Federal Home Loan Bank of San Francisco
2004 Third Quarter Report

To Our Members

The Federal Home Loan Bank of San Francisco achieved strong financial results in the third quarter of 2004. Based on its adjusted net income, the Bank paid a dividend rate of 3.70% (annualized) for the quarter, compared to 4.18% for the third 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 1.62% for the quarter, compared to 2.03% for the prior-year period.

For the quarter, net income was $15 million and adjusted net income was $72 million. The significant difference between net income and adjusted net income during the quarter was almost entirely due to fair value adjustments required by SFAS 133[1] in connection with the Bank's derivatives and hedging activities. In some prior periods, SFAS 133 adjustments relating to the Bank's derivatives and hedging activities resulted in net unrealized gains; the gains increased net income in those periods, but did not affect adjusted net income. In the second quarter of 2004, for example, the SFAS 133 adjustments increased net income by $79 million to $150 million, while adjusted net income was $83 million. By contrast, in the third quarter of 2004, the SFAS 133 adjustments resulted in net unrealized losses, which reduced net income by $58 million, but did not affect adjusted net income. For the most part, the SFAS 133 net unrealized losses in the third quarter were reversals of prior-period SFAS 133 net unrealized gains.

The reason the Bank excludes SFAS 133 net unrealized gains and losses from adjusted net income is that the effects of SFAS 133 on the Bank are primarily a matter of timing. Because almost all of the Bank's derivatives-based hedging strategies involve holding both the derivative and the hedged item to maturity, the unrealized gains and losses on the combined transaction will ultimately net to zero. The Bank puts primary emphasis on the cost-efficiency and effectiveness of its hedging strategies and considers the accounting effects (including the fair value adjustments required by SFAS 133) to be an important but secondary consideration. The Bank's business model focuses on the Bank's core financial performance even when the relevant accounting requirements may lead to significant income volatility.

When the application of SFAS 133 results in cumulative net unrealized gains, the Bank retains an equivalent amount in restricted retained earnings in anticipation of the future reversal of the gains. At June 30, 2004, the Bank had experienced cumulative net unrealized gains totaling $136 million and had restricted an equivalent amount in retained earnings. These retained earnings were more than sufficient to cover the net unrealized loss of $58 million that resulted from the reversal of prior-period SFAS 133 gains during the third quarter. At September 30, 2004, the Bank had a total of $80 million in cumulative net unrealized gains resulting from SFAS 133, and had restricted an

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[1] "SFAS 133" is 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 1, 2003.

equivalent amount in retained earnings. Some or all of this amount may be made available for dividends in the future to offset losses resulting from the reversal of the net gains.

In the future, the net effects of SFAS 133 could result in a cumulative net unrealized loss for the Bank, and the Bank's retained earnings at that time could be insufficient to offset the loss. To address this and other potential future effects of SFAS 133, as well as a number of other risks, the Bank's Retained Earnings and Dividend Policy provides for the build-up of additional retained earnings totaling $130 million by yearend 2007. As of September 30, 2004, the Bank had accumulated $43 million in restricted retained earnings under this provision of the Retained Earnings and Dividend Policy. Because the purpose of these retained earnings is to protect the Bank against a variety of risks, we cannot predict whether or not some of these retained earnings would be available to pay dividends in the event that the Bank experienced a cumulative net unrealized loss from SFAS 133.

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

The Bank met its members' continuing strong demand for funding during the quarter, increasing advances by $4.6 billion, or 4%, to $123.7 billion at September 30, 2004. Since December 31, 2003, advances have grown by $31.4 billion, or 34%.

During the quarter, the Bank expanded its blanket lien pledging method to broaden member eligibility, add new collateral types, and offer new options for reporting loan data. To date, 107 members have signed up for the expanded program, which we expect will increase their access to Bank credit and make it easier for them to do business with us.

In October, our conference in Los Angeles on faith-based affordable housing and economic development attracted almost 200 representatives from a wide variety of organizations. Those attending received training in housing and commercial real estate development, fundraising, partnership development, community building, and organizational development. We are grateful to California State Treasurer Phil Angelides, HUD Deputy Secretary Roy Bernardi, U.S. Representative Diane Watson (D-CA), and all of the other speakers and participants for sharing their knowledge and expertise to foster affordable housing and economic development in our communities.

Sincerely,

Dean Schultz
President and Chief Executive Officer

Federal Home Loan Bank of San Francisco
2004 Third Quarter Report

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Financial Highlights

(Dollars in millions)	September 30, 2004	June 30, 2004	March 31, 2004	December 31, 2003	September 30, 2003
Selected Balance Sheet Items					
Total Assets	$ 172,573	$ 160,375	$ 148,315	$ 132,390	$ 115,663
Advances	123,722	119,124	106,250	92,330	81,983
Mortgage Loans	6,200	6,335	6,431	6,445	5,177
Mortgage-Backed Securities	21,388	19,595	17,964	16,317	14,363
Capital	7,306	7,055	6,399	5,846	5,576
Quarterly Operating Results					
Net Interest Income	$ 129	$ 143	$ 117	$ 110	$ 106
Net Income	15	150	46	60	127
Ratios					
Capital to Assets Ratio	4.24%	4.40%	4.32%	4.42%	4.84%
Net Interest Margin	0.31	0.38	0.33	0.35	0.41
Operating Expenses as a Percent of Average Assets	0.03	0.04	0.04	0.05	0.05
Return on Average Equity	0.82	8.99	3.00	4.22	9.62
Dividend Rate	3.70	4.68	3.95	3.85	4.18
Adjusted Quarterly Operating Results *					
Adjusted Net Income	$ 72	$ 83	$ 65	$ 60	$ 61
Adjusted Net Interest Margin**	0.27%	0.33%	0.29%	0.30%	0.36%
Adjusted Return on Average Equity	4.05	5.04	4.33	4.29	4.64
Potential Dividend Yield	4.10	5.12	4.39	4.34	4.71
Dividend Benchmark	2.48	2.36	2.46	2.58	2.68
Spread of Potential Dividend Yield to Dividend Benchmark	1.62	2.76	1.93	1.76	2.03
Reconciliation of Net Income (GAAP) to Adjusted Net Income (Non-GAAP)					
Net Income	$ 15	$ 150	$ 46	$ 60	$ 127
Net (Gain)/Loss on Held-at-Fair-Value Securities	(2)	11	(3)	5	8
Net Loss/(Gain) on Derivatives and Hedging Activities***	58	(79)	21	(4)	(71)
Other Adjustments	1	1	1	(1)	(3)
Adjusted Net Income	$ 72	$ 83	$ 65	$ 60	$ 61

* The Bank calculates adjusted financial performance measures to provide a more meaningful comparison of the Bank's performance over time and to provide members with an enhanced understanding of the Bank's financial performance. These measures are not intended to be a presentation in accordance with generally accepted accounting principles (GAAP). Adjusted financial performance measures exclude the effects of any current period fair value changes (net of applicable assessments) made in accordance with 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 1, 2003 (together referred to as "SFAS 133"), and fair value adjustments on held-at-fair-value securities reclassified from held-to-maturity securities upon the adoption of SFAS 133, because these effects are generally expected to reverse over 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, associated 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 (loss)/gain on derivatives and hedging activities" in the Statements of Income.

*** Excludes the interest income and expense on non-hedge qualifying derivatives that are economic hedges classified in "Net (loss)/gain 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 30, and the Bank's 2003 Annual Report.

Quarterly Overview

The Federal Home Loan Bank of San Francisco (Bank) achieved strong financial results in the third quarter of 2004. The Bank paid a dividend rate of 3.70% (annualized) for the quarter, compared to 4.18% for the third 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 1.62% for the quarter, compared to 2.03% for the prior-year period.

For the third quarter of 2004, net income was $15 million, a decrease of $112 million, or 88%, relative to the same period in 2003. The significant difference was almost entirely due to fair value adjustments made in accordance with 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 1, 2003 (together referred to as "SFAS 133"). The fair value adjustments on derivatives and hedging activities during the third quarter of 2004 resulted in net losses totaling $100 million (including net interest expense on derivative instruments used in economic hedges of $21 million). By contrast, the fair value adjustments on derivatives and hedging activities for the same period in 2003 resulted in net gains totaling $85 million (including net interest expense on derivative instruments used in economic hedges of $12 million). Excluding the impact of net interest expense on derivative instruments used in economic hedges, net unrealized losses (net of applicable assessments) totaled $58 million for the third quarter of 2004 compared to net unrealized gains (net of applicable assessments) of $71 million for the same period in 2003.

At June 30, 2004, the Bank had cumulative net unrealized gains resulting from SFAS 133 totaling $136 million and had restricted an equivalent amount as part of its restricted retained earnings in anticipation of the future reversal of those gains. These retained earnings were more than sufficient to cover the net unrealized loss (from fair value adjustments) of $58 million during the third quarter of 2004. At September 30, 2004, the Bank had a total of $80 million in cumulative net unrealized gains resulting from SFAS 133, and had restricted an equivalent amount as part of its restricted retained earnings.

The effects of SFAS 133 on the Bank are primarily a matter of timing because almost all of the Bank's derivative-based hedging strategies involve holding both the derivative and the hedged item to maturity. Therefore, the unrealized gains and losses on the combined transaction will ultimately net to zero. The Bank puts primary emphasis on the cost-efficiency and effectiveness of its hedging stratetgies and considers the accounting effects (including the fair value adjustments required by SFAS 133) to be an important but secondary consideration. The Bank's business model focuses on the Bank's core financial performance even when the relevant accounting requirements may result in significant income volatility.

Net interest income in the third quarter of 2004 was $129 million, a 22% increase from the third quarter of 2003. The increase was largely due to significant growth in capital and average interest-earning assets outstanding, particularly in the advances and mortgage portfolios. The volume increases were partially offset, however, by narrower profit spreads on advances, lower yields on invested capital as yields declined from lower average interest rates, and narrower profit spreads on the mortgage portfolio (resulting primarily from faster projected prepayments of existing mortgage loans and MBS investments, attributable to decreases in interest rates during the third quarter of 2004 relative to 2003). The faster projected prepayments during the third quarter of 2004 resulted in retrospective adjustments to amortization from the acquisition dates of the mortgage loans and MBS totaling $7 million (reducing net interest income), in accordance with Statement of Financial Accounting Standards No. 91 (SFAS 91), *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. In contrast, during the third quarter of 2003, retrospective adjustments made in accordance with SFAS 91 increased net interest income by $11 million.

Financial Performance

The 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 seeks to achieve 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 capital plan and 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 (i) fair value adjustments and (ii) advance prepayment fees, net of the amortization of current and prior period prepayment fees and other deferred items, as a percentage of capital stock. The dividend benchmark reflects the Bank's capital investment strategy and is calculated as the average of two yields: the daily average of the overnight Federal funds effective rate and the four-year moving average of the four-year Treasury note yield. The dividend spread (the difference between the potential dividend yield and the dividend benchmark) represents the potential financial return on the members' investment in Bank capital stock relative to the return on a mix of investments in overnight Federal funds and intermediate-term Treasury investments.

The potential dividend yield was 4.10% for the third quarter of 2004, a decrease of 61 basis points from the third quarter of 2003. The decrease in the potential dividend yield was primarily due to lower profit spreads on the mortgage portfolio (mortgage loans and MBS) resulting primarily from faster projected prepayments of existing mortgage loans and MBS investments, which were attributable to decreases in interest rates. The faster projected prepayments resulted in retrospective adjustments to amortization from the acquisition dates of the mortgage loans and MBS, in accordance with SFAS 91. In addition, lower profit spreads on the advances portfolio (resulting from increased competition from members' other sources of wholesale funding) and lower yields on invested capital (resulting from lower average interest rates) compared to the same period in 2003 contributed to the decrease in the potential dividend yield. The dividend benchmark was 2.48% for the third quarter of 2004, a decrease of 20 basis points from 2.68% for the same period of 2003. The dividend spread (the difference between the potential dividend yield and the dividend benchmark) was 1.62% for the third quarter of 2004, a decrease of 41 basis points from the third quarter of 2003.

The potential dividend yield was 4.54% for the first nine months of 2004, a decrease of 29 basis points from 4.83% for the first nine months of 2003. The decrease was primarily due to lower profit spreads on the advances portfolio and lower yields on invested capital, which were driven by lower average interest rates during the first nine months of 2004 relative to the same period in 2003. The dividend benchmark was 2.43% for the first nine months of 2004, a decrease of 43 basis points from 2.86% for the same period of 2003, also reflecting lower average interest rates for both components of the dividend benchmark. The dividend spread was 2.11% for the first nine months of 2004, an increase of 14 basis points from 1.97% for the first nine months of 2003.

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 nine months ended September 30, 2004 and 2003, together with the related interest income and expense. They also present the average rate on total earning assets and the average cost of total funding sources. The Change in Net Interest Income tables detail the changes in interest income and interest expense for the third quarter of 2004 compared to the third quarter of 2003 and for the first nine months of 2004 compared to the first nine 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, and investments, less interest paid on consolidated obligations, deposits, and other borrowings. The net interest margin decreased 10 basis points during the third quarter of 2004 compared to the same period in 2003. The net interest spread also decreased 10 basis points during the third quarter of 2004 compared to the same period in 2003. These decreases were primarily due to lower profit spreads on the advances and mortgage portfolios. These decreases were partially offset, however, by a larger proportion of mortgage portfolio balances relative to the overall asset mix.

For the first nine months of 2004, the net interest margin decreased 5 basis points and the net interest spread decreased 4 basis points when compared to the first nine months of 2003. These decreases were primarily due to narrower profit spreads on the advances portfolio. In addition, lower average interest rates in 2004 relative to 2003 reduced the yield on invested capital, contributing to the decrease in the net interest margin. These decreases were partially offset by higher profit spreads on the mortgage portfolio and a larger proportion of mortgage portfolio balances relative to the overall asset mix.

Average Balance Sheets

	Three months ended					
	September 30, 2004			September 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	$ 5,386	$ 20	1.48%	$ 2,690	$ 7	1.03%
Resale agreements	1,635	6	1.46	2,577	7	1.08
Federal funds sold	7,166	25	1.39	6,742	17	1.00
Held-to-maturity securities:						
Other investments	2,810	11	1.56	2,264	7	1.23
MBS	19,516	176	3.59	13,947	129	3.67
Held-at-fair-value securities	771	7	3.61	971	9	3.68
Mortgage loans	6,266	74	4.70	2,962	34	4.55
Advances[1]	120,518	492	1.62	71,643	244	1.35
Deposits for mortgage loan program with other FHLBank	2	—	1.59	9	—	0.88
Loans to other FHLBanks	17	—	1.40	18	—	1.10
Total interest-earning assets	164,087	811	1.97	103,823	454	1.74
Other assets[2]	1,587	—	—	2,307	—	—
Total Assets	$165,674	$ 811	1.95%	$106,130	$ 454	1.70%
Liabilities and Capital						
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds[1]	$127,093	$ 576	1.80%	$ 83,735	$ 305	1.45%
Discount notes[1]	29,246	104	1.41	14,695	42	1.13
Deposits	734	2	1.08	397	1	1.00
Borrowings from other FHLBanks	7	—	1.14	1	—	0.79
Other borrowings	12	—	2.32	8	—	0.99
Total interest-bearing liabilities	157,092	682	1.73	98,836	348	1.40
Other liabilities[2]	1,388	—	—	2,065	—	—
Total Liabilities	158,480	682	1.71	100,901	348	1.37
Capital	7,194	—	—	5,229	—	—
Total Liabilities and Capital	$165,674	$ 682	1.64%	$106,130	$ 348	1.30%
Net Interest Income		$ 129			$ 106	
Net Interest Spread[3]			0.24%			0.34%
Net Interest Margin[4]			0.31%			0.41%
Total Average Assets/Capital Ratio	23.0x			20.3x		
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 spread is the difference between the average rate earned on interest-earnings assets and average rates paid on interest-bearing liabilities.
[4] Net interest margin is net interest income (annualized) divided by average interest-earning assets.

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

(In millions)	Increase/ (Decrease)	Attributable to Changes in[1] Average Volume	Attributable to Changes in[1] Average Rate
Interest-earning assets:			
Interest-bearing deposits in banks	$ 13	$ 10	$ 3
Resale agreements	(1)	(3)	2
Federal funds sold	8	1	7
Held-to-maturity securities:			
Other investments	4	2	2
MBS	47	50	(3)
Held-at-fair-value securities	(2)	(2)	—
Mortgage loans	40	39	1
Advances[2]	248	199	49
Total interest-earning assets	357	296	61
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds[2]	271	195	76
Discount notes[2]	62	52	10
Deposits	1	1	—
Total interest-bearing liabilities	334	248	86
Net interest income	$ 23	$ 48	$ (25)

[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

(Dollars in millions)	Nine months ended September 30, 2004 Average Balance	Interest Income/ Expense	Average Rate	Nine months ended September 30, 2003 Average Balance	Interest Income/ Expense	Average Rate
Assets						
Interest-earning assets:						
Interest-bearing deposits in banks	$ 4,184	$ 39	1.25%	$ 3,581	$ 33	1.23%
Resale agreements	2,653	22	1.11	2,613	23	1.18
Federal funds sold	7,800	68	1.16	6,461	57	1.18
Held-to-maturity securities:						
Other investments	2,783	28	1.34	2,154	22	1.37
MBS	17,498	469	3.58	14,478	431	3.98
Held-at-fair-value securities	964	22	3.05	823	24	3.90
Mortgage loans	6,366	234	4.91	1,936	65	4.49
Advances[1]	110,842	1,153	1.39	77,393	850	1.47
Deposits for mortgage loan program with other FHLBank	4	—	3.61	12	—	1.34
Loans to other FHLBanks	16	—	1.09	14	—	1.43
Total interest-earning assets	153,110	2,035	1.78	109,465	1,505	1.84
Other assets[2]	1,943	—	—	2,685	—	—
Total Assets	$155,053	$ 2,035	1.75%	$ 112,150	$1,505	1.79%
Liabilities and Capital						
Interest-bearing liabilities:						
Consolidated obligations:						
Bonds[1]	$115,426	$ 1,373	1.59%	$ 89,466	$1,048	1.57%
Discount notes[1]	30,604	269	1.17	14,357	134	1.25
Deposits	594	4	0.90	412	3	0.97
Borrowings from other FHLBanks	2	—	1.40	1	—	0.80
Other borrowings	7	—	1.72	9	—	0.38
Total interest-bearing liabilities	146,633	1,646	1.50	104,245	1,185	1.52
Other liabilities[2]	1,729	—	—	2,489	—	—
Total Liabilities	148,362	1,646	1.48	106,734	1,185	1.48
Capital	6,691	—	—	5,416	—	—
Total Liabilities and Capital	$155,053	$ 1,646	1.42%	$ 112,150	$1,185	1.41%
Net Interest Income		$ 389			$ 320	
Net Interest Spread[3]			0.28%			0.32%
Net Interest Margin[4]			0.34%			0.39%
Total Average Assets/Capital Ratio	23.2x			20.7x		
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 spread is the difference between the average rate earned on interest-earnings assets and average rates paid on interest-bearing liabilities.

[4] Net interest margin is net interest income (annualized) divided by average interest-earning assets.

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

(In millions)	Increase/ (Decrease)	Attributable to Changes in[1] Average Volume	Average Rate
Interest-earning assets:			
Interest-bearing deposits in banks	$ 6	$ 6	$ —
Resale agreements	(1)	—	(1)
Federal funds sold	11	12	(1)
Held-to-maturity securities:			
Other investments	6	6	—
MBS	38	81	(43)
Held-at-fair-value securities	(2)	3	(5)
Mortgage loans	169	162	7
Advances[2]	303	349	(46)
Total interest-earning assets	530	619	(89)
Interest-bearing liabilities:			
Consolidated obligations:			
Bonds[2]	325	310	15
Discount notes[2]	135	143	(8)
Deposits	1	1	—
Total interest-bearing liabilities	461	454	7
Net interest income	$ 69	$ 165	$ (96)

[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 in the third quarter of 2004 was $129 million, a 22% increase from the third quarter of 2003. Net interest income in the first nine months of 2004 was $389 million, a 22% increase from the first nine months of 2003. The increases were largely due to significant growth in capital and average interest-earning assets outstanding, particularly in the advances and mortgage portfolios. The volume increases were partially offset, however, by narrower profit spreads on advances and lower yields on invested capital as yields declined from lower average interest rates during the first nine months of 2004 relative to the same period in 2003. In addition, narrower profit spreads on the mortgage portfolio resulting primarily from faster projected prepayments of existing mortgage loans and MBS investments, attributable to decreases in interest rates during the third quarter of 2004 relative to the same period in 2003, further offset the volume increases. The faster projected prepayments during the third quarter of 2004 resulted in retrospective adjustments to amortization from the acquisition dates of the mortgage loans and MBS totaling $7 million (reducing net interest income), in accordance with SFAS 91. In contrast, during the third quarter of 2003, retrospective adjustments made in accordance with SFAS 91 increased net interest income by $11 million.

As discussed in Note 1 to the Financial Statements, the Bank reclassified realized gains and losses on derivative instruments used in economic hedges from net interest income to other income, increasing net

interest income and decreasing other income by $12 million in the third quarter of 2003 and by $26 million in the first nine months of 2003. Economic hedges are hedges of an asset or liability that do not qualify for hedge accounting treatment under the provisions of SFAS 133.

Other (Loss)/Income. Primarily as a result of fair value adjustments associated with derivatives and hedging activities under SFAS 133, other (loss)/income was a net loss of $93 million in the third quarter of 2004 compared to a net gain of $82 million in the third quarter of 2003, and a net loss of $53 million for the first nine months of 2004 compared to a net gain of $82 million for the first nine months of 2003. See "Adjusted Financial Performance" (below) for a discussion of financial performance measures excluding the effects of 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 loss or gain 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.

Nearly all of the Bank's derivatives and hedged instruments are held to maturity, call date, or put date. Therefore, the SFAS 133 cumulative net unrealized fair value gains or losses are primarily a matter of timing because they will generally reverse over the remaining contractual terms to maturity, or by the exercised call or put date, of the hedged financial instruments and associated interest rate exchange agreements.

During the third quarter of 2004, the ineffective portion of all hedges resulted in a net loss (fair value adjustments) of $100 million compared to a net gain (fair value adjustments) of $85 million during the third quarter of 2003. During the first nine months of 2004, the ineffective portion of all hedges resulted in a net loss (fair value adjustments) of $55 million compared to a net gain (fair value adjustments) of $78 million during the first nine months of 2003. Most of these losses were due to changes in the fair value of the callable bond portfolio that had offsetting callable interest rate swaps and represent a reversal of unrealized fair value gains recorded in prior periods. The fair value net losses reflect the impact of declining interest rates during the third quarter of 2004, which shortened the expected lives of the callable bonds and callable swaps compared to the end of the second quarter of 2004 and to yearend 2003. Widening spreads between market rates on consolidated obligations and interest rate swaps (rates on the consolidated obligations decreased more than rates on the interest rate swaps) also contributed to the unrealized losses in the swapped callable bond portfolio. These losses included net interest expense on derivative instruments used in economic hedges of $21 million in the third quarter of 2004, compared to $12 million in the third quarter of 2003, and $55 million in the first nine months of 2004, compared to $26 million in the first nine months of 2003.

Net Income. Net income was $15 million in the third quarter of 2004, an 88% decrease from the third quarter of 2003, and $211 million in the first nine months of 2004, a 20% decrease from the first nine months of 2003. These decreases were primarily due to the reversal of unrealized fair value gains reported in prior periods in accordance with SFAS 133, as discussed above, partially offset by the increase in net interest income. As a result of these decreases, return on equity (ROE) was 0.82% in the third quarter of 2004, a decrease of 880 basis points from the third quarter of 2003. ROE was 4.21% in the first nine months of 2004, a decrease of 228 basis points from the first nine months of 2003. See "Adjusted Financial Performance" (below) for a discussion of financial performance measures excluding the effects of SFAS 133.

Adjusted Financial Performance. The Bank uses adjusted financial performance measures to provide more meaningful comparisons of the Bank's performance over time and to provide members with an enhanced understanding of the Bank's financial 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) and fair value adjustments on held-at-fair-value securities made in accordance with SFAS 133 because these effects will generally reverse over the remaining contractual terms to maturity 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, related 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 derivative instruments used in economic hedges that are recorded in "Net (loss)/gain on derivatives and hedging activities" in other income.

Adjusted net income in the third quarter of 2004 was $72 million, an increase of $11 million, or 18%, from the third quarter of 2003. Adjusted net interest income in the third quarter of 2004 was $111 million, an increase of $16 million, or 17%, from the third quarter of 2003. Adjusted net income in the first nine months of 2004 was $220 million, an increase of $28 million, or 15%, from the first nine months of 2003. Adjusted net interest income in the first nine months of 2004 was $341 million, an increase of $44 million, or 15%, from the first nine months of 2003. These increases were primarily due to significant growth in the advances and mortgage portfolios. The effects of these volume increases were partially offset by narrower profit spreads on advances and lower yields on invested capital resulting from lower average interest rates during the first nine months of 2004. In addition, narrower profit spreads on the mortgage portfolio during the third quarter of 2004 relative to the third quarter of 2003 further offset the volume increases in that period.

Adjusted ROE for the third quarter of 2004 was 4.05%, a decrease of 59 basis points from the third quarter of 2003. Adjusted ROE for the first nine months of 2004 was 4.47%, a decrease of 27 basis points from the first nine months of 2003. These decreases were primarily due to lower profit spreads on a growing advances portfolio coupled with lower average interest rates in 2004 relative to 2003, which decreased the yield on invested capital. In addition, narrower profit spreads on the mortgage portfolio during the third quarter of 2004 relative to the third quarter of 2003 contributed to the decrease for that period.

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

	Three months ended		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Adjusted net interest income	$ 111	$ 95	$ 341	$ 297
Adjusted net income	72	61	220	192
Adjusted net interest margin	0.27%	0.36%	0.31%	0.35%
Adjusted return on average equity	4.05	4.64	4.47	4.74
Potential dividend yield	4.10	4.71	4.54	4.83
Dividend benchmark	2.48	2.68	2.43	2.86
Spread of potential dividend yield to dividend benchmark	1.62	2.03	2.11	1.97

Reconciliation of Net Interest Income (GAAP) to Adjusted Net Interest Income (Non-GAAP)
(In millions)

	Three months ended		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Net interest income	$ 129	$ 106	$ 389	$ 320
Amortization of deferred advance prepayment fees	2	2	7	6
Amortization of realized basis adjustments	1	(1)	—	(3)
Net interest expense on economic hedges	(21)	(12)	(55)	(26)
Adjusted net interest income	$ 111	$ 95	$ 341	$ 297

Reconciliation of Net Income (GAAP) to Adjusted Net Income (Non-GAAP)
(In millions)

	Three months ended		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Net income	$ 15	$ 127	$ 211	$ 263
Net (gain)/loss on held-at-fair-value securities	(2)	8	6	6
Net loss/(gain) on derivatives and hedging activities	58	(71)	—	(76)
Deferred advance prepayment fees, net	1	(3)	3	(1)
Adjusted net income	$ 72	$ 61	$ 220	$ 192

Dividends. The Bank's annualized dividend rate for the third quarter of 2004 was 3.70%, compared to 4.18% in the third quarter of 2003. The decrease in the dividend rate over the two quarters was primarily due to narrower profit spreads in the growing advances and mortgage portfolios, coupled with lower yields on invested capital from lower average interest rates. As discussed below, to provide for a build-up of retained earnings, the Bank retained $7 million in the third quarter of 2004 and $7 million in the third quarter of 2003, which reduced the quarterly annualized dividend rate by 40 basis points and 54 basis points, respectively.

The Bank's Retained Earnings and Dividend Policy establishes 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. 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 advance 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 $7 million at September 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 unrealized gains in earnings (net of applicable assessments) resulting from SFAS 133. Retained earnings restricted in accordance with this provision totaled $80 million at September 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. As net unrealized gains are reversed (by net unrealized losses), the amount of cumulative net unrealized gains decreases. The amount of retained earnings required by this provision of the policy is therefore decreased; that portion of the previously restricted retained earnings becomes unrestricted and may be made available for dividends. In this case, the potential dividend payout in a given period will be substantially the same as it 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 restricting retained earnings in accordance with this provision of the policy may preserve the Bank's ability to pay dividends, the reversal of the cumulative net unrealized SFAS 133 gains in any given period may result in a net loss if the reversal exceeds net earnings before the impact of SFAS 133 for that period. Also, if the net effect of SFAS 133 since inception results in a cumulative net unrealized loss, the Bank's other retained earnings at that time (if any) may not be sufficient to offset the net unrealized loss. As a result, the future effects of SFAS 133 may cause the Bank to reduce or temporarily suspend paying dividends.

In addition to the restricted retained earnings from advance prepayment fees and cumulative SFAS 133 gains, if any, the Bank holds additional restricted retained earnings to address other potential effects of SFAS 133 and other financial risks. 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 unrealized 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 the build-up to reach $100 million (less any cumulative net unrealized fair value losses in net income resulting from SFAS 133, with a floor of zero) by the end of 2006. Effective September 24, 2004, the Board of Directors further amended the policy to provide for the build-up to reach $130 million by the end of 2007. The retained earnings restricted in accordance with this provision totaled $43 million at September 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.

The Board of Directors may declare and pay dividends only from retained earnings or current net earnings. There is no requirement that the Board of Directors declare and pay any dividend. A decision by the 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.

The Bank has historically paid dividends, if declared, in stock form (except fractional shares) and intends to continue this practice.

Financial Condition

Total assets were $172.6 billion at September 30, 2004, a 30% increase since December 31, 2003. Average total assets were $165.7 billion for the third quarter of 2004, a 56% increase compared to the third quarter of 2003. Average total assets were $155.1 billion for the first nine months of 2004, a 38% increase compared to the first nine months of 2003. Financial condition is further discussed below under "Segment Information."

Segment Information

The Bank analyzes financial performance based on the net interest income, as adjusted, of two operating segments: the advances-related business and the mortgage-related business. Net interest income, as adjusted, includes the net interest expense on derivative instruments used in economic hedges that are recorded in "Net (loss)/gain on derivatives and hedging activities" in other income.

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 associated with the Bank's role as a liquidity provider, and member capital.

Net interest income, as adjusted, for this segment was $81 million in the third quarter of 2004, an increase of $15 million, or 23%, compared to the third quarter of 2003. In the first nine months of 2004, net interest income, as adjusted, for the segment was $218 million, an increase of $3 million, or 1%, from the first nine months of 2003. The increases were primarily due to a strong upsurge in average advance balances, partially offset by narrower profit spreads on the advance portfolio and lower earnings on invested capital caused by lower average interest rates in 2004 relative to 2003.

Net interest income, as adjusted, for this segment represented 75% and 70% of total net interest income, as adjusted, for the third quarter of 2004 and 2003, respectively, and 65% and 73% of total net interest income, as adjusted, for the first nine months of 2004 and 2003, respectively.

The balance of assets associated with this segment increased to $144.9 billion (84% of total assets) at September 30, 2004, an increase of $35.3 billion, or 32%, since December 31, 2003. The increase was primarily due to higher demand for advances by the Bank's members.

Advances— Advances outstanding increased 34% since December 31, 2003, to $123.7 billion at September 30, 2004. Advances outstanding included unrealized fair value gains of $153 million at September 30, 2004, and unrealized fair value gains of $367 million at December 31, 2003. The increase in advances outstanding at September 30, 2004, relative to December 31, 2003, was primarily due to higher demand from a few of the Bank's largest members to fund portfolio growth. In total, 138 members increased their advance borrowings during the first nine months of 2004, while 70 members decreased their advance borrowings. During the first nine months of 2004, short-term fixed rate advances grew $13.1 billion to $42.0 billion, long-term fixed rate advances increased $9.9 billion to $32.5 billion, and long-term adjustable rate advances rose $10.1 billion to $45.8 billion, while short-term adjustable rate advances fell $1.4 billion to $3.2 billion.

Average advances were $120.5 billion for the third quarter of 2004, a 68% increase from the third quarter of 2003. Average advances for the first nine months of 2004 were $110.8 billion, a 43% increase from the first nine months of 2003. The increases in average advances reflected continued mortgage portfolio growth in members' balance sheets, particularly those of the largest members.

Non-MBS Investments—The Bank's total non-MBS investment portfolio was $20.8 billion as of September 30, 2004, an increase of $4.1 billion, or 24%, since December 31, 2003. During the first nine months of 2004, Federal funds sold increased $4.6 billion and interest-bearing deposits in banks increased $0.9 billion, while securities purchased under agreements to resell (resale agreements) fell by $1.3 billion and housing finance agency bonds decreased $0.1 billion. The overall increase in non-MBS investments was primarily the result of a larger capital base and the temporary investment of proceeds from unanticipated advance paydowns that occurred near the end of the third quarter. The decline in resale agreements reflects the availability of more attractive investment yields in Federal funds sold and interest-bearing deposits in banks relative to resale agreements. Non-MBS investments other than housing finance agency bonds

generally have terms to maturity of three months or less and facilitate the Bank's role as a cost-effective provider of credit and liquidity to members. The interest rates on housing finance agency bonds generally adjust quarterly.

Borrowings— Consistent with the increase in advances, total liabilities (primarily consolidated obligations) funding the advances-related business increased $33.8 billion, or 33%, since December 31, 2003, to $137.6 billion at September 30, 2004.

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, typically the Bank simultaneously enters into interest rate exchange agreements with features that offset the complex features of the bonds and, in effect, convert the bonds to adjustable rate instruments tied to an index, primarily the London Interbank Offered Rate (LIBOR). Fixed rate callable bonds issued for the Bank are typically 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 September 30, 2004, the notional amount of interest rate exchange agreements associated with the advances-related business totaled $202.5 billion, of which $85.5 billion were hedging the advances and $117.0 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 hedges associated with advances and consolidated obligations were primarily used to effectively convert the fixed rate cash flows of the advances and consolidated obligations 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 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, as adjusted, for this segment was $27 million in the third quarter of 2004, a decrease of $1 million, or 4%, from the third quarter of 2003. The decrease was primarily due to lower profit spreads on the mortgage portfolio resulting primarily from faster projected prepayments of existing mortgage loans and MBS investments, attributable to decreases in interest rates, partially offset by higher average portfolio balances. The faster projected prepayments resulted in retrospective adjustments to amortization from the acquisition dates of the mortgage loans and MBS, in accordance with SFAS 91. Average mortgage loans increased $3.3 billion and average MBS investments increased $5.6 billion in the third quarter of 2004 compared to the third quarter of 2003.

In the first nine months of 2004, net interest income, as adjusted, for this segment was $116 million, an increase of $37 million, or 47%, from the first nine months of 2003. The increase was largely due to higher average balances and wider profit spreads on the mortgage portfolio relative to 2003. Compared to the first

nine months of 2003, average mortgage loans increased by $4.4 billion and average MBS investments increased by $3.0 billion in the first nine months of 2004.

Net interest income, as adjusted, for this segment represented 25% and 30% of total net interest income, as adjusted, for the third quarter of 2004 and 2003, respectively, and 35% and 27% of total net interest income, as adjusted, for the first nine months of 2004 and 2003, respectively.

The balance of assets associated with this segment was $27.7 billion (16% of total assets) at September 30, 2004, an increase of $4.9 billion, or 22%, since December 31, 2003. The increase was primarily due to increased investments in MBS.

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 $6.2 billion at September 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 individual loans that are 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 September 30, 2004, the Bank had 15 loans totaling $2 million classified as nonaccrual or impaired. Because the amount of the credit enhancement and supplemental mortgage insurance associated with these loans was sufficient to cover the estimated losses on these loans, management determined that a specific 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. As of September 30, 2004, the Bank established an allowance for credit losses of $294,000 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 the Bank as of December 31, 2003.

MBS Investments—The Bank's MBS portfolio increased 31% to $21.4 billion, or approximately 293% of capital, at September 30, 2004, from $16.3 billion, or approximately 279% of capital, at December 31, 2003. During the first nine months of 2004, the Bank purchased $10.9 billion in MBS. However, as a result of relatively low interest rates, MBS principal payments during the same period totaled $5.8 billion. MBS portfolio balances continued to be slightly below the regulatory maximum authorized level of 300% of capital. The Bank 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.

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; as a result, the unrealized fair value gains or losses on these MBS will partially offset the unrealized losses or gains on the associated interest rate exchange agreements. During the third quarter of 2004 and 2003, this designation allowed the Bank to mark certain MBS to fair value (for a $4 million unrealized gain and a $10 million unrealized loss, respectively) to partially offset the mark-to-fair value of the associated interest rate exchange agreements (a $3 million unrealized loss and a $9 million unrealized gain, respectively), for a net unrealized gain of $1 million and a net unrealized loss of $1 million, respectively. During the first nine months of 2004 and 2003, this designation allowed the Bank to mark certain MBS to fair value (for a $7 million unrealized loss and an $8 million unrealized loss, respectively) to partially offset the mark-to-fair value of the associated interest rate exchange agreements (an $8 million unrealized gain and an $8 million unrealized gain, respectively), for a net unrealized gain of $0.5 million and net unrealized loss of $0.1 million, respectively.

Borrowings— Total consolidated obligations funding the mortgage-related business increased $4.9 billion, or 21%, since December 31, 2003, to $27.7 billion at September 30, 2004, paralleling the growth in mortgage portfolio assets.

At September 30, 2004, the notional amount of interest rate exchange agreements associated with the mortgage-related business totaled $9.8 billion, of which $0.3 billion were hedging specific MBS classified as held-at-fair-value and $9.5 billion were hedging the consolidated obligations funding the mortgage portfolio.

Capital

Capital. Average capital during the third quarter of 2004 was $7.2 billion, a 38% increase from the third quarter of 2003. Average capital during the first nine months of 2004 was $6.7 billion, a 24% increase from the first nine months of 2003. These increases were consistent with the rise in average advances and mortgage loans outstanding from the third quarter of 2003 through the third quarter of 2004, and primarily reflect capital stock purchases by new members and additional capital stock purchases by existing members to support additional borrowings and mortgage loan sales during the period. These increases were 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 $121 million in surplus capital stock in October 2004 that was subject to repurchase as of September 30, 2004.

As of September 30, 2004, the Bank had $501 million of capital stock in excess of the minimum amount required to be held in accordance with the Bank's capital plan. This excess capital stock included the $121 million of surplus capital stock that was subsequently repurchased in October. A member may obtain redemption of excess capital stock following a five-year redemption period, subject to certain conditions, by providing a written redemption notice to the Bank. At its discretion, under certain conditions the Bank may

repurchase excess stock at any time before the five years have expired. The Bank's capital requirements are more fully discussed in Note 13 to the Financial Statements in the Bank's 2003 Annual Report.

Capital Requirements. The FHLB Act of 1932, as amended, and Finance Board regulations specify that each FHLBank must meet certain minimum regulatory capital standards. The Bank must maintain (i) total capital in an amount at least equal to 4.0% of its total assets; (ii) leverage capital in an amount at least equal to 5.0% of its total assets; and (iii) permanent capital in an amount at least equal to its regulatory risk-based capital requirement. At September 30, 2004, the Bank had a total capital to assets ratio of 4.24%, a leverage capital to total assets ratio of 6.36%, and a risk-based capital requirement of $859 million.

Risk Management

The Bank has an integrated corporate governance and internal control framework designed to support effective management of the Bank's business activities and the risks inherent in these activities. As part of this framework, 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 for credit risk, market risk, liquidity risk, operations risk, and business risk in accordance with Finance Board regulations, the risk profile established by the Board of Directors, and other applicable guidelines in connection with the Bank's capital plan and overall risk management. The Member Products Policy, which applies to products offered to members and housing associates, 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 September 30, 2004, the Bank had a concentration of advances totaling $87 billion outstanding to three members, representing 71% of total advances outstanding, as presented below. Advances held by these three members generated approximately $358 million, or 62%, of advances interest income before the impact of interest rate exchange agreements for the third quarter of 2004, and $866 million, or 59%, of advances interest income before the impact of interest rate exchange agreements for the first nine months of 2004.

Concentration of Advances
September 30, 2004
(In millions)

Name of Borrower	Advances Outstanding
Washington Mutual Bank, FA	$ 48,901
World Savings Bank, FSB	21,017
Citibank (West), FSB	17,146
Subtotal	87,064
Other borrowers	36,495
Total par amount	$ 123,559

Because of this concentration of advances, the Bank has implemented enhanced 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 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 level, outstanding debt, and operating expenses. The timing and magnitude of the adjustments would depend on a number of factors, including: (i) the amount and the period over which the advances were prepaid or repaid, (ii) the amount and timing of any decreases in capital; (iii) the profitability of the advances; (iv) the size and profitability of the Bank's short-term and long-term investments; (v) the extent to which debt matured as the advances were prepaid or repaid; and (vi) the ability of the Bank to extinguish debt or transfer it to other FHLBanks and the costs to extinguish or transfer the debt. As discussed in "Our Business Model" in the Bank's 2003 Annual Report, the Bank's financial strategies are designed to enable it to shrink and grow its assets, liabilities, and capital in response to changes in membership composition and member credit needs. Under the Bank's 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 Finance Board 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 the issuance of new consolidated obligation bonds and discount notes. Other short-term borrowings, such as Federal funds purchased, securities sold under agreements to repurchase, and loans from other FHLBanks may 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 issuance of new consolidated obligations, the Bank maintained at least three months of liquidity for such circumstances during the third quarter of 2004. On a daily basis, the Bank models its cash commitments and expected cash flows for the next 90 days to determine the Bank's projected liquidity position. If a market or operational disruption occurred preventing the issuance of new consolidated obligation bonds or discount notes through the capital markets, the Bank could meet its contractual obligations by: (i) allowing short-term liquid investments to mature; (ii) using eligible securities as collateral for repurchase agreement borrowings; and (iii) if necessary, allowing advances to mature without renewal.

Credit Risk

Advances. The Bank manages the credit risk associated with lending to members by closely monitoring the creditworthiness of the members and the quality and value of the assets that they pledge as collateral. The Bank also has procedures to assess the mortgage underwriting and documentation standards of the members that pledge mortgage collateral. In addition, the Bank has collateral policies and restricted lending procedures in place to help manage its exposure to members that experience difficulty in meeting their capital requirements or other standards of creditworthiness.

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

MPF Program. The Bank and any member selling loans to the Bank through the MPF Program share in the credit risk of the loans sold by that member as specified in a master agreement. These assets may have more credit risk than advances, even though the member is required to provide 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 the credit enhancement, for any impaired loans and for the estimates of other probable losses, and the Bank has policies and procedures in place to manage the credit risk appropriately. 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:

(Dollars in millions)	September 30, 2004	December 31, 2003
30 – 59 days delinquent	$ 19	$ 35
60 – 89 days delinquent	2	1
90 days or more delinquent	1	—
Total delinquencies	$ 22	$ 36
Nonaccrual loans[1]	$ 2	$ —
Loans past due 90 days or more and still accruing interest	—	—
Delinquencies as a percentage of total mortgage loans outstanding	0.35%	0.56%
Nonaccrual loans as a percentage of total mortgage loans outstanding	0.03%	—

[1] The nonaccrual loans included 9 loans totaling $864,000 that were in foreclosure or bankruptcy as of September 30, 2004.

For the nine months ended September 30, 2004, interest income that was contractually due but not received and interest income foregone on the nonaccrual loans was $34,000.

Investments. The Bank has adopted credit policies and exposure limits for investments that promote diversification and liquidity. These policies restrict the amounts and terms of the Bank's investments 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
September 30, 2004
(In millions)

Investment Type	Credit Rating[1] AAA	AA	A	BBB	Total
Interest-bearing deposits in banks	$ —	$ 2,590	$ 1,582	$ —	$ 4,172
Securities purchased under agreements to resell[2]	3,800	—	—	—	3,800
Federal funds sold	—	5,366	4,616	23	10,005
Held-to-maturity securities:					
Commercial paper	750	—	299	—	1,049
Housing finance agency bonds	1,470	—	—	—	1,470
MBS	21,024	—	—	—	21,024
Total held-to-maturity securities	23,244	—	299	—	23,543
Held-at-fair-value securities:					
Housing finance agency bonds	266	—	—	—	266
MBS	364	—	—	—	364
Total held-at-fair-value securities	630	—	—	—	630
Total investments	$ 27,674	$ 7,956	$ 6,497	$ 23	$ 42,150

December 31, 2003
(In millions)

Investment Type	Credit Rating[1] 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 September 30, 2004, $1.6 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 September 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 indicated by rating agencies' 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
September 30, 2004
(In millions)

Credit Rating	Notional Balance	Gross Credit Exposure	Collateralized Exposure	Net Unsecured Exposure
AA	$ 141,582	$ 43	$ 33	$ 10
A	69,896	60	51	9
Subtotal	211,478	103	84	19
Member institutions [1]	847	12	12	—
Total derivatives	$ 212,325	$ 115	$ 96	$ 19

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 investments in Bank capital to significant interest rate risk.

Total Bank Market Risk.

Market Value of Equity Sensitivity—The Bank uses market value of equity sensitivity (the interest rate sensitivity of the net fair value of all assets, liabilities, and interest rate exchange agreements) to measure the Bank's exposure to changes in interest rates. The Bank 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 changes in interest rates under different interest rate scenarios.

Market Value of Equity Sensitivity
Percentage Change in Market Value of Bank Equity for Various Changes in Interest Rates:

Interest Rate Scenario*	September 30, 2004	December 31, 2003
+200 basis point change	–7.3%	–4.9%
+100 basis point change	–3.4%	–2.2%
–100 basis point change	+2.8%	+1.2%
–200 basis point change	+3.6%	–0.8%

* Instantaneous change from actual rates at dates indicated.

The increase in the sensitivity of the estimated market value of equity to changes in interest rates at September 30, 2004, compared to December 31, 2003, was due in part to an increase in the sensitivity of the market value of the mortgage portfolio.

Potential Dividend Yield—The Bank limits the sensitivity of projected financial performance through a policy limit on adverse changes 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 potential dividend yield, measured over a 12-month forecast period, to –175 basis points. Results of simulations as of September 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 –73 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"). The Bank monitors and manages the net assets in the periodic gaps of the advances segment to reflect the investment of the Bank's capital. The net assets in this segment are equal to total capital, with slightly more than half in the "less than 6 months" period and most of the remaining assets in the "6 months to 1 year" and "1 to 5 year" periods. As of September 30, 2004, 58% of net assets in the advances segment were in the "less than 6 months" period, indicating that a significant portion of invested capital was subject to minimal fluctuations from changes in interest rates.

Repricing Gap Analysis
As of September 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	$ 20,786	$ —	$ —	$ —
Advances	87,785	18,054	16,287	1,596
Other assets	385	—	—	—
Total Assets	108,956	18,054	16,287	1,596
Liabilities				
Consolidated obligations:				
Bonds	46,971	12,095	53,156	4,560
Discount notes	16,743	531	—	—
Deposits	1,023	—	—	—
Other liabilities	2,320	—	—	189
Total Liabilities	67,057	12,626	53,156	4,749
Interest rate exchange agreements	(37,640)	(4,947)	39,537	3,050
Periodic gap of advances-related business	4,259	481	2,668	(103)
Mortgage-related business:				
Assets				
MBS	7,497	1,611	6,968	5,312
Mortgage loans	552	418	2,129	3,101
Other assets	92	—	—	—
Total Assets	8,141	2,029	9,097	8,413
Liabilities				
Consolidated obligations:				
Bonds	2,543	835	12,843	4,092
Discount notes	6,239	576	—	—
Other liabilities	551	—	—	—
Total Liabilities	9,333	1,411	12,843	4,092
Interest rate exchange agreements	744	—	1,013	(1,757)
Periodic gap of mortgage-related business	(448)	618	(2,733)	2,564
Total periodic gap	$ 3,811	$ 1,099	$ (65)	$ 2,461

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 maturity and repricing cash flows for assets and liabilities are matched. The Bank monitors duration gap analysis at the total Bank level but does not have a policy limit. The Bank's duration gap was 1.3 months as of September 30, 2004, and 0.6 months as of December 31, 2003. The change was partially due to a decrease in the duration of mortgage asset-related funding, which increased the net duration.

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

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 investments 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 interest rate swaps or options 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, creates an advances portfolio with low net interest rate risk.

Non-MBS investments 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 variable rate funding.

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, given the uncertainty of the 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 a mortgage portfolio that has 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 September 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 for Various Changes in Interest Rates:

Interest Rate Scenario*	September 30, 2004	December 31, 2003
+200 basis point change	–4.7%	–3.3%
+100 basis point change	–2.3%	–1.5%
–100 basis point change	+2.1%	+0.7%
–200 basis point change	+1.7%	–1.1%

* Instantaneous change from actual rates at dates indicated.

Potential Dividend Yield Sensitivity

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

	September 30, 2004	December 31, 2003
Instantaneous +200-basis-point change	–0.34%	–0.07%
Instantaneous –200-basis-point change	–0.29%	–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 September 30, 2004, the total notional amount of interest rate exchange agreements outstanding was $212.3 billion, compared with $126.8 billion at December 31, 2003. The $85.5 billion increase in the notional amount of derivatives during the first nine months of 2004 was primarily due to (i) a $25.5 billion increase in interest rate swaps used to hedge the market risk of new short- and intermediate-term fixed rate advances, (ii) a $10.6 billion increase in interest rate swaps that hedge the cash flow (basis) risk of new short and intermediate-term floating rate advances (the swaps effectively convert the floating rate advance interest payments to LIBOR), and (iii) a $43.3 billion increase in interest rate swaps that hedge various types of consolidated obligations. 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 September 30, 2004.

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

		Cumulative Gain/(Loss)		
(In millions)	Notional Amount	Derivatives	Hedged Instruments	Difference
Qualifying for Fair Value Hedge Accounting:				
Advances	$ 74,734	$ (158)	$ 157	$ (1)
Callable bonds	55,142	(229)	289	60
Non-callable consolidated obligations	34,571	38	(35)	3
Mortgage asset funding	1,750	30	(26)	4
Subtotal	166,197	(319)	385	66
Not Qualifying for Hedge Accounting:				
Advances	10,760	(2)	—	(2)
Consolidated obligations:				
Bifurcated	495	10	(10)	—
Other	25,095	(1)	—	(1)
Intermediated	1,690	1	—	1
Mortgage assets:				
Mortgage asset funding	7,542	22	—	22
MBS – held-at-fair-value	345	(15)	15	—
MPF firm commitments	1	23	—	23
Subtotal	45,928	38	5	43
Total	$ 212,125	$ (281)	$ 390	109
REFCORP/AHP assessments				(29)
Fair value gain after assessments, recorded to income				$ 80
Qualifying for Cash Flow Hedge Accounting:				
Other comprehensive income/(loss):				
Mortgage asset funding	$ 200	$ (8)	$ —	$ (8)
Total Notional Amount of Derivatives	$ 212,325			

* The notional amounts outstanding are as of September 30, 2004, and the cumulative gains and losses are since the adoption of SFAS 133 on January 1, 2001, through the period ended September 30, 2004.

The primary source of SFAS 133-related income volatility arises from hedging certain callable 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, and the Bank's retained earnings in the future may not be sufficient to offset the impact of SFAS 133. As a result, the effects of SFAS 133 may lead

to increased volatility in future earnings, other comprehensive income, and dividends. Because the SFAS 133 cumulative net unrealized gains or losses are primarily a matter of timing, the unrealized gains or losses will generally reverse over the remaining contractual terms to maturity of the hedged financial instruments and associated interest rate exchange agreements.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with GAAP requires the Bank 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, expenses, gains, and losses during the reported period. Although the Bank 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 the Bank 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 advances 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 meet other requirements. 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.

Federal Reserve Bank Policy Statement on Payments System Risk (PSR Policy). The Federal Reserve Board announced the revision of its PSR Policy as it applies to interest and redemption payments on Fedwire-eligible securities issued by government-sponsored enterprises (GSEs) and certain international organizations. Currently, the Federal Reserve Banks process and post these payments to depository institutions' Federal Reserve accounts by 9:15 a.m. Eastern time, even if the issuer has not fully funded its payments, creating an intraday overdraft in some instances. Beginning July 20, 2006, the Federal Reserve Banks will post these payments only if the issuer's Federal Reserve account contains sufficient funds to cover them. The Federal Reserve has coordinated the formation of a working group of industry representatives to promote a smooth transition to the revised policy. The Bank participates in the working group and is evaluating the potential impact of the revised PSR Policy on its operations.

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 the Federal Home Loan Bank of San Francisco as of September 30, 2004 and 2003, and the related Statements of Income for each of the three-month and nine-month periods ended September 30, 2004 and 2003, and the Statements of Capital Accounts for the three-month and nine-month periods ended September 30, 2004 and 2003, and the Statements of Cash Flows for the nine-month periods ended September 30, 2004 and 2003. These interim financial statements are the responsibility of the Bank'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
November 15, 2004

Statements of Condition

(In millions-except par value)	Sept. 30, 2004 (Unaudited)	Dec. 31, 2003	Sept. 30, 2003 (Unaudited)
Assets			
Cash and due from banks	$ 18	$ 18	$ 85
Interest-bearing deposits in banks	4,172	3,287	3,266
Deposits for mortgage loan program with other Federal Home Loan Bank	5	12	14
Securities purchased under agreements to resell	3,800	5,100	2,200
Federal funds sold	10,005	5,434	5,020
Held-to-maturity securities ($109, $127, $205, respectively, were pledged as collateral)	23,543	18,263	16,203
Held-at-fair-value securities	630	917	1,103
Advances	123,722	92,330	81,983
Mortgage loans held in portfolio, net of allowance for credit losses on mortgage loans of $0.3, $0, $0, respectively	6,200	6,445	5,177
Accrued interest receivable	286	218	199
Premises and equipment, net	7	8	9
Derivative assets	115	266	347
Other assets	70	92	57
Total Assets	$ 172,573	$ 132,390	$ 115,663
Liabilities and Capital			
Liabilities:			
Deposits:			
Demand and overnight	$ 933	$ 832	$ 802
Term	41	66	45
Other	49	90	94
Total deposits	1,023	988	941
Other borrowings	800	—	—
Consolidated obligations, net:			
Bonds	137,095	92,751	86,142
Discount notes	24,089	31,882	21,850
Total consolidated obligations	161,184	124,633	107,992
Accrued interest payable	723	528	572
Affordable Housing Program	130	135	140
Payable to REFCORP	10	16	32
Derivative liabilities	251	181	273
Other liabilities	1,146	63	137
Total Liabilities	165,267	126,544	110,087
Commitments and Contingencies: Note 11			
Capital: Note 7			
Capital stock-Class B ($100 par value) issued and outstanding: 72 shares	7,184	—	—
Capital stock ($100 par value) issued and outstanding: 57 shares and 55 shares, respectively	—	5,739	5,483
Retained earnings	130	119	112
Accumulated other comprehensive loss:			
Unrecognized net loss related to hedging activities	(8)	(12)	(19)
Total Capital	7,306	5,846	5,576
Total Liabilities and Capital	$ 172,573	$ 132,390	$ 115,663

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

Statements of Income

(Unaudited)

(In millions-except per share amounts)	Three months ended Sept. 30, 2004	Three months ended Sept. 30, 2003	Nine months ended Sept. 30, 2004	Nine months ended Sept. 30, 2003
Interest Income:				
Advances	$ 492	$ 244	$ 1,153	$ 850
Interest-bearing deposits in banks	20	7	39	33
Securities purchased under agreements to resell	6	7	22	23
Federal funds sold	25	17	68	57
Held-to-maturity securities	187	136	497	453
Held-at-fair-value securities	7	9	22	24
Mortgage loans	74	34	234	65
Total Interest Income	811	454	2,035	1,505
Interest Expense:				
Consolidated obligations	680	347	1,642	1,182
Deposits	2	1	4	3
Total Interest Expense	682	348	1,646	1,185
Net Interest Income	129	106	389	320
Other Income:				
Prepayment fees	2	5	6	8
Services to members	1	1	1	1
Net gain/(loss) on held-at-fair-value securities	4	(10)	(7)	(8)
Net (loss)/gain on derivatives and hedging activities	(100)	85	(55)	78
Other, net	—	1	2	3
Total Other Income	(93)	82	(53)	82
Other Expense:				
Operating expense	14	13	43	39
Federal Housing Finance Board	1	1	3	3
Office of Finance	1	1	3	2
Total Other Expense	16	15	49	44
Income Before Assessments	20	173	287	358
REFCORP assessments	4	32	53	66
Affordable Housing Program assessments	1	14	23	29
Total Assessments	5	46	76	95
Net Income	$ 15	$ 127	$ 211	$ 263

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

Statements of Capital Accounts

(Unaudited)

(In millions)	Capital Stock Class B Shares	Capital Stock Class B Par Value	Capital Stock Shares	Capital Stock Par Value	Retained Earnings Restricted	Retained Earnings Unrestricted	Retained Earnings Total	Accumulated Other Comprehensive Income/(Loss)	Total Capital
Balance, June 30, 2003	—	$ —	54	$5,371	$ 39	$ —	$ 39	$ (4)	$5,406
Issuance of capital stock	—	—	5	504					504
Redemption of capital stock	—	—	(4)	(446)					(446)
Comprehensive income:									
Net income						127	127		127
Other comprehensive income:									
Net amounts recognized as earnings								(1)	(1)
Net change in period relating to hedging activities								(14)	(14)
Total comprehensive income									112
Transfers to restricted retained earnings					73	(73)	—		—
Dividends on capital stock (4.18%)									
Stock issued	—	—	—	54		(54)	(54)		—
Balance, September 30, 2003	—	$ —	55	$5,483	$112	$ —	$112	$(19)	$5,576
Balance, June 30, 2004	69	$6,882	—	$ —	$181	$ —	$181	$ (8)	$7,055
Issuance of capital stock	4	330	—	—					330
Redemption/repurchase of capital stock	(1)	(94)	—	—					(94)
Comprehensive income:									
Net income						15	15		15
Other comprehensive income:									
Net amounts recognized as earnings								2	2
Net change in period relating to hedging activities								(2)	(2)
Total comprehensive income									15
Transfers to restricted retained earnings					(51)	51	—		—
Dividends on capital stock (3.70%)									
Stock issued	—	66	—	—		(66)	(66)		—
Balance, September 30, 2004	72	$7,184	—	$ —	$130	$ —	$130	$ (8)	$7,306

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

Statements of Capital Accounts

(Unaudited)

(In millions)	Capital Stock Class B Shares	Capital Stock Class B Par Value	Capital Stock Shares	Capital Stock Par Value	Retained Earnings Restricted	Retained Earnings Unrestricted	Retained Earnings Total	Accumulated Other Comprehensive Income/(Loss)	Total Capital
Balance, December 31, 2002	—	$ —	56	$5,586	$ 26	$ 75	$101	$(2)	$ 5,685
Issuance of capital stock	—	—	12	1,158					1,158
Redemption of capital stock	—	—	(15)	(1,513)					(1,513)
Comprehensive income:									
Net income						263	263		263
Other comprehensive income:									
Net amounts recognized as earnings								—	—
Net change in period relating to hedging activities								(17)	(17)
Total comprehensive income									246
Transfers to restricted retained earnings					86	(86)	—		—
Dividends on capital stock (4.44%)									
Stock issued	—	—	2	252		(252)	(252)		—
Balance, September 30, 2003	—	$ —	55	$5,483	$112	$ —	$112	$(19)	$5,576
Balance, December 31, 2003	—	$ —	57	$5,739	$119	$ —	$119	$(12)	$ 5,846
Issuance of capital stock	10	966	7	689					1,655
Redemption/repurchase of capital stock	(2)	(209)	(2)	(201)					(410)
Comprehensive income:									
Net income						211	211		211
Other comprehensive income:									
Net amounts recognized as earnings								4	4
Net change in period relating to hedging activities								—	—
Total comprehensive income									215
Transfers to restricted retained earnings					11	(11)	—		—
Conversion to Class B shares	63	6,286	(63)	(6,286)					—
Dividends on capital stock (4.10%)									
Stock issued	1	141	1	59		(200)	(200)		—
Balance, September 30, 2004	72	$7,184	—	$ —	$130	$ —	$130	$(8)	$ 7,306

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

Statements of Cash Flows

(Unaudited)

(In millions)	Nine months ended Sept. 30, 2004	Sept. 30, 2003
Cash Flows from Operating Activities:		
Net Income	$ 211	$ 263
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization:		
Net premiums/discounts on consolidated obligations and investments	17	(18)
Net discounts/premiums on mortgage loans	2	9
Concessions on consolidated obligations	31	34
Bank premises and equipment	2	2
Deferred net losses on interest rate exchange agreements	5	1
(Decrease)/increase in Affordable Housing Program (AHP) liability and discount on AHP advances	(5)	9
(Decrease)/increase in REFCORP liability	(6)	18
Loss/(gain) due to change in net fair value adjustment on derivative and hedging activities	2	(79)
(Decrease)/increase in held-at-fair-value securities	287	(592)
Decrease/(increase) in derivative asset accrued interest	23	(14)
(Decrease)/increase in derivative liability accrued interest	(28)	15
(Increase)/decrease in accrued interest receivable	(68)	86
Increase/(decrease) in accrued interest payable	195	(144)
Decrease/(increase) in other assets	32	(6)
(Decrease)/increase in other liabilities	(14)	100
Total adjustments	475	(579)
Net cash provided by/(used in) operating activities	686	(316)
Cash Flows from Investing Activities:		
Net (increase)/decrease in interest-bearing deposits in banks	(885)	1,568
Net (increase)/decrease in Federal funds sold	(4,524)	1,048
Net decrease in securities purchased under agreements to resell	1,800	2,200
Net decrease in short-term held-to-maturity securities	5	249
Purchases of long-term held-to-maturity securities	(10,674)	(7,470)
Maturities of long-term held-to-maturity securities	5,931	8,918
Principal collected on advances	597,598	398,590
Advances made	(629,203)	(399,730)
Principal collected on mortgage loans	643	498
Purchases of mortgage loans	(400)	(5,421)
Net decrease in deposits for mortgage loan program with other Federal Home Loan Bank	7	44
Increase to premises and equipment	(1)	(3)
Net cash (used in)/provided by investing activities	(39,703)	491

Statements of Cash Flows

(Unaudited)

(In millions)	Nine months ended Sept. 30, 2004	Sept. 30, 2003
Cash Flows from Financing Activities:		
Net increase in deposits	35	534
Net increase/(decrease) in other borrowings	800	(525)
Net proceeds from sale of consolidated obligations:		
Bonds	83,619	84,222
Discount notes	168,343	116,899
Payments for maturing and retiring consolidated obligations:		
Bonds	(38,878)	(93,395)
Discount notes	(176,147)	(107,479)
Proceeds from issuance of capital stock	1,655	1,158
Payments for redemption/repurchase of capital stock	(410)	(1,513)
Net cash provided by/(used in) financing activities	39,017	(99)
Net decrease in cash and cash equivalents	—	76
Cash and cash equivalents at beginning of year	18	9
Cash and cash equivalents at end of period	$ 18	$ 85
Supplemental Disclosure:		
Interest paid during the period	$ 1,231	$ 1,531

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

Notes to 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 third 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 nine-month periods ended September 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, expenses, gains, and losses 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 September 30, 2004.

Reclassifications. Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 presentation. For the three-month and nine-month periods ended September 30, 2003, the Bank reclassified realized gains and losses (net interest payments) on 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 1, 2003 (together referred to as "SFAS 133"). Previously, realized gains and losses on derivatives used in economic hedges were classified in "Net Interest Income," while unrealized gains and losses on these derivatives were recorded in "Net gain/(loss) on derivatives and hedging activities" in Other Income. Realized gains and losses on derivatives used in economic hedges have been reclassified and are now included in "Net gain/(loss) on derivatives and hedging activities" for the three-month and nine-month periods ended September 30, 2003. As a result of this reclassification, for the quarter ended September 30, 2003, "Net Interest Income" changed from $94 to $106, and "Net (loss)/gain on derivatives and hedging activities" changed from a gain of $97 to a gain of $85. For the nine months ended September 30, 2003, "Net Interest Income" changed from $294 to $320, and "Net (loss)/gain on derivatives and hedging activities" changed from a gain of $104 to a gain of $78.

Note 2 – Held-to-Maturity Securities

Held-to-maturity securities were as follows:

September 30, 2004	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Commercial paper	$ 1,049	$ —	$ —	$ 1,049
Housing finance agency bonds	1,470	12	(1)	1,481
Subtotal	2,519	12	(1)	2,530
Mortgage-backed securities (MBS):				
U.S. government agency-guaranteed	1,117	14	(8)	1,123
Non-agency	19,907	56	(113)	19,850
Total MBS	21,024	70	(121)	20,973
Total	$ 23,543	$ 82	$ (122)	$ 23,503

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

Based on the creditworthiness of the issuers and the value of the underlying collateral, the Bank believes that the estimated gross unrealized losses in the above tables for the periods ended September 30, 2004, and December 31, 2003, were temporary.

Redemption Terms. The amortized cost and estimated fair value of certain securities by contractual maturity and MBS as of September 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.

September 30, 2004 Year of Maturity	Amortized Cost	Estimated Fair Value	Weighted Average Interest Rate
Due in one year or less	$ 1,049	$ 1,049	1.54%
Due after five years through ten years	43	43	1.84
Due after ten years	1,427	1,438	1.91
Subtotal	2,519	2,530	1.76
MBS:			
U.S. government agency-guaranteed	1,117	1,123	4.22
Non-agency	19,907	19,850	3.86
Total MBS	21,024	20,973	3.88
Total	$ 23,543	$ 23,503	3.76%

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 $75 at both September 30, 2004, and December 31, 2003.

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

	September 30, 2004	December 31, 2003
Amortized cost of held-to-maturity securities other than MBS:		
Fixed rate	$ 1,049	$ 1,042
Adjustable rate	1,470	1,328
Subtotal	2,519	2,370
Amortized cost of held-to-maturity MBS:		
Passthrough securities:		
Fixed rate	717	649
Adjustable rate	224	274
Collateralized mortgage obligations:		
Fixed rate	15,171	10,499
Adjustable rate	4,912	4,471
Subtotal	21,024	15,893
Total	$ 23,543	$ 18,263

Note 3 – Held-at-Fair-Value Securities

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

	September 30, 2004	December 31, 2003
Housing finance agency bonds	$ 266	$ 493
MBS: U.S. government agency-guaranteed	364	424
Total	$ 630	$ 917

The net gain/(loss) on held-at-fair-value securities was $4 for the quarter ended September 30, 2004, and $(10) for the quarter ended September 30, 2003, and was $(7) for the nine months ended September 30, 2004, and $(8) for the nine months ended September 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 4.10% and 3.36% for the periods ended September 30, 2004, and December 31, 2003, respectively.

Note 4 – Advances

Redemption Terms. The Bank had advances outstanding at interest rates ranging from 1.13% to 8.75% at September 30, 2004, and 0.75% to 8.75% at December 31, 2003, as summarized below.

	September 30, 2004		December 31, 2003	
Year of Maturity	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Overdrawn demand deposit accounts	$ 10	1.63%	$ 2	2.94%
Due in 1 year or less	67,780	1.74	53,199	1.43
Due after 1 year through 2 years	25,016	2.15	12,370	1.88
Due after 2 years through 3 years	20,354	2.17	15,874	1.63
Due after 3 years through 4 years	5,163	3.22	3,944	2.51
Due after 4 years through 5 years	3,285	3.52	4,553	3.16
Thereafter	1,951	5.15	2,010	5.26
Subtotal	123,559	2.06%	91,952	1.74%
SFAS 133 valuation adjustments	153		367	
Net premium on advances	10		11	
Total	$ 123,722		$ 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 September 30, 2004, the Bank had a concentration of advances totaling $87,064 outstanding to three members, representing 71% of total outstanding advances (40%, 17%, and 14%, respectively). The interest income from advances to these members amounted to approximately $358 during the third quarter of 2004

and $866 for the first nine 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. The Bank 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 of members' financial condition, 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 September 30, 2004, and December 31, 2003, are detailed below:

	September 30, 2004	December 31, 2003
Par amount of advances:		
Fixed rate	$ 74,508	$ 51,547
Adjustable rate	49,051	40,405
Total	$ 123,559	$ 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, 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 September 30, 2004, and December 31, 2003, on mortgage loans, all of which are conventional, conforming fixed rate loans on single-family properties:

	September 30, 2004	December 31, 2003
Fixed rate medium-term mortgage loans	$ 2,290	$ 2,282
Fixed rate long-term mortgage loans	3,932	4,183
Unamortized net discounts	(22)	(20)
Total mortgage loans	$ 6,200	$ 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		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Balance, beginning of the period	$ 0.2	$ —	$ —	$ 0.2
Chargeoffs	—	—	—	—
Recoveries	—	—	—	—
Provision for/(reduction of) credit losses	0.1	—	0.3	(0.2)
Balance, end of the period	$ 0.3	$ —	$ 0.3	$ —

The Bank's allowance for credit losses consists of two components. The first is a component that is assigned to individual loans that are 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 September 30, 2004, the Bank had 15 loans totaling $2 classified as nonaccrual or impaired. Because the amount of the credit enhancement and supplemental mortgage insurance associated with these loans was sufficient to cover the estimated losses on these loans, management determined that a specific 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. As of September 30, 2004, the Bank had established an allowance for credit losses of $294 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 Federal Housing Finance Board (Finance Board) and the U.S. Secretary of the Treasury have 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:

	September 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	$ 48,659	1.98%	$ 26,177	2.70%
Due after 1 year through 2 years	37,883	2.39	23,716	1.91
Due after 2 years through 3 years	17,359	3.06	14,516	2.91
Due after 3 years through 4 years	11,358	3.29	6,692	3.43
Due after 4 years through 5 years	10,806	3.71	10,194	3.37
Thereafter	11,313	4.51	11,282	4.57
Index amortizing notes	15	4.61	15	4.61
Subtotal	137,393	2.68%	92,592	2.88%
Bond premiums	67		74	
Bond discounts	(157)		(144)	
SFAS 133 valuation adjustments	(208)		229	
Total	$ 137,095		$ 92,751	

The Bank's participation in consolidated obligation bonds outstanding includes callable bonds of $55,403 at September 30, 2004, and $35,370 at December 31, 2003. Contemporaneous with the issuance of callable bonds, 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 Bank had notional amounts of interest rate exchange agreements hedging callable bonds of $55,142 at

September 30, 2004 and $28,515 at December 31, 2003. 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 net 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:

	September 30, 2004	December 31, 2003
Par amount of consolidated obligation bonds:		
Non-callable	$ 81,990	$ 57,222
Callable	55,403	35,370
Total par value	$ 137,393	$ 92,592

The following is a summary of the Bank's participation in consolidated obligation bonds outstanding at September 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	September 30, 2004	December 31, 2003
Due in 1 year or less	$ 90,199	$ 56,717
Due after 1 year through 2 years	29,767	21,094
Due after 2 years through 3 years	7,280	8,412
Due after 3 years through 4 years	4,257	923
Due after 4 years through 5 years	3,852	4,030
Thereafter	2,023	1,401
Index amortizing notes	15	15
Total	$ 137,393	$ 92,592

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

	September 30, 2004	December 31, 2003
Par amount of consolidated obligations:		
Bonds:		
Fixed rate	$ 93,762	$ 61,576
Adjustable rate	30,472	23,429
Step-up	8,417	5,044
Fixed rate that converts to adjustable rate	1,797	325
Adjustable rate that converts to fixed rate	1,740	862
Comparative index	927	808
Zero-coupon	175	175
Inverse floating	88	358
Index amortizing notes	15	15
Total bonds, par	137,393	92,592
Discount notes, par	24,147	31,932
Total consolidated obligations, par	$ 161,540	$ 124,524

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

	September 30, 2004		December 31, 2003	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Par value	$ 24,147	1.61%	$ 31,932	1.05%
Discounts	(57)		(50)	
SFAS 133 valuation adjustments	(1)		—	
Total	$ 24,089		$ 31,882	

Note 7 – Capital

Retained Earnings and Dividend Policy. The Bank's Retained Earnings and Dividend Policy establishes 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. 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 Finance Board regulations.

In accordance with the Retained Earnings and Dividend Policy, the Bank restricts retained earnings for that portion of income from advance 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 $7 at September 30, 2004, and $10 at December 31, 2003.

Also in accordance with the Retained Earnings and Dividend Policy, the Bank retains in restricted retained earnings any cumulative net unrealized gains in earnings (net of applicable assessments) resulting from SFAS 133. Retained earnings restricted in accordance with this provision totaled $80 at September 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. As net unrealized gains are reversed (by net unrealized losses), the amount of cumulative net unrealized gains decreases. The amount of retained earnings required by this provision of the policy is therefore decreased; that portion of the previously restricted retained earnings becomes unrestricted and may be made available for dividends. In this case, the potential dividend payout in a given period will be substantially the same as it 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 restricting retained earnings in accordance with this provision of the policy may preserve the Bank's ability to pay dividends, the reversal of the cumulative net unrealized SFAS 133 gains in any given period may result in a net loss if the reversal exceeds net earnings before the impact of SFAS 133 for that period. Also, if the net effect of SFAS 133 since inception results in a cumulative net unrealized loss, the Bank's other retained earnings at that time (if any) may not be sufficient to offset the net unrealized loss. As a result, the future effects of SFAS 133 may cause the Bank to reduce or temporarily suspend paying dividends.

In addition to the restricted retained earnings from advances prepayment fees and cumulative SFAS 133 gains, if any, the Bank holds additional restricted retained earnings to address other potential effects of SFAS 133 and other financial risks. 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 (less any cumulative net unrealized 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 the build-up to reach $100 (less any cumulative net unrealized fair value losses in net income resulting from SFAS 133, with a floor of zero) by the end of 2006. Effective September 24, 2004, the Board of Directors further amended the policy to provide for the build-up to reach $130 by the end of 2007. The retained earnings restricted in accordance with this provision totaled $43 at September 30, 2004, and $22 at December 31, 2003. The Board of Directors may amend the Retained Earnings and Dividend Policy from time to time.

The Board of Directors may declare and pay dividends only from retained earnings or current net earnings. There is no requirement that the Board of Directors declare and pay any dividend. A decision by the 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.

The Bank has historically paid dividends, if declared, in stock form (except fractional shares) and intends to continue this practice.

Surplus Capital Stock Repurchase Policy. The Bank's surplus capital stock repurchase policy provides for the reduction of capital stock outstanding 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, generally excluding stock dividends earned and credited for the current year. In accordance with this policy, the Bank repurchased $121 of surplus capital stock in October 2004 that was subject to repurchase as of September 30, 2004.

Excess Capital Stock. As of September 30, 2004, the Bank had $501 of capital stock in excess of the minimum amount required to be held in accordance with the Bank's capital plan. This excess capital stock included the $121 of surplus capital stock that was subsequently repurchased in October. A member may obtain redemption of excess capital stock following a five-year redemption period, subject to certain conditions, by providing a written redemption notice to the Bank. At its discretion, under certain conditions the Bank may repurchase excess stock at any time before the five years have expired. The Bank's capital requirements are more fully discussed in Note 13 to the Financial Statements in the Bank's 2003 Annual Report.

Concentration. As of September 30, 2004, the Bank had a concentration of capital stock totaling 45 million shares outstanding to three members, representing 63% of total capital stock outstanding (36%, 14%, and 13%, respectively).

Note 8 – Segment Information

The Bank analyzes financial performance based on the net interest income, as adjusted, 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, as adjusted, 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, as adjusted, 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 present the Bank's financial performance by operating segment for the three months and nine months ended September 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					
	September 30, 2004			September 30, 2003		
	Advances-Related Business	Mortgage-Related Business	Total	Advances-Related Business	Mortgage-Related Business	Total
Net interest income	$ 82	$ 47	$ 129	$ 67	$ 39	$ 106
Interest income/(expense) on economic hedges not included in net interest income	(1)	(20)	(21)	(1)	(11)	(12)
Net interest income, as adjusted	$ 81	$ 27	$ 108	$ 66	$ 28	$ 94

	Nine months ended					
	September 30, 2004			September 30, 2003		
	Advances-Related Business	Mortgage-Related Business	Total	Advances-Related Business	Mortgage-Related Business	Total
Net interest income	$ 216	$ 173	$ 389	$ 218	$ 102	$ 320
Interest income/(expense) on economic hedges not included in net interest income	2	(57)	(55)	(3)	(23)	(26)
Net interest income, as adjusted	$ 218	$ 116	$ 334	$ 215	$ 79	$ 294

The following table presents total assets by operating segment:

	Advances-Related Business	Mortgage-Related Business	Total Assets
September 30, 2004	$ 144,893	$ 27,680	$ 172,573
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 $212,325 at September 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 a favorable interest rate exchange agreement if the counterparty defaults; this amount is substantially less than the notional amount. Based on management's credit analyses of Bank counterparties and on the Bank's netting arrangements and bilateral 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 (has a net unrealized gain) if the counterparties all defaulted and the related collateral proved to be of no value to the Bank. At September 30, 2004, and December 31, 2003, the Bank's maximum credit risk, as defined above, was estimated at $115 and $266, respectively, including $70 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 $96 and $215 as collateral from interest rate exchange counterparties as of September 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 $1,690 at September 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 derivative instrument that does not qualify as a hedge of an asset or liability under SFAS 133 for asset/liability management (economic hedge) are recorded each period in current earnings.

As a result of SFAS 133, for the three months ended September 30, 2004 and 2003, the Bank recorded net (losses)/gains on derivatives and hedging activities of $(100) and $85, respectively, in other income. For the nine months ended September 30, 2004 and 2003, the Bank recorded net (losses)/gains on derivatives and hedging activities of $(55) and $78, respectively, in other income. Net (losses)/gains on derivatives and hedging activities were as follows:

	Three months ended		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Net (losses)/gains related to fair value hedge ineffectiveness	$ (93)	$ 90	$ (23)	$ 101
Net gains on economic hedges	14	7	23	3
Net interest expense on derivative instruments used in economic hedges	(21)	(12)	(55)	(26)
Net (losses)/gains on derivatives and hedging activities	$ (100)	$ 85	$ (55)	$ 78

As of September 30, 2004, approximately $4 in unrecognized net losses on derivative instruments accumulated in other comprehensive income is 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 September 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 September 30, 2004, and December 31, 2003, were as follows:

Fair Value of Financial Instruments – September 30, 2004

	Carrying Value	Net Unrealized Gains/(Losses)	Estimated Fair Value
Assets			
Cash and due from banks	$ 18	$ —	$ 18
Deposits for mortgage loan program	5	—	5
Interest-bearing deposits in banks	4,172	—	4,172
Securities purchased under agreements to resell	3,800	—	3,800
Federal funds sold	10,005	—	10,005
Held-to-maturity securities	23,543	(40)	23,503
Held-at-fair-value securities	630	—	630
Advances	123,722	35	123,757
Mortgage loans, net of allowance for credit losses on mortgage loans	6,200	(6)	6,194
Accrued interest receivable	286	—	286
Derivative assets	115	—	115
Other assets	77	(49)	28
Total	$ 172,573	$ (60)	$ 172,513
Liabilities			
Deposits	$ 1,023	$ —	$ 1,023
Other borrowings	800	—	800
Consolidated obligations:			
Bonds	137,095	(45)	137,140
Discount notes	24,089	8	24,081
Accrued interest payable	723	—	723
Derivative liabilities	251	—	251
Other liabilities	1,286	—	1,286
Total	$ 165,267	$ (37)	$ 165,304

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 was $850,466 at September 30, 2004, and $759,510 at December 31, 2003. The par value of the Bank's participation in consolidated obligations was $161,540 at September 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 obligate the Bank for additional advances totaled approximately $60 at September 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 account with the Bank or converted into a collateralized advance to the member.

Outstanding standby letters of credit were approximately $802 at September 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 September 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 $2 at September 30, 2004. Based on management's credit analyses of members' financial condition 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 like other advances to members (see Note 4). The estimated fair value of commitments and letters of credit was immaterial to the balance sheet as of September 30, 2004, and December 31, 2003.

Commitments that unconditionally obligate the Bank to purchase mortgage loans totaled $2 at September 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 September 30, 2004, and December 31, 2003, the Bank had pledged as collateral securities with a fair value of $112 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 $2,408 of consolidated obligations and entered into $1,931 of notional amount of interest rate exchange agreements that had traded but not yet settled at September 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		Nine months ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Compensation and benefits	$ 9	$ 8	$ 28	$ 26
Professional and contract services	2	2	7	6
Other	3	3	8	7
Total operating expense	$ 14	$ 13	$ 43	$ 39

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President and Chief Executive Officer

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