Federal Home Loan Bank of San Francisco
2004 Second Quarter Report

To Our Members

During the second quarter of 2004, the Federal Home Loan Bank of San Francisco produced very strong financial results while continuing to meet members' expanding credit needs.

The Bank declared an annualized dividend rate of 4.68% for the quarter, up from 4.34% for the second quarter of 2003. The spread of the potential dividend yield to the dividend benchmark, a primary measure of the Bank's core financial performance, was significantly higher at 2.76% for the quarter, compared to 1.84% for the prior year period. Net income was $150 million, and adjusted net income was $83 million, up from $88 million and $63 million, respectively, in the second quarter of 2003.

In response to strong credit demand from members to fuel growth in their mortgage portfolios, the Bank's advance balance grew $12.1 billion during the quarter, resulting in a record total of $119.1 billion in advances outstanding at June 30, 2004. While most of the increase was attributable to several of our largest members, many other members contributed to the growth. In all, 130 members increased their Bank borrowings during the quarter, while 62 decreased their borrowings. As a result of the increase in advances, total assets grew $12.1 billion, to $160.4 billion.

For a more complete discussion of our financial results, please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations, which begins on page 3 of the 2004 Second Quarter Report.

On June 29, 2004, the Bank's regulator, the Federal Housing Finance Board, published its final rule requiring each of the 12 Federal Home Loan Banks to register a class of its equity securities with the Securities and Exchange Commission under section 12(g) of the Securities Exchange Act of 1934, as amended. The FHLBanks are required to file a registration statement with the SEC no later than June 30, 2005, and the registration statement must be declared effective no later than August 29, 2005. The Bank fully supports the Finance Board's objective of ensuring that each of the FHLBanks provides comprehensive, fully transparent disclosures, and we are continuing to work with the SEC to resolve any remaining issues associated with registration.

During the second quarter, the Bank awarded approximately $24.8 million in affordable housing grants. The awards included $19.3 million for 51 rental and homeownership projects submitted in Round A of the 2004 Affordable Housing Program (AHP) competition, which will generate nearly 3,100 affordable housing units. The remaining $5.5 million will be used to provide matching grants to help lower-income residents become homeowners in Arizona, California, and Nevada. The Bank awarded $3.5 million to 24 members under the Individual Development and Empowerment Account (IDEA) Program and $2 million to 9 members under the Workforce Initiative Subsidy for Homeownership (WISH) Program.

In keeping with its strategy of promoting community investment and revitalization through innovative partnerships, the Bank is hosting "Making Your Vision A Reality: A Faith-Based Conference for Affordable Housing and Economic Development" on October 17-19, 2004, in Los Angeles. This conference will bring together financial institutions, faith-based groups, nonprofit organizations, government entities, developers, and policymakers for in-depth training on organizational development, fundraising, partnership development, community building, and case studies of exemplary projects. The event will feature two keynote speakers:

U.S. Housing and Urban Development Secretary Alphonso Jackson and California State Treasurer Phil Angelides.

I look forward to seeing many of you at our 2004 member conference, "Focusing Forward: Financial Industry Outlook," on September 12-13 in Carlsbad, California. Members who have attended this event in the past have found it to be a great opportunity for learning and networking. You will find detailed information about the event in our conference brochure.

Sincerely,

Dean Schultz
President and Chief Executive Officer

Federal Home Loan Bank of San Francisco
2004 Second Quarter Report
(Revised 10/21/04)

Table of Contents

Financial Highlights 1

Management's Discussion and Analysis
of Financial Condition and Results of Operations 3
- Financial Performance 3
- Results of Operations 4
- Financial Condition 13
- Capital 16
- Risk Management 17
- Critical Accounting Policies and Estimates 27
- Recent Developments 27

Report of Independent Accountants 28

Financial Statements 29
- Statements of Condition 29
- Statements of Income 30
- Statements of Capital Accounts 31
- Statements of Cash Flows 33

Notes to Financial Statements 35

Directors and Management 50

Financial Highlights

(Dollars in millions except per share amounts)	June 30, 2004	March 31, 2004	December 31, 2003	September 30, 2003	June 30, 2003
Selected Balance Sheet Items					
Total Assets	$ 160,375	$ 148,315	$ 132,390	$ 115,663	$ 106,307
Advances	119,124	106,250	92,330	81,983	71,634
Mortgage Loans	6,335	6,431	6,445	5,177	2,390
Mortgage-Backed Securities	19,595	17,964	16,317	14,363	15,713
Capital	7,055	6,399	5,846	5,576	5,406
Quarterly Operating Results					
Net Interest Income	$ 143	$ 117	$ 110	$ 106	$ 106
Net Income	150	46	60	127	88
Net Income Per Share	2.31	0.77	1.10	2.48	1.63
Ratios					
Capital to Assets Ratio	4.40%	4.32%	4.42%	4.84%	5.09%
Net Interest Margin	0.38	0.33	0.35	0.41	0.38
Operating Expenses as a Percent of Average Assets	0.04	0.04	0.05	0.05	0.05
Return on Average Equity	8.99	3.00	4.22	9.62	6.53
Dividend Rate	4.68	3.95	3.85	4.18	4.34
Adjusted Quarterly Operating Results *					
Adjusted Net Income	$ 83	$ 65	$ 60	$ 61	$ 63
Adjusted Net Interest Margin**	0.33%	0.29%	0.30%	0.36%	0.36%
Adjusted Return on Average Equity	5.04	4.33	4.29	4.64	4.67
Potential Dividend Yield	5.12	4.39	4.34	4.71	4.75
Dividend Benchmark	2.36	2.46	2.58	2.68	2.91
Spread of Potential Dividend Yield to Dividend Benchmark	2.76	1.93	1.76	2.03	1.84
Reconciliation of Net Income to Adjusted Net Income					
Net Income	$ 150	$ 46	$ 60	$ 127	$ 88
Net Loss/(Gain) on Held-at-Fair-Value Securities	11	(3)	5	8	(2)
Net (Gain)/Loss on Derivatives and Hedging Activities	(79)	21	(4)	(71)	(23)
Other Adjustments	1	1	(1)	(3)	—
Adjusted Net Income	$ 83	$ 65	$ 60	$ 61	$ 63

* The Bank calculates adjusted financial performance measures to provide a more meaningful comparison of the Bank's financial results over time. These measures are not intended to be a presentation in accordance with generally accepted accounting principles. Adjusted financial performance measures exclude the effects of any current period fair value changes (net of applicable assessments) made in accordance with Statement of Financial Accounting Standards (SFAS) 133, *Accounting for Derivative*

Instruments and Hedging Activities, 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 time. 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 items, in accordance with the Bank's Retained Earnings and Dividend Policy, 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.

** Includes the interest income and expense on non-hedge qualifying derivatives that are economic hedges classified in "Net gain/(loss) on derivatives and hedging activities" in the Statements of Income.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Statements contained in this report, including statements describing the objectives, projections, estimates, or predictions of the future of the Bank, may be "forward-looking statements." These statements may use forward-looking terms, such as "anticipates," "believes," "could," "estimates," "may," "should," "will," or their negatives or other variations on these terms. The Bank cautions that by their nature, forward-looking statements involve risk or uncertainty and that actual results could differ materially from those expressed or implied in these forward-looking statements or could affect the extent to which a particular objective, projection, estimate, or prediction is realized. These forward-looking statements involve risks and uncertainties including, but not limited to, the following: economic and market conditions; volatility of market prices, rates, and indices; political, legislative, regulatory, or judicial events; the Bank's new capital structure; membership changes; competitive forces; changes in investor demand for consolidated obligations and/or the terms of interest rate exchange agreements and similar agreements; and timing and volume of market activity. This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Bank's interim financial statements and notes, which begin on page 29, and the Bank's 2003 Annual Report.

Financial Performance

The Federal Home Loan Bank of San Francisco (Bank) seeks to maintain a balance between its public policy mission of supporting housing and community development 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. The Bank's dividends are largely the result of earnings on the capital stock issued to its members, while net earnings on member advances, mortgage loans, mortgage-backed securities (MBS), and other investments are generally used to pay operating expenses and other costs (with additional earnings, if any, also contributing to the dividend or retained earnings).

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 not intended to be a presentation in accordance with generally accepted accounting principles (GAAP). The potential dividend yield is current period earnings (excluding fair value adjustments, as explained below, and advance prepayment fees, net of the amortization of current and prior period prepayment fees and other deferred items, and any other restrictions to retained earnings) 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 (dividend spread) represents the potential financial return on the members' investment in Bank capital stock relative to the return on a comparable mix of investments in overnight Federal funds and intermediate-term Treasury investments.

The potential dividend yield was 5.12% for the second quarter of 2004, an increase of 37 basis points from the second quarter of 2003. The increase in the potential dividend yield was primarily due to improved

earnings on the mortgage loan and MBS portfolios resulting from higher average balances and higher profit spreads. The higher profit spreads primarily resulted from slower prepayments of existing MBS investments and mortgage loans attributable to increases in interest rates that began in the third quarter of 2003, coupled with favorable profit spreads on $7.3 billion of MBS investments purchased during the first half of 2004. The dividend benchmark was 2.36% for the second quarter of 2004, a decrease of 55 basis points from 2.91% for the same period of 2003, reflecting lower average interest rates for both components of the dividend benchmark: the overnight Federal funds component and the four-year moving average of the four-year Treasury note yield. The spread between the potential dividend yield and the dividend benchmark (dividend spread) was 2.76% for the second quarter of 2004, an increase of 92 basis points from the second quarter of 2003.

The potential dividend yield was 4.77% for the first six months of 2004, a decrease of 12 basis points from 4.89% for the first six months of 2003. The decrease in the potential dividend yield was primarily due to lower earnings on invested capital, which was driven by lower average interest rates during 2004 relative to 2003. The dividend benchmark was 2.41% for the first six months of 2004, a decrease of 55 basis points from 2.96% for the same period of 2003, also reflecting lower average interest rates for both components of the dividend benchmark. The dividend spread was 2.36% for the first six months of 2004, an increase of 43 basis points from 1.93% for the first six months of 2003. This increase was largely the result of improved earnings on the mortgage loan and MBS portfolios resulting from higher average balances and higher profit spreads.

Results of Operations

The Average Balance Sheet tables that follow present average balances of earning asset categories and the sources that fund those earning assets (liabilities and capital) for the three and six months ended June 30, 2004 and 2003, together with the related interest income and expense. They also present the rate on total earning assets and the cost of total funding sources. The Change in Net Interest Income tables detail the changes in interest income and interest expense for the second quarter of 2004 compared to the second quarter of 2003 and for the first six months of 2004 compared to the first six months of 2003. Changes in both volume and interest rates influence changes in net interest income and the net interest margin.

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 margin for the second quarter of 2004 remained unchanged from the second quarter of 2003 at 38 basis points. The net interest spread increased 2 basis points during the second quarter of 2004 compared to the same period in 2003, primarily because of higher profit spreads on the mortgage loan and MBS portfolios. The increase was partially offset, however, by narrower profit spreads on a larger advance portfolio. Earnings on invested capital remained essentially flat, as the increase in average capital outstanding was offset by the decline in the average yields earned as a result of lower average interest rates.

For the first six months of 2004, the net interest spread decreased 1 basis point while the net interest margin decreased 3 basis points when compared to the first six months 2003, primarily because of narrower profit spreads on a larger advance portfolio and lower average interest rates in 2004 relative to 2003, which reduced the yield on invested capital. These decreases were partially offset by improved profit spreads on the mortgage loan and MBS portfolios and a higher proportion of mortgage loans and MBS to total assets in 2004 relative to 2003.

Average Balance Sheets

(Dollars in millions)	Three months ended June 30, 2004 Average Balance	June 30, 2004 Interest Income/ Expense	June 30, 2004 Average Rate	June 30, 2003 Average Balance	June 30, 2003 Interest Income/ Expense	June 30, 2003 Average Rate
Assets						
Interest-earning assets:						
Interest-bearing deposits in banks	$ 3,718	$ 10	1.08%	$ 4,064	$ 13	1.28%
Resale agreements	1,932	5	1.04	3,035	9	1.19
Federal funds sold	7,637	21	1.11	6,310	20	1.27
Held-to-maturity securities:						
Other investments	2,677	8	1.20	2,015	7	1.39
MBS	17,138	156	3.66	14,674	142	3.88
Held-at-fair-value securities	1,079	7	2.61	781	7	3.59
Mortgage loans	6,396	82	5.16	1,910	20	4.20
Advances[1]	112,686	351	1.25	78,785	286	1.46
Deposits for mortgage loan program with other FHLBank	5	—	0.88	13	—	1.54
Loans to other FHLBanks	14	—	1.06	4	—	1.00
Total interest-earning assets	153,282	640	1.68	111,591	504	1.81
Other assets[2]	2,211	—	—	1,944	—	—
Total Assets	$155,493	$ 640	1.66%	$113,535	$ 504	1.78%
Liabilities and Capital						
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds[1]	$120,429	$ 427	1.43%	$ 90,464	$ 353	1.57%
Discount notes[1]	25,959	69	1.07	14,606	45	1.24
Deposits	500	1	0.80	452	1	0.89
Borrowings from other FHLBanks	—	—	—	1	—	1.60
Other borrowings	6	—	1.34	9	—	1.34
Total interest-bearing liabilities	146,894	497	1.36	105,532	399	1.52
Other liabilities[2]	1,877	—	—	2,566	—	—
Total Liabilities	148,771	497	1.34	108,098	399	1.48
Capital	6,722	—	—	5,437	—	—
Total Liabilities and Capital	$155,493	$ 497	1.29%	$113,535	$ 399	1.41%
Net Interest Income Before Mortgage Loan Loss Provision		$ 143			$ 105	
Net Interest Spread			0.32%			0.30%
Net Interest Margin[3]			0.38%			0.38%
Total Average Assets/Capital Ratio	23.1x			20.9x		
Interest-bearing Assets/ Interest-bearing Liabilities	1.0x			1.1x		

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

Change in Net Interest Income: Rate/Volume Analysis
Three Months Ended June 30, 2004, Compared to Three Months Ended June 30, 2003

(In millions)	Increase/ (Decrease)	Attributable to Changes in[1] Average Volume	Average Rate
Interest-earning assets:			
Interest-bearing deposits in banks	$ (3)	$ (1)	$ (2)
Resale agreements	(4)	(3)	(1)
Federal funds sold	1	4	(3)
Held-to-maturity securities:			
Other securities	1	2	(1)
MBS	14	22	(8)
Held-at-fair-value securities	—	2	(2)
Mortgage loans	62	57	5
Advances[2]	65	105	(40)
Total interest-earning assets	136	188	(52)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds[2]	74	105	(31)
Discount notes[2]	24	30	(6)
Total interest-bearing liabilities	98	135	(37)
Net interest income before mortgage loan loss provision	$ 38	$ 53	$ (15)

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

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

Average Balance Sheets

	Six months ended					
	June 30, 2004			June 30, 2003		
(Dollars in millions)	Average Balance	Interest Income/ Expense	Average Rate	Average Balance	Interest Income/ Expense	Average Rate
Assets						
Interest-earning assets:						
Interest-bearing deposits in banks	$ 3,577	$ 19	1.07%	$ 4,034	$ 26	1.30%
Resale agreements	3,168	16	1.02	2,632	16	1.23
Federal funds sold	8,121	43	1.06	6,318	40	1.28
Held-to-maturity securities:						
Other investments	2,769	17	1.23	2,098	15	1.44
MBS	16,478	293	3.58	14,749	302	4.13
Held-at-fair-value securities	1,062	15	2.84	747	15	4.05
Mortgage loans	6,417	160	5.01	1,414	31	4.42
Advances[1]	105,951	661	1.25	80,316	606	1.52
Deposits for mortgage loan program with other FHLBank	5	—	4.02	14	—	1.44
Loans to other FHLBanks	15	—	0.94	11	—	1.83
Total interest-earning assets	147,563	1,224	1.67	112,333	1,051	1.89
Other assets[2]	2,121	—	—	2,876	—	—
Total Assets	$149,684	$ 1,224	1.64%	$ 115,209	$1,051	1.84%
Liabilities and Capital						
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds[1]	$109,528	$ 797	1.46%	$ 92,378	$ 743	1.62%
Discount notes[1]	31,291	165	1.06	14,185	92	1.31
Deposits	523	2	0.77	419	2	0.96
Borrowings from other FHLBanks	—	—	0.74	1	—	0.81
Other borrowings	5	—	0.82	9	—	0.12
Total interest-bearing liabilities	141,347	964	1.37	106,992	837	1.58
Other liabilities[2]	1,900	—	—	2,706	—	—
Total Liabilities	143,247	964	1.35	109,698	837	1.54
Capital	6,437	—	—	5,511	—	—
Total Liabilities and Capital	$149,684	$ 964	1.30%	$ 115,209	$ 837	1.47%
Net Interest Income Before Mortgage Loan Loss Provision		$ 260			$ 214	
Net Interest Spread			0.30%			0.31%
Net Interest Margin[3]			0.35%			0.38%
Total Average Assets/Capital Ratio	23.3x			20.9x		
Interest-bearing Assets/ Interest-bearing Liabilities	1.0x			1.0x		

[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.

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

Change in Net Interest Income: Rate/Volume Analysis
Six Months Ended June 30, 2004, Compared to Six Months Ended June 30, 2003

(In millions)	Increase/ (Decrease)	Attributable to Changes in[1] Average Volume	Average Rate
Interest-earning assets:			
Interest-bearing deposits in banks	$ (7)	$ (2)	$ (5)
Resale agreements	—	3	(3)
Federal funds sold	3	10	(7)
Held-to-maturity securities:			
Other securities	2	4	(2)
MBS	(9)	32	(41)
Held-at-fair-value securities	—	4	(4)
Mortgage loans	129	124	5
Advances[2]	55	162	(107)
Total interest-earning assets	173	337	(164)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds[2]	54	127	(73)
Discount notes[2]	73	91	(18)
Total interest-bearing liabilities	127	218	(91)
Net interest income before mortgage loan loss provision	$ 46	$ 119	$ (73)

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

[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 in the second quarter of 2004 was $143 million, a 36% increase from the second quarter of 2003. Net interest income before mortgage loan loss provision in the first six months of 2004 was $260 million, a 21% increase from the first six months of 2003. The increases were largely due to significant growth in average interest-earning assets outstanding, particularly in the advance, mortgage loan, and MBS portfolios. Higher profit spreads on mortgage loans and MBS investments also contributed to the rise in net interest income. These increases were partially offset, however, by narrower profit spreads on advances and lower earnings on invested capital as yields declined as a result of lower average interest rates during 2004 relative to 2003.

As discussed in Note 1 to the Financial Statements, 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 $9 million in the second quarter of 2003 and by $14 million in the first six months of 2003. Economic hedges are hedges of an asset or liability that do not qualify for hedge accounting treatment under the provisions of Statement of Financial Accounting Standards (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 by SFAS No. 149, *Amendment*

of Statement 133 on Derivative Instruments and Hedging Activities, on July 31, 2003 (together referred to as "SFAS 133").

Other Income/(Loss). Other income was $78 million in the second quarter of 2004, a $50 million increase over the second quarter of 2003. For the first six months of 2004, other income was $40 million, a $40 million increase over the first six months of 2003. These changes were primarily due to fair value adjustments associated with derivatives and hedging activities in accordance with 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, which represents the amount by which the change in the fair value of the derivative differs from the change in the fair value of the hedged item or the variability in the cash flows of the forecasted transaction, is recognized in current period earnings.

During the second quarter of 2004, the ineffective portion of all hedges resulted in a net gain of $90 million, an increase of $67 million compared to the second quarter of 2003. During the first six months of 2004, the ineffective portion of all hedges resulted in a net gain of $45 million, an increase of $52 million compared to the first six months of 2003. The majority of these gains was due to changes in the fair value of the callable bond portfolio that had offsetting callable interest rate swaps. The net gains reflect the impact of rising interest rates during the second quarter of 2004, which resulted in the extension of the expected lives of the callable consolidated obligations and callable swaps compared to the lives expected at the end of the first quarter of 2004 and at yearend 2003. Narrower spreads between market rates on consolidated obligations and interest rate swaps also contributed to the gains in the swapped callable debt portfolio. The gains were partially offset by higher net interest expense on stand-alone derivative instruments used in economic hedges ($17 million in the second quarter of 2004 compared to $9 million in the second quarter of 2003, and $34 million in the first six months of 2004 compared to $14 million in the first six months of 2003).

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

Net Income. Net income was $150 million in the second quarter of 2004, a 70% increase over the second quarter of 2003, and was $196 million in the first six months of 2004, a 44% increase over the first six months of 2003. Return on equity (ROE) was 8.99% in the second quarter of 2004, an increase of 246 basis points from the second quarter of 2003. ROE was 6.13% in the first six months of 2004, an increase of 115 basis points from the first six months of 2003. The increases in net income and ROE were primarily due to the increase in other income resulting from the fair value adjustments associated with SFAS 133 and the rise 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 and other parties 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 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. The Bank makes 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, adjusted net interest income includes the net interest expense 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 in the second quarter of 2004 was $83 million, an increase of $20 million, or 32%, from the second quarter of 2003. Adjusted net interest income in the second quarter of 2004 was $127 million, an increase of $29 million, or 30%, from the second quarter of 2003. Adjusted ROE for the second quarter of 2004 was 5.04%, an increase of 37 basis points from the second quarter of 2003. These increases were primarily due to growth in the advance, mortgage loan, and MBS portfolios, along with higher profit spreads on the mortgage loan and MBS portfolios.

Adjusted Operating Results and Other Non-GAAP Financial Measures
(In millions)

	Three months ended	
	June 30, 2004	June 30, 2003
Adjusted net income	$ 83	$ 63
Adjusted net interest margin	0.33%	0.36%
Adjusted return on average equity	5.04	4.67
Potential dividend yield	5.12	4.75
Dividend benchmark	2.36	2.91
Spread of potential dividend yield to dividend benchmark	2.76	1.84

Reconciliation of Net Interest Income to Adjusted Net Interest Income
(In millions)

	Three months ended	
	June 30, 2004	June 30, 2003
Net interest income	$ 143	$ 106
Amortization of deferred advance prepayment fees	2	2
Amortization of realized basis adjustments	(1)	(1)
Net interest expense on economic hedges	(17)	(9)
Adjusted net interest income	$ 127	$ 98

Reconciliation of Net Income to Adjusted Net Income
(In millions)

	Three months ended	
	June 30, 2004	June 30, 2003
Net income	$ 150	$ 88
Net loss/(gain) on held-at-fair-value securities	11	(2)
Net gain on derivatives and hedging activities	(79)	(23)
Deferred advance prepayment fees, net	1	—
Adjusted net income	$ 83	$ 63

Adjusted net income in the first six months of 2004 was $148 million, an increase of $17 million, or 13%, from the first six months of 2003. Adjusted net interest income in the first six months of 2004 was $230 million, an increase of $28 million, or 14%, from the first six months of 2003. These increases were primarily due to growth in the advance, mortgage loan, and MBS portfolios, coupled with higher profit spreads on the mortgage loan and MBS portfolios. Adjusted ROE for the first six months of 2004 was 4.70%, a decrease of 10 basis points from the first six months of 2003 that was primarily due to lower average interest rates in 2004 relative to 2003, which decreased earnings on invested member capital.

Adjusted Operating Results and Other Non-GAAP Financial Measures
(In millions)

	Six months ended	
	June 30, 2004	June 30, 2003
Adjusted net income	$ 148	$ 131
Adjusted net interest margin	0.31%	0.36%
Adjusted return on average equity	4.70	4.80
Potential dividend yield	4.77	4.89
Dividend benchmark	2.41	2.96
Spread of potential dividend yield to dividend benchmark	2.36	1.93

Reconciliation of Net Interest Income to Adjusted Net Interest Income
(In millions)

	Six months ended	
	June 30, 2004	June 30, 2003
Net interest income	$ 260	$ 214
Amortization of deferred advance prepayment fees	5	4
Amortization of realized basis adjustments	(1)	(2)
Net interest expense on economic hedges	(34)	(14)
Adjusted net interest income	$ 230	$ 202

Reconciliation of Net Income to Adjusted Net Income
(In millions)

	Six months ended	
	June 30, 2004	June 30, 2003
Net income	$ 196	$ 136
Net loss/(gain) on held-at-fair-value securities	8	(2)
Net gain on derivatives and hedging activities	(58)	(5)
Deferred advance prepayment fees, net	2	2
Adjusted net income	$ 148	$ 131

Dividends. The Bank's annualized dividend rate for the second quarter of 2004 was 4.68%, compared to 4.34% in the second quarter of 2003. The increase in the dividend rate over the two quarters was primarily due to growth in the advance, mortgage loan, and MBS portfolios relative to capital, coupled with higher profit spreads on the mortgage loan and MBS portfolios. As discussed below, to provide for a build-up of retained earnings, the Bank retained $7 million in the second quarter of 2004 and $8 million in the second quarter of 2003, which reduced the quarterly annualized dividend rate by 43 basis points and 60 basis points, respectively.

The Bank's Retained Earnings and Dividend Policy establishes the amounts to be retained in restricted retained earnings, subject to the dividend resolution that may be 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 may 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 Federal Housing Finance Board (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 $8 million at June 30, 2004, and $10 million at December 31, 2003.

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) resulting from SFAS 133. Retained earnings restricted in accordance with this provision totaled $136 million at June 30, 2004, and $87 million at December 31, 2003. Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will generally 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 the 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. Although restricted retained earnings may preserve the Bank's ability to pay dividends, reversal of the cumulative net unrealized gains in any given quarter may result in a net loss if the reversal exceeds net earnings before the impact of SFAS 133 for that quarter. If the cumulative net effect of SFAS 133 since inception ($136 million of cumulative net gains as of

June 30, 2004) results in a net loss, the Bank's future retained earnings 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 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. 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 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 retained earnings restricted in accordance with this provision totaled $36 million at June 30, 2004, and $22 million at December 31, 2003. The Board of Directors may amend the Retained Earnings and Dividend Policy from time to time to update the policy and address Finance Board guidance.

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 Federal Home Loan Bank Act of 1932, as amended (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.

Financial Condition

Total assets were $160.4 billion at June 30, 2004, a 21% increase since December 31, 2003. Average total assets were $155.5 billion for the second quarter of 2004, a 37% increase compared to the second quarter of 2003. Average total assets were $149.7 billion for the first six months of 2004, a 30% increase compared to the first six months of 2003.

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 and other credit products provided 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 $73 million in the second quarter of 2004, a decrease of $1 million, or 1%, compared to the second quarter of 2003. In the first six months of 2004, net interest income for the segment was $137 million, a decrease of $12 million, or 8%, from the first six months of 2003. The decreases were primarily due to narrower profit spreads on the advance portfolio and lower average interest rates in the second quarter of 2004 relative to the second quarter of 2003, partially offset by a strong upsurge in advance balances.

Including the cash flows from associated interest rate exchange agreements, this segment represented 58% and 76% of total Bank net interest income including cash flows from economic hedges for the second quarter of 2004 and 2003, respectively, and 61% and 74% of total Bank net interest income including cash flows from economic hedges for the first six months of 2004 and 2003, respectively.

The balance of total assets associated with this segment increased to $134.4 billion at June 30, 2004, an increase of $24.7 billion, or 23%, since December 31, 2003. The increase is primarily due to higher demand for advances by the Bank's members.

Advances— Average advances were $112.7 billion for the second quarter of 2004, a 43% increase from the second quarter of 2003. Average advances for the first six months of 2004 were $106.0 billion, a 32% increase from the first six months of 2003. The increase in average advances reflected changes in members' balance sheets, particularly those of the largest members, whose mortgage portfolio growth outpaced deposit growth during the first half of 2004.

Advances outstanding increased 29% since December 31, 2003, to $119.1 billion at June 30, 2004. Advances outstanding included fair value losses of $33 million at June 30, 2004, and fair value gains of $367 million at December 31, 2003. The increase in advances outstanding at June 30, 2004, relative to December 31, 2003, was primarily due to higher demand from a few of the Bank's largest members to fund mortgage portfolio growth. In total, 130 members increased their advance borrowings during 2004, while 62 members decreased their advance borrowings. During the first half of 2004, short-term fixed rate advances grew $20.0 billion to $48.9 billion, long-term fixed rate advances increased $4.2 billion to $26.9 billion, and long-term adjustable rate advances rose $2.9 billion to $38.7 billion at June 30, 2004, while short-term adjustable rate advances were unchanged at $4.7 billion.

Non-MBS Investments—The Bank's total non-MBS investment portfolio was $14.9 billion as of June 30, 2004, a decrease of $1.8 billion, or 11%, since December 31, 2003. During 2004, resale agreements fell by $4.2 billion, while Federal funds sold increased $1.5 billion, housing finance agency bonds increased $0.4 billion, interest-bearing deposits in banks increased $0.3 billion, and commercial paper increased $0.2 billion. This change in the portfolio's composition reflects a shift away from resale agreements primarily because of more attractive spreads in Federal funds sold and other non-MBS investments. 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 liabilities (primarily consolidated obligations) funding the advances-related business increased $23.5 billion, or 23%, to $127.3 billion at June 30, 2004, since December 31, 2003.

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). The Bank issues fixed rate callable bonds that are offset with interest rate exchange agreements with call features offsetting the call options embedded in the callable bonds. This combined financing structure enables 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, fixed rate MBS, and fixed rate mortgage loans.

At June 30, 2004, the notional amount of interest rate exchange agreements associated with the advances-related business totaled $183.5 billion, of which $80.3 billion were hedging the advances and $103.2 billion were hedging the consolidated obligations funding the advances. At December 31, 2003, the notional amount of interest rate exchange agreements associated with the advances-related business totaled $119.8 billion, of which $46.9 billion were hedging the advances and $72.9 billion were hedging the consolidated obligations

funding the advances. The additional hedges associated with advances and consolidated obligations were primarily used to convert the fixed rate cash flows to adjustable rate cash flows.

Mortgage-Related Business. The mortgage-related business consists of MBS investments, mortgage loans acquired through the Mortgage Partnership Finance® (MPF®) Program, and the consolidated obligations specifically identified as funding those assets and related hedging instruments. ("Mortgage Partnership Finance" and "MPF" are registered trademarks of the Federal Home Loan Bank of Chicago.) 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 for this segment, including the cash flows from associated interest rate exchange agreements, was $53 million in the second quarter of 2004, an increase of $30 million, or 130%, from the second quarter of 2003, and was $89 million in the first six months of 2004, an increase of $38 million, or 75%, from the first six months of 2003. The increases were largely due to higher average balances and wider profit spreads on the mortgage loan and MBS portfolios. In particular, average mortgage loans increased $4.5 billion and average MBS investments increased $2.5 billion in the second quarter of 2004 compared to the second quarter of 2003. Compared to the first six months of 2003, average mortgage loans increased by $5.0 billion and average MBS investments increased by $1.7 billion in the first six months of 2004.

Including the cash flows from associated interest rate exchange agreements, this segment represented 42% and 24% of total Bank net interest income including cash flows from economic hedges for the second quarter of 2004 and 2003, respectively, and 39% and 26% of total Bank net interest income including cash flows from economic hedges for the first six months of 2004 and 2003, 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. One or more of the other Federal Home Loan Banks (FHLBanks) may participate in all or a portion of the loans purchased by the Bank.

The Bank held conventional fixed rate conforming mortgage loans totaling $6.3 billion at June 30, 2004, and $6.4 billion at December 31, 2003, which were purchased from 8 participating members.

The Bank periodically reviews its mortgage loan portfolio to identify probable credit losses within the portfolio and to determine the likelihood of collection of the portfolio. The Bank establishes an allowance for credit losses on the mortgage loan portfolio based on management's estimate of probable credit losses as of the balance sheet date.

The Bank's allowance for credit losses consists of two components. The first is a component that is assigned to any individual loan that is specifically identified as "impaired." A loan is considered impaired when it is reported 90 days or more past due or when it is probable, based on current information and events, that the Bank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreement. At June 30, 2004, the Bank had 11 loans totaling $1 million classified as nonaccrual or impaired. Because the amount of credit enhancement and supplemental mortgage insurance associated with these loans was sufficient to cover the estimated losses on these loans, management determined that an allowance for credit losses was not required for these loans.

The second component of the Bank's allowance for credit losses is that portion assigned to loans that are not specifically identified as impaired, based on management's estimate of probable credit losses inherent in the portfolio. At June 30, 2004, the Bank established an allowance for credit losses of $240,000 for the mortgage loan portfolio.

No mortgage 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.

MBS Investments—The Bank's MBS portfolio increased 20% to $19.6 billion, or approximately 278% of capital, at June 30, 2004, from $16.3 billion, or approximately 279% of capital, at December 31, 2003. During 2004, the Bank purchased $7.3 billion in MBS. However, as a result of relatively low interest rates, MBS principal payments totaled $4.0 billion. MBS portfolio balances continued to be slightly below the regulatory maximum authorized level of 300% of capital. Management expects to continue to invest in MBS near the maximum authorized 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 intermediate-term and long-term fixed rate MBS investments are subject to prepayment risk, and the long-term adjustable rate MBS investments are subject to interest rate cap risk. The Bank has managed these risks by (i) funding the fixed rate MBS with non-callable and callable debt, and (ii) 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.

Total consolidated obligations funding the mortgage-related business increased $3.3 billion, or 14%, to $26.0 billion at June 30, 2004, since December 31, 2003, paralleling the growth in mortgage-related assets.

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 partially offset the losses or gains on the associated interest rate exchange agreements. During the second quarter of 2004 and 2003, this designation allowed the Bank to mark certain MBS to fair value (for a $15 million loss and a $3 million gain, respectively) to partially offset the mark-to-fair value of the associated interest rate exchange agreements (a $14 million gain and a $1 million loss, respectively), for a net loss of $1 million and a net gain of $1 million, respectively. During the first six months of 2004 and 2003, this designation allowed the Bank to mark certain MBS to fair value (for an $11 million loss and a $2 million gain, respectively) to partially offset the mark-to-fair value of the associated interest rate exchange agreements (an $11 million gain and a $415,000 loss, respectively), for a net loss of $674,000 and net gain of $2 million, respectively.

At June 30, 2004, the notional amount of interest rate exchange agreements associated with the mortgage-related business totaled $8.6 billion, of which $0.4 billion were hedging specific MBS classified as held-at-fair-value and $8.2 billion were hedging the consolidated obligations funding the mortgage portfolio.

Capital

Capital and Capital Ratios. Average capital during the second quarter of 2004 was $6.7 billion, a 24% increase from the second quarter of 2003. Average capital during the first six months of 2004 was $6.4 billion, a 17% increase from the first six months of 2003. This increase is consistent with the rise in average advances and mortgage loans outstanding from the second quarter of 2003 through the second quarter of 2004, and

primarily reflects capital stock purchases by new members and additional capital stock purchases by existing members to support additional borrowings during the period. This increase was net of repurchases of capital stock, which primarily resulted from 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. In accordance with this policy, the Bank repurchased $94 million in surplus capital stock in July 2004 that was subject to repurchase as of June 30, 2004.

The Bank implemented its new capital plan on April 1, 2004, under which each member is required to own stock in an amount equal to the greater of its membership stock requirement or its activity-based stock requirement. Four members, which had capital stock with a total par value of $16 million at March 31, 2004, opted not to participate in the capital plan, and the Bank redeemed their capital stock. All other members participated in the exchange, and outstanding shares of existing capital stock were automatically exchanged for Class B stock redeemable upon five years' notice to the Bank. The implementation of the capital plan resulted in a net $179 million increase in the Bank's capital. Provisions of the new capital plan are more fully discussed in the Bank's 2003 Annual Report in Note 13 to the Financial Statements.

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 Member Products Policy addresses the Bank's management of products offered to members and housing associates. 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. For more information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Risk Management" in the Bank's 2003 Annual Report.

Concentration Risk

At June 30, 2004, the Bank had a concentration of advances totaling $83.8 billion outstanding to three members, representing 70% of total advances outstanding, as presented below. Advances held by these three members generated approximately $273 million or 58% of advances interest income for the second quarter of 2004, and $508 million or 57% of advances interest income for the first six months of 2004.

Concentration of Advances
June 30, 2004
(In millions)

Name of Borrower	Advances Outstanding
Washington Mutual Bank, FA	$ 48,954
World Savings Bank, FSB	18,213
Citibank (West), FSB	16,646
Subtotal	83,813
Other borrowers	35,333
Total par amount	$ 119,146

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 its financial management and profitability if it were to lose one or more of these members.

If these members were to prepay the advances (subject to the Bank's limitations on the amount of advance prepayments from a single member in a day and/or a month) 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, outstanding debt, and operating expenses. The timing and magnitude of the adjustment period would depend on a number of factors, including: (i) the period over which the advances are prepaid or repaid, (ii) the amount and timing of any decreases in capital; (iii) the profitability of any loans that were repaid; (iv) the profitability of the Bank's investment portfolio; (v) the amount of outstanding advances remaining; (vi) the degree to which debt can be paid down as advances are prepaid or repaid; and (vii) the ability of the Bank to extinguish debt or transfer it to other FHLBanks and the costs to extinguish or transfer debt. As discussed in "Our Business Model" in the Bank's 2003 Annual Report, however, the Bank's financial strategies are designed to enable it 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. However, at its discretion, under certain conditions the Bank may repurchase excess Class B stock at any time before the five years have expired.

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 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 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 up to three times the Bank's capital to satisfy these requirements and objectives.

The Bank's primary sources of liquidity are short-term investments and 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. On a regular basis, the Bank monitors its liquidity position by projecting cash flows and funding needs over various maturity horizons.

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. Although the Bank's regulatory liquidity requirement is to maintain at least five days of liquidity without access to the capital markets, the Bank maintains at least three months of liquidity. On a daily basis, the Bank models its cash commitments and expected cash flows for the next 90 days to determine each day's projected liquidity position. If a market or operational disruption occurred in which the Bank could not issue new consolidated obligation bonds or discount notes via the capital markets, the Bank could meet its contractual obligations by: (i) allowing short-term liquid investments to mature; (ii) borrowing against eligible securities; and (iii) if necessary, allowing advances to mature without rollover or renewal.

Credit Risk

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 members. 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 members that experience difficulty in meeting their capital requirements or other standards of creditworthiness.

Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no allowance for credit losses on advances is deemed necessary by management.

MPF Program. The Bank and the member selling loans to the Bank under the MPF Program share in the credit risk of the loans sold by that member 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 a level equivalent to at least an AA rating.

The Bank provides for a loss allowance, net of credit enhancement, for any impaired loans in addition to estimates of other probable losses, 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.

Mortgage loan delinquencies were as follows:

(In millions)	June 30, 2004	December 31, 2003
30 – 59 days delinquent	$ 19	$ 35
60 – 89 days delinquent	1	1
90 days or more delinquent	1	—
Total delinquencies	$ 21	$ 36
Nonaccrual loans[1]	$ 1	$ —
Loans past due 90 days or more and still accruing interest	—	—
Delinquencies as a percent of total mortgage loans outstanding	0.33%	0.56%
Nonaccrual loans as a percent of total mortgage loans outstanding	0.02%	—

[1] The nonaccrual loans included 6 loans totaling $575,000 that were in foreclosure or bankruptcy as of June 30, 2004.

For the six months ended June 30, 2004, interest income that was contractually due but not received and interest income foregone on the nonaccrual loans was $20,000.

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. The following tables present the Bank's investment credit exposure at the dates indicated, based on counterparties' long-term credit ratings provided by Moody's Investors Service, Standard and Poor's, or Fitch Ratings.

Investment Credit Exposure
June 30, 2004
(In millions)

	Credit Rating[1]				
Investment Type	AAA	AA	A	BBB	Total
Interest-bearing deposits in banks	$ —	$ 2,790	$ 785	$ —	$ 3,575
Securities purchased under agreements to resell[2]	850	—	—	—	850
Federal funds sold	—	3,567	3,385	18	6,970
Held-to-maturity securities:					
Commercial paper	460	300	499	—	1,259
Housing finance agency bonds	1,561	—	—	—	1,561
MBS	19,225	—	—	—	19,225
Total held-to-maturity securities	21,246	300	499	—	22,045
Held-at-fair-value securities:					
Housing finance agency bonds	682	—	—	—	682
MBS	370	—	—	—	370
Total held-at-fair-value securities	1,052	—	—	—	1,052
Total investments	$ 23,148	$ 6,657	$ 4,669	$ 18	$ 34,492

December 31, 2003
(In millions)

	Credit Rating[1]				
Investment Type	AAA	AA	A	BBB	Total
Interest-bearing deposits in banks	$ —	$ 3,100	$ 187	$ —	$ 3,287
Securities purchased under agreements to resell[2]	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

[1] At June 30, 2004, $1.3 billion of the A-rated investments and all of the BBB-rated investments were with members. At December 31, 2003, all of the A-rated investments were with members. The A- and BBB-rated investments all had maturities of 3 months or less as of June 30, 2004, and December 31, 2003.
[2] Classified based on the credit rating of securities held as collateral.

Derivatives Counterparties. The Bank has also adopted credit policies and exposure limits for derivatives and off-balance sheet credit exposure. All extensions of credit (including interest rate swaps, caps, and floors) to counterparties that are members of the Bank must be fully secured by eligible collateral. For non-member

counterparties, the Bank selects only highly rated 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 unsecured credit exposure to these counterparties. Under these policies and agreements, the amount of unsecured credit exposure to an individual counterparty is the lesser of (i) an amount commensurate with the counterparty's capital and its credit quality, as determined by rating agency long-term credit ratings of the counterparty's debt securities or deposits, or (ii) 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
June 30, 2004
(In millions)

Credit Rating	Notional Balance	Gross Credit Exposure	Collateralized Exposure	Net Unsecured Exposure
AAA	$ 25	$ —	$ —	$ —
AA	79,802	30	20	10
A	111,387	34	18	16
Subtotal	191,214	64	38	26
Member institutions [1]	922	23	23	—
Total derivatives	$ 192,136	$ 87	$ 61	$ 26

December 31, 2003
(In millions)

Credit Rating	Notional Balance	Gross Credit Exposure	Collateralized Exposure	Net Unsecured 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

[1] Collateral held with respect to interest rate exchange agreements with members 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 members for the benefit of the Bank.

Market Risk

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 profile reflects the Bank's objective of maintaining a conservative asset-liability mix and its commitment to providing value to its members without subjecting their capital to significant interest rate risk.

Total Bank Market Risk

Market Value of Equity Sensitivity—Management uses market value of equity sensitivity (the sensitivity of the net value of all assets, liabilities, and interest rate exchange agreements) 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 following table presents the estimated percentage change in the Bank's market value of equity that would result from a 100-basis point change in interest rates under different interest rate scenarios.

Market Value of Equity Sensitivity
Percentage Change in Market Value of Bank Equity Per 100-Basis-Point Change in Interest Rates:

Interest Rate Scenario	June 30, 2004	December 31, 2003
Actual rates at dates indicated	–3.1%	–2.2%
Rates start 200 basis points higher	–3.9%	–3.5%
Rates start 200 basis points lower	+1.9%	+1.0%

The change in the sensitivity of the estimated market value of equity to changes in interest rates at June 30, 2004, compared to December 31, 2003, was due in part to the Bank's periodic reinvestment of capital into intermediate-term fixed rate assets during 2004 and in part to an increase in the sensitivity of the market value of the mortgage portfolio to changes in interest rates.

Net Interest Income Sensitivity—The Bank limits the sensitivity of projected 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 (limited such that interest rates cannot be less than zero) on the projected dividend yield, measured over a 12-month forecast period, to –175 basis points. Results of simulations as of June 30, 2004, showed that the adverse change in the projected potential dividend yield from an instantaneous and parallel plus or minus change of 200 basis points in interest rates was –91 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). 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").

Repricing Gap Analysis
As of June 30, 2004
(In millions)

	Interest Rate Sensitivity Period			
	Less Than 6 Months	6 Months to 1 Year	1 to 5 Years	Over 5 Years
Advances-related business:				
Assets				
Investments	$ 14,915	$ —	$ —	$ —
Advances	84,560	19,456	13,601	1,507
Other assets	318	—	—	—
Total Assets	99,793	19,456	13,601	1,507
Liabilities				
Consolidated obligations:				
Bonds	41,369	13,587	42,382	5,233
Discount notes	21,943	653	—	—
Deposits	906	—	—	—
Other liabilities	1,039	—	—	190
Total Liabilities	65,257	14,240	42,382	5,423
Interest rate exchange agreements	(30,436)	(4,742)	31,376	3,802
Periodic gap	4,100	474	2,595	(114)
Mortgage-related business:				
Assets				
MBS	5,922	1,381	6,562	5,731
Mortgage loans	403	347	2,162	3,423
Other assets	87	—	—	—
Total Assets	6,412	1,728	8,724	9,154
Liabilities				
Consolidated obligations:				
Bonds	3,277	880	11,644	3,851
Discount notes	5,804	562	—	—
Total Liabilities	9,081	1,442	11,644	3,851
Interest rate exchange agreements	1,035	—	713	(1,748)
Periodic gap	(1,634)	286	(2,207)	3,555
Total periodic gap	$ 2,466	$ 760	$ 388	$ 3,441

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 1.1 months as of June 30, 2004, and 0.6 months as of December 31, 2003. The slight increase in the duration gap during

the first half of 2004 was due to the rise in intermediate-term interest rates that lengthened the expected lives of fixed rate MBS and mortgage loans.

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 into fixed rate assets of targeted amounts and maturities. In general, advances create very little net interest rate risk for the Bank because most fixed rate advances with original maturities greater than 3 months and advances with embedded options are hedged contemporaneously with an interest rate swap or option with terms comparable to the advance. The interest rate swaps and options generally are maintained as hedges for the life of the advances. 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 advance portfolio with low net interest rate risk.

Non-MBS investments assets have maturities of less than 3 months or are variable rate investments. These investments also effectively match the interest rate risk of the Bank's funding that is swapped to a variable rate.

Mortgage-Related Business—The Bank's mortgage assets include MBS, of which most are classified as held-to-maturity and some are classified as held-at-fair-value, and mortgage loans purchased under the MPF Program. The Bank is exposed to interest rate risk from the mortgage-related business because the cash flows of the mortgage assets and the liabilities that fund them are not exactly 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 Bank purchases a mix of long-term and intermediate-term fixed rate and floating rate MBS. This results in portfolios of MBS and mortgage loans that have a diversified set of interest rate risk attributes.

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 June 30, 2004, and December 31, 2003.

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:

Interest Rate Scenario	June 30, 2004	December 31, 2003
Actual rates at dates indicated	–1.9%	–1.5%
Rates start 200 basis points higher	–2.6%	–2.4%
Rates start 200 basis points lower	–1.6%	–1.4%

Net Interest Income Sensitivity
Potential Dividend Yield Change Attributable to the Mortgage-Related Business for the Following 12-Month Period:

	June 30, 2004	December 31, 2003
Instantaneous +200-basis-point change	–0.27%	–0.07%
Instantaneous –200-basis-point change	–0.41%	–0.67%

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 putable interest rate swaps, and futures and forward contracts (collectively, interest rate exchange agreements) to manage its exposure to changes in interest rates.

At June 30, 2004, the Bank had $192.1 billion total notional amount of interest rate exchange agreements outstanding, compared with $126.8 billion at December 31, 2003. The $65.4 billion increase in the notional amount of derivatives during the 2004 is primarily due to (i) a $33.4 billion increase in interest rate swaps used to hedge the market risk of new short- and intermediate-term fixed rate advances made during 2004, and (ii) a $31.1 billion increase in interest rate swaps that hedge various types of consolidated obligations issued during 2004. 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 value gains and losses of the Bank's interest rate exchange agreements, excluding accrued interest, and related hedged items by product and type of accounting treatment under SFAS 133 as of June 30, 2004.

Fair Value Gains/(Losses) of Derivatives, Hedged Items, and Held-At-Fair-Value Securities
June 30, 2004 *

(In millions)	Notional Amount	Cumulative Gain/(Loss) Derivatives	Hedged Instruments	Difference
Qualifying for Hedge Accounting:				
Advances	$ 75,564	$ 28	$ (28)	$ —
Callable bonds	39,597	(443)	598	155
Non-callable consolidated obligations	35,722	(87)	91	4
Mortgage asset funding	1,565	16	(13)	3
Subtotal	152,448	(486)	648	162
Not Qualifying for Hedge Accounting:				
Advances	4,739	(2)	—	(2)
Consolidated obligations:				
Bifurcated	394	12	(12)	—
Other	25,670	(2)	—	(2)
Intermediated	1,834	1	—	1
Mortgage assets:				
Mortgage asset funding	6,581	3	—	3
MBS – held-at-fair-value	355	(12)	11	(1)
MPF firm commitments	5	24	—	24
Subtotal	39,578	24	(1)	23
Total	$ 192,026	$ (462)	$ 647	185
Assessments				(49)
Fair value gain after assessments, recorded to income				$ 136
Other comprehensive income/(loss):				
Mortgage asset funding	110			$ (8)
Total	$ 192,136			

* The notional amounts outstanding are as of June 30, 2004, and the cumulative gains and losses are since the adoption of SFAS 133 through the period ended June 30, 2004.

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 (i) interest rate spreads between FHLBank System consolidated obligation debt and comparable term LIBOR rates and interest rate swaps, (ii) the expected life of swapped callable debt resulting from changes in the absolute level of interest rates, and (iii) the implied volatility of interest rates.

The ongoing impact of SFAS 133 on the Bank cannot be predicted. Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will generally reverse over the remaining contractual terms to maturity of the hedged financial instruments and associated interest rate exchange agreements. Although restricted retained earnings may preserve the Bank's ability to pay

dividends, reversal of SFAS 133 cumulative net unrealized gains in any given quarter may result in a net loss before the impact of SFAS 133 for that quarter. If the cumulative net effect of SFAS 133 since inception ($136 million of cumulative net gains as of June 30, 2004) results in a net loss, the Bank's future retained earnings 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 and dividends.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with GAAP requires management to make a number of judgments, estimates, and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities (if applicable), and the reported amounts of income and expenses during the reported period. Although management believes these judgments, estimates, and assumptions to be reasonably accurate, actual results may differ.

The Bank has identified three accounting policies that it believes are critical because they require management to make subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies include estimating the allowance for credit losses on the advance and mortgage loan portfolios; estimating fair values on certain assets and liabilities, including investments classified as held-at-fair-value and all derivatives and associated hedged items accounted for in accordance with SFAS 133; and estimating the fair value of the collateral that members pledge for advance borrowings. These policies and the judgments, estimates, and assumptions are described in greater detail in the Bank's 2003 Annual Report in Note 1 to the Financial Statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Polices and Estimates."

Recent Developments

Finance Board Rule on Registration under the Securities Exchange Act of 1934. On June 29, 2004, the Finance Board published its final rule requiring the FHLBanks to voluntarily register a class of equity securities with the Securities and Exchange Commission (SEC) under Section 12(g)(1) of the Securities Exchange Act of 1934 (1934 Act). Registration of equity securities will require the FHLBanks to comply with the disclosure and reporting requirements of the 1934 Act and to file annual, quarterly, and current reports with the SEC, as well as any other materials required. The final rule requires the FHLBanks to file their registration statements with the SEC no later than June 30, 2005, with registration to be effective no later than August 29, 2005. It is uncertain at this time what effect, if any, such registration will have on the cost of FHLBank System debt or other aspects of the Bank's operations.

Proposed Changes to GSE Regulation. In April 2004, the Senate Banking, Housing and Urban Affairs Committee narrowly approved draft legislation restructuring the regulation of Fannie Mae, Freddie Mac, and the FHLBanks (housing GSEs) by, among other steps, establishing a new regulator for the housing GSEs. At this time, it appears unlikely that there will be any final legislation affecting the FHLBanks, the other housing GSEs, or their regulators in 2004.

Report of Independent Accountants

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

We have reviewed the accompanying Statements of Condition of Federal Home Loan Bank of San Francisco as of June 30, 2004 and 2003, and the related Statements of Income for each of the three-month and six-month periods ended June 30, 2004 and 2003, and the Statements of Capital accounts for the three-month and six-month periods ended June 30, 2004 and 2003, and the Statements of Cash Flows for the six-month periods ended June 30, 2004 and 2003. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial statements consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of management and the Board of Directors of the Federal Home Loan Bank of San Francisco and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP
San Francisco, California
August 9, 2004

Statements of Condition

(In millions-except par value)	June 30, 2004 (Unaudited)	Dec. 31, 2003	June 30, 2003 (Unaudited)
Assets			
Cash and due from banks	$ 17	$ 18	$ 1
Interest-bearing deposits in banks	3,575	3,287	3,600
Deposits for mortgage loan program with other Federal Home Loan Bank	2	12	39
Securities purchased under agreements to resell	850	5,100	4,300
Federal funds sold	6,970	5,434	5,307
Held-to-maturity securities ($318, $127, $245, respectively, were pledged as collateral)	22,045	18,263	17,545
Held-at-fair-value securities	1,052	917	772
Advances	119,124	92,330	71,634
Mortgage loans held in portfolio, net of allowance for credit losses on mortgage loans of $0.2, $0, $0	6,335	6,445	2,390
Accrued interest receivable	243	218	207
Premises and equipment, net	7	8	8
Derivative assets	87	266	458
Other assets	68	92	46
Total Assets	$ 160,375	$ 132,390	$ 106,307
Liabilities and Capital			
Liabilities:			
Deposits:			
Demand and overnight	$ 843	$ 832	$ 830
Term	38	66	32
Other	25	90	87
Total deposits	906	988	949
Consolidated obligations, net:			
Bonds	122,223	92,751	89,202
Discount notes	28,962	31,882	9,541
Total consolidated obligations	151,185	124,633	98,743
Accrued interest payable	592	528	554
Affordable Housing Program	135	135	133
Payable to REFCORP	38	16	22
Derivative liabilities	409	181	343
Other liabilities	55	63	157
Total Liabilities	153,320	126,544	100,901
Commitments and Contingencies: Note 11			
Capital:			
Capital stock-Class B ($100 par value) issued and outstanding: 69 shares	6,882	—	—
Capital stock ($100 par value) issued and outstanding: 57 shares and 54 shares, respectively	—	5,739	5,371
Retained earnings	181	119	39
Accumulated other comprehensive loss:			
Unrecognized net loss related to hedging activities	(8)	(12)	(4)
Total Capital	7,055	5,846	5,406
Total Liabilities and Capital	$ 160,375	$ 132,390	$ 106,307

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

Statements of Income

(Unaudited)

(In millions-except per share amounts)	Three months ended June 30, 2004	Three months ended June 30, 2003	Six months ended June 30, 2004	Six months ended June 30, 2003
Interest Income:				
Advances	$ 351	$ 286	$ 661	$ 606
Interest-bearing deposits in banks	10	13	19	26
Securities purchased under agreements to resell	5	9	16	16
Federal funds sold	21	20	43	40
Held-to-maturity securities	164	149	310	317
Held-at-fair-value securities	7	7	15	15
Mortgage loans	82	20	160	31
Total Interest Income	640	504	1,224	1,051
Interest Expense:				
Consolidated obligations	496	398	962	835
Deposits	1	1	2	2
Total Interest Expense	497	399	964	837
Net Interest Income Before Mortgage Loan Loss Provision	143	105	260	214
Provision for credit losses on mortgage loans	—	(1)	—	—
Net Interest Income After Mortgage Loan Loss Provision	143	106	260	214
Other Income:				
Prepayment fees	2	2	4	3
Net (loss)/gain on held-at-fair-value securities	(15)	2	(11)	2
Net gain/(loss) on derivatives and hedging activities	90	23	45	(7)
Other, net	1	1	2	2
Total Other Income	78	28	40	—
Other Expense:				
Operating expense	15	13	29	26
Federal Housing Finance Board	1	1	2	2
Office of Finance	1	—	2	1
Total Other Expense	17	14	33	29
Income Before Assessments	204	120	267	185
REFCORP assessments	37	22	49	34
Affordable Housing Program assessments	17	10	22	15
Total Assessments	54	32	71	49
Net Income	$ 150	$ 88	$ 196	$ 136
Net income per share	$ 2.31	$ 1.63	$ 3.11	$ 2.52
Average shares outstanding	65	54	63	54

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

Statements of Capital Accounts

(Unaudited)

(In millions)	Capital Stock Class B		Capital Stock		Retained Earnings			Accumulated Other Comprehensive Income/(Loss)	Total Capital
	Shares	Par Value	Shares	Par Value	Restricted	Unrestricted	Total		
Balance, March 31, 2003	—	$ —	57	$5,680	$ 9	$ —	$ 9	$(4)	$5,685
Issuance of capital stock			2	215					215
Redemption of capital stock			(6)	(582)					(582)
Comprehensive income:									
Net income						88	88		88
Other comprehensive income:									
Net amounts recognized as earnings								1	1
Net change in period relating to hedging activities								(1)	(1)
Total comprehensive income									88
Transfers to restricted retained earnings					30	(30)	—		—
Dividends on capital stock (4.34%)									
Stock issued			1	58		(58)	(58)		—
Balance, June 30, 2003	—	$ —	54	$5,371	$ 39	$ —	$ 39	$(4)	$5,406
Balance, March 31, 2004	—	$ —	63	$6,302	$106	$ —	$106	$(9)	$6,399
Issuance of capital stock	6	636	—	—					636
Redemption/repurchase of capital stock	(1)	(115)	—	(16)					(131)
Comprehensive income:									
Net income						150	150		150
Other comprehensive income:									
Net amounts recognized as earnings								(1)	(1)
Net change in period relating to hedging activities								2	2
Total comprehensive income									151
Transfers to restricted retained earnings					75	(75)	—		—
Conversion to Class B shares	63	6,286	(63)	(6,286)					—
Dividends on capital stock (4.68%)									
Stock issued	1	75	—	—		(75)	(75)		—
Balance, June 30, 2004	69	$6,882	—	$ —	$181	$ —	$181	$(8)	$7,055

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

Statements of Capital Accounts

(Unaudited)

(In millions)	Capital Stock Class B		Capital Stock		Retained Earnings			Accumulated Other Comprehensive Income/(Loss)	Total Capital
	Shares	Par Value	Shares	Par Value	Restricted	Unrestricted	Total		
Balance, December 31, 2002	—	$ —	56	$5,586	$ 26	$ 75	$101	$(2)	$ 5,685
Issuance of capital stock			7	654					654
Redemption of capital stock			(11)	(1,067)					(1,067)
Comprehensive income:									
Net income						136	136		136
Other comprehensive income:									
Net amounts recognized as earnings								1	1
Net change in period relating to hedging activities								(3)	(3)
Total comprehensive income									134
Transfers to restricted retained earnings					13	(13)	—		—
Dividends on capital stock (4.57%)									
Stock issued			2	198		(198)	(198)		—
Balance, June 30, 2003	—	$ —	54	$5,371	$ 39	$ —	$ 39	$(4)	$5,406
Balance, December 31, 2003	—	$ —	57	$5,739	$119	$ —	$119	$(12)	$ 5,846
Issuance of capital stock	6	636	7	689					1,325
Redemption/repurchase of capital stock	(1)	(115)	(2)	(201)					(316)
Comprehensive income:									
Net income						196	196		196
Other comprehensive income:									
Net amounts recognized as earnings								2	2
Net change in period relating to hedging activities								2	2
Total comprehensive income									200
Transfers to restricted retained earnings					62	(62)	—		—
Conversion to Class B shares	63	6,286	(63)	(6,286)					—
Dividends on capital stock (4.33%)									
Stock issued	1	75	1	59		(134)	(134)		—
Balance, June 30, 2004	69	$6,882	—	$ —	$181	$ —	$181	$(8)	$ 7,055

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

Statements of Cash Flows

(Unaudited)

(In millions)	Six months ended June 30, 2004	June 30, 2003
Cash Flows from Operating Activities:		
Net Income	$ 196	$ 136
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization:		
Net premiums/discounts on consolidated obligations and investments	9	(19)
Net discounts/premiums on mortgage loans	(1)	6
Concessions on consolidated obligations	20	28
Bank premises and equipment	2	1
Deferred net losses on interest rate exchange agreements	—	1
Increase in Affordable Housing Program (AHP) liability and discount on AHP advances	—	1
Increase in REFCORP liability	22	8
Gain due to change in net fair value adjustment on derivative and hedging activities	(431)	(14)
Increase in held-at-fair-value securities	(135)	(239)
Decrease in derivative asset accrued interest	6	30
Increase in derivative liability accrued interest	351	26
(Increase)/decrease in accrued interest receivable	(25)	78
Increase/(decrease) in accrued interest payable	64	(161)
Decrease/(increase) in other assets	32	(5)
Decrease in other liabilities	(18)	(1)
Total adjustments	(104)	(260)
Net cash provided by/(used in) operating activities	92	(124)
Cash Flows from Investing Activities:		
Net (increase)/decrease in interest-bearing deposits in banks	(288)	1,234
Net (increase)/decrease in Federal funds sold	(1,536)	761
Net decrease in securities purchased under agreements to resell	4,250	100
Net (increase)/decrease in short-term held-to-maturity securities	(209)	156
Purchases of long-term held-to-maturity securities	(7,552)	(5,517)
Maturities of long-term held-to-maturity securities	3,987	5,813
Principal collected on advances	395,578	243,081
Advances made	(422,771)	(233,678)
Principal collected on mortgage loans	449	139
Purchases of mortgage loans	(338)	(2,272)
Net decrease in deposits for mortgage loan program with other Federal Home Loan Bank	10	19
Increase to premises and equipment	—	(2)
Net cash (used in)/provided by investing activities	(28,420)	9,834

Statements of Cash Flows

(Unaudited)

(In millions)	Six months ended June 30, 2004	June 30, 2003
Cash Flows from Financing Activities:		
Net (decrease)/increase in deposits	(82)	542
Net decrease in other borrowings	—	(525)
Net proceeds from sale of consolidated obligations:		
Bonds	57,245	59,701
Discount notes	116,634	75,233
Payments for maturing and retiring consolidated obligations:		
Bonds	(26,920)	(66,139)
Discount notes	(119,559)	(78,117)
Proceeds from issuance of capital stock	1,325	654
Payments for redemption/repurchase of capital stock	(316)	(1,067)
Net cash provided by/(used in) financing activities	28,327	(9,718)
Net decrease in cash and cash equivalents	(1)	(8)
Cash and cash equivalents at beginning of year	18	9
Cash and cash equivalents at end of period	$ 17	$ 1
Supplemental Disclosure:		
Interest paid during the period	$ 786	$ 1,131

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

(Dollars in millions except per share amounts)

Note 1 – Summary of Significant Accounting Policies

The significant accounting policies and the financial condition and results of operations of the Federal Home Loan Bank of San Francisco (Bank) as of December 31, 2003, are contained in the 2003 Annual Report. The unaudited second quarter 2004 financial statements should be read in conjunction with the 2003 Annual Report. The accompanying financial statements of the Bank contain all adjustments necessary for a fair presentation of the interim financial condition and results of operations, and conform with generally accepted accounting principles (GAAP). The results of operations for the three-month and six-month periods ended June 30, 2004, are not necessarily indicative of the results to be expected for the full year.

Use of Estimates. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if applicable, and the reported amounts of income and expenses during the reporting period. Changes in the estimates and assumptions could potentially affect the Bank's financial position and results of operations significantly. In addition, actual results could differ from these estimates.

Descriptions of the significant accounting policies of the Bank are included in Note 1 to the Financial Statements in the Bank's 2003 Annual Report. There have been no significant changes to these policies as of June 30, 2004.

Reclassifications. Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 presentation. In particular, for the three-month and six-month periods ended June 30, 2003, the Bank reclassified realized gains and losses (net interest payments) on stand-alone derivative instruments used in economic hedges based on guidance provided by the Securities and Exchange Commission to users of derivative instruments. Economic hedges are hedges of an asset or liability that do not qualify for hedge accounting treatment under the provisions of Statement of Financial Accounting Standards (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 by SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities,* on July 31, 2003 (together referred to as "SFAS 133"). Previously, realized gains and losses on stand-alone derivatives used in economic hedges were classified in "Net Interest Income After Mortgage Loan Loss Provision," while unrealized gains and losses on these derivatives were recorded in "Net gain/(loss) on derivatives and hedging activities" in Other Income. These amounts have been reclassified and are now both included in "Net gain/(loss) on derivatives and hedging activities" for the three-month and six-month periods ended June 30, 2003. As a result of this reclassification, for the quarter ended June 30, 2003, "Net Interest Income After Mortgage Loan Loss Provision" changed from $97 to $106, and "Net gain/(loss) on derivatives and hedging activities" changed from a gain of $32 to a gain of $23. For the six months ended June 30, 2003, "Net Interest Income After Mortgage Loan Loss Provision" changed from $200 to $214, and "Net gain/(loss) on derivatives and hedging activities" changed from a gain of $7 to a loss of $7.

Note 2 – Held-to-Maturity Securities

Held-to-maturity securities were as follows:

June 30, 2004	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$ 1,259	$ —	$ —	$ 1,259
Housing finance agency bonds	1,561	9	(1)	1,569
Subtotal	2,820	9	(1)	2,828
Mortgage-Backed Securities (MBS):				
U.S. government agency-guaranteed	1,210	15	(19)	1,206
Non-agency	18,015	29	(168)	17,876
Total MBS	19,225	44	(187)	19,082
Total	$ 22,045	$ 53	$ (188)	$ 21,910

December 31, 2003	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$ 1,042	$ —	$ —	$ 1,042
Housing finance agency bonds	1,328	6	(1)	1,333
Subtotal	2,370	6	(1)	2,375
MBS:				
U.S. government agency-guaranteed	1,180	22	(8)	1,194
Non-agency	14,713	50	(67)	14,696
Total MBS	15,893	72	(75)	15,890
Total	$ 18,263	$ 78	$ (76)	$ 18,265

Redemption Terms. The amortized cost and estimated fair value of certain securities by contractual maturity and MBS as of June 30, 2004, and December 31, 2003, are shown below. Expected maturities of certain securities and MBS will differ from contractual maturities because borrowers generally have the right to prepay obligations without prepayment fees.

June 30, 2004 Year of Maturity	Amortized Cost	Estimated Fair Value	Weighted Average Interest Rate
Due in one year or less	$ 1,259	$ 1,259	1.16%
Due after five years through ten years	48	48	1.33
Due after ten years	1,513	1,521	1.39
Subtotal	2,820	2,828	1.28
MBS:			
U.S. government agency-guaranteed	1,210	1,206	4.00
Non-agency	18,015	17,876	3.57
Total MBS	19,225	19,082	3.60
Total	$ 22,045	$ 21,910	3.30%

December 31, 2003 Year of Maturity	Amortized Cost	Estimated Fair Value	Weighted Average Interest Rate
Due in one year or less	$ 1,042	$ 1,042	1.09%
Due after ten years	1,328	1,333	1.37
Subtotal	2,370	2,375	1.26
MBS:			
U.S. government agency-guaranteed	1,180	1,194	4.16
Non-agency	14,713	14,696	3.45
Total MBS	15,893	15,890	3.51
Total	$ 18,263	$ 18,265	3.16%

The amortized cost of the Bank's MBS classified as held-to-maturity included net premiums of $88 at June 30, 2004, and $75 at December 31, 2003.

Interest Rate Payment Terms. Interest rate payment terms for held-to-maturity securities at June 30, 2004, and December 31, 2003, are detailed in the following table:

	June 30, 2004	December 31, 2003
Amortized cost of held-to-maturity securities other than MBS:		
Fixed rate	$ 1,259	$ 1,042
Adjustable rate	1,561	1,328
Subtotal	2,820	2,370
Amortized cost of held-to-maturity MBS:		
Passthrough securities:		
Fixed rate	771	649
Adjustable rate	240	274
Collateralized mortgage obligations:		
Fixed rate	13,019	10,499
Adjustable rate	5,195	4,471
Subtotal	19,225	15,893
Total	$ 22,045	$ 18,263

Note 3 – Held-at-Fair-Value Securities

Held-at-fair-value securities were as follows:

	June 30, 2004	December 31, 2003
Housing finance agency bonds	$ 682	$ 493
MBS: U.S. government agency-guaranteed	370	424
Total	$ 1,052	$ 917

The net (loss)/gain on held-at-fair-value securities was $(15) for the quarter ended June 30, 2004, and $2 for the quarter ended June 30, 2003, and was $(11) for the six months ended June 30, 2004, and $2 for the six months ended June 30, 2003. These amounts represent the changes in the fair value of the securities during the reported periods. The weighted average interest rates on held-at-fair-value securities were 2.85% and 3.36% for the periods ended June 30, 2004, and December 31, 2003, respectively.

Note 4 – Advances

Redemption Terms. The Bank had advances outstanding at interest rates ranging from 0.99% to 8.75% at June 30, 2004, and 0.75% to 8.75% at December 31, 2003, as summarized below.

	June 30, 2004		December 31, 2003	
Year of Maturity	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Overdrawn demand deposit accounts	$ 1	3.38%	$ 2	2.94%
Due in 1 year or less	73,618	1.47	53,199	1.43
Due after 1 year through 2 years	15,513	1.91	12,370	1.88
Due after 2 years through 3 years	19,086	1.80	15,874	1.63
Due after 3 years through 4 years	5,422	2.83	3,944	2.51
Due after 4 years through 5 years	3,632	2.90	4,553	3.16
Thereafter	1,874	5.17	2,010	5.26
Subtotal	119,146	1.74%	91,952	1.74%
SFAS 133 valuation adjustments	(33)		367	
Deferred net loss on terminated interest rate exchange agreements	11		11	
Total	$ 119,124		$ 92,330	

Security Terms. The Bank lends to member financial institutions involved in housing finance that have a principal place of business in Arizona, California, or Nevada. The Bank is required by the Federal Home Loan Bank Act of 1932 (FHLB Act) to obtain sufficient collateral for advances to protect against losses and to accept only certain U.S. government or government agency securities, residential mortgage loans or MBS, cash or deposits in the Bank, and other eligible real estate-related assets as collateral for advances. The Bank may also accept secured small business, small farm, and small agribusiness loans as collateral from members that are community financial institutions (CFIs). For additional information on security terms, see Note 7 to the Financial Statements in the Bank's 2003 Annual Report.

Credit Risk. The Bank's potential credit risk from advances is concentrated in savings institutions. As of June 30, 2004, the Bank had a concentration of advances totaling $83,813 outstanding to three members, representing 70% of total outstanding advances (41%, 15%, and 14%, respectively). The interest income from advances to these members amounted to approximately $273 during the second quarter of 2004 and $508 for

the first six months of 2004. The Bank held collateral with an estimated value in excess of advances to these institutions, and the Bank does not expect to incur any credit losses on these advances.

The Bank has never experienced any credit losses on advances to a member. Management has policies and procedures in place to manage the credit risk of 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.

Interest Rate Payment Terms. Interest rate payment terms for advances at June 30, 2004, and December 31, 2003, are detailed below:

	June 30, 2004	December 31, 2003
Par amount of advances:		
Fixed rate	$ 75,775	$ 51,547
Adjustable rate	43,371	40,405
Total	$ 119,146	$ 91,952

Note 5 – Mortgage Loans

Under the Mortgage Partnership Finance® (MPF®) Program, the Bank purchases qualifying mortgage loans from its participating members. ("Mortgage Partnership Finance" and "MPF" are registered trademarks of the Federal Home Loan Bank of Chicago.) The mortgage loans represent held-for-investment loans under the MPF Program, under which the Bank's members originate, service, and credit-enhance home mortgage loans that are owned, either in part or in full, by the Bank. The following table presents information as of June 30, 2004, and December 31, 2003, on mortgage loans, all of which are conventional, conforming fixed rate loans on single-family properties:

	June 30, 2004	December 31, 2003
Fixed rate medium-term mortgage loans	$ 2,333	$ 2,282
Fixed rate long-term mortgage loans	4,022	4,183
Unamortized net discounts	(20)	(20)
Total mortgage loans	$ 6,335	$ 6,445

Medium-term loans have contractual terms of 15 years or less, and long-term loans have contractual terms of more than 15 years.

The allowance for credit losses on the mortgage loan portfolio was as follows:

	Three months ended		Six months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Balance, beginning of the period	$ 0.2	$ 1.2	$ —	$ 0.2
Chargeoffs	—	—	—	—
Recoveries	—	—	—	—
Provision for/(reduction of) credit losses	—	(1.2)	0.2	(0.2)
Balance, end of the period	$ 0.2	$ —	$ 0.2	$ —

The Bank established the allowance for credit losses on the mortgage loan portfolio based on management's estimate of probable credit losses, in addition to estimated losses on any impaired loans, as of the balance sheet date.

The Bank's allowance for credit losses consists of two components. The first is a component that is assigned to any individual loan that is specifically identified as "impaired." A loan is considered impaired when it is reported 90 days or more past due or, based on current information and events, it is probable that the Bank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreement. At June 30, 2004, the Bank had 11 loans totaling $1 classified as nonaccrual or impaired. Because the amount of credit enhancement and supplemental mortgage insurance associated with these loans was sufficient to cover the estimated losses on these loans, management determined that an allowance for credit losses was not required for these loans.

The remaining component of the Bank's allowance for credit losses is that portion assigned to loans that are not specifically identified as impaired, based on management's estimate of probable credit losses inherent in the portfolio as of that date. At June 30, 2004, the Bank established an allowance for credit losses of $240 thousand for the mortgage loan portfolio.

The Bank did not have any loans classified as nonaccrual or impaired, and no allowance for credit losses on mortgage loans was deemed necessary by management as of December 31, 2003.

Note 6 – Consolidated Obligations

Consolidated obligations are the joint and several obligations of the 12 Federal Home Loan Banks (FHLBanks) and consist of consolidated obligation bonds and discount notes. Consolidated obligations are jointly issued by the FHLBanks through the Office of Finance, which serves as their agent. The U.S. Secretary of the Treasury has oversight over the issuance of FHLBank debt through the Office of Finance.

Redemption Terms. The following is a summary of the Bank's participation in consolidated obligation bonds:

	June 30, 2004		December 31, 2003	
Year of Maturity	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Due in 1 year or less	$ 40,098	1.71%	$ 26,177	2.70%
Due after 1 year through 2 years	35,980	1.96	23,716	1.91
Due after 2 years through 3 years	14,916	2.97	14,516	2.91
Due after 3 years through 4 years	9,556	3.23	6,692	3.43
Due after 4 years through 5 years	10,339	3.49	10,194	3.37
Thereafter	12,063	4.41	11,282	4.57
Index amortizing notes	15	4.61	15	4.61
Subtotal	122,967	2.47%	92,592	2.88%
Bond premiums	67		74	
Bond discounts	(159)		(144)	
SFAS 133 valuation adjustments	(652)		229	
Total	$ 122,223		$ 92,751	

The Bank's participation in consolidated obligation bonds outstanding includes callable bonds of $52,361 at June 30, 2004, and $35,370 at December 31, 2003. Contemporaneous with such callable bond issuance, the Bank usually enters into an interest rate swap (in which the Bank pays a variable rate and receives a fixed rate) with a call feature that mirrors the option embedded in the bond (a sold callable swap). The combined sold callable swap and callable bond enable the Bank to meet its funding needs at costs not otherwise directly

attainable solely through the issuance of non-callable debt, while converting the Bank's payment to an adjustable rate. The Bank also uses fixed rate callable bonds to finance fixed rate callable advances, fixed rate MBS, and fixed rate mortgage loans.

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

	June 30, 2004	December 31, 2003
Par amount of consolidated obligation bonds:		
Non-callable	$ 70,606	$ 57,222
Callable	52,361	35,370
Total par value	$ 122,967	$ 92,592

The following is a summary of the Bank's participation in consolidated obligation bonds outstanding at June 30, 2004, and December 31, 2003, by the earlier of the year of contractual maturity or next call date:

Earlier of Year of Contractual Maturity or Next Call Date	June 30, 2004	December 31, 2003
Due in 1 year or less	$ 79,329	$ 56,717
Due after 1 year through 2 years	30,761	21,094
Due after 2 years through 3 years	5,281	8,412
Due after 3 years through 4 years	2,321	923
Due after 4 years through 5 years	3,688	4,030
Thereafter	1,572	1,401
Index amortizing notes	15	15
Total	$ 122,967	$ 92,592

Interest Rate Payment Terms. Interest rate payment terms for consolidated obligations at June 30, 2004, and December 31, 2003, are detailed in the following table:

	June 30, 2004	December 31, 2003
Par amount of consolidated obligations:		
Bonds:		
Fixed rate	$ 76,755	$ 61,576
Adjustable rate	35,194	23,429
Step-up	6,823	5,044
Fixed rate that converts to adjustable rate	2,051	325
Adjustable rate that converts to fixed rate	1,060	862
Comparative index	806	808
Zero-coupon	175	175
Inverse floating	88	358
Index amortizing notes	15	15
Total bonds, par	122,967	92,592
Discount notes, par	29,016	31,932
Total consolidated obligations, par	$ 151,983	$ 124,524

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

	June 30, 2004		December 31, 2003	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Par value	$ 29,016	1.16%	$ 31,932	1.05%
Discounts	(52)		(50)	
SFAS 133 valuation adjustments	(2)		—	
Total	$ 28,962		$ 31,882	

Note 7 – Capital

Capital Requirements. The Bank's new capital plan was implemented on April 1, 2004. To implement the capital plan, the Bank exchanged its outstanding capital stock for new Class B stock. Under the capital plan, the Bank issues only Class B stock, with a par value of $100 per share, which may be redeemed (subject to certain conditions) upon five years' notice by the member to the Bank. However, at its discretion, under certain conditions the Bank may repurchase excess stock at any time before the five years have expired. The stock may be issued, exchanged, redeemed, and repurchased only at its stated par value. The Bank may only redeem or repurchase capital stock from a member if, following the redemption or repurchase, the member will continue to meet its minimum stock requirement and the Bank will continue to meet its regulatory requirements for total capital, leverage capital, and risk-based capital.

Four members, which had capital stock with a total par value of $16, opted not to participate in the capital plan, and the Bank redeemed their capital stock. All other members participated in the exchange, and outstanding shares of existing capital stock were automatically exchanged for Class B stock redeemable upon five years' notice by the member to the Bank.

Capital requirements under the new plan are more fully discussed in Note 13 to the Financial Statements in the Bank's 2003 Annual Report.

Retained Earnings and Dividend Policy. The Bank has a Retained Earnings and Dividend Policy that establishes 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 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 $8 at June 30, 2004, and $10 at December 31, 2003.

In accordance with the Retained Earnings and Dividend Policy, the Bank also retains in restricted retained earnings any cumulative net unrealized gains in earnings, net of applicable assessments, resulting from SFAS 133. The unrealized gains exclude the realized interest income or expense on stand-alone derivatives used in economic hedges. Retained earnings restricted in accordance with this provision totaled $136 at June 30, 2004, and $87 at December 31, 2003. Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will generally reverse over the remaining contractual terms to maturity of the hedged financial instruments and associated interest rate exchange agreements. Although restricted retained earnings may preserve the Bank's ability to pay dividends, reversal of SFAS 133 cumulative net unrealized gains in any given quarter may result in a net loss if the reversal exceeds

net earnings before the impact of SFAS 133 for that quarter. If the cumulative net effect of SFAS 133 since inception ($136 of cumulative net gains as of June 30, 2004) results in a net loss, the Bank's future retained earnings may not be sufficient to offset the full impact of SFAS 133. As a result, the effect of SFAS 133 may lead to increased volatility in future earnings and dividends.

Effective April 1, 2003, the Board of Directors amended the Retained Earnings and Dividend Policy to provide for a build-up of retained earnings totaling $50 (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. Effective January 30, 2004, the Board of Directors further amended the Retained Earnings and Dividend Policy to provide for a build-up of retained earnings totaling $100 (less any cumulative net fair value losses in net income resulting from SFAS 133, with a floor of zero) by the end of 2006. At June 30, 2004, the retained earnings restricted in accordance with these provisions totaled $36.

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. The Bank has historically paid dividends on its stock in stock form and anticipates that any dividends will continue to be paid in stock form.

Surplus Capital Stock Repurchase Policy. The Bank's surplus capital stock repurchase policy allows the Bank to reduce its capital stock base if advances and mortgage loan balances decline. A member's surplus capital stock is defined as any stock holdings in excess of 115% of the member's capital stock requirement, excluding stock dividends earned and credited for the current year. In accordance with this policy, the Bank repurchased $94 of surplus capital stock in July 2004 that was subject to repurchase as of June 30, 2004.

Concentration. As of June 30, 2004, the Bank had a concentration of capital stock totaling 43 million shares outstanding to three members, representing 64% of total capital stock outstanding (38%, 13%, and 13%, respectively).

Note 8 – 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, based on the Bank's method of internal reporting. The advances-related business consists of advances and other credit products provided to members, related financing and hedging instruments, liquidity and other non-MBS investments associated with the Bank's role as a liquidity provider, and member capital. Net interest income for this segment is derived primarily from the difference, or spread, between the yield on all business activities in this segment and the cost of funding those activities, including earnings on invested member capital and the cash flows from associated interest rate exchange agreements. The mortgage-related business consists of MBS investments, mortgage loans acquired through the MPF Program, 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.

The following tables set forth the Bank's financial performance by operating segment for the three months and six months ended June 30, 2004 and 2003. Interest income and interest expense associated with economic hedges are recorded in other income in "Net gain/(loss) on derivatives and hedging activities" on the Statements of Income.

Net Interest Income

	Three months ended					
	June 30, 2004			June 30, 2003		
	Advances-Related Business	Mortgage-Related Business	Total	Advances-Related Business	Mortgage-Related Business	Total
Net interest income after mortgage loan loss provision	$ 71	$ 72	$ 143	$ 78	$ 28	$ 106
Interest income/(expense) on economic hedges not included in net interest income	2	(19)	(17)	(4)	(5)	(9)
Net interest income, as adjusted	$ 73	$ 53	$ 126	$ 74	$ 23	$ 97

	Six months ended					
	June 30, 2004			June 30, 2003		
	Advances-Related Business	Mortgage-Related Business	Total	Advances-Related Business	Mortgage-Related Business	Total
Net interest income after mortgage loan loss provision	$ 134	$ 126	$ 260	$ 151	$ 63	$ 214
Interest income/(expense) on economic hedges not included in net interest income	3	(37)	(34)	(2)	(12)	(14)
Net interest income, as adjusted	$ 137	$ 89	$ 226	$ 149	$ 51	$ 200

The following table sets forth total assets by operating segment:

	Advances-Related Business	Mortgage-Related Business	Total Assets
June 30, 2004	$ 134,357	$ 26,018	$160,375
December 31, 2003	$ 109,628	$ 22,762	$ 132,390

Note 9 – Interest Rate Exchange Agreements

The contractual or notional amounts of interest rate exchange agreements reflect the extent of the Bank's involvement in particular classes of financial instruments. The Bank had notional amounts outstanding of $192,136 at June 30, 2004, and $126,774 at December 31, 2003. The notional amount does not represent the exposure to credit loss. The Bank is subject to credit risk relating to the nonperformance by a counterparty to a non-exchange-traded interest rate exchange agreement. The amount potentially subject to credit loss is the estimated cost of replacing the favorable interest rate exchange agreement if the counterparty defaults; this amount is substantially less than the notional amount. However, based on management's credit analyses of Bank counterparties and on the Bank's bilateral netting arrangements and collateral requirements, no allowance for losses is deemed necessary by management.

Maximum credit risk is defined as the estimated cost of replacing all interest rate exchange agreements the Bank has transacted with counterparties where the Bank is in a net favorable position (i.e., has a net unrealized gain) if the counterparties all defaulted and the related collateral proved to be of no value to the Bank. At June 30, 2004, and December 31, 2003, the Bank's maximum credit risk, as defined above, was estimated at $87 and $266, respectively, including $34 and $93 of net accrued interest receivable, respectively. Accrued interest receivables and payables and the legal right to offset assets and liabilities by counterparty (under which amounts recognized for individual transactions may be offset against amounts recognized for

other transactions with the same counterparty) are considered in determining the maximum credit risk. The Bank held investment grade securities and mortgage loans valued at $60 and $215 as collateral from interest rate exchange counterparties as of June 30, 2004, and December 31, 2003, respectively. This collateral has not been sold or repledged. A significant number of the Bank's interest rate exchange agreements are transacted with financial institutions such as major banks and broker-dealers. Some of these banks and dealers or their affiliates buy, sell, and distribute consolidated obligations. Assets pledged as collateral by the Bank to these counterparties are more fully discussed in Note 11.

Intermediation. Interest rate exchange agreements in which the Bank is an intermediary may arise when the Bank enters into offsetting interest rate exchange agreements with members and other counterparties to meet the needs of members. The notional principal of the interest rate exchange agreements in which the Bank was an intermediary was $1,834 at June 30, 2004, and $976 at December 31, 2003.

Accounting for Derivative Instruments and Hedging Activities. SFAS 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The gains and losses on derivative instruments that are reported in other comprehensive income are recognized as earnings in the periods in which earnings are affected by the variability of the cash flows of the hedged item. The gains or losses on the ineffective portion of all hedges are recognized in current period earnings. Changes in the fair value of a non-SFAS 133 hedge of an asset or liability (economic hedge) for asset/liability management are recorded each period in current earnings.

As a result of SFAS 133, for the three months ended June 30, 2004 and 2003, the Bank recorded net gains on derivatives and hedging activities of $90 and $23, respectively, in other income. For the six months ended June 30, 2004 and 2003, the Bank recorded net gains/(losses) on derivatives and hedging activities of $45 and $(7), respectively, in other income. Net gains/(losses) on derivatives and hedging activities were as follows:

	Three months ended	
	June 30, 2004	June 30, 2003
Gains related to fair value hedge ineffectiveness	$ 106	$ 31
Losses on economic hedges	1	1
Net interest expense on stand-alone derivative instruments used in economic hedges	(17)	(9)
Net gains on derivatives and hedging activities	$ 90	$ 23

	Six months ended	
	June 30, 2004	June 30, 2003
Gains related to fair value hedge ineffectiveness	$ 70	$ 11
Losses on economic hedges	9	(4)
Net interest expense on stand-alone derivative instruments used in economic hedges	(34)	(14)
Net gains/(losses) on derivatives and hedging activities	$ 45	$ (7)

As of June 30, 2004, approximately $2 in deferred net losses on derivative instruments accumulated in other comprehensive income was expected to be reclassified to earnings during the next 12 months. The maximum length of time over which the Bank is hedging its exposure to the variability in future cash flows for forecasted transactions, excluding those forecasted transactions related to the payment of variable interest on existing financial instruments, is less than three months.

Note 10 – Estimated Fair Values

The following estimated fair value amounts have been determined by the Bank using available market information and the Bank's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to the Bank as of June 30, 2004, and December 31, 2003. 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. For example, because an active secondary market does not exist for a portion of the Bank's financial instruments, in certain cases fair values are not subject to precise quantification or verification and may change as economic and market factors and evaluation of those factors change. Therefore, these estimated fair values are not necessarily indicative of the amounts that would be realized in current market transactions. The fair value summary tables do not represent an estimate of the overall market value of the Bank as a going concern, which would take into account future business opportunities. The estimated fair values of the Bank's financial instruments are more fully discussed in Note 17 to the Financial Statements in the Bank's 2003 Annual Report.

The estimated fair values of the Bank's financial instruments at June 30, 2004, and December 31, 2003, were as follows:

Fair Value of Financial Instruments – June 30, 2004

	Carrying Value	Net Unrealized Gains/(Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 17	$ —	$ 17
Deposits for mortgage loan program	2	—	2
Interest-bearing deposits in banks	3,575	—	3,575
Securities purchased under agreements to resell	850	—	850
Federal funds sold	6,970	—	6,970
Held-to-maturity securities	22,045	(135)	21,910
Held-at-fair-value securities	1,052	—	1,052
Advances	119,124	(14)	119,110
Mortgage loans, net of allowance for credit losses on mortgage loans	6,335	(141)	6,194
Accrued interest receivable	243	—	243
Derivative assets	87	—	87
Other assets	75	(46)	29
Total	$ 160,375	$ (336)	$ 160,039
Liabilities			
Deposits	$ 906	$ —	$ 906
Consolidated obligations:			
Bonds	122,223	333	121,890
Discount notes	28,962	14	28,948
Accrued interest payable	592	—	592
Derivative liabilities	409	—	409
Other liabilities	228	—	228
Total	$ 153,320	$ 347	$ 152,973

Fair Value of Financial Instruments – December 31, 2003

	Carrying Value	Net Unrealized Gains/(Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 18	$ —	$ 18
Deposits for mortgage loan program	12	—	12
Interest-bearing deposits in banks	3,287	—	3,287
Securities purchased under agreements to resell	5,100	—	5,100
Federal funds sold	5,434	—	5,434
Held-to-maturity securities	18,263	2	18,265
Held-at-fair-value securities	917	—	917
Advances	92,330	113	92,443
Mortgage loans, net of allowance for credit losses on mortgage loans	6,445	(132)	6,313
Accrued interest receivable	218	—	218
Derivative assets	266	—	266
Other assets	100	(38)	62
Total	$ 132,390	$ (55)	$ 132,335
Liabilities			
Deposits	$ 988	$ —	$ 988
Consolidated obligations:			
Bonds	92,751	44	92,707
Discount notes	31,882	—	31,882
Accrued interest payable	528	—	528
Derivative liabilities	181	—	181
Other liabilities	214	—	214
Total	$ 126,544	$ 44	$ 126,500

Note 11 – Commitments and Contingencies

All FHLBanks have joint and several liability for FHLBank consolidated obligations. Accordingly, if any FHLBank were unable to repay its participation in the consolidated obligations, the other FHLBanks could be required to repay all or a portion of that FHLBank's participation, as determined by the Finance Board. The Bank has never been required to repay any consolidated obligation on behalf of another FHLBank. In addition, at this time Bank management is not aware that any FHLBank is likely to be unable to repay its participation in the consolidated obligations. Accordingly, the Bank has not recognized a liability for its joint and several obligation related to other FHLBanks' participations in the consolidated obligations. The par amount of the outstanding consolidated obligations of all 12 FHLBanks, including consolidated obligations issued by other FHLBanks, was approximately $838,550 at June 30, 2004, and $759,510 at December 31, 2003. The par value of the Bank's participation in consolidated obligations was $151,983 at June 30, 2004, and $124,524 at December 31, 2003. The Bank's joint and several liability for FHLBank consolidated obligations is more fully discussed in Note 19 to the Financial Statements in the Bank's 2003 Annual Report.

Commitments that legally bind and obligate the Bank for additional advances totaled approximately $971 at June 30, 2004, and $419 at December 31, 2003. Commitments are generally for periods up to 12 months. Standby letters of credit are generally issued for a fee on behalf of members to support their obligations to third parties. If the Bank is required to make payment for a beneficiary's drawing, the amount is charged to the member's demand deposit account with the Bank or converted into a collateralized advance to the

member. Outstanding standby letters of credit were approximately $960 at June 30, 2004, and $1,015 at December 31, 2003, and had original terms of 30 days to 10 years, with the latest final expiration in 2014. Unearned fees for transactions prior to June 30, 2004, as well as the value of the guarantees related to standby letters of credit entered into after 2003 are recorded in other liabilities and amounted to $1 at June 30, 2004. Based on management's credit analyses and collateral requirements, no allowance for losses is deemed necessary by management on these advance commitments and letters of credit. Advances funded under these advance commitments and letters of credit are fully collateralized at the time of issuance in a manner consistent with advances to members (see Note 4). The estimated fair value of commitments and letters of credit was immaterial to the balance sheet as of June 30, 2004, and December 31, 2003.

Commitments that unconditionally obligate the Bank to purchase mortgage loans totaled $5 at June 30, 2004, and $5 at December 31, 2003. Commitments are generally for periods not to exceed 45 days. In accordance with SFAS 149, commitments entered after June 30, 2003, were recorded as derivatives at their fair value.

The Bank executes interest rate exchange agreements with major banks and broker-dealers that have long-term credit ratings of single-A or better from both Standard & Poor's and Moody's Investors Service. The Bank also executes interest rate exchange agreements with its members. The Bank enters into master agreements with netting provisions and bilateral security agreements with all counterparties and requires all member counterparties to fully collateralize their net credit exposure. As of June 30, 2004, and December 31, 2003, the Bank had pledged as collateral securities with a fair value of $316 and $134, respectively, to broker-dealers that have a net credit risk exposure to the Bank related to interest rate exchange agreements.

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

The Bank had committed to issue $1,190 of consolidated obligations and entered into $1,549 of notional amount of interest rate exchange agreements that had traded but not yet settled at June 30, 2004.

Other commitments and contingencies are discussed in Notes 4, 5, 6, 7, and 9.

Note 12 – Other

The table below discloses the largest categories included in operating expense.

	Three months ended	
	June 30, 2004	June 30, 2003
Compensation and benefits	$ 9	$ 9
Other	6	4
Total operating expense	$ 15	$ 13

	Six months ended	
	June 30, 2004	June 30, 2003
Compensation and benefits	$ 19	$ 18
Other	10	8
Total operating expense	$ 29	$ 26

Directors and Management

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Chairman of the Board

Timothy R. Chrisman
Vice Chairman of the Board

Craig G. Blunden
James P. Giraldin
Kenneth R. Harder
Rick McGill
Monte L. Miller
Frank P. Pekny
John F. Robinson
Scott C. Syphax
John T. Wasley
Connie R. Wilhelm
Charlene Gonzales Zettel

Executive Officers

Dean Schultz
President and Chief Executive Officer

Ross Kari
Executive Vice President and Chief Operating Officer

Senior Vice Presidents

Steven T. Honda
Lisa B. MacMillen
David H. Martens
Vera Maytum
Albert McCloskey
Kenneth C. Miller
David A. O'Brien
Lawrence H. Parks
Stephen P. Traynor
George T. Wofford

Vice Presidents

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Richard A. Alesci
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Gerald A. Hinkle
Joseph F. Humphrey
Jonathan D. Kibrick
Rosemary E. Kim
Janice Kubota
Cynthia K. Lopez
John S. McCormack
Michelle A. Meyer
Matthew M. Park
Patricia M. Remch
Michael Roth
Antonio D. Ruscitti
Suzanne Titus-Johnson
Curtis Tung
Anthony T. Wong
James E. Yacenda
James Zabel