

Statements of Condition

(IN THOUSANDS – EXCEPT PAR VALUE)

DECEMBER 31, 2003

DECEMBER 31, 2002

ASSETS

Cash and due from banks	\$ 17,579	\$ 8,759
Interest-bearing deposits in banks	3,287,000	4,834,000
Deposits for mortgage loan program with other Federal Home Loan Bank	11,611	58,113
Securities purchased under agreements to resell	5,100,000	4,400,000
Federal funds sold	5,434,000	6,068,000
Held-to-maturity securities (\$127,375, \$250,007, respectively, were pledged as collateral)	18,263,315	17,878,844
Held-at-fair-value securities	917,322	533,090
Advances	92,329,621	81,237,041
Mortgage loans held in portfolio, net of allowance for credit losses on mortgage loans of \$0, \$180	6,445,192	262,426
Accrued interest receivable	218,123	285,055
Premises and equipment, net	8,388	7,343
Derivative assets	265,677	518,734
Other assets	91,908	38,076
Total Assets	\$ 132,389,736	\$ 116,129,481

LIABILITIES AND CAPITAL

Liabilities:

Deposits:

Demand and overnight	\$ 831,942	\$ 352,344
Term	65,450	34,510
Other	90,273	19,785
Total deposits	987,665	406,639

Other borrowings

— 525,000

Consolidated obligations, net:

Bonds	92,751,350	95,821,797
Discount notes	31,882,203	12,446,816
Total consolidated obligations	124,633,553	108,268,613

Accrued interest payable	527,947	715,620
Affordable Housing Program	134,990	131,706
Payable to REFCORP	16,211	14,012
Derivative liabilities	180,690	345,865
Other liabilities	62,858	37,328
Total Liabilities	126,543,914	110,444,783

Commitments and Contingencies: Note 19

Capital:

Capital stock (\$100 par value) issued and outstanding: 57,390 shares in 2003 and 55,860 shares in 2002	5,738,966	5,585,988
Retained earnings	118,922	100,978
Accumulated other comprehensive loss:		
Unrecognized net loss related to hedging activities	(12,066)	(2,268)
Total Capital	5,845,822	5,684,698
Total Liabilities and Capital	\$ 132,389,736	\$ 116,129,481

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

Statements of Income

(IN THOUSANDS)	FOR THE YEARS ENDED DECEMBER 31,		
	2003	2002	2001
INTEREST INCOME:			
Advances	\$ 1,128,638	\$ 1,818,901	\$ 4,733,629
Interest-bearing deposits in banks	43,971	78,309	142,429
Deposits for mortgage loan program with other Federal Home Loan Bank	136	59	—
Securities purchased under agreements to resell	30,035	47,853	63,861
Federal funds sold	77,895	119,213	349,341
Held-to-maturity securities	580,582	819,607	828,862
Held-at-fair-value securities	31,417	32,654	40,359
Mortgage loans	138,474	1,600	—
Loans to other Federal Home Loan Banks	140	250	843
Total Interest Income	2,031,288	2,918,446	6,159,324
INTEREST EXPENSE:			
Consolidated obligations	1,597,638	2,395,569	5,579,602
Deposits	3,545	7,148	15,994
Borrowings from other Federal Home Loan Banks	6	68	78
Other borrowings	103	133	218
Total Interest Expense	1,601,292	2,402,918	5,595,892
NET INTEREST INCOME BEFORE MORTGAGE LOAN LOSS PROVISION	429,996	515,528	563,432
(Reduction of)/provision for credit losses on mortgage loans	(180)	180	—
NET INTEREST INCOME AFTER MORTGAGE LOAN LOSS PROVISION	430,176	515,348	563,432
OTHER INCOME/(LOSS):			
Prepayment fees	15,486	9,032	5,953
Services to members	893	851	904
Net (loss)/gain on held-at-fair-value securities	(15,403)	22,745	7,653
Net gain/(loss) on derivatives and hedging activities	65,303	(83,029)	54,986
Other, net	3,677	3,137	2,901
Total Other Income/(Loss)	69,956	(47,264)	72,397
OTHER EXPENSE:			
Operating expense	54,001	53,561	48,803
Federal Housing Finance Board	3,742	4,596	4,134
Office of Finance	2,708	2,846	2,526
Arbitration award	—	9,395	—
Total Other Expense	60,451	70,398	55,463
INCOME BEFORE ASSESSMENTS AND CUMULATIVE EFFECT OF ADOPTING SFAS 133	439,681	397,686	580,366
REFCORP assessments	80,758	73,045	106,147
Affordable Housing Program assessments	35,892	32,464	47,177
Total Assessments	116,650	105,509	153,324
INCOME BEFORE CUMULATIVE EFFECT OF ADOPTING SFAS 133	323,031	292,177	427,042
Cumulative effect of adopting SFAS 133	—	—	(2,453)
NET INCOME	\$ 323,031	\$ 292,177	\$ 424,589

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

Statements of Capital Accounts

(IN THOUSANDS)	CAPITAL STOCK		RETAINED EARNINGS			ACCUMULATED OTHER	TOTAL CAPITAL
	SHARES	PAR VALUE	RESTRICTED	UNRESTRICTED	TOTAL	COMPREHENSIVE INCOME/(LOSS)	
Balance, December 31, 2000	62,679	\$ 6,267,859	\$ 24,179	\$ 107	\$ 24,286	\$ —	\$6,292,145
Issuance of capital stock	6,655	665,502					665,502
Redemption of capital stock	(5,680)	(567,965)					(567,965)
Comprehensive income:							
Net income				424,589	424,589		424,589
Other comprehensive income:							
Cumulative effect of adopting SFAS 133						(17,065)	(17,065)
Net amounts recognized as earnings						12,217	12,217
Net change in period relating to hedging activities						102	102
Total comprehensive income							419,843
Transfers to restricted retained earnings			38,015	(38,015)	—		—
Dividends on capital stock (5.99%)							
Cash payment					(61)		(61)
Stock issued	3,865	386,545		(386,545)	(386,545)		—
Balance, December 31, 2001	67,519	6,751,941	62,194	75	62,269	(4,746)	6,809,464
Issuance of capital stock	5,026	502,535					502,535
Redemption of capital stock	(19,219)	(1,921,905)					(1,921,905)
Comprehensive income:							
Net income				292,177	292,177		292,177
Other comprehensive income:							
Net amounts recognized as earnings						4,189	4,189
Net change in period relating to hedging activities						(1,711)	(1,711)
Total comprehensive income							294,655
Transfers from restricted retained earnings			(36,710)	36,710	—		—
Dividends on capital stock (5.50%)							
Cash payment					(51)		(51)
Stock issued	2,534	253,417		(253,417)	(253,417)		—
Balance, December 31, 2002	55,860	5,585,988	25,484	75,494	100,978	(2,268)	5,684,698
Issuance of capital stock	14,229	1,422,948					1,422,948
Redemption of capital stock	(15,749)	(1,574,970)					(1,574,970)
Comprehensive income:							
Net income				323,031	323,031		323,031
Other comprehensive income:							
Net amounts recognized as earnings						(1,526)	(1,526)
Net change in period relating to hedging activities						(8,272)	(8,272)
Total comprehensive income							313,233
Transfers to restricted retained earnings			93,301	(93,301)	—		—
Dividends on capital stock (4.29%)							
Cash payment					(87)		(87)
Stock issued	3,050	305,000		(305,000)	(305,000)		—
Balance, December 31, 2003	57,390	\$ 5,738,966	\$118,785	\$ 137	\$ 118,922	\$(12,066)	\$5,845,822

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

Statements of Cash Flows

(IN THOUSANDS)	FOR THE YEARS ENDED DECEMBER 31,		
	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net Income	\$ 323,031	\$ 292,177	\$ 424,589
Cumulative effect of adopting SFAS 133	—	—	2,453
Income before cumulative effect of adopting SFAS 133	323,031	292,177	427,042
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization:			
Net discounts on consolidated obligations and investments	(1,092)	(117,013)	(422,974)
Net premiums on mortgage loans	8,793	128	—
Concessions on consolidated obligations	43,899	45,096	50,326
Bank premises and equipment	2,434	1,694	1,602
Deferred net losses on interest rate exchange agreements	1,529	2,208	9,712
(Reduction of)/provision for credit losses on mortgage loans	(180)	180	—
Increase in Affordable Housing Program (AHP) liability and discount on AHP advances	3,189	4,527	17,260
Increase/(decrease) in REFCORP liability	2,199	(22,863)	11,560
(Gain)/loss due to change in net fair value adjustment on derivative and hedging activities	(228,712)	59,296	(45,527)
Increase in held-at-fair-value securities	(384,233)	(5,219)	(520,737)
Decrease/(increase) in derivative asset accrued interest	18,344	119,925	(231,041)
Increase/(decrease) in derivative liability accrued interest	28,035	(112,676)	143,690
Decrease in accrued interest receivable	66,933	133,551	2,718,170
Decrease in accrued interest payable	(187,673)	(364,507)	(2,808,127)
(Increase)/decrease in other assets	(39,570)	2,923	(2,555)
Increase/(decrease) in other liabilities	25,412	(1,120)	2,287
Total adjustments	(640,693)	(253,870)	(1,076,354)
Net cash (used in)/provided by operating activities	(317,662)	38,307	(649,312)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net decrease/(increase) in interest-bearing deposits in banks	1,547,000	(347,000)	(1,789,000)
Net decrease/(increase) in Federal funds sold	634,000	2,377,000	(69,000)
Net increase in securities purchased under agreements to resell	(700,000)	(2,250,000)	(1,750,000)
Net decrease in short-term held-to-maturity securities	267,435	934,907	1,593,196
Purchases of long-term held-to-maturity securities	(11,544,881)	(10,286,685)	(7,242,976)
Maturities of long-term held-to-maturity securities	10,883,973	8,067,420	4,771,175
Principal collected on advances	557,274,742	353,940,025	343,437,997
Advances made	(568,983,409)	(332,850,038)	(334,746,482)
Principal collected on mortgage loans	640,465	3,057	—
Purchases of mortgage loans	(6,831,845)	(265,791)	—
Net decrease/(increase) in deposits for mortgage loan program with other Federal Home Loan Bank	46,502	(58,113)	—
Net decrease/(increase) in loans to other Federal Home Loan Banks	—	25,000	(25,000)
Net increase to premises and equipment	(3,479)	(3,508)	(2,805)
Net cash (used in)/provided by investing activities	(16,769,497)	19,286,274	4,177,105

Statements of Cash Flows

(IN THOUSANDS)	FOR THE YEARS ENDED DECEMBER 31,		
	2003	2002	2001
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase/(decrease) in deposits	581,026	(344,978)	375,204
Net (decrease)/increase in other borrowings	(525,000)	325,000	200,000
Net proceeds from sale of consolidated obligations:			
Bonds	103,600,962	71,761,000	92,897,300
Discount notes	182,665,980	96,800,665	196,443,370
Payments for maturing and retiring consolidated obligations:			
Bonds	(105,854,609)	(80,889,105)	(86,604,445)
Discount notes	(163,220,289)	(105,550,872)	(206,939,393)
Proceeds from issuance of capital stock	1,422,948	502,535	665,502
Payments for redemption of capital stock	(1,574,970)	(1,921,905)	(567,965)
Cash dividends paid	(69)	(51)	(61)
Net cash provided by/(used in) financing activities	17,095,979	(19,317,711)	(3,530,488)
Net increase/(decrease) in cash and cash equivalents	8,820	6,870	(2,695)
Cash and cash equivalents at beginning of year	8,759	1,889	4,584
Cash and cash equivalents at end of period	\$ 17,579	\$ 8,759	\$ 1,889
SUPPLEMENTAL DISCLOSURE:			
Interest paid during the period	\$ 2,131,336	\$ 3,258,314	\$ 7,174,678

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

Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001

(Dollars in thousands)

BACKGROUND INFORMATION

The Federal Home Loan Bank of San Francisco (Bank), a federally chartered corporation exempt from ordinary federal, state, and local taxation except real property taxes, is one of 12 District Federal Home Loan Banks (FHLBanks). The FHLBanks serve the public by enhancing the availability of credit for residential mortgages and targeted community development by providing a readily available, low-cost source of funds to their member institutions. Each FHLBank is operated as a separate entity with its own management, employees, and board of directors. The Bank does not have any special purpose entities or any other type of off-balance sheet conduits. The Bank is a cooperative whose member institutions own the capital stock of the Bank and may receive dividends on their investments. Regulated financial depositories and insurance companies engaged in residential housing finance and community financial institutions are eligible to apply for membership. Community financial institutions are defined for 2003 as FDIC-insured depository institutions with average total assets over the preceding three-year period of \$538,000 or less. All members are required to purchase stock in the Bank.

The Federal Housing Finance Board (Finance Board), an independent federal agency in the executive branch of the United States government, supervises and regulates the FHLBanks and the FHLBanks' Office of Finance. The Finance Board ensures that the FHLBanks operate in a financially safe and sound manner, carry out their housing finance mission, remain adequately capitalized, and are able to raise funds in the capital markets. Also, the Finance Board establishes policies and regulations governing the operations of the FHLBanks.

A primary source of funds for the FHLBanks is the proceeds from the sale to the public of the FHLBanks' debt instruments (consolidated obligations), which are the joint and several obligations of all FHLBanks and are sold to the public through the Office of Finance using authorized securities dealers. Other funds are provided by deposits, other borrowings, and the issuance of capital stock to members. The Bank primarily uses these funds to provide advances to members.

In accordance with the Finance Board's regulations, the Bank has established a formal policy governing the compensation and expense reimbursement provided to its directors. Directors are compensated based on the level of responsibility assumed. Fees are paid for attendance at certain meetings. Directors are also reimbursed for reasonable and necessary Bank-related travel, subsistence, and other related expenses under a policy similar to the Bank's travel policy for employees. During 2003, meeting fees totaled \$244 and reimbursed travel and related expenses totaled \$168.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Investments. Held-to-maturity securities and securities purchased under agreements to resell (resale agreements) are carried at cost, adjusted for the amortization of premiums and the accretion of discounts using methods that approximate the level-yield method. These investments are classified as held-to-maturity securities because management has the positive intent and ability to hold these securities until maturity.

The Bank classifies certain investments as held-at-fair-value securities and carries them at fair value. The Bank records changes in the fair value of these investments through other income. Under Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, the investments would be classified (described) as "trading." Given that Finance Board regulation prohibits the Bank from trading investments, the Bank does not participate in trading activities. Therefore, the Bank classifies the investments as "held-at-fair-value" securities because it believes that description is more appropriate.

The Bank treats resale agreements as collateralized investments.

The Bank regularly evaluates outstanding investments for impairment. If there is an other-than-temporary impairment in the value of an investment, the decline in value is recognized as a loss in other expense.

Advances. The Bank presents advances (loans to members) net of unearned fees and presents advances under the Affordable Housing Program (AHP) net of discounts. Interest on advances is credited to income as earned. Following the requirements of the Federal Home Loan Bank Act of 1932, as amended (FHLB Act), the Bank obtains sufficient collateral for advances to protect the Bank from losses. The FHLB Act limits eligible collateral to secure advances to certain investment securities, residential mortgage loans, cash or deposits with the Bank, and other eligible real estate-related assets. As more fully discussed in Note 7, the Bank may also accept secured small business, small farm, and small agribusiness loans as collateral from members that are community financial institutions (CFIs). The Bank has never experienced any credit losses on advances. Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no allowance for losses on advances is deemed necessary by management.

Mortgage Loans Held in Portfolio. Under the Mortgage Partnership Finance® (MPF®) Program, the Bank purchases government-insured and conventional conforming fixed rate residential mortgage loans from its participating members. (“Mortgage Partnership Finance” and “MPF” are registered trademarks of the Federal Home Loan Bank of Chicago.) The Bank manages the liquidity, interest rate, and options risk of the loans, while the member retains the marketing and servicing activities. The Bank and the member selling the loans share in the credit risk of the loans, with the Bank assuming the first loss obligation limited by the First Loss Account (FLA), and the member assuming credit losses in excess of the FLA, up to the amount of the credit enhancement obligation as specified in the master agreement. The Bank will incur credit losses when the loss experience exceeds the credit enhancement provided by the member for that master agreement.

The amount of the credit enhancement is calculated so that any credit losses (excluding special hazard losses) in excess of the enhancement are limited to those expected from an equivalent investment with a long-term credit rating of AA. The participating member receives from the Bank a credit enhancement fee for managing this portion of the credit risk in the loans. These fees are paid monthly based on the remaining unpaid principal balance of the mortgage loans. The amount of the member’s required credit enhancement obligation may vary depending on which product alternative is selected. The member may obtain supplemental mortgage insurance (SMI) for any portion of its credit enhancement obligation under some product alternatives. The Bank manages credit exposure to SMI carriers in the same way that it manages unsecured credit in its investment portfolio.

The Bank classifies mortgage loans as held for investment and, accordingly, reports them at their principal amount outstanding net of unamortized premiums and discounts. The Bank defers and amortizes premiums and discounts as interest income over the estimated life of the related mortgage loan. Actual prepayment experience and estimates of future principal prepayments are used in calculating the estimated lives of the mortgage loans. The Bank aggregates the mortgage loans by similar characteristics (type, maturity, note rate, and acquisition date) in determining prepayment estimates.

The Bank records credit enhancement fees as a yield adjustment to interest income and records delivery commitment extension fees and pair-off fees in other income.

The Bank places a mortgage loan on nonaccrual status when the collection of the contractual principal or interest from the participating member is reported 90 days or more past due. When a mortgage loan is placed on nonaccrual status, accrued but uncollected interest is reversed against interest income. The Bank records cash payments received on nonaccrual loans as interest income and a reduction of principal.

Allowance for Credit Losses on Mortgage Loans. The Bank bases the allowance for credit losses on mortgage loans on management’s estimate of probable credit losses in the Bank’s mortgage loan portfolio as of the balance sheet date. Actual losses greater than the levels defined for each participating member for loans purchased from that member are offset by the member’s credit enhancement. The Bank performs periodic reviews of its portfolio to identify the losses in the portfolio and to determine the likelihood of collection of the portfolio. The overall allowance is determined by an analysis that includes consideration of various 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. As of December 31, 2003, no loans were classified as either impaired or reported 90 days or more past due. As a result, no allowance for credit losses on mortgage loans was recorded as of December 31, 2003.

Affordable Housing Program. As more fully discussed in Note 8, the FHLB Act requires each FHLBank to establish and fund an AHP. The Bank charges the required funding for the AHP to earnings and establishes a liability. The AHP funds provide subsidies in the form of direct grants and below-market interest rate advances to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. AHP advances are made at interest rates below the customary interest rate for non-subsidized advances. When an FHLBank makes an AHP advance, the net present value of the difference in the cash flows attributable to the difference between the interest rate of the AHP advance and the FHLBank’s related cost of funds for comparable maturity funding is charged against the AHP liability and recorded as a discount on the AHP advance.

Prepayment Fees. The Bank charges its members a prepayment fee when certain advances are paid prior to original maturity. If a member prepays an advance and takes down a second advance within a short period of time after the prepayment of the first advance, the Bank evaluates whether the second advance meets the criteria to qualify as a modification of the first advance or is a new advance. If the second advance qualifies as a modification, the net prepayment fee on the prepaid advance is deferred, recorded in the basis of the advance, and amortized over the life of the modified advance as interest income. If the modified advance is hedged, it is marked to fair value after the amortization of the basis adjustment. This amortization results in offsetting amounts being recorded in net interest income and in “Net realized and unrealized gain/(loss) on derivatives and hedging activities” in other income. If the Bank determines that the second advance is a new advance, the net prepayment fees are recorded in other income.

Other Fees. Other fees for advances are deferred and amortized to interest income using the straight-line method. Issuance fees for letters of credit are recorded as other income when received.

Derivatives. Accounting for derivatives is addressed in SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of Effective Date of FASB Statement No. 133*, and as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (herein referred to as “SFAS 133”). Accordingly, all derivatives are recognized on the balance sheet at fair value and designated as either (1) a hedge of the fair value of (a) a recognized asset or liability or (b) an unrecognized firm commitment (a “fair value” hedge); (2) a hedge of (a) a forecasted transaction or (b) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a “cash flow” hedge); (3) a non-SFAS 133-qualifying hedge of an asset or liability (an “economic” hedge) for asset-liability management purposes, or (4) a non-SFAS 133-qualifying hedge of another derivative (an “intermediation” hedge) that is offered as a product to members or used to offset other derivatives with non-member counterparties.

Changes in the fair value of a derivative that is effective as and is designated and qualifies as a fair value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk (including changes that reflect losses or gains on firm commitments), are recorded in current period earnings.

Changes in the fair value of a derivative that is effective as and is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, a component of capital, until earnings are affected by the variability of the cash flows of the hedged transaction (i.e., until the periodic recognition of interest on a variable rate asset or liability is recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the change in the fair value of the derivative differs from the change in the fair value of the hedged item or the variability in the cash flows of the forecasted transaction) is recorded in current period earnings.

Changes in the fair value of a derivative designated as an economic hedge or an intermediation hedge are recorded in current period earnings with no fair value adjustment to an asset or liability. Hedge ineffectiveness and changes in the fair value of economic hedges are recorded in other income as “Net gain/(loss) on derivatives and hedging activities.” In addition, the interest income and interest expense associated with economic hedges are recorded in other income as “Net gain/(loss) on derivatives and hedging activities.”

The Bank routinely issues debt and makes advances in which derivative instruments are embedded. Upon execution of these transactions, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the advance or debt (the host contract) and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative has economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and (2) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and designated as a stand-alone derivative instrument pursuant to an economic hedge. However, if the entire contract (the host contract and the embedded derivative) is to be measured at fair value, with changes in fair value reported in current earnings (such as an investment security classified as “trading” under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*), or if the Bank cannot reliably identify and measure the embedded derivative for purposes of separating that derivative from its host contract, the entire contract is carried on the balance sheet at fair value and no portion of the contract is designated as a hedging instrument.

The Bank documents all relationships between derivative hedging instruments and hedged items, its risk management objectives and strategies for undertaking various hedge transactions, and its method of assessing effectiveness. This process includes linking all derivatives that are designated as fair value or cash flow hedges to (1) assets and liabilities on the balance sheet, (2) firm commitments, or (3) forecasted transactions. The Bank also formally assesses (both at the hedge’s inception and at least quarterly on an ongoing basis) whether the derivatives that are used in hedging transactions have been effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain effective in future periods. The Bank typically uses regression analyses or other statistical analyses to assess the effectiveness of its hedges. When it is determined that a derivative has not been or is not expected to be effective as a hedge, the Bank discontinues hedge accounting prospectively.

The Bank discontinues hedge accounting prospectively when (1) it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative and/or the hedged item expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur in the originally expected period; (4) a hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designating the derivative as a hedging instrument in accordance with SFAS 133 is no longer appropriate.

When hedge accounting is discontinued because the Bank determines that the derivative no longer qualifies as an effective fair value hedge, the Bank will continue to carry the derivative on the balance sheet at its fair value, cease to adjust the hedged asset or liability for changes in fair value, and begin amortizing the cumulative basis adjustment on the hedged item into earnings over the remaining life of the hedged item using a method that approximates the level yield. When hedge accounting is discontinued because the Bank determines that the derivative no longer qualifies as an effective cash flow hedge of an existing hedged item, the Bank will continue to carry the derivative on the balance sheet at its fair value and will amortize the cumulative other comprehensive income adjustment to earnings when earnings are affected by the original forecasted transaction.

When the Bank discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period plus the following two months, but it is probable the transaction will still occur in the future, the gain or loss on the derivative remains in accumulated other comprehensive income and is recognized as earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within two months thereafter, the gains and losses that were accumulated in other comprehensive income are recognized immediately in earnings.

When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Bank will continue to carry the derivative on the balance sheet at its fair value, removing from the balance sheet any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current period earnings.

In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Bank will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value of the derivative in current period earnings.

Hedging Activities.

General – The Bank may enter into interest rate swaps (including callable and putable swaps), swaptions, and cap and floor agreements, (collectively, interest rate exchange agreements or derivatives).

Most of the Bank's interest rate exchange agreements are executed in conjunction with the origination of advances and the issuance of consolidated obligation bonds to create variable rate structures. The interest rate exchange agreements are generally executed at the same time as the advances and bonds are transacted and generally have the same maturity dates as the related advances and bonds.

Additional active uses of interest rate exchange agreements include: (1) offsetting interest rate caps embedded in adjustable rate advances made to members, (2) hedging the

anticipated issuance of debt, (3) matching against consolidated obligation discount notes or bonds to create the equivalent of callable fixed rate debt, (4) modifying the repricing intervals between variable rate assets and variable rate liabilities, and (5) exactly offsetting other derivatives executed with members (the Bank serves as an intermediary). The Bank's use of interest rate exchange agreements results in one of the following classifications: (1) a fair value or cash flow hedge of an underlying financial instrument, (2) a forecasted transaction, (3) an economic hedge for specific asset and liability management purposes (a non-SFAS 133-qualifying economic hedge), or (4) an intermediary transaction for members.

An economic hedge is defined as an interest rate exchange agreement hedging specific or non-specific underlying assets, liabilities, or firm commitments that does not qualify for hedge accounting treatment under the rules of SFAS 133, but is an acceptable hedging strategy under the Bank's risk management program. These economic hedging strategies also comply with Finance Board regulatory requirements prohibiting speculative hedge transactions. An economic hedge by definition introduces the potential for earnings variability due to the change in fair value recorded on the interest rate exchange agreements that are not offset by corresponding changes in the value of the economically hedged assets, liabilities, or firm commitments.

Consistent with Finance Board regulation, the Bank enters into interest rate exchange agreements only to reduce the interest rate risk exposures inherent in otherwise unhedged assets and funding positions, to achieve the Bank's risk management objectives, and act as an intermediary between our members and counterparties. Bank management uses interest rate exchange agreements when they are deemed to be the most cost-effective alternative to achieve the Bank's financial and risk management objectives. Accordingly, the Bank may enter into interest rate exchange agreements that do not necessarily qualify for hedge accounting under SFAS 133 accounting rules. As a result, the Bank recognizes only the change in fair value of these interest rate exchange agreements in other income as "Net gain/(loss) on derivatives and hedging activities" with no offsetting fair value adjustments for the asset, liability, or firm commitment.

The Bank is subject to credit risk as a result of the risk of nonperformance by counterparties to the derivative agreements. All derivative agreements are subject to master netting arrangements to mitigate the credit risk exposure. The Bank manages counterparty credit risk through credit analyses and collateral requirements and by following the requirements of the Bank's risk management policies and credit guidelines and the Finance Board's Financial Management Policy. Based on the master netting arrangements, its credit analyses, and the collateral requirements in place with each counterparty, management of the Bank does not anticipate any credit losses on its agreements.

Intermediation – As an additional service to its members, the Bank enters into offsetting interest rate exchange agreements, acting as an intermediary between exactly offsetting derivatives transactions with members and other counterparties. This intermediation allows members indirect access to the derivatives market. The offsetting derivatives used in intermediary activities do not receive SFAS 133 hedge accounting treatment and are separately marked to market through earnings. The net result of the accounting for these derivatives does not significantly affect the operating results of the Bank.

Investments – The Bank may invest in U.S. agency securities, mortgage-backed securities (MBS), and the taxable portion of state or local housing finance agency securities. The interest rate and prepayment risk associated with these investment securities is managed through a combination of debt issuance and derivatives. The Bank may manage prepayment and interest rate risk by funding investment securities with consolidated obligations that have call features, or by hedging the prepayment risk with caps or floors, callable swaps, or swaptions. These investment securities may be classified as held-to-maturity or held-at-fair-value.

The Bank may also manage the risk arising from changing market prices or cash flows of investment securities classified as held-at-fair-value by entering into interest rate exchange agreements (economic hedges) that offset the changes in fair value or cash flows of the securities. The market value changes of both the held-at-fair-value securities and the associated interest rate exchange agreements are included in other income in the Statements of Income.

Advances – The Bank offers a wide array of advance structures to meet member’s funding needs. These advances can have maturities out to 30 years with variable or fixed rates and may include early termination features or options such as caps or floors. Generally, whenever a member executes a fixed rate advance or a variable rate advance with embedded options, the Bank will simultaneously execute an interest rate exchange agreement with terms that offset the terms and embedded options, if any, in the advance. The combination of the advance and the interest rate exchange agreement effectively creates a simple variable rate asset.

The Bank does not offer certain advance structures that when hedged may lead to significant volatility in income or in other comprehensive income.

Mortgage Loans – The Bank invests in fixed rate mortgage loans. The prepayment options embedded in mortgage loans can result in extensions or contractions in the expected maturities of these investments, depending on changes in estimated prepayment speeds. The Bank manages the interest rate and prepayment risk associated with fixed rate mortgage loans through a combination of debt issuance and derivatives. The Bank issues both callable and non-callable debt to achieve cash flow patterns and market value sensitivities for liabilities similar to those expected on the mortgage

loans. Net income could be reduced if the Bank replaces the mortgages with lower-yielding assets and the Bank’s higher funding costs are not reduced accordingly.

The Bank executes callable swaps and purchases swaptions in conjunction with the issuance of certain liabilities to create funding equivalent to fixed rate callable debt. Although these derivatives are economic hedges against the prepayment risk of specific loan pools and are referenced to individual liabilities, they do not receive either fair value or cash flow hedge accounting treatment. The derivatives are marked to market through earnings and provide modest income volatility

Consolidated Obligations – While consolidated obligations are the joint and several obligations of the FHLBanks, FHLBanks individually are counterparties to interest rate exchange agreements associated with specific debt issues.

The Bank issues consolidated obligation bonds with the structures and maturities to meet investor needs. Common structures include fixed rate bonds with or without call options and variable rate bonds with embedded options. Generally, when the Bank issues one of these bond structures, the Bank will simultaneously execute an interest rate exchange agreement with terms that offset the terms and embedded options, if any, of the consolidated obligation bond. This combination of the consolidated obligation bond and the interest rate exchange agreement effectively creates a simple variable rate bond. The cost of this funding combination is lower than what would otherwise be available through the issuance of just a variable rate bond. These transactions generally receive fair value hedge accounting treatment under SFAS 133. Despite the fair value hedge classification, there has been material accounting income volatility from the Bank’s portfolio of callable bonds that has been hedged by offsetting callable interest rate swaps to effectively create variable rate bonds. (See Note 2.)

The Bank has not issued consolidated obligation discount notes or bonds denominated in currencies other than U.S. dollars.

Firm Commitments – In accordance with SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (herein referred to as “SFAS 149”), which amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, mortgage purchase commitments entered into after June 30, 2003, are considered derivatives. Accordingly, the commitment is recorded as a derivative asset or derivative liability at fair value, with changes in fair value recognized in current-period earnings. When the mortgage purchase commitment derivative settles, the current market value of the commitment is included with the basis of the mortgage loan and amortized accordingly.

The Bank may also hedge a firm commitment for a forward starting fixed rate advance through the use of an offsetting forward starting interest rate swap. In this case, the interest rate swap functions as the hedging instrument for both the firm commitment and the subsequent advance. When the commitment is terminated and the advance is made, the current market value associated with the firm commitment is included with the basis of the advance. The basis adjustment is then amortized into interest income over the life of the advance.

Anticipated Debt Issuance – The Bank may enter into interest rate swaps for the anticipated issuance of fixed rate bonds to lock in the cost of funding. These hedges are accounted for as cash flow hedges. The interest rate swap is terminated upon issuance of the fixed rate bond, with the realized gain or loss on the interest rate swap recorded in other comprehensive income. Realized gains and losses reported in accumulated other comprehensive income are recognized as earnings in the periods in which earnings are affected by the cash flows of the fixed rate bonds.

Premises and Equipment. The Bank records premises and equipment at cost less accumulated depreciation and amortization, which totaled approximately \$8,388 and \$7,343 at December 31, 2003 and 2002, respectively. Depreciation is computed on the straight-line method over the estimated useful lives of assets ranging from 3 to 10 years, and leasehold improvements are amortized on the straight-line method over the estimated useful life of the improvement or the remaining term of the lease, whichever is shorter. Improvements and major renewals are capitalized; ordinary maintenance and repairs are expensed as incurred. Depreciation and amortization expense was \$2,434, \$1,694, and \$1,602 for the years ended December 31, 2003, 2002, and 2001, respectively. The Bank includes gains and losses on disposal of premises and equipment in other income. The net realized gain on disposal of premises and equipment, primarily related to the 1999 sale of the Bank's building, was \$2,073, \$2,073, and \$2,057 in 2003, 2002, and 2001, respectively.

Concessions on Consolidated Obligations. The amounts paid to dealers in connection with the issuance of consolidated obligation bonds are deferred and amortized using a method approximating the level-yield method over the term of the obligations or estimated life of the bonds. The amount of the concession is allocated to the Bank by the Office of Finance based on the percentage of the debt issued for which the Bank is the primary obligor. Unamortized concessions were \$38,717 and \$24,457 at December 31, 2003 and 2002, respectively, and are included in "Other assets." Amortization of such concessions are included in consolidated obligation interest expense and totaled \$9,786, \$9,328, and \$13,498 in 2003, 2002, and 2001, respectively. Concessions applicable to the issuance of consolidated obligation discount notes are generally charged to interest expense as incurred because of the short-term maturities of these notes.

Discounts and Premiums on Consolidated Obligations. The discounts on consolidated obligation discount notes are amortized to expense using a method approximating the level-yield method over the term to maturity. The discounts and premiums on consolidated obligation bonds are amortized to expense using a method approximating the level-yield method over the term to maturity of the consolidated obligation bonds or estimated life of the bonds.

Resolution Funding Corporation (REFCORP) Assessments. Although the FHLBanks are exempt from ordinary federal, state, and local taxation except real property taxes, they are required to make payments to the REFCORP. Each FHLBank is required to pay 20% of net earnings (after AHP contributions) to REFCORP. The FHLBanks will expense these amounts until the aggregate amounts actually paid by all 12 FHLBanks are equivalent to a \$300 million annual annuity whose final maturity date is April 15, 2030, at which point the required payment of each FHLBank to REFCORP will be fully satisfied. The Finance Board in consultation with the Secretary of the Treasury will select the appropriate discounting factors to be used in this annuity calculation. The cumulative amount to be paid to REFCORP by the Bank is not determinable at this time because it depends on the future earnings of the Bank and the other FHLBanks. The FHLBanks' payments through 2003 defease all future benchmark payments after the third quarter of 2020 and \$21,456 of the \$75,000 benchmark payment for the third quarter of 2020.

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

Estimated Fair Values. Many of the Bank's financial instruments lack an available liquid trading market as characterized by frequent transactions between a willing buyer and willing seller engaging in an exchange transaction. Therefore, significant assumptions and present value calculations have been used by the Bank for the purpose of disclosing estimated fair values. Thus, the fair values may not represent the actual values of the financial instruments that could have been realized as of yearend or that will be realized in the future. The Bank continually refines its assumptions and present value calculations to better reflect market indications.

Carrying value is assumed to approximate fair value for financial instruments with three months or less to repricing or maturity. Fair values for certain financial instruments are based on quoted prices, market rates, or replacement rates for similar financial instruments as of the last business day of the year. The estimated fair values of the Bank's financial instruments and related assumptions are detailed in Note 17.

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

Reclassifications. Certain amounts in the 2002 and 2001 financial statements have been reclassified to conform to the 2003 presentation.

In particular, for the years ended December 31, 2002 and 2001, the Bank has reclassified realized gains and losses (net interest payments) on stand-alone derivative instruments used in economic hedges. Previously, realized gains and losses on stand-alone derivatives used in economic hedges were classified in “Net Interest Income After Mortgage Loan Loss Provision,” while unrealized gains and losses on these derivatives were recorded in “Net gain/(loss) on derivatives and hedging activities” in other income. These amounts have been reclassified and are now both included in “Net gain/(loss) on derivatives and hedging activities” for the years ended December 31, 2002 and 2001. As a result of this reclassification, “Net Interest Income After Mortgage Loan Loss Provision” changed from \$495,790 to \$515,348 and from \$554,307 to \$563,432 for the years ended December 31, 2002 and 2001, respectively. In addition, “Net gain/(loss) on derivatives and hedging activities” changed from (\$63,582) to (\$83,029) and from \$63,951 to \$54,986 for the years ended December 31, 2002 and 2001, respectively.

NOTE 2 – CHANGE IN ACCOUNTING PRINCIPLE AND RECENTLY ISSUED ACCOUNTING STANDARDS AND INTERPRETATIONS

Adoption of SFAS 145. The Bank adopted SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* (herein referred to as “SFAS 145”) on June 30, 2002. SFAS 145 rescinds both SFAS 4, *Reporting Gains and Losses from the Extinguishment of Debt*, and the amendment to SFAS 4, SFAS 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*, and eliminates the requirement that gains and losses from the extinguishment of debt (except for those considered unusual or infrequent in nature) be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. In accordance with the transition provisions of SFAS 145, previously reported gains and losses on early retirement of debt have been reclassified into other income under “Other, net.” The amounts reclassified were not material.

Adoption of SFAS 149. FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (herein referred to as “SFAS 149”), which amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In most cases, SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003, and, in most cases, all provisions of SFAS 149 should be applied prospectively. The Bank adopted SFAS 149 as of the effective date. Included in “Net gain/(loss) on derivatives and hedging activities” is \$29,950 in net gains from the adoption of SFAS 149 for the year ended December 31, 2003.

Adoption of SFAS 150. FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (herein referred to as “SFAS 150”) in May 2003. The Bank will adopt SFAS 150 as of January 1, 2005, and is currently in the process of assessing the impact of SFAS 150 on the financial statements.

Adoption of SFAS 132 (revised 2003). FASB issued SFAS No. 132 (revised 2003), *Employers’ Disclosures about Pensions and Other Postretirement Benefits* (herein referred to as “SFAS 132 (revised 2003)”) in December 2003. The Bank will adopt SFAS 132 (revised 2003) for the year ending December 31, 2004, and is currently in the process of assessing the impact, if any, of SFAS 132 (revised 2003) on its related disclosures.

Adoption of FIN 45. FASB issued Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34* (herein referred to as “FIN 45”) on November 25, 2002. FIN 45 expands existing disclosure requirements at December 31, 2002, for guarantees and provides initial recognition and measurement provisions to be applied on a prospective basis for guarantees issued or modified after December 31, 2002. The initial recognition and measurement provisions apply to the Bank’s letters of credit. The resulting amounts recognized in other liabilities in 2003 were not material. For more information, see Note 19.

Adoption of SFAS 133. The Bank adopted SFAS 133 on January 1, 2001. 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 ineffective portion of all hedges is recognized in current period earnings. Changes in the fair value of a non-SFAS hedge of an asset or liability (economic hedge) for asset/liability management are recorded each period in current earnings.

In accordance with the transition provisions of SFAS 133, the Bank reported the transition adjustment for each derivative designated as a fair value hedge as a cumulative effect adjustment of net income. Concurrently, any fair value gain or loss on the hedged item was recognized as an adjustment of the hedged item’s carrying amount, but only to the extent of the offsetting transition adjustment of the derivative, and was also reported as a cumulative effect adjustment of net income. The transition provisions also provided that at the date of initial implementation, an entity was permitted to transfer any security classified as “held-to-maturity” to “trading” (“held-at-fair-value” securities).

In accordance with the transition provisions of SFAS 133, the Bank recorded the following cumulative effect adjustments to increase or (decrease) earnings as of January 1, 2001:

Net adjustments related to (1) fair value hedges, (2) derivative transactions not designated as hedges under SFAS 133, and (3) derivative transactions not meeting the requirements for fair value or cash flow hedges	\$(9,587)
Unrealized net gains on investments transferred from "held-to-maturity" to "held-at-fair-value"	7,134
Total cumulative effect on earnings of adopting SFAS 133	\$(2,453)

The Bank also recorded cumulative effect adjustments to increase or (decrease) other comprehensive income as of January 1, 2001, and recorded changes in other comprehensive income for the years ended December 31, 2003, 2002, and 2001, as follows:

Total cumulative effect of adopting SFAS 133 on accumulated other comprehensive income at January 1, 2001, resulting from previously deferred hedging losses	\$(17,065)
Net amounts recognized as earnings for the year ended December 31, 2001	12,217
Net change associated with hedging activities for the year ended December 31, 2001	102
Total cumulative effect of adopting SFAS 133 on other comprehensive income at January 1, 2001, less net change during the year ended December 31, 2001, related to hedging activities	(4,746)
Net amounts recognized as earnings for the year ended December 31, 2002	4,189
Net change associated with hedging activities for the year ended December 31, 2002	(1,711)
Accumulated comprehensive income related to hedging activities at December 31, 2002	(2,268)
Net amounts reclassified to earnings for the year ended December 31, 2003	(1,526)
Net change associated with hedging activities for the year ended December 31, 2003	(8,272)
Accumulated comprehensive income related to hedging activities at December 31, 2003	\$(12,066)

On January 1, 2001, the Bank transferred held-to-maturity securities with an amortized cost of \$664,274 and an estimated fair value of \$671,408 into the held-at-fair-value securities category. The unrealized net gain related to the transfer of these held-to-maturity securities into the held-at-fair-value securities category was \$7,134 and was shown as an increase to the Bank's results of operations in 2001 as a cumulative effect of adopting SFAS 133. The remaining cumulative effect of adjustments related to fair value hedges and derivative transactions either not designated as hedges under SFAS 133 or not meeting the requirements for fair value or cash flow hedges was shown as a charge to the Bank's results of operations in 2001 as part of the cumulative effect of adopting SFAS 133, decreasing net income by \$9,587. These factors combined resulted in a net SFAS 133 transaction loss on January 1, 2001, totaling \$2,453. In addition, the Bank recognized a loss of \$17,065 in accumulated other comprehensive income as part of the cumulative effect of adopting SFAS 133 at transition, decreasing capital.

As a result of SFAS 133, for the years ended December 31, 2003, 2002, and 2001, the Bank recorded net gains/(losses) on derivatives and hedging activities of \$65,303, (\$83,029), and \$54,986, respectively, in other income. Net (losses)/gains on derivatives and hedging activities for the years ended December 31, 2003, 2002, and 2001, were as follows:

	2003	2002	2001
Gains/(losses) related to fair value hedge ineffectiveness	\$ 64,248	\$(47,797)	\$ 70,400
Gains on firm commitments	29,950	—	—
Losses on economic hedges	(31,501)	(35,987)	(15,414)
Gains related to cash flow hedge ineffectiveness	2,606	755	—
Net gains/(losses) on derivatives and hedging activities	\$ 65,303	\$(83,029)	\$ 54,986

For the years ended December 31, 2003, 2002, and 2001, \$778, \$540, and \$0, respectively, were reclassified into earnings as a result of the discontinuance of cash flow hedges because it became probable that the original forecasted transactions would not occur by the end of the originally specified time period or within a two-month period thereafter. As of December 31, 2003, the deferred net gains/(losses) on derivative instruments accumulated in other comprehensive income expected to be reclassified to earnings during the next 12 months were not material. 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 3 – CASH AND DUE FROM BANKS

Compensating Balances. The Bank maintains average collected cash balances with commercial banks in consideration for certain services. There are no legal restrictions under these agreements as to the withdrawal of these funds. The average compensating balances for the years ended December 31, 2003 and 2002, were approximately \$1,040 and \$1,920, respectively.

In addition, the Bank maintained average collected balances with the Federal Reserve Bank of San Francisco as required clearing balances and to facilitate the movement of funds to support the Bank's activities. There are regulations governing the withdrawal of these funds; however, earnings credits on these balances may be used to pay for services received. The average balances for this account for the years ended December 31, 2003 and 2002, were approximately \$1,143 and \$1,848, respectively.

NOTE 4 – SECURITIES PURCHASED UNDER AGREEMENTS TO RESELL

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

	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
December 31, 2003	\$5,100,000	\$ —	\$ —	\$5,100,000
December 31, 2002	\$4,400,000	\$ —	\$ —	\$4,400,000

Redemption Terms. The amortized cost and estimated fair value of resale agreements by contractual maturity as of December 31, 2003 and 2002, are shown below.

YEAR OF MATURITY	2003		2002	
	AMORTIZED COST	ESTIMATED FAIR VALUE	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$5,100,000	\$5,100,000	\$4,400,000	\$4,400,000

The Bank engages in resale agreements with securities dealers, all of which are “primary dealers” as designated by the Federal Reserve Bank of New York. The amounts advanced under these agreements represent short-term loans and are reflected as assets in the Statements of Condition. The collateral from resale agreements, all of which is highly rated, is held by the Bank’s safekeeping custodian. If the market value of the underlying securities decreases below the market value required as collateral, the counterparty is required to place additional securities in safekeeping in the name of the Bank. The Bank had rights to securities collateral with an estimated value in excess of the resale agreements outstanding at December 31, 2003 and 2002.

Resale agreements averaged \$2,605,623 and \$2,731,781 during 2003 and 2002, respectively. The maximum amounts outstanding at any monthend during 2003 and 2002 were \$5,100,000 and \$4,550,000, respectively.

Interest Rate Payment Terms. The amortized cost of resale agreements, all with fixed rate interest payment terms, were \$5,100,000 and \$4,400,000 with average yields of 1.05% and 1.33% at December 31, 2003 and 2002, respectively.

NOTE 5 – HELD-TO-MATURITY SECURITIES

Security Types. Held-to-maturity securities were as follows:

DECEMBER 31, 2003	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Commercial paper	\$ 1,042,493	\$ —	\$ —	\$ 1,042,493
Housing finance agency bonds	1,327,995	6,111	(647)	1,333,459
Subtotal	2,370,488	6,111	(647)	2,375,952
MBS:				
U.S. government agency-guaranteed	1,179,612	22,305	(7,902)	1,194,015
Non-agency	14,713,215	49,808	(67,359)	14,695,664
Total MBS	15,892,827	72,113	(75,261)	15,889,679
Total	\$18,263,315	\$78,224	\$(75,908)	\$18,265,631

DECEMBER 31, 2002	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Commercial paper	\$ 1,297,450	\$ —	\$ —	\$ 1,297,450
Housing finance agency bonds	1,113,490	2,380	(4,059)	1,111,811
Subtotal	2,410,940	2,380	(4,059)	2,409,261
MBS:				
U.S. government agency-guaranteed	1,673,436	45,132	(4,845)	1,713,723
Non-agency	13,794,468	159,933	(20,464)	13,933,937
Total MBS	15,467,904	205,065	(25,309)	15,647,660
Total	\$17,878,844	\$207,445	\$(29,368)	\$18,056,921

DECEMBER 31, 2001	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Commercial paper	\$ 2,465,646	\$ —	\$ —	\$ 2,465,646
Housing finance agency bonds	837,080	—	(1,219)	835,861
Subtotal	3,302,726	—	(1,219)	3,301,507
MBS:				
U.S. government agency-guaranteed	3,003,086	35,552	(1,273)	3,037,365
Non-agency	10,238,077	119,124	—	10,357,201
Total MBS	13,241,163	154,676	(1,273)	13,394,566
Total	\$16,543,889	\$154,676	\$(2,492)	\$16,696,073

Redemption Terms. The amortized cost and estimated fair value of certain securities by contractual maturity and MBS as of December 31, 2003, 2002, and 2001, 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.

DECEMBER 31, 2003		
YEAR OF MATURITY	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 1,042,493	\$ 1,042,493
Housing finance agency bonds (all due after ten years)	1,327,995	1,333,459
Subtotal	2,370,488	2,375,952
MBS:		
U.S. government agency-guaranteed	1,179,612	1,194,015
Non-agency	14,713,215	14,695,664
Total MBS	15,892,827	15,889,679
Total	\$18,263,315	\$18,265,631

DECEMBER 31, 2002		
YEAR OF MATURITY	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 1,297,450	\$ 1,297,450
Housing finance agency bonds (all due after ten years)	1,113,490	1,111,811
Subtotal	2,410,940	2,409,261
MBS:		
U.S. government agency-guaranteed	1,673,436	1,713,723
Non-agency	13,794,468	13,933,937
Total MBS	15,467,904	15,647,660
Total	\$17,878,844	\$18,056,921

DECEMBER 31, 2001		
YEAR OF MATURITY	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 2,465,646	\$ 2,465,646
Housing finance agency bonds (all due after ten years)	837,080	835,861
Subtotal	3,302,726	3,301,507
MBS:		
U.S. government agency-guaranteed	3,003,086	3,037,365
Non-agency	10,238,077	10,357,201
Total MBS	13,241,163	13,394,566
Total	\$16,543,889	\$16,696,073

The average yields on held-to-maturity securities due in one year or less were 1.09%, 1.40%, and 2.09%, on those due after 10 years were 1.37%, 1.95%, and 2.64%, on U.S. government agency-guaranteed MBS were 4.16%, 4.63%, and 5.33%, and on non-agency issued MBS were 3.45%, 4.60%, and 5.52% for the years ended December 31, 2003, 2002, and 2001, respectively. The amortized cost of the Bank's MBS classified as held-to-maturity included net premiums of \$75,456, net premiums of \$30,578, and net discounts of \$20,211 at December 31, 2003, 2002, and 2001, respectively.

Interest Rate Payment Terms. Interest rate payment terms for held-to-maturity securities at December 31, 2003, 2002, and 2001, are detailed in the following table:

	2003	2002	2001
Amortized cost of held-to-maturity securities other than mortgage-backed securities:			
Fixed rate	\$ 1,042,493	\$ 1,297,450	\$ 2,465,646
Adjustable rate	1,327,995	1,113,490	837,080
Subtotal	2,370,488	2,410,940	3,302,726
Amortized cost of held-to-maturity MBS:			
Passthrough securities:			
Fixed rate	648,545	618,777	984,694
Adjustable rate	274,570	381,733	522,636
Collateralized mortgage obligations:			
Fixed rate	10,498,801	10,196,231	8,505,740
Adjustable rate	4,470,911	4,271,163	3,228,093
Subtotal	15,892,827	15,467,904	13,241,163
Total	\$18,263,315	\$17,878,844	\$16,543,889

The following table summarizes the held-to-maturity securities with unrealized losses as of December 31, 2003. The unrealized losses are aggregated by major security type and length of time that individual securities have been in a continuous unrealized loss position.

	LESS THAN 12 MONTHS		12 MONTHS OR MORE	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
Housing finance agency bonds	\$1,327,995	\$ 647	\$ —	\$ —
MBS:				
U.S. government agency-guaranteed	400,397	5,627	253,228	2,275
Non-agency	7,427,844	65,605	448,056	1,754
Total MBS	7,828,241	71,232	701,284	4,029
Total	\$9,156,236	\$71,879	\$701,284	\$4,029

Based on the credit quality of the issuers and the underlying collateral, management fully expects to receive all scheduled payments of principal and interest in a timely manner. As a result, management does not consider these investments to be impaired.

NOTE 6 – HELD-AT-FAIR-VALUE SECURITIES

	2003	2002	2001
Housing finance agency bonds	\$493,283	\$ —	\$ —
MBS: U.S. government agency-guaranteed	424,039	533,090	527,870
Total	\$917,322	\$533,090	\$527,870

Net (losses)/gains on held-at-fair-value securities during the years ended December 31, 2003, 2002, and 2001, were \$(15,403), \$22,745, and \$7,653, respectively. These amounts represent the changes in the fair value of the securities during the reported periods. The average yields on held-at-fair-value securities were 3.36%, 6.24%, and 6.64% for the years ended December 31, 2003, 2002, and 2001, respectively.

NOTE 7 – ADVANCES

Redemption Terms. At December 31, 2003 and 2002, the Bank had advances outstanding, including AHP advances (see Note 8), at interest rates ranging from 0.75% to 8.75% and 1.01% to 8.75%, respectively, as summarized below. AHP advances had interest rates ranging from 3.30% to 7.00% in 2003 and 2002.

DECEMBER 31, 2003		
YEAR OF MATURITY	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
Overdrawn demand deposit accounts	\$ 1,838	2.94%
2004	53,198,845	1.43
2005	12,369,925	1.88
2006	15,873,964	1.63
2007	3,944,671	2.51
2008	4,552,934	3.16
Thereafter	2,010,038	5.26
Subtotal	91,952,215	1.74%
Discount on AHP advances	(225)	
SFAS 133 valuation adjustments	367,036	
Deferred net loss on terminated interest rate exchange agreements	10,595	
Total	\$92,329,621	

DECEMBER 31, 2002		
YEAR OF MATURITY	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
Overdrawn demand deposit accounts	\$ 765	3.16%
2003	49,645,412	2.49
2004	16,749,023	3.10
2005	7,945,379	2.40
2006	1,748,357	3.94
2007	1,005,284	4.38
2008	1,482,748	5.15
Thereafter	1,675,795	5.55
Subtotal	80,252,763	2.77%
Discount on AHP advances	(321)	
SFAS 133 valuation adjustments	983,956	
Deferred net loss on terminated interest rate exchange agreements	643	
Total	\$81,237,041	

Many of the Bank's advances are prepayable at the member's option. However, when advances are prepaid, the member is generally charged a prepayment fee that makes the Bank financially indifferent to the prepayment. Some advances may be repaid on pertinent call dates without incurring prepayment fees (callable advances). At December 31, 2003 and 2002, the Bank had callable advances outstanding totaling \$473,733 and \$1,524,057, respectively.

The following table summarizes advances at December 31, 2003 and 2002, by the earlier of the year of contractual maturity or next call date for callable advances:

EARLIER OF YEAR OF CONTRACTUAL MATURITY OR NEXT CALL DATE	2003	2002
Overdrawn demand deposit accounts	\$ 1,838	\$ 765
2003	—	49,735,412
2004	53,530,845	16,777,023
2005	12,293,625	7,870,379
2006	15,721,964	1,723,357
2007	3,972,671	987,284
2008	4,541,267	1,482,748
Thereafter	1,890,005	1,675,795
Total par value	\$91,952,215	\$80,252,763

The Bank also provides below-market fixed rate advances in exchange for the right of the Bank to retain a put option. At the Bank's discretion, on pertinent put dates, the Bank may terminate the advance (Puttable Advance/Termination Option) or convert the advance to an Adjustable Rate Credit advance of predetermined index and spread for the remaining term to maturity (Puttable Advance/Conversion Option). The Bank's advances at December 31, 2003 and 2002, included \$1,754,700 and \$1,991,700, respectively, of Puttable Advances/Termination Option. There were no Puttable Advances/Conversion Option outstanding as of December 31, 2003 and 2002.

The following table summarizes advances to members at December 31, 2003 and 2002, by the earlier of the year of contractual maturity or next put date for puttable advances:

EARLIER OF YEAR OF CONTRACTUAL MATURITY OR NEXT PUT DATE	2003	2002
Overdrawn demand deposit accounts	\$ 1,838	\$ 765
2003	—	51,150,812
2004	54,667,745	16,718,523
2005	12,349,925	7,802,379
2006	15,804,364	1,640,757
2007	3,900,671	961,284
2008	3,712,934	787,748
Thereafter	1,514,738	1,190,495
Total par value	\$91,952,215	\$80,252,763

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 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 CFIs.

The Bank requires each borrowing member to execute a written Advances and Security Agreement, which describes the Bank's credit and collateral terms. The capital stock of the Bank owned by each borrowing member is pledged as additional collateral for the member's indebtedness to the Bank. As more fully discussed in Note 13, until the Bank implements its new capital plan, the FHLB Act requires that aggregate advances from the Bank to a member may not exceed 20 times the amount paid by the member for capital stock of the Bank. At December 31, 2003 and 2002, the Bank had a perfected security interest in collateral pledged by each borrowing member with an estimated value in excess of outstanding advances for that member. Based on the financial condition of the borrowing member, the Bank may either (i) allow the member to physically retain mortgage collateral assigned to the Bank, provided that the member agrees to hold the collateral for the benefit of the Bank, or (ii) require the member to deliver physical possession of the mortgage collateral to the Bank or its

safekeeping agent. All securities collateral is delivered to the Bank's safekeeping agent. All loan collateral pledged by the member is also subject to a UCC-1 filing statement.

Beyond these provisions, Section 10(e) of the FHLB Act affords any security interest granted by a member to the Bank priority over claims or rights of any other party, except claims or rights that (i) would be entitled to priority under otherwise applicable law and (ii) are held by bona fide purchasers for value or secured parties with perfected security interests.

Credit Risk. The Bank's potential credit risk from advances is concentrated in savings institutions. As of December 31, 2003, the Bank had a concentration of advances totaling \$61,978,282 outstanding to three members, representing 67% of total outstanding advances (35%, 17%, and 15%, respectively). The interest income from advances to these members amounted to approximately \$1,100,124 during 2003. The Bank held collateral with an estimated value in excess of advances to these institutions, and the Bank does not expect to incur any credit losses on these advances.

The Bank has never experienced any credit losses on advances to a member. Management has policies and procedures in place to manage the credit risk of advances. Based on the collateral held as security for advances, management's credit analyses, and prior repayment history, no allowance for losses on advances is deemed necessary by management.

Interest Rate Payment Terms. Interest rate payment terms for advances at December 31, 2003 and 2002, are detailed below:

	2003	2002
Par amount of advances:		
Fixed rate	\$51,547,101	\$45,081,308
Adjustable rate	40,405,114	35,171,455
Total	\$91,952,215	\$80,252,763

Prepayment Fees, Net. During 2003, 2002, and 2001, the Bank charged its members prepayment fees when the principal on certain advances was paid prior to original maturity. In addition, some of these advances were associated with interest rate exchange agreements. Upon termination of these advances, prior to January 1, 2001, the associated interest rate exchange agreements were either marked to market and redesignated as hedges of other advances or terminated, and the resulting gains or losses were netted with the prepayment fees on the Statements of Income. Starting January 1, 2001, the resulting gains or losses were recognized in accordance with SFAS 133 (see Note 2). These transactions during the years ended December 31, 2003, 2002, and 2001, are summarized in the following table:

	2003	2002	2001
Prepayment fees received	\$ 15,486	\$ 9,032	\$ 5,953
Advance principal prepaid	\$3,649,894	\$7,491,982	\$1,859,685

NOTE 8 – AFFORDABLE HOUSING PROGRAM

Section 10(j) of the FHLB Act requires each FHLBank to establish an AHP. Each FHLBank provides subsidies in the form of direct grants and below-market interest rate advances to members, which use the funds to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Annually, the FHLBanks must set aside for their AHPs, in the aggregate, the greater of \$100 million or 10% of the current year's income before charges for the AHP but after the assessment for REFCORP (see Note 1). To the extent that the aggregate 10% calculation is less than \$100 million, the shortfall is allocated among the FHLBanks based on the ratio of each FHLBank's income before AHP and REFCORP to the sum of the net incomes before AHP and REFCORP of the 12 FHLBanks. There was no AHP shortfall in 2003, 2002, or 2001. The Bank set aside \$35,892, \$32,464, and \$47,177 during 2003, 2002, and 2001, respectively, for the AHP. These amounts were charged to earnings each year and recognized as a liability. As subsidies are disbursed, the AHP liability is reduced. All subsidies were distributed in the form of direct grants in 2003, 2002, and 2001. The Bank had \$11,705 and \$12,873 in outstanding AHP advances at December 31, 2003 and 2002, respectively.

NOTE 9 – MORTGAGE LOANS

Under the MPF Program, the Bank purchases qualifying mortgage loans from its participating members. The mortgage loans represent held-for-investment loans under the MPF Program, under which the Bank's members originate, service, and credit-enhance home mortgage loans that are owned by the Bank. The following table presents information as of December 31, 2003 and 2002, on mortgage loans, all of which are conventional, conforming fixed rate loans on single-family properties:

	2003	2002
Fixed rate medium-term mortgage loans	\$2,297,236	\$180,064
Fixed rate long-term mortgage loans	4,196,294	77,640
Unamortized net (discounts)/premiums	(48,338)	4,902
Total mortgage loans	\$6,445,192	\$262,606

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 these loans was as follows:

	2003	2002
Balance, beginning of the period	\$ 180	\$ —
Chargeoffs	—	—
Recoveries	—	—
(Reduction of)/provision for credit losses	(180)	180
Balance, end of the period	\$ —	\$180

Mortgage loans are considered impaired when a loan 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 agreements. At

December 31, 2003 and 2002, 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 10 – DEPOSITS

The Bank maintains demand deposit accounts that are directly related to the extension of credit to members and offers short-term deposit programs to members and qualifying non-members.

Interest Rate Payment Terms. Interest rate payment terms for deposits at December 31, 2003 and 2002, are detailed in the following table:

	2003	2002
Deposits:		
Fixed rate	\$ 65,450	\$ 34,510
Adjustable rate	922,215	372,129
Total	\$987,665	\$406,639

NOTE 11 – BORROWINGS

At times the Bank enters into sales of securities under agreements to repurchase (repurchase agreements) with securities dealers, all of which are “primary dealers” as designated by the Federal Reserve Bank of New York. The amounts received under these agreements represent short-term borrowings and are reflected as liabilities in the Statements of Condition. The securities sold under agreements to repurchase are delivered to the purchasing primary dealers or their custodians. Should the market value of the underlying securities decrease below the market value required by the repurchase agreements, the Bank is required to deliver additional securities to the dealers. There were no repurchase agreements outstanding during 2003 or 2002.

The Bank had other borrowings due to commercial banks at December 31, 2002, of \$525,000, bearing interest at the overnight Federal funds rate, and none were outstanding as of December 31, 2003.

NOTE 12 – CONSOLIDATED OBLIGATIONS

As more fully discussed in Note 19, consolidated obligations are the joint and several obligations of the 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. Consolidated obligation bonds are issued primarily to raise intermediate- and long-term funds for the FHLBanks. Usually the maturity of consolidated obligation bonds ranges from one year to fifteen years, but the maturity is not subject to any statutory or regulatory limits. Consolidated obligation discount notes are primarily used to raise short-term funds. These notes are issued at less than their face amount and redeemed at par when they mature.

The par amount of the outstanding consolidated obligations of all 12 FHLBanks, including consolidated obligations issued by other FHLBanks, was approximately \$759,509,748

and \$680,695,058 at December 31, 2003 and 2002, respectively. Regulations require the FHLBanks to maintain, for the benefit of investors in consolidated obligations, in the aggregate, unpledged qualifying assets in an amount equal to the consolidated obligations outstanding. Qualifying assets are defined as cash; secured advances; assets with an assessment or credit rating at least equivalent to the current assessment or credit rating of the consolidated obligations; obligations, participations, mortgages, or other securities of or issued by the United States or an agency of the United States; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located.

As more fully discussed in Note 13, until the Bank implements its capital plan, each FHLBank’s assets are generally limited to no more than 21 times its capital unless an FHLBank has non-mortgage assets, after deducting deposits and capital, that do not exceed 11% of its assets. In that case, an FHLBank’s total assets cannot exceed 25 times its capital. At December 31, 2003 and 2002, the Bank’s total assets to capital and non-mortgage assets to total assets ratios were 22.6x and 6.52% and 20.4x and 9.8%, respectively.

To provide the holders of consolidated obligations issued prior to January 29, 1993 (prior bondholders), protection equivalent to that provided under the FHLBanks’ previous leverage limit of 12 times the FHLBanks’ aggregate capital stock, prior bondholders have a claim on a certain amount of the qualifying assets (Special Asset Account or SAA) if the FHLBanks’ aggregate capital stock is less than 8.33% of consolidated obligations outstanding. At December 31, 2003 and 2002, the FHLBanks’ capital stock was 5.0% and 5.2% of the par value of consolidated obligations outstanding, and the minimum SAA balance was approximately \$23,989 and \$24,004, respectively. The Bank’s share of this SAA balance was approximately \$3,370 and \$3,975 at December 31, 2003 and 2002, respectively. In addition, each FHLBank is required to transfer qualifying assets in the amount of its allocated share of the FHLBanks’ SAA to a trust for the benefit of the prior bondholders if its individual capital-to-assets ratio falls below 2.0%.

General Terms. Consolidated obligations are generally issued with either fixed rate payment terms or adjustable rate payment terms, which use a variety of indices for interest rate resets, including the London Interbank Offered Rate (LIBOR), Federal funds, U.S. Treasury Bill, Constant Maturity Treasury (CMT), Prime Rate, and others. In addition, to meet the specific needs of certain investors, fixed rate and adjustable rate consolidated obligation bonds may also contain certain embedded features, which may result in call options and complex coupon payment terms. Generally, when such consolidated obligations bonds are issued, the Bank simultaneously enters into interest rate exchange agreements containing offsetting features to convert the terms of the bond, in effect, to the terms of a simple adjustable rate bond (tied to an index, such as those detailed above).

Consolidated obligations, in addition to having fixed rate or simple adjustable rate coupon payment terms, may also include “callable bonds,” which the Bank may redeem in whole or in part at its discretion on predetermined call dates according to the terms of the bond offerings; “step-up callable bonds,” which generally pay interest at increasing fixed rates for specified intervals over the life of the bond and can be called at the Bank’s option on the step-up dates; “conversion bonds,” which have coupon rates that convert from fixed to adjustable or from adjustable to fixed; “comparative index bonds,” which have coupon rates that are determined by the difference between two or more market indices; “zero-coupon callable bonds,” which are long-term discounted instruments that earn a fixed yield to maturity or to the optional principal redemption date, and for which all principal and interest are paid at maturity or at the optional principal redemption date, if exercised prior to maturity; “inverse floating bonds,” which have coupons that increase as an index declines and decrease as an index rises; and “index amortizing notes,” which repay principal according to predetermined amortization schedules that are linked to the level of a certain index. As of December 31, 2003, the Bank’s index amortizing notes had fixed rate coupon payment terms. Usually, as market interest rates fall, the maturity of the index amortizing notes contracts.

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

DECEMBER 31, 2003	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
YEAR OF MATURITY		
2004	\$26,177,410	2.70%
2005	23,716,380	1.91
2006	14,515,500	2.91
2007	6,692,250	3.43
2008	10,194,210	3.37
Thereafter	11,281,775	4.57
Index amortizing notes	15,000	4.61
Total par value	92,592,525	2.88%
Bond premiums	74,270	
Bond discounts	(144,030)	
SFAS 133 valuation adjustments	228,585	
Total	\$92,751,350	

DECEMBER 31, 2002	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
YEAR OF MATURITY		
2003	\$50,179,130	2.51%
2004	18,295,000	3.76
2005	9,493,400	3.79
2006	6,147,500	4.58
2007	5,050,750	4.08
2008	1,433,000	4.99
Thereafter	4,050,030	5.39
Index amortizing notes	76,805	5.05
Total par value	94,725,615	3.26%
Bond premiums	66,732	
Bond discounts	(71,976)	
SFAS 133 valuation adjustments	1,101,426	
Total	\$95,821,797	

The Bank’s participation in consolidated obligation bonds outstanding at December 31, 2003 and 2002, includes callable bonds of \$35,370,560 and \$36,271,005, respectively. Contemporaneous with such callable bond issuance, the Bank usually enters into an interest rate swap (in which the Bank pays a variable rate and receives a fixed rate) with a call feature that mirrors the option embedded in the bond (a sold callable swap). The combined sold callable swap and callable bond enable the Bank to meet its funding needs at costs not otherwise directly attainable solely through the issuance of non-callable debt, while converting the Bank’s own payment to an adjustable rate. The Bank also uses fixed rate callable bonds to finance fixed rate callable advances (see Note 7), fixed rate MBS, and fixed rate mortgage loans.

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

	2003	2002
Par amount of consolidated obligation bonds:		
Non-callable	\$57,221,965	\$58,454,610
Callable	35,370,560	36,271,005
Total par value	\$92,592,525	\$94,725,615

The following is a summary of the Bank’s participation in consolidated obligation bonds outstanding at December 31, 2003 and 2002, by the earlier of the year of contractual maturity or next call date:

EARLIER OF YEAR OF CONTRACTUAL MATURITY OR NEXT CALL DATE	2003	2002
2003	\$ —	\$70,761,135
2004	56,716,570	15,662,700
2005	21,094,380	4,806,400
2006	8,412,500	2,105,500
2007	922,750	424,750
2008	4,030,000	493,000
Thereafter	1,401,325	395,325
Index amortizing notes	15,000	76,805
Total	\$92,592,525	\$94,725,615

Interest Rate Payment Terms. Interest rate payment terms for consolidated obligations at December 31, 2003 and 2002, are detailed in the following table:

	2003	2002
Par amount of consolidated obligations:		
Bonds:		
Fixed rate	\$ 61,576,315	\$ 66,205,205
Adjustable rate	23,429,000	23,766,000
Step-up	5,044,260	3,227,000
Fixed rate that converts to adjustable rate	324,750	261,900
Adjustable rate that converts to fixed rate	862,000	580,000
Comparative index	807,700	478,705
Zero-coupon	175,000	105,000
Inverse floaters	358,500	25,000
Index amortizing notes	15,000	76,805
Total bonds, par	92,592,525	94,725,615
Discount notes, par	31,931,984	12,483,980
Total consolidated obligations, par	\$124,524,509	\$107,209,595

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

	2003		2002	
	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE	AMOUNT OUTSTANDING	WEIGHTED AVERAGE INTEREST RATE
Par value	\$31,931,984	1.05%	\$12,483,980	1.53%
Discounts	(49,615)		(38,034)	
SFAS 133 valuation adjustments	(166)		870	
Total	\$31,882,203		\$12,446,816	

Section 11(i) of the FHLB Act authorizes the Secretary of the Treasury, at his discretion, to purchase certain obligations issued by the FHLBanks aggregating not more than \$4.0 billion; terms, conditions, and interest rates are to be determined by the Secretary of the Treasury. There were no such purchases by the U.S. Treasury during the two-year period ended December 31, 2003.

NOTE 13 – CAPITAL

Capital Requirements. The Gramm-Leach-Bliley Act (GLB Act) required a number of changes in the capital structure of the FHLBanks. On January 30, 2001, the Finance Board published a final capital rule requiring each FHLBank to submit a capital plan to the Finance Board for approval. The Bank's capital plan was approved by the Bank's Board of Directors on May 31, 2002, and was approved by the Finance Board on June 12, 2002. The Bank's Board of Directors approved amendments to the capital plan on May 30, 2003, and the Finance Board approved the amendments on August 6, 2003.

The Bank is scheduled to implement the capital plan on April 1, 2004. To implement the capital plan, the Bank will exchange its current capital stock for new Class B stock. Under the capital plan, the Bank will issue only Class B stock, with a par value of \$100 per share, which may be redeemed (subject to certain conditions) upon five years' notice. The stock may be issued, exchanged, redeemed, and repurchased only at its stated par value. The Bank may only redeem or repurchase capital stock from a member if, following the repurchase or redemption, the member will continue to meet its minimum stock requirement and the Bank will continue to meet its regulatory requirements for total capital, leverage capital, and risk-based capital.

Members that opted not to participate in the capital plan implementation were required to provide written notice of intention to withdraw from membership on or before January 1, 2004. The Bank received opt-out notices from four members, which had capital stock with a total par value of \$15,587 at December 31, 2003. All other members will participate in the exchange, and outstanding shares of existing capital stock will automatically be exchanged for Class B stock redeemable only upon five years' notice to the Bank.

Once the Bank's capital plan is implemented, the Bank will be subject to risk-based capital requirements, which must be met with permanent capital (defined as retained earnings and Class B stock). In addition, the Bank will be subject to a 5% minimum leverage capital ratio with a 1.5 weighting factor for permanent capital, and a 4% minimum total capital ratio calculated without reference to the 1.5 weighting factor. The FHLB Act and Finance Board regulations require that the minimum stock requirement for members must be sufficient to enable the Bank to meet its regulatory requirements for total capital, leverage capital, and risk-based capital.

In general, the capital plan requires each member to own stock in an amount equal to the greater of its membership stock requirement or its activity-based stock requirement. The Bank may adjust these requirements from time to time within limits established in the capital plan.

A member's initial membership stock requirement will be 1.0% of its membership asset value. The membership stock requirement for a member is initially capped at \$25.0 million. The Bank may adjust the membership stock requirement within a range of 0.5% to 1.5% of a member's membership asset value and may adjust the cap within an authorized range of \$10 million to \$50 million. A member's membership asset value is determined by multiplying the amount of the member's membership assets by the applicable membership asset factors. Membership assets are those assets (other than Bank capital stock) of a type that could qualify as collateral to secure a member's indebtedness to the Bank under applicable law, whether or not the assets are pledged to the Bank or accepted by the Bank as eligible collateral. The membership asset factors were based on the typical borrowing capacity percentages generally assigned by the Bank to the same types of assets when pledged to the Bank (although the factors may differ from the actual borrowing capacities, if any, assigned to particular assets pledged by a specific member at any point in time).

A member's initial activity-based stock requirement will be the sum of 4.7% of the member's outstanding advances plus 5.0% of any portion of any mortgage loan sold by the member and owned by the Bank. The Bank may adjust the activity-based stock requirement within a range of 4.4% to 5.0% of the member's outstanding advances and a range of 5.0% to 5.7% of any portion of any mortgage loan sold by the member and owned by the Bank.

Until the Bank fully implements its capital plan, the current capital rules remain in effect. At this time, each member is required to hold capital stock in the Bank equal to the greatest of:

- 5% of the member's total outstanding Bank advances plus 5% of the Bank's interest in the aggregate unpaid principal balance of all loans sold by the member to the Bank, or
- 1% of the member's total unpaid principal balance of residential mortgage loans (usually as of the most recent yearend), or
- \$500.

At the Bank's discretion, capital stock that is greater than a member's minimum requirement may be repurchased or transferred to other Bank members at par value.

The GLB Act established voluntary membership for all members. Any member may withdraw from membership and have its capital stock redeemed after giving the required notice. Members that withdraw from membership may not re-apply for membership for five years, in accordance with Finance Board rules.

Retained Earnings and Dividend Policy. The Bank has a Retained Earnings and Dividend Policy that establishes amounts to be retained in restricted retained earnings, subject to the dividend resolution adopted by the Board of Directors for each dividend period. In accordance with this policy, the Bank restricts retained earnings for that portion of income from prepayment fees that, if allocated on a pro rata basis over the original term to maturity of the advances prepaid, would be allocated to future dividend periods. Other gains and losses related to the termination of interest rate exchange agreements and early retirement of consolidated obligations associated with the prepaid advances are similarly treated. Retained earnings restricted in accordance with this provision totaled \$10,090 and \$6,604 at December 31, 2003 and 2002, respectively.

In accordance with the Retained Earnings and Dividend Policy, the Bank also retains in restricted retained earnings any cumulative net gains in earnings (net of applicable assessments) and any cumulative net gains in other comprehensive income resulting from SFAS 133. Retained earnings restricted in accordance with this provision totaled \$86,695 and \$18,785 at December 31, 2003 and 2002, respectively. (The Bank's retained earnings in the future may not be sufficient to offset the full impact of SFAS 133. As a result, the effect of SFAS 133 may lead to increased volatility in future earnings and dividends.)

Effective April 1, 2003, the Board of Directors amended the Retained Earnings and Dividend Policy to provide for a build-up of retained earnings totaling \$50,000 (less any cumulative net fair value losses in net income resulting from SFAS 133, with a floor of zero) over seven quarters beginning in the second quarter of 2003. At December 31, 2003,

the retained earnings restricted in accordance with this provision totaled \$22,000. The Finance Board recently provided guidance to the FHLBanks requiring an analysis of the adequacy of their retained earnings and a plan to achieve a target level of retained earnings. Effective January 30, 2004, the Board of Directors further amended the Retained Earnings and Dividend Policy to provide for a build-up of retained earnings totaling \$100,000 (less any cumulative net fair value losses in net income resulting from SFAS 133, with a floor of zero) by the end of 2006.

The Bank's Board of Directors may declare and pay dividends only from retained earnings or current net earnings. There is no requirement that the Bank declare and pay any dividend. A decision by the Bank's Board of Directors to declare or not declare a dividend is a purely discretionary matter and is subject to the requirements and restrictions of the FHLB Act and applicable Finance Board requirements and guidance. The Bank has historically paid dividends on its stock in stock form and anticipates that any dividends will continue to be paid in stock form.

Surplus Capital Stock Repurchase Policy. The Bank's surplus capital stock repurchase policy allows the Bank to reduce its capital stock base if advances and mortgage loan balances decline. A member's surplus capital stock is defined as any excess stock holdings above 115% of the member's capital stock requirement, excluding stock dividends earned and credited for the current year. In accordance with this policy, the Bank repurchased \$1,502,893 and \$1,687,674 in surplus capital stock in 2003 and 2002, respectively. In January 2004, the Bank repurchased \$47,078 of surplus capital stock that was subject to repurchase as of December 31, 2003.

Concentration. As of December 31, 2003, the Bank had a concentration of capital stock totaling 35,907 shares outstanding to three members, representing 63% of total capital stock outstanding (35%, 15%, and 13%, respectively).

NOTE 14 – EMPLOYEE RETIREMENT PLANS

The Bank provides retirement benefits through a Bank-sponsored Cash Balance Plan, a defined benefit plan. The Cash Balance Plan covers all employees who have completed at least six months of Bank service. Under the plan, each eligible Bank employee accrues benefits annually equal to 6% of the employee's annual pay, plus 6% interest on the benefits accrued to the employee through the prior yearend. The Cash Balance Plan is funded through a trust established by the Bank. The projected benefit obligation and the accrued benefit cost of the Cash Balance Plan were \$7,870 and (\$400), respectively, at December 31, 2003, and \$5,695 and \$1,140, respectively, at December 31, 2002. The periodic pension cost for the years ended December 31, 2003 and 2002, totaled \$1,405 and \$1,061, respectively.

The following tables summarize the changes in the projected benefit obligation, the plan assets, and funded status of the defined benefit cash balance plan for the years ended December 31, 2003, 2002, and 2001.

	2003	2002	2001
Change in benefit obligation:			
Benefit obligation,			
beginning of year	\$ 5,695	\$ 4,466	\$ 4,044
Service cost	1,058	850	696
Interest cost	435	322	253
Actuarial loss/(gain)	763	129	(390)
Benefits paid	(81)	(72)	(137)
Benefit obligation, end of year	\$ 7,870	\$ 5,695	\$ 4,466
Change in plan assets:			
Fair value of plan assets,			
beginning of year	\$ 2,536	\$ 1,927	\$ 1,070
Actual return on plan assets	745	(371)	(46)
Employer contributions	1,272	1,052	1,040
Benefits paid	(81)	(72)	(137)
Fair value of plan assets, end of year	\$ 4,472	\$ 2,536	\$ 1,927
Funded status	\$(3,398)	\$(3,159)	\$(2,539)
Unrecognized net actuarial loss	1,857	1,836	1,407
Unrecognized prior service cost	268	183	—
Contributions after			
measurement date	1,673	—	—
Accrued benefit cost	\$ 400	\$(1,140)	\$(1,132)

The following table summarizes the assumptions used in computing the projected benefit obligation and net pension expense for the years ending December 31, 2003, 2002, and 2001.

	2003	2002	2001
Discount rate in determining expense	7.00%	7.00%	7.00%
Discount rate in determining benefit obligations at yearend	7.00	7.00	7.00
Rate of increase in future compensation levels for determining expense	5.00	5.00	5.00
Rate of increase in future compensation levels for determining benefit obligations at yearend	5.00	5.00	5.00
Expected return on plan assets	8.00	8.00	8.00

The net periodic pension cost for the years ended December 31, 2003, 2002, and 2001 are as follows:

	2003	2002	2001
Service cost	\$1,059	\$ 850	\$ 696
Interest cost	435	322	253
Expected return on assets	(253)	(209)	(106)
Amortization and deferral	164	98	—
Net periodic pension cost	\$1,405	\$1,061	\$ 843

Prior to January 1, 2002, the Bank participated in the Financial Institutions Thrift Plan, a defined contribution savings plan. Contributions to this plan consisted of elective participant contributions and a Bank matching contribution of up to 6% of those participant contributions (based on compensation). The Bank contributed approximately \$634 to the plan in 2001. Effective January 1, 2002, the Bank withdrew its participation in the Financial Institutions Thrift Plan and implemented a successor defined contribution savings plan, the Federal Home Loan Bank of San Francisco Savings Plan. Contributions to the successor plan also consist of elective participant contributions and a Bank matching contribution of up to 6% of those participant contributions (based on compensation). The Bank contributed approximately \$877 and \$990 in 2003 and 2002, respectively.

The Bank also provides the Benefit Equalization Plan (BEP). The BEP is a non-qualified retirement plan restoring those benefits offered under the qualified plans that have been limited by laws governing such plans. The Bank's projected benefit obligation and accrued benefit cost for this plan was \$1,186 and \$1,388, respectively, at December 31, 2003, and \$1,408 and \$1,224, respectively, at December 31, 2002.

Effective January 1, 2003, the Bank provides a Supplemental Executive Retirement Plan (SERP) for the Bank's executive management. The SERP is a non-qualified retirement benefit plan that will provide a service-linked supplemental cash balance contribution to SERP participants that is in addition to the contributions made to the qualified Cash Balance Plan. The Bank's projected benefit obligation was \$361 at December 31, 2003.

In addition, the Bank maintains a deferred compensation plan that is available to all officers and directors. The plan liability consists of the accumulated compensation deferrals and accrued earnings on the deferrals. The Bank's obligation for this plan at December 31, 2003 and 2002 was \$14,026 and \$9,825, respectively.

NOTE 15 – SEGMENT INFORMATION

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

the MPF Program, the consolidated obligations specifically identified as funding those assets, and related hedging instruments. Net interest income for this segment is derived primarily from the difference, or spread, between the yield on the MBS securities and mortgage loans and the cost of the consolidated obligations funding those assets, including the cash flows from associated interest rate exchange agreements, less the provision for credit losses on mortgage loans.

The following table sets forth the Bank's financial performance by operating segment for the years ended December 31, 2003, 2002, and 2001. Interest income and interest expense associated with economic hedges are recorded in other income as "Net gain/(loss) on derivatives and hedging activities."

NET INTEREST INCOME

	ADVANCES-RELATED BUSINESS	MORTGAGE-RELATED BUSINESS	SUBTOTAL	INTEREST INCOME/EXPENSE ON ECONOMIC HEDGES	NET INTEREST INCOME
2003	\$279,540	\$106,657	\$386,197	\$43,979	\$430,176
2002	\$360,451	\$135,339	\$495,790	\$19,558	\$515,348
2001	\$466,880	\$ 87,427	\$554,307	\$ 9,125	\$563,432

TOTAL ASSETS	ADVANCES-RELATED BUSINESS	MORTGAGE-RELATED BUSINESS	TOTAL ASSETS
2003	\$109,627,678	\$22,762,058	\$132,389,736
2002	\$ 99,903,593	\$16,225,888	\$116,129,481
2001	\$121,629,626	\$13,754,246	\$135,383,872

NOTE 16 – 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. At December 31, 2003 and 2002, the Bank had \$126,774 and \$124,649, respectively, in notional amounts outstanding. The notional amount does not represent the exposure to credit loss. The Bank is subject to credit risk relating to the nonperformance by a counterparty to a non-exchange-traded interest rate exchange agreement. The amount potentially subject to credit loss is the estimated cost of replacing the favorable interest rate exchange agreement if the counterparty defaults; this amount is substantially less than the notional amount. However, based on management's credit analyses of Bank counterparties and on the Bank's bilateral netting arrangements and collateral requirements, no allowance for losses is deemed necessary by management.

Maximum credit risk is defined as the estimated cost of replacing all interest rate exchange agreements the Bank has transacted with counterparties where the Bank is in a net favorable position (i.e., has a net unrealized gain) if the counterparties all defaulted and the related collateral proved to be of no value to the Bank. At December 31, 2003 and 2002, the Bank's maximum credit risk, as defined above, was estimated at \$265,677 and \$518,734, respectively, including \$92,773 and \$111,117 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 with a fair value of \$215,485 and \$428,300 as collateral from counterparties as of December 31, 2003 and 2002, 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 19.

Intermediation. Interest rate exchange agreements in which the Bank is an intermediary may arise when the Bank enters into offsetting interest rate exchange agreements with members and other counterparties to meet the needs of members or when the Bank enters into interest rate exchange agreements to offset the economic effect of other interest rate exchange agreements that are no longer designated to advances, investments, or consolidated obligations. The notional principal of the interest rate exchange agreements in which the Bank was an intermediary at December 31, 2003 and 2002, was \$975,800 and \$904,200, respectively.

NOTE 17 – 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 December 31, 2003 and 2002. 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.

Cash and Due from Banks. The recorded carrying value approximates the estimated fair value.

Interest-Bearing Deposits in Banks, Deposits for Mortgage Loan Programs, Securities Purchased Under Agreements to Resell, and Federal Funds Sold. The estimated fair values of these instruments have been determined based on quoted prices or by calculating the present value of expected cash flows for instruments with more than three months to maturity or repricing excluding accrued interest. The discount rates used in these calculations are the replacement rates for securities with similar terms. For instruments with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

Held-to-Maturity and Held-at-Fair-Value Securities. The estimated fair value of these instruments with more than three months to maturity or repricing, including MBS, has been determined based on quoted prices, by calculating the present value of expected cash flows as of the last business day of the year excluding accrued interest, or by using industry standard analytical models and certain actual and estimated market information. The discount rates used in these calculations are the replacement rates for securities with similar terms. Estimates developed using these methods require judgments regarding significant matters such as the appropriate discount rates and prepayment assumptions. Changes in these judgments often have a material effect on the fair value estimates. For instruments with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

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

Mortgage Loans, Net of Allowance for Credit Losses for Mortgage Loans. The estimated fair values for mortgage loans have been determined based on quoted prices of similar mortgage loans available in the market. These prices, however, can change rapidly based on market conditions and are highly dependent on the prepayment assumptions that are used.

Accrued Interest Receivable and Payable and Other Assets and Liabilities. The recorded carrying value approximates the estimated fair value.

Derivative Assets and Liabilities. The Bank bases the estimated fair value of interest rate exchange agreements on the estimated costs of instruments with similar terms or available market prices, including accrued interest receivable and payable. However, active markets do not exist for many types of financial instruments. Consequently, fair values for these instruments are estimated using techniques such as discounted cash flow analysis, option pricing models, and comparisons to similar instruments. Estimates developed using these methods are subjective and require judgments regarding significant matters such as the amount and timing of future cash flows, the volatility of interest rates, and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes. The fair values are netted by counterparty where such legal right exists. If these netted amounts are positive, they are classified as an asset and, if negative, a liability.

Deposits and Other Borrowings. For deposits and other borrowings with more than three months to maturity or repricing, the estimated fair value has been determined by calculating the present value of expected future cash flows from the deposits and other borrowings excluding accrued interest. The discount rates used in these calculations are the cost of deposits with similar terms. For deposits and other borrowings with three months or less to maturity or repricing, the recorded carrying value approximates the estimated fair value.

Consolidated Obligations. The estimated fair value has been determined based on the estimated cost of raising comparable term debt and, where applicable, option pricing models. The estimated cost of issuing debt is determined daily based on the primary market for debt of the FHLBank System and other government-sponsored enterprises and other indications from securities dealers; the estimated cost of issuing debt includes non-interest selling costs. Estimates of the fair value of callable consolidated obligations that are developed using these methods require judgments regarding significant matters such as the volatility of market rates for agency debt. Changes in these judgments often have a material effect on the fair value estimates. Since these estimates are made as of a specific point in time, they are susceptible to material near-term changes.

Commitments. The estimated fair value of the Bank's commitments to extend credit, including letters of credit, was immaterial at December 31, 2003 and 2002.

The estimated fair values of the Bank's financial instruments at December 31, 2003 and 2002, were as follows:

FAIR VALUE OF FINANCIAL INSTRUMENTS – 2003	CARRYING VALUE	NET UNREALIZED GAINS/(LOSSES)	ESTIMATED FAIR VALUE
ASSETS			
Cash and due from banks	\$ 17,579	\$ —	\$ 17,579
Deposits for mortgage loan program	11,611	—	11,611
Interest-bearing deposits in banks	3,287,000	—	3,287,000
Securities purchased under agreements to resell	5,100,000	—	5,100,000
Federal funds sold	5,434,000	—	5,434,000
Held-to-maturity securities	18,263,315	2,316	18,265,631
Held-at-fair-value securities	917,322	—	917,322
Advances	92,329,621	113,294	92,442,915
Mortgage loans, net of allowance for credit losses on mortgage loans	6,445,192	(131,725)	6,313,467
Accrued interest receivable	218,123	—	218,123
Derivative assets	265,677	—	265,677
Other assets	100,296	(38,718)	61,578
Total	\$132,389,736	\$ (54,833)	\$132,334,903
LIABILITIES			
Deposits	\$ 987,665	\$ —	\$ 987,665
Consolidated obligations:			
Bonds	92,751,350	44,683	92,706,667
Discount notes	31,882,203	(298)	31,882,501
Accrued interest payable	527,947	—	527,947
Derivative liabilities	180,690	—	180,690
Other liabilities	214,059	—	214,059
Total	\$126,543,914	\$ 44,385	\$126,499,529
FAIR VALUE OF FINANCIAL INSTRUMENTS – 2002			
	CARRYING VALUE	NET UNREALIZED GAINS/(LOSSES)	ESTIMATED FAIR VALUE
ASSETS			
Cash and due from banks	\$ 8,759	\$ —	\$ 8,759
Deposits for mortgage loan program	58,113	—	58,113
Interest-bearing deposits in banks	4,834,000	—	4,834,000
Securities purchased under agreements to resell	4,400,000	—	4,400,000
Federal funds sold	6,068,000	—	6,068,000
Held-to-maturity securities	17,878,844	178,077	18,056,921
Held-at-fair-value securities	533,090	—	533,090
Advances	81,237,041	226,992	81,464,033
Mortgage loans, net of allowance for credit losses on mortgage loans	262,426	1,406	263,832
Accrued interest receivable	285,055	—	285,055
Derivative assets	518,734	—	518,734
Other assets	45,419	(24,457)	20,962
Total	\$116,129,481	\$ 382,018	\$116,511,499
LIABILITIES			
Deposits	\$ 406,639	\$ (2)	\$ 406,641
Other borrowings	525,000	—	525,000
Consolidated obligations:			
Bonds	95,821,797	(270,774)	96,092,571
Discount notes	12,446,816	(3,042)	12,449,858
Accrued interest payable	715,620	—	715,620
Derivative liabilities	345,865	—	345,865
Other liabilities	183,046	—	183,046
Total	\$110,444,783	\$(273,818)	\$110,718,601

NOTE 18 – ARBITRATION AWARD

In August 2002, the Bank received notice of a final court order confirming an arbitration decision awarding a member a refund of \$7,879 in prepayment fees paid to the Bank in 1998. The final award, with interest, was \$9,395, and this amount was included in other expense in 2002.

NOTE 19 – COMMITMENTS AND CONTINGENCIES

As indicated in Note 12, 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 Finance Board's joint and several liability regulation provides a general framework for addressing the possibility that an FHLBank may be unable to repay its participation in the consolidated obligations for which it is the primary obligor. In accordance with the Finance Board regulation, the President of each FHLBank is required to provide a quarterly certification that, among other things, the FHLBank will remain capable of making full and timely payment of all its current obligations, including direct obligations.

Further, the regulation requires that an FHLBank must provide written notice to the Finance Board if at any time the FHLBank is unable to provide the quarterly certification; projects that it will be unable to timely and fully meet all of its current obligations, including direct obligations, during the quarter; or negotiates or enters into an agreement with another FHLBank for financial assistance to meet its obligations. If an FHLBank gives any one of these notices (other than in a case of a temporary interruption in the FHLBank's debt servicing operations resulting from an external event such as a natural disaster or a power failure), it must promptly file a consolidated obligations payment plan for Finance Board approval specifying the measures the non-complying FHLBank will undertake to make full and timely payments of all of its current obligations.

Notwithstanding any other provisions in the regulation, the Finance Board in its discretion may at any time order any FHLBank to make any principal or interest payment due on any consolidated obligation. To the extent an FHLBank makes any payment on any consolidated obligation on behalf of another FHLBank, the paying FHLBank is entitled to reimbursement from the non-complying FHLBank, which will have a corresponding obligation to reimburse the FHLBank for the payment and associated costs, including interest.

The Finance Board may allocate the outstanding liability of an FHLBank for consolidated obligations among the other FHLBanks on a pro rata basis in proportion to each FHLBank's participation in all consolidated obligations outstanding or on any other basis determined by the Finance Board.

Commitments that legally bind and obligate the Bank for additional advances totaled approximately \$419,286 and \$29,483 at December 31, 2003 and 2002, respectively. Commitments are generally for periods up to 12 months. Standby letters of credit are generally issued for a fee on behalf of members to support their obligations to third parties. If the Bank is required to make payment for a beneficiary's drawing, the amount is charged to the member's demand deposit account with the Bank or converted into a collateralized advance to the member. Outstanding standby letters of credit were approximately \$1,015,009 and \$1,391,652 at December 31, 2003 and 2002, respectively, and had original terms of 84 days to 10 years, with a final expiration in 2013. Unearned fees for transactions prior to 2003 as well as the value of the guarantees related to standby letters of credit entered into after 2002 are recorded in other liabilities and amounted to \$1,881 at December 31, 2003. Based on management's credit analyses and collateral requirements, no allowance for losses is deemed necessary by management on these advance commitments and letters of credit. Advances funded under these advance commitments and letters of credit are fully collateralized at the time of issuance in a manner consistent with advances to members (see Note 7). The estimated fair value of commitments and letters of credit was immaterial as of December 31, 2003 and 2002.

Commitments that unconditionally obligate the Bank to purchase mortgage loans totaled \$4,628 and \$15,426 at December 31, 2003 and 2002, respectively. 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 enters into bilateral security agreements with all counterparties. As of December 31, 2003 and 2002, the Bank had pledged as collateral securities with a fair value of \$133,755 and \$261,442, respectively, to broker-dealers that have a net credit risk exposure to the Bank related to interest rate exchange agreements.

The Bank charged operating expenses for net rental costs of approximately \$3,434, \$3,360, and \$3,382 for the years ending December 31, 2003, 2002, and 2001, respectively. Future minimum rentals at December 31, 2003, were as follows:

YEAR	PREMISES	EQUIPMENT	TOTAL
2004	\$ 3,117	\$226	\$ 3,343
2005	3,218	228	3,446
2006	3,242	23	3,265
2007	3,476	21	3,497
2008	3,469	2	3,471
Thereafter	1,628	—	1,628
Total	\$18,150	\$500	\$18,650

Lease agreements for Bank premises generally provide for increases in the basic rentals resulting from increases in property taxes and maintenance expenses. Such increases are not expected to have a material effect on the Bank's financial condition or results of operations.

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

The Bank executed orders to issue \$1,001,618 of consolidated obligations and entered into \$843,700 of notional amount of interest rate exchange agreements that had traded but not yet settled at December 31, 2003.

Other commitments and contingencies are discussed in Notes 1, 7, 8, 12, 13, 14, and 16.

NOTE 20 – OTHER

Other income consisted of the following:

	FOR THE YEARS ENDED DECEMBER 31,		
	2003	2002	2001
Fees earned on letters of credit	\$1,255	\$1,424	\$1,398
Amortization of gain from sale of building	2,073	2,073	2,057
Gain/(loss) on early extinguishment of debt	(100)	(394)	(556)
Other	449	34	2
Total	\$3,677	\$3,137	\$2,901

The table below discloses the largest categories included in operating expense. Professional and contract services expense includes the Bank's independent accountants, attorneys, and other consultants used for special projects.

Operating expenses consisted of the following:

	FOR THE YEARS ENDED DECEMBER 31,		
	2003	2002	2001
Compensation and benefits	\$34,987	\$33,318	\$27,748
Professional and contract services	9,192	10,319	12,001
Travel	1,277	1,241	1,064
Occupancy	3,936	3,820	3,566
Equipment	2,783	2,452	2,523
Other	1,826	2,411	1,901
Total operating expense	\$54,001	\$53,561	\$48,803