

Management's Discussion and Analysis

of Financial Condition and Results of Operations

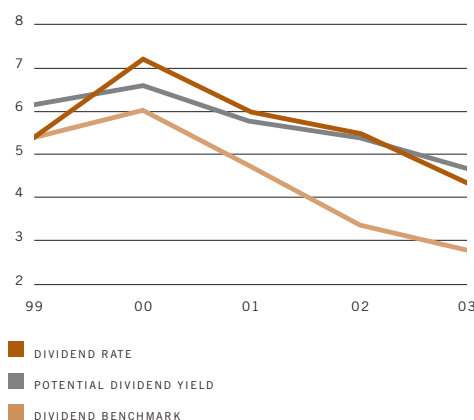
FINANCIAL PERFORMANCE

The Bank seeks to maintain a balance between its public policy mission and its ability to provide adequate returns on the capital supplied by its members. The Bank achieves this balance by delivering low-cost financing to help members meet the credit needs of their communities while paying members a market-rate dividend. Dividends that may be paid by the Bank are largely the result of the Bank's earnings on invested member capital. Net earnings on member credit, MBS, mortgage loans, and other investments are approximately equivalent to the Bank's operating expenses and assessments, with any excess potentially contributing to dividends.

The Bank's financial strategies are designed to enable the Bank to expand and contract its capital, assets, and liabilities in response to member credit needs and membership composition. The Bank invests member capital in high-quality, short- and intermediate-term financial assets. This strategy reduces the risk of market value loss if investments have to be liquidated for the redemption or repurchase of excess capital stock when a member reduces its use of Bank credit or withdraws from membership.

To measure its financial performance, the Bank compares the "potential dividend yield" on its capital stock to a dividend benchmark. The potential dividend yield is current period earnings (excluding fair value adjustments, as explained below, and advances prepayment fees, net of the amortization of current and prior period prepayment fees and other deferred items) as a percentage of capital stock. The dividend benchmark reflects the Bank's capital investment strategy and is calculated as the average of two yields: the daily average of the overnight Federal funds effective rate and the four-year moving average of the four-year Treasury note yield. The difference between the potential dividend yield and the dividend benchmark represents the potential financial return on the members' investment in Bank capital stock relative to the return on a comparable investment in Federal funds and intermediate-term Treasury investments.

DIVIDEND RATE, POTENTIAL DIVIDEND YIELD & DIVIDEND BENCHMARK (PERCENT)



The spread between the potential dividend yield and the dividend benchmark (dividend spread) was 191 basis points for 2003 compared to 201 basis points for 2002. The Bank's potential dividend yield was 4.70% for 2003, a decrease of 67 basis points from 5.37% for 2002. The dividend benchmark was 2.79% for 2003, a decrease of 57 basis points from 3.36% for 2002. The decrease in the potential dividend yield in 2003 was primarily due to the decline in market interest rates, as reflected in the dividend benchmark, coupled with lower average capital balances, which reduced the earnings on invested member capital. The decrease in the spread between the potential dividend yield and the dividend benchmark was due to the compression of profit spreads on the Bank's MBS and mortgage loan portfolios. This compression was caused by lower average interest rates during 2003, which led to accelerated principal prepayments and a higher rate of amortization of purchase premiums on mortgage-related assets.

RESULTS OF OPERATIONS

The following table presents average balances and yields of earning asset categories and the sources that fund those earning assets (liabilities and capital). 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 (interest-bearing liabilities plus capital plus other interest-free liabilities that fund earning assets).

The primary source of Bank earnings is net interest income, which is the interest earned on advances, mortgage loans,

investments, and invested capital less interest paid on consolidated obligations, deposits, and other borrowings. The net interest spread decreased slightly while the net interest margin decreased 4 basis points during 2003 compared to 2002, reflecting the 57-basis-point drop in the yield on invested capital and the commensurate effect on the net interest income component of the net interest margin. In contrast, the increase in the net interest spread and the net interest margin in 2002 compared to 2001 was primarily due to improved earnings from the Bank's MBS portfolio resulting from higher investment balances and profit spreads.

AVERAGE BALANCE SHEETS

(DOLLARS IN MILLIONS)	2003			2002			2001		
	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	AVERAGE RATE	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	AVERAGE RATE	AVERAGE BALANCE	INTEREST INCOME/ EXPENSE	AVERAGE RATE
Assets									
Interest-earning assets:									
Interest-bearing deposits in banks	\$ 3,681.3	\$ 44.0	1.19%	\$ 4,405.0	\$ 78.3	1.78%	\$ 3,636.0	\$ 142.4	3.92%
Resale agreements	2,605.6	30.0	1.15	2,731.8	47.9	1.75	1,544.9	63.9	4.14
Federal funds sold	6,808.8	77.9	1.14	6,787.9	119.2	1.76	8,436.0	349.3	4.14
Held-to-maturity securities:									
Other investments	2,212.9	30.2	1.36	3,353.9	64.3	1.92	3,688.0	156.8	4.25
MBS	14,418.5	550.5	3.82	14,394.8	777.1	5.40	11,208.3	684.7	6.11
Held-at-fair-value securities	829.8	31.4	3.79	513.3	10.8	2.10	584.3	27.7	4.74
Mortgage loans	2,971.7	138.5	4.66	31.6	1.6	5.07	—	—	—
Advances ¹	79,419.6	1,128.6	1.42	90,095.3	1,818.9	2.02	107,605.3	4,733.7	4.40
Deposits for mortgage loan program with other FHLBank	10.4	0.1	1.30	3.7	0.1	1.35	—	—	—
Loans to other FHLBanks	12.3	0.1	1.14	15.2	0.2	1.65	26.8	0.8	2.99
Total interest-earning assets	112,970.9	2,031.3	1.80	122,332.5	2,918.4	2.39	136,729.6	6,159.3	4.50
Other assets ²	2,596.5	—	—	2,860.2	—	—	2,382.4	—	—
Total Assets	\$115,567.4	\$2,031.3	1.76%	\$125,192.7	\$2,918.4	2.33%	\$139,112.0	\$6,159.3	4.43%
Liabilities and Capital									
Interest-bearing liabilities:									
Consolidated obligations:									
Bonds ¹	\$ 89,928.1	\$1,391.6	1.55%	\$ 99,395.1	\$2,082.6	2.10%	\$ 94,383.3	\$4,065.7	4.31%
Discount notes ¹	17,356.6	206.1	1.19	16,192.3	312.9	1.93	34,783.2	1,513.9	4.35
Deposits	416.6	3.5	0.85	503.3	7.2	1.43	480.2	16.0	3.33
Borrowings from other FHLBanks	0.5	0.0	1.20	3.8	0.1	2.60	2.1	0.1	3.80
Other borrowings	8.9	0.1	1.16	9.2	0.1	1.08	6.1	0.2	3.58
Total interest-bearing liabilities	107,710.7	1,601.3	1.49	116,103.7	2,402.9	2.07	129,654.9	5,595.9	4.32
Other liabilities ²	2,378.9	—	—	2,914.7	—	—	2,912.1	—	—
Total Liabilities	110,089.6	1,601.3	1.45	119,018.4	2,402.9	2.02	132,567.0	5,595.9	4.22
Capital	5,477.8	—	—	6,174.3	—	—	6,545.0	—	—
Total Liabilities and Capital	\$115,567.4	\$1,601.3	1.39%	\$125,192.7	\$2,402.9	1.92%	\$139,112.0	\$5,595.9	4.02%
Net Interest Income		<u>\$ 430.0</u>			<u>\$ 515.5</u>			<u>\$ 563.4</u>	
Net Interest Spread			<u>0.31%</u>			<u>0.32%</u>			<u>0.19%</u>
Net Interest Margin³			<u>0.38%</u>			<u>0.42%</u>			<u>0.41%</u>
Total Average Assets/Capital Ratio	<u>21.1x</u>			<u>20.3x</u>			<u>21.3x</u>		
Interest-Bearing Assets/ Interest-Bearing Liabilities	<u>1.0x</u>			<u>1.1x</u>			<u>1.1x</u>		

¹ Interest income/expense and average rates include the effect of associated interest rate exchange agreements.

² Includes forward settling transactions and fair value adjustments in accordance with SFAS 133 for hedged cash items.

³ Net interest margin is net interest income divided by average interest-earning assets.

Changes in both volume and interest rates influence changes in net interest income and the net interest margin. The following table details the changes in interest income and interest expense.

**CHANGE IN NET INTEREST INCOME: RATE/VOLUME ANALYSIS
2003 COMPARED TO 2002**

(IN MILLIONS)	(DECREASE)/ INCREASE	ATTRIBUTABLE TO CHANGES IN ¹	
		AVERAGE VOLUME	AVERAGE RATE
Interest-earning assets:			
Interest-bearing deposits			
in banks	\$ (34.3)	\$ (8.8)	\$ (25.5)
Resale agreements	(17.9)	(1.6)	(16.3)
Federal funds sold	(41.3)	0.5	(41.8)
Held-to-maturity securities:			
MBS	(226.7)	1.3	(228.0)
Other securities	(34.1)	(15.8)	(18.3)
Held-at-fair-value securities	20.7	11.7	9.0
Mortgage loans	136.9	137.6	(0.7)
Advances ²	(690.3)	(155.6)	(534.7)
Loans to other FHLBanks	(0.1)	—	(0.1)
Total interest-earning assets	(887.1)	(30.7)	(856.4)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds ²	(691.0)	(150.0)	(541.0)
Discount notes ²	(106.8)	13.0	(119.8)
Deposits	(3.7)	(0.8)	(2.9)
Borrowings from other FHLBanks	(0.1)	—	(0.1)
Total interest-bearing liabilities	(801.6)	(137.8)	(663.8)
Net interest income before mortgage loan loss provision	\$ (85.5)	\$ 107.1	\$(192.6)

¹ Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.

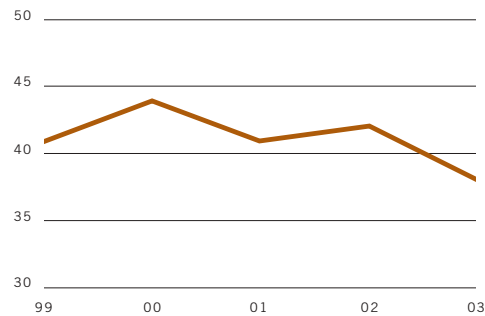
² Interest income/expense and average rates include the interest effect of associated interest rate exchange agreements.

Net Interest Income. Net interest income before mortgage loan loss provision was \$430.0 million in 2003, a decrease of \$85.5 million, or 17%, from \$515.5 million in 2002. The decrease was primarily due to the impact of the lower interest rate environment during 2003, coupled with lower average capital balances, which reduced earnings on invested capital. Lower average interest rates in 2003 also resulted in faster prepayment rates and a higher rate of purchase premium amortization, reducing earnings on the Bank's MBS and mortgage loan portfolios.

To a lesser degree, lower average balances and narrower profit spreads on advances and non-MBS investments contributed to the decline in net interest income. The net interest margin in 2003 decreased 4 basis points to 38 basis points compared to 42 basis points in 2002. The average yield on interest-earning assets in 2003 was 1.80%, compared to 2.39% in 2002, a decrease of 59 basis points. The average cost of interest-bearing liabilities in 2003 was 1.49%, compared to 2.07% in 2002, a decrease of 58 basis points.

As discussed in Note 1 to the Financial Statements on page 54, the Bank reclassified realized gains and losses on stand-alone derivative instruments used in economic hedges from net interest income to other income, increasing net interest income and decreasing other income by \$19.6 million in 2002 and \$9.1 million in 2001, respectively.

**NET INTEREST MARGIN
(BASIS POINTS)**



Other Income/(Loss). Other income/(loss) was a net gain of \$69.9 million in 2003, an increase of \$117.2 million compared to a net loss of \$47.3 million in 2002. This increase was primarily due to fair value adjustments associated with derivatives and hedging activities in accordance with Statement of Financial Accounting Standard (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* on January 1, 2001, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* on July 31, 2003 (together referred to as "SFAS 133").

Under SFAS 133, the Bank is required to carry all of its derivative instruments on the balance sheet at fair value. If derivatives meet the hedging criteria (including effectiveness measures) specified in SFAS 133, the underlying hedged instruments may also be carried at fair value, so that some or all of the unrealized gain or loss recognized on the derivative is offset by a corresponding unrealized gain or loss on the underlying hedged instrument. The unrealized gain or loss on the ineffective portion of all hedges is recognized in current period earnings. During 2003, this resulted in a net gain of \$65.3 million, an increase of \$148.3, compared to a net loss of \$83.0 million in 2002.

The majority of the gain in 2003 and loss in 2002 was attributable to changes in the net fair value of the portfolio of callable bonds that have offsetting callable interest rate swaps. The net gain in 2003 reflects the lower net costs of the outstanding callable bonds and swaps compared to the higher net cost of new market-rate callable bond and swap issuances. The net gain also reflects the general rise in interest rates during the second half of 2003, which resulted in the extension of the expected lives of the callable consolidated obligations and callable swaps compared to the lives expected at the time the swapped callable bonds were originally issued. The net loss in 2002 primarily reflected a reversal of the unrealized gains in 2001 on the portfolio of swapped callable bonds. The 2001 gains on the swapped callable bonds were reversed in 2002 as a result of the generally falling interest rate environment during 2002,

which resulted in shorter expected lives compared to the expected lives of the swapped callable bonds at yearend 2001. In addition, prepayment fees increased \$6.5 million to \$15.5 million in 2003 from \$9.0 million in 2002; members prepaid \$3.6 billion of advances in 2003, compared to \$7.5 billion in 2002. The decline in interest rates during 2003 contributed to the relatively higher prepayment fees collected in 2003.

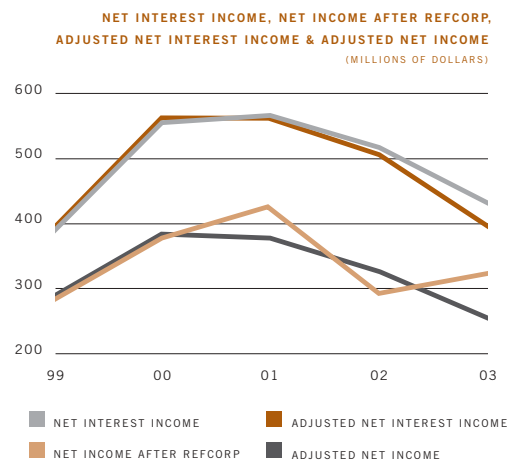
Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will reverse over the remaining contractual terms to maturity of the hedged financial instruments and associated interest rate exchange agreements.

Other income includes the amortization of deferred gains resulting from the 1999 sale of the Bank's office building in San Francisco, which totaled \$2.1 million in both 2003 and 2002. The remaining unamortized amount of the deferred gain on the sale of the building at December 31, 2003, was \$11.2 million. In addition, fees earned on standby letters of credit were \$1.3 million and \$1.4 million for the years ended December 31, 2003, and 2002, respectively.

Other Expenses. Other expenses were \$60.5 million in 2003, a decrease of \$9.9 million, or 14%, from \$70.4 million in 2002. The decrease was primarily due to a \$9.4 million non-recurring charge recognized in 2002, which resulted from a final court order confirming an arbitration decision that awarded a member a refund of \$7.9 million in prepayment fees paid to the Bank in 1998 plus interest.

Operating expenses were \$54.0 million in 2003, essentially flat compared to the prior year.

REFCORP and AHP Assessments. The Bank's REFCORP assessment was \$80.8 million in 2003 compared to \$73.0 million in 2002, reflecting higher earnings in 2003. Each FHLBank is required to pay 20% of net earnings (after AHP contributions) to REFCORP. The FHLBanks' aggregate payments in 2003 shortened the remaining term of the REFCORP obligation to the third quarter of 2020. The Bank set aside \$35.9 million for the AHP in 2003, compared to \$32.5 million in 2002, reflecting higher earnings in 2003. 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 the assessment for REFCORP. 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 shortfall for 2003, 2002, or 2001. The Bank's total REFCORP and AHP assessments equaled \$116.7 million in 2003, compared with \$105.5 million in 2002. The combined assessments in 2003 and 2002 reflect the Bank's effective "tax" rate on pre-assessment income of 27%.



Net Income. Net income was \$323.0 million in 2003, an increase of \$30.8 million, or 11%, from \$292.2 million in 2002, and return on equity (ROE) was 5.90% in 2003, an increase of 117 basis points from 4.73% in 2002. These increases were primarily due to the increase in other income resulting from the fair value adjustments associated with SFAS 133, partially offset by the decline in net interest income.

Adjusted Financial Performance. The Bank uses adjusted financial performance measures to provide comparisons of the Bank's performance over time and to provide members with an enhanced understanding of the Bank's economic performance. These measures are not intended to be a presentation in accordance with GAAP. Adjusted financial performance measures exclude the effects of any current period fair value changes (net of applicable assessments) made in accordance with SFAS 133 and fair value adjustments on held-at-fair-value securities reclassified from held-to-maturity securities upon the adoption of SFAS 133 because these effects are generally expected to reverse over the remaining lives of the hedged assets, hedged liabilities, and derivatives. Adjusted financial performance measures also reflect earnings before advance prepayment fees and certain other gains and losses associated with advance prepayments (including certain gains and losses associated with the early retirement of debt), net of the current amortization of current and prior period prepayment fees and other deferred items, in accordance with the Bank's Retained Earnings and Dividend Policy. We make these adjustments in order to recognize prepayment fees, debt retirement gains and losses, and other transactions over the periods remaining through the related instruments' original maturity dates.

In addition to the above, adjusted net interest income includes the net interest payments on stand-alone derivative instruments used in economic hedges that are recorded in "Net gain/(loss) on derivatives and hedging activities" in other income.

Adjusted net income was \$251.8 million, a decrease of \$72.5 million or 22% from \$324.3 million in 2002. Adjusted net interest income was \$391.5 million, a decrease of \$112.1 million, or 22%, from \$503.6 million. Adjusted ROE was 4.60%, a decrease of 70 basis points from 5.30% in 2002. These decreases were primarily due to the decline in market interest rates, which, coupled with lower average capital balances, decreased earnings on invested member capital. Lower average interest rates in 2003 also resulted in faster prepayment rates and a higher rate of purchase premium amortization, reducing earnings on the Bank's MBS and mortgage loan portfolios.

ADJUSTED ANNUAL OPERATING RESULTS AND OTHER NON-GAAP FINANCIAL MEASURES

(DOLLARS IN MILLIONS)	2003	2002	2001
Adjusted net income	\$252	\$324	\$376
Adjusted net interest margin	0.35%	0.41%	0.41%
Adjusted return on average assets	0.22	0.26	0.27
Adjusted return on average equity	4.60	5.30	5.75
Potential dividend yield	4.70	5.37	5.80
Dividend benchmark	2.79	3.36	4.69
Spread of potential dividend yield to dividend benchmark	1.91	2.01	1.11

RECONCILIATION OF NET INTEREST INCOME TO ADJUSTED NET INTEREST INCOME

(IN MILLIONS)	2003	2002	2001
Net interest income	\$430	\$515	\$563
Amortization of deferred advance prepayments fees	8	7	5
Amortization of realized basis adjustments	(2)	1	—
Net interest expense on economic hedges	(44)	(19)	(9)
Adjusted net interest income	\$392	\$504	\$559

RECONCILIATION OF NET INCOME TO ADJUSTED NET INCOME

(IN MILLIONS)	2003	2002	2001
Net income	\$323	\$292	\$425
Net loss/(gain) on held-at-fair-value securities	11	(17)	(6)
Net (gain)/loss on derivatives and hedging activities	(80)	47	(47)
Amortization of realized basis adjustments	2	2	1
Cumulative effect of adopting SFAS 133	—	—	2
Deferred advance prepayment fees, net	(4)	—	1
Adjusted net income	\$252	\$324	\$376

Dividends. The Bank's annual dividend rate was 4.29% for 2003, compared to 5.45% in 2002. The decline in the dividend rate was primarily due to the decline in net interest income. As discussed below, the Bank also retained \$22.0 million in 2003 to provide for a build-up of retained earnings, which reduced the annual dividend rate by 41 basis points.

The Bank's Retained Earnings and Dividend Policy establishes the amounts to be retained in restricted retained earnings, subject to the dividend resolution adopted by the Board of Directors for each dividend period. In accordance with this policy, the Bank may be restricted from paying dividends if the Bank is not in compliance with any of its minimum capital requirements or if payment would cause the Bank to fail to meet any of its minimum capital requirements. In addition, the Bank will not pay dividends if any principal or interest due on any consolidated obligations has not been paid in full, or, under certain circumstances, if the Bank fails to satisfy certain liquidity requirements under applicable Finance Board regulations.

In accordance with the Retained Earnings and Dividend Policy, the Bank restricts retained earnings for that portion of income from prepayment fees that, if allocated on a pro rata basis over the original term to maturity of the advances prepaid, would be allocated to future dividend periods. Other gains and losses related to the termination of interest rate exchange agreements and early retirement of consolidated obligations associated with the prepaid advances are similarly treated. Retained earnings restricted in accordance with this provision totaled \$10.1 million and \$6.6 million at December 31, 2003 and 2002, respectively.

Also in accordance with the Retained Earnings and Dividend Policy, the Bank retains in restricted retained earnings any cumulative net gains in earnings (net of applicable assessments) and any cumulative net gains in other comprehensive income resulting from SFAS 133. Retained earnings restricted in accordance with this provision totaled \$86.7 million and \$18.8 million at December 31, 2003 and 2002, respectively.

Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will reverse over the remaining contractual terms to maturity of the hedged financial instruments and associated interest rate exchange agreements. Restricted retained earnings will be adjusted as these cumulative net unrealized gains are reversed, resulting in substantially the same potential dividend payout as there would have been without the effects of SFAS 133, provided that the cumulative net effect of SFAS 133 since inception is a net gain. If the cumulative net effect of SFAS 133 since inception is a net loss, however, the Bank's retained earnings in the future may not be sufficient to offset the full impact of SFAS 133. As a result, the future effects of SFAS 133 may cause the Bank to reduce or temporarily suspend paying dividends.

Effective April 1, 2003, the Board of Directors amended the Retained Earnings and Dividend Policy to provide for an additional build-up of retained earnings totaling \$50.0 million (less any cumulative net fair value losses in net income resulting from SFAS 133, with a floor of zero) over seven quarters beginning in the second quarter of 2003. At December 31, 2003, the retained earnings restricted in accordance with this provision totaled \$22.0 million. The Finance Board recently provided guidance to the FHLBanks requiring an analysis of the adequacy of their retained earnings and a plan to achieve a target level of retained earnings. Effective January 30, 2004, the Board of Directors further amended this provision of the Retained Earnings and Dividend Policy to provide for a build-up of retained earnings totaling \$100.0 million (less any cumulative net fair value losses in net income resulting from SFAS 133, with a floor of zero) by the end of 2006.

The Bank's Board of Directors may declare and pay dividends only from retained earnings or current net earnings. There is no requirement that the Bank declare and pay any dividend. A decision by the Bank's Board of Directors to declare or not declare a dividend is a purely discretionary matter and is subject to the requirements and restrictions of the FHLB Act and applicable Finance Board requirements and guidance.

All dividends except fractional shares were paid in the form of capital stock. The Bank has historically paid dividends, if declared, in stock form and intends to continue this practice.

Comparison of 2002 to 2001. Net income was \$292.2 million in 2002, a decrease of \$132.4 million, or 31%, from \$424.6 million in 2001, and ROE was 4.73% in 2002, a decrease of 176 basis points from 6.49% in 2001. Net interest income was \$515.3 million in 2002, a decrease of \$48.1 million, or 9%, from \$563.4 million in 2001. The decreases were primarily due to lower earnings on invested member capital resulting from lower interest rates in 2002 compared to 2001 and lower member capital, and, to a lesser degree, lower average balances and narrower profit spreads on advances. These decreases were partially offset by improved earnings from the Bank's MBS portfolio in 2002 resulting from higher investment balances and profit spreads.

CHANGE IN NET INTEREST INCOME: RATE/VOLUME ANALYSIS 2002 COMPARED TO 2001

(IN MILLIONS)	(DECREASE)/ INCREASE	ATTRIBUTABLE TO CHANGES IN ¹	
		AVERAGE VOLUME	AVERAGE RATE
Interest-earning assets:			
Interest-bearing deposits			
in banks	\$ (64.1)	\$ 12.2	\$ (76.3)
Resale agreements	(16.0)	20.4	(36.4)
Federal funds sold	(230.1)	(33.7)	(196.4)
Held-to-maturity securities:			
MBS	92.4	172.7	(80.3)
Other securities	(92.5)	(8.1)	(84.4)
Held-at-fair-value securities	(16.9)	(1.9)	(15.0)
Mortgage loans	1.6	1.5	0.1
Advances ²	(2,914.7)	(413.0)	(2,501.7)
Loans to other FHLBanks	(0.6)	(0.1)	(0.5)
Total interest-earning assets	(3,240.9)	(250.0)	(2,990.9)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds ²	(1,983.1)	32.4	(2,015.5)
Discount notes ²	(1,201.0)	(386.6)	(814.4)
Deposits	(8.8)	0.1	(8.9)
Other borrowings	(0.1)	—	(0.1)
Total interest-bearing liabilities	(3,193.0)	(354.1)	(2,838.9)
Net interest income before mortgage loan loss provision	\$ (47.9)	\$ 104.1	\$ (152.0)

¹ Combined rate/volume variances, a third element of the calculation, are allocated to the rate and volume variances based on their relative size.

² Interest income/expense and average rates include the interest effect of associated interest rate exchange agreements.

Other (loss)/income was a net loss of \$47.3 million in 2002, a decrease of \$119.7 million compared to other income of \$72.4 million in 2001. This decrease was primarily due to fair value adjustments associated with derivatives and hedging activities in accordance with SFAS 133. These fair value adjustments decreased \$138.0 million, from a net gain of \$55.0 million in 2001 to a net loss of \$83.0 million in 2002. The majority of the loss in 2002 and the gain in 2001 was attributable to changes in the net fair value of the portfolio of callable bonds that have matching callable interest rate swaps. The net loss in 2002 primarily reflected a reversal of the unrealized gains in 2001 on the portfolio of swapped callable bonds. The 2001 gains on the swapped callable bonds were reversed in 2002 as a result of the general falling interest rate environment during 2002, which resulted in shorter expected lives for the callable bonds and swaps when compared to the expected lives of the swapped callable bonds at yearend 2001. This decrease was partially offset by an increase of \$15.1 million resulting from fair value adjustments related to the Bank's held-at-fair-value securities and an increase of \$3.1 million in prepayment fees, as members prepaid \$7.5 billion of advances in 2002 compared to \$1.9 billion in 2001.

Other expenses were \$70.4 million in 2002, an increase of \$14.9 million, or 27%, from \$55.5 million in 2001. This increase primarily resulted from a final court order in 2002 confirming an arbitration decision awarding a member a refund of \$7.9 million in prepayment fees paid to the Bank in 1998 plus interest for a total amount of \$9.4 million. The increase in operating expenses was primarily the result of higher compensation and benefits, \$33.3 million in 2002 compared to \$27.7 million in 2001, reflecting general pay increases and an increase in pension and health care insurance costs.

The Bank's REFCORP assessment was \$73.0 million in 2002 compared to \$106.1 million in 2001, reflecting lower earnings in 2002. The FHLBanks' payments in 2002 shortened the remaining term of the REFCORP obligation to the third quarter of 2021. The Bank set aside \$32.5 million for the AHP in 2002, compared to \$47.2 million in 2001, reflecting lower earnings in 2002. The Bank's total REFCORP and AHP assessments equaled \$105.5 million in 2002, compared with \$153.3 million in 2001. The combined assessments reflected the Bank's 2002 and 2001 effective "tax" rate on pre-assessment income of 27%.

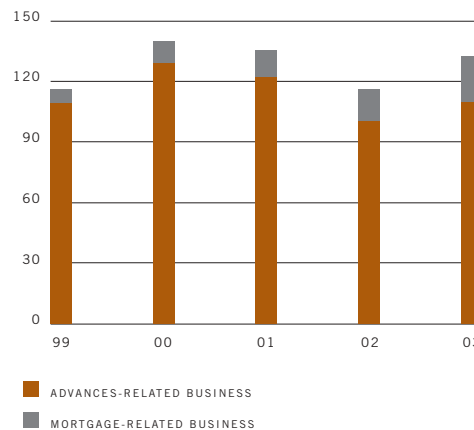
Adjusted net income was \$324.3 million, a decrease of \$51.6 million or 14%, from \$375.9 million in 2001. Adjusted net interest income was \$503.6 million, a decrease of \$55.9 million or 10% from \$559.5 million. Adjusted ROE was 5.30%, a decrease of 45 basis points from 5.75% in 2001, primarily because of lower earnings on member capital resulting from the significant decline in interest rates in 2002, partially offset by improved earnings from the Bank's MBS portfolio, which resulted from higher investment balances and profit spreads.

The Bank's annual dividend rate was 5.45% for 2002, compared to 5.99% in 2001. The decline in the dividend rate was primarily attributable to lower earnings on member capital resulting from the lower interest rate environment in 2002, partially offset by improved earnings from the Bank's MBS portfolio resulting from higher investment balances and profit spreads. All dividends except fractional shares were paid in the form of capital stock.

FINANCIAL CONDITION

Total assets were \$132.4 billion at December 31, 2003, an increase of \$16.3 billion, or 14%, from \$116.1 billion at December 31, 2002. Average total assets were \$115.6 billion in 2003, a decrease of \$9.6 billion, or 8%, compared to \$125.2 billion in 2002.

YEAREND ASSET LEVELS
(BILLIONS OF DOLLARS)



SEGMENT INFORMATION

Management analyzes financial performance based on the net interest income of two operating segments: the advances-related business and the mortgage-related business.

Advances-Related Business. The advances-related business consists of advances to members, related financing and hedging instruments, liquidity and other non-MBS investments (which are associated with the Bank's role as a liquidity provider) and member capital. Net interest income for this segment, including the cash flows from associated interest rate exchange agreements, was \$279.5 million in 2003, a decrease of \$81.0 million, or 22%, from \$360.5 million in 2002. This decrease was primarily due to the lower interest rate environment in 2003 relative to 2002 and lower member capital, which resulted in lower earnings on member capital, and to a lesser degree, lower balances and narrower profit spreads on advances. The balance of total assets associated with this segment increased to \$109.6 billion, an increase of \$9.7 billion, or 10%, from \$99.9 billion. This segment represented 72% and 73% of total Bank net interest income, including the cash flows from associated interest rate exchange agreements, for 2003 and 2002, respectively.

Advances – Advances outstanding increased \$11.1 billion, or 14%, in 2003, to \$92.3 billion at December 31, 2003, from \$81.2 billion at December 31, 2002. Average advances were \$79.4 billion in 2003, a decrease of \$10.7 billion, or 12%, from \$90.1 billion in 2002. Advances outstanding at December 31, 2003 and 2002, included fair value adjustments of \$0.4 billion and \$1.0 billion, respectively.

The increase in advances outstanding at yearend was primarily the result of a broad-based increase in demand from members of all sizes and charter types, combined with an increase in borrowings by several large members to fund asset growth in the second half of the year. The Bank's largest members accounted for close to one-third of the increase. In total, 156 members increased their advance borrowings during the year, while 65 members decreased their advance borrowings.

The decrease in average advances reflected fluctuations in advance levels throughout the year, influenced by changes in members' balance sheets, particularly those of the largest members. Advance levels declined by \$9.4 billion in the first half of the year, as retail deposit growth and mortgage escrows at some member institutions surged ahead of asset growth. Advances then grew by \$21.1 billion in the second half of the year, when mortgage originations and the growth of other assets outpaced deposit growth at the Bank's largest members.

The composition of advances shifted during the year, as well. Short-term fixed rate advances grew by \$19.4 billion, to \$28.9 billion at December 31, 2003, while long-term fixed rate advances decreased by \$13.0 billion, to \$22.6 billion at December 31, 2003. Short-term adjustable rate advances grew by \$1.7 billion, to \$4.7 billion at yearend, and long-term adjustable rate advances grew by \$3.5 billion, to \$35.7 billion at yearend.

Demand for new term advances (advances with terms greater than one day) grew considerably in 2003 relative to the prior year. New term advances totaled \$172.3 billion in 2003, compared to \$87.5 billion in 2002. The demand for advances with terms of up to one year doubled, from \$72.2 billion in 2002 to \$146.7 billion in 2003. While demand for new advances with terms greater than one year and up to two years declined by \$2.6 billion, or 40%, from \$6.6 billion in 2002 to \$4.0 billion in 2003, demand for new advances with terms greater than two years grew by \$13.0 billion, or 150%, to a total of \$21.6 billion in 2003, compared to \$8.6 billion in 2002. Most of this growth in demand was in long-term adjustable rate advances.

Non-MBS Investments – The Bank's total non-MBS investment portfolio decreased \$1.0 billion in 2003 to \$16.7 billion as of December 31, 2003, from \$17.7 billion as of December 31, 2002. During 2003, interest-bearing deposits in banks decreased \$1.5 billion, Federal funds sold decreased \$0.6 billion, and commercial paper decreased \$0.3 billion, while resale agreements increased \$0.7 billion and housing finance agency bonds increased \$0.7 billion. Non-MBS investments other than housing finance agency bonds generally have terms to maturity of three months or less to facilitate the Bank's role as a cost-effective provider of credit and liquidity to members.

Borrowings – Consistent with the increase in advances, total consolidated obligations funding the advances-related business increased \$9.6 billion, or 10%, in 2003, to \$103.8 billion at December 31, 2003, from \$94.2 billion at December 31, 2002.

To meet the specific needs of certain investors, fixed and adjustable rate consolidated obligation bonds may contain embedded call options or other features that result in complex coupon payment terms. When such consolidated obligation bonds are issued, the Bank typically enters into interest rate exchange agreements simultaneously with features that offset the complex features of the bonds and, in effect, convert the bonds to conventional adjustable rate instruments tied to an index, primarily the London Interbank Offered Rate (LIBOR). During 2003 and 2002, the Bank used fixed rate callable bonds that were usually offset with interest rate exchange agreements with call features offsetting the call options embedded in the callable bond. This combined financing structure enabled the Bank to meet its funding needs at costs not generally attainable solely through the issuance of non-callable debt. The Bank also uses fixed rate callable bonds to finance fixed rate callable advances.

The notional amount of interest rate exchange agreements associated with the advances-related business totaled \$119.8 billion, of which \$46.9 were hedging the advances and \$72.9 billion were hedging the consolidated obligations funding the advances.

FHLBank System consolidated obligation discount notes and bonds, along with similar debt securities issued by other GSEs such as Fannie Mae and Freddie Mac, are generally referred to as agency debt. The agency debt market is a large and growing sector of the debt capital markets. The relative cost of FHLBank System consolidated obligation bonds and discount notes compared to market benchmark rates such as LIBOR has risen modestly over the past two years because of several factors. These factors include continued strong growth in the supply of agency debt as a result of the growth of all major GSE debt issuers; the overall decline in short- and intermediate-term rates, which tends to compress the differences between agency debt costs and other market rates; increased issuance of intermediate-term Treasury securities, which tends to push up and also compress the differences between market rates for comparable term securities of other debt issuers, including the GSEs; and increased demand for receive-fixed interest rate swaps by end-users of derivatives, which contributed to compression of the difference between intermediate-term agency debt costs and interest rate swap rates. In addition, beginning in June 2003, the cost of consolidated obligation bonds was further adversely impacted by events that affected all of the housing GSEs: the accounting restatements and related management changes at Freddie Mac, the losses announced by some FHLBanks, and the uncertainty caused by the debate within the federal government regarding the proper oversight and regulatory structure for the housing GSEs.

The sectors of FHLBank System consolidated obligation bonds that experienced the largest increase in relative cost over the past two years were intermediate-term non-callable bonds and intermediate-term callable bonds. In the past two years, the cost of intermediate-term non-callable bonds relative to LIBOR increased 0.05% to 0.10% (5 to 10 basis points), and the cost of intermediate term callable bonds relative to LIBOR increased 0.05% to 0.07% (5 to 7 basis points). The increases in the relative costs of these types of consolidated obligation bonds has resulted in modest compression in the profit spreads earned on intermediate-term advances to members, modest increases in the rates for intermediate-term advances offered to members, and modest compression in the profit spreads earned on investments. At December 31, 2003, the Bank had \$26.2 billion of swapped intermediate-term fixed rate non-callable bonds and \$27.5 billion of swapped callable bonds that primarily funded advances and non-MBS investments. These swapped non-callable and callable bonds combined represented 58% of the Bank's total consolidated bonds outstanding. The cost of short-term discount notes relative to LIBOR has remained largely unchanged over the past two years; discount notes outstanding at December 31, 2003, were \$31.9 billion.

Mortgage-Related Business. The mortgage-related business consists of MBS investments, mortgage loans acquired through the MPF Program, and the consolidated obligations specifically identified as funding those assets and related hedging instruments. Net interest income for this segment is derived primarily from the difference, or spread, between the yield on the MBS securities and mortgage loans and the cost of the consolidated obligations funding those assets, including the cash flows from associated interest rate exchange agreements, less the provision for credit losses on mortgage loans. Net interest income was \$106.7 million in 2003, a decrease of \$28.6 million, or 21%, from \$135.3 million in 2002. The decrease was primarily due to the impact of the lower interest rate environment during 2003 that reduced earnings on the Bank's MBS and mortgage loan portfolios. Lower interest rates resulted in faster prepayment rates, which reduced the spread between earnings on mortgage assets and the related cost of funds and resulted in a higher rate of amortization of purchase premiums. This segment represented 28% and 27% of total Bank net interest income, including the cash flows from associated interest rate exchange agreements, in 2003 and 2002, respectively.

MPF Program – Under the MPF Program, the Bank buys qualifying conventional conforming and government-guaranteed fixed rate mortgage loans from members and pays them a monthly credit enhancement fee for managing the credit risk of the loans. The Bank may participate all or a portion of the loans it purchases to one or more of the other FHLBanks.

At December 31, 2003 and 2002, the Bank held conventional fixed rate conforming mortgage loans totaling \$6.5 billion and \$0.3 billion, respectively, which were purchased from eight and four participating member institutions, respectively. The growth in mortgage loans held was primarily due to purchases from two large sellers. The residential mortgage refinance activity that continued for much of 2003 contributed to the Bank's results for the MPF Program.

No mortgage loans were reported 90 days or more delinquent at December 31, 2003 and 2002; no loans were in foreclosure or classified as nonaccrual or impaired during 2003; and no allowance for loan losses on mortgage loans was deemed necessary by management as of December 31, 2003. Depending on the mortgage market and member demand, management expects to continue to grow the mortgage loan portfolio at a steady pace in 2004 within the Bank's risk management guidelines.

MBS Investments – The Bank's MBS portfolio increased 2% in 2003, to \$16.3 billion, or approximately 279% of capital, at December 31, 2003, from \$16.0 billion, or approximately 281% of capital, at December 31, 2002. During the year, the Bank purchased \$11.1 billion in MBS. However, as a result of declining interest rates during 2003, MBS principal run-off totaled \$10.8 billion. The small increases in the MBS portfolio and in member capital resulted in balances that continued to be slightly below the regulatory maximum authorized level of 300% of capital. Management expects to continue to invest at this level in the future subject to the availability of MBS that meet the Bank's credit risk, interest rate risk, and expected profitability parameters.

The fixed rate, long-term MBS investments are subject to prepayment risk, and the adjustable rate long-term MBS investments are subject to interest rate cap risk. The Bank has managed these risks by (1) funding the fixed rate MBS with non-callable and callable debt, and (2) purchasing certain MBS that are structured with interest rate exchange agreements, creating synthetic, floating rate assets that may have lifetime interest rate caps but do not have periodic interest rate caps. These financial strategies provide the Bank with a relatively stable net interest income stream over a range of interest rates.

Total consolidated obligations funding the mortgage-related business increased \$6.5 billion, or 40%, in 2003, to \$22.8 billion at December 31, 2003, from \$16.3 billion at December 31, 2002, paralleling the growth in mortgage loans during 2003.

In accordance with the provisions of SFAS 133, interest rate exchange agreements associated with held-to-maturity securities are non-hedge qualifying. The transition provisions of SFAS 133 allowed the Bank to transfer any securities classified as held-to-maturity to trading (or "held-at-fair-value"). The Bank transferred its portfolio of economically hedged MBS to the held-at-fair-value securities category on January 1, 2001, so that fair value gains or losses on these MBS will partly offset the losses or gains on the associated interest

rate exchange agreements. During 2003 and 2002, this designation allowed the Bank to mark certain MBS to fair value (for a \$15.4 million loss and a \$22.7 million gain, respectively) to offset the mark-to-fair value of the associated interest rate exchange agreements (a \$14.9 million gain and a \$26.2 million loss, respectively), for net losses of \$0.5 million and \$3.5 million, respectively.

The notional amount of interest rate exchange agreements associated with the mortgage-related business totaled \$7.0 billion, of which \$0.4 billion were hedging specific MBS classified as held-at-fair-value and \$6.6 billion were hedging the consolidated obligations funding the mortgage portfolio.

CAPITAL

Capital and Capital Ratios. Until the Bank implements its new capital plan on April 1, 2004, each member is required to hold Bank stock based on the amount of either (i) its residential mortgage loans or (ii) its outstanding Bank advances and mortgage loans sold to and held by the Bank. Average capital during 2003 was \$5.5 billion, an 11% decrease from \$6.2 billion in 2002. This decrease is consistent with the decline in average advances outstanding during 2003, primarily because of the Bank's surplus capital stock repurchase policy. Surplus capital is defined as any excess stock holdings above 115% of a member's minimum capital stock requirement, generally excluding stock dividends earned and credited for the current year. As advance balances declined during the first three quarters of 2003, the minimum capital stock requirements for many members declined as well. In accordance with this policy, the Bank repurchased \$1,502.9 million and \$1,687.7 million in surplus capital stock during 2003 and 2002, respectively.

Until an FHLBank implements its new capital plan, Finance Board regulations generally limit each FHLBank's assets to no more than 21 times capital unless the FHLBank has non-mortgage assets, after deducting deposits and capital, that do not exceed 11% of its assets. In that case, the FHLBank's total assets cannot exceed 25 times its capital. As of December 31, 2003 and 2002, the Bank's total assets to capital ratio was 22.6x and 20.4x, respectively, and its non-mortgage assets to total assets ratio was 6.5% and 9.8%, respectively. The Bank's advances and mortgage-related assets combined averaged 18.0 times capital and 17.3 times capital in 2003 and 2002, respectively. The Bank's non-mortgage investments and other non-interest-bearing, non-mortgage assets averaged 3.1 times capital and 3.0 times capital in 2003 and 2002, respectively. The Bank's average ratio of total assets to capital was 21.1x in 2003 compared to 20.3x in 2002. The 11%-of-assets limit that applies to non-mortgage assets when total assets exceed 21 times capital has not restricted the Bank's ability to maintain the target amount of liquid investments necessary to meet its operating needs and the liquidity and credit needs of members.

The GLB Act imposes new minimum leverage and risk-based capital requirements on the 12 FHLBanks and requires each FHLBank to implement a new capital structure to replace the current structure. The Bank's capital plan was approved by the Bank's Board of Directors on May 31, 2002, and approved by the Finance Board on June 12, 2002. The Bank's Board of Directors approved amendments to the capital plan on May 30, 2003, and the Finance Board approved the amendments on August 6, 2003. The Bank plans to implement its new capital plan on April 1, 2004. The provisions of the plan are discussed in Note 13 in the Notes to the Financial Statements. Until the Bank fully implements its capital plan, the existing capital requirements will remain in effect.

RISK MANAGEMENT

The Bank's Board of Directors has adopted a Risk Management Policy and a Member Products Policy, which are reviewed regularly and updated at least annually. The Risk Management Policy establishes risk guidelines, limits, and procedures in accordance with Finance Board regulations, the Finance Board's Financial Management Policy, the risk profile established by the Board of Directors, and other applicable guidelines.

The Risk Management Policy addresses the Bank's liquidity, market, credit, business, and operations risks and related requirements and guidelines. Management performs an annual risk assessment that is reviewed by the Board of Directors and updates the Risk Management Policy accordingly, if necessary.

The Bank's Member Products Policy addresses the Bank's management of products offered by the Bank to members and housing associates, including advances, standby letters of credit, acquired member assets, and other products. In terms of risk management, the Member Products Policy addresses the credit risk of secured credit by establishing credit underwriting criteria, appropriate collateralization levels, and collateral valuation methodologies.

BUSINESS RISK

Business risk is defined as the possibility of an adverse impact on the Bank's profitability or financial or business strategies resulting from factors that may occur in both the short and long term. Such factors may include, but are not limited to, continued financial-services industry consolidation; a declining membership base; concentration of borrowing among members; the introduction of new competing products and services; increased inter-FHLBank and non-FHLBank competition; initiatives to weaken the FHLBank System's GSE status; changes in the deposit and mortgage markets for the Bank's members; and other factors that may have a significant direct or indirect impact on the ability of the Bank to achieve its mission and strategic objectives.

The identification of these business risks is an integral part of the Bank's annual planning process, and the Bank's strategic plan identifies initiatives and supporting operating plans to address these risks.

As discussed earlier, the relative cost of the Bank's participation in consolidated obligation bonds and discount notes compared to market benchmark rates such as LIBOR has risen modestly over the past two years. If the relative cost of consolidated obligation bonds and discount notes continues to increase, it could further compress profit spreads on advances and investments, result in increased rates on advances offered to members, reduce the competitiveness of advances as a wholesale funding source for certain members, and lead to reduced demand for advances by some members that have alternative sources of wholesale funding. Some of the factors that may adversely affect the relative cost of FHLBank System consolidated obligations may be cyclical in nature and may reverse at some point in the future, such as the low level of interest rates and the demand for receive-fixed interest rate swaps. Other factors that may affect the relative cost of FHLBank System consolidated obligations may not reverse at some point in the future. These factors may include the growing issuance volume of Treasury securities and the growth rate of the housing GSEs. Still other factors are event-related and may reverse or may reoccur in the future; these factors include operating issues or losses disclosed by individual GSEs and uncertainty regarding the future regulatory structure of the housing GSEs. It is not possible at this time to determine the exact impact on the future relative cost of the Bank's participation in consolidated obligation bonds or discount notes of these factors and any other potential future events.

OPERATIONS RISK

Operations risk is defined as the risk of an unexpected loss to the Bank resulting from human error, fraud, unenforceability of legal contracts, or deficiencies in internal controls or information systems. The Bank's operations risk is controlled through an effective system of internal controls designed to minimize the risk of operational losses. Also, the Bank has established and annually tests its business resumption plan under various disaster scenarios involving offsite recovery and the testing of the Bank's operations and information systems. In addition, an extensive and ongoing internal audit function audits all significant risk areas to assess the effectiveness of the Bank's internal controls.

CONCENTRATION RISK

For the advances-related business, at December 31, 2003, the Bank had a concentration of advances totaling \$62.0 billion outstanding to three members, representing 67% of total advances outstanding. At December 31, 2002, the Bank had a concentration of advances totaling \$58.1 billion outstanding

to three members, representing 72% of total advances outstanding. Advances held by these three members generated approximately \$1.1 billion or 59%, \$1.9 billion or 67%, and \$4.0 billion or 76% of advance interest income, before the impact of interest rate exchange agreements, for the years ending December 31, 2003, 2002, and 2001, respectively.

Because of this concentration in advances, the Bank has implemented specific credit and collateral review procedures for these members. In addition, the Bank analyzes the implications for our financial management and profitability if we were to lose one or more of these customers.

If these members were to prepay the advances or repay the advances as they came due and no other advances were made to replace them, the Bank's assets would decrease significantly, and income could be adversely affected. The loss of a significant amount of advances could have a material adverse impact on the Bank's dividend until appropriate adjustments were made to the Bank's capital levels and operating expenses. The timing and magnitude of the adjustment period would depend on a number of factors, including: (a) the amount of any decreases in capital; (b) the profitability of any loans that were repaid; (c) the profitability of the Bank's investment portfolio; and (d) the amount of outstanding advances remaining. As discussed in "Our Business Model" on pages 15–16, however, our financial strategies are designed to enable us to shrink and grow in response to changes in membership composition and member credit needs. Under the Bank's new capital plan, Class B stock is redeemable upon five years' notice. The Bank may, however, repurchase excess Class B stock at any time before the five years have expired, at the Bank's discretion.

CONCENTRATION OF ADVANCES

NAME OF BORROWER	ADVANCES OUTSTANDING ¹ AS OF DECEMBER 31,		
	2003	2002	2001
Washington Mutual Bank, FA	\$32,439	\$32,945	\$ 45,647
Citibank (West), FSB ²	16,039	13,490	—
California Federal Bank, AFSB ²	—	—	22,323
World Savings Bank, FSB	13,500	11,635	11,038
Subtotal	61,978	58,070	79,008
Other borrowers	29,974	22,183	22,332
Total	\$91,952	\$80,253	\$101,340

¹ Member advance amounts and the total advance amounts are at par value, and the total advance amounts will not match amounts shown in the Statements of Condition. The difference between the par and book value amounts primarily relates to basis adjustments arising from hedges of advances under SFAS 133.

² Citibank (West), FSB, acquired California Federal Bank, AFSB, in November 2002.

LIQUIDITY RISK

Liquidity risk is defined as the risk that the Bank will be unable to meet its obligations as they come due or meet the credit needs of its members and eligible nonmember borrowers in a timely and cost-efficient manner. The Bank is required to maintain liquidity in accordance with certain regulations, with the Finance Board's Financial Management Policy, and with the Bank's own Risk Management Policy. In their asset/liability management planning, members may look to the Bank to provide standby liquidity. The Bank also needs liquidity to satisfy the repayment of maturing consolidated obligations and other obligations. The Bank seeks to be in a position to meet its customers' credit and liquidity needs and pay its obligations without maintaining excessive holdings of low-yielding liquid investments or being forced to incur unnecessarily high borrowing costs. The Bank maintains short-term, high quality money market investments in amounts that average close to three times the Bank's capital to satisfy these requirements and objectives.

The Bank's primary sources of liquidity are the short-term investments and the issuance of new consolidated obligation bonds and discount notes. Other short-term borrowings, such as Federal funds purchased, securities sold under agreements to repurchase, and loans from other FHLBanks, also provide liquidity. The Bank maintains contingency liquidity plans designed to enable it to meet its obligations and the liquidity needs of members in the event of operational disruptions at the Bank or the Office of Finance (the FHLBanks' fiscal agent for issuing consolidated obligations) or short-term disruptions of the capital markets.

CREDIT RISK

Credit risk is defined as the risk that the market value, or estimated fair value if market value is not available, of an obligation will decline as a result of deterioration in creditworthiness. The Bank further refines the definition of credit risk as the risk that a secured or unsecured borrower will default and the Bank will suffer a loss due to the inability to fully recover, on a timely basis, amounts owed the Bank.

Advances. The Bank closely monitors the creditworthiness of the institutions to which it lends funds. The Bank also places great importance on the quality of the assets that are pledged as collateral by its customers. The Bank emphasizes credit monitoring and collateral asset review and valuation to manage the credit risk associated with its lending activities. It also has procedures to assess the mortgage underwriting and documentation standards of its borrowing members. In addition, the Bank has collateral policies and restricted lending procedures in place to manage its exposure to those customers that experience difficulty in meeting their capital requirements or other standards of creditworthiness. These credit and collateral policies balance the Bank's dual goals of meeting members' needs as a reliable source of liquidity and effectively precluding credit loss by adjusting the credit and collateral terms. Eligible collateral includes whole first mortgages on improved residential property, or securities representing a whole interest in such mortgages; securities issued, insured, or guaranteed by the U.S. government or any of its agencies, including without limitation MBS issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae; cash or deposits in the Bank; and other real estate-related collateral, such as home equity loans or commercial real estate, acceptable to the Bank. For qualifying community financial institutions, eligible collateral also includes small business, farm, and agribusiness loans, provided that the collateral has a readily ascertainable value and the Bank can perfect a security interest in the property.

The FHLB Act affords any security interest granted to the Bank by any member of the Bank, or any affiliate of any such member, priority over the claims and rights of any party, including any receiver, conservator, trustee, or similar party having rights of a lien creditor, except claims and rights that would be entitled to priority under otherwise applicable law or are held by actual bona fide purchasers for value or by parties that are secured by actual perfected security interests.

The Bank perfects its security interest by completing a UCC-1 filing for each member and will take physical delivery of collateral if the financial condition of a particular member so warrants. The Bank has never experienced a credit loss on an advance. Based on the collateral held as security for advances, management's policies and procedures for managing credit risk, and the Bank's lack of any prior loss experience, the Bank has not established an allowance for losses on advances.

Management determines the borrowing capacity of a member based on the member's credit quality and eligible collateral received in accordance with the Bank's Risk Management Policy and regulatory requirements. Credit quality is determined and periodically assessed using the member's financial information, regulatory examination and enforcement actions, and other public information. The following tables present a summary of the status of members' credit quality and borrowing capacity as of December 31, 2003. As noted below, substantially all borrowing capacity and approved financing availability are with members that have the top three credit quality ratings. Credit quality ratings (CQR) are determined based on results from the Bank's credit model and on other qualitative information, with the assignment of a rating within the range of one to ten, with one being the highest credit rating.

MEMBER FINANCING AVAILABILITY AND BORROWING CAPACITY BY CHARTER TYPE

DECEMBER 31, 2003

CHARTER TYPE	ALL MEMBERS		MEMBERS WITH CREDIT OUTSTANDING			
	NUMBER	APPROVED FINANCING AVAILABILITY	NUMBER	CREDIT OUTSTANDING*	COLLATERAL BORROWING CAPACITY	
					TOTAL	USED
Savings associations	39	\$174,325	36	\$77,086	\$109,652	70%
Banks	242	62,298	177	15,112	24,690	61
Credit unions	71	12,949	31	1,158	3,133	37
Insurance companies	1	1	—	—	—	—
Total	353	\$249,573	244	\$93,356	\$137,475	68%

MEMBER FINANCING AVAILABILITY AND BORROWING CAPACITY BY CREDIT QUALITY RATING

DECEMBER 31, 2003

MEMBER CQR	ALL MEMBERS		MEMBERS WITH CREDIT OUTSTANDING			
	NUMBER	APPROVED FINANCING AVAILABILITY	NUMBER	CREDIT OUTSTANDING*	COLLATERAL BORROWING CAPACITY	
					TOTAL	USED
1	94	\$ 74,555	74	\$28,836	\$ 41,506	69%
2	110	152,517	78	59,449	87,975	68
3	62	16,785	43	3,897	6,205	63
4	64	5,124	37	1,060	1,609	66
5	18	353	10	65	110	59
6	4	186	2	49	70	70
7-10	1	53	0	0	0	0
Total	353	\$249,573	244	\$93,356	\$137,475	68%

*Includes letters of credit, the market value of swaps, Federal funds and other investments, and the credit enhancement obligation on MPF loans.

MPF Program. The Bank and the member selling loans to the Bank under the MPF Program share in the credit risk of the loans as specified in the master agreement. These assets may have more credit risk than advances, even though the member provides credit enhancement to protect the Bank to an AA level. The credit risks of MPF loans are managed by structuring potential credit losses into several layers. As is customary for conventional mortgage loans, private mortgage insurance (PMI) is required for MPF loans with a loan-to-value ratio greater than 80%. Losses beyond the borrower's equity and the PMI layer are absorbed first by a First Loss Account established by the Bank. If additional losses beyond this layer are incurred, the member is obligated to cover those losses up to the amount of the member's required credit enhancement. For some MPF products, the member's credit enhancement obligation may be fulfilled through the purchase of supplemental mortgage insurance. For providing this credit enhancement, the member receives monthly credit enhancement fees from the Bank, subject, in some cases, to the performance of the loans. The size of each member's credit enhancement is calculated so that any credit losses in excess of the borrower's equity, any PMI, and the credit enhancement, excluding special hazard losses, are limited to those expected from an equivalent investment with a long-term credit rating of AA.

The Bank provides for a loss allowance, net of credit enhancement, for any impaired loans, and management has policies and procedures in place to appropriately manage the credit risk. The Bank bases the allowance for credit losses for the Bank's mortgage loan portfolio on management's estimate of probable credit losses in the portfolio as of the balance sheet date. The Bank performs periodic reviews of its portfolio to identify the probable losses within the portfolio. The overall allowance is determined by an analysis that includes consideration of observable data such as delinquency statistics, past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, and prevailing economic conditions, taking into account the credit enhancement.

Investments. The Bank has adopted credit exposure limits for investments that promote diversification and liquidity. These policies restrict the amounts and terms of the Bank's investment holdings according to the Bank's own capital position as well as the capital and creditworthiness of the counterparty. In addition, the Bank's investments include AAA-rated non-agency MBS; MBS that are guaranteed by GSEs (Fannie Mae, Freddie Mac, and Ginnie Mae); and housing finance agency bonds, which are AAA-rated mortgage revenue bonds (federally taxable) that are collateralized by pools of residential mortgages and credit enhanced by bond insurance. The Bank also invests in short-term unsecured Federal funds sold, negotiable certificates of deposits

(interest-bearing deposits in banks), and commercial paper with counterparties with a long-term credit rating of at least A and capital in excess of \$250 million. The following tables present the Bank's investment credit exposure at the dates indicated, based on ratings provided by Moody's Investors Service, Standard and Poor's, or Fitch Ratings.

INVESTMENT CREDIT EXPOSURE

DECEMBER 31, 2003				
INVESTMENT TYPE	CREDIT RATING			TOTAL
	AAA	AA	A	
Interest-bearing deposits in banks	\$ —	\$3,100	\$187	\$ 3,287
Securities purchased under agreements to resell ¹	5,100	—	—	5,100
Federal funds sold	—	5,167	267	5,434
Held-to-maturity securities:				
Commercial paper	742	300	—	1,042
Housing finance agency bonds	1,328	—	—	1,328
MBS	15,893	—	—	15,893
Total held-to-maturity securities	17,963	300	—	18,263
Held-at-fair-value securities:				
Housing finance agency bonds	493	—	—	493
MBS	424	—	—	424
Total held-at-fair-value securities	917	—	—	917
Total investments	\$23,980	\$8,567	\$454	\$33,001

DECEMBER 31, 2002				
INVESTMENT TYPE	CREDIT RATING			TOTAL
	AAA	AA	A	
Interest-bearing deposits in banks	\$ —	\$ 4,356	\$478	\$ 4,834
Securities purchased under agreements to resell ¹	4,400	—	—	4,400
Federal funds sold	—	6,068	—	6,068
Held-to-maturity securities:				
Commercial paper	998	299	—	1,297
Housing finance agency bonds	1,114	—	—	1,114
MBS	15,468	—	—	15,468
Total held-to-maturity securities	17,580	299	—	17,879
Held-at-fair-value securities:				
MBS	533	—	—	533
Total investments	\$22,513	\$10,723	\$478	\$33,714

¹ Classified based on the credit rating of securities held as collateral.

The following tables present the portfolio concentration in the Bank's held-to-maturity securities portfolio of issuers whose aggregate carrying values represented 10% or more of the Bank's capital at the dates indicated.

DECEMBER 31, 2003		
(IN MILLIONS)	CARRYING VALUE	ESTIMATED FAIR VALUE
Commercial paper ¹	\$ 1,042	\$ 1,042
Housing finance agency bonds:		
California Housing Finance Agency	1,328	1,334
MBS:		
U.S. government agency issuers	1,180	1,194
Bank of America Mortgage Securities	1,370	1,373
Countrywide Home Loans	1,034	1,034
CS First Boston Mortgage Securities Corp.	2,107	2,104
Master Adjustable Rate Mortgages Trust	651	643
Sequoia Mortgage Trust	1,154	1,150
Structured Asset Mortgage Investments, Inc.	640	637
Structured Asset Securities Corp.	2,776	2,775
Washington Mutual	1,888	1,879
Other non-agency issuers ¹	3,093	3,101
Total MBS	15,893	15,890
Total held-to-maturity securities	\$18,263	\$18,266

DECEMBER 31, 2002		
(IN MILLIONS)	CARRYING VALUE	ESTIMATED FAIR VALUE
Commercial paper:		
GE Capital International Funding	\$ 798	\$ 798
Other issuers ¹	499	499
Total commercial paper	1,297	1,297
Housing finance agency bonds:		
California Housing Finance Agency	1,114	1,112
MBS:		
U.S. government agency issuers	1,673	1,714
Bank of America Mortgage Securities	1,805	1,838
Bear Stearns Adjustable Rate Mortgage Trust	608	617
Countrywide Home Loans	870	883
CS First Boston Mortgage Securities Corp.	1,063	1,063
Residential Funding	609	625
Sequoia Mortgage Trust	1,033	1,025
Structured Asset Mortgage Investments, Inc.	724	721
Structured Asset Securities Corp.	1,836	1,850
Washington Mutual	1,791	1,811
Other non-agency issuers ¹	3,456	3,501
Total MBS	15,468	15,648
Total held-to-maturity securities	\$17,879	\$18,057

¹ Includes issuers of securities that have a carrying value that is less than 10% of total Bank capital.

The following table presents the portfolio concentration in the Bank's held-at-fair-value securities portfolio at the dates indicated.

DECEMBER 31, 2003		
(IN MILLIONS)	CARRYING VALUE	ESTIMATED FAIR VALUE
Housing finance agency bonds:		
California Housing Finance Agency	\$493	\$493
MBS: U.S. government agency issuers	424	424
Total held-at-fair-value securities	\$917	\$917

DECEMBER 31, 2002		
(IN MILLIONS)	CARRYING VALUE	ESTIMATED FAIR VALUE
MBS: U.S. government agency issuers	\$533	\$533

Derivatives Counterparties. The Bank has also adopted credit policies and exposure limits for derivatives and off-balance sheet credit exposure. The Bank selects as derivatives counterparties only highly rated non-member derivatives dealers that meet the Bank's eligibility criteria. In addition, the Bank has entered into master netting arrangements and bilateral security agreements with all active non-member derivatives counterparties that provide for delivery of collateral at specified levels to limit net credit exposure to these derivatives. Under these policies and agreements, the amount of unsecured credit exposure to an individual counterparty is the lesser of (1) an amount commensurate with the counterparty's capital and its credit quality, as determined by rating agency credit ratings of the counterparty's debt securities or deposits, or (2) an absolute credit exposure limit. The following tables present the Bank's credit exposure to its derivatives counterparties at the dates indicated.

DERIVATIVES COUNTERPARTIES CREDIT EXPOSURE

DECEMBER 31, 2003

(IN MILLIONS) CREDIT RATING	NOTIONAL BALANCE	CREDIT EXPOSURE	EXPOSURE COLLAT- ERALIZED	NET EXPOSURE
AA	\$ 71,660	\$101	\$ 57	\$44
A	54,621	155	149	6
Subtotal	126,281	256	206	50
Member institutions ¹	493	10	10	—
Total derivatives	\$126,774	\$266	\$216	\$50

DECEMBER 31, 2002

(IN MILLIONS) CREDIT RATING	NOTIONAL BALANCE	CREDIT EXPOSURE	EXPOSURE COLLAT- ERALIZED	NET EXPOSURE
AAA	\$ 11	\$ —	\$ —	\$—
AA	76,379	295	228	67
A	47,807	210	190	20
Subtotal	124,197	505	418	87
Member institutions ¹	452	14	14	—
Total derivatives	\$124,649	\$519	\$432	\$87

¹ Collateral held with respect to interest rate exchange agreements with member institutions represents either collateral physically held by or on behalf of the Bank or collateral assigned to the Bank, as evidenced by a written security agreement, and held by the member institution for the benefit of the Bank.

MARKET RISK

Market risk is defined as the risk to the Bank's net equity value and net interest income (excluding the impact of SFAS 133) as a result of a movement in interest rates, interest rate spreads, market volatility, and other market factors.

The Bank's market risk management objective is to maintain a relatively low exposure of net equity value and future earnings (excluding the impact of SFAS 133) to changes in interest rates. This low risk profile reflects the Bank's conservative asset-liability mix and its commitment to providing value to its members without subjecting their capital to significant interest rate risk. Risk identification and risk

measurement are primarily accomplished through (1) market value sensitivity analyses, (2) net interest income sensitivity analyses, and (3) repricing gap analyses. The Risk Management Policy approved by the Board of Directors establishes market risk policy limits and market risk measurement standards at the total Bank level. Additional guidelines approved by the Bank's Asset-Liability Committee (ALCO) apply to the Bank's two business segments. These guidelines provide limits that are monitored at the segment level and are consistent with the total Bank policy limits. Interest rate risk is managed for each business segment on a daily basis, as discussed in "Segment Market Risk." Exceptions to Bank policies or management guidelines are presented to the ALCO or Board of Directors, as appropriate, with a corrective action plan.

Total Bank Market Risk.

Market Value of Equity Sensitivity – Management uses market value of equity sensitivity to measure the Bank's exposure to changes in interest rates. Management maintains its market value of equity sensitivity within the limits specified by the Board of Directors in the Risk Management Policy primarily by managing the interest rate attributes of assets, liabilities, and interest rate exchange agreements. The Bank's market value of equity exposure analysis generally shows that a 100-basis-point increase in interest rates results in a modest decrease in the market value of equity, while a comparable decrease in interest rates shows a modest increase in the market value of equity, but to a lesser degree. This non-linear change in the sensitivity of the market value of equity to changes in interest rates is generally the result of the impacts of the options embedded in the Bank's assets and liabilities (such as the prepayment option inherent in mortgage assets). The Bank manages the risks associated with these embedded options, but does not completely eliminate these risks.

The Bank's market value of equity sensitivity policy is to limit the adverse impact of an instantaneous parallel shift of a plus or minus 100-basis-point change in interest rates from current rates ("base case") to no worse than -4% of the value of equity. In addition, the policy limits the adverse impact of an instantaneous plus or minus 100-basis-point change in interest rates measured from interest rates that are 200 basis points above or below the base case to no worse than -6% of the value of equity.

At December 31, 2003, the estimated percentage change in the Bank's market value of equity (the net value of all assets, liabilities, and interest rate exchange agreements) was -2.2% if rates increased by 100 basis points, and +1.2% if interest rates decreased by 100 basis points. If interest rates had been 200 basis points higher at December 31, 2003, a 100-basis-point additional increase in interest rates would be expected to decrease the Bank's market value of equity by 3.5%. If interest rates had been 200 basis points lower at December 31, 2003 (interest rates cannot be less than zero), a

100-basis-point additional decline in interest rates would be expected to increase the Bank's market value of equity by 1.0%.

To determine the market value of equity and its sensitivity to interest rates, the Bank uses an external proprietary asset and liability system to calculate market values under alternative interest rate scenarios. The system analyzes all of the Bank's financial instruments including derivatives on a transaction-level basis using sophisticated valuation engines with consistent and appropriate behavioral assumptions, market prices, and current position data. The system also includes a mortgage prepayment model. At least on an annual basis, the Bank reexamines the major assumptions and methodologies used in the model, including discounting curves, spreads for discounting, and prepayment assumptions. The Bank also compares the prepayment assumptions in the proprietary model to other sources, including actual prepayment history.

Net Interest Income Sensitivity – The Bank limits the sensitivity of net interest income through a policy limit on the adverse change in the potential dividend yield. The policy limits the adverse impact of a simulated plus or minus 200-basis-point instantaneous change in interest rates (interest rates cannot be less than zero) on the projected dividend yield, measured over a 12-month forecast period, to –175 basis points (–1.75%). Results of simulations during the year ended December 31, 2003, showed that the adverse change in the potential dividend yield from an instantaneous and parallel plus or minus change of 200 basis points in interest rates was –113 basis points, well within the policy limit of –175 basis points.

Repricing Gap Analysis – Repricing gap analysis shows the interest rate sensitivity of assets, liabilities, and interest rate exchange agreements by term-to-maturity (fixed rate instruments) or repricing interval (adjustable rate instruments). In assigning assets to repricing periods, management considers expected prepayment speeds, amortization of principal, and expected exercise of call options, where applicable, in addition to the contractual maturities of financial instruments. The repricing gap analysis excludes the reinvestment of cash received or paid for maturing instruments. The Bank monitors and reports repricing gap analysis at the total Bank level but does not have a policy limit due to the variability of mortgage cash flows as interest rate levels change. The amounts shown in the following table represent the net difference between total asset and liability repricings, including the impact of interest rate exchange agreements, for a specified time period (the “periodic gap”). For example, the positive periodic gap for the “6 months or less” time period indicates that as of December 31, 2003, there were \$3.3 billion more assets than liabilities repricing or maturing during the 6-month period beginning on December 31, 2003. The large positive net periodic gap in the first 6-month period equals approximately 57% of the Bank's total capital, indicating that: (1) the market value risk for a large portion

of invested Bank capital, as measured by net periodic gaps, is maintained at a low level, and (2) the income sensitivity for a large portion of invested Bank capital is responsive to changes in short-term interest rates.

REPRICING GAP ANALYSIS

DECEMBER 31, 2003 (IN MILLIONS, NET OF INTEREST RATE EXCHANGE AGREEMENTS)	INTEREST RATE SENSITIVITY PERIOD			
	LESS THAN 6 MONTHS	6 MONTHS TO 1 YEAR	1 TO 5 YEARS	OVER 5 YEARS
Advances-related business:				
Assets	\$82,984	\$13,227	\$11,769	\$1,647
Liabilities	58,852	6,743	32,981	5,205
Interest rate exchange agreements	(20,838)	(5,847)	23,214	3,471
Periodic gap	3,294	637	2,002	(87)
Mortgage-related business:				
Assets	7,704	1,816	7,086	6,157
Liabilities	8,202	1,169	9,103	4,289
Interest rate exchange agreements	540	—	667	(1,207)
Periodic gap	42	647	(1,350)	661
Total periodic gap	\$ 3,336	\$ 1,284	\$ 652	\$ 574

Duration Gap – Duration gap is a measure of market risk published by several large wholesale financial institutions. The duration gap is the difference between the estimated durations (market value sensitivity) of assets and liabilities (including the impact of interest rate exchange agreements) and reflects the extent to which estimated cash flows for assets and liabilities are matched. The Bank monitors and reports duration gap analysis at the total Bank level but does not have a policy limit. The total Bank's duration gap was 0.6 and 0.8 months as of December 31, 2003 and 2002, respectively.

Segment Market Risk. The financial performance and interest rate risks of each business segment are managed within prescribed management guidelines, which, when combined, are consistent with the total Bank policy limits.

Advances-Related Business – Interest rate risk arises from the advances-related business primarily through the investment of the Bank's member-contributed capital. In general, advances create very little interest rate risk for the Bank because most fixed rate advances with maturities greater than 3 months and advances with embedded options are hedged contemporaneously with an interest rate swap. These hedged advances effectively create a pool of variable rate assets, which, in combination with the strategy of raising debt swapped to variable rate liabilities, create an advances portfolio with low interest rate risk.

Non-MBS investments have maturities of less than 3 months or are variable rate investments. These investments are also a good interest rate risk match with the Bank's variable rate funding.

The interest rate risk in the advances-related business is primarily associated with the Bank's strategy for investing the members' contributed capital. The Bank invests approximately 50% of its capital in short-term assets (maturities of three months or less) and approximately 50% of its capital in a laddered portfolio of fixed rate financial instruments with maturities of one month to four years ("targeted gaps"). This investment strategy is intended to mitigate the market value of capital risks associated with potential repurchase of members' surplus capital stock and to take advantage of the higher earnings available from a generally positively sloped yield curve in which intermediate-term investments generally have higher yields than short-term investments. Surplus capital stock primarily results from a decline in a member's advances; capital stock, when repurchased, is required to be repurchased at its statutory purchase price of \$100 per share.

On a weekly basis management evaluates the projected impact of expected maturities and scheduled repricings of assets, liabilities, and interest rate exchange agreements on the interest rate risk of the advances-related portfolio. Management regularly compares the targeted repricing and maturity gaps to the actual repricing and maturity gaps to identify rebalancing needs for the targeted gaps. The analyses are prepared under base case and alternate interest rate scenarios to assess the effect of put options and call options embedded in the advances, related financing, and hedges. These analyses also are used to measure and manage potential reinvestment risk (when the remaining term of advances is shorter than the remaining term of the financing) and potential refinancing risk (when the remaining term of advances is longer than the remaining term of the financing). For the advances-related business, actual net asset repricings were 56% in the "less than 6 months" period and 44% for periods of 6 months and more, compared to the targeted amounts of approximately 50% each. Net market value sensitivity analysis and net interest income simulations are also used to identify and measure risk and variances to the target interest rate risk exposure in the advances-related segment.

Mortgage-Related Business – The Bank's mortgage assets include MBS, classified as both held-to-maturity and held-at-fair-value, and mortgage loans purchased under the MPF Program. The Bank is exposed to interest rate risk because the cash flows of the mortgage assets and the liabilities that fund them are not matched through time and across all possible interest rate scenarios because of the uncertainty of mortgage prepayments and the existence of interest rate caps on certain adjustable rate MBS.

The market risk of the mortgage-related business is managed both at the time an individual asset is purchased and on a total portfolio level. At the time of purchase (for all significant mortgage asset acquisitions), the Bank analyzes the earnings sensitivity risk, net market value sensitivity, and prepayment sensitivity of the mortgage assets and anticipated funding and hedging under various interest rate scenarios.

At or close to the time of purchase of a mortgage asset, the related funding and hedging transactions are executed.

At least monthly, management reviews the market risk of the entire portfolio of mortgage assets and related funding and hedges. Rebalancing strategies to modify the mortgage portfolio market risks are then considered. At least quarterly, more in-depth analyses are performed, which include the impact of non-parallel shifts in the yield curve and assessments of unanticipated prepayment behavior. Based on these analyses, management may take actions to rebalance the mortgage portfolio's market risk profile. These rebalancing strategies may include the issuance of new funding and hedging transactions or the termination of certain funding and hedging transactions for the mortgage asset portfolio.

The Bank manages the interest rate and prepayment risk associated with mortgage assets through a combination of debt issuance and derivatives. The Bank may issue callable debt and non-callable debt and execute derivative transactions to achieve cash flow patterns and market value sensitivities for the liabilities and derivatives similar to those expected on the mortgage assets. Derivatives may be used as temporary hedges of anticipated debt issuance or as permanent hedges of debt used to finance the mortgage assets. The derivatives used to hedge the interest rate risk of fixed rate mortgage assets may be options to enter into interest rate swaps (swaptions) or callable and non-callable pay-fixed interest rate swaps. Derivatives used to hedge the periodic cap risks of adjustable rate mortgages may be receive-adjustable, pay-adjustable swaps with embedded caps that offset the periodic caps in the mortgage assets. Debt issued to finance mortgage assets may be fixed rate debt, callable fixed rate debt, or adjustable rate debt.

The following tables present results of market value of equity sensitivity and net interest income sensitivity analyses attributable to the mortgage-related business as of December 31, 2003 and 2002.

MARKET VALUE OF EQUITY SENSITIVITY

PERCENTAGE CHANGE IN MARKET VALUE OF BANK EQUITY ATTRIBUTABLE TO THE MORTGAGE-RELATED BUSINESS PER 100-BASIS-POINT CHANGE IN INTEREST RATES:	DECEMBER 31,	
	2003	2002
INTEREST RATE SCENARIO		
Actual rates at December 31	-1.5%	-1.3%
Rates start 200 basis points higher	-2.4%	-1.9%
Rates start 200 basis points lower	-1.4%	-0.3%

NET INTEREST INCOME SENSITIVITY

POTENTIAL DIVIDEND YIELD CHANGE ATTRIBUTABLE TO THE MORTGAGE-RELATED BUSINESS FOR THE FOLLOWING 12-MONTH PERIOD:	DECEMBER 31,	
	2003	2002
Instantaneous +200-basis-point change	-0.07%	-0.11%
Instantaneous -200-basis-point change	-0.67%	-0.53%

Interest Rate Exchange Agreements. The Bank uses interest rate swaps, options to enter into interest rate swaps (swaptions), interest rate cap and floor agreements, callable and puttable interest rate swaps, and futures and forward contracts (collectively, interest rate exchange agreements) to manage its exposure to changes in interest rates. The following list shows the primary ways the Bank uses interest rate exchange agreements. The percentages in parentheses show the proportion of the Bank's total portfolio of interest rate exchange agreements (notional amounts) represented by each use as of December 31, 2003.

- To reduce funding costs by combining a derivative and a consolidated obligation bond. The combined funding structure can be lower in cost than a comparable consolidated obligation bond. (57%)
- To create variable rate assets by executing an interest rate swap that effectively converts fixed rate advances to variable rate advances primarily indexed to LIBOR. (37%)
- To reduce the costs to fund and hedge the potential adverse earnings effects of the possible shortening or extension of the expected lives of mortgage assets caused by changes in interest rates. (5%)

While management uses interest rate exchange agreements to achieve the specific financial objectives described above, certain transactions do not qualify for hedge accounting under the rules of SFAS 133. As a result, changes in the fair value of the interest rate exchange agreement are recorded in current period earnings. Finance Board regulation and the Bank's Risk Management Policy prohibit the speculative use of interest rate exchange agreements, and the Bank does not trade derivatives for profit. It is the Bank's policy to use interest rate exchange agreements only to reduce the market risk exposures inherent in the otherwise unhedged asset and funding positions of the Bank and to achieve other financial objectives of the Bank, such as providing low-cost funding for advances and mortgage assets. The central focus of the financial management practices of the Bank is preserving and enhancing the long-term economic performance of the Bank. Under SFAS 133 it is expected that reported GAAP net income and other comprehensive income will exhibit greater variability than had been the case prior to implementation of SFAS 133.

At December 31, 2003, the Bank had \$126.8 billion total notional amount of interest rate exchange agreements outstanding compared with \$124.6 billion at December 31, 2002. The notional amount serves as a basis for calculating periodic interest payments or cash flows received and paid.

The following table categorizes the notional amounts and estimated fair values of the Bank's interest rate exchange agreements, excluding accrued interest, and related hedged items by product and type of accounting treatment as of December 31, 2003.

FAIR VALUE GAINS/(LOSSES) OF DERIVATIVES, HEDGED ITEMS, AND HELD-AT-FAIR-VALUE SECURITIES

(IN MILLIONS)	NOTIONAL AMOUNT	CUMULATIVE GAIN/(LOSS)		
		DERIVATIVES	HEDGED INSTRUMENTS	DIFFERENCE
DECEMBER 31, 2003*				
Qualifying for Hedge Accounting:				
Advances	\$ 46,748	\$(370)	\$ 367	\$ (3)
Callable bonds	27,050	(97)	187	90
Non-callable consolidated obligations				
Mortgage asset funding	28,439	363	(354)	9
	1,273	38	(39)	(1)
Subtotal	103,510	(66)	161	95
Not Qualifying for Hedge Accounting:				
Advances	112	—	—	—
Consolidated obligations	16,483	20	(22)	(2)
Intermediated	976	—	—	—
Mortgage assets:				
Mortgage asset funding	5,291	1	—	1
MBS: held-at-fair-value	397	(22)	22	—
MPF firm commitments	5	28	—	28
Subtotal	23,264	27	—	27
Total	\$126,774	\$ (39)	\$ 161	122
Indirect effects				(4)
Fair value gain before assessments				118
Assessments				(31)
Fair value gain after assessments				\$ 87
Other comprehensive income/(loss)				\$ (12)

*The notional amounts outstanding are as of December 31, 2003, and the cumulative gains and losses are since the adoption of SFAS 133 through the year ended December 31, 2003.

The primary source of SFAS 133-related income volatility arises from hedging the callable consolidated obligation bonds to effectively create floating rate debt with uncertain maturities. Since the implementation of SFAS 133, these transactions have usually resulted in net gains because of the relatively low cost of this swapped debt compared to the estimated cost of comparable new swapped callable consolidated obligations. These net gains can be volatile from period to period as a result of changes in (1) interest rate spreads, (2) the expected life of swapped callable debt due to the absolute level of interest rates, and (3) the volatility of interest rates.

The ongoing impact of SFAS 133 on the Bank cannot be predicted, and the Bank's retained earnings in the future may not be sufficient to offset the impact of SFAS 133. As a result, the effects of SFAS 133 may lead to increased volatility in future earnings, other comprehensive income, and dividends. Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will reverse over the remaining contractual terms to maturity of the hedged financial instruments and associated interest rate exchange agreements.

RECENT DEVELOPMENTS

Proposed Rule on Registration Under the Securities Exchange Act of 1934. On September 17, 2003, the Finance Board published a proposed rule that would require the FHLBanks to voluntarily register a class of securities with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 (1934 Act). Comments on the proposed rule were due January 15, 2004. The Bank and other FHLBanks are working with staff of the SEC and the Finance Board to address the implications of voluntary registration. It is uncertain at this time whether the FHLBanks will become subject to financial and operational reporting requirements under the 1934 Act.

Proposed Changes to GSE Regulation. Congressional committees have considered draft legislation to establish a new regulator for the housing GSEs (the FHLBanks, Fannie Mae, and Freddie Mac). The Administration has proposed the creation of a new regulator within the U.S. Department of the Treasury to oversee the housing GSEs. It is uncertain at this time whether there will be final legislation affecting the FHLBanks, the other housing GSEs, or their regulators.

Governance Practices. In early 2004, the Finance Board held two hearings on FHLBank governance to collect information about possible changes to Finance Board regulations or to the FHLB Act to help the boards of directors of the FHLBanks to better identify, measure, monitor, and control the risks on the FHLBanks' balance sheets. In 2003, the Finance Board completed a horizontal review to identify FHLBank board governance practices that contribute to effective governance programs among the FHLBanks. It is uncertain at this time whether there will be changes in the governance requirements and practices of the FHLBanks.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Fair Values. As of December 31, 2003 and 2002, certain of the Bank's assets and liabilities, including investments classified as held-at-fair-value securities and all derivatives and associated hedged items accounted for in accordance with SFAS 133, are presented in the Statements of Condition at fair value. Many of these financial instruments lack an available liquid trading market as characterized by frequent transactions between a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant assumptions and various valuation techniques have been used by the Bank for the purpose of determining estimated fair values. Changes in these assumptions, calculations, and techniques could significantly affect the Bank's financial position and results of operations. Thus, the fair values may not represent the actual values of the financial instruments that could have been realized as of yearend or that will be realized in the future. Although the Bank uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique or valuation methodology. The Bank continually refines its assumptions and valuation techniques and methodologies to better reflect market indications. Therefore, these estimated fair values are not necessarily indicative of the amounts that would be realized in current market transactions.

Management also estimates the fair value of the collateral that members pledge against advance borrowings to confirm that the Bank has sufficient collateral to protect it from loss.

Provision for Credit Losses.

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 is required by Finance Board regulation to obtain sufficient collateral on advances to protect against losses, and to accept only certain collateral on its advances, such as U. S. government or government-agency securities, residential mortgage loans, deposits in the Bank, and other real estate-related assets. At December 31, 2003 and 2002, the Bank had rights to collateral, either loans or securities, on a member-by-member basis, with an estimated fair value in excess of outstanding advances. The Bank's management believes that policies and procedures are in place to effectively manage its credit risk.

Mortgage Loans Acquired Under MPF Program – No loans were reported 90 days or more delinquent at December 31, 2003; no loans were in foreclosure or classified as nonaccrual or impaired during 2003; and no allowance for credit losses on mortgage loans was deemed necessary by management as of December 31, 2003. The Bank bases its allowance on management's estimate of probable credit losses in the mortgage loan portfolio as of the balance sheet date. The overall allowance is determined by an analysis that includes consideration of various observable data, such as delinquency statistics, past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, and prevailing economic conditions, taking into account the credit enhancement provided by the member under the terms of each master commitment.

OFF-BALANCE SHEET ARRANGEMENTS AND AGGREGATE CONTRACTUAL OBLIGATIONS

Off-Balance Sheet Arrangements, Guarantees, and Other Commitments. In accordance with Finance Board regulations, the Bank is jointly and severally liable for the System's consolidated obligations issued under Section 11(a) of the FHLBank Act, and in accordance with the FHLBank Act, the Bank is jointly and severally liable for consolidated obligations issued under Section 11(c) of the FHLBank Act. Accordingly, should one or more of the FHLBanks be unable to repay their participation in the consolidated obligations in which they are the primary obligor, each of the other FHLBanks could be called upon to repay all or part of such obligations, as determined or approved by the Finance Board. The Bank's joint and several contingent liability is a guarantee, as defined by FIN 45, but is excluded from the initial recognition and measurement provisions of FIN 45. Therefore, the valuation of this contingent liability is not recorded on the balance sheet of the Bank. At December 31, 2003, the System had \$759.5 billion of consolidated obligations outstanding. For additional information on the Bank's joint and several liability contingent obligation, see Notes 12 and 19 in the Notes to the Financial Statements.

In addition, in the ordinary course of business, the Bank engages in financial transactions that are not recorded on the Bank's balance sheet, in accordance with GAAP, or may be recorded on the Bank's balance sheet in amounts that are different from the full contract or notional amount of the transactions. For example, the Bank routinely enters into commitments to extend credit such as advances and standby letters of credit. While these commitments represent future cash requirements of the Bank, the standby letters of credit usually expire without being drawn upon. Such commitments are subject to the same underwriting and collateral requirements as advances made by the Bank. At December 31, 2003, the Bank had \$0.4 billion of advance commitments and \$1.0 billion in standby letters of credit outstanding.

The financial statements do not include a liability for future statutorily mandated payments from the FHLBanks to REFCORP. No liability is recorded because each FHLBank must pay 20% of net earnings (after its AHP obligation) to REFCORP to support the payment of part of the interest on the bonds issued by REFCORP, and the FHLBanks are unable to estimate their future required payments because the payments are based on future earnings and not estimable under SFAS 5, *Accounting for Contingencies*. Accordingly, the REFCORP payments are disclosed as a long-term statutory payment requirement and, for accounting purposes, are treated, accrued, and recognized like an income tax.

Contractual Obligations. In the ordinary course of operations, the Bank enters into certain contractual obligations. Such obligations primarily consist of consolidated obligations for which the Bank is the primary obligor. Other contractual obligations include leases for premises and consolidated obligations that have traded but not yet settled. Further, the Bank enters into purchase commitments for mortgage loans in connection with the Bank's participation in the mortgage purchase program. The table below summarizes the Bank's significant contractual obligations as of December 31, 2003, except for obligations associated with short-term discount notes and pension and retirement benefits. Additional information with respect to the Bank's consolidated obligations is presented in Notes 12 and 19 in the Notes to the Financial Statements. In addition, refer to Note 14 in the Notes to the Financial Statements for a discussion of the Bank's pension and retirement expenses and commitments, and see Note 9 in the Notes to the Financial Statements for a discussion of the Bank's mortgage purchase program.

The Bank enters into derivative financial instruments, which create contractual obligations, as part of the Bank's interest rate risk management. See Note 16 in the Notes to the Financial Statements for additional information regarding derivative financial instruments.

CONTRACTUAL OBLIGATIONS

(IN MILLIONS)	PAYMENTS DUE BY PERIOD				TOTAL
	< 1 YEAR	1 TO < 3 YEARS	3 TO < 5 YEARS	≥ 5 YEARS	
CONTRACTUAL OBLIGATIONS					
Long-term debt	\$26,177	\$38,232	\$16,886	\$11,297	\$92,592
Operating leases	3	7	7	2	19
Mortgage loans	5	—	—	—	5
CO bonds traded not settled	641	—	—	—	641
Total contractual obligations	\$26,826	\$38,239	\$16,893	\$11,299	\$93,257