reimbursement provided its directors. Directors are compensated based on the level of responsibility assumed. Fees are paid for attendance at certain meetings. In 1999, a retainer was also paid for the period the director was designated by the Finance Board as a director of the Bank. Directors are also reimbursed for reasonable and necessary Bank-related travel, subsistence, and other related expenses

under a policy similar to the Bank's travel policy for employees. During 1999, meeting and retainer fees totaled \$380 and reimbursed travel and related expenses totaled \$81.

### Note 1 – Summary of Significant Accounting Policies

*Use of Estimates.* The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

*Investments Held to Maturity and Securities Purchased Under Agreements to Resell.* Investments held to maturity and securities purchased under agreements to resell (resale agreements) are carried at cost, adjusted for amortization of premiums and accretion of discounts and for amortization of deferred gains and losses from associated interest rate exchange agreements using methods that approximate the level-yield method. All investments are classified as held-to-maturity securities because management has the positive intent and ability to hold these securities until maturity. Purchases of securities under agreements to resell the same securities are recorded as collateralized investments. Sales of securities under agreements to repurchase the same or substantially the same securities are treated as financings.

*Advances to Members.* The Bank presents advances to members, net of unearned commitment fees and discounts on advances for the Affordable Housing Program (AHP), as discussed below. In addition, the carrying value of advances is adjusted for the unamortized cost of deferred net gains and losses from associated interest rate exchange agreements, participation advances to other FHLBanks, as well as overdrawn demand deposit accounts. Interest on advances is credited to income as earned. Deferred gains and losses are recognized over the life of the underlying advance. As more fully discussed in Note 5, the Federal Home Loan Bank Act, as amended (the FHLB Act), limits eligible collateral to secure advances to certain investment securities, residential mortgage loans, deposits with the Bank, and other real-estate-related assets. In accordance with the Federal Home Loan System Modernization Act of 1999 (Modernization Act), the Bank will also be able to accept secured small business and agriculture loans as collateral from members that are "community financial institutions," defined as FDIC-insured depository institutions with average total assets over the preceding three-year period of less than \$500 million. The Bank has never experienced any losses on advances since its inception. Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no

allowance for losses on advances is deemed necessary by management.

**Affordable Housing Program.** As more fully discussed in Note 6, the Bank is required to establish and fund an AHP. The Bank charges the required funding to earnings and establishes an offsetting liability. AHP funds provide subsidies to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Advances that qualify under the Bank's AHP are made at interest rates below the Bank's cost of funds. When an AHP advance is made, the net present value of the difference in the cash flows attributable to the difference between the interest rate of the AHP advance and the Bank's related cost of funds for comparable maturity funding is charged against the AHP liability and recorded as a discount on the AHP advance.

**Prepayment Fees.** The Bank charges its members a prepayment fee when certain advances are paid prior to original maturity. Such fees are credited to income when received. Gains and losses on terminated or redesignated interest rate exchange agreements associated with advances that have been prepaid are netted with prepayment fees in the Statements of Income.

**Commitment Fees.** Commitment fees for advances are deferred and amortized to interest income using the straight-line method. The Bank defers refundable fees until the commitment expires or until the advance is funded if material. Commitment fees for letters of credit are recorded as a deferred credit when received and amortized to other income over the term of the letter of credit.

**Interest Rate Exchange Agreements.** As more fully discussed in Notes 12 and 13, the Bank enters into interest rate swap, cap, and floor agreements (interest rate exchange agreements) to manage the Bank's exposure to changes in interest rates. These interest rate exchange agreements, when linked with a designated financial instrument, effectively alter the financial characteristics of the designated instrument. They may adjust the effective maturity, repricing frequency, or option-related characteristics of certain financial instruments to achieve certain risk management objectives. Interest rate exchange agreements are used by the Bank to hedge an underlying financial instrument or when acting as an intermediary for members.

The differentials of interest payments, received or paid, resulting from designated interest rate exchange agreements associated with financial instruments are recognized as adjustments to the yield or interest expense of the underlying financial instrument. The differentials of interest payments, received or paid, resulting from interest rate exchange agree-

ments in which the Bank acts as an intermediary are recognized when incurred as other income. The intermediated interest rate exchange agreements are classified as other assets and other liabilities and measured at fair value in the Statements of Condition if material.

A designated interest rate exchange agreement's association with a designated underlying financial instrument ceases upon termination of the designated underlying financial instrument or when high correlation has not been met. Upon termination of the underlying financial instrument, the interest rate exchange agreement is marked to market (and the resulting gain or loss is included with the gain or loss on the termination of the underlying financial instrument) and is either terminated or redesignated as a hedge of other financial instruments. The Bank may also enter into new interest rate exchange agreements and designate them to the original interest rate exchange agreements to mitigate the economic effects of the original interest rate exchange agreements. Gains and losses on terminated interest rate exchange agreements and redesignated interest rate exchange agreements that were linked with a designated underlying financial instrument are deferred as long as the related underlying financial instrument remains outstanding. These deferred gains and losses are reported as adjustments to the carrying value of the designated underlying financial instrument. Deferred gains and losses related to interest rate exchange agreements are amortized over the shorter of the remaining life of the underlying financial instrument or the period ending on the original maturity date of the interest rate exchange agreement had it not been terminated. Unamortized costs, such as premiums paid for interest rate caps and floors and deferred gains and losses on these agreements, are reported as adjustments to the carrying value of the designated financial instrument and amortized, using a method approximating the level-yield method, over the remaining life of the interest rate exchange agreement.

**Bank Premises and Equipment.** The Bank records premises and equipment at cost less accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of assets ranging from 3 to 10 years, and leasehold improvements are amortized on the straight-line method over the estimated useful life of the improvement or the remaining term of the lease, whichever is shorter. Improvements and major renewals are capitalized; ordinary maintenance and repairs are expensed as incurred. Gains and losses on disposal are included in other income. In May 1999, the Bank sold its San Francisco office building and realized a gain of \$24,099. The Bank recognized \$4,580 during 1999 and will defer and amortize the remaining \$19,519 over the remaining term of the Bank's 10-year leaseback of the space the Bank occupies.

**Concessions on Consolidated Obligations.** The amounts paid to dealers in connection with the sale of consolidated obligation bonds are deferred and amortized using a method approximating the level-yield method over the term of the obligations or through the first call date for callable bonds. The amount of the concession is allocated to the Bank by the Office of Finance based upon the percentage of the debt issued that is assumed by the Bank. Concessions applicable to the sale of consolidated obligation discount notes are generally charged to interest expense as incurred because of the short-term maturities of these notes.

**Discounts and Premiums on Consolidated Obligations.** The discounts on consolidated obligation discount notes are amortized to expense using a method approximating the level-yield method over the term to maturity. The discounts and premiums on consolidated obligation bonds are amortized to expense using a method approximating the level-yield method over the term to maturity of the consolidated obligation bond or through the first call date for callable bonds.

**Capital Distributions to Resolution Funding Corporation (REFCORP).** Through 1999, the FHLBanks charged the \$300 million annual capital distribution to the Resolution Funding Corporation (REFCORP) directly to retained earnings (see Note 10). Effective January 1, 2000, each FHLBank is required to pay 20% of net earnings to REFCORP. The FHLBanks will expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a \$300 million annual annuity whose final maturity date is April 15, 2030, at which point the obligation of each FHLBank to REFCORP will be fully satisfied.

**Assessments.** Each FHLBank is assessed a share of the cost of operating the Finance Board and the Office of Finance, which manages the sale and servicing of consolidated obligations.

**Estimated Fair Values.** Many of the Bank's financial instruments lack an available trading market as characterized by a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant assumptions and present value calculations have been used by the Bank for the purposes of determining estimated fair values. Thus, the fair values may not represent actual values of the financial instruments that could have been realized as of yearend or that will be realized in the future.

Carrying value is assumed to approximate fair value for financial instruments with three months or less to repricing or maturity. Fair values are based on quoted prices, market rates, or replacement rates for similar financial instruments as of the last business day of the year. The estimated fair values of the

Bank's financial instruments and related assumptions are detailed in Note 13.

**Cash Flows.** For purposes of the Statements of Cash Flows, the Bank considers cash on hand and due from banks as cash and cash equivalents.

**Recently Issued Accounting Standard.** In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," which amends SFAS No. 133, deferring its effective date. SFAS No. 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 (January 1, 2001, for the Bank). SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives will be recorded each period in current earnings or other comprehensive income (a component of capital), depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on the derivative instrument that will be reported in other comprehensive income will be reclassified into earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged items. The ineffective portion of all hedges will be recognized in current-period earnings.

The Bank has not yet determined the full effect that the implementation of SFAS No. 133 will have on its earnings or statement of financial position. However, the new standard may have a negative effect on earnings and other comprehensive income (a component of capital).

**Reclassification.** Certain amounts in the 1998 and 1997 financial statements have been reclassified to conform with the 1999 presentation.

## Note 2 – Cash and Due From Banks

**Compensating Balances.** The Bank maintains average collected cash balances with several commercial banks in consideration for certain services. There are no legal restrictions under these agreements as to the withdrawal of these funds. The average collected balances for the years ended December 31, 1999 and 1998, were approximately \$5,253 and \$5,124, respectively.

In addition, the Bank maintained average collected balances with various Federal Reserve Banks as required clearing balances and to facilitate the movement of funds to support the Bank's activities. There are regulations governing the with-

## Notes to Financial Statements

drawal of these funds; however, earnings credits on these balances may be used to pay for services received. The average balances for these accounts for the years ended December 31, 1999 and 1998, were approximately \$999 and \$243, respectively.

### Note 3 – Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell (resale agreements) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 1999	\$2,558,885	\$1,144	\$—	\$2,560,029
December 31, 1998	\$2,226,625	\$ 162	\$—	\$2,226,787
Associated interest rate swaps	—	—	(4)	(4)
<b>Total</b>	<b>\$2,226,625</b>	<b>\$ 162</b>	<b>\$(4)</b>	<b>\$2,226,783</b>

**Redemption Terms.** The amortized cost and estimated fair value of resale agreements, excluding associated interest rate swaps, by contractual maturity as of December 31, 1999 and 1998, are shown below.

Year of Maturity	1999		1998	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$2,558,885	\$2,560,029	\$2,226,625	\$2,226,787

The Bank engages in resale agreements with a limited number of securities dealers, all of which are “primary dealers,” as designated by the Federal Reserve Bank of New York, and previously engaged in resale agreements with members that met certain credit eligibility criteria. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the Statements of Condition. The collateral from resale agreements, all of which is highly rated, is held by the Bank’s safekeeping custodian. Should the market value of the underlying securities decrease below the market value required as collateral, the counterparty is required to place an equivalent amount of additional securities in safekeeping in the name of the Bank. The Bank had rights to securities collateral with an estimated value in excess of the resale agreements outstanding at December 31, 1999 and 1998.

Resale agreements averaged \$2,098,691 and \$1,220,008 during 1999 and 1998, respectively. The maximum amounts outstanding at any monthend during 1999 and 1998 were \$4,318,410 and \$3,217,359, respectively. As of December 31, 1999 and 1998, resale agreements outstanding with members were \$0 and \$221,000, respectively.

**Interest Rate Payment Terms.** Interest rate payment terms for resale agreements and interest rate swap agreements associated with these agreements at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Amortized cost of resale agreements:		
Fixed rate	\$1,000,000	\$2,005,625
Adjustable rate	1,558,885	221,000
<b>Total</b>	<b>\$2,558,885</b>	<b>\$2,226,625</b>
Notional principal of interest rate swaps associated with resale agreements	\$ —	\$ 75,000

The effect of these interest rate swaps on interest income is disclosed in Note 12.

### Note 4 – Investments Held to Maturity

**Major Security Types.** Investments as of December 31, 1999 and 1998, were as follows:

December 31, 1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	\$ 3,333,236	\$ 1,787	\$ —	\$ 3,335,023
Mortgage-backed securities	7,048,793	—	(115,162)	6,933,631
<b>Subtotal</b>	<b>10,382,029</b>	<b>1,787</b>	<b>(115,162)</b>	<b>10,268,654</b>
Associated interest rate exchange agreements:				
Interest rate swaps	—	11,638	(1,343)	10,295
<b>Total</b>	<b>\$10,382,029</b>	<b>\$13,425</b>	<b>\$(116,505)</b>	<b>\$10,278,949</b>

December 31, 1998	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	\$2,294,815	\$ —	\$ —	\$2,294,815
Investments in consolidated obligations of other FHLBanks	8,750	98	—	8,848
<b>Subtotal</b>	<b>2,303,565</b>	<b>98</b>	<b>—</b>	<b>2,303,663</b>
Mortgage-backed securities	5,669,532	61,952	(23,909)	5,707,575
<b>Subtotal</b>	<b>7,973,097</b>	<b>62,050</b>	<b>(23,909)</b>	<b>8,011,238</b>
Associated interest rate exchange agreements:				
Interest rate swaps	—	—	(26,734)	(26,734)
Interest rate floors purchased	714	3,601	—	4,315
<b>Total</b>	<b>\$7,973,811</b>	<b>\$65,651</b>	<b>\$(50,643)</b>	<b>\$7,988,819</b>

## Notes to Financial Statements

**Redemption Terms.** The amortized cost and estimated fair value of investments held to maturity, excluding associated interest rate exchange agreements, by contractual maturity as of December 31, 1999 and 1998, are shown below. Expected maturities of certain mortgage-backed securities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment fees.

Year of Maturity	1999		1998	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 3,333,236	\$ 3,335,023	\$ 2,303,565	\$ 2,303,663
Mortgage-backed securities	7,048,793	6,933,631	5,669,532	5,707,575
<b>Total</b>	<b>\$10,382,029</b>	<b>\$10,268,654</b>	<b>\$7,973,097</b>	<b>\$8,011,238</b>

The amortized cost of the Bank's mortgage-backed securities, all of which are classified as held to maturity, included net premiums of \$2,629 and \$23,510 at December 31, 1999 and 1998, respectively.

**Interest Rate Payment Terms.** Interest rate payment terms for investments held to maturity and the notional principal of the interest rate exchange agreements associated with these investments at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Amortized cost of investments held to maturity other than mortgage-backed securities:		
Fixed rate	\$ 3,333,236	\$ 2,294,815
Adjustable rate	—	8,750
<b>Subtotal</b>	<b>3,333,236</b>	<b>2,303,565</b>
Amortized cost of mortgage-backed securities held to maturity:		
Pass-through securities:		
Fixed rate	1,644,129	1,482,244
Adjustable rate	1,244,192	1,711,820
Collateralized mortgage obligations:		
Fixed rate	2,855,802	1,131,420
Adjustable rate	1,304,670	1,344,048
<b>Subtotal</b>	<b>7,048,793</b>	<b>5,669,532</b>
<b>Total</b>	<b>\$10,382,029</b>	<b>\$7,973,097</b>
Notional principal of interest rate exchange agreements associated with investments held to maturity:		
Interest rate swaps	\$ 1,157,505	\$ 984,144
Interest rate floors purchased	—	455,000
<b>Total</b>	<b>\$ 1,157,505</b>	<b>\$1,439,144</b>

The effect of these interest rate exchange agreements on interest income is disclosed in Note 12.

### Note 5 – Advances to Members

**Redemption Terms.** The Bank had advances outstanding to members, including AHP advances (see Note 6), at interest rates ranging from 3.04% to 9.34% at December 31, 1999 and 1998, as summarized below:

December 31, 1999 Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
Overdrawn demand deposit accounts	\$ 1,529	5.99%
2000	49,134,618	5.82
2001	20,608,737	5.97
2002	7,762,001	5.71
2003	6,578,864	5.41
2004	4,046,355	5.87
2005 and thereafter	2,382,572	5.81
<b>Subtotal</b>	<b>90,514,676</b>	<b>5.81%</b>
Discount on AHP advances	(854)	
Deferred net gain on interest rate exchange agreements	(176)	
Unamortized fees on interest rate caps	183	
<b>Total</b>	<b>\$90,513,829</b>	

December 31, 1999 Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
Overdrawn demand deposit accounts	\$ 288	6.07%
1999	27,847,584	5.30
2000	17,484,656	5.50
2001	5,954,813	5.42
2002	1,890,216	5.62
2003	8,298,639	5.37
2004 and thereafter	2,512,567	5.72
<b>Subtotal</b>	<b>63,988,763</b>	<b>5.40%</b>
Discount on AHP advances	(1,200)	
Deferred net loss on interest rate exchange agreements	2,075	
Unearned advance fees	(333)	
<b>Total</b>	<b>\$63,989,305</b>	

Many of the Bank's advances to members are prepayable at the member's option. However, members are charged a prepayment fee when certain advances are prepaid. Other advances may be repaid on pertinent call dates without incurring prepayment fees (Callable Advances). At December 31, 1999 and 1998, the Bank had Callable Advances outstanding totaling \$2,009,819 and \$1,010,000, respectively.

The following table summarizes advances to members at December 31, 1999 and 1998, by year of maturity or next call date for Callable Advances:

Year of Maturity or Next Call Date	1999	1998
1999	\$ —	\$28,100,872
2000	49,887,847	17,734,656
2001	20,614,037	6,208,813
2002	7,762,001	1,890,216
2003	5,825,864	7,545,639
2004	4,046,355	—
2004 and thereafter	—	2,508,567
2005 and thereafter	2,378,572	—
<b>Total par value</b>	<b>\$90,514,676</b>	<b>\$63,988,763</b>

The Bank also provides below-market fixed rate advances in exchange for the right of the Bank to retain a “put” option. At the Bank’s discretion, on pertinent put dates, the Bank may terminate the advance (Putable Advance/Termination Option) or convert the advance to an Adjustable Rate Credit advance of predetermined index and spread for the remaining term to maturity (Putable Advance/Conversion Option). The Bank’s advances at December 31, 1999 and 1998, included \$2,810,500 and \$6,285,000, respectively, of Putable Advances/Termination Option. There were no Putable Advances/Conversion Option outstanding as of December 31, 1999 and 1998.

The following table summarizes advances to members at December 31, 1999 and 1998, by year of maturity or next put date for Putable Advances:

Year of Maturity or Next Put Date	1999	1998
1999	\$ —	\$30,861,373
2000	50,917,647	17,598,656
2001	21,005,237	6,438,313
2002	7,393,001	1,382,716
2003	5,812,364	5,960,138
2004	3,756,855	—
2004 and thereafter	—	1,747,567
2005 and thereafter	1,629,572	—
<b>Total par value</b>	<b>\$90,514,676</b>	<b>\$63,988,763</b>

**Security Terms.** The Bank lends to member financial institutions involved in housing finance that have a principal place of business in California, Arizona, or Nevada. The Bank is required by the FHLB Act to obtain sufficient collateral for advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans or privately issued mortgage-backed securities, deposits in the Bank, and other real-estate-related assets as collateral for advances. In accordance with the Modernization Act, the Bank will also be able to accept secured small business loans and agriculture loans as collateral from mem-

bers that are “community financial institutions,” defined as FDIC-insured depository institutions with average total assets over the preceding three-year period of less than \$500 million.

The Bank requires each borrowing member to execute a written Advances and Security Agreement. The capital stock of the Bank owned by each borrowing member is pledged as additional collateral for the member’s indebtedness to the Bank. The FHLB Act requires that the aggregate advances from the Bank to a member may not exceed 20 times the amount paid by the member for capital stock of the Bank. At December 31, 1999 and 1998, the Bank had a security interest in collateral with an estimated value in excess of outstanding advances for each member. Based upon the financial condition of the borrowing member, the Bank may either (i) allow the member to physically retain mortgage collateral assigned to the Bank provided that the member executes a written agreement and agrees to hold the collateral for the benefit of the Bank, or (ii) require the member to deliver physical possession of the mortgage collateral to the Bank or its safekeeping agent.

**Credit Risk.** The Bank has never experienced any credit losses on advances. Based on the collateral held as security for advances, management’s credit analyses, and prior repayment history, no allowance for losses on advances is deemed necessary by management.

The Bank’s potential credit risk from advances is concentrated in savings institutions. As of December 31, 1999, the Bank had a concentration of advances totaling \$68,853,955 outstanding to two members, representing 76% of total outstanding advances (one member represented 50% and the other represented 26%). The income from advances to these members amounted to approximately \$3,087,446 during 1999. The Bank held collateral with an estimated value in excess of advances to these institutions.

**Interest Rate Payment Terms.** Interest rate payment terms for advances and the notional principal of the interest rate exchange agreements associated with advances at December 31, 1999 and 1998, are detailed below:

	1999	1998
Par amount of advances:		
Fixed rate	\$47,072,427	\$43,403,023
Adjustable rate	43,442,249	20,585,740
<b>Total</b>	<b>\$90,514,676</b>	<b>\$63,988,763</b>
Notional principal of interest rate exchange agreements associated with advances:		
Interest rate swaps	\$31,083,669	\$39,540,498
Interest rate caps purchased	37,360	37,360
<b>Total</b>	<b>\$31,121,029</b>	<b>\$39,577,858</b>

The effect of these interest rate exchange agreements on interest income is disclosed in Note 12.

At December 31, 1998, the Bank had an outstanding participation in advances to members purchased from another FHLBank totaling \$2,685. This participation matured in 1999, and the 1998 amount is included in advances to members in the Statements of Condition.

**Prepayment Fees, Net.** During 1999, 1998, and 1997, the Bank charged its members prepayment fees when the principal on certain advances was paid prior to original maturity. In addition, some of these advances were associated with interest rate exchange agreements. Upon termination of these advances, the associated interest rate exchange agreements were either marked to market and redesignated as hedges of other advances, or terminated, and the resulting gains or losses (see Note 12) were netted with the prepayment fees on the Statements of Income. These transactions during the years ended December 31, 1999, 1998, and 1997, are summarized in the following table:

	1999	1998	1997
Prepayment fees received	\$ 1,398	\$ 23,249	\$ 17,910
Net gains/(losses) on interest rate exchange agreements associated with prepaid advances	701	1,477	(45)
<b>Prepayment fees, net</b>	<b>\$ 2,099</b>	<b>\$ 24,726</b>	<b>\$ 17,865</b>
Advance principal prepaid	\$537,000	\$5,191,083	\$624,896

#### Note 6 – Affordable Housing Program

Section 10(j) of the FHLB 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, which use the funds to assist the purchase, reconstruction, or rehabilitation of housing for very low-, low-, and moderate-income families. Annually, the FHLBanks must set

aside for their AHPs, in the aggregate, the greater of \$100 million or 10% of the current year's income before charges for the AHP but after charges for REFCORP (see Note 10). To the extent that the aggregate 10% calculation is less than \$100 million, the shortfall is allocated among the FHLBanks based on the ratio of each FHLBank's income before AHP and REFCORP to the sum of the net incomes before AHP and REFCORP of the 12 FHLBanks. There was no AHP shortfall in either 1999 or 1998. The Bank set aside \$31,651, \$27,352, and \$22,219, during 1999, 1998, and 1997, respectively, for the AHP. These amounts were charged to earnings each year and recognized as a liability. As subsidies are disbursed, the AHP liability is reduced.

#### Note 7 – Deposits

The Bank maintained demand deposit accounts that are directly related to the extension of credit to members and offered short-term deposit programs to members.

**Interest Rate Payment Terms.** Interest rate payment terms for deposits at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Deposits:		
Fixed rate	\$ 23,810	\$144,429
Adjustable rate	303,143	333,786
<b>Total</b>	<b>\$326,953</b>	<b>\$478,215</b>

#### Note 8 – Borrowings

At times the Bank enters into sales of securities under agreements to repurchase with a limited number of securities dealers, all of which are "primary dealers" as designated by the Federal Reserve Bank of New York. The amounts received under these agreements represent short-term borrowings and are reflected as liabilities in the Statements of Condition. The securities sold under agreements to repurchase (repurchase agreements) are delivered to the purchasing primary dealers. Should the market value of the underlying securities decrease below the market value required by the repurchase agreements, the Bank is required to deliver additional securities to the dealers. Repurchase agreements averaged \$40,000 and \$3,425 during 1999 and 1998, respectively, and the maximum amount outstanding at any monthend during 1999 and 1998 was \$150,000. There were no repurchase agreements outstanding at December 31, 1999.

There were no borrowings due to other FHLBanks at December 31, 1999. The Bank had borrowings due to other FHLBanks at December 31, 1998, of \$150,000, bearing interest at the overnight Federal funds rate.

There were no borrowings due to a member at December 31, 1999. The Bank had borrowings due to a member at December 31, 1998, of \$6,111, bearing interest equal to the Bank's dividend rate.

#### Note 9 – Consolidated Obligations

Consolidated obligations are the joint and several obligations of the FHLBanks and consist of consolidated obligation bonds and discount notes. Bonds are issued by the Finance Board through the Office of Finance primarily to raise intermediate- and long-term funds for the FHLBanks. Usually the maturity of consolidated bonds ranges from one year to ten years, but the maturity is not subject to any statutory or regulatory limits. Discount notes are issued to raise short-term funds and are issued at less than their face amount and redeemed at par when they mature.

On December 14, 1999, the Finance Board proposed a regulation that would reorganize the Office of Finance. One of the proposed changes would be for the FHLBanks to issue consolidated debt through the Office of Finance under Section 11(a) of the FHLB Act. Currently, the Finance Board issues the consolidated debt on behalf of the FHLBanks through the Office of Finance under Section 11(c) of the FHLB Act. If the proposed regulation is adopted, the consolidated debt issued by the FHLBanks would continue to be the joint-and-several obligation of all of the FHLBanks.

The par value of the outstanding consolidated obligations of all of the FHLBanks was \$549,370,500 and \$398,188,782 at December 31, 1999 and 1998, respectively. Regulations require the FHLBanks to maintain, in the aggregate, unpledged "qualifying assets" in an amount equal to 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, participations, mortgages or other securities of or issued by the United States or an agency of the United States; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located. In addition, effective January 29, 1993, Finance Board regulations prohibit the issuance of senior bonds, other than bonds issued to refund consolidated bonds previously issued, if immediately following such issuance, the aggregate amount of senior bonds and unsecured senior liabilities of the FHLBanks exceeds 20 times the total paid-in capital stock, retained earnings, and reserves of all the FHLBanks.

To facilitate Year 2000-related lending by the FHLBanks, the Finance Board has temporarily increased the senior liability to capital leverage ratio limit for the FHLBanks to 25 to 1 through June 30, 2000. For an FHLBank to exceed the 20 to 1 leverage

ratio limit, the FHLBank's net non-mortgage investments (defined as total investments less mortgage-backed securities, mortgage loan assets, member deposits, member capital investment in the Bank, retained earnings, and binding advances commitments) may not exceed 12% of outstanding consolidated obligations for which the FHLBank is the primary obligor. To meet the potential needs of its members, the Bank obtained a waiver from the Finance Board to increase the limit on its net non-mortgage investments to 14% of consolidated obligations and to increase its maximum leverage ratio to 22.5 to 1 through February 29, 2000. At December 31, 1999, the Bank's leverage ratio was 20.3 to 1 and its net non-mortgage investments were 9.9% of its consolidated obligations. At December 31, 1998, the Bank's leverage ratio was 17.2 to 1.

At December 31, 1999 and 1998, the ratio of total Bank System debt to total Bank System capital, as defined, was 19.1:1 and 17.9:1, respectively, and accordingly, the Bank System was in compliance with this regulation at December 31, 1999 and 1998.

On December 14, 1999, the Finance Board proposed a change to the leverage provisions of the Financial Management Policy (FMP). It would change the way the leverage ratio limit applicable to each FHLBank is stated. Currently, consolidated obligations and senior unsecured liabilities cannot exceed 20 times capital for any FHLBank. The proposal would limit assets to no more than 21 times capital.

To provide the holders of consolidated obligations issued prior to January 29, 1993 (prior bondholders), protection equivalent to that provided under the Bank System's previous leverage limit of 12 times Bank System capital, prior bondholders have a claim on a certain amount of the qualifying assets (Special Asset Account or SAA) if the FHLBanks' aggregate capital stock is less than 8.33% of consolidated obligations outstanding. The FHLBanks' capital stock at December 31, 1999 and 1998, was 5.2% and 5.6%, respectively, of the par value of consolidated obligations outstanding, and the SAA balance was approximately \$67,300 and \$151,500, respectively. The Bank's share of this SAA balance was approximately \$14,300 and \$26,600 at December 31, 1999 and 1998, respectively. Further, each FHLBank is required to transfer qualifying assets in the amount of its allocated share of the Bank System's SAA to a trust for the benefit of the prior bondholders if its individual capital-to-assets ratio falls below 2.0%.

*General Terms.* Consolidated obligations are generally issued with either fixed rate payment terms or adjustable rate payment terms, which use a variety of indices for interest rate resets, including the London Interbank Offered Rate (LIBOR), Federal funds, U.S. Treasury Bill, Constant Maturity Treasury (CMT), Prime Rate, and others. In addition, to meet the specific needs of certain investors, fixed rate and adjustable rate

## Notes to Financial Statements

consolidated obligation bonds may also contain certain embedded features, which may result in complex coupon payment terms and call options. Generally, when such consolidated obligations are issued, the Bank simultaneously enters into interest rate exchange agreements containing offsetting features to convert the terms of the bond, in effect, to the terms of a simple adjustable rate bond (tied to an index, such as those detailed above) or a fixed rate bond.

Consolidated obligations, in addition to having fixed rate or simple adjustable rate coupon payment terms, may also include "callable bonds," which the Bank may redeem in whole or in part at its discretion on predetermined call dates according to the terms of the bond offerings; "step-up bonds," which generally pay interest at increasing fixed rates for specified intervals over the life of the bond and can be called at the Bank's option on the step-up dates; "comparative index bonds," which have coupon rates that are determined by the difference between two market indices; "inverse floating bonds," which have coupons that increase as an index declines and decrease as an index rises; and "zero-coupon bonds," which are long-term discounted instruments that earn a fixed yield to maturity or to the specified call dates, and for which all principal and interest are paid at maturity or on the specified call dates, if the call option is exercised prior to maturity.

**Redemption Terms.** The following is a summary of the Bank's participation in consolidated obligation bonds at December 31, 1999 and 1998:

<i>December 31, 1999</i> Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
2000	\$27,049,500	5.30%
2001	16,135,000	5.43
2002	13,091,000	5.51
2003	12,634,500	5.65
2004	6,225,000	6.10
2005 and thereafter	1,642,725	5.90
Total par value	76,777,725	<u>5.50%</u>
Concessions	(8,669)	
Bond premiums	14,881	
Bond discounts	(58,195)	
Deferred net loss on interest rate exchange agreements	(53)	
Total	<u>\$76,725,689</u>	

<i>December 31, 1999</i> Year of Maturity	Amount Outstanding	Contractual Weighted Average Interest Rate
1999	\$26,251,000	5.15%
2000	6,538,000	5.55
2001	7,645,000	5.72
2002	4,765,000	5.90
2003	13,529,500	5.59
2004 and thereafter	3,698,375	5.73
Total par value	62,426,875	<u>5.45%</u>
Concessions	(3,973)	
Bond premiums	17,351	
Bond discounts	(846)	
Deferred net loss on interest rate exchange agreements	(483)	
Deferred fees relating to interest rate exchange agreements	(314)	
Total	<u>\$62,438,610</u>	

The Bank's participation in consolidated obligation bonds outstanding at December 31, 1999 and 1998, includes callable bonds of \$31,674,000 and \$30,350,000, respectively. Contemporaneous with such callable debt issuance, the Bank usually enters into an interest rate swap (in which the Bank pays variable and receives fixed) with a call feature that mirrors the option embedded in the debt (a sold callable swap). The combined sold callable swap and callable debt enable the Bank to meet its funding needs at prices not otherwise directly attainable solely through the issuance of callable debt. The Bank also uses fixed rate callable bonds to finance callable advances (see Note 5) and mortgage-backed securities. Based on the prevailing interest rates at December 31, 1999, none of the Bank's callable bonds were in-the-money. If these conditions continue throughout 2000, the Bank estimates that almost none of the call options may be exercised. However, depending on the level and volatility of interest rates and other factors, actual results may differ.

The Bank's participation in consolidated obligation bonds was as follows:

	1999	1998
Par amount of consolidated bonds:		
Non-callable	\$45,103,725	\$32,076,875
Callable	31,674,000	30,350,000
Total par value	<u>\$76,777,725</u>	<u>\$62,426,875</u>

## Notes to Financial Statements

The following is a summary of the Bank's participation in consolidated obligation bonds outstanding at December 31, 1999 and 1998, by year of contractual maturity or next call date:

Earlier of Year of Contractual Maturity or Next Call Date	December 31, 1999	December 31, 1998
1999	\$ —	\$48,786,000
2000	48,939,500	7,343,000
2001	14,920,000	1,250,000
2002	6,911,000	35,000
2003	4,749,500	4,029,500
2004	265,000	—
2004 and thereafter	—	983,375
2005 and thereafter	992,725	—
<b>Total</b>	<b>\$76,777,725</b>	<b>\$62,426,875</b>

**Interest Rate Payment Terms.** Interest rate payment terms for consolidated obligations and the notional principal of the interest rate exchange agreements associated with consolidated obligations at December 31, 1999 and 1998, are detailed in the following table:

	1999	1998
Par amount of consolidated obligations:		
Consolidated bonds:		
Fixed rate	\$ 63,743,325	\$44,989,325
Adjustable rate	10,597,500	15,832,000
Zero-coupon	1,150,000	—
Step-up	910,000	1,075,000
Inverse floating	100,000	225,000
Comparative index	276,900	305,550
Total consolidated bonds, par	76,777,725	62,426,875
Consolidated discount notes, par	31,083,943	11,623,517
<b>Total consolidated obligations, par</b>	<b>\$107,861,668</b>	<b>\$74,050,392</b>
Notional principal of interest rate exchange agreements associated with consolidated obligations:		
Interest rate swaps	\$ 90,337,556	\$69,036,550
Interest rate floors purchased	—	645,000
Interest rate caps purchased	—	500,000
<b>Total</b>	<b>\$ 90,337,556</b>	<b>\$70,181,550</b>

The effect of these interest rate exchange agreements on interest expense is disclosed in Note 12.

The Bank's participation in consolidated obligation discount notes, all of which are due within one year, was as follows:

	1999		1998	
	Amount Outstanding	Contractual Weighted Average Interest Rate	Amount Outstanding	Contractual Weighted Average Interest Rate
Par value	\$31,083,943	5.54%	\$11,623,517	5.04%
Discounts	(373,581)		(74,654)	
Concessions	(1,022)		(439)	
Deferred net loss on interest rate exchange agreements	(32,594)		(9,104)	
Deferred fees relating to interest rate exchange agreements	—		(17,329)	
<b>Total</b>	<b>\$30,676,746</b>		<b>\$11,521,991</b>	

Section 11(i) of the FHLB Act authorizes the Secretary of the Treasury, at his discretion, to purchase certain obligations issued by the FHLBanks aggregating not more than \$4.0 billion; terms, conditions and interest rates are to be determined by the Secretary of the Treasury. There were no such purchases by the U.S. Treasury during the two-year period ended December 31, 1999.

**Extraordinary Item – Early Retirement of Debt.** During 1999 and 1998, the Bank retired consolidated obligations either by purchasing such obligations in the open market or by selling its participation in certain obligations to other FHLBanks. Some of these obligations were designated to interest rate exchange agreements that were marked to market and terminated at the date of retirement. The resulting gain or loss (see Note 12), if material, was netted with the gain or loss on the early retirement of debt. The Bank did not retire any consolidated obligations during 1997. The 1999 and 1998 transactions are summarized in the following table:

	1999	1998
Gain on sale of consolidated obligations to other FHLBanks	\$ 772	\$ —
Gain on retirement of consolidated obligations	2,063	—
Loss on interest rate exchange agreements associated with consolidated obligations sold to other FHLBanks or retired in the market	(1,489)	—
<b>Extraordinary gain</b>	<b>\$ 1,346</b>	<b>\$ —</b>
Par value retired	\$533,650	\$680,000

### Note 10 – Capital

The Modernization Act will lead to a number of changes in the capital structure of the FHLBanks. These changes will be phased in, and the Modernization Act requires the Finance Board to issue regulations prescribing a uniform capital structure for the FHLBanks by November 12, 2000. Until new capital regulations are in place, the current capital rules remain in effect. In particular, the FHLB Act requires each member to purchase capital stock equal to the greater of 1% of its mortgage-related assets or 5% of its outstanding FHLBank advances. However, the Modernization Act removed the provision that required a nonthrift member to purchase additional stock to borrow from its FHLBank if the nonthrift member's mortgage-related assets were less than 65% of its total assets. A member may, at the Bank's discretion, redeem at par value any capital stock greater than its statutory requirement or sell it to other Bank members at par value.

When the Finance Board adopts regulations implementing the recent statutory changes and capital structure plans have been approved by the Finance Board and implemented at each FHLBank, the FHLBanks will be subject to risk-based capital rules. Each FHLBank may offer two classes of stock. Members may redeem Class A stock by giving six months' notice, and members may redeem Class B stock by giving five years' notice. Only "permanent" capital, defined as retained earnings and Class B stock, can satisfy the risk-based capital requirement. In addition, the Modernization Act specifies a 5% minimum leverage capital ratio with a 1.5 weighting factor for permanent capital, and a 4% minimum leverage capital ratio without the 1.5 weighting factor.

The Modernization Act established voluntary membership for all members, but former mandatory members (federally chartered savings institutions regulated by the Office of Thrift Supervision) may not withdraw from membership before May 12, 2000. All other members may generally withdraw from membership and redeem their capital six months after giving notice. Members that withdraw from membership may not re-apply for membership for five years.

At December 31, 1999, of the total capital stock outstanding, mandatory members held 44.7 million shares, or 84%, and voluntary members held 8.3 million shares, or 16%. Two mandatory members held 34.5 million shares, representing 65% of total capital stock outstanding (one member represented 43% and the other represented 22%).

The Bank is required by Finance Board dividend policy to retain in restricted retained earnings that portion of income from prepayment fees that, if allocated on a pro-rata basis over the maturity of the advances prepaid, would be allocated to future dividend periods. In addition, other gains and losses

related to the termination of interest rate exchange agreements and early retirement of consolidated obligations are similarly treated. Retained earnings restricted in accordance with this Finance Board policy totaled \$10,716, \$14,366, and \$3,053, at December 31, 1999, 1998, and 1997, respectively.

To provide financial flexibility and in anticipation of the possible effect of implementing SFAS No. 133, the Board of Directors authorized management to transfer certain amounts from unrestricted retained earnings to restricted retained earnings. During the fourth quarter of 1998, the Bank transferred \$16,288, the amount of unrestricted retained earnings as of September 30, 1998, to restricted retained earnings. In addition, during 1999, the Bank transferred, net of applicable assessments, the one-time gain of \$8,095 from the spin-off/termination involving the Bank's Cash Balance Plan and recognized gains totaling \$3,533 from the sale of the Bank's office building to restricted retained earnings. Retained earnings restricted by the Board of Directors totaled \$27,916 and \$16,288 at December 31, 1999, and 1998, respectively.

Dividends may be paid in the form of cash or capital stock, as authorized by the Bank's Board of Directors and as approved by the Finance Board. In 1999, 1998, and 1997, the Bank was permitted to pay quarterly dividends out of unrestricted retained earnings and current year earnings, pursuant to Finance Board policy.

Through 1999, the FHLB Act required the 12 FHLBanks combined to pay \$300 million annually through 2030 to fund a portion of the interest on REFCORP debt. Prior to the payment of any dividends, each FHLBank was initially assessed up to 20% of its net income (after AHP contributions) to meet the required \$300 million assessment. To the extent that 20% of net income was insufficient to meet the required \$300 million assessment in any year, the shortfall was allocated among all FHLBanks based on the percentage equal to the ratio of the FHLBank's average advances to members that were members of the Savings Association Insurance Fund (SAIF) during the preceding year to the FHLBank System's total average advances to SAIF-insured members during that year. The Bank's share of such advances was approximately 36.79% and 35.31% in 1999 and 1998, respectively. If the initial 20% assessment calculation exceeded the required \$300 million, the \$300 million was allocated among the FHLBanks based on their net income after their AHP contribution to the System net income after AHP contributions. Higher net earnings in 1999 and 1998 for the 12 FHLBanks combined enabled the FHLBanks to pay their \$300 million annual assessment without a shortfall allocation. Retained earnings were charged \$47,694 and \$48,503 for REFCORP interest assessments in 1999 and 1998, respectively.

The Modernization Act changed this obligation to 20% of net earnings for each FHLBank, with the final payment adjusted so that the aggregate payments made by all 12 FHLBanks are equivalent to a \$300 million annual annuity whose final maturity date is April 15, 2030. The cumulative amount to be paid to REFCORP by the Bank is not determinable at this time due to the uncertainty of the FHLBanks' future earnings.

Effective April 1999, the Bank implemented its new mandatory surplus capital stock redemption policy. Surplus capital stock is defined as any excess stock holdings above 115% of a member's statutory capital stock requirement, excluding stock dividends earned and credited for the current year. In accordance with this plan, the Bank redeemed \$413,444 in surplus capital stock in 1999. At December 31, 1999, surplus capital stock subject to mandatory redemption in January 2000 was \$45,606.

### Note 11 – Employee Retirement Plans

Prior to January 1, 1996, the Bank was a participating employer in the Financial Institutions Retirement Fund (FIRF), a defined benefit plan. The Bank funded its share of FIRF's normal cost each plan year through June 30, 1987. In the plan year beginning July 1, 1987, the "full-funding limitation" (as defined by the Employee Retirement Income Security Act) became applicable to the Bank because of favorable investment and other actuarial experience in previous years. As a result, the Bank was no longer required or permitted to make payments to FIRF in subsequent plan years.

Effective January 1, 1996, the Bank ceased to be a participating employer in FIRF, and the Bank began providing retirement benefits through a new Bank-sponsored Cash Balance Plan, a defined benefit plan. The Cash Balance Plan covers all employees who have completed six months of Bank service. Under the plan, each eligible Bank employee accrues benefits annually equal to 6% of the employee's annual pay, plus 6% interest on the benefits accrued to the employee through the prior yearend. The Cash Balance Plan is funded through a trust established by the Bank. In general, the amount to be funded by the Bank each year is determined by an independent actuary. Because of the transfer of surplus assets from FIRF, the assets of the Cash Balance Plan have substantially exceeded the amount of accrued benefits, so the Bank has not made additional payments to the Plan since its inception. The funded status of the Cash Balance Plan was \$15,878 and \$15,220, at December 31, 1998 and 1997, respectively. The unrecognized net gain amounted to \$12,355 and \$12,811, resulting in prepaid pension costs of \$3,523 and \$2,409 at December 31, 1998 and 1997, respectively. For the years ended December 31, 1998 and 1997, the Bank recognized net periodic pension income of \$1,114 and \$1,200, respectively,

primarily from the expected return on the excess funded status and the amortization of the unrecognized net gain.

In February 1999, with approval from the Internal Revenue Service, the Bank implemented a spin-off/termination involving the Cash Balance Plan. The benefits of all inactive Cash Balance Plan participants (individuals who no longer work for the Bank) as of February 28, 1999, along with most of the surplus assets in the Cash Balance Plan (plan assets that exceeded Cash Balance Plan liabilities) net of the 2000 funding requirement for active employees, were transferred to a separate spin-off plan, which was then immediately terminated. At that time, the Bank recognized the remaining unamortized deferred gain, or \$10,507. The projected benefit obligation and the accrual pension cost of the Cash Balance Plan were \$3,125 and \$1,560, respectively, at December 31, 1999. The periodic pension cost for the year totaled \$560.

The Bank also participates in the Financial Institutions Thrift Plan, a defined contribution savings plan. The Bank's contribution consists of elective participant contributions and a Bank matching contribution of up to 6% of those participant contributions (based on compensation). The Bank contributed approximately \$521, \$472, and \$452, in 1999, 1998, and 1997, respectively, to the plan.

In addition, the Bank maintains a deferred compensation plan that is available to all officers and directors. The plan liability consists of the accumulated compensation deferrals and accrued earnings on the deferrals. The Bank's obligation for this plan at December 31, 1999 and 1998, was \$6,500 and \$4,723, respectively.

### Note 12 – Interest Rate Exchange Agreements

In connection with the Bank's interest rate risk management program, the Bank uses interest rate swaps, caps, and floors. When the Bank enters into interest rate exchange agreements, certain assets and liabilities are normally identified and designated as financial instruments hedged by such agreements. The interest rate exchange agreement together with the hedged item create terms that support the Bank's risk management objectives. The Bank monitors both the interest rate exchange agreements and the related hedged items to ensure that their relationship has not changed. The Bank also may act as an intermediary between members and third parties for interest rate exchange agreement transactions.

Interest rate swap transactions generally involve the contractual exchange of an adjustable rate for a fixed or another adjustable rate interest payment obligation based on a notional principal amount as defined in the agreement. Interest rate swaps associated with discount notes may effectively increase the maturity of the underlying borrowings. Interest

rate caps and floors obligate one of the parties to the contract to make payments to the other if an interest rate index exceeds a specified upper "capped" level or if the index falls below a specified "floor" level. The Bank does not enter into speculative interest rate swaps, caps, or floors.

These off-balance sheet instruments may involve, to varying degrees, elements of credit and interest rate risk. The maximum credit risk may be in excess of the amount recognized in the Statements of Condition. The Bank has adopted policies related to credit and interest rate risk limits and monitors transactions and positions for adherence to these policies. The contract or notional amounts of these instruments reflect the extent of the Bank's involvement in particular classes of financial instruments. For interest rate exchange agreements, the notional amount does not represent the exposure to credit loss. The amount potentially subject to credit loss is the estimated cost of replacing the favorable interest rate exchange agreement if the counterparty defaults and is substantially less than the notional amount. The Bank is subject to credit risk relating to the nonperformance by a counterparty to a non-exchange-traded interest rate exchange agreement. However, based on management's credit analyses of its counterparties, all of which are highly rated, and on the Bank's collateral requirements, no allowance for losses is deemed necessary by management.

Maximum credit risk is defined as the estimated cost of replacement for favorable interest rate exchange agreements in the event of counterparty default if the related collateral proves to be of no value to the Bank. At December 31, 1999 and 1998, the Bank's maximum credit risk, as defined above, was approximately \$153,000 and \$113,000, respectively, including \$106,427 and \$73,400 of net accrued interest receivable, respectively. Accrued interest receivables and payables, and the legal right to offset assets and liabilities by counterparty, in which amounts recognized for individual transactions may be offset against amounts recognized for other transactions with the same counterparty, are considered in determining the maximum credit risk. The Bank held highly rated securities with a fair value of \$120,000 and \$79,000 as collateral where the credit risk exceeded the Bank's unsecured credit risk limits as of December 31, 1999 and 1998, respectively.

A significant number of the Bank's interest rate exchange agreements are transacted with financial institutions such as major banks and broker-dealers, with no single institution dominating the business. Some of these banks and dealers or their affiliates buy, sell, and distribute consolidated obligations. Assets pledged as collateral by the Bank to these counterparties are more fully discussed in Note 14.

The notional principal, amortized costs, and estimated fair values by class type of all interest rate exchange agreements outstanding at December 31, 1999 and 1998, are detailed in Note 13.

The notional principal by class type of designated interest rate exchange agreements associated with securities purchased under agreements to resell, investments held to maturity, advances, and consolidated obligations outstanding at December 31, 1999 and 1998, is detailed in Notes 3, 4, 5, and 9, respectively. The notional principal of interest rate exchange agreements by class in which the Bank is an intermediary is detailed below.

*Intermediation.* Interest rate exchange agreements in which the Bank is an intermediary may arise when the Bank enters into offsetting interest rate exchange agreements with members and other counterparties to meet the needs of members or when the Bank enters into interest rate exchange agreements to offset the economic effect of other interest rate exchange agreements that are no longer designated to advances, investments, or consolidated obligations. The agreements have expiration dates between January 2000 and September 2008. The notional principal of the interest rate swap agreements in which the Bank is an intermediary at December 31, 1999 and 1998, was \$1,436,400 and \$2,201,600, respectively.

*Loss on Interest Rate Exchange Agreements, Net.* During 1999, the Bank terminated \$575,000 in notional principal of interest rate swaps, \$1,100,000 in notional principal of interest rate floors, and \$500,000 in notional principal of interest rate caps that were hedging the current and future issuance of discount notes. During 1998, the Bank terminated \$150,000 in notional principal of interest rate swaps that were hedging the future issuance of discount notes. The unamortized balance of the resulting deferred loss at December 31, 1999 and 1998, totaled \$32,646 and \$11,102, respectively, and the loss is included in the carrying amount of discount notes. These deferred losses are being amortized over the original term to maturity of the terminated interest rate swaps. During 1997, the Bank terminated \$385,000 in notional principal of its term interest rate swaps because the Bank determined that these swaps were no longer required to hedge anticipated issuances of discount notes. As a result, the Bank recognized a net loss of \$19,768 in other income.

## Notes to Financial Statements

**Income Effect.** The effect of the Bank's interest rate exchange agreements for the years ended December 31, 1999, 1998, and 1997, was to increase (decrease) interest income, interest expense, and other income and to produce extraordinary gains (losses) on early retirement of debt as follows:

	1999	1998	1997
Interest income:			
Advances to members	\$ (68,651)	\$ (24,992)	\$ (6,432)
Investments held to maturity	(7,549)	(7,592)	(9,514)
Resale agreements	(16)	(182)	(5,372)
Federal funds sold	—	26	(3)
Interest expense:			
Consolidated obligations	(143,583)	(100,007)	(85,314)
Deposits	—	—	1,061
Other income:			
Prepayment fees	701	1,477	(45)
Net loss on terminated and redesignated interest rate swaps	—	—	(19,681)
Other income	(60)	4	75
Extraordinary gain on early retirement of debt	\$ 1,489	\$ —	\$ —

### Note 13 – Estimated Fair Values

**Cash and Due from Banks.** The estimated fair values approximate the carrying values.

**Resale Agreements and Federal Funds Sold.** The estimated fair values of these instruments have been determined by calculating the present value of expected cash flows. The discount rates used in these calculations are the replacement rates for securities with similar terms.

**Interest-Bearing Deposits in Banks and Investments Held to Maturity.** The estimated fair value of these instruments, including mortgage-backed securities, has been determined based on quoted prices or by calculating the present value of expected cash flows as of the last business day of the year excluding accrued interest.

**Advances to Members.** For advances with more than three months to maturity or repricing, the estimated fair value has been determined by calculating the present value of expected cash flows from the advances and reducing this amount for accrued interest receivable. The discount rates used in these calculations are the replacement rates for advances with similar terms. Pursuant to the Finance Board's advances regulation, advances with a maturity or repricing period greater than six months generally require a prepayment fee sufficient to make the Bank financially indifferent to the borrower's decision to prepay the advances. Therefore, the estimated fair value of advances does not assume prepayment risk. For advances with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

**Accrued Interest Receivable and Payable.** The recorded carrying value approximates the estimated fair value.

**Deposits.** For deposits with more than three months to maturity or repricing, the estimated fair value has been determined 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. For deposits with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

**Consolidated Obligations.** The estimated fair value has been determined based on the estimated cost of raising comparable term debt. The estimated cost of issuing debt is determined daily based on the primary market for debt of government-sponsored enterprises and other indications from securities dealers; the estimated cost of issuing debt includes non-interest selling costs.

**Borrowings.** For borrowings with more than three months to maturity or repricing, the estimated fair value has been determined 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 costs of borrowings with similar terms. For borrowings with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

**Commitments.** The estimated fair value of the Bank's commitments to extend credit, including letters of credit, was immaterial at December 31, 1999 and 1998.

**Interest Rate Exchange Agreements.** The estimated fair values of these agreements are based on the estimated cost of interest rate exchange agreements with similar terms or available market prices, excluding 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. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes. The estimated fair values of the Bank's financial instruments at December 31, 1999 and 1998, were as follows:

## Notes to Financial Statements

### *Fair Value of Financial Instruments – 1999*

	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
<i>Assets</i>			
Cash and due from banks	\$ 1,424	\$ —	\$ 1,424
Interest-bearing deposits in banks	1,702,000	1,585	1,703,585
Federal funds sold	8,636,000	5,028	8,641,028
Resale agreements	2,558,885	1,144	2,560,029
Investments held to maturity	10,382,029	(113,375)	10,268,654
Interest rate exchange agreements associated with investments held to maturity	—	10,295	10,295
Investments held to maturity, net	10,382,029	(103,080)	10,278,949
Advances to members	90,513,646	(558,007)	89,955,639
Interest rate exchange agreements associated with advances to members	183	546,246	546,429
Advances to members, net	90,513,829	(11,761)	90,502,068
Accrued interest receivable	2,099,622	—	2,099,622
Other assets	18,258	—	18,258
<b>Total</b>	<b>\$115,912,047</b>	<b>\$ (107,084)</b>	<b>\$115,804,963</b>
<i>Liabilities</i>			
Consolidated obligations:			
Bonds	\$ 76,725,689	\$ 1,420,795	\$ 75,304,894
Discount notes	30,676,746	(38,013)	30,714,759
Interest rate exchange agreements associated with consolidated obligations	—	(1,214,172)	1,214,172
Consolidated obligations, net	107,402,435	168,610	107,233,825
Deposits	326,953	(7)	326,960
Accrued interest payable	2,606,541	—	2,606,541
Other liabilities	136,226	—	136,226
Interest rate exchange agreements in which the Bank is an intermediary	1,493	533	960
<b>Total</b>	<b>\$110,473,648</b>	<b>\$ 169,136</b>	<b>\$110,304,512</b>

## Notes to Financial Statements

### Fair Value of Financial Instruments – 1998

	Carrying Value	Net Unrealized Gains (Losses)	Estimated Fair Value
<i>Assets</i>			
Cash and due from banks	\$ 2,707	\$ —	\$ 2,707
Interest-bearing deposits in banks	402,000	—	402,000
Federal funds sold	4,894,000	—	4,894,000
Resale agreements	2,226,625	162	2,226,787
Interest rate exchange agreements associated with resale agreements	—	(4)	(4)
Resale agreements, net	2,226,625	158	2,226,783
Investments held to maturity	7,973,097	38,141	8,011,238
Interest rate exchange agreements associated with investments held to maturity	714	(23,133)	(22,419)
Investments held to maturity, net	7,973,811	15,008	7,988,819
Advances to members	63,989,305	353,207	64,342,512
Interest rate exchange agreements associated with advances to members	—	(238,948)	(238,948)
Advances to members, net	63,989,305	114,259	64,103,564
Accrued interest receivable	1,521,982	—	1,521,982
Other assets	113,473	—	113,473
<b>Total</b>	<b>\$81,123,903</b>	<b>\$ 129,425</b>	<b>\$81,253,328</b>
<i>Liabilities</i>			
Consolidated obligations:			
Bonds	\$62,438,924	\$(104,013)	\$ 2,542,937
Discount notes	11,539,320	(14,917)	11,554,237
Interest rate exchange agreements associated with consolidated obligations	(17,643)	15,389	(33,032)
Consolidated obligations, net	73,960,601	(103,541)	74,064,142
Deposits	478,215	(111)	478,326
Securities sold under agreements to repurchase	150,000	—	150,000
Other borrowings	156,111	—	156,111
Accrued interest payable	1,819,720	—	1,819,720
Other liabilities	120,673	—	120,673
Interest rate exchange agreements in which the Bank is an intermediary	3,281	3,241	40
<b>Total</b>	<b>\$76,688,601</b>	<b>\$(100,411)</b>	<b>\$76,789,012</b>

## Notes to Financial Statements

### Fair Value Supplemental Tables

The Bank enters into some interest rate swap agreements that a counterparty may cancel at its option. While the counterparty generally may exercise this option to cancel at any specified cancellation date, the movement of interest rates usually determines whether the option will be exercised. If the interest rate exchange agreement has a positive fair value from the

Bank's perspective, the counterparty is likely to exercise the option assuming interest rates and volatilities remain the same through the next cancellation date of the instrument. The following tables categorize interest rate swap agreements as non-cancelable, cancelable by the counterparty, and cancelable by the Bank:

### Fair Value Supplemental Table – 1999

Interest Rate Exchange Agreements (by class)	Notional Principal	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Interest rate swaps:					
Non-cancelable:					
Bank pays fixed, receives adjustable	\$ 22,460,523	\$ (1,493)	\$ 529,811	\$ (12,514)	\$ 515,804
Bank pays adjustable, receives fixed	46,640,398	—	7,902	(582,596)	(574,694)
Bank pays adjustable, receives adjustable	24,008,159	—	34,169	(38,362)	(4,193)
Cancelable by counterparty:					
Bank pays adjustable, receives fixed	27,059,000	—	530	(608,870)	(608,340)
Bank pays fixed, receives adjustable	2,808,500	—	31,176	(513)	30,663
Bank pays adjustable, receives adjustable	1,025,000	—	838	(19,048)	(18,210)
Cancelable by Bank:					
Bank pays fixed, receives adjustable	13,550	—	562	—	562
Subtotal	124,015,130	(1,493)	604,988	(1,261,903)	(658,408)
Interest rate caps purchased	37,360	183	—	(183)	—
<b>Total</b>	<b>\$124,052,490</b>	<b>\$(1,310)</b>	<b>\$604,988</b>	<b>\$(1,262,086)</b>	<b>\$(658,408)</b>

### Fair Value Supplemental Table – 1998

Interest Rate Exchange Agreements (by class)	Notional Principal	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Interest rate swaps:					
Non-cancelable:					
Bank pays fixed, receives adjustable	\$ 27,045,205	\$ 3,917	\$ 25,088	\$ (244,737)	\$(215,732)
Bank pays adjustable, receives fixed	19,616,800	46	136,615	(16,487)	120,174
Bank pays adjustable, receives adjustable	30,507,587	—	16,029	(54,680)	(38,651)
Cancelable by counterparty:					
Bank pays adjustable, receives fixed	27,000,000	—	52,587	(47,831)	4,756
Bank pays fixed, receives adjustable	6,187,000	—	485	(109,361)	(108,876)
Bank pays adjustable, receives adjustable	1,315,000	—	226	(1,200)	(974)
Cancelable by Bank:					
Bank pays fixed, receives adjustable	166,200	—	22	(2,938)	(2,916)
Subtotal	111,837,792	3,963	231,052	(477,234)	(242,219)
Interest rate caps purchased	537,360	9,409	—	(6,000)	3,409
Interest rate floors purchased	1,100,000	1,704	8,727	—	10,431
<b>Total</b>	<b>\$113,475,152</b>	<b>\$15,076</b>	<b>\$239,779</b>	<b>\$(483,234)</b>	<b>\$(228,379)</b>

**Note 14 – Commitments and Contingencies**

As indicated in Note 9, all FHLBanks have joint and several liability for the consolidated obligations issued by the Finance Board. Accordingly, should one or more of the FHLBanks be unable to repay its participation in the consolidated obligations, the other FHLBanks could be called upon to repay all or a portion of such obligations.

Commitments that legally bind and obligate the Bank for additional advances totaled approximately \$206,000 and \$1,100,487 at December 31, 1999 and 1998, respectively. Commitments generally are for periods up to 12 months. Outstanding standby letters of credit were approximately \$824,537 and \$1,197,681 at December 31, 1999 and 1998, respectively. Based on management's credit analyses and collateral requirements, no allowance for losses is deemed necessary by management on these advance commitments and letters of credit. Advances funded under these advance commitments and letters of credit are fully collateralized at the time of issuance in a manner consistent with advances to members (see Note 5).

These credit-related financial instruments have off-balance sheet risk, which is essentially the same as that involved in extending advances to members. The credit risk amounts are equal to the notional amounts of the transactions assuming that the members completely fail to meet their obligations and the collateral or other security is of no value.

The Bank executes interest rate exchange agreements with major banks and broker-dealers that have a long-term credit ratings of single-A or better from both Standard & Poor's and Moody's. The Bank enters into bilateral security agreements with all counterparties. As of December 31, 1999 and 1998, the

Bank had pledged as collateral securities of \$638,600 and \$181,000, respectively, to broker-dealers that have credit risk exposure to the Bank related to interest rate exchange agreements.

The Bank charged operating expenses net rental costs of approximately \$2,047, \$388, and \$369 for the years ending December 31, 1999, 1998, and 1997. Future minimum rentals at December 31, 1999, were as follows:

Year	Premises	Equipment	Total
2000	\$ 2,606	\$255	\$ 2,861
2001	2,623	31	2,654
2002	2,811	25	2,836
2003	2,811	14	2,825
2004	2,942	—	2,942
Thereafter	14,016	—	14,016
<b>Total</b>	<b>\$27,809</b>	<b>\$325</b>	<b>\$28,134</b>

Lease agreements for Bank 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 Bank's financial condition or results of operation.

The Bank is subject to various pending legal proceedings arising in the normal course of business. After consultation with legal counsel, management does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on the Bank's financial condition or results of operations.

Other commitments and contingencies are discussed in Notes 6, 9, 10, and 12.

To the Board of Directors and Shareholders  
of the Federal Home Loan Bank of San Francisco:

In our opinion, the accompanying statements of condition and the related statements of income, of capital accounts and of cash flows present fairly, in all material respects, the financial position of the Federal Home Loan Bank of San Francisco (the Bank) at December 31, 1999 and 1998, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the Bank's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which 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 the opinion expressed above.



San Francisco, California

February 11, 2000

### Financial Statements

The management of the Federal Home Loan Bank of San Francisco (the Bank) prepared the financial statements contained in the Annual Report in accordance with generally accepted accounting principles. Management has primary responsibility for the integrity and objectivity of the financial statements, which include amounts that are based on management's best estimates and judgments. Other information in the Annual Report is consistent with that contained in the financial statements.

The Bank's financial statements have been audited by PricewaterhouseCoopers LLP, independent accountants approved by the Federal Housing Finance Board. Management has made available to PricewaterhouseCoopers LLP all the Bank's financial records and related data, as well as the minutes of the meetings of the Bank's Board of Directors. The report of the independent accountants expresses an opinion as to the fairness of the financial position and results of operations of the Bank based on their audit conducted in accordance with generally accepted auditing standards.

### Internal Control Systems

In meeting its responsibility for the integrity and objectivity of the financial statements, management of the Bank has established and relies upon a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. The system of internal controls provides for appropriate division of responsibility and is documented by written policies and procedures that are communicated to employees with significant roles in the financial reporting process. Management monitors the system of internal controls for compliance, adequacy, and cost-effectiveness. Management believes that as of December 31, 1999, the Bank's system of internal controls was adequate to accomplish the objectives discussed herein.

The Bank maintains an internal auditing program and the Federal Housing Finance Board performs an examination function that independently assess the effectiveness of the Bank's internal controls and recommend possible improvements thereto. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The Audit Committee of the Board of Directors is composed of independent directors and oversees the Bank's financial reporting and system of internal controls. In addition to meeting regularly with the Bank's management, the Committee met with the Bank's Director of Internal Audit, Federal Housing Finance Board examiners, and independent accountants, without management present,

to discuss the results of their audits, their evaluations of the system of internal controls, and the overall quality of the Bank's financial reporting.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system can change with circumstances.

The Bank assesses its internal control system in relation to, among other things, criteria for effective internal control over financial reporting described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the Bank believes that, as of December 31, 1999, its system of internal controls over financial reporting met those criteria.

### Code of Conduct

Management also recognizes its responsibility for fostering a strong ethical climate so that the Bank's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the Bank's code of corporate conduct, which is communicated to employees.



Dean Schultz  
*President and Chief Executive Officer*



Steven T. Honda  
*Senior Vice President and Chief Financial Officer*



Vera Maytum  
*Senior Vice President and Controller*

February 11, 2000